The Reporting Entity Concept in the Public Consolidated Financial Statement

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Abstract

The need to quantify and control public spending of local government has highlighted the evident limits of separate financial reports that do not reflect the public sector as a whole. The public consolidated financial statement (CFS) could overcome these limits. By comparing the reporting entity concept among the main accepted international accounting standard systems and according to the accounting regulation theoretical framework, the paper aims to examine the application of the new Italian accounting standard on the CFS. The research highlights two critical aspects: the first is that the Italian proposal is far from that of the accepted international accounting standards, as it is mostly focused on bureaucratic control rather than on an informational role for the external users; the second is that the objectives assigned to the CFS in the Italian regulation are not fully coherent with the accounting standard criteria to define the reporting entity.

Keywords: Accounting Harmonisation, Public Consolidated Financial Statement, Financial Accountability, Local Government Group, Reporting entity

1. Introduction

In a context of increasingly scarce financial resources (Bracci et al.,2015; Heald et al., 2015), debates are emerging on the debt management of local government in a broad sense, comprising both local authorities and the many entities operating under them (Grossi et al., 2015, Kara et al., 2011).Attention to the CFS, a reporting tool which can provide an accurate picture of the economic-financial performance of the group (Almquist et al., 2013), has become important because local governments have increased over time the number of their controlled/noncontrolled companies/organizations (i.e. hybrid organizations) outside the boundary of the local authority that provide public or private services. In this context, the separate financial statements do not accurately reflect and represent the dynamics of this public group in allits complexity. The theme has been further fueled by the intervention of the international regulators. For example, the European Commission has initiated a discussion on the expediency of using the international public sector accounting standards (IPSAS) as a common base for harmonizing the accounting systems of the member states (Jones et al., 2015). With regard to the CFS, the International Public Sector Accounting Board of the IFAC published, in January 2015, the IPSAS 35, applicable as from January 2017,renewing the discussion on how to represent the Local Government Group (LGG) (Bisogno et. al, 2015; Jones et al., 2015; Manes Rossi et al., 2015).According to the accounting regulation theoretical framework, the paper compares and analyses the different proposals for definition of the reporting entity at international level(IPSAS and GASB) and then focuses on the Italian context. Italy offers an important case study for two reasons. Firstly, recent reports (Corte deiConti, 2016; MEF 2016; Cottarelli, 2014; ISTAT, 2014) highlight that the approximately 8,000 Italian municipalities have holdings in 7,726 entities, 4,543 of which are represented by companies with share capital. These entities employ approximately 500 thousand employees and, in addition to the public services, they operate in the trade, manufacturing and financial sectors. In Italy, therefore, the phenomenon of municipal capitalism is particularly widespread (Grossi et al., 2008; Teodori et al., 2009; Scarpa et al., 2010).Secondly, Italy is one of the few European countries (Brusca et al., 2015) to have prescribed, under the recent public accounting reform, adoption of the CFS: although this document has existed for several years on a voluntary basis, the Legislative Decree118/2011 imposes a mandatory CFS for all Muni-cipalities. Parliament has established a graduated process to fully implement this reform: a two-year pilot program (accounting periods 2013 and 2014), subsequently extending the mandatory regulation to Municipalities with more than 5,000 inhabitants, starting from the 2015 accounting period, with the system up and running in 2016; complete implementation of the reform, which will also involve Municipalities with fewer than 5,000 inhabitants, is scheduled for the2017 accounting period.

Through the Italian case study, the paper aims to examine the effects of application of the Italian accounting standard (PCA 4/4)4 on the CFS, after comparing the International Accounting Standards (IPSAS and GASB) and the Italian one on the reporting entity concept. The research question is: "Regarding the Italian Standard, what are the effects of the option criteria to include or exclude entities from the reporting entity composition? What is the behavior of Municipalities?"The paper is organized as follows. Par. 2 describes the theoretical framework. Par. 3 discusses the reporting entity concept in the main accounting systems and par. 4 deals with the same issues in the Italian context. Par. 5 presents the research methodology and par. 6discusses the results. Par. 7 summarizes and concludes.

2. Theoretical framework

The field of the study is the accounting regulation as defined by Taylor and Turley "Regulation has been defined as the imposition of constraints upon the preparation, content and form of external reports by bodies other than the preparers of the reports, or the organisations and the individual for which the reports are prepared" (Taylor et al.,1986). In this field, the research on the regulation of accounting (Laughlin, 2007) examines the behaviors of preparers regarding a new regulation. In this perspective the analysis focuses on the reaction/action of preparers vis-à-vis the law. This process of analysis allows evaluation of the quality of regulation (Radaelli et al., 2012; Parker et al., 2012), i.e. if the regulation meets its policy objectives within the analysis of Municipalities' behavior. According to this framework, the study implements a two-step research: the first one is analysis of the institutional context in which the regulation is made; the second one is focus on the subjects (behavior, characteristics, etc.).For example, a question for the subjects could be whether they have had problems adopting the law or are they fully compliant?

The paper examines the international accounting standard context on CFS and then focuses on the Italian one; following, it studies the behavior of Italian Municipalities in the pilot program to evaluate the quality of the public reform on CFS.

3. The generally accepted reporting entity concept at international level

With reference to the regulations governing the methods of drawing up the CFS, the literature agrees that the main aspect of interest (Teodori, 2012; Walker, 2011; Walker,2009) is the consolidation area (Grossi et al., 2015; Tagesson et al., 2012, Tagesson, 2009;Grossi et al., 2008), which reflects the reporting entity and the identification of the entities to be included and excluded – mandatorily or voluntarily. Selection of the entities to be consolidated is the moment when the information scope of the CFS is defined, the preparers have margins of discretion and the greatest differences in the regulatory proposals are encountered (Gardini et al., 2014; Grossi et al., 2015). Generally Accepted Public Sector Accounting Standards define reporting entity referring to two approaches: the test of control and the criterion of financial accountability (Bergmann et. al, 2016; Grossi et al.,2015; Bisogno et al., 2015). The approaches are referred to the IPSAS 6, to the formulations of the GASB and to the new IPSAS 35. Criteria are complemented by the ownership approach (PSC, 1996) which is identified merely by juridical ownership. The test of control approach is proposed in its best-known version by IPSAS 6 – Consolidated and Separate Financial Statements (2013), which is drawn primarily on IAS27, Consolidated and Separate Financial Statements (2003). Under the IPSAS 6 the consolidation area is defined, giving priority to the relationships of control (Lombrano etal., 2011; Christiaens et al., 2009; Benito et al., 2007; Christiaens et al., 2010). Control is"the power to govern the financial and operating policies of another entity so as to benefit from its activities" (Grossi et al., 2008).

However, the configuration of the reporting entity expressed by the IPSAS 6 – since it derives from the private sector – does not allow full appreciation of the multiform composition of the public group (Broadbent et al., 2008;Liguori et al., 2014).

Starting from another approach, the GASB (Anessi Pessina, 2007; Grossi et al., 2008) has underlined that the configuration of the reporting entity must be based on the notion of financial accountability (GASB 14). The concept of reporting entity in GASB 14(explanatory material) considers that an entity is financially accountable, if: (1) the government "is able to impose its will" on that entity; (2) there is a potential for the entity to provide specific financial benefits or to impose specific financial burdens on the government; (3) the entity is fiscally dependent (financial dependence) on the government whether it has or has not a separately elected governing board. One of the main elements of novelty of the IPSAS 35 is modification of the objective assigned to the CFS. In line with the process of updating of the IPSAS, which is already identified at Framework level, the usefulness of the CFS is connected with the user need for accountability and not only with decision-making purposes (IPSAS 35, Basis for Conclusion no. 3 and no. 10). A second element of novelty can be found in the use of theIFRS 10 as the reference standard. Although based on the control approach (Bisogno et al.,2015; Carini et al., 2016), the international standard has been adapted specifically to address public sector issues and the circumstances that are more prevalent in the public sector. However the majority of the paragraphs that differentiate the standard from theIFRS 10 are for the most part introduced to reflect the specificities of the public sector, moreover they can already be found in the IPSAS 6 and are consequently re-proposed, rather than being elements of innovation.

Concluding, while IPSAS and consequently the test of control is more related to a CFS drawn up on the basis of notions of power, benefit and control, similar to that of business accounting, GASB and the financial accountability approach, on the other hand, focus more on the responsibility to govern the public resources, either separately or by means of a group. For example, if an entity depends financially on the government, but the government does not have a shareholding interest, or this interest is not sufficient to assure control of the governing body, it will not be consolidated according to IPSAS, but according to GASB.

4. The reporting entity concept in the Italian regulation

The recent law making the CFS mandatory forms part of the wider reform of public accounting started by law 169/2009 and law 42/2009. The intention of the Legislative Decree 118/2011 is "… contributing to the pursuit of the objectives of public finance … the pursuit of these objectives is achieved according to the fundamental principles of harmonization of government financial reports and coordination of public finance". Central government's need to quantify and control public spending as a whole is the objective of the requirement for Municipalities to draft the CFS. This purpose converges partly with the one assigned to the financial statement in the recent IPASAS 35 which extends evaluation of the financial position to analysis of the performance and risk of the local government group (LGG) (IPASAS 35, BC 10).

The concept of group and the reporting entityIn the Italian Accounting Standard there is no definition of LGG, which is identified indirectly including, in addition to the controlling local government, the entities that should be considered in the CFS. To construct the CFS reporting entity, the PCA 4/4provides a two-step tick box approach. The first step is identifying the "potential" reporting entity (Table 1), which includes the following entities:controlled institutions ("entistrumentali"): they comprise everything which, in juridical terms, is different from a company (for example, a foundation), independently of the nature of the shareholders (private or public). The control could be control by law or control in substance;non-controlled institutions ("entistrumentalipartecipati"): their specific characteristic is the presence of the participation, with other partners, without the condition of full orjoint control. The category aims to represent the public sector "common" control of externalised services, such as cultural, educational, environmental or social services;controlled companies ("societàcontrollate"): the distinguishing element is the concept of company, as defined by Italian commercial law and with evident reference to companies with share capital. Here again, reference is made to control by law and control in substance, both direct and indirect;non-controlled companies ("società partecipate") area well-defined type of entity with total public participation: they conduct local public services (direct outsourcing from Municipalities) and the shareholding of the individual local government is not relevant. The second step is the option given by the Standard to exclude from this first list some entities due to the following two causes of exclusion. It is worth pointing out that this is a voluntary choice, i.e. an option, the exercise of which will decisively influence the information capacity and usefulness of the CFS.

The first refers to irrelevance (materiality), also establishing precise quantitative parameters (total assets, equity, operating revenues), which must be below the established threshold (10% Municipalities) of the corresponding values of the report of the controlling local government. Irrelevance is quantified for each entity individually.

The second cause is connected with the impossibility of obtaining the information necessary for consolidation in a reasonable timescale and without disproportionate costs. Finally, for the first period of application (until 2017), the standard excludes listed controlled companies, although from a theoretical point of view this exclusion appears debatable, especially in cases where the company distributes large dividends to the local government. This last option decisively simplifies the consolidation in operating terms. Considerations on the reporting entity of the Italian consolidated financial statement Some strengths and some evident weaknesses emerge from comparing the PCA 4/4 with the Generally Accepted Public Sector Accounting Standards (IPSAS and GASB).The concept of control underlies membership of the Italian LGG, as it comprises control by law, control in substance and "contractual" control, also in cases in which, theoretically, there is no participation, either direct or indirect. The ownership, test of control and financial accountability approaches are also found in the PCA, which adopts a broad notion of reporting entity (Table 1) (Carini et al., 2016). However; this strength is offset by three evident weaknesses.

Table 1 – The consolidation area in the Legislative Decree 118/2011

		Controlled institutions	*Non-controlled institutions*	*Controlled companies*	*Non-controlled companies*
Direct or indirect possession of the majority of votes	(TC)	X			
Direct or indirect possession of the majority of votes also via shareholders' agreements	(TC)			X	
Appointment or revocation of majority of members of decision-making bodies	(TC)	X			
Direct or indirect exercise of the majority of voting rights at the meetings of the decision-making bodies	(TC)	X			
Obligation to balance the finance deficits in excess of the shareholding	(FA)	X			
Exercise of controlling influence by means of statutory agreements or clauses	(TC)	X		X	
Controlling influence as a result of public service agreements and concessions	(FA)	X		X	
Controlling influence at ordinary meeting	(TC)			X	
Total public participation and direct outsourcing of local public services	(O)				X
Other participation (without control)	(O)		X		

TC: conditions derived from the test of control approach
FA: conditions derived from the financial accountability approach
O: conditions derived from the ownership approach

Firstly, the Italian legislator, adopting a legalistic-formal rationale grounded in civil law, unlike the IPSAS and GASB standards, does not offer a general definition of group, which can only be deduced on the basis of analytical criteria. In fact, the group is constituted mainly by the – formal – presence of certain legal conditions, presented in the PCA. There is no reflection on the exercise – in substance – of the power/benefit prerogatives or financial responsibility of the controlling local authority.

Secondly, a further weakness derives from the desire to include "non-controlled" institutions and companies in the consolidation area; the ownership approach in the absence of control or financial accountability conditions is preferred. This is a choice of the legislator not coherent with the general purpose of the CFS, almost as if it were an attempt to recover the concept of outsourcing5, originally introduced as a possible objective.

Thirdly, the further element concerns the cases of optional exclusion – not scheduled in the IPSAS 6, in the IPSAS 35 or by the GASB. In the provision of the PCA 4/4 an entity5 A broad concept of outsourcing: a local government "arm's length" organization still in the public sector or in the private one that could conduct public or private services. can be excluded from the reporting entity if: irrelevant, according to quantitative parameters, or retrieval of the information necessary for the consolidation is not possible. While the second aspect openly conflicts with the notion of group, the first condition significantly reduces the usefulness of the CFS, since it would deprive it of its role as a tool for complete reporting of the management activity by the controlling local government (aparadox in view of the Regulation's objective).

5. Research methodology

To answer the RQ, the paper analyses the behaviors of Italian Municipalities. Thus the first methodological aspect is definition of the criteria for selection of the sample analysed and its identification. The reference population is identified in all Italian Municipalities with a population exceeding 10,000 inhabitants obliged to draw up the consolidated financial statement since they are part of the pilot program for the 2014 accounting period. The full list defined consists of 190 Municipalities. For these we sought the public availability of the CFS for each Municipality. For the 2014 accounting period the final sample consisted of 69 local authorities because they have a CFS available on their website. The documents analysed are the CFSs as of 31/12/2014.

The second methodological profile concerns analysis carried out by using a disclosure scoring system, a partial form of content analysis (Beattie et al., 2004; Krippendorff, 1980;Krippendorff, 2004), widely used in studies aimed at understanding the degree of compliance (Carini et al., 2016; Teodori et al., 2013; Teodori, 2006) of the financial statements with the accounting standards (IPSAS and GASB).The disclosure-scoring sheet was drawn up ascertaining the presence/absence of the following information, required by the Italian accounting standard, within the management report/explanatory notes: the information variables are related to the composition of the "potential" reporting entity, the "effective" reporting entity and the reasons for the voluntary exclusions. In order to ensure homogeneity and to reduce the subjectivity of the findings, the search for the variables was carried out on the basis of a coding scheme, developed according to the main references indicated by the literature.

6. Findings

The first result of the behavioural analysis is that vis-à-vis a normative obligation, albeitin a pilot stage, out of the 190 Municipalities involved, only 36.3% published the CFS. Of these, the larger Municipalities, with population exceeding 100,000 inhabitants, were more likely to draw up and publish the CFS (Table 2). The sample also contains 9 CFS (13%) in which there is no management report or explanatory notes: for these Municipalities no analysis of the reporting entity was possible.

Table 2 – Sample analysis

Population	No. of Municipalities	No. of Consolidated Financial Statements Available	%
x>100,000	14	7	50.0
50,000<x≤100,000	19	8	42.1
20,000<x≤50,000	68	24	35.3
10,000<x≤20,000	89	30	33.7
Total	**190**	**69**	**36.3**

This result, together with the 36.3% of Table 2above, highlights the low level of attention paid to the CFS by the Municipalities and constitutes the first result of the research. In order to empirically analyses the purpose of the CFS, a fundamental requirement is availability of the information on the LGG: how "potential" reporting entity becomes "effective" reporting entity.

The analysis of the variables investigated and described in the methodology found that, on average, out of the 60 CFSs studied, the level of disclosure on the composition of the “potential” and “effective” reporting entity is 70%. More generally, 87% of the Municipalities examined have a level of information completeness higher than 50%, 5%between 25% and 50%, and 8% lower than 25%.The PCA 4/4 considers the “potential” reporting entity as a starting area, a “sort of listno. 1” from which to determine the “effective” reporting entity (“sort of list no. 2”), using the two possible causes of exclusion (par. 4).

The empirical analysis of CFSs revealed, however, that in 60 financial reports the “effective” reporting entity is present in all cases but the “potential” reporting entity is present in only 54.In order to answer the RQ and to investigate the reasons for the above result, the analysis focuses on the arbitrariness of the authorities in the choice of the entities to be consolidated with respect to the provisions of the accounting standard because it was found to play an important role. In one particular case, the Municipality decided to include only two entities in the reporting entity since they were “participants in the accounting pilot program”, excluding all the others (in one of which the Municipality had a 41.93% shareholding) without providing any further explanation and contrary to the provision of the PCA. This case highlights the uselessness of a CFS in which the reporting entity is chosen at the complete discretion of the Municipality, whose objective appears to be to comply with a simple “obligation” of the pilot. Another example are five Municipalities that declared only the list of entities included in the reporting entity, without specifying the passage from the potential area to the reporting entity, an essential element in analysis of the function of the document in the light of the fact that “the first deal before compiling CFS is the choice of entities in the area of consolidation” (Grossi et al., 2015). It is evident that in these cases, the CFS does not perform its function of representing the group and consequently its ultimate objective of control of public finance. One Municipality encountered problems in retrieving information and in construction ofthe CFS. It decided to schedule periodic meetings with the managers of the consolidated entities (also to harmonize the criteria and align the methodologies). This effort, although initially probably only at administrative level, is a first result of the CFS as an accountability tool. Other best practices are four local authorities who declare that they have analysed the relations with the entities for the purpose of greater efficiency and overall programming of the Group and improved response to the need to reconstruct the costs ofthe services offered. In these cases it is clear that the choice of the entities to be consolidated coincided with the effort of the Municipalities to analyse the LGG and the relationships with the entities to be consolidated. A further and fundamental point of the paper is to study the causes of voluntary exclusion of entities present in the “potential” reporting entity but not in the “effective” one. Not all the Municipalities clarify this information: 41 Municipalities out of 60 (68%) declare these reasons in the explanatory notes or in the management report, while 32% do not provide any information in this regard. In the 41 CFSs that clarify this point, the main cause identified is irrelevance (materiality). 80% of the Municipalities use irrelevance. Almost all (85%) use the possibility of excluding the irrelevant entities due to the fact thatthey do not exceed the quantitative parameter of 10% described in paragraph 3. In some cases this calculation is described in a table: an example is given in Table 3, from which itcan be clearly seen that out of 7 entities of the “potential” reporting entity of the Municipality, only the first (X1) was subsequently consolidated, since it was the only oneto exceed the parameter of 10%. Concerning this cause of exclusion, the choice of the Municipalities was to evaluate each entity individually with respect to the three parameters, thus excluding many of them from the reporting entity. In this regard, in the particular case taken as an example, it is also interesting to note that if the three entities excluded X2, X4and X6 were considered jointly, in terms of total operating revenues, the sum of them would be higher than 10% (10.57%). This point prompts a reflection on the objective of the CFS in Municipalities: i.e. the controlling local authority has not analysed whether these excluded entities could offer fundamental services for the territory in which they operate or are important at the level of Group governance.

Table 3 – Example of irrelevance determination

	Annual financial report values (1)	Level of irrelevance (10%)
Total Assets Controlling Municipality	297,024,053	29,702,405
Equity Controlling Municipality	233,426,332	23,342,633
Operating Revenues Controlling Municipality	86,652,163	8,665,216

Entity	Total assets (2)	Equity (3)	Operating Revenues (4)	% (2/1)	% (3/1)	% (4/1)
X1	**101,646,190**	**46,383,757**	**40,278,617**	**34.22**	**19.87**	**46.48**
X2	1,075,736	225,617	2,875,962	0.36	0.10	3.32
X3	253,306	241,892	2,087	0.09	0.10	0.00
X4	1,911,912	482,855	3,511,091	0.64	0.21	4.05
X5	195,196	176,370	27,398	0.07	0.08	0.03
X6	2,500,557	1,752,941	2,770,548	0.84	0.75	3.20
X7	129,305	18,695	38,860	0.04	0.01	0.04

Reading the CFSs, it emerged that theMunicipalities opted, in the majority of cases, for a quantitative perspective analysis.In only two Municipalities, although entities could be classified as irrelevant byapplication of the 10% parameter, they were consolidated because they are important for atrue and fair view of the Group's financial position.The second type of exclusion established by the standard, i.e. the absence ofinformation, is used by only 5 Municipalities out of 41, mainly because the group entitiesconsidered were unable to provide accrual accounting but only cash accounting.

Table 4 – Results of the definition criteria applied

	Controlled institutions	*Non-controlled institutions*	*Controlled companies*	*Non-controlled companies*
Direct or indirect possession of the majority of votes	X **(13)**			
Direct or indirect possession of the majority of votes also via shareholders' agreements			X **(23)**	
Appointment or revocation of majority of members of decision-making bodies	X **(1)**			
Direct or indirect exercise of the majority of voting rights at the meetings of the decision-making bodies				
Obligation to balance the finance deficits in excess of the shareholding				
Exercise of controlling influence by means of statutory agreements or clauses				
Controlling influence as a result of public service agreements and concessions			X **(1)**	
Controlling influence at ordinary meeting			X **(1)**	
Total public participation and direct outsourcing of local public services				X **(27)**
Other participation (without control)		X **(26)**		
No information			X **(2)**	
Total	**14**	**26**	**27**	**27**

The behavior of the Municipalities in the sample reveals that it is not sufficient to consider only the classic concept of control by law (Bergmann et al., 2016) and quantitative determination of the irrelevance of drawing up a public CFS; the analysis must be widened to concrete operative evaluations of the relationships of the authorities with the entities constituting the Group (Bergmann et al., 2016) thus achieving, as has emerged in some best practices of the sample (described above), the objective of control of public finance. According to the theoretical framework, the quality of the regulation is good if the CFSs area tool to control public finance, otherwise the regulation will not achieve its policy objective. The Italian regulatory context provides for application of the quantitative parameter but in so doing gives the authorities an option: the results, albeit at the pilot stage, showed the tendency to use this option in the majority of cases, thus excluding many entities from the consolidation. The last point in the analysis is the composition of the "effective" reporting entity.

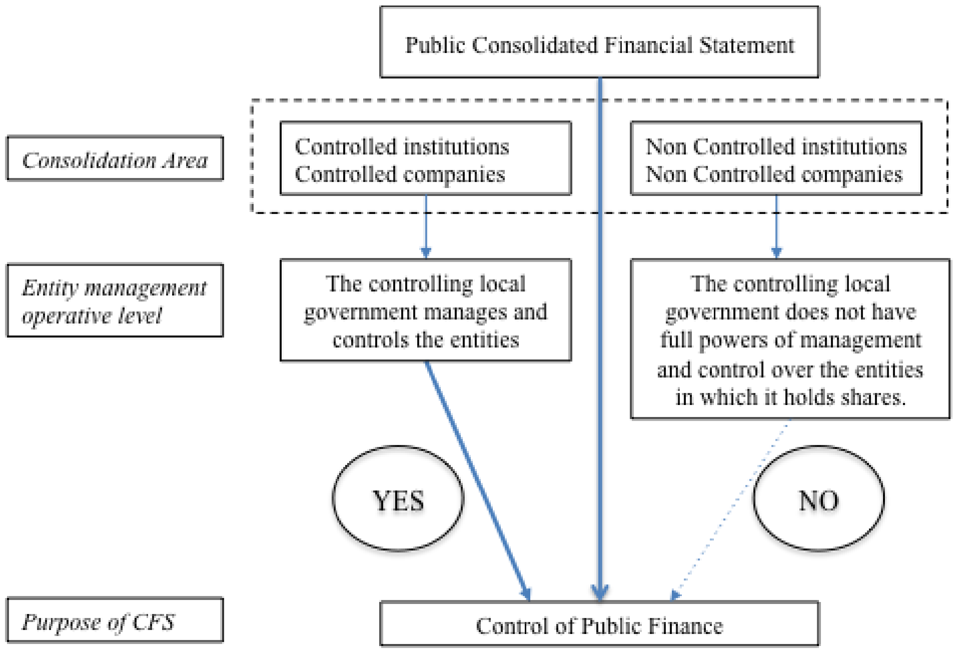
Table 4 shows the types of entity in the reporting entity of the Municipalities: the most common are controlled companies (this type of entity is present in 27 reporting entities), no controlled companies (this type is also present in 27 reporting entities) and non-controlled institutions (this type is present in 26 reporting entities). In some Municipalities several types of entity are present, whereas in others there are no indications. Despite the options of using different criteria offered by the standard, for controlled companies/institutions the behavior of the Municipalities is mainly oriented to the test of control (TC) approach (in23 cases out of 27 for controlled companies the approach is the TC; in 13 cases out of 14 for controlled institutions the approach is the TC); financial accountability approach is used as an exclusive selection criterion in only one case. The non-controlled situations reflect the particular definition criterion of the PCA (ownership).

Finally, listed companies were identified in only 2 Municipalities. Both of them took advantage of the possibility of excluding the listed companies from the reporting entity, as provided by the PCA (par. 3).

7. Conclusions

The obligation to draw up the CFS, introduced in Italy by the Legislative Decree 118/2011, represents a completely new development with which the Italian local authorities are required to engage. In this context, according to the accounting regulation theoretical framework, the paper firstly analyses the Italian regulation and the related Standard compared to the main accepted international accounting standard systems (IPSAS and GASB) to highlight differences and similarities. Secondly, the study focuses on the Italian situation to evaluate, through the behavioral analysis of Municipalities, whether the objectives of the law are achieved by application of the Accounting Standard (PCA 4/4), although at a pilot stage, i.e. if the CFS could be used as a financial tool to control public finance. According to the theoretical framework, this allows evaluation of the quality of regulation.
The focus of the paper is on the reporting entity, the first step to constructing a CFS (Grossi et al., 2015). The reporting entity defined in the Italian Standard shows points both in common with and distinct from the one in the IPSAS 6, IPSAS 35 and in the GASB. Otherwise, the research highlights that the Italian regulation proposal is far from that of the accepted international accounting standards, as it is mostly focused on bureaucratic control rather than on an informational role for the external users; in the authors' opinion this is a critical point because the provision of inclusion of non-controlled entities is not coherent with the general purpose of control of public finance (in these entities there is no control over the financial assets by the Municipality) (Diagram 1).

Diagram 1 – The effects of the missing definition of the Local Government Group



In the empirical analysis, the results have shown that attention to the phenomenon is not perceived at local level with the same interest as at central normative level and the even greater consideration afforded to it by the academic world: only 36.3% of the pilot Municipalities made the CFS available. Concerning the available CFSs, the analysis investigated the behavior of the Municipalities with respect to the strengths and weaknesses of the accounting standard. It emerged that despite the various possibilities of control contained in the PCA, the Municipalities adopt mainly a test of control, preferring control by law. Moreover, results reveal that many entities are excluded from the reporting entity according to the option of quantitative exclusion.

There is no reference to the role of these excluded entities in the management/control/governance of the LGG or their relevance in providing local public services (exempt from some best practice described in par. 6). A limit of the quantitative approach is that it reduces subjectivity and helps to increase the certainty of the Italian PCA. However, literature and the international regulators emphasise the communication aspect of the CFS. In this perspective the irrelevance (materiality) should also provide qualitative elements connected with the public context, such as the delivery of fundamental services for the area or the support in pursuing social or political objectives. In addition, if the objective of the CFS is to focus attention on the financial position of the groups, the parameters and reference thresholds for the relevance test should be re-thought and should respond, among other things, to the requirement for the financial report to provide communication. Finally, the majority of the Municipalities do not fully identify their LGG, but they respond to the requirements of the standard to provide – as if it were a “tick box” – two lists(“potential” and “effective” reporting entity). The lack of definition of “group” in the Standard is a weak point because it means that the Italian local authorities do not have a basic/conceptual framework which can be referred to in the event of doubts on the consolidation or on why to include non-controlled companies in the reporting entity, without then having the possibility of control. In addition, the group is defined by the formal presence of certain legal conditions.

There is no reflection on the exercise – in substance – of power and benefit jointly (IPSAS). The control conditions stated in the PCA4/4 are one-sided: power or benefit, never using both concepts jointly. Furthermore, the concept of financial responsibility (Benito et al., 2007; Anessi Pessina, 2007; GASB 14) of public entities that manage public money is not consistent with the one accepted in the PCA. The absence of this concept is a clear limit of the Italian Standard, much more relevant if it is analysed compared to the objective of the CFS: the control of public finance. Concluding, the “tick box” approach is a critical point in non-controlled institutions and non-controlled companies because the provision for their inclusion appears to respond more to a need for information on the outsourcing carried out by the Municipalities rather than on control of the LGG, and this has little to do with the ultimate objective of control of public finance.

In fact, it is not clear how a Municipality, a controlling local government, can manage and control its LGG, via the medium of the CFS, if there are non-controlled institutions and companies within the reporting entity, over which it has no full powers of control other than jointly with other authorities (Diagram 1). According to the theoretical framework, the quality of the regulation is not adequate to achieve the goal of control of public finance. Thus the objective assigned to the CFS in Italian regulation is not fully coherent with the criteria to define the reporting entity through the accounting standard. If there is no fair representation of the reporting entity, there will be no useful consolidated information and the role of the CFS as a financial tool will be pointless.

In order to improve the regulatory choices, some policy implications are suggested to the Legislator. Firstly, compared to the International Standard, the Italian standard should give the Municipalities a framework with a simple and clear definition of LGG, to provide analysis and identification of the group area, without or not only with a "tick box approach". Financial accountability should be the most suitable framework to achieve the final objective of control of public finance.

The voluntary exclusion of entities discussed in the paper should be analysed not only in a quantitative approach individually (with standardized thresholds and parameters) but adding a qualitative approach, in a wider context of the group definition, such as governance of public local services (Almquist et al., 2013).2014 is the first year of drafting of the CFS for the majority of the local authorities involved in the pilot program; in this situation it is natural to expect a mainly compliant approach to the regulatory prescription and to its technical rules (Jones et al., 2004;Steccolini, 2004). Further research is ongoing to study the evolution of reporting in the following years.

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