



**INTERNATIONAL FEDERATION
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Agenda Item
4

DATE: August 14, 2009
MEMO TO: Members, Technical Advisors and Observers of the IPSASB
FROM: Ian Carruthers-Task Force Chairman-& John Stanford
SUBJECT: Long-Term Fiscal Sustainability

ACTION REQUIRED

Members, Technical Advisors and Observers are asked to:

- **Consider** the revised draft Consultation Paper, “Long-Term Fiscal Sustainability Reporting in the Context of General-Purpose Financial Reporting”;
- **Confirm** that its structure, coverage, and content conforms with directions provided at the May 2009 meeting;
- **Confirm** the approach on the specific issues highlighted in this memorandum; and
- **Approve** the Consultation Paper for publication.

MATERIAL ATTACHED

- 4.1 Extract from draft minutes of Washington DC Meeting, May 2009
- 4.2 Revised draft Consultation Paper, “Long-Term Fiscal Sustainability in the Context of General-Purpose Financial Reporting”
- 4.3 Project Brief

OBJECTIVE OF THIS SESSION

The objective of this session is to approve the revised draft Consultation Paper for publication.

BACKGROUND

At its meeting in Beijing in November 2007, Members agreed to initiate a project on long-term fiscal sustainability. A Project Brief was issued publicly in February 2008. The response was generally supportive of the IPSASB’s decision to initiate the project. The IPSASB also agreed to establish a Task Force and Ian Carruthers, the UK Technical Advisor, was appointed as Chair. The Task Force had its first meeting in London in September 2008.

At the Zurich meeting a preliminary discussion was held on a proposed outline of the structure and content envisaged by the Task Force. The IPSASAB reaffirmed its commitment to this project while noting that the first Conceptual Framework Consultation Paper was addressing the scope of general-purpose financial reporting.

The Task Force, including additional representatives from the Organization for Economic Co-operation and Development (OECD), subsequently met in Paris in March 2009 and considered an early draft report. A revised version of this draft was considered at the Washington meeting of the IPSASB together with a covering memorandum highlighting certain key issues, on which the Task Force considered that the IPSASB needed to provide direction. At the Washington meeting it was:

- Decided that the working definition of “long-term fiscal sustainability” and the accompanying narrative should be amended to address concerns that it did not recognize sufficiently service delivery considerations and constraints on increases in taxation and borrowing;
- Agreed that a reliance on cross-references to separate voluminous and complex long term fiscal sustainability reports would not meet the objectives of general purpose financial reporting, so it was appropriate to explore financial statements presenting fiscal sustainability projections and the presentation of fiscal sustainability information as part of narrative reporting;
- Reaffirmed the view expressed during discussion on the Conceptual Framework project that a general purpose financial report (GPFR) does not have to be a unitary report covering all aspects of financial reporting and that a GPFR does not have to be published with the general purpose financial statements;
- Agreed that, although long-term fiscal sustainability reporting was relevant to sub-national levels of government and those levels should therefore be within the scope of guidance, the primary focus should be on the consolidated national government level;
- Confirmed that the approach should be to develop high level and broad principles-based guidance and not to seek to prescribe or recommend complex methodological approaches; and
- Directed that the section on Assurance should be deleted and replaced by less prescriptive guidance proposing that the measures taken by the preparer to enhance the reliability of assumptions should be disclosed.

The detailed sections of the draft minutes of the May 2009 meeting are provided at Agenda Item 4.2.

A further version of the Consultation Paper was circulated to the Task Force on July 10th with a request for comments by July 24th. Comments received from Task Force Members are reflected in the version that is at Agenda Item 4.2, as well as a number of editorial and positioning changes designed to improve the flow of the document.

KEY ISSUES

The IPSASB is asked to provide confirmation of the approach adopted or revised directions on the following key issues:

- Definition of “Long-Term Fiscal Sustainability”
- Assurance
- Approach to Sub-national Levels of Government
- Executive Summary
- Status and Terminology of Guidance

Key Issue 1: Definition of “Long-Term Fiscal Sustainability”

At the Washington DC meeting the Board considered a working definition of the term “long-term fiscal sustainability” as “the ability of government to manage its finances so it can meet financial commitments both new and in the future.” While there was a general view that this definition was on the right lines, reservations were expressed that this draft definition:

- Did not recognize sufficiently service delivery considerations;
- Included a phrase “manage its finances so it can meet” that was otiose; and
- Was insufficiently rigorous in failing to recognize constraints on increases in taxation and borrowing;

The working definition has therefore been modified to read: “*the ability of government to meet its service delivery and financial commitments both now and in the future.*”

The Task Force Chair and Staff consider that this working definition gives readers a reasonable idea of the nature and purpose of information on long-term fiscal sustainability and its importance to meeting the objectives of financial reporting, particularly accountability.

IPSASB View Required

Is the revised working definition of long-term fiscal sustainability and accompanying discussion in Section 1 of the Paper appropriate? If not, how should the definition and narrative be modified further?

Key Issue 2: Assurance

The version of the Consultation Paper presented at the Washington meeting included a section on Assurance (Section 8), as specified in the project brief. There was a general view that decisions on the need for formal assurance and the appropriate level of such assurance should be left to the preparer. Therefore, Members directed that this section should be deleted and replaced by less prescriptive and broader guidance dealing with the

disclosure of measures taken by the preparer to enhance the reliability of the assumptions underpinning projections. Such measures might include assurance by an external auditor, but could also include other more informal approaches, such as peer review.

In accordance with this direction, Section 8 has been deleted and replaced by a sub-section of Section 7. This sub-section includes the US Government Accountability Office Opinion on the Statements of Social Insurance for 2007 and 2008. This allows readers to view the format and level of assurance that has been applied to the Statement of Social Insurance in the USA.

IPSASB View Required

Do you agree with the newly inserted paragraphs in Section 7 dealing with “Ensuring the reliability of assumptions”? If not, how should this part of the Consultation Paper be modified?

Key Issue 3: Approach to Sub-national Levels of Government

At the Zurich meeting the IPSASB directed that the approach should be linked to the reporting entity and therefore should not be restricted to the consolidated national government level. While this view was reaffirmed at the Washington meeting it was agreed that, in light of the global financial crisis, the primary focus of the Consultation Paper should be on the national level. Consequently, the sections of the Paper dealing with the sub-national levels have been grouped in Section 4.

IPSASB View Required

Do you agree with the approach to the sub-national levels of government adopted in the paper? If not how should this approach be modified?

Key Issue 4: Executive Summary

The revised version of the Consultation Paper at Agenda Item 4.2 now includes an Executive Summary.

IPSASB View Required

Do you agree with the structure and substance of the Executive Summary? If not how should the Executive Summary be modified?

Key Issue 5: Status and Terminology of Guidance

At the Washington meeting the IPSASB formed a tentative view that pronouncements on the broader aspects of financial reporting – e.g. narrative reporting and service delivery and accomplishments – should be guidance rather than requirements. This raises questions about the status of any future guidance in the IPSASB’s hierarchy and the assertiveness of the terminology used in the Consultation Paper, particularly in Preliminary Views 5 and 6 where the word ‘require’ has been square bracketed. For

example, if guidance, is it appropriate to require entities to have made projections within 5 years of the reporting date or should less forceful language be used, such as it is good practice for entities to have made projections within 5 years of the reporting date?

IPSASB View Required

Provide a view on the status of future guidance and the tone of terminology appropriate to such guidance, and for use in the Consultation Paper.

Ian Carruthers, Chair of Task Force
John Stanford: Deputy Technical Director

**EXTRACT FROM DRAFT MINUTES OF
WASHINGTON DC MEETING: MAY 2009**

5. LONG-TERM FISCAL SUSTAINABILITY

Discuss Issues (Agenda Item 3)

The Chair of the Task Force updated Members on the meeting of the Task Force held at the Organization of Economic Co-operation and Development (OECD) in Paris in early March. He noted that, in accordance with the direction at the October 2008 meeting, an invitation had been extended to the OECD to join the Task Force. The OECD had accepted this invitation and officials of the OECD had attended the Paris meeting. The OECD had recently initiated its own project on “Fiscal Futures” and the Task Force Chair and Staff acknowledged the significant benefits to the IPSASB project of some of the comparative material compiled by OECD officials.

Members reaffirmed their support for continuing this project, treating it as a “test bed” for the broader approach to financial reporting proposed in the first Conceptual Framework CP (see agenda item 2(a)). In light of the response to that first CP, Members indicated that it would be inappropriate to formulate requirements for reporting projections on long term fiscal sustainability and that the final output from the project is therefore likely to take the form of guidance rather than an IPSAS.

Members considered a number of key issues raised by the Task Force on Long Term Fiscal Sustainability and a preliminary draft of a CP, “Long-Term Fiscal Sustainability in the Context of General Purpose Financial Reporting.” The key issues discussed were:

- A working definition of long-term fiscal sustainability;
- Alignment of fiscal sustainability reports and general purpose financial statements (GPFSs);
- The nature of a general purpose financial report (GPFR);
- A high-level principles-based approach; and
- Assurance.

Working definition of long-term fiscal sustainability

In response to the direction at the October 2008 Zurich meeting to develop a working definition of long-term fiscal sustainability the Task Force proposed the following working definition: “... *the ability of government to manage its finances so it can meet financial commitments both now and in the future.*”

There was broad support for the proposed working definition. However, reservations were expressed that the phrase “financial commitments” did not recognize sufficiently service delivery considerations; it might be possible for an entity to meet its financial

commitments, but it is contestable whether the entity is sustainable if it drastically reduces the level and quality of service delivery. A further concern was that the proposed working definition was insufficiently rigorous in failing to include constraints on increases in taxation and borrowing, together with the maintenance of service delivery in accordance with current policy and known future policy changes. Some reservations were, however, expressed about anticipating future policy decisions and the need for full disclosure of any such assumptions. There was an acceptance that a definition cannot encapsulate all aspects of the topic and that these issues need to be identified and discussed in the narrative. There was also a general view that the phrase “manage its finances so it can meet” in the proposed working definition was redundant and should be removed.

Staff was directed to further develop the working definition and narrative discussion in order to address these concerns.

Alignment of fiscal sustainability reports and GPFSs

The Task Force Chair and Staff noted that the CP contains preliminary views that the presentation of information on long-term fiscal sustainability is necessary for accountability and decision-making purposes and that guidance and requirements, if any, should be linked to the concept of the reporting entity. However, they noted the views of one Task Force member that, although long-term fiscal sustainability reports are important for accountability purposes, long term fiscal sustainability projections should not be linked to the reporting boundary for the general purpose financial statements and long-term fiscal sustainability reporting should be considered outside the scope of general purpose financial reporting. The IPSASB acknowledged these concerns, but accepted the view that reliance on voluminous and complex long-term fiscal sustainability reports would not meet the objectives of general purpose financial reporting.

Nature of a GPFR

Members reaffirmed the view formulated in the discussion on the response to the first Conceptual Framework report that a GPFR did not have to be a unified report covering all aspects of financial reporting and that a GPFR did not have to be published with the general purpose financial statements.

High-level principles-based approach

Members reaffirmed the view expressed at the Zurich meeting that the reporting of long-term fiscal sustainability in GPFRs would rely on the work of other professionals. In this respect it had some parallels with the reliance on actuaries and valuers for aspects of accounting for long term employee benefits and property, plant and equipment. Members confirmed that the approach should be to develop high-level and broad principles and not to seek to prescribe complex methodological approaches. For example, the CP should acknowledge that reporting on long-term fiscal sustainability might not be on an annual basis.

Assurance

The Task Force Chair explained that the CP had included a section on Assurance (Section 8) in accordance with the project brief. The CP contained a preliminary view that formal assurance should be provided on the reasonableness of assumptions underpinning long term fiscal sustainability projections and that such assurance might be on a “negative basis.” Some Task Force members had reservations as to whether this guidance was appropriate. There was a general view that decisions on the need for formal assurance and the appropriate level of such assurance should be left primarily to the preparer. Members directed that this section should be deleted and replaced by less prescriptive guidance that the measures taken by the preparer to enhance the reliability of assumptions should be disclosed.

Staff highlighted three models of reporting:

- A specific financial statement showing forward projections over a pre-determined time horizon;
- Discussion of long-term fiscal sustainability in narrative reporting; and
- Cross-references in GPFRs to other reports addressing long term fiscal sustainability.

It was also noted that the approach advocated by the Task Force member who did not accept that there should be an alignment of boundaries for fiscal sustainability reporting and the reporting entity for the GPFSs effectively constituted a fourth model of reporting: that such reports should be considered as disconnected from the GPFRs. As noted above, while this view was not accepted by Members, consideration should be given to discussing it in the CP

Members were broadly supportive of the structure, format and detail of the report. Consistent with their view that a high-level principles-based approach should be adopted, a number of Members emphasized that the themes underpinning the project should be transparency and the disclosure of assumptions, methodology and changes in assumptions and methodology between reporting periods. It was generally accepted that rigid requirements and inflexible guidance are inappropriate.

The CP reflected the direction at the Zurich meeting that the Paper should be linked to the reporting entity. Some reservations were expressed that an emphasis on the reporting entity might lead to the imposition of unduly onerous and inappropriate reporting requirements or expectations on small and medium sized public sector entities and supra-national organizations. Members were also of the view that, although the CP would not be restricted to the national level of government, in view of the financial crisis, the focus would likely be at the consolidated national level. Staff was directed to address these considerations in further developing the CP.

Members directed that a revised version of the CP be brought to the September IPSASB meeting.

Consultation Paper
October XX 2009

REVISED DRAFT (VERSION 6)

Long-Term Fiscal Sustainability in the Context of General Purpose Financial Reporting



International Federation
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REQUEST FOR COMMENTS

The IPSASB welcomes comments on the proposals in this Consultation Paper. Please submit your comments, preferably by email, so that they will be received February 28, 2010. All comments will be considered as a matter of public record. Comments should be addressed to:

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto Ontario Canada M5V 3H2

Email responses should be sent to: publicsectorpubs@ifac.org

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EXECUTIVE SUMMARY

Long-term fiscal sustainability is the ability of a government to meet its service delivery and financial commitments both now and in the future. Separate reports providing information about the anticipated long term financial consequences of governmental programs have recently become a regular feature of public reporting in an increasing number of jurisdictions. Although these reports can be voluminous and highly complex, it is important that information on long-term fiscal sustainability is made available to a wide audience in an accessible format in order to meet the objectives of general-purpose financial reporting, particularly accountability. The global financial crisis and the need to understand the significant financial interventions made by many governments have underlined the need for concise and transparent reporting in this area.

Long-term fiscal sustainability information for national governments has the potential to complement the information provided in the main financial statements, and to fill the information gaps in these with respect to future resources, obligations and commitments. There are a number of ways in which it could be presented as a part of general-purpose financial reports prepared on both the accrual and cash bases. In the long-term the IPSASB thinks that the presentation of specific financial statements providing details of projections on future government spending and receipts may be the best way of satisfying users' needs. In many jurisdictions such a statement would take some time to develop. Therefore in the interim, the discussion of long-term fiscal sustainability issues and indicators as part of narrative reporting is a more realistic approach. IPSASB believes that simpler forms of long term fiscal sustainability reporting may also be appropriate for individual reporting entities below the national government level.

Long-term fiscal sustainability reporting involves complex analysis and assumptions using the expertise of a range of professions, including economists and statisticians and raises many technical challenges. The boundary for long-term fiscal sustainability reporting is often determined on statistical accounting or budgetary bases rather than on the control concept that underpins the annual consolidated financial statements. This means that succinct explanations of differences between the various boundaries must be provided together with appropriate quantifications.

Many of the indicators used to report fiscal sustainability such as comprehensive net worth, net financial worth and the fiscal gap are statistically derived measures. The IPSASB therefore does not think it appropriate to prescribe specific indicators or methodological approaches. However it proposes that information reported should meet the qualitative characteristics of financial reporting: relevance, faithful representation, timelines, understandability, comparability and verifiability. It is therefore important that the basis of preparation and the key principles and methodologies underpinning projections of inflows and outflows are disclosed. Such disclosures should include the main demographic and economic assumptions, the sensitivity to changes in these assumptions, and the extent to which the approach to modeling projections for age-related and non-age related programs differ. IPSASB believes that projections based on current policy will be most relevant and understandable to users. Therefore, any assumptions that have been made about changes to current policy should be disclosed. The need to take into account the potential future economic impacts of climate change

must be considered as part of this process. The extent of the fiscal challenge must also be disclosed in order to meet the accountability objective for financial reporting.

Certain more detailed methodology choices should be disclosed including the time horizons for projections and the reason for the choice, the frequency of reporting, discount rates and their rationale and the steps taken to ensure the reliability of assumptions. It is essential that where the principles or key assumptions have changed, or methodologies have been modified since the last report, that the main impacts of the changes are disclosed together with the reasons for them.

REQUEST FOR COMMENTS

The IPSASB welcomes comments on whether you agree or disagree with the Preliminary Views in this Consultation Paper. Comments are most useful when they include the reasons for agreeing or disagreeing.

1. The presentation of information on long-term fiscal sustainability is necessary in GPFRs in order 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".
2. For the objectives of financial reporting as proposed by the IPSASB to be met by national governments either specific financial statements providing details of long-term fiscal sustainability projections to be included in the GPFRS of national government, or long-term fiscal sustainability projections initially prepared for other reports must be summarized and included in narrative reporting.
3. Guidance on long-term fiscal sustainability reporting in GPFRs should be based on the concept of the reporting entity, and should apply to all levels of government, although individual controlled entities should not have to report on long-term fiscal sustainability unless users for such information can be identified.
4. The choice of long-term fiscal sustainability indicators to be reported should be based on their relevance to the entity, the extent to which they meet the qualitative characteristics of financial reporting, and their ability to describe the scale of the fiscal challenge facing the entity. The reasons for ceasing to report indicators should be disclosed if this occurs.
5. Guidance on long-term fiscal sustainability reporting in GPFRs should [require] the entity to disclose:
 - The basis on which projections of inflows from taxation and other material revenue sources have been made;
 - All key assumptions underpinning long-term fiscal sustainability projections;
 - Any material programs and transactions not reflected in the projections;
 - Any deviations from the principle that long-term fiscal sustainability projections should be on the basis of current policy; and
 - Details of key aspects of governing legislation and regulation, and the underlying macro-economic policy and fiscal framework
6. Guidance on long-term fiscal sustainability reporting in GPFRs should [require] the entity to disclose:
 - Time horizons for fiscal sustainability projections presented or discussed in the GPFRs as well as the reason for modifying time horizons and any published plans to modify those horizons;
 - Discount rates, together with the rationale for their selection;
 - Results of sensitivity analyses; and
 - Steps taken to ensure that assumptions underpinning projections are reliable.
7. Long-term fiscal sustainability information disclosed in GPFRs should have been prepared or updated within five years of the reporting date.

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1 INTRODUCTION: WHAT IS FISCAL SUSTAINABILITY?

1.1 Global challenges facing governments

- 1.1.1 Regardless of the stage of economic development of their jurisdictions, governments and public sector entities constantly face fiscal challenges. Such challenges include maintaining, or if possible, increasing the quantity and quality of goods and services provided to citizens, meeting entitlements for state pensions and other cash transfer entitlement programs and servicing debt obligations within acceptable taxation levels.
- 1.1.2 Recently, the ability of governments to manage the public finances so that an unfair burden is not placed on future generations of taxpayers has become an increasing concern as a result of the global financial crises. However a number of existing factors were already creating fiscal pressure points, including demographic change, technological advances creating new demands by citizens, and costs in certain sectors, particularly health, accelerating more quickly than the general rate of inflation. In many developed countries the focus has been primarily on ageing populations which are leading to increases in health care expenditure for elderly people and pensions. However, in developing countries fiscal pressures are more likely to arise from a younger demographic profile, which brings a demand for greater educational spending, as well as different types of health spending, such as neo-natal care.
- 1.1.3 The Organisation for Economic Co-operation and Development's (OECD) has recently initiated a project on Fiscal Futures¹ which identifies further challenges in the form of:
- The risks imposed by climate change and natural disasters and their impact on future economic growth; and
 - The need to replace ageing infrastructure.
- 1.1.4 The global financial crisis has significantly increased these underlying fiscal pressures in many jurisdictions. Citizens are questioning the long-run financial consequences of interventions, such as loan guarantees and insurance for bank deposits and toxic assets, that have been adopted to deal with the crisis in the banking and manufacturing sectors, as well as the broader fiscal stimuli deployed by governments and liquidity operations such as quantitative easing undertaken by central banks.
- 1.1.5 All these factors have led to an increasing awareness of the importance of long-term fiscal sustainability reporting in enabling stakeholders to hold governments to account and make key decisions. Users of financial statements are likely to be interested in the extent of the fiscal challenge facing governments in reconciling their spending and taxation policies over the medium to long term. The urgency

1. OECD Project on Fiscal Futures, Institutional Budget Reforms and their Effects initiated in early 2009

with which this challenge needs to be tackled as the conditions above emerge and crystallize, and how this challenge is changing over time, is also likely to be of interest, so that decisions are well informed and governments can be held to account for the long term impact of their decisions. In addition, capital markets are looking for assurance that plans are in place to meet obligations to repay levels of national debt that are unprecedented in recent times.

1.2 Definitions of long-term fiscal sustainability

- 1.2.1 At a very high level, fiscal sustainability involves an assessment of the extent to which governmental policies under existing legal frameworks can be met in the future, assuming certain fiscal constraints, principally on taxation levels. There is however no single, widely accepted global definition of the term “long-term fiscal sustainability”.
- 1.2.2 Fiscal sustainability has been linked to the concept of inter-generational equity or fairness, which evaluates the extent to which future generations of taxpayers will have to deal with the fiscal consequences of current policies. The concepts of intergenerational efficiency and intergenerational effectiveness are also relevant. Intergenerational efficiency highlights the risk that failure to address long-term issues in a timely manner may force future governments to adopt policies, the cost of which to the future population will significantly exceed the costs borne by taxpayers today. Intergenerational effectiveness highlights a further risk that the failure to address long term fiscal pressures may weaken the ability of governments to respond to other, less predictable future problems. Such future problems may relate to environmental factors, such as climate change and the degradation of natural resources.
- 1.2.3 A number of governments and supra-national organizations have developed formal or implied definitions of fiscal sustainability. In many cases these definitions are located in the context of medium-term fiscal planning, fiscal frameworks or budgetary frameworks; for example, long-term fiscal sustainability is typically linked to specific targets such as a pre-determined Net Debt/Gross Domestic Product (GDP) ratio or a Gross/Net Debt/GDP per capita ratio and the maintenance of taxation at a specified level of GDP. Where fiscal sustainability is defined by reference to specific targets, overall governmental spending is said to be fiscally sustainable if it is contained within these pre-determined and publicly communicated targets over a specified period. In many European countries the frameworks adopted are largely those developed by the European Commission in the context of the Stability and Growth Pact.
- 1.2.4 The Australian Budget papers for 2008-2009 define fiscal sustainability as “the ability of government to manage its finances so it can meet its spending commitments, both now and in the future.” In its Exposure Draft, “Reporting Comprehensive Long-Term Fiscal Projections for the U.S. Government”, the US Federal Accounting Standards Advisory Board used a more rigorous working definition of “fiscal sustainability” as the federal government’s “ability to continue, both now and in the future, current policy without change regarding

public services and taxation, without causing debt to rise continuously as a share of GDP.” This definition is related to the approach linking long-term fiscal sustainability with debt not being on an ‘explosive’ path and is closer to the approach taken by many economists and statisticians.

- 1.2.5 In the absence of a formal definition an adapted version of the Australian definition is used as a working definition in this Consultation Paper:

“The ability of government to meet its service delivery and financial commitments both now and in the future.”

- 1.2.6 The definition recognizes that there are at least 2 dimensions to fiscal sustainability. Long-term fiscal sustainability is dependent upon an ability to fund spending levels to provide goods and services, but also extends to debt servicing obligations. It also emphasizes that reporting the extent of the challenge faced in maintaining a sustainable fiscal path is critical to accountability. By taking this approach the definition avoids constraining governments’ ability to modify taxation levels, (notwithstanding the fact that the extent of this ability may be quite limited in the current global environment) and also that governments have an ability to modify current policies for the delivery of goods and services.
- 1.2.7 The above definition applies only to long-term fiscal sustainability. It does not directly address environmental sustainability. Reporting on environmental sustainability is a hugely important subject in its own right and there is an increasing recognition that assumptions about future levels of economic growth are likely to be affected by factors such as climate change and its impact on sectors such as agriculture. Climate change may also impose further financial pressures on government, such as increased expenditures on flood defenses and changes in demand for services, which will need to be reflected in the cash flow projections underpinning long-term fiscal sustainability reports.

1.3 Fiscal sustainability reporting at national government levels

- 1.3.1 Exhibit One provides an overview of some of the long-term fiscal sustainability reports currently produced at the national and supra-national levels. It provides details of report titles, the originating government department, executive or legislative agency, the year when such reports were first published and, where it exists, the legal underpinning for such reports. It is not an exhaustive listing of fiscal sustainability reporting.

Exhibit One
Overview of Fiscal Future Reports at National and Supra-national Levels

Country	Legal Requirement	Title	Source	Start
Australia	Charter of Budget Honesty	Intergenerational Report	Treasury	2002
Denmark		A Sustainable Future	Min of Finance	1997
Germany		Report on Sustainability of Public Finance	Min of Finance	2005
Korea		Vision 2030	Ministry of Planning and Budget	2006
Netherlands	EC Stability Program	Aging and the Sustainability of Dutch Public Finances	Central Planning Bureau	2000
New Zealand	Public Finance Act	Long Term Fiscal Position	Treasury	1993
Norway		2006 White Paper	Min. of Finance	2004
Sweden		Sweden's Economy (annex to budget)	Min. of Finance	1999
Switzerland		Long-term Sustainability of Public Finance in Switzerland	Federal Dept. of Finance	2008
United Kingdom	Code of Fiscal Stability	Long Term Public Finance Report	Treasury	1999
USA: Congressional Budget Office (CBO)		Long Term Budget Outlook	Congressional Budget Office	1991-2000
USA: General Accountability Office (GAO)		Long Term Fiscal Outlook	General Accountability Office	1992-97
USA: Office of Management and Budget (OMB)		Long Term Budget Outlook in Analytical Perspectives	Office of Management and Budget	1979-97
USA: Financial Report of US Government		Statement of Social Insurance	Department of Treasury	2004
European Union Countries	Stability & Convergence Programming Surveillance	Public Finances – EMU	Economic Policy Comm.	2005
International Monetary Fund		Financial Transparency Reviews	Fiscal Affairs Department	2001

Source: OECD Fiscal Futures Project

- 1.3.2. Information about the anticipated long term consequences of governmental programs has become a regular feature of public reporting in a number of jurisdictions. In most cases this is a relatively recent development (initiated over the last 10-15 years). The compilation of fiscal sustainability projections has generally been carried out by economists, statisticians and budget and policy specialists. Financial accountants have been peripheral to the process.

1.4 Existing types of fiscal sustainability reporting

- 1.4.1 Long-term fiscal sustainability can be assessed by looking at the expected path of capital and operating expenditure in the future, what that implies for taxes, and the risks that assumptions used in determining that path will fluctuate materially. Such information typically includes the future cost of goods and services, the cost of entitlement programs, the cost of servicing debt obligations and the tax inflows and other resources that will need to be generated in the future to fund these commitments and obligations. Information about the likely future resource needs for continued operation of those programs at existing levels will also provide input to decisions, such as whether to support continued operation of the program and at what level, or to advocate changes to a government's service delivery priorities.
- 1.4.2 The discussion of existing types of fiscal sustainability reporting in this paper is based on an informal survey completed by members of a Task Force set up to oversee the project, and on information collected and summarized by the OECD. Although much of the analysis in this Consultation Paper is developed from the conceptual underpinnings of accrual-based financial reporting, reporting on long-term fiscal sustainability is equally applicable to governments that report on the cash basis.
- 1.4.3 The next section of this paper considers how information on long-term fiscal sustainability relates to the reporting objectives proposed by the Board in its first Consultation Paper, "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities."

2. RELEVANCE OF LONG-TERM FISCAL SUSTAINABILITY INFORMATION TO GENERAL PURPOSE FINANCIAL REPORTING

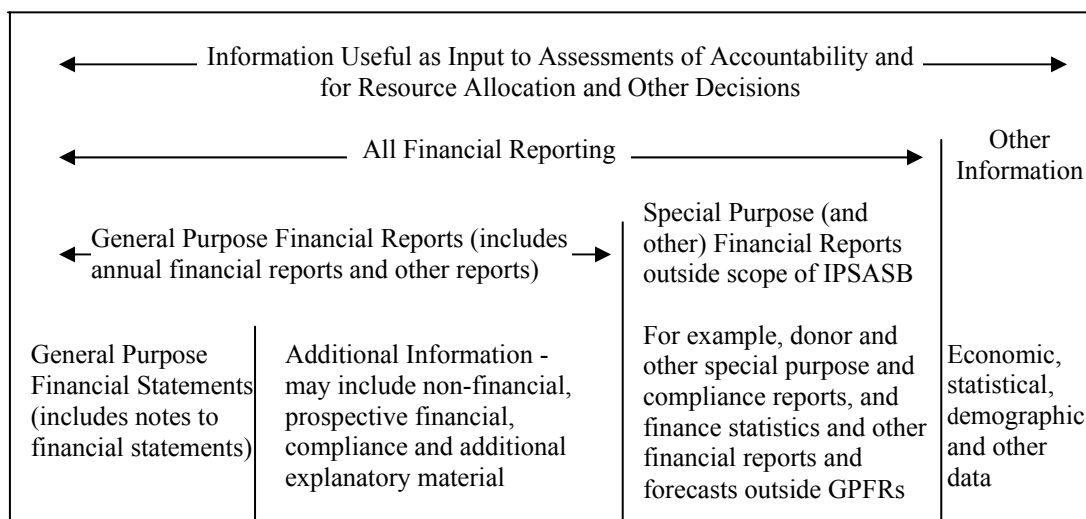
2.1 Introduction

2.1.1 This section considers the need for information on long-term fiscal sustainability information in GPFRs. It includes sub-sections on:

- Information currently provided in GPFSSs;
- Information provided in GPFRs
- The ‘going concern’ assumption underlying GPFSSs;
- Why there are gaps in information currently provided in GPFSSs; and
- How long-term fiscal sustainability information could fill the gaps in GPFSSs.

2.1.2 In its first Conceptual Framework Consultation Paper the IPSASB distinguished general purpose financial statements (GPFSSs) and general purpose financial reports (GPFRs). Exhibit Two (reproduced from that Consultation Paper) below illustrates the relationship between GPFSSs and GPFRs.

Exhibit Two
Information needs of users



2.2 Information currently provided in General Purpose Financial Statements

2.2.1 IPSAS 1, Presentation of Financial Statements” states that a complete set of GPFSSs comprises:

- A statement of financial position
- A statement of financial performance
- A statement of changes in net assets/equity
- A cash flow statement
- Notes, including a statement of significant accounting policies

- 2.2.2 Where the entity makes its approved budget publicly available, IPSAS 1 also requires a comparison of budget and actual amounts as either a separate additional financial statement or by way of additional columns in the financial statements.
- 2.2.3 A key attribute of the current suite of GPFSSs is that they are historical in nature. This historical focus is useful for both accountability and decision-making purpose, but it constrains the way in which commitments to provide public services and entitlements and funding for those commitments through taxation and other significant revenues are reported in the financial statements.
- 2.2.4 Although financial statements use estimation techniques to determine the future recoverable amount of assets and the carrying amount of liabilities that will not be settled until future reporting periods, they are limited to present rights and obligations that arise from past events. In making these measurements, however, GPFSSs generally assume that the entity's activities are sustainable-the going concern assumption (see below section 2.4).

2.3 Information provided in General Purpose Financial Reports

- 2.3.1 GPFRs are broader than the GPFSSs and provide information about the past and future. However, there is considerable debate on the type and format of information that should be referred to as GPFRs and GPFSSs. Both GPFSSs and GPFRs are intended to meet the common information needs of a potentially wide range of users, who are unable to demand the preparation of financial reports tailored for their specific information needs. Exhibit Two also recognizes other information useful for decision-making and the assessment of accountability that are outside the GPFRs. Such information includes special purpose and other financial reports and a range of economic, statistical, demographic and other data.
- 2.3.2 In the first Conceptual Framework Consultation Paper the IPSASB put forward a preliminary view that the scope of GPFRs should include "prospective financial and other information about the reporting entity's future service delivery activities and objectives, and the resources necessary to support those activities." The Consultation Paper also noted that the scope of financial reporting and information that may be provided by GPFRs is developing and evolving in response to a number of factors including:
- The changing operating environment faced by entities which prepare GPFRs; and
 - Users' needs for reliable and relevant information about new and innovative transactions that have an impact on matters such as the assessment of the financial position and performance of the entity, and the discharge of its accountability.
- 2.3.3 In addition, there is no expectation that broader information within the scope of GPFRs will be published in a unitary report including GPFSSs. Such information may be published in a number of separate reports.

2.4 The “Going Concern” assumption underpinning General Purpose Financial Statements

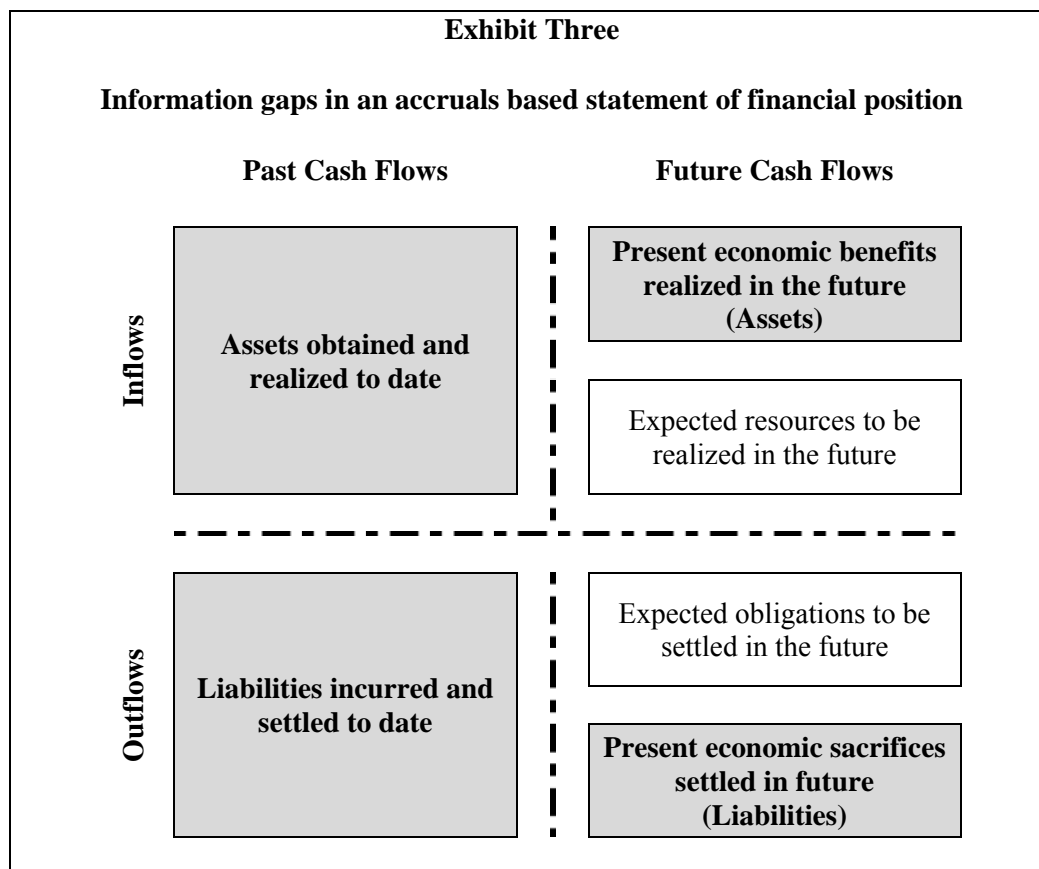
- 2.4.1 The “going concern” assumption is fundamental to the preparation of financial statements in both the private and public sectors. GPFSSs are required to be prepared on a going concern basis, unless there is an intention to liquidate the entity, to cease operating or there is no realistic alternative to do so. Where there are material uncertainties that cast significant doubt upon the entity’s ability to continue as a going concern, those uncertainties must be disclosed. The assessment of the adequacy of the going concern assumption is a key aspect of an auditor’s work in forming a view on the GPFSSs.
- 2.4.2 Going concern has been generally less relevant in the public sector than in the private sector because, while sub-national entities may get into financial difficulties it is likely that their main service delivery commitments will be transferred to restructured successor entities, rather than lapsing completely. However, the recent global financial crisis and the significant interventions made by many governments, reflected in the distressed state of many governments’ finances, have and the recent global financial crisis has stimulated considerable discussion of the topic, from the perspectives of both preparers and auditors.
- 2.4.3 With respect to the assessment of going concern, there are inherent limitations with accrual-based financial statements, as they are not intended to provide comprehensive forward looking information. They are intended to focus on the present circumstances—the balances of resources and obligations existing in the present—and the performance of the entity during the period of time covered by the statements.

2.5 Why there are gaps in General Purpose Financial Statements

- 2.5.1 There are a number of areas in which there are “gaps” in the information that is necessary to facilitate an assessment of governmental accountability. In its project on intangible assets, the IPSASB has taken the view that a government’s right to tax does not give rise to an asset. For this reason IPSASs do not recognize, as an asset, prospective inflows of future tax revenue and other revenues anticipated to be generated to support the entity’s activities in the future. Only revenue where a taxable event has been identified is recognized.
- 2.5.2 The approach to the recognition of liabilities in GPFSSs is another major example of where such “gaps” exist. Liabilities are only recognized in the statement of financial position when present obligations have arisen. There has been considerable debate about when present obligations related to governmental programs arise and therefore the extent of resultant liabilities that should be recognized in the statement of financial position. The IPSASB has considered this explicitly in its project on social benefits. Generally, governments reporting on the accrual basis of accounting have adopted an approach known as “due and payable” under which liabilities recognized at the reporting date are limited to cash transfers to individuals or households for which eligibility criteria have been

satisfied, but which have not been settled at the end of a reporting period. While some have challenged the “due and payable” approach for being over-restrictive in its recognition of liabilities, even a broader interpretation of present obligations and the recognition of larger liabilities will not fill all the information gaps in historical financial statements. In fact, based on the work that the IASB has undertaken in developing a modified definition of a liability as part of its Conceptual Framework project, it appears that the global trend is towards a narrower, more restrictive and more understandable definition of a liability, involving a notion of present enforceability.

- 2.5.3 Exhibit Three provides a simplified schematic of the statement of financial position. It illustrates that while that statement captures transactions in the shaded areas for which there have been identified past events, including liabilities which will be settled in future reporting periods, it does not recognize cash flows related to future revenues and future obligations for which there has been no identifiable past event.

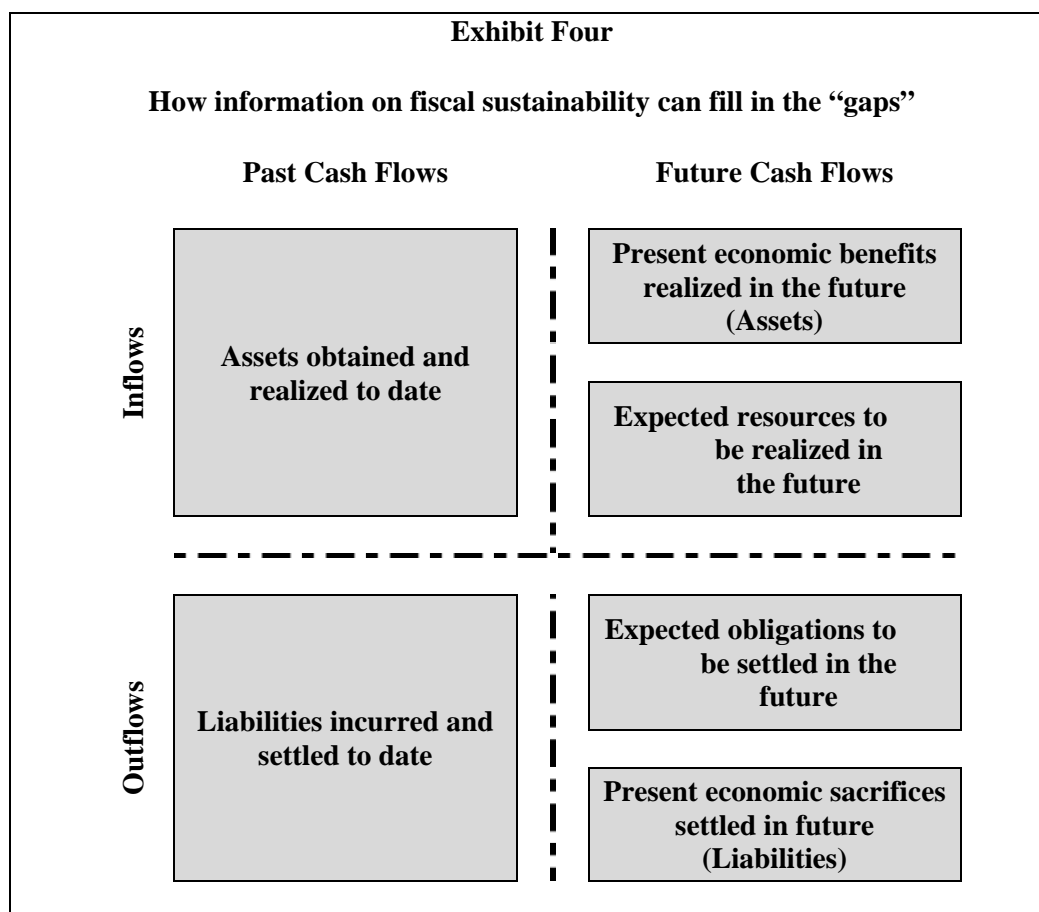


- 2.5.4 Consistent with the above analysis, during the development of its project on social benefits the IPSASB formed a preliminary view that the main historically-based financial statements of an entity cannot satisfy all the needs of users in assessing the future viability of that entity and its major programs. The IPSASB holds this view regardless of the approach that is taken to the point(s) at which a present obligation(s) occur(s) (which may vary for different types of social benefits and

other government programs), the extent of those present obligations and the amount of the resultant liabilities. The long-term financial effect of government policies need to be made transparent to meet both the decision-making and accountability objectives of financial reporting. Therefore, in order to satisfy user-needs and meet the objectives of financial reporting, information presented in the financial statements needs to be complemented by the presentation of other information about the long-term fiscal sustainability of those programs, including their financing

2.6 How Long-Term Fiscal Sustainability information could fill the gaps in General Purpose Financial Statements

- 2.6.1 Long-term fiscal sustainability reporting is not constrained by the focus on past events and the definitions of elements that govern the compilation of current GPFSSs. Such reporting can provide greater flexibility and therefore has the potential to fill many of the gaps in the statement of financial position identified above, in particular by providing information on prospective revenue inflows and outflows related to future obligations. Exhibit Four shows how such additional prospective information can complement the information in the statement of financial position. It therefore demonstrates the importance of incorporating information on long-term fiscal sustainability in GPFRs.



- 2.6.2 The section of the MD &A on financial condition in the 2007 Financial Report of the United States Federal Government summarizes the position succinctly by stating that “a complete assessment of the Government’s financial or fiscal condition requires analysis of historical results, projections of future revenues and expenditures, and an assessment of the long-term fiscal sustainability of programs and services.”

Preliminary View One

The presentation of information on long-term fiscal sustainability is necessary in GPFRs in order 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”.

3. HOW COULD LONG-TERM FISCAL SUSTAINABILITY INFORMATION BE REPORTED IN GENERAL PURPOSE FINANCIAL REPORTS OF NATIONAL GOVERNMENT?

3.1 Potential General Purpose Financial Report models

3.1.1 This section considers how information on long-term fiscal sustainability might be reported as part of National Government general-purpose financial reports. It examines three models:

- Specific financial statements providing details of forward projections;
- Summarizing forward projections in narrative reporting;
- Cross-references in GPFRs to other reports addressing long-term fiscal sustainability.

3.1.2 These reporting approaches are not mutually exclusive. For example, it is possible to combine narrative reporting with a specific financial statement showing projected cash flows as in the Annual Report of the US Federal Government.

Model One: Specific financial statements providing details of forward projections

3.1.3 As already identified in Exhibit One, the Annual Financial Report of the US Federal Government currently includes a Statement of Social Insurance (SOSI) providing projected inflows and outflows of the most significant social insurance programs, principally Social Security, and Medicare. The format of this statement is shown in Exhibit Five. The estimates presented are actuarial present values of the projections and are based on the economic and demographic assumptions set forth in the Social Security and Medicare Trustees' reports and in the relevant agency performance and accountability reports for two additional more minor programs. The Annual Report also includes a Citizen's Guide, "The Federal Government's Financial Health" that provides a broader narrative summary of financial condition (a prospective notion) and financial position (a current notion). This summary is not limited to the entitlement programs reflected in the SOSI (see below paragraph 3.3.5) The Citizen's Guide is also available as a stand-alone document.²

² The Citizen's Guide is available at <http://www.gao.gov/financial/citizensguide2008.pdf>

Exhibit Five

**United States Government
Statements of Social Insurance
Present Value of Long-Range (75 Years, except Black Lung) Actuarial Projections**

	*****UNAUDITED*****				
(In billions of dollars)	2007	2006	2005	2004	2003
Federal Old-Age, Survivors and Disability Insurance (Social Security): (Note 22)					
<i>Revenue (Contributions and Earmarked Taxes) from:</i>					
Participants who have attained age 62	477	533	484	411	359
Participants ages 15-61	17,515	16,568	15,290	14,388	13,576
Future participants (under age 15 and births during period)	16,121	15,008	13,696	12,900	12,213
All current and future participants	34,113	32,107	29,450	27,699	26,147
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained age 62	(6,329)	(5,866)	(5,395)	(4,933)	(4,662)
Participants ages 15-61	(27,928)	(26,211)	(23,942)	(22,418)	(21,015)
Future participants (under age 15 and births during period)	(6,619)	(6,480)	(5,816)	(5,578)	(5,398)
All current and future participants	(40,876)	(38,557)	(35,154)	(32,928)	(31,075)
<i>Present value of future expenditures in excess of future revenue</i>	<i>(6,763)¹</i>	<i>(6,449)²</i>	<i>(5,704)³</i>	<i>(5,229)⁴</i>	<i>(4,927)⁵</i>
Federal Hospital Insurance (Medicare Part A): (Note 22)					
<i>Revenue (Contributions and Earmarked Taxes) from:</i>					
Participants who have attained eligibility age 65	178	182	162	148	128
Participants who have not attained eligibility age 15-64	5,975	5,685	5,064	4,820	4,510
Future participants (under age 15 and births during period)	4,870	4,767	4,209	4,009	3,773
All current and future participants	11,023	10,644	9,435	8,976	8,411
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age 65	(2,558)	(2,397)	(2,179)	(2,168)	(1,897)
Participants who have not attained eligibility age 15-64	(15,639)	(15,633)	(12,668)	(12,054)	(10,028)
Future participants (under age 15 and births during period)	(5,118)	(3,904)	(3,417)	(3,246)	(2,653)
All current and future participants	(23,315)	(21,934)	(18,264)	(17,468)	(14,577)
<i>Present value of future expenditures in excess of future revenue</i>	<i>(12,292)¹</i>	<i>(11,290)²</i>	<i>(8,829)³</i>	<i>(8,492)⁴</i>	<i>(6,166)⁵</i>
Federal Supplementary Medical Insurance (Medicare Part B): (Note 22)					
<i>Revenue (Premiums) from:</i>					
Participants who have attained eligibility age 65	433	409	363	332	283
Participants who have not attained eligibility age 15-64	3,184	3,167	2,900	2,665	2,148
Future participants (under age 15 and births during period)	1,172	908	924	891	688
All current and future participants	4,789	4,481	4,187	3,889	3,119
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age 65	(1,834)	(1,773)	(1,622)	(1,475)	(1,306)
Participants who have not attained eligibility age 15-64	(12,130)	(12,433)	(11,541)	(10,577)	(8,845)
Future participants (under age 15 and births during period)	(4,257)	(3,407)	(3,408)	(3,277)	(2,622)
All current and future participants	(18,221)	(17,613)	(16,571)	(15,329)	(12,773)
<i>Present value of future expenditures in excess of future revenue</i>	<i>(13,432)¹</i>	<i>(13,131)²</i>	<i>(12,384)³</i>	<i>(11,440)⁴</i>	<i>(9,653)⁵</i>
Federal Supplementary Medical Insurance (Medicare Part D): (Note 22)					
<i>Revenue (Premiums and State Transfers) from:</i>					
Participants who have attained eligibility age 65	167	173	195	176	
Participants who have not attained eligibility age 15-64	1,627	1,700	1,790	1,857	
Future participants (under age 15 and births during period)	611	492	572	618	
All current and future participants	2,405	2,368	2,547	2,651	
<i>Expenditures for Scheduled Future Benefits for:</i>					
Participants who have attained eligibility age 65	(794)	(792)	(880)	(773)	
Participants who have not attained eligibility age 15-64	(7,273)	(7,338)	(7,913)	(7,566)	
Future participants (under age 15 and births during period)	(2,099)	(2,121)	(2,440)	(2,431)	
All current and future participants	(10,766)	(10,250)	(11,233)	(10,770)	
<i>Present value of future expenditures in excess of future revenue</i>	<i>(8,361)¹</i>	<i>(7,884)²</i>	<i>(8,686)³</i>	<i>(8,119)⁴</i>	

Totals do not necessarily equal the sum of components due to rounding.

The accompanying notes are an integral part of these financial statements.

- 3.1.4 The US Federal level approach is significant, as it is the only jurisdiction in which a financial statement is currently required providing projections of inflows and outflows for specific programs. The Comptroller General of the United States gave an unqualified audit opinion on the 2007 and 2008 SOSIs, although the form

of the opinion differed from that given on the other financial statements. (Section 7 provides the text of this opinion).

- 3.1.5 The Federal Accounting Standards Advisory Board (FASAB), which promulgates accounting standards for the federal level in the USA, has recently completed a consultation period on an Exposure Draft that proposes extending prospective information beyond the SOSI. The proposed new statement would provide information about federal spending and receipts, including programs areas such as defense and education, as well as entitlement programs, and all revenue sources. The outline of how this financial statement might be presented is shown in Exhibit Six below. It includes current year and prior year projections and presents the inter-period change in both absolute terms and as a percentage of GDP.

Exhibit Six

Basic Financial Statement Long-Term Fiscal Projections for the U.S. Government						
Long-Term Fiscal Projections for the U.S. Government Amounts projected to 75 years						
	As of January 1, 20XX (Current Year)		As of January 1, 20XX (Prior Year)		Change from Prior Year	
	PV Dollars in trillions	% GDP*	PV Dollars in trillions	% GDP*	PV Dollars in trillions	% GDP *
Receipts						
Medicare	\$ 10.7	1.5%	\$ XX.X	X.X%	\$ XX	X.X%
Social Security	36.3	5.1%	XX.X	X.X%	XX	X.X%
All Other Receipts	<u>91.0</u>	<u>12.8%</u>	<u>XX.X</u>	<u>X.X%</u>	<u>XX</u>	<u>X.X%</u>
Total Receipts	\$ 137.9	19.4%	\$ XX.X	X.X%	\$ XX	X.X%
Spending						
Medicare	\$ 44.8	6.3%	\$ XX.X	X.X%	\$ XX	X.X%
Medicaid	15.6	2.2%	XX.X	X.X%	XX	X.X%
Social Security	40.5	5.7%	XX.X	X.X%	XX	X.X%
Rest of Federal Government**	<u>73.9</u>	<u>10.4%</u>	<u>XX.X</u>	<u>X.X%</u>	<u>XX</u>	<u>X.X%</u>
Total Spending	\$ 174.9	24.6%	\$ XX.X	X.X%	\$ XX	X.X%
Spending in excess of receipts	<u>\$ 37.0</u>	<u>5.2%</u>	<u>\$ XX.X</u>	<u>X.X%</u>	<u>\$ XX</u>	<u>X.X%</u>

- 3.1.6 Locating the current SOSI and the proposed broader statement within the context of the spectrum of information discussed in Section 2 of this Paper is not straightforward. It is the intention of FASAB that the broader proposed statement discussed above will initially be part of supplementary information, but will become a basic financial statement after an initial period

Model Two: Summarizing forward projections in narrative reporting

- 3.1.7 A second approach to reporting fiscal sustainability information in GPFRs is to mandate or permit narrative reporting, such as management commentary and Management's Discussion and Analysis (MD&A), to include information on long-term fiscal sustainability derived from other reports. Again recent US

experience provides an example of how such reporting might be presented. The MD&A section of the 2008 Financial Report of the US Government contains a section entitled Government's Financial Condition, which uses graphs, charts and tabular formats to present both historical information and forward projections over a 75 year period.

- 3.1.8 The historical information presented includes the budget deficit, net operating cost, key national economic indicators, such as real GDP growth and real construction growth, the consumer price index, unemployment levels and historical trends of debt held by the public as a percentage of nominal GDP. Projections presented include outflows on social insurance programs and other government programs, interest on debt, revenues, and debt held by the public as a percentage of GDP. The discussion in the MD&A has also been used as the basis of the separate stand-alone Citizen's Guide discussed above.
- 3.1.9 The inclusion of long-term fiscal sustainability information in narrative reports published with the financial statements could require substantial explanation since it potentially introduces another type of information. Readers may already be presented with historical information on both a budgetary and actual basis, necessitating an explanation for these differences. Long-term fiscal sustainability information then introduces a forward focus and requiring further explanation.

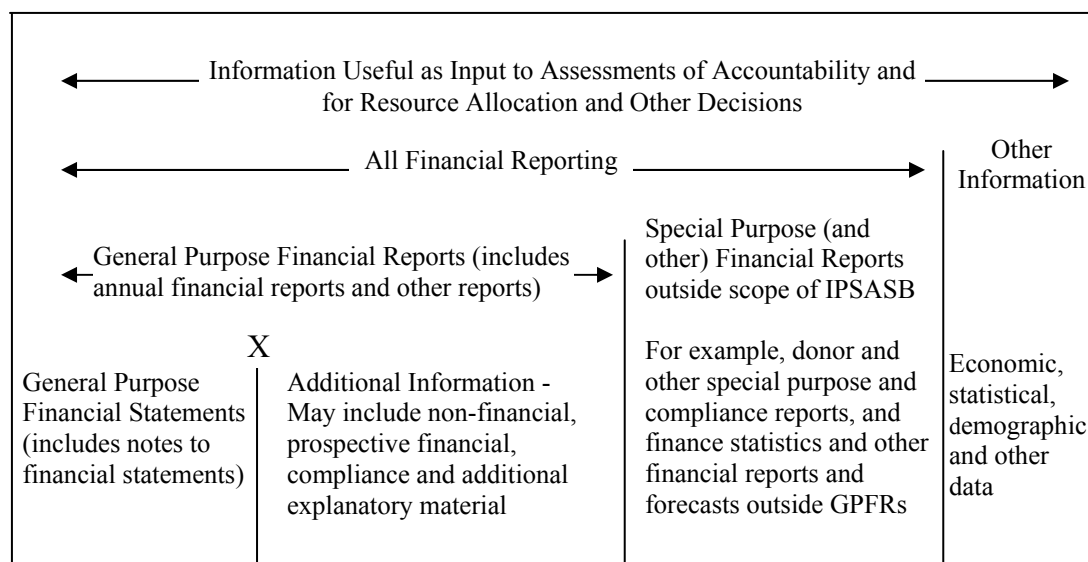
Model Three: Cross-references in GPFRs to other reports addressing long-term fiscal sustainability

- 3.1.10 A third, less ambitious, approach to the reporting of long-term fiscal sustainability in GPFRs is to require references in narrative reports within the GPFRs to fiscal sustainability reports that are outside the GPFRs, but without any detailed discussion or interpretation of trends or indicators. Proponents of this approach recognize the importance of information on long-term fiscal sustainability in meeting the objectives of GPFRs, but acknowledge the difficulties in summarizing complex information in voluminous reports and the risks to faithful representation if such information is presented selectively.
- 3.1.11 Proponents of this approach do not advocate providing summarized information on fiscal sustainability in the GPFRs themselves, but instead consider that user needs can be best satisfied through cross-references to other publicly available reports that are not GPFRs. The converse view is that GPFRs present aggregated information that is understandable to users. The highly detailed technical descriptions and complex presentational formats often used in separate long-term fiscal sustainability reports could impair understandability for the users of GPFRs. Consequently it is questionable whether references in narrative reports to separate, complex and voluminous reports would meet the qualitative characteristics of financial reporting and therefore achieve the objectives of GPFRs.

3.2 Conceptual analysis of potential reporting models

- 3.2.1 In assessing how long term fiscal sustainability information might be reported in GPFRs, the IPSASB referred to the qualitative characteristics of information (i.e. relevance, faithful representation, timeliness, understandability, comparability and verifiability.) The IPSASB's tentative view is that the first option of specific financial statements providing details of projections, would produce statements that are on the boundary between GPFS and GPFRs (see position X in Exhibit Seven below). This view is largely based on uncertainties with respect to the capacity for such statements to meet two qualitative characteristics-faithful representation and verifiability. The current SOSI and proposed broader statements in the US federal level's GPFSs are an example of such statements and the change to the form of the audit report on the SOSI reinforces this view.

Exhibit Seven **Locating the US Statement of Social Insurance in** **the IPSASB reporting spectrum**



- 3.2.2 A potential challenge with models two and three is that the reporting boundary for specialist long-term fiscal sustainability reports is unlikely to be the same as that for the GPFSs. In order to meet accountability and comparability requirements, explanations would therefore have to be provided of entities and transactions that are within the boundary of the consolidated GPFSs, but not within the boundary for sustainability reporting and vice-versa.
- 3.2.3 Such explanations risk impairing understandability. However, as long as the information reported addressed the major areas subject to demographic change, simplifying assumptions could still allow an understandable and useful report to be derived in a cost-effective manner for inclusion in the GPFRs. As noted in Preliminary View One, the Board does not consider that GPFRs are complete

- without adequate consideration of the long-term viability of government programs and government's ability to meet financial commitments. For this reason the Board's preliminary view is that references alone to specialist long-term fiscal sustainability reports do not provide users with the information that they need for decision-making and accountability purposes and that therefore model 3 is inappropriate.
- 3.2.4 The Board believes that both the other two models-specific financial statements providing details of forward projections, and including summarized forward projections in narrative reporting- would satisfy GFPR reporting objectives. This is an evolving area where many countries have yet to start reporting long-term fiscal sustainability information, and those that do undertake such reporting adopt a variety of approaches. Therefore the Board does not believe it should prescribe either approach at this stage. Instead it should encourage the production of specific financial statements providing details of fiscal sustainability projections as an eventual objective, while approaches evolve for the presentation of information on long-term fiscal sustainability in narrative reporting as an interim step.

Preliminary View Two

For the objectives of financial reporting as proposed by the IPSASB to be met by national governments either specific financial statements providing details of long-term fiscal sustainability projections to be included in the GPFRS of national government, or long-term fiscal sustainability projections initially prepared for other reports must be summarized and included in narrative reporting.

4. THE REPORTING ENTITY AND LONG-TERM FISCAL SUSTAINABILITY REPORTING

4.1 Introduction

4.1.1 Previous sections of this Consultation Paper have:

- Established that long-term fiscal sustainability reporting is an aspect of financial management of acknowledged, and growing, global importance;
- Identified ways in which long-term fiscal sustainability reporting might fill the “gaps” in GPFSSs, and put forward a preliminary view that information on long-term fiscal sustainability is necessary in GPFRs for the objectives of financial reporting to be achieved; and
- Proposed a preliminary view on how information on long-term fiscal sustainability should be presented in the GPFRs.

4.1.2 This section considers reporting boundary issues, in particular the differences between reporting boundaries based on the control concept that governs compilation of consolidated financial statements and reports based on the statistical basis of accounting and on budget accounting. The potential application of long-term fiscal sustainability reporting at sub-national levels is discussed. Finally it considers whether long-term fiscal sustainability reports should be presented in the consolidated reports of government or in the reports of separate entities within the economic entity.

4.2 Reporting boundary issues

4.2.1 Globally only a minority of governments use a reporting boundary for long-term fiscal sustainability reporting that is based on the control concept used for their GPFSSs. The main issue is whether this is an obstacle to the reporting of information on long-term fiscal sustainability in the GPFRs and, if so, what steps can be taken to address this.

Reporting boundary based on the control concept

4.2.2 Both IPSAS 6, “Consolidated and Separate Financial Statements” and the separate IPSAS on the cash basis of accounting, “Financial Reporting Under the Cash Basis of Accounting” provide requirements and guidance for the determination of the reporting boundary for consolidation purposes. Under both IPSASs, application of the concept of control determines whether an entity is within the reporting boundary. Control of an entity is defined as “the power to govern the financial and operating policies of another entity so as to benefit from its activities.” The term “economic entity”, rather than the private sector term “group reporting entity”, is used in both IPSASs. An economic entity is a group of entities and comprises a controlling entity and one or more controlled entities.

4.2.3 The definition of control includes both a “power element” (the power to govern the financial and operating policies of another entity, at least at the strategic level)

and a “benefit element” (the ability of the controlling entity to benefit from the activities of the other entity. If either or both of these elements are absent an entity would not be controlled and would therefore not be within the reporting boundary.

Reporting boundaries based on statistical accounting and budgeting approaches

- 4.2.4 Although there are exceptions, such as New Zealand and the Statement of social insurance at the US Federal level, many governments that report publicly information on long-term fiscal sustainability do not use the same boundary as for consolidated GPFSSs. Instead they adopt a boundary determined by statistical bases of accounting or one based on the budget sector.
- 4.2.5 Statistical accounting bases reflect requirements consistent with, and derived from, the System of National Accounts 1993 (SNA 93) prepared by the United Nations and other international organizations: SNA 93 is currently being updated and the new “SNA 2008” will be introduced across countries in the coming years. These statistical bases of financial reporting focus on the provision of financial information about the General Government Sector (GGS). The GGS comprises those non-profit entities that undertake non-market activities and rely primarily on appropriations or allocations from the government budget to fund their service delivery activities. The full public sector comprises both the GGS and the public financial corporation sector (PFC), such as government financial institutions and public non-financial corporation sector (PNFC), such as government owned utilities.
- 4.2.6 GPFSSs consolidate only controlled entities. In some jurisdictions a national government controls state/provincial and local government entities in accounting terms, and therefore those entities are consolidated in the GPFSSs; in other jurisdictions there is no control relationship. For example, whereas the local government tier will be consolidated within whole of government accounts in the United Kingdom, that sector is not consolidated in whole of government accounts in Australia and New Zealand. Under the statistical basis of financial reporting, the GGS of all levels of government are combined. This means that in many jurisdictions the GGS will include units that are not consolidated in the GPFSSs. One advantage of boundaries based on the GGS is that they enhance global comparability since varying relationships between national and sub-national government would not affect the boundary. Statistically-based information may therefore be useful to the users of GPFRs in order to complement information based on IPSAS 6 boundaries.
- 4.2.7 In order to meet accountability requirements the Board believes that long-term fiscal sustainability information used in GPFRs should be prepared for the same reporting entity as for these reports. This would provide greater clarity regarding the sources of funds available to the reporting entity and the scope of obligations that an entity must meet. Where the underlying fiscal sustainability information is prepared using another boundary, it should be adjusted to provide consistency with the GPFR/GPFS reporting boundary. IPSAS 22, “Disclosure of Financial

Information about the General Government Sector” prescribes reconciliation requirements for entities which elect to disclose financial information about the statistically based GGS and provides illustrative examples of how reconciliations might be presented.

- 4.2.8 Similar challenges exist where the boundary for long-term fiscal sustainability reporting is set on a budgetary basis. This may occur where the consolidated financial statements include agencies that, although controlled, have a certain amount of operational autonomy and are subject to separate budgetary approvals, or where the budget is prepared only for the general government sector. It may also be the case that the budget and financial statements are compiled on different accounting bases, so that the baseline position differs. IPSAS 24, “Presentation of Budget Information in Financial Statements” provides further consideration on reconciling the budgetary information and information presented in the financial statements.

4.3 Fiscal Sustainability Reporting at Sub-National levels

- 4.3.1 This Consultation Paper has so far focused on the consolidated national level of government. The Board considers that long-term fiscal sustainability reporting at this level is particularly important in order to assess the impact of interventions to address the global financial crisis. Although long-term fiscal sustainability reporting has become more widespread as shown in Exhibit One, it is less common at the sub-national levels. Portland (Oregon) and Maricopa County (Phoenix, Arizona) are large municipal entities in the United States that have produced fiscal condition reports. The latter is the most rapidly growing statistical metropolitan area in North America. Both these reports are primarily historical in nature providing historic ten year trend information on a range of financial and demographic variables, highlighting favorable and unfavorable trends and in the case of Maricopa, presenting a significant amount of comparative data with other large US municipalities.
- 4.3.2 In Canada the Provincial Government of Ontario published a report, “Towards 2025: Assessing Ontario’s Long-Term Outlook”, in 2005. This report presented a long-range assessment of Ontario's economic and fiscal future. It included a description of anticipated changes in the Ontario economy and in the province’s demographic profile over a 20 year horizon, a description of the potential impact of these changes on the public sector and on Ontario's fiscal situation during that future period. It also presented an analysis of key fiscal issues likely to affect the long-term sustainability of the economy and the province’s public sector.
- 4.3.3 Time horizons for sub-national reporting tend to be much shorter than those adopted at the national level. The 20 year time horizon in Ontario appears atypical for sub-national levels. For example the ‘Financial Condition Report on the State of New York’ by the State Comptroller primarily focuses on historical trends, but does include a section on “Implications for the Future” which illustrates forward trends over a 5 year horizon, including the proportion of state funds projected to be consumed on Medicaid, school funding and meeting debt service obligations.

In New Zealand local governments are required to publish budgets with ten year time horizons.

- 4.3.4 The US Governmental Accounting Standards Board (GASB), which promulgates accounting standards for the sub-federal levels in the USA, has a project on “Economic Condition Reporting: Fiscal Sustainability.” The project’s aim is to identify the information that users require to assess a sub-federal government entity’s economic condition and its components, including information regarding long-term fiscal sustainability, to compare these needs with the information users receive in the comprehensive annual financial report and other sources and to consider whether guidance or guidelines should be considered for the remaining information. The principal focus of the project is for GASB to consider whether any additional information necessary for assessing a government’s economic condition should be required or encouraged got inclusion as part of general purpose external financial reporting. This project also will consider the information identified by users as necessary to assess the risks associated with a sub-federal entity’s intergovernmental financial dependencies.
- 4.3.5 The definition of economic condition used by GASB comprises three components: financial position, fiscal capacity and service capacity. Financial position is the status of its assets, liabilities, and net assets, derived from the statement of financial position. Fiscal capacity is the ability to meet financial obligations as they come due on an ongoing basis and is therefore linked to debt maturity and liquidity, while service capacity is an entity’s ability and willingness to meet its commitments to provide services on an ongoing basis. Consistent with the IPSASB’s working definition (see Section One), this GASB definition recognizes both future service delivery commitments and the servicing of debt obligations.
- 4.3.6 The IPSASB believes that long-term fiscal sustainability information is also required at sub-national levels in order to meet both the decision-making and accountability objectives of financial reporting. However, the nature and extent of the reports required to meet these objectives will vary between entities and discussed in Section 5

4.4 Consolidated financial statements or financial statements of individual entities?

- 4.4.1 Regardless of the levels of government at which entities are required to report information on long-term fiscal sustainability, there is an issue whether requirements should be linked and restricted to the consolidated financial statements, comprising the controlling entity and controlled entity/entities, or whether they should apply to the individual financial statements of controlled entities.
- 4.4.2 Determining whether the benefits of information for the users of the financial statements of controlled entities justify the costs of providing that information, may depend on factors such as whether a controlled entity has significant tax

generating powers or debt servicing obligations, and therefore whether users exist for fiscal sustainability information. In general, it seems questionable whether the cost of producing reports on fiscal sustainability by individual entities, within the economic entity, is likely to justify the benefits to users of that information. Furthermore, there may be risks to understandability if individual entities within an economic entity producing separate sustainability reports and disclosures. It could also be misleading if entities with limited tax-raising powers provide projections, based on taxation decisions over which they have no control.

Preliminary View Three

Guidance on long-term fiscal sustainability reporting in GPFRs should be based on the concept of the reporting entity, and should apply to all levels of government, although individual controlled entities should not have to report on long-term fiscal sustainability unless users for such information can be identified.

5 WHICH FISCAL SUSTAINABILITY INDICATORS SHOULD BE REPORTED?

5.1 Introduction

- 5.1.1 This section considers how information should be reported by different entities in the context of the qualitative characteristics of financial reporting.

5.2 Indicators currently used

- 5.2.1 Publicly available reports on fiscal sustainability contain a range of indicators.

Examples of reported indicators together with working definitions include:

- **Gross debt:** The sum of government securities (on consolidated basis), loans received and other borrowing, deposits held and advances received.
- **Net debt:** Gross debt minus the sum of investments, loans made, cash and deposits, and advances paid.
- **Net Worth:** Total assets (financial and non-financial) minus total liabilities (debt, superannuation and other) minus shares and other contributed capital.
- **Net Financial Worth:** Total financial assets minus total liabilities minus shares and other contributed capital.
- **Fiscal gap:** The size of the immediate and permanent increase in revenues or decrease in outlays, expressed as a percent of GDP, that would be necessary to keep debt at or below its current share of GDP for a future projection period.
- **Inter-temporal budget gap:** Derived from the inter-temporal budget constraint (IBC). The IBC calculates the primary balance (surplus or deficit exclusive of interest payment) required to stabilize (eliminate, in some versions) the debt burden. This is done by discounting to present value all projected future revenue and spending flows plus the current debt burden. An inter-temporal budget gap exists when the present discounted value of projected primary balances does not cover the current debt burden.
- **Fiscal dependency:** Extent to which an entity is dependent upon sources of funding outside its control.

- 5.2.2 Many of the above indicators are generally presented as a proportion of Gross Domestic Product or in per capita terms. This section considers whether the IPSASB should recommend a minimum set of indicators, which should be disclosed in the GPFRs regardless of the prominence that they play in a particular jurisdiction's fiscal framework. The advantage of such an approach is that it promotes global consistency. The disadvantages are that there appears to be no consensus on the relevance of these indicators as yet, and they may be of limited local or regional significance. For example, gross debt may be misleading as it fails to recognize trends such as the accumulation of assets in public sector pension funds. Misgivings have been expressed in New Zealand about the use of

fiscal gap information, and in Australia the primary indicator of fiscal sustainability has been changed from net debt to net financial worth. Allen Schick has explained the power of the inter-temporal budget gap, but notes that it is sensitive to the starting year of the projection and the discount rate.³

5.3 Relevance of different types of indicators

5.3.1 In considering approaches to the disclosure of information in narrative reporting, the conceptual framework developed by Schick is useful. He puts forward four dimensions of fiscal sustainability

- **Solvency:** the capacity of governments to finance existing and probable future liabilities/obligations;
- **Growth:** the capacity of government to sustain economic growth over an extended period;
- **Fairness:** the capacity of government to provide net financial benefits to future to future generations that are not less than the net benefits provided to current generations; and
- **Stable taxes:** the capacity of governments to finance future obligations without increasing the tax burden.

The dimensions of solvency and fairness are similar to the notions of fiscal capacity and service capacity developed in the GASB project discussed in Section 4.

5.3.2 Solvency is relevant at all levels of the public sector. Therefore forward debt projections will be relevant to all bodies. However, the relevance and salience of the other dimensions above may vary between governmental levels and will depend on factors such as size and tax-generating powers. For example, the growth dimension is important for national governments and for larger sub-national entities, particularly those with powers over corporate taxation and economic regeneration powers. However it may be of more limited significance in predominantly suburban and residential municipalities with a limited ability to affect economic activity in a larger metropolitan area.

5.3.3 Similarly the stable taxation dimension will be at the core of analysis for national governments, but may be of more limited relevance for entities with limited tax-generating powers, which are dependent on inter-government transfers for a high proportion of their revenues.

5.3.4 Gross Domestic Product is a relevant indicator for large and economically significant sub-national entities in federalized structures such as American states, Australian states, Canadian provinces and certain European regions with high levels of economic activity.

³ Allen Schick “Sustainable Budget Policy Concepts and Approaches”

- 5.3.5 It is unlikely to be relevant or even available for small municipalities. Similarly the fiscal gap and inter-temporal budget constraints are national level constructs that apply to the entire public sector and cannot easily be applied for discrete sub-national entities.
- 5.36 As already suggested in paragraph 5.3.3 one factor which may be relevant to the issue of how entities should report on fiscal sustainability is the existence and extent of tax-raising powers. GASB has used the term “intergovernmental financial dependency” to indicate the extent to which entities rely on transfers from other tiers of government in order to meet financial obligations. It seems questionable whether entities that do not have significant tax generating powers and are heavily dependent on inter-governmental transfers for their fiscal capacity should be making projections for external general purpose users covering lengthy time horizons. It may suggest to users that entities have tax-generating powers that they do not control. This might be considered analogous to an entity that does not control an asset reporting that asset in the GPFSs.
- 5.3.7 The extent to which an entity is fiscally dependent upon the taxation policies of a higher level of government is likely to be an important indicator in illustrating the extent to which the maintenance of current service provision and the ability to meet financial obligations are dependent on the decision of other entities. A 1995 Canadian Institute of Chartered Accountants (CICA) report, “Indicators of Financial Condition” defined the term “vulnerability” to denote the degree to which a government becomes dependent on, and therefore vulnerable to, sources of funding outside its control or influence, both domestic and international.

5.4 Relevance of Qualitative Characteristics of Financial Reporting

- 5.4.1 IPSASB’s project on the public sector conceptual framework has considered the qualitative characteristics of financial reporting. The qualitative characteristics of information included in GPFRs are the attributes that make that information conducive to the achievement of the objectives of financial reporting – that is, for accountability purposes and for making resource allocation, political and social decisions. From the accountability perspective it is particularly important that the long-term fiscal indicator(s) chosen and the supporting narrative describe the scale of the fiscal challenge facing the entity.
- 5.4.2 The qualitative characteristics of information included in GPFRs are relevance, faithful representation, timeliness, understandability, comparability and verifiability. Materiality, cost and achieving an appropriate balance between the qualitative characteristics are pervasive constraints on that information. In assessing which information on long-term fiscal sustainability should be provided in the GPFRs all these characteristics are relevant.
- 5.4.3 A number of issues are likely to arise in applying the qualitative characteristics of financial reporting to long-term fiscal sustainability information. In order for prospective information to be decision-useful and valuable in demonstrating accountability it needs to be transparent, thereby reflecting the qualitative

characteristics of relevance and faithful representation. It is therefore important that assumptions are based on published fiscal frameworks and targets. The use of prospective information also gives rise to issues about the verifiability of the information. Both areas are discussed in a later section of the paper. The profile of indicators across time is also likely to be significant as the indicators may be volatile; reporting an indicator at just one point may therefore be misleading.

5. 4.4 As a result of the differing relevance of the various types of indicators, and the extent to which they would meet the qualitative characteristics of financial reporting, the Board does not consider that a uniform set of indicators should be prescribed or recommended. Instead it believes that but that the reasons for selecting particular indicators should be disclosed with regard to the qualitative characteristics of financial reporting. The reasons for ceasing to report indicators should also be disclosed if this occurs. The avoidance of frequent changes will provide stability and enhance understandability.

Preliminary View Four

The choice of long-term fiscal sustainability indicators to be reported should be based on their relevance to the entity, the extent to which they meet the qualitative characteristics of financial reporting, and their ability to describe the scale of the fiscal challenge facing the entity. The reasons for ceasing to report indicators should be disclosed if this occurs.

6 BASIS OF PREPARATION: KEY PRINCIPLES

6.1 Introduction

- 6.1.1 This section of the Consultation Paper looks at the programs and transactions that are covered by long-term fiscal sustainability reporting and the principles that should be adopted for their inclusion in GPFRs. The basis of accounting—whether statistical, accrual or budget—can influence the programs and transactions that are reported, and the following sections should be considered in the context of the areas covered in sections 4 and 5.

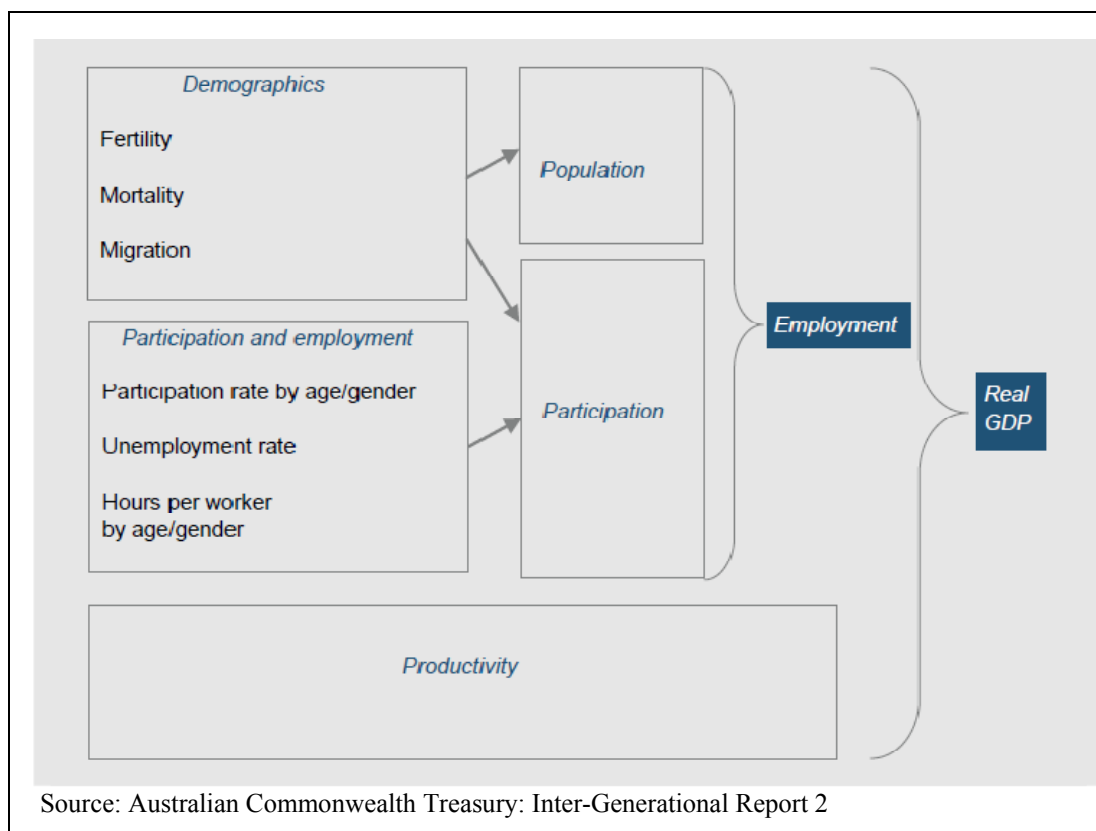
6.2 Revenue Inflows

- 6.2.1 As already noted one of the main advantages of fiscal sustainability reporting is that, unlike the GPFRs, such reporting can take into account projected inflows from taxation and other sources for which the taxable event giving rise to an inflow is in the future. (See above Section 2.)
- 6.2.2 All the jurisdictions informally surveyed for this Paper include projections of taxation and other government financing in their projections. In most jurisdictions the approach is to assume an unchanged tax policy over the projection period. The European Commission suggests that this reflects two main assumptions:
- The main tax bases remain constant as a share of GDP and there is no change in the structural wage share of the economy, or the savings rate of households.
 - The average tax rate is constant on the different tax bases, which is consistent with assuming an indexation of all thresholds, bands, minima and exemption of the tax system on average wage.
- 6.2.3 Adopting such an approach involves a modification of the principle governing the GPFRs that only legally enacted measures should be taken into account. Assuming that personal taxation is a constant proportion of GDP is also a straightforward way of dealing with “fiscal drag”, where increases in nominal incomes result in individuals moving into higher tax bands. However, in its 2006 report on “Long-Term Fiscal Position” New Zealand expressed reservations about this approach by suggesting that “assuming a constant tax to GDP ratio is a strong assumption.” For personal taxation New Zealand is therefore considering adoption of more sophisticated approach, held as a constant proportion of nominal GDP.
- 6.2.4 In the context of long-term fiscal sustainability projections in the GPFRs the most important requirements are that users are informed of the main sources of tax revenue and the way in which the tax base is projected to grow (or diminish) over the reported time horizon i.e., where revenues are modeled individually and the principal assumptions or where revenues are not modeled individually, but instead are projected to grow in line with GDP.

6.3 Demographic and economic assumptions

- 6.3.1 While there is considerable congruence in the assumptions used by governments in making projections there are differing ways of classifying them. For example, Australia disaggregates real GDP into three components: population, participation and productivity. Population is the number of people of working age, participation is the average number of hours worked in the labor force by each working-age person and productivity is the average output produced per hour worked. Population is determined by assumptions about fertility, mortality and migration. Population also has an impact on participation because employment levels and hours worked are related to both age and gender. This disaggregation is shown schematically in Exhibit Eight, which is reproduced from the most recent Australian Commonwealth “Intergenerational Report”.

Exhibit Eight
Disaggregating GDP: The Australian Commonwealth Approach



- 6.3.2 Accounting standards that rely on prospective information to measure the impact of past events on items reported in the financial statements require disclosure of the main assumptions. For example, IPSAS 25, “Employee Benefits” requires disclosure of principal actuarial assumptions for determining liabilities and assets related to post-employment obligations. These include the expected return on plan assets, the expected rates of salary increases and medical cost trends.

- 6.3.3 Given increasing significance of environmental sustainability, assumptions may need to take into account environmental factors, such as the depletion and degradation of ecosystem services, such as water and finite natural resources on estimates of economic growth.
- 6.3.4 The Board believes that it is good practice to disclose all key assumptions underpinning long-term fiscal sustainability projections in the GPFRs. The challenge for preparers is how to distill a very complex process into an explanation that is succinct and understandable to users of the GPFRs, but does not over-simplify and therefore diminish the reliability of the information reported.

6.4 Age-related and non age-related programs

- 6.4.1 A common approach is to distinguish programs that are age-related and subject to demographic risk and programs that are non-age related or where ageing and demography are not key drivers of spending pressures. For example, in developing its Intergenerational Reports, the Australian Commonwealth Government has modeled individually health, aged care, social security payments and education - which accounted for around 70 per cent of government spending in 2007-08. Other areas of Government spending, such as defense and national security, the environment, transport and communications infrastructure, public order and safety have not been modeled individually, but have been assumed to grow broadly in line with GDP. The rationale is that these other areas do not have a clear link with demographic factors. Furthermore, given their diverse nature, it is difficult to project spending in these areas with certainty. This aggregated approach and the assumption that spending will grow in line with GDP provides some flexibility, because it allows spending to increase as a proportion of GDP in some areas while being offset by declines in other areas. France and Switzerland have adopted broadly similar approaches, distinguishing age-related and non-age related expenditure: non-age related expenditure is projected to be constant in real terms or to be a fixed proportion of GDP.
- 6.4.2 In order for information on long-term fiscal sustainability to be relevant to users of GPFRs all material programs and transactions must be reflected. If this is not the case it is important that the material programs and transactions that are not included are clearly identified. This particularly applies to entitlement programs such as social security, aged pensions and medical insurance and also obligations related to public sector occupational pension plans. Omission of such programs and plans will understate expenditure projections and may have an impact on the relevance and reliability of information.

6.5 Current versus future policy

- 6.5.1 IPSASs have adopted the general principle that transactions and elements are evaluated and determined within current legal frameworks. This is based on the view that the preparers of the financial statements should not predict governmental actions and that there should be no assumption that programs will

discontinue, unless legislation to that effect has been enacted at the reporting date. Although this principle is sound for the GPFSs, it is less clear that it is always appropriate for fiscal sustainability projections elsewhere in the GPFRs and its application may even lead to imprudent and unreliable projections.

- 6.5.2 In the context of long-term fiscal sustainability there can be tensions where legal obligations conflict or where current programs have sunset provisions. This is more likely to be a problem in certain countries- in both Australia and New Zealand it seems that cases of legal conflict are unlikely or highly limited and where they exist are reflected in policy assumptions. An example of such tension is where a requirement that benefits are only paid out of a segregated fund that is projected to be exhausted may not be compatible with the projected volume of entitlements. Programs subject to sunset provisions may be replaced by similar programs, so adopting a strict “legal termination” principle may lead to the understatement of projected outflows. A principle that has been largely adopted for reasons of prudence in the financial statements might lead to imprudent projections for long-term fiscal sustainability!
- 6.5.3 The projections of participation in the labor market in the UK’s December 2006 Long-Term Public Finance Report actually reflected Government intentions to raise the age of entitlement for the state pension even though legislation to effect such a change had not been enacted at the date of publication. The Report acknowledged the difficulty of predicting with complete accuracy the impact of changed state pension dates on labor markets and therefore modeled three different variants of that effect. Notwithstanding such estimation complexity the approach of the UK shows that there may be cases where making projections on the basis of firmly announced Government proposals can provide more robust information than using a current legal position which is highly likely to be superseded.
- 6.5.4 The preliminary view of the IPSASB is that disclosures should be on the basis of current policy; that is future events such as the adoption of proposed policies should not be incorporated in assumptions. Deviation from this principle should be disclosed. Such disclosures would include any anticipation of a change in legal position or entitlement criteria that have not been enacted at the reporting date, but were assumed for the purposes of making projections.

6.6 Bottom-up versus top-down approaches

- 6.6.1 One approach to dealing with legal obligations is to distinguish between top-down and bottom-up approaches. Under top-down approaches assumptions are made that tax policies and fiscal rules do not change. Conversely, under bottom-up approaches, each material individual expenditure or revenue item representing existing government policy is projected and agreed. The United Kingdom has used both approaches in its public reporting on fiscal sustainability: top-down modeling approaches in its “Economic and Fiscal Strategy Report” and bottom-up approaches in its “Long-Term Fiscal Sustainability Report.” New Zealand has also adopted a top-down approach to complement its analysis. Usually high-level

constraints (on debt or deficit) almost always lead to a “non-explosive” debt path when they are respected.

- 6.6.2 Under bottom-up approaches each material individual expenditure or revenue item is projected and aggregated. Bottom up approaches can involve both a full set of modeled assumptions and projections and a more simplified approach whereby only certain programs are modeled and spending on other programs is assumed to remain constant as a proportion of GDP over the time horizon (see above section 6.4). Bottom-up approaches are more penetrative tools for identifying points of fiscal pressure and are therefore more relevant to the users of GPFRs.
- 6.6.3 It is the view of the Board that projections should be based on bottom-up approaches, but that top down approaches may complement bottom-up approaches by illustrating the scale of the fiscal changes that is necessary to achieve a sustainable path. It is therefore important that GPFRs disclose whether specific projections are made using top-down or bottom-up approaches or a combination of the two.

6.7 Impact of Legal Requirements and Policy Frameworks

- 6.7.1 In some jurisdictions long-term fiscal sustainability reporting is governed by a legal or regulatory framework (see Section 1.3 which notes legal requirements for sustainability reporting). Such frameworks typically cover responsibilities for preparation and presentation as well as many of the areas noted above. They may also specify the frequency with which reports should be published, and may reflect the requirements of supra-national bodies such as the European Commission. An example of such a national-level framework from New Zealand is shown below in Exhibit Nine.

Exhibit Nine

Governing Legal Framework for Development and Reporting of Long-Term Fiscal Sustainability in New Zealand

Section 26N of the Public Finance Act 1989 (as amended in 2004) states:
Statement on long-term fiscal position

- 1) Before the end of the second financial year after the commencement of this section and then at intervals not exceeding 4 years:-
 - a) The Treasury must prepare a statement on the long-term fiscal position; and
 - b) The Minister must present each statement to the House of Representatives.
- 2) The statement must:-
 - a) Relate to a period of at least 40 consecutive financial years commencing with the financial year in which the statement is prepared; and
 - b) Be accompanied by:-
 - i) a statement of responsibility signed by the Secretary stating that the Treasury has, in preparing the statement under subsection (1), used its best professional judgments about the risks and the outlook; and
 - ii) a statement of all significant assumptions underlying any projections included in the statement under subsection (1)

6.7.2 It is important for the users of GPFRs to be provided with details of the key aspects of governing legislation and regulation. However, there is a risk that such information will be over-detailed and undermine understandability. To address this risk it may therefore be appropriate for cross-references to be made in the GPFRs to other publicly available reports.

6.7.3 It is also important that the users are provided with sufficient information on the underlying macro-economic policy and fiscal framework to allow them to interpret projected information. The challenge is to provide such information in a form that is understandable and relatively concise, but also verifiable. In broader reports on long-term fiscal sustainability the Australian, New Zealand and United Kingdom Governments have attempted to do this. Exhibit Ten gives examples of the approaches taken at the Commonwealth level in Australia and by the European Commission.

Exhibit Ten

Disclosing information on fiscal frameworks: Australia and the European Commission

Australia

In its most recent Intergenerational Report, published in 2007, the Australian Commonwealth Government highlighted the key aspects of its macro-economic policy framework for fiscal policy and the “Charter of Budget Honesty” and medium-term fiscal strategy that both flow from that framework. The Charter requires the Government to frame its fiscal strategy having regard to fiscal risks, including the maintenance of general government debt at prudent levels, the state of the economic cycle, the adequacy of national saving, the stability and integrity of the tax system and the financial effect of policy decisions on future generations. Key aspects of the medium-term fiscal strategy include the maintenance of a balanced budget over the course of the economic cycle, with supplementary objectives of not increasing the overall tax burden from its 1996-1997 level and improving the Australian government net worth position over the medium to long-term. The macro-economic framework also includes an inflation target for inflation, based on the Consumer Price Index (CPI), to be 2-3 per cent per year on average over the course of the economic cycle.⁴

European Commission

European Commission’s assessment of debt sustainability is derived from the inter-temporal budget constraint. This constraint requires that the current total liabilities of the government, i.e. the current public debt and the discounted value of future expenditure, should be covered by the discounted value of future government revenue. If current policies ensure that the inter-temporal budget constraint is respected, current policies are considered sustainable. Two sustainability gap indicators measure the size of required permanent budgetary adjustments that enables one of the following conditions to be met : (i) reaching a target of 60 % of GDP for the Maastricht debt in 2050 (the S1 indicator); and (ii) fulfilling the inter-temporal budget constraint over an infinite horizon (the S2 indicator). The European Commission’s (DGEFIN)’s publication, “Long-Term Sustainability of Public Finances” published in 2006 provided projections for the assessment of the budgetary implications of demographic change and the sustainability of public finances across the 25 EU Member States. Based on the projected expenditure trends, deficit and debt levels were projected over a 50 year horizon.

⁴ The Australian Commonwealth Government has subsequently updated its fiscal strategy.

Preliminary View Five

Guidance on long-term fiscal sustainability reporting in GPFRs should [require] the entity to disclose:

- The basis on which projections of inflows from taxation and other material revenue sources have been made;
- All key assumptions underpinning long-term fiscal sustainability projections;
- Any material programs and transactions not reflected in the projections;
- Any deviations from the principle that long-term fiscal sustainability projections should be on the basis of current policy; and
- Details of key aspects of governing legislation and regulation, and the underlying macro-economic policy and fiscal framework.

7 SPECIFIC METHODOLOGY ISSUES

7.1 Introduction

- 7.1.1 This section looks at time horizons for long-term fiscal sustainability projections, discount rates and the role of sensitivity analysis, approaches to ensuring the reliability of assumptions and the frequency of such projections.

7.2 Time horizons for projections and their rationale

- 7.2.1 Globally there is significant variation in the time horizons- the period to which projections relate-used by governments to develop projections and report on long-term fiscal sustainability. Exhibit Eleven highlights the position for the national level reports identified in section 1. Both Australia and New Zealand currently use a 40 year reporting horizon, in Europe 2050 is commonly used as the horizon, while in the US most of the federal agencies involved in projections use a 75 year horizon. This is also the time horizon used for the information reported in the Financial Report of the US Government.
- 7.2.2 In some jurisdictions projections may be made over much longer time horizons than those publicly reported- both the UK and Sweden make projections to the end of this century, but only publicly report up to 2050. There is an obvious relationship between the robustness of assumptions and the time horizon — 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. Conversely, excessively short time horizons may increase the risk that events and modified trends just outside the reporting horizon, or beyond the economic cycle, might have a significant impact on reported information. In the US, in the Annual Trustee Reports for Social Security and Medicare, the latter risk has been partially addressed by adopting an infinite time horizon for certain projections.
- 7.2.3 It is important that the time horizons used for long-term fiscal sustainability projections should be disclosed in the GPFRs as well as the reason for any changes already implemented or planned to these time horizons.

Exhibit Eleven
Overview of Time Horizons in Selected Long-Term Fiscal Sustainability Reports

Country	Title	Time Horizon
Australia	Intergenerational Report	40
Denmark	A Sustainable Future	9
Germany	Rpt on Sustainability of Public Finance	45
Korea	Vision 2030	25
Netherlands	Aging and Sustainability of Dutch Public Finances	Until 2100 (with separate discussion to 2040)
New Zealand	LT Fiscal Position	40
Norway	2006 White Paper	55
Sweden	Sweden's Economy (annex to budget)	45
United Kingdom	LT Public Finance Report	30
USA: CBO	LT Budget Outlook	75
USA: GAO	LT Fiscal Outlook	75
US: OMB	LT Budget Outlook in Analytical Perspectives	75
USA: Financial Report of US Government	Statement of Social Insurance	75
European Union Countries	Public Finances – EMU	55
Switzerland	Long-term sustainability of public finance in Switzerland	40

Source: OECD Fiscal Futures project

7.3 Discount rates

- 7.3.1 Assumptions and projections may involve the application of discount rates, although not all indicators discussed in section 4 entail discounting. The responses to the informal questionnaire indicated a variety of approaches to determining discount rates. These included growth – interest difference used by a number of

EC member states, implicit interest rate paid on the public debt (Switzerland), and the average of 10 year and 90 day treasury interest rates at the US federal level.

- 7.3.2 Accounting standards generally require that when liabilities are to be settled more than one year after the reporting date they are discounted to present value using a specified discount rate. For example IPSAS 25, “Employee Benefits” requires that the discount rate should be a rate that reflects the time value of money and permits entities to make a judgment as to whether the time value of money is best approximated by market yields. A similar principle applies to cash-generating assets in determining the value-in-use of a cash-generating asset for impairment testing purposes the estimate of future cash flows that the entity expects to derive from the asset are to reflect the time value of money, represented by the current market risk-free rate of interest. This approach reflects a view that undiscounted nominal amounts do not meet the qualitative characteristic of relevance.
- 7.3.3 The issue is whether in order to enhance comparability consideration should be given to specifying a discount rate that represents best practice for discounting projections on long-term fiscal sustainability to present value in the GPFRs. The alternative would simply be to encourage disclosure of discount rates applied and their rationale. The Board believes that the latter approach would be acceptable at this stage given the developmental nature of this area and the range of professional groups involved.

7.4 Sensitivity analysis

- 7.4.1 Demographic and economic projections are inherently uncertain. Public reports on fiscal sustainability in many jurisdictions have therefore devoted considerable attention to the impact of variations to base case projections and assumptions about the drivers of economic growth. The most recent Australian IGR commented that “the projections in this report were built using assumptions to form a plausible central case. Significant uncertainties surround those assumptions and as a result, the projections in the report should not be treated as forecasts.”
- 7.4.2 In the context of the financial statements certain current Standards require the disclosure of specified sensitivity information. For example, IPSAS 25 mirrors IAS 19 by including a requirement for disclosure of the effects of a 1% increase and 1% decrease in the assumed medical cost trend rates on components of revenue and the accumulated post-employment benefit obligation for medical costs. IFRS 7, “Financial Instruments: Disclosure” requires a sensitivity analysis for each type of market risk to which an entity is exposed at the end of the reporting period and the methods and assumptions used in preparing the sensitivity analysis.
- 7.4.3 As for demographic and economic assumptions the issue is how the results of sensitivity analyses are best presented in the GPFRs. At this stage it is perhaps too early for the Board to be over-prescriptive in this area. However, a preliminary

view is that the results of any sensitivity analysis should be disclosed in order to provide better information on the scale of the fiscal challenges faced.

7.5 Ensuring the reliability of assumptions

- 7.5.1 Currently publicly reported projections are subject to formal audit assurance only in the United States. At the US federal level the Statement of Social Insurance (SOSI) has been a principal financial statement in the Financial Report of the US Government since 2006. The SOSI provides estimates of the financial condition of the most significant social insurance (contributory entitlement) programs of the federal government, principally most parts of Medicare and Social Security. The SOSI uses assumptions from Annual Trustee Reports and adopts a 75 year time horizon. The GAO disclaimed an opinion on the SOSI in 2006, but in 2007 the GAO gave an opinion that the SOSI “presents fairly, in all material respects, the financial condition of the US government’s social insurance programs.” Further information on the sensitivity of assumptions is contained in supplemental information and the MD & A, both of which are not subject to audit or assurance currently. The current wording of the unqualified audit opinion given on the SOSI for 2007 and 2008 is given in Exhibit Thirteen overleaf.

Exhibit Thirteen
US Government Accountability Office Opinion on Statement of Social Insurance

UNQUALIFIED OPINIONS ON THE STATEMENTS OF SOCIAL INSURANCE FOR 2008 AND 2007

In our opinion, the Statements of Social Insurance for 2008 and 2007 present fairly, in all material respects, the financial condition of the federal government's social insurance programs, in conformity with GAAP. We disclaim an opinion on the 2006 Statement of Social Insurance and have not audited and do not express an opinion on the Statements of Social Insurance for 2005 and 2004, and on other information related to such statements that is included in the accompanying *2008 Financial Report*. As discussed in Note 23 to the consolidated financial statements, the Statement of Social Insurance presents the actuarial present value of the federal government's estimated future revenue to be received from or on behalf of participants and estimated future expenditures to be paid to or on behalf of participants, based on benefit formulas in current law and using a projection period sufficient to illustrate the long-term sustainability of the social insurance programs. In preparing the Statement of Social Insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the Statement of Social Insurance and the fact that such assumptions are inherently subject to substantial uncertainty (arising from the likelihood of future changes in general economic, regulatory, and market conditions, as well as other more specific future events, significant uncertainties, and contingencies), there will be differences between the estimates in the Statement of Social Insurance and the actual results, and those differences may be material. The Supplemental Information section of the *2008 Financial Report* includes unaudited information concerning how changes in various assumptions would change the present value of future estimated expenditures in excess of future estimated revenue. As discussed in that section, Medicare projections are very sensitive to changes in the health care cost growth assumption.

- 7.5.2 The IPSASB is of the view that the need for, level of and extent of assurance is a matter for preparers to form a judgment on in conjunction with their auditors. However, due to the inherent uncertainty in long-term projections it is important that entities disclose succinctly the steps that have been taken to ensure that assumptions underpinning projections are realistic and reliable. In its "Code of Practice on Fiscal Sustainability" the IMF states that "independent experts should be invited to assess fiscal forecasts, the macroeconomic forecasts on which they are based, and their underlying assumptions and that a national statistical body should be provided with the institutional independence to verify the quality of fiscal data." Both Eurostat and the Canadian Province of Ontario use peer review processes. This approach is consistent with guidance issued by the Canadian Institute of Chartered Accountants on public performance reporting, which states

that it is good practice for the reports to disclose basis on which those responsible for the preparation of the report have confidence in the reliability of the information in the report.

7.6 Frequency of reporting

- 7.6.1 Publication of GPFSs is, at a minimum, on an annual cycle. As for time horizons, the frequency of long-term fiscal sustainability reporting varies. Australia is required by legislation to publish Intergenerational Reports at least every five years. The legislative requirement in New Zealand is for a statement on New Zealand's long-term fiscal position to be published every four years. Switzerland also reports publicly every four years. Other governments report annually and may make projections more frequently e.g., Sweden. Exhibit Twelve gives the position for the jurisdictions identified in Section 3 of the paper.

Exhibit Twelve
Overview of Reporting Frequency in Certain Jurisdictions

Country	Title	Freq.
Australia	Intergenerational Report	Every 5 yrs
Denmark	A Sustainable Future	Every 5 yrs
Germany	Rpt on Sustainability of Public Finance	Every 3 yrs
Korea	Vision 2030	Ad Hoc
Netherlands	Aging and Sustainability of Dutch Public Finances	Ad Hoc
New Zealand	LT Fiscal Position	Every 4 yrs
Norway	2006 White Paper	Annually
Sweden	Sweden's Economy (annex to budget)	Annually
United Kingdom	LT Public Finance Report	Annually (not since 2006)
USA: CBO	LT Budget Outlook	Every 2 yrs
USA: GAO	LT Fiscal Outlook	3 times/yr
USA: OMB	LT Budget Outlook in Analytical Perspectives	Annually
USA: Financial Report of US Government	Statement of Social Insurance	Annually
European Union Countries	Public Finances – EMU	Annually
Switzerland	Long-term sustainability of public finance in Switzerland	Every 4 yrs

Source: OECD Fiscal Futures Project

- 7.6.2 Reporting frequencies for publicly available reports outside the GPFRs are not within the scope of this Consultation Paper. However, where projections are made considerably earlier than the reporting date for the GPFRs, it may be questionable whether such projections meet the qualitative characteristic of timeliness. At a

minimum, the date at which projections were made should be disclosed. A more rigorous approach would be to endorse a good practice benchmark that long-term fiscal sustainability projections in the GPFRs should have been made within a pre-determined period before the reporting date for the GPFSs. For items subject to revaluation in GPFSs, intervals exceeding five years are not permitted. The Board's view is that a similar maximum timescale should be adopted for long-term fiscal sustainability information disclosed in GPFRs

Preliminary View Six

Guidance on long-term fiscal sustainability reporting in GPFRs should [require] the entity to disclose:

- Time horizons for fiscal sustainability projections presented or discussed in the GPFRs as well as the reason for modifying time horizons and any published plans to modify those horizons;
- Discount rates, together with the rationale for their selection;
- Results of sensitivity analyses; and
- Steps taken to ensure that assumptions underpinning projections are reliable.

Preliminary View Seven

Long-term fiscal sustainability information disclosed in GPFRs should have been prepared or updated within five years of the reporting date.

Long-Term Fiscal Sustainability Reporting



**International Federation
of Accountants**

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This Project Brief was prepared by the International Public Sector Accounting Standards Board (IPSASB), an independent standard-setting body within the International Federation of Accountants (IFAC). The objective of the IPSASB is to serve the public interest by developing high quality accounting standards for use by public sector entities around the world in the preparation of general purpose financial statements. This will enhance the quality and transparency of public sector financial reporting and strengthen public confidence in public sector financial management.

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INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

LONG-TERM FISCAL SUSTAINABILITY REPORTING

PROJECT BRIEF AND OUTLINE

1. Subject

Reporting on the long-term fiscal sustainability of governmental programs and finances.

2. Project Rationale and Objectives

During the development of its project on social benefits the IPSASB has formed a view that the financial statements of an entity cannot satisfy all the needs of users in assessing the future viability of programs providing social benefits. The IPSASB holds this view regardless of the approach that is taken to the point(s) at which a present obligation(s) occur(s) (which may vary for different types of social benefits), the extent of those present obligations and the amount of the resultant liabilities. Information presented in the financial statements may need to be complemented by the presentation of other information about the long-term fiscal sustainability of those programs, including their financing.

a) Objectives to be achieved

The ultimate objective of the project is to produce a framework for the reporting of information related to the long-term fiscal sustainability of governmental programs and finances.

The intermediate objective is to produce a Consultation Paper. The Consultation Paper will highlight and analyze existing approaches in jurisdictions, where long-term fiscal sustainability reporting is a feature of governmental financial management, as well as the approaches of supra-national bodies (such as the European Commission and the International Monetary Fund) in making comparative fiscal projections.

The project is not directly related to the accrual basis of financial reporting and the traditional financial statements and is not linked to an existing International Financial Reporting Standard. It is therefore not feasible or appropriate to provide definitive final outputs at the initiation stage. Dependent upon decisions to be made following analysis of submissions on the Consultation Paper, a Standard (providing requirements) and/or Guidance will be developed.

b) Link to IFAC/IPSASB Strategic Plans

Link to IFAC Strategic Plan

Issuing requirements and guidance on public sector financial reporting issues is a primary role of the IPSASB. The development of such requirements and guidance supports IFAC's mission of serving the public interest by contributing to its aim of becoming the international standard setter for governmental financial reporting.

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Link to IPSASB Strategy

This is an area which has become increasingly topical and relevant to the enhancement of public sector accountability. The absence of public sector specific guidance on fiscal sustainability reporting is a “gap” in the IPSASB literature that has become apparent during the IPSASB’s project on social benefits (see above). It is consistent with IPSASB’s strategic theme of developing requirements and guidance on public sector specific issues.

3. Outline of the Project

a) Project Scope

The scope of the project is reporting on the long-term fiscal sustainability of governmental programs, including their financing. The range of entities and levels of government to be within the scope of finalized outputs will be determined following analysis of submissions on a Consultation Paper.

Certain other issues relating to scope will be considered in the course of the project. These include whether:

- All governmental programs should be within the scope; or
- Whether the scope should be restricted to certain programs, for example, contributory programs or social insurance programs.

This project only addresses long-term fiscal sustainability reporting and not environmental sustainability. However, there may be linkages between environmental sustainability and long-term fiscal sustainability, because assumptions about environmental sustainability may impact upon financial assumptions such as changes in Gross Domestic Product (GDP) and demographic assumptions such as population growth, emigration and immigration. The project will acknowledge such potential linkages.

b) Major Problems and Key Issues that Should be Addressed

(i) Definitions

There is no globally accepted definition of fiscal sustainability or long term-fiscal sustainability, although a number of governments have developed formal or implied definitions of these terms or related terms. In some cases these definitions are located in the context of medium-term fiscal planning or budgetary frameworks, such as when long-term fiscal sustainability is linked to specific targets such as a pre-determined net debt/Gross Domestic Product (GDP) ratio or net debt/GDP per capita ratio. In these cases overall governmental spending is said to be fiscally sustainable if it is contained within these pre-determined and publicly communicated targets over a certain period.

At a very high level, long-term fiscal sustainability reporting involves an assessment of the extent to which service delivery can be maintained at existing levels, and the extent to which governmental obligations to citizens under

LONG-TERM FISCAL SUSTAINABILITY REPORTING
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existing legal frameworks, can be met from predicted inflows over a pre-determined future period. The analysis of long-term fiscal sustainability therefore takes account of both current and future beneficiaries, regardless of whether governments have present obligations to them, determined in accordance with accrual accounting principles at the reporting date.

Long-term fiscal sustainability is sometimes coupled with the broad concept of inter-generational equity, which evaluates the extent to which future generations of taxpayers will be affected by the fiscal consequences of current policies for the delivery of goods and services.

As noted above, the reporting of long-term fiscal sustainability is also commonly linked to frameworks involving targets and benchmarks involving such indicators as:

- Net Debt;
- Net Debt/GDP;
- Fiscal Gap;and
- Fiscal Imbalance.

The project will therefore consider relevant terminology, the adequacy of existing definitions, and the extent to which those definitions need to be supplemented. It will also consider whether a Standard and/or guidance should specify or recommend that a minimum set of indicators should be reported.

(ii) *Status and Nature of Outputs*

The project will consider whether the IPSASB should be developing requirements and if so, whether such requirements should specify the information to be reported if an entity elects to report information about long-term fiscal sustainability or should require all entities within the scope of those requirements to provide specified information about long-term fiscal sustainability. This will involve determining whether all entities should be required to report on long-term fiscal sustainability as a regular feature of their general purpose reporting or whether the scope of the requirements should be restricted by, for example:

- Only applying to entities which elect to make their fiscal sustainability reports publicly available; or
- Only applying to entities that mention or discuss the fiscal sustainability report in the general purpose financial statements?

The project will also examine whether any requirements should apply to all entities that apply IPSASs or only to entities that apply accrual basis IPSASs. The rationale for not applying requirements to jurisdictions and entities on the cash-basis may be that to do so would be onerous.

LONG-TERM FISCAL SUSTAINABILITY REPORTING
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(iii) *Reporting Entity for Long-Term Fiscal Sustainability Reporting*

The main issue is whether the requirements and guidance are to apply to all public sector entities; only entities at the national level, to the national whole-of-government level, to all levels of government combined, or to another level.

In this context, the project will consider the view that requiring individual entities to prepare and report information on the fiscal sustainability of operations is onerous and not proportionate to the benefit that users will derive from the information. It will also consider the view that only by developing requirements for all levels of government combined will user needs for information about the overall long-term fiscal sustainability of the public sector be satisfied – this particularly applies to nations with federalized structures, where the service delivery of significant public sector programs is the responsibility of entities at sub-national levels of government and where sub-national level entities have wide tax-raising powers.

National statistical accounting is used as the basis for long-term fiscal sustainability reporting in a number of jurisdictions. The project will therefore consider statistical accounting approaches and in particular whether the general government sector (GGS) may provide the appropriate reporting boundary for fiscal sustainability reporting. At a national level, the GGS encompasses all levels of government, as well as social security funds and non-market non-profit entities controlled by government units. At a jurisdictional level within a nation (for example, for a state government), the GGS is identified for that jurisdiction, and, in that instance, would have regard to whether control relationships exist. Under statistical accounting the public sector also comprises public financial corporations and public non-financial corporations. In contrast to the basis generally applied under accrual IPSAS, the GGS does not consolidate controlled entities outside the GGS sector and does not therefore eliminate balances and transactions between entities in the GGS and other sectors. It treats controlling interests in entities outside GGS as investments.

(iv) *Time Horizons*

In jurisdictions that make long-term fiscal sustainability reports publicly available there is variation in the time horizons adopted—the period over which projections are made. There is a relationship between the robustness of assumptions and the time horizon — the further the time horizon is from the reporting date the less robust and potentially less verifiable the assumptions become. Conversely, excessively short time horizons may increase the risk that events and modified trends just outside the reporting horizon might have a significant impact on reported information. The project will explore various time horizons and consider how prescriptive any reporting requirements should be.

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(v) *Regularity of Reporting*

Publication of the general purpose financial statements is, at a minimum, on an annual cycle. The project will examine whether the same frequency of reporting should be required or recommended for long-term fiscal sustainability reporting. Factors to be considered include the costs of reporting and the view that material policy assumptions, demographic assumptions and economic assumptions are often unlikely to change sufficiently rapidly within a year to justify the additional costs of annual reporting. Conversely, there is a view that material changes in policy assumptions can be quite common, especially for pensions and social security programs. This militates towards more regular reporting or at least more regular updating.

The project will consider whether there should be minimum intervals between reporting or whether any requirements should be more flexible, for example, requiring reporting intervals to be disclosed with any changes to those intervals since previous reports were produced.

(vi) *Assumptions and Sensitivity of Assumptions*

Fiscal sustainability reporting entails a range of assumptions. These assumptions include:

- Policy assumptions;
- Demographic assumptions; and
- Economic assumptions.

The term *policy assumptions* refers to the basis on which future levels of service delivery will be determined and the approach to taxation levels, including fiscal drag (see also the section on tensions with Current Legal Frameworks below).

Demographic assumptions include mortality and fertility projections, estimates of immigration and emigration and participation levels in the workforce and education.

Economic assumptions include productivity changes, unemployment rates and participation rates in education and the workforce, and real and nominal economic growth rates.

The project will consider whether the IPSASB should develop for the reporting of these assumptions used for long-term fiscal sustainability analysis.. Assumptions also include discount rates for projection models.

(vii) *Tensions with Current Legal Frameworks*

As a general principle IPSASs have adopted the tenet that transactions and elements are evaluated and determined within current legal frameworks. This is largely based on the view that the preparers of the financial statements should not predict governmental actions and that there should be no assumption that programs will discontinue unless legislation to that effect has been enacted at

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the reporting date. The project will consider whether such a principle is relevant for long-term fiscal sustainability reporting and whether a complementary approach for taxation inflows should be adopted, so that inflows should be determined using current legal requirements (including taxation rates) unless changes have been effected at the reporting date.

The project will consider approaches for reporting information on projections under current frameworks where different legal obligations conflict or where projections are clearly unreasonable. Examples might be where:

- There is a legal requirement for a balanced budget and that requirement cannot be met under existing expenditure projections unless expenditure is reduced, benefits changed, contributions and taxation raised or through extensive disposals of assets: should balanced budget requirements take precedence over entitlements determined under existing legal frameworks or predicted growth trends?; and/or
- Where a program is operated on a segregated fund basis and benefits cannot be paid once the fund's earmarked assets have been exhausted. If exhaustion of the fund is projected within the time horizon of the reporting framework; should that exhaustion be reflected in projections of outflows of benefits?

In many instances legal obligations cannot be discharged unless annual appropriations are in place; limiting projections to appropriations would result in very short time horizons. The relationship between ongoing spending commitments and appropriation mechanisms will therefore be examined.

(viii) Approach to Discretionary Programs

The project will explore possible approaches to reporting information on discretionary programs. Discretionary programs are programs that the government is not required to maintain under current legal requirements beyond a clearly specified date. Discretionary programs may be contrasted with mandatory programs that involve entitlements to individuals or households. Authorizations for discretionary programs may be renewed on an annual basis.

The main issue is whether expenditure projections should extend beyond the limit of current authorizations and, if so, how expenditure projections are to be projected for such programs. A related issue is that discretionary programs are likely to expire before the time horizons used for reporting. The project will therefore consider whether an assumption should be made that such programs will be renewed on expiry.

(ix) Financing

The project will consider the approaches to be taken to reporting information on estimates of financial resources (taxes and other revenue) available to fund the programs in question.

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(x) *Assurance and Verifiability*

The project will explore whether information reported on long-term fiscal sustainability can and should be assured and, if so, the possible levels of that assurance. It will explore the balance of responsibilities between preparers of fiscal sustainability reports in ensuring the verifiability of assumptions and auditors in providing any appropriate level of assurance.

4. **Implications for Specific Groups**

a) International Accounting Standards Board (IASB)

There is an indirect relationship with the IASB's Conceptual Framework project, although this is primarily addressed through the IPSASB's own Conceptual Framework project. The IASB also has a project on Management Commentary and issued a Discussion Paper in late 2005. In December 2007, the IASB decided to add a project on Management Commentary to its active agenda. While this project will primarily have an influence on the planned IPSASB project on Management's Discussion and Analysis (see below) it will be relevant indirectly to this project. In its Discussion Paper the authors of the IASB Discussion Paper proposed that, in addition to consideration of the key aspects of performance in the period covered by the financial statements, the Management Commentary should take a prospective view in considering the main trends and factors likely to affect an entity's future development, performance and position.

b) Relationship to other IPSASB projects in process or planned

There are relationships with a number of current or planned IPSASB projects:

(i) *Social Benefits*

The IPSASB has an ongoing project on social benefits. Key outputs from that project have been issued with this project brief. The IPSASB's deliberations on social benefits have been catalysts in the decision to initiate this project. The approach in ED 34, "Social Benefits: Disclosure of Cash Transfers to Individuals or Households" is intended as a bridge between accrual approaches and the development of approaches to long-term fiscal sustainability reporting.

(ii) *Conceptual Framework*

A project to develop a public sector conceptual framework is underway. This is led by the IPSASB and carried out in collaboration with certain national standard setters. The components of that project dealing with the objectives of financial reporting, the qualitative characteristics of financial information, the scope of financial reporting, the reporting entity, and the elements of financial statements are especially relevant to this proposed project.

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(iii) *Management's Discussion and Analysis (Management Commentary/Narrative Reporting)*

The IPSASB plans to initiate a project on Management's Discussion and Analysis (MD&A), also known as Management Commentary, narrative reporting or operating and financial review) in the first quarter of 2008. In some jurisdictions the MD&A or equivalent is the main means by which expected future trends and changing conditions to the operating environment and their potential impact on the reporting entity are highlighted. Both this project and the separate MD&A project will consider the extent to which the MD&A should include details, and indicators, of long-term fiscal sustainability.

c) Other projects

Reports on the long-term fiscal sustainability of governmental programs are made publicly available in a number of jurisdictions and supra-national bodies also make comparative analyses of the financial condition of nation states available: For example, the European Commission assesses comprehensively the sustainability of the public finances of each Member State of the European Union ever 4 years. This assessment is based on a common methodological framework to account for the budgetary risks of population ageing. It is partially updated every year when countries submit their medium-term budgetary plans ("stability and convergence programs").

Globally a number of public sector standard setters are considering or developing requirements for the reporting of aspects of long-term fiscal sustainability in the public sector:

- At the federal level, the Financial Report of the United States Government includes a Statement of Social Insurance (SOSI), which adopts a 75-year time horizon for specified programs;
- Also at the federal level the US Financial Accounting Standards Advisory Board (FASAB) has a Standard, SFFAS 17, "Accounting for Social Insurance (Revised 2006)", which provides requirements for the SOSI. FASAB is also developing a Standard, providing requirements for broader fiscal sustainability reporting;
- At the state, local and municipal level, the US Governmental Accounting Standards Board has a project on economic condition;
- The Canadian Public Sector Accounting Board has a project on indicators of financial condition, which is developing guidance in the form of a statement of recommended practice; and
- Other standard setters have projects considering prospective information and narrative reporting.

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5. Development Process, Project Timetable and Project Output

a) Development process

The development of outputs will be subject to the IPSASB's formal due process. The issuance of documents for public comment will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm the nature of the outputs and the proposed path in the project timetable. .

The initial output will be a Consultation Paper. Following analysis of submissions on the Consultation Paper a decision will be made on whether to develop an Exposure Draft of a Standard and/or Guidance. Any Exposure Draft will also be subject to formal due process, including a consultation period of at least four months.

Project timetable

2007	
November	Project approved
2008	
February-March	Task Force selected and confirmed
February-March	Project brief finalized
March	Update to Meeting of IPSASB
March-September	Task Force develops Consultation Paper under oversight of Task Force
June	Update to Meeting of IPSASB
October	IPSASB reviews first draft of Consultation Paper
2009	
February	IPSASB reviews second draft of Consultation Paper and approves for publication
March	Publication of Consultation Paper
March-July	Exposure period for Consultation Paper
August-September	Staff analysis of submissions on Consultation Paper
September	Briefing for staff of International Auditing and Assurance Standards Board (IAASB) on assurance implications.
October	IPSASB considers analysis of submissions on Consultation Paper and adopts approach for final stage of project
2010	
February	IPSASB reviews first draft of Exposure Draft (ED) of an IPSAS and/or guidance
June	IPSASB approves ED and/or guidance
July	ED and/or guidance issued
July-November	Exposure period for ED and/or guidance
2011	
February	IPSASB considers analysis of submissions to ED/Guidance and provides directions for finalization of final stage outputs
June	IPSASB approves IPSAS and/or Guidance

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(b) Project output

The initial output will be a Consultation Paper. As indicated above definitive final outputs will be determined following analysis of submissions on the Consultation Paper. Further final outputs may be a Standard and/or detailed Guidance.

6. Resources Required

a) Task Force

A task force of 8-10 (including Chair) is to be established – a task force of this size is necessary to reflect a broad cross section of IPSASB constituents and to enable a range of points of view, technical expertise and discussion for the development of this project.

Selection of task force members will be made by the Technical Director and IPSASB Chair.

Communication will be primarily carried out electronically. The majority of meetings are expected to be by conference call. It is expected that there will be at least two face-to-face meetings.

It is the current intention that all project materials will be developed by IPSASB staff.

b) Staff

It is envisaged that 0.75 Full Time Equivalent (FTE) resource (not dedicated) will be required to resource the project.

7. Important Sources of Information that Address the Matter being Proposed

- A number of governments and supra-national bodies publish reports on the long-term fiscal sustainability of programs;
- A number of standard setters have developed, are developing or refining existing requirements and guidance for long-term fiscal sustainability reporting or financial condition;
- A number of standard setters are developing approaches to public sector narrative reporting;
- Some standard setters have developed, or are in the process of initiating development, of requirements for prospective reporting; and
- Some auditors are reporting on financial condition.

8. Factors that might add to complexity or length

The project addresses a large subject in an area which is outside the general-purpose financial statements. This is a new topic for the IPSASB and there are few current pronouncements and therefore limited relevant experience to draw on. Decisions made following analysis of the initial consultation paper will also affect the length of the project, in particular whether it is decided to develop both requirements and guidance.