Modernising the EU accounts

Enhanced management information and greater transparency

Your guide to the EU’s new financial reporting
**Better management of public funds**

High quality financial information is essential to effective management in the public sector.

With the reform of its accounts in 2005, the European Union is now firmly on course to a world class system of financial reporting. At the heart of the reform lies a shift from traditional cash accounting to the more accurate and efficient accrual accounting.

This is not merely a technical change. It is a profound change in management culture, vital to ensure effective scrutiny over spending, minimise the risk of errors, and improve the day-to-day management of EU funds.

I strongly believe these improvements will have a visible long-term effect on the performance of the EU and, as a result, will yield concrete benefits to its citizens.

*Dalia Grybauskaitė*  
Commissioner for Financial Programming and Budget

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**Accountability and transparency**

The use by the European Commission of International Public Sector Accounting Standards in developing its new accounting rules is a major step in its financial management reform towards full transparency in financial reporting.

The European Federation of Accountants fully recommends the use of accrual-based accounting by governments and public sector entities, as it increases the accountability and transparency of their financial reports and provides better information for planning and management purposes.

We do hope the lead of the EU and of those public organisations and governments that have already introduced similar standards, will encourage others, resulting in more transparent, clear and comparable financial information in the public sector across Europe and beyond.

*David Devlin*  
President of the European Federation of Accountants
Cash accounting vs. accrual accounting

Accrual accounting is best explained by comparing it to the more traditional cash accounting:

- In cash accounting, transactions are recorded only when cash is received or paid out. Cash accounting does not distinguish (whereas accrual accounts do) between the purchase of an asset and the payment of an expense — both would be simply ‘payments’.

- In the accrual accounts, transactions are recognised when they occur: if an EU-funded project sends a bill in December, it will be recorded that month, even if the payment is to be made the following year.

Benefits of accrual accounting

- Full view of assets and liabilities
- Multi-annual vision in financial statements
- Analytical view of accounting entries

- More effective management and decision making through enhanced information
- More effective audits thanks to clear and coherent records
- Tighter political control through better understanding of the financial impact of policies
- Minimised risk of errors in payments to beneficiaries

Accrual accounting in the public sector — a global perspective

OECD countries which use the accrual basis for consolidated financial statements (1):

Australia  Canada  Finland  France
Greece  New Zealand  Sweden  Switzerland
United Kingdom  United States  Iceland  Italy

(1) Source: Organisation for Economic Co-operation and Development (OECD)
(2) Accrual basis with some elements on cash basis
EU accounts — an overview

EU accounts:

Did you know?
The EU accounting system registers around 1.45 million payments a year.

EU accounts:

**Budgetary accounts**

They give a detailed picture of how the annual budget was spent and are therefore based on cash accounting.

**General accounts**

They show all expenditure and revenue over the financial year (economic outturn) and are designed to establish the financial position of the institutions (balance sheet). Since 2005 they are based on accrual accounting.

The accounts of the European Union serve **two principal purposes**. First, they provide the EU budgetary authority (i.e. the European Parliament and the Council of the EU made up of Member States’ governments), as well as the general public, with a view of how the voted budget was implemented in the course of the year (cash-based budgetary accounts).

Second, they present the institutions’ financial statements for the year, including the balance sheet, which describes the EU’s financial position, with all assets and liabilities, on 31 December (accrual-based general accounts).
The ABAC reform

ABAC (Accrual Based Accounting) is part of the Commission’s global effort to modernise the management of the EU finances. In December 2002 the Commission presented an ambitious action plan to switch its general accounts to accrual base as of 2005 — in just two years! As planned, in January 2005, the new accounting system became operational, and a new set of accounting rules came into force.

International standards
These new rules are based on internationally accepted standards for the public sector — the IPSAS (i.e. International Public Sector Accounting Standards) — and, for accounting transactions that are not yet covered by IPSAS, the relevant International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS).

Information technology
The IT architecture — a crucial element of the EU accounting system and of the reform — was thoroughly overhauled to ensure that each accounting event would be fully registered when it occurs, and not just when there is a cash movement.

The end result was the preparation of the 2005 annual accounts based on the new accounting rules.

EU accounts and DAS

The statement of assurance or DAS (from déclaration d’assurance) is delivered each year by the European Court of Auditors. In the DAS the Court gives its opinion on two separate issues:

1) whether the accounts of the EU are reliable;

2) whether all the underlying transactions were actually legal and correct (e.g. whether the beneficiary received the correct amount on time).

Ever since the first DAS in 1994, the Court has declared the EU accounts reliable (1), with reservations, the major one concerning pre-financing (i.e. advance payments to beneficiaries of EU aid), which should be recorded as debts towards the EU as long as the project is not finalised. This issue is thus solved as of 2005 with the introduction of accrual accounting.

(1) On the other hand, in each DAS so far the Court has been unable to give unreserved positive opinion on the regularity of some transactions (the second issue), which is often wrongly interpreted as a negative opinion on the accounts as such.
IT systems — security and functionality

IT systems form the arteries for transmitting, analysing and storing accounting information. A thorough overhaul of the existing IT solutions is one of the crucial elements of the reform.

Data warehouse

• reporting
• management

Reconciled data are sent to a single data warehouse

European Parliament
National governments
EU citizens

Improved, more comprehensive information on EU accounts

ABAC financial management systems

• contracts
• budgetary workflow
• accrual workflow
  (invoices, guarantees, pre-financing)
• inventory of assets
• loans and borrowings

ABAC accounting
(run on SAP (1) software)

New functionalities:
• more efficient and secure data storage
• easier control/tracking of data enabling better control over the use of EU funds
• new Legal Entity Files
• integrated accounting data on assets
• analytical accounting
• project management functionalities

RESULT: FULL ACCRUAL ACCOUNTING

User enters financial operations into the web-based, integrated system

Minimised risk of errors in payments to beneficiaries

SWIFT (2)

• payments
• revenue collection

(1) SAP — a leading software provider in the field of corporate and public accounting, is a registered trademark;
(2) SWIFT — financial industry-owned co-operative supplying messaging services and interface software to 7800 financial institutions (such as banks) in more than 200 countries.
ABAC accounting — increased capacities

A general ledger suitable for accrual accounting, with new elements such as:
- pre-financing
- guarantees
- invoices

This new tool gives access to a breakdown of costs by directorates-general and by policy areas.

A multi-annual project management tool used by the Joint Research Centre.

The Corporate Financial Module (CFM) deals with loans and borrowings made by the Directorate-General for Economic and Financial Affairs outside the EU budget.

Financial information
Cost accounting
Project system

Funds management
Loans and borrowings

Accounts receivables/payables
Assets accounting
ABAC accounting

Used to manage the voted budget and related operations, e.g. checks on availability of funds.

This module comprises the upgraded Legal Entity Files which record all third parties the Commission has financial relations with, as well as related bank accounts.

The LEF allow the Commission to define precisely its financial position towards its partners, contractors, debtors etc.

This system gathers accounting information about the EU assets. While in the past every management centre had its own system of reporting, the data is now entirely integrated.
The 2005 annual accounts were the first to be prepared on an accrual basis. Here is a selection of key tables and figures.

1. Budget outturn

Budget outturn for the year describes how the budget was spent. It represents the difference between total revenue received for that year and total payments made against that year’s appropriations, with some adjustments.

### Improving budget implementation rate

In 2005 the surplus was only 2.3% of the total budget. The final figure was the result of two factors:

- higher-than-forecast revenue, which increased the surplus;
- good budget implementation (at a record 99%), which reduced the surplus.

The EU treaties require the budget to be balanced each year. The annual surplus is entered into the budget for the following year, thus reducing contributions paid by Member States.

### In financial statements a negative value (e.g. a payment) is shown in parentheses.

<table>
<thead>
<tr>
<th>million EUR</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue for the financial year</td>
<td>107 091</td>
</tr>
<tr>
<td>Payments against 2005 appropriations</td>
<td>(103 548)</td>
</tr>
<tr>
<td>Payments appropriations carried over to 2006 (¹)</td>
<td>(2 687)</td>
</tr>
<tr>
<td>EFTA payment appropriations carried over from 2004</td>
<td>(91)</td>
</tr>
<tr>
<td>Cancellation of unused payment appropriations carried over from 2004</td>
<td>1 519</td>
</tr>
<tr>
<td>Exchange differences for the year</td>
<td>41</td>
</tr>
<tr>
<td><strong>Budget outturn 2005</strong></td>
<td><strong>2 415</strong></td>
</tr>
</tbody>
</table>

(¹) The resources budgeted for a given year may only be carried over to the following year under very strict conditions.
2. Economic outturn account

This financial statement sets out all revenue and expenditure incurred during the year, even if the related movement of cash will only take place in later years.

| million EUR |
|------------------|------------------|
| **Operating revenue** | 107 890 |
| • Own resources and contributions revenue | 103 964 |
| • Operating revenue (including fines, recovery of expenses, revenues from administrative operations) | 3 926 |
| **Operating expenses** | 107 597 |
| • Administrative expenses | 6 127 |
| • Operating expenses (¹) | 101 470 |
| **Surplus from operating activities** | 293 |
| **(Deficit) from non-operating activities (²)** | (8 014) |
| **Share of net (deficit) associates and joint ventures (³)** | (91) |
| **(Deficit) from ordinary activities** | (7 812) |
| **Economic result for the year** | (7 812) |

(¹) This covers all the major EU expenditure, such as cohesion and structural funds, research grants, etc.

(²) This line includes the financial operations result of EUR 30 million and the change in the estimated total value of pension rights of EU staff (EUR 8 044 million), which have to be recognised in the accounts, though the corresponding revenue will only be covered by future budgets and is not recognised here (see Glossary: principle of prudence).

(³) Investments in the European Investment Fund and in the European satellite navigation programme (Galileo).

The economic result for the year is a reflection of accrual principles, whereby expenses (including long-term estimates) are recognised before revenues. The resulting figure corresponds to expenditure which Member States have agreed to incur, and which they will cover in the following years. This should not be confused with a national budget deficit (i.e. when in a given year more money is spent than collected); actually, in 2005, the EU budget recorded a surplus, which was returned to Member States (see p. 6).

The sources of revenue in 2005:

- **66%**: a uniform rate applied to Gross National Income of EU countries;
- **15%**: a uniform rate applied to all EU countries’ VAT basis;
- **13%**: customs duties, agricultural duties and sugar levies;
- **6%**: unspent amounts from previous years, contributions of EU staff, etc.

Did you know?

As much as **76%** of the expenses of the EU are delegated to Member States under the so-called **shared management**.

Centralised management (by the Commission): **22%**

Decentralised and joint management (delegated to third countries or international organisations): **2%**

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3. Balance sheet

The balance sheet gives a description of assets and liabilities at year-end. Assets are presented according to their liquidity (i.e. potential exchangeability into cash); liabilities are presented according to the extent to which they are due.

### Non-current assets

- **Intangible fixed assets**: 27 million EUR
- **Tangible fixed assets**: 4,141 million EUR
- **Investments**: 1,874 million EUR
- **Loans**: 2,397 million EUR
- **Long-term pre-financing**: 22,732 million EUR
- **Long-term receivables**: 244 million EUR

### Current assets

- **Stocks**: 126 million EUR
- **Short-term investments**: 1,440 million EUR
- **Short-term pre-financing**: 6,633 million EUR
- **Short-term receivables**: 7,238 million EUR
- **Cash and cash equivalents**: 11,854 million EUR

### Total assets

58,707 million EUR

### Non-current liabilities

- **Employee benefits**: 33,156 million EUR
- **Provisions for risks and charges**: 1,097 million EUR
- **Financial liabilities**: 1,920 million EUR
- **Other long-term liabilities**: 1,853 million EUR

### Current liabilities

- **Provisions for risks and charges**: 275 million EUR
- **Financial liabilities**: 22 million EUR
- **Accounts payable**: 82,528 million EUR

### Total liabilities

120,851 million EUR

### Net assets

(62,145)

Net assets are represented by:

- **Reserves**: 2,808 million EUR
- **Amounts to be called from Member States**, of which
  - **Staff pensions (long-term)**: 33,156 million EUR
  - **Other amounts**: 31,797 million EUR

Examples of **non-current** assets:
- Intangible fixed assets — e.g. computer software;
- Tangible fixed assets — land, buildings, equipment, etc.;
- Investments — Guarantee Fund, European Investment Fund, joint-ventures (e.g. Galileo programme);
- Long-term pre-financing — e.g. structural fund advances paid out to Member States.

Examples of **current** assets:
- Stocks — such as scientific equipment and production materials used by the Joint Research Centre, publications of the Publications Office;
- Short-term investments — available-for-sale securities;
- Short-term pre-financing — advances paid to beneficiaries still outstanding;
- Short-term receivables — e.g. own resource amounts due from Member States;
- Cash and cash equivalents — all the funds the Commission keeps in its bank accounts, including amounts ‘frozen’ for pending court decisions.

Examples of **non-current** liabilities:
- Future pensions rights of EU staff (employee benefits);
- Nuclear site dismantlement (provisions for risks and charges).

**Current liabilities** include eligible expenses incurred by beneficiaries of EU funds (accounts payable).

The EU’s **net assets** reflect the application of accrual accounting rules and principles (e.g. the principle of prudence — see Glossary) to a public body which finances its activities not through tangible assets, but mainly through the right to collect revenue (own resources) from Member States. Thus the net assets are expenses already incurred for which the corresponding revenue will be collected later on before the actual payment will have to be made. These expenses have been incurred only because Member States have agreed to finance them.
**ABAC (Accrual Based Accounting):** the acronym of the European Commission’s project to switch from cash-based to accrual accounting, and of the new accounting system introduced (see pp. 3–5).

**Accrual accounting:** a system of accounting which recognises ‘generating events’ rather than cash transfers (see p. 1).

**Appropriations:** the funds in the budget. The budget forecasts both commitments (legal pledges to provide finance — hence ‘commitment appropriations’) and payments (cash or bank transfers to the beneficiaries — ‘payment appropriations’). Appropriations for commitments and payments often differ because multi-annual programmes and projects are usually committed in the year they are decided and are paid over the years as the implementation of the programme and project progresses.

**Assets:** resources controlled by an entity as a result of past events from which future economic benefits or service potential is expected to flow to the entity.

**Cash-based accounting:** a system of accounting which only registers transactions following a cash movement (see p. 1).

**DAS (from déclaration d’assurance):** statement of assurance on EU accounts and underlying transactions, delivered by the European Court of Auditors (see p. 3).

**Liabilities:** present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of its resources.

**Own resources:** amounts automatically paid to the European Union budget, pursuant to the treaties and implementing legislation, without the need for any subsequent decision by national authorities.

**Pre-financing:** payment intended to provide the beneficiary with a cash advance to carry out a project (a ‘float’); under accrual accounting it is recorded as an asset because it is not a definitive expense until the relevant contractual conditions are met (see pp. 3 and 8).

**Principle of prudence:** an accounting principle saying that assets and income shall not be overstated and liabilities and charges shall not be understated (see p. 8). This is why accrual accounts recognise expenditure before revenue.

The new accounting system, particularly through improved financial workflow and more effective project management, is expected to facilitate the disbursement of EU funds to EU beneficiaries and reduce the risk of errors.
Europe Direct is a service to help you find answers to your questions about the European Union.

For feedback on the brochure:
budget@ec.europa.eu

For more information on the EU accounts, budget, financial programming and accounting

EU Budget:
http://ec.europa.eu/budget/index.htm

Commissioner Dalia Grybauskaitė:
http://ec.europa.eu/commission_barroso/grybauskaite/index.htm

Directorate-General for Budget:
http://ec.europa.eu/dgs/budget/index.htm

European Federation of Accountants:
http://www.fee.be