



INTERNATIONAL FEDERATION  
OF ACCOUNTANTS

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## Agenda Item 5

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Date: June 2<sup>nd</sup> 2011  
Memo to: Members of the IPSASB  
From: John Stanford and Ian Carruthers  
Subject: Reporting on the Long-Term Sustainability of Public Finances

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### Objectives

1. The objectives of this session are:
  - To consider key issues related to the preliminary draft Exposure Draft (ED) of the Recommended Practice Guideline (RPG), *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances* identified in this memorandum and to highlight other issues; and
  - To review the preliminary draft ED and provide directions for further development.

### Agenda Material

- 5.1 Preliminary Draft ED of an RPG, *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*.

### Background

2. The genesis of the project, "Reporting on the Long-Term Sustainability of Public Finances" was in the IPSASB's long-running project on Social Benefits. The IPSASB formed a view that, regardless of the difficulties is establishing the point at which liabilities arise for social benefits, the general purpose financial statements do not provide users with all the information that they need for accountability and decision-making purposes. Following public exposure of a project brief the IPSASB therefore decided to initiate a further project dealing with the presentation of information on long-term fiscal sustainability in general purpose financial reports and to use this project as a test bed for the 'more comprehensive scope' topics that it was proposed should be within the scope of financial reporting in the Conceptual Framework document CF-CP-1 and subsequently CF-ED-1.
3. The Consultation Paper (CP), *Reporting on the Long-Term Sustainability of Public Finances*, was issued in late November 2009. 32 responses were received to the CP. A summary and analysis of those responses was discussed at the Vienna meeting in June 2010. At the Vienna meeting the IPSASB decided in principle to proceed with the project with a view to developing non-mandatory guidelines. It was tentatively agreed that such a document should be termed a

- “Recommended Practice Guideline”. At the Jakarta meeting in November 2010 IPSASB further considered a number of key issues identified at consultation and reviewed a very high level outline structure for the RPG. Members agreed that the Task Force on Long-Term Fiscal Sustainability chaired by Ian Carruthers should oversee development of a preliminary draft ED of the RPG to be brought to this meeting.
4. The Task Force met in Paris in March 2011 prior to the IPSASB meeting and considered a further outline bullet point summary of a proposed ED. Based on their comments Staff developed a preliminary draft ED and this was circulated to the Task Force in May 2011. The Task Force held a teleconference at the end of May when it considered this preliminary draft ED. Due to other commitments many Task Force members were unable to attend this teleconference, although some submitted written comments. Most of the comments made by Task Force members have been addressed in the version on the agenda for this meeting and some of the most significant points are discussed in the Key Issues section.

### Key Issues

5. The key issues considered in this memorandum are:
- Overall Approach and Structure
  - Scope and Status
  - Definitions
  - Key Dimensions of Sustainability
  - Effective Date
  - Approach to Illustrative Examples

### Overall Approach and Structure

6. As indicated above, the overall structure of the version at Agenda Item 5.1 reflects comments made by members of the Task Force. In particular the current positioning the section ‘Key Dimensions of Fiscal Sustainability’ has been elevated to follow the section on Reporting Entity, because it sets the scene for the following sections. The section on ‘Disclosure of Principles and Methodologies’ reflects the view in the Consultation Paper that the IPSASB should not be prescriptive on approaches, but that it is good practice to disclose key principles and methodologies.

#### Action Required

Members are asked to **consider** whether the current approach and structure is appropriate and to **provide** directions for further development.

## Status and Scope

7. In accordance with directions at the Jakarta meeting the ED does not propose requirements. It therefore does not follow the approach in IPSAS 22, *Disclosure of Financial Information about the General Government Sector*, and IPSAS 24, *Presentation of Budget Information in Financial Statements*, that entities need not report on a particular information area, but, if they elect to do so, they are required to follow the approach in the IPSAS.
8. One of the Task Force members considered that the discussion in paragraph BC5 indicating why the IPSASAB considers this an important area, suggested that reporting on the long-term sustainability of an entity's finances should be required. In order to address this point the rationale for adopting a non-mandatory approach is provided in paragraph BC6.
9. Paragraph 3 acknowledges that reporting on the long-term sustainability of their finances may not be appropriate for all public sector entities and directs entities to other sections of the draft ED in determining whether they will present information in this area. In particular the ED reflects the view put forward at the 2011 Vienna meeting that the decision on whether to report on the long-term sustainability of an entity's finances should be based on an evaluation of whether there are users for such information, rather than by establishing rules such as that controlled entities or entities at particular levels of government should not report information on the sustainability of their finances. Therefore paragraph 23 provides guidance that there may be occasions where controlled entities, such as local governments, would decide to report on the long-term sustainability of their finances.

### Action Required

Members are asked to **consider** the section of the draft ED dealing with Status and Scope and to **indicate** any areas which should be amended and **provide** any directions for further development.

## Definitions

10. The ED uses the same definition of 'long-term fiscal sustainability' as the working definition in the Consultation Paper. At the time that the Consultation Paper was approved, it was considered that this definition balances the service delivery commitments of public sector entities and their obligations relating to entitlement programs with their financial obligations to those holding debt and other creditors.
11. The IPSASB acknowledged that some professional groups such as macro-economists use a more rigorous definition of fiscal sustainability that focuses on projected debt paths; an entity that can only maintain current service delivery

- levels and meet entitlement obligations by raising taxation or levels of current debt levels would be considered unsustainable. Paragraphs BC10 acknowledges these views and paragraph BC11 explains the IPSASB's decision to retain the definition in the Consultation Paper, while suggesting that entities which give sufficient attention to the key dimensions of fiscal sustainability discussed in paragraphs 15-19, will provide adequate information that that an entity cannot maintain existing service levels, meet obligations to the current and future beneficiaries of entitlement programs and meet financial obligations without increasing taxation or increasing borrowing.
12. The terms 'presentation', 'display' and 'disclosure' have been defined in accordance with the current approach in Phase 4 of the Conceptual Framework. Staff considers that this is appropriate given the intention to use the project as a test bed for the Conceptual Framework project. The term 'economic condition' has been defined as 'an assessment starting with financial position that takes into account all projected inflows and outflows over the specified time horizon'. In response to a view from the Task Force that this definition is too narrow, paragraph 6 highlights some of the factors that may need to be considered in assessing 'economic condition'. The term 'economic condition' has been used by the Governmental Accounting Standards Board GASB, whereas both the Federal Accounting Standards Advisory Board and the Public Sector Accounting Standards Board (PSAB in Canada have used the term 'financial condition' for a broader assessment of an entity's financial health. Staff does not have a strong preference, but, on balance, thinks that the term 'economic condition' may be less easily confused with 'financial position', which is derived from the statement of financial position.

#### Action Required

Members are asked to **consider** the definitions in paragraph 6 and **propose** any necessary changes or additions.

#### Key Dimensions of Sustainability

13. The Consultation Paper highlighted the key dimensions of sustainability developed by Allen Schick of the Organisation for Economic Cooperation and Development. The Consultation Paper also noted the 'components' of economic condition developed by the GASB. Since the Consultation Paper was issued Staff has also considered the 'elements' included in the PSAB's Statement of Recommended Practice 4, *Indicators of Financial Condition*, which was issued in 2009.
14. The Staff view is that such dimensions/elements/components provide an organizing framework, which is helpful to entities in ensuring that the presentation of information on the sustainability of their finances is comprehensive and therefore meets the qualitative characteristic of faithful representation. Staff considers that the notion of 'vulnerability' developed

by PSAB is particularly relevant for entities at sub-national levels with limited tax-generation powers, which are dependent for significant levels of funding from entities at other levels of government. ‘Vulnerability’ is explained in paragraph 18 of the ED and the rationale behind this dimension in paragraph BC 12.

#### Action Required

Members are asked to **consider** the key dimensions of fiscal sustainability, **indicate** whether the dimensions and the discussion in the ED are appropriate and provide directions for further development.

#### Effective Date

15. The ED contains an effective date in paragraph 48 whereby the RPG will take effect 18 months after issuance with a strong encouragement for earlier implementation if feasible. While it is questionable whether an effective date is warranted as an RPG is voluntary the Task Force Chair and Staff consider that the insertion of an effective date lends weight to the view that the RPG conveys good practice.

#### Action Required

Members are asked to **consider** (a) whether an effective date is necessary and , if so (b) whether 18 months after issuance is appropriate.

#### Approach to Illustrative Examples

16. The ED is a concise document that does not contain illustrative examples. Some Task Force members considered that, although it is straightforward and to the point, the document’s tone is rather dry and that some examples might make it more readable, especially the section on ‘Methods of Communicating Information on Fiscal Sustainability’.
17. There are two approaches to addressing this concern. The first is to incorporate examples in the document itself, either in the body of the text or in an Appendix. The second is to provide links to examples of existing practice. The Task Force Chair and Staff generally prefer the second approach. The creation of new examples for insertion in the document itself would probably create a template, which would be at odds with the aim of encouraging flexible and innovative reporting, while the broad scope of the ED, might require the development of numerous examples to cover a range of entities with different characteristics. For example, time horizons for relatively small local government

entities are unlikely to be the same as for a national whole-of-government reporting entity. Links to existing practice could be included on the IPSASB section of the IFAC website when the ED is issued.

**Action Required**

Members are asked to **consider** the approach to illustrative examples and to **indicate** whether they support the view of the Task Force Chair and Staff that readers should be directed to examples of existing practice by website links.

*Proposed Recommended Practice Guideline*

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**Reporting on the Long-Term  
Sustainability of a Public  
Sector Entity's Finances**

**REQUEST FOR COMMENTS**

The International Public Sector Accounting Standards Board (IPSASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved for publication in September 2011 this Exposure Draft, *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*.

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by January 31, 2012.**

Respondents are asked to submit their comments **electronically** through the IFAC website ([www.ifac.org](http://www.ifac.org)), using the "Submit a Comment" link on the Exposure Drafts and Consultation Papers page. Please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the IFAC website. Although IFAC prefers that comments be submitted electronically, e-mail may be sent to [stepheniefox@ifac.org](mailto:stepheniefox@ifac.org). Comments can also be faxed to the attention of the IPSASB Technical Director at +1 (416) 204-3412, or mailed to:

The Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West, 6th Floor  
Toronto, Ontario M5V 3H2 CANADA

Copies of this Exposure Draft may be downloaded free-of-charge from the IFAC website at [www.ifac.org](http://www.ifac.org).

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ISBN:



## **Objective of the Exposure Draft**

The objective of this Exposure Draft (ED) is to provide guidance on reporting on the long-term sustainability of an entity's finances in order to supplement the statement of financial position and meet the objectives of financial reporting—accountability and decision-making.

## **Guide for Respondents**

The IPSASB would welcome comments on all the proposals in the Exposure Draft. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for proposed changes to the ED.

### **Specific Matters for Comment**

The IPSASB would particularly value comments on the Specific Matters for Comment below.

#### **Specific Matter for Comment 1**

Do you agree with the advice on the considerations that an entity should take into account in deciding whether to report on its long-term fiscal sustainability? If not how would you modify them?

#### **Specific Matter for Comment 2**

Do you agree that the core information presented will be projections of inflows and outflows commencing in the current reporting period for a period specified by the reporting entity? If not, why not?

#### **Specific Matter for Comment 3**

Do you agree that the “dimensions” of long-term fiscal sustainability provide a viable framework for reporting on the long-term sustainability of an entity's finances? If not, how would you modify this approach?

#### **Specific Matter for Comment 4**

Do you agree with the guidelines on disclosure of principles and methodologies? If not, how would you modify this approach?

**September 2011**

**ED 46 REPORTING ON THE LONG-TERM  
SUSTAINABILITY OF A PUBLIC SECTOR ENTITY'S  
FINANCES**

**CONTENTS**

	Paragraph
Objective.....	1
Scope.....	2–5
Definitions .....	6–9
Reporting Entity.....	10–14
Key Dimensions of Fiscal Sustainability .....	15–19
Relationship with Objectives, Qualitative Characteristics and Scope of Financial Reporting .....	20–26
Reporting Projections of Prospective Inflows and Outflows .....	27–29
Methods of Communication Information on Fiscal Sustainability .....	30–33
Disclosure of Principles and Methodologies.....	34–47
Updating of Projections and Frequency of Reporting.....	35
Current and Future Policy.....	36–38
Approach to Revenue Flows.....	39
Demographic and Economic Assumptions .....	40
Approach to Age-Related and Non-Age-Related Programs .....	41
Impact of Legal Requirements and Policy Frameworks .....	42–43
Discount Rates .....	44
Sensitivity Analysis .....	45
Reliability of Projections .....	46–47
Effective Date .....	48
Appendix A: Glossary of Indicators	
Basis for Conclusions	

## **Objective**

1. This Recommended Practice Guideline (RPG) provides advice on the approach to reporting on the long-term sustainability of the finances of an entity when an entity reports on this information area. The aim of reporting on the long-term sustainability of public finances is to provide an indication of the economic condition of the reporting entity over a specified time horizon in accordance with transparent assumptions.

## **Status and Scope**

2. This RPG does not have the status of an International Public Sector Accounting Standard (IPSAS). However, the provision of information in accordance with this RPG represents good practice.
3. This RPG potentially applies to all public sector entities, except Government Business Enterprises (GBEs). In assessing whether it is appropriate for an entity to report on the long-term sustainability of its finances an entity may consider the factors outlined in the sections on the Key Dimension of Sustainability and Relationship with Objectives, Qualitative Characteristics and Scope of Financial Reporting.
4. As stated in paragraph 3 this RPG does not apply directly to GBEs. The prospective inflows and outflows related to GBEs over a pre-determined time horizon that affect the reporting entity are within the scope.
5. This RPG does not deal directly with environmental sustainability. However, it is important that the fiscal impact of environmental degradation is taken into account in making projections and assessing the long-term fiscal sustainability of an entity.

## **Definitions**

6. The following terms are defined in this RPG:

**Long-Term Fiscal Sustainability** is the ability of an entity to meet service delivery and financial commitments both now and in the future.

**Financial position** is the difference between all assets and all liabilities at the reporting date (net assets/liabilities).

**Economic condition** is an assessment starting with financial position and taking into account all projected inflows and outflows over the specified time horizon.

**Inflows** are cash and cash equivalents projected to come under the control of the reporting entity over the time horizon of the projections.

**Outflows** are cash and cash equivalents over which the reporting entity cedes control over the time horizon of the projections.

**Presentation** is the communication of information by display or disclosure.

**Display** is the communication of information by a statement.

**Disclosure** is the communication of information by means other than a statement.

7. This RPG distinguishes financial position and economic condition. Financial position is derived from information in the general purpose financial statements (hereafter the financial statements). Economic condition is a broader assessment that takes into account projected inflows and outflows over a pre-determined time horizon. Economic condition takes into account obligations related to decisions made by the reporting entity on or before the reporting date that do not meet the definition and/or recognition criteria for liabilities and future taxation receipts that are not recognized as assets.
8. Assessments of economic condition involve the use of a broad range of data. These data include financial and non-financial information about current economic and demographic conditions, assumptions about national and global trends such as productivity and the relative competitiveness of the national or local economy and expected changes in demographic variables such as age, longevity, gender, educational attainment, morbidity and income.
9. Information on the long-term sustainability of an entity's finances may be communicated by display in a statement and by other disclosure methods such as narrative reporting and graphs. Paragraphs 30-33 discuss presentation.

## **Reporting Entity**

10. The reporting entity for the presentation of projections and the discussion of economic condition is the same as for the financial statements.
11. In the event that entities within the reporting boundary for the financial statements are not included in the presentation of the long-term sustainability of the entity's finances it is important that users are made aware of those entities and, where possible, the estimated impact of their exclusion from projections.
12. Conversely, users need to be informed if presentation of the long-term sustainability of the entity's finances includes entities that are not within the reporting boundary for the financial statements.

13. At the consolidated national or whole-of-government levels it may be considered appropriate to disclose information based on the General Government Sector (GGS), as defined in the System of National Accounts (SNA). This may be to enhance consistency and comparability with other jurisdictions and also because the majority of indicators that are used to assess fiscal sustainability at the consolidated national level are based on the GGS. Where such disclosures are made it is important that an explanation is provided of how the boundary of the GGS differs from that of the reporting entity. Entities providing information on the GGS are encouraged to also present information in accordance with IPSAS 22, *Disclosure of Financial Information about the General Government Sector*.
14. For accountability reasons it may be considered appropriate to disclose information on the budget sector. In such cases it is important that an explanation is provided of how the boundary of the budget sector differs from that of the reporting entity.

### **Key Dimensions of Fiscal Sustainability**

15. It is important that the presentation of information on the long-term sustainability of an entity's finances is faithfully representative of that entity's economic condition. Faithful representation can be satisfied by considering the adequacy of information presented along three inter-related dimensions of fiscal sustainability:
  - Fiscal capacity;
  - Service capacity; and
  - Vulnerability.
16. *Fiscal capacity* is the ability of an entity to meet financial obligations, such as the servicing and repayment of debt and liabilities to creditors, on a continuing basis over the period of the projections without increasing the tax burden and without increasing the level of net debt.
17. *Service capacity* is the extent to which (a) the entity can maintain services at the volume and quality provided to current recipients at the reporting date and (b) meet obligations related to entitlement programs for current and future beneficiaries without increasing the tax burden and without increasing the amount of net debt.
18. *Vulnerability* is the extent to which an entity is dependent upon funding sources outside its control, principally inter-governmental transfers. This dimension also addresses the extent to which an entity has powers to vary existing taxation levels and to create new sources of taxation or terminate existing sources. It is important to identify the entities on which the reporting entity is dependent.

Generally, an entity that is highly vulnerable is likely to have limited control over its economic condition.

19. Both *fiscal capacity* and *service capacity* involve the consideration of stable taxation, which is the capacity of entities to finance the future obligations identified within the fiscal capacity and service capacity dimensions without increasing the tax burden.

## **Relationship with Objectives, Qualitative Characteristics and Scope of Financial Reporting**

20. As stated in paragraph 2 all public sector entities are potentially within the scope of this RPG with the exception of GBEs. In assessing their approach to reporting on the long-term sustainability of their finances entities are likely to consider the extent to which they can rely on the projections made by other governmental bodies such as ministries of finance, rather than making the projections themselves. Where appropriate, reliance on projections made by other bodies can reduce the cost of reporting on the long-term sustainability of the entity (see also paragraph 14).
21. This RPG presumes that fiscal sustainability reporting will be relevant at the whole-of-government level, consolidated national level, and for major sub-national entities such as regions, provinces, states and very large cities and municipalities.
22. It may not be appropriate for all entities to report on the long-term sustainability of their finances. In evaluating whether to report on this information area entities need to assess whether users exist for prospective financial information and whether the benefits of such reporting are commensurate with the costs.
23. The extent to which fiscal sustainability reporting is relevant for controlled entities may vary. Entities such as local government units controlled by an entity at another level of government, such as a state, province or regional government may identify users for information on the sustainability of their finances even if they are dependent upon inter-governmental transfers for the majority of their funding. If such users are identified an entity can demonstrate accountability and enhance the decision-making capabilities of users by providing information on the long-term sustainability of its finances.
24. Conversely, reporting on the sustainability of their finances is unlikely to be to be relevant for individual government departments with no revenue generation powers that are funded through budgetary appropriations. Providing long-term projections on such entities may be misleading

because they have no control over their funding. In many jurisdictions the configuration of government departments can change quite regularly as a result of modifications in ministerial portfolios both following elections and in the period between elections.

25. Entities that are dependent upon funding that is outside their control need to ensure that reporting along the “vulnerability” dimension described in paragraph 26 is given adequate emphasis. A failure to give sufficient emphasis to “vulnerability” enhances the risk that information will not meet the qualitative characteristics of relevance and faithful representation.
26. It is important to highlight any legal provisions that have been enacted before the publication of projections that will have an impact on economic condition. However, it is not the purpose of a general purpose financial report (GPFR) on the long-term sustainability of an entity’s finances to provide a detailed policy statement of how a government or governing body may intend to address a fiscal challenge in the future. Such statements and reports may provide useful information for users of GPFRs, but they are not within the scope of financial reporting because they have not been enacted into law and do not meet the qualitative characteristic of verifiability.

## **Reporting Projections of Prospective Inflows and Outflows**

27. The core information presented will be present value projections of inflows and outflows commencing in the current reporting period for a period selected by the reporting entity and explained in disclosures. The length of this period will reflect the characteristics of the reporting entity and is likely to be affected by aspects such as the longevity of key programs, the extent to which an entity has its own revenue generation powers, the estimated lives of major infrastructure assets and the time horizons adopted by other government bodies and agencies providing prospective information. An entity with limited revenue generation powers is likely to adopt a shorter time horizon than an entity with more extensive powers..
28. Reporting on the long-term sustainability of the public finances may be considered a continuum. It is important that projections begin with the cash flows related to the settlement of liabilities and cash-generating assets recognized in the statement of financial position of the entity. Projections will then address short-term solvency, including cash flows related to obligations and powers not recognized as liabilities and assets in the statement of financial position and finally obligations and inflows that may not be settled for many years.
29. In selecting an appropriate time horizon an entity needs to balance the qualitative characteristics of verifiability and faithful representation. The further the time horizon is from the reporting date the more future events are captured. However, the assumptions underpinning the projections become less robust and potentially

less verifiable. Conversely, excessively short time horizons may increase the risk that the consequences of events outside the time horizon may be ignored thereby reducing the relevance of projections.

### **Methods of Communicating Information on Fiscal Sustainability**

30. The core information will probably be annual cash inflows and outflows during the projection period. Such data can be displayed in graphical or tabular formats providing details of the activities and programs giving rise to outflows and the sources of inflows. In determining the format of such tabular statements entities need to balance considerations of understandability and relevance. Multi-columnar presentation of a large number of points between the reporting date and the end of the time horizon risks will provide a more complete information set, but risks information overload and the impairment of understandability. Conversely, a focus on financial condition at a very small number of future points may neglect trends arising from key events between those points. It is good practice to display a supplementary statement that shows the changes in projections between reporting dates.
31. The considerations in paragraph 28 mean that one communication approach is unlikely to satisfy the objectives of financial reporting. Statements will need to be complemented by additional presentational methods involving a combination of narrative reporting, graphical presentation and the use of indicators. Examples of indicators include:
  - (a) Gross debt;
  - (b) Net debt;
  - (c) Net worth;
  - (d) Net financial worth;
  - (e) Fiscal gap;
  - (f) Inter-temporal budget gap; and
  - (g) Fiscal dependency.
32. Working definitions of these indicators are provided in the Glossary of Indicators at Appendix A.
33. Graphical disclosure may be more understandable than lengthy narrative discussion. However, there is a risk that graphical disclosure can be skewed to present a misleadingly favorable picture. It is therefore important that formats are consistent between reporting periods and that modifications of formats are highlighted and explained.



## **Disclosure of Principles and Methodologies**

34. It is important that the basis of preparation of projections is clear. This means that the principles, assumptions and approaches to methodology that underpin the projections are transparent. This section discusses:
- Updating of projections and frequency of reporting;
  - Current and future policy;
  - Approach to revenue flows;
  - Demographic and economic assumptions;
  - Approach to age-related and non-age-related programs;
  - Impact of legal requirements and policy frameworks;
  - Discount rates;
  - Sensitivity analysis; and
  - Reliability of projections.

## **Updating of Projections and Frequency of Reporting**

35. It is important that users are aware of the date at which a full set of projections was made and of the basis and timing of subsequent updating. At the national level the Organisation for Economic Cooperation and Development (OECD) has recommended that projections should be updated on an annual basis. This RPG acknowledges that annual updating may not be realistic for all entities, particularly those at sub-national levels, which may be undertaking projections for the first time. However, there is clearly an inverse relationship between the robustness of assumptions on which projections are made and the elapse of time since they were made. During periods of global financial volatility the risk that projections made some time before the reporting date are outdated increases, with a consequent reduction of the ability of such information to meet the objectives of accountability and decision-making.

## **Current and Future Policy**

36. This RPG adopts the view that, where flows for particular programs and activities are individually modeled, information is most useful if it is assumed that current policy continues. There can be tensions if (a) there is a conflict in legal obligations or (b) if current programs have “sunset provisions.” For example a social security program may be governed by legal provisions that it is unlawful to incur expenditures once an earmarked fund is exhausted, although entitlements of beneficiaries will continue after the exhaustion of the fund. Assuming that the fund will not meet obligations once it is exhausted might

reflect a strict legal position, but preparers may need to assess whether the presentation of projections on such a basis underestimates the extent of the fiscal challenge facing the social security program.

37. Some programs have “sunset” provisions whereby they terminate after a specific period. In many cases there may be a strong probability that such programs will be replaced by similar programs, so adopting a strict legal termination principle may lead to an underestimate of outflows, which impairs the usefulness of information. It is therefore important that the approach to any legal conflicts and sunset provisions is disclosed.
38. For flows that are not individually projected, the distinction between current and future policy is unlikely to be critical to the projections and it may be sufficient to disclose general assumptions.

### **Approach to Revenue Flows**

39. It is important that the main sources of taxation and other revenue flows, such as inter-governmental transfers, are identified, together with their significance to an entity’s revenue sources. Taxation flows may be projected to grow in line with gross domestic product or an inflation index or may be individually modeled using a more sophisticated approach. Users need to be informed of the approach and of any relevant considerations relating to tax banding, allowances and thresholds.

### **Demographic and Economic Assumptions**

40. It is good practice to disclose the key assumptions that underpin projections. These are likely to include economic growth rates, demographic assumptions such as fertility, mortality and migration rates and workforce participation rates. This disclosure may extend to environmental factors, such as the impact of the depletion and degradation of ecosystems and the erosion of water and finite natural resources on economic growth.

### **Approach to Age-Related and Non-Age-Related Programs**

41. Age-related programs are programs with eligibility criteria including age and other demographic factors. In making projections programs and activities that are age-related may be distinguished from non-age related programs. Age-related programs may be individually modeled while non-age-related programs may be projected to increase in line with other variables, such as GDP, or to be constant in real terms. Such an approach to non-age-related programs provides some flexibility, as it allows above GDP/real terms increases in some activities and programs to be offset by lower increases or spending declines in other areas. It is important that (a) an entity identifies its major age-related programs and provides details of

how projections are made and (b) indicates how projections are made for other non-age-related-programs.

### **Impact of Legal Requirements and Policy Frameworks**

42. In some jurisdictions reporting on the long-term sustainability of the public finances is governed by a legal or regulatory framework that applies at the national level. There may also be legal requirements at sub-national levels. These might include balanced budget requirements. Making users aware of the key aspects of governing legislation and regulation can enhance the understandability of projections and other disclosures. Consideration can also be given to providing details of where other publicly available reports can be accessed.
43. It is also important to provide users with sufficient information on underlying macro-economic policy and fiscal frameworks. These might include references to other documents outside the GPFRs.

### **Discount Rates**

44. Projections are likely to involve the application of discount rates. Entities are advised to (a) disclose the discount rates applied, (b) the reason for their selection, (c) any changes in discount rates since the last reporting date, and (d) the reason for such changes.

### **Sensitivity Analysis**

45. The demographic and economic assumptions on which projections are based are inherently uncertain. In some cases small changes in variables can have significant impacts on the projections. While it is unlikely to be appropriate in a GPFR for an entity to provide sufficient data to enable users to remodel projections by modifying assumptions it is important that users are made aware of (a) the sensitivity of demographic and economic assumptions and (b) at a high level the results of any key sensitivity analyses.

### **Reliability of Projections**

46. Users need to be made aware that that it is unlikely that projections over the time horizon will match the actual outcome, and that the extent of the difference between the projections and actual outcomes will depend upon the future actions of the entity in meeting any identified fiscal challenge. The projections need to be reasonable and realistic and the assumptions on which they are based supportable. The projections are not forecasts and it is helpful to emphasize to users, who may not be familiar with the reporting of this kind of prospective information, that they are not subject to the same materiality considerations as the historically based financial statements and do not purport to provide accurate future predictions.

47. There are a variety of approaches that entities may take to enhance the reasonableness and realism of projections. These include formal assurance by an external auditor and peer review by independent experts. It is good practice to disclose the steps that have been taken to ensure that key assumptions underpinning projections are realistic and that such assumptions are internally consistent.

### **Effective Date**

48. This RPG takes effect on MM DD YY (18 months after issue). Earlier implementation is strongly encouraged if systems to provide the information are in place.

## **Appendix A**

### **Glossary of Indicators**

**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 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 percentage 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.

## **Basis for Conclusions**

### **Background**

- BC1. The IPSASB initially launched a project on accounting for social policy obligations (subsequently re-termed social benefits) in 2002. This led to the publication of an Invitation to Comment (ITC), *Accounting for Social Policies of Government*, in November 2003. Following an analysis of responses to that ITC, the IPSASB began to develop proposals for accounting for obligations related to different sub-categories of social benefits. In late 2006, due to failure to agree on recognition points and measurement requirements for liabilities, the IPSASB decided not to develop further proposals on recognition and measurement.
- BC2. As an interim step the IPSASB developed proposals for the disclosure of amounts to be transferred to those eligible at the reporting date for cash transfers (benefits settled in cash). It expressly did not require the disclosure of liabilities. ED 34, *Social Benefits: Disclosure of Cash Transfers to Individuals or Households* was issued in March 2008.
- BC3. The deliberations on identifying the point at which liabilities for social benefits arise had led the IPSASB to the view that the financial statements cannot provide all the information that users need on social benefits. The IPSASB considered that before launching any further project it should consult constituents. Therefore the IPSASB raised this issue in a further Consultation Paper, *Social Benefits: Issues in Recognition and Measurement* and issued a Project Brief, *Long-Term Fiscal Sustainability Reporting*. Both these documents were issued at the same time as ED 34.
- BC4. In October 2008 the IPSASB reviewed responses to all of the above documents. In the light of these responses, it was decided not to develop ED 34 into an IPSAS. The IPSASB also noted that a large majority of respondents agreed that the financial statements cannot convey sufficient information about the financial condition of governmental programs providing social benefits. In light of this view the IPSASB decided to initiate a project on long-term fiscal sustainability (subsequently re-termed “Reporting on the Long-Term Sustainability of Government Finances”). This led to the issue of a Consultation Paper, *Reporting on the Long-Term Sustainability of Public Finances* in November 2009. Drawing on existing practice the Consultation Paper put forward the case for reporting on the long-term sustainability of the public finances, made suggestions as to how information on long-term fiscal sustainability might be presented and sought the views of constituents. The majority of respondents to the Consultation Paper favored the continuation of the project, although many said that they preferred the IPSASB to develop guidelines rather than requirements.

- BC5. The IPSASB has further developed its thinking on the long-term sustainability of the public finances in the course of its project on the Conceptual Framework. In particular the IPSASB has noted that projected outflows relating to obligations as a result of past decisions and projected inflows related to sovereign powers and taxation powers may not be recognized or may only be partially recognized in the statement of financial position and the statement of financial performance. Therefore, in order to meet the objectives of accountability and decision-making, users need information on prospective inflows and outflows relating to past decisions at the reporting date in order to complement information on the entity's financial position in the financial statements. Phase 1 of the IPSASB's project has considered the scope of financial reporting and proposed that, although the financial statements are at the core of financial reporting, a more comprehensive scope is necessary to meet the needs of users.
- BC6. The IPSASB acknowledges that the rationale for long-term fiscal sustainability reporting in paragraph BC5 might indicate that for some entities such reporting should be required. The IPSASB concluded that it would be premature to issue an IPSAS, because (a) reporting on long-term fiscal sustainability in the GPFRs is an area where practice is developing, (b) reporting entities need to exercise judgment as to whether such reporting is warranted and (c) where entities cannot use projections developed by other bodies the costs can be considerable.

### **Scope of this RPG**

- BC7. The IPSASB considered whether the scope of the RPG should be limited to the consolidated national and whole-of-government levels. The IPSASB acknowledged that reporting on the long-term sustainability of the public finances is particularly relevant at these levels, but concluded that such reporting may be highly useful at sub-national levels and therefore that a narrow scope limited to the national and whole-of-government levels is not justified.
- BC8. The Consultation Paper questioned whether reporting on the long-term sustainability of its finances is appropriate for individual controlled entities. This reservation was based on a tentative view that (a) the cost of producing the information for such entities is likely to be greater than the benefits to users, (b) the production of separate reports and disclosures by individual entities within an economic entity might be confusing to users and (c) it could be misleading if entities with limited tax-raising powers and a dependency for resources on entities at other tiers of government provide projections that are dependent on taxation decisions over which they have little or no control. Some respondents challenged this view and suggested that there are cases where users for information on the economic condition of controlled entities can be identified. The example of a local government entity controlled by a state or provincial government was cited. These respondents proposed that the test for whether an entity provided information on the long-term sustainability of its finances should be whether it had identified users

for this type of information. The IPSASB was persuaded by these arguments and the ED reflects these views in paragraph 16.

- BC9. The IPSASB remains of the view that reporting on the long-term sustainability of their finances is unlikely to be appropriate for individual government departments. This is because of their funding through appropriations and the fact that, in many jurisdictions, government departments are subject to frequent changes after elections or when ministerial portfolios are amended.

### **Definitions**

- BC10. The Consultation Paper noted that there is no universally accepted definition of long-term fiscal sustainability and included a working definition that long-term fiscal sustainability is “the ability of government to meet its service delivery and financial commitments both now and in the future.” The IPSASB acknowledged the view that this definition is insufficiently rigorous and that a definition should be adopted that provides users with a clearer indication whether an entity’s current economic position is sustainable. Such an approach might involve linking current service delivery levels and the settling of obligations relating to entitlement programs to the maintenance of current taxation levels and (b) focusing on projected debt paths, so that an entity that can only maintain current service delivery levels and meet entitlement obligations and financial obligations by increasing taxation or current debt levels is identified as being in an unsustainable position. Macroeconomists tend to adopt this more rigorous approach and focus on “explosive” debt paths, which is a term that connotes that existing service levels and existing benefits from entitlement programs cannot be sustained without major increases in levels of indebtedness.

- BC11. The IPSASB decided to retain the definition in the Consultation Paper. In coming to this conclusion the IPSASB noted the need for governments and public sector entities to both (a) provide services and meet obligations relating to entitlement programs and (b) meet financial obligations, principally debt servicing. The IPSASB also noted the sovereign power of government to legislate for new taxation sources and to vary the levels of existing taxation, while acknowledging that in a global environment the ability to increase taxation might be practically constrained. The IPSASB took the view that, provided an entity gives appropriate attention to the key dimensions of fiscal capacity and service capacity, highlighted in paragraphs 24 and 25 users will be given adequate information that an entity cannot maintain existing service levels, meet obligations to the current and future beneficiaries of entitlement programs and meet financial obligations without increasing taxation or increasing borrowing.



### **Key Dimensions of Fiscal Sustainability**

- BC12. The IPSASB considered that providing a flexible framework for the disclosure of information might help entities to organize the way in which they communicate information and ensure that information is faithfully representative of an entity's economic condition. The IPSASB noted the work done by the US Governmental Accounting Standards Board and the Canadian Public Sector Accounting Board (PSAB) in defining "components" and "elements" for reporting an entity's economic condition. In particular the IPSASB considered that the GASB's notions of fiscal capacity and service capacity should be adopted in a slightly modified form. The IPSASB also noted the PSAB's notion of "vulnerability" as "the degree to which a government is dependent on sources of funding outside its control or influence or is exposed to risks that could impair its ability to meet its existing financial obligations both in respect of its service commitments to the public and financial commitments to creditors, employees and others." The IPSASB considered that a variant of this notion is particularly important for entities at sub-national levels which have limited taxation powers and are therefore exposed to decisions, over which they have no or very limited control, taken by other entities at other levels of government. The IPSASB noted that the approach taken by these standard setters had similarities to the "dimensions" developed by Allen Schick and discussed in the Consultation Paper.
- BC13. One of the dimensions that Schick discussed was "economic growth." The IPSASB considered that explicitly introducing a dimension of economic growth was inappropriate because the determinants of economic growth are complex and not under the control of the reporting entity. Economic growth assumptions will be key to the development of projections and are likely to feature heavily in sensitivity analyses.

### **Reporting Projections of Prospective Inflows and Outflows**

- BC14. The IPSASB considered whether it should recommend time horizons for projections for entities at particular levels of government. The IPSASB decided that such benchmarks would be inappropriate and that reporting entities should explain the reason for the time horizons that they select.

### **Methods of Communicating Information on Fiscal Sustainability**

- BC15. The Consultation Paper included illustrative examples of tabular statements showing 75 year projections for key programs and activities. IPSASB noted the view of some respondents that a focus on the position at the end of the time horizon may obscure events between the reporting date and the end of the time horizon. The IPSASB accepted this view and included guidance on the need to

balance the qualitative characteristics of faithful representation and understandability in displaying projections.

BC16. The Consultation Paper considered three models for reporting information on long-term fiscal sustainability and suggested that (a) the provision of additional statements providing details of projections and (b) summarized projections in narrative reporting were appropriate. Some respondents suggested that, although it was acknowledged in the Consultation Paper that these reporting approaches were not mutually exclusive, the IPSASB should have recognized that reporting on long-term fiscal sustainability just by displaying projections in statements is insufficient to meet user needs and that other communication methods need to be deployed. The IPSASB was persuaded by this view and reflects it in paragraph 29.

### **Disclosure of Principles and Methodologies**

BC17. The Consultation Paper discussed the principles that should be adopted for the inclusion of programs and transactions in long-term fiscal sustainability reporting and methodological approaches key to the outcome of projections. The areas addressed included whether projections should be based on current or future policy, the approach to revenue inflows, the approach to age-related and non-age-related programs and the approach to sensitivity analysis. The IPSASB considered whether in order to meet the qualitative characteristic of comparability the IPSASB should make firm recommendations on best practice approaches.

BC18. The IPSASB did not consider it appropriate to make firm recommendations on best practice because (a) the scope of the RPG includes all public sector entities and practice that is appropriate at one level of government may not be suitable elsewhere in the public sector, (b) while reporting on long-term fiscal sustainability has become a feature of financial management in an increasing number of jurisdictions it is at an early stage of development and (c) it is not the intention of the IPSASB to usurp the role of other professional groups with expertise in this area. In some cases the IPSASB has considered it appropriate to express a view on a preferred high level approach such as (a) projections are likely to be most useful if based on current policy and (b) projections are most useful if they encompass revenue inflows as well as outflows.