ACCOUNTING RULES FOR THE EUROPEAN COMMUNITIES: A THEORETICAL ANALYSIS

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Abstract: A theoretical analysis is provided of the accounting framework and rules applied to the annual accounts of the European Communities (EC) since 2004. This accounting system draws upon International Public Sector Accounting Standards (IPSAS) and is based on accrual accounting, under a dual integrated accounting process with the cash accounting that is maintained. It purports to shape the financial accounting and reporting of the supranational entity that are the EC. This entity carries out a wide range of policies and programmes through the financial resources provided by the European Union Member States, making it accountable for incurred expenditure to these constituents. By analysing the accounting conceptual framework and the sixteen specific rules, the paper assesses the capacity of its accounting system to provide a true and fair representation of the economy of the EC entity featured by that expenditure-sharing purpose, under the overall no-profit motive that is typical of every public administration.

Keywords: public sector financial accounting, governmental financial accounting, public sector accountability, cash basis, accrual basis, modified cash basis, European Commission, accounting and economics of supranational organisations, conceptual framework

JEL codes: H83, M48, M41, E02, P48

LONG ABSTRACT

The paper provides a theoretical analysis of the accounting rules recently issued by the European Commission. These rules purport to shape the financial accounting and reporting of the supranational organization that are the European Communities (EC). Through this

organisation, the Commission carries out a wide range of policies and programmes through the financial resources provided by the European Union (EU) Member States. These policies, activities and programmes could range from supporting education projects for the mobility of students and teachers, to projects aimed at supporting better work environment for workers in the EU, to enhance the control of the external borders.

The recent decades have been characterised by accounting reform processes concerning public administration at the local, regional, national, and supranational levels. Since the end of the XX century, even the European Commission has been engaged in a modernisation effort concerned with its systems of organisation, management and information and control. This effort has been devoted to better its functioning and enhance accountability for Member States and the European citizenship (White paper, 2000). The modernisation of the accounting system is an integral part of this overall effort.

Called ABAC (Accruals-Based Accounting), the new accounting system addresses the financial accounting and reporting by the EC, including consolidated accounts. Sixteen accounting rules stand at the core of this reformed system: they define the general purpose and objectives of the EC financial accounting and reporting, its main statements and the modes of recognition, measurement, and representation of various accounting elements. According to the European financial rulebook (art. 133 par. 2), these rules draw upon International Public Sector Accounting Standards (IPSAS) and are based on accrual accounting, whilst establishing a dual accounting system under an integrated accounting process with the cash accounting that is maintained.

Problems associated with applying accrual accounting to the public administration are well known: the existence of specific types of assets and liabilities, expenses and revenues that do not exist in business enterprises suggests a need for a special conceptual framework for public sector (non lucrative) entities. The case of the EC accounting system is especially significant because EC is not only a public administration (thus having no profit motive), but also a supranational organization that is accountable to other public administrations that are national Member States. By receiving financial resources from the latter, the EC plays a key role of economic coordination by redistributing resources through the provision of public services and direct transfers or grants throughout the European territories.

The paper aims to develop a theoretical analysis of the EC accounting system to assess its capacity to truly and fairly represent this specific economic functioning of the supranational organisation that is governed by the EC. Its accounting rules will be then analysed from a theoretical perspective comparing different accrual accounting

representations respectively based on wealth (static accounting), cash or flow (dynamic accounting). The suitable conceptual framework is shaped by the featuring absence of any "profit motive" and by the specific coordination role of economic redistribution accomplished by the EC. Whilst the wealth-basis refers to fair value accounting and results to be at odds with the specificities of public sector economics, a dynamic view of the accruals basis may be properly applied to the assessment of EC accounting rules. The concept of non-business entity is then used to explore further the economic role provided by the EC supranational public entity and the economic meaning of its system of accounting and accountability.

In sum, the paper adopts a hypothetical-deductive and normative approach by applying a dynamic accounting conceptual framework to the analysis of the EC accounting rules. It will describe the EC case study and its context; illustrate the theoretical background; present the research design, and eventually provide the analysis of the main EC accounting rules, based on the comparative theoretical approach mentioned above. A synthesis of results and recommendations will conclude.

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Accounting Rules for the European Communities:
A Theoretical Analysis

Section I – Introduction

The recent decades have been characterized by important processes of public sector accounting reform at different levels (local, national, supranational, international). These changes are fostered by various attempts of modernization and rationalization of organizational, managerial and financial dimensions of government, which purport to both recover efficiency and effectiveness, and improve transparency and accountability (Pollit & Bouckaert, 2004; Kettl, 2005). These attempts have been part of the so-called New Public Management movement, characterized by the transplantation and hybridation of business principles and instruments to the public sector, including accrual-based systems of financial accounting and control (Aucoin, 1990; Hood, 1991, 1995).

Since the end of the twentieth century, even the European Union (EU) has been engaged in a modernization effort devoted to better its functioning and enhance its accountability towards Member States and the European citizenship (European Commission, 2000). The modernization of its accounting system is an important, integral part of this overall effort. The renewed accounting system addresses the financial accounting and reporting by the European Communities (EC), including consolidated accounts. Sixteen accounting rules stand at the core of this reformed system: following the European Financial Regulation (art. 133, par. 2), these rules draw upon IPSAS (International Public Sector Accounting Standards) and are based on accrual accounting, even if cash accounting has been maintained, thanks to an integrated accounting process (dual system).

One of the most interesting points of this reform concerns the place and role of the EC in the European public sector. In fact, even if European countries are autonomous as for their own government accounting model today, they are members of this supranational organization, whose powers and functions are still evolving. Monitoring what is going on with the EC accounting reform, and analyzing the choices made by the European Commission in the area of government accounting and financial reporting, may reveal the critical patterns and choices that might influence – in a more or less compulsory way – the EU member states in the future. The current focus on reinforced control and reduction of public deficit spending

and borrowing can reinforce the need of such a harmonized accounting system and reporting in Europe.

Theoretically speaking, the main point of interest concerns the specific economic functioning of the supranational organization that is governed by the EC. Our theoretical analysis aims to assess the capacity of the EC accounting system to "truly and fairly" represent its economic activity as a "non business entity". Our focus is on the set of "new" EC accounting concepts and rules, that are analyzed from a theoretical perspective comparing different accrual accounting representations respectively based on wealth (static accounting), cash or economic flow (dynamic accounting). A hypothetical-deductive and normative approach is then adopted by adapting a dynamic accounting conceptual framework to public sector economics, and applying it to the assessment of the EC accounting system. Concerning documental analysis, in addition to the usual literature review and to the EC financial statements, we will make reference to primary sources that are not publicly available, such as EC accounting rules and regulation, accounting guidelines and other working documents produced by the EC offices. The descriptive vein of some sections of the article actually allows readers to acquire summary information and relevant access to this documentation.

The rest of the paper is structured as follows. The next section provides the theoretical background and a literature review concerning the public sector accounting, with particular reference to the debate on accrual accounting; section three provides the conceptual framework adopted by this paper; section four illustrates the research context, focusing on the EC as an economic entity; section five contains the analysis of the EC accounting concepts and rules, based on the comparative theoretical approach mentioned above. A synthesis of results and comments will conclude.

Section II – Theoretical background: accrual accounting in the public sector

The several public sector accounting reforms realized in recent decades show the importance of the accounting dimension of public management modernization. All fields of public sector accounting have been concerned: management accounting, financial accounting and auditing. In particular, changes in financial reporting systems are considered as a key element of the reform of public finances and management (Olson et al., 1998). In fact, financial resources

are an essential condition for the ongoing working of public entities over time: controlling how these resources are employed is then an evergreen issue for scholars and public servants.

Traditional financial reporting and accounting standards for public sector have been especially questioned by such recent attempts of reform, and the introduction of the accrual accounting is one of the main innovations that resulted from them. They have claimed that costs and revenues should be imputed to the period in which they are consumed and earned, substituting the traditional cash accounting system. In fact, this is definitely not a new subject. Several attempts of commercial accounting introduction in the public sector have been made in history: for instance, the ones carried out in Spain in the XVI century (Jurado-Sanchez, 2002), in the UK and Italy in the XIX century (Edwards et al., 2002; Anselmi, 2006), and in the USA in the first part of the XX century (Antony, 2000). Reasons for which these attempts did not succeed are different and they vary according to the specific countries' context: the common element seems to concern their low fitness with public sector needs and features (Anessi Pessina, 2007: 26). However, in the ninety of the last century, the adoption of accrual accounting by public sector has been pushed forward and considered as "self-evident" (Lapsley et al., 2009).

The debate of accrual accounting in the public sector remains unfolded (Christensen 2007). Main studies have advocated relevant advantages from accrual accounting application to the public sector (Brorström, 1998; Perrin, 1998; IFAC-PSC, 2003; FEE, 2007). Accordingly, positive aspects are:

- the link with management accounting;
- cost measurement of supplied services and political programs, so as to maximize public sector's efficiency and productivity;
- monitoring of assets;
- more accurate measurement and communication of public sector entities' financial position and performance;
- long-term assessment of public policies financial sustainability;
- the possibility to draw up consolidated financial statement.

In sum, accrual accounting is expected to provide better information for internal use (for cost and price calculation, make-or-buy choices, outsourcing, etc.) and external use, improving thus public entities' transparency, accountability and performances evaluation. These advantages correspond to the critique of cash accounting that is accused of preventing the

carrying out the above mentioned measures and assessments. Consequently, cash accounting could not fit with public resources management control, being not able to highlight the connection between resources consumption and achieved results.

On the opposite front of the debate stand theoretical and empirical studies which point out all the problems arising from the implementation of accrual accounting in the public sector. From a theoretical point of view, some authors argue that cash accounting is more suitable for government's kind of activities, primarily concerned with collection, allocation and appropriation of financial funds. Other authors claim that, as far as public sector's ultimate purpose is not profit, financial performance cannot be a relevant measure. Finally, some studies underline that a conceptual pattern has not been identified and followed while putting in practice accrual accounting reforms, resulting into an uncritical and misleading transferring of business practices in the public sector (Mautz 1981; Guthrie, 1998; Ellwood, 2003; Guthrie et al., 2005; Christiaens & Rommel, 2008). As argued by Hodges and Mellet (2003: 110):

> There is a danger in adopting an uncritical assumption that private sector methods are superior to those of the public sector and should provide the model to be followed.

Moreover, some operational difficulties have came out in implementing accrual accounting, depending on the public sector's specific nature and kind of activities (Guthrie, 1998; Antony, 2000; Blöndal, 2002; Christiaens, 2004; Newberry & Pallot, 2005). In particular:

- the market absence, which causes some relevant consequences concerning definition, valuation, classification, depreciation and presentation of assets;
- the drawing up the opening balance sheet, that requires identifying and evaluating assets and liabilities at the starting point of the accounting reform;
- operational difficulties of accounting office staff in recording transactions under a double-entry bookkeeping system, as well as the public managers' troubles in understanding accrual-based financial reporting;
- problems with information systems, especially the transition to the new accounting system, as well as its costs in relation to time, financial and human resources.

Some studies underline the limits of business-like accounting systems in the specific context of public sector, which performs extremely heterogeneous activities and produces critical results that cannot be measured and represented by a financial point of view (Stewart & Walsh, 1994). In brief, the non-business features of the public sector economy leads to the existence of specific types of assets and liabilities, expenses and revenues that do not exist in business enterprises, and raises then a need for a special conceptual framework devoted to

public sector (non lucrative) entities (Guthrie, 1998; Chan, 2003; Ellwood, 2003). However, the development of accounting and performance measurement models that are increasingly difficult to be implemented and expensive undermines the difficulties to measure government performance, eventually considering the measure of the activity as an aim and not as a mean (Jones et al., 2001; Olson et al., 2001).

Finally, from a management perspective, usefulness of accrual accounting reports – especially their ability to improve politicians and other stakeholders' decision-making – seems not to be proved, since public sector decision makers do not find such information so useful, relevant, and understandable (Jones & Pendlebury, 2004; Brusca & Montesinos, 2006; Wynne, 2008).

Section III – Disentangling a theoretical perspective of accounting for public entities

This section aims at presenting an accounting theoretical synthesis that moves the dialectics between cash and accrual accounting bases a step upward. From advocate of accrual basis, we take the focus on the measurement of consumed resources, whilst we also accept caution with the specificities of the public sector economic functioning that are raised by its critics. Furthermore, we disagree with the alleged idea that cash-basis cannot impute outflows and inflows to the period or activity of reference. The main difference between cash-basis and accrual-basis stands on the different recognition and measurement of assets and liabilities, including the timing of these accounting operations, not with the imputation process. Therefore, we purport to develop a comprehensive conceptual framework to assess the capacity of the accounting system to report a "true and fair" representation of the economic activity of public administration (PA) in general and EC in particular.[1]

The EC economy is featured by the absence of any "profit motive" that is typical of every PA. It has a very particular nature: it is a supranational organization that embeds different institutions and other bodies (such as agencies). In addition, it is further characterized by the special economic role that this entity plays on behalf of the Member States that are the constituents of its organization. The EC receives financial resources from those Member States, and redistributes resources among them through the provision of public services,

[1] We utilize here the expression "true and fair" as a normative notion concerned with the quality of accounting system. It obviously depends on the purpose, scope and principles of reference for that system.

transfers and grants throughout the European territories. The "own resource revenue" that accrues automatically to the EC (in 2008, it is 92% of total revenue[2]) and that enables it to finance its budget "is determined by total expenditure less other revenue" (EU 2008, p. 7), and is limited to 1.24% of the gross national income (GNI) of the Member States. The revenue based on GNI corresponds to the 70% of the total own resource revenue[3] and is "used to balance budget revenue and expenditure, i.e. to finance the part of the budget not covered by any other sources of revenue" (EU 2008, p. 8).

The EC entity is then accountable for incurred expenditure that the Member States must recovered. This *expenditure-sharing* purpose adds to the usual *no profit motive* in the context of the EC economy. Following Anthony (1978) and Biondi (2008 and 2009), which provide further references, these features require a specific accounting framework to be accounted for. The accounting system shall first establish the expenditure that corresponds to the period of reference, and then matches the revenue that accrued to cover it over time. Furthermore, the revenue is expected not only to pay for consumed resources (cost absorbed), but also to finance their acquisition for the EC activities (cash outflow). The accounting system becomes then a joint mode of accounting for the EC activities to the Member States which aim at making the governing bodies accountable for incurred expenditure and matching revenue that has to be levied on those States.

Under the overall no-profit motive and the expenditure-sharing purpose, the accounting system of EC economics requires determining both incurred expenditure and matching revenue. Accrual accounting should be adapted to fit with these specific accounting needs. Following Biondi (2008 and 2009), three main families of accrual accounting exist and provide distinctive definitions of the accounting elements and objectives (Table 1), including expenditures:

– A static representation (patrimonial), focusing on the net worth of the firm and its valuation at a specific moment in time;
– A financial representation (cash flow), focusing on the financial inflows and outflows of the firm and representing the resources available at a particular time to meet the needs or purposes of its activities;

[2] The remaining 8% consists of "sundry revenue" arising from the activities of the EC such as competition fines and recovery orders to private and public debtors other than Member States.
[3] The remaining 30% consists of shares of value added tax levies, customs duties, agricultural duties and sugar levies collected by the Member States on behalf of the EU.

– A dynamic representation (economic), focusing on the resource inflows and outflows of the firm and representing the resources mobilized (and utilized) by its activities during a particular period.

Table 1 - Accounting representation of the non business firm

	Static view	**Financial view**	**Dynamic view**
Orientation	*Wealth*	*Cash Flows*	*Net result*
Focus	*Net worth*	*Resources available*	*Resources mobilized (and utilized)*
Basis of reference	*Properties and claims*	*Cash outflows and inflows*	*Matching of costs and revenues*
Timing	*Moment in time; changes between moments*	*Time period*	*Time period*
Recovery of …	*Values conferred*	*Cash outflows*	*Costs absorbed*

These three different representations complement each other within any given accounting system; however, as overall guides for representation and interpretation, they are ultimately alternatives. In particular, under democratic political regimes, the static model is at odds with the usual understanding and the legal basis of tax levy, which imply the redistribution of collected resources either by transfers or non-business furnishing of goods and services. Stanton and Stanton (1998) provided a critique of the economics underlying static accounting and concluded that the use of the economic concept of value is inadequate and unreliable in the public sector. This kind of accounting would result in information which reflects neither the financial nor the economic position of the reporting public entity. Already Holder (1980, p. 31) doubted of such a view in the public sector, and adopted a dynamic view which made clear the appropriate relationship between government and citizens (taxpayers), for example in terms of "command over resources." Moreover, Robinson (1998) criticized the static approach based on current valuation, and tried to improve on an accrual accounting model fitting with sustainability and "intergenerational equity" implications of fiscal policy. McCrae and Aiken (2000) developed a "flow of obligations" perspective of accounting for the public sector that refers to a flow (or matching) concept of service provision rather than a "stock" (or "valuation") concept.

Concerning the EC economy, the featuring purpose of expenditure-sharing requires a specific definition of expenditure to be recovered. This excludes the application of the static representation, which does not fit with the "true and fair view" of the underlying economy. For the static representation focalizes on the net worth and related changes in value and does not represent *incurred expenditure that has to be recovered over time*. However, this purpose implies a combination of financial and economic representations, that is, the integration between budgetary accounting and dynamic accrual accounting that are both required to obtain the "true and fair" representation of the EC activities. Whilst the budgetary accounting may represent the resources that are made available to different projects and programs (cash outflow), the dynamic accrual accounting may represent the resources absorbed by them and by the whole of EC economy (cost absorbed). Cash and accrual accounting are then allied to recognize and measure those acquired and consumed resources (expenditures) that must be recovered to assure the continuity of the EC economy over time.

In sum, the suitable conceptual framework for EC economy is shaped by the featuring absence of any "profit motive" and by the supranational coordination role accomplished by the EC. Whilst the wealth-basis refers to fair value accounting and results to be at odds with the specificities of public sector economics, a dynamic view of the accrual basis can be properly applied to the assessment of EC accounting concepts and rules. This latter basis of accounting results to fit the economic redistribution function performed by the EC. The next section will apply this accounting framework to assess the capacity of the EC accounting system to provide a "true and fair" representation of the EC economy jointly featured by the "expenditure-sharing" purpose and by the "no-profit motive".

Section IV – Research context: European Communities as an economic entity and the reform of its accounting system

The EU is the result of an extremely complex process of cooperation and voluntary, peaceful integration, unique and still evolving[4], which some European countries have started since the fifties of the last century. Established by the Treaty of Maastricht in 1992, the EU builds on existing EC and supports them with new forms of cooperation in the fields of justice and home affairs: this has led to the coexistence of two distinctive cores that operate on the basis

[4] For instance, the Treaty of Lisbon, enforced on 1st December 2009, providing some important changes in the working methods of the EU institutions.

of different procedures: the communitarian and the intergovernmental procedure[5]. For these reasons, the EU institutional framework and its working mechanisms are characterized by a relevant degree of complexity and heterogeneity[6]: EU is a public administration much younger than national States, hardly comparable to them from a political and institutional point of view (Pollitt & Bouckaert, 2004: 58-61).

During the last decade, many reform processes have begun, involving several EU dimensions (especially internal organization, management, finances and control), fostered by the institutional crisis occurred at the end of the nineties (marked by the resignation of the Commission[7]) and by the enlargement process that led EU members to increase from six to twenty-seven. Therefore, the original model shaped by the EC founding fathers resulted to be inappropriate. Two main shortcomings were stressed among others: a "democratic deficit" (Tsakatika, 2007) concerning the European government; and a "management deficit" related to the inadequacy of management tools employed to assign performance responsibilities to political and administrative actors operating at different EU levels (Metcalfe, 2000; Harlow, 2002). The Commission's reform process on this matter started in 2000 with the White Book publication (European Commission, 2000): it has been based on the principles of accountability, efficiency and effectiveness of actions put in place and transparency within the Commission, as well as towards external stakeholders (Levy, 2004). Three intervention areas were envisaged by the reform: the implementation of an activity-based management system which led to a reform of the arrangements for setting policy priorities and resources allocation[8]; the reassessment of human resources policies and management; the reform of financial management, control and audit systems (European Commission, 2000).

Concerning the third intervention area, the Commission accounting modernization project – called "Accrual Based Accounting" or ABAC – concerns accounting systems and financial reporting, as well as EU consolidated financial statements. Why did the Commission decide to

[5] Even if often the EU is identified as a supranational PA, it's true only according to its communitarian component, predominant but not extensible to the whole EU.

[6] The current institutional framework comprises institutions (the most important being the European Parliament, the European Commission, the European Council, the Court of Justice of the European Communities and the European Court of Auditors), financial bodies, advisory bodies, inter-institutional bodies and decentralized bodies (agencies). All these actors operate in order to achieve the EU institutional goals, as defined in their founding treaties, through the implementation of various and heterogeneous policies and programs, in collaboration with the Member States (Nugent, 2006).

[7] Following fraud, nepotism and financial mismanagement highlighted by a report published by a Committee of Independent Experts (Harlow, 2002).

[8] The EU budget has been amended according to the principles of the Activity Based Management.

reform its accounting system? This move relates to the rise of New Public Management and the critique of cash-based accounting that has dominated that rise. In particular, the European Court of Auditors, through its annual DAS – *Declaration d'assurance*[9] – had stressed several times the incomplete reliability of the EU accounts, due to the accounting system totally based on cash accounting[10]. Started in 2002 (European Commission, 2002)[11], the ABAC reform is not fully completed yet, but one important step was achieved with the preparation of the annual accounts of 2005 based on accrual accounting driven by new Financial Regulation and Implementing Rules.

> Adopting accounting rules and methods, the Commission's accounting officer shall be guided by the internationally accepted accounting standards for the public sector, but may depart from them where justified by the specific nature of the Communities' *(art. 133, par. 2, Financial Regulation).*

The renewed accounting system is a dual system that integrates cash and accrual accounting. Accrual accounting has been implemented whilst cash accounting is still employed to manage budget appropriations. In particular, as far as the budgetary accounting is concerned, expenses are recorded under a modified cash basis, and revenues under a cash basis; financial accounting is accrual based and recorded under double-entry bookkeeping. The coexistence of the two accounting systems is possible thanks to specific software's integration (European Commission, 2008).

The economic role played by the European Commission deserves special consideration from the financial accounting viewpoint. It is a European institution that embodies the supranational spirit of the EU, defending the general communitarian interests beyond the particular interests of each Member State. In particular, it holds executive powers to ensure the proper implementation of European legislation, budget and communitarian programs. Therefore, the Commission is not only a public administration – thus having no profit motive – but also a supranational organization that is accountable to other public entities that are EU institutions and national Member States. By receiving financial resources from the latter, it plays a key role of economic coordination by redistributing resources through the provision of

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[9] The DAS is the Court's formal statement on the reliability of the EU accounts and on the legality and regularity of the underlying transactions. It aims to provide stakeholders, mainly the European Parliament and the Council, but also EU citizens, with an audit opinion on whether EU money has been properly spent in accordance with Community law and reliably recorded in the annual consolidated accounts of the EC.

[10] For instance, one of the most important declaration was issued with the DAS related to financial year 2000, published on Official Journal of the EC n. 2001/C 359.

[11] The reform process of the EU accounting model started since 2000, with a study carried out by a group of scholars who provided suggestions and ideas about redefining EU financial reporting (Montesinos, 2000).

public services and direct transfers or grants throughout the European territories. In this context, the EU accounting model plays a role of utmost importance, defining accounting principles and rules to be applied by EU institutions, including consolidation of the various EU entities' financial statements.

On the basis of Financial Regulation (art. 124), financial statements are established in accordance with generally accepted accounting principles, that are going-concern basis, prudence, consistency of accounting methods, comparability of information, materiality, no netting, substance over form, and accrual-based accounting. Further implementing Rules provide an interpretation of these principles with reference to EU's features and specificities (art. 186-192). Accordingly, the Commission Accounting Officer, assisted by an Accounting Standards Committee, has issued sixteen accounting rules: Committee's role is to deliver an independent professional judgment on the accounting standards and rules proposed by the Commission's Accounting Officer and to advise him on financial reporting principles and standards' application (Introduction of Accounting Rules, par. II.5). These communitarian accounting rules define the general purpose and objectives of the EC financial accounting and reporting, its main statements and the modes of recognition, measurement, and disclosure requirements of main financial statements' items. The Commission has established these rules after having observed communitarian features and specificities. This has implied a process of adjustment of IPSAS that has identified which IPSAS can be directly applied, without integration need; detailed and adapted some IPSAS; and also created some "new" standards regarding areas left uncovered by IPSAS[12]. Every standard is divided into several sections: the introductory section regards general purposes of the accounting rule; thereafter, key-words, measurement rules and disclosure requirements are explained; the last section concerns other rules of reference, which treats IPSAS (also the ones that cannot be applied, with specific motivations), IAS/IFRS (completing or substituting IPSAS, if they lack) and financial regulation articles which the standard refers to.

Section V – Research findings

This section will assess the capacity of the EC accounting framework and rules to provide a "true and fair" representation of its economy featured by the purpose of "expenditure-sharing" and by the "no-profit motive". This assessment is performed by applying the conceptual

[12] For instance, accounting rule N° 5 is dedicated to pre-financing, one of the specificities of the Commission's activity.

framework presented by the section three to the EC accounting regulatory system. After some general comments on the connection between budget and accrual accounting and the accounting framework, specific comments will be provided on the sixteen accounting rules:

- N1: Group accounting;
- N2: Financial statements;
- N3: Expenses and payables;
- N4: Revenues and receivables;
- N5: Pre-financing;
- N6: Intangible fixed assets;
- N7: Tangible fixed assets;
- N8: Leases;
- N9: Stock;
- N10: Provisions, contingent assets and liabilities;
- N11: Financial assets and liabilities;
- N12: Employee benefits;
- N13: Foreign currency translation;
- N14: Economic result of the year, fundamental errors and changes in accounting policies;
- N15: Related party disclosures; and
- N16: presentation of budget information in annual accounts.

General purpose and scope of EC accounting: the accounting framework

According to the EC accounting framework, EC financial reporting must "demonstrate the accountability of the EC for the financial affairs and resources entrusted to it" (*ibidem*, p. 2). This principle makes the mentioned reconciliation even more important, since the EU entity operates as a collective device whose financing pertains to the Member States that have to share it fairly.

In particular, the accrual accounting basis that is retained by the EC accounting system requires that both revenue and expense are matched to the period of reference (that is, the financial year). This helps the reconciliation with the budget accounting, and facilitates the accounting work that is not expected to match every revenue item (that generally does not have a specific purpose) to the related expenses:

> "Generally, expenses are recognized in the economic outturn account on the basis of a direct association between costs incurred and the earning of specific items of revenue.

> But the European Communities' main revenues include both taxes and contributions from Member States. Moreover, the payment of taxes or contributions does not entitle a taxpayer to an equivalent value of services or benefits, as there is no direct exchange relationship between paying the tax or the contribution and receiving European Communities services or transfers. Consequently, matching revenues and expenses is not a concept that is readily applicable to the European Communities" (EU rule n° 3 – expenses and payables, p. 10).[13]

Connection between budget and general accounts

Virtually all EC accounting rules mention the difference between budget and general accounting at the beginning, but insist that both "are monitored in a single integrated process which allows the two set of accounts to be reconciled" (EU 2004). However, this reconciliation is neither reported nor disclosed by the financial statements until 2008 (EU 2008). In fact, a new accounting rule n° 16, issued in December 2008, makes this reconciliation compulsory since the annual accounts of the financial year 2009.

This lack of reconciliation does not appear to be material in 2008. The total budgeted amount of revenue (121,385 EUR billions) is of the same order of the total accrued revenue (122,444 EUR billions). Nevertheless, the accumulated economic result (called economic surplus/(deficit) or outturn) is negative (47,424 EUR billions). This implies a continued unbalance between revenue and expenditure on accrual basis, whilst the European budget is expected to be balanced every year, that is, "the budget revenue should always equal or exceed budget expenditure and any excess of revenue is returned to Member States" (EU 2008, p. 74). This negative result represents "that part of the expenses already incurred by the Communities up to 31 December 2008 that must be funded by future budgets" (*ibidem*). In 2008, the 25% of it is explained by recognized expenses in the year N (2008) that will be actually paid only in year N+1 (2009) by using the budget of the year N+1. The remaining part is due to "employee benefits obligations of the Communities towards its staff" that are "guaranteed by the Member States". This surely means that, even though EC has introduced accrual reporting for employee benefits, their funding is still based on cash-basis.

Anyway, the reconciliation of budget and general accounting – that is being to become compulsory since 2009 – is suitable from the theoretical perspective adopted by this paper and suggested by Anthony (1978) and Biondi (2008 and 2009) among others. A reconciliation scheme is actually provided by the EC (2004, p. 3) itself:

[13] Cf. also EU rule n° 4 – revenues and receivables, p. 2.

= Budget accounting year N
+Revenue receivable -Expenses payable +Budget commitments for delivery in N+1
+/-Budget operations recorded in the balance sheet (e.g. investments, asset disposals, etc.)
+/-Operations relating to pensions
+Pre-financing -Eligible expenses giving rise to pre-financing
= General accounts year N

This scheme of reconciliation consists of different adjustments: the timing of inflow and outflow, including future commitments; the operations related to investing and financing, and pensions; and the operations related to pre-financing. This reconciliation is in line with the general accounting principles defined by the accounting framework (EU 2004, p. 2): "The economic result (from the economic outturn) is expected to make the link between cash-based budget accounts and the general accounts, which are moving towards accrual accounting". In particular, it "reveals the impact on the balance sheet of expenditure and revenue not originating from budget accounting" (*ibidem*). Actually, the scheme published by the 2009 Final Accounts is different:

RECONCILIATION: ECONOMIC RESULT – BUDGET OUTTURN 2009		
ECONOMIC OUTTURN FOR THE YEAR	*Current Year (2009)*	*Previous year (2008)*
Revenues Entitlements established in current year but not yet collected Entitlements established in previous years and collected in current year Accrued revenue (net)		
Expenditure Accrued expenses (net) Expenses prior year paid in current year Net-effect pre-financing Payment appropriations carried over to next year Payments made from carry-overs & cancellation unused payment appropriations Movement in provisions Other		
Economic outturn agencies + ECSC		
BUDGET OUTTURN FOR THE YEAR		

The latter scheme and the related comments (EC Final Accounts 2009, p. 137-38) are merely technical, and do not provide an understanding of the reconciliation of some usefulness for external users or decision-makers. This undermines the actual capacity of accruals to improve on public finances and financial management at the European level.

The US Government Accountability Office (GAO) provides another example of reconciliation. Accordingly, "while cash and accrual measures each serve different purposes, they present complementary information and can be used together to provide a more comprehensive picture of the government's fiscal condition today and over time" (GAO 2006: 2). As for the case of EC accounting, revenue is primarily recognized on modified cash basis and there is little difference between cash receipts and accrued revenue. The differences are almost entirely on the spending side and arise when a cost is accrued (and affects the accrual deficit) in one fiscal year but paid (and affects the cash deficit) in another fiscal year. The largest differences are accounted for by employees' benefits, veterans' compensation, environmental liabilities, insurance programs, depreciation expenses, and capital assets. The "crosswalk between accrual and cash deficit" follows this scheme (*ibidem*: 14-15):

= Net operating cost (i.e., accrual deficit)
Components of accrual deficit not part of the cash budget deficit: +Changes in employees' benefits +Changes in veterans' compensation +Changes in environmental liabilities +Depreciation expense +Changes in insurance liabilities +Other
Components of cash budget deficit not part of the accrual deficit: -Outlays for capitalized fixed assets -Other (e.g., principal repayments on pre-credit reform loans)
All other reconciling differences: +Net amount (i.e., the "plug" needed to force the statement to balance)
= Unified budget surplus/deficit (i.e., cash surplus/deficit)

This scheme allows to better identify the main factors of difference between the two surpluses/deficits, and to group them according to their sign. But it has the disadvantage to

start from the accrual balance, whilst preparers and readers are supposed to know better the cash basis at the present[14].

Accounting rule n° 1 – Group Accounting

The first rule is devoted to the consolidation of the whole of entities that constitute the EC economy. This consolidation is critical to the true and fair representation of its economy. Following IPSAS, the rule applies the "control concept" to the decision of including an entity in the scope of consolidation and to the choice of the related method. In fact, "the most common indicator of control – the majority of voting rights – is in most of the cases not applicable for the EC as these are normally no capitalistic links between the entities" (rule n° 1, p. 5). Generally speaking, these entities have been created through their founding treaties that establish also modifications of their structure and statutes. These entities "represent the basis of the organizational structure of the European Communities and contribute incontestably to the European Communities objectives" (*ibidem*, p. 5). This specific mode of organization implies a double definition of control: from one side, control is defined through "a power element such as the power to govern the financial and operating policies of another entity"; from another side, control is defined through "a benefit (and loss) element, which represents the ability of the controlling entity to benefit from the activities of the other entity" (p. 4) and/or "be liable for certain obligations of the other entity" (p. 21). This composite definition is further articulated on three decreasing degrees of control: exclusive control, joint control, and influence, as summarized by the table 2.

Table 2 - Decreasing degrees of control for consolidation purpose	EC Framework	EC retained method	IPSAS
Controlled entities	Control	Global consolidation	Exclusive control
Joint ventures	Joint control	Proportionate consolidation	Joint Control
Associated entities	Influence	Equity method	Significant Influence

Even though the definition of control is based on substantial (not formal) economic control, regulatory power and economic dependence are reasonably excluded by its application

[14] According to IFAC-PSC (2003), the cash accounting has been maintained to gradually introduce major accounting changes, to match the development of incurred costs' recognition, and to adjust with historical tradition and habits of administrative staff in dealing with cash accounting.

(*ibidem*, p. 6), and a list of indicators of control is provided (*ibidem*, p. 21), based on distinctive conditions of power and benefit/loss.

Rule n° 2 – Financial statements

EU financial reporting comprises several documents and annexes: all European institutions and bodies have to draw up financial statements based on the EC accounting rules, in addition to budget accounts.

The "balance sheet" is established as a list where both assets and liabilities are divided between current and not current: their algebraic sum allows determining net assets. This latter item includes, in addition to the economic outturn of the year (surplus or deficit), some reserves – including the reserve due to fair value application – and the amounts to be called from member States.

The "economic outturn account" is also established as a list which contains operating revenues and expenses: revenues are split between own resource and contribution revenues and other operating revenues; whilst expenses between administrative expenses and operating expenses. Then, the economic outturn of the year is calculated adding up the surplus from operating activities, financial revenues and expenses, movements in employee benefits liability and share of net surplus (deficit) of associates and joint-ventures.

While there are not differences concerning the "statement of changes in net assets", which is in line with IPSAS' requirements, the EC *cash-flow table* is established according to the indirect method, whilst IPSASB recommends the direct method. Operations are grouped by EC into three areas: operating activities, investing activities and financing activities.

Finally, the "notes to the financial statements" provide further details on and explanation of accounting items included in all these statements, including additional information prescribed by internationally accepted accounting practices, where such information is relevant to the EC activities (Financial Regulation, par. 126.2).

Contrary to the budget outturn account, the accrual-based economic outturn account is very aggregate and does not assist the users to understand its economic meaning and significance. No reconciliation is provided with the budget outturn and the budget classification of expenditures among 31 policy areas. Only segment reporting splits operating revenue and expense by policy areas that are then grouped in three larger headings: "Activities within the EU" comprising the many policy areas; "Activities outside the EU" concerning trade and aid; and Services and other that concern the internal and horizontal activities necessary to the functioning of the Communities' Institutions and bodies (EU 2008, pp. 83-89).

Furthermore, even though the definition of expense is based upon the critical distinction among exchange and non-exchange expense, the financial statements do not exploit it for reporting and disclosure, but a somewhat obscure distinction between operational and administrative expenses that does not help to understand the EU activities.
Interestingly enough, the "net assets" item of the balance sheet is not directly explained by cumulated surplus and deficit and other reserve movements, but connected to the "amounts to be called from Member States", distinguished among "employee benefits" and "other amounts". The connection with cumulated surplus and deficit is made only by the "statement of changes in net assets".

Rule n° 3 – Expenses and payables

The rule applies a critical distinction between exchange expenses related to commercial transactions, and non-exchange expenses that relate to transfers, provision of public services and other non-reciprocal transactions. This distinction is in line with theoretical suggestions for non business accounting systems by Anthony (1978) and Biondi (2008 and 2009) among others.
The main criterion of measurement for expenses is their historical cost, that is "the amount of the original invoice", improperly called "fair value" (rule n° 3, p. 10). This is in line with the purpose of "expenditure-sharing" that lie at the heart of the EC accounting system and of the underlying EC economy. Nevertheless, this purpose is not properly applied to commitments for future payments that "should not be recognized as liabilities and, subsequently, as expenses" (rule n° 3, p. 14). Only any contingent liability – related to possible losses – should be disclosed in the notes to the financial statements. This exclusion of commitments mainly depends on the peculiar definition that denotes a commitment as a voluntary act that may change, instead of a committed obligation whose amount is still uncertain.
From the economic viewpoint, committed obligations represent a potential expenditure for the constituents (i.e., the Member States) that have to recover it in the next future. In some cases, it may derive from a contractual obligation to pay, as for operating leases. Accordingly, the accounting system should recognize it first in the balance sheet, and later in the economic outturn account, once the payment becomes payable to the beneficiaries. If the commitment results from the acquisition of an asset, such commitment may be treated as the liability contracted through a finance lease (see below), and capitalized as the estimated cost of dismantling the asset and restoring the site according to the rule n° 7 (p. 7).

Rule n° 4 – Revenue and receivables

As for the case of expenses, the revenues of EC economy are mainly non-exchange revenues. Interestingly enough, even the cancellation of a borrowing from a third party corresponds to revenue, since it is equivalent to receiving a grant or a donation from that third party.

Even though the definition confounds sometimes the economic substance of the occurrence of revenue with its accounting formulation, which is "an increase in net assets/equity" (rule n° 4, p. 3, 6 and 7), accrued revenue is properly recognized when the generating event or transaction occur, not when it is actually received. The accepted method of measurement is its historical cost, that is « the amount of the original invoice » (*ibidem*, p. 6), improperly called "fair value".

As recognized by Biondi (2008 and 2009), taxes on employees' salaries and pensions raise an accounting trouble since the reporting PA results to pay taxes to itself. In line with the purpose of expenditure-sharing, the EC accounting rule establishes a meaningful accounting reporting that overcomes that paradox (*ibidem*, p. 13). These taxes are included in the "revenue from administrative operations": in this way, only the net salaries and pensions are accounted for as expenses in the economic outturn account that properly reports then the net annual expense to be recovered.

Even staff contributions to their pension scheme are accounted for as « revenue from administrative operations ». In this case, the change in the pension liability – that is included among the annual expenses – is made net of annual contributions to the pension fund. Therefore, the final balance includes only the remaining part of the total pension liability that has to be covered during the year of reference.

Rule n° 5 – Pre-financing

Pre-financing constitutes a specific financial operation related to the EC economy of redistributing resources through grants and transfers. The transfer process constitutes the main economic activity of the EC, and is then represented by the economic outturn account. The pre-financing phase constitutes only a financial step of that process, i.e. the cash advance that provides the beneficiary with a float (rule n° 5, p. 1). This financial step is then properly represented by the balance sheet, until the transfers are actually accrued:

> "In the general accounts, pre-financing is a sum of money paid to a beneficiary and constitutes a simple cash movement with no impact on the European Communities' outturn account. No expense is booked to the outturn account as the generating event (delivery of good, performance of service or acceptance of eligible expenditure) has not yet occurred." (*ibidem*, p. 1)

Rule n° 6 – Intangible fixed assets

The recognition of intangibles and the capitalization of related investments are strictly justified by the "existence of future economic benefits [for the European Communities] attributable to the asset purchased or developed by the European Communities" (rule n° 6, p. 1 and 5). The rule introduces the usual distinction among research and development expenses, and allows a transitional period of five years to start applying this criterion with improved information systems. The restatement of previous research expenses is explicitly forbidden, making the separation even more stringent (*ibidem*, p. 6).

This criterion prevents therefore the capitalization and amortization of various expenditures, including research expenditures, which are expected to generate benefits for Member States and the European citizenship over time. These expenditures do not produce a reliable expectation of future benefits to the EU as an entity, but the EU purpose of expenditure-sharing should require their capitalization in order to better share them among the Member States, thus asking future taxpayers to contribute to these expenditures of public interest. These capitalized expenditures could then be shared among present and future taxpayers through accruals accounting allocation (Robinson, 1998).

By the way, the gains on sales of intangibles are included in the operating revenue, even though they are not part of the core operating activity (*ibidem*, p. 4). In fact, the impact of this misrepresentation is certainly not material, since intangible assets do not have either a size or a key role in the EC economy.

Rule n° 7 – Tangible fixed assets

Even the gains on sales of tangible are included in the operating revenue (rule n° 7, p. 5). The revenue related to tangibles fixed assets accounts for 25 EUR millions in 2008, that is, the 0,020% of the gross operating revenue, and the 0,197% of the economic result of the year.

Furthermore, the rule explicitly excludes to value tangible fixed assets at their market value (fair value), and prescribes that they "should be carried at cost, less any accumulated depreciation and any accumulated impairment loss" (*ibidem*, p. 10). On this basis, the depreciation is improperly defined as a "loss in value" (*ibidem*, p. 10).

The impairment test is based on the higher of the net selling price (liquidation value) and the value in use of the asset to be tested. The value in use is based on the identifiable active market value (whenever available) or on its replacement cost (*ibidem*, p. 12-13). The impairment loss should be material and not to be temporary, and the reversal of it should not

exceed the not-impaired historical cost, which remains the benchmark measurement (*ibidem*, p. 14).
The estimated cost of dismantling the asset and restoring the site may be capitalized to the extent it is recognized as a provision (*ibidem*, p. 7). At this point, from the expenditure-sharing purpose, that cost is passed twice through the economic outturn: as part of the annual depreciation of the asset, and as provision for future expenses. The accounting system should then compensate the depreciation and the provision charge on the economic outturn account, and show the correspondence of the capitalized cost and related provision in the balance sheet.

Rule n° 8 – Leases

The critical distinction among finance and operating lease bases upon the substantial transfer of "all the risks and rewards incident to ownership to the lessee" (rule n° 8, p. 4). When they are substantially transferred, the lease is accounted for as a finance lease.
The operating lease is recognized as an expense in the economic outturn account. The related assets are regarded as rentals, and no liability is recognized. The total amount committed to the payment of future rents is disclosed only by the notes. From the purpose of expenditure-sharing, this method generates a doubtful asymmetry between finance and operating lease, since even the latter involves a contractual commitment to pay for future rents over the lease term. The "control concept" may allow its recognition as an asset of the EC that controls it: the leased asset is exploited by the lessee entity and is contractually bounded to this exploitation. Therefore, its future service potential to the entity makes it accountable as an asset to the entity, even though the ownership (and the related whole of risks and rewards) belongs to the lessor.
The finance lease is accounted for the same amount in both sides of the balance sheet, with the actuarial depreciation allowing the symmetrical reduction of both amounts through the distinction between the rent charge (recognized as finance expense) and the capital installment (recognized as depreciation expense). "No subsequent measurement of the finance lease (i.e. change in the initial value of the asset) is allowed, as the value of the asset is determined once and for all in the contract" (*ibidem*, p. 11). This assimilates the contractual cost for the leased asset, including interest charges, to the original invoiced amount that is the basis of historical cost according to other accounting rules.

Rule n° 9 – Stock

In line with historical cost basis and dynamic accrual accounting, the EC accounting rule applies the first in - first out (FIFO) method or, in some exceptional cases, the weighted average cost formula (WAC), on the basis of periodic physical stocktaking. The rule also excludes LIFO method and perpetual stocktaking. Each item is then valued at its acquisition cost, and impaired at the lower of cost and net realizable value (rule n° 9, p. 10).

The definition of stock does not include agricultural stocks that constitute a significant activity of the EC. The rule explains that "the Communities do not buy in stocks and that the intervention stocks are held by the Member States" (rule n° 9, p. 16). Only the assistance in respect to these stocks must be recorded in the general accounts and assimilated to grants (*ibidem*, p. 17). These grants are employed to regulate market prices. The notes should give further information on the nature of these stocks (wheat, barley, rice, etc.).

Rule n° 10 – Provisions, contingent assets and liabilities

According to the rule n° 10, the provisions are recognized by the general accounts and reported by the financial statements, whilst contingent assets and liabilities are only disclosed in the notes to those statements.

The distinction between provisions and contingent liability is based on the probability of the generating event and the reliability of the measurement of the related amount (*ibidem*, p. 8):

- If the event is provable and the measurement is reliable, the amount is recognized as a payable item by the general accounts;
- If the event is probable but the measurement remains uncertain, the estimated amount is recognized as a provision;
- If the event is uncertain, but the related outflow is probable in the near future, the estimated amount is disclosed as a contingent liability in the notes;
- If the event is uncertain and the outflow remains remote, no report or disclose is made.

Concerning the estimation of provision, time value of money applies and values are then discounted (*ibidem*, p. 10): this significantly reduces the value that is accounted for it during the current financial year, and postpones a larger part of the recovery to future periods. From the purpose of expenditure-sharing, the security of recovery is then weakened, and no information has to be disclosed in the notes on the planned timing of future payments and recoveries, period by period. Furthermore, the definition of provision excludes future charges, and includes only the potential losses that do not depend on voluntary acts. The future

payments involved by a contract are not included unless the contract becomes “onerous”, that is, implies an economic loss: an economic outflow that is not compensated by economic benefits (*ibidem*, p. 11). Finally, this definition of provision materially prevents the provision calculation that could facilitate the sharing of future expenditures among Member States.

Rule n° 11 – Financial assets and liabilities

Problems with fair value accounting of financial assets and liabilities are well known for business firms, and are also recognized for non business activities carried on by public administrations (Biondi 2008 and 2009). EC “has no present intention to use the fair value option” that allows full fair value accounting for all financial elements (rule n° 11, preface, p. 1). Fair value accounting is then introduced only for short-term financial assets and liabilities, and for available-for-sale financial assets (*ibidem*, p. 15). Whilst fair value accounting is incoherent with the purpose of expenditure-sharing and the no-profit motive, its impact shall not be material, since the EC utilizes financial operations only to compensate financial unbalances in the budget management. Debt financing is then very limited and deficit spending is prohibited in principle.

Rule n° 12 – Employee benefits

The main principle of this rule is that “the cost of providing employee benefits should be recognized in the period in which the benefit is earned by the employee, rather than when it is paid or payable” (rule n° 12, p. 4).

The preparer of the EU accounts is then expected to make complex calculations that are not further explained and comprise discounted values based on actuarial basis (for long-terms benefits and defined benefit plans) and nominal values (for short term benefit e defined contribution plans). The combined employee benefit liability is then accounted for among the non-current liabilities in the balance sheet. The annual change of this liability is accounted for as an expense in the economic outturn of the year.

Whilst France and USA have excluded this liability from the general accounts, in order to avoid its impact on the net operating annual result (Biondi 2008 and 2009), the EC introduces the liability and its change in order to share the related expenditure among the Member States that are responsible for its recovery. However, from the material viewpoint, the outstanding liability accounts for a large part of the cumulated deficit of the EU on accrual basis. The Member States are probably not recovering it on accrual basis, but only paying for it on cash

basis, thus postponing to future periods the recovery of charges that are payable only in the future.

Rule n° 13 – Foreign currency translation

According to the EC rule, both realized and unrealized exchange differences are recorded as revenue or expense for the year in which they occurred (rule n° 13, p. 10). This method is at odds with the purpose of expenditure-sharing, since it pretends to share non realized expense, and with the prudence principle, since it pretends to share non realized revenue. In fact, this might suggest a peculiar accounting policy devoted to make the Member States responsible for exchange differences. In this way, the EU has not to cover these differences on their behalf, but pass them through to the Member States.

The impact of this accounting misrepresentation should not be material, since "most of all financial assets and liabilities are denominated in Euro" (EU 2008, p. 114), and so do most of all operating expense and revenue.

Rule n° 14 – Result of the year, errors and changes

The rule requires the EC to "present the net surplus or deficit from ordinary activities of the period, with specific additional disclosures, including extraordinary items" (*ibidem*, p. 1).

According to the analysis of the accounting framework and rules developed above, this principle is generally applied, since the impact of fair value accounting is very limited, and the inclusion of extraordinary revenue (such as gains from liquidated fixed assets, whether tangible or intangible) or the inclusion of non-realized revenue (such as positive exchange difference) are not material. In addition, the economic result is net of taxes paid by employees on their salaries and pensions, thus avoiding the overwhelming paradox of paying taxes to itself.

The economic result of the year as reported by EC is then in line with the purpose of expenditure-sharing among the Member States, under the overall no-profit motive typical of every public administration. This result may nevertheless be more meaningful if integrated by further information on economic sustainability over time. For this, its coherence with annual and multiannual budget should be disclosed, providing that annual excess on budget has to be refunded to the Member States. Furthermore, this implies the inclusion of commitments for future charges as liabilities in the balance sheet, even in case of operating leases or other certain commitments for future charges or contractual payments. The deferred expense on the asset side may then be recognized against the committed/contractual liability on the liability

side. The deferred expense should be released as current expense through the economic outturn according to the underlying payment plan and the actual payment flow over time.
In addition, this result relates to the "amounts to be called from the member states", which are responsible for its eventual recovery. The complex procedure that makes these amounts recognizable by budget and general accounts should deserve specific attention in this accounting rule.

Rule n° 15 – Related party disclosure

The rule n° 15 addresses two kinds of related party disclosures, concerned with control disclosure and key management personnel disclosure, by making reference to the concepts of transparency, and materiality.
Control disclosure purports to reveal the existence of related party relationships "*where control exists*". It applies only to general accounts on accrual basis. Once the related parties are within the frontiers of control, significance influence or common control of the reporting entity, this control should be disclosed irrespective of whether there have been transactions between the related parties, but only the transactions "other than transactions that would occur within a normal supplier or client/recipient relationship" (*ibidem*, p. 5) should be disclosed concerning the nature of the relationship, broad terms and conditions of the (class of) transaction(s), amounts or appropriate proportions of outstanding items. Aggregate disclosure is allowed for items of a similar nature.
Key management disclosure concerns remunerations, compensation and some loans to key management personnel and close members of their families. Actually, the rule complains that "key management" is difficult to be reduced "to a limited number in the case of the European Communities." Furthermore, in order "to observe confidentiality as regards private data and to comply with the relevant legislation", only aggregate "information on the top grade in the entity" should be disclosed (*ibidem*, p. 7).
These restrictions appear to potentially undermine the relevance of information disclosure, and do not follow widespread practices for members of governing bodies of business firms. Concerned with related party disclosure in the business context, IFRS (24, BC4) rejected the "privacy issue" to justify exemption for the disclosure of management compensation.

Rule n° 16 – Presentation of budget information in annual accounts

The need of coherence with the budget accounting and the combined meaningfulness of the financial accounting system is reinforced by the rule n° 16, which requires nowadays "a

reconciliation of actual amounts on a budget basis, with actual amounts presented in the financial statements when the accounting and the budget basis differ" (*ibidem*, p. 3). "The actual amounts presented on a comparable basis to the budget shall be reconciled to the actual amounts presented in the financial statements, identifying separately the major differences on both the revenue and the expenditure side" (*ibidem*, p. 8). This reconciliation shall be applied since the financial accounts of 2009.

Section VI – Synthesis and conclusion

Nowadays, business accounting models are the object of a progressive harmonization process: internationalization and integration of markets have been involving a transformation of the information and representation required decision-making by economic actors. As a consequence, the employed accounting language and regulation – its institutional framework - has changed. This change has been fostered by the EU, which imposed IAS/IFRS compulsory adoption to all listed companies in Europe. But what is going on about the public sector?

Concerning the latter, the EC could play a leading role in the future, taking decisions similar to those ones assumed for listed companies, even if a communitarian intervention in this field could clash with the EU member States' national autonomy with reference to their budgets and accounting models (Jones, 2007: 103).

This paper has analyzed the choices made by the EC in terms of its own accounting system and financial reporting reforms, with particular reference on the accounting concepts and rules recently issued. The EC case is a very peculiar one: it is not only a public administration with no profit motive, but it is a supranational organization including different supranational institutions with specific functions (such as European Commission and European Parliament) and other bodies (such as the European agencies). Furthermore, the EC activities are often realized with the operational support of NGOs, no profit organizations and other private entities, which receive EC grants and fund transfers, carry out programs and deliver services through European territories and abroad.

Our theoretical analysis has assessed the capacity of the EC financial accounting and reporting to provide a "true and fair" representation of the economy of the EC entity. This economy is featured by the purpose of expenditure-sharing among the Member States that ultimately are responsible for EC expenditure.

Generally speaking, the choice of combining accrual-based general accounting with cash-based budget accounting in an integrated dual accounting system has been in line with this

purpose, under the overall no-profit motive that is typical of every PA. This choice is also in line with the specificities of EC activities that mostly deal with cash fund and flow transactions, but also mix public and private intervention, causing public and private sector co-operation at different levels.

Full accrual accounting application is very expensive for wide and complex public entities as central governments. Christiaens and Rommel, for example, suggest using accrual accounting "when government engages in businesslike activities", while cash accounting should be applied when public entities "provide social services without business like or profit objectives". They further argue for a combination of both systems when different kinds of activities coexist (Christiaens and Rommel, 2008: 59-75). The EC case appears to be in line with this view. It shows both the importance of accrual accounting for improving activities' cost measurement, and the necessity of its integration with cash-based information, considering the featuring qualities of the EU activities. At the moment the dual accounting system does not seem a temporary choice. Any documents we have analyzed speak about a definite move to accrual accounting based on such combined approach.

Furthermore, deviations from proper accounting representation (established according our conceptual frame of analysis based upon dynamic accrual accounting) proved to be very limited and never material. For example, the definition of intangibles is limited to the interest of the EC entity and excludes then public interest purposes, but their size and role are not critical in the case of EC economy. Therefore, we can conclude that the new accounting system has bettered the following objectives of EC financial accounting and reporting:

- The economic function of redistribution, related to the economic solidarity between the Member States, through an enhanced representation of revenue and expense;
- The prevention of frauds concerned with transfers and related financial operations made by the EC;
- The accomplishment of intergenerational and transnational equity, through the recovery of incurred expenditures by various taxpayers located in different places at different times on the European territories.

Within the public sector, IPSAS do not still have the same importance than IFRS for private companies, given that the adoption of these accounting standards is not compulsory for the European public entities. But the EC has taken IPSAS as reference for its accounting reform, in order to develop their own accounting rules and concepts. The EC, with its Financial Regulation, indirectly supports the use of IPSAS by the EU member States and this choice

actually improves their legitimacy, in line with what other international public organizations did or are doing (such as OECD, NATO and UN).

In conclusion, the EC accounting experience is significant since the European Commission may decide to play a role in harmonizing the accounting systems of the Member States, as was the case for group companies listed in national regulated Exchanges. The EC accounting system may then become the accounting model to be emulated by various national administrations that are submitted to the European Commission. Furthermore, the latter may even impose this system by driving the public sector accounting convergence within the EU.

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