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Our ref: ICAEW REP 32/14

EUROSTAT D4
GFS quality management and government accounting
European Commission
Eurostat D4
BECH B4/401
5, rue Alphonse Weicker
L-2721 Luxembourg

By email: ESTAT-EPSAScontact@ec.europa.eu

Dear Sir or Madam,

European Public Sector Accounting Standards

ICAEW is pleased to respond to your request for comments on *Towards implementing European Public Sector Accounting Standards (EPSAS) for EU Member States - Public consultation on future EPSAS governance principles and structures*.

In our response, we have included a number of additional observations under the 'Major Points' section to those raised by the specific questions in your questionnaire. We see this as necessary to appropriately frame our response to the consultation exercise.

Please do not hesitate to contact me or my colleague Simon Tosserams (Simon.Tosserams@icaew.com; +32 (0)2235 0616) should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

PUBLIC CONSULTATION ON FUTURE EPSAS GOVERNANCE PRINCIPLES AND STRUCTURES

Memorandum of comment submitted in February 2014 by ICAEW, in response to Eurostat consultation paper on *Towards implementing European Public Sector Accounting Standards (EPSAS) for EU Member States - Public consultation on future EPSAS governance principles and structures* published in November 2013.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on the consultation paper *Towards implementing European Public Sector Accounting Standards (EPSAS) for EU Member States - Public consultation on future EPSAS governance principles and structures* published by Eurostat on 25 November 2013, a copy of which is available from this [link](#).

WHO WE ARE

2. ICAEW is a world leading professional membership organisation that promotes, develops and supports over 142,000 chartered accountants worldwide. We provide qualifications and professional development, share our knowledge, insight and technical expertise, and protect the quality and integrity of the accountancy and finance profession. As leaders in accountancy, finance and business our members have the knowledge, skills and commitment to maintain the highest professional standards and integrity. Together we contribute to the success of individuals, organisations, communities and economies around the world.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The ICAEW Europe Region is headquartered in Brussels and brings a pan-European perspective to ICAEW's work through regular interaction with professional bodies, firms, oversight authorities and market participants across Europe. It also engages with approximately 5,000 members in EU member states outside the UK. ICAEW is listed in the Transparency Register (ID number: 7719382720-34).

MAJOR POINTS

Support for the overall objective but not the proposed approach

5. As explained in our May 2012 submission to the previous Eurostat consultation on the assessment of the suitability of International Public Sector Accounting Standards (IPSAS) for use in Europe, ICAEW strongly supports improvements in accounting across EU member states in order to achieve greater accountability, comparability, transparency, governance and ethics in the public sector.
6. While we agree with the overall objective of Eurostat to achieve these improvements, we have significant reservations regarding the overall approach of establishing a new EPSAS standard setter. These reservations are enhanced still further given the principles and structures for EPSAS set out in the consultation document. While we commend Eurostat's initiative to advance better accounting and financial reporting in the European Union, we note that there is a fundamental difference in perspectives between statistical needs and financial reporting.
7. The UK experience over the last few years suggests that there is much that can be gained by having more than one well-founded viewpoint on a country's financial health, performance and potential economic future. In particular, the comparison of national statistical accounts and historical financial reporting (IFRS-based, but adapted, in the case of the UK) has raised helpful questions about what each shows, why the differences between them arise (due to their different objectives), and what can be learned from those differences; they each have their strengths and weaknesses. Specifically, national statistical accounts are a tool for evaluating, analysing and forecasting future economic development and growth at both a micro and macro level.
8. National accounts describe a national economy and how it works. Their inputs include business accounting, production, employment, productivity, monetary policy, inflation,

budgetary policy and so on, and in consequence in some ways they contain much more information than a set of government historical financial statements would. However, historical financial statements (which are produced using a set of accounting standards such as IFRS/IPSAS) give a wider picture of a country's assets and liabilities at a given point in time, particularly its real assets and longer term provisions and contingent liabilities, thus giving some information around the potential income that needs to be raised for known or expected future outcomes. They are also important as a stewardship mechanism to report to taxpayers and their representatives how public assets and revenues have been utilised.

9. National statistical accounts and historical financial statements should thus be mutually reinforcing when used as part of the overall strategic decision-making process; if done properly, the combination of the two approaches creates a whole greater than the sum of their parts. Much efficiency can also be gained by using as the basis for each proper accruals accounting, which generally gives a more rigorous and accurate picture of financial performance than cash accounting.

Improving public sector financial reporting across the EU: role of harmonisation

10. The EU's plans for achieving better public sector financial reporting in all member states must take into full consideration the fact that member states are at different stages in terms of their use of either cash or accruals-based accounting. Some member states are well-advanced in their financial reporting and are using high-quality international accounting standards such as International Financial Reporting Standards (IFRS) or IPSAS. We believe that the EU's forthcoming steps should focus at this time in helping member states that have not yet made the transition from cash accounting to a base line accruals accounting system. Therefore, a first milestone would be for all member states to identify how they will move from cash accounting to adopt accruals accounting and what they need to do to achieve this within a specified timescale. We do not believe that it is appropriate to pursue a policy of full harmonisation based on standards that are yet to be defined by a standard setter which, under the outline design in the Eurostat consultation, raises serious concerns regarding overall governance, independence and expertise.
11. The harmonisation approach proposed by Eurostat raises a major risk for some member states, which have already made considerable investment in their financial reporting practices and are using high-quality international accounting standards. These efforts may well be undermined. We support an EU approach which would ultimately lead to all member states' using high-quality international accounting standards for accounting and financial reporting and believe that the EU's efforts in this regard should aim to achieve this in the longer-term, with clearly defined milestones along the way. We do not consider that establishing an EPSAS system would achieve these goals.

International standards: EU influence and endorsement

12. The drive towards much-needed reform of public sector accounting standards in many member states needs to recognise the key role that international markets play in terms of government bonds and financing sovereign debt. The increasingly global financial environment in which member states operate makes it desirable for accounting standards to be comparable at the international level. Any approach that may result in distinct EU standards could distract attention and resources from the ultimate goal of achieving greater international transparency and comparability.
13. In our view Eurostat therefore needs to place more emphasis on the role and importance of international standard-setting and focus on the actions needed to allow the EU to play a larger role in the enhancement of existing standard-setting processes and the related governance mechanisms, coupled with an adequate endorsement mechanism for the implementation of international accounting standards in the EU.

14. In this regard, we note of the proposals for reform of the International Public Sector Accounting Standards Board (IPSASB), in particular the consultation paper on The Future Governance of the International Public Sector Accounting Standards Board (IPSASB) published in January 2014. ICAEW's view is that a thorough assessment of the proposed changes to the governance structure of IPSASB is essential: EU stakeholders can play a key role in improving the governance structure and ensuring that there is greater confidence in the standard setting process.

A governance model needs to be cost-effective and efficient

15. In line with one of the key principles set out in the Eurostat consultation, namely cost effectiveness, we think there are clear benefits to joining forces with IPSASB to channel efforts and resources into a better governance model for international standard setting. This should allow IPSASB to develop a more complete and robust set of international standards, making efficient use of existing structures, processes and skills. Setting up a parallel standard setting system from scratch in the EU would demand a far higher investment of time and resources. We therefore see critical advantages in a model that would use existing infrastructures and expertise, allowing public money to be allocated most efficiently and generally reducing the financial burden on taxpayers. Ultimately, this model would also decrease the risk of further diversity and potential confusion over public sector financial reporting by member states.

Major concerns regarding proposed governance of EPSAS

Independence is a critical element of any credible standard setting body

16. We are concerned that the proposals in the Eurostat consultation are not sufficiently robust with regard to independence. Our view is that the key inter-relationships in the proposed governance model will not work well in the public interest. We note that the proposals put forward by Eurostat primarily involve government officials setting standards. They will then implement the standards, and government performance will then be assessed against the reported financial information. In the private sector, such an approach would be deemed inappropriate and unworkable and we do not think it is an appropriate model for the public sector to adopt. With regard to the specific points raised in the consultation paper on EPSAS governance principles, we have a number of broader comments and concerns.
17. ICAEW views independence as a critical element of any credible standard setting body. There is widespread international acceptance of the principle that accounting standards should only be formulated by a properly constituted and independent standard setter with an appropriate mandate and level of technical expertise, following transparent due process. Accounting solutions should be determined principally on their technical merits in achieving the objective of enhancing transparency, comparability and the quality of reported financial information. We do not believe that the model foreseen for EPSAS would meet this test.
18. As in the case of private accounting standards, it is necessary to have clarity on the objectives for public sector accounting, the stakeholders involved and the relationship with the public interest. This permits appropriate reflection on the relationship and degree of independence between the parties responsible for setting standards, the parties who implement the standards and the parties who use or could use the standards, as well as those who are impacted by them. Experience from the private sector demonstrates that where decisions are unduly influenced by governmental or regulatory organisations or the lobbying of particular interest groups, the result is a lack of adequate due process or rigorous exposition of the issues involved. This damages the credibility of the standard setting process and can cause long-term damage to the credibility and quality of financial reporting and ultimately to the confidence of stakeholders, the sustainability of public finances and the well-being of citizens.

19. We thus believe that there is a need for a broader discussion with regard to the inter-relationship between the different parties and the overall public interest. We do not believe that the proposed governance for EPSAS is appropriate in this respect.

RESPONSES TO SPECIFIC QUESTIONS/POINTS

Q1: Please state the main motivation of your interest in this public consultation.

20. ICAEW is a world leading professional membership organisation established under a UK Royal Charter to serve the public interest. ICAEW's 142,000 chartered accountants worldwide. ICAEW members operate around the world across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. The ICAEW Europe Region is headquartered in Brussels and brings a pan-European perspective to ICAEW's work through regular interaction with professional bodies, firms, oversight authorities and market participants across Europe.

Q2: Do you consider that the sets of principles described for the EPSAS governance structure and process as well as for the EPSAS standards are relevant?

21. No.

Q3: Please provide any comments or proposals on the principles.

22. As discussed above (see 'Major Points' section), we regard independence as a critical element of any credible standard setting body. Accounting standards should only be formulated by a properly constituted and independent standard setter with an appropriate mandate and level of technical expertise, following transparent due process. We do not believe that the proposal on the governance of EPSAS meets this test.
23. The relationship and degree of independence between the parties responsible for setting standards, the parties who implement the standards and the parties who use or could use the standards as well as those who are impacted by them is of particular importance. In respect of the proposed model, we see a clear need for a broader discussion of the inter-relationship between different governance elements and the overall public interest. We have serious concerns that the proposals in the Eurostat consultation are not sufficiently robust with regard to independence and whether the key inter-relationships mentioned above are in line with these principles and will work appropriately in the public interest.
24. Accounting solutions should be determined first and foremost on their technical merits in achieving the objectives of enhancing transparency, comparability and quality of data. As in the case of private sector accounting standards, it is necessary to have clarity on the objectives for public sector financial reporting, the stakeholders involved and the relationship to the public interest. This permits appropriate reflection on the required diversity of involvement in the standard setting process.
25. Experience from the private sector demonstrates that where decisions are unduly influenced by governmental or regulatory organisations or the lobbying of particular interest groups, the result tends to be a lack of adequate due process or rigorous exposition of the issues involved. This damages the credibility of the standard setting process and can have further implications which cause long-term damage to the credibility and quality of financial reporting and to the confidence of investors in capital markets. In the public sector, without credible accounting standards and governance over the standard setting process, there is a risk that financial information which is critical to sustainable public finances and the well-being of citizens will not be forthcoming.
26. We therefore see clear benefits in engaging in a broader discussion with regard to the inter-relationship between the different parties and the overall public interest. We do not believe that the proposed governance for EPSAS is appropriate in this respect.

Q4: Following the normal institutional organisation within the EU, the EPSAS governance would be subject to oversight by the Commission itself, and by the Council, the European Parliament and the European Court of Auditors. Do you consider that any further oversight function should be established?

27. Yes. We support an alternative approach that focuses on ensuring appropriate EU influence on international standard setting and an effective endorsement mechanism. Setting up an entirely new standard setting and endorsement system for EPSAS would demand a considerable amount of time and resources. This raises serious concerns in terms of cost-effectiveness, efficiency and the ultimate aim of enhancing comparability and transparency of public sector financial reporting internationally. As outlined above, we see critical advantages in a model that would use existing infrastructures and expertise, allowing public money to be allocated most efficiently and generally reducing the financial burden on taxpayers. Ultimately, this model would also decrease the risk of further diversity and potential confusion over public sector financial reporting by member states.

Q4a: Do you consider that the oversight role of the EPSAS Governance Advisory Board as outlined in the consultation paper would be appropriate for EPSAS?

28. No.

Q5: Please provide any comments or proposals on the oversight.

29. In addition to our broader concerns on the suggested governance architecture of EPSAS, we note that the proposals put forward by Eurostat primarily involve government officials setting standards. They will then implement the standards, and government performance will then be assessed against the reported financial information. Such an approach would be deemed inappropriate and unworkable in the case of private sector financial reporting. The suggested oversight model raises serious concerns in terms of independence between the parties responsible for setting standards, the parties who implement the standards and the parties who use or could use the standards, as well as those who are impacted by them.

30. Moreover, given the doubts about the adequacy in many member states of public sector financial reporting, it is questionable whether there will be sufficient standard setting skills available in any structure which has such a composition. In our view, any governance model should be checked against the availability of the required expertise and skills and take account of the resources available through existing international standard setting bodies.

Q6: Taking into account that stakeholders' views could be collected by open consultations during the standard setting process, do you consider that an organised, formal representation of EPSAS stakeholders should be established?

31. We do not think that the proposed governance structure guarantees sufficient independence. This key point needs to be addressed first, before the question of stakeholder involvement can adequately be answered.

Q6a: Do you consider that the role of the EPSAS Technical Advisory Group as outlined in the consultation paper would be appropriate for EPSAS?*

32. No. Again, the broader concern regarding sufficient independence of actors within the proposed governance model needs to be addressed before an appropriate answer to the question regarding the EPSAS Technical Advisory Group can be reached.

Q7: Please provide any comments or proposals on stakeholder involvement.

33. The proposal as it stands does not ensure sufficient independence between the different actors of the proposed governance model. A model without sufficiently credible accounting standards and governance over the standard setting process increases the risk that key financial information which is critical to sustainable public finances and the well-being of citizens will not be forthcoming.

Q8: If you think that both the EPSAS Governance Advisory Board and the EPSAS Technical Advisory Group would be appropriate for EPSAS, could their role and tasks be fulfilled by a single advisory group?

34. We think that it is too early to ask this question, given that the proposed approach raises a number of broader questions regarding the international standard setting process.

Q9: Do you consider that an interpretation function should be foreseen for EPSAS?

35. No. Broader concerns regarding the proposed approach need to be addressed first.

Q10: Please provide any comments or proposals on the interpretation

36. As for Q 8 and Q 9, we believe that this is not an appropriate issue to be addressing at the present time. Questions that derive from the proposed approach regarding IPSAS need to be addressed first.

Q11: Do you have any additional comments concerning the proposed EPSAS governance structure?

37. We find that the consultation is focusing on an approach based on creating an EU standard setter without having sufficiently clarified the overall way forward. We do not believe that Eurostat has explained how such an approach will be of greater benefit to the EU and member states than other alternatives, such as those offered by the use of existing international standards. There seem to be clear benefits in a model that dedicates available resources most efficiently by focusing on areas of concern with regard to IPSAS. At the same time, possible negative implications of the proposed approach for international comparability and transparency of public sector financial reporting do not seem to be fully addressed.

38. The proposed approach fails to recognise the important role that international markets play in terms of using public sector financial reporting information. The increasingly dynamic and globalised market for bonds and member states' growing use of financial markets for financing purposes require comparable and transparent public sector financial reporting internationally. A parallel EU standard setting system could lead to further confusion and undermine the objective of achieving greater international comparability.

39. We also have serious concerns that member states which have already implemented recognised high-quality international accounting standards may be obliged to adopt alternatives which could reduce the quality of their financial reporting. While it is critical to focus on achieving better public sector financial reporting in all member states over time, it is important to recognise that member states are at different stages in terms of their use of either cash or accruals-based accounting and international accounting standards such as IFRS or IPSAS. It is essential to avoid an approach that might lower standards of reporting in member states which have already made considerable investment in their financial reporting practices.

40. We support an EU approach which would ultimately lead to all member states' using high-quality international accounting standards for accounting and financial reporting and believe that the EU's efforts in this regard should aim to achieve this in the longer-term, with clearly defined milestones along the way. The first milestone would be for all member states to have moved from cash accounting to accruals accounting. This approach would facilitate the allocation of resources in the most efficient way and address shortcomings rightly recognised by Eurostat. We do not believe that it is appropriate to pursue a policy of full harmonisation based on standards that are yet to be defined by a standard setter which, under the outline design in the Eurostat consultation, raises serious concerns regarding overall governance, independence and expertise.

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