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**Lecture Topic**
# Greece: Government Accounting Reform as a Pre-Condition to EU Funds

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*Slide 1*

**Introduction**

Thank you for this opportunity to speak at the Munich Seminars, a joint initiative of CESifo and Süddeutsche Zeitung, which is chaired by Professor Dr. Hans-Werner Sinn and Marc Beise, Chief Editor, Economics, Süddeutsche Zeitung.

*Slide 2*

The lecture will discuss the absence of transparency and accountability associated with an institutional and cultural aversion to Greece government accounting reform as a major cause of the lack of trust and confidence in the government. The lecture will provide a quantification of the benefits for sustainable fiscal policy of making Greece government accounting reform a pre-condition to EU funds.

*Slide 3*

The outline of today's lecture is organized into five sections with several subsections. To those reading the lecture or hearing the audio, please note that there are supporting working draft slides that contain greater details.

**Lecture Outline**

1. Background
2. The Right Framework of Analysis
   2.1. International Alternatives
   2.2. ESA 2010 Misinterpretations
3. Analytical Research Findings
   3.1. Net Debt
   3.2. Cash Interest Expense
   3.3. Cost of Recent Financial Mismanagement
4. Field Research Findings
   4.1 Transparency Reform Failure
   4.2. Countervailing Pressures
5. Pre-Conditions for EU Funding
   5.1. Immediate Conditions
   5.2. Long-Term Planning

*Slide 4*

**1. Background**

*Slide 5*

By way of background, in the spring of 2012, we first visited Greece on the last leg of our tour of the southern periphery looking for companies we could acquire and turnaround their operating performance. Investing in and acquiring large corporate turnarounds is our firm's core business. At the time, the Greece government was concluding the largest financial debt restructuring in history. As part of our due diligence, we met several senior officials in the Greece government, mostly in the finance ministry. The first very significant finding was that the government did not have useable financial statements. In particular, balance sheet statements were essentially non-existent. What the government called its balance sheet was nothing more than a list of numbers on a sheet of paper in a distinctly arbitrary combination. What was even more surprising, the senior finance ministry officials claimed to have no knowledge that standard financial statements are used throughout the modern world by both businesses and governments.

As we dug deeper into our research simply to get a rudimentary understanding of the financial situation of the government, we found a government that was very content with having non-transparent and incomprehensible financial information based on what could best be described as garbage-can accounting. Thinking that amid this chaos there could be something of interest that others could not see, we began what is now a three-year effort to build a team of over 100 professionals to better understand Greece government financials and work to correct what could well be one of the largest accounting and financial mismanagement situations in history.

*Slide 6*

Greece is for all practical purposes a country very content to operate without modern finance controls, systems, and audits. The clientele system thrives on this lack of accounting to maintain a pervasive system of rent seeking and corruption. It is true to say that the government is not managed with accurate numbers, by design.

To put the management challenges of the government in perspective, understand the following facts: the Greece government is responsible for managing an 80 billion euro budget annually. The government is responsible for managing over 650,000 employees. And the Greece government is reported to compose approximately 50% of the country's entire GDP.

Based on our research findings that discovered huge misperceptions arising from the poor quality of Greece government financial information, we did something our firm had never done before. We made a very large investment in government bonds, Greece government bonds, mostly in the summer of 2012.

*Slide 7*

**2. The Right Framework of Analysis**

The selection of the right framework with which to analyze the Greece situation was a necessary first step for us as accurate financial information that reflects economic reality and could be compared globally is the foundation of good analysis. We, as managers, who are assessed by both short-term and long-term key performance indicators, know it is only with quality numbers that a financial situation can be managed. We must remember the timeless wisdom, "you can't manage what you can't measure".

*Slide 8*

If we could find the right framework, then it would be possible to start on the long-road for what we call the "Trinity" for prosperity in Greece: 1. For prosperity in Greece, the Greece ministers' first priority is to build trust and confidence with all stakeholders. 2. To build trust and confidence, Greece ministers must make transparency and accountability of government finances their most important reform. And, 3. The starting point for transparency and accountability in Greece is accurate government financial information obtained through international public sector accounting standards and audits.

*Slide 9*

### 2.1. International Alternatives

*Slide 10/11*

In selecting the right framework, we assessed the landscape of alternative financial measurement systems. From the accounting world, there is International Public Sector Accounting Standards (IPSAS) in the public sector and International Financial Reporting Standards (IFRS) in the private sector. The international statistics guidelines include the System of National Accounts (SNA 2008) endorsed by five multi-national organizations: the European Commission, the IMF, the OECD, the UN, and the World Bank; and, the EC's system, which is titled the European System of Accounts (ESA 2010). International statistics lender covenant guidelines include the IMF's system is the Global Finance Statistics Manual (GFSM 2014), and the Maastrict Treaty.

*Slide 12*

All statistics systems have the same goal as international accounting standards, IPSAS and IFRS: financial information that best reflects economic reality.

SNA 2008 cites in Section 1.4 that SNA depends on economic reasoning and principles that should be universally valid and invariant to the particular economic circumstances in which they are applied. ESA 2010 cites in Section 20.164 that reporting the economic reality where it is different from the legal form is a fundamental accounting principle to give consistency and to make sure that transactions of a similar type will produce similar effects on the macroeconomic accounts, irrespective of the legal arrangements. This is of particular importance for transactions involving the general government. GFSM 2014 cites in Section 1.5 that it is based on economic principles that should be universally valid regardless of the circumstances in which they are applied.

*Slide 13*

In measuring debt there are eight key principles to understand. As a general matter, IPSAS and IFRS share seven out of the eight principles with statistics guidelines. The exception is that international accounting standards do not provide for a change in debt values based on changes in market prices unless there has been a substantial modification or similar transaction. The IMF has principles that are generally consistent with other statistics guidelines but differs in areas where its conflicting role as a lender asserts priority. The three statistics guidelines are generally consistent with IPSAS/IFRS, except they are much less refined in the areas of restructured debt and concessionary debt and do not have the audit integrity of accounting standards. It's worth noting that accounting and statistics both share the same views on hierarchy of valuation and arm's length valuation.

A very important point to make and remember is the Maastricht treaty definition of debt is not an accounting or statistics measurement system, but instead a legal definition that has no intention to measure economic reality.  Maastricht simply takes the face value of debt as the value regardless of the terms or the economic value.  Accordingly, the Maastricht treaty receives a “no” designation on all eight of the debt measurement principles.

*Slide 14*

It may be helpful to take a minute to describe these principles.  In a hierarchy of valuation the order of valuation is as follows: (1st) market prices/YTMs [yield-to-maturity], (2nd) market prices/YTMs of most comparable, and (3rd) market YTM of most comparable to determine a present value.  As for arm’s length valuation both SNA and GFS specifically use the IPSAS/IFRS term “arm’s length” as a part of market valuation.  ESA uses the phrase “market transaction between two parties”.  As for calculating net debt, which is defined as gross financial debt obligations less financial assets, all measurement frameworks provide the necessary information.  For clarification, financial liabilities do not include payables, and likewise, financial assets do not include receivables.

*Slide 15*

As mentioned, Maastricht is a treaty definition that takes the face value of debt as the value regardless of the terms or economic value.  To demonstrate, I’ll provide two examples of how the Maastricht debt definition is flawed and actually damaging.  First, Maastricht would show €100 billion of debt with zero interest and a due date of perpetuity as a €100 billion liability on today’s balance sheet.  When, in fact, the economic reality is that the €100 billion is a gift.  A second example: under Maastricht, a debtor is considered to have the same financial debt burden on a €100 billion of borrowing regardless of whether the money is totally depleted by spending on consumables or invested in AAA-rated one week T-bills.  Maastricht simply does not reflect economic reality.

*Slide 16*

By way of process, it may be helpful to also touch upon several unacceptable debt revaluation practices all too often found in analyses of Greece debt.  The following unacceptable practices are common to both international accounting standards and international statistics guidelines. They fail to use market prices/YTMs. They fail to use most comparable prices/YTMs.  They use date(s) other than date of event.  They do not use present value as last alternative but the first. They use a single rate rather than the event dates and instrument specific rates. Point of note, ESA section 20.242 specifically states and I quote, “there is no single market interest rate to be used”.  They use insufficient independently sourced market data; a process that violates independent audit verification. A special word of caution: it is totally unacceptable to use a so-called discount rate as it creates inevitable exposure to nefarious consequences, especially on concessional loans. The most frequently found nefarious consequence is using the approach to reach a pre-determined desired number.

*Slide 17*

All five measurement systems are crystal clear that a creditor's cost of capital is not a consideration in calculating present value obligations. And, as our economist team members have been so kind as to indicate, that using the cost of capital is directly inconsistent with one of the core principles of microeconomics, which is the opportunity cost of the highest comparable best alternative.

*Slide 18*

The flaws of using face value to measure debt, if not already obvious, can also be seen when understanding that present value of the future principal payment is only a small portion of the current debt obligation value. For instance, with debt maturing in 40-years, a below market 1% interest rate when the market is 7% calculates to a present value of the principal payment of only 6.7% of the face value.

*Slide 19*

The flaws of using face value can also be seen when comparing the future impact of concessionary/rescheduled liabilities on net debt. Remember that the impact of interest rate payments and the compounding impact, if the payments are being borrowed because a government is running a deficit, do not appear in current debt but will clearly add to future debt in an explosive fashion. Using the above 7% 40-year debt example, the future liability in year 40 would be almost 14 times greater than the face value. In contrast, if a concessionary rate was placed on the same debt, the future liability would be only 3 times the current face value. The flaws of using face value can also been seen when comparing the debt to GDP ratios over the period. When measuring debt at fair value, the debt to GDP ratios progress evenly in a logical pattern. When using face value, the relationships are highly distorted and send misleading messages.

*Slide 20*

In the context of Greece, the government has had five opportunities to show net debt numbers that reflect economic reality, but has chosen not to report the numbers. It should be noted, that the government is totally free to report its debt under either IPSAS or IFRS. To be clear, reporting and using debt numbers according to international accounting standards can be viewed as an administrator or manager's preference that supplements existing or future financial information requirements. To date, Greece has made the decision not to utilize international accounting standards and audits.

What is surprising to most is that Greece could also report net debt numbers that reflect economic reality under all three statistics guidelines. At risk of being overly technical, ESA 2010 provides the opportunity under sections 20.236, 20.241-242 as well as in Excessive Deficit Procedure (EDP) table #4, item #4. Within SNA, the disclosure would come under sections 22.106-113 and 22.123-124. Under GFS, the disclosure would fall under sections 3.113-115 or 7.246.

*Slide 21*

It is worth noting again that the Greece government did not disclose present value of its debt as requested by the European Commission's EDP Table #4, Item #4. The table specifically states: "In case of substantial differences between the face value and the present value of government debt, please provide information on: (i) the extent of these differences. (ii) the reasons for these differences." The answers provided by Greece in the table avoid the disclosure by providing mockingly qualitative words and not quantitative responses. They answered (i) with the words "market value of securities much lower than nominal value" and answered (ii) with two words, "economic crisis".

*Slide 22*

There are three schools of thought on net versus gross debt. School #1 views net debt as essential for transparency and accountability, especially to assess government fiscal performance. School #2 uses gross debt as a punitive measure, especially for under-developed governments where financial asset data is suspect. School #3 uses either gross or net debt based on convenience, especially for database analysis.

*Slide 23*

As attested by the many global benchmarks in sovereign accounting, net debt really matters. A wide range of countries, including the UK, Canada, Australia, New Zealand, Austria, and Portugal focus on net debt as the key driver of fiscal performance.

*Slide 24*

In fact, a preliminary comparison of general government Maastricht gross debt and net debt ratios from 2001 to 2013 clearly demonstrates outperformance in the form of reduced debt to GDP ratios in those benchmark countries that focus on net debt. While during the same period, the Eurozone, where the focus on net debt is less enlightened, the average increased dramatically.

*Slide 25*

## 2.2. ESA 2010 Misinterpretations

*Slide 26*

To provide a better understanding for those seeking to measure their debt in good faith according to ESA 2010, we conducted a careful examination of secondary documents and located a document titled the Manual on Government Deficit and Debt 2014 (MGDD). Here we found critical misinterpretations and subsequently presented our findings at the 15th Annual OECD Public Sector Accruals Symposium in Paris on 27 February 2015.

Let me briefly summarize. The MGDD, which claims to provide "necessary clarification" and "useful practical guidance" for national income accountants in the context of calculating restructured and concessional debt, misinterprets ESA 2010 and SNA 2008 and should be corrected. See the MGDD 2014 claim on page 354. The misinterpretations lead to incorrect accounting for Greece restructured and concessional debt. A comparison of the MGDD interpretation of the sections cited with the actual section text confirms the misinterpretations and the importance of correcting the text. Importantly, ESA 2010 and SNA 2008 are harmonized.

*Slide 27*

With regard to MGDD's guidance on ESA 2010 related to restructuring loans MGDD Part VII.3.3.2 cites that there is "no real guideline" in ESA 2010 and mention is only made in 20.236 without specifying that the difference "is in nominal terms". According to MGDD, using nominal value is the correct conclusion. Contrary to MGDD, ESA does indeed provide significant guidelines in sections 20.221 and 20.236, as well as Chapter 5. Here there is a section titled "Debt Operations" with several subsections including "Debt assumption and cancellation" and "Other debt restructuring". Also contrary to MGDD, within this section, it is quite clear that rescheduling is not in nominal value terms but is the difference in value, as defined in the Chapter 5 reference cited within the Debt Operations section, which determines the amount of the capital transfer. Chapter 5 provides careful text on the value of financial transactions being "current market value" made using "purely commercial considerations". Additionally, the MGDD omits to mention very detailed text in ESA section 20.236 on how the debt instrument "is considered to be extinguished and replaced by a new debt instrument". In another notable omission, MGDD fails to tell its reader that ESA has three references to a capital transfer.

*Slide 28*

With regard to MGDD's guidance on SNA 2008 related to debt rescheduling, MGDD Part VII 3.3.2 states that the topic of rescheduling of a loan is mentioned "but in a rather descriptive way only in 20.107 (b) [sic]…whereas there is no mention of a possible capital transfer." To begin with, the section reference contains a typo; the correct section is 22.106 (b) not 20.107 (b). The first misinterpretation is the message that there is only one mention, when in fact there is an entire section titled "Debt reorganization" with a subsection titled "Debt rescheduling and refinancing" with five extensive points. See sections 20.109 to 20.113. A second misinterpretation cites that there is "no mention of a possible capital transfer" and minimizes the significance of the reference to a present value change. In fact, the opposite is true. There is a specific reference to a "capital transfer" in 22.110 and the extinguishment of debt and a new contract with a new value is clear.

*Slide 29*

With regard to MGDD's guidance on ESA 2010 related to concessional loans, MGDD Part V.6.2 on low interest rate loans comments that ESA 2010 (as part of public policy activities) concludes that there is no recording of an implicit benefit. Again to the contrary, 20.241 – 20.242 contains two points on concessional debt/loans, which clearly cite a transfer/capital transfer is to be recorded as a memorandum item.

*Slide 30*

With regard to MGDD's guidance on SNA related to concessional loans,, MGDD fails to provide any comment on SNA 2008 guidance in the appropriate Part V.6.2. In fact, SNA 2008 is quite helpful in 22.123-124 with two points on concessional loans citing a transfer/current transfer and calls for disclosure in supplementary tables, given the impact has "not been fully developed".

*Slide 31*

In summary, 86% of Greece government debt should be valued under one or both of the rescheduling debt or concessional loan rules.

*Slide 32*

## 3. Analytical Research Findings

In this section we will discuss our analytical research findings, which unlike the prior section are mostly numerical. We presented these findings at an executive program jointly sponsored by the Institute of International Finance and Standard & Poor's.

*Slide 33*

### 3.1. Net Debt

*Slide 34*

We start with Greece net debt and that of several of its EU peers, including the three EU post-programme countries. As often reported in the press, Greece's debt according to Maastricht is approximately 175% of GDP compared to its peer average of 120%. However, when this debt number, which is stated at face value, is calculated under international accounting standards, for those countries with rescheduled or concessionary debt, the value declines. For Greece, the value declines from €319 billion to €124 billion, which is 68% of GDP. In the next step, financial assets are deducted to arrive at a net debt number. Here, Greece debt to GDP declines to 18% at the end of 2013 compared to peer average of 80%. To put this in comparative perspective, Greece net debt as a percent of GDP is 1/4 of its peers. We should note that Greece IPSAS/IFRS 2013 net debt was independently verified by a Big Four accounting firm on 15 August 2014 (commissioned by us).

*Slide 35*

To state what may be obvious, debt can effectively be turned into a gift by changing the terms. This is accomplished by using the time value of money, which some consider "the first law of finance" and the "rock upon which much of finance rests". In the case of Greece, its debt started with shortish maturities and high market rates, and over a period time the terms changed to include maturities extending to almost 50 years, way below market interest rates, deferred interest payments, and rebates of interest and principal. And, this doesn't include the approximately €5.4 billion of "free" EU funds that flow into Greece annually from the same Eurozone creditors.

*Slide 36*

In the context of determining if the most accurate debt number is presented, it is strongly advised to ask the right net debt integrity question. Did the net debt number earn the following expert's opinion statement by a Big Four accounting/auditing firm whose independence is beyond question? "Nothing has come to our attention that causes us to believe that the calculations of Greece financial liabilities as reported to us as of December 31, 2013 have not been, in all material respects conducted reasonably in accordance with IAS 39 and IFRS 13, which are deemed an appropriate approximation of IPSAS 29, applicable for Greece."

*Slide 37/38*

To better understand Greece's complex debt structure, it's helpful to know that the €212 billion of concessionary loans at face value have an accounting value of only €60 billion. The €63 billion of rescheduled securities at face value have an accounting value of €20 billion. €44 billion of debt has no change in value as it was neither rescheduled nor concessionary.

Overall, 86% of Greece debt requires IPSAS/IFRS revaluation.

*Slide 39*

From a technical perspective, there are four debt measurement accounting standards to highlight. (1) Initial recognition, which is the fair value on incurrence. (2) Substantial modification of debt terms, which occurs if a change in terms results in a valuation change of greater than 10%. (3) Concessionary loans that are considered a non-exchange transaction. And, (4) the subsequent measurement that takes into consideration the ongoing accretion back to face value upon maturity.

*Slide 40*

To get a better understanding of how Greece debt has evolved since May 2010, it is helpful to see the progression of the Maastricht gross debt to IPSAS/IFRS net debt over time. The first Official Sector Involvement (OSI) on May 2010 had a small impact of €11 billion as a concessionary loan was made at a lower interest rate than market. The next adjustment was made in June of 2011, with an impact of €6 billion by reducing interest rates and extending maturities. A major change in debt value occurred in February/March of 2012 with what is called the Official Sector Involvement #2 and Private Sector Involvement #1. Here interest rates were again lowered, debt was exchanged, and maturities were extended. This impact resulted in a €121 billion debt value reduction. Then in December 2012, there was yet another debt modification and a debt buyback, which reduced debt values further by €57 billion. By the end of 2013, gross debt under international accounting standards was €124 billion and, with Greece showing financial assets of €91 billion, net debt was €33 billion or 18% of GDP.

*Slide 41*

**3.2. Cash Interest Expense**

*Slide 4*2

As for claims that Greece interest expense is taking too large a percentage of revenue and thus depriving those more deserving, the numbers show quite the opposite. To start, yes, Greece gross interest using appropriate accrual standard is projected at 8.7% of revenue in 2015. This however, is noticeably less than its peer countries. It's important to note, however, of this €7.3 billion, €1.4 billion is deferred under an initial 10-year interest deferred loan, and Greece, if it delivers on its agreed upon reforms, will receive a €3.9 billion return of interest and principal payments made to the ECB and national central banks holding the Greece bonds. Therefore, on a cash basis, Greece cash interest payments as a percentage of revenue are only 2.4% of revenue compared to the 10% for its peers, which is approximately 1/4. It is also valuable to note these cash interest payments are only 0.6% of Greece debt at face value. This compares to peers with an average of 3.5%.

*Slide 43*

A review of the individual debt instruments shows that certain categories of debt have interest at 0% and two others at a minus 7%. The negative interest rate results from a portion of the principal being returned to Greece following its payment.

*Slide 44*

**3.3. Cost of Recent Financial Mismanagement**

*Slide 45*

A preliminary analysis seeking to quantify the opportunity costs of financial mismanagement from not using international accounting standards found that the cost since the 2012 OSI/PSI could be in the range of €35 to €45 billion. The losses can broadly be attributable to the following: Equity and fixed income losses on government financial assets. Unwise debt buybacks based on flawed accounting contributing to the liquidity crisis. Destruction of bank equity as financial assets on forced sale of GGBs. Revenue losses from selling inaccurate debt data contributed to further depress the economy. Inaccurate debt data increased borrowing costs. Forced intra-government repo funding. Reduced bank collateral through forced GGB swaps. And, game playing with tax installments, arrears, and IRR schemes.

*Slide 46*

And, let's not forget to assess the examples of the opportunity cost from revenue losses following the government's misguided financial management including: reduced corporate profits, increased net operating tax losses, diminished real estate profits, reduced taxes on wages, reduced social security payments, diminished stock market gains, increased stock market loss tax shields, reduced profits from higher borrowing costs, and increased tax arrears defaults from failed businesses.

*Slide 47*

It's important to keep in mind that at the end of 2013, according to IMF, Eurostat, and ECB data, Greece had almost €91 billion in financial assets. This is an obvious positive, but can be a huge negative when government policies destroy market values of stocks and bonds.

*Slide 48*

Very preliminary estimates indicate that the government has lost €31.2 billion on its financial assets from January 2014 through March of 2015.

Since early 2014, the government, by selling fear and other intentionally damaging actions, destroyed more than €30 billion in financial assets owned by the country. You could say they were held accountable by being thrown out of office in a vote that was much more a vote against them, rather than a vote for the new government. The price was huge. To put the €30 billion plus loss on government financial assets within the past year in perspective, Greece would need a generation or two of fiscal balances to recover this loss. A generation, or more, to recover losses incurred in less than 12 months. Yet, there are few voices of alarm within Greece.

*Slide 49*

A preliminary analysis using international accounting standards highlights the troubling high costs of recent financial mismanagement. Look at what appears to be a 2014 primary balance massive shortfall.

Greece Budget and AMECO at year end had projected a primary balance for 2014 of 2.9% and 2.7% of GDP respectively. However, ELSTAT reported on 15 April 2015 a Primary Balance including ANFA/SMP rebates of only 0.3% of GDP.

Originally the ANFA/SMP rebates were projected to be €2 billion in 2014. These are the agreed upon rebates of interest and principal on Greek bonds held by the ECB and NCBs. These rebates are re-circulated into revenue to give the fiscal illusion of a larger primary balance. Yes, you heard this correctly, Greece has devised yet another accounting fiscal illusion that allows them to take interest and principal rebates and re-circulate them into revenue to show a higher primary balance. Using this scheme, Greece could create any primary balance desired without really achieving anything other than a paper target and no added funds to reduce or improve the fiscal balance.

Excluding these ANFA/SMP rebates results in a Primary Balance as a percent of GDP of almost zero. Primary Balance less ANFA/SMP Rebates and the 2014 HFSF reported loss amounts to a negative 5.5% of GDP. Adjusting this number further to exclude estimated 2014 EU In-Budget Net Receipts, Greece Primary Balance would be a negative 6.5% of GDP. IMF and EC 2014 projections were in line with the Budget and AMECO and show a primary balance of approximately 1.5% of GDP excluding ANFA/SMP rebates.

It is also worth noting that in 2015 Greece is projected to receive EU funds, including Rebates and net receipts, equal to a total of 3.4% of GDP.

*Slide 50*

As you look more closely into the quarterly changes in 2014, you will note that the government was on target until the end of the third quarter.  It was only after the prior government began selling fear, publically stating its wish to kick out the IMF, and engaging in election vote buying (especially its promises of delaying tax payments), did the fiscal performance really go off the rails.

*Slide 51/52*

Looking more carefully at the first quarter of 2015 from an economic reality perspective using international accounting standards, Greece reported primary surplus of €1.7 billion or 4% of GDP drops massively to a loss of €5.2 billion or 12.3% of GDP.  From a management perspective, this primary deficit increases to €5.7 billion or 13.5% of GDP when adjusted for estimated EU in-budget net receipts.  Indeed, the massive losses on financial assets, in particular the bank stocks, are not included in the reported number.  It is as if the loss of taxpayer assets has absolutely no impact or need for accountability.  It also appears that the government is again playing games with expenditure payments as illustrated with its disclosure as to why the expenditures are lower:  "the lower expenditures are mainly due to the rearrangement of the cash payments projection, according to prevailing conditions.  It is estimated that after the stabilization of the conditions, expenditures will revert to the levels of the budget targets."

*Slide 53*

To put this 2014 primary balance in perspective, it is often reported that Greece accomplished an extraordinary reduction in its primary balance deficit from 10.5% in 2009 to 2%+ in 2014.  While the reduction in expenditures has indeed been huge (23% from 2008 to 2014), let's put this in context.  2009 was an aberrant year with both 2008 and 2010 having a smaller primary balance deficit of around 5%.

*Slide 54*

In our last comment in the section, we've also begun a very preliminary estimate of the change in net debt from year-end 2013 to year-end 2014 for Greece and EU post-programme countries.  It appears that Greece net debt has almost doubled, increasing by 24 points, largely a result of destroying the value of its financial assets.  Ireland has declined by six points, Spain is up three points, and Portugal is up seven points.

*Slide 55*

## 4. Field Research Findings

Now, let's move on to our less analytical but still somewhat quantitative field research findings.

*Slide 56*

**4.1 Transparency Reform Failure**

*Slide 57*

It's fair to say that Greece has had countless headline reforms with little, if any, transparency or accountability improvements. We've counted over 1,000 reform recommendations since the May 2010 OSI, but found no government accounting or auditing transparency reforms. The IMF and EC have had three major reform packages but all are silent on government financial transparency. The same absence of transparency reforms exists for the EC Task Force on Reform, the Hellenic National Reform Programs, the OECD reform recommendations, the reforms proposed by the nation's leading think tanks, the reforms proposed by the largest business groups, and the lengthy reform report recommendations by the leading international consulting firms.

*Slide 58*

As for government accounting reforms, Greece has had at least five failed attempts at implementing government accrual accounting: 1992, 2005, 2009, 2011/2012, and 2014. The reasons for the failed attempts vary but the conclusions are the same; no accounting reforms.

*Slide 59*

**4.2. Countervailing Pressures**

*Slide 60*

As for countervailing pressures preventing transparency and accountability, in summary, our field research findings are simple and clear: There is NO tradition of the government building trust and confidence. There is NO tradition of transparency and accountability of government finances. There is NO desire by the government to have financial information based on international accounting standards and audits.

*Slide 61*

Jacob Soll, professor of history and accounting at USC and author of "The Reckoning: Financial Accountability and the Rise and Fall of Nations" offers the following observations: "Greece has a weak tradition of accounting, with few homebred trained accountants." "There is just not an accounting culture. Politically, nobody on the right or the left relies on accounting because nobody trusts it." "The Greeks, for their part, don't want serious accountants anywhere near their books." "There is an absence of the Big Four on the topic. Even in major meetings of the Greek Chamber of Commerce on accounting, there are no representatives of the Big Four."

*Slide 62*

Greece's lack of transparency and accountability are reflected in its rankings on relevant global indices. Stanford Sovereign Fiscal Responsibility Index ranks Greece last among 35 countries. Transparency International's Corruption Perceptions Index ranks Greece among the worst three countries in the EU in terms of perceived public sector corruption. The World Bank Voice & Accountability Index ranks Greece among the bottom four countries in the EU. The World Bank Government Effectiveness Index ranks Greece among the bottom three countries in the EU in quality of public and civil services and credibility of government's commitment.

*Slide 63*

Greece is by far one of the worst sovereign accounting offenders. Dating back to at least 1997, research shows that the EC was seriously critical of Greece accounting. The IMF 2005 Fiscal Transparency Report on Standards and Codes (ROSC) was very negative on its findings. And, the 2010 EC Report on Greek Government Deficit and Debt Statistics was very critical, noting the lack of accountability.

*Slide 64/65*

The public's perception of Greece accounting is no better summarized than by it being the source of the infamous term "Greek statistics" as a disgraceful label for cooking the books. Comments such as the following are emblematic. "Greece's deficit situation takes "there's lies, damned lies, and statistics" to a whole new level." WSJ, November 2009. "But the new administration in Athens soon proved to be just as creative with its accounting as its predecessor" Der Spiegel, October 2011.

*Slide 66*

It's important to understand that successive governments use Greek statistics to seek EU funds and buy votes. One government seeks to claim the Greece debt is massive to scare voters that the sky is falling, and they are the only ones who can save them. Indeed, the same government even organized a special four-page advertisement in the Wall Street Journal that was very negative on Greece. Other government officials seek to use a false and over-stated primary balance number combined with claims of "suffocating debt" to win more EU money to buy votes. These politicians really don't care about the debt, because they will yell odious debt whenever it's convenient. What they care about is getting more EU money to buy votes.  Is it surprising that you have not heard a word from any Greece politician explaining how Greece has a huge competitive advantage relative to its peers with its net debt and cash interest expense at 1/4 of its peers?

*Slide 67*

The current Bank of Greece Governor goes so far as to ask for a list of cash flow generating debt reduction modifications claiming that they are deserved because Greece has a significant primary balance and that the modifications will result in no creditor losses.  He is wrong on both counts, and both false claims have their roots in bad accounting.

*Slide 68*

The current Greece finance minister even goes on a televised think tank interview proclaiming: “…to make a commitment that is cast in stone, iron, even, you know, penned in our own blood, in order to increase capability that we shall never slip again into primary deficit.”  Meanwhile, the primary balance, when accounted for properly, is a huge negative.

*Slide 69*

Indeed, one government senior economist creates his own definition of unsustainable debt to be whatever you think it is:  “It’s unsustainable from the point of view of the majority of the people.  The agreement of the former government is that the country creates a primary surplus of 4.5% from next year on in order to repay not only the interest but also the principal. This is going to function as an austerity and recession trap. So from the point of view of growth and the interest of the majority of the people, [the debt] is absolutely unsustainable.”

*Slide 70*

There is no end to the number of excuses as to why the Greece government cannot and will not implement international accounting standards and audits.  Suffice it to say, they are all baseless.

*Slide 71*

Nor have the attempts to use creative accounting stopped.  Indeed, they appear to be growing.  For example, the ECB and national central bank interest and principal rebates are added to revenue to artificially inflate the primary balance. The 100 tax installments vote buying scheme has no reported cost.  Destroying value of financial assets is not recorded. A one trillion euro “Decentralised Europeanisation” proposal by the current Greece finance minister claims to have no cost for anyone, and therefore Greece should receive their fair share.  A big difference between the Government’s reported primary balance and the number reported by ELSTAT. Delaying vendor payments to reduce expenditures in the first quarter of 2015. And, a return to using defense spending cash payment timing games.

*Slide 72*

**5. Pre-Conditions for EU Funding**

*Slide 73*

**5.1. Immediate Conditions**

*Slide 74*

As for the immediate pre-conditions for EU funding, we strongly recommend the following:

The Greece government should be required to report publicly the change in net debt and net worth according to international accounting standards and with independent expert verification. They should start now reporting: Monthly, financial assets. Monthly, net debt. And, prior to approval, they should disclose the financial impact of ALL government €100 million plus decisions.

*Slide 75*

In setting transparency and accountability of government financials as a pre-condition to further EU funds, the EU should let the following be known broadly within Greece.

Greece has been given approximately €340 billion of debt relief between 2010 and 2013.

*Slide 76*

Greece net debt under international accounting standards is among the lowest in the Eurozone.

*Slide 77*

Greece has between €5 to €15 plus billion in annual interest cost benefits. Greece is currently rated in the CCCs by the major rating agencies yet has cash interest payments 1/4 of its peers. And, its overall cash payments on debt are less than 1%.

*Slide 78*

Greece borrowing costs in the market are sky high in both absolute and relative terms. For example, Greece 3-year borrowing cost is over 20%. Nonetheless, its overall borrowing cost is less than 1% given massive EU concessional financing.

*Slide 79*

Greece receives approximately €7 billion per year in EU funds. €5.4 billion in “free” EU funds and €1.5 billion in EIB loans.

*Slide 80*

Greece has avoided debt of €160+ billion with “free” EU annual funds.

*Slide 81/82*

Almost everyone in Greece benefits from the “free” EU funds. See the list.

*Slide 83*

Greece receives approximately €1.5 billion per year in European Investment Bank funds.

*Slide 84/85*

There is a long list of beneficiaries in Greece of EIB funds. Again, see the other list.

*Slide 86*

**5.2. Long-Term Planning**

*Slide 87*

Revised baseline projections using IMF/EC assumptions indicate that with proper fiscal management, Greece could keep its net debt as a percent of GDP below 20% though 2017. And, Greece could reduce the projected primary balance percentage to the highest projected for EU post-programme countries and show an additional €10 billion in funds available while keeping below the 20% ratio.

*Slide 88*

Portugal has the highest primary balance in 2015 and 2016 at 1.6% and 2.0%, respectively. Ireland tops the list in 2017 with 3.2%.

*Slide 89*

Respected members of the IMF have recommended that Greece adopt international accounting standards to improve the poor quality of their fiscal reporting systems. We strongly recommend that the IMF Fiscal Affairs Department be given a larger role going forward. Their calls for Greece to move on IPSAS have, as of today, fallen on deaf ears.

*Slide 90*

The IMF's statistics manual acknowledges how IPSAS is best suited for evaluating financial performance and position. In contrast, the IMF notes that government finance statistics are more suited to evaluating economic impact.

*Slide 91*

It's worth noting that the IMF has published papers supporting the use of present value in better measuring debt and using financial assets to calculate net debt.

*Slide 92*

The IMF has also been a strong advocate of government fiscal transparency. The IMF has recorded notable success in Portugal and Ireland. Greece has shown comparatively little, if any, progress.

*Slide 93*

The potential cost to Europe is at a minimum massive and continues to increase. On the minimum side, at the end of April, Europe had loans to Greece through a number of different vehicles totaling approximately €326 billion. And, the amount is increasing every couple weeks by one to two billion as the ECB funds deposits leaving Greek banks. How can anyone rationally argue that implementing good accounting and audits is not the most important reform and starting point for protecting this investment in Greece?

*Slide 94*

It's time to expand the public debate globally and for Greece to implement international accounting standard and audits and improve government fiscal performance.

- Greece has already received €340 billion in debt forgiveness.
- Greece benefits annually from:
    - €5+ billion of EU "free" funds
    - €1.5 billion in EIB loans
    - €5 to €15+ billion in avoided interest expense with EU borrowings

With €11.5 to €21.5 billion in annual financial advantage, the Greece government already has more than generous financial support.

*Slide 95*

Now, what Greece needs is the “Trinity”: 1. For prosperity in Greece, the Greece ministers' first priority is to build trust and confidence with all stakeholders. 2. To build trust and confidence, Greece ministers must make transparency and accountability of government finances their most important reform. And, 3. The starting point for transparency and accountability in Greece is accurate government financial information obtained through international public sector accounting standards and audits.

**Thank you for this opportunity to discuss our research findings and much welcome your questions.**