International
Public Sector
Accounting
Standards Board

Exposure Draft 46
October 2011
Comments requested by February 29, 2012

Proposed Recommended Practice Guideline

Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances

International Federation of Accountants

REQUEST FOR COMMENTS

The International Public Sector Accounting Standards Board (IPSASB), an independent standard-setting body within the International Federation of Accountants (IFAC), approved for publication in September 2011 this Exposure Draft, *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances.*

The proposals in this Exposure Draft may be modified in light of comments received before being issued in final form. **Comments are requested by February 29, 2012**.

Respondents are asked to submit their comments **electronically** through the IFAC website (www.ifac.org), using the "Submit a Comment" link on the Exposure Drafts and Consultation Papers page. Please submit comments in both a PDF and Word file. Also, please note that first-time users must register to use this feature. All comments will be considered a matter of public record and will ultimately be posted on the IFAC website. Although IFAC prefers that comments be submitted electronically, e-mail may be sent to stepheniefox@ifac.org. Comments can also be faxed to the attention of the IPSASB Technical Director at +1 (416) 977-8585, or mailed to:

The Technical Director
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Copies of this Consultation Paper may be downloaded free-of-charge from the IFAC website at http://www.ifac.org.

ISBN:

Objective of the Exposure Draft

Reporting on the long-term sustainability of an entity's finances provides users with information on the impact of decisions made by the reporting date under current policy, but not fully reflected in the general purpose financial statements. The objective of this Exposure Draft (ED) of a Recommended Practice Guideline is to provide guidance on how to supplement the statements of financial performance and financial position and meet the objectives of financial reporting—accountability and decision-making—by presenting projections of inflows and outflows and complementary information on an entity's projected long–term fiscal sustainability.

Guide for Respondents

The IPSASB would welcome comments on all the proposals in the ED. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for proposed changes to the ED.

Specific Matters for Comment

The IPSASB would particularly value comments on the Specific Matters for Comment below.

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.

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?

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?

ED 46 REPORTING ON THE LONG-TERM SUSTAINABILITY OF A PUBLIC SECTOR ENTITY'S FINANCES

CONTENTS

Objective

1. Reporting on the long-term sustainability of an entity's finances provides information on the impact of current policies and decisions made at the reporting date and supplements information in the general purpose financial statements (hereafter, the financial statements). This Recommended Practice Guideline (RPG) provides advice on the approach to reporting on the long-term sustainability of the finances of a public sector entity. The aim of such reporting is to provide an indication of the projected long-term fiscal sustainability of the reporting entity over a specified time horizon in accordance with transparent assumptions.

Status and Scope

2. The reporting of information in accordance with this RPG represents good practice. Although this RPG does not have the authority of an International Public Sector Accounting Standard, an entity reporting on the long-term sustainability of its finances is encouraged to follow this RPG. As part of reporting on its long-term fiscal sustainability an entity should indicate that it has followed this RPG or disclose if it has departed from the RPG and explain why such a departure was necessary.

3. The flows relating to programs providing social benefits, including entitlement programs that require contributions from participants, can be a highly significant component of reporting on long-term fiscal sustainability for many entities. However, the scope of this RPG includes all an entity's projected flows and is not limited to those related to programs providing social benefits.

4. Environmental sustainability is not directly within the scope of this RPG. However, it is important that the financial impact of environmental factors is taken into account in making projections and assessing the long-term fiscal sustainability of an entity.

5. This RPG applies to all public sector entities, except Government Business Enterprises (GBEs). In assessing whether it is appropriate for an entity to report on the long-term sustainability of its finances an entity may consider the factors outlined in the section on 'Determining Whether to Report on Long-Term Fiscal Sustainability.'

6. Although this RPG does not apply directly to GBEs, the prospective inflows and outflows to/from the reporting entity from/to a GBE over the pre-determined time horizon are within the scope of this RPG.

Definitions

7. The following terms are defined in this RPG:

   <u>Inflows</u> are cash and cash equivalents projected to accrue to the reporting entity over the time horizon of the projections.

   <u>Long-Term Fiscal Sustainability</u> is the ability of an entity to meet service delivery and financial commitments both now and in the future.

   <u>Outflows</u> are cash and cash equivalents related to expenditure projected to be incurred by the reporting entity over the time horizon of the projections.

8. Measures of long-term fiscal sustainability are broader than measures of financial position derived from the financial statements. They include projected inflows and outflows related to the provision of goods and services under current policy over a pre-determined time horizon and therefore take into account commitments related to decisions made by the reporting entity on or before the reporting date that do not meet the definition and/or recognition criteria for liabilities. Similarly they take into account future taxation receipts, contributions and inter-governmental transfers that do not meet the definition of, and/or recognition criteria for, assets.

9. Assessments of long-term fiscal sustainability involve the use of a broad range of data. These data include financial and non-financial information about current economic and demographic conditions, assumptions about national and global trends such as productivity, the relative competitiveness of the national or local economy and expected changes in demographic variables such as age, longevity, gender, income, educational attainment and morbidity.

Reporting Boundary

10. This RPG reflects the view that entities and activities included in long-term fiscal sustainability projections should be the same as those for the financial statements. This enhances the understandability of projections and increases their usefulness to the users of general purpose financial reports.

11. In the event that entities within the reporting boundary for the financial statements are different to those for the long-term fiscal sustainability projections, those entities should be identified, and, where possible, the estimated impact on the projections disclosed.

12. At the consolidated national or whole-of-government levels it may be considered appropriate to disclose information based on the General Government Sector (GGS), as defined in the System of National Accounts. This may be to enhance consistency and comparability with other jurisdictions and also because many indicators that are used to assess fiscal sustainability at the consolidated national level are based on the GGS. Where such disclosures are made it is important that an explanation is provided of how the boundary of the GGS differs from that of the reporting entity. Entities providing information on the GGS are encouraged to also present information in accordance with IPSAS 22, *Disclosure of Financial Information about the General Government Sector.*

13. It may be considered appropriate to disclose information on long-term fiscal sustainability based on the boundary of the budget sector. In such cases it is important that an explanation is provided of how the boundary of the budget sector differs from that of the reporting entity.

Determining Whether to Report on Long-Term Fiscal Sustainability

14. In evaluating whether to report on the long-term sustainability of its finances an entity needs initially to assess whether potential users exist for prospective financial information.

15. The relevance of reporting on an entity's long-term fiscal sustainability should be considered in the context of that entity's funding and capacity to determine service delivery

levels. There are likely to be users for long-term fiscal sustainability information for entities with one or more of the following characteristics:

(a) Significant tax and/or other revenue raising powers;

(b) Powers to incur debt; or

(c) Wide decision-making powers over service delivery levels.

16. If a controlled entity determines that there are users for information on the long-term sustainability of their finances it should ensure that the information reported is (a) consistent with information reported by the controlling entity, (b) that the controlling entity is identified, and (c) users are made aware of information on long-term fiscal sustainability reported by the controlling entity.

Presenting Projections of Prospective Inflows and Outflows

17. The core information presented on the long-term sustainability of an entity's finances will be projections of inflows and outflows commencing in the current reporting period for a period selected and disclosed by the reporting entity. The information may be presented in a statement or through graphs, supported by narrative reporting.

18. Where an entity determines that it is appropriate to report on the long-term sustainability of its finances, it should assess the extent to which it can draw on the projections and indicators prepared by other governmental bodies, such as ministries of finance, rather than making the projections itself, in order to reduce the cost of such reporting.

19. Projections can be displayed in tabular statements or graphical formats providing details of the activities and programs giving rise to outflows and identifying the sources of inflows. In determining the format of tabular statements entities need to balance considerations of understandability and relevance. Multi-columnar presentation of a large number of time periods between the reporting date and the end of the time horizon provides a more complete information set, but risks information overload and the impairment of understandability. A focus on a very small number of time periods may neglect trends arising from key events between time periods.

20. A single presentation approach is unlikely to satisfy the objectives of financial reporting. Statements will need to be complemented by additional presentational methods involving a combination of narrative reporting, graphical presentation and the use of indicators. Projections of net debt are likely to be central for many reporting entities. Other examples of indicators include:

(a) Total gross debt;

(b) Net worth;

(c) Net financial worth;

(d) Fiscal gap;

(e) Inter-temporal budget gap;

(f) Net debt/total revenues; and

(g) Fiscal dependency.

21. Descriptions of these indicators are provided in the *Glossary of Indicators* at Appendix A.

22. There is a risk that both tabular statements and graphical disclosure can be skewed to present a misleadingly favorable picture. It is therefore important that formats are consistent between reporting periods and that any modifications of formats between reporting periods are highlighted and explained. It is also good practice to display a supplementary statement that shows the changes in projections between reporting dates and the reasons for those changes.

23. Projections should begin with the cash flows related to the settlement of liabilities and cash-generating assets recognized in the statement of financial position of the entity. Projections will then address short-term solvency, including cash flows related to commitments and powers not recognized as liabilities and assets in the statement of financial position, and finally, obligations and inflows that may not be settled for many years.

24. In selecting an appropriate time horizon an entity needs to balance the qualitative characteristics of verifiability and faithful representation. The further the time horizon is from the reporting date the more future events are captured. However, the assumptions underpinning the projections become less robust and potentially less verifiable. Conversely, excessively short time horizons may increase the risk that the consequences of events outside the time horizon may be ignored, thereby reducing the relevance of projections.

25. There is a strong relationship between fiscal dependency and time horizons. Generally, high levels of fiscal dependency may lead to the selection of shorter time horizons, because a high proportion of the reporting entity's prospective inflows are dependent upon decisions by other entities over which the reporting entity has no control and limited influence.

26. Apart from fiscal dependency, the length of the time horizon will reflect the characteristics of the reporting entity. It is likely to be influenced by aspects such as the longevity of key programs, the estimated lives of major infrastructure assets and the time horizons adopted by other government bodies and agencies providing prospective information.

Addressing the Dimensions of Fiscal Sustainability

27. The presentation of information on the long-term sustainability of an entity's finances should be faithfully representative. This requires the inclusion of narrative discussion in order to put the projections in context. Faithful representation can be satisfied by presenting narrative information on both a historical and prospective basis along three inter-related dimensions of fiscal sustainability:

    - Fiscal capacity;
    - Service capacity; and
    - Vulnerability.

28. *Fiscal capacity* is the ability of an entity to meet financial commitments, such as the servicing and repayment of debt and liabilities to creditors, on a continuing basis over the period of the projections without increasing levels of taxation.

29. The level of net debt is critical to an assessment of fiscal capacity, as, at any reporting point, it represents the amount expended on the past provision of goods and services that has to be serviced and financed in the future. By projecting current policies for the provision of goods and services, and current policies for raising taxes and other revenues into the future, projected levels of net debt can be presented. Users can then assess the entity's ability to raise and maintain such levels of debt and thereby evaluate fiscal capacity.

30. At national levels a factor to consider in presenting such projections is whether to distinguish: (a) the primary deficit, which is total projected government spending, excluding interest payable on debt, minus tax revenues, and (b) the total deficit, which includes outflows related to interest payable on debt. At sub-national levels the focus may be on net debt as a percentage of total revenues. Increases in this indicator show that an increasing proportion of revenues will be required for debt servicing, thereby diverting resources from service delivery, and that the long-term position may become unsustainable.

31. *Service capacity* is the extent to which (a) the entity can maintain services at the volume and quality provided to current recipients at the reporting date and (b) meet obligations related to entitlement programs for current and future beneficiaries.

32. By projecting the impact of policies for raising taxes and other revenues, and policies for raising and maintaining debt into the future, long-term sustainability reports can present the amounts available for the provision of goods and services under these policies. Users can contrast this information with the entity's service commitments, and thereby use long-term fiscal information to evaluate service capacity.

33. A factor to consider in making such comparisons is the extent to which expenditure on certain programs is likely to increase more steeply than the overall levels of expenditure of the entity. This may be because the number of beneficiaries is projected to increase for a particular program or because costs associated with certain programs, such as healthcare, are projected to increase more quickly than the general inflation rate. For capital intensive activities the dimension of service capacity also involves an assessment of infrastructure lives and replacement cycles in order to ensure that net outflows on property, plant and equipment are recorded.

34. *Vulnerability* is (a) the extent to which an entity is fiscally dependent upon funding sources outside its control, principally inter-governmental transfers, and (b) the extent to which an entity has powers to vary existing taxation levels or other revenue sources and to create new sources of taxation and revenue.

35. *Vulnerability* is exemplified by an indicator of the proportion of total inflows that are received from entities at other levels of government; for example a local government entity that can raise property taxes, but is partially dependent upon a mixture of general grants and specific grants from national and state governments. As policies for the provision of goods and services, and policies for managing debt are projected into the future, the level of revenue required to maintain such policies can be presented in a long-term fiscal sustainability report. Users are then enabled to assess this information against the entity's revenue-raising ability and thereby evaluate vulnerability.

36. The main entities on which the reporting entity is fiscally dependent should be identified. Reporting along this dimension may also involve consideration of the extent to which the entity is able to generate taxes and other sources of revenue. Generally, an entity that is highly vulnerable is likely to have limited control over the sustainability of its finances. Trends indicating that vulnerability is increasing suggest that an entity's future sustainability is dependent upon funding decisions by entities at other levels of government. It is important that users are provided with details of constitutionally or statutorily-based revenue sharing or grant arrangements. Vulnerability may be mitigated if inter-governmental transfers have constitutional or other legal underpinning, which may make the entity less susceptible to sudden adverse funding decisions by other entities and therefore increase the probability of receiving funds.

37. Both *fiscal capacity* and *service capacity* involve consideration of the capacity of entities to finance future obligations identified in the fiscal capacity and service capacity dimensions without increasing aggregate levels of taxation.

Disclosure of Principles and Methodologies

38. The basis of preparation of projections should be clear. This means that the principles, assumptions and approaches to methodology that underpin the projections should be disclosed. This section discusses:

- Updating projections and frequency of reporting;
- Current and future policy;
- Approach to revenue flows;
- Demographic and economic assumptions;
- Approach to age-related and non-age-related programs;
- Impact of legal requirements and policy frameworks;
- Inflation and discount rates;
- Sensitivity analysis; and
- Reliability of projections.

Updating Projections and Frequency of Reporting

39. The date at which a full set of projections was made and the basis and timing of subsequent updating should be disclosed. While regular updates are desirable, this RPG acknowledges that annual updating may not be realistic for all entities, particularly those at sub-national levels, which may be making and reporting on projections for the first time. However, there is an inverse relationship between the robustness of assumptions on which projections are made and the elapse of time since they were made. During periods of global financial volatility the risk that projections made some time before the reporting date are outdated increases, with a consequent reduction of the ability of such information to meet the objectives of accountability and decision-making.

Current and Future Policy

40. This RPG adopts the view that, where flows for particular programs and activities are individually modeled, information is most useful if it is assumed that current policy is held constant through the entire projection period. There can be tensions if (a) there is a conflict in legal obligations or (b) if current programs have "sunset provisions." For example a social security program may be governed by legal provisions that it is unlawful to make payments once an earmarked fund is exhausted, although entitlements of beneficiaries will continue after the exhaustion of that fund. Assuming that the fund will not meet obligations once it is exhausted might reflect a strict legal position, but an entity may need to assess whether the presentation of projections on such a basis underestimates the extent of the fiscal challenge facing the social security program.

41. Some programs have sunset provisions whereby they terminate after a specific period. In many cases there may be a strong probability that such programs will be replaced by similar programs, so adopting a strict legal termination principle may lead to an underestimate of outflows, which impairs the usefulness of information. The approach to any legal conflicts and sunset provisions should therefore be disclosed.

42. For flows that are not individually projected, the distinction between current and future policy is unlikely to be critical to the projections and it may be sufficient to disclose general assumptions.

Approach to Revenue Flows

43. The main sources of taxation and other revenue flows, such as inter-governmental transfers, should be identified, together with their significance to an entity's revenue sources. Taxation flows may be projected to grow in line with nominal gross domestic product or an inflation index or may be individually modeled using a more sophisticated approach. Users need to be informed of the approach and of any relevant considerations relating to tax banding, allowances and thresholds.

Demographic and Economic Assumptions

44. An entity should disclose the key assumptions that underpin projections. These are likely to include economic growth rates, inflation, demographic assumptions such as fertility, mortality and migration rates, and workforce participation rates. Such disclosures may extend to environmental factors, such as the impact of the depletion and degradation of ecosystems and the erosion of water and finite natural resources on economic growth.

Approach to Age-Related and Non-Age-Related Programs

45. Age-related programs are programs that are subject to eligibility criteria including age and other demographic factors. In making projections programs and activities that are age-related may be distinguished from non-age related programs. Age-related programs may be individually modeled while non-age-related programs may be projected to increase in line with other variables, such as GDP, or to be constant in real terms. Such an approach to non-age-related programs provides some flexibility, as it allows above GDP/real terms increases in some activities and programs to be offset by lower increases or spending declines in other areas. It is important that (a) an entity identifies its major age-related programs and

provides details of how projections are made and (b) indicates how projections are made for other non-age-related-programs.

Impact of Legal Requirements and Policy Frameworks

46. In some jurisdictions reporting on the long-term sustainability of the public finances is governed by a legal or regulatory framework that applies at the national level. There may also be legal requirements at sub-national levels. These might include balanced budget requirements. Making users aware of the key aspects of governing legislation and regulation can enhance the understandability of projections and other disclosures. Consideration can also be given to providing details of where other publicly available reports can be accessed.

47. It is helpful to provide users with sufficient information on underlying macro-economic policy and fiscal frameworks. These might include references to other publicly available documents outside the GPFRs.

Inflation and Discount Rates

48. Entities should indicate how they deal with inflation, in particular whether inflation has been taken into account in making projections or whether projections are made at current prices (prices prevailing at the reporting date). If the projections include inflation, then the discount rate should also include inflation. If the projections are at current prices, the discount rate should exclude inflation. Entities are advised to disclose: (a) the approach to inflation (b) the discount rates applied, (c) the reasons for their selecting these rates, (d) any changes in these rates since the last reporting date, and (e) the reason for such changes.

Sensitivity Analysis

49. Many assumptions on which projections are based are inherently uncertain. In some cases small changes in variables can have significant impacts on the projections. While it is unlikely to be appropriate in a GPFR for an entity to provide sufficient data to enable users to remodel projections by modifying assumptions it is important that users are made aware of (a) the sensitivity of demographic and economic assumptions and (b) at a high level the results of any key sensitivity analyses. If inflation has been taken into account in making projections, sensitivity analysis should include the effects of variations in inflation assumptions.

Reliability of Projections

50. Users need to be made aware that that it is unlikely that projections over the time horizon will match the actual outcome, and that the extent of the difference between the projections and those actual outcomes will depend upon a range of factors, including the future actions of the entity in meeting any identified fiscal challenge. The projections need to be reasonable and realistic and the assumptions on which they are based need to be supportable. The projections are not forecasts and it is helpful to emphasize that actual cash flows will differ from projections to users, who may not be familiar with the reporting of this kind of prospective information.

51. There are a variety of approaches that entities may take to enhance the reasonableness and realism of projections. These include formal assurance by an external auditor and peer review by independent experts. It is good practice to disclose the steps that have been taken to ensure that key assumptions underpinning projections are realistic and that such assumptions are internally consistent.

Appendix A

Glossary of Indicators

Total gross debt: Total gross debt—often referred to as "total debt" or "total debt liabilities"—consists of all liabilities that are debt instruments. A debt instrument is defined as a financial claim that requires payment(s) of interest and/or principal by the debtor to the creditor at a date, or dates, in the future. (Source: International Monetary Fund: *Public Sector Debt Statistics—Guide for Compilers and Users*: 2011 (draft))

Net debt: Gross debt minus financial assets corresponding to debt instruments **(**Source: International Monetary Fund: *Public Sector Debt Statistics—Guide for Compilers and Users*: 2011 (draft))

Net worth: Total assets less total liabilities. (Source: International Monetary Fund: *Government Finance Statistics Manual 200*1)

Net financial worth: Total financial assets less total financial liabilities. (Source: International Monetary Fund: *Government Finance Statistics Manual 200*1)

Fiscal gap: The size of the immediate and permanent increase in revenues or decrease in outlays, expressed as a percentage of GDP that would be necessary to keep debt at or below its current share of GDP for a future projection period. (Source: Adapted from United States Congressional Budget Office: *The Long-Term Budget Outlook*: 2000)

Inter-temporal budget gap: Derived from the inter-temporal budget constraint (IBC). The IBC is satisfied if the projected outflows of the government (current public debt and the discounted value of all future expenditure, including the projected increase in age-related expenditure) are covered by the discounted value of all future government revenue. An inter-temporal budget gap exists when the present discounted value of future government revenue does not cover the current debt burden. (Source (derived from definition of inter-temporal budget constraint): European Commission: *Sustainability Report*: 2009))

Net Debt/Total Revenues: Net debt as a proportion of total revenues (Source Canadian Public Sector Accounting Board (PSAB): Statement of Recommended Practice 4 (SORP 4), *Indicators of Financial Condition*: 2009)

Fiscal dependency: Proportion of an entity's total revenues currently provided by entities at other levels of government. (IPSASB: adapted from PSAB: SORP 4, *Indicators of Financial Condition*: 2009)

Basis for Conclusions

Background

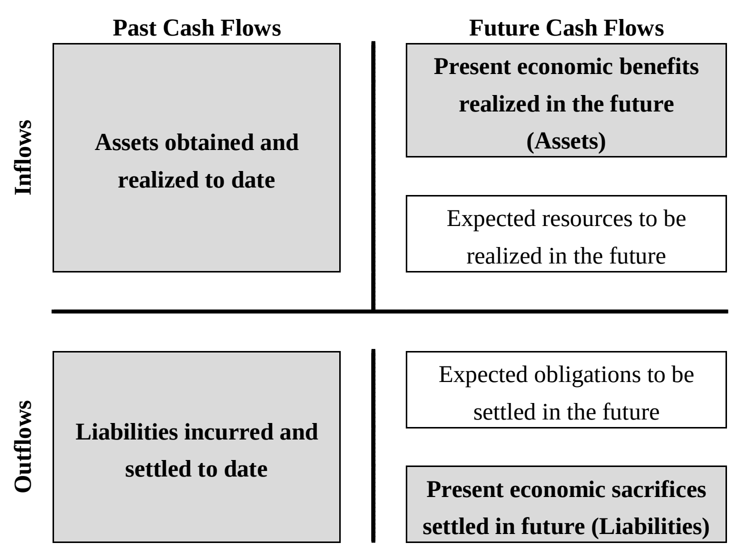
BC1. The IPSASB initially launched a project on accounting for social policy obligations (subsequently re-termed social benefits) in 2002. This led to the publication of an Invitation to Comment (ITC), *Accounting for Social Policies of Government*, in January 2004. Following an analysis of responses to that ITC, the IPSASB began to develop proposals for accounting for obligations related to different sub-categories of social benefits. In late 2006, due to failure to agree on recognition points and measurement requirements for liabilities, the IPSASB decided not to develop further proposals on recognition and measurement at that time.

BC2. As an interim step the IPSASB developed proposals for the disclosure of amounts to be transferred to those eligible at the reporting date for cash transfers (benefits settled in cash). It expressly did not propose the disclosure of obligations and liabilities. ED 34, *Social Benefits: Disclosure of Cash Transfers to Individuals or Households* was issued in March 2008.

BC3. The deliberations on identifying the point at which liabilities for social benefits arise had led the IPSASB to the view that the financial statements cannot provide all the information that users need on social benefits. This is illustrated in Exhibit One below where the shaded boxes indicate information provided in the financial statements. The IPSASB considered that before launching any further project it should consult constituents. Therefore the IPSASB raised this issue in a further Consultation Paper, *Social Benefits: Issues in Recognition and Measurement* and issued a Project Brief, *Long-Term Fiscal Sustainability Reporting.* Both these documents were issued at the same time as ED 34.

Exhibit One

Supplementing information provided in the statement of financial position



BC4. In October 2008 the IPSASB reviewed responses to all of the above documents. In the light of these responses, it was decided not to develop ED 34 into an IPSAS. The IPSASB also noted that a large majority of respondents agreed that the financial statements cannot convey sufficient information to users about the long-term financial implications of governmental programs providing social benefits. In light of this view the IPSASB decided to initiate a project on long-term fiscal sustainability (subsequently re-termed "Reporting on the Long-Term Sustainability of Public Finances"). This led to the issue of a Consultation Paper, *Reporting on the Long-Term Sustainability of Public Finances,* in November 2009. Drawing on existing practice the Consultation Paper put forward the case for reporting on on long-term fiscal sustainability, made suggestions on how such information might be presented and sought the views of constituents. The majority of respondents to the Consultation Paper favored the continuation of the project, although many said that they preferred the IPSASB to develop guidelines rather than requirements.

BC5. The IPSASB has further developed its thinking on long-term fiscal sustainability in the course of its project on the Conceptual Framework. Phase 1 of the IPSASB's project has considered the scope of financial reporting and adopted a view that, although the financial statements are at the core of financial reporting, a more comprehensive scope is necessary to meet the needs of users. Conceptual Framework ED 1, *Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity* proposed a scope that includes prospective financial information The IPSASB has also noted that projected outflows relating to obligations as a result of past decisions and projected inflows related to sovereign powers and taxation powers may not be recognized or may only be partially recognized in the statement of financial position and the statement of financial performance. Therefore, in order to meet the objectives of accountability and decision-making, users need information on prospective inflows and outflows in order to supplement information on the entity's financial position in the financial statements.

BC6. The IPSASB acknowledges that the rationale for long-term fiscal sustainability reporting in paragraph BC5 might indicate that for some entities such reporting should be required. However the IPSASB concluded that it would be premature to issue an authoritative pronouncement, because reporting on long-term fiscal sustainability in the GPFRs is an area where practice is developing and the IPSASB wishes to encourage innovative and flexible approaches.

Scope

BC7. The IPSASB considered whether the scope of the RPG should be limited to the consolidated national and whole-of-government levels. The IPSASB acknowledged that reporting on the long-term sustainability of the public finances is particularly relevant at these levels, but concluded that there might be significant user demand for such information at sub-national levels. The IPSASB therefore concluded that a narrow scope limited to the national and whole-of-government levels is not justified.

Definitions

BC8. The Consultation Paper noted that there is no universally accepted definition of long-term fiscal sustainability and included a working definition that long-term fiscal sustainability is "the ability of government to meet its service delivery and financial commitments both now and in the future." The IPSASB acknowledged the view that this definition is insufficiently rigorous and that a definition should be adopted that provides users with a clearer indication whether an entity's current economic position is sustainable. Such an approach might involve (a) linking current service delivery levels and the settling of obligations relating to entitlement programs to the maintenance of current taxation levels and (b) focusing on projected debt paths, so that an entity that can only maintain current service delivery levels and meet entitlement obligations and financial obligations by increasing taxation or current debt levels is identified as being in an unsustainable position. Macro-economists tend to adopt this more rigorous approach and focus on "explosive" debt paths, which is a term that connotes that existing service levels and existing benefits from entitlement programs cannot be sustained without major increases in levels of indebtedness.

BC9. The IPSASB decided to retain the definition in the Consultation Paper. In coming to this conclusion the IPSASB noted the need for governments and public sector entities to both (a) provide services and meet obligations relating to entitlement programs and (b) meet financial obligations, principally debt servicing. The IPSASB also noted the sovereign power of government to legislate for new taxation sources and to vary the levels of existing taxation, while acknowledging that in a global environment the ability to increase taxation might be practically constrained by a number of considerations. The IPSASB took the view that, provided an entity gives appropriate attention to the dimensions of fiscal capacity and service capacity, as highlighted in paragraphs 28 and 31, users will be given adequate information that an entity cannot maintain existing service levels, meet obligations to the current and future beneficiaries of entitlement programs and meet financial obligations without increasing taxation or increasing borrowing.

Determining Whether an Entity Should Report on Fiscal Sustainability

BC10. As discussed in paragraph BC7 the IPSASB concluded that the scope should not be limited to particular levels of government. However, the IPSASB acknowledged that reporting on the long-term sustainability of their finances might not be appropriate for all entities. The IPSASB considered this issue at length.

BC11. The Consultation Paper questioned whether reporting on the long-term sustainability of its finances is appropriate for individual controlled entities. This reservation was based on a tentative view that (a) the cost of producing the information for such entities is likely to be greater than the benefits to users, (b) the production of separate reports and disclosures by individual entities within an economic entity might be confusing to users and (c) it could be misleading if entities with limited tax-raising powers and a dependency on resources on entities at other tiers of government provide projections that are contingent on taxation decisions over which they have little or no control. Some respondents challenged this view and suggested that there are cases where users for information on the economic condition of controlled entities can be identified. The example of a local government entity controlled by a state or provincial government was cited. These respondents proposed that the test for whether an entity provided information on the long-term sustainability of its finances should be whether it had identified users for this type of information. The IPSASB was persuaded by these arguments and the ED reflects these views in paragraph 14.

BC12. The IPSASB acknowledged that direct evidence of the existence of users of information on long-term fiscal sustainability might not be readily available. The IPSASB considered what proxies might indicate the existence of users. The IPSASB concluded that there are likely to be users for long-term fiscal sustainability information for entities with one of more of the following characteristics:

(a) Significant tax and / or other revenue raising powers;

(b) Significant powers to incur debt; or

(c) Wide decision-making powers over service delivery levels.

BC13. The IPSASB believes that fiscal sustainability reporting is likely to be relevant at the whole of government level, consolidated national level, and for major sub-national entities such as regions, provinces, states and large local government entities (for examples, cities), which have tax raising powers enabling them to generate a significant proportion of their total revenues. The IPSASB remains of the view that reporting on the long-term sustainability of their finances is unlikely to be appropriate for individual government departments. This is because often they do not have tax-raising powers, their expenditure is controlled through appropriations, and they do not have powers to incur debt. In addition, in many jurisdictions, government departments are subject to frequent changes after elections or when ministerial portfolios are amended.

Presenting Projections of Prospective Inflows and Outflows

BC14. The IPSASB considered whether it should recommend time horizons for projections for entities at particular levels of government. It acknowledged the view that standard time horizons for particular classes of public sector entity might enhance comparability. The IPSASB decided that such benchmarks would be over-prescriptive and impractical. The scope of the RPG is such that standard time horizons would have to be determined for a wide range of entities, including single-purpose entities[1]. In addition the fiscal autonomy of entities at the same level of government can differ markedly between jurisdictions. The IPSASB concluded, however, that it is good practice for reporting entities to explain the reason for the time horizons that they select. The IPSASB considers that the extent of an entity's fiscal dependency will have an impact on time horizons; the higher the level of fiscal dependency, the higher the likelihood of shorter time horizons.

BC15. The Consultation Paper included illustrative examples of tabular statements showing 75 year projections for key programs and activities. IPSASB noted the view of some respondents that a focus on the position at the end of the time horizon may obscure events between the reporting date and the end of the time horizon. The IPSASB accepted this view and included guidance on the need to balance the qualitative characteristics of faithful representation and understandability in displaying projections in paragraph 19.

BC16. The Consultation Paper considered three models for reporting information on long-term fiscal sustainability and suggested that (a) the provision of additional statements providing details of projections and (b) summarized projections in narrative reporting were appropriate. Some respondents suggested that, although the Consultation Paper

[1] For example, such entities might include school boards or bodies responsible for water and drainage.

acknowledged that these reporting approaches were not mutually exclusive, the IPSASB should highlight that reporting on long-term fiscal sustainability just by displaying projections in statements is insufficient to meet user needs and that other presentation methods need to be deployed. The IPSASB was persuaded by this view and it is reflected in paragraph 20.

Addressing the Dimensions of Fiscal Sustainability

BC17. The IPSASB considered that providing a flexible framework for the disclosure of information might help entities to organize the way in which they communicate information and ensure that information is faithfully representative of an entity's long–term fiscal sustainability. The IPSASB noted the work done by the US Governmental Accounting Standards Board (GASB)[2] and the Canadian Public Sector Accounting Board (PSAB)[3] in defining "components" and "elements" for reporting the long-term sustainability of an entity's finances. In particular the IPSASB considered that the GASB's notions of "fiscal capacity" and "service capacity" should be adopted in a slightly modified form. The IPSASB also noted the PSAB's notion of "vulnerability" as "the degree to which a government is dependent on sources of funding outside its control or influence or is exposed to risks that could impair its ability to meet its existing financial obligations both in respect of its service commitments to the public and financial commitments to creditors, employees and others." The IPSASB considered that a variant of this notion is particularly important for entities at sub-national levels which have limited taxation powers and are therefore exposed to decisions, over which they have no or very limited control, taken by other entities at other levels of government. The IPSASB noted that the approach taken by these standard setters had similarities to the "dimensions" developed by Allen Schick[4] and discussed in the Consultation Paper.

BC18. One of the dimensions that Schick discussed was "economic growth." The IPSASB considered that explicitly introducing a dimension of economic growth was inappropriate because the determinants of economic growth are complex and not under the control of the reporting entity. However, assumptions about economic growth will be critical to the development of projections and are likely to feature heavily in sensitivity analyses.

Disclosure of Principles and Methodologies

BC19. The Consultation Paper discussed the principles that should be adopted for the inclusion of programs and transactions in long-term fiscal sustainability reporting and methodological approaches central to the outcome of projections. The areas addressed included whether projections should be based on current or future policy, the approach to revenue inflows, the approach to age-related and non-age-related programs and the approach to sensitivity analysis. The IPSASB considered whether, in order to meet the qualitative characteristic of comparability, the IPSASB should make firm recommendations on best practice approaches.

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2 Project on *Economic Condition* (Governmental Accounting Standards Board: Norwalk, CT, USA)

3 Statement of Recommended Practice 4, *Indicators of Fiscal Condition* (Public Sector Accounting Board: Canada, Toronto, 2009)

4 Allen Schick, *Sustainable Budget Policy Concepts and Approaches* (OECD: Paris, 2008)

BC20. The IPSASB did not consider it appropriate to make firm recommendations on best practice because (a) the scope of the RPG includes all public sector entities and practice that is appropriate at one level of government may not be suitable elsewhere in the public sector, (b) while reporting on long-term fiscal sustainability has become a feature of financial management in an increasing number of jurisdictions it is at an early stage of development and (c) it is not the intention of the IPSASB to usurp the role of other professional groups with expertise in this area. In some cases the IPSASB has considered it appropriate to express a view on a preferred high level approach such as those projections are likely to be most useful when based on current policy and when they encompass both inflows as well as outflows. The IPSASB also noted that, at the national level, the Organization for Economic Cooperation and Development has recommended that projections should be updated on an annual basis.

Alternative View of Mr. David Bean

AV1. This member believes that the public sector entities that prepare reports in accordance with International Public Sector Accounting Standards (IPSAS) should be required to present fiscal sustainability information within general purpose financial statements, including note disclosures, or in a separate general purpose financial report. This member believes that current practice associated with this type of information for public sector entities that are issuing accrual-basis financial reports has moved beyond an "early stage for development" and the need for "good practices." A public sector entity that issues general purpose financial statements in conformity with IPSAS also has demonstrated that it has the capacity to present fiscal sustainability information of equal standing.

AV2. This member notes that the IPSASB, in the Exposure Draft on Phase 1 of the Conceptual Framework project[5], recognized that the presentation of information about prospective financial information is necessary to meet the objectives of financial reporting (accountability and decision-making) in response to user needs. Therefore, this member concludes that if prospective financial information is truly necessary to meet the financial reporting objectives it should be required.

AV3. This member believes that the recommendations presented have been developed from a principles-based perspective that can be applied to all public sector entities without significant modifications. Therefore, this member concludes that suitability is not a barrier to establishing requirements. This member is concerned that without specific reporting requirements many governments will simply choose not to report fiscal sustainability information that is needed by users of public sector financial reports.

[5] Conceptual Framework Exposure Draft 1, *Conceptual Framework for General Purpose Reporting by Public Sector Entities: Role, Authority and Scope: Objectives and Users; Qualitative Characteristics; and Reporting Entity* (IFAC: New York, 2010)

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