Yuri Biondi*

Harmonising European Public Sector Accounting Standards (EPSAS): Issues and Perspectives

<https://doi.org/10.1515/ael-2017-0014>

Published online February 22, 2017

Abstract: An important reform project is ongoing concerning harmonising Europe's public sector accounting standards (EPSAS). The European Commission appears willing to mimic and take the international private sector accounting as frame of reference, following the same pattern of implementation for international public sector accounting standards (IPSAS) that was enacted for the IAS-IFRS. But the Member States did react in a different way, this time, showing alert, raising questions, and providing resistance in some cases. Public sector accounting shall be considered in the specific context provided by public finances in general, and by a monetary union in particular. This paper takes perspective on these specificities while raising issues (i) on the EPSAS-making governance; (ii) relationship between cash-basis and accrual-basis of accounting; (iii) accounting for governmental liabilities by Member States; and (iv) evidence of net assets under accruals-basis.

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Accounting for the European Public Sector: Roundtable on the Ongoing Reform of European Public Sector Accounting Standards (EPSAS)

1. "Harmonising European Public Sector Accounting Standards (EPSAS): Issues and Perspectives" by Yuri Biondi, <https://doi.org/10.1515/ael-2017-0014>
2. "France Supports Accrual Accounting For The Public Sector" by Marie-Pierre Calmel, <https://doi.org/10.1515/ael-2017-0019>
3. "Challenges for European Public Sector Accounting" by David Heald, <https://doi.org/10.1515/ael-2017-0021>

***Corresponding author: Yuri Biondi**, Cnrs – IRISSE (UMR7170, University Paris Dauphine PSL) and Labex ReFi, Paris, France, E-mail: yuri.biondi@gmail.com

4. “Italian Public Sector Accounting Reform: A Step Towards European Public Sector Accounting Harmonisation” by Riccardo Mussari and Daniela Sorrentino, <https://doi.org/10.1515/ael-2017-0006>
5. “European Public Sector Accounting Standards (EPSAS)” by Alexandre Makaronidis, <https://doi.org/10.1515/ael-2017-0008>
6. “Open Debate on Accounting for the European Public Sector” by Imke Graeff, <https://doi.org/10.1515/ael-2017-0025>

My speech opens our panel discussion on public sector accounting standards in Europe. This debate is important and timely because a EU project of harmonisation of public sector accounting standards (EPSAS) is ongoing. Discussion is currently carried on between the Member States and the European Commission, under the leading coordination of Eurostat.

The ways toward European Public Sector Accounting Standards (EPSAS)

Through several accompanying documents, the European Commission (EC) has provided to explain and justify this harmonisation project. Since 2011, the European Union has announced an interest in developing this harmonisation. In 2013, the EC provided the first background documentation – comprising reports, executive summaries, etc. – in view to start the proper harmonisation process which is yet far from being achieved. The announced approach was very similar to what was developed for the private sector between 1995 and 2002. The reference to the private sector has been clear and clear-cut: The EC appears willing to mimic and take the private sector accounting as frame of reference, following the same kind of implementation of the international public sector accounting standards (IPSAS) as it was done for the IAS-IFRS. They started the process in a similar vein, but the Member States did react in a different way, this time, showing alert, raising questions, and providing resistance in some cases.

Are sovereign debt holders sovereigns?

Among the arguments argued by the EC, one was especially surprising in the context of the European Monetary Union. It concerns the EC’s insistence on the competition between issuances of sovereign debt by Member States, along with the alleged information needs by ‘owners’ of those debts. As a matter of fact,

investors are not directly involved in the governance of the Member States, while public sector accounting is still quite embedded into the working of public administration, especially deficit spending. However, the EC decided to consider holders of sovereign debt securities – especially bonds and gilts – as a replacement concept for shareholders. They describe these debt holders as if they were playing the same functional role as an investor in a listed company. As a matter of fact, this is definitely not the case from an institutional or constitutional viewpoint: A creditor of a Member State is not granted with the right to decide the policies and the government of the State itself, not yet at least. As for plutocracy is not (yet) our political regime, we still maintain the Parliament and the three separate powers in place, while financial powers are not (yet) the fourth one.

By insisting on this idea that ‘owners’ of government debt securities are the key beneficiaries and the reference for public sector accounting, the European Commission is missing one of the specificities of public sector accounting and finances. To be sure, debt holders are legitimate stakeholders of governmental entities. They hold stakes in the public debt and need financial information; but they are among other stakeholders, and their needs should be considered as well as those of the others. This plurality of stakeholders is even more important than in the private sector, because investors are not in charge of governmental entities: The governance of companies may depend on them – mostly and surely primarily – but this is not the case for the governance of Member States. In the public sector context, investors are just debt holders among other stakeholders. This larger set of stakeholders is then even more fundamental than for the private sector.

A market basis of accounting for public sector entities under a common currency?

Another surprising idea concerns the European Monetary Union. According to the 2013 Report by the European Commission, Member States should compete against each other in order to attract investment by potential debt holders. As a matter of fact, Member States are also part of what is one monetary union, where they are expected to coordinate among each other. It is unclear and somehow doubtful what the EC has in mind when it insists on the market coordination for sovereign debts in Europe, while we have established a monetary union to cope with this very task of coordination. A monetary and economic union involves interdependence links that may require market and non-market modes of coordination and supervision. Moreover, this market perspective does neglect the

longstanding and privileged relationship which exists between sovereign debt and the monetary basis creation and management.¹

Who made the global excess borrowing?

As a matter of fact, the issue of the level of sovereign debt of the Member States was not explicitly raised by the 2013 Report of the European Commission. Still, it is in everyone's mind. We have been accusing governments of being spendthrifts in recent decades. Virtually all the media and the public debate keep condemning public debt as guilt in itself, although this seems quite surprising from an economic viewpoint and even from a financial viewpoint. In the last twenty or thirty years – in all the major Member States – governments were not at the origin of the overall rise of excess borrowing. Descriptive statistics provided by Eurostat concerning overall debt by sectors – as measured by national statistics – show that public administration cannot be blamed for excess debt growth in recent decades. For instance, in France, the level of debt owed by the government in the last 20 years has the least contributed to the general indebtedness of the country. Similar results can be found for Germany, while officers of the Bank of England have computed similar results for the UK. It is comforting that this latter prestigious institution has found the same evidence that the UK government has contributed the least to the general indebtedness of the country.

Therefore, although wishful thinking keeps blaming the governments to spend too much and to owe too much debt, the origin of the current debt 'overhang' – if we assess it to be excessive by our own beliefs or by our own analyses, though I am not discussing this point here – cannot be found in governmental behaviour. These same statistics show that the non-bank private financial institutions were responsible for the most part of the indebtedness during the past twenty or thirty years. They show evidence that the overall debt has then a private origin and a financial origin, being mostly originated and owed by non-bank financial entities (including the shadow banking system and the non-bank financial intermediaries). This appears to be true and relevant all over the world.

This evidence may help to better situate the role of sovereign debt holders in the current debate on harmonisation of public sector accounting standards in

¹ Biondi, Y. (2016). Public debt accounting and management in UK: Refunding or refinancing? Or, the strange case of Doctor Jekyll and Mr Hyde in the aftermath of the Global Financial Crisis. *Accounting Forum*. DOI: <http://dx.doi.org/10.1016/j.accfor.2016.02.003>.

Europe. These investors do not hold the only legitimate interests to be considered and made accountable for.

EPSAS and the Europe's economy and society

Further evidence about the current state of public sector accounting in Europe was provided by the thematic issue of the journal *Accounting, Economics and Law: A CONVIVIUM* that we have developed together with Prof. Riccardo Mussari.² We asked contributors to respond to the following four questions, concerning: (i) the EPSAS governance; (ii) the relationship between cash-basis and accrual-basis of accounting; (iii) accounting for governmental liabilities by Member States; and (iv) evidence of net assets under accruals-basis.

Our findings were quite clear: No clear-cut answer was provided concerning who should lead the process and eventually prepare the European public sector accounting standards (EPSAS). This governance question is still open; the Member States and the other constituencies did not provide a clear response. At the present, they do not know exactly whether they want to delegate standard-setting to the IPSAS Board – which would then assume the role that the IASB plays for the European private sector – or to Eurostat – which is a unit of the European Commission. Eurostat is carrying out the harmonisation process but it is still not formally in charge of the standard-making. A specific European Authority may be established, a solution that the Maystadt Report considered for the private sector. The EPSAS can also be established by coordinating the Member States' regulatory bodies which are already in place. The European Court of Auditors (ECA) may also take some role in this process.

In sum, we do not have a clear-cut response for the governance question, but we found that the cash- and the accruals- basis of accounting – which relate respectively to the budget and to the reporting – are always complemented and integrated in a dual-accounting system by the Member States. All the case studies that were treated by our contributors show this complementarity and this integration of the two accounting systems. No Member State has been replacing cash accounting and suppressing budgets, to obtain financial reporting similar to private companies, because the budget is still a valid and important accounting need and transparency device from their viewpoint. Even the European Community itself for its own accounts – which constitutes our inter-

2 Biondi, Y. (2014). Harmonising European Public Sector Accounting Standards (EPSAS): Issues and perspectives for Europe's economy and society. *Accounting, Economics and Law: A Convivium*, 4(3) October, 165–178. DOI: <http://dx.doi.org/10.1515/acl-2014-0015>.

state coordination level of government and may become our federal level in the future – does complement the two accounting systems.

The third finding was that sovereign debt is not accounted for at fair value (current market prices), as for most of the Member States have systematically disregarded the application of fair value to the liability side of their balance sheet on accruals-basis. Member States reporting remains then in line with the cash basis, concerning financial liabilities. In so doing, they also consistently exclude the pension obligations that are considered as financial commitments, which differ from financial liabilities.³ This finding holds for most of the Member States, especially for the ones belonging to the European Monetary Union.

The fourth finding was that, by applying the accruals-basis of accounting, all the Member States which have already started preparing accounts on this basis – and they are not the majority – show consistent material negative net assets. This indicator may send a misleading signal to sovereign debt holders and the general public, if interpreted by imitation of private sector. Concerning public administration, negative net assets just show that the mere mimicking of private sector accounting is not appropriate. By reporting negative net assets without a consistent representation, accounts are providing a message that neglects the monetary base creation and management. Sovereign debt issuance and refinancing is concerned with creation and management of this base, as for this debt has been employed as quasi-money for treasury management and bank money base for centuries. In this context, sovereign debt has been issued to be rolled over cohorts of successive refinancing issuances, which are functional to the working of the financial system and facilitate redistributive policies.⁴ It seems quite absurd and certainly unfeasible to stop using this sovereign debt refinancing mechanism that is central to public spending. Member States have been having recourse to financial markets to issue and refinance their debt positions for so long, showing that debt holders do accept this longstanding practice. This refinancing mechanism needs to be properly addressed and represented when we apply an accrual-basis of accounting to the public sector, since

³ Biondi, Y., & Boisseau, M. (2015). Accounting for pension flows and funds: A case study for accounting, economics and public finances. EGPA XII Permanent Study Group Public Sector Financial Management Workshop, Zurich-Winterthur (Switzerland), May 7-8. DOI: <http://dx.doi.org/10.2139/ssrn.2606547>.

⁴ Biondi, Y. (2013, June). Hyman Minsky's financial instability hypothesis and the accounting structure of economy. *Accounting, Economics and Law: A Convivium*, 3(3), 141–166. DOI: <http://dx.doi.org/10.1515/acl-2013-0045>.

merely showing negative assets may give a biased and even misleading representation of its financial sustainability.

Acknowledgments: Yuri Biondi is senior tenured research fellow of the National Center for Scientific Research of France (Cnrs – IRISSO), and research director at the Financial Regulation Research Lab (Labex ReFi), Paris, France. This article was prepared for and read at the international workshop on “Which Accounting Regulation for Europe’s Economy and Society?” organised under the auspices of the European Parliament in Strasbourg, on 20 May 2015, in tribute to Mr Jérôme Haas (1963–2014), first chairman of the Accounting Standards Authority of France (ANC). It was organised by the Laboratory of Excellence on Financial Regulation (Labex ReFi), which is supported by PRES heSam under the reference ANR-10-LABX-0095. It benefitted from a French government grant by the National Research Agency (ANR) under the funding program ‘Investissements d’Avenir Paris Nouveaux Mondes (Investments for the future Paris – New Worlds) reference ANR-11-IDEX-0006-02.

Funding: Labex ReFi / PRES heSam (Grant / Award Number: ‘ANR-10-LABX-0095’); ‘Investissements d’Avenir Paris Nouveaux Mondes (Investments for the future Paris – New Worlds) (Grant / Award Number: ‘ANR-11-IDEX-0006-02’).

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DOI: <http://dx.doi.org/10.2139/ssrn.2606547>