

# Long-Term Fiscal Sustainability Reporting



**International Federation  
of Accountants**

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This Project Brief was prepared by the International Public Sector Accounting Standards Board (IPSASB), an independent standard-setting body within the International Federation of Accountants (IFAC). The objective of the IPSASB is to serve the public interest by developing high quality accounting standards for use by public sector entities around the world in the preparation of general purpose financial statements. This will enhance the quality and transparency of public sector financial reporting and strengthen public confidence in public sector financial management.

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# INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

## LONG-TERM FISCAL SUSTAINABILITY REPORTING

### PROJECT BRIEF AND OUTLINE

#### 1. Subject

Reporting on the long-term fiscal sustainability of governmental programs and finances.

#### 2. Project Rationale and Objectives

During the development of its project on social benefits the IPSASB has formed a view that the financial statements of an entity cannot satisfy all the needs of users in assessing the future viability of programs providing social benefits. The IPSASB holds this view regardless of the approach that is taken to the point(s) at which a present obligation(s) occur(s) (which may vary for different types of social benefits), the extent of those present obligations and the amount of the resultant liabilities. Information presented in the financial statements may need to be complemented by the presentation of other information about the long-term fiscal sustainability of those programs, including their financing.

##### a) Objectives to be achieved

The ultimate objective of the project is to produce a framework for the reporting of information related to the long-term fiscal sustainability of governmental programs and finances.

The intermediate objective is to produce a Consultation Paper. The Consultation Paper will highlight and analyze existing approaches in jurisdictions, where long-term fiscal sustainability reporting is a feature of governmental financial management, as well as the approaches of supra-national bodies (such as the European Commission and the International Monetary Fund) in making comparative fiscal projections.

The project is not directly related to the accrual basis of financial reporting and the traditional financial statements and is not linked to an existing International Financial Reporting Standard. It is therefore not feasible or appropriate to provide definitive final outputs at the initiation stage. Dependent upon decisions to be made following analysis of submissions on the Consultation Paper, a Standard (providing requirements) and/or Guidance will be developed.

##### b) Link to IFAC/IPSASB Strategic Plans

###### *Link to IFAC Strategic Plan*

Issuing requirements and guidance on public sector financial reporting issues is a primary role of the IPSASB. The development of such requirements and guidance supports IFAC's mission of serving the public interest by contributing to its aim of becoming the international standard setter for governmental financial reporting.

*Link to IPSASB Strategy*

This is an area which has become increasingly topical and relevant to the enhancement of public sector accountability. The absence of public sector specific guidance on fiscal sustainability reporting is a “gap” in the IPSASB literature that has become apparent during the IPSASB’s project on social benefits (see above). It is consistent with IPSASB’s strategic theme of developing requirements and guidance on public sector specific issues.

**3. Outline of the Project**

a) Project Scope

The scope of the project is reporting on the long-term fiscal sustainability of governmental programs, including their financing. The range of entities and levels of government to be within the scope of finalized outputs will be determined following analysis of submissions on a Consultation Paper.

Certain other issues relating to scope will be considered in the course of the project. These include whether:

- All governmental programs should be within the scope; or
- Whether the scope should be restricted to certain programs, for example, contributory programs or social insurance programs.

This project only addresses long-term fiscal sustainability reporting and not environmental sustainability. However, there may be linkages between environmental sustainability and long-term fiscal sustainability, because assumptions about environmental sustainability may impact upon financial assumptions such as changes in Gross Domestic Product (GDP) and demographic assumptions such as population growth, emigration and immigration. The project will acknowledge such potential linkages.

b) Major Problems and Key Issues that Should be Addressed

*(i) Definitions*

There is no globally accepted definition of fiscal sustainability or long term-fiscal sustainability, although a number of governments have developed formal or implied definitions of these terms or related terms. In some cases these definitions are located in the context of medium-term fiscal planning or budgetary frameworks, such as when long-term fiscal sustainability is linked to specific targets such as a pre-determined net debt/Gross Domestic Product (GDP) ratio or net debt/GDP per capita ratio. In these cases overall governmental spending is said to be fiscally sustainable if it is contained within these pre-determined and publicly communicated targets over a certain period.

At a very high level, long-term fiscal sustainability reporting involves an assessment of the extent to which service delivery can be maintained at existing levels, and the extent to which governmental obligations to citizens under

existing legal frameworks, can be met from predicted inflows over a pre-determined future period. The analysis of long-term fiscal sustainability therefore takes account of both current and future beneficiaries, regardless of whether governments have present obligations to them, determined in accordance with accrual accounting principles at the reporting date.

Long-term fiscal sustainability is sometimes coupled with the broad concept of inter-generational equity, which evaluates the extent to which future generations of taxpayers will be affected by the fiscal consequences of current policies for the delivery of goods and services.

As noted above, the reporting of long-term fiscal sustainability is also commonly linked to frameworks involving targets and benchmarks involving such indicators as:

- Net Debt;
- Net Debt/GDP;
- Fiscal Gap;and
- Fiscal Imbalance.

The project will therefore consider relevant terminology, the adequacy of existing definitions, and the extent to which those definitions need to be supplemented. It will also consider whether a Standard and/or guidance should specify or recommend that a minimum set of indicators should be reported.

(ii) *Status and Nature of Outputs*

The project will consider whether the IPSASB should be developing requirements and if so, whether such requirements should specify the information to be reported if an entity elects to report information about long-term fiscal sustainability or should require all entities within the scope of those requirements to provide specified information about long-term fiscal sustainability. This will involve determining whether all entities should be required to report on long-term fiscal sustainability as a regular feature of their general purpose reporting or whether the scope of the requirements should be restricted by, for example:

- Only applying to entities which elect to make their fiscal sustainability reports publicly available; or
- Only applying to entities that mention or discuss the fiscal sustainability report in the general purpose financial statements?

The project will also examine whether any requirements should apply to all entities that apply IPSASs or only to entities that apply accrual basis IPSASs. The rationale for not applying requirements to jurisdictions and entities on the cash-basis may be that to do so would be onerous.

(iii) *Reporting Entity for Long-Term Fiscal Sustainability Reporting*

The main issue is whether the requirements and guidance are to apply to all public sector entities; only entities at the national level, to the national whole-of-government level, to all levels of government combined, or to another level.

In this context, the project will consider the view that requiring individual entities to prepare and report information on the fiscal sustainability of operations is onerous and not proportionate to the benefit that users will derive from the information. It will also consider the view that only by developing requirements for all levels of government combined will user needs for information about the overall long-term fiscal sustainability of the public sector be satisfied – this particularly applies to nations with federalized structures, where the service delivery of significant public sector programs is the responsibility of entities at sub-national levels of government and where sub-national level entities have wide tax-raising powers.

National statistical accounting is used as the basis for long-term fiscal sustainability reporting in a number of jurisdictions. The project will therefore consider statistical accounting approaches and in particular whether the general government sector (GGS) may provide the appropriate reporting boundary for fiscal sustainability reporting. At a national level, the GGS encompasses all levels of government, as well as social security funds and non-market non-profit entities controlled by government units. At a jurisdictional level within a nation (for example, for a state government), the GGS is identified for that jurisdiction, and, in that instance, would have regard to whether control relationships exist. Under statistical accounting the public sector also comprises public financial corporations and public non-financial corporations. In contrast to the basis generally applied under accrual IPSAS, the GGS does not consolidate controlled entities outside the GGS sector and does not therefore eliminate balances and transactions between entities in the GGS and other sectors. It treats controlling interests in entities outside GGS as investments.

(iv) *Time Horizons*

In jurisdictions that make long-term fiscal sustainability reports publicly available there is variation in the time horizons adopted—the period over which projections are made. There is a relationship between the robustness of assumptions and the time horizon — the further the time horizon is from the reporting date the less robust and potentially less verifiable the assumptions become. Conversely, excessively short time horizons may increase the risk that events and modified trends just outside the reporting horizon might have a significant impact on reported information. The project will explore various time horizons and consider how prescriptive any reporting requirements should be.

(v) *Regularity of Reporting*

Publication of the general purpose financial statements is, at a minimum, on an annual cycle. The project will examine whether the same frequency of reporting should be required or recommended for long-term fiscal sustainability reporting. Factors to be considered include the costs of reporting and the view that material policy assumptions, demographic assumptions and economic assumptions are often unlikely to change sufficiently rapidly within a year to justify the additional costs of annual reporting. Conversely, there is a view that material changes in policy assumptions can be quite common, especially for pensions and social security programs. This militates towards more regular reporting or at least more regular updating.

The project will consider whether there should be minimum intervals between reporting or whether any requirements should be more flexible, for example, requiring reporting intervals to be disclosed with any changes to those intervals since previous reports were produced.

(vi) *Assumptions and Sensitivity of Assumptions*

Fiscal sustainability reporting entails a range of assumptions. These assumptions include:

- Policy assumptions;
- Demographic assumptions; and
- Economic assumptions.

The term *policy assumptions* refers to the basis on which future levels of service delivery will be determined and the approach to taxation levels, including fiscal drag (see also the section on tensions with Current Legal Frameworks below).

*Demographic assumptions* include mortality and fertility projections, estimates of immigration and emigration and participation levels in the workforce and education.

*Economic assumptions* include productivity changes, unemployment rates and participation rates in education and the workforce, and real and nominal economic growth rates.

The project will consider whether the IPSASB should develop for the reporting of these assumptions used for long-term fiscal sustainability analysis.. Assumptions also include discount rates for projection models.

(vii) *Tensions with Current Legal Frameworks*

As a general principle IPSASs have adopted the tenet that transactions and elements are evaluated and determined within current legal frameworks. This is largely based on the view that the preparers of the financial statements should not predict governmental actions and that there should be no assumption that programs will discontinue unless legislation to that effect has been enacted at

the reporting date. The project will consider whether such a principle is relevant for long-term fiscal sustainability reporting and whether a complementary approach for taxation inflows should be adopted, so that inflows should be determined using current legal requirements (including taxation rates) unless changes have been effected at the reporting date.

The project will consider approaches for reporting information on projections under current frameworks where different legal obligations conflict or where projections are clearly unreasonable. Examples might be where:

- There is a legal requirement for a balanced budget and that requirement cannot be met under existing expenditure projections unless expenditure is reduced, benefits changed, contributions and taxation raised or through extensive disposals of assets: should balanced budget requirements take precedence over entitlements determined under existing legal frameworks or predicted growth trends?; and/or
- Where a program is operated on a segregated fund basis and benefits cannot be paid once the fund's earmarked assets have been exhausted. If exhaustion of the fund is projected within the time horizon of the reporting framework; should that exhaustion be reflected in projections of outflows of benefits?

In many instances legal obligations cannot be discharged unless annual appropriations are in place; limiting projections to appropriations would result in very short time horizons. The relationship between ongoing spending commitments and appropriation mechanisms will therefore be examined.

*(viii) Approach to Discretionary Programs*

The project will explore possible approaches to reporting information on discretionary programs. Discretionary programs are programs that the government is not required to maintain under current legal requirements beyond a clearly specified date. Discretionary programs may be contrasted with mandatory programs that involve entitlements to individuals or households. Authorizations for discretionary programs may be renewed on an annual basis.

The main issue is whether expenditure projections should extend beyond the limit of current authorizations and, if so, how expenditure projections are to be projected for such programs. A related issue is that discretionary programs are likely to expire before the time horizons used for reporting. The project will therefore consider whether an assumption should be made that such programs will be renewed on expiry.

*(ix) Financing*

The project will consider the approaches to be taken to reporting information on estimates of financial resources (taxes and other revenue) available to fund the programs in question.



(x) *Assurance and Verifiability*

The project will explore whether information reported on long-term fiscal sustainability can and should be assured and, if so, the possible levels of that assurance. It will explore the balance of responsibilities between preparers of fiscal sustainability reports in ensuring the verifiability of assumptions and auditors in providing any appropriate level of assurance.

4. **Implications for Specific Groups**

a) International Accounting Standards Board (IASB)

There is an indirect relationship with the IASB's Conceptual Framework project, although this is primarily addressed through the IPSASB's own Conceptual Framework project. The IASB also has a project on Management Commentary and issued a Discussion Paper in late 2005. In December 2007, the IASB decided to add a project on Management Commentary to its active agenda. While this project will primarily have an influence on the planned IPSASB project on Management's Discussion and Analysis (see below) it will be relevant indirectly to this project. In its Discussion Paper the authors of the IASB Discussion Paper proposed that, in addition to consideration of the key aspects of performance in the period covered by the financial statements, the Management Commentary should take a prospective view in considering the main trends and factors likely to affect an entity's future development, performance and position.

b) Relationship to other IPSASB projects in process or planned

There are relationships with a number of current or planned IPSASB projects:

(i) *Social Benefits*

The IPSASB has an ongoing project on social benefits. Key outputs from that project have been issued with this project brief. The IPSASB's deliberations on social benefits have been catalysts in the decision to initiate this project. The approach in ED 34, "Social Benefits: Disclosure of Cash Transfers to Individuals or Households" is intended as a bridge between accrual approaches and the development of approaches to long-term fiscal sustainability reporting.

(ii) *Conceptual Framework*

A project to develop a public sector conceptual framework is underway. This is led by the IPSASB and carried out in collaboration with certain national standard setters. The components of that project dealing with the objectives of financial reporting, the qualitative characteristics of financial information, the scope of financial reporting, the reporting entity, and the elements of financial statements are especially relevant to this proposed project.

(iii) *Management's Discussion and Analysis (Management Commentary/Narrative Reporting)*

The IPSASB plans to initiate a project on Management's Discussion and Analysis (MD&A), also known as Management Commentary, narrative reporting or operating and financial review) in the first quarter of 2008. In some jurisdictions the MD&A or equivalent is the main means by which expected future trends and changing conditions to the operating environment and their potential impact on the reporting entity are highlighted. Both this project and the separate MD&A project will consider the extent to which the MD&A should include details, and indicators, of long-term fiscal sustainability.

c) Other projects

Reports on the long-term fiscal sustainability of governmental programs are made publicly available in a number of jurisdictions and supra-national bodies also make comparative analyses of the financial condition of nation states available: For example, the European Commission assesses comprehensively the sustainability of the public finances of each Member State of the European Union ever 4 years. This assessment is based on a common methodological framework to account for the budgetary risks of population ageing. It is partially updated every year when countries submit their medium-term budgetary plans ("stability and convergence programs").

Globally a number of public sector standard setters are considering or developing requirements for the reporting of aspects of long-term fiscal sustainability in the public sector:

- At the federal level, the Financial Report of the United States Government includes a Statement of Social Insurance (SOSI), which adopts a 75-year time horizon for specified programs;
- Also at the federal level the US Financial Accounting Standards Advisory Board (FASAB) has a Standard, SFFAS 17, "Accounting for Social Insurance (Revised 2006)", which provides requirements for the SOSI. FASAB is also developing a Standard, providing requirements for broader fiscal sustainability reporting;
- At the state, local and municipal level, the US Governmental Accounting Standards Board has a project on economic condition;
- The Canadian Public Sector Accounting Board has a project on indicators of financial condition, which is developing guidance in the form of a statement of recommended practice; and
- Other standard setters have projects considering prospective information and narrative reporting.

**5. Development Process, Project Timetable and Project Output**

a) Development process

The development of outputs will be subject to the IPSASB’s formal due process. The issuance of documents for public comment will be subject to the usual IPSASB voting rules. As the project progresses, regular assessments will be made to confirm the nature of the outputs and the proposed path in the project timetable. .

The initial output will be a Consultation Paper. Following analysis of submissions on the Consultation Paper a decision will be made on whether to develop an Exposure Draft of a Standard and/or Guidance. Any Exposure Draft will also be subject to formal due process, including a consultation period of at least four months.

**Project timetable**

<b>2007</b>	
November	Project approved
<b>2008</b>	
February-March	Task Force selected and confirmed
February-March	Project brief finalized
March	Update to Meeting of IPSASB
March-September	Task Force develops Consultation Paper under oversight of Task Force
June	Update to Meeting of IPSASB
October	IPSASB reviews first draft of Consultation Paper
<b>2009</b>	
February	IPSASB reviews second draft of Consultation Paper and approves for publication
March	Publication of Consultation Paper
March-July	Exposure period for Consultation Paper
August-September	Staff analysis of submissions on Consultation Paper
September	Briefing for staff of International Auditing and Assurance Standards Board (IAASB) on assurance implications.
October	IPSASB considers analysis of submissions on Consultation Paper and adopts approach for final stage of project
<b>2010</b>	
February	IPSASB reviews first draft of Exposure Draft (ED) of an IPSAS and/or guidance
June	IPSASB approves ED and/or guidance
July	ED and/or guidance issued
July-November	Exposure period for ED and/or guidance
<b>2011</b>	
February	IPSASB considers analysis of submissions to ED/Guidance and provides directions for finalization of final stage outputs
June	IPSASB approves IPSAS and/or Guidance

(b) Project output

The initial output will be a Consultation Paper. As indicated above definitive final outputs will be determined following analysis of submissions on the Consultation Paper. Further final outputs may be a Standard and/or detailed Guidance.

6. **Resources Required**

a) Task Force

A task force of 8-10 (including Chair) is to be established – a task force of this size is necessary to reflect a broad cross section of IPSASB constituents and to enable a range of points of view, technical expertise and discussion for the development of this project.

Selection of task force members will be made by the Technical Director and IPSASB Chair.

Communication will be primarily carried out electronically. The majority of meetings are expected to be by conference call. It is expected that there will be at least two face-to-face meetings.

It is the current intention that all project materials will be developed by IPSASB staff.

b) Staff

It is envisaged that 0.75 Full Time Equivalent (FTE) resource (not dedicated) will be required to resource the project.

7. **Important Sources of Information that Address the Matter being Proposed**

- A number of governments and supra-national bodies publish reports on the long-term fiscal sustainability of programs;
- A number of standard setters have developed, are developing or refining existing requirements and guidance for long-term fiscal sustainability reporting or financial condition;
- A number of standard setters are developing approaches to public sector narrative reporting;
- Some standard setters have developed, or are in the process of initiating development, of requirements for prospective reporting; and
- Some auditors are reporting on financial condition.

8. **Factors that might add to complexity or length**

The project addresses a large subject in an area which is outside the general-purpose financial statements. This is a new topic for the IPSASB and there are few current pronouncements and therefore limited relevant experience to draw on. Decisions made following analysis of the initial consultation paper will also affect the length of the project, in particular whether it is decided to develop both requirements and guidance.





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