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***Consolidated financial statements in the public sector.  
Development and future directions***

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*Dubium sapientiae initium*

*Cartesio*

*Al mio papà e alla mia mamma*

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# Abstract

In the last decades, on the wave on the new public management philosophy (Christensen and Lægreid, 2002; Gow and Dufour, 2000; Pollitt & Summa, 1997), a profound process of changes has involved the public sector. The increase of inter-municipal collaboration and public-private partnerships can be observed, with the main aim being to improve the quality of services and fulfil the needs of citizens. The main aspect of the decentralization (contracting-out as well as privatization) is that many activities are frequently managed through controlled entities. In this new context, consolidated financial statements (CFS) are able to ensure a complete picture of the whole group at both central and local levels (Wise, 2006 Newberry, 2007; Grossi and Newberry, 2009) overlapping the limits of the financial statements.

The aim of this research is to investigate the development of the CFS in the public sector highlighting why the importance of this tool is growing, what role CFS play in different contexts, what issues are mainly investigated and what are the future directions of the research in this field.

The first step of the research is an overview of the state of the art on the topic, consisting of a structured literature review on public sector CFS. The aim is to clarify what it has been done as well as the future research agenda. In particular, this step of the thesis concentrates on how the CFS literature is developing, pointed out its focus as well as the future of CFS research within the public sector. The main findings emphasize that previous literature has largely investigated technical issues, paying less attention on theoretical issues. Additionally, previous studies are largely based on qualitative methodology. Finally, a dichotomy between

private vs. public sector accounting standards and, more generally, rules and criteria (relating to several issues, especially the definition of the consolidation area) emerge.

Focusing on this last point, the second step concentrates on a particular technical aspect: the definition of consolidation area by International Public Sector Standards Board (IPSASB). The literature has highlighted that the public sector international standards follow the private sector rules, defining similar criteria. Previous literature has largely debated this issue. More specifically, in order to understand the appropriateness of the “control approach” for the definition of consolidation area within the public sector, the different approaches have been investigated through an analysis of the comment letters submitted by the respondents of the Exposure Draft no. 49, which will replace the current IPSAS 6 in the new IPSAS 35. In fact, the IPSASB has recently published three new Exposure Drafts, among them, the ED no. 49 on *consolidated financial statements*. The focus is specifically on the assessment of control based on three key elements: “Power over the other entity”; “Exposure, or rights, to variable benefits from its involvement with the other entity”; and “The ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity”. The main findings of the research concern both the acceptance of the alignment between the proposed new standard and the IFRS 10 and the key role played by the control approach in contrast to other alternative approaches (such as the budgetary one).

The third step is based on a simple consideration: in several countries, public sector CFS are not mandatory; therefore, this tool is frequently implemented on a voluntary basis. Accordingly, this step of the thesis investigates the reasons underlined this voluntary implementation of CFS. In accordance with the legitimacy and institutional theory perspectives, this step explains the voluntary implementation of CFS in accordance with the aim of legitimating the deployment of a LG towards citizens as well as of achieving conformity

with the institutional environment. The research focuses on the Italian context because, recently, local government can decide to prepare CFS adhering experimental period defined by Decree no. 118/2011. A questionnaire was sent to both the Financial Councillor and the Chief Financial Manager, and with a principal component analyses and a regression model, the principal findings are that the choice to use the CFS is supported by both by strategic and technical reasons.

# Chapter 1

## Introduction

### 1. Research context and motivation

Several reforms were implemented in the public sector during the last three decades in accordance with the New Public Managements (NPM) paradigm (Hood, 1991). The radical changes in organizational, managerial and accounting aspects involved many countries (Broadbent and Guthrie, 1992; Burkitt and Whyman, 1994; and Barton, 2004). The reform had the aim of improving the efficiency, effectiveness, reliability and transparency (Hood, 1995; Lapsley, 1999; Borgonovi, 2002; Pollit and Bouckaert, 2002; da Costa Carvalho et al., 2007) in the delivery of public services in both local and central governments. For these reasons, there was a move towards privatization and quasi-privatization (Hood and Schuppert 1988; Dunleavy 1989) through the decentralization of services, displacement of old-style public administrations with a new management focus, an increase in the implementation of innovative ICT solutions for the production and distribution of public services, along with the introduction of accrual accounting systems overlapping traditional cash ones. The accounting reforms became an essential part of the NPM drive (Christiaens and Rommel, 2008) to enhancing the financial transparency of governmental organizations, decision-making and accountability (Guthrie et al., 1999; Groot and Budding, 2008). In particular, the introduction of full accrual accounting systems was considered to be part of the modernization process of financial information systems, thus leading to a better evaluation of the performance (Evans, 1995) of central governments.



The NPM trend, requiring privatization and quasi-privatization, reorganized the dimension and structure of public management. Outsourcing, decentralization, privatization and contracting out are considered to be a better form for the delivery of public services. Therefore, the public sector uses the market to discover partners, since among the various actors, private partners were often preferred due to their efficient and effective management of government services, especially when considering that NMP policy objectives are pursued through the market and competition (Bryson et al. 2014). The phenomenon of new forms of decentralization (public, private or public and private) has determined various types of entities which are connected to governmental organizations at either a central and/or local levels (Argento et al, 2012), with the role of co-ordination and control performed by governments (Osborne and Gaebler, 1992; Christensen and Laegraid, 2007) being essential for these new entities. A financial and economic tool was therefore, necessary, with it including the financial consequences of new entities: subsidiaries, joint ventures and associates considering that the traditional annual reports of governments showed only a partial view of their activities and financial situation. The consolidated financial statements lead to disclosing the lack of information. Therefore, in order to obtain a global vision of the financial impact at all levels of government, every country should include the consolidated financial statements (CFS) or whole government account (WGA) in its agenda.

CFS are the financial statements that evaluate the performance of a *group*. The aim of CFS is to provide an overview of the financial performance and position of the all decentralized government entities, considering that the traditional government annual accounts do not necessarily include decentralized entities' financial situation and performance (Wise, 2006; Newberry, 2007; Grossi and Newberry, 2009). Consolidated financial reporting provides better quality and more transparent information, along with the stakeholders having the right

a full picture of a municipality's financial position. In fact, consolidated financial reporting is considered to be essential to supporting decision-making processes as well as ensuring public accountability and transparency (Chan, 2003; Benito et al., 2007; Chow et al., 2007) as required by the NPM spirit.

The Whole of Government Account (WGA) refers to a view of the overall financial position of the government of a particular jurisdiction and is prepared *via* the consolidation of the financial statements and transactions of all the entities controlled by the government jurisdiction (Guthrie 1998, p. 2; Grossi, 2016). The aim of the WGA is to produce a single financial report that encompasses all government activities and entities within its area of authority, i.e. city, region, or central government in a country (Grossi and Newberry 2009). Alternatively, it may refer to a central government's efforts to produce a single financial report that encompasses public sector activities throughout the country. In this case, it requires an alignment of the accounting policies applied in all the separate financial statements with the accounting policies adopted for WGA. It sustains the micro economic level, reflecting the governance changes.

In this general view, the use of CFS or WGA, which refer to consolidation at different levels of government, gives the stakeholders a clear and complete financial information.

During the last years, many governments have implemented the CFS, in particular the accrual-based consolidated accounting (Bergmann et al., 2016). The preparation of CFS in accordance with accrual accounting gives an important contribution to macroeconomic policymaking, to enhancing parliamentary scrutiny and accountability, as well as facilitating "*a more holistic approach*" to government by integrating accounting information systems (Chow et al, 2016). The use of accrual accounting with the CFS represents a progressive step. While the simple aggregation of cash-based data of individual entities results in a form of

consolidated report, the accrual-based method of consolidated financial reporting includes adjustments designed to eliminate the double-counting of data where inter-entity transactions have occurred (Wise, 2004).

Regarding the accounting standards to prepare the CFS, the NPM highlights the need for more harmonized regulations (Müller Marrqués Berger, 2012), considering the diversity in the accounting practices and financial reporting at different government levels.

Roughly ten years ago, only a few countries on the international scenario compiled the consolidated financial reporting in their public sectors at whole, federal/central, state or local government (for example: Sweden, the UK, the USA, Canada, New Zealand, Australia, Austria, Finland, France, the Netherlands and Switzerland) (Grossi and Pepe, 2009), and only some countries established accounting standards in alternative to the international public sector accounting standards. Therefore, to fill this gap, the International Public Sector Accounting Standards Board (IPSASB), an independent standard-setting body, issued accrual-based standards to be used for the preparation of general-purpose financial statements by governments and other public sector entities around the world. The aim of the IPSASB is to enhance the quality, consistency and transparency of public sector financial reporting worldwide. The IPSASB strategy is to develop public sector accounting standards in accordance with private sector standards, namely the International Financial Reporting Standards (IFRS).

However, the use of the IPSAS can be a stimulus to the harmonization of public sector accounting. In fact, in the European context, there are several benefits of the harmonization such as (Lüder, 1988; Lüder and Kampmann, 1993; Benito et al., 2007) the possibility to establish comparisons between different countries, so the accounting systems are more comparable; the possibility to consolidate the financial statements of the member countries

so as to obtain an overall picture of the financial situation of the EC; the possibility for the equal treatment of European Union grants and European Union dues in the national accounting systems; the possibility of the citizens, as well as possible investors, to compare the situation of different member countries; the possibility to adopt generally accepted accounting principles in the European Union in order to compare accounting systems between different countries and between them and the European institutions; the harmonization of public accounting could contribute to guaranteeing the proper functioning of the common market.

Therefore, the crucial role of the CFS or WGA is emerging in every country; in fact, some countries are deciding to implement these tools, and therefore, current literature is focussing more on the topic.

## **2. Research problems and questions**

At the beginning of the century, several countries compiled the CFS, with some countries such as Sweden, the UK, the USA, Canada, the New Zealand, and Australia, having already established consolidation standards, in addition to IPSASB (Grossi and Pepe, 2009). Notwithstanding not many countries preparing CFS, current literature has highlighted the use of different approaches. In particular, there are two trends: the first, in the Anglo-Saxon countries (the UK, Australia, and New Zealand), shows that there is the convergence of the accounting standards traditionally toward a private sector approach; and the second shows that some countries (USA, Canada, and Sweden) adopt accounting standards modified for the application to the public sector in relation to influential role of the government (Grossi and Pepe, 2009; Grossi, 2016). There are also different methods used for the preparation of the

CFS. Considering the complexity of the scenario, with a wide variety of approaches and the growing attention from scholars, a review of current scientific literature is necessary.

In fact, the theoretical foundation of financial consolidation in the public sector needs to be more thoroughly investigated, and ad hoc perspectives, scopes, and methods should be explored in order to appropriately consolidate all the decentralized entities (Wise, 2010).

Therefore, the first step of this thesis is a literature review, aimed at providing a clear, complete, and comprehensive picture and understanding of the topic, while at the same time outlining a future research agenda.

The literature review analyzes all the articles published from 1980 to 2015, which focus on CFS or WGA. In this way, it is possible to discover what the scholars have investigated, what the main debated topics are, and more generally, it is possible to have a complete map of the studies on the topic. Therefore, the first research question to be investigated is: how is the accounting and public management literature on CFS within the public sector developing (What has been done?) and what its focus is; furthermore, the second question is: what is the future of research CFS in the public sector (What could be done?).

The methodology applied in the structured literature review follows the guidelines suggested by scholars (Tranfield et al., 2003; Jesson et al., 2013; Dumay et al., 2016; Massaro et al., 2016) and is articulated in three steps:

- Planning the review;
- Conducting the review, which consists of a comprehensive search, quality assessment and data extraction;
- Reporting and dissemination, which consists of both a descriptive analysis of the field and a more in-depth (thematic) analysis.

The main result shows that the debated topics are: 1) the definition of the consolidation area; 2) the level of consolidation; 3) the dichotomy between private and public sector accounting standards; 4) the relationship with the statistic rules; and 5) the usefulness of CFS.

The second step of the research investigates two aspects that emerged from the literature review:

- a) the dichotomy between private and public sector accounting standards; and
- b) the definition of the consolidation area.

Regarding *the dichotomy between private and public sector accounting standards (sub a)*, it is worth considering that many countries use the IPSAS for the preparation of CFS because they do not have their own standards; additionally, other countries use them in order to favor the harmonization trend. However, these standards, largely comply with the private sector international standards. The use of international standards represents a progressive step for the whole international community. However, current literature (Ellwood and Newberry, 2007; Robb and Newberry, 2007; Grossi and Steccolini, 2015) has highlighted how there is an uncritical adoption in the public sector of definitions, methodologies and practices of the private sector. Therefore, the public sector characteristics are not adequately taken into account and the objectives of the public sector are not considered (Christiaens, 2002; Grossi and Steccolini, 2015). This aspect should call for caution in order to avoid “perverse outcomes” in the public sector (Guthrie, 1998; Ellwood, 2003; Newberry 2007; Ellwood and Newberry, 2007; Robb and Newberry, 2007; Christiaens and Rommel, 2008; Broadbent and Guthrie, 2008; Brusca and Montesinos, 2009). However, other authors (Anthony, 1983; Anthony, 2000; Barton, 2011, pp. 422–423) agree with the connection with private standards.

Regarding *the definition of the consolidation area second (sub b)*, the review of current literature highlights how the definition of the reporting boundaries is a highly debated topic.

The international public sector accounting standards apply the control criterion to define the consolidation area, as in the private context. However, the adequacy of the control approach has been largely debated (Day, 2009; Chow et al., 2009; Walker, 2011; Grossi and Soverchia, 2011; Tagesson and Grossi, 2012; Howieson, 2013; Bergmann, 2014; Gardini and Grossi, 2014; Grossi and Steccolini, 2015). Accordingly, the IPSASB has recently modified the standards concerning consolidation. More specifically, the IPSASB revised the IPSAS 6, "*Consolidated financial statements*", used for the preparation of the CFS, which defines the control criterion for the area of consolidation. In accordance with the due process, the IPSASB issued three new Exposure Drafts (no. 48: *Separate financial statements*; no. 49: *Consolidated financial statements*; no. 50: *Investments in Associates and joint ventures*) and, consequently, three new international standards on the topic. Focusing on the most relevant Exposure Draft (ED) no. 49 regarding the preparation of the CFS, the main issue it concentrated on regarded the recognition of the consolidation area and the proposed concept of "control", which in turn seems to adhere to the parent company theory. In this case, the viewpoint of the EDs respondents is essential to understand if the methods and procedures adopted in the new standards were supported or not.

Therefore, the second step of the thesis consists of an analysis of the responses provided by the several respondents to the main problematic issues referring to the definition of appropriate criteria concerning the consolidation area and the concept of the control. Accordingly, the main research questions are (Bisogno et al., 2015):

1. "Do respondents agree with the proposed alignment between ED no. 49 and the IFRS 10? What are the arguments included in the comment letters in supporting or contradicting this alignment?"

2. “What is the scope of CFS? What are the arguments included in the comment letters about the scope of CFS? Are there any comments that deal with the decision-making or accountability reasons?”
3. “Do respondents agree with the proposed concepts of control, power and benefits as well as with the proposed definition of the consolidation area? What are the arguments included in the comment letters about these issues? Are there any comments that deal with the budgetary approach as well as the statistical perspective?”

From a methodological point of view, this step of the thesis is based on an in-depth analysis of the comment letters submitted to the IPSASB, contributing to the on-going debate in literature concerning the main debated issue of the concept of control and definition of the consolidation area, at the same time emphasising the dichotomy public vs. private sector accounting standards.

In addition to the above-mentioned issues, the literature review has revealed that there is a fragmented use of CFS in the international scenario. Sweden, for example, implemented the CFS in a voluntary way, in the 1980s and after few years, in 1992 they became mandatory (Tagesson and Grossi, 2012). On the other hand, others countries have only recently implemented the CFS (Bergmann et al., 2016). Considering the importance in term of the usefulness of CFS (Wise, 2010, Heald and Georgiou, 2011; Grossi et al., 2014), today, some local governments have voluntarily decided to use this tool. Accordingly, the question to analyze is why a public sector entity (and, in particular, a local government) could decide to voluntarily implement the CFS. The research focuses on the Italian case, since Italy has recently promoted an experimental period of three years during which local governments could decide to implement CFS on a voluntary basis according to national criteria. The



institutional theory and legitimacy theory has been used to investigate this national case. The institutional theory explains why organizations adopt some practices through three forms of institutional isomorphism (Di Maggio and Powell, 1983; Budding et al., 2015): *coercive isomorphism*, which can occur through requirements imposed by norms and governments; *mimetic isomorphism*, which refers to the adoption of practices used by others organizations defined as successful and which is likely to take place in contexts of ambiguity and uncertainty; *normative isomorphism*, which occurs as a result of shared value and ideas about appropriate conduct, often diffused through professional networks and education. Moreover, the voluntary preparation of CFS could be conceived as a training process, aimed at facing and resolving the difficulties revealed by the scholars. In addition to the technical reasons, the choice to use the CFS can also be considered strategic: the possibility to make public management more transparent could increase the *social perceptions* concerning the conduct of organizations; accordingly, public management is perceived by outside parties as being “legitimate”.

This last step of the thesis aims to investigate why several local governments voluntarily adhere to the experimental period, preparing CFS. Therefore, the research questions are:

1. “Does the aim of conforming with the institutional environment affect the decision of ILGs to voluntarily implement CFS?”
2. “Does the aim of being legitimate affect the decision of ILGs to voluntarily implement CFS?”

To answer these research questions, a questionnaire was sent to both the Financial Councillor and the Chief Financial Manager of the 284 Italian local governments that have decided to implement the CFS. The results of the questionnaire are analysed through a principal component analysis (PCA), with the main aim being to summarize the data losing as

little information as possible (Mardia *et al.*, 2003, p. 213). The main items emerging from the PCA have been used for defining aggregate indexes to be considered as variables in a regression model. This last analysis has been carried out in order to test the relevance of both strategic and technical reasons underlined the voluntary implementation of the CFS.

In short, the thesis aims to investigate the developments of the CFS not only in the European context but also at the international level, contributing on the on-going debate and highlighting future orientations.

### **3. Research contribution**

The research contribution is the result of the study and investigation of the research questions developed in the three next chapters. Every question, in fact, contributes to filling some existing gaps.

The structured literature review outlines the current “state of the art”, highlighting what the origins of the CFS in the public sector are, how it has developed over the years and what the possible future directions are.

Building on the results of the literature review, the second chapter of the thesis aims to contribute to an important question regarding the use of the control approach by public sector international standards for the definition of consolidation boundaries. This step shows that the control criterion is the most adopted one, notwithstanding many scholars having criticized the adoption of this approach in the public sector.

The last step of the thesis aims to investigate other partially unexplored aspects, taking the most debated issues further. Accordingly, it focuses on the possibility to understand the reasons why a public sector entity could decide to prepare the CFS or WGA on a voluntary basis, and what the aspects involved are. In evaluating this phenomenon, both the technical

and strategic aspects, coupled with the size and geographical localization of the local governments as well as their financial health emerge as relevant variables. As a consequence, both politicians and public managers chose to use the CFS as a strategic tool so as to increase their legitimation as well as resolve the technical aspects.

#### 4. Thesis structure

The thesis is divided into five chapters. The first chapter is an introduction of the topic, which aims to illustrate the research questions debated in the study.

The following four chapters deal with these questions. More specifically, after a structured literature review (chapter 2), chapter 3 (“The use and the evaluation of accounting standards”) focuses on the role of the IPSAS, while chapter 4 (“CFS in the Italian local governments”) investigates the voluntary implementation of CFS. Finally, chapter 5 presents a summary and also the conclusions.

The following table synthesizes the objectives and the chapter linked.

Chapter 1	Chapter 2	Chapter 3	Chapter 4	Chapter 5
Why the topic is relevant?	How is the literature developing and what is its focus? What are the future developments?	The use and the evaluation of accounting standards	What are the reasons of the implementation of the CFS?	Conclusion and future directions

Each chapter is structured in four sub-paragraphs concerning, respectively: the theoretical background; the research methodology; the results; and the discussion of the results coupled with final considerations.

These chapters are the results of the research carried out over three years and presented as three articles. These papers have been presented in workshops and conferences<sup>1</sup>; subsequently, in accordance with the suggestions and comments provided by the both discussants and participants, they were submitted for publication. The analysis of the comment letters on the IPSASB Exposure Draft investigated in the third chapter has already been published<sup>2</sup>. The other two papers are still under review in two international accounting journals.

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<sup>1</sup>“Consolidated financial statements of public sector entities: the concept of control”, (co-authors M. Bisogno, A. Tommasetti), EGPA Workshop, Lisbon, May 8-9, 2014.

“Literature review on consolidated financial statements: public vs public sector context” (co-authors M. Bisogno, G. Grossi) IV Spring Workshop EGPA, Winterthur (Switzerland), May 7-8, 2015.

“Strategic and technical reasons related to the experimentation of Consolidated Financial Statements in local governments” (co-authors M. Bisogno, G. Grossi), EGPA Annual Conference, Utrecht, The Netherlands 24 - 26 August 2016.

<sup>2</sup>Bisogno M., Santis S., Tommasetti A. (2015), Public sector consolidated financial statements: An analysis of the comment letters on IPSASB’s Exposure Draft no. 49, in *International Journal of Public Administration*, vol. 38, issue 4, pp. 311-324.

# Chapter 2

## The state of the art: a structured literature review

### 1. Public sector consolidated financial statements

In the last decades, on the wake of the reforms stimulated by the New Public Management philosophy (Pollitt and Summa, 1997; Gow and Dufour, 2000; Christensen and Lægreid, 2002) significant developments in public sector accounting and accountability systems have been observed in several countries. These reforms have led to the implementation of relevant accounting ideas, such as the gradual transition from cash to accrual accounting and the implementation of consolidated financial statements (CFS) (Olson, Humphrey and Guthrie, 1998).

In the private sector, CFS are considered pivotal in providing a global picture of the financial situation and position of business corporate groups, and the related literature is quite dated (Childs, 1949; Walker, 1978; Walker and Mack, 1998). Similarly, in the public sector, the decentralization of many services through public-private partnerships necessitate an accounting tool, such as CFS, which are able to provide a more complete picture of these partnerships, satisfying internal and external accountability needs (Humphrey *et al.*, 1993; Broadbent *et al.*, 1996). Accordingly, public sector CFS have been implemented, in a mandatory or a voluntary basis, in various countries (Grossi and Pepe, 2009, Bergmann *et al.*, 2016).

Several studies have been published on the topic, aiming at investigating both technical and methodological issues, such as the definition of the reporting entity and the boundaries

of the “public sector group”, the selection of a proper method of consolidation, and so forth (Heald and Georgiou, 2000; Robb and Newberry, 2007). Furthermore, scholars have observed the applicability of the private sector criteria of consolidation (and the related accounting standards) in the public sector realm (Broadbent and Laughlin, 1998; Olson, et al., 1998; Lapsley, 1999; Ellwood and Newberry, 2007). Other studies have concentrated on which level of government the CFS should refer to, especially dealing with the “whole-of-government accounts” (Chow et al., 2007; Walker, 2009), also focusing on the relationship between statistical and accounting approach towards public sector consolidation (Barton, 2011).

This means that studying public sector CFS requires a separate research agenda, since the public sector is organizationally specific because of its different levels of representativeness, accountability, and responsiveness (Massaro et al., 2015). In other words, public sector entities work in a unique context, where both their stakeholders and their accountability system differ appreciably from those of private sector organizations (Pallot, 1992). Therefore – and taking into account the increasing role of public sector CFS in overcoming the lack of accountability (Lande and Rousseau, 2005; Wise, 2006; Newberry, 2007) – applying in an uncritical way private sector theories, methods and rules concerning CFS may be counterproductive.

Hence, there is a need to understand how CFS are evolving within the context of public sector entities. Accordingly, this paper reviews public sector CFS literature, offering an overview of the state of the research on the topic at the same time outlining a future research agenda.

According to Massaro et al. (2016), a literature review can be carried out in different ways and a sort of continuum can be identified, moving from an approach characterized by the absence of rules (rapid and traditional reviews), to a methodology based on a rigid set of rules

to be adopted (systematic and structured reviews). This study is based on the structured literature review methodology, as proposed by Dumay et al. (2016), Guthrie et al. (2012, p. 70), Massaro et al. (2016) and Tranfield et al. (2003). More specifically, aiming at drawing implications for both scholars and practitioners regarding the main evolution of CFS and future research needs, this study would like to deal with the following research questions:

RQ1. How is the CFS literature within the public sector developing and what it is focusing on?

RQ2. What is the future of CFS research within the public sector?

The remainder of the paper is structured as follows. After a description of the research methodology, provided in the following section, the third section will concern a preliminary descriptive analysis of the selected papers. The following two sections will provide a more in-depth analysis of the papers selected for this review, while the final section will give its conclusive considerations.

## **2. Research methodology**

As stated above, a literature review is a written assessment concerning the existing knowledge regarding a field or an area of research and different strategies can be adopted. Therefore, a literature review can move from a “rapid review” or a “traditional authorship review” on the left side, to a “systematic” or a “structured” literature review, on the right side of the continuum proposed by Massaro et al. (2016).

The strategy adopted in the present study is based on a structured literature review methodology.

Accordingly, the data was retrieved and gathered through a prescribed and replicable methodology, aiming at providing a clear path for synthesizing and appraising the main

findings of relevant studies on a topic (Sweet and Moynihan, 2007). However, even if a structured literature review has to follow several steps, listed in chronological order, the process should not be considered as a strict series of events, thus the final implementation of a literature review is fluid.

Therefore, according to the literature (Tranfield et al., 2003; Jesson et al., 2013; Dumay et al., 2016; Massaro et al., 2016), the methodology used in this study is based on the following steps:

1. Planning the review;
2. Conducting the review (which consists of comprehensive search, quality assessment and data extraction);
3. Reporting and dissemination, which consists of both a descriptive analysis of the field and a more in-depth (thematic) analysis.

The main aim of the *first step* ("*Planning the review*") is to take into account if a review is opportune or not and to prepare a protocol, as well as defining the questions that the review intends to investigate. Firstly, there is the need to ascertain if to date there is no other comprehensive literature review on public sector CFS. Secondly, to write a protocol means explaining the procedure adopted in the review, in order to increase the reliability of the research, at the same time allowing readers to evaluate and replicate the adopted criteria. It is expected to support the goal of the research, clarifying the state of the art and what is lacking in knowledge in the investigated field. As stated in the previous section, the first research question will concentrate on how the CFS literature within the public sector is developing, highlighting the focus of previous studies. The second research question aims to delineate the future research agenda on public sector CFS.



The *second step* (“*Conducting the review*”) refers to the selection of studies, based on the definition of keywords and the identification of which databases to refer to. Additionally, this step concerns the clarification of inclusion/exclusion criteria, based on definite and precise rules (Tranfield et al., 2003). In this study, a funnel method has been used, which consists of an extensive research, which aims at encompassing all potentially relevant papers, followed by a restrictive selection.

Accordingly, in the first place the search was based on the following 9 keywords: (“consolidated financial statements”) OR (“consolidation method”) OR (“area of consolidation”) OR (“consolidated financial reporting”) OR (“public sector accounting”) OR (“IPSAS 6/IPSAS 35”) OR (“whole of government”) OR (“methods of consolidations”) OR (“GASB 14”). These keywords were inserted in three different databases: Business Source Premiere (BSP), Scopus, and ISI Web of Science. The research spanned from January 1980 to December 2015 and was limited to journal articles (with peer review) written in English. The initial output consisted of 1,045 articles, which were catalogued in the Zotero library. Subsequently, i removed any documents that were not papers, such as exposure drafts, call for papers, highlights, new digests and official releases (63 documents), as well as all the duplications (266 papers), because of several papers were included in more than one database. Finally, 7 other articles through a residual search, due to their diffusion in the literature concerning the public sector CFS were added. Having completed this preliminary step, a residual number of 723 papers was collected, as Table 1 illustrates.

Table 1. Database

	DATABASE			Total
	Ebsco	Scopus	Isi	
Keyword search in the title and/or abstract “Call for paper/ED, etc. <sup>1</sup> ”	588	310	147	1,045
After deleting “Call for paper/ED, etc.”				– 63
Number of total duplicates				982
After deleting duplicates				– 266
No. of articles found in the residual search				716
<b>Total</b>				<b>+ 7</b>
				<b>723</b>

Having completed the extensive research, a restrictive selection, based on an assessment of the quality of the selected papers, was carried out. As stated above, this is the most delicate phase, which requires a clear definition of inclusion/exclusion criteria.

Therefore, according to the literature (Denyer and Tranfield, 2009; Tranfield et al., 2003; Dumay et al., 2016; Massaro et al., 2016;), while avoiding to refer only to external criteria of relevance (such as those based on the journal ratings), the exclusion of the selected papers was based on the following criteria:

- Taking into account that the adopted keywords were quite extensive, the online search retrieved many papers concerning other fields and themes. Accordingly, after a careful reading of the abstracts, 109 papers were excluded, since they dealt with different fields of research (such as economic psychology, computer network, public health, engineering, and so on). Similarly, other 236 papers concerning other themes (such as accounting convergence and harmonization, cost vs. fair value in both private and public sector accounting, public sector accrual accounting) were eliminated;
- The second exclusion criterion refers to the “private vs. public sector” dichotomy. Therefore, all the papers were classified in accordance with their topic, separating studies concerning the public sector context from those concerning the private sector realm. This last group consisted of 253 papers, which were further classified in two sub-groups, in order to gain a more insightful understanding of their content. The first sub-group concerned papers focused on the private sector context, dealing with CFS issues among other broader topics (54 papers). The second sub-group consisted of papers concerning

<sup>1</sup> Call for paper, ED, Highlight, New Digest, Official Release.

specific CFS issues, such as theories of consolidation, methods of consolidation, and so forth (199 papers).

After these exclusions, a residual number of 125 papers was obtained.

Evaluating the relevance of these papers in accordance with a third criterion of exclusion, the result shows the distinction between papers focused on specific public sector CFS' issues vs. papers focused on public sector context, which mentioned CFS but without any in-depth investigation of their specific issues. This second category largely consists of studies concerning public sector reforms; as a consequence, these studies consider both CFS and further innovations within a wide agenda. Accordingly, 93 papers were excluded.

The final result was that 32 papers were relevant for this literature review. Table 2 shows all the mentioned steps.

*Table 2. Research of relevant articles*

Sample	Number of articles
• Selected papers	723
• Articles concerning other fields	– 109
• Articles concerning other themes	– 236
• Articles concerning private sector context (54 + 199)	– 253
• Articles concerning public sector but not focused on CFS	– 93
<b>Relevant papers</b>	<b>32</b>

In the *third step* (“*Reporting and dissemination*”) consists in a thorough reading of the selected papers. The aim of this crucial step is to highlight all the information and data upon which the analysis will be based. The following section will deal with a descriptive analysis, with the main aim being to provide a first overview of the selected papers (i.e.: journal and year of publication; country investigated in the study), at the same time investigating the impact of each article and the methodological approach adopted.

Building on these preliminary findings, the fourth and fifth sections will investigate the papers more thoroughly, providing answers to the research questions of this study.

## 2.1 Descriptive analysis

Generally, a descriptive analysis would provide a full and detailed information extracted from the selected papers using a simple set of categories, such as: year of publication; country of origin of authors; countries investigated in the study; general profile of the articles; methodology of research, and so forth (Tranfield et al., 2003).

In the case of this literature review, according to Broadbent and Guthrie (2008), the following classification criteria were used:

- Journal and journal' subject area;
- Year of publication;
- Countries investigated;
- Citations of the articles;
- Methodological approach.

Table 3 classifies the papers according to the journals where they were published and the subject area to which these journals belong. More specifically, the classification is based on two main subject areas: "Finance & Accounting" and "Public Sector Management" according to the Journal Quality List (JQL; Fifty-seventh Edition, 18 April 2016). Taking into account that several journals were not catalogued in JQL, they were included in the "Finance & Accounting" area or in the "Public Sector Management" area according to their main aim, as explained in the journal's website. However, a residual area was also identified.

Table 3. Studies reviewed by journal subject area

<b>Studies reviewed (by source journal and its subject area)</b>	<b>No. of papers</b>
<b><i>Finance &amp; Accounting (16)</i></b>	
Abacus ( <i>JQL</i> )	6
Accounting & Business Research ( <i>JQL</i> )	1
Australian accounting review ( <i>JQL</i> )	2
Financial Accountability & Management ( <i>JQL</i> )	1
Journal of Modern Accounting and Auditing	1
Journal of Public Budgeting, Accounting & Financial Management	2
Pacific Accounting Review	1
The Cpa Journal	2
<b><i>Public Sector Management (14)</i></b>	
Australian Journal of Public Administration ( <i>JQL</i> )	1

International Journal of Public Administration ( <i>JQL</i> )	2
International Journal of Public Sector Performance Management	1
International Review of Administrative Sciences	1
Journal of Government Financial Management	1
Public Money & Management ( <i>JQL</i> )	8
<b>Other subject areas (2)</b>	
Economic and Labour Market Review	1
International Review of Business Research Papers	1
<b>Total</b>	<b>32</b>

Table 3 shows that CFS have been considered and investigated not only in the accounting field (16 papers), but also through a managerial perspective (14 papers). This could mean that previous literature focused on both technical issues (such as methods and theories of consolidation) and on managerial implications deriving from the adoption of CFS. However, it is worth noticing that this result is largely due to two special issues published by an accounting-oriented journal (*Abacus*) and a managerial-oriented journal (*Public Money & Management*).

As far as the year of publication is concerned, Figure 1 illustrates that while a limited number of papers were published from 2000 to 2008, there was a considerable increase in the subsequent years, especially 2009 and 2011, when the two above-mentioned special issues were published.

The third classification criterion concerns the geographical area investigated in the paper. Table 4 classifies papers according to the geographical area to which they concentrated on, taking into account that several papers have dealt with more than one country. While Panel A refers to countries, Panel B is based on their aggregation as regions. Adapting the classification scheme from Dumay et al. (2016), the following regions were identified: 1: North America; 2: Australasia (including Australia, New Zealand and parts of Asia, such as China, India, Malaysia, Singapore, Thailand, Japan, etc.); 3: United Kingdom, including England, Ireland, Scotland and Wales; 4: European Union; 5: Africa; and 6: Others. However, it should

be observed that several papers adopted a comparative approach, investigating two or more countries (i.e. Brusca and Montesinos, 2009; Grossi and Pepe, 2009).

Figure 1: Papers per year

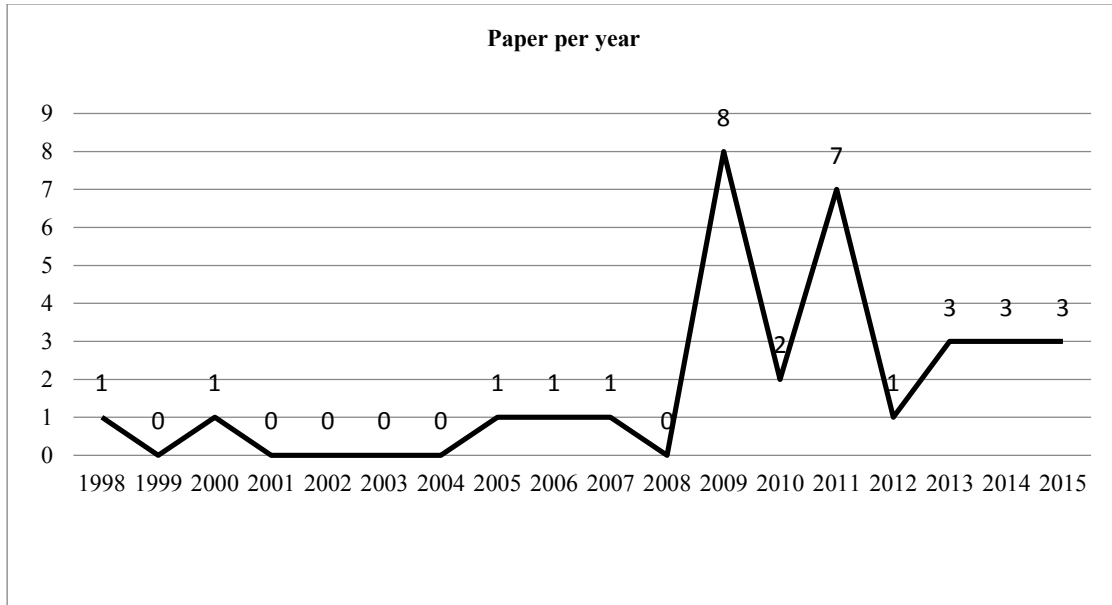


Table 4. Countries and Continent analysed

<b>Panel A: Countries</b>	<b>No.</b>	<b>Panel B: Continent</b>	<b>No.</b>
Australia	11	1. North America	7
UK	9	2. Australasia	17
New Zealand	5	3. UK	10
Italy	5	4. European Union	10
USA	4	5. Africa	0
Canada	3	6. Other	2
Sweden	2	<b>Total</b>	<b>46</b>
European Commission	1		
Germany	1		
Northern Ireland	1		
OECD Countries	1		
Spain	1		
Switzerland	1		
Vanuatu	1		
<b>Total</b>	<b>46</b>		

Panel A clearly shows that Australia (11) and United Kingdom (9) are the most investigated countries, even if a considerable number of papers focused on New Zealand (5), Italy (5) and the USA (4). The case of Vanuatu, as an example of adoption of CFS in a developing country,

is also worthy of mention. According to Panel B, the most investigated area is Australasia (17 papers), followed by the UK and the European Union (10 papers in both cases), and North America (7), while there were no papers concerning Africa. Therefore, some interesting questions may deserve attention: What are the main obstacles towards the adoption of public sector CFS in developing countries? Are there any lessons to be learnt from the experience of countries where CFS have a long tradition? Why are some geographical areas less investigated than others?

The fourth criterion of classification concerns the impact of the articles selected in this review, expressed through the number of Google Scholar citations. These citations were downloaded on 10 October, 2016 and Table 5 illustrates the top ten articles by citation. In addition, in order to avoid the potential bias due to year of publication (older papers can collect more citations compared with more recent articles), a second raking was calculated. Accordingly, Table 6 shows the top ten papers by citation per year.

*Table 5. Top ten articles by Google Scholar citations (as on October 10, 2016)*

No.	Reference	Paper	Cit.
1	Grossi and Soverchia (2011)	European Commission Adoption of IPSAS to Reform Financial Reporting	61
2	Chow, Humphrey, and Moll (2007)	Developing Whole of Government Accounting in the UK: Grand Claims, Practical Complexities and a Suggested Future Research Agenda	54
3	Heald and Georgiou (2000)	Consolidation Principles and Practices for the UK Government Sector	38
4	Barton (2011)	Why Governments Should Use the Government Finance Statistics Accounting System.	35
5	Walker (2009)	Public Sector Consolidated Statements—an Assessment	34
6	Heald and Georgiou (2009)	Whole of Government Accounts Developments in the UK: Conceptual, Technical and Timetable Issues	27
7	Wise (2006)	Cross-Sector Transfer of Consolidated Financial Reporting – Conceptual Concerns.	25
8	Heald and Georgiou (2011)	The Macro-Fiscal Role of the U.K. Whole of Government Account	24
9	Grossi and Pepe (2009)	Consolidation in the Public Sector: A Cross-Country Comparison	23
10	Brusca and Montesinos (2009)	International Experiences in Whole of Government Financial Reporting: Lesson-Drawing for Spain	21

Comparing Tables 5 and 6, nine articles are common to both rakings, with the only difference being the article of Newberry and Pont-Newby (2009), which is included only in the second table (citation per year). This result means that there is a series of studies that has

attracted the interest of several researchers, contributing in a considerable way to the development of the public sector CFS.

*Table 6. Top ten articles by citation per year (CPY) (as on October 10, 2016)*

No.	Reference	Paper	CPY
1	Grossi and Soverchia (2011)	European Commission Adoption of IPSAS to Reform Financial Reporting	12,20
2	Barton (2011)	Why Governments Should Use the Government Finance Statistics Accounting System.	7,00
3	Chow, Humphrey, and Moll (2007)	Developing Whole of Government Accounting in the UK: Grand Claims, Practical Complexities and a Suggested Future Research Agenda	6,00
4	Walker (2009)	Public Sector Consolidated Statements—an Assessment	4,86
5	Heald and Georgiou (2011)	The Macro-Fiscal Role of the U.K. Whole of Government Account	4,80
6	Heald and Georgiou (2009)	Whole of Government Accounts Developments in the UK: Conceptual, Technical and Timetable Issues	3,86
7	Grossi and Pepe (2009)	Consolidation in the Public Sector: A Cross-Country Comparison	3,29
8	Brusca and Montesinos (2009)	International Experiences in Whole of Government Financial Reporting: Lesson-Drawing for Spain	3,00
9	Newberry and Pont-Newby (2009)	Whole of Government Accounting in New Zealand: The Ownership Form of Control	2,57
10	Wise (2006)	Cross-Sector Transfer of Consolidated Financial Reporting – Conceptual Concerns	2,50

Finally, the last classification criterion concerns the methodological approach adopted in the selected studies. Adapting the attributes used by Guthrie et al. (2012) as well as those by Dumay et al. (2016), in this study seven categories were adopted. Table 7 shows the results.

*Table 7. Articles by research methods*

Code	Research methods	No.
1	Case/Field study/Interviews	8
2	Content analysis/Historical analysis	3
3	Survey/Questionnaire/Other empirical	2
4	Quantitative/Combined approach	1
5	Commentary/Normative/Policy	13
6	Theoretical/Conceptual	5
7	Literature review	0
<b>Total</b>		<b>32</b>

The first four research methods concern studies that are empirical in nature, being: 1: Case/Field study and interviews (e.g. Chow et al. 2009; Grossi, 2009; Lombrano and Zanin, 2013); 2: Historical analysis/Content Analysis (e.g., Newberry, 2011); 3: Surveys, Questionnaire and Other empirical (e.g., Newberry and Pont-Newby, 2009; Wise, 2010); and 4. Quantitative and Combined approach (e.g. Tagesson and Grossi, 2012). The next two attributes are normative in nature and include 5: Commentaries and normative (e.g., Grossi

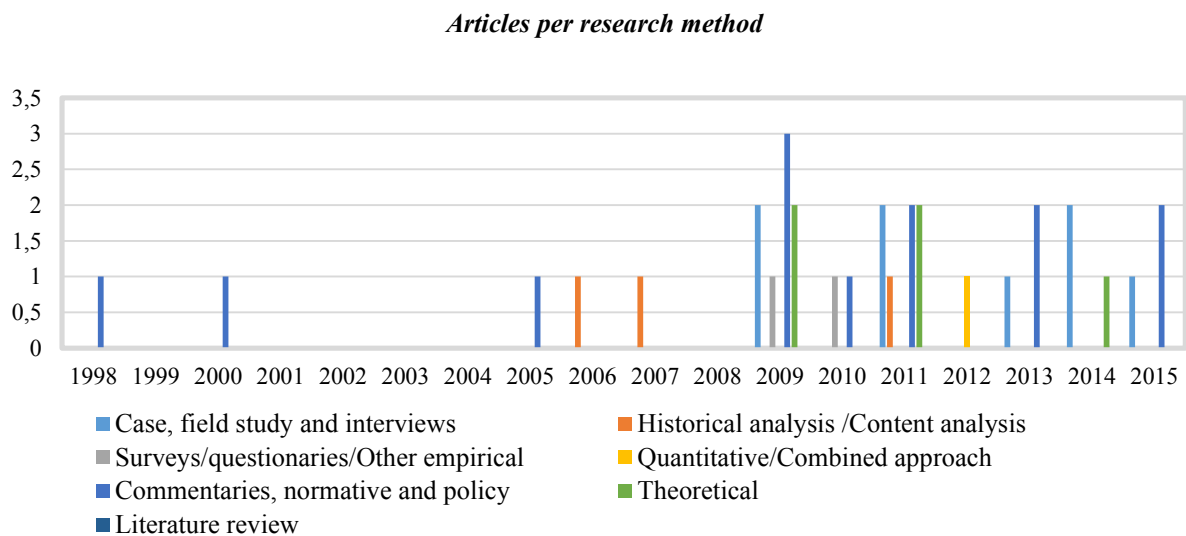


and Pepe, 2009; Bergmann, et al., 2015); and 6: Theoretical (e.g., Bergman, 2014). It is worthy of mention that there are not any previous structured literature reviews.

As Table 7 shows, the research method most commonly employed is Commentary/Normative/Policy (13 papers) followed by Case/Field study and interviews (8 papers) and Theoretical/conceptual (5 papers). Moreover, Historical analysis/Content analysis (3 papers), Survey/Questionnaire/Other empirical (2 papers) and Quantitative/Combined approach (1 papers) are less popular in the public sector CFS research.

Finally, as Figure 2 highlights, empirical methodology based on Commentaries, normative and Policy as well as on Case/Field study and interviews largely prevails especially in the last six years.

Figure 2 Research methods per year



### 3. Results: literature development and focus

After a descriptive analysis of the selected papers, this section will concentrate more on their contents, as summarized in Table 8. Taking into account the first research question of this study, the aim is to scrutinize these papers in order to investigate how CFS literature is developing as well as to unveil what are the main issues previous studies have focused on.

Table 8. Studies on public sector CFS

Author	Main aim	Accounting Theory	Main findings
Barton, 2011	The reason why Governments should use the Government Finance Statistic Accounting System	Legitimacy theory	The GFS system provides the information required by governments for fiscal policy, resource management and accountability purposes. Australia, which adopts the GFS system, can be considered as a leader in its adoption.
Bergmann, 2014	The investigation in the accounting and reporting of government interventions during the recent global financial crisis in the UK, Germany and Switzerland. The analysis of its impact on the fiscal sustainability	Decision theory	The global financial crisis has revoked determined unresolved problems of consolidation (the control over commercial firms and the potential risk due to central banks controlled by governments) and financial guarantees in the context of the government sector. Moreover, it has shown that these shortcomings may adversely affect the fiscal sustainability.
Bergmann, Grossi, Rauskala and Fuchs, 2015	The overview of the consolidation approaches in the OECD countries regarding methods and principles to define the area of consolidation	Agency and stakeholder theories	The analysis of the methods and principles adopted by the OECD (Organization for Economic Co-operation and Development) countries concerning the area of consolidation.
Bisogno, Santis and Tommasetti, 2015	The investigation on the appropriateness of the "control approach" within the public sector	Agency and stakeholder theories.	The public sector CFS, while applying the concept of control, should take into account the public sector characteristics.
Brown, 2011	The factors of resistance to the introduced Western model of reporting and accountability for the Whole-of-Government of Vanuatu	Institutional theory	The whole-of-government's lack of control over assets and operations, the misuse of public funds, the over-expenditure by heads and the lack of parliamentary control provide clear examples of the inefficiencies and waste in government.
Brusca and Montesinos, 2009	Lesson-drawing for Spain from the comparative perspective regarding the whole of government financial reporting in New Zealand, Australia, the UK and North America	No	The concept of control, as defined by the IPSAS 6, is applied in defining the area of consolidation at several levels (central and local). The need to pursue harmonization with macroeconomic accounts.
Challen and Jeffery, 2005	The harmonization of GAAP-GFS (Government Finance Statistics) framework and discussion regarding the criteria for the general-purpose reporting entity	No	Using the GFS to define the reporting entity makes it possible to define the consolidation area without taking into account the concept of control, which is exposed to subjective interpretations.
Chow, Humphrey and Moll, 2007	Developing whole of government accounting in the UK	Institutional theory	The usefulness of the WGA for macro-economic decision-making is expressed in terms of inter-generational fairness and fiscal sustainability. The WGA is considered a tool for exercising control and legitimizing governmental actions.
Chow, Humphrey and Moll, 2009	The practical pursuit and the evaluation of the WGA in the UK	No	The WGA does not increase accounting transparency since it does not follow clear rules in defining the consolidation boundaries and the governmental 'control'.
Daffin and Hobbs, 2011	Description of the main differences between National Accounts (NA) and Whole of Government Accounts (WGA)	No	The study highlights the main conceptual differences between the NA and the WGA concerning standards used, scope, data source, timing, sectoral coverage, consolidation, liability recognition, contingent assets and liabilities as well as measurement methods regarding the Public Sector Net Debt and the Surplus on Current Budget.

Day, 2009	The history of whole of government reports (WGR) in Australia	No	The control criterion and convergence between the GAAP and the GFS to overlap the difficulties in defining the consolidation area.
Dyson and Hasso, 1998	The auditing of the CFS of the U.S. Government in 1998	No	The auditing revealed that there were several problems such as incomplete documentation, several material internal control weaknesses and noncompliance with the Federal laws and regulations.
Ewer Sidney R., 2013	The description of the CFS of the U.S. Government	No	The CFS fairly represents the general financial condition of the federal government, providing financial transparency of federal operations.
Gardini and Grossi, 2014	The analysis of Fair Value Accounting (FVA) in the CFS of local governments in Italy	No	The use of fair value increases the transparency, even though it implies several difficulties in estimating fair values, due to the lack of an active and liquid market for certain assets. Moreover, it involves high implementation costs.
Grossi and Steccolini, 2015	The analysis on the debate concerning the application of the private sector practices and the principles in the public sector, with specific reference to the "reporting entity" concept.	Contingency theory	It is necessary to adopt a wider view of the reporting entity, taking into consideration alternative control forms, funding and financial dependence relationships. The budgetary criterion could be a complementary control criterion to increase financial accountability.
Grossi and Pepe, 2009	The analysis of the consolidated annual accounts in six countries (Sweden, the UK, the USA, Canada, New Zealand and Australia), and the international context (IPSASB).	No	Two conflicting trends have been identified: the first one, which concerns Anglo-Saxon countries, is characterized by the adoption of private sector accounting standards within the public sector. The second trend is characterized by an influential role of the government; therefore, specific public sector accounting standards are applied.
Grossi and Soverchia, 2011	The analysis of the implementation stage of the EU accounting reform with a focus on the consolidation of the annual accounts	No	The CFS of the EU is based on a <i>hybrid approach</i> (including both the control criteria and the budgetary principle), representing a synthesis of the Anglo-Saxon and continental European cultures.
Grossi, Mori and Bardelli, 2014	The evaluation of the needs and expectations of managers and politicians in order to improve their ability to take decisions and give an account in a pilot project	No	The consolidated and the segmental reporting provide information for outsourcing choices or for financial and strategic control over subsidiaries. Moreover, they clarify the resources spent by a municipality in providing services directly and indirectly.
Grossi, 2009	The analysis of the potential effect of consolidated financial reporting (CFR) in the Italian local governments	No	The CFR provides specific benefits for internal and external users, stimulating the full implementation of accrual accounting. However, several cultural, technical and legal obstacles were identified.
Heald and Georgiou, 2000	The UK proposals for the delineation of the consolidated reporting entity	No	In the UK, each department is considered as a parent company that controls other entities, namely the NDPBs (Non-Departmental Public Bodies) and the quasi-public sector bodies. However, several difficulties arise in applying the private sector rules based on accrual accounting at a governmental level.
Heald and Georgiou, 2009	The assessment of the potential uses, technical issues and the timetable for the publication of the WGA	No	The area of the UK Whole of Central Government Account (WCGA) is determined according to the powers under statute (public nature, public money). There is no reference to the concept of control.
Heald and Georgiou, 2011	The examination of the potential uses of the UK WGA and discussion of its policy	No	The UK WGA plays a pivotal role, due to its support of macro-fiscal policies and fiscal transparency. It provides useful information in relation to the public finances, fiscal sustainability and intergenerational equity.

Howieson, 2013	The interpretation of the Australian Accounting Standards Board (AASB) 127 and the analysis of practical difficulties in applying the control concept.	No	The implementation of the control concept, as defined by the AASB 127 for Not-For profit (NFP) public sector entities implies several conceptual problems. A better identification of the specific public sector information is required.
Lombrano and Zanin, 2013	The analysis of a new consolidation method (the 'territorial consolidation method') to improve local government accountability	No	The citizens can assess the cost of outsourcing policies and the profit (or losses). The Territorial Consolidation Method highlights the distinction between the cost of municipalities and delegated entities, showing clear local authority delegation policies.
Loughan, 2010	The definition of the boundaries of the federal reporting entity in the USA	No	The boundaries of the federal reporting entity should naturally include all the entities that are funded wholly or predominantly by public funds. In this way, the users are interested in the government's accountability of those funds, understanding how efficiently the policies of the federal government were carried out with respect to the resources entrusted.
Newberry and Pont-Newby, 2009	The form and the usefulness of the reporting in New Zealand	Agency theory	In NZ, WGA is commercial-style accounts, which cover the public sector as a whole; the distinctive ownership form of control is similar to that of the IPSAS 6. An alignment with government finance statistics (GFS) for comprehensive reports is required.
Newberry, 2011	The analysis of the WGA financial reports in New Zealand from 1993 to 2010	No	The WGA financial reports obscure, rather than reveal, portfolio changes resulting from privatization, and the growing involvement in financial market activities.
Tagesson and Grossi, 2012	How consolidated financial reporting (CFR) affects the financial picture and the comparability of financial data between different Swedish municipalities	No	The CFR has a significant influence on the picture of the municipality's economic position and performance. The CFR contributes to a better comparability and makes it possible to perform a more comprehensive analysis of the municipality's economic conditions. It is expected to support a more efficient resource allocation.
Walker, 2009	The identification of the objectives and the area of consolidation of the reporting.	No	The analysis of users and potential uses suggests that the optimal form of reporting by national, state and territorial governments would take the form of the 'whole public sector' reports, accompanied by consolidated statements encompassing both the general government and the non-financial public trading enterprise sectors.
Walker, 2011	The identification of a series of issues concerning the Australian practices over two decades in the preparation of public sector consolidated statements.	No	The concept of control has been considered inappropriate to determining the scope of consolidation. An alignment between the Australian government financial reports and the Government Finance Statistics is evoked.
Wise, 2006	The examination of the specific issues of a particular reporting method, consolidated financial reporting to the Australian public sector	No	The subjective interpretations of the concept of control have caused the exclusion of relevant organizations such as universities and local governments, which are economically associated with central governments.
Wise, 2010	The analysis of the issues surrounding the cross-sector transfer of a particular reporting practice for the CFR in the Australian public sector.	Commander Theory Agency theory	The Whole-of-government consolidated financial reports are useful for the discharge of accountability and for decision-making purposes. Doubts are raised regarding the purposes of the decisions by the government on resource allocation.

From a theoretical point of view, it is worth of mention that several papers mainly deal with the theories of consolidation (proprietary, entity and parent company theories); this finding could be interpreted as a signal of difficulties in applying these theories in the public sector. For example, scholars (Gardini and Grossi, 2014; Bisogno et al., 2015) have discussed on the adoption of the proprietary theory, arguing that it is not appropriate in the case of public sector CFS, where the entity theory seems to be more pertinent. Additionally, only a few papers explicitly refer to an accounting theory (legitimacy, institutional, agency or stakeholder theory); therefore, several recent papers (Brown, 2011; Bergmann, 2014; Bergmann et al., 2015; Bisogno et al., 2015; Grossi and Steccolini, 2015) have underlined the need to find a basic accounting theory aiming at strengthening the research in this field.

Moving on a more detailed analysis of the selected papers, the main investigated and most debated issues were:

- The definition of the consolidation area and the concept of control (i.e.: Chow et al., 2009; Howieson, 2013), compared with other alternative approaches (i.e. the budgetary perspective: Bisogno, et al., 2015), also illustrating the obstacles of implementing CFS (Grossi, 2009) or proposing a new method of consolidation to assess the group's solvency and liquidity (Lombrano and Zanin, 2013);
- The definition of the level which CFS refer to (Brusca and Montesinos, 2009; Grossi and Pepe, 2009; Bergmann et al., 2015) also highlighting the evolution of CFS or the Whole of Government Accounts (WGA) (Chow et al, 2007; Day; 2009; Newberry, 2011);
- The private vs. public sector accounting rules, highlighting the relevant differences between the two contexts (i.e.: Heald and Georgiou, 2000; Howieson, 2013; Bergmann, 2014; Grossi and Steccolini, 2015);
- The convergence with statistic regulations, especially in specific national contexts such as Australia (i.e. Challen and Jeffery, 2005; Barton, 2011;);
- The usefulness of CFS (Chow et al., 2007; Wise, 2010; Bergmann, 2014; Grossi et al., 2014).

The following sections will deal with these issues in detail.

### 3.1 *The definition of the consolidation area*

The most debated issue concerns the definition of the consolidation area <sup>1</sup>, which means identifying what entities have to be included in the public sector CFS. Bearing in mind that several countries define the consolidation area in accordance with national or international accounting standards they have adopted or are going to adopt (Grossi and Pepe, 2009; Bergmann et al., 2016), two main trends seem to emerge. The first one is essentially based on the control approach, while the second trend is mainly based on the way through which central governments finance other entities, as in the case of the USA and Australia (Grossi and Pepe, 2009).

At the international level, the IPSAS 6 (now replaced by the IPSAS) defines the consolidation area according to the control approach; however, this approach is largely influenced by the private sector context (Day, 2009; Grossi and Soverchia, 2011; Tagesson and Grossi, 2012; Gardini and Grossi, 2014; Bisogno et al., 2015; Grossi and Steccolini, 2015), as demonstrated by the substantial alignment between IPSAS 6 and IFRS 10 (i.e. the international private sector accounting standard concerning the CFS). Academics (as well as practitioners) have largely debated on this alignment, considering it as a sort of colonization of the private sector accounting practices (Tagesson and Grossi, 2012), even though the experience of the UK department (where the private sector control approach is adopted) has been considered positive (Heald and Georgiou, 2000; Wise, 2010). The main problematic aspect is the definition of the economic control as well as of the consolidation boundaries (Chow et al., 2009; Day, 2009; Howieson, 2013; Walker, 2011; Bergmann, 2014;), with the main risk being to provide

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<sup>1</sup> The IPSASB refers to the concept of economic entity. In particular, the IPSAS 35 states: “*the term economic entity is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities*”. Therefore, the expression “consolidation area” used in the text refers to the concept of economic entity.

subjective interpretations because of the historical, the political and the social context of each country (Grossi and Pepe, 2009). For this reason, scholars (Bisogno et al., 2015; Grossi and Steccolini, 2015) have pointed out how important it is to consider the peculiarities of the public sector in defining the control approach.

These problems have led scholars to propose different approaches, other than the control one. Therefore, on the wave of the American influence, where the boundaries of the federal reporting entity include all the entities that are largely financed by the budget of other public administrations (Loughan, 2010), the budgetary criterion has been considered as a valid alternative to the control approach or as a complementary option (Bisogno et al., 2015; Grossi and Steccolini, 2015) to increase accountability. This criterion makes it possible to include in the consolidation area all those entities that are not controlled by the government but are significantly financed by its budget; furthermore, it allows a better comprehension of how efficiently the policies of the government were carried out with respect to the entrusted resources (Heald and Georgiou, 2009; Loughan, 2010). However, this approach has been labeled as a very restrictive one (Brusca and Montesinos, 2009); accordingly, its adoption in conjunction with the control approach – the *hybrid approach* (Grossi and Soverchia, 2011) – has been considered as a good compromise between the Anglo-Saxon and the continental European cultures, as highlighted by the European Union case. In fact, the CFS of the EU include both the control criteria of IPSAS's consolidation standards (since 2005) and the budgetary principle.

It is interesting to note that the two approaches (control and budgetary) depend on the set of accounting standards adopted in each country. In fact, the control approach, which mainly refers to the UK, North America, Australia and New Zealand, would mean aspiring to a convergence between public and private sector accounting rules. On the other hand, the

budgetary approach is characterized by an influential role of the government, which means that private sector accounting standards are largely modified in order to take into account the peculiarities of the public sector (Grossi and Pepe, 2009). These trends are supposed to be influenced by the debate concerning the adoption of national vs. international accounting standards. However, the adoption of the IPSAS could be obstructed by cultural reasons as well as technical and legal issues (Grossi, 2009), even if this adoption could foster international harmonization, enhancing comparability. Nevertheless, the diffusion of the international accounting principles could slacken because of the strong influence of the private sector rules (namely IFRS), recently confirmed by the IPSAS 35 (which has replaced the IPSAS 6), where only a few changes concerning the control approach have been introduced.

In conclusion, notwithstanding these difficulties, the control approach is the most adopted one (Wise, 2006; Brusca and Montesinos 2009; Walker, 2011; Bergmann et al., 2016;). However, scholars (Bisogno et al., 2015; Grossi and Steccolini, 2015; Bergmann et al., 2016) have largely investigated other alternative approaches (budgetary, organizational and legal, statistical, and risk method), as well as consolidation methods such as the so-called “territorial consolidation method” proposed by Lombrano and Zanin (2013).

Finally, it should be observed that only a few papers have analyzed these issues in conjunction with the information needs of stakeholders (Howieson, 2013; Grossi et al., 2014), which means understanding who are the potential users of these reports or what are the potential uses of the information they provide (Walker, 2009).



### *3.2 The definition of the level to which CFS refer*

A second issue debated in the selected papers (strictly related to the previous one) concerns the level to which the CFS refer that, in turn, means understanding what is the reporting entity (and which organizations should be included in the consolidation area).

The first case occurs when the reporting entity is a central or a federal government, while the second one refers to the “municipal group”, where a municipality is the reporting entity.

More specifically, in the first case, a central or a federal government can include in the consolidation area only central (i.e. national) public sector entities (such as ministries and their agencies), or also all the other local public sector entities (such as municipalities, universities and so on). In this last case, all the consolidated entities, considered as a whole, are included in the so-called Whole of Government Accounts (WGA; Grossi, 2016).

However, the expression “Whole of Government Accounts” could be misleading, with the risk of being a misnomer (Brusca and Montesinos, 2009). According to scholars (Day, 2009; Walker 2009; Daffin and Hobbs, 2011; Walker 2011), several differences can be noted, due to the rules and the jurisdiction of each country.

For example, in the UK, the consolidated statements include all the local governments, trading funds, universities and other non-departmental public bodies (Heald and Georgiou, 2000; Chow et al., 2007; 2009; Heald and Georgiou, 2009; Walker, 2011); furthermore, the inclusion of local authorities have been explained in the light of fiscal planning (Heald and Georgiou, 2011).

Conversely, WGA of other jurisdictions (such as New Zealand and Australia) do not include both local governments and universities. This exclusion was explained in the light of a subjective interpretation of the concept of control (Wise, 2006), namely the central government does not “control” some local entities.

In the USA, two levels of consolidation can be identified. The first one is the federal level, where CFS include departments and independent agencies. The second one concerns both central and local governments, whose CFS are prepared in accordance with the standards issued by the Governmental Accounting Standards Board (GASB, 1991).

Apart from the latitude assigned to the concept of WGA, it is interesting to observe that while some countries provide CFS only at a central level, others are mainly focused on local governmental level.

An interesting case is that of Spain, where central, regional and local governments are largely independent from each other (Brusca and Montesinos, 2009; Grossi and Pepe, 2009). Accordingly, each level of government prepares its own CFS, *which are compulsory for the central government as for 2014 and will be mandatory for local government from 2017*.

In Italy, characterized by various similarities with the Spanish context, significant reforms have been introduced lately. In effect, in the past decades CFS were not mandatory; in the same wavelength, WGA were not required. Therefore, CFS were voluntarily prepared by a restricted number of local governments, based on the IPSASs (Grossi, 2009; Gardini and Grossi, 2014; Grossi et al., 2014). More recently, after an experimental test period of three years, CFS are mandatory for all local governmental entities from 2016 onwards.

### *3.3 The private vs. the public sector accounting rules*

A third debated issue concerns the accounting standards to be adopted in preparing CFS.

In a way, this question has been considered above, while discussing the consolidation area; however, it involves other conceptual issues.

Generally, the adoption of private sector accounting standards has been justified in the light of public-private partnerships. In fact, bearing in mind that a public sector entity can

control business-oriented firms, whose financial statements follow private sector accounting standards, adopting these last rules can facilitate several technical issues, making the preparation of CFS easier.

However, the question is more intricate than it is supposed; for example, while several controlled entities adopt a full accrual accounting system, public sector entities in several countries embrace cash or modified-cash approaches. This can imply a great difficulty in consolidating such different financial statements (Heald and Georgiou, 2000; Chow et al., 2007; Barton, 2011; Grossi and Steccolini, 2015). Accordingly, the use of a cash-based approach has slackened the implementation of the CFS.

Focusing on the dichotomy between the private and the public sector accounting standards, the international scenario shows different pictures. For example, the UK, Australia and New Zealand adopt the private sector accounting standards (Grossi and Pepe, 2009), while Sweden refers to specific rules adapted for local authorities (Tagesson and Grossi, 2012). Finally, the USA (at both state and local governmental levels) and Canada use the public sector accounting standards (Grossi and Pepe, 2009).

Accordingly, scholars have highlighted two opposite trends: the first one concerns (mainly Anglo-Saxon) countries where the private sector accounting rules are adopted; the second one refers to countries characterized by the accounting standards which adhere to the characteristics of the public sector (Grossi and Pepe, 2009).

It is worth noting that this dichotomy embraces also IPSASs. As a matter of fact, these standards are influenced by the private sector rules: even though they are adapted to the specific characteristics of the public sector, several critical observations have been provided by scholars (Ellwood and Newberry, 2007; Robb and Newberry, 2007; Grossi and Pepe, 2009). In the EU context, these critics are stimulating a debate on the adoption of the IPSAS,

proposing an alternative approach based on a set of European Public Sector Accounting Standards (EPSAS); however, the aim to achieve more harmonized accounting practices in the public sector has persuaded several countries such as Estonia, Slovakia, and Spain (as well as Israel) to implement the international standards (Bergmann et al., 2015).

This debate could benefit from further investigation based on the information CFS are supposed to provide, taking into account the different goals of the above-mentioned accounting standards and their compliance with the information needs of stakeholders.

#### *3.4 The convergence with the statistic regulations*

A fourth very relevant question concerns the relationship between accounting standards and statistic rules, investigating whether they should (or not) converge.

This convergence occurs in Australia, since the Government Financial Statistics (GFSs) are substantially aligned with the accounting standards. The main aim of this convergence, achieved through a single Whole of Government Reporting (WGR) for each governmental jurisdiction, is to harmonize macroeconomic and microeconomic perspectives (Challen and Jeffery, 2005; Brusca and Montesinos, 2009; Day, 2009; Newberry and Pont-Newby, 2009; Walker, 2009; 2011).

Australia is the first case where this approach has been used. According to Barton (2011), Australia represents the world's leader in adopting the GFS system for governmental accounting purposes.

In a broader sense, the convergence between statistic rules and accounting standards is expected to improve the transparency of financial reports (Brusca and Montesinos, 2009), providing more useful, relevant, reliable, comparable and understandable information. Scholars (Challen and Jeffery, 2005; Barton, 2011;) have highlighted that the use of

statistically-based definitions has the aim to increase the fiscal stability (namely macro-economic stability) as well as the international comparisons (Heald and Georgiou, 2000; Chow et al., 2007); furthermore, this statistically-based approach is expected to improve the evaluation of “the performance of the general government sector and the broader public sector of any country” (IMF, 2001, par. 1.2–1.4). Today, it would be interesting to debate on what are the information needs of users (and, as a consequence, the potential uses) to be considered in the WGA in the light of statistic standards.

In conclusion, bearing in mind that accounting-based consolidation is generally considered useful for macroeconomic policy planning within government (Barton, 2011), scholars (Chow et al., 2015) claim for a convergence with an international statistic framework, in order to improve usefulness of consolidated accounts for decision makers.

### *3.5 The usefulness of the CFS*

A final, but very important, issue analyzed by previous studies concerns the relevance of the public sector CFS in terms of usefulness for stakeholders. Usefulness would consist in a more comprehensive picture of the “public group”, supporting in a better way decision-making processes, at the same time ensuring public accountability (Heald and Georgiou, 2000; Chow et al., 2007; Grossi, 2009; Wise, 2010; Tagesson and Grossi, 2012; Bergmann et al. 2015; Bisogno et al., 2015; Grossi and Steccolini, 2015). The CFS, while providing a clearer economic picture of the public group, would support public sector efficiency, effectiveness, transparency, and accountability (Grossi, 2009; Bergmann et al., 2016) towards both internal users (such as politicians, managers and employees) and external stakeholders (namely citizens, voters, taxpayers, suppliers, other public administrations, financial institutions).

Performance achieved by a public sector group in providing public services is showed in a clear way through the CFS, which should better support decision-making processes.

However, on one hand scholars (Grossi and Soverchia, 2011) have raised some doubts on this usefulness, namely the ability of the public sector CFS to improve decision-making processes of politicians and other stakeholders, coupled with the relevance of accrual accounting report results. On the other hand, other research (Bergmann et al., 2016) have highlighted that this tool ensures a comprehensive and useful view for banks interested on the real and effective opportunities of creditworthiness of the governments and their owned corporations. More generally, financial markets, credit rating agencies, and other analysts (Chow et al., 2015) could benefit from information provided by the CFS on the public finances, contributing to a greater fiscal transparency at the same time supporting policy debates better (Heald and Georgiou, 2011).

#### **4. Final thoughts**

Papers selected in this literature review have largely contributed to the improvement of knowledge on the public sector CFS. Their findings seem to indicate that further researches are required and that several issues deserve attention from both a theoretical and a methodological perspective.

The most relevant aspect emerging from the analysis of the selected papers is that the aim and the uses of CFS could have major relevance (Chow et al., 2007, Walker, 2009; 2011; Newberry, 2011). Several preliminary interesting questions seem to emerge: Who are the main users of the public sector CFS? Do the CFS support the decision-making process of stakeholders? What are the uses of the public sector CFS?

As a matter of fact, the investigation of users, uses, and the main decision-making processes CFS would support, can help identifying the objectives of the CFS, at the same time contributing to selecting appropriate rules for the preparation of these reports (Walker, 2009).

The most debated issue, the definition of the consolidation area, while being essentially a technical issue, has several implications and it is not a neutral choice: for example, a national telecommunication service provider could be included in the consolidation area according to the control approach but it should not be consolidated according to the budget approach (Bisogno et al., 2015). As a consequence, adopting the first approach rather than the second one (or other alternative criteria) should better take into account what is the reporting entity (i.e. central or local governments) and what are the goals of the CFS in relation to users and uses. Therefore, future research could investigate the consolidation area in the light of the usefulness of the CFS for users, providing answers to questions such as: What are the objectives the CFS are supposed to pursue in a specific context and which information should the CFS disclose? Is the control approach coherent with the scope of the CFS as well as with the information they provide to the users?

On this line, the next chapter investigates what are the stakeholders' opinions regard the appropriateness of control approach thanks to the recently Exposure draft issued.

In the same wavelength, future research could provide a further insight into the comprehension of both the use of the CFS at different levels (central vs. local) and the reasons of the observed differences (concerning, for example, the WGA), considering the criteria through which the consolidation area is defined. Furthermore, future research could investigate the reasons why some public administrations (especially at a local level) prepare the CFS without any legal obligations to do so. Are there any strategic reasons that suggest adopting the CFS on a voluntary basis? Are the decisions to voluntarily prepare the CFS due to

the wishes of improving political consensus? These questions will be investigated in the fourth chapter.

As far as the relationship between private and public sector accounting rules is concerned, this topic has been extensively debated; in the specific case of the CFS, previous studies have shed light on the implications concerning the identification of both the reporting entity and the consolidation area. Further research could examine this delicate issue by relating to the scope of the CFS. Possible research questions could be: Taking into account both the aim and the uses of the CFS, should the CFS be based on specific public sector accounting standards? Or can the CFS be based on private sector accounting standards?

The usefulness of the CFS is also relevant in the light of the convergence between accounting and statistic criteria. As a matter of fact, the GFS are prepared in most countries around the world and, in this way, they are more relevant and more used in decision-making processes than the information provided by financial accounting (Bergmann, 2009). For example, in the European context, the Treaty of Maastricht defines several criteria, which EU countries are supposed to comply with, largely based on the GFS. Additionally, the GFS around the world are more harmonized than financial statements, since they are prepared in accordance with several national and international standards, such those provided by the International Monetary Fund (Barton, 2011). Accordingly, providing answers to the question of whether accounting standards should (or not) converge towards statistic standards is not an easy task. Further research could investigate the topic especially focusing on the different objectives of each system and each set of rules. If these systems have different goals, it would be normal to obtain different results, for example different measures of the deficit or the Net Lending/Borrowing of the Government. The main problem would be to understand if there is coherence between the goals of these systems and the applied methodologies.



In conclusion, the literature review gives us a complete map of the topic highlighting what are the emerging gaps. Therefore, the next chapters will deal with two particular aspects of these gaps.

# Chapter 3

## The use and the evaluation of accounting standards

### 1. The International Public Sector Accounting Standards

Over the last decades, according to the NPM approach (Pollitt and Summa, 1997), public sector entities (PSEs) have been involved in a profound process of changes, with one of the main aspects being the decentralization of many activities (contracting-out as well as privatization in their different forms) frequently managed through controlled entities. This means that external stakeholders, in evaluating how politicians and managers act in managing public resources, need to have a complete picture of the performance of a PSE through consolidated financial statements (CFS) (Broadbent *et al.*, 1996; Chow *et al.*, 2007; Grossi and Newberry, 2009; Wise, 2010). In fact, a growing importance and diffusion of CFS can be observed in different countries.

Recently, the IPSASB has published three new Exposure Drafts<sup>1</sup> (no. 48: *Separate financial statements*; no. 49, *Consolidated financial statements*; no. 50, *Investments in Associates and joint ventures*), emphasizing the importance of the topic. In this study, I will focus on the ED no. 49, more specifically on the assessment of control, which is the main concern (Grossi *et al.*, 2013). This assessment is based on three key elements:

- “Power over the other entity”;
  - “Exposure, or rights, to variable benefits from its involvement with the other entity”;
- and

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<sup>1</sup> January 30, 2015, the IPSASB has published IPSAS 35, 36 and 37 that have superseded, respectively, the IPSAS 6 (regarding consolidated financial statements), IPSAS 7 and 8. The standards have been analyzed before of their publication.

- “The ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity”.

Taking into account that the IFRS 10, concerning the private sector, defines similar criteria, the aim is to investigate these key concepts (focusing on the first and the second issued raised by the ED no. 49), in order to understand the appropriateness of the “control approach” within the public sector.

From a methodological point of view, all the comment letters submitted on the ED no. 49 are investigated, adopting an approach based on an in depth analysis of each comment. The reason for investigating the topic through the responses from this ED is due to the growing relevance in the international scenario of the IPSASB and its standards. In fact, many countries do not have their own standards about the consolidation of PSEs, therefore they incline towards the adoption of the IPSAS (see, for example, the case of Italy investigated by Grossi and Steccolini, 2014). Furthermore, in the European context, the EU has recognized the importance of international standards (even if it is planning to adopt its own standards, named EPSAS, European Public Sector Accounting Standards), stating that: “the IPSAS could therefore serve as a starting point and reference model for the development of harmonised public sector accounting standards in Europe” (<http://www.epsas.eu/en/why-do-we-need-epsas.html>).

Comment letters submitted by the respondents of the ED no. 49 are analysed as they can help understand what the preferences of the stakeholders of CFS are in relation to some critical points, such as the alignment between IFRSs and IPSASs as well as the appropriateness of the approach used in preparing CFS.

The remainder of the chapter is structured as follows. The second section summarizes consolidation theories and approaches to be used in defining the consolidation area, the third

presents the research questions, while the fourth illustrates the research methodology. In the fifth section, I present and discuss the results, while in the last one, I provide conclusions as well as final thoughts.

## **2. Consolidation theories and approaches**

Literature has pointed out how definitions, methodologies and practices from the private sector have been adopted in the public sector in an uncritical way, sometimes without a thorough analysis of the objectives and characteristics of PSEs (Christiaens, 2002). More generally, even though literature has long discussed the applicability of private sector accounting practices in the public sector, with valid motivations both in supporting this concept (the so-called sector neutrality: Anthony, 1983; Anthony, 2000; see also Barton, 2011: 422-423) and contradicting it (Broadbent and Laughlin, 1998; Olson et al., 1998; Lapsley, 1999; TerBogt and Van Helden, 2000; Broadbent et al., 2001; Carlin and Guthrie, 2003; Carlin, 2006; Ezzamel et al., 2007; Nasi and Steccolini, 2008), in the specific case of CFS some problems can arise, concerning both the consolidation theory and approaches to be used in defining the consolidation area. These theories and approaches, in turn, refer to the decision-making or accountability reasons, requiring a clarification concerning the goals of the CFS in the public sector.

Regarding the consolidation theory, in the private sector CFS can be drafted following different paths.

According to the *proprietary theory*, an entity is considered an extension of its owners, hence there is no distinction between the owners and the entity. CFS are drafted adopting the viewpoint of owners, as both the assets and liabilities of this entity are considered to be assets and liabilities of the owners themselves. According to this theory, a pro-rata consolidation is

applied, in order to illustrate only the percentage of assets and liabilities upon which the entity has its owner rights in the statements.

According to the *parent company theory*, an entity has the power to control its subsidiaries i.e. all their assets and liabilities, not only a proportionate share. Even if minority shareholders are seen as outsider interests, CFS represent them (more specifically: a consolidated balance sheet illustrates claims on the net assets of the minority interests, considering them as a sort of liability; a consolidated income statement indicates earnings attributable to minority interests). From a methodological point of view, the full consolidation approach is adopted.

According to the *entity theory*, the perspective of the entity itself is adopted as it is separated from its owners. Consequently, CFS are based on the viewpoint of the entity (Viganò, 1966), to which the economic activities have to be referred, representing both the controlling and minority interests as parts of its equity (Belkaoui, 2004: 215). Even though the parent company theory is used more than the entity theory (Kam, 1990), the latter is considered fundamental to modern accounting as well as more appropriate, especially in the public sector.

The ED no. 49 seems to refer to the parent company theory, as implicitly suggested by the proposed concept of control (see below), which in turn inclines towards agency theory, usually invoked in supporting the need for consolidation. The principal-agent approach is probably motivated by accountability reasons (even though the role of CFS in supporting both these reasons and the decision-making process of politicians and managers does not seem convincingly proven: Jones and Pendlebury, 2004; Steccolini, 2004; Brusca and Montesinos, 2006; Wynne, 2008; Kober et al., 2010). However, as demonstrated by Broadbent et al. (1996), the rejection of the principal-agent approach within the public sector does not mean that accountability cannot be provided by different means. In addition, within the public sector,

there is no room for the concept of proprietorship: both politicians and the management of PSEs act on a fiduciary base, having to produce services for citizens.

As such, the concept of agency<sup>2</sup> should be replaced by the concept of fiduciary duty, which can improve our knowledge on the adequacy of the governance of public (as well as private) sector entities to the needs of the whole society. Following this path, stakeholder theory should support CFS better than the agency approach, explaining why consolidation is significant in terms of accountability (Grossi et al., 2013) In fact, the formal separation of the annual accounts of a PSE and the providers of services could imply a reduction in the degree of accountability as well as decision usefulness of public sector financial statements: CFS can contribute to providing a solution to this lacuna, reinforcing accountability through a more complete financial information to both the internal and external stakeholders.

Nevertheless, a necessary clarification concerning the approaches that can be adopted in drafting CFS is needed, in order to understand the underlying accountability as well as decision-making reasons. In other words, the main problematic issue is the definition of appropriate criteria concerning the consolidation area (Heald and Georgiou, 2000; Robb and Newberry, 2007; Tagesson, 2009; Walker, 2009), whose solution should not be simplistically based on the criteria used in the private sector (Grossi and Steccolini, 2014). In fact, the consolidation area concerning PSEs can be identified in accordance with different criteria, which lead to different approaches (Bergman, 2009).

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<sup>2</sup> Moreover, and in more general terms, some recent studies (Robé, 2011; Viganò, 2012) have criticised agency theory on the ground that, in the private sector, shareholders *do not own the firm or its assets, they only own shares*. One of the main consequences is that agency theory (which is based on the overlapping among two distinct concepts: firm and corporation) should be considered incorrect, because the supposed contrast of interests between the principal (i.e. the proprietor) and the agents (i.e. managers) is based on a representation that does not correspond to the reality of the legal relationships among managers, shareholders and the corporation (Robé, 2011, pp. 32-33).

The first approach (the so-called *statistical perspective*) defines the consolidation area in accordance with the general government sector; consequently, CFS comprise all levels of government, regardless of the control of an entity on other entities, with the aggregation of statistical data being the main aim. In fact, in this perspective, CFS are close to the System of National Accounts, with the main goal being to provide macroeconomic information on the different sectors of the economy of a country. It is worth noting that CFS drafted according to this perspective would provide to a large extent the same information already provided by the Government Finance Statistics.

The second approach, named *organisational and legal perspective*, identifies the consolidation area in accordance with the organisational structure provided by legislation, therefore all the PSEs that legally depend on another superordinate entity have to be included in the CFS (Brusca and Montesinos, 2009). Even though such a perspective may solve many practical problems (for example, it is relatively easy to impose the adoption of the same accounting rules), some issues could emerge if there is not a clear and coherent organizational legislation.

The third approach, defined as *risk perspective*, involves that all the entities causing a financial risk to the central government are expected to be included in the consolidation area. Therefore, this approach extends the boundaries of the group, even though it is not easy to define the concept of financial risk, which could depend on what category of stakeholders the CFS are addressed to and, in a broader sense, on the scope of this report. In addition, central government could not have the power to impose the same accounting principles; in this case, Bergman (2009) suggests providing information about risk in the notes rather than through CFS.

The fourth approach (the so-called *budget* or *budgetary perspective*) is based on the concept that the CFS should include all the entities that receive consistent financial support from the government budget. Accordingly, CFS are mainly prepared for accountability reasons, which are the fulcrum in identifying the consolidation area (GASB, Statement no. 14); obviously, this approach requires an appropriate definition of the nature and significance of the relationship between the government and each financially supported entity. At the same time, it aims to demonstrate to users how effectively government policies for the allocation of public funds have been performed (Challen and Jefferey, 2005). In conclusion, such CFS aim at having a complete, understandable and comparable picture of the government's activities across different levels of government, in order to discharge accountability through a direct comparison with the budget statements.

Finally, the consolidation area can be defined according to the so-called *control approach*, where the concept of control expresses the ability of a controlling entity to govern the decision-making process of other (controlled) entities obtaining benefits from their activities. As stated above, both the control and ownership criteria should not be based on the same criteria used in the private sector since, on one hand, some PSEs (e.g., governmental agencies) do not have an autonomous status and, on the other hand, the government could manage some (private) organizations without any ownership relationships. This approach does not seem to bond with the accountability reasons, with the foremost idea being the use of information provided by CFS as a support for the decision-making process.

I focus on the budgetary and control approaches, due to their diffusion (Grossi and Pepe, 2009; Grossi et al., 2013). Taking into account that a compromise between the underlying accountability and decision-making reasons could be pursued (as in the EU case; Grossi and Soverchia, 2011), a contrast between them can be hypothesized because:



- The budgetary perspective implies that an entity is consolidated according to its relevance for the budget; consequently, an entity is not consolidated when it does not receive heavy funds from the government budget;
- The control perspective implies that an entity is consolidated according to the nature of both the power and benefits that the controlling entity can exercise and gain, respectively. Thus, a clear definition of these two concepts (power and benefits) is crucial in determining the boundaries of the consolidation area.

As a relevant example: a national telecommunications service provider could be included in the consolidation area according to the control approach but it should not be consolidated according to the budget approach.

From a theoretical perspective, the preference that can be given to either the control or budgetary approaches refers to a different view of the scope of CFS as well as the stakeholders to which these statements are addressed.

Even though the control approach as well as the underlying decision-making reasons seem to be rational and appropriate in the matter of consolidation, since they provide information primarily for investors, it is expected to modify the definition of control in order to satisfy the complexity of the public sector (Grossi and Tagesson, 2007). Otherwise, this approach does not properly take into account the special needs of the public sector. Taking this idea to an extreme would mean that the decision-making reasons do not appear so relevant for public sector accounting, whose goals and needs are better served by the accountability approach (Pallot, 1992). In fact, public sector activities are budget-controlled: as such, the accounting information is mainly used in the budget follow-up (Chan, 2003).

It is therefore clear the importance of properly identifying the goals of CFS, which in turn means understanding what aspects of accounting both internal users (politicians, managers,

employees) and external users (citizens, voters, taxpayers, suppliers, other public administrations, banks) draw their attention to (Grossi, 2009). As a matter of fact, accounting information should vary depending on whether accountability or decision making is emphasised (Stanton et al., 1998).

### 3. Research Questions

The ED no. 49 is essentially based on the control approach, focusing on “power” and “benefits” as the key criteria upon which the concept of control is based, providing the following definitions (emphasis added):

“An entity *controls* another entity when the entity is exposed, or has rights, to variable *benefits* from its involvement with the other entity and has the ability to affect the nature and amount of those benefits through its *power* over the other entity”.

“*Power* consists of existing rights that give the current ability to direct the relevant activities of another entity, including the right to direct the financial and operating policies of that entity”.

“*Benefits* are the advantages an entity obtains from its involvement with other entities. Benefits may be financial or non-financial. Benefits can have positive or negative aspects”.

It is worth noting that the IFRS 10, concerning the private sector, adopts similar criteria (even if it refers to the concept of “returns” instead of “benefits”). Therefore, it could be argued that IPSASB does not provide a comprehensive theoretical framework capable of taking into account both the specific conditions and needs of public sector accounting information.

As stated above, I have investigated the ED no. 49, which will replace the current IPSAS 6, because of the growing importance of the IPSAS in the international scenario; more precisely, the investigation regards all the comments submitted by respondents (focusing on the issues no. 1 and no. 2), which resulted in a better understanding of the viewpoint of different categories of stakeholders.

The research questions to investigate are:

**RQ1:** Do respondents agree with the proposed alignment between the ED no. 49 and the IFRS 10? What are the arguments included in the comment letters in supporting or contradicting this alignment?

**RQ2:** What is the scope of CFS? What are the arguments included in the comment letters about the scope of CFS? Are there any comments that deal with the decision-making or accountability reasons?

**RQ3:** Do respondents agree with the proposed concepts of control, power, and benefits as well as with the proposed definition of the consolidation area? What are the arguments included in the comment letters about these issues? Are there any comments that deal with the budgetary approach as well as the statistical perspective?

#### **4. Research Methodology**

In order to investigate the proposed research questions, I have analysed the comment letters submitted to the IPSASB, concerning the specific matters addressed by the ED no. 49 (comments were due on February 28, 2014). As stated above, I have focused on the Specific Matter for Comment 1 (*Do you agree with the proposed definition of control? If not, how would you change the definition?*) and Comment 2 (*Do you agree that a controlling entity*

*should consolidate all controlled entities (except in the circumstances proposed in this Exposure Draft)?).*

From a methodological point of view, I followed the steps described below.

First of all, there was an accurately reading the comments provided by each respondent (with the total number of respondents being 31). This in-depth reading suggests separating general comments concerning the ED no. 49 as a total from specific observations concerning issues no. 1 and no. 2.

Secondly, i classified the respondents in accordance with two main criteria: affiliation and geographical area. Regarding the affiliation of the respondents, the following groups are identified:

- International organizations;
- Governmental organizations;
- Professional organizations;
- Counties;
- Academics;
- Auditing/consulting firms.

Both the “governmental organizations” and “professional organizations” are on a national scale; however, while the first group (“governmental”) includes organizations managed under the auspices of the national government and/or are public sector entities, the second group (“professional organizations”) includes independent and private bodies.

Regarding the geographical area, the respondents are classified in referring to the macro-area (i.e. Europe) to which they belong.

In the third step, I summarised the respondents (classified according to the above-mentioned criteria) who agree and disagree. More specifically, I both calculated the number

of words the respondents used in describing their agreement or disagreement as well as investigated the arguments they provide in supporting or contradicting the proposed approaches and definitions.

The fourth step consisted of developing a taxonomy of common arguments provided by the respondents (Yen et al., 2007) in supporting or contradicting the proposed approaches and definitions through a systematic categorization of the arguments contained in the letters.

Therefore, I tried to preserve the uniqueness and richness of the text being analysed. More specifically, I aimed to understand whether there is a systematic link between those arguments and the category to which the respondents belong (or, on the contrary, if the arguments provided by the respondents are irrespective of their category) as well as if these systematic and wide categories of arguments refer or not, in an implicit or explicit way, to a theoretical approach (e.g.: control approach vs. budgetary approach or statistical perspective; decision-making vs. accountability reasons).

## **5. Results**

Table 1 provides a general overview of the comments submitted by the respondents, classified according to their affiliation. For both issues (no. 1 and no. 2), I identified the respondents who agree (A), and the respondents who disagree (D); the last two columns show the total. Since some respondents provided comments concerning all three of the new EDs (no. 48, 49 and 50), sometimes they focused only on some issues, not providing specific observations about issues no. 1 and no. 2 raised by the ED no. 49.

Table 1. Affiliation of respondents

International Organizations	Governmental Organizations	Professional Organizations	Counties	Academics	Auditing/Consulting firms	Specific Matter for Comments				Total		
						No. 1	No. 2	A	D	A	D	
ICGFM						A		D		1	1	
FEE						A	A			2	0	
EC						A	A			2	0	
	ADAA					A	A			2	0	
	DGFIP					A	A			2	0	
	CNOCP					A	A			2	0	
	HoTARAC					-	-	-	-	0	0	
	NZSupefund					A	A			2	0	
	ACAG					A	A			2	0	
	CdC						D		D	0	2	
	NSFMA					A			D	1	1	
	US GAO					-	-	-	-	0	0	
	SRS-CSPCP					A	A			2	0	
	ASB					A	A			2	0	
	AASB					A	A			2	0	
	The Treasury					A	A			2	0	
	NZASB					A	A			2	0	
		ACCA				A	A			2	0	
		ANAN				A	A			2	0	
		CPA Canada				A	A			2	0	
		ICPAK				A	A			2	0	
		JICPA				A	A			2	0	
		ZICA				A	A			2	0	
		JAB				A	A			2	0	
		MIA				-	-	-	-	0	0	
		CIPFA				A	A			2	0	
			Auckland C.			A	A			2	0	
				J.B. Mattret		A	A			2	0	
				D.S.F.Juernal		A	A			2	0	
				Ichabod's			D	-	-	0	1	
				PwC		A	A			2	0	
						<b>Total</b>	<b>26</b>	<b>2</b>	<b>24</b>	<b>3</b>	<b>50</b>	<b>5</b>
						<b>Total Agree (%)</b>	<b>92.9</b>		<b>88.9</b>			
						<b>Total Disagree (%)</b>	<b>7.1</b>		<b>11.1</b>			

**Legend:** ICGFM (International Consortium on Governmental Financial Management); FEE (Fédération des Experts Comptables Européens); EC (European Commission); ADAA (Abu Dhabi Accountability Authority); DGFIP (Direction générale des finances publiques); CNOCP (Conseil de normalisation des comptes publics); HoTARAC (Head of Treasuries Accounting and Reporting Advisory Committee); NZSupefund (New Zealand Superannuation Fund); ACAG (Australasian Council of Auditors-General); CdC (Cour des Comptes); NSFMA (National Swedish Financial Management Authority); US GAO (US Government Accountability Office); SRS-CSPCP (Swiss Public Sector Financial Reporting Advisory Committee); ASB (Accounting Standards Board); AASB (Australian Accounting Standards Board); ANAN (Association of National Accountants of Nigeria); ACCA (Association of Chartered Certified Accountants); CPA-Canada (Public Sector Accounting Board); ICPAK (Institute of Certified Public Accountants of Kenya); JICPA (Japanese Institute of Certified Public Accountants); ZICA (Zambia Institute of Chartered Accountants); JAB (Joint Accounting Bodies); MIA (Malaysian Institute of Accountants); NZASB (New Zealand Accounting Standards Board); CIPFA (Chartered Institute of Public Finance and Accountancy); AUCKLAND C. (Auckland Council); ICHABOD'S (Ichabod's Industries Limited); PwC (Price Waterhouse Coopers).

Figure 1. Affiliation of respondents

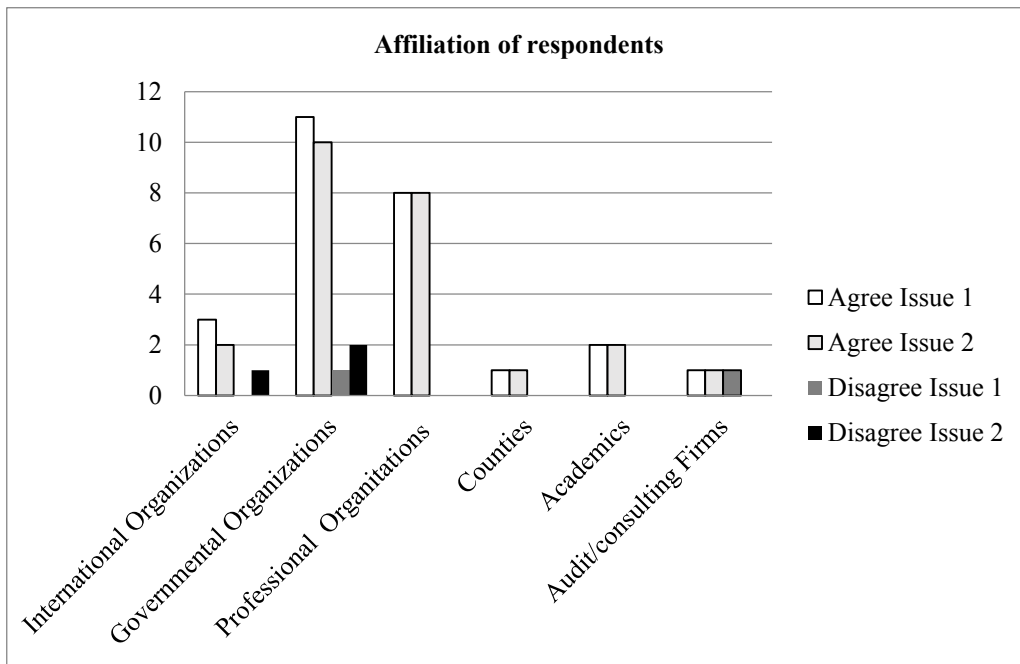
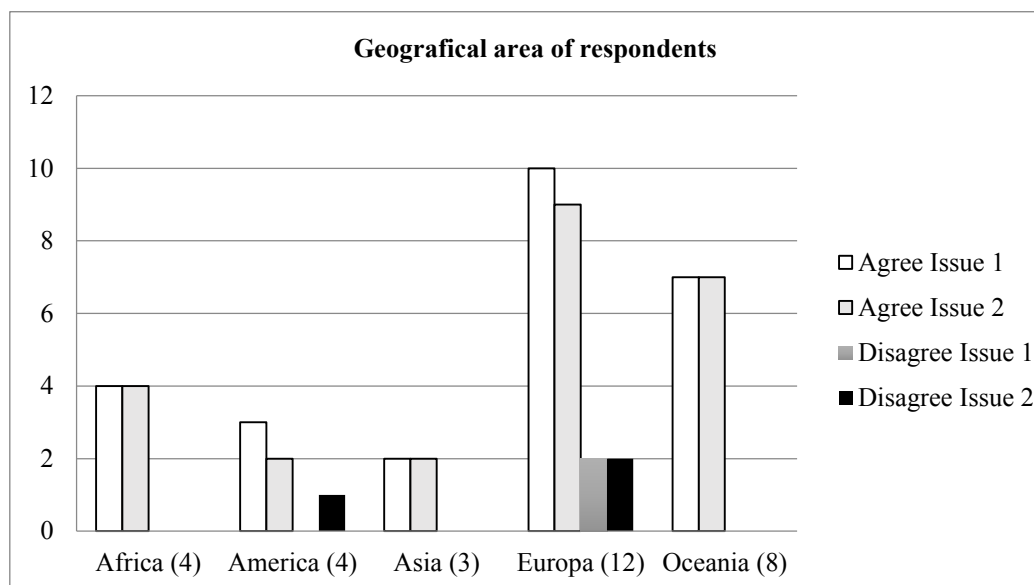


Table 1, as well as Figure 1, clearly show that the respondents largely agree with the approach proposed by the IPSASB (about 90% agree vs. 10% disagree), so a relevant differentiation among the categories of respondents does not emerge. Along the same lines, Figure 2, which clusters the respondents by macro-geographical area, shows similar results: as in the previous classification, also in this case a large percentage of agreement can be observed (the weighted mean value is 88.6%), with the geographical area not being a discriminatory variable

Figure 2. Geographical area of respondents



In order to complete this general overview of the submitted comments, I calculated the number of words the respondents used in describing their agreement or disagreement, in order to highlight the relative importance of each topic as well as the prevalence of the position expressed. As Table 2 clearly illustrates, issue no. 1 seems to be the most important. Nevertheless, even though the total number of words used in supporting the issues no. 1 and no. 2 are higher than those used against them, the respondents who disagree seem to contrast their point of view more incisively in comparison to those who agree. In fact, both the mean and the median values of the words per answer used by the respondents against each issue are higher than those used by the respondents who are in favour of the approaches the ED no. 49 proposes.

Table 2. Number of words employed in expressing agreement or disagreement

Value	Comments no. 1		Comments no. 2	
	Agree	Disagree	Agree	Disagree
No. of respondents	26	2	24	3
Total words	6,204	876	1,862	511
Mean	248.16	438.00	77.58	170.33
Median	122.00	438.00	40.50	144.00
Std. dev.	446.35	398.81	117.26	54.50



Moving beyond this preliminary representation, the study is going to consider in detail the arguments contained in the letters submitted by the respondents in supporting or contradicting the proposed approaches and definitions; as stated above, the aim is to propose a systematic categorization of these arguments.

Therefore, I separated the general remarks concerning the ED no. 49 as a total on one hand, and specific observations concerning the matter for comments no. 1 and no. 2, on the other.

Table 3 summarizes the main topics that emerged from the general observations and the corresponding comments addressed by the respondents.

*Table 3. General revisions suggested by respondents*

Topic	Comment on the ED proposals	No. of comments
Alignment to IFRS 10	This alignment: <ul style="list-style-type: none"> <li>• Is a correct approach, even if IPSAS should better take into account the differences between the public and private sectors (7 respondents);</li> <li>• Is an incorrect approach (2 respondents).</li> </ul>	9
Alignment to statistical reports	The ED should refer to statistical reports but the convergence between the two systems is not appropriate because of different purposes.	2
Focus on the information needs	This is a relevant point.	2
Objective and meaning of CFS in the public sector context	These relevant topics are not dealt with. Additional guidance is needed.	1
Accrual accounting vs. cash accounting	The ED should specify that it relates only to entities which adopt the accrual basis of accounting.	1

The most relevant point highlighted by Table 3 concerns the convergence between the IPSAS and IFRS. Only a few respondents do not approve of this alignment. The French Cour de comptes, for example, points out that there are no understandable reasons justifying the modification of the IPSAS 6 through the publication of a new ED; the only motivation seems to be that the IASB has changed its IFRS 10. Similarly, the CNOCP regrets that no Consultation Papers have been published prior to the new EDs that would be beneficial from deeper consideration and more in-depth contributions.

In contrast with these comments, a considerable number of respondents support the IPSASB's approach, which aligns the IPSAS with IFRS where appropriate, even though they retain it is important to adequately address the specific characteristics of the public sector in the standards to be developed.

It is worth noticing that only a few respondents pay attention to the convergence between the IPSAS and statistical perspective, underlying that they pursue different objectives; at the same time, many respondents do not take into account the budgetary approach as criteria upon which the CFS should be drawn, with the "control criterion" being the *fil rouge* of the whole ED no. 49.

Regarding the role of the CFS in supporting accountability reasons as well as the decision-making process, only two comments deal with the relevance of focusing on information needs, while only one respondent requires additional guidance, considering this topic relevant.

Table 4 summarizes in more detail the comments concerning the concept of control and the consolidation area (issues no. 1 and no. 2), aimed at outlining the viewpoint of the respondents who strongly motivate their observations in supporting or contradicting the ED no. 49. More specifically, Table 4 distinguishes the respondents who approve the approach as defined in the ED ("agree with no remarks"), those who express some observations, even though they support the proposed approach ("agree with remarks") and those who disagree.

Table 4. Submitted comments issues no. 1 and no. 2

International Organizations	Governmental Organizations	Professional Organizations	Countries	Academics	Auditing/consulting firms	Issue no. 1			Issue no. 2		
						Agree with no remarks	Agree with remarks	Disagree	Agree with no remarks	Agree with remarks	Disagree
ICGFM							X				X
FEE						X			X		
EC						X			X		
	ADAA					X			X		
	DGFIP						X			X	
	CNOCP						X		X		
	HoTARAC					-	-	-	-	-	-
	NZSuperfund					X			X		
	ACAG					X			X		
	CdC							X			X
	NSFMA					X					X
	US GAO					-	-	-	-	-	-
	SRS-CSPCP						X			X	
	ASB						X		X		
	AASB						X		X		
	The Treasury						X		X		
	NZASB						X		X		
		ACCA				X			X		
		ANAN				X			X		
		CPA Canada				X				X	
		ICPAK					X			X	
		JICPA					X		X		
		ZICA				X			X		
		JAB					X			X	
		MIA				-	-	-	-	-	-
		CIPFA					X		X		
			Auckland C.			X			X		
				J.B. Mattret		X			X		
				D.S.F.Juvenal		X			X		
				Ichabod's				X	-	-	-
				PwC			X		X		
				<b>Total</b>		<b>13</b>	<b>13</b>	<b>2</b>	<b>19</b>	<b>5</b>	<b>3</b>

**Legend:** ICGFM (International Consortium on Governmental Financial Management); FEE (Fédération des Experts Comptables Européens); EC (European Commission); ADAA (Abu Dhabi Accountability Authority); DGFIP (Direction générale des finances publiques); CNOCP (Conseil de normalisation des comptes publics); HoTARAC (Head of Treasuries Accounting and Reporting Advisory Committee); NZSuperfund (New Zealand Superannuation Fund); ACAG (Australasian Council of Auditors-General); CdC (Cour des Comptes); NSFMA (National Swedish Financial Management Authority); USGAO (US Government Accountability Office); SRS-CSPCP (Swiss Public Sector Financial Reporting Advisory Committee); ASB (Accounting Standards Board); AASB (Australian Accounting Standards Board); ANAN (Association of National Accountants of Nigeria); ACCA (Association of Chartered Certified Accountants); CPA-Canada (Public Sector Accounting Board); ICPAK (Institute of Certified Public Accountants of Kenya); JICPA (Japanese Institute of Certified Public Accountants); ZICA (Zambia Institute of Chartered Accountants); JAB (Joint Accounting Bodies); MIA (Malaysian Institute of Accountants); NZASB (New Zealand Accounting Standards Board); CIPFA (Chartered Institute of Public Finance and Accountancy); ICHABOD'S (Ichabod's Industries Limited); AUCKLAND C. (Auckland Council); PwC (Price Waterhouse Coopers).

Additionally, the comments through a more thorough analysis of respondents (especially those who “agree with remarks” or “disagree”) are developed: Tables 5 and 6 summarize

these positions, explaining the main common arguments provided by the respondents concerning issue no. 1 and issue no. 2, respectively.

*Table 5. Specific revisions suggested by respondents concerning Issue no. 1*

<b>Topic</b>	<b>Issue no. 1: Comments of respondents</b>	<b>No. of comments</b>
Appropriateness of the control approach	<p>Agreement with no remarks: the control criterion is correct (<i>13 respondents</i>)</p> <p>Agreement with remarks: the control criterion is correct but (<i>13 respondents</i>):</p> <ul style="list-style-type: none"> <li>• It requires better specification when it is applied to the “State group” (i.e. when the State is the controlled entity);</li> <li>• It should be less prescriptive (as in the statistical approach);</li> <li>• Its definition should be connected with the governance of public sector entities;</li> <li>• A list of entities “deemed” to be controlled by the Government should be prepared;</li> <li>• The identification of the reporting entity is a prerequisite;</li> <li>• Autonomy of local governments and the conditions of their supervision by the central government should have been more thoroughly analysed.</li> </ul> <p>The control criterion is incorrect in the public sector; the concept of “area of responsibility” (as in the statistical accounting) is more acceptable (<i>2 respondents</i>)</p>	28
Relationship between the definition of control/power and ownership interests, voting rights and political rights	<p>The definition of control/power should:</p> <ul style="list-style-type: none"> <li>• Be clearer in order to better specify if control requires quantifiable ownership interests because most PSEs adopt a “legal” point of view (<i>1 respondent</i>);</li> <li>• Ignore present ownership interests, because an entity can control another entity irrespective of its ownership interests (<i>3 respondents</i>);</li> <li>• Not refer to voting rights, because of their irrelevance in the public sector in defining power (<i>3 respondents</i>);</li> <li>• Be clearer in order to better specify if “political rights” imply (or not) a control (<i>1 respondent</i>).</li> </ul> <p>In the definition of control, the phrase «... including the rights to direct the financial and operating policies of that entity» should be removed or amended (<i>4 respondents</i>)</p>	12
“Benefits” vs. “Returns”	<p>The concept of:</p> <ul style="list-style-type: none"> <li>• “Benefits” is preferable but additional guidance and/or examples are needed (<i>3 respondents</i>);</li> <li>• “Return” is preferable (<i>1 respondent</i>).</li> </ul>	4
“Non-financial benefits”	<p>The concept of non-financial benefits:</p> <ul style="list-style-type: none"> <li>• Is correct even if it is not defined positively and/or needs to be explained in the light of the concept of “service potential” (<i>2 respondents</i>);</li> <li>• Is incorrect because of the characteristics of the public sector (<i>1 respondent</i>).</li> </ul>	3

Table 6. Specific revisions suggested by respondents concerning Issue no. 2

Topic	Issue no. 2: Comments of the respondents	No. of comments
Inclusion of all controlled entities in the CFS	The inclusion of all controlled entities in the consolidation area: <ul style="list-style-type: none"> <li>• Is correct except in the circumstances proposed by the ED (19 respondents);</li> <li>• Should provide other cases of exclusion (5 respondents);</li> <li>• Is incorrect because it is excessive and expensive (3 respondents).</li> </ul>	27
Exclusion from consolidation of controlled entities	Exclusion is suggested in the following cases: <ul style="list-style-type: none"> <li>• Materiality reasons, considering the high number of controlled entities (4 respondents);</li> <li>• Other reasons, such as: heavy cost; undue delay in providing information; major differences between the activity of the controlling entity and that of the controlled entities; when controlled entities are rescued by the government from financial distress (4 respondents).</li> </ul>	8
Fully consolidation approach vs. Equity method	Fully consolidation approach should be used for: <ul style="list-style-type: none"> <li>• Only non-business entities implementing public policies mainly funded by public or sovereign resources;</li> <li>• Entities that manage “core activities”.</li> </ul> Equity method should be used for: <ul style="list-style-type: none"> <li>• All business-controlled entities;</li> <li>• Entities that manage “peripheral activities”.</li> </ul>	6
Consolidation for sub-sectors	Consolidations for sub-sectors should precede any whole-of-government consolidation	1

The tables show that the respondents generally agree with the proposed definition of control, even though some of them require additional specifications (for example when the State is the controlling entity) or propose a consideration about its applicability in the public sector (suggesting the identification of the reporting entity as a prerequisite). For example, a less prescriptive approach is suggested, in order to make the relationship with statistical reports easier; taking this point to an extreme, a respondent points out that the “control approach” is incorrect within the public sector, with the “area of responsibility” being a preferable way of defining the consolidation area. A softer approach suggests merely taking into account the governance of PSEs while a more insightful respondent suggests providing a better distinction among the CFS and the whole-of-government accounts; more specifically, the latter can be produced in order to combine the accounts of all the entities of all government levels, even though the controlling entity (e.g. the central government) has no control over the others (e.g. local governments). Even though this respondent recognizes that such accounts fall outside the main purpose of the ED no. 49, he observes that some issues

(e.g. the elimination of intra-reporting entity transactions and the use of uniform accounting policies) could be of interest in any case. Another interesting remark concerns the relationship between central and local governments, requiring a more thorough analysis of the conditions under which the former supervises the latter.

Some respondents (i.e. the AASB) agree with the proposed definition of control, even though they query the alteration to the definition of “power” in IFRS 10 caused by adding the words *“including the right to direct the financial and operating policies of that entity”*; in fact, they observe that there is no valid reason (including any public sector specific reasons) for diverging from the IFRS 10’s definition of power. In the same way, other respondents entertain the idea that this expression could be misinterpreted in the sense that an entity *must* have the ability to direct the financial and operating policies of the other entity. However, these observations do not raise any doubts about the convergence between the IPSAS and IFRS.

According to several respondents, voting rights are usually irrelevant in the public sector and ownership interests should be ignored, while it could be of interest to provide a specification of “political rights”, in order to better specify their incidence in terms of control and power. As a relevant example, the US GAO, although it does not provide specific comments about issues no. 1 and no. 2, focuses on exceptional public sector interventions in the private sector (such as economic instability or security concerns); in this case, a PSE may exercise regulatory or other sovereign powers: some of these interventions may result in control over a private sector entity, while others do not. Accordingly, the US GAO pinpoints that “the standard should provide sufficient latitude to appropriately account for these types of circumstances”, which, in a way, should be referred to the above-mentioned risk approach.

One of the main differences between the proposed ED no. 49 and the IFRS 10 concerns the use of the term “benefits” instead of “returns”: more respondents are of the opinion that this

approach is correct; however, the New Zealand Accounting Standards Board suggests amending the definition of benefits to refer to the advantages that an entity *seeks to obtain*, in order to highlight that “the actual impact of having an interest in another entity may be better or worse than anticipated. Entities obtain interests in other entities because they hope to obtain benefits (both financial and non-financial) from the arrangement”.

In relation to the “non-financial results”, the respondents generally agree, because of the differences between public and private sector entities, even though some of them require a better specification. In fact, many factors (such as the absence of market pressures as well as the need to define the final objectives of PSEs by considering long term impacts on communities; Grossi and Steccolini, 2014) suggest taking into account both financial and non-financial performance, which in turn are affected by many different activities, functions and services (Boyne, 2002), because profit should not be assumed as ‘the’ goal of a PSE (Ma and Matthews, 1993; Guthrie and Johnson, 1994; Farnham and Horton, 1996, p. 31; Guthrie, 1998; Cohen et al., 2012).

Regarding the definition of the consolidation area, respondents largely agree with the approach the ED no. 49 proposes, due to the inclusion of all controlled entities (except in the specified circumstances) allow to provide a complete and useful assessment of the economic entity’s activities and current financial position.

However, in order to better satisfy the users’ needs, the Swedish National Financial Management Authority (ESV) proposes an interesting distinction between “core activities” and “peripheral activities” within the wide concept of a “group of entities” (even though the ESV acknowledges the difficulty in separating these two kind of activities): while the former entities (managing “core activities”) have to be consolidated, it should be sufficient to account for the latter (managing “peripheral activities”) with the equity method.

Along the same line, other respondents point out that the ED should provide some cases of exclusion from consolidation, such as materiality reasons, heavy costs, undue delay in providing information, etc. Moreover, other respondents highlight that some entities, especially governmental business enterprises (GBEs) or non-profit institutions, may consolidate themselves in their own perimeter, because they follow their own accounting rules. Coherently, these respondents retain that a full consolidation approach is not correct, with the equity method being a proper way of representation of the above-mentioned entities within the CFS.

In conclusion, regarding the first research question, the respondents largely agree with the alignment between the proposed standard and the IFRS 10, considering the approach suggested by the ED no. 49 to be both reasonable and appropriate. Nevertheless, some respondents are aware of the differences between the public and private sectors: accordingly, on one hand, most of them appreciate the variation of some central terms and expressions (such as “benefits” instead of “returns” or the emphasis laid on “non-financial benefits”); on the other, they require more attention on the specific characteristics of the public sector that the IPSASB should better take into account.

Regarding the second research question, a first reading of the submitted comment letters seem to suggest that the respondents do not pay enough attention to the crucial point concerning the scope of CFS in the public sector; in other words, they do not seem to investigate in detail the underlying accountability or decision-making reasons, focusing on the proposed definitions of control, power and benefits. However, a more insightful analysis of the positions expressed by some respondents reveals that the main purpose of public sector CFS should be to assess accountability, as suggested for example by the concept of “area of



responsibility” (instead of control) adopted in the statistical accounting. Along the same lines, several respondents propose some perspectives and methods (for example: equity method instead of line-by-line consolidation in consolidating GBEs) because they are supposed to produce useful information in the CFS for users to assess accountability.

Finally, regarding the third research question, the respondents are mainly concerned with the repercussion of the proposed definition of control as well as power and benefits. Along this line, even though they largely support the control approach, they propose some amendments in order to better reflect the specificities of the public sector; more specifically, most of them acknowledge that large modifications have already been made (such as the identification of administrative arrangements or legislation as dominant factors to assess the control and the above-mentioned replacement of the term “returns” by the term “benefits”) but they require other changes. Similarly, even though some respondents deal with the relationships between CFS and statistical reports or whole-of-government accounts, they do not investigate in detail the potential implications of this alignment.

## **6. Final thoughts**

The elaboration of consolidated accounts is a complex task but good financial statements are considered important to the overall accountability and governance of PSEs. In this vein, CFS should aim to support politicians and managers as well as other stakeholders in evaluating the performance of a PSE, providing a complete picture of how public resources are managed.

CFS could be drafted according to either the budgetary approach or the control approach, which in turn, at least implicitly, refer to a theory of consolidation as well as to the underlying accountability or decision-making reasons. From this perspective, since the Basis for conclusions (BC 10) of the ED no. 49 explicitly points out, the IPSASB’s Conceptual Framework

(Chapter 2) states that the objective of financial reporting is to provide information that is useful for both accountability and decision-making purposes. However, as stated above, the ED no. 49 defines the consolidation area as well as the basic concept of control by referring to “power” and “benefits”, which in turn incline towards a decision-making process (as in the IFRS 10, to which the ED no. 49 substantially aligns).

The IPSASB coherently states that the budget approach (and, it could be argued, the underlying accountability reasons) are not appropriate for general purpose financial reporting.

However, the analysis of comment letters submitted to the ED no. 49 suggest better investigating this idea. In fact, even though the respondents largely agree with the IPSASB’s approach, they propose incisive adjustments and clarifications, in order to better take into account the typical characteristics of PSEs, which are different from their private counterparts. More specifically, the analysis of the submitted comment letters suggests what the main problematic matters of the CFS in the public sector are and, consequently, what the possible implications for policy makers could be: first of all, a clear identification of the reporting entity is auspicious, taking into account any potential relationships with other forms of aggregations of accounting data; accordingly the different accounting rules applied to PSEs, on one hand, and GBEs and/or non-profit institutions, on the other, should be taken into account.

Secondly, it would be opportune to provide better specifications about the level of government to which the consolidation process refer, more specifically providing additional guidance in the case of CFS of local governments. Thirdly, taking into account the high number of entities potentially included in the consolidation area, it is expected to provide a more precise specification of some exceptions to the consolidation of all controlled entities. In the

fourth place, more attention should be given to the incidence of the “legal aspect” in defining the concept of control.

Finally, in order to make adjustments to this last concept (avoiding an uncritical adoption of the same approach used in the private sector), a better specification of the goals of the CFS is also auspicious<sup>3</sup>; along this line, some respondents point out that the main scope of CFS should be to assess accountability, implicitly highlighting that the application of the budgetary approach should provide information that is extremely relevant for the budgetary decisions (Bergmann, 2009).

This means that some parameters, traditionally applied in consolidation of private sector entities, are not as easy and straightforward as it could be argued, requiring a proper definition of the objectives of the CFS in the public sector (Walker, 2009).

Therefore, if the aim of CFS is to provide a global picture of the financial circumstances of a nation, producing information to politics and media, a consistent approach is to “consolidate” state and local governments, focusing on budgets and their results: arguably, CFS should include entities that are completely or substantially funded by public money and exercise functions of a public nature, according to the budgetary approach. Furthermore, a prospective relationship with a statistical perspective should be investigated.

On the other hand, if the aim is to provide information to the management of a PSE as well as to citizens about the way of providing services, the focus should be on a consolidation area that includes this PSE and all its controlled entities through which these services are provided. In this vein, there is room for defining control, power and benefits, taking into account the

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<sup>3</sup> Recently, (Jan 31, 2017) the IPSASB issued a new accounting standard—IPSAS 40, Public Sector Combinations. IPSAS 40 provides the first international accounting requirements that specifically address the distinctive characteristics of combinations of entities and operations in the public sector. This is due to the necessity of providing adequate answers to the stakeholders’ needs, as stated by the IPSASB Chair Ian Carruthers: “*Yet our stakeholders have told us that these private sector standards are not suitable for the public sector*”.

context (public sector) within which they have to be applied; this also explains why the respondents mainly focus on the relationship between the power over other entities and the benefits that a controlling entity can obtain from its involvement in controlled entities, suggesting a better specification of these concepts.

Overall, the operationalization of the control approach could imply significant difficulties (Brusca and Montesinos, 2009) due to both the complex structure of the public sector as well as the heterogeneity of forms of “controlled” (i.e. decentralised) entities, such as GBEs, foundations, institutions, and so on.

The main limitation of this study is the small number of comments submitted by the respondents, which means that future research efforts are highly desirable, in order to investigate more thoroughly the point of view of different categories of stakeholders concerning the incidence on CFS of some relevant public sector peculiarities (such as the importance of the budget, the basic role of non-exchange transactions, infrastructure and heritage assets as well as the public service orientation, instead of profit-making, of public sector), which do not seem to be adequately taken into account by the IPSASB (Grossi et al., 2013).

# Chapter 4

## The Consolidated Financial Statements in local governments

### 1. Introduction

During the last decades, public sector entities have been characterised by several changes. One of the main effects is the increase of inter-municipal collaboration and public-private partnerships, with the main aim being to improve the quality of services and fulfil the needs of citizens. In this new context, consolidated financial statements (CFS) are able to ensure a complete picture of the whole group at both central and local levels (Wise, 2006; Newberry, 2007; Grossi and Newberry, 2009), supporting decision-making processes and guaranteeing public accountability (Heald and Georgiou, 2000; Chow *et al.*, 2007; Grossi, 2009; Bergmann, 2012).

Previous literature has investigated public sector CFS, focusing on the importance of this tool (Lande, 1998; Grossi, 2004; Wise, 2004, 2006; Heald and Georgiou, 2011; Grossi *et al.*, 2014), at the same time analyzing several technical issues (Brusca and Montesinos, 2009; Chow *et al.*, 2009; Walker, 2009; 2011; Grossi and Soverchia, 2011; Howieson, 2013; Lombrano and Zanin, 2013; Bisogno *et al.*, 2015). Nevertheless, scholars have not fully examined why a local government would decide to resort to CFS without any legal obligations to do so, namely on a voluntary basis.

The aim of the study is to understand what could be the technical and/or strategic reasons that motivate a local government to implement CFS on a voluntary basis.

From a theoretical perspective, the study refers to both legitimacy and institutional theories, explaining the voluntary implementation of CFS in accordance with the aim of

legitimizing the deployment of an LG towards citizens as well as of achieving conformity with the institutional environment.

The chapter focuses on the Italian context, where in the past (since 2004) only a few cases of voluntary use of CFS were observed, such as those in Tuscany and Emilia-Romagna regions. At that time, the main aims were to improve the transparency and accountability towards internal and external users as well as to provide more complete information to better support outsourcing choices for financial and strategic control over subsidiaries (Grossi *et al.*, 2014). Nevertheless, cultural and technical reasons as well as legal causes (Grossi, 2009) have long impeded a wider diffusion of CFS in Italy as well as in other EU continental countries (Lüder and Jones, 2003). More recently, the Decree no. 118/2011 has introduced a new set of accounting rules, leading to a new modified cash accounting system in correlation with accrual reporting (Manes-Rossi, 2015), at the same time instituting CFS. More specifically, this decree has defined an experimental period of two years (2013-2014), which was later extended to three years (i.e. 2015 was added). Even though the central government could constrain a restricted sample of public administrations to adhere to the pilot testing period, any other public sector entity could decide to adopt the new accounting rules and prepare CFS on a voluntary basis. This experimental period terminated in December 2015, with CFS being mandatory by 2016. Thanks to this phase, it is possible to understand the reasons why Italian Local Governments (ILGs) have implemented CFS.

From a methodological point of view, the research was based on a questionnaire sent to all the ILGs with more than 5,000 inhabitants, which have adopted the new accounting rules and have prepared CFS. After descriptive statistics concerning all the sections of the questionnaire, the study has scrutinized in-depth its last section which regarded the reasons why politicians (supported by top managers) decided to voluntarily join the test period.

Accordingly, through a principal component analysis, an aggregate index was calculated, in order to include it in a regression model as a dependent variable.

Findings from this model show that both technical and strategic reasons contributed to explaining the willingness to participate in the testing period: ILGs aimed to conform with the institutional environment, taking into account that CFS will be mandatory in the near future; additionally, they aimed to improve their transparency towards citizens through CFS, which provide a more complete financial and economic picture of the whole group.

The remainder of the chapter is structured as follows. The next section will review the theoretical background clarifying the research questions of the study, while section 3 will explain the research design and methodology. Section 4 will present findings of the survey while the last section will present the conclusions.

## **2. Theoretical background**

CFS have been implemented in many countries around the world and scholars (Heald and Georgiou, 2009; Grossi and Pepe, 2009; Newberry and Pont-Newby, 2009) have observed several differences relating to certain key issues such as: the definition of the consolidation area; the identification of the level (federal, national, and local) which CFS should refer to; the adoption of private or public sector accounting standards (Ryan et al.2007) or the statistic criteria (Barton, 2011); the mandatory or voluntary implementation of CFS.

Focusing on this last aspect, the international scenario shows that while certain countries (such as Sweden; see Tagesson, 2009; Tagesson and Grossi, 2012) have instituted CFS on a voluntary basis since the 80's, others (such as Austria, Belgium, Czech Republic, France, Italy, Portugal) have only recently implemented CFS on a mandatory basis (Bergman *et al.*, 2016) or

are going to do so. Moreover, several countries do not provide any legal obligations in instituting CFS, therefore various local governments have voluntarily used this tool.

The majority of the previous studies have mainly concentrated on technical issues (Chow *et al.*, 2009; Day, 2009; Grossi and Soverchia, 2011; Walker, 2011; Tagesson and Grossi, 2012; Howieson, 2013; Bergmann, 2014; Gardini and Grossi, 2014; Grossi and Steccolini, 2015), at the same time paying attention to the usefulness of CFS (Wise, 2010, Heald and Georgiou, 2011; Grossi *et al.*, 2014). Therefore, previous literature has comparatively paid less attention on contexts where local governments have voluntarily embraced CFS.

Taking into account that a lack of transparency is frequently related to corruption (Kolstad and Wiig, 2009; Sharman and Chaikin, 2009; Bertot *et al.*, 2010; Guillamón *et al.*, 2011; Bisogno *et al.*, 2016), especially at a Local government (LG) level (Tanzi, 1994; Treisman 2002; Schick, 2003), CFS could facilitate the comprehension of the allocation of resources, enhancing a positive perception of politics (Curtin, 1999). Accordingly, the decision of a LG to implement CFS on a voluntary basis could be motivated by the desire of increasing transparency. In so doing, a LG would legitimize its conduct towards citizens, at the same time conforming to the institutional environment. Therefore, this decision could be motivated by both *technical* and *strategic* reasons.

*Technical reasons* can be interpreted in the light of the above-mentioned technical difficulties (such as the definition of the consolidation area, the identification of the level which CFS should refer to, the adoption of private or public sector accounting standards or the statistic criteria) that several contexts have dealt with. Accordingly, the voluntary preparation of CFS could be conceived as a training process, aiming at facing and resolving these difficulties. More broadly, this voluntary implementation can be considered a signal of conformity with shared norms of rationality and progress, which are promoted by the ongoing



reform processes, namely principles of performance improvements and the accountability towards citizens (Marcuccio and Steccolini, 2005). This would pave the way for improving employees' skills and, in more general terms, for updating old organizational routines. Therefore, according to the institutional theory perspective (Di Maggio and Powell, 1983; Jones and Pendlebury, 2004; Dillard et al., 2004), the adoption of new accounting rules would be motivated by the aim of conforming with the institutional environment. Di Maggio and Powell (1983) try to explain why organizations adopt practices through three forms of institutional isomorphism: *coercive isomorphism*, which can occur through requirements imposed by norms and governments; *mimetic isomorphism*, which refers to the adoption of practices used by others organizations defined as successful and which is likely to take place in contexts of ambiguity and uncertainty; *normative isomorphism*, which occurs as a result of shared value and ideas about appropriate conduct, often diffused through professional networks and education. However, as stated by Grossi (2009), there could be also other reasons such as socio-psychological reasons that justify the voluntary implementation of CFS. Accordingly, the first research question of this study is:

**RQ1:** *Does the aim of conforming with the institutional environment affect the decision of ILGs to voluntarily implement CFS?*

As far as the *strategic reasons* are concerned, LGs are expected to disclose more detailed information through CFS. The main goals would be gaining political consensus, therefore in the long term a LG would improve and enhance its image. A tool (such as CFS) that emphasises the transparency of public management, at the same time being consistent with the social perceptions of the adequacy of the organizational conduct, could be considered necessary by the organization itself, contributing to impeding negative routines (such as attempts of

politicians to carry out transactions in ways which promote their self-interests; Copley *et al.*, 1997).

Legitimacy theory helps explain these phenomena regarding *social perceptions* concerning the conduct of organizations. This theory asserts that organizations continually seek to ensure that they operate within the bounds and norms of their respective societies, i.e. they attempt to ensure that their activities are perceived by outside parties as being “legitimate” (Richardson, 1997; Deegan and Unerman, 2011, p. 323). Dowling and Pfeffer (1975, p. 122) state: “Organizations seek to establish congruence between the social values associated with or implied by their activities and the norms of acceptable behaviour in the larger social system in which they are a part. [...] When an actual or potential disparity exists between the two values systems there is a threat to organizational legitimacy”. Legitimacy theory relies upon the notion of ‘social contract’ between the organization and the society in which the former operates. ‘Social contract’ is the concept used to represent the multitude of implicit and explicit expectations that society has about how the organisation should conduct its operations. Hence, the informative role played by CFS should be considered pivotal. Accordingly, the second research question of this study is:

**RQ2:** *Does the aim of being legitimate affect the decision of ILGs to voluntarily implement CFS?*

The study focuses on the Italian context, where in the past (since 2004) only a few cases of voluntary use of CFS were observed, such as those in Tuscany and Emilia-Romagna regions. At that time, the main aims were to improve the transparency and accountability towards internal and external users as well as to provide more complete information to better support outsourcing choices for financial and strategic control over subsidiaries (Grossi *et al.*, 2014). Nevertheless, cultural and technical reasons as well as legal causes (Grossi, 2009) have long

impeded a wider diffusion of CFS in Italy as well as in other EU continental countries (Lüder and Jones, 2003). More recently, in Italy, the Decree no. 118/2011 has introduced a new set of accounting rules, leading to a new modified cash accounting system in correlation with accrual reporting (Manes-Rossi, 2015), at the same time instituting CFS. More specifically, this decree has defined an experimental period of two years (2013-2014), which was later extended to three years (i.e. 2015 was added). Even though the central government could constrain a restricted sample of public administrations to adhere to the pilot testing period, any other public sector entity could decide to adopt the new accounting rules and prepare CFS on a voluntary basis. This experimental period terminated in December 2015, with CFS being mandatory by 2016. Thanks to this phase, it is possible to understand the reasons why Italian Local Governments (ILGs) have implemented CFS so to answer the research questions.

### **3. Research methodology**

In order to investigate these research questions, the study has focused on all the Italian Local Governments (ILGs) with more than 5,000 inhabitants, which have adopted the new accounting rules and prepared CFS in accordance with the experimental period criteria. The total number of the LGs investigated in the study was 284. A questionnaire was sent to both the Financial Councillor and the Chief Financial Manager of these LGs, consisting of five sections:

- Sections no. 1 to 3 aim to provide general information concerning the LG, such as: the number of inhabitants; the profile of the respondents; whether the LG prepared or not CFS, explaining the motivation in case of a negative answer; in what year (2013, 2014 and 2015) the LG prepared the CFS. Tables 1 and 2 provide details on these sections;
- Section no. 4 aims to investigate the main difficulties LGs had in preparing CFS;
- Section no. 5 focuses on why LGs decided to be involved in the pilot testing period.

Focusing on sections 4 and 5, the respondents were asked to express for each question the extent of their agreement or disagreement (where 1 corresponds to “strongly agree” and 6 corresponds to “strongly disagree”). A 6-point Likert scale was adopted in order to avoid that respondents choose the moderate value (the middle point; Garland, 1991; Manes-Rossi *et al.*, 2016). The questionnaire was pilot tested in order to identify any unclear questions or possible misunderstandings. The responses were confidential.

Having received a positive feedback from the pilot test, the survey was launched *via* a web based survey host (Google drive), including a cover letter to explain the purpose of the research and the basic concepts underpinning the questions. A follow-up reminder was sent to the respondents, aiming to limit the lack of participation and increase the response rate. The field study spanned about 3 months (June, July and September 2016). The final response rate was about 25% (141 respondents out of 568), and 103 ILGs out of 284 (36%) took part in the survey.

The information regarding how the survey has been carried out, what is the sample and to whom the questionnaire is sent, are synthesized in the following table:

<i>How the survey has been carried out</i>	<i>Sample</i>	<i>Recipients</i>
Survey host (Google drive)	284 Italian Local Governments	Financial Councillor Chief Financial Manager

After descriptive statistics concerning all the sections of the questionnaire, the study focused on the last section, aiming at unveiling the main relevant technical and strategic reasons underlying the voluntary preparation of the CFS. First of all, a principal component analysis (PCA) was carried out, allowing to summarize the data losing as little information as possible (Mardia *et al.*, 2003, p. 213). In so doing, the interpretation of the data was facilitated. In fact, PCA is defined in such a way that the first principal component explains as much of the

variability in the data as possible, and each succeeding component in turn has the highest variance possible.

Secondly, an aggregate index based on the items related to the first three components having a high factor loading was calculated. This index was considered as the dependent variable of a regression model, through which the statistical significance of both technical and strategic reasons was tested. The purpose of the regression analysis is to investigate the relationships among variables and measure the strength of the linear relationship between the variables. Therefore, this method is used to test and reveal relationships between the dependent variable and independent variables with different levels of significance.

## **4. Results**

### *4.1 Descriptive statistics*

As stated above, the first three sections of the questionnaire aimed to provide general information concerning the investigated LGs.

Section 1 concerns the denomination of the LG, the region to which it belongs, and its size; moreover, it deals with the profile of the respondents. Table 1 clearly shows that the majority (51.1%) of the ILGs, which decided to be involved in the testing period, is relatively small (between 5,000 and 20,000 inhabitants). Regarding the geographical area, LGs which adhered to the testing period mainly belong to the north (79.3%). This relevant difference between the north and the centre-south of the country can be due to previous experiences of voluntary implementation of CFS mainly concentrated in the north, especially in the Tuscany and Emilia-Romagna regions. In effect, as stated above, these two regions have already experimented the use of CFS several years before the current legislative decree (Grossi, 2009; Grossi et al., 2014).

As far as the profile of the respondents is concerned, it is worth observing that the percentage of managers (87.9%) is higher than that of politicians (12.1%).

*Table 1..Descriptvie statistics (section no. 1)*

<b>Size</b>	<b>%</b>	<b>Localization</b>	<b>%</b>	<b>Profile of respondents</b>	<b>%</b>
5.000-20.000	51.1	North	79.3	Managers	87.9
20.000-40.000	24.8	Centre and South	20.7	Politicians	12.1
40.000-100.000	16.3				
> 100.000	7.8				

Section 2 of the questionnaire provides information concerning the voluntary or mandatory adhesion to the pilot testing period, while section 3 gives information on the preparation of CFS. Table 2 summarizes findings from these sections.

Taking into account that the central government could constrain a restricted sample of ILGs (as well as other public administrations) to adhere to the pilot testing period, it is worth considering that about 91% of the LGs involved in the survey joined this experimental period on a voluntary basis. Accordingly, and also taking into account the international movement towards accounting harmonization, it would be of great interest to understand the reasons underlying this decision.

Bearing in mind that the test spanned three years (from 2013 to 2015), the most relevant year was 2014, when about 70% of the LGs adhered to the experimental period, adopting both the new accounting system and the CFS. Focusing on this last point, it should be observed that the Italian law as well the Italian accounting standards provide various cases of exclusion, according to which a LG is discharged from the preparation of CFS. As Table 2 shows, CFS were regularly implemented in the 76.6% of the cases. In the remainder 23.4%, CFS were not drawn because of a case of exclusion (15.2%), a lack of controlled entities (63.6%) or other minor reasons (21.2%). Finally, coherently with findings concerning the year of adhesion, Table 2 illustrates that ILGs implemented CFS in an incremental way during the three years of

experimentation. Considering the sub-sample that have prepared the CFS, the 6% of the LGs has implemented them in 2013; the 38% in 2014; and the 56% in 2015 highlighting the increase during the time.

Table 2. Descriptive statistics (Sections no. 2 and no. 3)

<b>Adhesion to the testing period</b>	<b>%</b>	<b>Year of adhesion to the testing period</b>	<b>%</b>	<b>Preparation of CFS</b>	<b>%</b>	<b>Year of preparation</b>	<b>%</b>
Voluntary	90.8	2013	26.2	Yes	76.6	2013	6
Mandatory	9.2	2014	70.2	No	23.4	2014	38
		2015	3.6	• <i>Cases of exemption</i>	15.2	2015	56
				• <i>No controlled entities</i>	63.6		
				• <i>Others</i>	21.2		

Table 3 expresses descriptive statistics (mean, median and standard deviation) of all the items relating to both question 4, which focused on the main difficulties the investigated LGs had in preparing CFS, and question 5, which focused on the main reasons supporting the voluntary adhesion to the test period. It is worth bearing in mind that, in the adopted Likert scale, 1 corresponds to “strongly agree” and 6 corresponds to “strongly disagree”.

Table 3. Descriptive statistic (sections no. 4 and no 5)

<b>Question no. 4: In my opinion, the main difficulties the LG had in preparing CFS are:</b>	<b>Mean</b>	<b>St.dev.</b>
Definition of the area of consolidation	3.24	1.52
The identification of entities to be excluded from the area of consolidation	3.39	1.55
Lack of previous experience	2.15	1.35
Obtaining information from controlled entities	3.18	1.65
Interpreting laws and accounting standards	2.54	1.07
Comparability problems	2.00	1.18
Intercompany transactions	2.58	1.45
The identification of minority interests	2.92	1.49
Preparation of notes	2.75	1.40
Preparation of an internal procedure manual	2.56	1.37

<b>Question no. 5: In my opinion, the LG adhered to the experimentation, preparing CFS because of:</b>	<b>Mean</b>	<b>St.dev.</b>
The approval and on the initiative of the Mayor	2.25	1.48
The approval and on the initiative of the executive body	2.25	1.45
The approval and on the initiative of the city council	2.88	1.63
The approval and on the initiative of the Financial councillor	2.17	1.38
The approval and on the initiative of the Top manager	2.57	1.64
The approval and on the initiative of the Financial manager	1.85	1.27
Obtaining awards from the central government	2.25	1.74
Obtaining visibility towards the central government	4.02	1.72
Obtaining citizens' trust	3.48	1.70
Improving transparency	2.50	1.55
Evaluating better the efficiency and the effectiveness of the resources managed	2.56	1.57
Evaluating the intelligibility and the comprehensibility of laws and GAAPs	2.43	1.54
Assessing the difficulties in defining the area of consolidation	2.97	1.65
Assessing the technical difficulties	2.83	1.63
Improving employees' skills	2.60	1.53
Acquiring experience on the structure of the CFS	2.12	1.43
Assessing the adequacy of the accounting software	2.91	1.66

Focusing on question 4, the majority of the respondents largely agreed in each item, highlighting the importance they gave to the technical difficulties featured in the implementation of the CFS. More specifically, one of the main issues encountered relate to the comparability between financial statements of the LGs and those of the controlled entities, largely consisting of firms adopting private sector accounting rules. The lack of previous experience, the preparation of an internal procedure manual and the difficulties in interpreting both the law and the public sector accounting standards have also been underlined, coupled with intercompany transactions. Moreover, the definition of the consolidation area and how to apply the cases of exclusion have been considered relevant too, even if the mean value is higher than those of other items. This probably occurs because of the adoption of the private sector control approach in identifying the consolidation area;



however, as underlined by scholars (Grossi and Steccolini, 2015 Bisogno *et al.*, 2015), this procedure could cause several practical problems.

Table 3 shows also the answers regarding the pivotal question 5, which focuses on the reasons why a LG adhered to the experimentation and who is involved in this process. Obviously, findings from this section relate only to the LGs that voluntarily joined the testing period (namely 90.8% of the LGs involved in the survey). The results clearly show the key role played by both managers (especially the Financial manager) and politicians (especially the Financial councillor, the Mayor and the executive body). Regarding the motives behind the decision to prepare the CFS, descriptive statistics have pointed out that the main ones seem to be the desire to gain experience on the structure of the CFS as well as to evaluate the intelligibility of both the law and the accounting standards. However, these results necessitate a more detailed and exhaustive analysis, as illustrated in the next section.

#### *4.2 Regression analysis*

In order to test the hypotheses of this study, a regression model has been carried out. As a preliminary step, items in the fifth section of the questionnaire (which deal with those involved and why LGs have joined the pilot testing period, preparing the CFS) were investigated through a principal component analysis (PCA), in order to achieve a more in-depth understanding of the phenomena investigated.

PCA summarises the observed data, through the extraction of a defined number of principal components, reducing the dimensionality of multivariate datasets. According to current literature (Jolliffe, 2002; Di Franco and Marradi, 2003), the first  $k$  factors with an eigenvalue greater than 1 were extracted. Table 4 shows the rotated component matrix of the factor loadings of the extracted principal components.

Table 4. Principal component Analysis (question no. 5)

In my opinion, the LG adhered to the experimentation, preparing CFS because of:	PC1	PC2	PC3	PC4
5.1 The approval and on the initiative of the Mayor	<b>.870</b>	.173	.020	-.082
5.2 The approval and on the initiative of the executive body	<b>.831</b>	.111	-.052	.096
5.3 The approval and on the initiative of the city council	<b>.815</b>	.104	.123	.165
5.4 The approval and on the initiative of the Financial councillor	<b>.906</b>	.188	-.084	-.080
5.5 The approval and on the initiative of the Top manager	<b>.852</b>	.079	.037	.089
5.6 The approval and on the initiative of the Financial manager	.492	.390	.219	-.418
5.7 Obtaining awards from the central government	.298	.272	-.591	.411
5.8 Obtaining visibility towards the central government	.481	.219	.028	<b>.674</b>
5.9 Obtaining citizens' trust	.427	.405	.289	.448
5.10 Improving transparency	.398	.369	<b>.691</b>	.164
5.11 Evaluating better the efficiency and the effectiveness of the resources managed	.180	.427	<b>.757</b>	.126
5.12 Evaluating the intelligibility and the comprehensibility of laws and GAAPs	.179	<b>.824</b>	.314	-.020
5.13 Assessing the difficulties in defining the area of consolidation	.078	.705	.138	.447
5.14 Assessing the technical difficulties	.058	.728	.205	.399
5.15 Improving employees' skills	.341	<b>.801</b>	.080	-.075
5.16 Acquiring experience on the structure of the CFS	.116	<b>.860</b>	-.156	-.230
5.17 Assessing the adequacy of the accounting software	.225	.632	-.325	.022

Four components were extracted; interpreting the items with the highest factor loadings (indicated in bold in the table), the following taxonomy can be proposed:

- *“Political and managerial choice”*. The first PC highlights that politicians, strongly supported by managers, were the key actors in adhering to the experimental period.
- *“Technical difficulties”*. Interpreting the items of the second Principal component (PC) with a high factor loading, the main issues were the structure of the CFS as well as the intelligibility of both the laws and the GAAPs. Additionally, the ILGs focused on the employees' skills, who may have been lacking in the experience to deal with a very complex tool such as CFS.
- *“Efficiency, effectiveness and transparency”*. The third extracted PC highlights that, according to the respondents, CFS would allow a more accurate evaluation of the use of resources, at the same time improving transparency towards the general public.
- *“Visibility”*. The aim of increasing visibility towards the central government can be interpreted as a desire to achieve legitimacy.

Assuming as a starting point these findings, a regression model has been implemented aiming at testing the research questions of the study: bearing in mind that the first extracted principal component clearly shows that politicians (strongly supported by the top managers) played a key role in adhering to the experimental period, an aggregate index of the items 5.1

to 5.6 with a higher factor loading was calculated. This aggregated index (termed “Political decision”, Pol\_Dec) was considered as the dependent variable of the regression model, whose main independent variables are the following:

- Tec\_ind (“Technical difficulties index”), expressed by an aggregated index<sup>1</sup> based on the items selected within the second principal component (items no. 5.12, 5.15 and 5.16), because of their higher factor loadings. These items (see Table 4) indicate the relevance of the institutional reasons in supporting the adherence to the testing period. This variable refers to the first hypothesis of the study and a positive sign of the coefficient is expected.
- Strat\_ind (“Strategic index”), expressed by an aggregated index based on the items selected within the third principal component (items no. 5.10 and 5.11), because of their higher factor loadings. These items (see Table 4) indicate the relevance of the strategic reasons in supporting the adherence to the testing period. This variable refers to the second hypothesis of the study and a positive sign of the coefficient is expected.

In addition, the regression model includes all the other items in the fifth question of the questionnaire, which, according to the results of the PCA (see Table 4), show a lower factor loading. More specifically, the model includes: items no. 5.7 (“Obtaining awards from the central government”), 5.8 (“Obtaining visibility towards the central government”), 5.9 (“Obtaining citizens’ trust”), 5.13 (“Assessing the difficulties in defining the area of consolidation”), 5.14 (“Assessing the technical difficulties”) and 5.17 (“Assessing the adequacy of the accounting software”). In this way, the model is expected to test the relevance of the remaining possible explanatory factors, even though they had a comparatively lower incidence on the identification of the profile of the extracted components.

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<sup>1</sup> The aggregation is the sum of the factors having the highest factor loadings.

The model also includes several control variables, concerning the size, the economic/financial conditions, the political orientation of the leading party as well as the geographical area to which the ILG belongs. More specifically:

- “Size”, expressed by the natural logarithm of the number of inhabitants. Previous studies investigating the Italian context (e.g. Grossi, 2009) when CFS were not mandatory, pointed out that mainly larger LGs tend to adopt this tool, because they are expected to have a consistent number of decentralized entities. However, results emerging from descriptive statistics (see Table 1) show that more than 50% of the investigated LGs are of small dimension, so a negative sign is expected for this variable (expected sign: -);
- “CR – CE (“Current Revenue – Current Expenses”). This ratio expresses the current equilibrium of a LG and it has been calculated in accordance with the Italian law, i.e. comparing accounts receivable and accounts payable. Therefore, it is not possible to predict the sign of the coefficient, as it depends on the period in which cash flows occur (Bisogno *et al.*, 2013) (expected sign: ?);
- Tot\_deb (“Total debt”; exp. sign: -), which expresses the level of indebtedness of each LG;
- Pol\_or (“Political orientation”), dummy variable which equals to 1 in case of a centre-left coalition, 0 otherwise. This variable has been used in several studies, for example those concerning financial sustainability (Guillamón *et al.*, 2011; Cuadrado-Ballesteros *et al.*, 2016). However, taking into account that the results of these studies are not so evident as expected, it is not possible to predict the sign of the coefficient (expected sign: ?);
- Geo (“Geographical area”), dummy variable which equals to 1 for LGs of central and southern Italy, 0 otherwise. This variable has been included in the model since the descriptive statistics showed that about 70% of the investigated LGs belong to northern Italy (expected sign: -).

The following equation shows the variables included in the model:

$$Pol\_Dec_i = \beta_1 Tec\_ind_i + \beta_2 Strat\_ind_i + \beta_3 v\_5.7 + \beta_4 v\_5.8 + \beta_5 v\_5.9 + \beta_6 v\_5.13 + \beta_7 v\_5.14 + \beta_8 v\_5.17 + \beta_9 Size + \beta_{10} (CR-CE)_i + \beta_{11} Tot\_deb_i + \beta_{12} Pol\_or_i + \beta_{13} Geo_i + \epsilon_i$$

Table 5 illustrates correlations between variables included in the model and a moderate correlation between them emerge. According to the literature (Niemi, 2005, p. 315), values of correlation coefficients exceeding 0.8 are generally interpreted as indicating significant multicollinearity problems, but in this case the coefficients are well below this threshold; as a consequence, in the proposed model multicollinearity does not represent a serious problem.

Table 5. Correlation matrix for independent variables

	Tec_ind	Strat_ind	v_5.7	v_5.8	v_5.9	v_5.13	v_5.14	v_5.17	Size	CR-CE	Tot_deb	Pol_or	Geo
<b>Tec_ind</b>	1.000												
<b>Strat_ind</b>	.524**	1.000											
<b>v_5.7</b>	.241*	-.077	1.000										
<b>v_5.8</b>	.262**	.375**	.425**	1.000									
<b>v_5.9</b>	.456**	.572**	.290**	.611**	1.000								
<b>v_5.13</b>	.580**	.428**	.253**	.382**	.410**	1.000							
<b>v_5.14</b>	.609**	.461**	.140	.368**	.437**	.863**	1.000						
<b>v_5.17</b>	.548**	.132	.263**	.291**	.316**	.327**	.351**	1.000					
<b>Size</b>	-.152	-.256**	.268**	.025	-.054	-.096	-.118	.078	1.000				
<b>CR-CE</b>	-.012	-.003	-.213*	-.179	-.178	.037	.054	-.027	.139	1.000			
<b>Tot_deb</b>	.021	.100	-.102	-.044	-.012	.049	.031	-.102	-.082	.007	1.000		
<b>Pol_or</b>	-.076	-.145	.113	-.015	.140	-.081	-.120	-.045	.182*	.113	-.186*	1.000	
<b>Geo</b>	.014	-.214*	.352**	.097	.016	.103	-.007	.006	.244**	-.364**	-.096	-.017	1.000

Legend: Tec\_ind = Technical difficulties index; Strat\_ind = Strategic index; v\_5.7 = Item 5.7 ("Obtaining awards from the central government"); v\_5.8 = Item 5.8 ("Obtaining visibility towards the central government"); v\_5.9 = Item 5.9 ("Obtaining citizens' trust"); v\_5.13 = Item 5.13 ("Assessing the difficulties in defining the area of consolidation"); v\_5.14 = Item 5.14 ("Assessing the technical difficulties"); v\_5.17 = Item 5.17 ("Assessing the adequacy of the accounting software"); Size = natural logarithm of the number of inhabitants; CR - CE = Current Revenue - Current Expenses; Tot\_deb = Total debt; Pol\_or = Political orientation (equals 1 in case of a centre-left coalition, 0 otherwise); Geo = Geographical area (1 if the LG is of the central and southern of Italy, 0 otherwise).

\*, \*\*. Correlation is significant at the 0.005 and 0.01 level, respectively (2-tailed).

Table 6 shows the estimated results for the regression model.

Table 6. Regression model results (n = 108)

Variables	Estimated coefficients	Std. Error	t	Sig.	
Tec_ind	.242	.123	1.973	.050	*
Strat_ind	.177	.106	1.676	.097	*
v_5.7	.015	.075	.200	.842	
v_5.8	.173	.081	2.144	.035	**
v_5.9	.122	.092	1.332	.186	
v_5.13	-.005	.125	-.040	.968	
v_5.14	-.123	.129	-.951	.344	
v_5.17	.035	.079	.436	.664	
Size	-.017	.007	-2.427	.017	**
CR – CE	-.001	.002	-.612	.542	
Tot_deb	.226	.080	2.836	.006	***
Pol_or	-.022	.232	-.095	.925	
Geo	.054	.297	.182	.856	
R <sup>2</sup>	0.87				
Adjusted R <sup>2</sup>	0.85				
F	47.46			.000	***

Legend: Pol\_Dec = Political Decision Index (dependent variable); Tec\_ind = Technical difficulties index; Strat\_ind = Strategic index; v\_5.7 = Item 5.7 (“Obtaining awards from the central government”); v\_5.8 = Item 5.8 (“Obtaining visibility towards the central government”); v\_5.9 = Item 5.9 (“Obtaining citizens’ trust”); v\_5.13 = Item 5.13 (“Assessing the difficulties in defining the area of consolidation”); v\_5.14 = Item 5.14 (“Assessing the technical difficulties”); v\_5.17 = Item 5.17 (“Assessing the adequacy of the accounting software”); Size = natural logarithm of the number of inhabitants; CR – CE = Current Revenue – Current Expenses; Tot\_deb = Total debt; Pol\_or = Political orientation (equals 1 in case of a centre-left coalition, 0 otherwise); Geo = Geographical area (1 if the LG is of the central and southern of Italy, 0 otherwise).

\*, \*\*, \*\*\*. Correlation is significant at, respectively, the 0.1, 0.05 and 0.01 level (2-tailed).

According to  $R^2$  as well as *Adjusted R<sup>2</sup>* coefficients, the model is able to explain a very relevant part of the total variability of the phenomena investigated.

Coefficients concerning both the first and the second variable (Technical index and Strategic index) are statistically significant at the 0.1 level and the signs of the coefficients are positive, as expected. Accordingly, both technical and strategic reasons contributed to explaining the decision of the politicians and the top managers of the investigated LGs to join the experimental period. Therefore, adhering to this experimental period means, among other things, having the possibility to understand what the main technical issues originated by the CFS would be. In the wake of the institutional theory, an *ex-ante* comprehension of CFS would express the aim of achieving conformity with the institutional environment (Di Maggio and Powell, 1983; Jones and Pendlebury, 2004; Dillard et al., 2004). Moreover, bearing in mind that the “technical index” concerns items 5.12 (“Evaluating the intelligibility and the

comprehensibility of laws and GAAPs), 5.15 (“Improving employees’ skills”) and 5.16 (“Acquiring experience on the structure of the CFS”), this voluntary adhesion is expected to achieve a greater knowledge of laws, accounting standards and the structure of the CFS as well as to improve employees’ skills. Coherently with the results emerging from PCA, other variables concerning technical issues (namely: v\_5.13: “Assessing the difficulties in defining the area of consolidation”; v\_5.14: “Assessing the technical difficulties”; v\_5.17: “Assessing the adequacy of the accounting software”) are not statistically significant.

In this vein, it is noteworthy that both the complexity of the CFS as well as the lack of specific skills and know-how led the Italian central government to extend the experimental period from two to three years. According to the mimetic isomorphism view, ILGs involved in the testing period seem to emulate practices used by other organizations perceived to be successful (Deegan and Unerman, 2011: 365).

Along this line, it is remarkable that the adhesion to the testing period is also encouraged by the need to improve transparency as well as efficiency and effectiveness in the use of resources. This result could be interpreted in the light of a positive influence by other countries that are using CFS (Brusca and Montesinos, 2009, Grossi and Pepe, 2009; Bergmann *et al.*, 2015). Taking into account the central role of information and disclosure in the so-called systems-oriented theories (Gray *et al.*, 1996, p. 45), the aim of obtaining support by outside parties, being perceived as “legitimate”, would be a salient stimulus in voluntarily joining the testing period (Deegan and Unerman, 2011). According to the legitimacy theory perspective, this could be interpreted as a willingness to achieve political consensus (Dowling and Pfeffer, 1975), at the same time increasing the faith in institutions. This interpretation can also be supported by considering the statistical significance at 0.05 level of the variable v\_5.8 (“Obtaining visibility towards the central government”).

In synthesis, CFS are largely perceived as a tool through which a LG can provide a clearer picture on the efficient and effective use of public resources, while also improving the transparency and the social perceptions of the adequacy of the organizational conduct (Copley *et al.*, 1997). Consequently, the analysis of the responses regarding the fifth section of the questionnaire emphasises the importance of both technical and strategic reasons as pivotal elements supporting the decision to prepare CFS on a voluntary basis.

Additionally, findings show that size is significant at 0.05 level and the sign of the coefficient is negative, as expected. This result is coherent with that concerning the first variable (Tec\_index): the smaller the LG, the higher the technical difficulties (largely due to the lack of previous experience), the higher the likelihood to join the testing period on a voluntary basis.

As far as the financial variables (CR – CE; Tot\_debt) are concerned, only the last one regarding the level of indebtedness is statistically significant at 0.01 level. Finally, the political orientation and the geographical localization did not affect the voluntary adhesion to the experimentation.

## **5. Final thoughts**

The hypotheses of the research have been investigated according to both the institutional and the legitimacy theory (Guthrie and Parker, 1990; Deegan and Unermann, 2011, p. 322). The main aim was to explain the possibility to overlap technical difficulties, emulating practices used by other organizations perceived to be successful, to improve political consensus and the legitimacy of the LG towards citizens. The results show that both technical and strategic reasons have influenced the decision of the local politicians (supported by managers) to participate in the experimental period; moreover, findings show the relevance



of other variables, such as the size of the LGs and the financial and economic variables, expressed by the total debt.

This study has shed light on an issue that has not been investigated in depth; understanding why the reasons to participate in an experimental period was taken is of great interest, especially in the current scenario characterised by a wide international accounting harmonisation in the public sector. Therefore, even though the study has focused on a single country (which, in a way, can be considered as a limitation of the research), it provides practical suggestions that could be useful in other contexts.

Firstly, taking into account the technical complexity of the CFS and that this tool is not mandatory (or will be mandatory in the near future) in several countries, a pilot testing period could be a suitable path to follow in order to facilitate a gradual introduction of the CFS in the public sector. Findings from the study highlight the importance of the experimental period, which can allow LGs to achieve a greater knowledge of the accounting standards and the structure of the CFS, at the same time improving employees' skills.

Secondly, results emerging from the regression analysis highlight the relevance of both technical and strategic reasons.

Accordingly, in order to facilitate the implementation of the CFS, a central government could stimulate the aspiration of LGs to be "legitimate", namely to improve their political and managerial consensus towards citizens, as well as their willingness to conform to the institutional environment. In the same vein, a central government could provide technical assistance through ad-hoc training courses or preparing procedure manuals, firmly supporting the implementation of such a complex tool. Finally, feedbacks emerging from the experimental period could support the revision of both laws and public sector accounting standards concerning CFS.

# Chapter 5

## Summary and conclusions

The research project investigates the Consolidated Financial Statements (CFS) in the public sector context. When New public management (NPM) became a dominant approach, it established that markets and competition are the preferred way of delivering government services in the most efficient and effective way (Bryson et al. 2014); therefore, a change regarding the delivery of public services was observed. Public and private partnerships, corporatization, contracting out, agencies, privatization and decentralization were the preferred forms of public service management blurring the boundary between the public and private sectors (Osborne and Gaebler, 1992; OECD, 1993; Walsh, 1995; Lowndes and Skelcher, 1998; Lane, 2000; Hupe and Meijs, 2000, Pina and Torres, 2002). Thus, the corporatization and decentralization process has led to a great lack of information (Walsh, 1995). In fact, in this new complex structure, the traditional report of a single public sector entity does not consider subsidiaries, joint ventures and associates of the new group of entities. Therefore, the CFS present a clear picture of the current economic status of the whole interrelated group (Chow et al., 2007; Grossi and Newberry, 2009; Wise, 2010) providing better information for decision-making at all government levels (Chow et al., 2007), while at the same time showing what the internal and external accountability relationships are (Chan 2003). In particular, through the CFS, public sector entities can improve their “*management of the economy*” and processes of public accountability (Humphrey et al., 1993; Broadbent et al., 1996; Chan, 2003; Likierman, 2003; Carruthers, 2004; Chow et al., 2007).

At the beginning of the century, several countries prepared the CFS according to their own rules, or alternatively according to the International Public Sector Accounting Standards (IPSAS) in order to facilitate international harmonization. However, public sector accounting has been influenced by the private sector (Guthrie, 1998; Chan, 2003; Carlin, 2005; Pina et al., 2009). Private sector methods and practices have been implemented in the public sector without any thorough analysis of its objectives and characteristics (Ellwood and Newberry, 2007; Robb and Newberry, 2007). The theoretical foundation of financial consolidation in the public sector therefore needs to be more thoroughly investigated, and ad hoc perspectives, scopes, and methods should be explored in order to appropriately consolidate all the decentralized entities (Wise, 2010).

It is worth noting the academic literature on public sector CFS developed by accounting and public management scholars in the last decade, investigating both countries that implemented the CFS several years ago, and countries that have implemented (or are going to implement) this tool more recently. The move towards the decentralization of services, coupled with a general aim to improve efficiency and effectiveness of the public sector entities (Chow et al., 2007) has progressively enhanced the role of the CFS. As a matter of fact, the CFS present a clear picture of the current economic status of the whole group (Chow et al., 2007; Grossi and Newberry, 2009; Wise, 2010) of all the entities controlled by a public sector entity at every level as for the Whole of Government Account. Previous scholars have concentrated mainly on the following issues, the consolidation area, the convergence between accounting and statistic rules, the dichotomy between the private and the public sector accounting standards, as well as the usefulness of the CFS.

The thesis aimed to investigate the development of the CFS in the public sector, contributing to the ongoing theoretical and practical debate regarding two primary issues: i)

assess the adequacy of the control approach for the definition of the reporting's boundaries;

ii) taking into account that the CFS in several countries are not mandatory, understand the reasons why a certain public sector entity decide to voluntarily implement the CFS.

The use of the control approach for the determination of consolidation area is the main issue under debate. As argued in the previous chapters, this is not a mere technical problem; it is linked to the role CFS are supposed to play, which in turn relates to the accountability reasons or the decision-making reasons. Accordingly, the main problematic issue is the definition of the aim of CFS and hence appropriate criteria concerning the consolidation boundaries (Heald and Georgiou, 2000; Robb and Newberry, 2007; Tagesson, 2009; Walker 2009). The control approach is based on private sector accounting standards; accordingly, current literature has pointed out how the private sector methodologies and practices have been adopted in the public sector in an uncritical way, sometimes without a thorough analysis of the objectives and characteristics of the public sector (Christiaens, 2002). However, the IPSASB recently issued new Exposure Drafts (subsequently approved) defining the new IPSAS 35, *Consolidated Financial Statements*, which replaced the previous IPSAS 6, *Consolidated Financial Statements – Accounting for Controlled Entities*. This Exposure Draft (ED no. 49) proposed several questions, with the most important one referring to the implementation of the control approach. Therefore, in order to contribute to the ongoing debate, the comment letters regarding these crucial questions were investigated. ED no. 49 defines the consolidation area and the basic concept of control by referring to “power” and “benefits,” which in turn incline toward a decision-making process (as in the IFRS 10, to which the ED no. 49 substantially aligns). As the IPSASB stated, the alternative budget approach criteria, which puts emphasis on the accountability reasons, is not appropriate for general-purpose financial reporting. The main results of this step of the research demonstrate that the respondents

largely agree with the IPSASB approach. However, some other specifications should be considered such as a clear identification of the reporting entity as well as a more precise specification of some exceptions to the consolidation of all the controlled entities. Therefore, the different aims of the CFS determine the type of information to include in the tool and hence what the entities include in the consolidation area. Accordingly, if the aim of the CFS is to provide a global picture of the financial circumstances of a nation, producing information to politics and media, a consistent approach is to “consolidate” state and local governments, focusing on budgets and their results: arguably, CFS should include entities that are completely or substantially funded by public money and exercise functions of a public nature, according to the budgetary approach. Furthermore, the relationship with the statistical perspective should be investigated. On the other hand, if the aim of the CFS is to give information to the management of public sector entities (PSEs) as well as citizens about the way of providing services, the focus should be on a consolidation area that includes this PSE and all its controlled entities through which these services are provided. There is room for defining control, power, and benefits, taking into account the context (public sector) within which they have to be applied. Overall, the operationalization of the control approach could imply significant difficulties (Brusca and Montesinos, 2009) due to both the complex structure of the public sector and the heterogeneity of forms of “controlled” (i.e., decentralized) entities, such as governmental business enterprises, foundations, institutions. However, the CFS should aim to support politicians and managers as well as other stakeholders in evaluating the performance of public sector entities providing a complete picture of how public resources are managed. Therefore, the CFS could be prepared according to either the budgetary or control approach, which in turn, at least implicitly, refer to a theory of consolidation as well as to the underlying accountability or decision-making reasons. From this perspective, both

the Basis for conclusions (BC 10) of the ED no. 49 explicitly points out and the IPSASB Conceptual Framework (Chapter 2) states that the objective of financial reporting is to provide information that is useful for both accountability and decision-making purposes (IPSASB, 2014).

The literature review has revealed, among other aspects, that certain countries have implemented the CFS even though they were not obliged to do so. Accordingly, the fourth chapter focused on why either a central or local government should decide to voluntarily implement the tool.

The international scenario is varied. Countries such as Australia, Chile, New Zealand, Sweden, and USA have implemented the CFS for quite a time (Grossi and Pepe, 2009). Other countries, however, are currently planning to implement the CFS (Bergmann et al., 2016). In the 1980s, Sweden voluntarily introduced consolidated financial statements to municipalities and local governments; subsequently, in 1992, the CFS became mandatory (Tagesson and Grossi, 2012). In the same year, the New Zealand government became the first sovereign government to publish financial reports for the whole of the central government (Newberry, 2011). However, in several countries, the CFS are not still mandatory. The final step of this research investigates the reasons at the basis of voluntarily implementing CFS by central or local governments. The nature and drivers of public sector reporting are different in every country and the historical, political and social features of the context determine the development of the rules to follow. Different countries give different importance to this tool. The main aim of the CFS or WGA is to provide a clear and complete picture of the overall financial position of the government. Accordingly, disclosing more information could mean that central or local governments attempt to legitimize their behavior and practices towards the general public, having potential legitimacy motivation and benefits. Alternatively, the

voluntary implementation can be considered as a signal of conformity with shared norms of rationality and progress, which are promoted by the ongoing reform processes, namely principles of performance improvements and the accountability towards citizens already present in some countries. Hence, the hypotheses of this last step of the research have been investigated according to both institutional and legitimacy theory (Guthrie and Parker, 1990; Deegan and Unermann, 2011, p. 322). From an empirical point of view, the last chapter focuses on the Italian context. Recently, legislative decree 118/2011 established new accounting rules leading to a new modified cash accounting system in correlation with accrual reporting (Manes-Rossi, 2015), while at the same time requiring the preparation of CFS. More specifically, the decree defines an experimental period during which the local governments (LGs) can decide to adhere to preparing the CFS. The findings show that both technical and strategic reasons have influenced the decision of the local politicians (supported by managers) to participate in the experimental period; moreover, other variables, such as the size of the LGs and the total indebtedness, are also relevant. In sum, this study has shed light on an issue that has not been investigated in depth. Therefore, even though this last step has focused on a single country, it provides practical suggestions that could be useful in other contexts: the experimental period is very useful in testing a new accounting system of a complex accounting tool such as the CFS, helping LGs to overcome some technical issues. In fact, taking into account the technical complexity of the CFS and that this tool is not mandatory (or will be mandatory in the near future) in several countries, a pilot testing period could be a suitable path to follow in order to facilitate a gradual introduction of the CFS in the public sector. Hence, the experimental period can allow LGs to achieve a greater knowledge of the accounting standards and the structure of the CFS, at the same time improving employee skills. A central government could also provide technical assistance through ad-hoc training

courses or preparing procedure manuals, firmly supporting the implementation of such a complex tool.

Additionally, the research reveals another reason for implementing the tool: in order to facilitate the implementation of the CFS, a central government could stimulate the aspiration of LGs to be “legitimate”. In fact, the use of the CFS when they are not mandatory highlights that the public sector follows rules of transparency and integrity. These rules can improve the legitimation that citizens have in the government and therefore politicians and managers can increase public consensus.

Finally, feedback from the experimental period could support the revision of both laws and public sector accounting standards concerning CFS.

For the future, it would be interesting to investigate the effects of the testing period when the CFS is mandatory, in order to understand if this period has been useful in solving the technical issues. Moreover, it would be interesting to compare contexts (such as the Italian one) where CFS have been adopted only recently, with countries where CFS have been in use for many years (such Sweden, UK, Australia and New Zealand), with the purpose of evaluating if CFS sustain the decision-making processes of politicians and managers.

In conclusion, this research project has showed the development of the CFS in the public sector, investigating two aspects. The first is the use of the control approach already discussed in current literature; however, this study supports the positive use of the budgetary approach as a future direction. The second issue concerns the reasons why a central or a local government decide to implement CFS on a voluntary basis.

However, the implementation of the CFS in the public sector is quite recent, in comparison with the long tradition of this accounting tool in the private sector. Therefore, the above-



mentioned issues, as well as others, are expected to be further investigated due to the growing diffusion of the CFS in the public sector. New problems are expected to rise from the growing implementation of the CFS in different contexts, requiring appropriate responses on both a theoretical and methodological level. As it continues to become more widespread, new questions will need to be answered: Will the role of the CFS change as they become more popular? Will the CFS assume a relevant role in supporting the decision-making processes of internal (politicians, managers, auditors, etc.) as well as external users (financial institutions, rating agencies, etc.)? These questions are just examples of the many relevant problems that can be investigated in the future. Researchers who are experts in many areas that directly apply to the CFS research, from both accounting and managerial perspectives, can provide insights into these questions. For example, researchers who are experts in analyzing financial statements and financial performance can contribute to refining the understanding of the basic accounting figures expressed by the CFS. In addition, researchers with expertise in evaluating the disclosure level, which is expected to gain importance as the CFS become more popular, can enhance the understanding on the disclosure determinants concerning the public sector CFS. Furthermore, researchers with expertise in decision-making processes and tools supporting strategic decisions can shed light on the use of the CFS and the usefulness for internal and external stakeholders of governments. In addition, researchers with experience in auditing and assurance can help to understand if there is room for adopting standardized rules. These are all critical areas of the future of the public sector CFS research, that represent stimulating challenges.

# Appendix A

## Questionnaire



### Università degli Studi di Salerno

Dipartimento di Scienze Aziendali - Management & Innovation Systems

### Kristianstad University (Svezia)

## Questionario in merito alla redazione del bilancio consolidato - D.Lgs 118/2011 e successive modificazioni

L'Università degli Studi di Salerno in collaborazione con l'Università di Kristianstad (Svezia) sta conducendo un'indagine volta a verificare il grado di partecipazione dei Comuni Italiani alla redazione del bilancio consolidato così come prevista dalla sperimentazione contabile di cui all'articolo 36, del decreto legislativo 23 giugno 2011, n. 118 (e successive modificazioni).

Lo studio intende analizzare i motivi di adesione alla sperimentazione e le eventuali criticità sorte nella redazione del bilancio consolidato.

I risultati della suddetta indagine saranno analizzati in maniera aggregata ed è pertanto garantito l'anonimato.

La durata media del questionario è di circa 5 - 8 minuti.

La ringraziamo preventivamente per la sua collaborazione.

### Sezione 1: Anagrafica

1.1 Nome dell'Ente: \_\_\_\_\_

1.2 Provincia e Regione: \_\_\_\_\_

1.3 Numero di abitanti:

- a) Tra 5.000 e 20.000
- b) Tra 20.000 e 40.000
- c) Tra 40.000 e 100.000
- d) Oltre 100.000

#### 1.4 Profilo del compilatore:

- a) Sindaco
- b) Assessore al Bilancio
- c) Segretario/Direttore generale
- d) Responsabile del Servizio finanziario

### Sezione 2. Adesione alla sperimentazione

#### 2.1 L'ente ha partecipato alla sperimentazione:

- a) come campione individuato dal Ministero
- b) su base volontaria

#### 2.2 L'ente ha deciso di partecipare alla sperimentazione dall'anno:

- a) 2013
- b) 2014
- c) 2015

#### 2.3 L'ente ha redatto il bilancio consolidato come previsto dalla sperimentazione:

- a) si  (andare alla domanda 2.5)
- b) no  (rispondere alla domanda 2.4 e terminare il questionario)

#### 2.4 In caso di risposta negativa, quali sono le motivazioni?

- a) L'ente era esonerato
- b) Non vi erano enti o società oggetto di consolidamento
- c) Altro (specificare)

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### Sezione 3. Redazione Bilancio Consolidato

#### 3.1 L'ente ha redatto il bilancio consolidato nell'anno (fino a 3 risposte):

- a) 2013
- b) 2014
- c) 2015

#### 3.2 L'ente ha pubblicato il bilancio consolidato nell'anno: (fino a 3 risposte)

- a) 2013
- b) 2014
- c) 2015
- d) mai

### Sezione 4: Nella redazione del bilancio consolidato, le difficoltà tecniche più rilevanti sono state:

	<i>Fortemente d'accordo</i>	<i>D'accordo</i>	<i>Parzialmente e in accordo</i>	<i>Parzialmente e in disaccordo</i>	<i>Disaccordo</i>	<i>Fortemente in disaccordo</i>
<i>Le difficoltà tecniche più rilevanti sono state:</i>						
<b>4.1</b> la definizione del gruppo pubblico locale						
<b>4.2</b> l'individuazione dei casi di esonero per irrilevanza						
<b>4.3</b> mancanza di esperienze significative da considerare come esempi						
<b>4.4</b> l'individuazione dei casi di esonero per difficoltà nel reperire le informazioni necessarie al consolidamento						
<b>4.5</b> difficoltà interpretative delle norme e/o principi contabili						
<b>4.6</b> l'omogeneizzazione dei bilanci degli enti e delle società inserite nel bilancio consolidato						

4.7 l'eliminazione delle operazioni infra-gruppo						
4.8 l'identificazione delle quote di pertinenza di terzi						
4.9 la predisposizione della nota integrativa						
4.10 la definizione del manuale operativo per la redazione del bilancio consolidato						

**Sezione 5: l'Ente locale ha aderito alla sperimentazione e ha predisposto il bilancio consolidato:**

*Esprima il suo grado di accordo rispetto alle seguenti affermazioni*

<i>L'ente locale ha aderito alla sperimentazione e ha predisposto il bilancio consolidato:</i>	<i>Fortemente d'accordo</i>	<i>D'accordo</i>	<i>Parzialmente e in accordo</i>	<i>Parzialmente e in disaccordo</i>	<i>Disaccordo</i>	<i>Fortemente in disaccordo</i>
5.1 per volontà del Sindaco						
5.2 per volontà di tutta la Giunta						
5.3 per volontà del Consiglio comunale						
5.4 per volontà dell'Assessore al Bilancio						
5.5 per volontà del Segretario/Direttore generale						
5.6 per volontà del Responsabile del Servizio finanziario						
5.7 per ricevere gli incentivi previsti dalla normativa						
5.8 per acquisire visibilità nei confronti del Ministero						
5.9 per acquisire la fiducia dei cittadini						
5.10 per migliorare la trasparenza						
5.11 per consentire una migliore valutazione dell'efficienza e dell'efficacia nell'utilizzo delle risorse						
5.12 per valutare la chiarezza e la comprensibilità delle nuove norme e dei principi contabili						
5.13 per valutare le difficoltà di definizione del gruppo pubblico locale						
5.14 per valutare le difficoltà tecniche di predisposizione del bilancio consolidato						
5.15 per migliorare le competenze del personale						
5.16 per acquisire familiarità con i nuovi schemi di bilancio						
5.17 per valutare l'adeguatezza del software di contabilità						

*La ringraziamo per la sua gentile collaborazione*



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