I. EPSAS in the context of the Six Pack and existing accounting systems

The European Commission aims, as a follow-up to the "Six Pack" (Directive 2011/85/EU of the Council of 8 November 2011, Article 16(3)), to create common accounting standards (European Public Sector Accounting Standards (EPSAS)) which are intended to apply to all levels of government in the Member States of the EU (presented for the first time in the report dated 6 March 2013 (Council Document No. 7677/13)).

As part of the preparatory work for the legislative procedure, it is necessary, in accordance with the Bundesrat's decision of 14 February 2014, to hold an unbiased discussion and evaluation process on the possible need for action and possible measures.

"From the perspective of the Bundesrat ... the causes of gaps, weaknesses and inconsistencies in the financial reporting of the Member States must in any case first be identified and corresponding optimisation strategies must be discussed .... The Bundesrat calls on the federal government to in any case ensure that the options for public budget management and financial reporting that currently exist in Germany are retained" (BR-DS 811/13).

The Bundestag called on the federal government *"to make sure that the existing freedom in Germany to decide between the cash-based and accruals-based systems of budgetary planning, budget management and accounting remains preserved; double-entry bookkeeping and accrual accounting should be introduced on a voluntary basis at most, even in the event of a possible development of EPSAS"* (BT-DS 18/4182).

A fundamental discussion of the plans with regard to the aims specified in Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States, which was adopted on 8 November 2011 as part of the Six Pack, namely to ensure uniform compliance with budgetary discipline, has not yet taken place.

The mandatory introduction of accrual accounting that is now planned on the basis of EPSAS is the result of the European Commission's previous mandate (Article 16(3) of the directive) to assess the suitability of the International Public Sector Accounting Standards for the Member States. The directive did not prescribe a particular type of accounting.

The European Commission's goal to secure the high quality of Member States' government finance statistics in the long term, and further improve it, can generally be supported. Due to the large structural differences between the political and administrative systems in the Member States, there are however significant doubts as to whether the goal of improving the quality and comparability of data for the purpose of preventing financial and economic crises can be achieved by introducing EPSAS.

Appropriate measures should, independently of the accounting system, aim at ensuring that the required data is disseminated in the same quality and according to the same criteria and standards by each administration. Using existing statistical control mechanisms it is already possible to monitor adherence to these prerequisites.

All measures have to pay due respect to the constitutional principles of the budgetary sovereignty of the Federation and the *Länder*.

Before EPSAS is introduced, the following questions must be answered:

Objective:

By introducing EPSAS, the European Commission aims to achieve complete, reliable and comparable budgetary data on the actual economic situation of public budgets. To date, it has not been convincingly demonstrated that any deficits relating to the reliability, comparability and completeness of fiscal statistics, and thus to budgetary surveillance on the EU level, would be remedied through the introduction of common accrual public sector accounting standards. It has also not been investigated whether there are simpler and less expensive alternatives available that could also fulfil these requirements. The Commission itself has already admitted, in its report on “The suitability of IPSAS for the Member States”, that the introduction of a new accounting system is by itself not enough to ensure that criteria are applied reliably and uniformly.

New European public sector accounting standards should guarantee transparency and comparability through the recognition and measurement of assets and liabilities, in particular the presentation of implicit debt (primarily with regard to risks such as pension liabilities). To this end, common standards must be defined.

The existing freedom to choose between cash-based and accruals-based systems of budgetary planning, budgetary management and accounting, which has proved its worth in Germany, must remain preserved. Double-entry accrual accounting should, at most, be introduced on a voluntary basis, even in the event that EPSAS are developed.

Time frame:

Past experience in Germany’s *Länder* and local authorities shows that comprehensive reforms of the accounting system generally take at least 10 years. This must be taken into consideration during the project planning and when setting possible deadlines.

Benefit-cost ratio:

It continues to be questionable whether the benefits of introducing accruals-based European accounting standards on a mandatory basis can justify the accompanying costs. To date, benefits have only been mentioned selectively. Apart from that, they are difficult to quantify, tend to be long-term in nature and are only realisable in combination with additional reform measures (e.g. fiscal policy reforms). On the other side of the equation, the costs of the procurement of hardware and software, external consultancy services and training measures (which play a decisive role in the quality of the outcomes) will be significant even under a conservative estimate.

As part of its proposal on the harmonisation of accounting systems in Europe, the European Commission must examine possible alternatives as well as the necessity and effectiveness of introducing European standards, without prejudging the outcome. To this end, and with a view to the scope of the project, it must be investigated whether pilot projects should be carried out. Similarly, the project plan must provide for assessments of the different stages of development as well as possible exit scenarios.

The development process of European accounting standards must ensure that introducing and applying the standards involves as few costs as possible.

Given the public sector’s limited financial and human resources, requirements that force entities to operate parallel systems are to be avoided.

Legal basis for the legislative proposal:

The European Commission has for the time being abstained from issuing a communication regarding the legislative proposal which would have presented a clear statement on the proposal’s legal basis. Taking into account the legal opinions which have been published in the meantime, the question of whether a sufficient legal basis for the project exists remains unanswered.

The principles of proportionality and subsidiarity must be respected. Any harmonisation measures must respect the independence of Member States.

II. Governance and framework principles from the perspective of accruals-based accounting:

Irrespective of the question of whether the mandatory introduction of accruals-based European accounting standards is regarded as necessary, either for the Member States as a whole or for a limited group of public-sector entities, the following section lists the principles and requirements for the design of EPSAS that must be reflected in the conceptual framework.

a. Basic requirements for the development and implementation of EPSAS:

1) EPSAS must be based on a conceptual foundation in order to ensure consistency and a systematic approach in public-sector accounting within the European Union. This framework must be adopted before the statutory introduction of the individual European accounting standards.

2) The EPSAS conceptual framework must be developed as a basis for public-sector accounting before the individual EPSAS standards are developed. During the standard-setting process, speed must not be prioritised over legitimacy and quality.

3) The EPSAS conceptual framework must be designed as superordinate legislation in relation to the individual EPSAS standards. In this way, it will be ensured that
   a) future EPSAS standards and their interpretations will be required to be consistently based on the conceptual framework, and
   b) in the event of regulatory gaps, it will be possible to derive relevant guidance from the EPSAS conceptual framework.

4) EPSAS – its conceptual framework and standards – should be adopted using the ordinary legislative procedure in order to ensure its democratic legitimacy. The following conditions must therefore be ensured during the process of introducing these standards:
   a) the EPSAS conceptual framework, being adopted in the ordinary legislative procedure, will be binding for standard-setters and users;
   b) the EPSAS conceptual framework must define the purposes of public-sector accounting, the underlying assumptions and accounting principles.

5) In order to ensure the independence and impartiality of EPSAS, the EPSAS conceptual framework, as well as the standards based on it, must be developed by representatives of the bodies that are responsible for setting national public-sector accounting standards in the EU member states. A standard-setting structure similar to the EU endorsement process of the International Financial Reporting Standards for the private sector is not acceptable.

6) Other accounting standards, in particular IPSAS, can only be reflected in the future EPSAS standards to the extent that they are compatible with the EPSAS conceptual framework, which forms the conceptual basis for public-sector accounting.

7) During the development and application of accounting standards, the interests of all stakeholders in public-sector accounting standards must be taken into account. Their interests must be defined beforehand. In the process, it must be borne in mind that private-sector organisations will only be directly affected in as much as they are responsible for setting public-sector accounting standards in Member States.

8) When developing the EPSAS standards, it must be taken into consideration that requirements that have no significant effect on values presented but which carry considerable costs relative to their

indicative value should be limited to the absolute minimum necessary (e.g. extensive required reporting in annexes, segment reporting, component approach for property, plant and equipment).

9) Simplified rules must be developed for smaller and less risk-prone entities. These regulations should also meet the requirements of the conceptual framework.

b. Content-related requirements for EPSAS:

1) The fundamental purposes of public-sector accounting systems are:
   - Transparency and information purposes to fulfil public accountability obligations, inter alia for comprehensive and clear reporting on assets, financial performance and position and fiscal policy decision-making;
   - Stability and intergenerational fairness in public finances (protective function);
   - Comparability of public-sector entities (including for statistical and fiscal policy purposes).

2) Ensuring these basic objectives of public-sector accounting requires linking them to the primary principles of reliability and objectivity, as well as the principle of prudence in the sense of conservative accounting.

3) Reliability is the most important principle for attaining the objectives of sound public-sector accounting. Public sector-specific control, aggregation and fiscal guidance mechanisms depend entirely on reliable accounting data.

4) The principle of objectivity stipulates that discretionary leeway must be as limited as possible with regard to specific accounting questions about recognition, verification and valuation of assets and liabilities. Optional exclusions should be limited to exceptional cases. Only in this way can comparability be ensured for different public-sector entities, and an appropriate consolidation of public entities be achieved.

5) The principles of reliability and objectivity, in a broader sense, also include the principles of neutrality, completeness and freedom from material error, as well as the principles of clarity, understandability and cost-efficiency. These principles would need to be specified in detail in a conceptual framework.

6) The principle of prudence is of crucial importance for public-sector accounting. In particular, the acquisition or production costs of an asset should be viewed as its upper valuation threshold. Lower attributable values (e.g. fair market values and stock market values) must be anticipated by value adjustments made on the annual account closing dates. In appraising value, foreseeable risks and losses that have occurred up until the account closing date must be considered.

7) The realisation principle and loss recognition are notable aspects of the prudence principle. According to these, profits should only be recorded when they are realised. In contrast, losses should be recorded as soon as they are expected with adequate certainty.

8) The accruals concept requires revenue and expenses to be recorded independently of the time of their actual payment.

9) According to the principle of individual valuation, all assets and liabilities must generally be valued individually. Group valuation should however also be admissible in special cases, where it would simplify procedures.

10) The principle of correspondence (*Bilanzidentität)* must be maintained, i.e. the opening balance sheet for each financial year must be the same as the closing balance sheet for the preceding financial year.

11) The adjustment or correction of balance sheet errors following the approval of financial statements is usually only necessary if the statement gives an impression of assets, financial performance and position that does not correspond to the actual situation. As a rule, it is adequate to make adjustments or corrections in current accounts and to explain them in annexes.

12) The principle of consistency requires consistent use of accounting and valuation methods. If there are individual cases where different methods are used, this change should be explained in an annex. Adjustments and changes to the method should, as a rule, be made prospectively to current accounts.