



Sustainable public finances – EU perspectives

# Ten key insights

Drawn from a discussion series with senior policy-makers and stakeholders



# Introduction

This report sets out ten key insights drawn from the 2013 discussion series on 'Sustainable Public Finances – EU perspectives' organised by ICAEW, with support from PwC. These insights are designed to enhance understanding of the specific challenges of achieving sustainable public finances among policymakers and stakeholders engaged in the highly topical EU debate of how to move forward public sector accounting and financial management in Europe.

The global financial and economic crisis revealed the poor quality of financial management, reporting and governance within much of the public sector, stemming in particular from the inadequate application of accruals, accounting and budgeting, and the management of government balance sheet assets and liabilities. The causes and consequences of the crisis were far broader, but the shortcomings in accounting and financial management are now widely recognised in Europe and across the world.

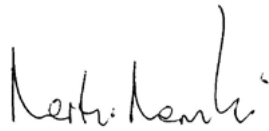
Government accounting standards and arrangements remain extremely diverse in Europe. According to Eurostat, taking into account all tiers and branches of government and the public sector across EU member states, no two countries currently have the same system or apply the same standards. A major debate is taking place within the EU on the best way to improve public sector accounting standards across Europe. Eurostat is leading an ongoing project to develop European Public Sector Accounting Standards (EPSAS).

Important developments are also taking place at the international level with regard to International Public Sector Accounting Standards (IPSAS). Oversight and governance, as well as the accounting standards themselves, are key issues within the debate.

ICAEW, with PwC, convened a series of four separate meetings to address in turn specific areas within the overall area of sustainable public finances. Each discussion drew together a wide range of policymakers, interested organisations and experts, to provide a stimulating multi-perspective analysis of key challenges and priorities. A synopsis capturing the major aspects was published after each discussion. This report distils the key insights from these synopses. We hope that it can help inform debate on the best way forward in the public interest.

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We would be delighted to receive comments on this publication, to be sent to [europa@icaew.com](mailto:europa@icaew.com)



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# Ten key insights

Ten key insights for achieving better public finances in the EU based on democratic accountability and fiscal sustainability

1

## Shortcomings mask the real picture and pose major risks to the public interest

The shortcomings in the current state of accounting, reporting and financial management within much of the public sector in Europe constitute a major risk for the sustainability of public finances in many European countries. They effectively mask the real financial picture of member states, making it difficult for the wider public and government stakeholders to understand the true and complete picture of public finances. The areas of public sector pensions and the debt of quasi-governmental entities are common examples of acute shortcomings in accounting and reporting. At stake is the capacity of governments to take and implement decisions which affect the public interest today and in the future. The consequences of neglecting public sector liabilities and inadequate management of public debt have been all too visible in Europe, through the impact of austerity. Action in a number of areas is urgently needed if EU member states are to tackle medium and long-term challenges to their public finances; including managing costs of changing demographics and ensuring public investment for future growth. Therefore, it is a critical public interest issue to address the current shortcomings.

2

## Public sector is multi-faceted and tiered

It is essential to recognise the multi-faceted and tiered structures of national government. The allocation of public resources between central, regional and local government always generates debate. In periods of austerity, these debates can become very intense. Reliable information, drawn on the basis of common accounting systems which accurately recognise liabilities and assets, is essential to inform decision-making between central, regional and local government. It creates a common language which is required to deal with what can become serious strains on previously accepted fiscal arrangements between localities and regions within member states. Similarly, account needs to be taken of the various entities and other branches of the state where, as experience shows, large liabilities can develop with significant impact on national finances. Recognising that the public sector is multi-faceted and tiered is therefore also a critical part of the overall picture, both for individual member states as well as for broader EU economic governance.



# 3

## Accountability is key to well-functioning democracies

Achieving sustainable public finances is always challenging; even more so if the starting point is one of significant imbalances. Sharp adjustments, such as austerity measures, can undermine trust in the ability of governments to maintain basic safety nets, thereby also encouraging the emergence of populist movements on the right and left of the political spectrum. While they can take time to deliver results, effective accountability structures can however provide a critical bulwark against excessive demands, allowing proper costing of policies and debate regarding financial impacts. Greater transparency and comparability will also help to underpin informed and properly functioning democratic processes where the use of public monies is concerned. Accounting systems are a key building block providing the information on which the whole accountability structures depend. Taken together, a strengthened 'accountability community', with different intermediaries helping to transmit intelligible information to citizens and politicians, is essential to embed democratic accountability. Democratic accountability also needs to constantly evolve; it is not static but needs to ensure proper accountability at the various points where executive decisions are taken, including at national, EU and global levels.

# 4

## Financial literacy needs to improve

A more effective and informed process of democratic accountability also depends on improvements in the financial literacy of citizens, politicians, administrators, journalists and other stakeholders. This is particularly challenging when it comes to debates on fiscal sustainability which can be very complex and hard to understand. Without ascribing unrealistic expectations of citizens, a basic grasp of the extent of the current and future fiscal difficulties confronting EU countries, should help deliver a more informed debate with greater demands for accountability. Popular pressure for greater accountability is primarily enacted via democratic elections. However, greater awareness of the connections between financial markets and public finances can also help ensure citizens play a more active role in demanding effective accountability and better long-term fiscal sustainability.

# 5

## The cost of not reforming is higher than the cost of reform

Reform in many member states to embed accruals based accounting throughout the public sector and put in place the right systems and processes is critical to achieving sustainable public finances in Europe. There will be costs associated with introducing such reforms. Furthermore, the reform process needs to be considered carefully in relation to specific steps to prepare the different key players in the process. At a time of scarce resources, questions inevitably arise as to whether member states can afford accounting and financial management reform. In reality, member states simply cannot afford not to pursue reforms in these spheres: the costs of not pursuing reform have to be considered, with full appreciation for the broad implications. Reforms are critical to improving the management of public resources in light of the ongoing debt crisis and to instil confidence among citizens regarding the ability of their governments to meet existing commitments and plan for the future. For all economies within Europe, and indeed economies operating on larger scales outside of Europe, growth is not sufficient on its own to achieve sustainability in the longer term without appropriate public sector accounting and financial management.





# 6

## Debate over standards must focus on information needed for decision-making

The debate in the EU over which path to take to harmonise public sector accounting standards is becoming more prominent, through the work of Eurostat as well as of individual member states. Questions concerning the governance required for standard setting as well as legal competence and appropriate legal instrument will doubtless figure prominently in the debate. Parallels can be drawn with the experience of reforming private sector accounting in Europe for listed companies. The EU debates take place in a broader international context, as the recent public consultation on the governance of IPSASB demonstrates. It is essential to ensure that the debate on the way forward in Europe pays due attention to the ultimate end game – which is to be judged on the degree of financial transparency and comparability achieved. Standards must provide the most appropriate starting point for those charged with decision-making in the public sector to make informed decisions regarding the longer-term sustainability of their national finances. The most important test will be whether standards provide the right and relevant information needed for such decision-making.

# 7

## Accounting is critical – but is one piece in the jigsaw

The introduction of accruals accounting is not an end in itself; in fact, it is just one piece in the jigsaw – albeit a critical one upon which all others in the financial management and governance systems depend. The move from cash accounting to accruals accounting will not by itself deliver sustainable public finances. To reap the full benefits of reform, a comprehensive change management and education process involving the broader financial management and governance systems of the public sector is required. Ensuring that appropriate systems and processes are in place is essential. Good accounts will not help if there is not full commitment within this broader context to use the information provided through accruals accounting in the decision-making process. Understanding and using the available information is equally important and requires the right development of skills and structures throughout the entire financial process. Other complementary instruments are required; this means ensuring proper evaluations of what happens in reality – not just in the financial statements. Forward looking sustainability statements could also be particularly helpful, to assist in tackling persistent medium to long-term challenges to the public finances of member states. Fiscal consolidation in the face of such challenges needs to be addressed with care and requires strong financial leadership; accounting is critical to the provision of information for those responsible for making such decisions.

# 8

## Financial markets have a role to play

International financial markets have a key role to play in contributing, along with other interested stakeholders, in the reform of public sector accounting and reporting. Bond issuance by governments outstrips many times that of private companies, thereby confirming that financial market players have a major stake in this area. To date, there has tended to be limited direct engagement by financial markets' representatives on issues relating to public sector accounting and reporting by individual countries or regions. However, the influence of international financial markets has been considerable, particularly through its signalling of a lack of confidence in the financial position of certain countries. A more direct engagement by markets on the underlying financial management of countries could be beneficial, as it could act as a catalyst for reform. Together with an increased engagement by citizens as well as the efforts of interested stakeholders, markets can exercise an important influence to help achieve change in the right timeframe.



# 9

## Lessons can be drawn from international organisations

International organisations have a wealth of insights that can help the current debate taking place in the EU on reform of public sector accounting and broader public sector management. Their global perspective on country reform efforts as well as their own experiences of implementing accounting and management reforms can be highly instructive. It is important that broader benefit is drawn from the key lessons learnt. There is a risk that the receptiveness to the lessons could wane and that the drive to pursue reform measures could slow down. To some degree, this may reflect the view that the reaction to the crisis did not always mirror the appropriate sense of urgency. To encourage change, the different drivers of reform need to be clearly identified. This will also require the interaction between elected politicians and citizens to be based on a more informed understanding of existing and longer-term financial realities. It is also important that the benefits of reform are communicated more broadly – and in this respect the positive experiences which have already been achieved by international organisations as well as some individual countries could be instructive.

# 10

## Europe can play a leadership role in the world

The EU has a key opportunity to drive reform in public sector accounting and financial management. As in the case of private sector accounting where the EU championed global standards through IFRS, the EU could again play a leadership role in the world. There is a risk that short-term considerations at national level may block or slow progress, on the grounds that the recognition of liabilities would worsen the financial balance sheet of some governments. For this reason, the incentives for promoting and embedding reform require careful consideration. A shared and positive agenda is needed, which could be based on a common determination to ensure that Europe maintains its current high standards of living and quality of life. To achieve this, better accounting and financial management is critical. A mandatory push to achieve this, such as the use of legal instruments as envisaged in the Eurostat project is one way forward. Greater attentiveness to financial reporting and management by member states could help drive reform, not least through a type of competitive peer pressure. In any event, the path towards better financial reporting needs to be seen as part of a broad consensus to enhance management, transparency and accountability of national governments across the EU in order to address an acute public interest need. In this respect, Europe can also give a clear signal of international leadership.



# Appendix

## Organisations that participated in the 2013 'Sustainable Public Finances: EU perspectives' series:

Belgium Federal Government

Cabinet of the President of the European Council

Centre for European Policy Studies

Conseil de normalisation des comptes publics (France)

Delegation of the Government of Catalonia to the EU

DG Budget, European Commission

DG Economic and Financial Affairs, European Commission

DG Internal Audit Service, European Commission

Dutch Court of Auditors

*Economia*

European Central Bank

European Centre of Employers and Enterprises providing Public Services

European Court of Auditors

European Group of International Accounting Networks and Associations

European Parliament

European Savings Banks Group/World Savings Banks Institute

European Stability Mechanism

Eurostat

Federation of European Accountants (FEE)

Finance Watch

Ghent University

House of the Dutch Provinces

ICAEW

Institut des Réviseurs d'Enterprises/Instituut van de Bedrijfsrevisoren

International Federation of Accountants (IFAC)

International Integrated Reporting Council

International Public Sector Accounting Standards Board (IPSASB)

Interpol

Lombardy Region – Presidency Delegation to the EU

North Atlantic Treaty Organisation (NATO)

PensionsEurope

Public Interest Oversight Board (PIOB)

PwC

Representation of the State of Baden-Württemberg to the EU

UK Financial Reporting Council

UK National Audit Office (seconded to Department of Health)

University of Aberdeen Business School

University of Athens

University of Birmingham

Welsh Government

World Bank



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