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Europe Slow to Adopt New Accounting Standard Despite Greek Crisis

Greece is hardly the only European country with weak public accounting systems, says Simon Nixon

By Simon Nixon | April 12, 2015

Laid-off public-sector workers and others protest austerity measures in Athens this month. *PHOTO: NIKOLAS GEORGIOU/ZUMA PRESS*

Greece's new government may not have achieved much in its first two months, but it did succeed last week in establishing a parliamentary inquiry into the circumstances surrounding the country's bankruptcy.

Oddly, this inquiry will only be allowed to investigate decisions taken since October 2009 following the election that brought George Papandreou's Pasok government to office. Its aim appears to be to point the finger of blame for Greece's current predicament entirely on those who signed and attempted to implement the bailout programs agreed in 2010 and 2012 with Greece's eurozone partners and the International Monetary Fund.

Previous governments whose poor decision-making made those bailouts necessary seem to have been officially absolved.

This looks like a missed opportunity. While most of the decisions taken over the past five years were taken in the full glare of international scrutiny, it is still not fully clear how Greece was able to run up a deficit of 15% of gross domestic product apparently without anyone noticing. How did previous governments manage to conceal the ruinous state of Greece's public finances for so long, not just from their own citizens, who have borne the cost of past profligacy, but also from their eurozone partners, whose own economic and financial stability has been put at risk?

Any answer to these questions would inevitably highlight major weaknesses in Greece's public-sector accounting systems. Athens didn't have the management and information systems to ensure that spending decisions were taken transparently and accountably.

By law, European companies are required to publish rigorously audited balance sheets and profit and loss accounts. These are compiled on an accruals basis, whereby transactions are recorded whenever value is created or destroyed, or when claims and obligations arise or are settled. They allow investors to hold boards to account. But in Greece, government transactions were recorded on a cash basis—in other words, only when funds actually flowed into or out of the Treasury. This made the true state of its public finances almost impenetrable to outsiders—and most likely to insiders too.

Greece is hardly the only European country with weak public accounting systems. In the five years since the eurozone crisis exploded, the European Union has adopted a great number of measures to improve its fiscal governance. Yet amazingly, it still does not have a robust, harmonized way of measuring and monitoring the financial activities of its member states.

Each country has its own national rules for public-sector accounting. Currently only 11 of the 28 EU member states use accruals-based accounting at some level of government, according to a study by consultants PWC for the European Commission. In many countries, different systems operate across the public sector. Most are cash-based, which creates opportunities for governments to arrange the timing of payments to suit political objectives.

Some of the strongest pressure for reform is coming from Eurostat, the statistical arm of the European Commission. As things stand, it is obliged to present government deficit and debt data on an accruals basis to enable cross-border comparisons. But it has to estimate the true state of national balance sheets by making its own adjustments and approx-imations to the cash-based data supplied by most governments.

By Eurostat's own admission, the current approach to compiling EU public-sector financial data is incoherent and reaching its limits. It wants the EU to adopt a harmonized system of accruals-based public-sector accounting.

Eurostat believes the benefits of high-quality public accounting extend far beyond inoculating the eurozone against future Greek-style disasters. Indeed, high quality record-keeping has been a feature of all commercially successful economies, from Renaissance Italy to the Dutch Republic to 19th-century Britain, notes Jacob Soll, professor of history and accounting at the University of Southern California, in his book "The Reckoning."

In ancient Athens, a complex system of bookkeeping and public auditing was seen as being at the heart of democratic government. The Athenian treasury was considered sacred and kept at Delos under the watchful eyes of its treasurers.

In contrast, most financial collapses, like that of modern Greece, can be traced to accounting failures. This reflects the role that accounting plays not only in providing an accurate picture of a country's financial health, but also in promoting greater transparency that allows for better decision-making and helps combat corruption. Perhaps not surprisingly, the country whose public accounting scored most poorly after Greece in the PWC survey was Italy.

But while the EU has held consultations and established a number of working groups, progress toward an accruals-based public accounting standard for Europe has been slow. Eurozone governments have ruled out adopting International Public Sector Accounting Standards, a new-ish set of global rules closely modelled on the International Financial Reporting Standards used widely in the corporate sector, despite the clear benefits these have brought to countries that have already adopted them, including New Zealand, Australia and Switzerland.

Instead, the EU is now debating whether to introduce its own European Public Sector Accounting Standards, a second-best option that would allow the EU to retain legal control. But this too faces opposition, partly on the grounds of cost and partly because some countries, including Germany, remain wedded to their cash-based systems.

To many observers, this reluctance to embrace even EPSAS appears short-sighted. Momentum is building behind IPSAS as a new global standard supported by an alliance of international organizations including the IMF, the World Bank, the Organization for Economic Cooperation and Development and the International Federation of Accountants.

Europe risks getting left behind. While the costs and benefits for individual countries may be difficult to quantify, the long-term benefits of robust, harmonized data could boost confidence in the eurozone. That in turn could lead to lower borrowing costs and help foster the trust required to underpin further integration.

As for Greece, an analysis by hedge fund Japonica Partners suggests a switch to accruals-based accounting would show that after debt relief already received, Greece's long-term position isn't as dire as it looks on a cash basis. Of course, this verdict may be as unwelcome to the current government as pre-crisis reality was to past administrations.

(http://www.wsj.com/articles/eurozone-methods-called-to-account-1428869160?tesla=y)

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