

The Economist, 19th Roundtable with the Government of Greece
“EUROPE: THE COMEBACK? – GREECE: HOW RESILIENT?”
Athens, 14th + 15th of May 2015

Speech:

“International Public Sector Accounting Standards and the Greek Debt”

The Economist Conference, Athens, May 2015

Dear Ladies and Gentlemen,

Thank you very much for the invitation to speak again at this important conference here in Athens. Last year, I spoke on the importance of an appropriate accounting framework for a country in general. My key statement was that in order to build trust, it is important to implement appropriate accrual accounting standards which are able to reflect economic reality.

Today, I want to specifically look at accounting for sovereign debt and debt restructurings under IPSAS. My remarks will focus on what contribution IPSAS can make in order to present a true and fair view of the Greek debt - or in other words in order to reflect the economic reality regarding debt.

I want to structure my short intervention in three parts:

1. What is the accounting subject under IPSAS?
2. How is the accounting treatment of the subject?
3. What conclusions can be derived for Greece?

So let's **firstly** investigate the accounting subject “sovereign debt” or “net debt” under IPSAS. It might be to the surprise to at least some of you that IPSAS do not use the term “debt” or even more “net debt” at all. The underlying economic phenomena, the granting of financial assets to a government which has to be repaid in the future, is summarized under IPSAS as “financial instruments” or “financial liabilities”. The relevant standards are IPSAS 28 to 30.

Within these instruments, IPSAS additionally defines public sector specific liabilities called “concessionary loans”. A loan is deemed to be concessionary, when the transaction price is not equivalent to the fair value of the loan – for instance because the interest rate is below current market conditions.

A net position, in other words the off-setting in the balance sheet of financial liabilities and financial assets such as cash, is not foreseen under IPSAS. In the opposite, there is a general prohibition for off-setting assets and liabilities, which is

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only exempted in rare cases such as for pension liabilities. So a net debt position might be derived from IPSAS Financial Statements as performance indicator for analytical purposes, but is neither suggested nor encouraged by the presentation guidance of IPSAS 28.

For purposes of the Excessive Deficit Procedure of the Maastricht Treaty, which is the basis for reporting on government debt and debt restructurings in Europe, data and terminology of European System of National Accounts (ESA) is used. Under ESA 2010, “debt” includes

- Currency and deposits
- Debt Securities and
- Loans

In essence – despite of different terminology, and leaving aside issued currency which is not covered by IPSAS yet, there is no major difference between what is covered in general under IPSAS and under statistical accounting guidelines.

Coming to the **second** part: how is the accounting treatment for financial liabilities under IPSAS, and how does this relate to the statistical requirements of ESA 2010?

Concerning **recognition**, very simplified, a government has to show the liability in their financial statements when payments according to the contractual provisions of this debt instrument can be enforced by law.

Derecognition is only possible when these financial liabilities are extinguished by either

- settling the obligation by payment,
- assumption of the obligation by another party or
- substantial modification of the terms and conditions of the arrangement

A modification of terms according to IPSAS is deemed to be substantial, when the discounted present value of the cash flows needed for repayment is at least 10 percent different from original amounts. This, Ladies and Gentlemen, is what we would commonly call a Sovereign Debt Restructuring. In this case, according to IPSAS the original debt is derecognized and the modified liability is recognized instead.

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Beyond the recognition requirements, measurement of debt leads to key differences between IPSAS and statistical reporting frameworks. Under the current ESA 2010 requirements, debt securities are measured at market value. However, loans are measured at nominal value – including concessionary loans. That means, that regardless of whether a loan has to be repaid after 1 year or after 30 years – and regardless of whether the interest rate is at market rates or whether no interest is paid at all - the amount recognized is the same.

Under IPSAS, financial liabilities, including loans and debt securities, are recognized at fair value according to the concept of time value of money. In simplified terms, that means that payments on a long-term loan have to be discounted over the duration of the contract. Consequentially, the book value is much lower than the nominal value.

Concessionary loans are also recognized at fair value. The economic benefit from the below-market interest rate is considered as a grant and therefore recognized as revenue - either immediately or over the period of the loan, depending on the conditions. It is obvious that this leads to major differences in the face of the balance sheet and of the income statement - compared to what is shown under ESA 2010.

To illustrate the effect, I want to quote an example described by Prof. Jacob Soll in an article in the New York Times dated January 21 of this year. He looked at the German loans of about 57 billion Euros at the end of 2014, which have been made at under 2 percent with repayment as far out as 2054. As the interest rate is below market rates, this is a concessionary loan. In combination with the long repayment terms in effect it contains a grant. Under IPSAS, this loan would have to be accounted for at the present value of the repayments, which according to Prof. Soll would amount only at 13 billion Euros. The difference to 57 billion, in other words the remaining 44 billion Euros, would have to be accounted according to the IPSAS standard on non-exchange revenues – and would therefore end up as revenue from grants in the income statement of Greece.

Based on assumptions for the entirety of Greek debt, measurement based on IPSAS would lead to a gross debt to GDP ratio of around 70% instead of 175% as reported under the EDP procedures, according to Ian Ball in the Public Finance Management blog of January 26 this year.

And that brings me to the **third and last** part of my intervention today: regardless what the exact figures would be, it is clear that using nominal values for debt measurement leads to an overstatement of the Greek debt compared to IPSAS.

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Overvaluing debt however is counterproductive not only for Greek stability, but for the European stability as a whole. I therefore support the European plans to align harmonized public sector accounting based on IPSAS and statistics as much as possible. The timeframe however – actually considering full implementation of EPSAS not before 2020 – is probably too far away for Greece.

Greek leaders should therefore rather now require that the Greek debt is calculated on the basis of IPSAS. In order to provide the informational basis, the implementation of these standards is a necessary precondition. On that basis, Greece will be able to persuasively showcase its achievements in restructuring sovereign debt. International experiences show that accurate financial information is the cornerstone for transparency and accountability. And with that, trust and confidence of capital markets and investors can be regained.

In that sense, I wish you all the best!

Thank you for your attention!