

Reporting on the Long-Term Sustainability of Public Finances

Draft Comments on the IPSASB's Preliminary Views

Introduction

1. This paper sets out the preliminary views (boxed) in the IPSASB Consultation Paper and seeks feedback from the Boards on the key points they would like to make in relation to these issues. As a prompter for discussion, the staff's recommended responses by the Boards and some related discussion points are provided beneath each preliminary view (PV). The staff recommends that the Boards provide views on most, but not all, PVs. Recommended responses are drafted as if the Boards make a joint submission: whether they do is an issue discussed in agenda paper B2.1.

Preliminary Views, background and draft responses

PV1. The presentation of information on long-term fiscal sustainability is necessary to meet the objectives of financial reporting (accountability and decision-making) as proposed in the IPSASB's first Consultation Paper, "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities", issued in September 2008 (Section Two).

Brief background

2. Information on long-term fiscal sustainability is, to a significant extent, prospective in nature. In its April 2009 submission on the IPSASB's Consultation Paper on phase 1 of its Conceptual Framework project, the AASB argued that:
 - (a) the amount of prospective information provided in financial reports should be limited to information best communicated in financial reports, given that financial reports cannot provide all information that is useful for accountability purposes and for making decisions; and
 - (b) prospective financial and other information about an entity's future service-delivery activities and objectives, and the resources necessary to support those activities, should be limited in general purpose financial reports (GPFRs) to information that is central to assessing such matters, to avoid information overload.
3. In its February 2010 submission on IASB ED/2009/6 *Management Commentary*, the AASB supported the issuance of *Management Commentary* as non-mandatory guidance. The AASB considered that depending on the circumstances, an entity's management commentary may include forward-looking information. The FRSB's comments reflected a similar view. The FRSB recommended that the IASB add a guiding principle that any future-oriented information provided as part of management commentary should be consistent with other forward looking information disseminated by an entity.
4. In its April 2009 submission on the IPSASB's Consultation Paper on phase 1 of its Conceptual Framework project, the FRSB recommended that the scope of financial reporting should be limited to include only information that is best communicated through GPFRs. In particular, the FRSB recommended that the amount of non-financial and prospective information be limited to information that is central to assessing the entity's future objectives and service delivery activities as well as the resources necessary to support those activities. However, the FRSB has previously indicated, in the context of developing domestic financial reporting standards, that it regards prospective financial

statements as general purpose financial statements. This suggests that the FRSB may be comfortable with the idea of general purpose financial reports including a prospective rather than an historical focus.

5. In considering a diagram presenting the IPSASB's views on the scope of GPFs, the FRSB commented that there may be an overlap between 'additional information' presented in the context of annual and other general purpose financial reports and 'other information'. The FRSB suggested that prospective financial information included within that 'additional information' may contain elements of economic and statistical data which is also presented in reports that would be regarded as 'other information' – ie outside the scope of general purpose financial reporting. The FRSB commented that the boundary between 'additional information' and 'other information' is likely to change as public sector financial reporting develops over time.

Suggested response

6. The presentation of information on long-term fiscal sustainability is likely to be useful for accountability assessments and making resource allocation decisions about governments and other public sector entities that present that information. The Boards have yet to decide whether this information should be regarded as falling within the scope of GPFs of public sector entities. Therefore, they do not express a view on whether the presentation of information on long-term fiscal sustainability is necessary to meet the objectives of financial reporting.

- Discussion points for AASB and FRSB: (1) Is it valid to say both Boards have yet to decide whether this information should be regarded as falling within the scope of GPFs of public sector entities? (2) For those members who consider this information should not be included within the scope of GPFs, are you concerned only with *requiring* this information to be included in GPFs, or would you also be concerned with *permitting* it to be included?

If members consider information about long-term fiscal sustainability is useful for accountability assessments and making resource allocation decisions, and are comfortable with it being included in GPFs, they might wish to encourage exploration of, and experimentation with, reporting this information, either within or outside GPFs.

- PV2. IPSASB guidance should recommend that long-term fiscal sustainability information in GPFs be presented either through:
- Additional statements providing details of projections; or
 - Summarized projections in narrative reporting (Section Three).

Brief background

7. The background information for PV1 is also pertinent to this PV.

Suggested response

8. Because information on long-term fiscal sustainability is, to a significant extent, prospective in nature, the Boards do not intend to decide whether this information should be regarded as falling within the scope of GPFs of public sector entities until substantial progress occurs with identifying the scope of GPFs in the Conceptual Framework projects of both the IASB and IPSASB. [*Staff comment: see discussion point on PV1*] Such a decision should be made in conjunction with considering whether other prospective information (including that provided in narrative reporting) should be included in the scope of GPFs.

This issue affects for-profit and not-for-profit entities in the private and public sectors. Therefore, the Boards encourage the IPSASB to work with the IASB in addressing whether prospective information should be included in GPFRs.

PV3. IPSASB guidance should be based on the concept of the reporting entity and should provide recommended practice for consolidated reports presented by all levels of government (Section Four).

Brief background

9. The Paper focuses primarily on national governments. It notes that long-term fiscal sustainability reporting is less common at sub-national levels than at the national government level in various jurisdictions. The Paper argues that long-term fiscal sustainability reporting would also be appropriate for 'sub-national levels' of public sector entities and recommends developing recommended practice for consolidated reports presented by all levels of government. Paragraph 4.4.2 of the Paper says it seems questionable whether the benefits of producing reports on long-term fiscal sustainability information by controlled entities justify the costs. It also argues that it could be misleading if entities with limited tax-raising powers provide projections based on taxation decisions over which they have no control, without disclosing this fact.
10. The Paper notes that many governments that report publicly on long-term fiscal sustainability do not use the same boundary for these reports as for their consolidated general purpose financial statements. Instead, they adopt a boundary determined by statistical bases of accounting or one based on the budget sector (paragraph 4.2.4).
11. The Paper proposes that long-term fiscal sustainability information included in GPFRs should be prepared for the same reporting entity as for GPFRs (paragraph 4.2.7). For example, long-term fiscal sustainability information presented in GPFRs of a national government should not include information for entities that are not controlled by that national government.

Suggested response

12. The Boards agree that information on long-term fiscal sustainability presented within a GPFR should not encompass information about entities outside the boundary of the reporting entity.
13. The Boards consider that information on long-term fiscal sustainability—or equivalent information of a prospective nature—is likely to be useful in respect of all entities in the private and public sector, including entities that are dependent on other entities for most of their revenues and funding. Therefore:
 - (a) they do not consider that a demarcation should be made between reporting this information in consolidated GPFRs and in GPFRs of individual entities (such as controlled entities); and
 - (b) they would not support treating information on long-term fiscal sustainability as being primarily of relevance to national governments. (In this sense, the Boards support the IPSASB's preliminary view above, rather than the weight given in the Paper to reporting this information by national governments.) The Boards note that information on long-term fiscal sustainability is already required in the context of New Zealand local governments.

14. Regarding (a) above, the Boards note that the focus of Preliminary View 3 on *consolidated* reports may have an unintended consequence. It may be considered to imply that an entity (e.g., a local government) without controlled entities would not report information on long-term fiscal sustainability, but a similar entity with controlled entities would report such information. The Boards would not support any distinction that would permit single entities to avoid such reporting. However, we understand that some hold the view that a single entity's financial statements are also consolidated financial statements.
15. The Boards also consider that information on the long-term fiscal sustainability of components of an individual entity should be permitted, provided that the information is representationally faithful (that is, the economic substance of the component is that it is distinct from the other activities of the entity). In that sense, information on long-term fiscal sustainability would be a matter of display about an entity rather than a reporting entity matter (provided, on the other hand, it does not encompass economic phenomena outside the reporting entity).
- Discussion point for AASB and FRSB: if information on long-term fiscal sustainability is not required to be presented in GPFRs, should entities be permitted to select the boundary of the activities covered by that information provided that the GPFR faithfully represents that boundary? For example, if, in a particular jurisdiction, funding for a particular major program is limited by legislation to a particular tax (e.g., payroll tax), should the entity be permitted to report information on the long-term fiscal sustainability of that program even though the entity has other service-delivery programs?

PV4. IPSASB guidance should recommend that long-term fiscal sustainability indicators be selected based on (a) their relevance to the entity, (b) the extent to which the indicators meet the qualitative characteristics of financial reporting, and (c) their ability to describe the scale of the fiscal challenge facing the entity. It should also recommend that comparative information is provided and that the reasons for ceasing to report indicators, if this occurs, are disclosed (Section Five).

Brief background

16. In Section 5, the IPSASB Paper discusses whether a minimum set of indicators (such as the entity's fiscal gap) should be recommended. It notes that whilst such an approach would promote global consistency of reporting information on long-term fiscal sustainability, there presently appears to be no consensus on the relevance of particular indicators, and the relevance of particular indicators may be affected by institutional arrangements affecting the reporting entity. The IPSASB does not recommend a uniform set of indicators at this stage.

Suggested response

17. The Boards support basing the selection of indicators of long-term fiscal sustainability on the extent to which they meet the qualitative characteristics of financial reporting (including relevance, which is mentioned separately in the Preliminary View). The Boards also support providing comparative information and the reasons for ceasing to report indicators, if this occurs.

PV5. IPSASB guidance on long-term fiscal sustainability reporting in GPFs should recommend that the entity disclose:

- Any deviations from the principle that long-term fiscal sustainability projections are based on current policy;
- The basis on which projections of inflows from taxation and other material revenue sources have been made;
- Any other key assumptions underpinning long-term fiscal sustainability projections; and
- Details of key aspects of governing legislation and regulation, and the underlying macro-economic policy and fiscal framework (Section Six).

Brief background

18. Section 6 discusses whether information on long-term fiscal sustainability should be prepared on the assumption that the current policy of government regarding the entity's programs (such as social benefit programs) will continue for any projected period covered by the information. Paragraph 6.2.4 says the IPSASB's PV is that it is good practice for disclosures to assume that current policy continues for those significant expenditures that are individually projected. However, the PV (above) on which the IPSASB seeks comment is more modest: the IPSASB recommends disclosure of any deviations from the principle that long-term fiscal sustainability projections are based on current policy.
19. The Boards may be interested that differing jurisdictions currently have differing practices about what is regarded as current policy and the extent to which information on long-term fiscal sustainability should reflect current policy.

Suggested response

20. The Boards agree with the IPSASB recommending disclosure of whether long-term fiscal sustainability projections are based on current policy. However, they do not express a view on whether a presumptive principle should be established that long-term fiscal sustainability projections should be based on current policy.
21. The Boards support the IPSASB recommending disclosure of:
- the basis on which projections of inflows from taxation and other material revenue sources have been made;
 - any other key assumptions underpinning long-term fiscal sustainability projections; and
 - details of key aspects of governing legislation and regulation, and the underlying macro-economic policy and fiscal framework.
- Discussion point for AASB and FRSB: if the Boards decide not to express a view on whether information on long-term fiscal sustainability should be presented in GPFs, do they wish to express a view on such specific aspects of disclosure?

PV6. IPSASB guidance on long-term fiscal sustainability reporting in GPFs should recommend that the entity disclose:

- Time horizons for fiscal sustainability projections presented or discussed in the GPFs as well as the reason for modifying time horizons and any published plans to modify those horizons;
- Discount rates, together with the reason for their selection;
- Results of key sensitivity analyses; and
- Steps taken to ensure projections are reliable (Section Six).

Brief background

22. Section 7 of the IPSASB Paper notes that, globally, there is significant variation in the time horizons used to develop projections for long-term fiscal sustainability information. Paragraph 7.2.2 notes that “the further the time horizon is from the reporting date, the more future events are captured but the less robust and potentially less verifiable the assumptions become”.
23. Paragraph 7.3.3 notes the IPSASB considered specifying the discount rate to be applied to projections used in information on long-term fiscal sustainability, and decided instead to recommend disclosing the discount rates applied and the rationale for selecting them. Although the Paper refers to discount rates (which literally would mean their amounts), the staff construes this as a reference to the nature of the discount rates.
24. Paragraphs 7.5.1 – 7.5.4 of the IPSASB Paper discuss the steps entities may take to assure themselves of the reasonableness and reliability of projections in information on long-term fiscal sustainability. The IPSASB decided not to make recommendations on audit assurance in regard to reporting this information. Paragraph 7.5.4 of the Paper says it is important that entities succinctly disclose the steps that have been taken to ensure that key assumptions underpinning projections are realistic and reliable and that these assumptions are consistent.

Suggested response

25. The Boards agree with the IPSASB recommending disclosure of:
- the time horizons for fiscal sustainability projections presented or discussed in the GPFs, as well as the reason for modifying time horizons and any published plans to modify those horizons;
 - the nature of the discount rates applied, together with the reason for their selection; and
 - steps taken by the entity to facilitate including reliable projections in information reported on long-term fiscal sustainability.
26. The Boards do not wish to express a view on whether the IPSASB should recommend disclosing the results of any key sensitivity analyses. Whilst the Boards agree that such information would be useful, they would need further information to assess the complexity of such analyses and the cost of preparing them. In addition, they note that, unless it is recommended that sensitivity analyses are prepared, a recommendation to disclose any key sensitivity analyses that are prepared may have little effect.

Discussion point for AASB and FRSB: if the Boards decide not to express a view on whether information on long-term fiscal sustainability should be presented in GPFs, do they wish to express a view on such specific aspects of disclosure?

PV7. IPSASB guidance on long-term fiscal sustainability reporting in GPFs should recommend that (a) the underlying projections should have been prepared or updated within five years of the reporting date, and (b) the date of preparation or update should be disclosed (Section Seven).

Brief background

27. Paragraph 7.6.2 says reporting frequencies for publicly available reports outside the GPFs are not within the scope of the Paper. It says that where projections are made considerably earlier than the reporting date for the GPFs, it may be questionable whether such projections meet the qualitative characteristic of timeliness. For this reason, the Paper includes the proposals noted in the box above.

Suggested response

28. The Boards agree with the IPSASB recommending disclosure of the date of preparation or update of projections underlying information on long-term fiscal sustainability. However, the Boards do not wish to express a view on the maximum time period between preparing/updating projections and reporting them. The Boards consider that any information on long-term fiscal sustainability provided in GPFs should satisfy the qualitative characteristics of financial information, including timeliness.