

7 April 2010

Ms Stephenie Fox
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International Public Sector Accounting Standards Board
International Federation of Accountants
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CANADA

Dear Stephenie

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

The Australian Accounting Standards Board (AASB) is pleased to submit its comments on the above-named Consultation Paper. In formulating its comments, the AASB sought and considered the views of constituents. The comment letters received are published on the AASB's website.

In developing this submission, the AASB consulted with the New Zealand Financial Reporting Standards Board.

Importance of this project

The AASB considers this is a very important project of the IPSASB, particularly from the viewpoint of the probable usefulness to users of the information involved and because it brings much needed focus onto the identification of the boundaries of general purpose financial reporting. It therefore encourages the IPSASB to give this project a high priority from both viewpoints.

The scope of general purpose financial reporting

The AASB generally agrees with the Preliminary Views in the Consultation Paper. Its main concern is that, whilst it considers that some information useful for assessing long-term fiscal sustainability (LTFS) belongs within the scope of general purpose financial reporting, it is quite probable that not all information useful for that purpose belongs within that scope. The AASB considers that usefulness of information, per se, is not a sufficient discriminator to decide what is part of general purpose financial reporting. If it were, annual reports, and more, would fall within the scope of GPFs. We need criteria to determine what is part of financial reporting and what is not. This project illustrates that there is a gap in the conceptual framework. Whilst the IPSASB is addressing the scope of financial reporting in Phase 1 of its conceptual framework project, it has tentatively decided that the scope of financial reporting should evolve in response to users' information needs –

this decision addresses the boundaries of useful information but not of financial reporting information.

The IPSASB has found it difficult to define fiscal sustainability. The AASB suspects that this is because the IPSASB is rightly trying to encourage an emerging practice which has been born not out of efforts to try to develop financial reporting, but rather out of a desire to have governments communicate about the consequences of their policies. Some of those consequences are financial and of those some relate to matters covered in financial reports already and some relate to matters that should be included in such reports in the future.

Strategically, the AASB supports the IPSASB's short-term fostering of fiscal sustainability reporting through guidance, but would like to see rigour, over time, in delineating the financial reporting aspects thereof and helping others to see what falls to them. We do not envisage that accounting standards would be the source of guidance or requirements for everything that might be embraced by the topic.

General relevance of long-term fiscal sustainability reporting

Conceptually, the AASB sees no reason why financial sustainability is not a legitimate subject of every entity's financial reporting, whether in the private or public sector, and whether for profit or not. Conversely, it would be misleading for financial statements to be produced which ignore the anticipated consequences of existing or changed policies, changes in markets or changes in other environmental circumstances. Users' attention would need to be drawn to these to correct impressions about sustainability that might flow from just presenting basic financial statements.

We would encourage the IPSASB to challenge the IASB on reporting information about LTFS (and, therefore, the scope of general purpose financial reporting), so that both Boards consider it in their conceptual framework projects. Further, we would urge that the IPSASB not treat the topic as if it were something unique to reporting by governments or even the public sector.

The prime examples seen to date of such reporting are focused on the fiscal sustainability of governments' current policies, but it is doubtful that this is where things will finish.

The AASB recommends that, to resolve the scoping issue, it is crucial that the IPSASB defines general purpose financial reporting in its Conceptual Framework project.

Other significant comments

The AASB's other significant comments on the Preliminary Views are that:

- (a) in relation to Preliminary View 2, information useful for assessing LTFS provided outside general purpose financial statements should not necessarily be provided in additional statements provided with each set of general purpose financial statements or as summarised projections in narrative reporting; and
- (b) in relation to Preliminary View 3, the AASB would not support limiting information about LTFS in GPFRs to being reported only in respect of an entire reporting entity.

It seems that (a) depends on an implicit relationship between existing financial reporting and fiscal sustainability reporting that is not well explored and about which it is too early to be definitive. In relation to (b), we see no reason why a component or segment of an entity could not be the subject of such reporting.

As indicated, the AASB recognises that reporting information about LTFS is an evolving area, and further experience with such reporting will provide further insights into the ways in which the information can best be communicated and the part with which financial reporting can assist.

The AASB's specific comments on the Preliminary Views are set out in the attached submission.

If you have queries regarding any matters in this submission, please contact me or Jim Paul (jpaul@asb.gov.au).

Yours sincerely,

Kevin M. Stevenson
Chairman

AASB comments on IPSASB Consultation Paper *Reporting on the Long-Term Sustainability of Public Finances*

Specific matters for comment

The AASB provides the following comments on the IPSASB's Preliminary Views set out in the Consultation Paper.

Preliminary View 1

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).

The AASB agrees that some information useful for assessing an entity's long-term fiscal sustainability (LTFS) belongs within the scope of general purpose financial reporting. However, the Board is not convinced that all information currently provided in LTFS reports is within the scope of financial reporting. For example, a government, for political reasons, may produce a report aiming to shore up its political position by illustrating the affordability of its policies when compared with those of its opposition. The subject could revolve around sustainability. We do not think that standard-setting can regulate such political activity and nor would we see all that might be published in that context to be suitable for financial reporting.

Therefore, the AASB considers it is crucial to conceptually define the scope of general purpose financial reporting, to identify which information useful for assessing an entity's LTFS belongs within the scope of general purpose financial reporting.

Preliminary View 2

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).

The AASB agrees that some LTFS information is part of general purpose financial reporting. As indicated above in relation to Preliminary View 1, the AASB considers it is crucial to define the scope of general purpose financial reporting, to identify *which* information useful for assessing an entity's LTFS belongs within the scope of general purpose financial reporting. The AASB emphasises its focus on the subject matter of general purpose financial *reporting*, rather than on the various vehicles in which general purpose financial reporting information is conveyed [i.e., in different forms of general purpose financial reports (GPFRs)]. This is because general purpose financial reporting can occur in different GPFRs, and the form of the report is a subsidiary issue to identifying which information should be included in an entity's general purpose financial reporting.

Nevertheless, the AASB has the following comments about the form of GPFRs in which information about LTFS may be provided.

The AASB considers that general purpose financial statements should provide at least some of the information useful for assessing an entity's LTFS. The AASB also considers that, for various entities, information useful for assessing their LTFS is appropriately provided outside their general purpose financial statements. Where this occurs, the AASB considers some of that information would also be within the scope of general purpose financial reporting information. The extent to which that information falls within the scope of general purpose financial reporting would depend on how that scope is defined.

The remainder of the AASB's comments on Preliminary View 2 are in respect of information useful for assessing LTFS that is within the scope of general purpose financial reporting, but provided outside current general purpose financial statements.

The AASB supports fostering reporting of LTFS information in additional statements providing details of projections or in narrative reporting. However, the AASB considers that IPSASB guidance on recommended practice:

- (a) should not indicate that additional statements providing information on LTFS should necessarily be provided with each set of general purpose financial statements. Statements providing information on LTFS may not be needed annually (paragraphs 3.1.3 – 3.1.4 of the Consultation Paper emphasise such reporting on an annual basis);
- (b) should treat projections and related narrative on LTFS as a form of narrative reporting in its own right. This viewpoint is consistent with the comment in paragraph 3.1.2 of the Paper, but that comment generally is not reflected elsewhere in the Paper's discussion. The AASB considers that IPSASB guidance should neither require information on LTFS to be reported jointly with other narrative reporting information (as is emphasised in paragraph 3.1.7 of the Paper), nor should it require projections to be summarised for the purpose of inclusion in narrative reporting. The process of summarisation can present difficulties in providing a balanced and comprehensive overview of the factors and projected circumstances that are relevant to assessing an entity's LTFS; and
- (c) should acknowledge the appropriateness of preparing standalone GPFRs containing information specifically regarding LTFS. In this regard, paragraph 3.1.10 of the Paper notes, as an alternative to the two reporting mechanisms mentioned in the Preliminary View, the possibility of requiring narrative reports within a GPFR to refer to LTFS reports outside the GPFRs. The AASB considers that such separate LTFS reports should not be presumed to be outside the entity's GPFRs.

The AASB's recommendations above reflect a view that guidance on LTFS reporting:

- (a) should not be too prescriptive as the form of presentation of information about LTFS in an entity's general purpose financial reporting; and

- (b) should focus on whether an entity's GPFRs, collectively, provide all of the information that is useful to users of the entity's GPFRs for accountability and decision-making purposes. Thus, it should be acceptable for:
- (i) GPFRs providing some of the information useful for assessing an entity's LTFS to be presented separately from other GPFRs of the entity (such as those including its general purpose financial statements); and, as a corollary,
 - (ii) a GPFR (such as a report including an entity's general purpose financial statements) not to include all of the information useful for assessing the entity's LTFS.

Preliminary View 3

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).

The AASB considers that information about LTFS presented within a GPFR should not encompass information about entities outside the boundary of the reporting entity. In that sense, the AASB agrees that the concept of a reporting entity should be reflected in IPSASB guidance on reporting information about LTFS. However, the AASB would not support limiting information about LTFS in GPFRs to being reported only in respect of an entire reporting entity. For example, the IPSASB should not preclude reporting of such information in respect of particular segments or other components of a government in LTFS information provided within, or together with, a GPFR for that government (such as the government's general purpose financial statements).

Regarding the range of entities that should report information about LTFS, the AASB considers that emphasising national governments is a good starting point. However, the AASB recommends that the IPSASB should keep a flexible outlook on which public sector entities should report this information in their general purpose financial reporting. For example, it considers that users of GPFRs of sub-national levels of government, such as state and provincial governments, may also find information about LTFS useful for accountability and decision-making purposes.

The AASB is concerned that the focus of Preliminary View 3 on *consolidated* financial reports (as discussed in paragraphs 4.4.1 – 4.4.2 of the Paper) may be unintentionally restrictive, for the reason explained below. Accordingly, the AASB recommends referring to providing recommended practice for consolidated financial reports or, where the reporting entity does not include controlled entities, for the financial report of that entity.

The AASB's concern that the wording of this Preliminary View may be unintentionally restrictive is illustrated by the following example regarding local governments. Some local governments may be structured as single entities, and thus would not have controlled entities. Consequently, those local governments would not prepare *consolidated* financial reports. The AASB is unsure whether the IPSASB intended that its guidance should:

- (a) encourage an entity at a particular level of government that has controlled entities to report information about LTFS in GPFRs; but

- (b) not encourage another entity at the same level of government within the same jurisdiction without controlled entities to report such information in GPFs.

If that distinction was intended, the AASB would not agree with it. Whether an entity has controlled entities should not be a determinant of whether it reports information about LTFS in its GPFs.

Preliminary View 4

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).

The AASB agrees. As a matter of expression, the AASB suggests referring to relevance and the other qualitative characteristics. The separation of parts (a) and (b) of this Preliminary View implies relevance is not a qualitative characteristic.

Preliminary View 5

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

The AASB agrees.

The AASB considers that, in reporting information on LTFS, entities should present a balanced objectively-determined range of indicators, focusing on key assumptions and scenarios, to avoid such reports becoming political or management tools.

The AASB considers that the IPSASB should, in addition to recommending disclosure of key assumptions underpinning LTFS projections, recommend disclosure of the reasons for selecting these assumptions.

Preliminary View 6

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

- Time horizons for fiscal sustainability projections presented or discussed in the GPFs 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).

The AASB agrees, subject to the comments below.

In relation to disclosures about discount rates, the AASB considers that disclosure should be made of the basis on which discount rates were determined rather than of the discount rates used. For example, is risk incorporated in the measurement of the amounts disclosed and, if so:

- (a) what is the nature of the risks incorporated? and
- (b) is the risk adjustment made to the estimated cash flows or the discount rate used?

In relation to the last recommendation in Preliminary View 6, the AASB considers it should be clarified that the disclosure is of the steps the entity's management or governing body took in ensuring projections are supportable, and not the steps taken by those responsible for external assurance. This is not clear in paragraphs 7.5.1 – 7.5.4 of the Paper. Given the problems noted by the IASB and FASB with misconceptions about the meaning of 'reliable' information, the AASB suggests referring to 'supportable' projections (in the sense that the projections can be supported by available evidence and reasonable assumptions about uncertain future events).

Preliminary View 7

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

The AASB agrees with the IPSASB recommending disclosure of the date of preparation or update of projections underlying information on LTFS. However, the AASB does not have a view on the particular maximum time period between preparing/updating projections and reporting them. The AASB considers that any information on LTFS provided in GPFs should satisfy the qualitative characteristics of financial information, including timeliness.