



Opportunities and risks of European Public Sector Accounting Standards from a normative perspective

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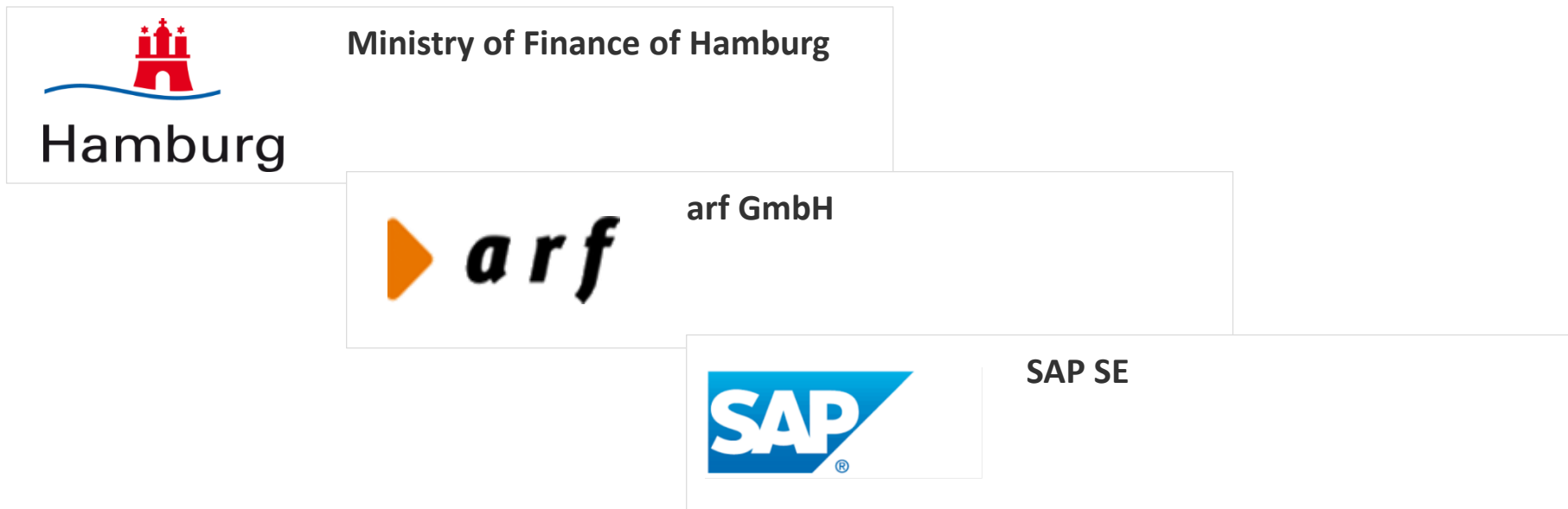
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Introductory remarks

- The Proof of Concept study (POC study) is a joint project of



- The POC study examines the practicability of European Public Sector Accounting Standards (EPSAS) in Hamburg, Germany.
- Why Hamburg? Because it is the only federal state in Germany with an **accrual-based accounting and budgeting system**.

1

Introductory remarks


- Theoretical basis for the POC study:

International Public Sector Accounting Standards (IPSAS) offer accounting options that enable users to produce **two different kinds of financial statements**.



Cost based

- Prevents the use of profits available only when the economic situation is favourable
- Protects creditors and future generations
- Allows for the creation of hidden reserves
- Provides a solid basis for long-term budgetary planning and the observance of fiscal rules



The result reflects the principles of public sector accounting in Germany.

Fair value based

- Presents a true and fair view on the current financial position
- Basis of valuation subject to fluctuations in line with economic cycles
- Prevents the creation of hidden reserves

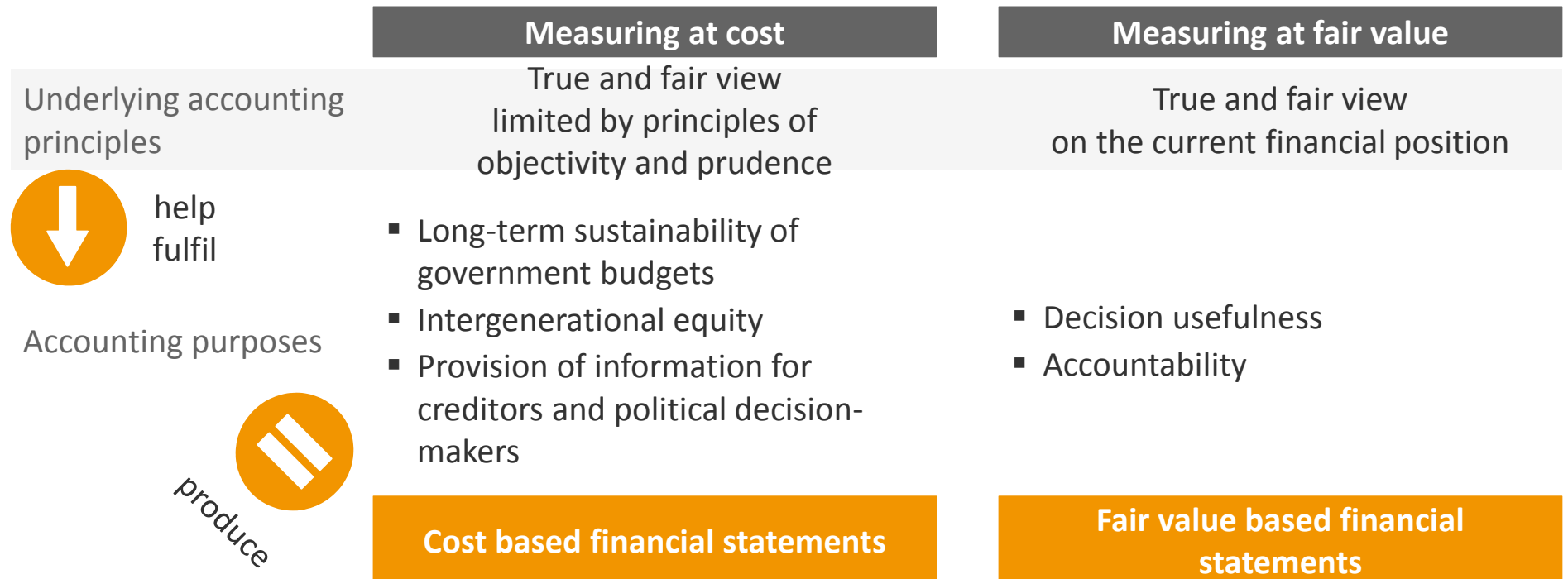
The result does not reflect the principles of public sector accounting in Germany.

1

Introductory remarks

- Theoretical basis for the POC study:

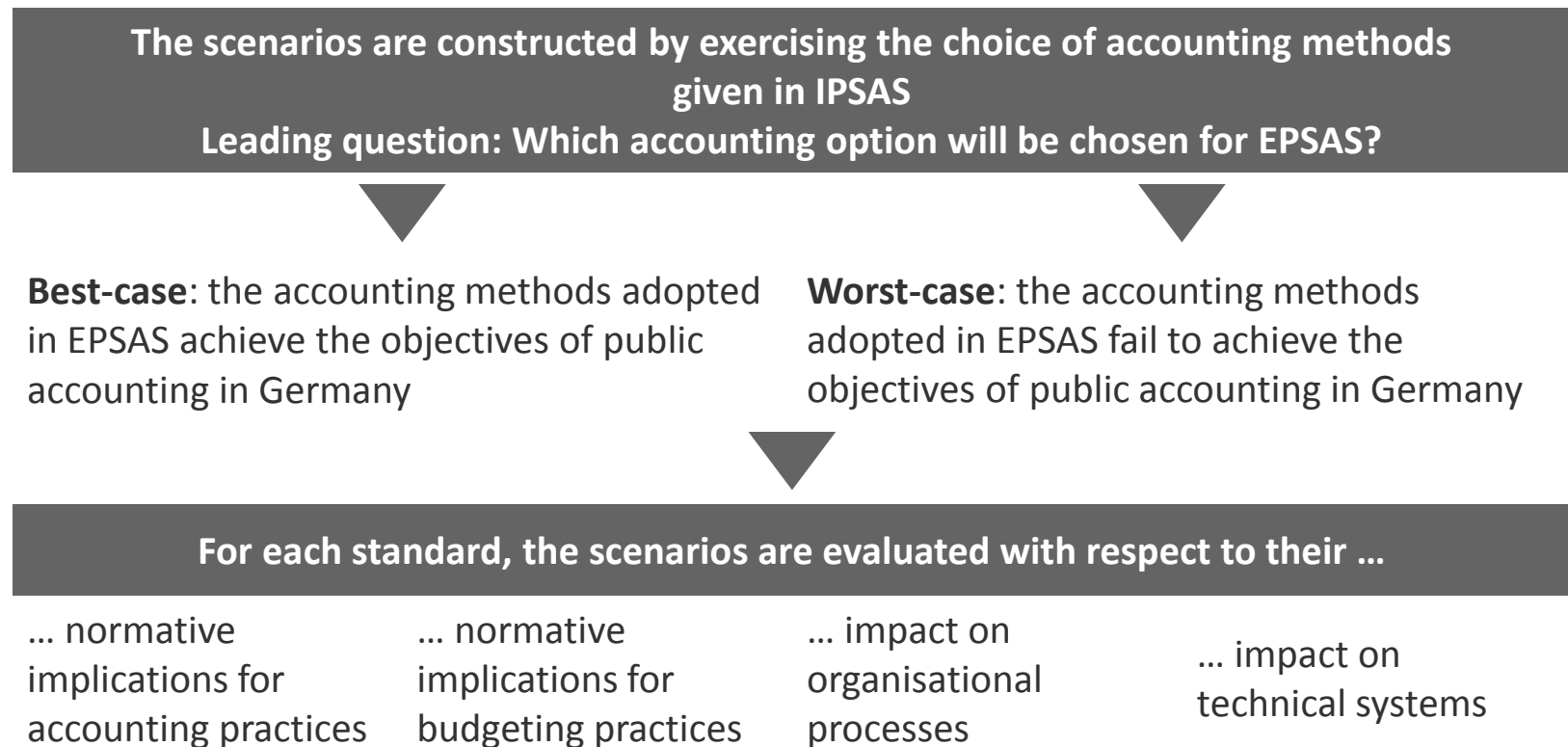
By choosing one of the accounting options – measuring at cost or at fair value – users also choose between different accounting principles.



2

Methods of the POC study

- Based on the theoretical concepts, the POC describes the best-case and worst-case scenario for each future EPSAS from the perspective of Hamburg.
- In the absence of officially defined EPSAS standards, 30 IPSAS standards are evaluated.



3

Results of the POC study

- Under the **best-case scenario**, Hamburg already fulfils a majority of the requirements of IPSAS.
- Still, even the best case creates a need for adjustment. Additional expenditure is due to



- the valuation of financial statements;
- adjustments in the system of accounts;
- increased number of users of financial statements;



- segment reporting;
- disclosure in the notes to the financial statements;
- valuation rules for investment property.

- A risk for additional expenditure arises from the development of new IPSAS on social benefits and government grants.

3

Results of the POC study

- Under the **worst-case scenario**, the situation for Hamburg worsens significantly as it involves considerable expenditure and requires additional justification of budgetary decisions.
- Additional expenditure is due to



- the valuation of financial statements;
- adjustments in the system of accounts;
- increased number of users of financial statements;
- measurement of assets at fair value;
- measurement of tax revenue;



- adoption of IFRS by GBEs;
- segment reporting;
- separate depreciation of significant parts and revaluation of assets;
- disclosure in the notes to the financial statements;
- valuation rules for investment property.

4

Conclusion

- International and national accounting standards and laws have different purposes, e.g.

IFRS	IPSAS	German standards for accrual-based accounting in government entities	German Commercial Code
		Protection of creditors and intergenerational equity	Protection of creditors and capital maintenance
Decision usefulness	Decision usefulness	Transparency (provision of information)	(Provision of information)
(Stewardship)	Accountability	Legitimize budgetary decisions and actions	Accountability

- In the light of the EPSAS-project's objective (as indicated in Directive 2011/85/EU), it seems useful that an EPSAS framework will define purposes similar to those of German budgetary law.
Thus, it can be assumed that EPSAS will produce cost based financial statements.

4

Conclusion (theoretical background)

The purpose matters: numerical fiscal rules vs. capital market information.

Principle of government financial reports

Future benefits (capital)	Future burden (debts)
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Financial report of Hamburg 2014 (bn €)

		Equity	-- (0%)
Fixed assets	44,4 (77%)	Special items	1,3 (2%)
Current assets	2,8 (5%)	Pension provisions	25,8 (45%)
Other assets	0,3 (1%)	Other provisions	1,9 (3%)
Deficit	10,0 (17%)	Liabilities	28,5 (50%)
Total	57,5 (100%)	Total	57,5 (100%)

- The **fundamental principle of budgeting** states that debts (future burden) should be incurred only in order to make investments (future benefits). Therefore, assets are measured based on their amortised cost of acquisition or production and liabilities are measured at their nominal value.
- Following the **rules of capital market information**, however, an asset's current value is contrasted with the fair value of liabilities. This current value is fluctuating in line with economic cycles, especially between periods of boom and crisis.
- The primary purpose of public accounting and government financial reporting is to **protect creditors and future generations** with the help of a normative concept.
- Therefore, political decisions require **reliable and objective data that is readily intelligible** and, moreover, **is not fluctuating between economic cycles**.

4

Conclusion

- The European Commission's efforts provide a good **opportunity to harmonise and modernise** public accounting (and budgeting) in EU Member States, especially in Germany.
- To achieve this objective, **EPSAS should specify valuation rules.**
- The process for developing EPSAS should start by establishing a **general framework** that defines **accounting purposes** and lays down **accounting principles.**
- We recommend that **EPSAS adopt the purposes and principles** of public sector accounting as defined, for instance, by the **fundamental principle of budgeting** (future debts \leq future benefits).
- The result of choosing one of the accounting options given in IPSAS should therefore be **cost based financial statements**, which help to determine the leeway for budgeting decisions and to ensure future generations' capacity to act.

Thank you for your attention!



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