



FEE public sector roundtable

Paving the way to accruals accounting in Europe: challenges and potential solutions for transition

2 July 2015

EC first time implementation approach

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EC accounting modernisation

- Political Decision: Commission decision December 2002
- EC accounting modernisation project implemented 2003-2005
- Move from "modified cash accounting" to full accruals based on IPSAS
- EC opening balance sheet 1/1/2005
- Including all consolidated entities: consolidated annual accounts of the EU (institutions, agencies and JUs)

Situation before 1st implementation

- Modified cash: during the year cash accounting and at year-end adjustments for some assets and liabilities
- Accounting principle followed EC Directives
- Tangible fixed assets already capitalised, but not integrated
- Pension liability already recognised but also a receivable (not in line with IPSAS)
- **Not recognised:** some assets and liabilities (FIs, invoices & cost claims, prefinancing, provisions)
- Expense recognition followed cash principle
- Limited consolidation perimeter

First time implementation

Steps taken for modernisation:

- Working in parallel:
 - Definition of accounting framework: rules and procedures
 - Open balance sheet
 - IT developments
 - Training
- Inventory combined with recognition and measurement rule for fixed assets
- Development of accounting principles (pre-financing , expenses)

First time implementation

Steps taken at modernisation:

- Inventory and recognition of all **non-exchange transfers** (given/received)
- Pension liability already recognised; measurement under IAS 19
- Removal of receivable towards Member States
- Completeness: All assets and liabilities
- Involvement other entities

First time implementation

Exemption periods for first time adoption: Own approach developed (materiality/availability)

- Internally generated intangible assets 5 years
- 5 year period for financial instruments: line by line presentation instead of investment
- Present value adj. of long-term financial instruments 3 years
- Current/non-current split for some financial instruments: 3 years
- Specific rules for financial guarantee contracts (no IPSAS)

First time implementation

- Important principles & advices:
 - Clear rules, procedures and guidelines
 - Stock taking
 - Training and awareness raising
 - IT development
 - Materiality considerations
 - Completeness
 - Measurement
 - Staged approach
 - Quick wins

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challenges and potential solutions for transition

Achieving a smooth transition in the EU: dream or reality?

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Europe: a multicolored mosaic

- Europe is a pluralistic mosaic
 - Identify trends and streams
- The challenge: preparing for IPSAS/EPSAS
- Overcoming difficulties and obstacles to a smooth transition

Harmonization in Europe

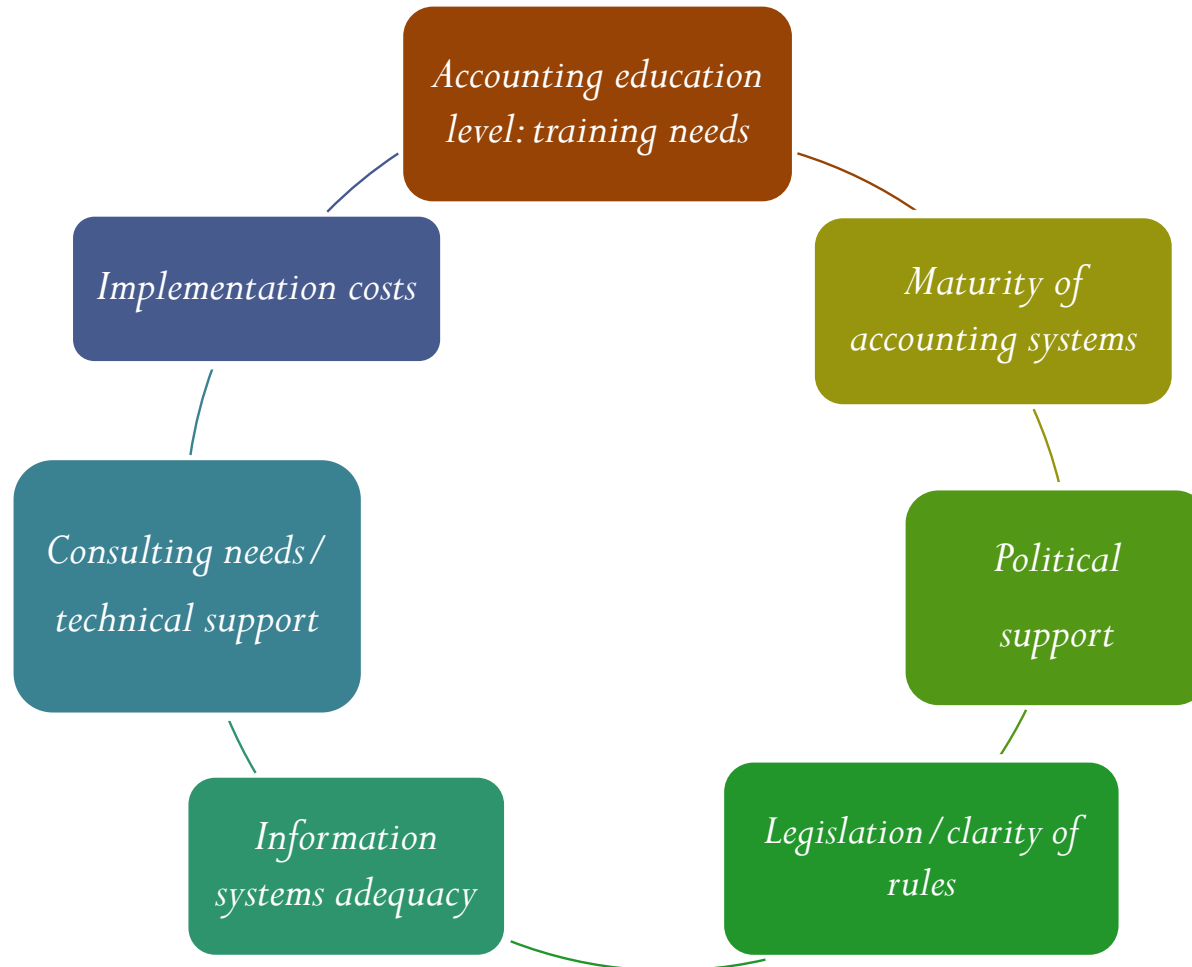
- The first challenge is international harmonization in the context of governmental accounting in Europe forming a multifaceted mosaic within and among countries.
- The second challenge is the choice and implementation of international standards and whether IPSAS (or EPSAS) provide answers to the harmonization puzzle

Readiness for change

	Central Government	Regional Government	Local Government	Reform in progress to obtain vertical harmonization	Willingness to adopt IPSASs/IFRSs
Austria	Accrual	Diverse	Different bases	Yes	IPSASs
Belgium	Accrual	Differences by regions	Accrual	Differences by regions	Only Flemish local entities (IPSASs)
Denmark	Accrual	Accrual	Cash / modified accrual	No	No
Finland	Accrual	n/a	Accrual	Already in place	No
France	Accrual	Modified accrual	Modified accrual	Yes	Yes, both
Germany	Modified cash	Most states are with cameral (cash) accounting, a few with accrual	Mainly accrual, but cash and modified cash still allowed	No	No
Greece*	Modified Cash	Cash/Accrual in the near future	Accrual	Yes	No
Italy	Modified Cash+ Accrual	Modified cash+ Accrual	Modified Cash+ Accrual	Already in place	No
The Netherlands	Modified cash	n/a	Modified Accrual	No	No
Portugal	Accrual	n/a	Accrual	Yes	IPSASs
Spain	Accrual	Accrual	Accrual	Already in place	IPSASs
Sweden	Accrual	n/a	Accrual	Already in place	to some extent both IPSASs and IFRSs are considered as reference
Switzerland	Accrual	Accrual	Accrual	Yes	Yes
UK	Accrual	n/a	Accrual	No	IFRSs are already a source of inspiration

Adapted by Brusca, I., Caperchione, E., Cohen, S., & Manes Rossi, F. (2015). *Public Sector Accounting and Auditing in Europe: The Challenge of Harmonization*. Palgrave Macmillan.

Factors related to readiness for change



How can accruals improve decision-making

1. Support investment policy
2. More effective regulation: increased Transparency and Internal Controls
3. Enhanced Financial and Resource Stewardship
4. Better Management of Property, Plant and Equipment
5. Enhanced Awareness of Existing Intangible Assets
6. Enhanced Disclosure of Financial Instruments
7. Improved Visibility of Liabilities
8. Timely Revenue Recognition
9. Better Expense Management
10. Support proper planning to determine the appropriate level of funding for employee liabilities (asset-liability study)
11. Provide holistic treatment of post-delivery losses, write-offs and ex-gratia payments in future annual accounts
12.

Main difficulties of moving from cash to accrual

- All accounting data should be prepared considering *accountability purposes*
- The coordination between budgeting, accounting and reporting in accrual systems
 - Budgeting, accounting and reporting should be prepared under the same accounting system (e.g. accrual) ?
- How would these changes affect the auditing system?

Proposing a roadmap for accrual accounting

A detailed guide to support both the preparation of the Opening Balance Sheet and the following budgets and reports :

- *Recognition and measurement of assets*, providing a step-by-step procedure to be completed within three years by the first adoption;
 - Important first step to recognize assets (which are included and which are excluded – prioritization)
 - Identification of deemed cost: is fair value a useful criterion?
 - In this respect it would be useful to propose a **hierarchy** from historical cost to use value (i.e. depreciated replacement cost method as in France for road infrastructures)
 - Ranges of economic lives for fixed assets to support amortization
 - Recognition and measurement of infrastructures and heritage assets (possibly in the future)
 - Measurement of certain intangibles (sovereign rights)

Proposing a roadmap for accrual accounting

A detailed guide to support both the preparation of the Opening Balance Sheet and the following budgets and reports (continue) :

- *Recognition and measurement of liabilities*, providing clear criteria to create provisions
- Methods for recognising certain operations typical in the public sector, such as revenue from non exchange transactions (i.e. taxes and transfers) - should there be a convergence with ESA 2010 principles?
- Measurement and presentation of the pensions in the Balance Sheet
- Methods for allocating costs to functions if a function based analysis of expenses is adopted
- How to restate data if necessary?
- Great emphasis on *Required Supplementary Information* to give a wider accountability

Proposing a roadmap for accrual accounting

- Permanent Study Groups in each country (and an European PSG to coordinate all national PSGs), to favour the transition to accrual and to discuss operative problems, in order to take stock of previous/similar experiences
 - Coordination of these Groups at the European level – Should Eurostat be in charge?
- Provision of Funds to countries that have low maturity to keep pace with the more advanced ones – Transfer of expertise
- All documents should be in national languages to facilitate transition
- Decision on the auditing of these financial statements (type of auditor, appointment procedure)
- Discuss the opportunity of a simplified approach for small public entities

How to change dreams into reality....

- Strong political support
- Institutional legitimacy
- A substantive process of standardisation
- To consider reasonable and appropriate opportunities for all interested parties to express any opinions that may influence the process of standardisation (*public consultations*).
- Training courses for practitioners and public servants
- IT support tools
- Adequate auditing and control systems, to take into account the three years period to adapt accounting system to accrual;
- Harmonized reports in order to reduce the cost of capital for countries retrieving funds by the capital markets
- To implement accrual step-by-step, in stages, starting with the easier areas and going on to the areas with more difficulties (i.e. heritage assets) (in accordance with IPSAS 33)

Thank you for your attention!

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