



JOINT ICAEW-PWC SERIES ON SUSTAINABLE PUBLIC FINANCES – EU PERSPECTIVES

# How can governments achieve more with less? Why accounting is good for governments and citizens

Summary of discussion on 5 May 2015, Brussels

Sustainable public finances in Europe continue to be a critical issue. The findings of the recent **ICAEW-PwC** survey on citizens' trust in public finances and the recurring political and media debate on public debt levels and budgetary deficits underline this importance.

Within the framework of the EU's efforts to enhance economic governance there is growing recognition of the need for appropriate accounting and financial management in the public sector, as a key means of achieving sustainable public finances.

We await the European Commission to come forward with new steps and ideas to progress the debate across Europe. In order to progress and use the reform momentum, it is important to find suitable solutions which help overcome remaining concerns.

On 5 May 2015, ICAEW and PwC organised the sixth in a series of informal discussions to address particular issues within this overall policy sphere. The meeting brought together a senior group of national and European policymakers, media representatives and other interested stakeholders to exchange views on how better financial information can inform better decision-making.

This brief summary seeks to capture the key elements of the discussion, to encourage feedback and further development of the ideas raised. It aims to inform other key stakeholders who have an interest in the overarching theme of sustainable public finances in Europe and who may wish to contribute to the next discussions taking place in late 2015.

We would be delighted to receive your comments on the summary, to be addressed to:

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# How can governments achieve more with less?

## Why accounting is good for governments and citizens

Governments across Europe are facing a massive challenge: they need to get the budget deficit and debt levels down while continuing to deliver operational and policy priorities. But in order to 'do more with less', the way public finances are managed needs to be transformed. While there are important differences between the public and private sector, it is essential that similar professionalism is applied to the management of public finances as is expected in successful private companies. In both cases, accurate and reliable financial information is at the heart of efficient management systems to ensure that entities – whether countries or companies – are sustainable and effective in meeting their stakeholders' objectives. This involves managing debt levels, ensuring liquidity and planning for long-term investments in key areas such as infrastructure, energy, security and welfare systems.

### Public perceptions and understanding

In late 2014, ICAEW and PwC surveyed 10,000 citizens in 10 different EU member states to better understand their attitudes on, and interest in, public finances. The results revealed limited awareness and understanding of public finances and low levels of trust in governments' handling of public finances across all genders and age groups. Seen from the angles of different stakeholders, these results are not surprising. They underline a desire for better planning and management of public spending.

Scrutinising public finances is challenging as the information can be highly technical. Citizens often do not have the time or the necessary skills to access complex financial information even if governments provided it. The same is true for journalists and parliamentarians, particularly those who are not active in specialised financial oversight or economic committees.

Clarity of definitions and terminology is another issue. Do we really know what is meant when reading about public finances? Is there sufficient understanding of what the concept of public financial management entails?

### A challenge for journalists

Traditional media remains a primary source for citizens' information on public finances in many member states. Its role is critical in assessing value for money considerations and informing the wider public. But writing about public finances is not an easy task. Technical details and numbers can easily intimidate readers and journalists themselves may lack the necessary time to dig deeper into the subject.

Financial watchdogs and public interest bodies are therefore essential sources of information for journalists. Amid all the rhetoric on public finances, there is a need for objective analysis of the various competing visions on offer. A balance sheet analysis of the public finances – as recently prepared by ICAEW in the context of the Institute of Fiscal Studies (IFS) Green Budget (report) – can offer an accurate framework through which to assess the current state of the nation's financial health. This evidence base is a prerequisite for good public policy development and a better-informed electorate.

Turning complex, technical information into compelling articles that catch the public's attention is one challenge for journalists. Another is to strike the right balance between creating interesting headlines and reflecting a complete picture. As with other news items, there is a tendency to focus on negative headlines or sensational information. 'Snappy' headlines can, in some cases, reinforce negative perceptions and, most importantly, lead to a downward cycle in the perception of public finances, even if important improvements have been made. Similarly there is generally little interest to understand and consequently to report what is the heart of the problem: inadequate financial reporting does not highlight the long-term implications of political decisions and does not give a sense of accountability either.

A key question in the debate on better financial management has to be how to ensure that information is better used and interpreted. Consequently, trust in the professionalism of journalism is an important element in the debate on public finances. Media can be an important partner of public administrations. It can help to generate a wider debate on the right use of public funds and support positive change through pressure by public debate.

## Progressing the reform debate

A number of civil society organisations also publish examples of severe mismanagement of public funds to point the finger at extreme cases. These headlines are often eye-catching – and often get picked up by the media. While a ‘name and shame’ approach can be a very effective way of generating wider public attention and illustrate some of the issues, a constructive policy debate to tackle the underlying problems is ultimately required.

The debate on public sector accounting has taken place at European level since 2013, led by Eurostat, the EU’s statistical arm. At EU level, the debate has centred on the appropriateness of international or European public sector accounting standards in order to introduce a more unified system of public sector accounting, based on accruals. In March 2013, the European Commission published a report *Towards implementing harmonised public sector accounting standards in the member states*, suggesting that while International Public Sector Accounting Standards (IPSAS) might not be suitable for wholesale adoption by the EU, they would be an ‘indisputable reference’ for potential European standards (EPSAS – European Public Sector Accounting Standards). The report found that accounting practices not only diverge between most EU countries but also often between different government entities within the same country. This has triggered an intense debate on a cost-effective EU-wide approach which will help pave the way to greater comparability, transparency and accountability.

While there has been broad recognition that improvements are needed, there has been less agreement on how to achieve this. Eurostat contracted a study<sup>1</sup> with a view to informing its impact assessment of EPSAS implementation by the member states. The study was published on Eurostat’s website on 30 September 2014. It highlights the benefits of harmonised accrual accounts for EU member states, provides a methodology for assessing the related costs, confirms the suitability of the IPSAS standards as a basis for EPSAS and provides proposals for implementation, acknowledging that starting points are very different across Europe and that the planned reform should address those diverging national contexts. At the heart of the European debate is the need to create trust between countries as a basis for future cooperation. The European Commission is expected to propose next steps in this regard.

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<sup>1</sup> Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standard. <http://ec.europa.eu/eurostat/documents/1015035/4261806/EPSAS-study-final-PwC-report.pdf>

## Better accounting and reporting as a catalyst for better public finance management

At national level, more and more governments in Europe are looking at ways to enhance public financial management and strengthen accountability structures. These efforts are part of a broader agenda to rebuild trust and confidence in public finances. Transparency and comparability are increasingly seen as important means to this end. However, changing negative attitudes towards public finances can be a long process, requiring continued commitment by successive governments.

In Europe, the search for financial management and leadership in the public sector is giving rise to different trends in public administration. Practices such as accrual and cost accounting, performance budget and whole of governments’ accounts are already significantly developed in a number of cases to highlight lessons, benefits and avoidable mistakes. Examples from across Europe show that public sector financial management and accounting reform is a long-term process that requires constant learning by administrations and stakeholders. Even those member states that have made good progress over the years see reform as an ongoing process. Good financial management ultimately revolves around the question of whether or not revenues are increasing at the same pace as liabilities are piling up. That is why a balance sheet approach can be helpful, as it provides insights beyond the current picture.

When a government draws up a balance sheet, it enhances governance. It enables policymakers to appraise the cost of decisions in real time and to engage on a different basis with stakeholders and the public at large. It can create greater political accountability as the impact of spending decisions on current and future generations is central to sound public finances.

After the collapse of the Soviet Union, many countries in Eastern Europe initiated critical reforms of their public financial management. In the case of the Slovak Republic, it became clear early in the process that there was insufficient financial information available to pursue meaningful reform, so reliable data became an important concern and objective. External partners, such as the World Bank, provided guidance and technical expertise, which was often not available in the countries themselves. In some countries, the initial plan was to move towards accruals accounting and budgeting at the same time, but progress was only made on the former. While a move towards an accrual basis is clear on the accounting side, there seems to be less appetite for accrual budgeting. It is often viewed and portrayed as too complex. Across the EU, budgets remain largely on a cash basis. However, proponents of accrual budgeting argue that it could provide better insight for decision-making, considering the long-term impact of political decisions.

Public financial management and accounting reform is as much a top-down as it is a bottom-up process. Meeting the continued challenge of limited fiscal leeway requires appropriate change management through all levels. Creating a culture of producing and using accurate information to ensure more efficient deployment of public resources is not an easy task: it depends on impetus from the top, a basic technical understanding of financial information, and the appreciation of working towards a common goal. Equally, it is important that all affected users have the right skills to use financial information and understand their responsibilities. In that sense, training and education are key pillars of reform, but the importance of these elements has been underestimated in some countries.

## Engaging the citizens in the public finance debate

Experiences from member states underline that a good communication strategy is critical. The challenges that public administrations face when they publish information are similar to those experienced by media: a need to condense large quantities of information, without compromising on its meaningfulness, to attract interest in the information provided. Different users of information have different needs. Examples from across Europe show that it is important to carefully consider what the target audience of information is and what its needs are. Equally, it is important that the overall picture is not lost. In some countries different messages communicated by federal, regional and local policymakers have led to misunderstandings. Another communication challenge for governments is that their efforts to reduce debt and deficit levels may have negative implications for parts of the society in the short term. This is mirrored by the wider debate about austerity and its societal implications. Reform can ultimately help to avoid making the mistakes of the past by increasing public scrutiny through transparency and greater comparability.

Even in countries that are leading in terms of transparency, citizens are currently often not heavily engaged in the discussion on better public finances. Across the EU, there seems to be room to further familiarise public audiences with financial information. Transparency is not just about providing information, it is also about making it understandable by those concerned by the provided information. This should trigger a greater focus on the demand side of information, at the core of which lies the question: how can this interest in financial information be increased? Changes also have to be explained to consecutive governments and strong political support is required throughout the reform cycle. Moving forward with reforms can require significant investments, even if standards are already available. In Slovakia, capacity building was seen as a key step that helped the country to produce a set of externally-audited accounts in a relatively short time. However, investments need to be

explained carefully to the wider public, drawing out the benefits of reform.

Traditionally, most attention in the debate on public finances has focused on budgets (spending) or taxation (income). Control has sometimes too strongly focused on compliance, rather than performance. However, assessing value for money considerations in public expenditure is increasingly at the centre of discussion and requires a holistic view. Financial accounts can provide a comprehensive picture of public finances, which allows policymakers to take better informed spending decisions. While discussions on budgets and financial accounts can be sometimes technical and difficult to follow, it is clear that policymakers' decisions can benefit from the link between both.

The power of the purse comes with responsibility. This responsibility exists for today's citizens as well as future generations. Transparent, high-quality data can show future liabilities of today's spending decisions. This helps to move from a spending to a managing approach in public finances.

## Insights from outside Europe

New Zealand is largely regarded as one of the most advanced countries when it comes to public sector financial management and reporting. Next to the financial statements, the Treasury prepares a 'snapshot' of the annual financial statements of the government, which is a high-level presentation of key facts and figures for the financial year, intended to make the financial statements more user-friendly and accessible. Citizens are more likely to read this snapshot than the full financial statements. Ideas from outside Europe can provide interesting examples for innovative means to involve and engage citizens more actively in debates on how public money is used.

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