30 April 2010

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
Toronto, Ontario M5V 3H2

Dear Sir:

Thank you for the opportunity to comment on the International Public Sector Accounting Standards Board (IPSASB) Consultation Paper – *Reporting on the Long-Term Sustainability of Public Finances*. I am responding on behalf of the Office of the Auditor General of Canada.

The consultation paper presents several preliminary views establishing the concepts that are to be applied in developing IPSAS and other documents that provide guidance on long-term sustainability information to be included in General Purpose Financial Reports.

We offer the following responses to the specific questions posed to respondents and trust that you will find these comments helpful. Should you have any questions, please do not hesitate to contact Richard Domingue at (613) 995-3708.

Yours sincerely,

Neil Maxwell
Assistant Auditor General

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 Consultation Paper, "Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities," issued in September 2008 (Section Two).

We are in agreement with this view.

Because the long-term impact of a continually rising debt burden is the steady erosion of the public's standard of living, governments should ensure that public finances are managed soundly in a context of long-term economic growth. The assessment of long-term fiscal sustainability is required to meet the objectives of long-term economic growth.

Not only should information about the past and present be reported but also prospective financial and other information about future service delivery should be disclosed. The degree to which a government will be able to maintain existing programs and meet creditors requirements in the future allows for the sustainability of the financial condition to be assessed.

In addition to being a requirement for appropriate financial reporting, long-term financial and non-financial information can support governments in making decisions and provide the legislature with the appropriate perspective to review budget proposals.

As mentioned in our letter of 31 March 2009 regarding the IPSASB *Consultation Paper – Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* we continue to believe that given the scope of the GPFRs goes beyond "financial" reporting, the report might be more appropriately called "*General Purpose Performance Reports*".

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).**

We are in agreement with this view.

Considering the challenges of producing and reporting long-term fiscal sustainability information, the proposed approach is reasonable. The presentation of long-term sustainability summarized in narrative reporting would be a significant first step. Long-term challenges such as demographic changes, environmental liabilities, globalisation, economic conditions and how they could put pressure on the public finances in the long-term should be published. Fiscal sustainability could be described by reporting on issues such as: future liabilities/obligations; funding of future liabilities; and the governments' ability to provide services to future generations compared to benefits provided to current generations. The narrative description could also include sensitivity analysis for changes in assumptions (e.g. economic uncertainty) to illustrate the long-term exposure to fiscal risks.

The production of additional statements providing details of fiscal sustainability projections is a more difficult reporting objective to meet. It requires more robust methodology, analytical/modelling capacity, key assumptions (for example: real GDP growth, employment rate, labour productivity, demographic projections…) and access to accurate data.

It is important to note that the capacity to produce fiscal sustainability information will vary greatly between jurisdictions. Also, by association to the financial statement, the SAIs might have to provide some assurance that the reported long-term projections are reasonable and based on fair assumptions. This capacity to review the projections will greatly impact some SAIs since their ability to review the information reported can be limited.

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).

We are in agreement with this view.

A consolidated approach by levels of government to reporting fiscal sustainability should be used. Individual entity reporting on fiscal sustainability could be of low value and could be costly to produce. Because some entities do not have revenue raising capacity and they do not control the funding decisions, reporting on fiscal sustainability could be misleading. This should not prevent some controlled entities from reporting long-term sustainability of their financial position if they believe it would be useful to support the decision-making process.

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).

We are in agreement with this view.

Common sustainability indicators usually include Debt-to-GDP and Deficit-to-GDP. As proposed by the CICA in 1997, other sustainability indicators could include: assets-to-liabilities; financial assets-to-liabilities; and net debt-to-total annual revenue.

In regard to criteria c) mentioned above, it is important that IPSASB recognizes that using historical data for projecting future fiscal position has limitations. Future trends will not be captured properly by simply reporting sustainability indicators. For example, even though a government with low debt-to-GDP ratios is better off because of lower debt servicing costs, what matters from a sustainability perspective is the speed at which the ratio increase. A rising debt burden will lead to a gradual erosion of living standards. For appropriate reporting, what are required are not only statistics and ratios that will report the fiscal position at a given time based on historical data but also long-term fiscal projections. As mentioned by the CICA in its report entitled *Indicators of Government Financial Condition* (1997), sustainability is both a dynamic and a static concept – in the sense that the speed at which fiscal position changes as well as its level matter. Therefore, governments must project trends in public expenditures and tax revenues using appropriate methodology (this includes reporting demographic projection as well as long-term economic and fiscal projections).

5. IPSASB guidance on long-term fiscal sustainability reporting in GPFRs 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).**

We are in agreement with this view.

For making projections, it would be a good practice to assume that current policy continues and not to incorporate future events based on assumptions. However, there could be cases where including firmly announced government commitments could add valuable information (e.g. promised tax reduction) and increase the accuracy of the long-term projections. Any deviation should be clearly disclosed.

We agree with paragraphs 6.2.5 - 6.2.7 which state that both bottom-up and top-down approaches are useful and complementary approaches to project fiscal sustainability. A particular strength of the top-down approach is that it starts from the proposition that governments will operate in a fiscally prudent manner. This approach assumes that the path of fiscal aggregate will be kept in line with fiscal policy objectives and that spending will be constrained at one point. The bottom-up approach allows richer details of the individual drivers of spending and revenue to be examined. It illustrates the pressure that long-term trends such as ageing or environmental depletion could exert on public finance. Both bottom-up and top-down fiscal projections should be included since they present a good picture of what challenges the government might be facing in the future and what might have to be done to meet the fiscal rules. However, projecting revenues and spending level when the economy is operating below its full potential can be misleading since the government actions deal with exceptional conditions. It could be misleading to project the fiscal position resulting from exceptional circumstances over the long-term.

We agree that it is important that users be informed of the main sources of tax revenues and the method used to project its growth. Also, key demographic and economic assumptions should be clearly disclosed.

We also agree that when there is a legal obligation to report long-term fiscal sustainability that the legal framework for developing and reporting of long-term fiscal sustainability information be disclosed in the GPFR. If there are no legal requirements, the guiding principles for reporting long-term projections should be published (this could include: frequency of reporting, the need to include sensitivity analysis and the requirement to clearly present changes in the methodology, key assumptions and source of data). Finally the fiscal framework of the government and the guiding principles for managing the public finances should also be clearly reported (these principles could include for example: transparency, stability, fairness, efficiency or responsibility, economic growth).

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

- **Time horizons for fiscal sustainability projections presented or discussed in the GPFRs 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 that projections are reliable (Section Seven).**

We are in agreement with this view.

Time horizons should be determined. As well, in order to assure credibility and quality, changes in methodologies, assumptions and data sources should be mentioned in the GPFRs. Changes must be justified to provide assurance about the quality of the projections and a basis for a fair assessment of a country's fiscal future. Sensitivity analyses should also be reported to illustrate the impact demographic changes or economic shock could have on fiscal risks. Alternative projections should be considered for key economic variables such as employment rate, productivity growth and interest rates. Finally it is reasonable to expect that measures will be taken by the reporting entity to challenge the quality of the projections, including a peer review process or the use of private sector forecasters.

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

We are in agreement with this view.

This being said, it should be noted that the OECD now suggests (see: OECD, The Benefits of Long-term Fiscal Projections, October 2009) that fiscal projections be prepared annually in order to "draw attention to the long-term fiscal consequences of current policies and eliminate discretion over when projections are produced". Based on that principle, the Committee might wish to review the frequency of reporting.