



Accounting Standards Board

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Dear Stephenie

IPSASB Consultation Paper: *'Reporting on the Long-term Sustainability of Public Finances'*

1. I am writing on behalf of the UK Accounting Standards Board's (ASB) Committee on Accounting for Public-benefit Entities.
2. In its letter dated 28 July 2008, the ASB expressed strong support for IPSASB taking forward a project on long-term fiscal sustainability. We share this view and welcome the opportunity to comment on IPSASB's consultation paper *'Reporting on the Long-term Sustainability of Public Finances'*.
3. We believe the IPSASB consultation paper is valuable. In particular, it provides a clear, principles-based framework that should encourage governments and other public sector entities to systematically report information in general purpose financial reports on the long-term consequences of government programs.
4. We agree with most of the proposals that are made and consider these will result in improvements to the financial reporting of governments, particularly given the additional pressures on the public finances that have arisen as a result of the financial crisis. We also note the proposal to include information on long-term fiscal sustainability in general purpose financial reports is consistent with paragraph 10 of the IASB's Exposure Draft *'Management Commentary'*, which discusses time-frames and notes that 'management commentary looks not only at the present, but also the past and the future'.

5. We consider that information on long-term fiscal sustainability should be regarded as falling within the scope of general purpose financial reporting and is particularly suited to the narrative report. We note that IPSASB's conceptual framework project is considering further issues such as the scope of general purpose financial reporting and the extent to which commitments to provide social benefits should be reported as liabilities in the balance sheet. These are important issues that are expected to impact upon any guidance that IPSASB might issue on long-term fiscal sustainability. However, we do not consider that IPSASB should wait until work is completed on the conceptual framework before issuing guidance on long-term fiscal sustainability. Any guidance issued can then be updated as appropriate.

6. One of the most significant issues raised in the consultation paper is the time periods to be covered. When very long time horizons, e.g. 75 years, are used, the assumptions used are likely to be very fragile and could undermine the value of the projected information for the whole period considered. We suggest that IPSASB consider including some caution about the difficulty of selecting assumptions that are intended to be valid over very long periods. One possibility may be to recommend projections for a number of different periods.

7. We note the consultation paper does not set out the next steps for this project, including any subsequent due process. This may be because a decision has not yet been taken and IPSASB is intending to consider responses to the consultation paper alongside developments in its other projects and the IASB Framework and Management Commentary projects. Whilst we appreciate the need to take account of these other projects, we would encourage IPSASB to avoid any unnecessary delay in progressing its work on long-term fiscal sustainability. We would also support an approach that results in non-mandatory guidance rather than an IPSAS.

8. The Appendix to this letter addresses each of the Preliminary Views raised in the consultation paper. If you require any further information please contact me or Alan O'Connor (a.oconnor@frc-asb.org.uk) or telephone +44 (0)20 7492 2421).

Yours sincerely



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Comments on Preliminary Views

PV 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)

Response

1.1 We agree that information on long-term fiscal sustainability would be useful to users of general purpose financial reports of governments and other public sector reporting entities. We consider the information would support accountability and decision-making, particularly where there is an expectation that certain services, such as state pensions and other welfare benefits, will be provided for an indefinite period.

1.2 We agree that information on long-term fiscal sustainability has the potential to enhance the information in general purpose financial reports and is consistent with the objectives of financial reporting. However, we do not consider that it is essential or necessary to meet the objectives of financial reporting and would therefore question the use of the word 'necessary' in the Preliminary View.

PV 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)**

Response

2.1 The consultation paper puts forward three models for presenting information on long-term fiscal sustainability in general purpose financial reports. These are (i) additional statements providing details of projections; (ii) summarized projections in narrative reporting; and (iii) cross references in GPFRs to other reports addressing long-term fiscal sustainability. We consider there is scope for each of these models to contribute to the information that entities may present in general purpose financial reports on long-term fiscal sustainability.

2.2 The wording of the Preliminary View appears restrictive, suggesting that reporting entities should use one model or the other. We would suggest reporting entities should be allowed to use any of the three models and, where appropriate, a combination of each of the three models. We consider the approach adopted should be based on the entity's circumstances and how it might best present information on the long-term sustainability of its activities, including how these activities will be financed.

- 2.3 We do not think that model three should be rejected, although we acknowledge that, in itself, a cross-reference from the narrative report or the notes to the financial statements to information on long-term fiscal sustainability in other publicly available reports may not be that helpful to users of general purpose financial reports. We would suggest that IPSASB develop model three to encourage reporting entities to provide cross-references and to also provide, as appropriate, information in the general purpose financial report in accordance with models one and two.
- 2.4 We accept that, in developing model three, there are risks in trying to summarise what is often voluminous and complex information in special reports. We agree with IPSASB that the emphasis should be on 'summarising' information that is already being generated; something that we consider falls well within the skill set of an accountant preparing a general purpose financial report. We would also expect this type of web signposting to become more helpful as more entities make their financial reports available on-line.

PV 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)

Response

- 3.1 We agree that it is desirable and necessary for the boundary for reporting on long-term fiscal sustainability should be the same as that used for general purpose financial reports. If IPSASB were to consider a different boundary, for example based upon statistical bases of accounting or a budget framework, there would be a strong case for not publishing information on long-term fiscal sustainability together with general purpose financial reports as this might be confusing.
- 3.2 We accept there may be instances where information on long-term fiscal sustainability will be useful to users of general purpose financial reports at lower tiers of government. We also agree with IPSASB that the nature and extent of the reports that may be required at sub-national level will vary and that deciding what indicators and other information might be provided on long-term fiscal sustainability is a matter for individual reporting entities.
- 3.3 We agree the requirement to include information on long-term fiscal sustainability should apply to the consolidated accounts of reporting entities. We also agree there are risks to understandability if individual entities within an economic entity produce separate sustainability reports and disclosures. However, there may be circumstances where such an approach might be appropriate and where, with adequate explanation, individual entities should be able to mitigate the risks to understandability. For this reason, we would suggest the guidance allows sustainability reporting at the individual reporting entity, subject to satisfying understandability and cost-benefit criteria.

PV 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)

Response

- 4.1 There is an argument that, in the interests of comparability, it might be preferable for IPSASB to encourage a more standardized format for reporting information on long-term fiscal sustainability. However, on balance, we agree that the guidance should not be prescriptive and that the choice of what indicators to use should be left to the reporting entity. We would also suggest that comparability across reporting entities is not a primary objective.
- 4.2 We also accept the need to select indicators based on the extent to which they meet the qualitative characteristics of financial reporting, but note there are some tensions that arise as a result of these qualitative characteristics being set in the context of historical financial information. In particular, we consider there are tensions around verifiability which will presumably need to be redefined because information on long-term fiscal sustainability will not be prepared to the same degree of accuracy of precision that is required for financial statements.
- 4.3 We consider further the desirability of having some form of assurance regards the information that will be presented on long-term fiscal sustainability in our response to Preliminary View 6.
- 4.4 We agree that comparative information should be provided and that the reasons for ceasing to report indicators, if this occurs, should be disclosed.
- 4.5 We note there is some overlap in parts (a) and (b) of the preliminary view with regard to relevance, which is the focus of (a) but also covered as part of the qualitative characteristics in (b). We would suggest that relevance is included as part of the general discussion of qualitative characteristics and not as a separate issue.

PV 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)**

Response

- 5.1 We support the recommendations. Whilst we are concerned the number of recommended disclosures will result in greater complexity in an entity's general purpose financial report, we consider the disclosures are necessary to ensure the information reported on long-term fiscal sustainability is understandable to users and meets the objectives of financial reporting. The risk of introducing complexity will, however, need to be managed.
- 5.2 We agree the need to disclose the assumptions underlying the reporting of future inflows from taxation, particularly as the basis for preparing this information may range from a fairly straightforward projection that assumes taxation is a constant proportion of GDP to more sophisticated approaches.
- 5.3 We agree the need to provide details of key aspects of governing legislation and regulation, and the underlying macro-economic policy and fiscal framework. This is a highly complex area and we note that paragraph 6.6.2 of the consultation paper suggests that, to avoid this information becoming over-detailed and therefore undermining understandability, it may be appropriate to cross-refer to other publicly available reports. We would agree with this approach which provides a good example of how reporting entities might want to combine the three reporting models that are considered in section 3 of the consultation paper (and discussed under Preliminary View 2 above).

PV 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 Six)**

Response

- 6.1 We fully support the recommended disclosures in this Preliminary View and consider that, alongside the disclosures being recommended in Preliminary View 5, will ensure the information presented on long-term fiscal sustainability meets the objectives of financial reporting and is helpful to users. It is important that the rationale behind the fiscal sustainability numbers is both transparent and is understandable to users.

- 6.2 We also note that some of the information, for example on discount rates, will complement the disclosures supporting other information in the general purpose financial reports, in particular the balance sheet. We suggest the Preliminary View makes clear the need to explain both the type of discount rate used as well as the percentage rate applied.
- 6.3 We note in the covering letter that one of the most significant issues for reporting information on long-term fiscal sustainability is the decision on the time horizon to be covered. We are sceptical about the value of very long time horizons and suggest the disclosures should make very clear the inherent uncertainty that exists within a time horizon of 75 years or more. Inevitably, the longer the time horizon, the more fragile the assumptions underpinning the projections will become. On the other hand we acknowledge that shorter time horizons run the risk of ignoring key events that might fall just beyond the period chosen.
- 6.4 We consider that some of the examples in the consultation paper, for example exhibits five and six, over-emphasise the 75 year view. To help address this issue, we suggest IPSASB consider whether there might be scope to consider projections, and the assumptions that underpin them, over a series of shorter periods. For example, a 75 year time horizon could be made up of three periods, perhaps 10 years, 25 years and 75 years.
- 6.5 We would also note that some assumptions will be more fragile than others, for example there may be scope to make reasonably informed forecasts of the long-term financial consequences of social benefit programmes but it is far more difficult to foresee and factor in the impact of developments such as technological advance. This emphasises the importance of reporting on the results of key sensitivity analysis, including information on the range of uncertainty where demographic and economic projections are inherently uncertain.
- 6.6 We agree that it is important for general purpose financial reports to disclose the steps taken by the entity to ensure that projections are reliable. We appreciate that auditors might be reluctant to embrace sustainability reporting within their normal audit of financial statements, but the need for some form of external validation makes it desirable that the profession develops some form of assurance model. As a minimum, we would suggest a model that verified that assumptions were reasonable, properly disclosed and appropriately applied to base data in generating the projections that are being reported.
- 6.7 We note that determining an appropriate assurance model for long-term fiscal sustainability reports falls outside the scope of the IPSASB consultation. We believe the proposed guidance should emphasise the need to be clear on the extent of any assurance provided. We would also emphasise the need for the general purpose financial reports to be clear that the information on long-term fiscal sustainability does not fall within the 'presents fairly' basis upon which the financial statements are prepared and audited.

- 6.8 We would suggest the Preliminary View also makes clear the need to explain the impact of changes to assumptions, for example where forecasts of mortality rates or GDP growth rates are updated. The Preliminary View that the results of key sensitivity analyses should be disclosed could be expanded by specifically addressing this.

PV 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)

Response

- 7.1 We acknowledge the potential mismatch between the reporting date of financial statements and the frequency with which fiscal projections might be made and updated. For this reason we agree the importance for general purpose financial reports to be clear on the timings of reports and updates.
- 7.2 We are however concerned that updating underlying projections only within 5 years of the reporting date is too infrequent. We would encourage some form of annual update, perhaps along the lines of an interim desk top valuation of property assets.
- 7.3 We would also suggest that a comparison of indicators or bottom line figures, showing the present situation against five or ten years ago, would be a helpful disclosure.