NEW ZEALAND INSTITUTE OF CHARTERED ACCOUNTANTS

3 May 2010

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CANADA

Submitted to: www.ifac.org

Dear Stephenie

Reporting on the Long-Term Sustainability of Public Finances

The Financial Reporting Standards Board (FRSB) of the New Zealand Institute of Chartered Accountants is pleased to submit its comments on the IPSASB's Consultation Paper *Reporting on the Long-Term Sustainability of Public Finances*. These comments are set out in an Appendix to this letter.

The FRSB considers that information on the long-term sustainability of public finances (henceforth referred to as information on long-term fiscal sustainability, or LTFS) is critical in providing a broader context for users of a government's general purpose financial statements, particularly for those items which may have major implications for a government's long-term fiscal position but which are not recognised as liabilities in the financial statements. The FRSB therefore considers the IPSASB should give a high priority to this project.

However, the FRSB does not feel that there is currently general agreement amongst financial reporting standards setters and users about the respective boundaries of general purpose financial reporting and reporting on LTFS and has reservations about whether all of the information presently included in current (and possibly future) LTFS reporting falls within the scope of general purpose financial reporting. The FRSB strongly encourages the IPSASB to address the boundaries of general purpose financial reporting and reporting on LTFS in the context of its conceptual framework project. The FRSB supports the development by IPSASB of guidance on fiscal sustainability reporting at least in the short term, but would encourage the IPSASB to strive to identify the financial reporting aspects of such reporting and those aspects that should remain the responsibility of others.

The FRSB notes that LTFS reporting is an evolving area and would be reluctant for any guidance developed by the IPSASB to constrain the ongoing development of these reports.

As noted in the Consultation Paper, both central government and local governments within New Zealand are required by legislation to prepare public reports that provide information on LTFS. These reports are published separately from the general purpose financial statements of these entities. The importance of this information and the right of constituents to this information has therefore been acknowledged by New Zealand legislators.

If you have any queries or require clarification of any matters in this submission, please contact Joanne Scott (joanne.scott@nzica.com) in the first instance, or me.

Yours sincerely

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Appendix – FRSB comments on Reporting on the Long-Term Sustainability of Public Finances

Preliminary Views, background and draft responses

PV1.	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 first Consultation Paper, "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities", issued in September 2008 (Section Two).

1. In its April 2009 submission on the IPSASB's Consultation Paper on phase 1 of its Conceptual Framework project, the FRSB recommended that the scope of financial reporting should be limited to include only information that is best communicated through general purpose financial reports. In particular, the FRSB recommended that the amount of non-financial and prospective information be limited to information that is central to assessing the entity's future objectives and service delivery activities as well as the resources necessary to support those activities.

2. In that submission, the FRSB also commented that (i) there may be some overlap between 'additional information' presented in the context of annual and other general purpose financial reports and 'other information' and (ii) that prospective financial information included within 'additional information' may contain elements of economic and statistical data which is also presented in reports that would be regarded as 'other information' – ie outside the scope of general purpose financial reporting.

3. A number of factors give the FRSB reservations about forming any conclusions on this preliminary view. These include:

   - the difficulty of identifying the respective boundaries of general purpose financial reporting and information on LTFS;
   - the fact that information on LTFS is likely to be broader than the type of financial information usually found in general purpose financial statements;
   - the difficulties of summarising information on LTFS for use in another document; and
   - the fact that this is an evolving area of reporting, even for those countries that currently produce such reports. Such reports are used as a communication tool to highlight the fiscal challenges facing a government and the options available to it in dealing with those challenges. The FRSB would be reluctant for any future guidance to constrain the ongoing development of these reports.

4. In relation to the first point above, the FRSB would strongly encourage the IPSASB to address the boundaries of general purpose financial reporting and reporting on LTFS in the context of its conceptual framework project.

5. Despite the concerns noted above, the FRSB agrees that this is an important topic and supports the IPSASB in considering issues associated with information on LTFS and improving the quality of that information. Rather than developing guidance on the form or contents of possible additional statements, the FRSB considers that guidance on the principles that should underpin the development of information on LTFS and appropriate disclosures may be a more useful approach for the IPSASB to consider. Our comments on PV6 are also relevant in this regard.

6. The FRSB also notes that some have concerns about the appropriateness of standard setters considering developing guidance on LTFS because of the prospective nature of that information. The FRSB does not share those reservations and the mere fact that LTFS information is prospective has not influenced the FRSB's comments on this PV.

PV2.	IPSASB guidance should recommend that long-term fiscal sustainability information in GPFRs be presented either through: • Additional statements providing details of projections; or • Summarized projections in narrative reporting (Section Three).

7. Please refer to our comments on PV1.

PV3.	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).

8. The FRSB supports the view that IPSASB guidance should provide recommended practice for consolidated reports prepared by whole-of-government controlling entities. The FRSB also generally supports the view that IPSASB guidance should be based on the concept of the reporting entity. However, there may be cases in which a government wishes to publish information on the LTFS for components of the whole-of-government reporting entity.

PV4.	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).

9. The FRSB supports PV4. The FRSB considers that an entity should have regard to the qualitative characteristics, including relevance, in the preparation of all information in a general purpose financial report.

PV5.	IPSASB guidance on long-term fiscal sustainability reporting in GPFRs 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).

10. The FRSB generally supports the inclusion of the proposed disclosures in any forthcoming IPSASB guidance.

11. The FRSB strongly supports the disclosure of key assumptions underlying fiscal sustainability projections, including those assumptions identified by the IPSASB. In addition, the FRSB considers that IPSASB guidance should recommend the disclosure of the rationale for key assumptions.

12. The FRSB acknowledges that information on LTFS would be more comparable across jurisdictions if the underlying key assumptions, such as the use of current policy as the basis for making projections, were the same. However, the FRSB notes that current practice regarding the use of current policy varies across jurisdictions and that there may be valid reasons why a government would elect to incorporate the impact of certain future policies. Although the FRSB supports the IPSASB PV that an entity disclose any deviations from the principle that long-term fiscal sustainability projections are based on current policy, the FRSB considers that all entities should disclose the assumptions regarding current policy and the rationale for those assumptions.

PV6. IPSASB guidance on long-term fiscal sustainability reporting in GPFRs should recommend that the entity disclose:

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

13. Consistent with its comments on PV5, the FRSB supports PV6, particularly the preparation and disclosure of key sensitivity analyses. For example, the FRSB considers that it is essential that the sensitivity of the information to differing projected economic conditions and population age be disclosed.

14. The FRSB supports the disclosure of information about the discount rates used in preparing information on LTFS. Rather than requiring disclosure of the actual discount rates used, the FRSB would support disclosure of the basis on which the discount rate has been determined (consistent with existing requirements in IPSAS 25 *Employee Benefits*).

15. The final bullet point in PV6 proposes the disclosure of "Steps taken to ensure projections are reliable". The FRSB prefers the wording in the CP's Executive Summary which refers to "the steps taken to enhance the reasonableness of assumptions." The FRSB also supports the discussion in section 7.5 of the Consultation Paper which discusses reliability, in the context of information on LTFS, and states "the projections need to be reasonable and realistic, rather than an accurate prediction of the future". The FRSB acknowledges that the application of qualitative characteristics to information on LTFS, including reliability can be difficult. The following comments discuss the FRSB's efforts in developing principles to assist preparers in selecting reasonable and appropriate assumptions and enhancing the reliability of prospective financial information.

16. In developing a domestic financial reporting standard, FRS-42 *Prospective Financial Statements*[1], the FRSB grappled with the issue of how to accommodate the uncertainty associated with prospective financial information whilst still setting a high benchmark in terms of the expected quality of prospective financial information. FRS-42 establishes requirements for the preparation and presentation of general purpose prospective financial statements and is applied by local authorities in preparing financial statements over a ten year period. Requirements of FRS-42 which are pertinent when considering the reliability of prospective financial information include:

  - the principle of best information: "An entity shall use the best information that could reasonably be expected to be available at the time prospective financial statements are prepared in determining the assumptions and information used in the preparation of the prospective financial statements" (paragraph 13);
  - the principle that prospective financial information be reasonable and supportable: "Information in prospective financial statements shall be reasonable and supportable and faithfully represent the assumptions and information on which the statements are based" (paragraph 14);
  - application of the qualitative characteristics, including reliability. In discussing reliability the standard notes that "The reliability of prospective financial statements is affected by the appropriateness of the assumptions and the sources of uncertainty. Users should be able to assess the reliability of prospective financial statements and identify the factors that make the statements more or less reliable" (paragraph 17);
  - requirements to enhance the appropriateness of assumptions: "Assumptions shall be based on the best information that can reasonably be expected to be available to the entity, be consistent among themselves, be consistent with the current plans of the entity to the extent that this is relevant, and be applied consistently. An entity shall have a reasonable and supportable basis for the determination of assumptions underlying prospective financial statements" (paragraph 18);

[1] FRS-42 is available at www.nzica.com

- disclosures of bases for assumptions, risks and uncertainties (paragraphs 47-59): The Standard requires disclosure of:
  - (a) the entity's operations and activities;
  - (b) the purpose for which the prospective financial statements have been prepared;
  - (c) significant assumptions;
  - (d) any changes to the entity's existing business;
  - (e) the bases on which the significant assumptions have been prepared, including the principal sources of information from which they have been derived;
  - (f) the extent to which actual events and transactions have been reflected in the prospective financial statements;
  - (g) the factors that may lead to a material difference between the prospective financial statements and the actual financial results presented in historical financial statements in future reporting periods;
  - (h) the assumptions made in relation to those sources of uncertainty and the potential financial effect of the uncertainty on the prospective financial statements;
  - (i) significant accounting policies; and
  - (j) a cautionary note regarding possible variations in reported results.

PV7. 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).

17. The FRSB agrees with the IPSASB recommending disclosure of the date of preparation or update of projections underlying information on long-term fiscal sustainability. However, the FRSB does not wish to express a view on the maximum time period between preparing/updating projections and reporting them. The Board considers that any information on long-term fiscal sustainability provided in GPFRs should satisfy the qualitative characteristics of financial information, including timeliness.

18. The remainder of this comment letter provides some background on long-term fiscal sustainability reporting in New Zealand.

New Zealand developments in reporting information on long-term fiscal sustainability

<u>New Zealand Government</u>

19. The New Zealand Treasury is required under the Public Finance Act 1989 (as amended 2004) to publish a statement on New Zealand's long-term fiscal position at least every four years. Each statement must have a projection-horizon of at least 40 years. The New Zealand Government uses the same boundary for these reports as for the consolidated financial statements.

20. The most recent statement, *Challenges and Choices: New Zealand's Long-term Fiscal Statement*, was published on 29 October 2009.[2] This document is set out in three sections.
    - Part A discusses the broad issues facing New Zealand.
    - Part B looks at broad choices in relation to tax and spending.
    - Part C considers three possible scenarios and their impact on the projected fiscal position.

[2] URL on Treasury website at October 2009: http://www.treasury.govt.nz/governmentfinances/longterm/fiscalposition/2009
Persistent URL: http://www.purl.org/nzt/o-1243

21. At present the financial statements of the New Zealand Government do not include a summary of the information in the long-term fiscal statement. This possibility has been considered but given the way the long-term fiscal statement is structured it would be difficult to decide which aspect to include in the financial statements.

22. The long-term fiscal statement is used by international rating agencies and others with an interest in the Government's long-term fiscal position.

New Zealand Local Authorities

23. Local authorities are required, under sections 84 and 93 of the Local Government Act 2002, to publish Long-Term Council Community Plans (LTCCPs) which include projected financial statements with a 10-year time horizon. Local authorities prepare these financial statements in accordance with the New Zealand domestic standard, FRS-42 *Prospective Financial Statements*.

24. The main purpose of prospective financial statements in the LTCCP is to provide users with information about the core services that the Council intends to provide ratepayers, the expected cost of those services and, as a consequence, how much the Council requires by way of rates to fund the intended levels of service.

25. In addition to the ten year horizon explicitly required by the Local Government Act, the Act has other requirements which effectively require local authorities to prepare long-term asset management plans. The 10th Schedule of the Act requires that the LTCCP contain information on how the council will identify future asset requirements to manage services and maintenance requirements. The only effective way that a local authority can verify that it has done so is to have an asset management plan, and due to the nature of infrastructure assets, this plan must often extend for 40 or 50 years. Asset management plans may be published as part of an LTCCP or in a separate document. Because LTCCPs are audited, the auditor also reviews the asset management plans. The audit opinion covers underlying information of which the asset management plans are a key component.

26. Users of the financial information in LTCCPs include ratepayer associations, Statistics New Zealand, universities and lenders.

27. An extract from the Local Government Act 2002 is set out below:

Local Government Act 2002
Schedule 10
Part 1 Information to be included in long-term council community plans

Council plans and reports
2 Group of activities
(1) A long-term council community plan must, in relation to each group of activities of the local authority,—
    (a) identify the activities within the group of activities:
    (b) identify the rationale for delivery of the group of activities (including the community outcomes to which the group of activities primarily contributes):
    (c) outline any significant negative effects that any activity within the group of activities may have on the social, economic, environmental, or cultural well-being of the local community:
    (d) identify the assets or groups of assets required by the group of activities and identify, in relation to those assets or groups of assets,—
        (i) how the local authority will assess and manage the asset management implications of changes to—
            (A) demand for, or consumption of, relevant services; and
            (B) service provision levels and standards:
        (ii) what additional asset capacity is estimated to be required in respect of changes to each of the matters described in subparagraph (i):
        (iii) how the provision of additional asset capacity will be undertaken:
        (iv) the estimated costs of the provision of additional asset capacity identified under subparagraph (ii), and the division of those costs between each of the matters in respect of which additional capacity is required:
        (v) how the costs of the provision of additional asset capacity will be met:

(vi) how the maintenance, renewal, and replacement of assets will be undertaken:
(vii) how the costs of the maintenance, renewal, and replacement of assets will be met:

(e) include the information specified in subclause (2)—
(i) in detail in relation to each of the first 3 financial years covered by the plan; and
(ii) in outline in relation to each of the subsequent financial years covered by the plan.

(2) The information referred to in subclause (1)(e) is—

(a) a statement of the intended levels of service provision for the group of activities, including the performance targets and other measures by which actual levels of service provision may meaningfully be assessed:
(b) the estimated expenses of achieving and maintaining the identified levels of service provision, including the estimated expenses associated with maintaining the service capacity and integrity of assets:
(c) a statement of how the expenses are to be met:
(d) a statement of the estimated revenue levels, the other sources of funds, and the rationale for their selection in terms of section 101(3).