European accounting standards for the public sector

What contribution can the International Public Sector Accounting Standards (IPSAS) make?

Keywords: Cameralistics; Double-entry bookkeeping, EPSAS; Government Finance Statistics (GFS); IPSAS; National Accounts; Public Sector;

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With its report „Towards implementing harmonised public sector accounting standards in Member States“ of March 2013, the European Commission has announced the development of European accounting standards for the public sector (European Public Sector Accounting Standards, EPSAS). The report examines the suitability of the International Public Sector Accounting Standards (IPSAS) for the Member States’ financial reporting. Even though the Commission suggests that on the one hand „IPSAS cannot easily be implemented in EU Member States as it stands currently“ while on the other hand “the IPSAS standards represent an indisputable reference for potential EU harmonised public sector accounts“, the question of the concrete contribution IPSAS could make to the development and establishment of EPSAS remains unanswered. We are of the view that the IPSAS can provide guidance not only regarding the concrete development of the standards themselves but also for organizing the EPSAS governance, developing an EPSAS conceptual framework and designing a standard-setting process. Last but not least, when implementing EPSAS for the first time, one could certainly take advantage of the experience globally gained with implementing IPSAS.

1 The „I“ in EPSAS

Already in its report „Towards implementing harmonised public sector accounting standards in Member States“ of March 2013, the European Commission dealt with the potential of the IPSAS for improving measurement and forecasting of the financial situation of the Member States and for overcoming the lack of coherence between public sector accounting and Government Finance Statistics (GFS), thereby enhancing budgetary surveillance in the EU.¹ The European Commission concluded in its report that while “IPSAS cannot easily be implemented in EU Member States as it stands currently” they nevertheless “represent an indisputable reference for potential EU harmonised public sector accounts”.²

The debates that have followed the Commission’s report have shown that the role the IPSAS can play in harmonising public sector accounting is perceived very differently across Europe. The positions of the Member States vary in this regard from a complete rejection of IPSAS towards a comprehensive endorsement. Below, we present some arguments that speak for developing European Public Sector Accounting Standards based on IPSAS.

First of all, it should be noted that Europe is closely intertwined with the global (financial) markets and political developments. The debate around developing the EPSAS should therefore consider that the standards should not result in an isolated application. Rather, they must fit into the international public sector accounting landscape. Given the increasing importance of international capital markets for the financing of jurisdictions, deviating from IPSAS or developing IPSAS-independent standards could result in misleading signals being sent out to the rest of the world. In the context of the debate about developing a European-specific way, investors and rating agencies have often reacted with incomprehension. In case that EPSAS depart significantly from IPSAS European Member States will lose comparability internationally. This represents a risk that should be considered when developing the conceptual design of the EPSAS. Taking an international point of view, it would thus seem negligent to not consider the IPSAS, which are the only internationally recognized de facto set of standards, as a starting point and guidance for developing the EPSAS.

A standard setting process disconnected from IPSAS would moreover disregard the current public sector accounting situation in Europe. Several Member States – and this particularly applies to the more recent EU joiners – have already implemented a public sector accounting system close to IPSAS or are in the process of doing so. Regulations that deviate from IPSAS would therefore represent a step back for many EU Member States. One must not forget, in this context, that the IPSAS are already ten years ahead in terms of development and implementation experience. The EPSAS could, and also should, benefit from this advance. Furthermore, the detached development of EPSAS would require considerable resources, both in terms of capacities and intellectual capital.

An there is also the risk that the longer the European Commission takes to come up with a framework for EPSAS governance and authoritative regulations for EPSAS the more Member States will become “IPSAS-independent”. As a result they will likely have no interest in getting involved in the EPSAS discussion. If all Member States are using to some extent IPSAS already then there will be no need for an EPSAS project anymore.

Finally, an IPSAS-independent development of EPSAS is likely to result in delaying the envisaged timetable by Eurostat – the relevant European authority for developing and introducing the European standards. This would also imply a considerable extension of the project schedule.

Basing the development of EPSAS on IPSAS does however not mean that necessary European-specific adjustments should not be carried out. In our opinion, the adaptation of IPSAS – to make it match the objectives of the EPSAS-project (implementation of the accrual basis of accounting and harmonization of government financial reporting and alignment with Government Finance Statistics) – represents the best option to be followed and also the worldwide most observed approach.

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4 We refer in this regard to the recent decisions taken in Africa, Asia and South America on a coordinated approach towards implementing IPSAS.

5 Cf. Ernst & Young, Overview and comparison of public accounting and auditing practices in the 27 EU Member States, 2010, p. 23 et seq.
2 Starting point of EPSAS as compared with IPSAS

For developing and establishing the EPSAS, one must consider the different points of departure of the two sets of standards. Whereas the IPSAS have been developed almost without international bases in public sector accounting, the EPSAS already dispose of an international reference framework. It must be highlighted that the IPSAS are already harmonized with international private sector accounting standards in the form of IFRS where a sector-specific accounting approach is not deemed useful. Due to the intensive coordination between the IPSAS Board (IPSASB) and the standardization bodies for Government Finance Statistics (i.e. IMF, Eurostat) an alignment with the rules of GFS can more and more be observed in the context of the formulation of new standards. These “coordination efforts” are thus already taken care of and must not be provided anymore in case the IPSAS are taken into account by a European body for the financial reporting of the public sector.

Given that the IPSAS provide some scope for interpretation and choice, it seems however appropriate to undertake a concretion and narrowing of the IPSAS requirements in the course of the European harmonization. Regarding implementation, one should consider that the IPSAS do not require a direct application, neither with respect to content nor to time, except for jurisdictions committing themselves, by contract or by law, to make the IPSAS the foundation of their financial reporting. In contrast, it is planned that the EPSAS will be compulsory for the European Member States in the form in which they are adopted by the European Commission - without allowing for any national leeway. There will also be a close connection between the standard-setting and the then following implementation with regards to timing: Unlike in the case of adoption of IPSAS into national legislation, a first-time adopter of EPSAS will not be able to determine the moment of the first application. These aspects must be considered when defining the content and timing of transition periods for first-time adoption.

As regards the current situation for EPSAS, they can consequently build not only on a well-established and internationally agreed upon conceptual framework but also on a whole set of preexisting IPSAS. Moreover, whereas know-how from transitions to double-entry bookkeeping was still very limited during the IPSAS development phase, Member States have in the meanwhile collected substantial first-hand experience of converting to double-entry bookkeeping. There is thus a treasure trove of experience one should take advantage of with regard to the development of EPSAS.

3 The possible contribution of the international accounting standards

3.1 Governance

The Commission report of March 2013 had, amongst others, identified shortcomings in the governance of the IPSASB. One significant point of criticism related to the independence of the IPSASB and the resultant lack of oversight. In addition, the report pointed out that the governance of the IPSASB suffers from a lack of participation on the part of the authorities that are competent for the national public accounting standards in the EU.

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Independently of the European criticism regarding the IPSASB’s governance, reforming its governance had been an item on the IPSASB’s agenda for quite some time already. From January 2014 to April 2014, the International Public Sector Accounting Standards Board Governance Review Group, which is presided by the International Monetary Fund (IMF), the Organization for Economic Co-operation and Development (OECD) and the World Bank, carried out a public consultation on the future governance of the IPSASB. The main points of criticism on the IPSASB’s governance as highlighted by the Review Group relate to the lack of supervision of:

a. the nomination process for board members,
b. the concrete agenda-setting of the work plan and
c. the due process.

Finally, it was considered that an interpretation committee, similar to the International Financial Reporting Interpretations Committee (IFRIC) in the field of IFRS, is missing in the governance structure of the IPSASB.

Against the background of the discussion surrounding the organization of the IPSASB’s governance, Figure 1 describes the problem areas that the EPSAS governance will have to face.

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**Figure 1: Problem Areas Related to EPSAS Governance**

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To be able to develop harmonized European accounting standards, the Member States must surrender their national legislative competence, i.e. their sovereignty with regard to shaping their public sector accounting system, to a European standard-setting body. It is therefore imperative to ensure the standard-setting competencies of the Member States through an appropriate institutional standard-setting structure and an appropriate composition of the standard-setting bodies. However, the composition and modus operandi of the IPSASB also show that participation of other stakeholders (e.g. taxpayers, media representatives, regional and local government level representatives, representatives from national government finance statistics and from the scientific community, etc.) is a prerequisite for setting standards in the public sector. This participation may not be limited to being involved in the respective bodies but must also include participation in the so-called due process. Adequate public consultations on discussion papers and exposure drafts ensure that the stakeholders that are relevant for standard-setting purposes make their voices heard.

Principles like objectivity, independence, competence but also capacity are central to the determination of accounting standards. On the one hand, the above-mentioned due process can contribute to these principles. On the other hand, as shown by the last consultation of the Governance Review Group and by the measures derived from this consultation, an appropriately organized oversight is crucial to safeguarding these principles. An appropriately institutionalized supervising body however also ensures that Member States do not become subject to restrictions with regard to their participation rights in the EPSAS standard-setting process.

Against the background of the concrete organization of the EPSAS governance and the establishment of a possible EPSAS Governance Advisory Board, we stress the central importance of an appropriate oversight mechanism. The missing oversight of the IPSASB was the Governance Review Group’s central point of criticism. In addition, the weaknesses in the IPSASB’s governance were seen as one of the reasons explaining why many jurisdictions have still not implemented IPSAS.

Another problem area appears in the context of the legal design of the EPSAS. Given the Member States’ above-described loss of standard-setting competence, it is indispensable to arrange for a sufficient democratic legitimation of the standards. The democratic legitimation must however be obtained in a way that preserves the efficiency and timeliness of the standard-setting process. In this regard, it would for example be improper if each standard had to be individually adopted by the European Parliament and the European Council.

What conclusions can now be drawn from these first thoughts with regard to the organization of the EPSAS governance? As shown by the public consultation on the IPSAS governance, an independent oversight function represents an important element for an objective and independent standard-setting process. Even though the Eurostat consultation came to a different result, we are of the view that oversight is a “sine qua non-condition” for the functioning of the EPSAS governance. Especially when considering that the public sector is

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not only the regulator but also the preparer of EPSAS financial statements, an independent oversight of this standard-setting process appears to play a major role.

The setting up of an IPSAS interpretation committee did not form part of the review of the IPSAS governance. Setting up an interpretation committee for EPSAS is nevertheless deemed purposeful for safeguarding a consistent application of the standards. Especially during the EPSAS implementation phase can such an institution be of use for developing approaches facilitating the EPSAS implementation as well as for helping out on technical questions in relation to first-time adoption.

### 3.2 EPSAS Conceptual Framework

The discussions at European level, especially those related to the concrete design of an EPSAS framework regulation, have shown that a conceptual framework is deemed a constructive basis for development and interpretation also for EPSAS. The Hessian Court of Audit, for example, forcefully advocates the creation of such a conceptual framework for EPSAS. Furthermore, the French standard-setting body for the public sector (Conseil de Normalisation des Comptes Publics, CNoCP) has recently initiated a public consultation on a conceptual framework for public sector accounting in France.

End of October 2014, the IPSASB has published its Conceptual Framework for financial reporting in the public sector. In doing so, the IPSASB has for the first time laid down a conceptual framework for elements and recognition criteria in financial statements, for measurement bases of assets and liabilities and for presentation and disclosure requirements in general purpose financial reporting. Table 1 provides an overview of the structure of the conceptual framework.

<table>
<thead>
<tr>
<th>Chapter</th>
<th>Content</th>
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<tbody>
<tr>
<td>Chapter 1</td>
<td>Role and Authority of the Conceptual Framework</td>
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<td>Chapter 2</td>
<td>Objectives and Users of General Purpose Financial Reporting</td>
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<td>Chapter 3</td>
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<td>Chapter 4</td>
<td>Reporting Entity</td>
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<td>Chapter 5</td>
<td>Elements in Financial Statements</td>
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Since the IPSASB’s conceptual framework deals with the conceptual foundations of the IPSASs, we argue that the framework is also highly relevant in the context of laying down the foundations for the European harmonization of accounting by public sector entities. We therefore recommend to draw on these concepts not only in relation to the EPSAS framework regulation (for example when addressing the question of the users of the EPSAS reporting or of defining the reporting entity) but also for developing the envisaged European Public Sector Accounting Principles (EPSAP).

Differently from what was the case for the IPSAS, the development of the EPSAS provides the opportunity to set the foundations first and then to develop the standards by relying on these foundations. An EPSAS conceptual framework can now be developed on the basis of an already existing and internationally discussed conceptual framework. It is in our opinion indisputable that the selection of topics addressed by the IPSAS conceptual framework will be reflected in the same or similar manner in the EPSAS framework project. Concretely speaking, the IPSAS conceptual framework can be considered for developing the EPSAS conceptual framework with regard to:

- determining objectives and users,
- determining qualitative characteristics for public sector accounting,
- defining criteria for the reporting entity
- defining the elements of public sector financial statements,
- defining the recognition criteria for assets and liabilities,
- selecting appropriate measurement bases and
- the disclosures, notes specifications and structure as well the format of reports.

### 3.3 EPSAS standard-setting process

For a long time, the starting point and sole basis for the IPSAS standard-setting process was given by the IAS/IFRS. For preparing its standards, the IPSASB has then developed a structured approach that specifies how to proceed when modifying accounting standards of the IASB for the public sector. Figure 2\(^1\) presents the “Process for Reviewing and Modifying IASB documents, which is referred to as “Rules of the Road” in the terminology of the IPSASB.\(^2\)

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Process for reviewing and modifying IASB documents

1. Are there public sector issues that warrant departure?
   - Yes
     - 2. Should a separate public sector project be initiated?
       - Yes
         - 5. Separate public sector project
       - No
         - 3. Modify IASB documents
           - 4. Make IPSASB style and terminology changes
           - 6. IPSASB document
   - No
     - 3. Modify IASB documents

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Figure 2: The IPSASB’s Process for Reviewing and Modifying IASB Documents
During the IPSASB’s project on alignment of IPSAS with the guidelines of the GFS, the IPSASB has developed the "Process for Considering GFS Reporting Guidelines during Development of IPSASs", which is depicted in Figure 3\textsuperscript{17}.

The above-mentioned process stipulates that, unless they can already be addressed during an Annual Improvements projects (cf. for this steps A3 and A4), identified discrepancies shall be eliminated to the extent possible when revising existing standards or when developing new ones.

For a structured consideration of the European particularities and for increasing the level of coherence between EPSAS and the European System of Accounts (ESA) 2010 it is in our opinion advisable to develop European “Rules of the Road” in the context of a two-stage approach. First, one must address the question of whether there is an EU-specific reason for deviating from the IPSAS, or, even for developing a new standard. Second, one must address the question of whether there is an EPSAS accounting purpose that justifies a deviation from the ESA. Figure 4 clarifies this two-staged approach.

3.4 IPSAS Standards

In the context of setting the EPSAS, the question arises as to which of the IPSAS could be adopted as EPSAS without necessitating major adjustments, and which of the IPSAS could not, or only with major adjustments, be adopted as EPSAS. The European Commission’s
Staff-Working document, which accompanied the report of March 2013, distinguished the IPSAS according to their classification into one of the following three categories: 18

1. Standards that might be implemented with minor or no adaptation
2. Standards that need adaptation, or for which a selective approach19 is needed
3. Standards that are seen as needing to be amended20 for implementation.

Table 221 shows the categorization of IPSAS according to their degree of required adjustments.

<table>
<thead>
<tr>
<th>14 Standards that might be implemented with minor or no adaptation</th>
<th>14 Standards that need adaptation, or for which a selective approach is needed</th>
<th>4 Standards that are seen as needing to be amended for implementation</th>
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<tbody>
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<td>IPSAS 1</td>
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<td>IPSAS 32</td>
<td>IPSAS 31</td>
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Table 2: Categorization of IPSAS According to Their Degree of Required Adjustments (Status: March 2013)

Also Eurostat’s study on „Collection of information related to the potential impact, including costs, of implementing accruals accounting in the public sector and technical analysis of the suitability of individual IPSAS standards” from 1 August 2014, dealt with the question of

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19 Selective approach means that a standard cannot be adopted in its entirety and that only parts of it are deemed appropriate.

20 There is, for instance, a difference between the consolidation concepts in GFS and IPSAS. In view of that fact, a revision of IPSAS 6 is thus deemed necessary.

21 Cf. European Commission, i.C. (footnote 21), p. 125 et seq. IPSAS 33 till 38 were adopted by the end of 2014 and are therefore not included in this figure.
identifying those IPSAS that could be adopted without major adjustments. The IPSAS were moreover categorized depending on the extent to which they would require major amendments, or to the extent to which guidance would be needed for their implementation. In this respect, the two last categories of the previous Staff Working Document (Table 2) have been combined into one (see Table 3). However, the authors of the study also added a new category, which includes topics for which no standard exists yet but for which a standard or implementation guidance is needed (Cf. Table 3). The study insofar selectively addresses (yet) persisting gaps within the IPSAS whereby from today’s point of view the items of the missing conceptual framework and of a standard on first-time adoption of accrual basis IPSAS are already obsolete.

<table>
<thead>
<tr>
<th>22 IPSAS that might be implemented with minor or no adaptation</th>
<th>9 IPSAS that (may) need (some) amendments or for which implementation guidance is (may be) needed</th>
<th>4 Topics for which no standard exists yet but for which a standard or implementation guidance is needed</th>
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<tbody>
<tr>
<td>IPSAS 1, IPSAS 2, IPSAS 3, IPSAS 4, IPSAS 5, IPSAS 7, IPSAS 8, IPSAS 9, IPSAS 10, IPSAS 11, IPSAS 12, IPSAS 13, IPSAS 14, IPSAS 16, IPSAS 17, IPSAS 19, IPSAS 21, IPSAS 26</td>
<td>IPSAS 6, IPSAS 20, IPSAS 22, IPSAS 23, IPSAS 24, IPSAS 25, IPSAS 29, IPSAS 30</td>
<td>Conceptual Framework/basic EPSAS principles, Social Benefits, Non-exchange Expenses, First-time adoption of EPSAS</td>
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23 Cf. PwC, i.c. (footnote 25), p. 134 et seq. With regard to IPSAS 18, we would like to mention that in our view the practicability of this standard in public sector accounting has not yet been proven.
The empirical part of the aforementioned Eurostat study has shown that an application of IPSAS is looked upon positively by the questioned European administrative bodies. According to them the IPSAS should serve as underlying reference framework/benchmark for EPSAS.

The development and deduction of EPSAS should in our opinion happen stepwise whereby priorities during the development should be geared to the following key points:

- political sensitivity and economic consequences of the topics,
- implementation needs of the preparers,
- complexity of the questions and
- transaction-based bundling of the standards.

Regarding a transaction-based bundling of the standards, similar transactions (e.g. trade receivables as well as trade payables) should be treated together and, at the same time, the corresponding journal entry should be taken into account (e.g. provisions related to social benefits, for example, should be covered together with expenses from non-exchange expenses).

### 3.5 Implementation

Like in every transition from single-entry cash accounting to double-entry accrual accounting, the first-time adoption of EPSAS takes place at the interplay between

- a desired completeness of all assets and liabilities of an entity and their appropriate (in the sense of “correct”) measurement in the opening balance sheet on the one hand, as well as
- the restricting factors of time and resources on the other hand.

Despite intentions by the entities to present the most complete picture of their financial position and determine the most accurate measurement (for instance costs or fair values), limited resources and time restrictions imply that this will ultimately not be feasible. Furthermore, it needs to be seen that the opening balance sheet represents “only” the starting point for accrual accounting. In subsequent periods, inaccuracies in the recording and measurement of assets and liabilities will be reduced in the following financial statements.

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24 Given that IPSAS 15 has replaced IPSAS 28-30, the aforementioned IPSAS is no longer included in Table 3. As IPSAS 33 to 38 were approved by the IPSASB at the end of 2014 only, they could not yet be taken into account by the authors of the study.
The dilemma faced by the preparers during the first-time adoption of IPSAS is illustrated in Figure 5. The presented parameters ultimately influence the transparency and comparability of both the opening balance sheet and the following financial statements.

![Figure 5: The Dilemma Accompanying First-time Adoption of Accrual Basis IPSAS](image)

Standard setters can resolve this dilemma for first-time adopters basically by restricting the completeness requirement to the most significant assets and liabilities and providing relief with regard to the measurement requirements for selected items.

The IPSASB has reacted to the challenges linked to first-time adoptions of IPSAS with a distinct IPSAS. IPSAS 33 „First-time Adoption of Accrual Basis IPSASs”, which was published at the end of January 2015, distinguishes for example between exemptions that affect fair presentation and compliance with accrual basis IPSASs during the period of transition and exemptions that do not affect fair presentation and compliance with accrual basis IPSASs during the period of adoption.26

It is thus not possible for a public sector entity to provide an explicit and unreserved statement regarding compliance with IPSAS insofar as the entity applies transitional provisions belonging to the first category.

In addition, IPSAS 33 provides for a relief phase, i.e. a transitional period of 3 years, during which certain requirements of the IPSAS must not be complied with (e.g. the recognition and measurement of inventories, property, plant and equipment, defined benefit plans and other long-term employee benefits etc.). In this context, IPSAS 33 also points out that, depending on the level of advancement in implementing double-entry accounting, the preparations for the conversion to double-entry accounting might have to start before the commencement of

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26 Cf. IPSAS 33.27.
27 Cf. IPSAS 33.36 et seq.
the transitional period already (for instance because of extensive requirements regarding tendering procedures or because of the volume of assets that must be recorded). Hence, the total conversion process can, in the IPSASB’s view, last considerably longer than the transitional period of 3 years that has been foreseen in IPSAS 33.

The third edition of the IPSASB’s study No. 14 “Transition to the Accrual Basis of Accounting: Guidance for Public Sector Entities” provides further assistance with first-time adoptions of IPSAS. In addition, the IPSASB (or rather the so-called Public Sector Committee (PSC) of the IFAC) has in its starting time published country studies that addressed the transition to IPSAS in the context of concrete case studies.

According to our experiences with first-time adoptions of IPSAS, concrete guidelines are needed for the preparation of the EPSAS opening balance sheet, especially with regard to the recognition and measurement of assets and liabilities. Given that IPSAS 33 on initial adoption relies on the experiences made with first-time adoption of IFRS while taking into account the specific requirements of the public sector, the standard would offer an appropriate basis for the EPSAS as well. We would however like to point out that, for the concrete conversion, it is necessary to complement a possible standard on first-time adoptions of EPSAS with detailed instructions and instruments, such as implementation guidelines.

Regarding a possible transition phase of three years for setting up an EPSAS opening balance sheet, we consider it as insufficient especially for large administrative units in Europe; preparations for a transition to accrual accounting need to be started considerably earlier in many cases.

4 Concluding recommendation for the EPSAS

Orienting the EPSAS on the IPSAS is advisable for several reasons. In our opinion, a large potential would otherwise remain unused. On the one hand, the orientation on IPSAS should materialize in an EPSAS governance that considers the results of the discussions on appropriate IPSAS governance structures. On the other hand, for the development of EPSAS principles it is recommended to take stock of the IPSAS conceptual framework and to derive principles-oriented EPSAS from the (appropriate) IPSAS based on a clearly defined approach (“EPSAS rules of the Road”).

Owing to the numerous positive experiences with governments accounting under IPSAS, the IPSAS standards should in our opinion be envisaged as an opportunity rather than a threat for developing European Public Sector Accounting Standards (EPSAS).

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28 Cf. IPSAS 33.BC43.