Bundes
rechnungshof

Special Report

pursuant to Article 99 Federal Budget Code

on the intended implementation of harmonised European Public Sector Accounting Standards (EPSAS) in the Member States of the European Union

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0 Executive summary

The European Commission (the Commission) intends to introduce harmonised European Public Sector Accounting Standards (EPSAS) in the Member States of the European Union. These standards are intended to provide better comparable data and a more reliable basis for economic and fiscal governance within the European Union, thus helping to avoid future sovereign debt crises.

The EPSAS are to be based on accrual accounting and to be binding for all levels of government. According to estimates made by the Commission, the costs of implementing EPSAS in Germany alone are expected to amount to €3.1 billion. However, the reliability of such estimates is doubtful. We believe that the actual financial burdens will be higher.

0.1

The Commission did not submit an overall strategy for the project. Furthermore, the Commission has not explained to what extent the mandatory introduction of EPSAS can actually achieve the intended objectives. It has not considered any alternative options (numbers 4.1 and 4.5).

0.2

Since 2015, the Commission has promoted the voluntary transition to accrual-based accounting systems in the Member States, including by making EU funds available for this purpose. By doing so, the Commission practically preempts a decision (number 4.3).

0.3

The Commission closely involves private sector audit firms in the decision-making processes. These firms are key players and exert considerable influence on the development of EPSAS. We consider this a matter of concern because the mandatory introduction of EPSAS would also create business opportunities for management consulting and audit firms (number 4.4).

0.4

By introducing EPSAS, the Commission intends to strengthen confidence in the financial stability of the European Union and to improve fiscal monitoring, thereby helping to avoid future sovereign debt crises.

However, the issue in the European Union is not a lack of information or awareness but of enforcement of European fiscal rules. Past experience has shown that despite grave violations of fiscal rules no financial sanctions have been imposed. The problem is not the lack of high-quality financial data but of a sound fiscal policy and of strict compliance with the European fiscal rules. Neither of these requirements can be enforced by any sort of accounting system (number 5).

0.5

According to the Commission's approach, EPSAS is to be the means by which the Member States obtain more robust data, thus rendering better account of the use of public funds. By introducing EPSAS, the Commission also intends to enhance transparency and comparability of public budgets.

The EPSAS are to be aligned with Anglo-American standards oriented towards the capital market. Thus, they are meant to provide investors with information useful for decision-making and are therefore more future-oriented. However, the government must render account of the use of the public funds. In contrast to the accounting of a private sector enterprise, public sector accounting mainly serves the purpose of ex post oversight (number 6).

Furthermore, the implementation of EPSAS would furnish data on public budgets that only appear to be more reliable and better comparable. In order to actually achieve these qualities, it would be necessary to restrict the influence of subjective factors and to effectively prevent tampering. This, however, is not ensured. On the contrary: Discussions within bodies at EU level show that the introduction of EPSAS would provide the Member States with a wide discretionary scope for choosing among different options (number 7).

0.6

The EPSAS are to furnish additional information on the financial position of the Member States which, from the Commission's point of view, will provide a more robust basis for decisions.

Recent decisions taken by the German Parliament suggest that, also in the future, the German budget legislator intends to exercise its constitutional right to pass the budget by means of cash-based data. Thus, EPSAS would not be more effective in facilitating parliamentary control.

We assume that, if EPSAS were introduced at the federal level on a mandatory basis, it would be necessary to retain the cash-based system and to introduce an accrual-based system in parallel. As a result, this would mean high implementation costs for Germany not matched by any real benefits. The operation of a parallel system would impose additional burdens on the German budget (number 8).

0.7

The Federal Government should assert its weight at EU level and prevent the mandatory implementation of EPSAS in Germany. Furthermore, it should take steps to ensure that the Commission consider alternative options that would permit any necessary improvements of the transparency and comparability of the Member States' financial reporting. In this context, consideration should be given to the different administrative and accountability structures of the Member States (number 9).

0.8

The German Federal Ministry of Finance stated that it strongly agrees with the German SAI's key issues of concern. The Ministry also assured us that the Federal Government would continue to intensively monitor the EPSAS implementation process in conjunction with the federal states and would ensure that consideration will be given to Germany's interests (number 10).

1 Preliminary remarks

As a result of the sovereign debt crisis, the European Union's requirements for the Member States' budget policies have been tightened. Such requirements are, for the most part, incorporated in the "six-pack" (adopted in late 2011) consisting of five Regulations and one Directive[1].

While the Regulations primarily refer to the Stability and Growth Pact, the Directive is to ensure a minimum quality standard of the national budgetary frameworks[2]. The Commission increasingly focuses on the public sector financial data the Member States have to report. They provide the basis for the European statistics on public finance which are produced in accordance with the European System of Accounts (ESA)[3].

ESA is based on accrual accounting. The Member States' financial data are typically drawn from their public sector accounting systems. Where data are needed that are not part of those systems they may be derived from other sources. If only cash-based data are available, they have to be converted to accrual-based data.

The Member States must commit to budgetary discipline and are to avoid excessive public deficits. The Commission monitors national budgets (fiscal surveillance) on the basis of ESA data. In this process the Commission also assesses the quality of the data reported by the Member States.

In early 2010, the Commission drew attention to inappropriate financial reporting by Greece.[4] The Commission stated that inadequate data furnished by the Member States could impair the overall quality of European statistics on public finance and took steps to improve quality management.[5]

1 Council Directive 2011/85/EU of 8 November 2011.
2 The national budgetary framework is the entirety of the regulations, procedures and institutions on which the implementation of each Member State's fiscal policy is based. In particular, this includes public accounting, statistical reporting, budget planning, results and procedures of budget execution.
3 ESA imposes detailed and binding rules for the preparation of the national accounts by the Member States.
4 Cf. Commission report of 8 January 2010, COM(2010) 1 final.
5 Cf. Commission report of 15. April 2011, COM(2011) 211 final.

2 Point of departure

The Directive aims at ensuring uniform compliance with budgetary discipline. It requires all Member States to have in place national public accounting systems[6] that comprehensively and consistently cover all sub-sectors[7] of general government. The accounting system must also contain the information needed to prepare data that comply with the ESA.

In addition, the Directive calls for the Commission to assess the suitability of the International Public Sector Accounting Standards (IPSAS) for the Member States. The IPSAS are based on accrual accounting. However, the Directive does not require the Member States to convert their public accounting systems to accrual accounting or to apply the IPSAS.

In its final assessment report, the Commission stated that the IPSAS in their present form were not directly suitable for implementation in the Member States. However, they might constitute a reference framework for EPSAS still to be developed.[8]

Against this background, the Commission aims for the mandatory introduction of EPSAS at all government levels in the Member States.[9] The Commission has tasked Eurostat[10] to implement EPSAS.

The two Houses of the German Parliament are critical about the project.[11] Most recently, the Bundestag (lower House) stated in 2015 that
- it considered the Commission's aim as unrealistic and, given the different administrative structures in the Member States, as hardly achievable;
- it had doubts about whether the cost-benefit ratio of EPSAS justified their introduction; and that
- parallel systems had to be avoided in view of scarce financial and human resources.

It called upon the Federal Government
- to ensure that the freedom existing in Germany to choose between accrual-based and cash-based systems is maintained and that EPSAS should only be introduced on a voluntary basis if at all;
- to ensure the democratic legitimacy of the EPSAS by having them developed centrally by the bodies which are responsible for setting national public accounting standards in the Member States and

6 (Not translated because it refers explicitly to German terminology.)
7 The general government sector consists of the four sub-sectors central government, state government, local government and social security.
8 Cf. Commission report of 6 March 2013, COM(2013) 114 final.
9 The key milestones of the EPSAS process are listed in Annex 1.
10 Eurostat is a Directorate-General of the Commission. In order to facilitate reading, the terms Eurostat and Commission are used synonymously in this report.
11 Cf. Bundestag printed paper 17/14148 of 26 June 2013, Bundesrat printed paper 811/13 of 14 February 2014 and Bundestag printed paper 18/4182 of 3 March 2015.

- to get actively involved with a view to ensuring that consideration will be given to the accounting principles relevant in Germany[12]. Options to choose from and discretionary scope need to be largely ruled out.

The German Federal Ministry of Finance performs this task on behalf of the Federal Government. It regularly informs the Budget Committee of the Bundestag about the status of the activities to introduce EPSAS, lastly by means of a report dated 1 June 2017. In its report, the Ministry stated that Eurostat was unwilling to meet Germany's principal demands concerning the accounting principles and added that the reason given by Eurostat for this refusal was that Germany fundamentally opposed the introduction of EPSAS and would not agree to the legislative project anyway. The Ministry pointed out that – if at all – it would be able to assert only few of the Bundestag's demands.

This prompted us to submit this report informing Parliament, the Federal Government and the public about the emerging risks connected with the intended mandatory introduction of EPSAS.

3 Objectives of EPSAS

By introducing EPSAS, the Commission intends[13]
- to strengthen confidence in the stability of the Economic and Monetary Union;
- to facilitate an improvement of fiscal surveillance at EU level in order to avoid future sovereign debt crises;
- to obtain complete and reliable accrual-based data, thus improving the overall quality of European statistics on public finance;
- to harmonise the Member States' accounting systems, thereby enhancing accountability, transparency and comparability;
- to prevent accounting manipulations ("creative accounting");
- to obtain more reliable information as basis for policy decisions; and
- to enhance effectiveness and efficiency of public management by disclosing the consumption of resources and to facilitate the pursuit of intergenerational equity.

The Commission has meanwhile stated that it wishes first to improve transparency and thereby supports the transition to accrual-based accounting systems in the Member States. In a second step, it intends to accomplish the comparability of data by means of introducing EPSAS.

12 Accountability, objectivity, regularity and oversight.
13 Cf. in particular Council Directive 2011/85/EU of 8 November 2011 and Commission Report of 6 March 2013, COM(2013) 114 final.

4 Process of implementing EPSAS

4.1 Legal basis for the introduction of EPSAS

According to the principle of conferral (Article 5 para. 1 sentence 1 and para. 2 of the Treaty on European Union - TEU), the European Union can act only within the limits of its competences. The Commission must found any legislative initiative on a precise legal basis. The latter depends on the key contents of the planned legal act.

Up to now, the Commission has neither made any final statement about the legal basis nor about the procedure for the introduction of EPSAS. Two legal opinions[14] from Germany foresee high obstacles to any action by the Commission or, at best, limited regulatory power.

The Commission intends to introduce EPSAS as binding standards for the Member States. One option for action would therefore be to enact a Regulation by means of an ordinary legislative procedure. This would mean that the Commission submits a proposal for legislation about which the European Parliament and the Council would decide. The decision by the Council requires a qualified majority (Article 16 para. 4 TEU). Therefore, Germany alone cannot prevent such a legislative act. It would have to form a blocking minority with other Member States.

4.2 Baseline situation in the European Union

Most Member States have already implemented accrual accounting at the various levels of government or are in the process of doing so.[15] They largely base their systems on the IPSAS. Cyprus, Germany, Ireland and the Netherlands are the only Member States that still have cash-based accounting systems in place at central government level.[16]

Eurostat has declared that the introduction of EPSAS would not affect national budget planning, budget execution and the presentation of accounts. Member States with cash-based systems could continue to use these alongside the accrual-based systems.

14 Gröpl, Christoph: *Auf der Suche nach einer Unionskompetenz zur Einführung von EPSAS in das Haushaltsrecht der Mitgliedstaaten; in: Entwicklung der öffentlichen Rechnungslegung in Europa, Kommunal- und Schulverlag, Wiesbaden, 2014* and Ohler, Christoph: *Die europarechtliche Zulässigkeit der Einführung von EPSAS*, expert opinion of 2 April 2014.

15 Cf. Ernst & Young: Overview and comparison of public accounting and auditing practices in the 27 EU Member States of 19 December 2012.

16 Cyprus, Malta and Portugal have initiated reform projects for transition to accrual accounting.

4.3 Timetable for the development and implementation of EPSAS

Eurostat has presented a timetable[17] for the development and implementation of EPSAS within ten years, beginning in 2015 and comprising two stages. In the first stage, a framework regulation is to be adopted and the EPSAS framework and standards are to be developed. This is to take five years, i.e. up to 2020. The Commission encourages the Member States to implement accrual accounting already during this period and also provides financial assistance.[18] In the second stage, implementation of the EPSAS is to be mandatory for all public entities in the Member States. This is to take another five years, i.e. up to 2025.

At year-end 2015, Eurostat recommended, that the Member States first implement IPSAS on a voluntary basis, pending completion of the EPSAS. The Commission has appropriated a total amount of €140 million for structural reforms. The Member States can draw on these EU funds to finance part of the reform projects connected with EPSAS.

4.4 Development of EPSAS

Beginning in 2013, the Commission set up various bodies and forums for starting the ground work on the EPSAS and for preparing their implementation. In September 2015, it set up a Working Group[19] that will deal with the development, introduction and implementation of EPSAS on a permanent basis.[20] The Working Group is to support the Commission and provide it with information. It does not have the authority to take decisions.

Eurostat chairs the Working Group, which consists of representatives of the Member States. Furthermore, its meetings are attended by representatives of the business community and stakeholders such as Accountancy Europe[21] and the body responsible for developing the IPSAS (IPSAS Board)[22]. Although, formally, these representatives only have observer status, the German Federal Ministry of Finance has noted that they were treated like members and played a dominant part in the Working Group’s meetings and their preparation.

Eurostat commissioned the audit firms Ernst & Young (E&Y) and PricewaterhouseCoopers (PwC) to advise the Working Group and to each produce ten issue papers on selected issues of public sector accounting. These papers are to initiate and marshal the discussions in the Working Group. On this basis, the advisors also regularly issue recommendations for the formulation of the

17 Cf. Annex 2.
18 Cf. Eurostat: EPSAS Priorities 2015-2016, EPSAS WG 15/03 of 4 September 2015.
19 EPSAS Working Group.
20 In addition there are working sub-groups (known as cells) on various issues.
21 Up to 2016, this professional body was known as the Fédération des Experts Comptables Européens (FEE).
22 The IPSAS Board is a body under private law that is not democratically legitimised. As a rule, its members are private sector auditors appointed by an international professional body (cf. number 6.1).

standards and structure the further discussion. Eurostat has pointed out that the issue papers do not necessarily reflect a joint position.[23] It is not clear whether and to what extent Eurostat takes into account dissenting opinions, critical hints or concerns of the Working Group members on the issue papers during the further process.

The German Federal Ministry of Finance attends the Working Group meetings, advocating Germany's interests on the basis of a policy paper agreed between the Federal Government and the federal states. In the paper the necessity, the cost-benefit ratio, the proportionality of the project and the legal basis for Commission action on this issue are questioned. The Ministry understands its role in the meetings as critical monitoring of the process without thereby preempting any decision in favour of or against the project. Therefore, it also formulates requirements for the content and design of the EPSAS in the event that these will actually be implemented. The Ministry has stated that it focused on advocating the interests of the Federal States of Hamburg and Hessen that have accrual-based accounting systems in place.

4.5 Alternative options

So far, the Commission has not stated whether there are options other than the mandatory introduction of EPSAS through which the European Union could counteract the weaknesses or deficiencies with milder means. Neither has the Commission proven that it is impossible to enhance transparency and comparability of financial data also in the existing system, e.g. by the already initiated improvement of quality management. Furthermore, the Commission failed to specify how harmonisation can solve the data quality issues it has pointed out. At present, there is also a lack of assessments as to whether EPSAS would essentially strengthen the protection against accounting manipulations. The Commission has so far not stated how error-prone the application of the foreseeably complex set of rules will be. Neither has it shown that the proposed approach will adequately solve the problems or will go beyond that. In addition, there is no evidence to suggest that the Commission has assessed whether it could improve the situation in those Member States where it considers data quality as inadequate.

23 Cf. Eurostat: EPSAS Priorities 2015-2016, EPSAS WG 15/03 of 4 September 2015.

5 Stability of the Economic and Monetary Union

5.1 European fiscal rules

The European fiscal rules were established in the European Union by virtue of the agreements on Economic and Monetary Union. They are to ensure the soundness of public finances in the Member States. In 1992, the Maastricht Treaty[24] stipulated compulsory benchmarks for the public budget deficit and the debt-to-GDP ratio[25] (so-called Maastricht criteria). The Stability and Growth Pact concluded in 1997 imposes further requirements and specifies fiscal surveillance. It was changed and amended repeatedly over time. The Treaty on Stability, Coordination and Governance in the Economic and Monetary Union that entered into force on 1 January 2013 (known as Fiscal Compact) builds on the Stability and Growth Pact.

In a nutshell, today´s European fiscal rules consist of two parts, the preventive and the corrective arms of the Stability and Growth Pact. They are generally binding on all Member States, i.e. also those that have not introduced the euro.[26] However, the Pact places some more extensive requirements on the Euro area countries.

In its monthly report for June 2017, the German Central Bank (Bundesbank) analysed the design and implementation of the European fiscal rules and arrived at the conclusion presented below.[27] The German SAI (Bundesrechnungshof) fully concurs with the Bundesbank’s critical assessment.[28]

5.2 Preventive arm of the Stability and Growth Pact

The central element of the preventive arm is the medium-term budgetary objective, i.e. a structurally nearly balanced general government budget. The objective requires that the structural budget deficit ratio should in general not exceed 0.5 per cent of gross domestic product (GDP).[29] Each Member State is to comply with the medium-term budgetary objective. If it does not accomplish this, it has

24 The Treaty on the European Union (TEU) was signed in Maastricht on 7 February 1992 and came into force on 1 November 1993.
25 In this report, this benchmark will be subsequently referred to as debt ratio.
26 The requirements for adjustment applicable to Member States with an aid programme have not been stipulated in the Stability and Growth Pact.
27 Cf. Bundesbank: *Zur Ausgestaltung und Umsetzung der europäischen Fiskalregeln*; in: monthly report for June 2017, pp. 29 seq.
28 Cf. report (in German) pursuant to Art. 99 Federal Budget Code about the findings on trends in federal public finance – challenges and options for action for the 19th legislative period, Section 10.1.4, 25 October 2017.
29 If the debt ratio is substantially lower than 60 per cent, the structural budget deficit may amount to up to 1 per cent of GDP.

to gradually reduce the structural budget deficit ratio. A Member State may, however, deviate from this adjustment path, e.g. if it is justified by structural reforms or investments. However, the number of exceptions has continued to increase over time. For instance, deviations from the adjustment path can now be justified on the grounds of expenditure on refugees or the fight against terrorism.

The Member States have so far rarely achieved the medium-term budgetary objective. This is partly attributable to the wide discretionary scope for granting exceptions. For example, the Commission and the Council[30] considered that the adjustment path for Italy in 2016 was "largely complied with" in spite of a deterioration of the structural budget deficit ratio. This was explained and justified by structural reforms and by expenditure on investments, on refugees and on the fight against terrorism.

On balance, the option of declaring that an Euro area country[31] deviates significantly from the adjustment path has always been waived even in cases where the structural budget deficit ratio actually increased.

5.3 Corrective arm of the Stability and Growth Pact

The corrective arm is based on the Maastricht criteria. According to these, the public budget deficit ratio and the public debt ratio are not to exceed 3 per cent and 60 per cent of GDP, respectively. If a Member State does not comply with these benchmarks and so long as the transgression is not considered an extraordinary or temporary excess, the Excessive Deficit Procedure can be initiated. The Commission then issues an opinion and the Council decides at the Commission's proposal, whether there is an excessive deficit. If this is the case, the Council communicates recommendations and a timetable for corrective action to the Member State in question. If the Member State does not take effective action, the Excessive Deficit Procedure has to be reinforced. If so, financial sanctions may be imposed on Euro area countries.

Ultimately, the Euro area countries have repeatedly failed to meet the Maastricht criteria since the introduction of the Euro in 1999,
- in case of the budget deficit ratio in 109 cases (40 per cent), of which 13 cases involved non-compliance over three or more consecutive years; and
- in case of the debt ratio, in far more than half of the cases (59 per cent).[32]

30 Ecofin Council. The meetings on fiscal surveillance of the Euro area countries are attended only by the ministers of the members of the Euro group.

31 So far, the Commission declared a significant deviation from the adjustment path towards the medium-term budgetary objective only in the case of Romania (Non-euro area country) for 2016 and issued a warning pursuant to Art. 121, para. 4 of the Treaty on the Functioning of the European Union (TFEU) on 22 May 2017.

32 For the period 1999-2015, the ifo Institut studied the compliance with the budget deficit ratio by all Member States. It found that the benchmark was exceeded without permission in 114 cases, most frequently by France (in 10 cases).

At present, the debt ratio in all Member States except Estonia, Latvia, Lithuania, Luxembourg, Malta and Slovakia exceeds the benchmark. The general requirement imposed by the Stability and Growth Pact and the Fiscal Compact that, the deficits have to be reduced by an annual average of one twentieth ("1/20 rule") where the debt ratios exceed the benchmark, is often not implemented.

Nevertheless, no financial sanctions have been imposed so far. For example: Having found, in 2013, that Belgium had not taken any effective action, the Commission reinforced the Excessive Deficit Procedure. However, it did not propose any financial sanctions. In mid-2016, it was found that Spain and Portugal had not taken any effective action. In response, the Excessive Deficit Procedure was reinforced. However, the sanction proposed by the Commission and adopted by the Council amounted to "zero euros".

Concerning the debt ratio, it is unlikely that an excessive deficit will be noted and, in fact, this has never been the case so far. For instance, in the case of Italy, the Commission had examined the debt ratio for the previous year in May 2016 and had announced another review for autumn 2016. However, the relevant report was produced only in February 2017 after Italy's constitutional referendum. At that time, the Commission did not deem any further procedural steps necessary. Italy's debt ratio is still increasing and significantly exceeds the benchmark. The Commission expects that Italy's debt ratio will be 133.1 per cent in 2017.

5.4 Synopsis

According to the Bundesbank, the increased importance of the Commission after adoption of the Stability and Growth Pact did not result in a consistent implementation of the European fiscal rules. Instead, the Commission, in agreement with the Council, increasingly favours more flexible rules. The goals and targets have often not been met.

We concur with the assessment of the Bundesbank that the overall effectiveness of the preventive arm is low. Concerning the corrective arm, exceptions and discretions led to a situation where it became possible for a Member State to be considered compliant with the fiscal rules, despite showing continuous excessive budget deficit or debt ratios that were increasing or significantly exceeded the benchmark. It is true that, on the whole, budget deficit ratios[33] have decreased, which is mainly attributable to the general improvement of economic conditions and low interest rates in the Euro area. Nevertheless, the debt ratios[34] continue to be excessive in many Member States.

According to the Bundesbank, fiscal rules alone cannot ensure sustainable public finances in the absence of a fundamental consensus about compliance. The Bundesbank proposes additional reforms in order to strengthen the resilience

33 See annex 3.
34 See annex 4.

of the Economic and Monetary Union. For example, the privileges for government bonds[35] should be gradually phased out and an orderly procedure for their restructuring should be agreed in case a government becomes insolvent. This could help to avoid or better cope with financial and economic crises. In that context, the Bundesbank does not mention the introduction of harmonised accounting standards for the public sector.

6 Purposes of accounting

6.1 IPSAS as a reference framework for EPSAS

The Commission has stated that it is imperative to avoid unnecessary deviations between EPSAS and IPSAS, adding that the same applied to the relationship between EPSAS and International Financial Reporting Standards (IFRS).[36] Eurostat wishes to adopt also the philosophy of the IPSAS as comprehensively as possible.

The IPSAS are developed by the IPSAS Board[37]. Conceptually, they are aligned to the IFRS which are largely influenced by the Anglo-American accounting philosophy. The IFRS are developed by the International Accounting Standards Board (IAS Board)[38]. A basic agreement between the two bodies is in place. It is designed to strengthen their cooperation. Neither the IPSAS Board nor the IAS Board is democratically legitimised.

The structural problem of the cooperation between these two bodies is that the traditional information aims of public sector accounting differ from those of a private sector enterprise.[39]

6.2 Public sector accounting

Public sector accounting at federal level is governed by the principles of Parliament's right to control the budget (Art. 110 para. 2 German Constitution) and the responsibility of the executive branch for budget execution. The budget determines the employment of the resources made available by the citizens (Art. 110 para. 1 German Constitution).

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35 For instance, government bonds are currently exempt from capital requirements.
36 Cf. Commission report of 6 March 2013, COM(2013) 114 final.
37 The IPSAS Board is an 18-member body appointed by the International Federation of Accountants (IFAC). IFAC's business headquarters are in New York; its registered office is in Geneva. At present, more than 175 audit firms and international audit organisations from more than 130 countries are affiliated to IFAC. Together, they represent nearly 3 million private sector auditors.
38 The IAS Board is a 14-member body appointed by the trustees of the International Accounting Standards Committee Foundation (IASCF). IASCF is an international foundation with registered office in Delaware.
39 Cf. Gröpl, Christoph, loc. cit., pp. 259 seq.

Following the end of a financial year, the German Federal Minister of Finance must render account to Parliament of all revenues and expenditures as well as all assets and debts. The purpose of the rendering of account is the granting of discharge to the Federal Government by Parliament (Art. 114 para. 1 German Constitution).

The German SAI audits the accounts and the Federal Government's financial management. The applicable audit criteria are compliance and performance (Art. 114 para. 2 German Constitution).

Thus, the principles governing the public budgetary system are the coverage of expenditures by revenues and their democratic legitimisation. The primary purpose of public sector accounting is accountability. It aims at retrospective oversight over the use of public funds. Further purposes are financial stability, intergenerational equity and comparability. To meet all these purposes, public sector accounting must comply with the principles of reliability, objectivity[40] and prudence.

6.3 Accounting oriented towards the capital market

In contrast, IFRS and thus also IPSAS pursue fundamentally different informational aims. Their approach is oriented towards the capital market and aims at presenting a true and fair view of the financial status and performance of an enterprise, so as to furnish investors with information useful for decision-making. They therefore focus more strongly on future developments. It goes without saying that democratic legitimisation is not a matter of concern.

The IPSAS framework includes both accountability and relevance for decision-makers as purposes of accounting. Owing also to this conflict of interest, the prudence and objectivity principles are of minor importance. This is also reflected in the sheer number of options and discretions.

In the Working Group, the German Federal Ministry of Finance insisted on establishing a hierarchy of the accounting principles for EPSAS in order to emphasise the special importance of the principles of reliability, objectivity and prudence. Eurostat and the representatives of the audit firms have spoken out against this demand, advocating the strongest possible alignment with the IPSAS framework.

40 The objectivity principle stipulates that the use of options and discretions shall be restricted to exceptional cases.

7 Transparency and comparability

7.1 Prerequisites

The prerequisite for high-quality, reliable and comparable budget data is a public sector accounting system that minimizes discretions or accounting options as far as possible. The subsequent discussion of the issue areas taxes and pension liabilities exemplify the possible consequences of the introduction of EPSAS.

7.2 Taxes

7.2.1 Methods for recognising tax revenues

For the Working Group meeting in July 2016, E&Y prepared an issue paper[41] on the accounting treatment of taxes, especially of income tax and VAT. These two types of taxes account for about one half of all tax revenues in the European Union. The issue paper explains how revenues from these taxes have to be recognised under ESA and IPSAS.

ESA allows the Member States to choose between two methods of recognising revenues from these two types of taxes. These methods relate to two different points of time:

- Method 1
  Tax revenues are recognised on the basis of the tax declaration approach or the tax assessment approach. However, the resulting figures have to be adjusted downwards because it is unlikely that the declared and/or assessed taxes can be collected in full.

- Method 2
  Tax revenues are recognised when the respective payments are received ("time-adjusted cash method"). This may require adjustments if receipts have to be allocated to another financial period.

The IPSAS call for recognising a (tax) receivable when the future receipt of payment is probable and can be reliably estimated. While this approach permits methods 1 and 2, it rather focuses on an earlier point of time, i.e. the occurrence of the taxable event[42]. It therefore would give the Member States an additional third option for recognising tax revenues:

41 E&Y: EPSAS issue paper on the accounting treatment of taxes, EPSAS WG 16/07, 30 June 2016
42 i.e. the time of earning the income or revenue

- Method 3
  Tax revenues are recognised on occurrence of the taxable event. Since neither a tax declaration nor a tax assessment notice are available at that time and a payment has not been received, tax revenues have to be estimated, e.g. by means of a statistical model approach. Deviations between the estimated and the actual tax revenue are to be recognised as profit or loss in the subsequent periods.

7.2.2 Potential consequences

If EPSAS aligned with IPSAS are introduced, Member States will have additional accounting options for recognising tax revenues. Moreover, there will be further discretionary scope because estimation methods are always based on assumptions and the Member States may define some of the parameters used if they give an appropriate justification.

From the perspective of E&Y, the IPSAS provisions in this area are not detailed enough. It is therefore necessary to consider the extent to which practicable application rules can be developed or whether only general principles for the recognition of tax revenues should be laid down. E&Y also pointed out that, given the different tax systems in the European Union, the methods and statistical models would have to differ between Member States.

In addition, E&Y also explained the relationship between the time when tax revenues are recognised and the reliability of the estimate. As a consequence, the uncertainty is the greater the earlier the tax revenues are recognised. Data generated by means of method 3 are the most uncertain in comparison to those developed by the other two methods.[43]

The German Federal Ministry of Finance pointed out that method 3 would create additional opportunities for window dressing. It further argued that the implementation of EPSAS would require a large input of human and financial resources. For instance, extensive application rules would have to be developed in order to ensure a consistent and compliant approach in all Member States. The Ministry noted that the issue paper only dealt with two types of tax and pointed out that, in Germany alone, there were about 40 different types of tax.

43 See annex 5.

7.3 Pension liabilities

7.3.1 Initial situation in the Member States

The recognition of pension liabilities was the subject of another E&Y issue paper[44] and was dealt with in the November 2016 Working Group meeting. In the issue paper, E&Y refer to a PwC study of 2014, according to which the Member States usually do not disclose pension liabilities in their annual accounts or balance sheet and the majority of Member States recognise social benefits only when they are paid.

At the federal level, Germany discloses pension liabilities in its capital account. They are calculated on the basis of an actuarial method. In contrast, countries such as Finland or France disclose pension liabilities at central government level only in the notes to the accounts. During the Working Group meetings, representatives of France repeatedly advocated in favour of granting options to the Member States in this matter also.

E&Y think it is unlikely that, under IPSAS, only one method can be applied to all social benefits in place in the Member States. In the Working Group meeting, E&Y therefore stressed how important it is that each Member State calculates its pension liabilities by means of its own consistent valuation method and discloses valid information on the underlying assumptions in the notes to the accounts, e.g. also the discount rate applied.

7.3.2 Choice of discount rate

In Germany, public entities using accrual-based accounting have to recognise pension liabilities as provisions in their balance sheets. Pension liabilities always result in future payments. The present value of these liabilities becomes a debt item in the government balance sheet. To calculate the present value, the payments likely to become due in the future are discounted to the financial statement date and are added up.

The principle is that the higher the discount rate, the lower is the present value of pension liabilities and *vice versa*. The German Standards for Public Sector Accrual Accounting and the German Commercial Code require that the discount rate is identified on the basis of an average market interest rate over a reference period of seven or respectively at least ten years.

Since pension liabilities usually are a considerable debt item in the balance sheet, even minor changes of the discount rate may have an enormous impact on the

44 E&Y: EPSAS issue paper on the accounting treatment of social benefits, EPSAS WG 16/14 of 8 November 2016.

presentation of financial position and performance. As a result, policy decisions might be overhauled by these effects.

For example, if the discount rate is determined on the basis of a market-oriented (variable) interest rate as provided for under IPSAS[45], this may compel the government to act pro-cyclically. This would be the case e.g. if the market interest rate drops in a phase of economic downturn. If so, the present value of pension liabilities would increase and the government would have to recognise additional provisions. This could force policy-makers to increase taxes or cut expenditure during the downturn. Either measure would reinforce the downturn.

Against this background, the German SAI and the audit institutions of the German federal states recommend prescribing a fixed and uniform discount rate for the valuation of pension liabilities.[46]

7.3.3 Examples: Hessen and Hamburg

As from 1 January 2009, the State of Hessen implemented accrual accounting and since then has rendered account according to the German Generally Accepted Accounting Principles, applying *mutatis mutandis* the provisions of the German Commercial Code. As of 31 December 2015, the balance sheet of Hessen showed provisions for pension liabilities amounting to €76.1 billion[47]. For the purpose of valuing its pension liabilities, the State of Hessen applied a discount rate of 2.65 per cent. According to the German Standards for Public Sector Accrual Accounting, the interest rate would be 2.2 per cent; according to the German Commercial Code it would be approximately 2.9 per cent. Hessen has pointed out that it would have to make additional provisions of €4.4 billion if the lower interest rate were applied. If the higher interest rate were applied, it could reverse provisions of €2.2 billion.[48]

The Free and Hanseatic City of Hamburg has shifted to accrual accounting and, for the first time, prepared financial statements in line with accrual accounting for the year 2015. As of 31 December 2015, the balance sheet for Hamburg's core administration showed pension liabilities amounting to €23.1 billion. Hamburg opted for a discount rate of 6 per cent, thereby deliberately derogating from the discount rate that would have to be applied under the German Standards for Public Sector Accrual Accounting. Hamburg has stated that, if a discount rate of 3 per cent were applied, it would be compelled to increase its provisions for pension liabilities by about half – i.e. by €11.7 billion to €34.8 billion.[49]

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45 Cf. E&Y: Comparison of IPSAS with the Standards for Public Sector Accrual Accounting; study commissioned by the Federal Ministry of Finance, submitted on 31 March 2016.

46 Cf. position paper dated 22 June 2017 of the German audit institutions on the discounting of provisions for pension and health benefit liabilities in public sector financial management.

47 This figure includes health care benefits for public servants.

48 Cf. annual report (in German) of the State of Hessen for the year 2015, p. 65 seq.

49 Cf. annual report (in German) of the Free and Hanseatic City of Hamburg for the year 2015, pp. 47-48

8 Impact on Germany

8.1 Initial situation

Federal, state and local governments as well as the social security funds[50] in Germany use both cash-based and accrual-based systems, thus rendering account differently. While the Federal Government and most states[51] apply cash-based accounting, the majority of local governments have implemented accrual accounting. In social security, the picture is heterogeneous for social security funds. The territorial entities which use accrual accounting do so in line with the German Commercial Code, the German Generally Accepted Accounting Principles or the German Standards for Public Sector Accrual Accounting. If implementation of the EPSAS were made compulsory, about 19,000 public entities at all government levels would be affected.

8.2 Parallel system or accrual accounting

In line with the request of both Houses of the German Parliament (Bundestag and Bundesrat), the Federal Government is to ensure that the public entities of the Member States are free to choose between accrual-based and cash-based systems. In addition, the Bundestag indicated that the implementation of EPSAS must not affect preparation, content and execution of the budgets in the Member States.[52]

Eurostat already declared that the Member States might continue to operate their national systems of budget planning, execution and accounting and implement EPSAS in parallel. Thus, it can be assumed that, even if EPSAS were implemented on a compulsory basis, the German federal budget would continue to be prepared and executed in line with cash-based accounting. If EPSAS are made compulsory for all Member States, the German SAI considers one of the two following scenarios probable:

50 The social security comprises statutory pension insurance, occupational accident insurance, health insurance, long-term care insurance and unemployment insurance.

51 Hamburg and Hessen have completely switched to accrual accounting. Bremen and North Rhine-Westphalia are in the process of reform towards accrual accounting.

52 Cf. Bundestag printed paper 17/14148 of 26 June2013.

- Scenario 1
  EPSAS-compliant financial statements for the Federal Government cannot be prepared on the basis of the existing cash-based system. Therefore, the Federal Government will implement an additional accrual-based system and operate it permanently alongside the cash-based system (parallel system). Under this arrangement, the cash-based system will retain the key role. All infra-annual transactions are recorded in the cash-based system and are incorporated into a cash-based budget account at year-end. To provide the basis for EPSAS-compliant financial reporting, all transactions are additionally recorded in line with accrual accounting.
  The Federal Government could implement an IT system for this purpose.
  At present, however, no "off-the-shelf" solution comprising all functionalities necessary for parallel operation is available in the market. At least during a transition period, in which a "linked" IT system would have to be developed and implemented, it would be necessary to manually reconcile the data needed for EPSAS. This is likely to be error-prone and expensive. In addition, there would be the general risks involved in the development and introduction of what is probably a highly complex IT system.
  If the "linked" IT system is not implemented, the Federal Government would have to permanently operate two parallel systems requiring a large input of human and financial resources.

- Scenario 2
  The Federal Government shifts to accrual accounting as "lead system" and generates the cash-based budget information demanded by Parliament from this system. At present, there is also no "off-the-shelf" IT solution available on the market that combines the two functionalities.
  For instance, the State of Hessen prepares a "rudimentary cash-based budget" alongside the accrual-based budget. The data for this is manually transferred from the IT system.[53]

We assume that the cash-based system will remain the "leading system" of the Federal Government and that the compulsory introduction of EPSAS will require the permanent operation of a parallel system.

8.3 Steering effect

Parliament's decision to retain cash-based budget planning, execution and accounting suggests that the budget legislator intends to continue to exercise its constitutional power to pass the budget on the basis of cash-based data. This coincides with the experience from the State of Hessen where the transition to accrual accounting took place eight years ago and where the easier-to-handle

53 Cf. Hessen Ministry of Finance: Study on the conversion of an accrual-based accounting system to EPSAS, presented in the Working Group meeting on 26-27 April 2017, p. 12.

cash-based approach is still prevailing in the minds of policy-makers, according to a study by the Hessen Ministry of Finance.[54]

Thus, the information generated by accrual-based accounting, e.g. about the consumption of resources, are not used as input for the planning decisions of the budget legislator. The mandatory introduction of EPSAS would therefore not provide any direct benefit for budgetary decision-making.

8.4 Costs

The compulsory introduction of EPSAS would necessitate considerable adjustment especially for public entities that have so far practised cash-based accounting. In most cases, the restructuring exercise is likely to require external consulting and support services. Staff would have to be trained and IT systems would have to be adapted or replaced.

PwC has been contracted by the Commission to assess the expected costs of introducing EPSAS in the Member States. According to PwC's estimate, implementation costs for Germany are to be as high as €2.4 billion. However, PwC has pointed out in its study that comparable data from the Member States for similar reform projects were available to a limited extent only, adding that the data were inconsistent in many cases and that it had been impossible to develop a detailed cost model. PwC stated that, for its cost estimates, it had to rely on a limited database and strongly simplified assumptions. Against this background, PwC has further pointed out that actual costs in the Member States might differ significantly from the estimations, depending on the national circumstances and requirements.[55] We believe that they can only exceed the estimations.

In addition, the Commission stated that further cost estimates for the implementation of EPSAS were available. These estimates suggested that, depending on the structure of government and the *ex-ante* situation of the public accounting system, the costs of implementation could total up to 0.1 per cent of GDP. For Germany, this would amount to approximately €3.1 billion. However, the Commission's estimates do not take into account the investment required in terms of "leadership, expertise and resources" that would have to be incurred in the Member States.[56]

For the reasons given above, neither of the two cost estimates is robust. We assume that the actual costs of implementing EPSAS would considerably exceed the estimates given. Furthermore, the estimates do not take into account the permanent additional costs of operating parallel systems.

54 Cf. Hessen Ministry of Finance, loc. cit., p. 31.
55 Cf. PwC: 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 of 1 August 2014, p. 10-11.
56 Cf. Commission report of 6 March 2013, COM(2013) 114 final.

9 Conclusion

Having weighed-up all arguments, we take the view that the mandatory introduction of EPSAS intended by the Commission is not an appropriate means to achieve the improvements sought. This applies especially to the enforcement of a sound and compliant fiscal policy of the Member States with a view to avoiding future sovereign debt crises in Europe. In addition, the discussions in the Working Group have shown that, due to their alignment with the IPSAS, the EPSAS provide additional choices, options and discretions for the Member States. Hence, the introduction of EPSAS would result in less transparency and comparability of public budgets.

The Commission has neither submitted an overall strategy for the project nor identified the legal basis on which it will act in this matter. Furthermore, it has not concretely shown to what extent the objectives it seeks to achieve can actually be accomplished by means of EPSAS. The Commission has also not studied alternative options for improving the quality of European statistics on public finance and thereby ensuring transparency and comparability in financial reporting.

In view of the potential consequences of a compulsory introduction of EPSAS and the associated costs for the Member States, we would have expected the Commission to present an overall strategy at an early stage, thereby ensuring the transparency of the project.

Since 2015, the Commission has promoted the voluntary transition to accrual accounting and the application of IPSAS including by providing EU funds for that purpose. It leaps into action before any decision by the Member States has been taken.

Eurostat intensively involves private sector audit firms and their advocacy groups. These are decisive players and exert considerable influence on the development of EPSAS. We consider this a conflict of interest because the introduction of EPSAS creates demand for the services of external consultants and especially audit firms. In addition, this bears the risk of excessive dependence on the private sector.

Furthermore, we do not believe that a mandatory introduction of EPSAS is realistically achievable nor is it viable in view of the different administrative and oversight structures prevailing in the Member States. More precisely:

- The Commission’s aim of introducing EPSAS is to contribute to avoiding future sovereign debt crises by improved fiscal surveillance, thus strengthening confidence in financial stability.
  However, past experience has shown that there is no lack of information or awareness in the European Union concerning fiscal surveillance. The required information is generated by ESA. The root of the problem is insufficient enforcement of the European fiscal rules. These have been repeatedly diluted for

political reasons by introducing or extending discretions. The supposed improvement of financial reporting will not change this.
The key to avoiding sovereign debt crises is a sound fiscal policy. The latter does not primarily depend on whether a Member State has a public sector accrual-based accounting system in place or applies EPSAS. Compliance with the European fiscal rules cannot be enforced by any accounting system.
The Commission should therefore consistently urge compliance with fiscal discipline and exert pressure on the Member States to the effect that they sustainably strive for balanced budgets and a reduction of their debt ratios.

- According to the Commission's approach, the Member States are to underpin their accounting with more reliable data generated by the application of EPSAS, enabling them to render better account of the use of public funds. In addition, the Commission seeks to enhance transparency and comparability of public budgets by means of EPSAS.
The EPSAS also aim to provide investors with information useful for decision-making and are therefore more future-oriented. However, governments must render account for the use of public funds in the past.[57]
It only appears that the compulsory introduction of EPSAS will provide more reliable and better comparable data on public budgets. In order to actually achieve this, the influence of subjective factors would have to be restricted and window-dressing would have to be effectively prevented. However, this is not ensured. On the contrary: The issue papers on the recognition of tax revenues and pension liabilities discussed by the Working Group illustrate that the introduction of EPSAS would give Member States additional choices, options and discretions.
Apart from that, we find that it is untenable to urge Member States to introduce EPSAS at all levels of government without firm knowledge that this will substantially improve transparency and comparability of Member States' financial reporting – and due to the dimension of the project, it cannot be reasonably expected that this will be achieved.

- EPSAS are to generate additional information on Member States' fiscal positions. The Commission expects that this will provide better bases for decision-making.
Recent decisions taken by German Parliament suggest that, also in the future, the German budget legislator intends to exercise its constitutional right to control the budget by means of cash-based budget information. Any potential additional information provided by EPSAS will therefore not have a steering effect. In the event of a compulsory introduction of EPSAS, the cash-based system would have to be retained at least at the federal level and a parallel accrual-based system would have to be implemented.
For Germany, a compulsory implementation of EPSAS would therefore cause high costs practically not matched by any benefit. Furthermore, the potential

57 Some voices even maintain that there is no accounting system that simultaneously fulfils the objectives of public sector accounting and capital market oriented accounting. Against this background, they reject the introduction of EPSAS. Cf. e.g. Gerhards, Ralf: *Öffentliche Finanzkontrolle vor neuen Erwartungslücken? In: Verwaltung & Management*, 23rd year volume. (2017), issue 1, pp. 41-45.

need to implement an IT system that remains still to be developed could involve considerable risks.

With a view to the federal budget system in place in Germany and the separate and independent financial management systems of federal, state and local governments guaranteed by the Constitution, we expect that the costs of implementation will total more than €3 billion. In addition, public budgets will be permanently burdened by the costs of running parallel systems.

The Federal Government should bring its political weight to bear at EU level and prevent the mandatory introduction of EPSAS in Germany. It should also urge the Commission to consider alternative options – where necessary – for improving transparency and comparability of financial reporting. In doing so, it will be necessary to take into account differences in the administrative and oversight structures of the Member States.

10 Comment by the German Federal Ministry of Finance

The German Federal Ministry of Finance has commented on this report. It stated that it expressly concurred with the German SAI's presentation of key issues of concern. In addition, the Ministry assured us that the Federal Government would continue to closely monitor the EPSAS implementation process in cooperation with the federal states. In doing so, it would stand up for Germany's interests.

Furthermore, the Ministry assured us that it would continue to keep Parliament and the German SAI comprehensively informed of its activities in connection with the planned introduction of EPSAS.

The German SAI's Governing Board adopted this report on 10 October 2017.

Bonn, 15 November 2017

Kay Scheller
President

Milestones of the EPSAS Process

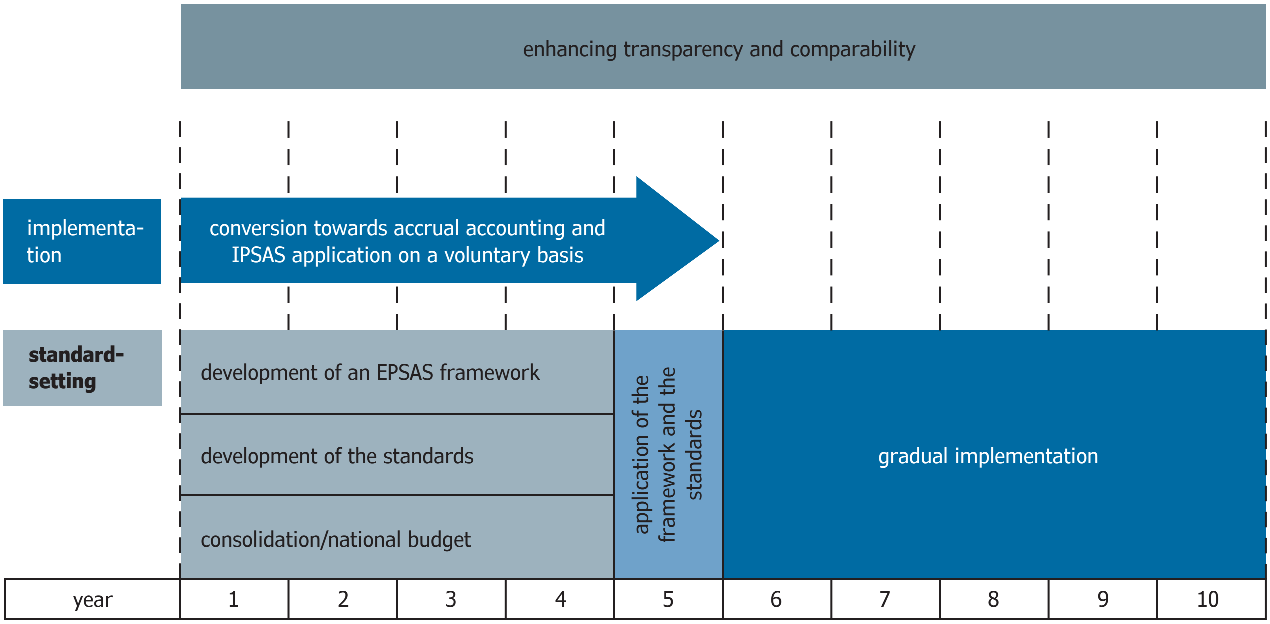
Annex 1

08.11.2011	Directive 2011/85/EU
15.02.2012 – 11.05.2012	IPSAS consultation process
27.02.2012 – 07.11.2012	Eurostat Task Force IPSAS
19.12.2012	E&Y study on public accounting in the EU Member States
06.03.2013	Commission report COM(2013) 114 final
29.05.2013 – 30.05.2013	European Commission Conference in Brussels
27.06.2013	German Parliament (*Bundestag*) decision
02.10.2013 – 18.03.2015	Task Force EPSAS Governance
since 11.10.2013	EPSAS Task Force of the Contact Committee of the Supreme Audit Institutions in the European Union
25.11.2013 – 17.02.2014	Consultation report on EPSAS governance
04.02.2014	German Federal Ministry of Finance report to the Budget Committee
since 12.02.2014	Task Force EPSAS Standards
13.02.2014	German SAI (Bundesrechnungshof) first report on EPSAS
14.02.2014	German Parliament (*Bundesrat*) decision
since 15.04.2014	State secretary committee on EPSAS, preceded by: EPSAS joint task force at federal and state level
14.05.2014	Position paper issued by the Presidents of the German SAI and the Audit Institutions of the German Federal States
01.08.2014	PwC cost-benefit analysis
05.03.2015	German Parliament (*Bundestag*) decision
03.06.2015	Adoption of the policy paper developed by the EPSAS joint task force by the state secretary committee on EPSAS
since 06.2015	First EPSAS Cell on First Time Implementation
15.09.2015 – 16.09.2015	First meeting of the EPSAS Working Group
01.10.2015	Workshop on EPSAS project organised by European Parliament's Committee on Budgetary Control
10.12.2015	Consultancy agreement between Eurostat and E&Y concluded
since 16.12.2015	Second EPSAS Cell on Governance Principles
21.12.2015	Communication by Eurostat Task Force EPSAS; alternative option: implementing IPSAS on an initially voluntary basis (within five years)
18.02.2016	German SAI (Bundesrechnungshof) second report on EPSAS
since 18.03.2016	Third EPSAS Cell on Accounting Principles
04.05.2016	Comparison of IPSAS with the Standards for Public Sector Accrual Accounting, presentation of the study commissioned by the German Federal Ministry of Finance
07.07.2016 – 08.07.2016	Second meeting of the EPSAS Working Group
15.07.2016	Decision taken by the Presidents of the German SAI and the Audit Institutions of the German Federal States
15.11.2016	Consultancy agreement between Eurostat and PwC concluded
22.11.2016 – 23.11.2016	Third meeting of the EPSAS Working Group
26.04.2017 – 27.04.2017	Fourth meeting of the EPSAS Working Group

Source: Own presentation based on a depiction from the Ministry of Finance of the Federal State of Hessen.

Timetable for EPSAS development and implementation

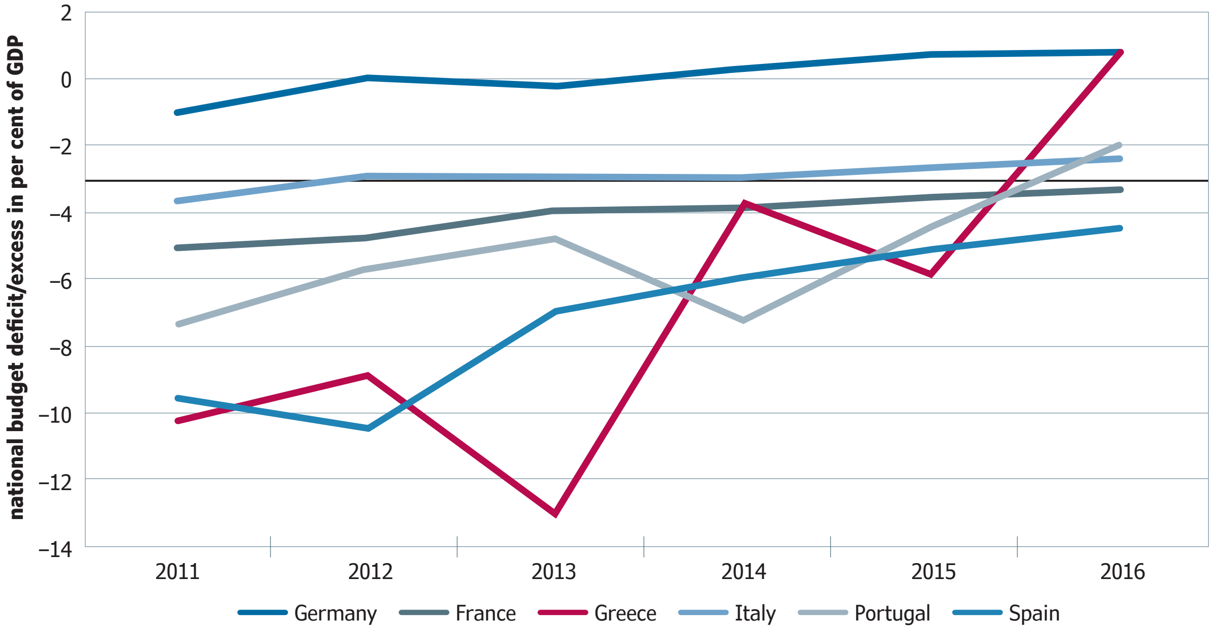
Annex 2



Source: Eurostat (own presentation).

Budget deficit ratios in the Member States (examples)

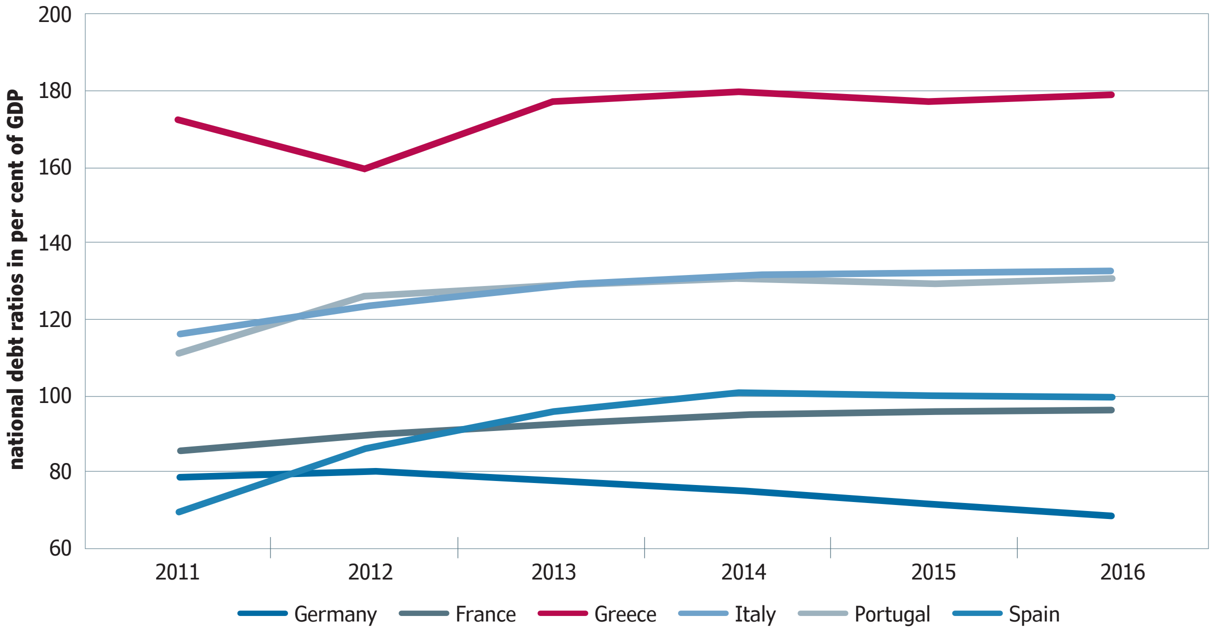
Annex 3



Source: Eurostat (own presentation).

Debt ratios in the Member States (examples)

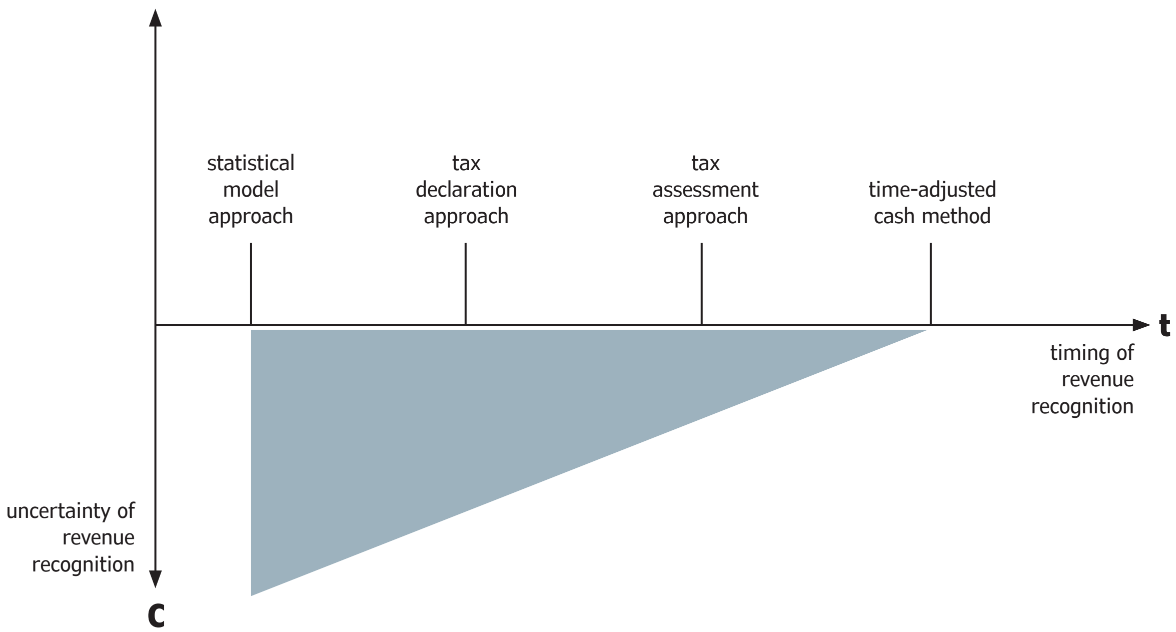
Annex 4



Source: Eurostat (own presentation).

Recognition and measurement of taxes

Annex 5



Notes:
Timing (t) and certainty (c) of revenue recognition
Source: E&Y: Accounting treatment of taxes, Issues paper presented at the EPSAS WG Meeting, Rome, 22–23 November 2016.