



Accounting Standards Board

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The Technical Director  
International Public Sector Accounting Standards Board  
International Federation of Accountants  
277 Wellington Street West  
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Per e-mail

27 February 2012

Dear Stephenie,

**COMMENTS ON THE PROPOSED RECOMMENDED PRACTICE GUIDELINE ON REPORTING ON THE LONG-TERM SUSTAINABILITY OF A PUBLIC SECTOR ENTITY'S FINANCES**

We welcome the opportunity to provide comments on the Proposed Recommended Practice Guideline (RPG) on *Reporting on the Long-Term Sustainability of an Entity's Finances*.

Our comments to you are set out in three parts: Part I outlines our general comments on the Proposed Guideline, Part II outlines our responses to the specific matters for comment and, Part III outlines editorial and other minor comments.

The comments outlined in this letter are those of the Secretariat and not the Board. In formulating the comments, the Secretariat consulted with a range of stakeholders including auditors, preparers, consultants, professional bodies and other interested parties. We were however unable to engage key officials within the National Treasury on the proposed RPG during the comment period due their involvement in the preparation of the national budget. We will endeavour to consult with them prior to the comments on the RPG being discussed at the June 2012 IPSASB meeting.

Please feel free to contact me should you have any queries relating to this letter.

Yours sincerely

A handwritten signature in blue ink that reads 'Erna Swart'.

Erna Swart

Chief Executive Officer

Board Members: Mr R Cottrell (Chairperson), Mr V Jack, Ms CJ Kujenga, Mr K Kumar,  
Mr T Makwetu, Mr F Nomvalo, Mr G Paul, Mr I Sehoole  
Chief Executive Officer: Ms E Swart



## **PART I – GENERAL COMMENTS**

### **1. Overall support for the Proposed Guideline**

- 1.1 Overall, we support the reporting of information that enables an assessment of an entity's long term fiscal sustainability, subject to the comments outlined below.

#### *Proposed content of the report and users' needs*

- 1.2 In paragraph 20, it is noted that reporting on certain indicators may be useful in assessing an entity's long term fiscal sustainability. While we do not disagree with the list of indicators, we question whether users of general purpose financial reports (GPFRs), including general purpose financial statements (GPFSSs), will necessarily find all of this information useful and understandable. For example, the "inter-temporal budget gap" listed in 20(e) is a term widely understood by economists, but would not be widely understood by the users of GPFRs and GPFSSs.
- 1.3 As one of the origins of this project was to develop information that would provide users of the financial statements with additional information about an entity's resources and obligations broadly, we question whether the scope of the proposed reporting is too wide and consequently is not entirely aligned with the needs of the users of GPFRs. Many of the reports currently published by governments in other jurisdictions are not necessarily published as an accompaniment to the financial statements, rather they are issued as an accompaniment to the budget or other policy documents. While we find this reporting useful in general, it would not necessarily meet the needs of the users of GPFRs, including GPFSSs as the intended audience of the report may be different. We are also of the view that the content of the report may vary depending on whether the report is intended to assess sustainability at a whole-of-government level or, the sustainability of a particular entity or program.
- 1.4 We suggest that the Proposed Guideline clarify for whom this type of reporting is intended and describe their overall information needs. It might be that, because the RPG addresses sustainability at a macro and an entity level, there should be two separate parts or explanations for the "content" of the information reported (paragraphs 17-37).

#### *Implementation of the Proposed Guideline*

- 1.5 At present in the South African public sector, no formal fiscal sustainability reports are published. At a central government level, models to facilitate such reporting are being developed although it is likely to take a significant period of time until reports are produced and published. At a provincial (state) government level, no fiscal sustainability reports are produced. At a local government level, these reports are produced informally for management purposes but the time horizon often does not extend beyond 10 years.
- 1.6 During our consultations on the Proposed Guideline, stakeholders indicated quite often that they were unsure of the type of reporting that was envisaged in the Proposed Guideline. As there may be other jurisdictions which have a limited knowledge of this type of reporting, we would urge the IPSASB to issue supplementary guidance to the RPG. This supplementary guidance should explain more clearly what is envisaged by this type of reporting, how to develop methodologies to report this information, the

period and rates used, the types of indicators that might be reported (for all three dimensions; not only those related to “fiscal capacity”) etc.

- 1.7 As an alternative suggestion, we would suggest that the Consultation Paper accompanies the Proposed Guideline (once published) on the website as it provides valuable background information to those jurisdictions that may not be familiar with this type of reporting. It would also be useful if the website could provide an indication of where information could be obtained about various models for long-term fiscal sustainability reporting (e.g. The OECD or IMF guidelines).

#### *Inter-relationship with other reporting frameworks*

- 1.8 In South Africa, the King III Code on Corporate Governance applies to public sector entities. This report encourages public sector entities to prepare an integrated report. During our consultations, many stakeholders questioned the inter-relationship of the Proposed Guideline and integrated reporting. While acknowledging that jurisdictional arrangements may differ, because the proposed IIRC framework intends to apply to public sector entities, we urge the IPSASB to articulate in the Basis for Conclusions how its Proposed Guideline is positioned in relation to integrated reporting.

## **2. Status of the Proposed Guideline**

- 2.1 We agree that the Proposed Guideline should encourage, rather than mandate, reporting on long-term fiscal sustainability. In many developing countries, the reporting of information on long-term fiscal sustainability is not common. Consequently, it may take some time for practice to develop and evolve. While the adoption of IPSASs is strongly encouraged in such jurisdictions, it is an onerous task to ensure compliance with IPSASs in preparing financial statements. If mandatory reporting requirements outside the GPFs became a prerequisite for adopting IPSASs, the adoption of these standards may be severely hampered in many jurisdictions.

## **3. Scope of Proposed Guideline**

- 3.1 At present, the Proposed Guideline provides reporting requirements for all public sector entities, except GBEs. While we accept that the current suite of IPSASs do not apply to GBEs as these entities should apply IFRSs, we are of the view that reporting on long-term fiscal sustainability may be applicable to many GBEs. In our jurisdiction, we consider that many GBEs (for example, power utilities, airport operations companies, rail and port authorities) would meet the criteria outlined in paragraph 15 and thus users for such information would exist. We are of the view that because these entities often rely on taxes, subsidies and debt to fund their operations and expansions, assessing their sustainability is crucial.
- 3.2 Similarly, we are of the view that other types of reporting outside the GPFs may be useful to GBEs, e.g. reporting on service performance information. We would therefore, as a broader issue, urge the IPSASB to consider the applicability of reporting outside of the GPFs to GBEs as part of the GBE project recently added to its work programme.
- 3.3 As an interim measure, we propose amending the scope of the document to indicate that although the Proposed Guideline is not intended to apply to GBEs, the Proposed Guideline could be used by GBEs in reporting such information (where the requirements in the Proposed Guideline are met).

## **4. Definitions**

- 4.1 Definitions of long-term fiscal sustainability commonly used in the economic environment refer to the ability of an entity being able to meet its commitments now and in the future based on inflows and outflows/revenues and expenses. This aspect has not been addressed in the definition of long-term fiscal sustainability, but has been described in paragraph 8.
- 4.2 Given that there is currently no universally accepted and recognised definition of long-term fiscal sustainability, even from an economic perspective, we question whether it is appropriate to attempt to define the concept in the Proposed Guideline. We are of the view that the “Definitions” section of the proposed Guideline should be replaced with a more robust section describing the “terminology/terms” used in the Guideline. This approach would also be more appropriate given that this is a Recommended Practice Guideline and not an IPSAS. Also, because users of the Guideline may not be accountants, a broader coverage of terminology used might be useful.
- 4.3 In defining “long-term fiscal sustainability” reference is made to “financial commitment”. As presently drafted, there is no description of what is meant by a “financial commitment”. Without a discussion on what a “financial commitment” constitutes, entities may have either a very narrow or broad interpretation. As an example, in South Africa, basic income grants are paid to beneficiaries who have applied to receive the grant, are 18 years old and, who otherwise meet the necessary criteria. At the date of preparing the report, there may be 10 million people who qualify, but only 5 million have applied and met the criteria. Using a narrow interpretation of a financial commitment, the projections could be made for the million who presently have applied and qualify. Using a broader interpretation based on legislation enacted at year end, the 10 million could be used in the projections. As a result, we are of the view that a brief description and discussion of a “financial commitment” should be included in the Proposed Guideline.
- 4.4 We also propose that a reference be made to certain terms in the Proposed Guideline being consistent with terms used in IPSASs (for example, GGS).

## **5. Reporting boundary**

- 5.1 The discussion in paragraph 10 reflects the principle that the entities and activities reflected in long-term fiscal sustainability projections should be the same as for the financial statements as this will increase the understandability and usefulness of the projections. The discussion in paragraph 11 goes on to describe that if the projections are not done on the same basis as the financial statements, this fact should be disclosed along with the possible impact.
- 5.2 The Proposed Guideline is not prescriptive about the format of long term fiscal sustainability reporting, e.g. should the report accompany a set of GPFs (within a broader GPFR) or can the report be issued on its own. The Proposed Guideline also does not indicate, for example, that the long term fiscal sustainability report should clearly indicate to which set of GPFs the projections relate.
- 5.3 Based on the statement in the last sentence of paragraph 10 that, the understandability and usefulness of the projections is enhanced when they are consistent with the financial statements, seems to imply that this information is more

useful if it accompanies the financial statements. We suggest that the Proposed Guideline should stipulate that the long term sustainability report should be made available at the same time as or, should accompany the financial statements.

5.4 In the South African context, as will be the case in other jurisdictions, a set of general purpose financial statements is not prepared at a whole of government level because the requirements for consolidation are not met. While it is appropriate to prepare information on the long-term fiscal sustainability for a whole of government level (using a macro-economic perspective), it is unclear whether:

(a) Such a report is consistent with the objective of general purpose financial reporting in the context of enhancing the information in the financial statements and providing users of a specific set of GPFs with additional information about an entity's resources and obligations.

(b) The disclosures envisaged in paragraph 11 would be meaningful in such a context as there are no GPFs available.

5.5 Based on this observation, we propose that the IPSASB considers whether it is necessary to be more prescriptive about how the report on long-term fiscal sustainability should be issued and its linkages with the GPFs. We are also of the view that a discussion on whole-of-government reporting (and other types of reporting) where there is no linkage to a specific set of GPFs could usefully be included in the text of the Proposed Guideline or the Basis for Conclusions.

## **6. Determining whether to report on long-term fiscal sustainability**

See the response to specific matter for comment 1.

## **7. Addressing the dimensions of fiscal sustainability.**

See the response to specific matter for comment 2.

## **8. Disclosure of principles and methodologies**

See the response to specific matter for comment 3.

## **9. Improving the Basis for Conclusions**

As some jurisdictions are not familiar with reporting on the long-term sustainability of an entity's finances, it would be useful to outline the distinction between projections/forecasts that are made as part of the medium-term budget process and the projections as part of this project.

## **10. Other**

After reviewing the Proposed Guideline, we noted that limited reference is made to the qualitative characteristics, mainly in the section dealing with "Presenting projections of prospective inflows and outflows". It might be useful to indicate more broadly, within the text of the Proposed Guideline, that the information is presented and disclosed after considering the qualitative characteristics and the constraints on information outlined in the Framework.

## **PART II – SPECIFIC MATTERS FOR COMMENT**

### **Specific matter for comment 1**

*Do you agree that the characteristics of an entity that indicate whether users exist for information on long-term fiscal sustainability are those set out in paragraph 15? If you consider that there are more appropriate indicators please provide them.*

We agree with the three criteria outlined in paragraph 15. In considering the appropriateness of the criteria and whether an entity should meet one, all three or any combination of the three criteria, we considered whether an entity could have wide decision making powers without having (a) and (b). We concluded that this would be possible in the South African context.

As currently drafted, there is no description of what is meant by “wide” decision-making powers. To avoid entities reporting unnecessarily on long-term fiscal sustainability, we suggest adding a description to the text of the Proposed Guideline or the Basis for Conclusions what is meant by the term “wide” decision-making powers.

### **Specific matter for comment 2**

*Do you agree that the “dimensions” of long-term fiscal sustainability in paragraphs 27-37 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?*

We agree broadly with the three broad dimensions which should be addressed in an entity’s report on long-term fiscal sustainability. We do however have the following comments on the labelling and descriptions of these dimensions:

- (a) Title of “vulnerability” dimension. While we agree with the concepts underpinning this discussion, we do not agree with this dimension being titled “vulnerability”. “Vulnerability” in an economic context has a negative connotation and is often used to denote liquidity risk and the risk of insolvency. Consequently, we suggest changing this to “Degree of Independence”.
- (b) The description of “fiscal capacity” refers to meeting commitments without raising taxes. Certain economic guidelines refer to fiscal sustainability being meeting commitments without raising taxes or, without raising taxes to an unrealistic level. As entities might follow the latter concept of sustainability, this should be discussed in the Proposed Guideline. Paragraph 30 refers to “primary deficit” and “total deficit”. These terms may not be well understood or have different meanings in different jurisdictions. As a result, we suggest either providing an explanation in the text of the Guideline or, including a definition in the Appendix.
- (c) The description of “service capacity” currently indicates that this dimension represents the extent to which (a) the entity can maintain services at the volume and quality provided to current recipients at the reporting date.... We question whether this is the correct measure, considering that:
  - There may be additional recipients who qualify for a particular service over and above those who already receive such goods and services. It would be important to consider not only the current recipients but all those who are eligible to receive specific goods and service based on legislation in force at the reporting date.

- The volume or quality currently provided may be sub-standard and may not be in line with defined or agreed specifications (for example, the volume and quality of services specified in a strategic plan). In addition, there may be different benchmarks used when assessing an entity's ability to continue providing services, i.e. current level of services versus expected level of services versus ideal level of services. We suggest that the Guideline clarify these possible benchmarks, and prescribe which level should be used in developing their projections and discussions. In addition, specific disclosure requirements may be necessary in paragraphs in paragraphs 38 to 51.

As a result, we suggest amending this paragraph to reflect that service capacity is measured based on an agreed/specified volume and quality.

### **Specific matter for comment 3**

*Do you agree with the guidelines in this ED on disclosure of principles and methodologies, including risks and uncertainties? If not, how would you modify these guidelines?*

While we agree with the disclosures related to the principles and methodology used to prepare the projections currently proposed in paragraphs 38 to 50, we suggest amending this section to deal more broadly with all the disclosures encouraged in the Proposed Guideline. A section that deals broadly with disclosures could include, for example:

- A statement indicating that the Proposed Guideline describes minimum disclosures, but that more information may be needed to meet users' needs.
- Disclosures about whether the Proposed Guideline was used to prepare the report, explaining any departures.
- Disclosing any differences between the entities covered in the long-term fiscal sustainability report and the GPFs.

Paragraph 49 notes that sensitivity analyses should be prepared. While we agree that this information can be useful, there is a risk of providing users with too much information on the variability of the projections, making the information overly complex and reducing its understandability.

*Updating projections and frequency of Reporting:* In paragraph 39 it is mentioned that annual updating is unrealistic; however in paragraph 48 it is proposed that entities discuss any changes in the inflation and discount rates since the last reporting date. It is not clear whether this implies the last reporting date of the fiscal sustainability information or annual reporting. We suggest that the frequency of reporting should be more clearly defined, especially in cases where the information is not necessarily updated on an annual basis.

*Reliability of Projections:* It was noted that this paragraph mentions that projections are not forecasts. We recommend that the difference be explained in the Guideline as our experience has been that people often use these terms interchangeably in practice.

### **PART III – EDITORIAL AND OTHER MINOR COMMENTS**

During our review of the Proposed Guideline, we noted the following editorial and other minor comments:

<b>Paragraph</b>	<b>Comment</b>
1, second sentence	Reference is made to “advice”. We would suggest changing this to “guidance” as it is within the IPSASB’s mandate to issue “guidance” rather than provide “advice”.
16, part (a)	We suggest that part (a) should be amended to indicate that information might not be prepared by the controlling entity. We suggest the following amendment: (a) consistent with information reported by the controlling entity <u>(if any)</u> , (b) .....
17	Paragraph 17 refers to “core” information being the projections of inflows and outflows. There is however no mention of “supporting” information or what this might constitute. Given that the Phase 4 Consultation Paper has only recently been issued, it may be premature to refer to “core” information in this Guideline.