

Financial Reporting Advisory Board Paper

Secretariat Paper

European Public Sector Accounting Standards – Update on recent developments

Issue:	<p>At recent FRAB meetings the Board has been updated by the FRAB Secretary on developments related to Eurostat's European Public Sector Accounting Standards (EPSAS) project.</p> <p>This paper provides a further update to the Board on recent developments. An EPSAS Governance Taskforce meeting is taking place on 20 and 21 November 2014 so a verbal update will also be provided at the meeting.</p>
Impact on guidance:	N/A at present
IAS/IFRS adaptation?	N/A at present
Impact on WGA?	N/A at present
IPSAS compliant?	N/A at present
Interpretation for the public sector context?	N/A at present
Impact on budgetary regime?	N/A at present
Alignment with National Accounts	N/A at present
Impact on Estimates?	N/A at present
Recommendation:	That Board members note the further work that is being undertaken in relation to the EPSAS project and comment on the recent developments.
Timing:	N/A

DETAIL

Background

1. At recent FRAB meetings the Board has been updated by the FRAB Secretary on developments related to the Eurostat's European Public Sector Accounting Standards (EPSAS) project. Since the verbal update provided at FRAB 121, the EPSAS project has seen some delays

from its initial timetable. This has been due to the complexity and increased scope of the work required to develop the planned Commission communication (a formal impact assessment is now required) and timing issues arising from the election of a new Commission.

2. This paper provides an overview of major developments that have occurred since FRAB 121. A further verbal update will be provided at the meeting on the EPSAS Governance Taskforce meeting that is taking place on 20 and 21 November 2014.

Economic and Financial Committee meeting

3. EPSAS was discussed at the two hundred and third meeting of the Economic and Financial Committee of the Council of the European Union which took place on 30 September and 1 October 2014. At the meeting, Eurostat presented a broad outline of the planned Commission communication on EPSAS, which is expected to be published early in the mandate of the new Commission. Eurostat also pointed to the availability of an initial impact assessment from PwC which is discussed in more detail below. After the Communication, a legal act would be prepared together with a full impact assessment.

4. Discussion at the Committee focussed on the need to ensure appropriate timing and for attention to be paid to subsidiarity and the balance of costs and benefits. While issues with EPSAS were recognised there was general support for accrual accounting. There was agreement that the Sub-Committee on Statistics would follow-up with a discussion on EPSAS principles ahead of the planned communication.

PwC study

5. The initial impact assessment produced by PwC was published at the end of September 2014 and is available at the following link -

http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/EP_SAS-study-final-PwC-report.pdf

6. Entitled "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" (hereafter "the study") it is organised around three areas:

- (i) An assessment of the cost and benefits of EPSAS implementation at the EU level utilising cost information and experiences from those Member States that have already made a transition to accrual-based standards;
- (ii) An analysis of the IPSAS standards and their application by EU Member States, including responding to comments made by Member States on individual IPSAS standards;
- (iii) The provision of a number of recommendations for implementation of EPSAS.

Cost benefit analysis

7. There are two broad benefits of the EPSAS project put forward in the study. The first relates to enhancing the quality of data on which ESA reporting is based by introducing uniform and comparable accrual-based accounting practices for all sector of general government. It is believed that this will improve budget surveillance and fiscal monitoring, enabling sound fiscal policy decision-making. Increased transparency and more credible government financial statements will also lead to improvements in democratic accountability, the long-term sustainability of public

finances, and could potentially also lead to a fall in government borrowing costs although it must be noted there is at present limited evidence for this last benefit.

8. The second broad benefit relates to the use of accrual accounting as a tool to enhance management reporting and decision-making as part of wider public finance reforms. Accrual accounting is seen as a necessity for enhanced management information systems, allowing governments to more clearly assess the cost of operations and programmes and to link these to desired fiscal and social policy outcomes.

9. Given the nature of these broad benefits it has not been possible to quantify them in the study. As we have seen in the UK they would be expected to bring significant financial gains from the better use of public finances.

10. For costs, the study has been to a degree hampered by a lack of information from Member States that have implemented accrual reforms. Few Member States that have undertaken reforms were able to provide sufficiently comprehensive cost data and this has meant it has been impossible to develop a detailed cost model. PwC have, however, been able to develop a costing methodology that provides an estimate by Member State based on cost coefficients, the government budget, and an assessment of accounting and IT maturity. This methodology provides EU wide and Member State specific costs for a range of scenarios, varying from €1.2bn for a relatively simple transition up to €6.9bn where new IT systems for those Member States that currently cash account would be required. The estimated UK cost is low at around €17m, others such as Germany and Italy could see costs of up to €2.5bn given their low scores for both accounting and IT maturity.

Analysis of IPSAS standards

11. The study confirms the diversity of accounting practice within the EU and indeed within individual Member States at different levels of government that was previously highlighted in the EY study¹ from 2012. IPSAS is a common source of reference for Member States, with the majority (at least at a central government level) drawing on the standards as either a primary source of reference or one among a number of references.

12. As part of the study Member States were invited to provide comments on the IPSAS standards, with concerns being raised mainly around the cost and complexity of implementation rather than the technical merits of individual standards. The requirement for a significant change in mindset and culture to enable the successful introduction of accruals and a lack of skilled resources featured prominently in responses, as did what was seen as an overly ambitious timescale for implementation. It was recognised that accounting for areas such as fixed assets, financial instruments and employee benefits would require a significant data collection and valuation/measurement exercise, and the need for dual reporting based on what could be different consolidation boundaries was also seen as potentially onerous.

13. Member States more advanced in accounting reforms also expressed concerns that EPSAS could lead to a reduction in quality unless the standards were clearly based on internationally accepted standards. It was noted that clearly developing EPSAS with direct reference to IPSAS could assist in mitigating this risk, and a classification of IPSAS standards is proposed in the study to assist in the EPSAS standard setting process. This classification distinguishes between:

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http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/documents/study_on_public_accounting_and_auditing_2012.pdf

- (i) Areas for which no standard currently exists, but for which a standard or implementation guidance is needed;
- (ii) Standards that may need amendment or for which implementation guidance is needed;
- (iii) Standards that can be implemented with minor or no adaptation.

14. Given the current IPSASB work programme the number of areas falling into the first category would be expected to be low by the time Eurostat currently expects Member States to transition to EPSAS provided that IPSAS is the primary reference.

Proposals for implementation

15. The study confirms that in light of prior reform experiences the implementation timeline proposed by Eurostat to date is very challenging, especially for those with low accounting and IT maturity. The length of the standard setting process will also clearly be contingent on the extent to which IPSAS is taken as the starting point for the development of EPSAS.

16. Were IPSAS to be a primary reference for the development of EPSAS then the study notes that focus could be placed on defining the core EPSAS principles, the scope of reporting, and those areas where guidance and/or standards currently do not exist. This would include practical guidance on the development of opening EPSAS financial statements. If IPSAS is not taken as a primary reference, then a 2020 deadline for implementation would not seem possible.

Implications for UK public sector financial reporting

17. The study notes that the UK has the highest levels of accounting and IT maturity amongst EU Member States and envisages low costs for conversion to EPSAS (taking IPSAS as a proxy for EPSAS). Given the maturity of accounting in the UK public sector direct quantifiable benefits from EPSAS would also be expected to be low, although the UK would of course benefit from an EU in which Member States and the Union as a whole were more fiscally sustainable. It should also be noted that to date Eurostat have been silent on how the costs highlighted in the study will be funded, i.e. will Member States bear the full costs of their own transition or would there be EU funding to support them.

Fourth Governance Taskforce meeting

18. The fourth Eurostat Governance Taskforce event will take place on 20 and 21 November 2014 in Luxembourg. A verbal update will be provided to the Board at the meeting.

Summary and recommendation

19. That Board members note the further work that is being undertaken in relation to the EPSAS project and comment on the recent developments.

**FRAB Secretariat
27 November 2014**