

# Are the EU Member States Ready for EPSAS?

## The European Public Sector Accounting Standards from the Perspective of European Experts

Abridged English Version



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# 1. EPSAS as a Result of the European Debt Crisis

The ongoing cohesion process of the European Union is hindered by the persistent debt crisis in most of the Member States in Southern Europe, by isolated national fiscal policies, and by a high level of heterogeneity in government fiscal reporting systems in the individual EU Member States. This makes it very difficult to assess the fiscal condition, in particular risks and opportunities, debts and assets, and the inherent threats to budgets and budgetary policies. Despite a clear trend of reform in converting from the cash accounting method to the accrual accounting method, this process has not led to a homogenous situation in public sector accounting across Europe. The EU Commission initiated a reform process in 2012 as a response to the debt crisis in November 2011 and because of the continuing and sometimes enormous burden of national debt and of the financial interdependence of the EU Member States. Its objective was to develop standards to be based on a private sector accounting philosophy and mainly on International Public Sector Accounting Standards (IPSAS) derived from IFRS.

Today the European Statistics Agency, Eurostat, has been commissioned to explore and to create uniform accounting standards for the EU. After having started with public consultations in 2013 and having held working groups, the reform path is now clear: although IPSAS could not be fully used as a basis, they were regarded as useful to provide a framework for developing the European Public Sector Accounting Standards (EPSAS).

At the macro level EPSAS should, from the European Commission's point of view, ensure better monitoring (and eventually governance) of the financial, economic and structural reform policies of EU Member States. At the same time the aim of EPSAS is to improve the quality and validity of European financial statistical data. At the micro level (for instance at local and state levels), EPSAS should additionally improve the transparency of the financial position of national governments and facilitate benchmarking fiscal performance information across borders. Furthermore, EPSAS should strengthen the accountability of public decision-makers and ultimately promote sustainable fiscal policies. |

## 2. The Survey and Its Design

In order to obtain an overview of previous accounting reform experiences and to evaluate future ways to reform and to modernise, KPMG in Germany conducted a scientific study of public accounting in Europe. Executives in ministries at the national level of government (in particular Ministries of Finance, Treasury, Ministries of the Interior or Ministries of the Economy) were questioned. Seventy-five

decision-makers and budget officials from 24 European countries took part in the standardised online survey acting as an expert panel on public finance and accounting. Responses from all EU countries (including the United Kingdom) and Switzerland, except Bulgaria, Estonia, Hungary and Croatia, were received. The findings were first published in German in 2018. |

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## 3. Key Results

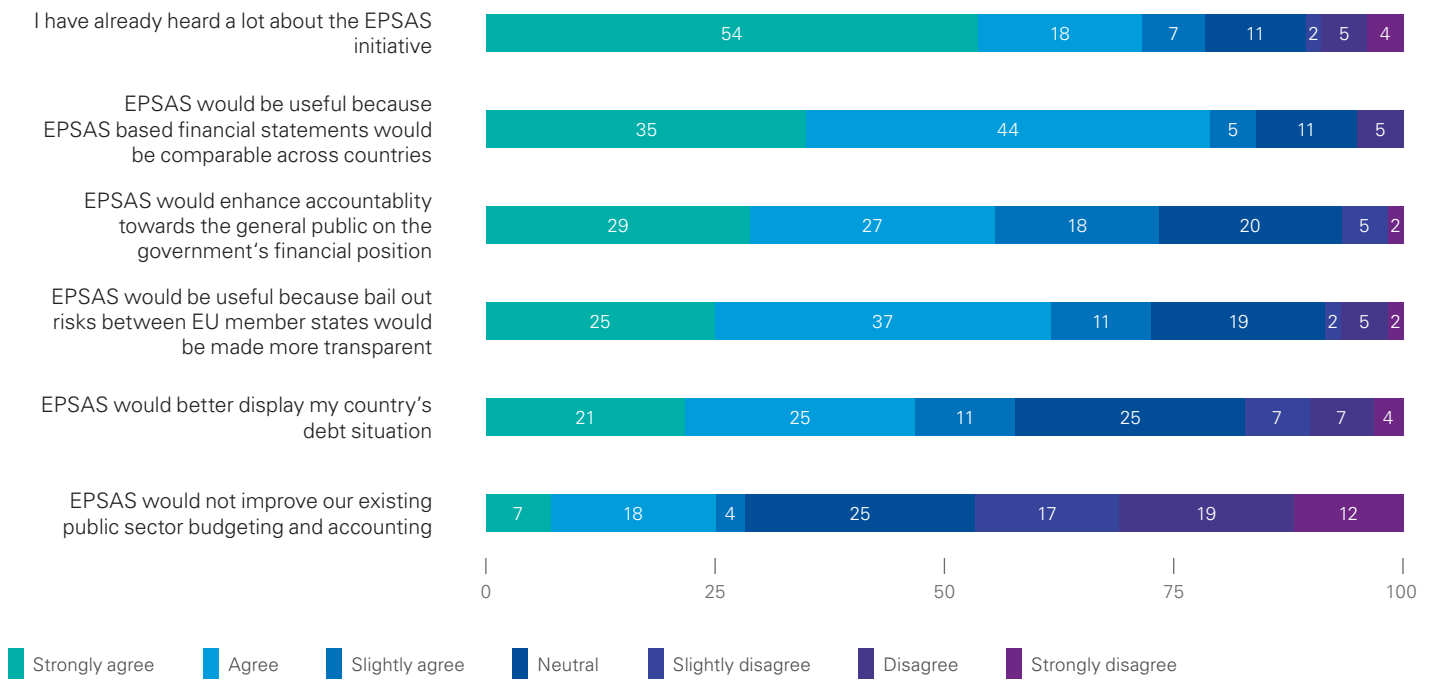
### EPSAS are well known and deemed as useful for benchmarking, reporting and evaluating bail out risks

Although public accounting in Europe is characterised by a high degree of heterogeneity, a trend to accrual accounting can clearly be seen. The survey respondents generally assessed EPSAS as being positive (see Figure 1). The EPSAS initiative was not only well known to those surveyed (79%), but the objectives announced by the EU Commission were also confirmed. Eighty-four percent of the respondents believed that comparability among Member States would increase with EPSAS-based financial statements. Almost three-quarters (73%) of the respondents confirmed that introducing EPSAS would enable bail out risks between EU member states to become increasingly more transparent. In addition, 74% affirmed the general suitability of EPSAS to account for the government's financial position towards citizens. The issue of EPSAS not improving existing public sector budgeting and accounting has clearly to be viewed in connection with conversion dates to accrual accounting. The further the change lay in the past (accounting maturity), the greater the agreement was that EPSAS would not lead to any improvement.

### EPSAS conversion: experts expect high conversion and training costs, half of them see their organisation ready

Concerning reform costs within a public organisation, 91% of the respondents saw a high need for training employees should EPSAS be implemented (see Figure 2). The participants also expected high conversion costs (70%) and a high demand for external consulting services (65%). Apparently, the high response rate for wanting a third party to cover costs (e.g. the European Union) was strongly linked to the statement that the EPSAS reform would trigger high conversion costs. On the other hand, half of the experts surveyed saw themselves as ready for the EPSAS reform from an organisational point of view.

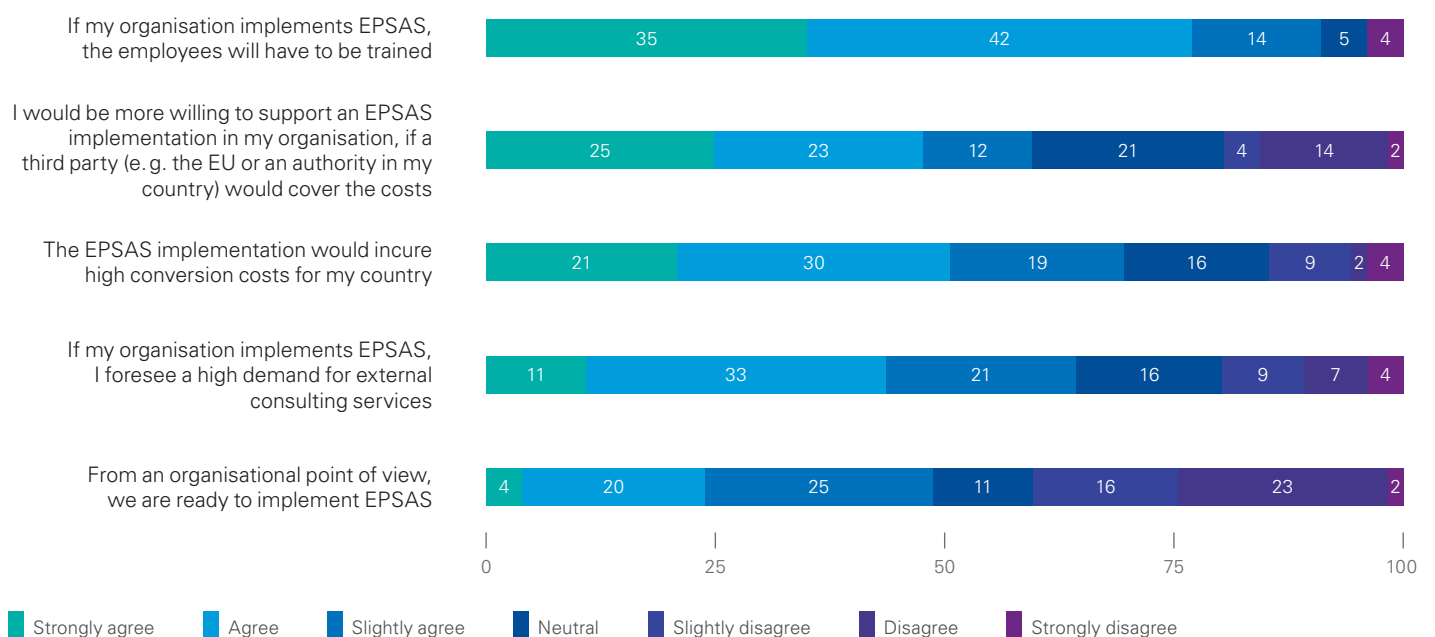
**Figure 1: Assessment of the EPSAS Project (figures in percent; n=57–56)**  
**To what extent do you agree with the following statements?**



Deviations from 100 percent are due to rounding errors.

Source: Own illustration, 2018

**Figure 2: Assessment of the reform requirements for introducing EPSAS (figures in percent; n=57)**  
**To what extent do you agree with the following statements?**



Deviations from 100 percent are due to rounding errors.

Source: Own illustration, 2018

### About 90 percent assumed EPSAS would be adopted – regional differences regarding the date

Concerning the question as to when decision-makers expected EPSAS to be introduced, it appeared that almost two-thirds expected EPSAS to be introduced within the next 10 years. Eleven percent forecast this introduction to be in more than 15 years and only 13 percent did not believe it would ever be introduced (see Figure 3). Regional differences are substantial: respondents from eastern or southern nations expected earlier conversion dates than those from western countries.

### IPSAS – regarded as adequate for certain accounting purposes, but a need for simplification for smaller entities

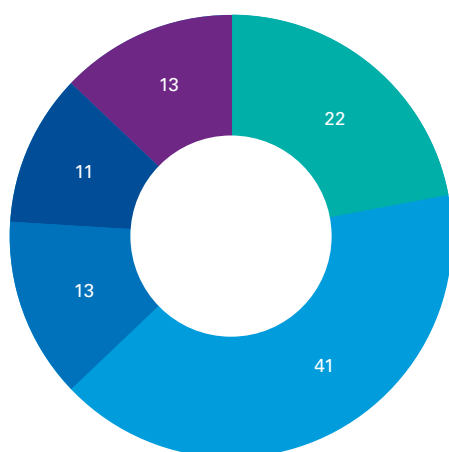
The decision-makers were also asked about IPSAS. Three-quarters of the respondents argued that IPSAS are an adequate basis for valuing public assets (see Figure 4). Sixty-nine percent confirmed that IPSAS were adequate for group accounting in the public sector (whole-of-government accounting). On the other hand, experts indicated a need for improving the existing IPSAS. Three quarters of the respondents (73 %) highlighted the need for simplification and exemption rules, especially for small entities. With regard to the general suitability of IPSAS for public sector accounting and to a need for EPSAS to be the new standard, respondents clearly did not support or reject the statements given. A similar, even more balanced picture resulted from the responses to the issue of IPSAS being good for reducing public debt.

### IT – a third see their systems ready for EPSAS

Past cost estimations have proven the high impact conversion will have on IT infrastructure facing a conversion to the accrual accounting system. Forty-nine of the respondents in our study saw a need for bigger adjustments in their IT infrastructure if EPSAS were to be introduced (see Figure 5). In contrast to this, only 13 % of the respondents had already performed an IT system check for assessing its readiness for EPSAS. On the other hand, 35 % of the experts indicated that their IT architecture had already been prepared for EPSAS.

In terms of the costs triggered by an EPSAS-related conversion of the whole IT infrastructure, decision-makers appeared uncertain. Only 9 % of the respondents had set up a budget for such a transition. According to Figure 3, only 22 % expected EPSAS to be introduced within the next 5 years. Against this background, it did not seem surprising that only a few respondents included potential IT costs in their current financial planning. Nevertheless, three quarters of the respondents would like to perform an assessment of their IT architecture in order to identify any potential risks related to implementing EPSAS.

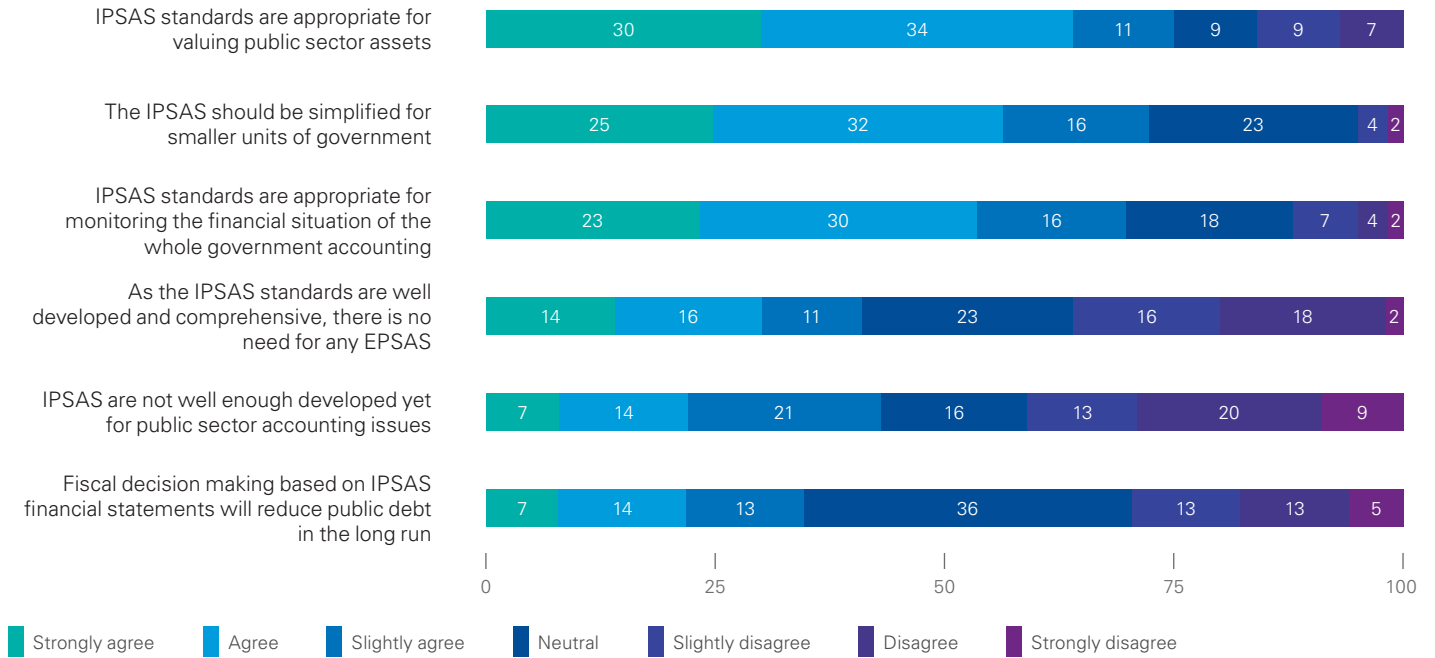
**Figure 3: Expected conversion date to EPSAS (figures in percent; n=54)**  
When do you expect your organisation to introduce EPSAS?



■ within the next 5 years ■ within the next 10 years ■ within the next 15 years ■ much later ■ never

Source: Own illustration, 2018

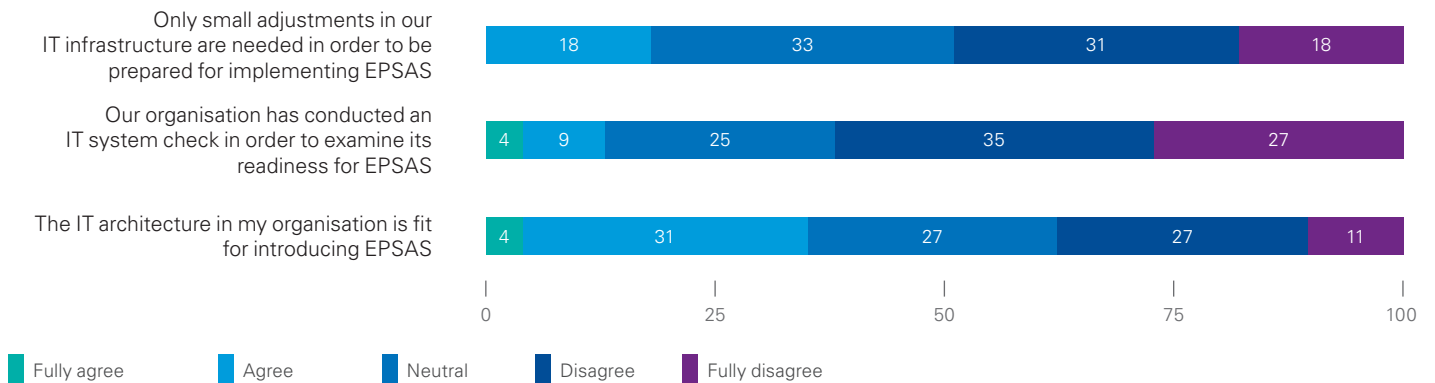
**Figure 4: Attitude towards IPSAS (figures in percent; n=57–54)**  
**What is your opinion on IPSAS?**



Deviations from 100 percent are due to rounding errors.

Source: Own illustration, 2018

**Figure 5: IT system readiness for introducing EPSAS (figures in percent; n=55)**  
**To what extent do you agree with the following statements?**



Source: Own illustration, 2018

### EPSAS readiness varies from country to country and correlates to a country's debt level

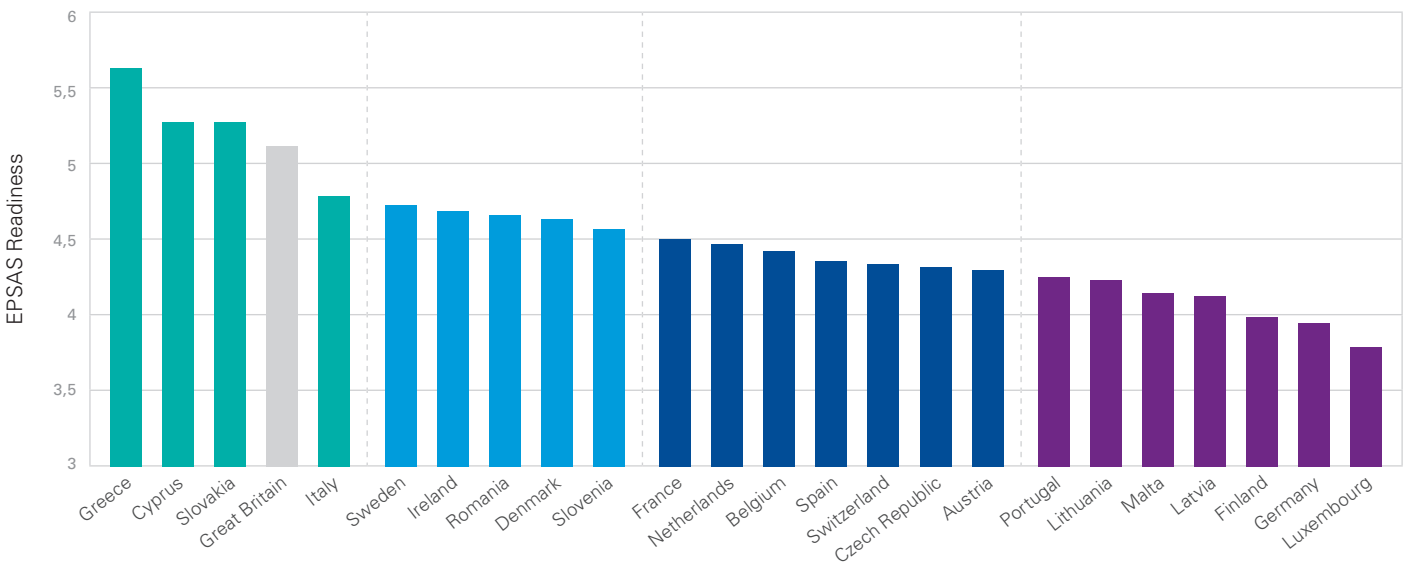
In order to be able to assess a country's readiness for implementing EPSAS, an index was formed in order to consolidate respondents' assumptions regarding reform readiness. This index consisted of five influencing factors:

- Knowledge (What information about the EPSAS initiative do the experts already have?)
- Benefit (What perceived added value would EPSAS provide?)
- People (How well prepared is staff for the possible reform?)
- Structure (How do participants appraise the organisation's condition for implementing EPSAS?)
- Budget (Are cost estimates available regarding the EPSAS initiative?)

An EPSAS readiness matrix was developed by taking all of these factors into account. With regard to EPSAS readiness across Europe, a very heterogeneous picture emerged (see figure 6). Among the top five countries, Greece, Cyprus and Italy showed a rather unfavourable fiscal situation. Britain already has an IFRS-based accounting system, which would mean a rather small step towards IPSAS-related standards. Behind Italy, a group of countries followed that have a rather favourable fiscal position, e.g. Sweden, Denmark, Romania. The last group consisted of countries such as Latvia, Lithuania, Malta and Portugal. The latter adopted IPSAS in 2017 and received EU funding for the conversion. Finland, Germany and Luxembourg are at the bottom of the readiness ranking; they shared a good financial status and were possibly rather reluctant towards converting to EPSAS because their current systems seemed to be sufficient.

The assumption that there is a correlation between the aggregated expert estimation of being ready for the EPSAS reform and the fiscal situation in each country was confirmed as shown by EPSAS readiness in relation to each country's public debt in 2016 (measured in relation to gross domestic product). Respondents from countries with a higher ratio of public debt showed a corresponding higher level of EPSAS readiness. |

**Figure 6: EPSAS readiness across Europe – country based display of survey participant's attitude towards an adoption of EPSAS**



Source: Own illustration, 2018

# 4. Policy Implications

## Accrual accounting has become the reference system in Europe

The EPSAS initiative can be judged as an approaching reform that will affect federal, state and most likely local levels of government across Europe. It is expected that an EU legislative process will require EPSAS to be implemented within the next decade. Until then, the majority of European Member States will not only have changed their accounting systems from the cash accounting system to the accrual accounting system on a voluntary basis, but their systems will closely be oriented to IPSAS. Therefore, a general discussion of a harmonized European accounting regime such as EPSAS makes sense. Those European countries that have already moved to IPSAS will only be faced with a minor effort of adjustment should it become mandatory to implement EPSAS. It may be assumed that these countries will support the EPSAS initiative and perhaps even promote it.

## Standardisation as a feature of modern fiscal management

This study shows that the experts interviewed perceived the EPSAS project of the European Commission to be a rational idea. The EPSAS initiative is well known and the objectives announced such as enhanced fiscal comparability among member states and their bail-out risks have been confirmed. Half of the respondents even stated that from an organisational viewpoint, they are currently ready to introduce EPSAS. Yet, EPSAS readiness apparently depends on a country's fiscal situation. Public debt levels and public accounting reforms seem to correlate. Thus the question on the table is how much EPSAS accounting and EPSAS-based financial statements will influence public budget management and fiscal policy behavior.

## An inclusive approach to public budgeting and accounting is needed

Our study shows that a public budget system that systematically uses data from an accrual accounting system for budget planning can scarcely be found in any of the EU Member States. However, the budget continues to be the main control instrument for the public sector. If accounting has an accrual character and budgeting is still cash-oriented, there is a risk that decision-makers will continue to decide on a cash basis. Against this background, it is important that the EPSAS reform also includes budgeting and outlines rules for a budget based on accrual principles. It would therefore be necessary to develop recommendations for a unitary budget system among the Member States in line with the development of EPSAS.

## Accrual Debt Brake

Europe is facing a sovereign debt crisis, which seems barely manageable politically and economically. Along with low interest rates and a lack of sanctions in the case of poor fiscal policies, the debt crisis may have been caused or at least intensified by a lack of transparency in traditional public budgeting and accounting procedures. If a mandatory harmonised EPSAS-based budgeting system proves to be unrealistic as prescribed for the Member States (due to the character of sovereign states), we should think about strengthening European institutions by monitoring Member States and developing debt rules, regulations and sanctions based on accrual accounting. |

## Contact

### **KPMG AG Wirtschaftsprüfungsgesellschaft**

Klingelhöferstraße 18  
10785 Berlin  
Germany

Mathias Oberndörfer  
Head of Public Sector  
T +49 30 2068 4971  
moberndoerfer@kpmg.com

[www.kpmg.com/government](http://www.kpmg.com/government)

### **Institut für den öffentlichen Sektor e.V.**

(Public Governance Institute)  
Klingelhöferstraße 18  
10785 Berlin  
Germany

Dr. Ferdinand Schuster  
T +49 30 2068 2060  
de-publicgovernance@kpmg.com

[www.publicgovernance.com](http://www.publicgovernance.com)

## Authors:

Prof. Dr. Dennis Hilgers  
(Johannes Kepler University Linz)

Markus Frintrup  
(Johannes Kepler University Linz)

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