

30 April 2010

Ms Stephenie Fox
Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
Toronto, Ontario M5V 3H2 CANADA

Dear Ms Fox

**CONSULTATION PAPER – ‘REPORTING ON THE LONG-TERM
SUSTAINABILITY OF PUBLIC FINANCES’**

Attached is the Australasian Council of Auditors-General (ACAG) response to the Consultation Paper referred to above.

The views expressed in this submission represent those of all Australian and New Zealand members of ACAG.

The opportunity to comment is appreciated and I trust you will find the attached comments useful.

Yours sincerely



Simon O'Neill
Chairman
ACAG Financial Reporting and Auditing Committee

cc: Mr Kevin Stevenson, Chairman, Australian Accounting Standards Board

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

ACAG has reviewed the consultation paper *Reporting on the Long-Term Sustainability of Public Finances* issued by the International Public Sector Accounting Standards Board (IPSASB) and provides the following comments.

Overall comment

ACAG welcomes the IPSASB's project to develop guidance for reporting on the long-term sustainability of public finances. We consider such information to be of significant public interest and consider that the proposals will result in improvements to the financial reporting of governments.

We note that both the IPSASB and the International Accounting Standards Board (IASB) are considering the scope of general purpose financial reporting as part of their respective projects on the conceptual framework. At this stage, neither Board has concluded whether prospective financial information falls within the scope of general purpose financial reports (GPFRs). The outcomes of these projects may impact any guidance developed by the IPSASB on the reporting of long-term fiscal sustainability. However, ACAG considers that the IPSASB should not wait until these projects are concluded before developing guidance in relation to reporting on the long-term sustainability of public finances.

Specific comments on preliminary views

- 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).***

ACAG agrees that the presentation of information on long-term fiscal sustainability would contribute to meeting the objectives of financial reporting as proposed in the IPSASB Consultation Paper *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*.

In our response to that Consultation Paper, ACAG supported the preliminary view that the objectives of financial reporting by public sector entities are to provide information about the reporting entity useful to users of general purpose financial reports (GPFRs) for accountability purposes and making resource allocation, political and social decisions.

ACAG also supported the preliminary view that the scope of financial reporting encompasses the provision of financial and non-financial information about, among other factors, prospective financial and other information about the reporting entity's future service delivery activities and objectives, and the resources necessary to support those activities.

However, we do not consider that the presentation of information on long-term sustainability is necessary to meet the objectives of financial reporting. There are two reasons to support this view.

Firstly, the objectives of financial reporting presented in the consultation paper on the conceptual framework relate to all public sector entities. However, information on long-term sustainability is likely to be presented only at the whole-of-government level (which in Australia may be at the federal, state and territory, or local government level and in New Zealand at the national or local government level). By stating that the presentation of such information is necessary to meet the objectives of financial reporting, it could indicate that individual entities that do not present such information are not meeting these objectives.

Secondly, the time and cost involved to prepare and update information on long-term sustainability may be prohibitive for it to be presented for each annual reporting period. Governments may choose to present information on long-term sustainability less frequently (for example, once every three years) after consideration of user needs. In particular, there may be little value in preparing and presenting information on long-term sustainability annually because the assumptions and projections would not change significantly from year to year, unless there is a significant change in policy. In such circumstances, the view that presenting information on long-term sustainability is necessary to meet the objectives of financial reporting could indicate that these objectives are not being met in the intervening period.

2. *IPSASB guidance should recommend that long-term fiscal sustainability information in GPFs be presented either through:*

- *Additional statements providing details of projections; or*
- *Summarized projections in narrative reporting (Section Three).*

ACAG agrees with this preliminary view. Entities should have a choice as to whether Model One (additional statements providing details of projections) or Model Two (summarized projections in narrative reporting) is most appropriate to meet the qualitative characteristics of financial information and the information needs of users. However, ACAG recommends that the IPSASB guidance should require entities to clearly differentiate prospective financial information from historical financial information to avoid confusion by users.

The IPSASB expresses the view that Model Three (cross-references in GPFs to other reports addressing long-term fiscal sustainability) is inappropriate as reference alone to special long-term sustainability reports does not provide users with the information they need for decision-making and accountability purposes. ACAG recommends that the IPSASB should clarify the extent to which it may be appropriate to include cross-references to such special long-term sustainability reports when reporting long-term fiscal sustainability information under Model One or Model Two.

We acknowledge that paragraph 2.3.3 of the Consultation Paper *Long-Term Sustainability of Public Finances* states that the IPSASB has no current expectation that broader information within the scope of general purpose financial reports (GPFs) will be published in a single report that also includes general purpose financial statements (GPFs), and that such information may be published in a number of separate reports. We recommend that this distinction is made clear in any guidance statement developed on the long-term sustainability of public finances.

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).*

ACAG agrees with this preliminary view. ACAG is of the view that developing guidance for application by national governments only would be inappropriate. Information on long-term sustainability would be of public interest at the national, state and territory, and local government levels in Australia, and at the national and local government levels in New Zealand.

ACAG agrees that information on long-term sustainability should be presented at the whole-of-government level. However, governments should have flexibility in how this information is presented. For example, in Australia, budget estimates are only prepared for the general government sector (GGS), which excludes entities within the public financial corporations (PFC) and public non-financial corporations (PNFC) sectors. Therefore, it may be also be appropriate to allow additional information on long-term sustainability for the GGS, the PFC sector and the PNFC sector to be presented separately, rather than aggregated at the whole-of-government level.

However, ACAG agrees that the boundary for which information on long-term sustainability is presented in the GPFR should not be broader than the boundary used to prepare the general purpose financial statements.

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).*

ACAG agrees that IPSASB guidance should recommend that long-term fiscal sustainability indicators be selected based on the extent to which the indicators meets the qualitative characteristics of financial reporting (which includes relevance) and their ability to describe the scale of the fiscal challenge facing the entity. We agree that a uniform set of indicators should not be recommended.

ACAG agrees that the IPSASB guidance should also recommend that comparative information is provided and that the reasons for ceasing to report indicators, if this occurs, are disclosed. We consider such inclusions necessary to meet the qualitative characteristics of understandability and comparability.

ACAG considers that the qualitative characteristic “verifiability” relates to historical financial information and that this characteristic may be of little relevance to the reporting of prospective financial information. ACAG recommends that each of these characteristics and their applicability to the reporting of prospective financial information should be considered by the IPSASB as part of the conceptual framework project.

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).**

ACAG agrees with this preliminary view.

At paragraph 6.6.3, the consultation paper highlights the importance of disclosing sufficient information on the underlying macro-economic policy and fiscal framework, but acknowledges that there is a risk such information will be overly detailed and undermine understandability. The IPSASB states that it may therefore be appropriate to cross-reference other publicly available reports in the GPFs. This is at odds with the IPSASB's view in Section 3 of the CP that Model Three is inappropriate as cross-references to other reports do not provide users with the information they need for decision-making and accountability purposes. In developing guidance, the IPSASB should consider and clarify to what extent cross-references to other reports would be appropriate to meet the information needs of users.

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).**

ACAG agrees with this preliminary view. Some additional comments in relation to each of these disclosure items are provided below.

ACAG believes that the IPSASB's guidance should emphasise the inherent uncertainty that exists for very long-term time horizons, such as 75 years or more. Where fiscal projections are included for such long-term time horizons, the guidance could require projections for shorter periods making up this very long-term horizon, such as 10, 25 and 50 years. ACAG recommends that the IPSASB guidance should recommend that entities explicitly disclose the inherent limitations of such projections.

In relation to discount rates, the IPSASB guidance should explicitly require disclosure of the type of discount rate(s) used and the quantum. The recommendation to disclose discount rates could be interpreted as requiring disclosure only of the type of discount rate and not the actual percentage used in determining the projections. Where the type of discount rate used differs

from the discount rate applied in the preparation of the general purpose financial statements, the guidance should require disclosure of the reason why the discount rates vary.

ACAG agrees that the disclosure of sensitivity analysis would provide users with useful information for decision-making. In paragraph 7.4.3 of the CP, the IPSASB's preliminary view is "that the results of any sensitivity analysis should be disclosed to provide better information on the scale of the fiscal challenges faced." This implies that sensitivity analysis need only be disclosed when the entity has prepared such analysis. ACAG considers that disclosure of such information should not be limited to those entities that have prepared such information. Instead, the IPSASB guidance should recommend the preparation and disclosure of key sensitivity analysis.

ACAG notes that the IPSASB is of the view that the need for, level and extent of assurance is a matter for preparers to form a judgment on in conjunction with their auditors. The current auditing standard applicable in Australia, AUS 804 *The Audit of Prospective Financial Information*, states that auditors may only report on the reasonableness of the assumptions on which the prospective financial information is based and that the auditor ordinarily provides only a moderate level of assurance by issuing a statement of negative assurance on best-estimate assumptions. In addition, the auditor does not express an opinion on hypothetical assumptions. As projections on long-term sustainability would be prepared on the basis of a mixture of best-estimate and hypothetical assumptions, auditors would be precluded from issuing any type of opinion on such information under the requirements of this auditing standard. This highlights the importance of entities disclosing steps taken to ensure that projections are reliable.

ACAG recommends that the IPSASB guidance should also require that information on long-term sustainability is clearly demarcated from audited financial information included in the general purpose financial statements. Preparers should clearly indicate that the projections are outside the scope of the audited financial report and clearly state that such information has not been audited.

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

ACAG agrees that the IPSASB guidance should recommend that the date of preparation or update be disclosed, given that there is a potential mismatch between the reporting date and the frequency with which fiscal projections may be made.

ACAG recommends that the IPSASB guidance should state that the underlying projections should meet the qualitative characteristics of relevance and timeliness. We consider that these characteristics should be the overarching principles applied in determining the timing or preparation and updating of the underlying projections, rather than the inclusion of a benchmark. However, IPSASB guidance should go on to state that the underlying projections should have been prepared or updated within five years of the reporting date, at a maximum, to meet these qualitative characteristics.