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Agenda item: 7.1

Recording of pension entitlements

Introduction

The 2008 System of National Accounts (SNA) contains improved guidance on the recording of pension entitlements. However, some ambiguity still exists in the new guidance, resulting in divergent interpretations and possible lack of comparability across countries. Therefore, the Advisory Expert Group (AEG) on National accounts agreed at its 2014 meeting in Washington that a note would be prepared to provide more clarity on the recognition of pension liabilities and related flows, in line with provisions of the 2008 SNA.

This issue paper points out the ambiguities in the current guidelines and proposes solutions on how the SNA may be interpreted with regard to the recording of pension entitlements and related flows. Doing so, the paper focuses on the distinction between social security schemes and employment-related schemes, but also touches upon the broader discussion on how to interpret the asset boundary of the SNA, especially with regard to so-called ‘constructive liabilities’.

Documentation

Paper: Recording of pension entitlements

Main issues to be discussed

The AEG is asked to express their views on the following issues:

- Do the AEG members agree with the presented ambiguity that one may derive from the current guidelines on pensions?
- Are members of the opinion that the decision on recording pension entitlements and related transactions comes down to the distinction between (i) social security schemes and (ii) employment-related schemes, or do they feel that it is better to focus on the asset boundary in deciding whether or not to record pension entitlements and related flows in the core accounts?
- In the case that the decision is based on the distinction between social security and employment-related schemes, do members agree that the control and finance of the system, the coverage of the system, and the emergence of the scheme have to be regarded as decisive criteria?
- In the case that the decision is based on the asset boundary, do members agree that it has to be checked whether the scheme is regulated by a legally binding contract or do participants also consider a ‘constructive liability’ as a sufficient criterion, in order to decide upon the recording of entitlements and related flows in the core accounts?

- Do AEG members agree that ‘constructive liability’ as mentioned in SNA para. 3.34 is currently not defined properly in the SNA and that criteria are needed to delineate what type of liabilities are covered by this category and that this goes beyond the pension discussion?

Recording of pension entitlements

1. Introduction

1. The 1993 System of National Accounts (SNA) and the European System of Accounts (ESA) 1995 only required the recognition and recording of pension obligations for funded “private” schemes. As a result, the national accounts of most countries did not include any pension liabilities related to social security and unfunded employment-related pension schemes. As the set-up of pension schemes, funded or unfunded, private or public, substantially differs across countries, this meant that the information on pension entitlements provided by the national accounts was neither fully comparable nor comprehensive.

2. When the latest international guidelines, 2008 SNA and ESA 2010, were being drafted, the recording of pension schemes was one of the main topics under review. Discussions led to improved guidance on the recording of pension schemes in the updated standards. However, although more clarity has been provided on the recording of pensions, there is still some ambiguity arising from the new guidance, resulting in divergent interpretations of the 2008 SNA worldwide, and still a possible lack of comparability between countries. The provision of more clarity in the interpretation of the standards on the recognition of pension entitlements and related flows is therefore urgently needed.

3. This note points out the ambiguities in the current guidelines and proposes additional guidance on how the 2008 SNA may be interpreted with regard to the recording of pension entitlements and related flows¹. In that, it also looks at relevant passages in the ESA 2010, the Public Sector Debt Statistics (PSDS) Guide, the Government Finance Statistics Manual (GFSM), the International Public Sector Accounting Standards (IPSAS), and the definitions used by the International Labour Organization (ILO). In arriving at a common understanding of the SNA standards, the paper discusses criteria that may be used to distinguish between the various types of schemes and also touches upon the question of how to interpret the asset boundary of the SNA.

4. The note starts, in section 2, with a short discussion of the current guidance provided in the 2008 SNA. Subsequently, in section 3, the main challenges in the interpretation of this guidance are summarized. Section 4 discusses criteria for distinguishing the various schemes, thus trying to minimise the possible ambiguity. It presents criteria focusing on the distinction between employment-related and social security schemes, but also looking at the asset boundary of the SNA. The note ends with some concluding remarks in section 5.

2. Current guidelines according to 2008 SNA

5. The recording of pensions was changed considerably in the 2008 SNA. These changes were mainly initiated for three reasons. First, the 1993 SNA was considered to be inconsistent in its recommended treatment of funded and unfunded pension schemes, affecting key variables like income, saving, financial assets and liabilities in different ways, thus leading to a lack of international comparability of data related to pension schemes. Second, unfunded employment-related pension schemes are financially significant for general government and the public sector. Large government expenditures related to economic stabilisation and recovery from the recent financial crisis as well as the

¹ The focus in the paper is on the recognition of entitlements in the core accounts, but it should be realised that this will also affect related entries in the non-financial accounts which can have an important impact on key aggregates such as income, saving and cost of employment.

anticipated financial burden stemming from aging populations both highlight the importance of having complete and comprehensive statistical information on the future financial commitments of governments. Third, the changes to the SNA were designed to ensure an improved consistency and alignment of the national accounts with international accounting standards, such as the International Accounting Standards (IAS) and the International Public Sector Accounting Standards (IPSAS), which both require the recognition of unfunded employment-related pension obligations as liabilities.

6. Considerable discussions took place at the international level, which ultimately led to several amendments to the 1993 SNA regarding the treatment of pension schemes. Most important in this respect are the conclusions of the Advisory Expert Group (AEG) on National Accounts, in view of the recommendations made by the *International Task Force meeting on employers' retirement schemes*. There was strong support of the AEG for the Task Force recommendation to recognise the pension liabilities for all employer pension schemes, including unfunded ones, and any associated assets and transactions. Nevertheless, due to the difficulties for some countries in drawing the line between employment-related pension schemes and social security schemes, the AEG stressed the importance to develop criteria that would distinguish between these types of schemes. The possibility was raised of countries not including the liabilities for pensions of government employees in the core accounts but including them together with the liabilities for social security schemes in a supplementary table, until criteria were developed to distinguish between the various types of schemes. Possible criteria to explain the distinction between the schemes recorded in the core accounts and those recorded only in the supplementary table were, among others, the employer/employee relationship and the nature of the liability (e.g. whether it is a contingent or an actual liability).

7. This international compromise can be considered as the basis for the current guidelines in the 2008 SNA, of which the relevant paragraphs are presented in Annex A. According to the 2008 SNA, pensions due under social security do not lead to the accrual of entitlements of households that have to be regarded as assets (see para. 9.20 and 17.124). On the other hand, liabilities (and entitlements) related to employment-related pension schemes have to be recognised, regardless of whether or not they are funded (see para. 9.20, 11.107 and 17.121). In recognising these liabilities the 2008 SNA allows some flexibility, however, for pension schemes which are intertwined with more generic social security type of schemes (see para 17.193). The latter need not be recorded in the core tables. To arrive at an internationally comparable set of data on pension liabilities, the 2008 SNA also contains a supplementary table (table 17.10), which includes all pension liabilities: both the liabilities which are recognised in the core system of national accounts and those which are not recognised in the core system. In this respect, it should be noted that the ESA 2010 does not offer the same degree of flexibility. It provides clear legislated rules with respect to the core / non-core allocation of schemes and the concomitant recording of pension entitlements and related flows² which are not fully consistent with the SNA guidance, but which do ensure a high degree of comparability of government data in Europe. According to the ESA 2010, the liabilities of all unfunded defined benefit schemes sponsored by government should only be recorded in the supplementary table (see ESA 2010, para. 17.48)³. The other two manuals, i.e. the GFSM and PSDS, do not contain specific references to intertwined pension schemes. They do, however, contain similar guidelines on treating social security and employment-related pension schemes as the SNA⁴.

8. Although the 2008 SNA provides more guidance on how to record pension schemes, it does not include a final set of unambiguous, clearly defined criteria to determine which schemes lead to

² Relevant paragraphs of the ESA 2010 are presented in Annex B.

³ This supplementary table is compulsory for all EU Member States from 2017.

⁴ Relevant paragraphs of the GFS and PSDS Manuals are presented in Annex C and D, respectively.

entitlements that have to be recorded in the core accounts. In this regard, para. 17.193 of the SNA states that a set of criteria is still required “*to explain the distinction between those schemes carried forward to the core accounts and those recorded only in the supplementary table*”. Ambiguity arises particularly around employment-related schemes that are intertwined with social security. In that regard, the current wording on pension schemes also leaves room for interpretation regarding the recording of government sponsored employment-related schemes more generally.

3. Challenges arising from the interpretation of the latest standards

9. The 2008 SNA guidelines on pensions provide improved guidance on how to record pension entitlements related to various types of pension schemes. However, as stated before, the current wording and the lack of a set of decisive criteria leave room for national interpretation of what is to be recorded in the core and what only in the supplementary table, and may therefore give rise to an inconsistent interpretation and recording of data on pension schemes across countries in the core accounts. The criteria will be the subject of the next section. This section will focus on the challenges arising from the interpretation of the current wording in the SNA.

10. The 2008 SNA includes multiple distinctions for pension schemes, sometimes applying different terms for the same phenomena. As these terms are also used in describing what is to be recorded in the core and what only in the supplementary table, this also gives rise to differences in interpretation. Below, the various distinctions that are made in 2008 SNA are presented, with a reference to the relevant paragraphs. Special attention is paid to potential contradictions.

Employment-related pension schemes versus social security pension schemes

11. The distinction between employment-related pension schemes and social security pension schemes is an important one, as pension entitlements related to social security type of pension schemes are not recognised in the core accounts, and as such only recorded in the supplementary table. The main reasons for this non-recognition are explained in 2008 SNA, para. 17.192, which states that “*there are two problems with simply suggesting that entitlements from social security should be shown in the SNA. The first is that reliable estimates of the entitlements may not be readily available whereas it is increasingly the case that such estimates exist for private schemes. Secondly, there is an argument that such estimates are of limited usefulness where government has the possibility of changing the basis on which entitlements are determined in order to keep the entitlements within the bounds of what is budgetary feasible. However, the consequence of simply accepting that entitlements for private schemes are shown and for social security are not, is that some countries would include the greater part of pension entitlements in the accounts and some would show almost none*”. The fact that governments have the possibility to change the basis on which entitlements are determined seems to be the decisive argument in this regard. The argument that reliable estimates may not be available only seems to stress the problems in coming up with good estimates, regardless of whether the relevant entitlements should be recognised in the core system. Para. 9.20 also includes a reference to why pension entitlements accruing under social security schemes are to be excluded from the core accounts. Referring to social assistance, it is stated that “*the amounts due do not necessarily accrue in a predictable fashion over time or for predictable reasons*”.

12. In addition to social security type of schemes, pensions may be provided via employment-related schemes, as explained in para. 17.118⁵ of the 2008 SNA. The entitlements and liabilities of these schemes should be recorded in the core accounts. Pension entitlements are defined in para. 11.107, where it is stated that they “*show the extent of financial claims both existing and future pensioners hold against either their employer or a fund designated by the employer to pay pensions earned as part of a compensation agreement between the employer and employee*”. Para. A3.127 also touches upon this by stating that “*the 2008 SNA recognizes that employment-related pension entitlements are contractual engagements that are expected or likely to be enforceable. They should be recognized as liabilities towards households, irrespectively of whether the necessary asset exist in segregated schemes or not*”.

13. Although these definitions clearly distinguish between employment-related and social security schemes, the distinction between the two is not always as straightforward as implied here, giving rise to discussion how some employment-related pension schemes, especially those that are intertwined with social security should be recorded, in the core accounts or only in the supplementary table. This is further explained in section 4.

“Private” versus “public” pension schemes

14. The 2008 SNA also makes a distinction between “private” and “public” pension schemes. These terms are used in a couple of paragraphs that relate to the recording of pension schemes. However, it seems that this is not done in a fully coherent way, leaving room for interpretation of what is exactly meant by “private” and by “public” in the relevant paragraphs.

15. Para. 17.121 refers to pension schemes that are run by private employers. It is mentioned that these are usually not subject to retrospective adjustments of the amounts payable, but that there is a risk that the employer may be unable to pay, because it has gone out of business. It is assumed that this reference to “not usually being subject to adjustments” is mentioned here to clarify where these schemes differ from the social security type of pension schemes. However, in this respect, it is not quite clear why only mention is made of “private” employers and not of all employers, thus including government as an employer. This is somewhat remarkable if one relates this to the next paragraph (17.122), in which it is stated that “*employment-related pensions, other than the most basic form of social security, are seen as part of the compensation package and negotiations between employees and employers may focus on pension entitlements as much as on current conditions of service and pay scales*”. This seems to imply that reference is made to “private” as well as to “public” employers. Here, it is assumed that the 2008 SNA wants to stress once again, as was done in para. 17.121, that employment-related pension schemes often provide more safeguard from adjustment of the amounts payable, and therefore differ from social security pension schemes. However, while para. 17.121 only refers to “private” employers, para. 17.122 refers to all employers.

16. Furthermore, in para. 17.193, schemes sponsored by the government are mentioned, probably to distinguish them from schemes that are sponsored by “private” employers. Para. 17.193 mentions that flexibility is provided regarding the recognition of pension entitlements of unfunded pension schemes sponsored by government for all employees (whether private sector employees or government’s own

⁵ SNA 17.118: Social insurance pensions in all countries are provided, if at all, in part by general government and in part by employers. The part provided by general government is called social security and the part by employers is called employment-related schemes other than social security.

employees). Doing so, the 2008 SNA may refer to the type of schemes that are closely related to social security schemes and cannot easily be distinguished from these latter schemes.

Funded versus unfunded pension schemes

17. The 2008 SNA also makes a distinction between pension schemes that are funded and those that are unfunded, the latter often referred to as “pay-as-you-go”. In para. 17.121, it is stated that “*while social security may be, and very often is, financed on a pay-as-you-go basis, without building up reserves for future liabilities, other employer schemes are increasingly likely to have reserves set aside*”. This is followed by the statement that “*even if there are no reserves, accounting conventions may require them to recognize pension entitlements of present and past employees in their accounts*”. Further, in para. 17.191, it is stated that “*in recognition of the fact that social security is normally financed on a pay-as-you-go basis, entitlements accruing under social security are not normally shown in the SNA*”. In summary, one can argue that all of this is to be interpreted as “unfunded” being a supporting argument, and not a decisive argument, for non-recognition in the core accounts.

18. Para. 17.193 also mentions unfunded pension schemes when explaining the problems of simply showing all entitlements from social security in the core system, “*some flexibility is provided regarding the recording of pension entitlements of unfunded pension schemes sponsored by government for all employees (whether private sector employees or government’s own employees)*”. In relation to the outcomes of the international discussions that led up to these amendments, it is assumed that this flexibility is provided because some employment-related pension schemes are strongly intertwined with social security and cannot easily be distinguished from the latter and no criteria were available at that time to make a clear distinction between the two. As a consequence of this flexibility, the entitlements and liabilities related to these schemes will usually not be recognised in the core accounts, and only recorded in the supplementary table. However, to stay in line with the rationale behind this flexibility, this should only be done in the case of a strong intertwinement with the social security type of schemes. If the employment-related pension scheme is funded, then it can normally be inferred that the system is not intertwined with social security. However, in the case of an employment-related pension scheme being unfunded and sponsored by the government, this can be an indication that it is intertwined. While this can be interpreted as a rather straightforward indicator (which seems to have been followed straightforwardly by the ESA2010), it does not seem to do full justice to the general thrust of the 2008 SNA. As a consequence, clearer criteria to determine when entitlements should be recorded in the core system and when only in the supplementary table are needed.

Conclusion

19. The current SNA uses three ways of categorising pension schemes. By using different approaches for the categorisation of the various pension schemes to determine what should (not) be recorded in the core system, there is an increased risk of users interpreting the 2008 SNA differently and arriving at different results in the recording of similar pension schemes. Therefore, it is considered necessary to review the current wording of the SNA and to come up with clear criteria for determining what should be recorded in the core accounts. The next section will look into these criteria.

4. Discussion on criteria for recording pension schemes

20. As mentioned in para. 17.193 of the current SNA, there is a need to define a set of criteria to explain the distinction between the schemes for which entitlements and related flows are carried forward to the core accounts versus those for which these are only recorded in the supplementary table. The use of different approaches for categorising pension schemes in the current SNA further emphasizes the need to come up with a clear set of guidelines.

21. The 2008 SNA already presents some criteria that may be of use to establish the distinction between the various schemes. Para. 17.194 mentions criteria that might be considered, focussing on the closeness of a government employer pension scheme to the prevailing social security system, the degree of benefits being tailored to the specific characteristics of the individual or the degree of applicability to the population at large, and the ability of government to alter the benefit formula. However, in discussions on these criteria it was concluded that none of these criteria alone seemed to be decisive for the classification of a pension scheme. Therefore, further work on the refinement of these criteria was stated as being part of the SNA research agenda.

22. In more recent discussions related to the implementation of the 2008 SNA, the AEG also took into consideration the work of the European Task Force on the Measurement of Pension Entitlements while elaborating on the criteria that are currently being mentioned in the SNA. The European Task Force considered five possible criteria to determine whether or not to record pension entitlements in the core national accounts: (a) the degree of integration within the general government structure; (b) the risk exposure and ability to change the benefit formula; (c) the nature of the contract; (d) the legal framework being close to social security pension schemes; and (e) the funding of the scheme. Moreover, the strength of the pension entitlements was considered as an additional criterion, but was not included in the list because of difficulties in interpretation. Annex E provides more detail on these possible criteria. However, even though the TF discussed these criteria extensively, it turned out to be difficult to find a single decisive criterion, taking into consideration the different national settings of government employer pension schemes.

23. In order to come up with accurate criteria to decide upon whether or not a pension entitlement should be recognised and recorded in the core system of national accounts, one can broadly apply two approaches. The first one is to start from the guidance in the 2008 SNA that employment-related schemes need to be recorded in the core accounts and social security schemes only in the supplementary table, and derive criteria to distinguish between these two types of schemes. The second approach is to focus on the asset boundary of the SNA, avoiding the discussion on how to categorize a scheme into employment-related or social security. Both approaches are discussed below.

Focusing on the distinction between social security and employment related pension schemes

24. According to the 2008 SNA guidelines, social security schemes do not lead to pension entitlements whereas employment-related pension schemes do. As ambiguity arises how to deal with employment-related pension schemes that are intertwined with social security, criteria could be formulated to more clearly distinguish between these two types of schemes and to record entitlements and related flows accordingly. To be able to clearly categorize a scheme as employment-related or social security, one needs to start from the definitions of both schemes and analyse what are to be considered the main distinguishing factors between the two types of schemes.

25. Para. 4.124 and 8.7 of the 2008 SNA state that social security schemes cover “*the entire community, or large sections of the community*” and that they “*are imposed and controlled and financed*

by government units”. Employment-related schemes on the other hand “derive from an employer-employee relationship in the provision of pension entitlement that is part of the conditions of employment and where responsibility for the provision of benefits does not devolve to general government under social security provisions” (SNA para. 8.7). These definitions are also used in the other manuals and are in line with the relevant sections of IPSAS 25 that deal with employee benefits relating to pensions⁶. Even though these definitions in 2008 SNA seem straightforward, some paragraphs in chapter 17 seem to contradict them. For example, para 17.118 states that “the part provided by general government is called social security and the part by employers is called employment-related schemes other than social security”, not explicitly mentioning that the part of social insurance provided by the government in its role as employer should also be regarded as employment-related schemes. Furthermore, as was mentioned before, para 17.121 states that “pension schemes run by private employers are usually not subject to retrospective adjustments of the amounts payable”, to distinguish them from social security schemes. In that, it lacks to mention ‘public’ employers for which the pension schemes should also be regarded as employment-related schemes. It would be best to review these wordings to bring them in line with the main definitions.

26. Focusing on the definitions presented above, the decisive criteria to distinguish between employment-related and social security schemes would relate to:

- A. *The control and finance of the system*: Social security schemes are always controlled and financed by government units, whereas this need not be the case for employment-related schemes. This is not a decisive criterion in itself, but provides a necessary condition to qualify as a social security system.
- B. *The coverage of the system*: Whereas employment-related schemes only cover groups of employees, social security schemes cover the entire community or large sections of the community^{7 8}. In some cases this distinction will be very clear, but sometimes it may still be too vague. Especially in case of intertwinement with social security, this criterion may not be sufficient.
- C. *The emergence of the scheme (legal nature)*: Employment-related schemes derive from an employer-employee relationship and are regarded as part of the conditions of employment, whereas social security schemes are imposed by government units. That implies that if the scheme derives from an employment contract it should be regarded as an employment-related scheme, and if it derives from government law it should be regarded as social security. This criterion also relates to the main reason for not recording entitlements under social security in the core accounts, as explained in para. 17.192 of the SNA. The legal nature of the scheme determines whether a “government has the possibility of changing the basis on which entitlements are determined”. If the scheme derives from an employment contract, this possibility is similar to that of other employees, whereas if it derives from government law, a government can more easily change the conditions.

27. The arguments presented in paragraph 26 are closely related to some of the arguments that are mentioned in para. 17.194 of the 2008 SNA and the recommendations made by the European Task Force

⁶ See Annex F for the relevant sections from IPSAS 25 on employee benefits.

⁷ The Social Security (Minimum Standards) Convention, 1952 (No. 102) of the International Labour Organization provides guidance on what the degree of coverage that should be provided by social security. It explains that the old-age benefit schemes should comprise “(a) prescribed classes of employees, constituting not less than 50 per cent of all employees; or (b) prescribed classes of the economically active population, constituting not less than 20 per cent of all resident; or (c) all residents whose means during the contingency do not exceed limits prescribed in such a manner as to comply with the requirements of Article 67; or (d) where a declaration made in virtue of Article 3 is in force, prescribed classes of employees, constituting not less than 50 per cent, of all employees in industrial workplaces employing 20 persons or more”. See Annex H for more information.

⁸ Also the GFS uses this criterion as an important one to distinguish between social security schemes and employment related schemes. See for more information Figure A2.2 and para. 2.18 to 2.24 in Appendix C that shows the decision tree that is used in the GFS to classify the various types of social protection.

on the Measurement of Pension Entitlements, such as the degree of applicability to the population at large, the ability of government to alter the benefit formula, the nature of the contract, and the legal framework. Arguments relating to funding of the scheme, the degree of benefits being tailored to the specific characteristics of the individual, the degree of integration within the general government structure, or schemes being defined benefit or defined contribution, that were also mentioned, seem less relevant in this respect. Although some of these criteria may frequently coincide with employment-related or social security schemes, they do not seem decisive in their own right. For example, it is true that social security schemes are often based on pay-as-you-go systems, and that employment-related schemes are often funded. However, the funding itself is not the reason why only the latter have to be recorded in the core accounts. The benefits being tailored to the specific characteristics of the individual is also not regarded as decisive. Although for social security there is often no direct link between the benefit and the characteristics of an individual, this is not always the case, as is also explained in para. 4.124. The degree of integration within the general government should also not be considered as a decisive criterion, as employment-related schemes run by the government may be well integrated within the government, but would still need to be treated as employment-related schemes. Finally, with regard to the distinction between defined benefit and defined contribution, it can be noted that although social security schemes are often defined benefit schemes, the benefits of a significant number of employment-related schemes are also defined (on the basis of salaries and wages), whereas schemes intertwined with social security may have benefits which are based on actual contributions plus a certain annual return. As such, this distinction can also not be regarded as decisive criterion.

28. The criteria presented in paragraph 26 can be used to distinguish between social security and employment-related schemes. If on the basis of these criteria, it is still not possible to classify intertwined schemes, one has to conclude that the current definitions in the SNA are not sufficiently distinctive. In that case it is advised to further tune the definitions in order to get a better distinction and to create a decision tree on the basis of these tuned definitions. Another option with regard to the recognition of pension entitlements and related flows may be to step away from the distinction between social security and employment-related schemes and to focus on the asset boundary to determine whether entitlements related to these schemes should be recognized in the core accounts. As this also seems to be the underlying rationale for recognizing entitlements in the case of employment-related schemes and for not recognizing those in the case social security pension schemes, this seems a valid alternative. The next section deals with this specific question.

Focusing on the asset boundary of the SNA

29. Instead of focusing on the distinction between employment-related and social security pension schemes, one could also have a look at whether the entitlements under the specific scheme at hand qualify as an asset according to the asset boundary of the SNA. If this is the case, they should be recorded in the core tables, regardless of the question whether or not it concerns pure employment-related schemes. If they do not fulfil the general criteria for the recognition of assets, they should only be recorded in the supplementary table.

30. The asset boundary is defined in para. 1.46 of the 2008 SNA which states that balance sheets “record the value of the assets that [institutional units or sectors] own or the liabilities they have incurred”. Economic ownership is defined in para. 3.26, which states that “the economic ownership of entities [...] is the institutional unit entitled to claim the benefits associated with the use of the entity in question in the course of an economic activity by virtue of accepting the associated risks”. From that definition, ‘assets’ and ‘liabilities’ are further defined in para. 3.5 and 3.33 respectively. Para. 3.5 defines assets as “entities that must be owned by some unit, or units, and from which economic benefits are

derived by their owner(s) by holding or using them over a period of time". Para. 3.33 states that *"a liability is established when one unit (the debtor) is obliged, under specific circumstances, to provide a payment or series of payments to another unit (the creditor)"*. It adds that a liability is most commonly established via a legally binding contract that specifies the terms and conditions of the payment(s) to be made and that payment according to the contract is unconditional. However, para. 3.34 explains that a liability may also be established *"not by contract but by long and well-recognized custom that is not easily refuted"*. In the latter case, the creditor has *"a valid expectation of payment, despite the lack of a legally binding contract"*. These liabilities are called 'constructive liabilities'. Para. 11.6 adds that *"some payments by government to individuals fall under this category."*

31. Looking at the asset boundary of the SNA, it is clear that it covers all items that are established via a legally binding contract. This means that all entitlements of schemes that derive from a legally binding contract, such as an employer contract, should be recorded in the core accounts. Following this line of reasoning, intertwined schemes that have a contractual basis should also be recorded in the core accounts. For all other schemes it needs to be checked whether they qualify as a 'constructive liability' to see whether they are within the asset boundary of the SNA. If they are regarded as 'constructive liability' they have to be recorded in the core accounts, otherwise they only need to be recorded in the supplementary table.

32. To determine whether schemes that do not derive from a legally binding contract qualify as 'constructive liability', one has to look at the definition of this type of liability. However, the SNA does not contain many details on how to interpret 'constructive liabilities'. The 2008 SNA only mentions them in para. 3.34, 3.40 and 11.6 in which it explains that these liabilities are established *"by long and well-recognized custom that is not easily refuted"* and that the creditor has *"a valid expectation of payment, despite the lack of a legally binding contract"*. However, no specific criteria are provided to clearly distinguish these types of liabilities.

33. The other statistical manuals do not provide any guidance in this regard either, as they do not contain explicit references to the term 'constructive liabilities'. It is not clear whether this implies that these kinds of liabilities are not covered within their systems or whether these manuals also regard constructive liabilities as items that need to be included. In this respect, ESA 2010 defines a financial claim as *"the right of a creditor to receive a payment or series of payments from a debtor"* (ESA2010, para. 5.05) and an economic asset as *"a store of value representing the benefits accruing to the economic owner by holding or using the entity over a period of time"* (ESA2010, para. 7.15). In that, *"the economic owner is the institutional unit entitled to claim the benefits associated with the use of the asset by virtue of accepting the associated risks"* (ESA2010, para. 7.17). It is unclear how this would relate to 'constructive liabilities'. The PSDS and GFSM also look at the 'claim' of a creditor on the debtor (see para. 2.8 of the PSDS Manual, and 3.47 of the GFSM). Both manuals state that debt liabilities *"are typically established through the provision of economic value by one institutional units, the creditor, to another, the debtor, normally under a contractual arrangement"*, but that *"liabilities can also be created by the force of law, and by events that require future transfer payments"*. This implies that the definition is broader than only legal obligations, but it is not specified to what extent other liabilities are recognized.

34. Whereas the statistical manuals do not contain a detailed elaboration of what constitutes a 'constructive liability', possible guidance may be derived from the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (referred to as "Framework") that has been developed by the IPSAS Board. This Framework that specifically aims at public sector reporting contains definitions that provide more clarity on how 'constructive liabilities' are to be interpreted. Para. 5.17 of the Framework states that *"for financial reporting purposes it is necessary to determine whether [...] commitments and obligations, including binding obligations that the entity has little or no realistic alternative to avoid but are not legally enforceable (non-legally binding obligations) are present"*

obligations and satisfy the definition of a liability". These non-legally binding obligations seem similar to the 'constructive obligations' as mentioned in the SNA. In that regard, one has to look at the degree to which an entity can realistically avoid a non-legally binding obligation.

35. Para. 5.23 of the Framework further explains that these "*non-legally obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement*". The paragraph further specifies that these obligations have the following attributes:

- "*The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;*
- *As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and*
- *The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.*"

36. This means that whenever an entity has no realistic alternative to avoid settling an obligation arising from past practice, published policies, or a sufficiently specific current statement, this will lead to a non-legally obligation according to the Framework. As this may still be liable to interpretation, para. 5.25 of the Framework provides some further guidance on the exact interpretation of "*no realistic alternative to avoid an outflow of resource*". It mentions that factors that are relevant in this respect are "*the nature of the past event or events that give rise to the obligation [and] the ability of the entity to modify or change the obligation before it crystallizes*". It also mentions a possible correlation between the availability of funding and the creation of a present obligation, but at the same time explains that "*the absence of a budgetary provision does not itself mean that a present obligation has not arisen*". In addition to the guidance in this Framework, the IPSAS Board also recently released a consultation paper on the 'Recognition and measurement of social benefits' that contains possible methods to determine what past events may give rise to a present obligation and when entities have little or no realistic alternative to avoid settling this obligation. These considerations may also be very relevant in further specifying criteria what constitutes 'constructive liabilities'⁹.

37. This guidance from the IPSASB Framework and the Consultation Paper may be helpful in further specifying what constitutes a "constructive liability" according to the SNA. This is necessary if the asset boundary is going to be used to determine which pension entitlements and related flows have to be reported in the core accounts. Furthermore, it may also provide guidance for related discussions. In clearly defining a "constructive liability", it will be interesting to see how this may affect the recording of social security schemes. From the definitions in the IPSASB Framework, it is not unlikely that the obligations related to social security schemes should be regarded as 'constructive liabilities'. In that case, it may affect the current guidelines of not acknowledging any entitlements of social security pension schemes in the core accounts. It may also have an impact on social security schemes other than pensions, although it is very uncertain whether the recognition of 'constructive liabilities' will be extended to, for example, education and health care. If the relevant entitlements keep being recorded on an accrued-to-date basis, it is most likely that these types of social security will remain unaffected.

38. Whatever the case, in discussing the proper interpretation of 'constructive liabilities', it is important to realise that the issue at hand deals with the (non-)recognition and the (non-)recording of these obligations in the System of National Accounts, and that it does not necessarily affect definitions of specific (government debt) measures. These are two separate issues. In this regard, it can be foreseen that, in case (some of) these types of entitlements are indeed recognized in the SNA, they should be recorded

⁹ See Annex I for more information on the consultation paper.

in such a way that they can be separately identified (providing users insights in the strengths of the various obligations) and can be included (or excluded) in specific (government or, more broadly, public) debt measures depending on the type of analysis.

5. Concluding remarks

39. In the above, it has been explained that the new 2008 SNA guidelines on recording pension schemes still leave room for interpretation. This is mainly caused by the use of various ways for characterising pension schemes and using various phrasings of the characteristics for deciding which entitlements should be recorded in the core accounts and which ones should only be reported in the supplementary table. Therefore, decisive criteria have to be established to provide clearer guidance on how to record pension entitlements. In this paper, it has been explained that these criteria can be reached via two approaches.

40. The first one focuses on the distinction between social security schemes and employment-related schemes, under the assumption that all social security schemes are excluded from the core accounts whereas all employment-related schemes are included. It has been explained that, looking at the characteristics of the two types of schemes, control and finance of the system, coverage of the system, and the emergence of the scheme are the relevant criteria to classify a specific scheme. The last criterion is regarded as the most relevant one in this regard, as it directly links to the underlying reason for (not) acknowledging entitlements for social security schemes.

41. The second approach focuses on the use of the asset boundary to determine whether or not to record pension entitlements in the core accounts. It has been explained that it is rather straightforward to apply the asset definition to schemes that are regulated by a legally binding contract, but that for other schemes it is still quite problematic to appropriately classify them, due to the current ambiguity with regard to the interpretation of 'constructive liabilities'. At the moment, no clear criteria have been defined in the SNA to determine when an item qualifies as a constructive obligation, and such criteria are needed in order to be able to decide which entitlements are to be recorded in the core accounts. As this may have broader implications than only pension schemes, this will need to be discussed in a broader context. The guidance provided by the IPSASB Framework may prove to be a good starting point for this discussion.

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Annex A – Relevant paragraphs in the SNA on the recording of pension entitlements

1.46 Balance sheets are compiled for institutional units, or sectors, and record the values of the assets they own or the liabilities they have incurred. Assets as defined in the SNA are entities that must be owned by some unit, or units, and from which economic benefits are derived by their owner(s) by holding or using them over a period of time. Financial assets and fixed assets, such as machinery, equipment and structures which have themselves been produced as outputs in the past, are clearly covered by this definition. [...]

3.1 The SNA is a system of accounts designed to measure stocks of, and changes in, economic value and to identify the person, group of persons, legal or social entity with claims on the economic value.

3.5 An asset is a store of value representing a benefit or series of benefits accruing to the economic owner by holding or using the entity over a period of time. It is a means of carrying forward value from one accounting period to another. Assets may be financial in nature or not. For almost all financial assets, there is a corresponding [financial] liability. A liability is established when one unit (the debtor) is obliged, under specific circumstances, to provide a payment or series of payments to another unit (the creditor). [...]

3.26 The economic owner of entities such as goods and services, natural resources, financial assets and liabilities is the institutional unit entitled to claim the benefits associated with the use of the entity in question in the course of an economic activity by virtue of accepting the associated risks.

3.33 A liability is established when one unit (the debtor) is obliged, under specific circumstances, to provide a payment or series of payments to another unit (the creditor). The most common circumstance in which a liability is established is a legally binding contract that specifies the terms and conditions of the payment(s) to be made and payment according to the contract is unconditional. [see also para. 11.5]

3.34 In addition, a liability may be established not by contract but by long and well-recognized custom that is not easily refuted. In these cases, the creditor has a valid expectation of payment, despite the lack of a legally binding contract. Such liabilities are called constructive liabilities.

3.35 Whenever either of these types of liability exists, there is a corresponding financial claim that the creditor has against the debtor. A financial claim is the payment or series of payments due to the creditor by the debtor under the terms of a liability. Like the liabilities, the claims are unconditional. [...]

3.37 All entities that meet the definition of an asset given above are included in the asset boundary of the SNA.

3.40 A liability, as defined in paragraph 3.33 above, is unconditional once the contract establishing the liability is agreed by both parties. If the liability is established not by a legal contract but by long and well-established custom, it is referred to as a constructive liability. Some liabilities may involve a legal contract but specify that one party is obliged to provide a payment or series of payments to another unit only if certain specified conditions prevail. Such liabilities are called contingent liabilities. In general, the SNA includes (legal) liabilities and constructive liabilities but not contingent liabilities. An exception is made for standardized guarantees where, although each individual arrangement involves a contingent liability, the number of similar guarantees is such that an actual liability is established for the proportion of guarantees likely to be called.

4.124 Social security schemes are social insurance schemes that cover the community as a whole or large sections of the community and are imposed and controlled by government units. The schemes cover a wide variety of programmes, providing benefits in cash or in kind for old age, invalidity or death, survivors, sickness and maternity, work injury, unemployment, family allowance, health care, etc. There is not necessarily a direct link between the amount of the contribution paid by an individual and the benefits he or she may receive.

8.76 All social insurance schemes are founded on an employment relationship even if the participants are self-employed or currently unemployed. Two main types of social insurance schemes may be distinguished:

a. The first consists of social security schemes covering the entire community, or large sections of the community, that are imposed, controlled and financed by government units. Pensions payable under these schemes may or may

not be related to levels of salary of the beneficiary or history of employment. Non-pension benefits are less frequently linked to salary levels.

b. The second type consists of other employment-related schemes. These schemes derive from an employer-employee relationship in the provision of pension and possibly other entitlements that are part of the conditions of employment and where responsibility for the provision of benefits does not devolve to general government under social security provisions.

Making this distinction is difficult in some countries where the ultimate responsibility for administering the scheme and paying benefits is undertaken by government on behalf of many employers not working for general government. In countries where there is no such arrangement, social insurance schemes organized by government units for their own employees, as opposed to the working population at large, should, if possible, be included in the group of other employment-related schemes and not remain within social security schemes.

9.20 As individuals accrue pension entitlements in a social insurance scheme throughout their working lives, the corresponding entitlements become their assets and the liabilities of the units ultimately responsible for paying the pensions. Pensions due under social assistance are excluded because the amounts due do not necessarily accrue in a predictable fashion over time or for predictable reasons. Similar arguments apply to benefits due under social security. In some countries, government assumes responsibility for paying pensions even for non-government employees and these pensions are paid via social security funds. There is detailed discussion in part 2 of chapter 17 about when the liabilities for these schemes can be integrated into the sequence of accounts and when they only appear in a supplementary table. [...]

11.6 [...] a liability may be established not by contract but by long and well-recognized custom that is not easily refuted. Some payments by government to individuals fall under this category. In these cases, the creditor has a valid expectation of payment, despite the lack of a legally binding contract. Such liabilities are called constructive liabilities.

11.107 Pension entitlements show the extent of financial claims both existing and future pensioners hold against either their employer or a fund designated by the employer to pay pensions earned as part of a compensation agreement between the employer and employee. [...]

17.93 When government takes over the responsibility for providing pensions to large sections of the community, the social security function is in effect filling the role of a multiemployer scheme. Like the insurance corporation, the government then takes on the responsibility for any shortfall in funds to meet the pension liabilities or may be entitled to retain any surplus generated. It is often the case, though, that social security is funded on a pay-as-you-go basis so there is no question of a surplus arising and, if there is a shortfall in resources, government may have powers to change the entitlements not just relating to future employment but for the past also.

17.116 Pensions are provided to individuals in an economy under of three mechanisms, via social security, via employment-related schemes other than social security or via social assistance. Together, social security and employment-related schemes other than social security constitute social insurance schemes. [...]

17.118 Social insurance pensions in all countries are provided, if at all, in part by general government and in part by employers. The part provided by general government is called social security and the part by employers is called employment-related schemes other than social security. The division between which pensions are provided by social security and which by other employment-related schemes varies considerably from country to country with the consequence that the coverage and therefore national perceptions of what the term “social security” designates also vary considerably. [...]

17.120 By contrast, in some countries most or all pension provision may be made via social security. In this case government acts as an intermediary relative to the employer so that once the government has received the contributions to the scheme paid by the employer and the households, the government then takes on the risk of making the eventual payment. Government relieves the employer of the risk that the cost of pensions may be too great for his enterprise to meet and assures the population that pensions will be paid, though it may do so with the qualification that it may alter the amount of pensions payable, even retrospectively, if economic conditions so dictate.

17.121 Pension schemes run by private employers are usually not subject to retrospective adjustments of the amounts payable. [...] While social security may be, and very often is, financed on a pay-as-you-go basis, without building up reserves for future liabilities, other employer schemes are increasingly likely to have reserves set aside. Even if there are no reserves, accounting conventions may require them to recognize pension entitlements of present and past employees in their accounts.

17.122 Employment-related pensions, other than the most basic form of social security, are seen as part of the compensation package and negotiations between employees and employers may focus on pension entitlements as much as on current conditions of service and pay scales. [...]

17.124 [...] Social security pensions are frequently funded on a pay-as-you-go basis. The normal assumption in the main accounts of the SNA is that this is how social security pensions are funded. ... No liabilities for the scheme are recognized in the main accounts of the SNA although concern is often expressed that benefits may exceed contributions and this situation is likely to worsen in an ageing society. For this reason, estimates of the liabilities of social security as well as any other pension schemes not included in the main accounts are included in a supplementary table [...].

17.191 In recognition of the fact that social security is normally financed on a pay-as-you-go basis, entitlements accruing under social security are not normally shown in the SNA. [...]

17.192 There are two problems with simply suggesting that entitlements from social security should be shown in the SNA. The first is that reliable estimates of the entitlements may not be readily available whereas it is increasingly the case that such estimates exist for private schemes. Secondly, there is an argument that such estimates are of limited usefulness where government has the possibility of changing the basis on which entitlements are determined in order to keep the entitlements within the bounds of what is budgetary feasible. However, the consequence of simply accepting that entitlements for private schemes are shown and for social security are not, is that some countries would include the greater part of pension entitlements in the accounts and some would show almost none.

17.193 In recognition of this dilemma, some flexibility regarding the recognition of pension entitlements of unfunded pension schemes sponsored by government for all employees (whether private sector employees or government's own employees) is provided. Given the different institutional arrangements in countries, only some of these pension entitlements may be recorded within the main sequence of accounts [...]. In addition, however, a further table is to be presented that provides information disclosing the proportion of pension provision covered in the core accounts with some approximate estimates for the remaining schemes. It is a requirement, though, that a set of criteria be provided to explain the distinction between those schemes carried forward to the core accounts and those recorded only in the supplementary table.

17.194 The sort of criteria that might be considered are the following: the closer a government employer pension scheme is to the prevailing social security, the less likely it is to appear in the core accounts; the less the benefits are tailored to the specific characteristics of the individual and the more they are applicable to the population at large, the less likely it is to appear in the core accounts; the greater the ability of government to alter the benefit formula, the less likely it is to appear in the core accounts. However, none of these criteria alone is necessarily decisive in determining whether the scheme is treated in the core accounts or not.

17.197 [...] All defined contribution pension schemes should be included in the core accounts. Estimates for all defined benefit pension schemes outside social security should also be included.

A3.127 The 2008 SNA recognizes that employment-related pension entitlements are contractual engagements, that are expected or likely to be enforceable. They should be recognized as liabilities towards households, irrespectively of whether the necessary assets exist in segregated schemes or not.

A3.128 For pensions provided by government via social security however, countries have some flexibility to deviate from this procedure in the set of standard tables. This is because the division between which pensions are provided by social security and which by other employment-related schemes varies considerably from country to country. However, the full range of information required for a comprehensive analysis of pensions should be

provided in a supplementary table that shows the liabilities and associated flows of all private and government pension schemes, whether funded or unfunded and including social security.

Annex B – Relevant paragraphs in ESA on the recording of pension entitlements

2.109 Pension fund schemes may be organised by employers or by general government. They may also be organised by insurance corporations on behalf of employees; or separate institutional units may be established to hold and manage the assets to be used to meet the pension entitlements and to distribute the pensions.

2.117 *Definition:* the social security funds subsector includes central, state and local institutional units whose principal activity is to provide social benefits and which fulfil each of the following two criteria:

a) by law or by regulation certain groups of the population are obliged to participate in the scheme or to pay contributions; and

b) general government is responsible for the management of the institution in respect of the settlement or approval of the contributions and benefits independently from its role as supervisory body or employer.

There is usually no direct link between the amount of the contribution paid by an individual and the risk to which that individual is exposed.

4.89 Two types of social insurance schemes may be distinguished:

(a) The first consists of social security schemes covering the entire community, or large sections of the community, that are imposed, controlled and financed by government units. Pensions payable under such schemes may or may not be related to levels of salary of the beneficiary or history of employment. Non-pension benefits are less frequently linked to salary levels;

(b) The second type consists of other employment related schemes. Such schemes derive from an employer-employee relationship in the provision of pension and possibly other entitlements that are part of the conditions of employment and where responsibility for the provision of benefits does not devolve to general government under social security provisions. [see also para. 17.02]

4.90 Social insurance schemes organised by government units for their own employees as opposed to the working population at large are classified as other employment related schemes and not as social security schemes.

5.05 *Definition:* a financial claim is the right of a creditor to receive a payment or series of payments from a debtor. Financial claims are financial assets that have corresponding liabilities. Equity and investment fund shares or units (AF.5) are treated as a financial asset with a corresponding liability even though the claim of the holder on the corporation is not a fixed amount.

5.06 *Definition:* liabilities are established when a debtor is obliged to provide a payment or a series of payments to a creditor.

5.180 *Definition:* pension entitlements comprise financial claims that current employees and former employees hold against either:

(a) their employers;

(b) a scheme designated by the employer to pay pensions as part of a compensation agreement between the employer and the employee; or

(c) an insurer.

5.184 The pension entitlements category does not include contingent pension entitlements established by institutional units classified as unfunded government defined benefit employer pension schemes or as social security pension funds. Their transactions are not fully recorded and their other flows and stocks are not recorded in the core accounts, but in the supplementary table on accrued-to-date pension entitlements in social insurance. Contingent pension entitlements are not liabilities of the central government, state government, local government or social security funds subsectors and are not financial assets of the prospective beneficiaries.

7.01 *Definition:* a balance sheet is a statement, drawn up for a particular point in time, of the values of assets economically owned and of liabilities owed by an institutional unit or group of units.

7.15 *Definition:* an economic asset is a store of value representing the benefits accruing to the economic owner by holding or using the entity over a period of time. It is a means of carrying forward value from one accounting period to another. [see also para. 5.04]

7.17 The economic owner of an asset is not necessarily the legal owner. The economic owner is the institutional unit entitled to claim the benefits associated with the use of the asset by virtue of accepting the associated risks.

17.03 The scope of social insurance schemes varies from country to country, and from scheme to scheme within the same country. Examples of such schemes are the following:

- (a) general government obliges all employees to participate in a social security scheme;
- (b) employers make it a condition of employment that employees participate in an insurance scheme specified by the employer;
- (c) an employer encourages employees to join a scheme by making contributions on behalf of the employee;
- (d) a trade union arranges advantageous insurance cover available only to the members of the trade union; or
- (e) the schemes other than social security may be arranged with an insurance corporation as a group policy or series of policies, or they may be managed by an insurance corporation in return for a fee. Alternatively, the schemes may be managed by an employer directly on his own behalf or by employers on behalf of their employees and their dependants or by others on behalf of a specified group.

17.10 Social security refers to social insurance schemes operated by general government.

17.17 *Definition:* social security schemes other than pension schemes are contractual insurance schemes where the beneficiaries as participants of a social insurance scheme are obliged by general government to insure against risks other than old age and other age-related risks. Social security benefits other than pension benefits, known as non-pension benefits, are provided to beneficiaries by general government. [see also para. 17.43]

17.19 Social security entitlements other than pension entitlements, as outstanding amounts for a social security scheme, are not recognised in the core national accounts of the ESA. Estimates of the outstanding amounts of entitlements under social security schemes other than pensions, as well as of any other employment-related non-pension schemes provided by general government, are not included in the core accounts and not recorded in Table 17.5. [see also para. 17.81]

17.20 *Definition:* other employment-related social insurance schemes are contractual insurance schemes, either compulsory by law or encouraged by a third party. In other employment-related social insurance schemes employers can make it a condition of employment that employees, the beneficiaries, participate in a social insurance scheme specified by the employer to insure against risk other than old age and age-related. Such employment-related schemes are provided to beneficiaries either by the employer or by other units on behalf of the employer. [see also para. 17.49]

17.21 Other employment-related social insurance schemes are seen, like related pension schemes, as part of the compensation package, and negotiations between employees and employers may focus on current conditions of service and pay scales. Often social insurance benefits other than pensions are provided by private employers from schemes that the employers control or contract to a third party such as an insurance corporation providing social benefits like private medical coverage.

17.22 In recognition of the fact that social security is normally financed on a pay-as-you-go basis, entitlements accruing under social security such as social benefits including pensions are not shown in the core national accounts. [see also para. 17.80]

17.23 Pension entitlements arising from social security schemes are included in the supplementary table for accrued-to-date pension entitlements in social insurance, but this is not the case for entitlements arising from social security schemes, other than pension schemes.

17.42 Social insurance pensions are provided to beneficiaries as participants in social insurance schemes. The part provided by general government is called social security pensions, including social security funds, and the part provided by other units is called other employment-related pensions. The division between which pensions are provided by social security and which by other employment-related schemes varies considerably from country to country with the consequence that the coverage, and therefore national perceptions, of the term 'social security' vary considerably.

17.48 Pension entitlements as outstanding amounts for a social security pension scheme are not recognised in the core national accounts of the ESA. Estimates of the outstanding amounts of entitlements under social security pension schemes as well as of any other employment-related defined benefit pension scheme provided by general government are not included in the core national accounts but are recorded in the supplementary table for accrued-to-date pension entitlements shown in Table 17.5.

17.50 Unless employers and beneficiaries agree to change the amounts payable, pension schemes run by private employers are usually not subject to retrospective adjustments. However there is a risk that the employer may be unable to pay because he has gone out of business. Protection for the pension entitlements of individuals is becoming more common. The pension built up with one employer may not be transferable to a new employer. Employer schemes are increasingly likely to have reserves set aside. Even if there are no reserves, accounting conventions may require them to recognise pension entitlements of present and past employees in their accounts.

17.51 Other employment-related pensions are seen as part of the compensation package, and negotiations between employees and employers may focus on current conditions of service and pay scales and pension entitlements. Often pensions are provided by private employers from schemes that the employers control or contract to a third party such as an insurance corporation. It is sometimes possible for a specialised unit to agree to assume responsibility for providing pensions for a number of employers in return for assuming the risk of ensuring adequate funding is available to make the promised pensions. Such an arrangement is called a multi-employer pension scheme.

17.77 When government takes responsibility for providing benefits to large sections of the community, the social security function fills the role of a multi-employer scheme. Like the insurance corporation, the government then takes on the responsibility for any shortfall in funds to meet the pension liabilities or may be entitled to retain any surplus generated. It is often the case, though, that social security is funded on a pay-as-you-go basis so there is no question of a surplus arising and, if there is a shortfall in resources, government may have powers to change the entitlements not just relating to future employment but also for the past.

17.127 The decision to record the pension entitlements of an unfunded employment-related defined benefit pension scheme where government is the pension manager within the standard national accounts or only in the supplementary table depends on the nature of the defined benefit scheme. The guiding principle for inclusion in the national accounts is the closeness of the scheme to the national social security pension scheme.

17.128 There is a wide diversity of schemes in the EU, and including all schemes would lead to inconsistencies in recording. So entitlements of unfunded employment-related defined benefit schemes where government is the pension manager are recorded only in the supplementary table. This affects the calculation method in the core national accounts of the imputed employer social contributions for these schemes.

17.163 The accrued-to-date liability concept is appropriate for national accounts purposes. It includes the present value of pension entitlements arising from already accrued pension rights. For example, it covers the pension entitlements accrued by current employees, including deferred pension entitlements, and the remaining pension entitlements of existing pensioners.

Annex C – Relevant paragraphs in GFS on the recording of pension entitlements

3.42 An asset is a store of value representing a benefit or series of benefits accruing to the economic owner by holding or using the resource over a period of time. It is a means of carrying forward value from one reporting period to another.

3.43 Only economic assets are recorded in the macroeconomic statistical systems (i.e., included within the asset boundary) and they appear in the balance sheet of the unit that is the economic owner of the asset. Economic assets are resources over which ownership rights are enforced and from which economic benefits may flow to the owners. [...]

3.45 A liability is established when one unit (the debtor) is obliged, under specific circumstances, to provide funds or other resources to another unit (the creditor). Normally, a liability is established through a legally binding contract that specifies the terms and conditions of the payment(s) to be made and payment according to the contract is unconditional. These are typically established through the provision of economic value by one institutional unit, the creditor, to another, the debtor, normally under a contractual arrangement. Liabilities can also be created by the force of law, and by events that require future transfer payments. In many cases, liabilities (and their corresponding financial claims) are explicitly identified by formal documents expressing the debtor-creditor relationship. In other cases, liabilities are imputed to reflect the underlying economic reality of a transaction, such as the creation of a notional loan when an asset is acquired under a financial lease. [see also para. 7.15]

3.46 Liabilities created by the force of law include those arising from taxes, penalties (including penalties arising from commercial contracts), and judicial awards at the time they are imposed. Liabilities established by events that require future transfer payments include claims on nonlife insurance companies, claims for damages not involving nonlife insurance companies, and claims arising from winnings from lottery and gambling activities.

3.47 Whenever a liability exists, the creditor has a corresponding financial claim on the debtor. A financial claim is an asset that typically entitles the owner of the asset (the creditor) to receive funds or other resources from another unit, under the terms of a liability. Like liabilities, financial claims are unconditional. A financial claim provides benefits to the creditor, such as by acting as a store of value, or by generating interest, other property income, or holding gains. Financial claims consist of equity and investment fund shares, debt instruments, financial derivatives and employee stock options, and monetary gold in the form of unallocated gold accounts (see paragraphs 7.15, 7.127, and 7.139).

4.48 In GFS, the net implicit obligations for future social security benefits (other than employment-related retirement benefits) are not recognized as liabilities (see Appendix 2). Social security contributions are classified as revenue (and therefore as an increase in net worth), and social security benefits payable as expense (a decrease in net worth). This treatment is in line with conventional fiscal analysis. Alternatively, in a full inter-temporal framework, social security contributions may be seen more appropriately as akin to a build-up of assets (arising from contributions made) associated with future liabilities of the government. Likewise, many social security benefit payments may be seen as the extinction of previously incurred government liabilities. This approach is not taken in the main tables of GFS because it is considered that social security schemes, other than employment-related pension schemes, do not result in a contractual liability for the government—that is, there is no direct link between the contributions made and the benefits eventually payable.

4.49 Indeed, it is not uncommon for governments to change unilaterally the structure of benefits of social security schemes (e.g., by changing the circumstances under which the benefits become payable or the amount of the benefit). Moreover, in most cases, these benefits become payable only when certain contingent events occur, such as sickness or unemployment. Nonetheless, it is important for a government to be aware of the implicit contingent liability that arises from its social security programs. Such a contingency recognizes the present value of future benefits that have already been earned according to the existing laws and regulations, net of the present value of future contributions to the scheme according to existing laws and regulations. As a result, a memorandum item is included in the *Balance Sheet*, with more details on these net obligations disclosed in this Statement (see Table 4.6).

4.50 The implicit contingent liabilities related to social security schemes exclude the liabilities associated with employment-related pension schemes, including in cases where the employment-related pensions are provided through the social security scheme. In GFS, imputed obligations incurred for unfunded government employee retirement schemes are considered to involve a contractual liability for a government or public sector unit to its employees. As a result, the actual or imputed contributions receivable to such employment-related schemes are considered to give rise to an incurrence of a liability, and the payment of retirement benefits is considered to be a reduction in the same liability (see paragraph 6.25).

7.190 Pension entitlements are financial claims that existing and future pensioners hold against either their employer or a fund designated by the employer, to pay pensions earned as part of a compensation agreement between the employer and employee. The nature of these claims, and the corresponding liabilities of the units operating the pension funds, depends on the type of benefit promised.

7.194 No liability is recognized in the primary accounts of macroeconomic statistical systems for benefits under social security schemes. The implicit obligation for future social security benefits are reported as a memorandum item to the balance sheet (see paragraph 7.261), regardless of the level of assets in a social security fund or other segregated accounts. Liabilities for the payment of social security benefits that were due to be paid but have not yet been paid are classified as *other accounts receivable/payable* (6308, 6318, 6328). If a social security fund also administers an employment-related pension scheme, those pension obligations are included under pension entitlements, and not as implicit social security obligations.

7.261 As explained in paragraphs 7.194 and A2.39, no liability is recognized in macroeconomic statistical systems for social security benefits—such as retirement benefits (other than employment-related pensions) and health care benefits—payable in the future. These implicit obligations to pay social security benefits in the future are not contractual obligations and are therefore not recorded on the balance sheet (see paragraph 7.252). The present value of social security benefits that have already been earned according to the existing laws and regulations but are payable in the future should be calculated in a manner similar to the liabilities of an employment-related pension scheme. This amount minus the present value of social security scheme contributions provides an indication of the net implicit obligations that a government unit has for social security benefits payable in the future.

9.63 If a public sector unit operates a pension scheme, then it will have transactions in liabilities for pension entitlements.

A2.17 As indicated in Figure A2.2, the following criteria are used in macroeconomic statistics to classify social protection arrangements:

- Contributory versus non-contributory—Contributory schemes require actual or imputed social contributions by the protected persons or by other parties on their behalf to obtain entitlement to the benefits. Non-contributory arrangements do not require the payment of contributions, but other eligibility requirements may apply.
- Compulsory versus voluntary—Compulsory schemes may be established by law and/or regulation or by agreement between employer and employees. In some cases, a scheme may be mixed, where some people are required to participate and others are allowed a choice. Participation in voluntary schemes is at free will.
- Cover the whole (or large segments of the) population or just government employees—Social protection is provided collectively to the general population (or a large segment of the general population), although possibly limited by eligibility criteria, while employment-related schemes provide benefits as part of the conditions of employment.
- Provide pension and other retirement benefits, or other types of social benefits—Social protection arrangements distinguish between those that provide pensions and other retirement benefits, and those that provide other types of non-pension benefits, such as medical, unemployment, disability, etc. This distinction determines the transactions recorded for the arrangement; for example, employment-related pension schemes are considered to give rise to liabilities in the form of pension entitlements recorded under the debt instrument insurance, pension, and standardized guarantee schemes.
- Autonomous versus non-autonomous—A social protection scheme is autonomous when a separate institutional unit exists that is directly held responsible, and accountable, for the decisions and actions the unit takes. Where a separate institutional unit does not exist, the arrangement would be considered non-autonomous and be classified with the unit that controls it.

- Defined-contribution versus defined-benefit schemes—A defined-contribution scheme is one where the benefits are determined by the actual contributions made to the scheme, and the investment income and holding gains and losses earned on these and previous contributions. Under a defined-benefit scheme, the ultimate benefit is calculated by means of a formula embodied in the terms of the social insurance scheme. These benefits are usually determined in terms of the undertakings made by the employer or operator of the scheme.
- Funded versus unfunded schemes—A social insurance scheme is funded if contributions are held in a segregated fund (reserve), from which future benefits will be payable. If a segregated fund is sufficient to finance the present value of the future benefits payable, the scheme is fully funded. If the segregated fund is insufficient to finance the net present value of the future benefits payable, it is underfunded. If the reserve is more than sufficient to finance the net present value of the future benefits payable, it is overfunded. For an unfunded scheme, contributions are not held in a segregated fund (reserve). By definition, unfunded schemes have no separate pool of reserves and cannot be a separate institutional unit.

A2.18 The classification of social protection is based on the type of social protection arrangement governing the payment of the benefits. Social protection can be organized as social assistance or social insurance schemes, with the latter organized as social security schemes or employment-related social insurance schemes. The units involved in the organization and operation of social protection can be general government units, public corporations, non-profit institutions serving households, or private corporations.

A2.19 Using the various aspects of the classification criteria for social protection, as described earlier, Figure A2.2 provides a typology designed to assist compilers in identifying and classifying various social protection arrangements. Identifying the type of unit involved in social protection arrangements is an important step in determining the recording of flows and stock positions, which differs depending on the type of arrangement.

A2.20 The first level in the typology of social protection is based on whether payments of contributions are required to obtain entitlement to benefits. Where no contributions are required, social protection is provided as a social assistance arrangement (see paragraphs A2.25–A2.29). The requirement to make payments of social contributions by the protected persons or by other parties on their behalf to obtain entitlement to the benefits indicates the existence of a social insurance scheme (see paragraphs A2.30–A2.31). However, non-contributory employment-related social protection schemes provided by employers for the benefit of their employees are treated as if they were contributory schemes because contributions are imputed. The amounts necessary to obtain coverage against the specified social risks are imputed as social contributions, and another transaction imputes the employees' payment of the same amounts to the employer as social contributions (see paragraph A2.40).

A2.21 The next level in the typology of social protection is determined by whether the social insurance is arranged as a defined-contribution or defined-benefit scheme. Defined-contribution schemes will constitute either a compulsory savings arrangement or an employment-related pension scheme, and, as described in paragraph A2.12, these arrangements are treated similarly to life insurance. Paragraphs A2.55–A2.59 describe the treatment of defined-contribution schemes.

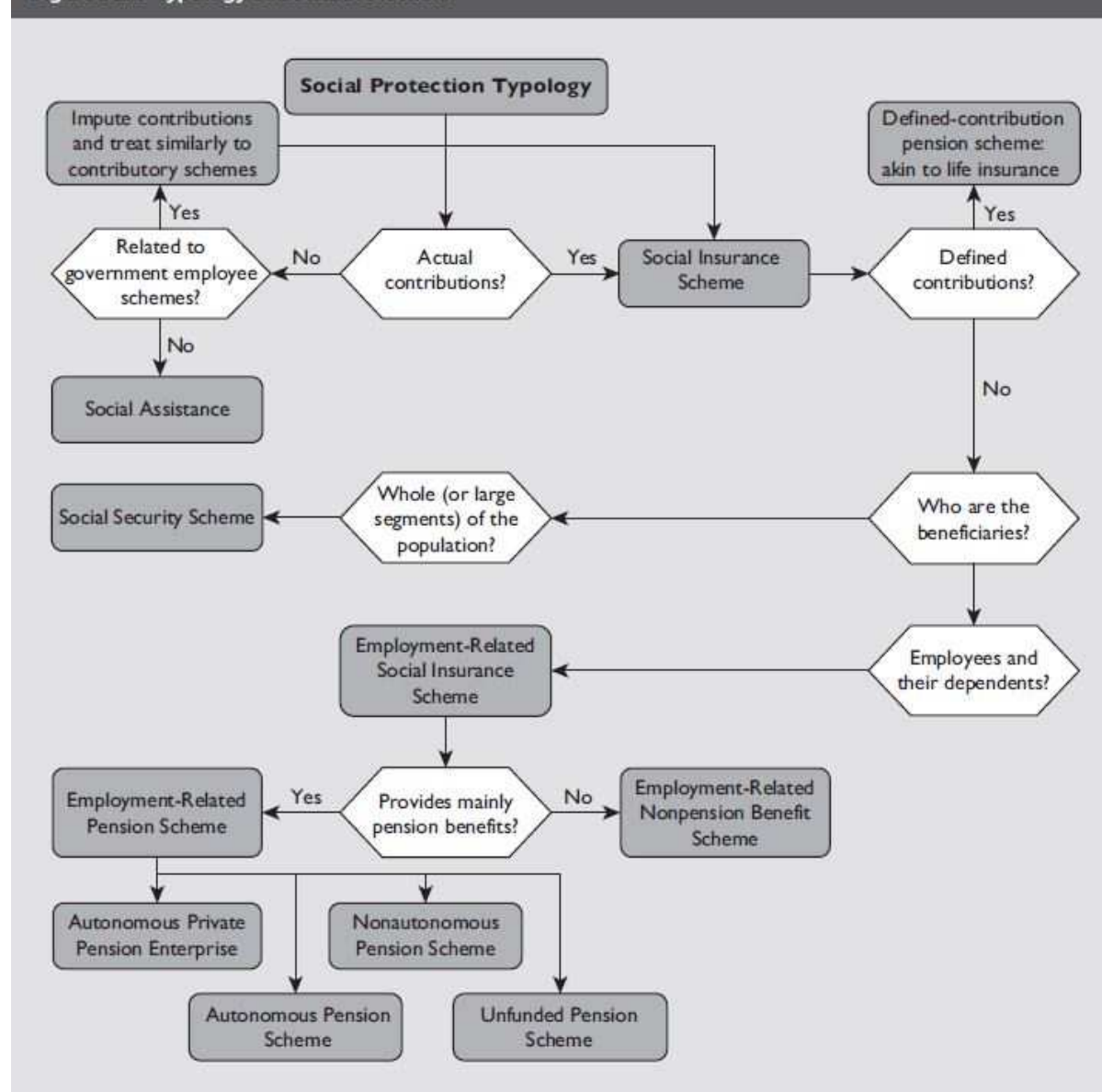
A2.22 Within social insurance, the types of beneficiaries covered by the scheme determine the next level in the typology. When the beneficiaries are the general population, or a large segment of the general population, the scheme would be a social security scheme, as discussed in paragraphs A2.33–A2.39. If individuals or households are eligible to receive social benefits as a group of employees, it is an employment-related social insurance scheme, as discussed in paragraph A2.40. Social Protection 283

A2.23 The typology of employment-related social insurance schemes further distinguishes based on the types of benefits provided by the scheme: Employment-related pension schemes provide pension and other retirement benefits and are discussed in paragraphs A2.41–A2.59; employment-related non-pension social insurance schemes provide non-pension benefits and are discussed in paragraphs A2.64–A2.66. These benefits may be provided in cash or in kind, similar to the benefits as described in paragraph A2.27.

A2.24 Employment-related pension and other retirement benefit schemes can further be distinguished by whether they are funded or unfunded (see paragraph A2.17). While unfunded schemes are always considered non-

autonomous, for funded schemes a further distinction is made between those that are non-autonomous (see paragraph A2.44) or autonomous (see paragraph A2.47).

Figure A2.2 Typology of Social Protection



A2.32 As indicated in paragraph A2.22, the types of beneficiaries covered by the social insurance scheme determine the next level in the typology of this scheme (see Figure A2.2). The individuals or households eligible to receive social insurance benefits are either a group of employees, the general population, or a large segment of the general population. Social security schemes are social insurance schemes that cover the community as a whole, or large sections of the community, and are imposed and controlled by government units. In contrast, as indicated in paragraph A2.40, social insurance schemes in which employers provide social insurance benefits only to their employees, former employees, or their beneficiaries are referred to as other employment-related social insurance schemes. Where the same scheme covers the general population and government employees, the scheme is treated as a social security scheme. However, if the conditions for participation and benefits payable, as determined by the employment contract, differ from those of the social security scheme for nongovernment employee participants, an

employment-related scheme exists and the flows and stock positions of the two schemes should be distinguished within the social security fund (see paragraph 2.102).

A2.33 Social security schemes are social insurance schemes covering the community as a whole, or large sections of the community, and are imposed and controlled by government units. These schemes cover a wide variety of programs, providing benefits in cash or in kind for old age, invalidity or death, survivors, sickness and maternity, work injury, unemployment, family allowance, health care, etc. There is not necessarily a direct link between the amount of the contribution payable by an individual and the benefits receivable.

A2.36 By definition, social security schemes are contributory—participants in the scheme are required to make regular contributions to be eligible to receive benefits for themselves or their dependents. Social security schemes are characterized by a degree of contingent reciprocity. Social security contributions secure entitlements to benefits that are contingent on the event underlying the social risk occurring. Nonetheless, the amount and timing of receipts of benefits by beneficiaries (if any) are subject to various eligibility criteria without necessarily a direct relationship between the amount of the contribution payable by an individual and the benefits receivable. Therefore, the link between benefits and contributions is not considered sufficiently strong to give rise to a financial claim on the part of contributors. The potential individual claims of contributors (and therefore the corresponding government obligations) are regarded as contingent. Also, because social security benefits can be changed at will by the government or legislature as part of its overall economic policy, there is uncertainty about the eventual payment or level of payment of these social benefits. As a result, in GFS, no liabilities are associated with the potential future claims on social security schemes. An expense is recorded only when payment of the benefits is due.

A2.39 However, a high expectation exists that social security benefits earned according to the existing laws will be payable in the future. Therefore, an estimate equal to the net implicit obligations for future social security benefits should be presented as a memorandum item to the Balance Sheet, and details of it presented as a supplementary statement, the *Summary Statement of Explicit Contingent Liabilities and Net Implicit Obligations for Future Social Security Benefits* (see paragraphs 4.47 and 7.261).

A2.40 Other employment-related social insurance schemes derive from an employer-employee relationship in the provision of pension entitlement and other social benefit to employees as part of the conditions of employment. By definition, these schemes are contributory and, for government or public sector units, protect only their own employees and dependents. The provision of social insurance benefits by government to its own employees is considered to be part of an actual or implicit contract between the government, as employer, and the employees, to compensate them for the provision of their labor services. Therefore, employment-related social insurance schemes give rise to required expense transactions for government when the social contributions became payable. To accurately reflect the accrued costs of employment, the actual and imputed social insurance contributions should be recorded as *employers' social contributions* (212) in the expense category for *compensation of employees* (21) (see Table 6.1).

A2.51 If government controls the financial corporation that manages the employment-related pension scheme for government employees, the corporation will be part of the public financial sector, and the relevant flows and stock positions would be recorded when compiling GFS for the public sector. The receipt of social contributions by this insurance enterprise or pension fund gives rise to a liability, classified in the financial instrument *insurance, pensions, and standardized guarantee schemes* (6306), and more specifically in *pension entitlements* (63063). The liability originates from the obligation to pay future pension benefits—any subsequent payment of the benefits will be recorded as a reduction in this liability. Although the social contributions are payable directly by the employer to the financial corporation, they are recorded in GFS as if payable by the employer to households as compensation of employees: households in turn pay the contributions to the financial corporation. Because of this rerouting, these transactions should not be eliminated in consolidation of the public sector (see paragraph 3.28).

Annex D – Relevant paragraphs in PSDS on the recording of pension entitlements

2.8 For a liability to be considered debt it must exist and be outstanding. The decisive consideration is whether a creditor has a claim on the debtor. Debt liabilities are typically established through the provision of economic value by one institutional unit, the creditor, to another, the debtor, normally under a contractual arrangement. Debt liabilities can also be created by the force of law, and by events that require future transfer payments. Debt liabilities include arrears of principal and interest. Commitments to provide economic value in the future do not establish debt liabilities until items change ownership, services are rendered, or income accrues; for example, amounts yet to be disbursed under a loan or export credit commitment are not to be included in the gross debt position. [see also para. 3.5]

2.78 Together, social security and employment-related schemes other than social security constitute social insurance schemes. Social insurance pensions in all countries are provided, if at all, in part by general government and in part by employers. Social insurance pensions provided by general government are called social security and those by employers are called employment-related schemes other than social security (including government as employer).

2.80 Macroeconomic statistical systems do not recognize future pension obligations of social security schemes, but recommend to supplement balance sheet (and debt) information with information on social security obligations (including pensions). As explained in paragraph 17.192 of the 2008 SNA, there are two problems with including future entitlements from social security as liabilities in the government's balance sheet. The first is that reliable estimates of the entitlements may not be readily available. Secondly, even if these estimates exist, there is an argument that such estimates are of limited usefulness where government has the possibility of changing the basis on which entitlements are determined in the order to keep the entitlements within the bounds of what is feasible within the budget.

2.81 Regarding unfunded pension schemes sponsored by government and provided via social security, the 2008 SNA does allow some flexibility in the recording of the pension entitlements. The following criteria should be considered: The closer the pension scheme is to a social security scheme (see paragraph 2.44), the less likely its liabilities are to be included in government's balance sheet; the less the benefits are tailored to the specific characteristics of the individual and the more they are applicable to the population at large, the less likely its liabilities are to be included in government's balance sheet; the greater the ability of government to alter the benefit formula, the less likely its liabilities are to be included in the government's balance sheet. However, none of these criteria alone is necessarily decisive in determining whether the scheme's liabilities are recognized in government's balance sheet or not.

2.82 Employment-related schemes other than social security derive from an employer–employee relationship in the provision of pension and possibly other entitlements that are part of the conditions of employment and where responsibility for the provision of benefits does not devolve to general government under social security provisions. There are two employment-related pension schemes other than social security: a defined contributions scheme and a defined benefit scheme (see paragraph 3.54). For both types of schemes, a fund or segregated reserve is assumed to exist. For a defined contribution pension scheme a fund or segregated reserve must exist and for a defined benefit pension scheme a fund or segregated reserve may exist in reality, or it may be a notional fund.

2.85 Pension liabilities (i.e., the pension entitlements of the beneficiaries) of employment-related pension schemes other than social security are debt liabilities of the respective institutional units. Chapter 3 discusses the instrument classification of pension entitlements.

3.4 Only economic assets are recorded in the macroeconomic statistical systems. *Economic assets are entities (i) over which economic ownership rights are enforced by institutional units, individually or collectively, and (ii) from which economic benefits may be derived by their owners by holding them or using them over a period of time.*

3.6 Whenever a liability exists, the creditor has a corresponding financial claim on the debtor. *A financial claim is an asset that typically entitles the owner of the asset (the creditor) to receive funds or other resources from another unit, under the terms of a liability.* Like liabilities, financial claims are unconditional. A financial claim provides benefits to the creditor, such as by acting as a store of value, or by possibly generating interest, other property income, or holding gains. Financial claims consist of equity and investment fund shares, debt instruments,

financial derivatives and employee stock options, and monetary gold in the form of unallocated gold accounts. *Financial assets consist of financial claims plus gold bullion held by monetary authorities as a reserve asset.*

3.8 In many cases, liabilities (and their corresponding financial claims) are explicitly identified by formal documents expressing the debtor-creditor relationship. In other cases, liabilities are imputed to reflect the underlying economic reality of a transaction, such as the creation of a notional loan when an asset is acquired under a financial lease. Regardless of how a liability is created, it is extinguished when the debtor pays the sum agreed in the contract.

3.11 Only actual liabilities (and assets) are included in the balance sheet:

- Contingent assets and liabilities are not recognized as financial assets and liabilities prior to the condition(s) being fulfilled.
- Amounts set aside in business accounting as provisions to provide for a unit's future liabilities, either certain or contingent, or for a unit's future expenditures, are not recognized in the macroeconomic statistical systems.
- No liability is recognized for government promises to pay social security benefits, such as retirement pensions and health care, in the future (see paragraph 2.80).
- Lines of credit, letters of credit, and loan commitments assure funds will be made available in the future, but no financial asset (and liability) in the form of a loan is created until funds are actually advanced.
- Uncalled share capital is contingent unless there is an obligation to pay the amount.
- Environmental liabilities, which are probable and measureable estimates of future environmental clean-up, closure, and disposal costs, are not recognized.

3.53 *Pension entitlements are financial claims that existing and future pensioners hold against either their employer, or a fund designated by the employer, to pay pensions earned as part of a compensation agreement between the employer and employee.* The nature of these claims, and the corresponding liabilities of the units operating the pension funds, depends on the type of benefits promised.

3.56 In addition to liabilities of pension funds, liabilities of unfunded pension schemes are included in this category. By its nature, an unfunded scheme must be organized and managed by the employer, which may be a general government unit or a public corporation.

3.57 With respect to social security schemes, no liability is recognized in the macroeconomic statistical systems for government promises to pay retirement pensions and other benefits in the future, regardless of the level of assets in a social security fund or other segregated accounts. Liabilities for the payment of benefits that were due to be paid but have not yet been paid are classified as other accounts payable. If a social security fund also acts as a pension scheme (as is sometimes the case for benefits for present and former government employees), those pension obligations are included under pension entitlements, but not the pension fund's social security obligations.

4.6 In general, contingent liabilities are not recognized as liabilities in macroeconomic statistics unless and until certain specified conditions prevail. However, for standardized guarantees (see paragraphs 4.12–4.13), the proportion of guarantees likely to be called for the pool of similar guarantees is treated as a liability, even though each individual arrangement involves a contingent liability. In some cases, specific guidance is needed to determine whether an instrument is a liability (and financial asset for the counterparty) or a contingent liability. Banker's acceptances are treated as financial assets (and liabilities) even though no funds may have been exchanged. There are other circumstances where future payments are not treated as liabilities (or financial assets), even though the size of the payment and the fact that it will be paid are known with a high degree of certainty. For example, an enterprise's future payments under a sales contract or future tax payments to government are not recorded as liabilities until an event occurs that creates a liability, such as the receipt of goods and services under a sales contract.

4.21 As explained in paragraph 4.7, implicit contingent liabilities do not arise from a legal or contractual source but are recognized when a condition or event is realized. Examples of implicit contingent liabilities are the net obligations of future social security benefits, ensuring solvency of the banking sector, covering the obligations of subnational (state and local) governments, or the central bank, in the event of default, environmental liabilities, unguaranteed debt of public sector units, obligations to meet the guarantees of other public sector units if they cannot meet them, and spending for natural disaster relief.

Annex E - Criteria that were considered by the European Task Force on the Measurement of Pension Entitlements on determining whether or not to record pension entitlements in the core accounts.

- (a) *Degree of integration within the general government structure (degree of autonomy):* The Task Force considered whether the scheme is separately organised or completely integrated into the government structure (autonomous versus non-autonomous pension schemes in the 1993 SNA). Autonomous pension schemes are seen as institutional units separate from the employers, while non-autonomous pension schemes are managed by the employers, with or without segregated reserves. Autonomous pension schemes are classified as financial corporations, while non-autonomous pension schemes are part of the sector of the sponsor; if quasi-corporations are established for the pension schemes they should be classified as autonomous pension schemes.
- (b) *Risk exposure and ability to change the benefit formula:* The Task Force decided that the risk exposure of a government-sponsored employer pension scheme may be assessed by two related questions. If the risk exposure is mainly with the government the pension scheme should only in the supplementary table (non-core). If the government is able to unilaterally change the benefit formula at any point in time, and thereby partially default on its pension obligations, the pension scheme should only be recorded in the supplementary table (non-core).
- (c) *Nature of the contract:* The question also arises whether the contract is voluntary or compulsory and imposed by government. The availability of a *contract* is usually determined by mutual agreement between the employer and its employees and the benefits are linked to the contributions. By contrast, participants of a government employer pension scheme might not enter into the agreement voluntarily, but are rather forced by law to participate (in a similar way to enforced membership of a social security scheme), which would be indicative of a non-core recording. Such agreements are of a ‘public’ law nature which does not always allow for “officially” acknowledged government obligations.
- (d) *Legal framework close to social security pension schemes:* The following features of social security have been identified and compared with a corresponding government-sponsored employer pension scheme: (i) Coverage and purpose; (ii) Funding; (iii) Property of separate funds (government or beneficiaries); (iv) Financing of the schemes (only contributions or also transfers from other government units); (v) Nature of the contracts; (vi) Benefits received not necessarily determined by the contributions paid; and (vii) Treatment of transfers of pension entitlements between schemes. If the legal framework is identical to or very close to that of social security, then this would be an indicative of a non-core recording.
- (e) *Funding (funding versus no funding):* Funded pension schemes are defined as those schemes that finance pension payments by drawing down on segregated and earmarked assets. These segregated and earmarked assets are dedicated to the payment of pension benefits. From a beneficiary perspective, a pension scheme is seen as funded if assets, the pension entitlements, exist against which households can establish legal claims. This meaning of funded does not refer to the adequacy of the reserves established for the payment of benefits vis-à-vis the pension obligations. That is, a funded scheme can be exactly funded, under-funded or over-funded depending on the size of the accumulated assets held for the payment of benefits relative to the value of the pension entitlements. By contrast, unfunded pension schemes are schemes with no identifiable reserves that are assigned for the payment of benefits and against which the beneficiaries (households) can lay claims. This does not exclude that unfunded schemes may hold sizeable assets (for example for liquidity purposes or as buffer funds). A funded pension scheme would be indicative of a core recording.

Annex F – Relevant sections from the IPSAS 25 – Employee benefits

1. The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The Standard requires an entity to recognize:

- (a) A liability when an employee has provided service in exchange for employee benefits to be paid in the future; and
- (b) An expense when the entity consumes the economic benefits or service potential arising from service provided by an employee in exchange for employee benefits.

3. [...] This Standard does not deal with benefits provided by composite social security programs that are not consideration in exchange for service rendered by employees or past employees of public sector entities.

4. The employee benefits to which this Standard applies include those provided:

- (a) Under formal plans or other formal agreements between an entity and individual employees, groups of employees or their representatives;
- (b) Under legislative requirements, or through industry arrangements, whereby entities are required to contribute to national, state, industry, or other multiemployer plans or where entities are required to contribute to the composite social security program; or
- (c) By those informal practices that give rise to a constructive obligation. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

10. [...] Composite social security programs are established by legislation; and

- (a) Operate as multi-employer plans to provide postemployment benefits; as well as to
- (b) Provide benefits that are not consideration in exchange for service rendered by employees.

55. When an employee has rendered service to an entity during a period, the entity shall recognize the contribution payable to a defined contribution plan in exchange for that service:

- (a) As a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the reporting date, an entity shall recognize that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and
- (b) As an expense, unless another Standard requires or permits the inclusion of the contribution in the cost of an asset (see, for example, IPSAS 12, "Inventories" and IPSAS 17, "Property, Plant and Equipment").

63. An entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity's informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

64. The formal terms of a defined benefit plan may permit an entity to terminate its obligation under the plan. Nevertheless, it is usually difficult for an entity to cancel a plan if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for postemployment benefits assumes that an entity which is currently promising such benefits will continue to do so over the remaining working lives of employees.

Annex G – Relevant sections from The Conceptual Framework for General purpose financial reporting by public sector entities (IPSASB)

5.12 In assessing whether it presently controls a resource, an entity assesses whether the following indicators of control exist:

- Legal ownership;
- Access to the resource, or the ability to deny or restrict access to the resource;
- The means to ensure that the resource is used to achieve its objectives; and
- The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.

While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision.

5.14 Public sector entities can have a number of obligations. A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.

5.17 To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of a past transaction or other event and requires an outflow of resources from the entity. The complexity of public sector programs and activities means that a number of events in the development, implementation and operation of a particular program may give rise to obligations. For financial reporting purposes it is necessary to determine whether such commitments and obligations, including binding obligations that the entity has little or no realistic alternative to avoid but are not legally enforceable (non-legally binding obligations) are present obligations and satisfy the definition of a liability. Where an arrangement has a legal form and is binding, such as a contract, the past event may be straightforward to identify. In other cases, it may be more difficult to identify the past event and identification involves an assessment of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity. In making such an assessment an entity takes jurisdictional factors into account.

5.20 A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. There are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the Conceptual Framework. For some types of non-exchange transactions, judgement will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists.

5.21 Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions – or having to take any further action – prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.

5.22 Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.

5.23 Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:

- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;

- As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
- The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

5.24 In the public sector, obligations may arise at a number of points. For example, in implementing a program or service:

- Making a political promise such as an electoral pledge;
- Announcement of a policy;
- Introduction (and approval) of the budget (which may be two distinct points); and
- The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).

The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability.

5.25 The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgements whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid an outflow of resource include:

- The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement in relation to an event or circumstance that has occurred may have such political support that the government has little option to withdraw. Where the government has committed to introduce and secure passage of the necessary budgetary provision such an announcement may give rise to a non-legally binding obligation;
- The ability of the entity to modify or change the obligation before it crystallizes. For example, the announcement of policy will generally not give rise to a non-legally binding obligation, which cannot be modified before being implemented. Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur; and
- There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, a non-legally binding obligation may exist. However the absence of a budgetary provision does not itself mean that a present obligation has not arisen.

5.26 “Economic coercion”, “political necessity” or other circumstances may give rise to situations where although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.

Annex H – Relevant sections from the Social Security (minimum standards) Convention (C102) by the International Labour Organization (ILO)

Part V. Old-age benefit

Article 25

Each Member for which this Part of this Convention is in force shall secure to the persons protected the provision of old-age benefit in accordance with the following Articles of this Part.

Article 26

1. The contingency covered shall be survival beyond a prescribed age.
2. The prescribed age shall be not more than 65 years or such higher age as may be fixed by the competent authority with due regard to the working ability of elderly persons in the country concerned.
3. National laws or regulations may provide that the benefit of a person otherwise entitled to it may be suspended if such a person is engaged in any prescribed gainful activity or that the benefit, if contributory, may be reduced where the earnings of the beneficiary exceed a prescribed amount and, if non-contributory, may be reduced where the earnings of the beneficiary or his other means or the two taken together exceed a prescribed amount.

Article 27

The persons protected shall comprise

- (a) prescribed classes of employees, constituting not less than 50 per cent, of all employees; or
- (b) prescribed classes of the economically active population, constituting not less than 20 per cent, of all residents; or
- (c) all residents whose means during the contingency do not exceed limits prescribed in such a manner as to comply with the requirements of Article 67; or
- (d) where a declaration made in virtue of Article 3 is in force, prescribed classes of employees, constituting not less than 50 per cent, of all employees in industrial workplaces employing 20 persons or more.

Article 28

The benefit shall be a periodical payment calculated as follows:

- (a) where classes of employees or classes of the economically active population are protected, in such a manner as to comply either with the requirements of Article 65 or with the requirements of Article 66.
- (b) where all residents whose means during the contingency do not exceed prescribed limits are protected, in such a manner as to comply with the requirements of Article 67.

Article 29

1. The benefit specified in Article 28 shall, in a contingency covered, be secured at least
 - (a) to a person protected who has completed, prior to the contingency, in accordance with prescribed rules, a qualifying period which may be 30 years of contribution or employments, or 20 years of residence; or
 - (b) where, in principle, all economically active persons are protected, to a person protected who has completed a prescribed qualifying period of contribution and in respect of whom, while he was of working age, the prescribed yearly average number of contributions has been paid.
2. Where the benefit referred to in paragraph 1 is conditional upon a minimum period of contribution or employment, a reduced benefit shall be secured at least
 - (a) to a person protected who has completed, prior to the contingency, in accordance with prescribed rules, a qualifying period of 15 years of contributions or employment; or
 - (b) where, in principle, all economically active persons are protected, to a person protected who has completed a prescribed qualifying period of contribution and in respect of whom, while he was of working age, half the yearly average number of contributions prescribed in accordance with subparagraph (b) of paragraph 1 of this Article has been paid.
3. The requirements of paragraph 1 of this Article shall be deemed to be satisfied where a benefit calculated in conformity with the requirements of Part XI but a percentage of ten points lower than shown in the Schedule appended to that Part for the standard beneficiary concerned is secured at least to a person protected who has completed, in accordance with prescribed rules, ten years of contribution or employment, or five years of residence.

4. A proportional reduction of the percentage indicated in the Schedule appended to Part XI may be effected where the qualifying period for the benefit corresponding to the reduced percentage exceeds ten years of contribution or employment but is less than 30 years of contribution or employment; if such qualifying period exceeds 15 years, a reduced benefit shall be payable in conformity, with paragraph 2 of this Article.

5. Where the benefit referred to in paragraph 1, 3 or 4 of this Article is conditional upon a minimum period of contribution or employment, a reduced benefit shall be payable under prescribed conditions to a person protected who, by reason only of his advanced age when the provisions concerned in the application of this Part come into force, has not satisfied the conditions prescribed in accordance with paragraph 2 of this Article, unless a benefit in conformity with the provisions of paragraph 1, 3 or 4 of this Article is secured to such person at an age higher than the normal age.

Annex I – Relevant sections from the IPSAS Consultation Paper on Recognition and measurement of social benefits

2.19 Social security schemes are social insurance schemes covering the community as a whole, or large sections of the community and are operated by a government. These schemes provide benefits such as pensions and unemployment benefits. As social insurance schemes, social security schemes are contributory schemes. In some cases, the government itself will make or impute contributions to the social security scheme on behalf of a recipient. This may happen, for example, during a period of unemployment. The legal form varies from country to country. In some countries, retrospective changes to entitlements are permissible; in other countries this is not the case. Social security schemes operate outside any employer-employee relationship.

2.20 The second category of social insurance is employment-related social insurance schemes. The terms of these schemes are determined by the employer, sometimes in conjunction with the employees and forms part of the contractual agreement of the employer-employee relationship. These schemes provide benefits such as employment-related pensions and health benefits. Governments and other public sector entities may operate employment-related social insurance schemes in addition to any social security schemes they operate.

2.27 The SNA approach identifies different categories of social benefits with potentially different economic consequences for a public sector entity. These differing consequences result in different treatment within the SNA, and might justify different accounting requirements within a future IPSAS.

2.28 The different economic consequences that might arise, and which have different classifications in the SNA are:

- The universal provision of services such as education and health are considered as ongoing activities of government. In the SNA, providing these services does not give rise to an obligation prior to the delivery of services.
- Households could receive benefits when they meet certain eligibility criteria related to a social risk without making any contributions (known as social assistance in the SNA). This will give rise to a consumption of resources. Within the SNA, these benefits are classified as an expense that leads to a redistribution of income through transfers. In developing a future IPSAS, the IPSASB would need to consider whether an obligation arises when the social risk materializes, the eligibility criteria are met, or the benefits are paid. The fact that no contributions are paid by the households is a factor that may be taken into account in making this determination.
- Households could make contributions and receive benefits in the event of the occurrence of the specified social risks (known as social insurance in the SNA). The finances of these arrangements function similarly to non-life insurance schemes. Such arrangements are essentially a process of redistribution across a wide section of the population with many individuals contributing resources so that those in need may benefit. These arrangements will give rise to a consumption of resources. Within the SNA, these social benefits are classified as an expense. In developing a future IPSAS, the IPSASB would need to consider whether an obligation arises when contributions are made, the social risk materializes, or benefits are paid. The fact that contributions are paid by the households is a factor that may be taken into account in making this determination.
- Households (including employees, self-employed, and unemployed) could make contributions (actual and imputed) to a scheme to accumulate assets (also known as social insurance in the SNA). They can withdraw from these accumulated assets in the event of the occurrence of the specified social risk. Examples are employment-related pensions and other retirement benefits, compulsory saving schemes, and various types of annuities. The finances of these arrangements function similarly to life insurance schemes. There is relatively little redistribution among the various households holding similar policies and members of households are able to predict with a reasonable degree of certainty what they will receive and when. Within the SNA, contributions and payments of these benefits are treated as transactions in financial assets and liabilities. It is generally assumed that these arrangements will give rise to an obligation, and in developing a future IPSAS, the IPSASB will need to consider the point at which a liability should be recognized.

3.1 Following the considerations outlined in Chapter 2, the IPSASB identified three broad approaches to accounting for social benefits. [...] The approaches can be summarized as follows:

- **Option 1: The obligating event approach.** This approach considers social benefits by reference to the definitions of a liability in the Conceptual Framework. [...] Under this approach, obligations to pay social benefits are seen as

no different (in principle) than other obligations. The key issue is when a present obligation arises. The CP identifies five distinct points at which a case can be made for recognizing an obligation in the financial statements:

- (a) Key participatory events have occurred;
- (b) Threshold eligibility criteria have been satisfied;
- (c) The eligibility criteria to receive the next benefit have been satisfied;
- (d) A claim has been approved; or
- (e) A claim is enforceable.

• **Option 2: The social contract approach.** [...] This approach acknowledges, as commitments, both: (a) Public sector obligations to provide goods, services and cash transfers to individuals or households; and (b) The rights of individuals or households to receive those benefits. The approach is underpinned by a view that the ongoing duty of individuals and households to contribute taxes and other sources of finance effectively offsets such obligations. There is an imputed social contract between the state and the citizens under which citizens agree to pay taxes to enable the state to provide social benefits. This is analogous to an executory contract, where an entity would not recognize a liability until the counterparty to a contract had performed their obligations. Under this approach, present obligations only arise once claims for social benefits become enforceable (or, under an alternative approach, claims for social benefits are approved). Using the executory contract analogy, this can be viewed as the state recognizing present obligations when entitlements are established, while citizens' performance is achieved through acknowledging their obligations to contribute taxes and other sources of finance as taxable and other obligating events occur.

• **Option 3: The insurance approach.** [...] This approach considers that some social benefits are similar in practice to insurance contracts. Therefore, it may be appropriate to use an insurance accounting model when accounting for such schemes. The insurance approach recognizes a present obligation to pay benefits at the point that coverage begins. The approach also recognizes a right to future receipts resulting from the provision of that coverage. The insurance approach is most suited to contributory schemes, where future contributions are compared to future payments to recipients and the net present value of the scheme is presented in the statement of financial position. Because of this, it may be appropriate to adopt the insurance approach for contributory benefits, and another approach for non-contributory benefits (i.e., some benefits are accounted for using one approach and other benefits are accounted for using a different approach, depending on the nature of the individual benefits).

4.7 The IPSASB's previous work on social benefits has shown that the difficulty in applying this approach has been the identification of an obligating event. The point at which an obligating event arises will determine the recognition of a liability. It may also affect the measurement of that liability. For obligations that accumulate over time, the earlier the obligating event the greater the liability will be. Views on what constitutes an obligating event differ. This chapter of the CP will explore those different views.

4.9 For legally binding obligations, the obligating event is the event that gives rise to the obligation. When considering social benefits, this is the point at which an individual or household could take legal action to enforce their entitlement to a benefit. An obligating event that gives rise to a legally binding obligation can usually be clearly identified.

4.10 Identifying the obligating event that may give rise to a non-legally binding obligation is generally more difficult than for legally binding obligations. In order for a non-legally binding obligation to give rise to a liability there must be:

- An indication to others that the entity will accept certain responsibilities;
- The creation of a valid expectation; and
- Little or no realistic alternative to avoid an outflow of resources. [...]

4.16 For a valid expectation to be created, announcements that an entity will accept certain responsibilities need to be sufficiently precise and certain. Policies included in election manifestos are unlikely to create a valid expectation as they are rarely sufficiently precise. Policies that are enshrined in legislation are more likely to create a valid expectation prior to an individual satisfying the entitlement requirements.

4.19 A government's ability to change legislation could mean that it has a realistic alternative to settling non-legally binding obligations. Governments frequently change the nature and amount of benefits. Governments rarely provide categorical assurances that current benefits will continue to be provided in future periods. In many

jurisdictions governments are frequently in power for limited periods. As such, they are unable to give such assurances even if they want to.

4.20 However, governments generally operate on the basis that they will meet their outstanding obligations as they fall due. Financial statements should reflect this. Financial statements should also reflect the legal framework at the reporting date. In addition, governments frequently have difficulty in changing policies that “promise” benefits to individuals or households. This applies particularly where past practice has created the valid expectation that those benefits will be provided. In this context, the “little or no realistic alternative to avoid an outflow of resources” criterion may not apply in the same way in the public sector as it does in the private sector. It may need to be interpreted having regard to the circumstances in each jurisdiction. Financial statements should, therefore reflect not only the legal framework at the reporting date, but a government’s past practice regarding the acceptance of non-legally binding obligations.

4.21 The IPSASB supports the approach in paragraph 4.20. It considers that reporting obligations in the financial statements in accordance with the legal framework in place and in accordance with past practice at the reporting date is more likely to provide useful information to users of the financial statements and meet the objectives of financial reporting. The IPSASB has identified a number of factors that it considers should be taken into account in determining whether an entity has little or no realistic alternative to avoid an outflow of resources. These factors are:

- (a) The extent to which households are dependent on a particular benefit. If households are heavily dependent on a benefit it is less likely that the entity will cancel or decrease the benefit.
- (b) The entity’s past practice in:
 - Removing or reducing particular benefits;
 - Changing the method of providing benefits; or
 - Changing eligibility criteria.

The ability to remove or reduce benefits may differ depending on the type of benefit and the groups of recipients.

- (c) The likely political impact of changing benefits.

4.22 Whether an entity has little or no realistic alternative to avoid an outflow of resources needs to be considered for all non-legally binding obligations. If an obligation exists, but the entity has a realistic alternative to avoid an outflow of resources, a liability is not recognized.

4.23 The three factors should not be considered in isolation. They act cumulatively. An entity must have given a sufficiently precise indication to others that the entity will accept certain responsibilities. It must be this indication that gives rise to a valid expectation that the entity will discharge those responsibilities. It must be as a result of creating that valid expectation that the entity has little or no realistic alternative to avoid an outflow of resources.

4.28 The IPSASB has identified five distinct points at which a case can be made for recognizing an obligation in the financial statements.

- (a) Key participatory events have occurred;
- (b) Threshold eligibility criteria have been satisfied;
- (c) The eligibility criteria to receive the next benefit have been satisfied;
- (d) A claim has been approved; and
- (e) A claim is enforceable [...]

4.70 Some argue that whether a scheme is contributory affects the point at which an obligating event occurs. According to this view, contributory schemes should be considered separately from non-contributory schemes. Under this view, the payment of a specified number, or amount, of contributions creates a valid expectation that an individual or household will receive benefits based on those contributions. These expectations may be strengthened by communications regarding personal details of estimated future benefits. Such expectations are stronger than for non-contributory schemes that are primarily funded from general taxation. It is also argued that it is unrealistic for the government to avoid paying such benefits. This is the case even if benefits will only be provided many years in the future.