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Our ref MT/288
Contact Mary Tokar

29 February 2012

Dear Ms Fox

ED – Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances

We appreciate the opportunity to respond to the International Public Sector Accounting Standards Board's ('IPSASB' or the 'Board') Exposure Draft ('ED') entitled *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*, dated October 2011. We have consulted within the KPMG network in respect of this letter, which represents the views of the KPMG network.

While we generally are supportive of the draft, we have identified specific matters that we believe merit further consideration. These follow below:

Overall Comments

a) The objective of the ED is to provide guidance on how to supplement the statements of financial performance and financial position. The status of this Recommended Practise Guidance ('RPG') is that public sector entities (except Government Business Enterprises) are 'encouraged' to follow this RPG. As such, the ED would not be a required standard, yet terminology included within the ED would seem to require entities to follow the recommendations. Terms such as "should" are used throughout the ED. For example, paragraph 2 states that "an entity should indicate that it has followed this RPG or disclose if it has departed from the RPG and explain why such a departure was necessary".

   Consideration should be given to revising the draft to make clear that compliance is voluntary in all instances and therefore, it should not be necessary to disclose when an entity has not applied voluntary guidance. A useful guide for the Board to consider may be the IFRS Practice Statement '*Management Commentary: A framework for presentation,*' which gives clear guidance on aspects of management commentary. The scope in the Practice Statement describes, for example in paragraph 4, that "The Practice Statement does not mandate which entities should be required to publish management commentary, how frequently an entity should do so or the level of assurance to which management commentary should be subjected."

b) The ED defines "long-term fiscal sustainability" as "the ability of an entity to meet service delivery and financial commitments both now and in the future". We would encourage IPSASB to provide more context and background on what "fiscal sustainability", "service delivery" and "financial commitment" are intended to represent and, in particular, what time frame "in the future" contemplates. There are currently a number of different uses of the terms "sustainability" and "fiscal sustainability" which create a risk of confusion in the marketplace as to the intention of the Board. We believe the ED should provide greater context through explanation and examples in the Objective, Definitions and Scope paragraphs.

   The definition of "Long-Term Fiscal Sustainability" in paragraph 7 does not clearly indicate what is meant by "future". The definition should clarify that judgement needs to be applied in determining the duration of the "future" period to which long-term fiscal sustainability reporting relates, however, the intended minimum period should be clearly stated.

c) Some of the terminology may not be universally understood, for example "General Government Sector", "boundary of budget sector" and "system of national accounts". We believe that these terms will need to be defined or explained so that the Board's meaning is clear.

Specific Matter for Comment 1

You ask whether "we 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".

We generally agree with the characteristics of an entity that indicate whether users exist for information on long-term fiscal sustainability as set out in paragraph 15 of the ED.

We note that characteristic (c) refers to "service delivery levels", which has not been defined in the ED. We recommend that the characteristic be defined or further explained in the ED, perhaps with examples. We believe that the information on service delivery should be consistent with, and should refer to, the term as used in the IPSASB Conceptual Framework.

Contextualisation of the ED is important for the reader to understand the relevance of the requirements. With regards to paragraphs 14 – 16, the reader should be able to understand why it is important to report on long-term sustainability of finances for preparers to better evaluate whether a particular entity should provide disclosures. The narrative explanations should serve to supplement the characteristics provided. We suggest that it might be helpful to clarify each of the characteristics provided in paragraph 15, with examples.

We believe additional characteristics could be included as follows:

a) Decision-making powers to implement public policy for new government programs, which may require significant outflows in future years.

b) Has significant depreciable assets used for, or necessary to provide, public service delivery (e.g. power stations, water and sanitation and roadway infrastructure).

c) Has significant long-term liabilities and obligations that may require future funding.

d) There is significant social dependence on the continuity of the entity.

Specific Matter for Comment 2

You ask whether "we 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."

We agree that the dimensions of long-term fiscal sustainability described in paragraphs 27 – 37 are important indicators of long-term fiscal sustainability.

We believe that flexibility should be added as it provides insights into how a government manages its finances. Flexibility is, for example, the degree to which an entity is able to change its debt or tax burden in the economy within which it operates in order to meet its existing financial obligation at the reporting date. Flexibility also might be relevant where a government, that increases its outstanding debt now, reduces its flexibility in the future to respond to adverse economic circumstances that may develop. A government that increases taxation or user-fees today may limit its ability to do so in the future as the rate of taxation approaches the limit of what citizens and businesses are willing or able to bear. Flexibility may include indicators such as the ratio of debt charges to revenues, net book value of capital assets to their gross cost or own source revenues to GDP or taxable assessment (local governments).

The ED's intention is to address prospective information on long-term sustainability, but the Objective states the RPG is to "provide guidance on how to supplement the statements of financial performance and financial position". We recommend more clarity be provided on where and how this long-term fiscal sustainability should be reported. KPMG believes that given that the ED is not mandatory and it may take time for governments to achieve the best practice recommended, such material should be outside of the financial statements. However, we believe that this project should continue to be of high importance particularly when considering the conceptual framework discussions around the nature of assets and liabilities, with the longer-term goal of clarifying what information is necessary for the financial statements. It may be possible that this prospective information is excluded from the financial statements but included as part of a public sector entity's general purpose financial report ('GPFR') (i.e. in the annual report) or as a complementary document.

If long-term fiscal sustainability information were to be included in a public sector entity's GPFR (i.e. in the annual report but not in the financial statements) it is likely to impact the role and responsibility of the auditor. Currently, auditors are required under standards issued by the International Auditing and Assurance Standards Board (IAASB) to read the information in documents that also contain the audited financial statements and the auditor's report and, if not remedied by management, report on inconsistencies of other information with the audited financial statements. If GPFR is expanded to include information such as long-term sustainability, service delivery or prospective financial reporting then auditors may be asked to provide some form of assurance on that information. ISAE 3000, *Assurance Engagements*, is the generic international standard that would be relevant when providing such assurance. In order to provide assurance, auditors require suitable criteria that they can use to evaluate the subject matter of the engagement.

We encourage the Board to engage in a dialog with the IAASB on whether any additional guidance, to supplement that provided in ISAE 3000, is required so that auditors may report on items such as long-term sustainability and prospective financial information.

Specific Matter for Comment 3

You ask whether "we agree with the guidelines in this ED on disclosure of principles and methodologies including risks and uncertainties."

We generally agree with the guidelines set out in paragraphs 38 through 51, but have the following comments:

Paragraphs 40 to 42 – We suggest changing the language to ensure that cash flows that are individually modelled should be based upon current policy as well as approved policy arising in the period after the reporting date that have a significant impact on the entity's outflows. Guidance also could be provided to determine when a policy is considered approved similar to that provided in IAS 12.48 with respect to the term "substantively enacted".

Paragraph 48 – We believe that a key methodological principle should be to take into account inflation or deflation when making projections. Most economies are subject to inflation. For those that are not, disclosure should be made. Assumptions used in determining inflation and the inflation rates used in the reporting period should be disclosed.

Paragraph 49 – We do not believe that the example for sensitivity analysis should be limited to inflation. Sensitivity analysis should be provided for any significant assumption (e.g. interest rates, foreign exchange rates) that has a reasonably possible chance of varying from the estimate that could impact the projections. The last sentence should be deleted or it should clearly state that this is only an example of an issue that will need sensitivity analysis. It might be helpful if paragraph 49 included more examples of assumptions on which a sensitivity analysis would be required.

KPMG appreciates the opportunity to respond to this Exposure Draft. Please contact Archie Johnston at +1 604 527-3757, Peter Greenwood at +1 604 691 3187, Mark Jerome at +856 20 7808 3399 or Mary Tokar at +44 207 694 8871 if you wish to discuss any of the issues in this letter.

Yours sincerely

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