



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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Agenda Item
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Date: October 19, 2010
Memo to: Members of the IPSASB
From: John Stanford and Ian Carruthers
Subject: Reporting on the Long-Term Sustainability of Public Finances: Further Consideration of Key Issues

Objectives

1. The objectives of this session are:
 - To consider changes needed to the current Terms of Reference to ensure the IPSASB's mandate includes issuing publications on the 'more comprehensive scope' aspects of financial reporting;
 - To consider in more detail some key issues identified in the responses to the Consultation Paper, 'Reporting on the Long-Term Sustainability of the Public Finances'; and
 - To provide an outline of a potential Exposure Draft (ED) of 'guidelines' on reporting on the long-term sustainability of the public finances and obtain views on this outline so that a preliminary draft can be brought to the second meeting of the IPSASB in 2011.

Background

2. The Consultation Paper (CP), "Reporting on the Long-Term Sustainability of Public Finances" was issued in late November 2010. The CP addressed one of the 'more comprehensive scope' ('broader') topics that the first Consultation Paper on the Conceptual Framework proposed should be within the scope of financial reporting.
3. 32 responses were received to the Consultation Paper. A summary and analysis of those responses was discussed at the Vienna meeting. At the Vienna Meeting the IPSASB decided to proceed with the project with a view to developing non-mandatory guidelines, i.e., an entity may assert compliance with IPSASs without following the approach in the guidelines. The exact terminology for such a publication was not determined at the Vienna meeting. The term 'guidelines' is used in this paper. It was also agreed that the decision to develop 'guidelines' rather than requirements for the long-term sustainability of the public finances should not be considered a precedent for future publications on 'more comprehensive scope' topics. This issue is discussed in more detail in the section dealing with 'Types of Pronouncements'.

4. Prior to commencing work on an ED of the guidelines it was directed that a number of key issues should be further considered.

Key Issues

5. The key issues identified were:
 - Types of publications the IPSASB is authorized to issue under its Terms of Reference and consequent revisions to the IPSASB's existing Terms of Reference;
 - A bottom-up approach providing key principles related to the dimensions of sustainability;
 - Links to the reporting entity and the objectives of financial reporting, particularly accountability; and
 - Further analysis of GPFs, including the frequency of reporting and the relationship to other publicly available documents.

Types of publications the IPSASB is authorized to issue under its Terms of Reference and consequent revisions to the IPSASB's existing Terms of Reference

6. Some respondents to the Consultation Paper questioned whether the IPSASB currently has the authority to issue publications that do not apply to the general purpose financial statements. This view also has implications for other 'more comprehensive' scope projects such as 'Service Performance' and 'Narrative Reporting'. Staff was asked to consider this view and, if necessary, suggest amendments to the current provisions.
7. The IPSASB's current Terms of Reference provide the IPSASB with the authority, on behalf of the IFAC Board, to issue:
 - International Public Sector Accounting Standards (IPSASs) as the standards to be applied by members of the profession in the preparation of general purpose financial statements of public sector entities. The IPSASB adopts a "due process" for the development of IPSASs, which provides all interested parties with the opportunity provide input to the standards development process.
 - Studies to provide advice on financial reporting issues in the public sector. They are based on study of the best practices and most effective methods for dealing with the issues being addressed to the Scope of the Standards' sub-section of the 'Scope and Authority of International Public Sector Accounting Standards' section of the 'Preface to International Public Sector Accounting Standards'.
 - Occasional Papers and Research Reports to provide information that contributes to the body of knowledge about public sector financial reporting issues and developments. They are aimed at providing new information or fresh insights and generally result from research activities such as: literature searches, questionnaire surveys, interviews, experiments, case studies and analysis.

8. Staff agrees that these current provisions do not directly address the question of the IPSASB issuing publications, whether requirements or guidelines, on the ‘more comprehensive’ aspects of general purpose financial reporting. The responses to the Conceptual Framework Group 1 Consultation Paper were supportive of the IPSASB’s mandate being broadened to address aspects of general purpose financial reporting outside the traditional financial statements.
9. Staff therefore proposes that the IPSASB request that the IFAC Board approve a modification of the Terms of Reference so that it is clear that the IPSASB may issue “publications on aspects of financial reporting that are outside the general purpose financial statements”. The wording is intentionally open as to whether such publications will include requirements or guidelines.
10. Once IFAC approves changes to the IPSASB’s terms of reference, related changes will be required to the ‘Preface to International Public Sector Accounting Standards’.
11. There are a number of possibilities for badging the nature of publications to be developed on ‘more comprehensive’ topics. As already indicated the Canadian PSAB uses the term ‘Statement of Recommended Practice’. The GASB has used the term ‘Suggested Guidelines for Voluntary Reporting’ for its publication on ‘Service Efforts and Accomplishments’ although the GASB Director of Research cautioned against use of this term on the grounds that it lacks impact and insufficiently emphasizes the importance of the subject. The IASB has recently decided to issue forthcoming guidance on management commentary as an ‘IFRS Practice Statement’, so by analogy ‘IPSAS Practice Statement’ might be a possibility.

Action Required

Members are asked to:

- **Agree** that IPSASB should request the IFAC Board to modify the IPSASB’s Terms of Reference, so that the IPSASB can issue publications on the ‘more comprehensive scope’ aspects of financial reporting; and
- **Consider** and **agree** a term for publications that provide ‘guidelines’ rather than requirements.

A bottom-up approach providing key principles related to the dimensions of sustainability

12. At Vienna it was reaffirmed that guidelines should apply to all levels of government and should not be restricted to central government or the consolidated whole of government level. It was noted that issues differ between national and sub-national levels and that, in particular, a number of key indicators commonly used in the evaluation of fiscal sustainability relate to the macro-economy (e.g. net debt to GDP, net financial wealth to GDP) rather than to individual entities. At Vienna the Board directed that a bottom-up approach be developed that would allow entities to select a reporting approach that reflected their individual fiscal and service delivery characteristics, rather than a prescriptive top-down approach

- where entities are expected to report certain indicators, regardless of the feasibility of computation and their relevance.
13. The CP highlighted the ‘dimensions’ of solvency, growth, fairness and stable taxation developed by Allan Schick. The high level definitions of these dimensions included in the CP were:
- **Solvency:** the capacity of governments to finance existing and probable future liabilities/obligations;
 - **Growth:** the capacity of government to sustain economic growth over an extended period;
 - **Fairness:** the capacity of government to provide net financial benefits to future generations that are not less than the net benefits provided to current generations; and
 - **Stable taxes:** the capacity of governments to finance future obligations without increasing the tax burden.
14. It was suggested these dimensions might inform the approach to narrative reporting. Some of the dimensions would be more applicable than others, depending on the nature of the reporting entity. For example, while *solvency* might be relevant to all entities, *stable taxation* is of limited relevance to entities with highly limited tax-raising powers which are primarily dependent upon transfers from higher tiers of government. *Growth* may be a problematic dimension, because, attributing causation to the various factors that contribute to economic growth is complex and holding a reporting entity accountable for factors that it does not control may not be relevant or representationally faithful.
15. It is likely that these dimensions might be modified and augmented by other dimensions to be developed by the IPSASB and informed by the work of other standards-setters. The work of the Canadian Public Sector Accounting Board (PSAB) provides an indication of the approach taken by one public sector standards-setter.
16. In 2009 the PSAB issued Statement of Recommended Practice 4, “Indicators of Financial Condition.” SORP 4 applies to governments that choose to report supplementary information on financial condition. SORP 4 puts forward sustainability, flexibility and vulnerability as factors to be considered in assessing financial condition:
- **Sustainability** is the degree to which a government can maintain its existing financial obligations both in respect of its service commitments to the public and financial commitments to creditors, employees and others without increasing the debt or tax burden relative to the economy within which it operates;
 - **Flexibility** is the degree to which a government can change its debt or tax burden on the economy within which it operates to meet its existing financial obligations both in respect of its service commitments to the public and financial commitments to creditors, employees and others; and

- **Vulnerability** is 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.
17. These three factors (or elements as they are termed in the SORP) lead to a series of specific and government related indicators. The *vulnerability* factor seems particularly valuable for entities with limited tax raising powers and limited control over inflows as discussed above in paragraph 8. Copies of SORP 4 are available from Staff on request.
18. As discussed in the Consultation Paper the Governmental Accounting Standards Board's (GASB) definition of economic condition comprises three components: financial position, fiscal capacity and service capacity. There are similarities between some of these components and both the PSAB terminology and the Schick dimensions:
- **Financial position** is an entity's assets, liabilities, and net assets, derived from the statement of financial position;
 - **Fiscal capacity** is the ability to meet financial obligations as they come due on an ongoing basis and is therefore linked to debt maturity and liquidity. It has similarities to the financial commitments strand of the PSAB's "sustainability" factor; and.
 - **Service capacity** is an entity's ability and willingness to meet its commitments to provide services on an ongoing basis. It has similarities to the service commitments strand of the PSAB's "sustainability" factor.
19. Staff and the Task Force Chair propose that the 'guidelines' include key components/dimensions within which entities present appropriate information on long-term fiscal sustainability, dependent upon the relevance of those dimensions to particular circumstances.
20. It was also suggested in Vienna that the view in the Consultation Paper that long-term fiscal sustainability reporting is probably only justified at consolidated levels might be too restrictive. An example was provided of a local government entity in a jurisdiction where local government is controlled by state government. It was suggested that there are probably users for prospective financial information for such an entity.
21. It is proposed that the determination of whether to develop and publish a GPFR component on long-term fiscal sustainability should be based on an assessment of whether users exist for such information. The Task Force Chair and Staff do not think that the intention of the IPSASB in the CP was to discourage entities such as the local government unit highlighted above from providing information on the long-term sustainability of their finances. The view in the Consultation Paper was primarily intended to indicate that it is unlikely to be useful for individual central government departments to develop long-term fiscal sustainability reports and that information on long-term fiscal sustainability at the central government level is probably most relevant to users on a consolidated basis. The Chair and Staff

- therefore propose to draft an ED of Guidelines on the basis that the existence of users should determine whether reports on long-term fiscal sustainability are provided.
22. The Task Force Chair and staff envisage the Guidelines as a short principles-based publication. A possible outline is shown at Appendix A. The Guidelines will need to be complemented by examples of existing practice at various levels of government. Staff considers that this might be a separate work stream in the overall project.

Action Required

Members are asked to **confirm** the views of the Task Force Chair and Staff that ‘guidelines’ should be developed on a bottom-up, principles-based approach using dimensions of sustainability.

Links to the reporting entity and the objectives of financial reporting, particularly accountability

23. Throughout the development of this project a key principle has been that the analysis and disclosure of information should be linked to the reporting entity. A number of respondents, and some Task Force members and IPSASB members, favour the publication of information based on the General Government Sector (GGS), as defined in the Government Financial Statistics Manual 2001. The rationale is that the GGS includes all institutional units within its four subsectors (central government, state governments, local governments and social security funds), regardless of whether a particular tier of government can direct the financial and operating policies of an entity at a lower level so as to benefit from its activities. Those advocating the use and publication of information based on the GGS highlighted the consistency and comparability that such information provides between jurisdictions. For example, the GGS always includes local government, whereas, in a two-tier system, whole of government accounts only includes local government if national government controls local government. They also noted that fiscal and macro-economic analysis is carried out using statistical accounting.
24. The disadvantage of disclosing GGS based information is that, arguably, it does not meet the objectives of financial reporting, particularly accountability, but also decision-making. This is because information will be presented on future rights, future resources, future obligations and commitments over which a reporting entity will have no control and, conversely, information on entities that are controlled, but are not institutional units within the four subsectors noted above will not be presented. Providing information on prospective flows relating to Public Financial Corporations (PFCs) and Public Non-Financial Corporations (PNFCs) provides a broader view of the public sector.
25. On balance Staff and Task Force Chair think that there may be benefit in disclosure of fiscal sustainability information on a basis that includes the broader public sector comprising GGS, PFCs and PNFCs. A flexible approach allows

- connections to be made to information that is already published. The IPSASB has addressed the disclosure of statistical information in IPSAS 22, “Disclosure of Financial Information about the General Government Sector”. IPSAS 22 prescribes disclosure requirements for governments that elect to present information about the GGS in their consolidated financial statements. It requires entities making GGS disclosures to apply all IPSASs except IPSAS 6, “Consolidated and Separate Financial Statements.
26. Because a publication on long-term fiscal sustainability will be in the nature of ‘guidelines’ not requirements, IPSAS 22 cannot be considered a template. In some respects inclusion of information on sectors that are not consolidated for accrual non-statistical purposes is more straightforward than the approaches specified in IPSAS 22, because the key information need is to identify flows, not to deal with differences in accounting policies. If statistically based information is to be provided at the consolidated national or whole of government level it is important that users are aware of (1) entities that are within the broader statistical definition of the public sector, but are not within the reporting boundary for the non-statistically based accrual consolidated statements and also (2) the more limited circumstances where there are entities that are not within the boundary of the statistically based accounts but are within the reporting boundary of the statistical accounting boundary e.g., where a non resident Government Business Enterprise does not meet the definition of a PNFC or PFC.

Action Required

Members are asked to **confirm** the views of the Task Force Chair and Staff on the disclosure of information on a statistical accounting basis or provide alternative directions.

Further analysis of GPFRs, including the frequency of reporting and the relationship to other publicly available documents

27. The Consultation Paper discussed approaches to reporting information on the long-term fiscal sustainability of the public finances, but was vague in its discussion of where information on the long-term sustainability of the public finances should be reported, whether in one or multiple GPFRs. Many respondents assumed that IPSASB intended the publication of an integrated GPFR including the financial statements and all ‘more comprehensive’ scope GPFR components. Considerable reservations were expressed about including information on long-term fiscal sustainability with the financial statements, not only by respondents who opposed the IPSASB’s further progression of the long-term sustainability project, but also by those who were generally supportive of the IPSASB developing a pronouncement. These reservations were generally based on audit considerations, in particular the negative way in which scope exclusions in audit reports might be interpreted by users.
28. One respondent also questioned whether, notwithstanding recent OECD advice recommending annual updating, if the underlying projections are only updated irregularly the entity would publish the same prospective financial information

- each year until updated. For this respondent such an approach appeared to be of dubious relevance. This situation is acknowledged, although it is proposed that ‘guidelines’ make clear that preparers should endeavour to ensure that baseline projections are updated annually.
29. The Task Force Chair and Staff consider that guidelines should make clear that there is no expectation that a GPFR component on the long term fiscal sustainability will be published with the financial statements. Entities may consider that it is appropriate to include long-term fiscal sustainability information with the financial statements, particularly because the statement of financial position provides a baseline of the current resources already available to a reporting entity (or the extent to which there is a deficit of such resources). However, there might also be local circumstances that lead entities to issue a separate GPFR on this topic.
30. Some respondents questioned what distinguished information that can be reported in a GPFR from that outside the GPFRs. Clarification of this issue provides a formidable challenge and a solution is likely to evolve over time. The Guidelines should particularly emphasize;
- The importance of the qualitative characteristics, particularly understandability; and
 - The importance of reporting information based on past decisions and events that are not reflected as assets and liabilities in the statement of financial position.
31. The flowchart on ‘Reporting Information in Accordance with the Conceptual Framework’ discussed at Agenda Item 2.1 might be of use in determining what should be reported, although it is accepted that this provides little assistance in determining exactly what sort of information on the long-term sustainability of the public finances is within the scope of the GPFRs. The flowchart is attached at Appendix B.

Action Required

Members are asked to **confirm** the views of the Task Force Chair and Staff on the approach to reporting information on the long-term sustainability of the public finances in GPFRs or provide alternative directions.

Timetable

32. The Task Force Chair proposes to engage the Task Force in development of the ED. It is intended to convene a meeting of the Task Force after the OECD Accruals Symposium in March 2011. A first draft of the ‘guidelines’ will then be brought to the June 2011 meeting of the IPSASB.

Action Required

Members are asked to **agree** that a first draft of guidelines on ‘Reporting on the Long-Term Sustainability of the Public Finances’ should be brought to the June 2011 meeting of the IPSASB or provide alternative directions.

Appendix A

Potential Structure of Guidelines

Objective

Scope

Definitions

Key Dimensions of Fiscal Sustainability

Methods of Communicating Information on Fiscal Sustainability

Non-Exhaustive Potential Indicators of Fiscal Sustainability

Relationship with Objectives and Qualitative Characteristics

Updating of Projections

Disclosure of Principles and Methodologies

Effective Date

Basis for conclusions

Appendix B

Reporting Information in Accordance with the Conceptual Framework

