CIPFA The Chartered Institute of Public Finance & Accountancy

ED 46 - Proposed Recommended Practice Guideline, *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*

response to exposure draft

12 March 2012

the people in public finance

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. Our 14,000 members work throughout the public services, in national audit agencies, in major accountancy firms, and in other bodies where public money needs to be effectively and efficiently managed.

As the world's only professional accountancy body to specialise in public services, CIPFA's portfolio of qualifications are the foundation for a career in public finance. They include the benchmark professional qualification for public sector accountants as well as a postgraduate diploma for people already working in leadership positions. They are taught by our in-house CIPFA Education and Training Centre as well as other places of learning around the world.

We also champion high performance in public services, translating our experience and insight into clear advice and practical services. They include information and guidance, courses and conferences, property and asset management solutions, consultancy and interim people for a range of public sector clients.

Globally, CIPFA shows the way in public finance by standing up for sound public financial management and good governance. We work with donors, partner governments, accountancy bodies and the public sector around the world to advance public finance and support better public services.

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Submitted electronically

Dear Stephenie Fox

IPSASB ED 46 - Proposed Recommended Practice Guideline, *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*

CIPFA is pleased to present its comments on this Exposure Draft, which have been reviewed by CIPFA's Accounting and Auditing Standards Panel.

General comments

As noted in successive CIPFA responses on this topic and others

- CIPFA strongly supports IPSASB's development of high quality standards for public sector financial reporting, whether through the Board's recent project to develop IFRS converged IPSASs or through wholly public sector specific IPSASs.

- CIPFA agrees that it is important to broaden the developing Conceptual Framework to cover matters which go beyond a focus on financial statements.

- CIPFA agrees that fiscal sustainability and other public sector issues such as reporting on social benefits are important issues which should be properly explored.

In the light of the above comments we would like to strongly reiterate and reinforce CIPFA's support for the aspirations of this project to provide a more complete view of the financial affairs of government than are presented in conventional financial statements, principally by setting out projections of future revenue and expenditure relating to current programmes and commitments.

These proposals fit well with many CIPFA initiatives through which we seek to improve public sector financial management, including matters set out in our publications *Fixing The Foundations*, and *Public Financial Management: A Whole Systems Approach (Volumes 1 and 2)*.

The proposals are also timely, given

- current private sector discussions of 'going concern' assessments for banks, insurance and other large companies (including the UK Sharman enquiry); and

- concerns over the extent to which governments and countries are managing their finances in a manner that command confidence, perhaps analogous to operating as going concerns. The global financial and sovereign debt crises have highlighted vividly the damaging consequences of weak public financial management based on incomplete, inaccurate, and out-of-date financial data.

Against this background, we consider that the long term fiscal effects of government programmes are a matter which should be considered in any initiative which seeks to improve or maintain public sector financial management. Having said this, we would not always consider these to be the most pressing matters to address. The governments which were 'surprised' by a sovereign debt crisis mostly lacked basic accrual accounts for assets and liabilities, and it might make sense to develop conventional financial statements before addressing more advanced reporting.

Drafting comments

Identifying the requirements of the Guideline

The proposed Recommended Practice Guideline will be the first document of its type issued by the IPSASB, and will differ from other pronouncements in that while it will not be mandatory, it will not be purely descriptive, and it will set out requirements for compliance with the standard. Furthermore, it will encourage those reporting on long term fiscal sustainability to indicate whether their reporting is compliant or partially compliant with those requirements.

Given this, it would be helpful if the proposed guideline were to clearly distinguish between descriptive material which reflects what can or may be done, and the RPG requirements which set out a baseline for what the entity should do based on its assessment of circumstances.

We would note that the IASB faced similar issues in its Practice Statement, *Management Commentary*. The IASB document adopts a drafting approach which starts with brief descriptive material, followed by requirements which the entity 'should' do, either in all cases or when appropriate.

ED 46 seems by contrast to use a variety of approaches to signposting requirements,

- 'it is important that an explanation is provided' (para 13)
- 'an entity needs initially to assess' (para 14); also
- 'fiscal sustainability should be considered in the context' (para 15)
- 'core information … will be …' (para 17)
- 'requires the inclusion of …' (para 23)

Although when taken in isolation these generally signify 'requirements', they are juxtaposed with descriptive and conditional material which makes things less clear. It would be helpful if the requirements and descriptive material were more clearly delineated.

Placement of discussion of the objectives of financial reporting

The ED explains at Para 20 of the draft RPG that 'A single presentation approach is unlikely to satisfy the objectives of financial reporting.'

As we indicated in the CIPFA response to the Consultation Paper in 2010, we were not convinced that fiscal sustainability reporting should be represented as necessary to satisfy the objectives of financial reporting.

Furthermore, this type of justification would be better contained in the Basis for Conclusions, together with more specific explanation of why and how multiple presentation approaches are desirable, for example, by providing more complete information of the economic circumstances of the entity which enhance faithful representation.

Discussion of representational faithfulness

Para 27 of the ED sets out a requirement that information reported should be 'faithfully representative', that this requires the inclusion of narrative discussion, and can be satisfied by presenting historical and prospective information on three dimensions.

We suggest that ‘representationally faithful’ would be a better term to use; both terms have been used in IASB briefings, but this is the predominant usage and seems to us to be more accurate.

We also suggest that it would be helpful to provide a more specific description of what is meant by faithful representation so that it can be better related to the content of reporting.

We would also note that the current drafting might be misread as implying that providing information on the three dimensions will automatically result in faithful representation. We suggest that reporting on the dimensions will normally be necessary, but will only be sufficient if the reporting provided on each dimension is of sufficient quality.

Use of the term ‘sustainability’

We would note that using the term “sustainability” in the title and the introductory text chimes well with our own experience in the context of the UK political and economic context. We would also expect it to be well received in other Anglophone nations and in most of the Eurozone. However, it may be considered by some to reflect a particular First World economic and political orthodoxy. IPSASB might therefore consider whether it would be more helpful to reframe the title and introductory material in more neutral terms of e.g. commentary on the long term fiscal effects of government programmes. This might also reduce the need to distinguish between actual ‘sustainability’ and ‘practical reporting on apparent indicators of sustainability, based upon current assumptions about resources, commitments and technology’.

Furthermore, while on balance we consider that it is helpful to introduce ‘long-term fiscal sustainability’ as a technical term, it would be helpful if this term were consistently used throughout, and informal usages (such as ‘unsustainable’ in para 30) were avoided.

More detailed drafting

Some more detailed drafting points are set out in an attached annex.

Specific Matters for Comment

CIPFA responses to the Specific Matters on which IPSASB would particularly value comment are set out 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.

CIPFA agrees that these characteristics provide a useful indicator of whether *users might exist for whom public sector reporting entities might reasonably be expected to provide such reporting*. It would be helpful to be clear at paragraph 14 that the ‘need’ for reporting is framed in terms of users who in some measure deserve this information, for example reflecting the government’s democratic, constitutional or other responsibility to be accountable.

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?

CIPFA agrees that the "dimensions" provide a viable framework for this reporting, subject to our detailed drafting comments.

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?

CIPFA agrees in general terms with the guidelines on disclosure of principles and methodologies, subject to some drafting observations.

I hope this is a helpful contribution to the development of the Board's guidance in this area.

Yours sincerely

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ANNEX

IPSASB ED 46 - Detailed drafting comments

Para 2

…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.

It would be more in keeping with the non-mandatory nature of the RPG if the entity explained why the departure was 'necessary or desirable'.

Para 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.

The term 'budget sector' is not self-explanatory and its meaning is not clear. It would be helpful if the intended meaning was explained.

Para 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.

We suggest it would be clearer and more accurate to say 'take reasonable steps to ensure', (ie based on the controlled entity's understanding of the controlling entity information).

Para 20

Projections of net debt are likely to be central for many reporting entities.

We suggest that the term 'central' is insufficiently clear. It would be helpful to provide a specific explanation, for example that net debt might be considered to be an important indicator, or one of the more important indicators of fiscal sustainability for the entity.

Para 22
There is a risk that both tabular statements and graphical disclosure can be <u>skewed</u> to present a misleadingly <u>favorable</u> picture.

'Skewed' is not a clear or accurate term for the wilful presentation (or misrepresentation) of data which without technical inaccuracy gives a misleading impression. Perhaps this should be framed in terms of 'selective' or 'unclear' presentation.

We also suggest 'misleadingly favorable <u>or unfavorable</u>' would better capture situations where, for example, newly elected governments might incorrectly attribute fiscal sustainability problems to predecessor governments.

Para 25
There is a strong relationship between fiscal dependency and time horizons.

We suggest that the relationship is between e.g. 'fiscal dependency and the time horizons over which it is beneficial or meaningful to report on'.

Para 36
<u>Generally, an entity that is highly vulnerable is likely to have limited control over the sustainability of its finances.</u> 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.

The underlined sentence 'Generally…' seems to be stating that an entity with little control over its funding has little control over its fiscal sustainability. This seems tautologous, and in any case, is better explained in the subsequent sentence on increasing vulnerability.

Para 36
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, <u>which may make the entity less susceptible to sudden adverse funding decisions by other entities and therefore increase the probability of receiving funds.</u>

The underlined portion '…which may…' also seems superfluous and less clear than the material which precedes it.

The drafting could be further clarified as follows:

'Vulnerability may be mitigated if <u>funding received from</u> inter-governmental transfers ~~have~~ <u>has</u> constitutional or other legal underpinning'.