Book Review

Review of “Public Sector Accounting and Auditing in Europe. The Challenge of Harmonization”, By Isabel Brusca, Eugenio Caperchione, Sandra Cohen and Francesca Manes Rossi (Palgrave Macmillan, 2015)

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1 Introduction

In Europe, governmental accounting systems differ horizontally among countries and vertically among layers of government within a country. The absence of a repository to systematically gather and analyze information motivated this timely book. The book aims to present the national accounting practices and norms of fourteen European Union members in addition to Switzerland. This description of national standards and practices is particularly salient in view of the European Public Sector Accounting Standards (EPSAS) project aiming to achieve comparable governmental accounting data and indirectly to improve statistical data. Since governmental accounts are inputs for the legally binding national accounts statistics, the EPSAS reform is crucial for supporting increased fiscal surveillance by the European Commission in the aftermath of the financial crisis. The book identifies the challenges of harmonization; the description of diverse practices could help to foresee the difficulties in implementing possible future harmonized standards.

2 The value added of the book

The book makes a valuable addition to the existing literature of institutions sources, academic publications and professional firms' position papers. The institutional sources are mainly from the European Commission (2013) and Eurostat (2012) in charge of EPSAS. In relation to the academic literature, this book is in effect a sequel to Lüder and Jones, eds. (2003) “Reforming Governmental Accounting and Budgeting in Europe” (Fachverlag Moderne Wirtschaft). Except Austria, Belgium, Denmark and Greece, other countries were all covered in the 2003 book. This book also adds to the “A Global history of accounting, financial reporting and public policy” (Fuelbier, 2014), which addresses national

differences and parallels in accounting traditions and to the 2014 thematic issue on EPSAS of the journal “Accounting, Economics and Law – A Convivium”. The book also complements the position papers on EPSAS by Ernst and Young (2012) and PricewaterhouseCoopers (2014).

In a growing literature on EPSAS, the book is a timely and relevant contribution contributing greatly to the rich array of information needed to make decisions concerning the possible EPSAS. It enables thoughtful consideration of the challenge of harmonization by its detailed depiction of the national environments in which the EPSAS reform would take place. Depicting the heterogeneity of current practices helps policy-makers and others “understand the commonalities and differences of reforms that are all placed under the New Public Management (NPM) umbrella” (Caperchione, 2006). By providing comparative knowledge on public sector accounting, the book provides relevant input to policy formulation and analysis.

The publisher states that the book “offers a valuable reference resource for academics, researchers, students, auditors, public administrators and policy makers”. I agree, except with regards to auditors. The country cases are not sufficiently developed to meet national auditor’s needs. Particularly useful are websites and primary sources, such as national legislature or the different financial statements published.

3 The objectives and structure of the book

Initiated by the Chairs of the XII Permanent Study Group of the European Group of Public Administration (EGPA), the book features twenty-five authors familiar with the countries being studied. With this book, academics aimed to contribute to the knowledge-background needed for policy developments. The editors and authors shared three objectives: (1) to “give an account of public sector accounting reforms in a panel of European countries”; (2) to clarify “what accounting harmonization is, whether it really deserves to be achieved, how this can happen, what we can expect from it”; and (3) to discuss the international accounting standards by examining in each case country “whether and to what extent public sector accounting follows any set of international standards, or if it still refers to national standards” (pp. 1–2).

A strength of the book is that it uses a common structure to present national cases. The cases structure covers various dimensions such as: public sector accounting standards for the central government and for regional and local governments, an analysis of the readiness for change, and the main challenges and problems. Some authors add personal reflections on the advantages and

disadvantages of IPSAS and on the outcomes of implementing new standards. It should be noted that the “A” in both EPSAS and IPSAS refers only to financial accounting, external financial reporting, and by extension auditing, specifically external auditing.

The book provides a forum for different views about EPSAS. For example, the authors of the German case expressed the concern the EPSAS would be IPSAS-based. The authors of the United Kingdom case raised the issue of sovereignty and the “possibility of modification by each member state for its own accounting”. The authors of the Danish, Finnish and Swedish cases brought up the concern that some valuation principles in IPSAS differ from the historical cost. The authors of the Finnish case underlined that IPSAS-adoption would impact the legislation based on another tradition. Several authors believed that it would be possible to provide the information required by Eurostat without major changes to government accounting systems, for example in Finland and the United Kingdom. As Lüder points out in the foreword (p.xii), “this EPSAS project – even if not implemented as planned – will put pressure on the governments of those member states that still have cash based or modified cash based accounting systems to shift them to an accrual base”. This has led to debates and to some resistance towards the EPSAS project centering on the sovereignty issue: “public sector accounting is one aspect of a country’s sovereignty, which cannot be disposed of without very compelling reasons.” (p.4)

Despite a common structure, the authors approach their tasks somewhat differently. Some chose to deal with specific aspects such as the link between the budget and financial accounting (in Spain), or consolidation (in Sweden). Concerning the main challenges and problems, some authors focused on broad challenges in at the national level (in Italy, Portugal, Spain, Austria, Great Britain); however, others recounted the specific challenges encountered in a past reform (in France, Belgium). The remaining ones linked it to the EPSAS project (in the Netherlands, Finland).

The first and last overview chapters serve as book ends for the country studies. The first chapter recalls the books’ objectives and presents the different challenges for harmonization and the current debate surrounding the EPSAS. The chapter presents the view of different institutions, such as the United Kingdom Financial Reporting Advisory Board, the German’s Bundesrechnungshof (federal supreme auditing court of Germany) willing to look for less far-reaching reforms. As a possibility of more modest reform, Lüder (2014: 419, 424) suggests “choosing the IMF’s GFS and the Government Finance Statistics Manual as the basis of harmonizing public sector accounting in Europe”. According to Caperchione, “practitioners, scholars and legislators ought to pursue an apparently more modest, but probably more effective, convergence on the essential points, if they really

wish to contribute to harmonization” (p.9). In this regard, it is necessary to clarify the definition of harmonization. For example, how does it differ from integration, convergence, uniformity? The last chapter synthesizes the similarities and differences of governmental accounting systems, thus enabling the reader to see the main trends and to better appreciate the extent of heterogeneity. It observes that the approach followed by “IPSAS gives room for discretion, while mitigating the use of options in financial reporting is more appropriate to the information needs of public entities” (p.251). It also argues that improved public sector accounting would be useful for compliance with the Stability Pact as a better fiscal coordination between levels of governments, medium-term budget frameworks.

4 Contribution and limitations

Concerning the main trends in accounting and budgeting systems, the book reports that the accounting systems in a majority of countries have moved to full accruals, with only four countries (Germany, Greece, Italy and the Netherlands) still using modified cash basis. In contrast, the cash or modified cash models are used in the budgeting system of 9 out of 14 countries. However, as Caperchione (p.1) explains, this characterization of reforms is simplistic and limited due to the fact that “the design may have been nearly the same in different countries, but not its actual development”.

The main impression by reading the book is that governmental accounting is still a very national specific phenomenon. Public sector accounting and auditing constitutes a “pluralistic mosaic” as the book cover suggests it and its content reveals it. The case studies reveal variations among and within countries’ accounting practices. The book describes diversity as a multi-dimensional phenomenon, leading to multiple modes of harmonization. There is great variation in diversity!

Indeed, diversity does not only stem from the different accounting bases adopted, but also from the possible existence of charts of accounts, of conceptual frameworks and of internal and external audits. The different types of financial reports published, the number of layers of governments in a country, the structure of audits and the existing internal homogeneity are numerous points revealing the diversity among countries practices’.

Diversity can emerge among countries – external diversity –, as well as within a country – internal diversity – and can be vertical or horizontal and concern various issues.

Within country vertical diversity is the diversity between the accounting systems used at different governmental levels in a single country. For example, in France and the United Kingdom local governments and central government

apply their own different accounting rules. Within country horizontal diversity exists when same government levels within a country use different systems. For example, the different regions in Austria, Belgium and Germany currently adopt different accounting paradigms. Nowadays, there is greater vertical homogeneity in budgeting systems (10 out of 14 cases) than the accounting system (4 out of 14 cases).

Because of these multiple dimensions of diversity, what is to be harmonized needs to be very well defined. As precised by Caperchione: “We then have to consider that the various kinds of harmonization do not always work in the same directions; if a country is requiring public sector accounting to move towards the same country’s private sector accounting, this may be to the detriment of an external harmonization.” (p.5). Interestingly but disturbingly, various attempts at harmonization may contradict each other. Therefore, it makes it necessary that “any harmonization action clarify and balance its objectives and priorities”.

The book, and especially in the first chapter, demonstrates that as there is more than one set of standards available and used. Therefore, the task to define and adopt a set of “best practice” standards will be complicated. A general consensus on which set would best fit the needs of EU member states is still illusive. Some national standards are influenced by IPSAS but none of the countries considered adopting IPSAS per se. Different set of standards also influence national standards. For example, the United Kingdom is influenced by the International Financial Reporting Standards (IFRS) (see Biondi (2016)), whereas Belgium by the European System of Accounts (ESA).

The book provides information to discern the proximity of national accounting systems to IPSAS. This proximity probably affects their ease of change. Their readiness or willingness for change may also vary with the degree of conservatism. Indeed, as mentioned by editors in the last chapter, “it has to be taken into account that in some of the more “mature” countries the possibility of following IPSAS has been already denied, as these principles have not been considered suitable to satisfy the information needs of the public sector, or because the traditional use of historical cost for asset evaluation is still preferred to the fair value logic implied by IPSAS” (p.250). As a consequence, scoring the proximity to IPSAS with a “maturity score”, as done by PricewaterhouseCoopers (2014), seems an incomplete approach as it overlooks the issues of the willingness to change.

Harmonization is challenging as countries differ in size, accounting traditions and culture, legal and political systems, institutional and administrative settings and in their degree of accounting innovation. The detailed challenges are stated in the case studies and are enumerated in the last chapter by the editors, including training needs, information systems adequacy, political support, legal barriers and implementation costs. The technical choice of the

common standards would be arduous as there is no consensus. Defining common best practices would be difficult as well because what might be “best” for one country or level of government might not be the “best” for the others. As the book (p.251) concludes, “the discussion has also highlighted that for some countries the approach followed by IPSAS gives room for discretion. [...] Moreover, the use of fair value would be difficult to apply, especially in those countries that, even if they have adopted an accrual basis, have been always devoted to prudence, the realization principle and historical costs”.

While a common structure enhances the comparability of case studies, it could also stifle creativity and innovations. For example, very little is mentioned about statistical reporting, the reporting for citizens, or about management accounting. These two last issues are however not at the heart of the EPSAS project. Moreover, it is puzzling that the editors did not make reference to the 2003 “European Comparative International Governmental Accounting Research” study and only some of the chapter authors referred to their counterparts in the 2003 book.

The last chapter very usefully present international similarities and differences in several summary tables. These tables cover, for example, the levels of government, and the characteristics of budgeting, accounting and auditing systems. Readers would need to refer to in-depth analyses in the country studies to fully appreciate the generalizations in these tables. The selective coverage of the tables means that some issues are not included. For example, how accruals are interpreted, similarly or differently, in EU’s budgeting, accounting and macro-fiscal statistic systems is not represented in the tables. Moreover, this chapter only classifies countries governments’ according to their basis of accounting and not according to their accounting model of reference (fair value and historical cost) or system’s architecture (single or double entry system) among other characteristics (see Chan (2008)). The generalizations in the concluding chapter are a useful but incomplete step toward a theoretical deepening of public sector accounting.

The practice orientation of the book is achieved at the expense of developing a theoretical underpinning, which would help achieve the second objective of the book in defining harmonization. As Mussari (2014) pointed out, harmonization could be distinguished from unification and uniformization, as well as from reconciliation, integration and convergence. The modality of harmonization – what is to be uniform across the EU, and what is to be left to national discretion – is not completely addressed in the book. Due to the differences in intensity of national control in budgeting, accounting and auditing, and public finance statistics, the difficulties in harmonization differ greatly across these components of macroeconomic statistics.

The coverage of the book is in some ways both more and less than one would expect. The first point is that budgeting is absent from the title of the book but is *de facto* present in its content. The actual content of the country studies strongly indicates the interconnected nature of budgeting and accounting and financial reporting. One caveat would be that the government finance statistics, also called statistical reporting, and its link with financial reporting are not very developed in the book, although they are inextricably related to EPSAS and to financial reporting. The second point is that the book title uses “public sector” instead of “government”. This raises the expectation about the coverage of state-owned enterprises and nonprofit institutions. However, some public entities or institutions as public hospitals, public universities or state-owned enterprise are not included in the book. Compensating this omission, the general government sectors as central, regional and local governments are very well developed in this book. Third, the term “Europe” in the title raises the expectation of a broader coverage. While fourteen western European countries are presented, EU member states in eastern Europe are totally absent from this book. In this regard, it was gratifying to learn of a plan to expand the number of countries studied.

The book could go beyond descriptions to assess the reasons for heterogeneity of national practices and evaluate whether this heterogeneity could be overcome. “The need of a convergence of public sector entities accounting systems has not yet been demonstrated” argued Jean-Paul Millot, a French high civil servant at a conference at the French Ministry of Finance in early 2016. Imposing common standards and practices might upset the control mechanisms and the delicate existing balances. A country’s government accounting system serves multiple purposes, including domestic and micro-level accountability. This point has received less attention than macro-fiscal surveillance and comparison and EU budgetary compliance, the core of the EPSAS project. Moreover, in considering the challenges for the EPSAS, the book could have separated the challenges facing budgeting, accounting, auditing, financial reporting and public finance statistics, as there are differences in intensity of national control of these functions. Finally, descriptions of current practices, no matter how complete and meticulous, could not by themselves motivate or compel policy actions. Nevertheless, I hope policy makers in European institutions would take advantage of the information presented in the book.

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