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Agenda Item
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Date: August 25th 2011
Memo to: Members of the IPSASB
From: John Stanford and Ian Carruthers
Subject: Reporting on the Long-Term Sustainability of Public Finances

Objectives

1. The objectives of this session are:

   - To **review** a revised draft Exposure Draft (ED) of the Recommended Practice Guideline (RPG), *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*; and
   - To **approve** the draft ED for issuance or **provide** directions for further development.

Agenda Material

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

Background

2. At the Naples meeting in June 2011 the IPSASB considered a preliminary draft RPG and discussed a number of key issues identified by the Task Force Chair and Staff. Members were broadly supportive of the approach and generally welcomed the concise format of the draft RPG. Members provided a number of directions for further development including that:

   - The section on 'Key Dimensions' is the core of the draft RPG and should be expanded and better linked to other parts of the RPG;
   - The rationale for the IPSASB's decision to issue an RPG rather than an IPSAS in the Basis for Conclusions should be explained as being attributable to the IPSASB's view that reporting on long-term fiscal sustainability in the GPFRs is an area where practice is developing and the IPSASB wants to encourage flexibility and innovation;
   - The RPG would be strengthened to indicate that the IPSASB considers it good practice for an entity to state that it had considered the RPG in developing its reporting approach in this area;
   - The term 'fiscal condition' should be used rather than 'economic condition' or 'financial condition' to denote a broader assessment of an entity's prospective position;

- The definitions of presentation, display and disclosure should be deleted; and
- In light of the decision that the proposals should be voluntary it is inappropriate to include an effective date.

3. The ED has been modified to address all the above points. Additionally, one of the exhibits from the Consultation Paper has been incorporated into the Basis for Conclusions in order to demonstrate how information on fiscal condition can complement the information in the statement of financial position.

4. The Task Force held a teleconference on August 4th when it considered a revised draft ED. Following the teleconference the draft RPG was further revised and re-circulated to the Task Force for further views on a very tight timescale. The Task Force Chair and Staff are very grateful to the Task Force members who participated in the teleconference, although it was at the height of the northern hemisphere holiday season and at an unsocial hour for many, and for their further comments on the document when it was re-circulated.

Key Issues

5. The key issues considered in this memorandum are:

- Overall Approach and Structure;
- Consultation Period; and
- Links to Examples of Existing Practice.

Overall Approach and Structure

6. The main changes to the draft ED from the version that was on the agenda at the June meeting relate primarily relate to structure. Substantively, the section on 'Key Dimensions of Fiscal Sustainability' has been expanded and the discussion linked to the projections. This section has also been renamed 'Addressing the Dimensions of Fiscal Sustainability'. The section provides guidelines on (a) how a preparer can ensure that the reporting of long-term prospective information on an entity's finances is faithfully representative of an entity's fiscal condition and (b) how users might use the information provided by the projections.

7. In view of the importance that Members attached to this section at the June meeting the Task Force Chair, Staff and the Task Force considered whether this section should be brought forward. It was decided not to move the section, because this would interrupt the flow of the RPG, which takes the reader through (i) deciding whether to report on long-term fiscal sustainability; (ii) communicating the core information (the projections) and (iii) ensuring that the core information is complemented by other information so that the overall package is faithfully representative of that entity's fiscal condition.

8. Both the Task Force Chair and Staff think that there may be a case for relocating the section on Reporting Entity from its current position to before the section on 'Disclosure of Methodologies and Principles'. The basis for this view is that in its current position the section is too prominent and this prominence could be interpreted as en encouragement to adopt a different reporting entity for the

reporting of information on long-term fiscal sustainability than for the financial statements, although paragraph 11 specifically refutes such a suggestion. The majority of the Task Force members took the view that the current location is appropriate and that identification of the reporting entity is a necessary first step before the entity considers whether it should report on the long-term sustainability of its finances.

Action Required

Members are asked to **consider** whether the current structure is appropriate and to **confirm** this structure or **provide** directions for modification.

Consultation Period

9. The Consultation Paper, *Reporting on the Long-Term Sustainability of Public Finances*, had a consultation period of just under six months. Staff acknowledges that the (a) the ED deals with an aspect of the 'more comprehensive scope' of financial reporting proposed in the Conceptual Framework ED, *Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity* and (b) that this is the first time that constituents will have seen an ED of a RPG rather than an IPSAS. Both these factors might suggest the need for a longer consultation period than the benchmark four months that the IPSASB normally adopts for IPSASs. However, the subject has been discussed in the Consultation Paper and the ED is fairly concise so the Task Force Chair and Staff consider that a four month consultation period is sufficient.

Action Required

Members are asked to **confirm** that the exposure period for ED 46 should be four months or **provide** an alternative consultation period**.**

Links to Examples of Existing Practice

10. It was agreed at the June meeting that the scope of the ED and the desire to foster innovative practice precludes the provision of illustrative examples. However, a medium term goal should be to accumulate an archive of documents and that the possibility of creating links to parts of reports rather than to the whole report should be evaluated. Members, Technical Advisers and Observers are asked to provide staff with examples for consideration for inclusion in such an archive.

Action Required

Members are asked to **provide** and/or **indicate** examples of existing practice for inclusion in an archive of publications on long-term fiscal sustainability.

International Public Sector Accounting Standards Board

Exposure Draft 46

September 2011

Comments are requested by January 31, 2012

Proposed Recommended Practice Guideline

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), 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. Comments can also be faxed to the attention of the IPASB 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.

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ISBN:

Objective of the Exposure Draft

Reporting on the long-term sustainability of an entity's finances provides users with information on the impact of decisions made by the reporting date under current policy, but not fully reflected in the general purpose financial statements. The objective of this Exposure Draft (ED) of a Recommended Practice Guideline (RPG) is to provide guidance on how to supplement the statements of financial performance and financial position and meet the objectives of financial reporting—accountability and decision-making—by presenting projections of inflows and outflows and complementary information on an entity's projected fiscal condition.

Guide for Respondents

The IPSASB would welcome comments on all the proposals in the ED. 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 that an entity should determine whether to report on its long-term fiscal sustainability by assessing whether there are users for this type of prospective information? If not how should an entity assess whether it should report on this subject?

Specific Matter for Comment 2

Do you agree that the best indicator of the whether users exist for information on long-term fiscal sustainability is the entity's fiscal dependency i.e., the more that the entity is dependent for its revenues on entities at other levels of government the higher the likelihood that there will be fewer users.

Specific Matter for Comment 3

Do you agree that the core information presented will be projections of inflows and outflows for a pre-determined period specified by the entity? If not, why not?

Specific Matter for Comment 4

Do you agree that the "dimensions" of long-term fiscal sustainability in paragraphs 31–41 provide a viable framework for narrative reporting on the long-term sustainability of an entity's finances that complements and interprets the projections? If not, how would you modify this approach?

Specific Matter for Comment 5

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

September 2011

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

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Basis for Conclusions

Objective

1. Reporting on the long-term sustainability of the public finances provides information on the impact of current policies and decisions made at the reporting date and supplements information in the general purpose financial statements (hereafter, the financial statements). This Recommended Practice Guideline (RPG) provides advice on the approach to reporting on the long-term sustainability of the finances of a public sector entity. The aim of such reporting is to provide an indication of the projected fiscal condition of the reporting entity over a specified time horizon in accordance with transparent assumptions.

Status and Scope

2. The reporting of information in accordance with this RPG represents good practice. Although this RPG does not have the status of an International Public Sector Accounting Standard (IPSAS), an entity reporting on the long-term sustainability of its finances is encouraged to follow this RPG, indicate that it has followed this RPG, disclose if it has departed from the RPG and explain why such a departure was necessary.

3. The flows relating to programs providing social benefits, including entitlement programs that require contributions from participants, can be a highly significant component of reporting on long-term fiscal sustainability. However, the scope of this RPG includes all an entity's projected outflows and is not limited to those related to programs providing social benefits.

4. Environmental sustainability is not directly within the scope of this RPG. However, it is important that the economic impact of environmental factors is taken into account in making projections and assessing the long-term fiscal sustainability of an entity.

5. 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 section on 'Determining Whether to Report on Long-Term Fiscal Sustainability.'

6. As stated in paragraph 5 this RPG does not apply directly to GBEs. However, the prospective inflows and outflows from/to the reporting entity from/to a GBE over the pre-determined time horizon are within the scope of this RPG.

Definitions

7. 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 net assets/equity at the reporting date.

Fiscal condition is an assessment of an entity's ability to meet its service delivery and financial obligations over the specified time horizon.

Inflows are cash and cash equivalents projected to accrue to the reporting entity over the time horizon of the projections.

Outflows are cash and cash equivalents related to expenditure projected to be incurred by which the reporting entity incurs over the time horizon of the projections.

8. This RPG distinguishes financial position and fiscal condition. Financial position is derived from information in the financial statements. Fiscal condition is a broader assessment that takes into account projected inflows and outflows related to the provision of goods and services under current policy over a pre-determined time horizon. Fiscal condition therefore 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. Similarly it takes into account future taxation receipts, contributions and inter-governmental transfers that do not meet the definition and/or recognition criteria for assets.

9. Assessments of fiscal 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, the relative competitiveness of the national or local economy and expected changes in demographic variables such as age, longevity, gender, income, educational attainment and morbidity.

10. Information on the long-term sustainability of an entity's finances may be communicated in a statement or through graphs,

supported by narrative reporting. Paragraphs 22–41 discuss communication.

Reporting Entity

11. This RPG reflects the view that it is good practice that the reporting entity for (a) the presentation of projections and the discussion of fiscal condition and (b) the financial statements is the same. This enhances the understandability of projections and increases their usefulness to the users of general purpose financial reports.

12. 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 reporting entity's finances it is important that such entities are identified, and, where possible, the estimated impact of their exclusion from projections is disclosed.

13. Conversely, users need to be informed if presentation of the long-term sustainability of the reporting entity's finances includes entities that are not within the reporting boundary for the financial statements.

14. 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 many 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*.

15. For accountability reasons it may be considered appropriate to disclose information on long-term fiscal sustainability based on the boundary of 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.

Determining Whether to Report on Long-Term Fiscal Sustainability

16. In evaluating whether to report on the long-term sustainability of its finances entities need initially to assess whether potential users exist

for prospective financial information. The main indication of the existence of users is the extent of the entity's fiscal dependency on other entities (see paragraph 17). Fiscal dependency is defined in Appendix A as: the proportion of an entity's revenues provided by entities at other levels of government.

17. 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 large local government entities (for example, cities), which have tax raising powers enabling them to generate a significant proportion of their total revenues.

18. The relevance of reporting on the long-term sustainability of the finances of other types of public sector entity will need to be considered in the context of how they are funded. Entities which (a) have very limited tax raising powers, (b) are highly fiscally dependent on other public sector entities and (c) have very limited powers to incur debt are less likely to have users for information on their fiscal sustainability and therefore to report on their fiscal condition than entities that have high levels of fiscal autonomy. If an entity decides not to report on the long-term sustainability of its finances it is informative to explain why.

19. Long-term fiscal sustainability reporting is unlikely to be to be relevant for individual government departments that do not have revenue generation powers and are funded through budgetary appropriations. Instead the focus of users is likely to be on the long-term sustainability of the government's overall finances.

20. It is important that if a controlled entity determines that there are users for information on the long-term sustainability of their finances they ensure that the information reported is (a) consistent with information reported by a controlling entity, (b) that the controlling entity is identified, and (c) users are made aware of information on long-term fiscal sustainability reported by that controlling entity.

21. If an entity determines that it is appropriate to report on the long-term sustainability of its finances it is important to assess the extent to which it can draw on the projections and indicators made by other governmental bodies such as ministries of finance, rather than making the projections themselves. Where appropriate, an ability to draw on projections made by other bodies can reduce the cost of reporting on the long-term sustainability of the entity.

Communicating Projections of Prospective Inflows and Outflows

22. The core information presented will be projections of inflows and outflows commencing in the current reporting period for a period selected and disclosed by the reporting entity.

23. Projections can be displayed in tabular statements or graphical formats providing details of the activities and programs giving rise to outflows and identifying the sources of inflows. In determining the format of tabular statements entities need to balance considerations of understandability and relevance. Multi-columnar presentation of a large number of time periods between the reporting date and the end of the time horizon provides a more complete information set, but risks information overload and the impairment of understandability. Conversely, a focus on fiscal condition at a very small number of time periods may neglect trends arising from key events between time periods.

24. Due to the considerations in paragraph 22 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. Projections of net debt are likely to be central for many reporting entities. Other examples of indicators include:

    (a) Gross debt;

    (b) Net worth;

    (c) Net financial worth;

    (d) Fiscal gap;

    (e) Inter-temporal budget gap;

    (f) Net debt/total revenues; and

    (g) Vulnerability.

25. Working definitions of these indicators are provided in the Glossary of Indicators at Appendix A.

26. There is a particular risk that both tabular statements and graphical disclosure can be skewed to present a misleadingly favorable picture. It is therefore important that formats are consistent between reporting periods and that any modifications of formats between reporting periods are highlighted and explained. It is also good practice to

display a supplementary statement that shows the changes in projections between reporting dates and the reasons for those changes.

27. 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.

28. 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.

29. There is a strong relationship between fiscal dependency and time horizons. Generally, high levels of fiscal dependency may lead to the selection of shorter time horizons, because a high proportion of the reporting entity's prospective inflows are dependent upon decisions by other entities over which the reporting entity has no control and limited influence.

30. Apart from fiscal dependency, the length of the time horizon will reflect the characteristics of the reporting entity. It is likely to be influenced by aspects such as the longevity of key programs, the estimated lives of major infrastructure assets and the time horizons adopted by other government bodies and agencies providing prospective information

Addressing the Dimensions of Fiscal Sustainability

31. 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 fiscal condition. This requires the inclusion of narrative discussion in order to put the projections in context. Faithful representation can be satisfied by presenting narrative information on both a historical and prospective basis along three inter-related dimensions of fiscal sustainability:

- Fiscal capacity;
- Service capacity; and

- Vulnerability.

32. *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 levels of taxation.

33. The level of net debt is critical to an assessment of fiscal capacity, as, at any reporting point, it represents the amount expended on the past provision of goods and services that has to be serviced and financed in the future. By projecting current policies for the provision of goods and services, and current policies for raising taxes and other revenues into the future, projected levels of net debt can be presented. Users can then assess the entity's ability to raise and maintain such levels of debt and thereby evaluate fiscal capacity.

34. At national levels a factor to consider in presenting such projections is whether to distinguish: (a) the primary deficit, which is total projected government spending, excluding interest payable on debt, minus tax revenues, and (b) the total deficit, which includes outflows related to interest payable on debt. At sub-national levels the focus may be on net debt as a percentage of total revenues. Increases in this indicator show that an increasing proportion of revenues will be required for debt servicing, thereby diverting resources from service delivery purposes, and that the long-term position may become unsustainable.

35. *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.

36. By projecting the impact of policies for raising taxes and other revenues, and policies for raising and maintaining debt into the future, long-term sustainability reports can present the amounts available for the provision of goods and services under these policies. Users can contrast this information with the entity's service commitments, and thereby use long-term fiscal information to evaluate service capacity.

37. A factor to consider in making such comparisons is the extent to which expenditure on certain programs is likely to increase more steeply than the overall levels of expenditure of the entity. This may be because the number of beneficiaries is projected to increase for a particular program or because costs associated with certain programs, such as healthcare, are projected to increase more quickly than the general inflation rate. For capital intensive activities the dimension of service capacity also involves

an assessment of infrastructure lives and replacement cycles in order to esure that net outflows on property, plant and equipment are recorded.

38. *Vulnerability* is (a) the extent to which an entity is fiscally dependent upon funding sources outside its control, principally inter-governmental transfers and (b) the extent to which an entity has powers to vary existing taxation levels and to create new sources of taxation or terminate existing sources.

39. *Vulnerability* is exemplified by an indicator of the proportion of total inflows that are received from entities at other levels of government, for example a local government entity that can raise property taxes, but is partially dependent upon a mixture of block grants and specific grants from national and state governments. As policies for the provision of goods and services, and policies for managing debt are projected into the future, the level of revenue required to maintain such policies can be presented in a long-term fiscal sustainability report. Users are then enabled to assess this information against the entity's revenue-raising ability and thereby evaluate vulnerability.

40. It is important to identify the entities on which the reporting entity is fiscally dependent. Reporting along this dimension may also involve consideration of the extent to which the entity relies on user fees.

Generally, an entity that is highly vulnerable is likely to have limited control over its fiscal condition. Trends indicating that vulnerability is increasing suggest that an entity's future sustainability is dependent upon funding decisions by entities at other levels of government. It is important that users are provided with details of constitutionally or statutorily-based revenue sharing or grant arrangements. Vulnerability may be mitigated if inter-governmental transfers have constitutional or other legal underpinning, which may make the entity less susceptible to sudden adverse funding decisions by other entities and therefore increase the probability of receiving funds.

41. As noted above both *fiscal capacity* and *service capacity* involve the consideration of stable taxation, which is the capacity of entities to finance the future obligations identified in the fiscal capacity and service capacity dimensions without increasing aggregate levels of taxation.

Disclosure of Principles and Methodologies

42. 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

43. 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 Organization 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 making and reporting on projections for the first time. However, there is 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

44. 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 is held constant through the entire projection period. 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 make payments once an earmarked fund is exhausted, although entitlements of beneficiaries will continue after the exhaustion of that 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.

45. 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.

46. 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

47. 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 (see also paragraphs 38-40 above). 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

48. It is good practice to disclose the key assumptions that underpin projections. These are likely to include economic growth rates, inflation, 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

49. Age-related programs are programs that are subject to 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

50. 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.

51. 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

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

Sensitivity Analysis

53. Many 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. Entities also need to indicate how they deal with inflation, in particular whether inflation has been taken into account in making projections or whether projections are made at current prices.

Reliability of Projections

54. 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 those actual outcomes will depend upon a range of factors, including 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 need to be 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 actual cash flows will differ from projections.

55. 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.

Appendix A

Glossary of Indicators

Government gross debt: Government gross debt comprises all financial liabilities of general government, typically mainly in the form of government bills and bonds. (Source: OECD: *Glossary of Statistical Terms:* 2007 (updated on ongoing basis))

Net debt: Government net debt comprises all financial liabilities minus all financial assets of general government. Financial assets of the general government sector have a corresponding liability existing outside that sector. The exceptions are monetary gold and Special Drawing Rights, financial assets for which there is no counterpart liability. Monetary gold and Special Drawing Rights may be included as assets of the general government sector or they may be classified as assets of the central bank, at the discretion of the government. (Source: OECD: *Glossary of Statistical Terms*)

Net worth: Net worth is the value of all the non-financial and financial assets owned by an institutional unit or sector less the value of all its outstanding liabilities. (Source: OECD: *Glossary of Statistical Terms*)

Net financial worth: Net worth is the value of all the non-financial and financial assets owned by an institutional unit or sector less the value of all its outstanding liabilities. (Source: Adapted from definition of net worth in OECD: *Glossary of Statistical Terms*)

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. (Source: Adapted from United States Congressional Budget Office: *The Long-Term Budget Outlook*: 2000)

Inter-temporal budget gap: Derived from the inter-temporal budget constraint (IBC). The inter-temporal budget constraint is satisfied if the projected outflows of the government (current public debt and the discounted value of all future expenditure, including the projected increase in age-related expenditure) are covered by the discounted value of all future government revenue. An inter-temporal budget gap exists when the present discounted value of future government revenue does not cover the current debt burden. (Source (definition of inter-temporal budget constraint): European Commission: *Sustainability Report*: 2009))

Net Debt/Total Revenues: Net debt as a proportion of total revenues (Source Canadian Public Sector Accounting Board (PSAB); Statement of

Recommended Practice 4 (SORP 4), *Indicators of Financial Condition*: 2009)

Fiscal dependency: Proportion of an entity's total revenues currently provided by entities at other levels of government. (IPSASB: adapted from PSAB SORP 4)

Basis for Conclusions

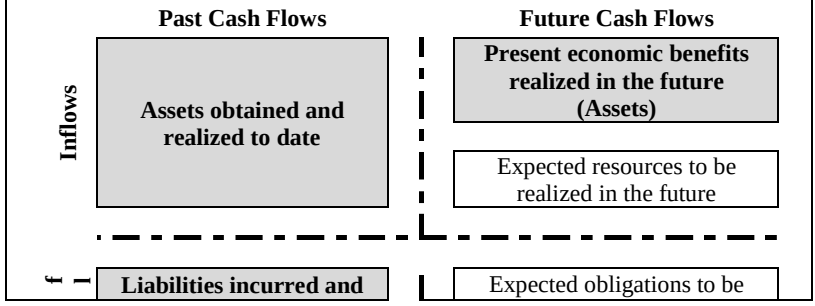
Background

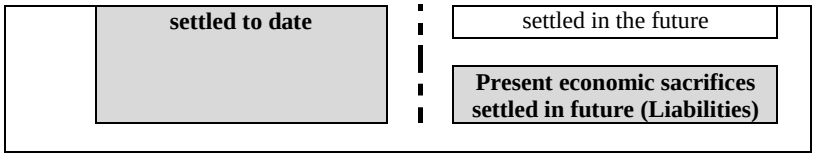
BC1. The IPSASB initially launched a project on accounting for social policy obligations (subsequently re-termed social benefits) in 2002. This led to the publication of an Invitation to Comment (ITC), *Accounting for Social Policies of Government,* in January 2004. Following an analysis of responses 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 at that time.

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 propose the disclosure of obligations and 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. This is illustrated in Exhibit One below. 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.

Exhibit One
Complementing information provided in the statement of financial position





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 long-term financial implications 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 Public 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 on long-term fiscal sustainability, made suggestions on how such information 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 long-term fiscal sustainability in the course of its project on the Conceptual Framework. Conceptual Framework ED 1, *Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity* proposed a scope for financial reporting that is more comprehensive than the financial statements and includes prospective financial information The IPSASB has also 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. However the IPSASB concluded that it would be premature to issue an IPSAS, because reporting on long-term fiscal sustainability in the GPFRs is an area where practice is developing and the IPSASB wishes to encourage innovative and flexible approaches.

Scope

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 there might be significant user demand for such at sub-national levels and therefore that a narrow scope limited to the national and whole-of-government levels is not justified.

Definitions

BC8. 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 (a) 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. Macro-economists 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.

BC9. 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 by a number of considerations. The IPSASB took the view that, provided an entity gives appropriate attention to the dimensions of fiscal capacity and service capacity, as highlighted in paragraphs 32 and 35 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.

Determining Whether an Entity Should Report on Fiscal Sustainability

BC10. As discussed in paragraph BC7 the IPSASB concluded that the scope should not be limited to particular levels of government. However, the IPSASB acknowledged that reporting on the long-term sustainability of their finances might not be appropriate for all entities. The IPSASB considered this issue at length.

BC11. 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 on resources on entities at other tiers of government provide projections that are contingent 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 20.

BC12. The IPSASB acknowledged that direct evidence of the existence of users of information on long-term fiscal sustainability might not be readily available. The IPSASB considered what proxies might indicate the existence of users. The IPSASB concluded that, although the relationship is imperfect, the number of users is likely to vary inversely with an entity's fiscal dependency – that is to say the higher the proportion of an entity's revenues that are provided by entities at other levels of government, the higher the level of an entity's fiscal dependency and the lower the likelihood of users.

BC13. 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 they do not have tax-raising powers and their funding is through appropriations. In addition, in many jurisdictions, government departments are subject to frequent changes after elections or when ministerial portfolios are amended.

Communicating 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. It acknowledged the view that standard time horizons for particular classes of public sector entity might enhance comparability. The IPSASB decided that such benchmarks would be over-prescriptive and impractical. The scope of the RPG is such that standard time horizons would have to be determined for a wide range of entities, including single-purpose entities[1]. In addition the fiscal autonomy of entities at the same level of government can differ markedly between jurisdictions. The IPSASB concluded, however, that it is good practice for reporting entities to explain the reason for the time horizons that they select. The IPSASB considers that the extent of an entity's fiscal dependency will have an impact on time horizons. The higher the level of fiscal dependency the higher the likelihood of shorter time horizons.

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

[1] For example, such entities might include school boards or bodies responsible for water, sewage and drainage.

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 in paragraph 28.

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 the Consultation Paper acknowledged that these reporting approaches were not mutually exclusive, the IPSASB should highlight 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 23.

Addressing the Dimensions of Fiscal Sustainability

BC14. 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 (GASB)[2] and the Canadian Public Sector Accounting Board (PSAB)[3] in defining "components" and "elements" for reporting an entity's fiscal 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-

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2 Project on *Economic Condition* (Governmental Accounting Standards Board: Norwalk, CT, USA)

3 Statement of Recommended Practice 4, *Indicators of Fiscal Condition* (Public Sector Accounting Board: Canada, Toronto, 2009)

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[4] and discussed in the Consultation Paper.

BC15. 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. However, economic growth assumptions will be key to the development of projections and are likely to feature heavily in sensitivity analyses.

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

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4 Allen Schick, *Sustainable Budget Policy Concepts and Approaches* (OECD: Paris, 2008)

current policy and (b) projections are most useful if they encompass revenue inflows as well as outflows.



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