

IAS 2022 Annual Conference

The importance of the introduction of accruals based accounts for the European Commission's internal control system and the successful implementation of the Next Generation EU instrument

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Introduction

Introduction

“There are no sound fiscal policies without good government finance statistics based on good public accounting. To put it bluntly: where to go is an elusive question if you don't know where you are!”

Keynote speech by the President of the European Council, Herman Van Rompuy 29 May 2013

Introduction

General benefits of accrual accounting

Promotes fiscal transparency and accountability (IMF 2012). Among others, it requires the recognition of future payment obligations that are not yet shown in the cash-based budgetary accounts (e.g. pensions).


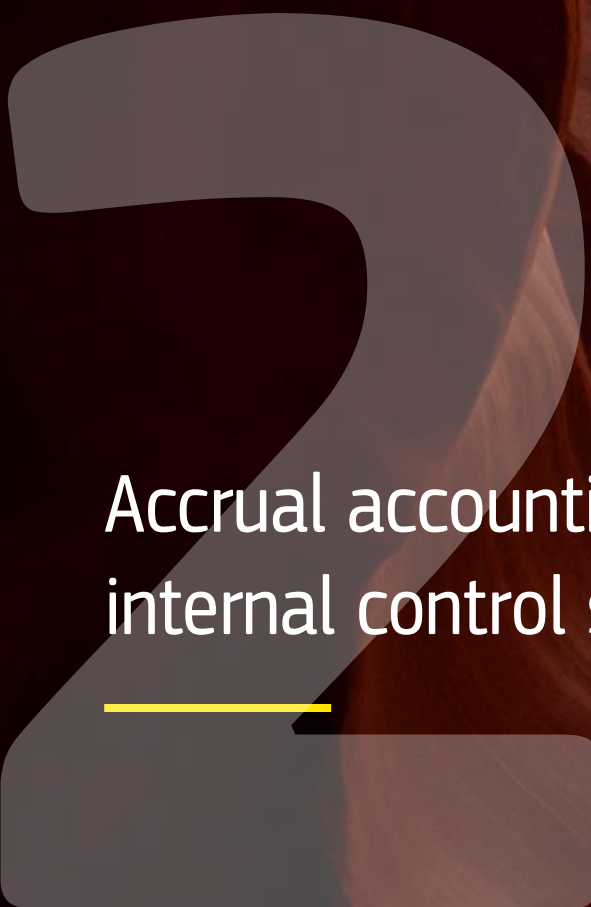
Contributes to the sustainability and intergenerational equity of public finances, providing a forward looking overview of resources and obligations.

Allows for the minimization of differences in government finance statistics and public sector accounting. Hence, it supports fiscal monitoring (Maastricht, EDP) by the Commission.

Enables better allocation of financial resources within the Commission and among Member States through enhanced transparency and comparability.

Leads to increased trust and confidence in EC financial reporting by investors, donors, auditors as well as internal and external users of the information, which results in increased fiscal and political support.

Provides a harmonized framework that facilitates the audit of annual accounts (auditors can rely on a single accounting framework), and ensures the consistency of the EU consolidated accounts.




Accrual accounting and the EC internal control systems

Accrual accounting and the EC internal control system

- ▶ Accrual Accounting processes are closely connected to or embedded in operational processes. Therefore, accrual accounting is **relevant for the management of public resources** (performance/asset management) and provides insightful information as the basis for **effective risk management** (compliance/financial risks).
- ▶ As an integrated system, accrual accounting **by nature leads to integrated controls**:
 - ▶ More and more meaningful financial KPIs allow broader and deeper performance control
 - ▶ Comprehensive presentation of financial and non-financial information such as surplus/deficit, condition/use of assets as well as the legal source for liabilities support financial & compliance audits
- ▶ The generated data allow **ex-post controls** regarding legality and regularity of key processes and individual transactions (e.g. payment or reclaim of grants based on the fulfillment of conditions)
- ▶ Even more important, integrated accounting processes enable **preventive ex-ante controls** such as approvals before committing to legal liabilities or potential future obligations (e.g. guarantees)

Accrual accounting and the EC internal control system

- ▶ Accrual accounting at EC level is a success story – the benefits are undisputed.
- ▶ The European Accounting Rules (EAR) provide a **harmonized** accrual accounting framework that supports the audit function, considering the broad range of financial risks incurred by the Commission and its various EU entities.
- ▶ The following EARs are important for the identification of financial risks:
 - ▶ **EAR 10, Provisions, Contingent Liabilities and Contingent Assets:** A close monitoring of events and transactions for potential (legally and non-legally binding) obligations allows risks to be managed at an early stage.
 - ▶ **EAR 11, Financial Instruments:** allows for better and more transparent management of loans and receivables including allowances based on expected credit losses. Requires to disclose the treasury strategies to mitigate the risks and uncertainties, including hedging strategies, currency exposures and any investment risks.
- ▶ The audits of the IAS focus on areas where the audited services are exposed to the highest risks. Accrual accounting contributes to the timely identification and presentation of risks through its required disclosures and long-term perspective.



Contribution of accrual accounting
to the successful implementation
of the NGEU instrument

Contribution of accrual accounting to the successful implementation of the NGEU instrument

Selected characteristics of the NGEU in the context of accrual accounting:

- 1 All 27 MSs are entitled to receive grants and loans with identical maturities and repayment conditions.
- 2 The funds will be repaid by MSs directly (for loans) or through the EU budget (non-repayable support) by December 2058 at latest.
- 3 For the Recovery and Resilience Facility (RRF), 90% of payments to each MS are structured bi-annually upon the achievement of agreed milestones and targets tied to the implementation of reforms and investment.

- ▶ There are heterogeneous accounting practices among the MSs which limits comparability of the financial information, and which might obscure the visibility and assessment of credit risks and liquidity risks from the EC perspective.
- ▶ With the NGEU, all MSs benefit from EU's credit rating - credit and liquidity risks are assumed by the EU.
- ▶ Therefore, the use of accrual accounting by the MS as beneficiaries of the NGEU instrument, would allow the EU to have a better understanding of the risks.
- ▶ Payments of the RRF require certain ex-ante monitoring of the fulfillment of conditions, which is in line with the accrual accounting principles for the recognition of revenue and expenses.
- ▶ Tracability and auditability is key for the creation of trust.
- ▶ Accrual accounting requires and supports the monitoring of the achievement of the agreed milestones and targets.



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Final considerations

Final considerations

Sound financial management is the basis for tackling current and future challenges of the EU and its Member States.

- ⇒ ***Accrual accounting enables the EU and its Member States “to know where you are” – in order to decide where to go! Accrual accounting processes with integrated controls are the basis for IAS to issue recommendations supporting sound financial management.***

The IAS has the role to provide the EC with assurance as to the achievement of milestones and targets, the effectiveness and efficiency of the use of resources and the establishment of risk management, control and governance processes.

- ⇒ ***Shared risks within the EU require comparable accountability and transparency among all Member States. In the context of NGEU, a strong monitoring of the achievement of agreed targets by the Member States is important for trust. Accrual accounting creates auditability and supports this monitoring task.***

The IAS is a major contributor to the harmonization of the processes for the use of funds and effective delivery of services.

- ⇒ ***However, harmonized accounting standards, continuous trainings and robust IT systems - in particular in the Member States - are needed to strengthen the accounting and audit functions. This is essential to manage the changes and meet the increased need for transparency and accountability due to the NGEU instrument.***


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The NGEU instrument represents an opportunity to foster the implementation of accrual accounting among Member States – as an enabler for increased trust and accountability within the EU.



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Thank you for your attention!



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