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The Technical Director  
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Per e-mail  
29 April 2010

Dear Stephenie,

**CONSULTATION PAPER ON REPORTING ON THE LONG TERM SUSTAINABILITY OF PUBLIC FINANCES**

We welcome the opportunity to provide comments on the Consultation Paper issued by the IPSASB dealing with *Reporting on the Long Term Sustainability of Public Finances*.

Our comments to you are set out in two sections:

- Section A outlines responses to the preliminary views outlines in the Consultation Paper; and
- Section B outlines general comments.

At the time of formulating our response to you, we were unable to engage with certain key stakeholders that would have an interest in this project. If additional comments are received, we will raise these with staff and the task force out of session.

Please feel free to contact me should you have any queries on our response.

Yours sincerely

Erna Swart  
Chief Executive Officer

Board Members: Ms K Bromfield, Mr R Cottrell (Chairperson), Mr V Jack, Ms CJ Kujenga, Mr K Kumar,  
Mr T Makwetu, Mr F Nomvalo, Mr G Paul, Mr I Sehoole  
Chief Executive Officer: Ms E Swart

## SECTION A – RESPONSES TO PRELIMINARY VIEWS

### PRELIMINARY VIEW ONE

*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 IPSASB's Consultation Paper, "Conceptual Framework for General-Purpose Financial Reporting by Public Sector Entities", issued in September 2008.*

While currently no fiscal sustainability reports are prepared locally, we agree that long-term fiscal sustainability reporting has the potential to enhance accountability and decision-making for users of financial statements. This type of reporting may also compliment other local initiatives, albeit in other disciplines, e.g., long term planning.

We do however note that, currently, many fiscal sustainability reports are provided as an enhancement to the budget and other documents, rather than as an enhancement to the financial statements. We are of the view that the IPSASB's focus in developing guidance on reporting long-term fiscal sustainability information, should be as an enhancement to general purpose financial statements. To ensure that the focus of the project is appropriate, the following key issues need to be addressed:

- (a) Are the users of financial statements and fiscal sustainability reports the same?
- (b) Can these users' needs be aligned?
- (c) Are the qualitative characteristics of general purpose financial statements and general purpose financial reports the same? (see response to preliminary view four)
- (d) Can fiscal sustainability measures, which are often expressed in economic terms, be linked back to and understood in the context of historical financial statements?

These questions may pose issues about how this type of information is reported as well as what information is reported.

### PRELIMINARY VIEW TWO

*IPSASB guidance should recommend that long-term fiscal sustainability information in GPFRs be presented either through:*

- *Additional statement providing details of projections; or*
- *Summarized projections in narrative reporting.*

We are of the view that the objectives of financial reporting and the needs of users may not be met by applying a single approach. It may be appropriate to adopt different approaches for central and sub-national levels of governments. At sub-national or local authority level it may be difficult to allocate revenue streams to specific programmes, particularly where these levels of government execute centrally funded programmes. In these instances, presentation of specific statements is difficult. At these levels, users' needs may best be met through of sustainability reports using summarized projections in narrative reporting that consider the activities of an entity taken as a whole.

At a national level, it may be easier to allocate revenue streams to specific programmes and therefore may be useful to present sustainability information using specific statements which provide detailed projections of programmes, accompanied by narrative reporting.

We agree that model three is not optimal as the objectives of other reports containing fiscal sustainability reports may differ from the objectives of general purpose financial reports as outlined in the conceptual framework.

### PRELIMINARY VIEW THREE

*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.*

We agree that if fiscal sustainability reports are provided to enhance general purpose financial statements that the boundary of financial statements and fiscal sustainability reports should be consistent. Thus, we support the use of a “control” based approach in determining the reporting boundary.

We agree that fiscal sustainability reports should be provided at all levels of government.

We would however not support the notion that fiscal sustainability reports are only prepared on a consolidated basis. To be consistent with the proposals in the Phase I of the IPSASB Conceptual Framework project, fiscal sustainability reports should be prepared for a reporting entity where users of such information exist. This would allow a more principles based approach to be followed when preparing fiscal sustainability reports.

### PRELIMINARY VIEW FOUR

*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 they 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.*

While we agree with the overall principles to be used in selecting and disclosing information about the indicators used, we note the following concerns.

#### Selection of indicators

Indicators should be selected based on the relevance to the entity, but also based on their relevance to understanding the extent of the fiscal challenge in relation to the financial statements.

#### Qualitative characteristics

The qualitative characteristics of general purpose financial reports, as outlined in the IPSASB’s proposed conceptual framework include: Relevance, faithful representation, timeliness, understandability, comparability, and verifiability.

While some of these qualitative characteristics may be applied to general purpose financial reports, some may be inappropriate, and in some instances additional qualitative characteristics may also exist. As examples:

- “Economic” based measures of fiscal sustainability such as net worth, fiscal gap, inter-temporal budget gap, may not be relevant in relation to an entity’s financial statements, and may not be understandable by the users of the financial statements.
- Changes in government policy may result in comparable information not being available.
- A key characteristic of performance measures/indicators is that they are “measurable”; a characteristic that does not seem to fit within the current qualitative characteristics.

We therefore question whether:

- all the qualitative characteristics for general purpose financial reports have been identified; and
- if the same set of qualitative characteristics be applied to both general purpose financial statements and general purpose financial reports.

### Use of indicators

Current disclosures recommend including the reasons for ceasing to report certain indicators. We believe that it may be useful to recommend disclosure of the reasons why new indicators were used.

### **PRELIMINARY VIEW FIVE**

*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 macroeconomic policy and fiscal framework.*

We agree with the recommended disclosures.

From reading the Consultation Paper it is unclear as to whether the actions to be taken by policy makers in correcting any “unsustainable” positions, if any, would be included in the report. It would be useful to clarify whether this is intended to be included in the report.

### **PRELIMINARY VIEW SIX**

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

- *Time horizons for the 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.*

While we agree with the proposed disclosures, we note the following concerns:

- While sensitivity analyses are useful, they may distract users from the key message in fiscal sustainability reports. Care should thus be exercised when preparing and disclosing sensitivity analyses so as not to overburden users with information.
- The last disclosure requires entities to disclose steps taken to ensure that the projections are reliable. It may be useful to also provide information about steps taken to ensure that the projections are “faithfully representative”, “comparable” etc.

### **PRELIMINARY VIEW SEVEN**

*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.*

[To be completed through other consultations]

A key determining factor in the frequency of reporting is the cost and effort of preparing the necessary information.

## **SECTION B - OTHER**

### **Definition of long-term fiscal sustainability**

The current “working” definition of fiscal sustainability as set out by the IPSASB in paragraph 1.2.6 of the Consultation paper is as follows:

The ability of government to meet its service delivery and financial commitments both now and in the future.

In general terms, fiscal sustainability should encompass four basic principles: solvency, growth, fairness and stable taxes. The current “working” definition captures the concepts of “solvency” and “growth” by references to meeting current and future commitments. The notions of fairness and stable taxes are, however, not adequately captured.

We are of the view that “fairness”, particularly in the context of intergenerational equity, is a key concept underpinning the assessment of fiscal sustainability.

The current definition appears to focus on the outflows to be incurred by governments, while sustainability encompasses an assessment of both inflows and outflows. References to sources of inflows, specifically taxes, may be useful in explanatory material accompanying the definition of fiscal sustainability. It may also be useful to note in explanatory material that fiscal sustainability implies “stable taxes”.

### **GENERAL**

#### **Role of the IPSASB and the format of guidance issued on General Purpose Financial Reports**

It is unclear from the Consultation Paper in what format the IPSASB plans to provide the “guidance” on long term fiscal sustainability reporting.

As fiscal sustainability reporting is relatively new area, we agree that it may not be appropriate to mandate the preparation of these reports. It should however be the long term intention of the IPSASB to require this type of reporting to give credence to the proposed shift from general purpose financial statements to general purpose financial reports.

In the interim, we would suggest that a similar approach is followed to that currently required in IPSAS 22, “Reporting on the General Government Sector”, i.e. if entities prepare their financial statements in accordance with IPSASs and present this information, they must comply with the relevant IPSAS/guidance issued by the IPSASB.

#### **Going concern**

If long term fiscal sustainability reports accompany the general purpose financial statements, questions may be raised about whether, or if, any “unsustainable” positions reflected in general purpose financial reports will affect the going concern assumption used to prepare financial statements.

As general purpose financial reports reflect commitments and not obligations/liabilities of government, it is arguable that the government can avoid such commitments by changing government policy. However, some would argue that while policy can be amended to avoid certain commitments, e.g. by changing pensionable age or reducing pension benefits, some commitments cannot be avoided, e.g. the provision of basic services such as water and energy. In the latter instance, government may have “no realistic alternative” but to fulfil its commitments.

If it is not in a position to do so in the long term, it may in fact affect the going concern assumption used in the general purpose financial statements.

### **Long-term fiscal sustainability in developing economies**

As noted above, we believe that fiscal sustainability reporting is both useful and necessary. We do however note as a developing economy, we would face a number of challenges in presenting this information. In particular:

- The necessary skills to produce this information at sub-national and local authority levels may be limited.
- Government policies change, some very drastically, with almost every election. This may have implications on the reliability and comparability of information presented.
- As infrastructure and other needs are being developed, government is often involved in many non-recurring projects that may span a period of less than 10 years (which is typically the minimum time frame envisaged in long-term fiscal sustainability reporting). Typical examples include construction of stadiums for international sporting events, construction of urban transport infrastructure etc. Current budgets and forecasts cover a period of 5 years. Many of these types of projects may not be sustainable within the medium term and do not require a “long term” assessment to establish their sustainability. Therefore what is typically “long term” in developed countries, may be “medium to long term” in other economies. The time horizon used will need to accommodate these scenarios.
- South Africa faces very volatile demographic risks, which may pose questions around the reliability of the information presented. The population growth and migration is very dynamic, making it difficult to obtain accurate census data. The prevalence, effect, treatment and research of HIV exacerbate issues regarding the assumptions used.