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The need for fiscal transparency and harmonised public sector accounting standards

Check Against Delivery
Seul le texte prononcé fait foi
Es gilt das gesprochene Wort

Olivier Boutellis-Taft, CEO of the Federation of European Accountants (FEE)

Thank you Chairman.

Thank you for inviting me to what I see as a very important event on a subject that is critical for the future of the EU.

Thank you also for asking me to speak on the easiest subject of these two days of debate: the need for fiscal transparency and the desirability of adopting harmonised public sector accounting standards in the EU.

It's easy because I think everybody has already said what needed to be said in favour of fiscal transparency and harmonised public sector accounting standards and first and foremost Eurostat that I would really like to commend.

This is not just a polite statement; there are instances where I can be critical of the Commission; but here, I think the European Commission and in particular the Eurostat report really did an excellent job: the analysis is comprehensive and well thought through; it is making a strong and convincing case for improved fiscal transparency and public sector accounting – and this is much needed.

Moreover it is showing something that is most needed today – and getting rather rare: it is showing political courage and leadership.

Having said that, I will however answer the question that was posed to me and I will probably repeat things that have been better said yesterday and that will be better said later today. So to avoid going in circles, I would also like to share a few thoughts as to how we can make progress, looking at what can be learned from experience in private sector accounting.

Talking about private sector maybe I should clarify that FEE is not only representing professional accountants in the private sector.

The members of our 45 member bodies from 33 countries in Europe work in accountancy firms of all sizes, small, medium and large, as well as in business and also in the public sector at all levels of government, in publicly owned companies and in education. The other thing I would like to outline before this turns into an advertisement is that the Constitution of the Federation mandates us to take into account the public interest into all our activities. And this is something we're very committed to.

So do we need fiscal transparency?

Transparency is a nice buzz word; what do we mean exactly? We can only have true transparency in public finance if all income and expenses and all assets and liabilities are publicly disclosed.

Only double entry accrual accounting would provide such a comprehensive and reliable view of the financial position and performance of the public sector.

So do we need such a thing?! I'm sure some will say, of course not, it's scary!
Why would you want to know about liabilities that you cannot pay for?

Why would you want others to know that you cannot meet promises you have made? That you won't be able to serve the pensions you committed to or that you cannot cope with the guarantees you've offered?

Why would you want to worry about things that the next public sector manager, the next elected government or the next generation will have to pay for?

If it is transparent, it's your problem; if it's not, it's their problem!

About 50 % of EU GDP is governments' spending. Can we seriously continue leaving this in the dark? This has a price that we have started paying in terms of interest rate spreads, administrative costs, social unrest...and this price is only going to increase.

What is needed is transparency at the level of the whole EU (not only in the euro-zone, not only at Member States central government level, not only at local government level: in all public sector entities) – and that brings us to the next question:

Do we need harmonised public sector accounting standards?

Harmonisation contributes to transparency because it makes information understandable across stakeholders and jurisdictions.

It enables comparison, improves accountability, reduces the cost of aggregation at EU level, contributes to enhancing mutual trust amongst Member States, not to mention its instrumental contribution to surveillance and stability.

But we have to be clear on what we mean by "harmonised standards".

I am not convinced that the kind of minimum harmonisation that results from certain directives leaving plenty of options and room to manoeuvre to Member States is fit for purpose when our economies and policies are interdependent and when Member States have committed to fiscal discipline – at least in words.

This should be a case for full harmonisation. This is to say that what we need is the same single set of high-quality accrual accounting standards for all public sector entities in the EU.

The Commission is proposing to move to European standards: so called EPSAS. This set of standards (that we are discussing even before it exists) would be based on the international standards, the IPSAS, and the Commission helpfully states that it would be important to avoid unnecessary divergence between EPSAS and IPSAS – and between EPSAS and IFRS.

Indeed, IPSAS are the only internationally recognised set of public sector accounting standards. IPSAS and IFRS represent the most complete and sophisticated reporting frameworks. Therefore one should have very good reasons to move away from such best practice and to reinvent the wheel.

And by the way, there are already today government-controlled entities that report on IFRS and that may have to be consolidated in Member States' reporting. Therefore divergences will have an extra cost.

All this has already been said. So what I would like to do now is spend a few minutes asking a slightly different question: why is it that something that appears so beneficial and so obvious has not happened yet?

We had this discussion yesterday wondering why we are only 500 years late with double entry accrual accounting in the public sector. The only answer that was offered to this question was that the public sector is different.

Yes it is! banking is different, mining is different, e-business is different. I run a not-for-profit organisation and I have to apply accrual accounting.

To move forward it is important to understand what the obstacles can be and to look at other experiences such as the

Lessons learned in the private sector

In this respect, I would like to make 5 points:

1. Standard setting is different from lawmaking and we need to understand what this means for the development of standards and their harmonisation

2. Independence is a key element of good governance in standards-setting

3. The debate on whether to move to European or international standards should be objective and consider facts and strategic choices

4. Transition to a new set of standards takes time – but not eternity

5. The world is changing and reporting must change too

1. First of all, we need to understand that accounting standard setting is different from lawmaking.

A good standard must be technically sound and aimed at achieving the best possible solution. Standard-setting should remain at equal distance from all particular interests. I would say it is a more horizontal, cooperative multi-stakeholders and users-centric activity than lawmaking. Lawmaking is more likely to be a kind of top-down activity.

Unlike lawmaking – and especially European lawmaking – it may be difficult to make compromises in standard-setting, as a compromise is often a half-way solution.

In this respect, **European accounting harmonisation** has proved to be a difficult exercise and I'm afraid I have mixed feelings regarding the track record of the EU in this field.

If we look at IFRS for listed entities, we've done pretty well. Why? Well, I believe this is because we adopted as a whole a reporting framework that is set by a global independent standard setter.

I know there is often a tendency to IASB bashing. But if we're honest with ourselves and realistic, I do not believe that we would have been able to do a better job if we had created a European standard setter.

I'm afraid the recent experience of the review of the 4th and 7th Directives (the European accounting rules for entities that do not apply IFRS) provides ample evidence of this.

It started with very good intentions of the European Commission to modernise and simplify the Directives.

The sad reality is that the institutional debate in both Council and Parliament has not really been focused on producing a robust and sound harmonised accounting framework for the Single Market.

The outcome reflects more the influence of certain national resistance and of various vested interests then a real vision of the European public interest.

In terms of harmonisation, it is also a telling example: one of the stated objectives put forward by the EC was to reduce the number of Member States options. The result is that I think we're moving from about 54 options today to *66* tomorrow*.*

If we reduce our fiscal deficits like we reduce the number of legislative options, our children can legitimately worry.

2. Later today, you will be debating the governance of EPSAS as the governance of the IPSAS Board has been seen as insufficient.

If we are talking about accountability, due process and oversight, this is a good debate to have.

If we're looking at politicians' control over the standard setting process – directly or through the back-door – than, I'm afraid we're on a slippery road. The independence and technical excellence of the standard-setter should be paramount.

What we have observed in the private sector is that standards-setting can turn into a real battle field where national interests can go at war on a particular standard.

And I'm talking about private sector accounting (companies), a field that is likely to be a lot less sensitive to the Member States than their own governmental accounting. Therefore independence is a key element of good governance.

Whatever we think of the need for global comparability, I think we should reflect on the genuine value that provides an independent standard-setter and moreover a standard-setter that is not entrenched into our little European politics.

3. But there is also a parallel reflection that we need to have on whether comparability within the EU is enough or whether we should seek international comparability?

Efforts in the private sector have shown that this is a long and winding road – but an essential one. And it is good that the G20 and Commissioner Barnier continue to be committed to this strategic goal because it contributes to facilitating access to capital for European companies, attracting foreign investment and creating a level playing field.

What about the public sector? Well I guess one element we should seriously consider before answering this question is: who is buying EU governments' securities? Today the answer to this question varies from one Member State to the other, with some States where the debt is mostly in the hands of nationals or EU citizens and others where global investors have a greater stake.

What can we anticipate for tomorrow? Well I'm afraid that the only thing that is really growing these days in the EU, is not the economy, not employment, not population, not natural resources: it's our debt!

And where will be the capacity to finance this debt tomorrow? Probably outside of the continent. Therefore having global standards *may* have a positive impact on our capacity to attract global investors and finance our debt.

These elements together with the point I made earlier on the independence of the standard-setter will have to be carefully assessed before making a decision. In that sense, EPSAS could be an appropriate *interim* solution: a step toward global standards.

4. Another interesting lesson to be learned from private sector accounting is that the transition to a new set of standards takes time.

It will be necessary to consider the pros and cons of a big-bang or a phased approach. The respective costs and benefits will have to be assessed, but I assume that political reality will also have to be factored in.

It may be that the new standards would gradually spread out to the entire public sector from layer to layer. It may be that we need to go through a phase where convergence amongst Member States would be encouraged, perhaps giving more time to Member States who have to take a bigger step.

But transition *must* have an end before it turns into leniency. In the private sector those who don't comply – worst: those who cheat with the rules – and I'm afraid this may happen in the public sector as well – expose themselves to serious consequences. Independent courts can and do impose severe sanctions, including jail, which I agree in the case of a Member State may be somewhat difficult, but we need to take compliance seriously – and experience has shown that we don't necessarily always do so, and that most of the time, this has a dramatic cost.

5. Apparently another issue is concerns around the stability of Standards

And indeed stability matters. But the right balance is always difficult to strike because the world is changing and reporting must adapt.

There are new challenges that become blatant and that should be addressed. We do not only have a problem with the sustainability of our debt, we also have a problem with the sustainability of our natural capital and our social model. Reporting has a role to play to help identify and measure – and therefore address – such problems.

In the private sector, reporting continues to evolve and improve. One of the most promising innovations is *Integrated Reporting*: an attempt to make the link between financial reporting and reporting about environmental, social and governance matters. It is a way of looking at the value creation process over the short, medium and long term. You could say that this line of thinking is in the same vein as the "Beyond GDP initiative".

Once the long overdue reform of public sector accounting will be on track, it will be important to continue improving and respond to the information needs of decision-makers, investors – and citizens.

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Indeed in reality what we are discussing today is <u>NOT</u> about accounting. Public sector accounting standards are only a means to an end; a means to contribute enhancing political accountability and securing the sustainability of our public finance but also of our social model.

It is a critical public interest issue that the EU Institutions and the Member States have a major responsibility to act upon – but they may need the help or even a little bit of a push from civil society. Professional accountants are ready to contribute advancing this key public interest issue.

Thank you