THE STRAITS TIMES / Opinion

What Greek accounting woes can teach Asia

PUBLISHED ON NOV. 26, 2014
BY PAUL B. KAZARIAN, WASHINGTON SYCIP AND IAN BALL

Pensioners demonstrate on Oct 2, 2014 in the centre of Athens against the Greek government's economic measures. -- PHOTO: AFP

Asia should care about Greece, because it offers two important lessons. One, that "Greek accounting" triggered the European crisis and weakened an important trading partner to Asia. Two, that weak Greek government financial management and reporting impaired trust and confidence in governing institutions.

The impact of the European crisis continues. The European economy is still struggling. Growth is anaemic at best. The crisis had an impact on the growth of Asian economies through the reduced level of trade between the continents. While exports from Asia to Europe grew by 81 per cent between 2003 and last year, they declined 7.2 per cent in the final two years.

The institutional implications of the Greek experience should not be lost on Asia. If any government does not have good financial management, then trust and confidence will inevitably decline. Asia must continue its progress in government accounting. Asia should be a global benchmark of international accounting best practices and should call on its European trading partners to do the same.

The realisation that the Greek government's numbers were seriously inaccurate shocked financial markets, destroyed trust, and triggered an economic and social crisis. With a financial reporting failure of this magnitude, the first order of business should be to ensure that reliable financial statements are produced so mistakes are not repeated. For governments, this means adopting International Public Sector Accounting Standards (IPSAS), the public sector equivalent of International Financial Reporting Standards (IFRS), which is the "gold standard" for government reporting.

Powerful voices of support for IPSAS within Greece have made progress but have yet to win sway. IPSAS was recommended by the International Monetary Fund (IMF) to Greece and other programme countries but Greece has continued to fall behind Portugal and Ireland in successful adoption. At a minimum, Greece should immediately report net debt and change in net debt, calculated in accordance with IPSAS.

Benefits of higher standards

GREECE creditors, both public and private, have shown unprecedented solidarity by sustaining over €340 billion (S$551 billion) in present value losses on their Greek debt. This massive wealth transfer to the people of Greece gave the country decades of breathing space. Greece received €275 billion in concessionary loans and rescheduled debt securities. The current debt is manageable if Greece starts with IPSAS to balance its budget, better manage its assets, and add new jobs through economic growth.

The positive and protective benefits of adopting IPSAS are clear, whether for Greece, Europe or Asia. The positive benefits include better fiscal decisions that result from better fiscal information. Countries adopting IPSAS identify many other benefits, including sustainable economic growth, lower levels of taxation, and, importantly, net debt reduction. Using IPSAS creates greater trust and confidence in the government. This facilitates foreign investment and earns benefits in the global capital markets, including lower borrowing costs, extended maturity profiles, and greater fundraising predictability.

The protective benefits include making corruption more difficult and reducing the damage associated with fiscal illusion and short-term decision-making. This is especially significant in large-scale privatisation programmes, where IPSAS is less conducive to corruption than cash accounting. Greece's failure to adopt IPSAS means the fiscal opacity that existed before the crisis remains substantially unchanged. The costs to Greece, Europe and Asia of that opacity remain high but avoidable.

For Greece, IPSAS would reveal a debt-to-GDP ratio not of 175 per cent, but significantly below 60 per cent. In fact, Greece's net debt-to-GDP ratio is one-third that of its credit peers, which is a huge competitive advantage. IPSAS would also show that Greece cash interest payments as a percentage of revenue are one-third that of its peers.

The Greece government's current bookkeeping for debt does not reflect fair value based on the present value of discounted future cash flows. Contrary to sound economic principles, Greece debt is booked as the amount due at maturity. It is as if by edict, Father Time can be stopped and a dollar in the distant future is worth the same as a dollar today.

This non-economic accounting is magnified by €275 billion in Greece debt incurred on vastly below market terms for comparable risk, such as insignificant interest rates, distant maturities, zero cash interest periods, grace periods on amortisations, and rebates on interest and principal.

Too many people have a misguided understanding that the book value of debt is always equal to the amount due at maturity. In fact, sound economic principles require that book value equal fair value, which is the present value of discounted future cash flows using market rates for comparable risk.

To be clear, Greece membership in the euro zone mandates that Greece cannot add more debt. Instead, Greece must work hard to increase growth and returns on government financial assets. Implementing IPSAS would make a huge difference to government and corporate costs of capital, and therefore to Greece's prospects for job creation, estimated at between 200,000 and 400,000 in the next 24 months.

Two action items for Asia

A RERUN of the euro crisis would have global impact, making growth in Asia much harder to sustain. In its own best interest, Asia should take two courses of action. First, Asia should press Greece and Europe to fix the accounting problems that led to the last crisis and could lead to the next. Second, Asian governments should continue their progress in accounting and financial management, winning a place as a global benchmark.

Indeed, Singapore government financials use an accrual accounting framework similar to IPSAS. Debt is reflected at fair value based on the present value of discounted future cash flows; IPSAS would result in no change. Also, a member of the IPSAS board is from China's Ministry of Finance.

Paul B. Kazarian is founder, chairman and chief executive of investment firm Japonica Partners and the Kazarian Foundations; Washington SyCip is founder of the Asian Institute of Management and SyCip Gorres Velayo & Co, and was president of the International Federation of Accountants (IFAC) from 1983 to 1985; and the last writer is the chair of CIPFA International and was IFAC chief executive from 2002 to last year.

BACKGROUND STORY

The institutional implications of the Greek experience should not be lost on Asia. If any government does not have good financial management, then trust and confidence will inevitably decline.