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REPORTING ON THE PROGRESS AS REGARDS THE EUROPEAN PUBLIC SECTOR ACCOUNTING STANDARDS (EPSAS)

REPORTING ON THE PROGRESS AS REGARDS THE EUROPEAN PUBLIC SECTOR ACCOUNTING STANDARDS (EPSAS)

1. INTRODUCTION

The EU Public Sector Accounting Standards (EPSAS) initiative aims to provide harmonised accruals-based public sector accounting. The main benefit would be providing a firmer basis for understanding the financial position and performance of public sector entities at all levels. This has the potential to improve evidence-based decision-making and accountability at both the EU and national and sub-national levels. In addition, this would further enhance the integration and efficiency of capital markets, the analysis of public finances and also provide more efficient ways of producing statistics and controlling revisions and risks.

Existing public sector accounting and financial reporting systems of many of the Member States serve the national purposes for which they were designed. However, from an EU-wide perspective, the transparency and comparability of financial accounting data and financial statements could be further improved. Transparency is generally an issue if only the cash or modified cash basis of accounting is followed for financial reporting. A number of ongoing and planned reforms in the Member States also motivates the need for a harmonised approach.

Cash and accrual accounting

*Under **cash accounting**, transactions and events are recognised when cash is received or paid. Cash accounting measures the financial result for a certain period as the difference between cash receipts and cash payments. In contrast, under **accrual** accounting transactions are recognised when the underlying economic events occur, regardless of the timing of cash transfers, and are reported in the financial statements of the periods to which they relate.*

*Financial reporting under **accrual accounting** provides a complete and reliable picture of the financial position and performance of the reporting entity in the reference period. The financial position is presented in the form of a balance sheet and financial performance in the form of an income statement or similar account. These, together with the cash-flow statements and explanatory notes on significant events and transactions, are generally perceived as providing the minimum set of elements for general purpose financial reporting.*

EPSAS and government deficit and debt indicators

Government deficit and debt indicators currently used for economic coordination and budgetary surveillance purposes in the EU are largely accrual-based and of high quality. Their use is firmly anchored in EU primary law. The data are based on the European System of Accounts (ESA) and are validated and made available by Eurostat. The accrual principle is established in ESA for macroeconomic statistics, nevertheless the exact method for ensuring accrual macro data is not prescribed, and country practices differ in this respect.

The systematic application of EPSAS has the potential to complement these statistical indicators and, as an enhanced and harmonised data source, to strengthen their efficient production.

The Budgetary Frameworks Directive[1] requested the European Commission to assess the suitability of International Public Sector Accounting Standards (IPSAS) for the Member States. In response, the Commission addressed in 2013 its report "*Towards implementing harmonised public sector accounting standards in Member States: The suitability of IPSAS for the Member States*"[2] (hereinafter referred to as the "IPSAS report") to the Council and the European Parliament.

IPSAS

IPSAS are a set of international accrual-based standards for public sector accounting promulgated by the International Public Sector Accounting Standards Board under the auspices of the International Federation of Accountants (IFAC). IPSAS are used as guidance by many governments around the world to improve public sector financial reporting.

The Commission's own accounting rules for the EU Institutions and bodies are based on IPSAS and, IPSAS are main reference in the guidance for public sector accounting standards in over half of Member States[3]. Taking that into account, the Commission closely co-operates with the IPSAS Board and is represented as an observer in its meetings.

The ***IPSAS report*** concluded that, although IPSAS, as they stood at the time when the report was written, could not be simply implemented[4] in the Member States, IPSAS represented a starting reference for future harmonised EPSAS, with these European standards being based on strong EU governance. It stated that the Commission would further develop the strategy outlined in the report, taking into account impact considerations and elaborating a road map setting out in more detail the steps to be taken, including legislative initiatives, to achieve harmonised public-sector accounting standards across the Union.

To take forward the conclusions of the IPSAS report, the services of the Commission have been following a ***two-phase approach to EPSAS***:

- Phase 1: Increase fiscal transparency in the Member States in the short to medium term by promoting accruals accounting and, in parallel, develop the EPSAS framework (covering governance, accounting principles and standards).

1 Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States.
2 Report From The Commission To The Council And The European Parliament, Towards implementing harmonised public sector accounting standards in Member States: The suitability of IPSAS for the Member States, COM(2013) 114 of 6.3.2013.
3 Overview and comparison of public accounting and auditing in 27 EU MS, EY 2012
4 Since the publication of the IPSAS report, IPSAS has developed substantially, addressing the concerns expressed on its governance and on the lack of a conceptual framework, and making progress on many technical public sector specific accounting issues.

- Phase 2: Address comparability within and between Member States by implementing EPSAS.

This progress report summarises how the services of the Commission have taken forward the initiative by addressing the issues identified in the IPSAS report.

2. MAIN PROGRESS IN ADVANCING EU PUBLIC SECTOR ACCOUNTING IN RECENT YEARS

During the past four years, the services of the Commission (Eurostat) have been actively engaged in Phase 1. This meant ***systematic communication*** on public sector harmonised accruals accounting with a wide range of stakeholders, including with policy makers, public sector accounting standard-setters, international organisations, auditors, accountancy experts and academia.

In 2015, the ***EPSAS Working Group*** was established. Ever since, it has served as a forum for Member States to provide advice and expertise in the preparation of EPSAS, from all levels of government. The delegates to the Working Group are primarily public sector accounting standard-setters and those responsible for public accounting in the Member States. Observers from the European Central Bank (ECB), World Bank, European Court of Auditors, Accountancy Europe (ACE) and IPSAS Board also attend.

The discussions within the Working Group have focussed on:

- Developing the basis for future public sector standard setting in Europe, including a draft ***EPSAS Conceptual Framework*** and the process for developing standards (including governance); and
- Building up the evidence base for assessing the ***costs and benefits*** associated with a future proposal on EPSAS.

In collaboration with Member States' experts, significant progress has been achieved in drafting an EPSAS Conceptual Framework. The draft Conceptual Framework consists of a set of concepts and definitions for the development of EPSAS and guidance for the preparation and the presentation of financial accounting information by public sector entities under EPSAS.

Alongside the Working Group, small "cells" of country experts have been providing technical input to the EPSAS initiative. The work of the cell on First Time Implementation resulted in preparation of ***Guidance for the First Time Implementation of Accrual Accounting***[5], which addresses issues faced by Member States when starting to prepare opening balance sheets on a full accruals basis or for those who would like to improve their accruals-based systems. The result of the work of two other cells (on Principles underlying EPSAS Governance and on Principles related to EPSAS Standards) has been used within the draft EPSAS Conceptual Framework.

5 Guidance for the First Time Implementation of Accrual Accounting

To prepare for the possible development of ***future EPSAS standards***, and based on a series of EPSAS issue papers, the EPSAS Working Group has held first discussions on the most challenging ***public sector accounting issues***, such as the accounting treatment of social benefits, grants and consolidation[6]. This work has also placed special emphasis on "***EPSAS flexibility***", i.e. the possibility of reducing the reporting burden and complexity of the standards for smaller and less risky public entities.

To analyse the ***costs and benefits*** of implementation of harmonised accruals accounting for the public sector in the EU, in recent years, the services of the Commission have sought to systematically build-up the evidence base to accompany a possible future EPSAS proposal, by commissioning:

- A survey of the public sector accounting and auditing practices in EU Member States[7];
- The collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards[8]. The study showed that a significant part of the expected total costs depends largely on the need to modernise financial IT systems, which some Member States may face irrespective of accrual accounting to update obsolete systems. The study suggested a cost for the total implementation of binding EPSAS standards ranging from EUR 1.2 billion to EUR 6.9 billion for the EU, depending notably on the need for new IT systems;
- A study including: a review to quantify the EU level opportunity cost of not implementing EPSAS; collection of up to date information on on-going or planned public accounting reforms in the Member States; and a summary of the impacts of the development of EPSAS for the Capital Market Union, investment, growth and jobs and democratic accountability and scrutiny[9]; The study pointed to a range of opportunity costs, and the quantifiable ones were substantial. Better management and decision-making could bring significant benefits, for example in the management of Government assets;
- A study including: analysis on lessons learnt from experiences of accruals implementation; analysis of capacity issues relating to public accounting reforms in the Member States; an analysis of how EPSAS could support financial audit and control in the Member States in the EU context; and methodology for measurement and monitoring of the transparency of public sector financial reporting in the Member States[10].

In parallel, the services of the Commission (Eurostat) have aimed to ***participate in EPSAS-related discussions as widely as possible***, including with other EU institutions, national

6 EPSAS Issues papers on specific public sector accounting issues
7 Overview and comparison of public accounting and auditing practices in 27 EU MS, EY 2012
8 Potential impact of implementing accrual accounting and suitability of IPSAS standards, PwC 2014
9 Collection of additional and updated information related to the potential impacts of EPSAS, EY 2017
10 Further and updated information related to the potential impact of implementing accrual accounting in the public sector, PwC 2018

stakeholders in EU Member States, other international organisations (in particular the IPSAS Board and the OECD) and the academic community. Strong emphasis has been placed on ***engaging with stakeholders across all levels of government*** in the Member States, attending a wide range of national events where EPSAS has been addressed, and has participated at the meetings of European City Economic and Financial Governance Group, where several major European cities discuss public accounting and financial management matters.

The services of the Commission (Eurostat) have presented EPSAS in the European Parliament, in seminars with both the Members of the Committee on Budgetary Control (CONT) and the Sub-Committee on Statistics of the Economic and Financial Committee (EFC-SCS). A workshop with the ***European Parliament CONT Committee***, informed Members of the European Parliament on the current state of the EPSAS initiative, the issues faced by the Member States and the possible role of the European Parliament in the way forward. Furthermore, in its resolution issued in June 2016, the European Parliament noted the ongoing efforts to enhance transparency and comparability of public accounts by developing EPSAS[11].

The ***EFC-SCS*** held two dedicated seminars on EPSAS addressing the issues raised by public accounting and statistical communities in the Member States. Further to this, in 2017, the ***ECOFIN Council*** took note of the work being done on EPSAS principles and standards and on supporting Member States' efforts to adapt and raise accounting maturity on a voluntary basis and underlined that work on EPSAS should also be informed by a detailed impact assessment. It also underlined that it should provide a comprehensive account of both positive and negative impacts[12]. The ***ECOFIN Council*** conclusions in 2018 took note of the ongoing technical work on developing the EPSAS framework and standards, alongside support measures to increase public sector accounting maturity in EU Member States, as well as the emphasis being given to the engagement of local and regional authorities in EPSAS discussions, and of the ongoing work on the potential impact of EPSAS[13].

The Commission has also ***provided financial support for public sector accounting reform efforts in the Member States***. Since 2014, it has co-financed a range of projects on modernisation of public sector accounting systems and a move to an accrual-based system. This includes scoping of modernisation needs, outlining an approach to implementation and a communication plan, exchange of knowledge and taking steps to implement accruals-based financial accounting systems across public sector. The 13 projects co-financed by the Commission for the amount of EUR 3.25 million are paving the way or directly contributing to the public sector accruals modernisation efforts in eight Member States[14]. Since 2017, this support has been complemented by support provided by the Commission through the

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[11] European Parliament resolution 2016

[12] ECOFIN Council Conclusions on EU Statistics, 2017

[13] ECOFIN Council Conclusions on EU Statistics, 2018

[14] Germany (Hesse), Spain (Cantabria), Italy, Cyprus, Hungary, Malta, Austria (Burgenland, Salzburg and Oberösterreich) and Portugal. Malta has also launched a project, CONvErGE – A major investment enabling Connected eGovernment, which includes government accounting reform – that benefits from European Structural and Investment Funds.

Structural Reform Support Service (SRSS), which is mandated to support the preparation, design and implementation of growth-enhancing reforms to achieve sustainable investment, growth and job creation. SRSS is providing support for various wider public financial management reforms in the Member States, several of which relate in part to public sector accruals accounting.

3. THE STATE OF PLAY OF PUBLIC SECTOR ACCOUNTING IN THE EU

The ***use of accrual accounting for the public sector has increased*** significantly in recent years, following various global initiatives as well as discussion surrounding EPSAS. At the time of the IPSAS report in 2013, a ***majority of Member States had already implemented accruals accounting*** according to national standards[15], whereas Austria, Belgium, Cyprus, Ireland, Italy, Malta and Portugal were in the process of doing so.

Case studies: Public sector accounting reforms in Portugal and Austria

The ongoing public sector accounting and management reforms in Portugal and Austria are among the widest-ranging reforms in the EU.

Portugal *seeks to improve public financial management and accountability through delivering on fiscal transparency. In the course of its reform, Portugal has integrated the budgetary and financial accounting and reporting systems under the accrual basis of accounting and IPSAS-based standards, with a simplified regime foreseen for small and less risky entities. The reform uses a nationally harmonised and multidimensional chart of accounts, which can serve a variety of information needs, including production of statistics for the Excessive Deficit Procedure (EDP) and national accounts, budgetary, financial and management accounting information. The reform aims to publish consolidated whole-of-government accounts covering entities across all government levels in 2022.*

In ***Austria****, the transition to accrual budgeting and accounting at the federal level was part of a broader set of budget reforms. The main goal of the reform was to improve decision-making and increase transparency for Parliament and the public. The reform benefited from strong political support leading to a relevant change in the Constitution.*

In 2013, a modification of the Austrian law introduced accrual budgeting and accounting in all federal entities. National IPSAS-based public accounting standards were introduced with necessary country specific modifications. The first set of accrual accounts at federal level as well as the first annual budget law including an income statement on a full accrual basis was published for the year 2013. At the level of the states and municipalities, a transition period until 2020 is in place. The reform aims to reach uniform and harmonised accruals-based budgeting and accounting in Austria by 2020.

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15 For example France prepared comprehensive accrual-based Central Government General Accounts already in 2006. For more examples please see: [Overview and comparison of public accounting and auditing practices in 27 EU MS, EY 2012]

Since the IPSAS report, Bulgaria, Czech Republic, Denmark, Estonia, Finland, some states in Germany (e.g. Hamburg and North Rhine-Westphalia), Hungary, Italy, Latvia, Poland, Slovenia and Spain have all reported reforms to either improve their existing accrual accounting and associated systems (e.g. budgeting systems) or to implement accrual accounting.

A stocktaking of government accounting maturity was issued in 2014[16]. Among the less advanced Member States in terms of accrual accounting identified then, many have since either launched modernisation efforts (e.g. Cyprus, Malta) or are making preparations in that direction (e.g. Italy, Greece and Luxembourg).

The Netherlands is taking steps to improve financial reporting, but has not yet decided to move towards accruals. It will consider this more fundamental step as an option in an evaluation in 2020[17].

In Germany, the implementation of accrual accounting is uneven across the public sector. Whilst a majority of public bodies in Germany at the municipal level have now switched to accrual accounting, this is not the case at federal level or consistently at state level. There has been no nationwide agreement or commitment towards an accrual-based reform.

From a global perspective, the increasing role of accrual based accounting for modern public sector financial management was confirmed by a 2016 OECD survey where 73% of OECD countries reported producing annual accounts on accrual basis. This compares to 2003, when only a quarter of the countries did so[18]. Of the remaining 27%, one third were in a transition phase from cash to accruals.

4. THE OUTLOOK FOR PUBLIC SECTOR ACCOUNTING IN THE EU

The trend towards accrual accounting is also expected to continue at global level, as accrual accounting is supported and promoted by other international institutions such as the International Monetary Fund, OECD and the World Bank. A recent joint report by the International Federation of Accountants (IFAC) and the Chartered Institute of Public Finance and Accountancy (CIPFA) forecasted a rapid acceleration of accrual accounting and international standards adoption, according to which 65% of governments globally will report on an accrual basis by the end of 2023[19].

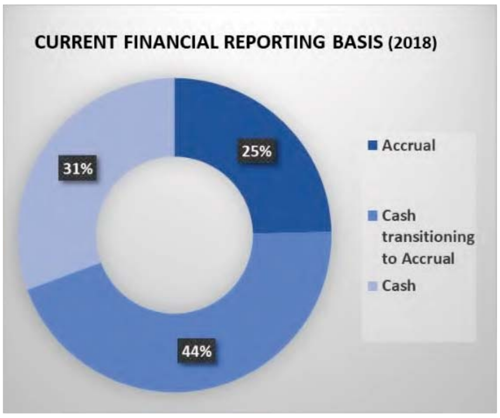
Figure 1: International Public Sector Financial Accountability Index – global view

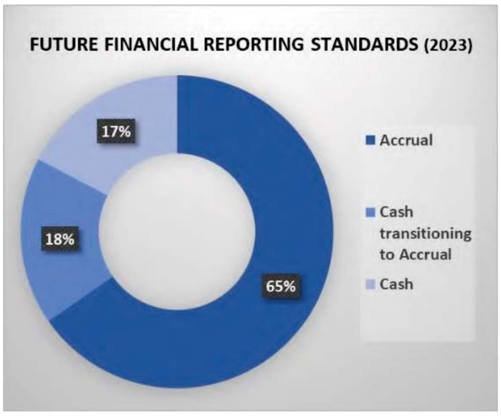
16 Accounting maturities for all sub-sectors of general government; Potential impact of implementing accrual accounting and suitability of IPSAS standards, PwC 2014, page 92, table 28

17 Report of the Dutch Parliament (Tweede Kamer) of 14 December 2018 on the central government reporting system (in Dutch)

18 Accrual practices and reform experiences in OECD countries, Results of the 2016 OECD Accruals Survey, OECD Journal on Budgeting, Volume 2017 Issue 1, p. 12., Moretti

19 International public sector financial accountability index, 2018 status report





Source: IFAC, CIPFA 2018 Status Report

The global developments mentioned above imply that much of the transition efforts and costs to accrual accounting have already occurred, or will anyway occur sooner or later, including for many governments in the EU but without the benefits of a European reference model behind their work.

The increased use of accrual accounting in the EU during Phase 1 of the EPSAS project, as described in the previous chapter, generated a momentum and increased support for developing common approaches and instruments. Such common approaches could reduce the burden on Member States who embark on accounting reforms, as they would be able to benefit from past experience, and would reduce the risk that the ongoing reforms lead to divergence, rather than convergence, across the EU.

During Phase 1 of the EPSAS project, there has been an increased readiness of the Member States to implement accrual accounting in their public sector, while significant progress was also made on the necessary technical preparations for taking forward the project. There is a growing acknowledgment of the benefits of accrual accounting for government entities in the Member States, and of comparable financial accounting and reporting practices.