

Private/Confidential

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**IPSASB Exposure Draft 46 Proposed Recommended Practice Guideline:
Reporting on the Long-Term Sustainability of Public Sector Finances**

Dear Ms. Fox,

The global organization of Ernst & Young is pleased to comment on the above Consultation Paper.

General comments:

The sovereign debt crisis in the Eurozone continues to impact economies all over the world as well as the public finance deficit in many other countries around the world including the US. As a result of recent developments in this area, we observed increased focus and call for enhanced transparency and accountability from governments, towards their management of public finances. Therefore, we are convinced that reporting on the long-term sustainability of public finances will become one of the cornerstones of good governance for nations.

The information on long-term fiscal sustainability (LTFS) provided by governments is crucial for users to evaluate a government's long-term fiscal position. We acknowledge that reporting information about LTFS is still evolving, but recent developments in Europe have emphasized the importance of a robust framework and guidance that is needed to communicate such information effectively for the benefit of users. Furthermore, it is crucial that countries converge in the area of reporting, including the reporting of LTFS, to move towards closer comparability of information among countries by users. As such, we see this as a project of high priority particularly from the users' viewpoint.

Some of the terms and concepts used in the ED appear to have been derived from macro-economic concepts but with the intention of applying them at all reporting levels subject to the characteristics in paragraph 15. This may be confusing for preparers, particularly where they have been trained as accountants focusing on the entity level rather than as macro-economists.

We believe that information about LTFS would be relevant at all reporting levels. Communities that are dependent on service delivery from the local municipality would, for instance, have a specific interest in the financial sustainability of that particular municipality, in addition to the sustainability of the government as a whole. However, the focus and nature of the sustainability information of each entity might differ, depending on the level at which it is reported. An example of this, pertaining to the issue of “vulnerability” is provided in point 4 of Appendix B to this comment letter. The ED does not seem to acknowledge this, and does not seem to give guidance on what these differences might be. We urge the IPSASB to consider providing guidance on different levels of reporting.

In our previous comment letter on the Consultation Paper,¹ we supported the IPSASB on issuing guidance for LTFS reporting by governments but to not follow the approach to issue a mandatory standard in the near future as such reporting is still at an early stage. We also note the IPSASB’s reasons as stated in the Basis for Conclusions section (BC) paragraph 20 of ED 46 for not proposing a mandatory standard. However, in light of the sovereign debt crisis, we propose to the IPSASB to reconsider its decision to issue the final form of ED46 as a recommended practice guideline (RPG). If the IPSASB comes to a consensus to issue a mandatory standard, we recommend that the IPSASB prescribes mandatory broad principles with clearly laid out objectives for the information required to be presented and disclosed, accompanied by non-mandatory best practice guidance on how an entity can best meet those reporting objectives. If the IPSASB decides to go ahead with issuing a recommended practice guideline, we would still recommend the IPSASB to clarify the objectives for each recommended disclosure. Please refer to further discussions in Appendix B.

Our comments on the specific matters for comments are set out in Appendix A and we have included other comments which feedback is not specifically sought in Appendix B.

¹ IPSASB Consultation Paper: Reporting on the Long-Term Sustainability of Public Finances

Appendix A

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 believe that public sector entities that are responsible for the provision and delivery of social benefits should be required to provide information on LTFS for their users/constituents. We do not believe that the characteristics as set out in paragraph 15 automatically would scope such entities into the proposed guidance/standard, and propose that the Board include an additional indicator on the responsibility of an entity to provide and deliver social benefits into paragraph 15.

The indicator in paragraph 15(c) is unclear to us, particularly, the notion of 'wide' decision-making powers over service delivery levels. We suggest that the Board include guidance on the level of autonomy an entity would have, that would constitute an entity having wide decision-making powers.

Furthermore, although we understand the Board has (according to the Basis for Conclusions) purposefully not limited the applicability to whole-of-government or consolidated national financial statements, we are concerned that little distinction has been made between the type of information that would be relevant at a whole-of-government or macro-economic level versus the type of information that would be relevant at an individual entity level. As mentioned in our cover letter, we believe that the Board should consider what levels of reporting is required and the relevant information to be provided for different levels of reporting.

Although government business enterprises (GBEs) currently fall outside the scope of IPSAS and consequently would not be required to apply this RPG, the users of these entities' financial statements would benefit significantly from this type of sustainability reporting. We are of the view that the long term sustainability information would be both useful and relevant and therefore should be applied by GBEs as well. We recommend that, where possible, the Board encourage the regulators in the respective jurisdictions to recommend GBEs to make use of the RPG when reporting on long term fiscal sustainability information.

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 with the dimensions of LTFS and the inter-relationship between fiscal capacity, service capacity and vulnerability as a viable framework for narrative reporting on LTFS of an entity’s public finances. Despite our general agreement with this approach of developing a framework, please refer to our earlier comments about the generality of the concepts and terms used in the RPG, as well as our specific concerns around “vulnerability” in point 4 of Appendix B to this Comment letter.

Furthermore, we are of the view that currently the service capacity dimension is not sufficiently reflected in the ED, for example in the list of indicators as provided by paragraph 20 of the ED.

We also believe that the notion of ‘quality’ within the definition of ‘service capacity’ needs to be expanded. Service capacity as defined in paragraph 30 ‘is the extent to which a) the entity can maintain services at the volume and quality provided to current recipients ...’ We believe that users would be interested and find it useful to understand how quality is achieved, but there needs to be properly defined benchmark, in order to ascertain how and to what extent ‘quality’ is achieved. Information on how this benchmark is determined, and met, would be crucial to determine quality. We stress the importance of quality of service that is performed by the entity for constituents. It is recommended that the RPG clarify these different benchmarks and precisely what entities should measure themselves against, when developing their projections.

We recommend that the service capacity disclosure be, at a minimum, split between a) maintaining services at the volume and quality provided to current recipients, and b) service at the 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?

We question the relationship between the proposed guidance and other guidance on sustainability reporting that may be relevant to individual jurisdictions. It may be useful to acknowledge the existence of these other guides, codes and practices and to provide guidance on the minimum level of information required, whether it presented as part of this other disclosure or not.

We also believe that it would be helpful to preparers for the Board to provide more guidance on disclosing environmental factors. For example, the requirement to disclose the 'impact of the depletion and degradation of ecosystems and erosion of water and finite natural resources on economic growth' - how should this type of information be presented and disclosed? We would urge the Board to be more specific on this issue, and consider also referencing preparers to other guidance in the field of environmental sustainability. For example, the guidance as provided by the Reporting Framework of the Global Reporting Initiative.

We also stress the importance of the disclosure of 'impact of legal requirements and policy frameworks' for fiscal sustainability reporting. For example, EU constituents would be interested and find it useful to obtain information on how the new fiscal mechanism in the EU would impact on a nation's LTFS. We agree with the rationale that making users aware of the key aspects of governing legislation would enhance the understandability of projections, but more importantly, such disclosures would enhance the transparency of the projections and disclosures provided by the entity, and provide more accountability to the constituents. However, developing countries would need to consider the impact the new fiscal mechanism could have on current and future funding from the European Union (EU) on the donor funded initiatives.

We suggest that the Board be more prescriptive of what the narrative information should cover, and also require preparers to discuss how the quantitative information disclosed links with the qualitative/narrative information. We suggest adding the following wording to paragraph 38:

'The qualitative disclosures should be provided in the context of the quantitative disclosures, which enable users to link related disclosures and be able to form an overall picture of the nature and extent of risks that the entity faces.' The interaction between qualitative and quantitative disclosures should contribute to disclosure of information in a way that better enables users to evaluate an entity's exposures/vulnerability.

In addition, we suggest that entities disclose changes in principles and methodologies from prior period(s), with these recommended wording: 'For each disclosure, the entity should consider the changes from the previous period and disclose the nature and extent of these changes.'

In addition, it is not clear what should be disclosed if an entity departs from the RPG's principles and methodologies. We suggest that the guidance include a section on how to report that departure, which should accompany the methodologies disclosure.

Sensitivity analysis: We believe that as currently worded, the flexibility in presentation format available to entities would impede comparability across entities. We recommend more specific requirements be provided in this regard.

Reliability of Projections: It was noted that this paragraph mentions that projections are not forecasts. Our understanding is that projections are normally extrapolations of the current data/statistics whilst forecasts would incorporate assumptions of the future state. We recommend that the Board clarifies this concept in the ED as that would be helpful for both preparers and users.

Appendix B

1. Objective of long-term fiscal sustainability reporting should include the concept of intergenerational or interperiod equity

We believe that this concept is inherent in public sector reporting and should be a central objective of reporting on the long-term sustainability of public finances. We suggest that the Board expand on the objective as currently stated in paragraph 1 to include this concept.

2. Overarching principles needed on recommended disclosures

From paragraphs 17 - 51 of the ED, the Board has provided guidance on presenting projected information, dimensions of fiscal sustainability, principles and methodologies. However, there seems to be a lack of an overarching objective for each of the different areas of reporting, and the lack of the objective that information disclosed should be in a form that meets users' needs.

For example, in paragraph 27, we suggest that the Board include the objective to provide information that a user should be able to use/analyse the information proposed from paragraphs 28-37, in order to understand the 'nature and extent' of the fiscal capacity, service capacity and vulnerability of the entity, besides providing faithfully representative information.

3. *Definitions of Proposed Guide*

We suggest that the guide better explain the concept "financial commitment", as this has different meanings in different contexts. For example, a financial commitment can refer to either a present economic obligation or liability to be settled in future, or it could be a promise to incur certain costs in the future.

It is noted that the guide includes an appendix with a glossary of indicators; we suggest that the guide include either an appendix or a section also explaining the terminology and terms used in the guide. It is likely that the primary users of this will not necessarily be familiar with all the economic terms that have been used. It was also noted that the definitions of some of these terms might differ depending on the jurisdiction or the branch of economics as a field of research. For example there may be differences in the definitions used by the International Monetary Fund and other organisations.

4. Dimensions: Vulnerability

The use of this term “vulnerability” at the individual entity level seems inappropriate. Public Sector entities that are reliant on government funding are usually considered to be less financially vulnerable than their counterparts that are required to generate their own revenues. We recommend that the Board consider replacing this term with a description that is more relevant at all levels within the economy, for example “extent of reliance on external funding sources”. This issue further supports the view that this RPG is trying to address macro and entity level fiscal sustainability in a single guide, when in fact the issues may differ depending on whether reporting is taking place at a macro (whole-of-government level) and an individual entity level. We suggest that these differences need to be acknowledged and addressed in the RPG.

Yours sincerely,

Ernst & Young GmbH
Wirtschaftsprüfungsgesellschaft



Prof. Dr. Peter Oser



Thomas Müller-Marqués Berger