

“THE CONSOLIDATED FINANCIAL STATEMENTS OF LOCAL GOVERNMENT’S GROUP AS A STRATEGIC TOOL TO EVALUATE PERFORMANCE OF LOCAL PUBLIC UTILITIES”

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Abstract:

Back in the ‘80s, many public utilities were directly managed by local governments. The Law 142 of 1990 introduced the public companies management model and many local public utilities were outsourced by local governments.

This change of local public utilities towards private models has had a very positive effect, for it has produced a wider and clearer view of the operation of public utilities and has resulted in clearer information being given to stakeholders.

However, a direct consequence of outsourcing process for Italian local public utilities was the extreme simplification of the local authority budget: this document, with its limited data, can not represent the extreme complexity of local authorities management.

Local Italian governments need detailed rules to evaluate the financial, economic and assets performances of the participated activities. The institutions have made requests which have been interpreted by the National Court of Auditors which will enact an accounting standard for the consolidated financial balance sheet of local governments and participated companies.

The local entity must be and remain the decision maker with regard to the strategy of its local public services, even if they are outsourced. The local entity must signal a basic strategic political direction for its local public service companies, to then leave the implemental decisions about strategy to the technical management. Moreover, after the activity and its results, the local entity must receive feedback from its local public service companies for strategic oversight.

The consolidated financial statements of local group could assure a complete view of its strategic interests in local public utilities. In other words, we think that this managerial tool could be a fundamental reference point for strategic control in local public utilities.

This paper examines and evaluates the Italian panorama of consolidated financial statements of the local government’s groups as a strategic tool, in the light of the latest accounting standard and of the main experiments in the drafting of the consolidated financial statements of the local authorities’ group.

The analytical framework for the development of the paper has focused, primarily, on comparing the latest accounting standard with the state of the art; afterwards we analyze the capacity of the consolidated financial statements of local public groups to give strategic information to improve efficiency and effectiveness of public governance. Finally we examine – with a critical approach – some current experiences about consolidated financial statements in Italy.

Keywords : Local public utilities, local government, consolidated financial statements, strategic control

Summary*:

1. The local government's role in managing local public utilities 2. The recent evolution of accounting system in local government towards private systems 3. The consolidated financial statements of the local government for strategic aims 4. The Italian experience about consolidated financial statements

1. The local government's role in managing local public utilities

It can be affirmed, without fear of contradiction, that delegating to outsiders the management of local public utilities is not a sole phenomenon of our time ¹.

From the early twentieth century to today, the number and variety of public utilities provided by local government have significantly and, above all, constantly increased. As a consequence, more and more frequently, local governments have been no longer able to take care of local public services without external assistance. This has emphasized the need, initially only in larger local governments, to delegate to other appropriate organisations the production and the distribution of public utilities. The Law 103/1903 and subsequent the Tuel of 1925 represented for nearly a century the reference legislative framework for the sector of local public services. However, in the late seventies, the system of municipalized companies and the rules to which they were subject underwent a rapid decline and the low levels of efficiency and economy led, in a few years, to a strong negative judgement of the public opinion on the sector ². As a matter of fact, the costs and deficits of the municipalized companies had been growing uncontrollably. In 1960 they were just over 3.5 billion liras, in 1975 they had reached 800 billion and in 1980 they had reached 1,800 billion ³.

* § 1-4 are by Silvia Fissi – English edition has been revised by Prof. Antoinette Russell; § 2-3 are by Elena Gori – English edition has been revised by Prof. Lydia Brody.

¹ At the end of the XIX century, Italy underwent a radical transformation. The population in the countryside rapidly decreased whereas urban centres underwent a dramatic increase. The growth of the cities rendered the management of fundamental services, such as transport, water, sewerage and drainage systems, public illumination, etc., completely inadequate considering the number of citizens now residing in them. The individual municipal districts tried to overcome the problems self governing. They rebuilt municipal establishments and they redeemed the concessions of private companies. However it was only with the Law 103/1903 that the local public services had the liberty to administrate directly – through the municipal enterprises – the local public services.

² G. GROSSI, R. MUSSARI, *I servizi pubblici locali nella prospettiva economico-aziendale*, Roma, Aracne, 2004, p. 224 et seq.

³ Cfr. Annuari Confservizi.

In over one hundred years of Italian legislation concerning local public utilities, legislative interventions had been numerous and frequent, but the turning point only came with the enactment of Law 142/1990⁴. The Law distinguished, both from the viewpoint of functional autonomy and legal subjectivity, between the local authorities, responsible for the public service, and the local companies, responsible for the activities assigned to them and for the economic results achieved. From this moment onwards it seems quite natural to include in the category of “public utilities” activities objectively aiming at the production of goods and services, not only administrative ones.

At the beginning of the third millennium there had been many interventions and attempts to reform the field of local public utilities. However, it was only in 2004, that a new framework of local public services established itself. It was introduced by Article 14 of L. 326/2003 (attached to the Finance Ordinance 2004) and Art. 4 of Law 350/2003 (Financial Law 2004), which provided a new classification of public services and their different regulations. Public utilities were no longer “of industrial relevance” but of economic relevance, in keeping with the Community definition of “services of general economic interest”⁵. In fact, the problem of managing local public utilities has been discussed in detail at EU level and it can be stated that the crucial impetus to the reform has indeed come from the European legislation⁶.

In Italian Law the definition of local public utility can be found in the art.112 of the Local Authorities Consolidation Act (Legislative Decree no. 267/2000) which states that it can be considered a public service every "production of economic goods and activities useful to achieve social aims and to promote the economic and social development of local communities". This is a broad definition that leaves a large flexibility to local authorities in the decision of both services to be provided to the administered community and ways to be used for their production and distribution, ie public companies, institutions, special agencies etc. This will ensure the necessary dynamism in time and space. Indeed, people's needs do not change only according to the period in which they occur, but also according to the place where people reside. It is quite evident, for example, that the needs expressed by a community

⁴ F. LIGUORI, *Servizi pubblici locali*, Torino, Giappichelli, 2007.

⁵ M. MULAZZANI, S. POZZOLI (ed.), *Le aziende dei servizi pubblici locali*, Rimini, Maggioli, 2006.

⁶ In May 2003, the European Union enacted the Green Book of local public services, which defined the concept of public utilities and distinguished the difference between economic and non economic services. In April of the following year the Second Green Book was enacted, which contained a detailed analysis of the public and private partnership of the management of public services. The fundamental concept at the base of the European regulatory, which was later taken up by the Italian legislation, is that of a “universal public service” which allows Italian citizens the right to obtain public services anywhere they reside in the territory and that they are supplied with appropriate quality services for which the price must be made reasonable.

that lives in a mountainous region may not be the same as those of a community that resides in a coastal town.

Today, anyway, all local governments, even the smaller ones, create ad hoc local public companies (especially corporations) which offer the necessary services to the users-citizens, in the belief that, in this way, their needs will be more readily satisfied, thanks to a greater proximity to the beneficiaries of those same services, but also in the knowledge that the scarce resources available will be used in a better way, more consciously and, therefore that the levels of economy, efficiency and effectiveness will be higher than in a municipality direct management. On the other hand, thanks to the exponential increase in the number of subsidiaries involved in the management of public utilities, the local governments have become leaders of a real holding of companies - especially Public Limited Companies - dealing with the distribution of services to the citizens.

It is clear that the role of local governments has extremely changed comparing to the past. From “public services providers” they have become, on one hand, a leading company that holds the stocks of Public Limited Companies (stockholder), and on the other, a stakeholder of those same companies, because of its role as representative of the public interests ⁷.

It is easy to understand that the problems concerning the management of such a group are numerous and varied, to the extent that the governance of local public utilities can be considered a new feature of the local authority ⁸. The local governments must indicate to the local public companies the strategy they have to follow to achieve appropriate levels of economy, efficiency, effectiveness and quality of services as well as ensuring proper accounting to the community managed ⁹. This requires a close collaboration between the local authority and its local public companies. Only this way, in fact, can the municipality be able to find all the information it needs, even for purposes of coordination, to implement control strategies able to adapt its economic, financial and social performances to the needs of the community managed. On the other hand, the local public companies will have to plan its activity so that it is coherent with the strategic direction and with the objectives identified by

⁷ N. PERSIANI, *La governance del gruppo di imprese di servizi pubblici locali*, Franco Angeli, Milano, 2003.

⁸ M. MULAZZANI (ed.), *Economia delle aziende e delle amministrazioni pubbliche*, Padova, Cedam, 2006, p. 411 et seq.

⁹ In this regards, “in assenza dell’adozione di opportuni strumenti, l’esternalizzazione può ridurre il grado di accountability dell’ente pubblico verso i suoi portatori di interesse. Infatti, in presenza di servizi esternalizzati, il bilancio consuntivo dell’ente pubblico, da solo, non consente l’apprezzamento degli impatti economici, finanziari, patrimoniali del complesso delle attività di prestazione di servizi, che risultano frammentate nei singoli soggetti gestori”. G. GROSSI, I. STECCOLINI, *Il bilancio consolidato negli enti locali: principi contabili e condizioni operative*, in *Azienda Pubblica*, n. 4/2008.

the local authority ¹⁰. To create such a collaboration it is necessary a total commitment on both sides, aimed at building an appropriate information system that allows the passage of information to and from the local authority. The latter, in fact, to adequately fulfil its role, must always have at its disposal a “snapshot” of the situation of the group that it leads and the detailed economic, financial and patrimonial data, constantly updated, concerning all subsidiaries. In other words, we are witnessing a union of public local governance and corporate governance ¹¹. For our purposes, what matters most is the control that the local authority must exercise towards public utilities and its related instruments. It is clear that the local authority, to plan an effective control system, should take note of the company’s internal governance managing local public services. Otherwise the risk is that the local authority threatens the autonomy of the local public company, which is managing a public limited company according to non-economic criteria with the result of distributing qualitatively unsuitable and expensive services ¹².

Currently, Italian legislation, according to the provisions of the Legislative Decree no. 6/2003, gives the possibility to choose among three different models of corporate governance: traditional, two-tier and one-tier ¹³. The majority of Italian organizations chose the traditional model ¹⁴. However, it is considered that for the local public utilities companies the two-tier model is more adequate. The two-tier model, in fact, permits the introduction of an intermediate level among the managers involved in the ongoing management of the company and the municipality that must show them the strategy to follow and the goals to pursue in terms of economy, efficiency and effectiveness in the distribution of public services. On the other hand, we should not run into the opposite extreme, namely that of a local authority not only unable to identify the strategies and objectives, but also to

¹⁰ R. REES, *The economics of public utilities*, Northampton, Edward Elgar Pub., 2006.

¹¹ L. FICI, *La governance degli enti locali*, Milano, Franco Angeli, 2004.

¹² S. POZZOLI, *Società di spl: a chi spetta la “governance”*, in *Azienditalia*, n. 6/2005.

¹³ The traditional administration organ, can be formed of a single administrator or a multi body of administrators, who are elected by common assembly, which have the exclusive responsibility of the management of the enterprise. The assembly also elects the board of trade union, which must control and supervise the respect of the law and the state inside the assembly and to be on the alert that the principals of correct administration, and the appropriateness of the organization, administrative and accountancy are being followed by the community.

The two-tier system predicts the election by the assembly of surveillance advisers, who are expected to control and supervise the functions attributed to the assembly a role similar to the board of trade unions. The surveillance advisers elect a managing council whose responsibility is the management and the directing of the society.

In the one-tier system the administration of the society is entrusted to a board of administrators nominated by the assembly of the partners, whereas the control of the management is the authority of a relevant committee within the administration board. To conclude the control of the book keeping is entrusted to a relevant external committee (an auditor or auditing firm) indicated by the assembly.

¹⁴ FONDAZIONE CIVICUM, *Una governance per le società a controllo comunale*, Milano, 2005.

exercise an effective control on the work of the local public company. To sum up, this involves the planning of a governance system capable of ensuring a balance between the powers of direction and control of the local stockholder authority and the management entrusted to the directors of the company.

It is, however, essential that the local government is committed to constantly monitor the quantitative and qualitative performances globally achieved. Thus, we implicitly refer to the need of measuring the results of the local authority also considering those achieved by its public utilities. Then again, the problem is not easy to solve because the local governments have financial accounting, while the local public utilities, in most cases Public Limited Companies, have an accrual accounting system.

2. The recent evolution towards the private system of the accounting systems in local government

Traditionally, the Italian public accounts systems has always been financial and focused on cash accounting instead of accrual accounting. Beginning from the years '90 is it was clear that these public accounting systems were inadequate and insufficient for the public sector's informative needs.

The increase of local government's functions and the extreme diversification of the management models of the local public utilities has reduced the importance of traditional accounting systems: financial accounting alone is no longer able to full fill its function.

The deficiencies of the accounting systems of local authorities are particularly evident in the performance and cost evaluation of outsourced public utilities that are managed by joint-stock companies or by other agencies. Too often the outsourced functions are beyond the control of the local governments and this can create hidden potential imbalances ¹⁵

Today a reform process of the public administration is taking place, with the aim of adapting the planning, the programming, the management and the control systems to the new institutional functions and to the greater complexity that are connected with the globalization of markets ¹⁶

¹⁵ For further information see: E. GORI, *Gli equilibri di bilancio degli enti locali*, Milano, Franco Angeli, 2009.

¹⁶ We refer to the first reforms that have affected all areas of Italian public administration. For local authorities, we refer to L. 142 of 1990 on the government and local authorities, to L. 241/1990 on the procedure and administrative simplification and the Legislative Decree 29/1993 on the organization and work in public administration. Concerning the health sector we refer to the Legislative Decree 502/92 on reordering of the discipline of the health system following the requirements of Law 214 of 1990. For the state accounting system we refer to the reform of Italian Lire Legislative Decree 94/1997 and the college. 279/1997. Finally, the accounting system of the Regions has been reformed with the L.76/2000.

The reforming process in local government started in the early '90s with the introduction of business-like management procedures that triggered the new public management course, which is still in progress ¹⁷

The financial accounting systems were complemented by the economic capital, to support the local public management in its business planning functions, management control and high management. The Legislative Decree 77/1995, which is reflected later in Tuel (Legislative Decree 267/00) introduced a particular accrual accounting, in writing the balance sheet.

These documents receive the accounting entries of economic value, cost and revenue accrual operating, amending and integrated values for determining the profit and the final patrimonial consistency.

In reality the Tuel did not impose accrual accounting, it drafted an income statement, a balance sheet and a table connecting cash and accrual accounting.

The balance sheet can be prepared using a minimal method (as indicated by the law) or by an integrated method ¹⁸

According to a survey carried out in Tuscany, the majority of local governments adopt the minimal method, a bigger and bigger share is opting for the integrated accounting method ¹⁹.

The mandatory use of integrated accounting systems would increase the content of information about cost, effectiveness and efficiency of management and would allow to free it from bureaucratic administrative logics.

The large number of reforms in local Italian governments has also changed the accounting system of Italian local public utilities, as the use of private accounting systems has sparked a real process of evolution in the connected sectors ²⁰.

Back in the '80s, many public utilities were directly managed by local governments, which

¹⁷ For further analysis about accrual accounting, see: M. MULAZZANI (ed), *Dalla contabilità finanziaria alla contabilità economico-patrimoniale negli enti locali*, Milano, Franco Angeli, 2002, p. 10 et seq.

¹⁸ The minimal method uses a table to convert the results of cash accounting into accrual accounting. The integrated method uses two integrated accounting systems: an accrual and a cash accounting.

¹⁹ According to this survey in Tuscany, 43% of the provinces, 21% of the municipalities and 13% of the mountain communities apply economic accounting with the integral method. Compared with a previous survey the utilization of the integral method has increased from 15 to 26 institutions, that is from 14% to 22% of the total. For further information see: M. MULAZZANI, M. POZZOLI, A. ROMOLINI, *Nasce un osservatorio sulla contabilità e sui controlli negli enti locali toscani*, in *Comuni d'Italia*, Rimini, Maggioli, n.4 del 2008.

²⁰ Reference is made to the first reforms that have affected every area of public administration in Italy. For local authorities we refer to L. 142 of 1990 on the government and local authorities, to L. 241/1990 on the procedure and administrative simplification and the Legislative Decree 29/1993 on the organization and work in public administration. Decree 77/1995, Tuel incorporated into the Local Government (Legislative Decree 267/00), went on to launch surveys of the economic balance-sheet, requiring the drafting of operating income, balance sheet and the prospectus Conciliation. For more detailed analysis of regulatory measures relating to the readings economic capital, see M. MULAZZANI (ed.), *Dalla contabilità finanziaria alla contabilità economico-patrimoniale negli enti locali*, Milano, Franco Angeli, 2002, p. 10 et seq.

usually mixed utility production or distribution with all the other items of the balance sheet of the local administration. As a matter of fact, they were handled as mere financial transactions.

In-house management of the utilities by local governments did not allow any juridical, administrative, financial and accounting autonomy in the operation of public utilities companies, as they were integrated in overall local government management. Any specific performance audit of the public utilities demanded a specific accounting system to be set up on a case by case basis.

The Presidential Decree 902 of 1986 allowed independent companies (still controlled by local governments) to manage local public utilities. These companies had their own accounting and administrative autonomy, but lacked any legal status and any freedom in the management of their own assets ²¹. The application of the aforesaid decree set up provisions for an economic and financial accounting system, aimed at evaluating costs and revenues, the dynamics of capital assets and liabilities, so that an income statement and a balance sheet could be produced.

However, the real big change came in 1990 with Law 142. Article 22 of the aforesaid law imposed further changes in the management of local public utilities, in favour of private accounting systems. Local authorities could choose how to manage public utilities, each one with its accounting approach: they could do the accounting internally, they could outsource it, they could set up specific companies in association with third parties, while maintaining the majority shareholding of the new entity.

The new law was drafted based on the firm belief that a private accounting system could bring useful information to management and improve public utilities performance.

Accordingly, with the introduction of public companies, the local public utilities sector finally opened up to private accounting and reporting system: the local public services adopted a private accounting system, in double entry according to the rules of the Civil Code and to the National Accounting Standards or to International Accounting Standards depending on the size of the company.

In conclusion, from an accounting standpoint, the whole public administration sector and its public utilities are moving towards private accounting systems, which provide a more complete view of the events and of the business performances.

This change of public accounting systems towards private models has had a very positive effect, for it has produced a wider and clearer view of the operation of local public utilities

²¹ The legal autonomy was introduced by the article 22 of the L. 142/1990.

and in clearer information being given to stakeholders.

3. The consolidated financial statements of the local government for strategic aims

In general, the ample use of public utilities outsourcing is connected to an attempt to reduce local government's expenses, to improve the general performances and to access capital markets to support expansion opportunities. A direct consequence of this process was the extreme simplification of the local authority budget: many old budget items just disappeared or stayed as mere financial transactions. The new form of the document, providing such a limited amount of data, can not overview the extreme complexity of the management of the local authorities. In other words, the budget of the local administration has lost some of its significance. Therefore, there is a strong demand for an accounting solution detailing the activities of local authorities for strategic control.

The local government must be able to make decisions about the strategy of its local public services, even if they are outsourced. The local government must be able to define the strategic political guidelines for its local public service companies and then leave the practical implementation of such guidelines to the technical management.

Moreover, the local administration must receive adequate feedback from its local public service companies, so that strategic oversight takes place. As a matter of fact, the the definition of the strategic guidelines is the very tool with which the local administration can manage its local public service companies.

The processes of outsourcing has affected the public sector over the last decade and caused an ever increasing need of strategic information for managing and being accountable for the provision of public services. We believe that the consolidated financial statements can provide an answer to these needs.

The so-called "local public groups" constitute a new and complex reality. In general, a business group is characterized by a complex economic assembly of different entities (most of them are joint stock companies) that are characterized by unitary strategy.

The local public group should be placed in this context: it is a group of public companies, private or even mixed, controlled by one or more local governments that define the strategy, the social and economic goals, the resources and the management models. The principal management difficulties of these entities are related to the fact that the group must meet the local private law principles and the ethical values of society.

Obviously, a local public group is a peculiar kind of business group, as its goals are mainly in terms of public interest and as the accounting and management systems of the single units

of the group may feature wide differences. In any case, all the units share the same political-strategic goals: to make public utilities available with maximum efficiency and cost-effectiveness.

As a matter of fact, public interest only should determine the strategies, in keeping with the institutional purposes of local government. The local government must identify the strategies to be pursued and at the same time, must implement an efficient strategic control over of utility companies. Unfortunately, the lack of a unified accounting view makes it difficult to quantify and evaluate the local group performances.

Recently a strong demand for accountability has come to light. It is fundamental to correctly understand the results of the local public group and to evaluate the impact on the community, in terms of balance sheet, drawing up a consolidated financial statement.

Unfortunately, the preparation of a consolidated financial statement is not yet mandatory and it is a challenging task, both from a theoretical and a technical point of view. To date some experiments pioneered the drafting of a consolidated financial statement for some local public groups, but there is a marked heterogeneity in techniques and contents.

The transposition of the provisions to private groups of enterprises according to D.lgs 127/1991 (which implemented the IV and VII European Union Directive) is simply impossible: peculiarities of the local public group simply do not allow such a procedure ²².

With this in mind we believe that the consolidated financial statements of the public group should become a mandatory and paramount document, aimed at effective strategic management and, at the same time at making the group performances available to the public.

The public body, the “public holding”, uses financial accounting based on the principle of authorization of the budget; the participated companies employ the double entry accounting system and corporate financial statements; some other institutions or associations may have specific and dedicated financial accounting systems; foundations or consortia have accounts which are based on the accounting of economic competence. Specific rules are then required to factor in the structure of the local group and to establish the consolidation methods.

Local Italian governments badly need detailed rules to evaluate the financial, economic and assets performances of the participated activities. The Board for Local Authorities is currently trying to address this issue by studying an accounting policy for the consolidated

²² One of the most obvious differences is that in local public groups the accounting practices and the accounting principles used in drafting the documents are not homogeneous: the local authority utilizes in fact primarily a financial accounting while the companies belonging to the group keep its accounts and prepare budget as per the Italian law (Civil Code). Moreover, it is difficult to fully define the group and the control links within the same. Some examples of such difficulties are the choice of the method for consolidation and the kind of control to be used to tell the members of the group from the minority participations.

financial balance sheet of the local governments and the participated companies.

The need to prepare a consolidated financial statement of the local public group also appears from the draft new Tuel, presented on July 9, 2009. Article 147 of the new Tuel introduces a significant reform of internal controls, which allows the evaluation of the economic-financial courses of the participated organisms. Moreover, the same article prescribes periodic reports from participated companies, the verification of the deviations in order to identify appropriate corrective actions on economic and financial imbalances and, last but not least, the evaluation of the overall results of the group by drawing consolidated financial statements in accordance with accrual principle.

The drafting of a consolidated financial statement of the local group should address three distinct issues.

The first issue is the control of the municipality: the administrative body needs detailed information regarding strategies, programs and projects involving all the local activities ²³.

The second issue is the need to report to citizens and give them clear detailed information regarding performance and costs of the services offered to them.

Finally, the third issue is the necessity to give the National Audit Office a clearer view of the financial, economic and asset risks undertaken by each local administration.

The main purpose of the consolidated financial statement of the local government is linked to internal and external governance requirements with regard to both strategic control, to ensure proper accountability.

In the Italian system it is therefore necessary to set up, as soon as possible, laws and accounting standards to draft the consolidated financial statements of the local authority's public group.

4. The Italian experience about consolidated financial statements

In Italian local public utilities, the consolidated financial statements spread is rather weak and its first applications are recent ²⁴. Indeed, the first pioneering effort of drafting the consolidated financial statement of a municipal group dates back to 2004. In December 2004,

²³ For a correct strategic control, The consolidated financial statements of the local group must include all the companies controlled by the local authority, regardless of their legal form: not only companies but also special agencies, consortia and others run by local public offices, or under the control of the institution. Moreover, the preparation of consolidated statements requires the definition of a consolidation area, including all subsidiaries, regardless of legal form, which may contribute to the overall risks and benefits.

²⁴ "La mancanza di una normativa esaustiva e la limitata diffusione della contabilità economico-patrimoniale rendono difficoltosa, nelle amministrazioni pubbliche locali italiane, la redazione del bilancio consolidato". G. GROSSI, M. MORI, *Introduzione del bilancio consolidato nel Comune di Pisa: finalità, percorso e metodologia*, in *Azienditalia*, n. 9/2006.

the local government of Perugia has submitted an experimental consolidated financial statements for the year 2003 ²⁵. The latter, however, as stated in the same document, just wanted to be a first test for the drafting of the balance of the local public group. This was to assess the practical difficulties (and their possible solutions) relating, on the one hand, to the need of consolidating accountings drafted according to different models (local governments, on the one hand, and local public companies, on the other) and, on the other, referred to public models (the holding) and private models (the local public companies). The weak point of this consolidated financial statements, as observed by the editors themselves, is due to the strong difficulties in eliminating the economic and financial effects of transactions among the public local group's units. These were due to the very poor and inadequate information available. The local government of Umbria has continued its "experiments" and, in 2006, it submitted the consolidated financial statements of 2005, stressing the changes in the entity and role of the participation shares comparing to the situation that was outlined for the year 2003 and overcoming some of the difficulties encountered during the drafting of the previous balance sheet.

Considering the specifications provided about the case of Perugia, the first universally recognized consolidated financial statements of an Italian local public group is that of Pisa ²⁶. In 2005, Pisa submitted the consolidated financial statements for the year 2004 which outlined the results of the local public group. Again it was a "first document", however, in comparison with the case of Perugia, the document was more complete and comprehensive in all its parts, probably because it was the result of a project at a more advanced stage.

The cases of Pisa and Perugia set precedents to be followed by other local authorities. They tried to replicate or made a firm decision to do it soon. The local government of Bergamo, for the year 2006, consolidated costs, revenues, credits and debits of the local government group. However, the total lack of information and additional comments concerning the followed method of consolidation, do not authorize us to consider it as a veritable consolidated financial statement, but only a first step towards the drafting of a local public group's balance sheet.

In June 2009, the local government of Siena has presented its consolidated financial statements for the year 2007, in order to better understand the package of societies to which the local authority is a shareholder.

²⁵ For further see: OSSERVATORIO SUI SERVIZI PUBBLICI LOCALI DEL COMUNE DI PERUGIA, *Il bilancio consolidato del gruppo "Comune di Perugia"*, 2004.

²⁶ The research group that was responsible for the preparation of consolidated financial statements of the Municipality of Pisa is coordinated by Professor Grossi.

Finally, it is important to remember the case of the local government of Sassuolo (Modena) which presented its consolidated financial statements in 2006, proving that even medium size towns (its population is just over 41,000 inhabitants) can produce a consolidated financial statements permitting it to check the overall results of the local public group and its levels of efficiency and effectiveness as well as to supply the administered community with increasing information concerning the economic, financial and assessment situation of the group.

The analysis of the consolidated financial statements of Italian local government so far published emphasize a great difference both in the criteria used to define the area of consolidation, and also in the balance sheet models used for the consolidated financial statements and income statements. The consolidated financial statements of the local authorities so far drafted, in fact, were drawn up according to the guidelines in the International Public Sector Accounting Standards (IPSAS 6, 7 and 8) and in the International Accounting Standards (IAS 27) ²⁷. In both cases, local authorities have had to adapt the principles and rules contained therein to the Italian reality, but of course, every local government has acted independently, using its own criteria. The main consequence of this is the complete lack of formal and substantial uniformity in the balances produced, which made it impossible to make a comparison between the performance achieved by local authorities. Undoubtedly, this causes a debasement of the information and control potentials of the consolidated financial statement. Indeed it should be used not only to achieve a constant and timely control over the results achieved by the local group, (providing more information to the community), but also to develop a benchmarking that would allow local governments to compete with the national Best Practices (being able to improve their own performances and those of the subsidiaries). In this way citizens would be able to benefit from improved public services (also from a qualitative point of view).

The high heterogeneity in the drafting of the consolidated financial statements of the local groups depends on the fact that it is not a mandatory requirement and therefore there are no principles, rules and procedures to be followed in its drafting. However, the increasing local governments that have independently decided to publish a consolidated financial statement and the commitment declared by many other local authorities have shifted the legislator and

²⁷ The IPSAS principles can be downloaded on the internet address www.ipsas.org, whereas the IAS principles are available at the www.iasb.org.

experts' attention on this new issue. In particular, interventions will simultaneously regard two aspects ²⁸.

The first of these concerns the abolition of significant normative shortcomings in our legal system about the consolidated financial statements of local authorities. In other words, it is necessary to amend the existing legislation to make the drafting of the municipal consolidated financial statements mandatory. In this sense, the Council of Ministers is performing a preliminary examination of a draft law of 9 July 2009. If it is approved we will witness a profound reform of Tuel. The most important new is in Section X of the non-government bill. In fact, the art. 34 illustrates the new art. 147 of the Tuel. In particular, among the internal controls, it is included the point e) that, together with the administrative and accounting regularity controls and the management and strategic control, it also provides for the verification of the effectiveness, efficiency and economy of the administrative local authority external institutions through the drafting of the consolidated financial statement, making it mandatory for at least the municipalities with a population of over 5,000 inhabitants and for the provinces.

The second aspect concerns the need to establish a set of principles and rules for the drafting of the consolidated financial statements. That's to say, a technical document that could possibly answer the questions of those persons responsible for the drafting of the consolidated financial statements of the local public group. The main problems to be solved regard the definition of the consolidation area, the methodology of consolidation and the balance sheet and income statement to be used in the drafting of the consolidated financial statement. In order to resolve these issues, the Board for Local Authorities, established at the Ministry of the Interior, has drawn up the draft of the accounting standard No 4, which contains the principles for the drafting and publication of the consolidated financial statements ²⁹. The Accounting standard no.4 should be finally approved before the legislation, setting the obligatory nature of the municipal consolidated financial statement, entry into force. In fact, the same principle, as well as describing the scope of the local authority

²⁸ Among the numerous regions which have officially given their commitment to revise a consolidated financial statement are Florence, Venice, Vicenza, Brescia and Genoa.

²⁹ The Board of Auditors called by the Observatory of the public finance of the local institutions were requested to express their opinion on the revision of the principles of the book keeping system of the local institutions. Their opinion was favourable and they gave a positive approval auguring however, in the presence of a significant loss of the auditing postal service written in the financial statement of the territorial institutions the introduction of analysis of the financial statements, having the consolidated results of the management of the institutions and the administrative bodies participating, thus demonstrating in a truthful and thorough manner the exact financial situation of the institution. For a closer examination see: CORTE DEI CONTI – SEZIONE AUTONOMIE, *Relazione sullo stato dei controlli della Corte dei conti sugli organismi partecipati dagli enti locali*, Deliberazione n.13/2008 del 18 settembre 2008.

consolidated financial statements, states that, although it does not represent a legal obligation, it is a necessary element for a veritable and correct presentation of the economic, financial and capital situation of the local public group³⁰.

The new principle of the Board for Local Authorities states that the local governments consolidated financial statements includes all the local public companies, regardless of their legal form, not only corporations then, but also special agencies, institutions, consortia and other institutions controlled by the local authority itself. The consolidation can also include institutions that are not bound to participation constraints, such as foundations (but only if so provided in the programming). It is clear that, compared with the principles of a private nature, such as IAS 27 and OIC 17, the scope of consolidation is certainly larger because of the peculiarities of the local public group which are different from those of the corporate ones³¹.

The consolidated financial statements should be drafted according to an accrual accounting system, follow the scheme attached to its own principle. To this end, first, the local authority group leader must ensure that each of the entities to be consolidated have a reliable accounting system, according to the double entry method and, if necessary, begin a course that would reconcile the group's accountings.

To define the consolidation area, as provided by the principle, it is necessary to identify those local public companies that are subject to municipal control, dominant influence or joint control.

Once the consolidation area is defined the following step is that of the consolidation of the accounts. It should be noted that the principle consent, for aggregation, to use the only book values, without assignment of goodwill to assets and liabilities³². For the drafting of the consolidated financial statements it is first necessary to eliminate the book value of the participation of each parent company and the corresponding part of the parent company's net assets of each subsidiary owned by the parent company. Furthermore, it is necessary to

³⁰ “Ad oggi la redazione del bilancio consolidato da parte dell’ente locale non costituisce un obbligo di legge, ma [...] è plausibile ritenere che il futuro principio contabile nazionale emanato in materia stabilirà che, qualora l’ente locale, pur avendo degli organismi partecipati, non proceda alla redazione del bilancio consolidato, non potrà dichiarare di rispettare i principi contabili degli enti locali”. Cfr. A. MONTRONE, *Il bilancio consolidato dell’ente locale nei principi contabili per il settore pubblico. Una simulazione per il Comune di Perugia*, Osservatorio per il monitoraggio delle aziende di servizi di pubblica utilità nel Comune di Perugia, 2005.

³¹ The Italian Board of Auditors (OIC) elaborate principles and standards of confirmed and elevated authority which establish the auditing procedure. To examine further see: F. GIUNTA, M. PISANI, *Il bilancio*, Milano, Apogeo, 2008, p. 9 et seq.

³² “Il mantenimento dei valori contabili viene considerato coerente con lo spirito del rendiconto dell’ente, che non ha un orientamento di mercato (quindi di fair value)”. S. POZZOLI, “*Consolidato pubblico*” con confini allargati, in *Il Sole 24 ore* del 27 aprile 2009.

identify the shares of the net revenue and net assets of each local public entities subject to consolidation that are attributable to third parties. Finally, it is necessary to eliminate balances, transactions, revenues and expenses within the economic set constituting the local public group. It is now possible to undertake the aggregation process of the balance sheets and income statement of the group companies. In general, it is expected the use of the full consolidation method emphasizing the net assets pertaining to third parties. However, the participation of the local authority in an associated company must be brought to account according to the net assets method, unless such a participation was bought exclusively in view of selling it back in the near future. In fact, it is applied the cost method. Finally, the proportionate consolidation or, alternatively, the equity method is proposed for companies subject to joint control.

The phase of integrating the items of the balance sheet and income statement implies that, in the drafting of the financial statements of every single company, accounting standards and consistent evaluation criteria are applied, but also that the dates of the financial statements accord with that of the parent's. The derogation from the obligation of complying with the standard evaluation criteria is permitted only when complying with different criteria would represent a veritable and correct situation, or whether the effects of a change in the criteria are quantitatively and qualitatively insignificant comparing to the consolidated value of the items they refer to.

The principle of the Board of Local Authorities, in order to ensure a complete understanding of the accounting document, stipulates that, together with the consolidated financial statement of the local public group, additional information (about the companies included in the consolidation area, but also those that have been excluded) must be added. Regarding the excluded companies it is necessary to produce a summary/memorandum of the main financial data, such as total assets, total liabilities, total income and economic statement as well as the reasons why they have been excluded.

The local government stakeholder, once the consolidated financial statements have been drafted according to the principle/standard no. 4, must submit it to the Council for the approval that must be given in conjunction with the deliberations on the reporting.

Finally, the principle shows that there are transitional provisions which should simplify its adoption immediately after its entry into force. In the first three years it is only possible to draw up the consolidated financial statement of in-house companies or corporations, to limit the calculation of intra-group balances, and to approve it at a different time with respect to the reporting.

The alignment of the provisions contained in the draft of the accounting principle/standard n. 4 of the Observatory to the indications contained in IPSAS 6, 7 and 8 is quite clear. In this regard, the opinion is certainly a positive one. First of all, because local Italian governments that drew up its group's balance have observed these provisions and, finally, recalling the need for uniformity in the principles and accounting rules applied to public sector increasingly pressing at international level.

In conclusion, we consider that the consolidated financial statements may be validly used to support the decision-making process of the top management of the local authority in the planning, programming and control, (even strategic) of the local public group's activities, and that it could simultaneously represent a powerful tool to achieve an adequate accountability when the fragmentation of the local activity into several subsidiaries makes the authority accounting less informative³³. So, in our opinion, it is necessary that the obligation to prepare consolidated financial statements for local group be soon introduced, as the only instrument capable of assessing the economy of the economic entity constituted by the local authority and by its local public companies and, simultaneously, to compare the costs required to the managed community to the received services. On the other hand, we realize that the technical delay times for the approval of legislative intervention are naturally long. Therefore, while waiting, we wish a rapid drafting of the final version of the Principle/standard 4 of the Board of Local Authorities as well as attempts/trials carried out on a sample of local authorities representative of the population of Italian municipalities. However, new attempts/trials carried out autonomously by the municipalities should not be misjudged, but considered another opportunity to solve problems that occur when an instrument of accountability as complicated as the consolidated financial statement is used for the first time in such a complicated sphere.

³³ However, compared to the private context where it is leading to the decision usefulness, it was noted that “il principio dell'accountability sembra assumere una rilevanza ancora maggiore nel contesto pubblico, dove la disciplina dei comportamenti di politici e manager non sempre passa dai soli mercati finanziari, le categorie di portatori di interesse sono ampie, la necessità di trasparenza sull'integrità dell'impiego delle risorse è fondamentale”. Cfr. G. GROSSI, I. STECCOLINI, *Il bilancio consolidato negli enti locali: principi contabili e condizioni operative*, in *Azienda Pubblica*, n. 4/2008.

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