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Ms Stephenie Fox
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Dear Ms Fox

COMMENTS ON IPSASB CONSULTATION PAPER *REPORTING ON THE LONG-TERM SUSTAINABILITY OF PUBLIC FINANCES*

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board on the Consultation Paper *Reporting on the Long-Term Sustainability of Public Finances*.

HoTARAC is an intergovernmental Committee that advises Australian Heads of Treasuries on accounting and reporting issues. HoTARAC is comprised of the senior accounting policy representatives from all Australian States, Territories and the Australian Government.

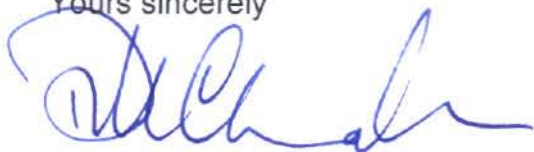
HoTARAC strongly supports the *Reporting on the Long-Term Sustainability of Public Finances* Project. Detailed comments are provided in Attachment 1.

In summary, HoTARAC:

- agrees that the aim of reporting on the long-term sustainability of public finances should be to fulfil decision-making and accountability purposes;
- recommends greater clarification on the distinction between General Purpose Financial Reports, General Purpose Financial Statements and Other Information reports;
- believes that the reporting entity should be the General Government Sector;
- supports the extension of IPSASB guidance to all levels of government on the basis that the IPSASB guidance remains flexible and based on high level principles;
- reiterates that it does not believe that long-term fiscal sustainability information should be presented as part of annual reports. HoTARAC is concerned that this would require long-term sustainability reports to be prepared every year and be subject to audit; and
- agrees that the long-term sustainability report would benefit from some degree of assurance, but not to an audit level, given the prospective characteristic of the information.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on +61 2 6215 3551.

Yours sincerely



D W Challen

CHAIR

HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

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Encl

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HoTARAC response to IPSASB Consultation Paper Reporting on the Long-Term Sustainability of Public Finances

HoTARAC strongly supports the Project on Reporting on the Long-Term Sustainability of Public Finances. In its view, such a report is a valuable tool for accountability and decision-making purposes for government. This reporting is potentially much more relevant to users, compared to General Purpose Financial Statements that focus more on historical information.

HoTARAC supports a principles-based approach. This allows for such a Report to be adapted to the circumstances of each country, increasing the relevance of the information provided. As Long-Term Sustainability of Public Finances Reports are relatively new, even for countries that do currently prepare them, flexibility allows for development and adaptation based on experience. Presently, there is not a great deal of international comparison between reports – but where this does or will happen, either the requirements can evolve and/or additional specific requirements can be overlaid.

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

HoTARAC agrees. Financial statements only concern the past and current accountability of an entity. HoTARAC considers that accountability should also extend to sustainability in the future. A long-term fiscal sustainability report provides accountability to the public and relevant information for government to make decisions. In particular, such a report may include information on the timing and extent of shortfalls.

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

HoTARAC disagrees. The formats proposed (Models One and Two) seem to apply to a General Purpose Financial Report that contains GPFs and not to a separate report as mentioned in Paragraph 2.3.3.

HoTARAC is unsure if it is possible to prepare a report in summary narrative form and still include all the other information necessary to be consistent with the IPSASB's proposals, for example, inclusion of assumptions.

HoTARAC's majority view is that Long-Term Sustainability of Public Finances Reports belongs to the Other Information report category, outlined in the Consultation Paper Exhibit Two on Page 15, as they provide economic, statistical and demographic data. The Other Information category is not within

the All Financial Reporting classification. However, it is still classified within the IPSASB's overall reporting framework under Information Useful as Input to Assessments of Accountability and for Resource Allocation and Other Decisions. In this instance, Model Three, which has been rejected by the IPSASB, would be the best approach of disclosing this type of information. HoTARAC recommends that Model Three be included as an option.

In HoTARAC's experience providing financial information in the same report on different bases tends to confuse rather than assist financial report users. Therefore a Long-Term Sustainability of Public Finances Reports would be better issued as a separate report, rather than being included in a GPFR containing GPFs. Alternatively, where GPFs and comprehensive forward looking information are provided in the same report, preparers should take great care in providing sufficient information to the report users to clearly outline the different bases applied in the report.

The Australian Government's Long-Term Sustainability of Public Finances Report, the Intergenerational Report, appears to fit in with the Model Two approach, summarising projections in a narrative report. However, the information on long-term fiscal sustainability is not derived from other reports (refer Paragraph 3.1.7), it is the primary report. Given that it is a separate report from GPFRs containing GPFs, the Intergenerational Report is more aligned to the Model Three approach, other information category type of report.

Notwithstanding the above, one jurisdiction believes it is possible that long-term fiscal sustainability reports are GPFRs within the broader IPSASB definition in its *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*¹.

In particular, when one considers the comment that "there is no current expectation that broader information within the scope of GPFRs will be published in a single report that also includes GPFs. Such information may be published in a number of separate reports", (refer Paragraph 2.3.3).

HoTARAC disagrees with the view in Paragraph 3.2.3 that GPFRs are inadequate without long-term fiscal sustainability information. Each GPFR may have a different focus and/or may satisfy different user's needs regarding financial information.

HoTARAC provides no view about whether Long-Term Sustainability of Public Finances Reports should be GPFRs. However, given the discussion above and the acknowledgement by IPSASB in Paragraph 2.3.1 that "there is still considerable debate on (a) the type and format of information that should be referred to as GPFRs, and GPFs and (b) the demarcation lines between

¹ The IPSASB GPFR definition is broadened so as to allow for the inclusion of additional information such as non-financial, prospective financial, compliance and/or additional explanatory material. This differs from the Australian Accounting Standards Board (AASB)'s definition in that, while the AASB does not preclude this information from being disclosed, it is not considered to be part of GPFRs. As long-term sustainability reports are prospective material, under the IPSASB definition they would be part of GPFRs.

GPFSSs, GPFRs and other information”, there is a need for IPSASB to more clearly distinguish between these different types of reports. Further, the IPSASB should clarify which information category Long-Term Sustainability of Public Finances Reports would belong to in terms of the categories illustrated in Exhibit 2 of the Consultation Paper. The types of presentation are described in very general terms and could benefit from some additional definition.

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

HoTARAC disagrees with the application of the consolidated reporting entity. IPSASB’s definition of the Reporting Entity concept aligns with the Australian Accounting Standards Board Reporting Entity concept. However, at least in the Australian context, under the Government Finance Statistics framework, it is the General Government Sector that collects the majority of taxes and is responsible for delivering government services and incurring any debt necessary to finance this service delivery. Information on those activities is critical for assessing long term sustainability of public sector finances. The Australian Intergenerational Report focuses on the GGS, which includes any significant financial transactions with other sectors.

However, a minority of HoTARAC members support the view that the guidance should be based on the reporting entity concept for general purpose financial statements, which would equate to the whole-of-government reporting entity rather than the GGS.

HoTARAC agrees with the proposal to extend IPSASB guidance to all levels of government. The majority of HoTARAC supports the extension of the IPSASB guidance for the preparation of fiscal sustainability reports to the state/local government levels, given the following IPSASB principles:

- that projections be based on current policy (e.g. current Australian Government revenue sharing methodologies), unless there is disclosure of any deviations from current policy;
- disclosure of the bases on which revenue sources have been projected; and
- disclosure of any other key assumptions underpinning projections.

There is evidence that, in Australia, Local Government revenue is mainly derived from rates, which would be considered to be independent and controllable.

A minority view of HoTARAC is that it is inappropriate to prepare long-term sustainability reports in the proposed format at all levels of government and recommends that the report be prepared at national level or by governments with a majority of revenue being independent and controllable, for example a government that can levy its own income taxes. In Australia, only the Australian Government has the power to raise income tax, not the States. Entities within the sub-national level rely mainly on allocations from the Australian Government Budget to fund their projects and operations. Some

Australian sub-national level governments prepare reports that are more akin to mid-term budget forecasts (e.g. with a time horizon of around 10 years) than Long-Term Sustainability of Public Finances Reports. The IPSASB Consultation Paper provides examples of Long-Term Fiscal Sustainability Reports (refer Exhibit Ten, page 43) with the majority having time horizons ranging from 25 to 75 years, reflecting fiscal sustainability over one or several generations. However, the IPSASB's proposed definition of Long-Term Sustainability does not cover the issue of time horizon. Is it IPSASB's intention that its guidance would cover mid-term estimates reports as well as intergenerational projections reports?

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

HoTARAC agrees that the criteria set out above assist preparers in determining the appropriate indicators for long-term fiscal sustainability. If the indicators were to be prescriptive, then some of the indicators may lose their relevance to particular jurisdictions. In HoTARAC's opinion, the relevance of the indicator is important as different jurisdictions may have different circumstances that need to be considered. Indicators may not always be a purely quantitative measure as qualitative characteristics may be more useful at times.

HoTARAC recommends that the IPSASB principles include the selection of fiscal sustainability indicators that ensure a balanced picture is published about the government's future fiscal position. This would allow both favourable and unfavourable projections to be reported.

Disclosing comparative information and reasons for ceasing to report indicators will enhance the comparability and reliability of the report. The Australian Intergenerational Report includes comparisons with the previous Intergenerational Reports.

Note that the format of comparative information may depend on the presentation format adopted as, unlike GPFs, the format for this reporting may not take the form of a standard set of financial statements where a second column can be presented for comparative figures.

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

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

HoTARAC agrees and is of the view that deviation from the principle that long-term fiscal sustainability projections are based on current policy should be disclosed to ensure that the comparability of the report is maintained between reports and between other government reports and for transparency. The disclosure of key assumptions and background information on legislation and regulations enhances the comparability and understandability of the report between governments.

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

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

HoTARAC agrees. HoTARAC considers that the disclosure of time horizons is essential to enable the information to be put into perspective and to ensure that the timeframe is long enough to provide useful information for policy decisions and analysis. The Australian Intergenerational Report covers a 40 year period.

Discount rates and the reasons for their selection should be disclosed, where applicable. In addition to the discount rates, information about the methods of discounting should be disclosed. Some Long-Term Sustainability of Public Finances Reports provide information that does not discount future cash flows to a current value number, in which case discount rates are irrelevant. Therefore, disclosure of discount rates should only be recommended where these are used in preparing the report. A single value number may not be adequate for assessing future financial sustainability because it does not identify the timings of the flows. The Australian Intergenerational Report uses a year by year analysis of current receipts with current payments. This removes the subjectivity of selecting a discount rate.

The disclosure of any key sensitivity analysis and assurance undertaken are important when dealing with long-term projections as it gives users increased confidence in the material and a greater understanding of the circumstances. However, HoTARAC's view is that guidance in this area should be focussed on the promotion of transparency about assumptions rather than merely recommending disclosure of assumptions.

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

- a) HoTARAC agrees and is of the view that five years is a reasonable timeframe to prepare or update the underlying projections. However, guidance on the frequency of preparing and updating underlying projections should remain flexible. Different jurisdictions have different circumstances which cannot be addressed by a single set of rules.

Guidance is needed about how to deal with publication of this information between updates. If a government chooses to present this information in an annual report, should the same information be repeated in each annual report for those intervening years when the information is not actually updated?

- b) HoTARAC agrees that the date of preparation or update is useful information for the reports readers and should be disclosed.

Other Comments

Consequences of including the Long-Term Sustainability of Public Finances Reports in an annual report

In the instance that IPSASB's guidance focuses on projections over a time horizon equal to or greater than 25 years, it is HoTARAC's opinion that it would appear inappropriate to prepare such reports on an annual basis, which may be a consequence of the requirement to provide such information in a GPFR containing GPFSSs. It is unlikely that long term projections would change significantly, due to their extended time horizon, unless unpredicted major events occur. The complexity of modelling projections over such a long period also requires significant time to prepare and validate. The Australian Intergenerational Report is issued every three to five years.

If Long-Term Sustainability of Public Finances Reports were included in the report containing GPFSSs, such information would result in it being reviewed as part of the financial statement audit process as required by Auditing Standards. HoTARAC is of the view that, while Long-Term Sustainability of Public Finances Reports would benefit from a level of assurance to enhance credibility, unlike the extensive set of standards that govern the preparation of information that is included in GPFSSs, this is not the case for long-term fiscal sustainability information, which would make an audit of that information substantially more challenging.

Consequences of a wider GPFR definition in the IPSASB Conceptual Framework

Although Long-Term Sustainability of Public Finances Reports may be GPFRs, within the definition proposed in the IPSASB Conceptual Framework, HoTARAC provides no view on whether they should be GPFRs. IPSASB may need to consider the consequences of having in their framework GPFRs, which have a broader scope to GPFs. GPFRs are largely definitional at one level; however at another level the presumption is that as GPFRs, the full conceptual framework would apply unaltered to Long-Term Sustainability of Public Finances Reports and the IPSASB may need to consider whether this is what is intended or whether this is appropriate.