



# REPORTING ON THE LONG TERM SUSTAINABILITY OF A PUBLIC SECTOR ENTITY'S FINANCES

RESPONSE FROM THE INSTITUTE OF CHARTERED ACCOUNTANTS OF  
SCOTLAND TO THE INTERNATIONAL PUBLIC SECTOR ACCOUNTING  
STANDARDS BOARD

29 February 2012

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## **Introduction**

The Public Sector Committee of The Institute of Chartered Accountants of Scotland (ICAS) welcomes the opportunity to comment on the International Public Sector Accounting Standards Board's (IPSASB's) consultation paper "Reporting on the Long Term Sustainability of a Public Sector Entity's Finances" (exposure draft 46). The Public Sector Committee is a broad based committee of ICAS members with representation from across the public services.

The Institute's Charter requires its Committees to act primarily in the public interest, and our responses to consultations are therefore intended to place the public interest first. Our Charter also requires us to represent our members' views and to protect their interests, but in the rare cases where these are at odds with the public interest, it is the public interest which must be paramount.

## **Key points**

We support the principle of providing users with a forward looking view of an entity's financial position, highlighting vulnerabilities and strengthening the accountability for decisions whose impact is beyond the financial year end.

We also support:

- A principles based approach and a flexible framework for disclosure of information
- The status of recommended practice, for voluntary adoption, and
- Efforts to ensure consistency through sharing projections prepared by other bodies (para 18).

We do however have concerns in a number of areas. The preparation and public reporting of projections appears most relevant at the national level. The publication of this information in financial statements needs to be user driven, however there is not sufficient evidence that users exist at the sub-national level out with major central government areas.

The criteria for determining whether users exist is too wide ranging and an alternative principles based approach is suggested in our response to "specific matter for comment 2". Further differentiation between national and sub-national levels is needed to avoid over burdening smaller organisations.

For sub-national levels a forward looking review of fiscal sustainability is useful however it is potentially a complex and significant additional workload, particularly at the entity level as they may not be accustomed to gathering the data for reporting and testing projections. The balance of information required and resource implications for implementation are important considerations, especially in the current economic climate. We believe that a one-size fits all Recommended Practice Guide (RPG) approach for such a wide variety of national and sub-national organisations is likely to have implementation difficulties and believe that an alternative simpler approach for smaller entities to retain the forward looking principle but reduce the complexity would be more effective and less costly to implement.

The location for this information is not specified. Whether it is within the financial statements, annual report or a separate Long Term Fiscal Sustainability (LTFS) report would impact on the appropriate level of detail and likely user. It would be helpful if the expected location could be clarified.

The reasonableness of LTFS is an area subject to risk given its reliance on projections, assumptions and a longer term horizon. Further details on audit and assurance arrangements to validate the robustness of the projections and assumptions are required.

### **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.**

The proposed scope could be interpreted to include all public sector entities. There is insufficient evidence that users exist for this information in financial statements for all such entities. It is agreed that the most relevant body is at the national level for example, the Office of Budget Responsibility in the UK who prepare the national LTFS reports.

This RPG should clarify if the prime audience is external (accountability to the public, to inform other government bodies) or internal (to improve longer term management financial planning and impact assessment) as this affects the level of detail required. Some entities may produce elements of the projections for internal management purposes, not publication. This RPG could also inform the development of good practice for internal reporting.

The characteristics to identify whether users exist are wide-ranging and likely to target more organisations than those which may actually have users, for example:

- The characteristic at 15(a) – this would apply only to the national level (for example, the UK Parliament as having significant tax-raising powers) whereas 15(b) swings to the other end of the spectrum.
- The characteristic at 15(b) “powers to incur debt” - many organisations can incur overdrafts. The expectation is that debt would include overdrafts but this needs clarification. Not all public sector entities have powers to raise debt (and may have limits to their overdraft facilities) however, they may draw down cash from central government and therefore have an impact on wider public finances so exclusion based on debt may not be appropriate.
- The characteristic at 15(c) needs further clarification on how this would be interpreted in practice, for example does it mean wide discretion in terms of the range and level of services the entity can provide?

The identification of a suitable user definition is complex. Instead of using 3 characteristics it is suggested that the RPG provides examples of probable users but the organisation should take responsibility for identifying users. For consistency with the “comply or explain” approach, the organisation should explain who those users of projections are along with their projections or alternatively, why users for this information do not exist and therefore why it is not appropriate to report long-term fiscal sustainability.

### **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?**

The three dimensions “fiscal capacity”, “service capacity” and “vulnerability” are appropriate and useful. We suggest replacing the term “fiscal capacity” in an international document with “revenue capacity” to recognise that some organisations can generate revenue through charges & sales, not just taxation.

Public sector net debt (public sector financial liabilities net of liquid financial assets) as a key target indicator of fiscal sustainability is a national indicator. The proposal to use net debt as a % of total revenues at the sub-national indicator is not consistent with normal entity/corporate ratio analysis of gearing levels which would be based on total debt (all borrowings + overdraft)/ total assets. Total debt may provide a more transparent and complete picture; for example to ensure Private Finance Initiative (PFI) liabilities (or their equivalent) are included, being a significant future cost.

As part of “service capacity” we suggest introducing references to recognise the impact of planned efficiencies on service capacity, as this is currently a high profile factor on future delivery for various governments.

Highlighting vulnerability and variable funding dependencies is informative and may help to demonstrate the effectiveness of organisations actions to mitigate their risk of vulnerable revenue streams, if reviewed over time and accompanied by a narrative explanation.

The definition provided for “vulnerability” is narrow. Vulnerability should form part of a more comprehensive forward looking risk analysis as funding dependencies although important, are not the only factor which can affect future fiscal sustainability. Other examples include political changes, restructures, the economy and rate movements. We believe this should be communicated through a supporting narrative explanation.

Where consolidated or whole of government accounts exist, this is a useful source for identifying significant liabilities which may have longer term impacts and should be included in a national LTFS report.

Commentary on an entity’s future prospects helps to improve accountability for decision makers and is consistent with other financial reporting developments as well as previous ICAS consultation responses such as “*Accounting for Public Service – Towards a New Reporting Framework*”<sup>1</sup>, “*Sharma Going Concern*”, “*BIS Narrative Reporting*”<sup>2</sup> and developments outlined in the International Integrated Reporting Council Discussion Paper on Integrated Reporting.

For example, “*Accounting for Public Service – Towards a New Reporting Framework*”, states that too much reporting is focused on outputs rather than outcomes. The concern is:

*“There is currently a democratic deficit in accountability, because the reporting framework simply does not address the extent to which we are moving towards the achievement of these outcomes [which politicians are elected on] and therefore accountable representatives cannot be held accountable for this”.* (para 1.7.1, page 20)

The level of need, detail and complexity will vary significantly between national and sub-national level entities. A one-size fits all RPG approach for such a large spread of organisations is likely to have implementation difficulties and be of questionable cost benefit. A two or three-tier approach to reflect different sizes and types of public sector organisations would be more appropriate. Although the proposals may be more appropriate at the national level, our preferred approach for public reporting at the entity level is to align with current narrative reporting developments for a strategic and targeted management narrative report which includes a forward looking evaluation and risk assessment rather than a financial model.

Further guidance on streamlining and tailoring to organisation types would help to align this Recommended Practice Guide (RPG) with current good practice developments to make financial statements and narrative reporting shorter and more focused on the important issues. This should remain at a strategic high level; a type of exception reporting which assumes the status quo for ‘x’ years except for probable changes with a significant impact in certain areas such as policy changes and/or the probability of movement in key assumptions. The RPG can outline suggested focus areas.

Greater emphasis is also needed on impact and materiality to ensure that effort is focused only on what matters most and to reduce unnecessary effort. For example, only key activities with significant impact and/or likelihood of fluctuation should be considered for forecasting.

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<sup>1</sup> <http://icas.org.uk/search-site/?jump=true&txtSearch=%2fsite%2fcms%2fcontentCategoryView.asp%3fcategory%3d4376>

<sup>2</sup> [http://icas.org.uk/Technical\\_Information\\_and\\_Guidance/Business\\_Issues.aspx](http://icas.org.uk/Technical_Information_and_Guidance/Business_Issues.aspx)

### **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?**

One of the most significant points is the assumption about current and future policy. The RPG says this will be disclosed but the impact could be substantial, to the extent it could mean that the information is of limited or no value.

It is suggested that the LTFS report would be more meaningful and a more comprehensive assessment of sustainability if it were accompanied by a narrative risk assessment. As mentioned in "specific matter for comment 2", factors impacting on vulnerability can be wider than funding dependencies. A comprehensive narrative risk assessment could include political and policy changes, restructures, the economy and rate movements.

The disclosure of the approach to legal conflicts and sunset provisions is reasonable.

The disclosure of assumptions used is critical, being a high risk area of misstatement which would render the projections meaningless if not robust. This should be accompanied by an outline of the policy for reviewing and testing these assumptions as this is an essential step to ensure they remain robust, not just good practice. Cross-organisational consistency on key areas may help quality standards.

Sharing of good practice and key variables (e.g. inflation and discount rates), where appropriate would be welcomed. Additional guidance would support consistency and data quality.

This is likely to be a tricky area for audit but a recommendation that an organisation maintains a clear policy with evidence of applying that policy would help provide some assurance. The RPG should contain guidance on best practice for reviewing and testing assumptions and an outline for an audit approach.

Impact of legal requirements – the relevant items could be myriad and too detailed for a published report. Information should only be provided on an exception basis i.e. where critical for understanding the information provided and signposting/ links to sources of additional information used to avoid excessive detail.

Guidance on whether to undertake sensitivity analysis needs to be linked to the likelihood of variation so as to focus this level of detail on the areas which need it most to reduce unnecessary effort.

The inclusion of caveats explaining the inherent uncertainties of projections are essential.

Consideration should also be given to including "safe harbour" provision on future performance where there may be commercial or political sensitivity.