The Consolidated Financial Statement: Are Ipsas And National Accounting Standards Comparable? The Turin City Council Case.

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Abstract

The research is to examine the accounting process for the consolidated financial statement of public sector with the comparison of Ipsas and the National Accounting System to discover their comparability. The Italian consolidated financial statement is regulated by the Annex 4 of the Prime Ministerial Decree 28/12/2011; Accounting Standard 4 – public accounting observatory which only gives some regulatory indications and is not regulated by law; International Accounting Standards, Ipsas 6,7, and 8, were not transposed in the Italian legal order: this is also demonstrated by the fact that not always Ipsas orientation corresponds to the Italian Accounting Standard orientation. Are they comparable? To answer the question this paper focuses on the determination of the consolidation area, as can be seen the criteria decided by national accounting standard are different from Ipsas one.

Keywords: International Public Sector Accounting Standard (Ipsas), Consolidated Financial Statements, Control of Public Finance, national accounting standards

Purpose

The aim of the research is to examine the accounting process for the consolidated financial statement of public sector with the comparison of Ipsas and the National Accounting System to discover their comparability.
In particular, the study will focus on:

- The evolution of the accounting practices about the consolidated financial statement of public sector;
- The comparison between Ipsas 6, 7, 8 and the Italian Accounting Systems.

Design/Methodology/Approach

We propose the following approach:

- A doctrinal evaluation on the public local group;
- An International Accounting Standard's analysis (Ipsas 6, 7, 8) on the consolidated financial statement of the public local group;
- A National Accounting Standard's analysis on the consolidated financial statement of the public local group;
- A comparison between the National and the International (Ipsas 6, 7, 8) Accounting Standard;
- The practical effects of the different national and international (Ipsas 6, 7, 8), Accounting Standard applied to the Turin City council case, specifically in determining the consolidation area

The method

The present research uses a mixed approach:
- Quantitative, starting from annual state-owned enterprise and its subsidiaries financial statements , and
- Qualitative, referring to the analysis of the consolidated financial statement implications on the management control and the programming of the public local group.

The sample (universe)

The TurinCity council and its subsidiary ies.

Originality/value

This research aims at analyze the Italian Accounting Principle and Ipsas relating to the consolidated financial statement, in order to define homogeneity and differences, also through the practical analysis of a real case.

Introduction

Company can be rationally analyzed and classified in several respects "this classification can be made in regard to the enterprise different aim, the different condition of the rights and obligations' subject, the different establishment of the administrative body than its two highest organs, and finally, the administrative work various extent"[1].

Classification categories are based on "Sources and uses" process certification of capital accumulation with a distinction between the two main categories:

1) Companies, "where the wealth is the object, the means and the purpose, therefore, those that care about the use of capital in the wealth generation";
2) Enterprises, where "the wealth is only the means".

Starting from this classification and using the singular "wealth generation" standard with a nature analytical classification of capital between sources and uses, it is possible to define some second level business class characteristics in which differentiated administrative mechanisms are reflected more specifically. This classification highlights "sources" and "uses" types that are in all companies and therefore that represent a common trait of each company.

It is possible to classify two groups of companies according to these differences (Table 1). This identity leads to different definitions of business legal form starting from significant and structural evaluation of business processes.

Table 1. Shows capital accumulation / redistribution processes in different companies[2].

Manufacturing Enterprise			**Consumer Enterprise**	
Company types / **Sources/Uses**	**Enterprise**	**Cooperative Enterprise**	**State-owned enterprise**[3]	**Non-profit Enterprise**
a) Capitalaccumulation sources:				
1a) Capital stock / endowment fund	YES[4]	YES[5]	NO	YES [6]
2a) Market Revenues	YES	YES	NO	NO/YES
3a) Taxation tributes	NO	NO	YES	NO
4a) third party contributions without payment	YES	YES	YES	YES
5a) Asset Disposals	YES	YES	YES	YES
6a) Debts	YES	YES	YES	YES
b) Capital Uses:				
1b) Share capital / endowment fund remuneration / repayment	YES	YES [7]	NO	NO
2-3-4b) Ownership Costs	YES	YES [8]	YES	YES
5b) Capital Assets	YES	YES	YES	YES
6b) Debt Repayment	YES	YES	YES	YES

A state - owned enterprise is characterized by carrying out public business processes aimed at satisfying the capital redistribution and not the capital accumulation.

[1] Fabio Besta, accounting professor (1909-1916).
[2]Source:Puddu L (2010)
[3] Institution.
[4] Whole share capital through income accumulation.
[5]With a maximum per member and per capital voting.
[6]Endowment fund to be used for institution purposes.
[7]With limit and indivisible reserves.
[8] Member repayment.

Private, public and mixed companies are controlled by a local enterprise. They all belong to a local group which has three distinctive elements:

- *a public economic entity*, although there could be a private entity with a significant rule; particularly there can be an individual entity or a Commons' alliance or other institutions' alliance that share production equipment of public utilities due to territorial and political features;
- *more different legal entities*, since a public group is ordinarily composed by private companies and state-owned enterprises;
- *a unified economic and strategic direction*, typical in every kind of group but in this case is supported by economic and strategic decisions related to the local enterprise public function.

The state – owned enterprise can operate directly or by means of other specialized enterprise, that are linked up by interdependent governance relationship.
This outline allows to identify a "financial equity holdings" system that can be:

1) Equity holding with equity holding securities (share);
2) Equity holding without equity holding securities.

A state – owned enterprise having equity holding securities is the holder of an ownership title that keeps its exchange value and then represents a real business asset.
This includes, for example, state – owned enterprise equity holdings in other limited companies that are traditionally engaged in public services (public transports, energy, water etc..).

The state – owned enterprise without equity holding securities is the holder of the governance (the nomination of director, auditors, statutory auditors etc…) but does not have a property exchange right or a contingent settlement. This includes, for examples, endowment fund contributions in different entities like associations, foundations, committees and consortia. These equity holdings miss their exchange value and do not have a strictly economic value, nevertheless, they can be classified as assets in the balance sheet. This is possible referring to a wider notion of economic value, thereby valuing both a legal and instrumental equity holdings use that see oneself in:

a) "legal use" in governing and controlling through appointing governance related subjects of the partially owned company (directors, auditors, etc…).
Furthermore this relationship is the reason that justifies additional grants' provision needed to cover the partially owned company management (association, foundation etc…);
b) "instrumental use" related to a business that is still engaged on public needs satisfaction (culture, sport etc…), but it is carrying out by third party companies.

The equity holding endowment fund without equity holding securities has both the "legal relationship" features and it is "assessment susceptible": the required characters by Italian law, denominated Tuel[9] article 230, paragraph 2 to define local authorities assets.

Moreover in the state – owned enterprise financial statement another asset has not an "exchange value" that is represented by the "state property", that are included in the asset balance sheet (art. 230 comma 3), with a simultaneous registration of an equity not available reserve called "net state properties". It can be gather that equity holdings in the endowment fund without equity holding securities can have a proper representation both in the financial fixed assets and in the net assets as a not available reserve.

Discussion

The Italian consolidated financial statement is regulated by the following accounting standards (Table 2):

- Annex 4 of the Prime Ministerial Decree 28/12/2011;
- Accounting Standard 4 – public accounting observatory which only gives some regulatory indicationsand is not regulated by law;
- International Accounting Standards, Ipsas 6,7, and 8, were not transposed in the Italian legal order: this is also demonstrated by the fact that not always Ipsas orientation corresponds to the Italian Accounting Standard orientation.

[9]Particularly, TUEL art. 230 comma 2, specifylocalauthoritiesequityas "(…) *complesso dei beni e dei rapporti giuridici, attivi e passivi, di pertinenza di ciascun ente suscettibili di valutazione e attraverso la cui rappresentazione contabile e il relativo risultato finale differenziale è determinata la consistenza netta della dotazione patrimoniale*".

Table 2. Accounting standards for the consolidated financial statement.

	Annex 4	**AS 4**	**IPSAS**
Consolidation Area	Significance	All subsidiaries	Benefit/control
Line by line method	Subsidiaries	Subsidiaries	Subsidiaries
Equitymethod	No	Associated	Associated
Proportionalmethod	Associated	Optional	Joint Venture
Additionaldisclosures	Yes	Yes	No
Outsourcing	Yes	No	No

This paper focuses on the determination of the consolidation area: as can be seenthe criteria decided by national accounting standard are different from Ipsas one.
With specific regard to the Accounting Standard 4 of the Acconting Observatory, the first to be issued in Italy and then replaced by Annex 4, it sets all the subsidiaries, profit or non profit,to be included in the consolidation area.

It is therefore necessary, in order tounderstand wich kind of entity can be controlled by the local autority and what is the meaning of the word “control”.

For this purpose it wonders if the criteria identified in art. 2359 civil code combined with the article 26 of the Legislative Decree n. 127/1991, the IAS 27 and the SIC 12are appropriate.
In terms of civil law pursuant to art. 2359, the following are considered controlled companies:

- Companies for which another company holds the majority of the voting rights exercisable in the ordinary shareholders meeting (so – called law situation);
- Company in which another company holds sufficient voting rights in order to exercise a leading influence in the ordinary shareholders meeting (actual situation);
- Company under the dominant influence of another company as a consequence of a specific contractual obligations (contractual situation).

In particular the article 26 of the Legislative Decree n. 127/1991 modified the contractual control criteria identifying it with a legal meaning referring to circumstances in which law, articles of association and shareholders agreements allow the holding company to appoint the directors majority.
In any case the definition is quite wide and includes all the situations in which a company has a dominant inluence, on the partially owned company, achieving a real appointment and orientation.
Our purpose is to identify the consolidation area of the public local group, which presents a lack in the regulation because not properly faced in a particular circumstance even if it frequently occurs in local authorities.

Infact, occur very often circumstances in which a city councildoes notexercise an appointment or do not owns a stakebut is interested in that particular authority. In this specific case, the privite approach limit is trying to identify a control relationship as an ownershiptaking no notice of the social responsibility which is innate in the local authority nature.

For example, the City Theater often takes a foundation legal form and it has a strong independence from the city council that often do not have the appointment of directors (or better the majority of them).

The Accounting Standard 4 of the Acconting Observatory 4 then decides to comment extensively the meaning of the term “group”: the consolidated financial statement of the Local Authority Group has to include all the local authority’s subsidiaries not considering their legal form among whichlimited companies, special companies and other controlled organizations. The consolidated financial statement is drawn up by the controlling local authority in line with the planning of the group. Indeed, the scope of the consolidated financial statement has to be early defined.

Substantially, according to the Accounting Standard 4 of the Acconting Observatory it “may” - and not “must” – include in the consolidation area also the companies for which there are no de jure or de fact requirements but which are qualified as “controlled companies” by an assumption of responsibility of the local authority.

Annex 4 introduces the significant criteria: all the relevant partially owned companies has to be included in the consolidation area.

The definition of the public administration group refers to a ”de jure”, “de facto” and “contractual”control criteria even when a local company has not direct or indirect stakes in the controlled companies’ equity and to an equity holding criteria.
The members of the “ public administration group” are:

1) The instrumental bodies of the parent public administration (hereinafter also “PPA”) as defined in Art. 20 of the present Decree, represent its organizational structure and, therefore, are already included in the financial statements of the Public Administrations;
2) The instrumental entities of the Public Sector, represented by public and private entities and companies for which the Public Administrations:
    a) owns, directly or indirectly, the majority of the voting power in the entity or company;
    b) has the powers assigned in law, articles of associations or agreement to appoint or remove the majority of the governing bodies members, in charge to define the strategic decisions and the sector policies, as well as to decide the strategic planning and programming activities of that entity or company;
    c) exercise, directly or indirectly the majority of the voting rights at governing bodies’ meetings, in charge to define the strategic decisions and the sector policies, as well as to decide the strategic, planning and programming activities of that entity or company;
    d) has the obligation to make up the deficits in the circumstances permitted by law, for percentages higher to the stake;
    e) exercises a dominant influence by virtue of contracts or statutory provisions, in circumstances in which law allows such contracts or statutory provisions. The public service and grant contracts agreements stipulated with entities or companies which mainly perform the activities covered by those contracts require a dominant influence;
3) Companies controlled by the Public Administrations, for which the parent company:
    a) owns, directly or indirectly, also on the basis of shareholders' agreements, the majority of voting rights at routine assembly or has sufficient votes to exercise a dominant influence at the routine assembly;
    b) has the right, by virtue of a contract or a statutory provision, to exercise a dominant influence when the law allows such contracts or statutory provisions. The public service and grant contracts agreements stipulated with companies who mainly perform the activity covered by those contracts require a dominant influence;
4) The partially owned companies of the Public Administrations, represented by totally state- owned enterprises direct foster of local public services of the region or of the local authority regardless of the participation fee. Based on the testing results the definition of subsidiary can be extended to companies in which the region or the local authority, directly or indirectly, has a significant share of votes at the general meeting, at or above 20 percent, or 10 per cent in the case of a listed company.

With regard to the inclusion into the public administration group does not notice the legal form or the nature of the activities performed.

The group can also include intermediate groups of public authorities and companies.
In such a case the consolidated financial statement is drawn up including the consolidated financial statements of the intermediate groups.

The authorities and companies of the group included at the above point 1 may not be included at point 2 in case of:

a) Irrelevance, when a company’s financial statement is not relevant for the purpose of giving a true and fair representation of the assets and liabilities, of the financial position and of the profit (loss) of the group’s financial year. The financial statement that present for each of the following parameters an effect of less than 10 per cent for local authorities and 5 per cent for Regions and Independent Provinces if compared with the parent company assets, liabilities and financial positions:

- Total Assets;
- Equity;
- Total ordinary Revenues;

b) Inability to find the information needed for the consolidation process in a reasonable time and without excessive expenses. In this case the exclusions from the consolidation area are extremely limited and related to extraordinary events (earthquakes, floods, and other natural disasters).
   However, Ipsas 6 introduces the authority/benefit concept (Figure 1):

- POWER: the right to govern the financial and operating policies of other economic entity;
- BENEFIT: parent entity's ability to obtain benefits from the activity of the controlled entity.

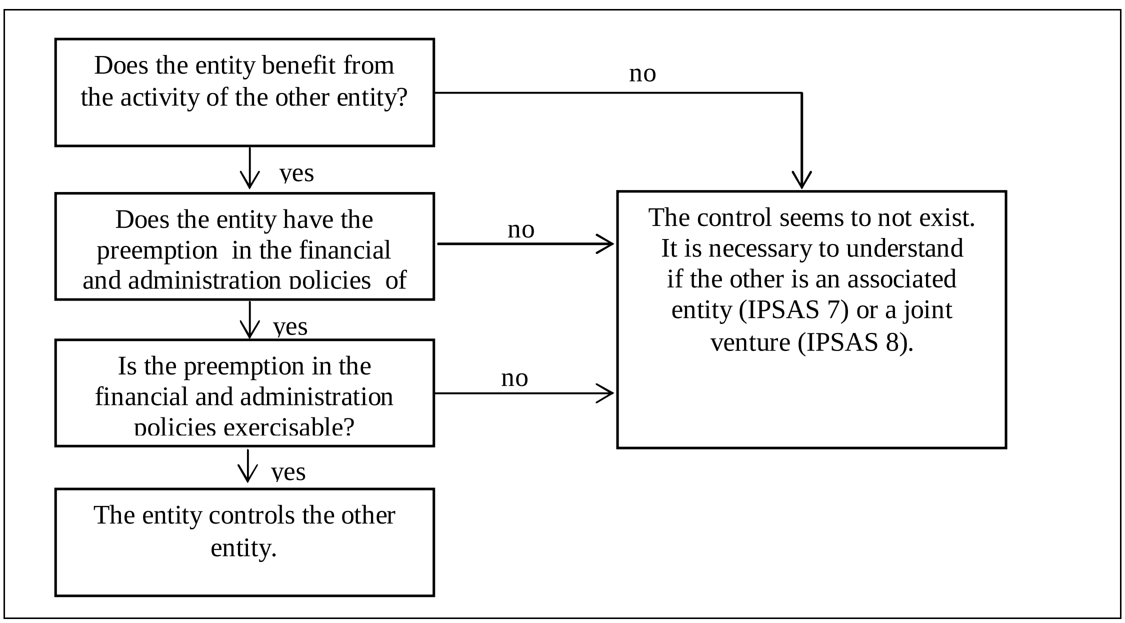
Power Conditions

- The state – owned enterprise has directly or indirectly through controlled entities, the ownership of a majority voting interest in the other entity;
- The state - owned enterprise has the power, either granted by or exercised within existing legislation to appoint or remove the majority of the members of the board of directors of the other entity;
- The state – owned enterprise has the power to cast the majority of the votes at a general meeting of the other entity.
  The state – owned enterprise has the power to cast the majority of the votes at a board of directors of the other entity.

Benefit Conditions

- The state – owned enterprise has the power to dissolve the other entity and obtain a significant level of the residual economic benefits or bear significant obligations;
- The stated – owned enterprise has the power to extract distributions of assets from the other entity.

Figure 1.



Therefore IPSAS application entail the exclusion of non-profit subsidiaries in which power/benefit conditions are not observed. This leads to a significant change in the consolidation area of the public local group with evident impact on the group's performance in the consolidated financial statement. This is better demonstrated in the Turin City council case. The Turin City council experience is represented by the creation of public services through a complex system of corporations, foundations, institutions and associations. Over the past 10 years the Turin City council has effectively intensified the outsourcing of many services using directly local public services with an economic interest.

The TurinCity council group includes about thirty directly partially owned companies and several foundations, institutions and associations and it has gradually expanded itself to include corporate and not corporate bodies that are engaged in different sectors and in which the city council itself has a different equity holdings percentage depending on the opportunity choices made.

For the purpose of drawing up the Consolidated Financial Statement of the Turin City councilits partially owned companies' group has been divided in two categories, one consisting of companies and the other one consisting of foundations, institutions and associations.

In determining the consolidation area it is required to carefully reflect on the above mentioned control and governance aspects and also on the relevance of the activity for the local area and for the local parent company. For example the contributions paid by the state – owned parent company are a relevant indicator. Furthermore the possibility of choosing the partially owned company employees is considered another element of relevance.

The figures below show the consolidation area pursuant to IPSAS (Figure 2) and the consolidation area pursuant to the National Accounting Standard - Annex 4 (Figure 3).

Figure 2. Accounting standards for the consolidated financial statement[10].

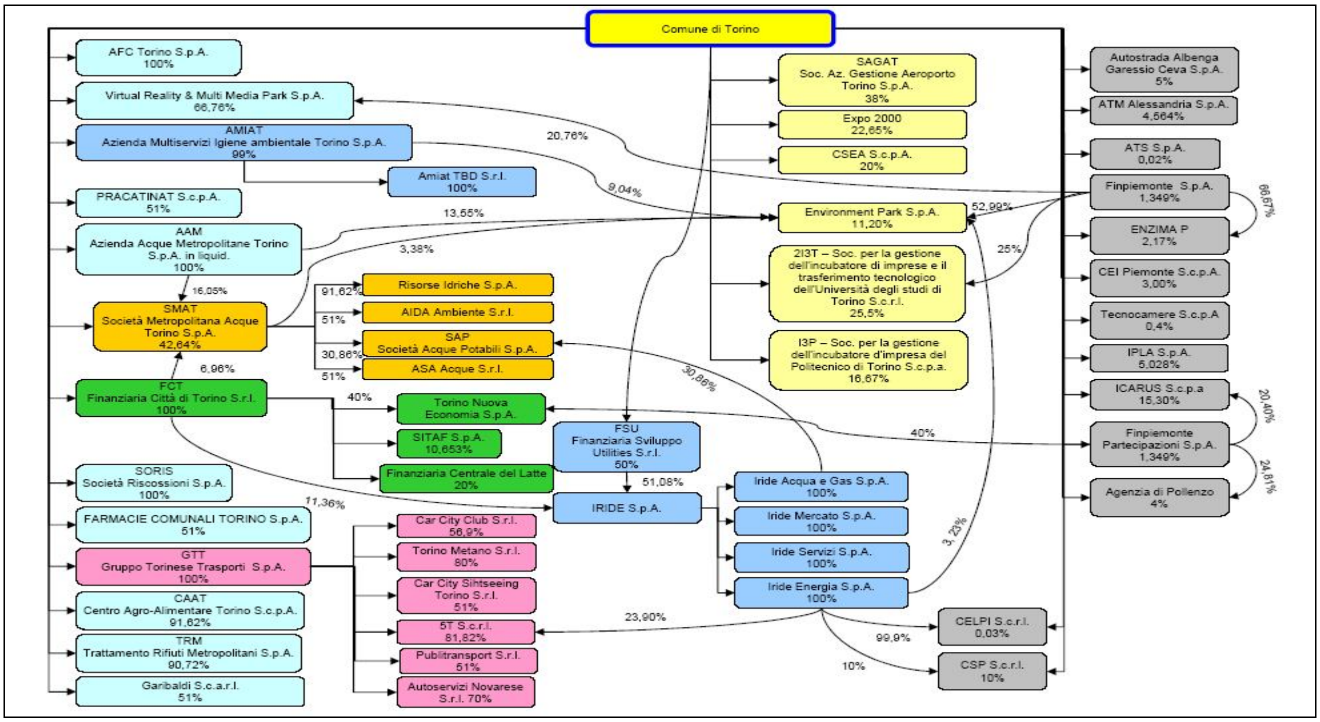


Figure 3. Accounting standards for the consolidated financial statement[11].

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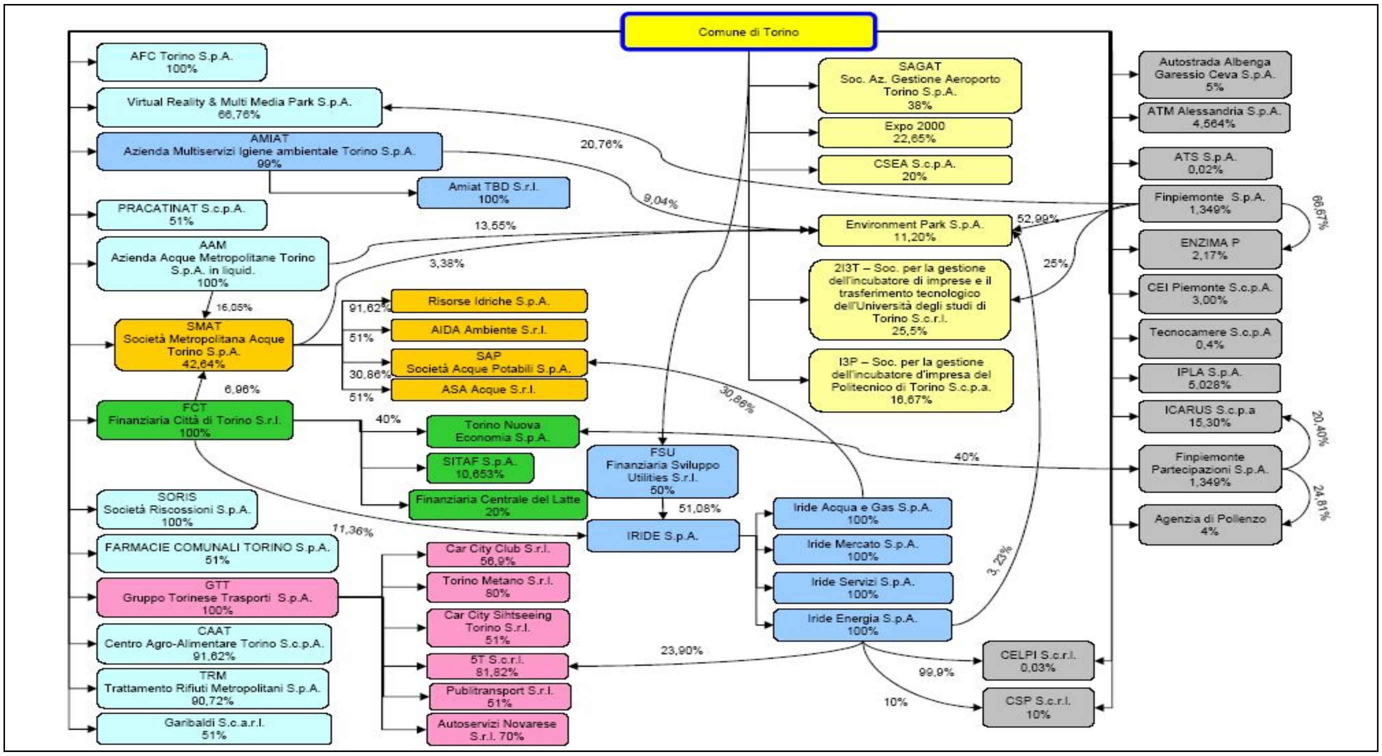
[10] Source: Department of Management, University of Turin.

[11] Source: Department of Management, University of Turin.



The Universe of Non Profit Organizations and the criteria used to determine the consolidation area:

- Non-profit partially owned organizations in different ways by the City of Turin: approximately 70;
- Non-profit organizations to consolidate: 14.

Significance criteria used for the identification of the scope of consolidation:

- Majority in the Board of Directors;
- Annual fee paid by the City of Turin at least equal to € 500.000.

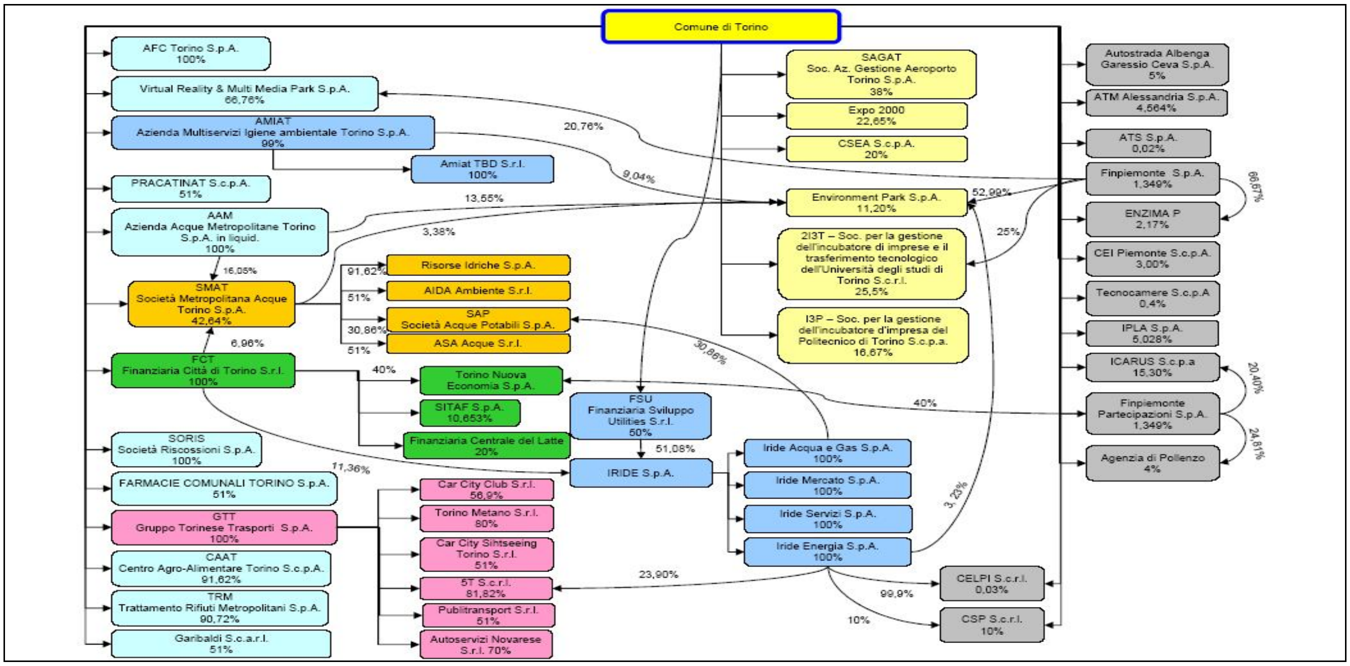
In more details (Table 3).

Table 3.

SECTOR	NON PROFIT CONSOLIDATED
CULTURE AND SHOW	COMITATO ITALIA 150
	FONDAZIONE 20 MARZO 2006 - TOP
	FONDAZIONE FILM COMMISSION TORINO - PIEMONTE
	FONDAZIONE MUSEO DELLE ANTICHITA' EGIZIE
	FONDAZIONE PER IL LIBRO, LA MUSICA E LA CULTURA
	FONDAZIONE PER LE ATTIVITA' MUSICALI ONLUS
	FONDAZIONE PROLO - MUSEO NAZIONALE DEL CINEMA
	FONDAZIONE TEATRO REGIO DI TORINO
	FONDAZIONE TEATRO STABILE DI TORINO
	FONDAZIONE TORINO MUSEI
RISEARCH	FONDAZIONE TORINO WIRELESS
ENVIRONMENT	AGENZIA ENERGIA E AMBIENTE TORINO
	COMITATO URBAN 2
TOURISM	AGENZIA TURISMO TORINO E PROVINCIA

The figure below shows the consolidation area pursuant to the 4 Observatory Accounting Standard (Figure 4).

Figure 4. Accounting standards for the consolidated financial statement[12].



Conclusions

National and International Accounting Standards show, therefore, different aspects, but integrated in order to provide a consolidated informative, representative of the local public group, composed at the same time of heterogeneous reality, public company, profit and non-profit companies.

Future Tasks for the Research

More in particular, it is important to proceed with a comparison between the national and international Accounting Standards for the local public group's consolidated financial statements about:

- Consolidation method
- Disclosures.

[12]Source: Department of Management, University of Turin.

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