COUNCIL OF EUROPE CONSEIL DE L'EUROPE

Local and Regional Democracy

Accounting rules and practice at local level

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Summary of survey results

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INTRODUCTION

The Steering Committee on local and regional democracy (CDLR) decided to include an activity concerning local accounting rules and practices in Council of Europe's member states in its programme for 2003.

A questionnaire was prepared and adopted by the Committee of experts on finance and public services at local and regional level (LR-FL) with the help of Professor Faska Khrouz, of the University of Brussels Solvay Business School, based on more than a decade of its experience in designing local-government accounting systems in Belgium and training municipal and provincial tax officers [collectors].

The questionnaire was sent to CDLR members, who are senior officials representing the ministries responsible for local and regional authorities in the member states.

During the first quarter of 2004, 23 countries returned the questionnaire, completed either partially or in full, adding a wide range of qualitative comments. Some countries did not answer all the questions while others did not reply, or submitted their responses very late (the questionnaires from Austria and Estonia were returned in May 2004).

The completed questionnaires were sorted and processed with the help of an assistant[1] at the Brussels University, applying mainly quantitative but also certain qualitative criteria. A first version of the report was prepared with the replies to the questionnaire.

Later, the report was completed with a supplementary questionnaire, with the help of Professor Isabel Brusca, of the University of Zaragoza (Spain), who also revised the first version of the report. The supplementary questionnaire was sent to the countries having replied to the first questionnaire.

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[1] Professor Khrouz is grateful to Olivier Mortehan for his help in sifting through the data collected and in processing them.

The present report shows the replies of the two corresponding questionnaires, presented in the summary tables which set out the questions asked, the responses from each country and a summary of those responses in both absolute and relative terms. In the case of Belgium, each of the country's three regions sent a separate reply because there are differences (in some cases significant) between their respective laws. Each region replied to questions on the areas which concerned it, and the responses from Wallonia (Belgium-W), Flanders (Belgium-F), and the Brussels Capital region (Belgium-BXL) therefore had to be treated separately.

The MS Excel table of the synthesis of the replies received, together with the various comments made by the respondents (included as "hypertext" links) is available on request by e-mail to webmaster.local@coe.int.

The report aims to summarise the main trends that emerged while at the same time reflecting factors specific to each country.

Limits of the analysis

There is one factor that may limit the scope of the analysis contained in this report. It is language. The Council of Europe has two official languages, English and French. The first questionnaire was originally prepared in French and subsequently translated into English. The second questionnaire was prepared in English and then translated into French. However talented the Council of Europe's translators may be, accounting concepts are very difficult to translate.

Accounting institutions, the terms and notions used and what they actually mean can vary from one country to another. This applies, for example, to widely-used English terms like "cash accounting" and "accrual accounting".

English is the official language of most of the specialised international organisations and institutions – such as the IFAC (International Federation of Accountants) and IASCF (International Accounting Standards Committee Foundation) and its IASB (International Accounting Standards Board). In order to guarantee the quality of the translations of its standards, the IASCF set up an official translation process in 1997. For each language, this involves one or more translators, a translation co-ordinator and an expert committee of revisers.

The European Union's decision to require quoted companies to prepare their consolidated financial documents using International Financial Reporting Standards (IFRS) from 2005 onwards created an urgent need for translations of the standards in the languages of the EU member states. IASCF reached an agreement with the European Commission to use its official translation process for this. The translations were revised by the national representatives on the Accounting Regulatory Committee and forwarded to the European Commission.

In local authority accounting, however, things are not so simple. The great debate between cash accounting and accrual accounting in British-style accounting resembles that between "budgetary" and "general" accounting in French law. The term "accrual accounting" has become increasingly associated with all-in, "patrimonial" accounting, and thus corresponds more to the French term *"comptabilité générale"* or general accounting, even if the European Union's International Accounting Standards (IAS) equate "accrual accounting" with *"comptabilité d'engagement"* and "cash accounting" with *"comptabilité de caisse"* or *"comptabilité camérale"*. Translating from French to English, *"comptabilité budgétaire"* should be translated by "budget accounts system" or "system based on the modified cash accounting principle" and *"comptabilité générale"* by "general accounts system". These terms are not used in the IAS, however, and are little used in practice. The translation of these terms into English in EU documents is often very "imaginative". It was therefore essential not to obscure the real issues that arise in the different countries, such as the choice between *"comptabilité budgétaire"* and *"comptabilité générale"* in countries where the accounting system resembles the French system, and between "cash accounting" and "accrual accounting" in those where it resembles the British system. This is why the consultant, Professor Khrouz, decided to equate *"comptabilité budgétaire"* with "cash accounting" and *"comptabilité générale"* with "accrual accounting".

Nevertheless, the supplementary questionnaire has attempted this problem, using the terms budgetary system and financial accounting system.

Furthermore, it should be understood that one cannot help wondering how the questionnaire translated into other languages and whether all the replies to each question are really 100% comparable. It is difficult to know, for example, if the Dutch or Romanian translation of *"livre journal"* or "journal" actually corresponds to exactly the same document.

In short, the difficulties of using a specific vocabulary in the questionnaire, together with a problem of translation into different languages may have led to some questions being misunderstood, and for this reason the results must be taken with some prudence and reserve.

In spite of these limitations, the information on local authority accounting that has been collected provides a very useful and important basis for reflection, as there is little information on the subject in the literature or in the documents produced by specialist international organisations or NGOs.

I. EVOLUTION AND REFORMS OF LOCAL GOVERNMENT ACCOUNTING IN THE INTERNATIONAL CONTEXT

At the moment, there seems to be a general consensus that accounting systems play an important role in economic and social developed municipalities, serving to improve the accountability of politicians and the improvement of public service management, and leading in turn to efficient and effective governance. They have traditionally emerged in an attempt to help the rationalisation of resources, which are always scarce when attending to the needs of citizens. It has been a cultural rationalisation that has driven the expansion of accounting in the public sector.

Financial reporting by local governments is used in making economic, social and political decisions and in assessing accountability primarily by: comparing actual financial results with the legally adopted budget; assessing financial condition and results of operations; assisting in determining compliance with finance-related laws, rules, and regulations and assisting in evaluating efficiency and effectiveness. Moreover, the budget is an expression of the public policy and financial intent as well as a management tool and a method of providing control.

As a consequence, the adoption of rational budgets and the application of modern accounting methods can have important benefits both for the politicians and for the citizens. Moreover, in democracy a good accounting system is a very useful instrument for the electorate to hold their politicians and administration accountable.

Trying to respond to these necessities and potential uses of accounting, over the last fifteen years, most countries in the OECD have undertaken reform processes of their local government accounting system, which, in many cases are still being developed. The scope of the reforms has been very diverse, even affecting the very objectives of the accounting information or the entry procedures used. In some cases, these reforms have affected the local administrations and, in other cases, the government administrations in general.

A common element to all the reforms carried out in the different countries is the interest to in providing local government accounting with a wider-ranging content, so that the information provided may be useful for decision-making and increase the transparency of public policy. Therefore, a fairly generalised modification of the traditional concept of governmental accounting has emerged, linked to accountability and legal controls and influenced by the regulations that regulate the budget and the administration of public funds in the different countries. The reform of the accounting systems also falls within a wider-ranging reform context where the governments of the different countries are making important efforts to control their public expenditure.

The reasons for reforms are numerous, diverse and even conflicting in nature. They include changing conceptions of local governments, changes in the cultural thinking of citizens, budgetary and economic restraint, the demand for better public services, the search for greater efficiency (for the same money, citizens expect more services), the demand for more accountability and especially more transparency, changes in business sector management tools and theories, new changes in technologies that can used in the delivery of public services and internal and external pressure, from other governmental entities and from international organisations.

In an attempt to answer these requirements, different levels of governments in most OECD countries have adapted and developed accounting and financial reporting systems in line with the New Public Management principles and methodology. The reforms have been very widespread and have even affected the objectives of public financial reporting. Nevertheless there are some countries where the reform is pending.

The New Public Management is a concept articulated in 1992 by David Osborne and Ted Gaebler in their book *Reinventing Government*. It applies the business customer service model to government. Citizens are seen as customers and the administrative role is streamlined by converting policy alternatives into market choices. The main characteristics of New Public Management can be summarised as: deregulation, decentralisation, market orientation, cultural change, citizen orientation, strategic abilities to adapt to new environmental changes, political responsibilities for accountability and transparency, and a focus on performance and the results of policies and actions, which promotes competition inside and outside government.

These new characteristics of public management have led to new information necessities. Under the New Public Management, information is oriented towards decision-making and responsibilities are assigned with a view to accountability. This requires changes in the accounting systems and as a consequence local governments have undergone an important reform process, responding to the idea that accounting systems are under constant evolution due both to internal factors of local governments of a country (cultural, changes in social values, etc.) and factors external to them (there is a general atmosphere of change in local government accounting systems on an international scale).

In this sense, and as a synthesis, some common and defining elements can be highlighted concerning the reforms carried out in local accounting systems in the international context:

– Introduction of double entry accounting, in accordance with generally accepted accounting principles, with progressive convergence to the business accounting model. Australia and New Zealand are leaders in the initiative for the convergence of both types of accounting systems, given that in both cases the accounting standards board is the same for public and private entities. In New Zealand the same standards are applied by governmental and by business entities. In Finland local governments apply the same standards as business entities.

– Maintenance of the importance of budget monitoring integrated as a subsystem of the Information System for Local Accounting or designed independently, with an increasing tendency towards accrual budgets. In any case, the reforms try to go beyond the mere budgetary information, making financial accounting and management accounting play an important role. Therefore, sometimes a coordination between budgetary and accounting subsystems can be seen, and sometimes there is even a unique system, which produces both kinds of reporting. Moreover, management accounting is usually connected with the budgetary system but it can also be a different system.

– Tendency towards the homogenisation of the accounting systems of the national, regional and local governments in each country, although there are still notable differences in some cases.

– A clear appreciation of the role played by accounting information systems can be seen, both from an internal point of view, as a support for the management process, and from an external point of view, as an instrument that improves the transparency and presentation of accounts.

– An increasing focus on accountability and results with the emergence of the concept of Managing by Results, where the emphasis is on outcomes and performance information is considered basic for accountability

> purposes. Although years ago financial accountability was thought to be enough, now it is not. Non-financial measures are important to demonstrate accountability and transparency. It is important to communicate to constituents to what extent goals and objectives have been achieved.

However, although the reform of local accounting systems is a generalised trend throughout the world, the situation and the degree of consolidation of the reforms is logically different in each country. Among the reasons for the differences in accounting reforms in different countries, can be mentioned the legal system, the organisation of the local sector, specific objectives of public financial reporting, principal users of the financial reporting, financial resource suppliers, the drive of public accounting regulatory bodies, interest and formation of professionals and the social, economic and political environment in which each system operates. For this reason, it is interesting to know the situation of the reforms in the local governments of a group of countries and in particular in the Council of Europe countries.

The purpose of this report is to show the present situation in local governments of the Council of Europe countries. To do so the situation in the different countries will be compared. Comparison can be a stimulus towards improving local accounting information, especially in countries which maintain traditional local accounting systems, in which it can push reform and modernisation forward.

II. THE SITUATION IN THE COUNCIL OF EUROPE COUNTRIES

This part presents the results of the two surveys carried out with the objective of finding out the situation of local accounting in the Council of Europe countries are presented. The first survey, carried out by Professor Krouz was answered by 27 countries: Albania, Austria, Azerbaijan, Belgium (Brussels-capital Region, Flemish Region and Walloon Region), Croatia, Czech Republic, Denmark, Estonia, Finland, France, Hungary, Italy, Luxembourg, Lithuania, Malta, Moldova, the Netherlands, Norway, Portugal, Romania, Russian Federation, Slovakia, Slovenia, Spain, Sweden, Turkey and United Kingdom.

The original idea was to send the supplementary questionnaire only to these countries, with the objective of clarifying some aspects that could have been misleading, such as the accounting and budgetary basis. Additional questions about budgetary and financial reporting have been asked to complete the report. This questionnaire was answered by 18 countries: Albania, Belgium (Brussels Capital, Flanders and Wallonia), Croatia, Czech Republic, Denmark, Germany, Greece, Hungary, Italy, the Netherlands, Norway, Portugal, Russian Federation, Slovakia, Slovenia, Spain, Sweden and United Kingdom. For this reason, in some tables there are different numbers of countries. Two countries that did not answer the first questionnaire have completed the supplementary questionnaire: Greece and Germany. For the latter, the responses of the regions of Bavaria and Northrhine-Westfalia contain some differences, and therefore have been treated separately (Germany B and Germany N).

1. Legal framework of the budget and accounting

All the countries that replied have a legal framework regulating accounting practice at local level and the budgetary requirements for these entities. It is usually the case that this same legal framework sets the requirements for budgets and for accounting, although some countries, such as Albania, Czech Republic, Greece and Slovakia, have different laws for budgeting and accounting. In Spain there is a law that establishes the basic requirements for accounting and budgeting, as well as supplementary laws for budgetary and accounting matters.

Legal Framework of Budget and Accounting for Local Government	Albania	Austria	Azerbaijan	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Germany B	Germany N	Greece	Hungary	Italy	Lithuania	Luxembourg	Malta	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
a. Budgetary and accounting rules are based on legal requirements	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
b. Budgetary and accounting rules are established in the same legal pronouncements				x	x	x	x		x								x		x		x	x	x	x		x		x		x		x
c. Local entities should apply the same accounting rules as business entities											x				x	x					x									x		
d. There are specific accounting rules for local government	x	x	x	x	x	x	x		x	x		x	x	x	x		x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
e. Although public sector accounting rules are different from business standards, the latter greatly influence the former	x		x				x	x	x	x	x	x	x	x	x	x	x	x				x	x	x				x	x	x		x
f. There is a Chart of Accounts for local government accounting	x	x		x	x	x	x	x	x	x		x	x	x	x	x	x		x	x	x		x	x	x		x		x		x	x
g. Local governments apply the same standards as regional or autonomous governments	x						x	x	x			x				x					x	x	x				x	x				
h. Local governments apply the same standards as the central government	x						x	x								x			x		x						x	x				

Figure 1: Legal framework of budgeting and accounting for local government

Legal texts do not usually specify the accounting system, but only require the basic rules, such as which statements to present or about the publication of the information. There is a specific Chart of Accounts for local government accounting in most countries. In the UK, there is no proper chart of accounts, but *A Statement of Recommended Practice: Code of Practice on Local Authority Accounting in the United Kingdom* (generally known as "the SORP"). It is a comprehensive statement of the accounting concepts, accounting policies and estimation techniques to be followed by local authorities, and also sets out the format of the accounting statements.

The Chart of Accounts is usually very rigid in some countries with a continental accounting culture, where there is a tendency for detailed description of the contents of the accounting information, which tries to guarantee compliance with the principles established in the legal guidelines. This is the case for example of Spain, France, Belgium F or Italy. In most cases the Chart contains several classes: net worth and borrowing; fixed assets; inventory; current receivables and liabilities; financial accounts; expense accounts; revenue accounts; and off-balance sheet commitments.

With regard to the accounting standards to be applied by local entities, only in the case of Finland, Greece, Hungary, Moldova and Sweden are they the same as those applied to business entities. In the other countries, there are specific accounting regulations for local governments, although a high percentage of these (65%) confirm that, even though the norms for local entities are different from those for companies, the latter have exercised an important influence on the former. In fact, the differences are minimal in most countries. Usually the Chart of Accounting is based on that of the business sector. In United Kingdom the SORP is based on generally accepted accounting principles in the business sector.

With respect to the harmonisation between different public sector entities, it is very usual that accounting standards of different levels differ between them. Only Albania, Croatia, Czech Republic, Hungary, Moldova Slovakia and Slovenia have the same standards for local, regional and central government. In other countries, regional and local government have the same rules, but different to the central government. Differences are very varied. For example, in the United Kingdom central government rules (set out in the *Resource Accounting Manual*, or RAM) are closer to the private sector, especially in accounting for fixed asset disposals. In Norway and Greece, central government only applies cash basis, while in the Netherlands central government uses a modified cash basis of accounting. In other cases, differences are very few, and are derived from the organisation of local governments.

The body responsible for budgetary and accounting rules is usually the same, although for example in Greece and Norway there are different bodies.

In 75% of cases this regulation stems from the ministry responsible for local government, which is often the Ministry of Finance or the Ministry of Interior. In Belgium, it is the Ministry of Interior at the level of each region which is responsible for the accounting regulations for each of the three Belgian Regions[2]: Flanders, Wallonia and Brussels Capital. This is why each region has its own accounting system and they have been included separately. However, in the UK, there is a high involvement of the professional body: the SORP is prepared and kept under review by a joint committee of the Chartered Institute of Public Finance and Accountancy (CIPFA), the public sector accountancy institute for the UK, and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC), a committee representing Scottish interests.

In the Netherlands, although accounting rules come from the Ministry of Interior, an independent body advises the government on the issuing of rules. In Finland, it is the Municipal Section of the Accounting Board, set up by the Ministry of Trade and Industry, which is responsible for accounting in local government, but the Associations of the Chartered Public Finance Auditing gives comments on accounting questions at the request of the Municipal section. In Norway, a local government accounting standard board has been established. Its purpose is to issue local government accounting standards. The local government association, as well as the chartered accountants association and the Ministry are members of the standard board.

In most countries it is also a governmental body which is responsible for advising the Ministry of Finance or Interior about accounting and budgetary rules. In some countries the task is shared with bodies or authorities at other levels: in France, Portugal, Estonia and Turkey the Auditor General's Department is the body responsible, together with the corresponding Ministry.

[2] Belgium has 589 municipalities, of which 308 are in the Flemish Region, 19 in the Brussels Capital Region and 262 in the Walloon Region.

Legal Framework of Budget and Accounting for Local Government	Albania	Austria	Azerbaijan	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Germany B	Germany N	Greece	Hungary	Italy	Lithuania	Luxembourg	Malta	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
Budget regulations and accounting standards for local government are established by the same	x			x	x	x	x	x	x					x		x	x		x	x	x	x		x			x	x	x	x		x
Accounting and financial reporting standards for local government are																																
- A governmental body, depending on the Ministry	F	F					F	F	I&H	F	T&I	F			F	F&I	I	I	I	I	F	I	I	F&I			F	F	F	x	I	x
- A regional body				x	x	x																										
- A private profesional																							x									x
Who advises the government on budget and accounting regulations for																																
- A governmental body	x	x		x	x	x	x	x	x	x	x	x	x	x	x	x	x		x		x			x			x	x	x		x	x
- An independent body																						x										
- A private profesional body											x												x									x

F: Finance; I: Interior; T&I: Commerce and Industry

Figure 2. Accounting and Budgeting Regulators

Some member states' present accounting system was set up in the 1990s[3], but there are many member states where, the accounting system was modified recently in the 2000's. This is especially the case in countries with more advanced systems, owing to recent reforms, particularly to the budgetary system.

[3] This was for example the case in Belgium, where the accounting rules were adopted in 1990, although did not come into effect until 1995.

Implantation of the actual systems and planned reforms	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
Year in which the budgeting rules for local governments have been changed		1990	1990	1990		2001	1992				1990	1995	1997	2003	2003	2000	1999	2004	2000	1990	1998	2000
Year in which the financial accounting rules for local governments have been changed		1990	1990	1990	2003	2001	2001-2004	2005	2005		1990	1995	1997	2004-2005	2003	2000	1999	2003	2000	1990	1998	1994

Figure 3. Year of the implantation of the actual system (approbation of the law and rules)

With respect to the entities concerned, the local government accounting and budgetary standards usually cover all sizes of municipalities, although few have a population of more than 100,000. In the majority of countries the accounting system also deals with the inter-municipal cooperation bodies.

Entities concerned	Albania	Austria	Azerbaijan	Belgium-BXL	Belgium-F	Belgium-W	Croatia	Czech Republic	Denmark	Finland	France	Hungary	Italy	Lithuania	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Turkey	United Kingdom
Communes / municipalities	y	y	y	n	n	n	y	y	y	y	y	y	y	y	y	y	y	y	y	y	y	y	y	y
ter-municipal co-operation structur	y	y	y	n	n	n	n	y	y	y	y	y	y		y	y	y	y	y	y	n	n	y	y

Figure 4: Entities concerned by local-government accounting

2. The measurement focus and basis of the budget and financial accounting

The *basis of accounting* refers to the body of accounting principles that determine when the effects of transactions or events should be recognised for financial or budgetary reporting purposes. It is a term used to refer to revenues, expenditures, expenses, and transfers and their related assets and liabilities that are recognised in the budget or accounts and reported in the financial statements. Specifically, it relates to the *timing* of the measurements made, regardless of the nature of the measurement.

Although the accrual and cash bases of accounting are opposite poles, between the two extremes modified cash and accrual bases are used. The difference between the different bases is due fundamentally to the moment in which the revenues and expenses and the related asset and liability transactions are recognised. The modified accrual or modified cash bases of accounting can approximate the accrual basis of accounting or the cash basis of accounting. The nature of the elements which are reported will depend on where the model lies on the spectrum between cash and full accrual accounting.

The *cash basis of accounting* recognises transactions and events only when cash has been received or paid. As a consequence, the system is designed to register the receipts and payments and a statement is usually prepared to disclose information about cash flows during a period and cash balances at the end of the period. Fixed assets are recognised as expenditures when they are acquired and debts are registered as cash in when they are received. Therefore there is no information about the existing stock of assets and liabilities. It is used in some cases in budgetary reporting.

The *modified cash basis of accounting* is similar to the cash basis but there are some differences. A common modification to the cash basis is to recognise not only cash received and paid but also those transactions and events that will result in cash receipts or disbursements within a short period immediately following year end. As well as cash flows and cash balances some receivables and payables are registered. This system is very often used for budgetary preparation and reporting in local governments.

The *full accrual basis* of accounting is geared towards recognising the financial effects of transactions and events in the periods in which they occur, and not only when cash or equivalents is received or paid. The full accrual basis of accounting reports on the economic resources or service potentials (assets) and obligations (liabilities) of the entity, and changes therein. It requires the capitalisation of expenditures on the acquisition of all capital assets and the depreciation of those assets as their potential is consumed. Therefore, the full accrual basis of accounting will recognise all assets, liabilities, revenues and expenses (including depreciation). It is the method usually used for business financial statements and also for local governments financial statements of the most Anglo-Saxon countries. The information discloses five items: assets, liabilities, revenues, expenses and equity (net assets).

The *modified accrual basis* of accounting also recognises transactions and events in the periods in which they occur, irrespective of whether or not cash has been received or paid, but there are some specific differences. A common modification at the accrual end of the spectrum is not capitalising physical assets, but considering them as expenditures. In some cases, the difference with the full accrual basis is that depreciation of assets is not registered, but in other it is the recognition of revenues for taxes when they are received, because of the difficulties of doing it before.

It is important to consider the impact that the use of alternative criteria will have on financial and budgetary reporting and especially on revenue and expense statements and on the balance sheet. Under different bases of accounting the elements of financial statements may be defined differently. For example, with the accounting bases and the correlated measurement focus, it is important to determine which assets and liabilities should be included in the balance sheet, when transactions affecting cash should be registered, which transactions that do not affect cash should be registered and how to evaluate assets and liabilities and their net changes.

Figure 5 summarises the elements of financial or budgetary reporting under different bases of accounting and the measurement focus used in each one.

The choice of one or another accounting criterion will cause important differences in the accounting systems which, without a doubt, will become the main cause of accounting diversity.

It is difficult to establish a comparison between accounting systems that use different criteria, inasmuch as the items of which the accounting system is composed are very different. In this way, while a full accrual system reflects all assets and liabilities, as well as revenues and expenses, a modified cash system only reflects the changes in current financial resources, leaving aside long term asset and liability transactions.

Basis of accounting	Measurement focus	Elements of reporting (budgetary or financial)
Cash Basis	Cash Balances (and changes therein)	- Cash receipts - Cash disbursements - Cash Balances
Modified Cash Basis	Current Financial resources (and changes therein). Receivables and payables	- Cash receipts plus receivables within a specific period from period end - Cash disbursements plus payables within a specific period at period end - Cash and near cash Balances
Modified Accrual	Total Financial Resources	- Revenues - Expenditures (includes the acquisition of physical assets) - Financial assets - Liabilities - Net financial resources
Full Accrual Basis	Economic Resources (and changes therein)	- Revenues - Expenses (including depreciation) - Assets (financial and physical) - Liabilities - Net assets (equity)

Source: IFAC Public Sector Committee (1993), Study 2 *Elements of the Financial Statements of National Governments*.
Figure 5. Accounting Basis and Measurement Focus

Bearing in mind that these four options can be used both for the budget and for the financial statements, two questions have been included to determine the real situation in the European countries. The results are shown in Figure 6.

Measurement focus and basis of recognition	Albania	Austria	Azerbaijan	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Germany B	Germany N	Greece	Hungary	Italy	Lithuania	Luxembourg	Malta	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
a. Cash basis of accounting (cash payments and cash receipts)							B	B		B					B	B			B/FR		B			B								
b. Modified cash basis of accounting (cash and near cash, in other words, obligations or commitments and receivables)		B/FR	B	B	B/FR	B		FR	B								B	B		B	FR		B		B	B	B	B	B		B/FR	
c. Modified accrual basis of accounting							FR					B/FR						FR		FR		B/FR	FR				FR	FR	FR			
d. Accrual basis of accounting	FR		FR	FR	FR	FR			FR	FR	B/FR			FR	FR	FR	FR							FR	FR					B/FR		B/FR

Figure 6. Accounting Basis and Measurement Focus for Budget (B) and Financial Reporting (FR)

The existence of different recognition criteria for the elements of financial statements is, without a doubt, one of the main factors that causes differences in governmental accounting systems. Although some countries use the complete accrual system, at the same time there are many countries in which the criterion applied is the modified accrual system and in others the cash basis of accounting still persists. In the budget there is also heterogeneity, as it can be seen in the figure.

Concerning the criteria used for the preparation of budgetary reporting, there are four countries where the accrual basis is applied: Finland, Sweden, the Netherlands and United Kingdom. In the Netherlands there is a small modification in the accrual basis, so it can be referred to as modified accrual basis. In France the system used is near to a modified accrual basis of accounting.

The reasons that those countries give for adopting accrual budget, as can be seen in Figure 7, are that it is easier for accountability purposes, it shows not only true cost but also service efforts and accomplishments, and above all, it allows improvement of decision-making.

Reasons for the budget to be on an accrual or modified accrual basis	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
- True costs are included															x						x	x
- It is easier to make investment decisions															x						x	
- It is easier for accountability purposes, because it shows service efforts and accomplishments, such as outputs and outcomes															x						x	x
- It allows the improvement of decision-making in the government															x						x	x
- It is the criterion used in financial accounts															x						x	x
- It is the criterion used traditionally																						

Figure 7: Reasons for the accrual or modified accrual basis in the budget

In the other countries, the cash or modified cash bases prevail. The cash basis is still maintained in Croatia, Czech Republic, Estonia, Greece, Hungary, Luxembourg, Moldova and Portugal, while in Belgian regions, Denmark, Italy, Norway, Slovakia, Slovenia and Spain the budget focuses on commitments and receivables together with cash, using a modified cash basis. In Italy, the budgetary system foresees, as compulsory, the budget and the budget account which consists of two kinds of documents. Both of them are processed with the criteria of cash basis of accounting and with the criteria of modified cash basis of accounting. Therefore, in Italy, two types of records are compulsory: i) record of expenditure for appropriation budgeting or for commitments and record of revenue for entitlements or receivables (modified cash accounting); ii) record of expenditure for cash payment and a recording of revenue for cash receipts (cash accounting).

The reason for the budget to be on cash or modified cash basis, as can be seen in Figure 8 below, is that it is the criterion used traditionally, being considered in some cases as more transparent than the accrual basis.

Reasons for the budget to be on a cash or modified cash basis	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
- It can be more transparent for e.g. authorisation of the budget					x		x				x	x	x	x			x	x	x			
- It is less complex than accrual														x				x	x	x		
- It is the criterion used traditionally			x			x	x					x	x	x			x	x	x	x		

Figure 8: Reasons for the cash basis or modified cash basis in the budget

As for financial reporting, there is more agreement on the use of the accrual or modified accrual basis of accounting. Only Austria, Czech Republic, Luxembourg, Moldova and Turkey use cash or modified cash basis. The reasons are that it is the criterion used traditionally and that the budget is elaborated using cash basis.

The full accrual basis is applied in Albania, Belgium, Denmark, Greece, Hungary, Italy, Portugal, Sweden and United Kingdom. Croatia, Norway, Spain and the Netherlands have some modifications that allow it to be considered as modified accrual basis.

The reasons for the financial report to be in accrual on modified accrual basis appear in Figure 9:

Reasons for the financial reports to be on an accrual or modified accrual basis	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
- It allows to know the cost of the exercise (cost are included)	x	x	x	x			x					x			x		x		x		x	x
- It allows a better understanding of the financial position	x	x	x	x			x					x			x		x		x	x	x	x
- It is the criterion used in the business sector	x						x					x			x		x			x	x	

Figure 9. Reasons for the accrual or modified accrual basis in the financial report

If the budget and the financial report do not have the same basis, some mechanism is necessary for the relationship between the accounting system and the budgetary system. There are different possible situations that will be commented on later.

There is also a question about possible plans for modifying the present rules of accounting or budgeting. As can be seen many countries are planning to change, usually with the objective of adapting to a new environment or harmonising different levels of government in the country.

For example, in Belgium Flanders, the objective is to create uniform budgeting and accounting rules for the different local authorities in the Flemish Region: the municipalities, the provinces, the Public Centres for Social Welfare. At present, each of them has its own rules.

Planned reforms	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
Are there plans for changing the budgeting rules for local government?	y	y	y	y	n	n	y	y	y	y	y	y	n	y	n	n	n	y	n	n	n	y
Are there plans for changing the financial reporting rules for local government?	y	y	y	y	n	n	y	y	y	n	n	y	n	y	n	n	n	y	n	y	n	y

Figure 10: Planned reforms in budgeting and accounting rules

Only Denmark is planning to change the basis of the budget with the intention of adopting the accrual basis. The introduction of accrual accounting principles in the budget in the period from 2006-2007 will be tested among a number of municipalities.

In the United Kingdom, there are proposals to require depreciation (already included in accounts and budgets) to be financed. At present, only charges for the repayment of borrowing need be financed.

In Italy, the intention is to harmonise the systems of the various levels of government (State, regions and local authorities)

3. Coordination of the budget system and the accounting system

As the budgetary and accounting systems are usually two subsystems of the Information System, it is necessary to establish some mechanisms for their coordination. In fact, most countries stated that there is integration of the budgetary and accounting systems through the use of budgetary procedures. This implies that the budget is at the end the most important document of local entities and the Information System revolves around it.

One possibility could be that the information system is limited to the registration of budgetary operations, and so there is no accounting system as such. In this case, the financial accounting is limited practically to the budgetary information and only the transactions that affect the budget are registered. It is very usual in countries where budget and financial reporting is carried out using the cash basis, and Austria, Czech Republic, Luxembourg and Turkey should be included in this category because they nearly only work with budgetary reporting. However, only Luxembourg responded to the supplementary questionnaire saying that this is their situation.

The situation varies greatly if accounting rules and budgetary rules are the same or if they are different. In the first case, a transaction should be recorded in the two systems equally and a single system can produce both kinds of documents: budgetary and financial.

Albania, Germany B, Italy, Moldova, Sweden, the Netherlands and United Kingdom affirm that accounting rules and budgetary rules are the same, so there is a unified system. In this case, the documents can contain both budgetary and financial data. For example, in Sweden, the Netherlands and United Kingdom, where the budget is elaborated using the same criteria as for the accounting statements, at the end of the period the accounting statements contain the real data, and forecast and real data can even be compared in the same document. In Norway, a similar basis in the budget and the accounting system is used.

Another possibility is that budgetary rules differ from accounting rules, but of course there is a connection between the two systems. This is the case of Belgium, Croatia, Czech Republic, Denmark, Germany N, Greece, Hungary, Norway, Portugal, Slovakia, Slovenia and Spain. There are two possibilities for the coordination of both systems. First, that during the year transactions are recorded only in the budgetary system and using the budget rules. At the end of the exercise, budgetary reporting is adjusted to obtain financial reporting. In this case, a conciliation of budgetary and accounting variables is usual. For example, in Greece books on accrual basis are adjusted at the end of the year, although there is no conciliation between budgetary and accounting variables in the financial report.

How are budgetary and financial accounting related	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
a. The accounting and budgetary system is limited to the recording of budgetary transactions and the budget is the only element of the system													x									
b. The budgetary system and the financial accounting system are linked but budgetary rules are different from accounting rules.		x	x	x	x	x	x		x	x	x					x	x	x	x	x		
c. The budgetary system and the financial accounting system are linked, and budgetary and accounting rules are the same, so there is a unified system	x							x				x		x	x						x	x
d. The financial report includes the budget report (comparison of budget and actual)	x	x	x	x	x		x	x	x		x	x	x	x	x	x	x		x	x	x	x
e. The financial report includes a reconciliation between budgetary variables and accounting variables (budgetary and accounting results for example)	x	x	x	x	x		x	x			x	x		x	x	x	x		x		x	
f. There is integration of the budgetary and accounting systems through the use of budgetary procedures		x	x	x	x	x		x	x		x			x	x	x			x	x	x	x

Figure 11. Links between the Budgetary and the Accounting System

The second possibility is that the introduction of a transaction in the information system produces a double entry: in the budgetary system and in the accounting system, with the corresponding codes and rules. This is, for example, the option adopted in Spain, where a computer program allows transactions to appear simultaneously in both systems. The system produces two kinds of information. With this alternative, the budgetary information is presented in a single statement, and the accounting criteria are not affected by the budgetary criteria, because only in the budgetary statements do the latter dominate, maintaining the disassociation of the two. Moreover, some countries establish a conciliation between the budgetary and accounting variables at the end of the period. That conciliation is missing in Denmark and in Spain.

In Italy, the legal framework in the field of financial accounting allows local authorities to adopt the accounting system they deem most suitable[4]. This has resulted in a certain amount of autonomy being granted to local authorities, especially small ones, in order to adopt the accounting system to particular operative requirements. For this reason, local authorities can use the accrual accounting on the basis of their own accounting system.

However, to guarantee fulfilment of the accrual accounting the legal framework requires local authorities to produce a balance sheet and cost and revenue account regarding the annual management report and, to this end, local authorities can take the data from the budgetary cash accounting. This is possible because the Italian budgetary accounting is extremely articulated, with more detailed information, which allows the economic result and the statement of assets and liabilities to be elaborated taking into consideration budgetary reporting. In particular, by means of the budgetary system it is possible to determine the economic result of the annual management report using a *scheme of conciliation* which highlights the assessment of income and the appropriation of expenditure of cash accounting and allows various adjustments to be made.

Nevertheless, in practice, most big local authorities adopt an accounting system, which foresees recording of accrual accounting in a journal and in a general ledger and use a trial balance of general account. The use of these documents is not compulsory for local authorities.

Finally, independently of the type of links between the two systems, it is usual for the financial report to include budgetary reporting, that is a comparison of the budget and the real situation. Only in Czech Republic, Greece and Slovakia is there a separation of the two systems, with budgetary comparisons not being included in financial reporting.

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[4] This is probably due to the fact that in Italy principles and fulfillments of accrual accounting are the same for all local authorities, be they big/small or very small demographic size.

4. The budget and budgetary reporting

4.1. Purposes of the budget

The budget is still an important document in local governments. In fact, it represents the overriding objective of financial reporting and is considered the most important document of the Information System in Albania, Czech Republic, Denmark, Germany, Hungary, Italy, Luxembourg, Moldova, the Netherlands, Norway, Portugal Slovenia and Spain.

As can be seen, except in the Czech Republic, all the other local governments use the budget for the authorisation of expenditures. Usually, the process used is the allocation of resources to economic expenditures, and only Czech Republic, the Netherlands and the United Kingdom do not use it.

The budget also serves for the allocation of resources to objectives and activities, most countries responding that they use allocation to activities, although there is no performance budget in most cases. Only Albania, Hungary, Italy, the Netherlands, Slovakia and Slovenia said that it serves for the allocation of resources to outcomes, to the achievements that authorities want to make. However, as in most of them a modified cash basis of budgeting is used, it cannot be considered as a performance budget.

There is agreement also about the consideration of the budget as a tool for management and control, and most countries responded affirmatively to those questions. Only Belgian Regions give less importance to this objective of the budget.

Purposes of the budget	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
a. Authorisation of expenditures	x	x	x	x	x		x	x	x	x	x	x	x		x	x	x	x	x	x	x	x
b. Allocation of resources to economic expenditures	x	x	x	x	x		x	x	x	x	x	x	x	x		x	x	x	x	x	x	
c. Allocation of resources to objectives and activities	x	x	x	x		x	x				x	x	x	x	x	x	x	x	x	x	x	x
d. Allocation of resources to outcomes	x										x	x			x			x	x			
e. The budget serves as the key tool for management	x		x		x	x	x	x	x	x		x	x	x	x	x	x	x	x	x	x	x
f. The budget serves as the key tool for control	x				x	x	x	x	x	x	x	x	x		x	x	x	x	x	x	x	x
g. It represents the overriding objective of financial reporting and is considered the most important document	x		x			x	x	x	x		x	x	x	x	x	x	x		x	x		

Figure 12. Objectives and purposes of the budget

4.2. Budgetary principles

With respect to the principles used for the budgetary reporting, most countries recognise all the standard principles, although the ways in which they are used in the rendering of accounts differ significantly.

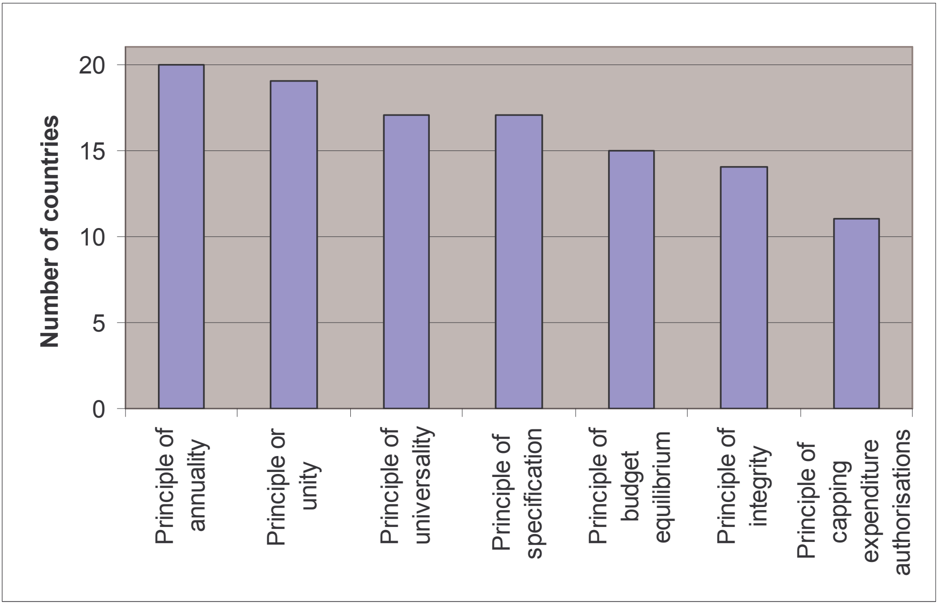

Figure 13. The most frequently encountered accounting principles

The respondent countries also use numerous other accounting principles, notably in a reflection of private-sector practice. Those listed include:

– the principle of established methodology,
– the historical cost principle,
– the principle of prudence,
– the principle that expenditure authorisation and accounting are separate functions,
– the "going concern" principle,
– the principle of essentiality.

A distinction is drawn in most of the respondent countries between mandatory (required by law) expenditure (that which cannot be reduced, eg wages and salaries and debt servicing) and discretional or optional expenditure (which it is possible to reduce, eg expenditure on receptions and grants to associations). In Finland and Croatia there is no differentiation between mandatory and optional expenditure.

4.3. Characteristics of the budget

All the countries affirm that the budget contains the limit of expenditure for the year and for each class of expenditure (with the exception of Sweden, where the budget contains the limit of expenditure but not for each class of expenditure). Thus, the budget is limitative, unlike in the business sector, where the budget is only indicative. The budget is always balanced in most of the countries. For example, in the Belgium regions the principle of balanced budget implies that the budget cannot be in deficit and that the budget cannot have an imaginary balance. In Finland there is an obligation to balance revenues and expenditures in a four-year plan.

According to the replies, cost estimates are integrated into the budget in several countries. Nevertheless, as only Finland, Sweden, the Netherlands and United Kingdom use the modified or full accrual basis in the budget, only the real cost can be determined. In Italy, cost estimates are included in the budget under the heading concerning current expenditure only to a certain extent. For example depreciation is included as a provision but it is not compulsory for local authorities. Moreover, there are provisions for bad debts and for unforeseen expenditure in the budget under the heading concerning current expenditure.”.

Targets and objectives are integrated in the budget in Albania, Germany, Hungary, Italy, Norway, Slovakia, Slovenia, Sweden and the Netherlands. Five of them affirm that the budget includes non-financial performance data, such as performance indicators, which could be used to understand the achievements of the local government and the level of accomplishment of the objectives. The budget includes a management executive plan, where the goals to be achieved by each manager are stated, in Albania, Croatia, Italy, Norway, Russian Federation, Slovenia and Sweden.

Characteristics of the budget	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
a. The budget contains the limit of expenditure for the year (approved budget) and for each class of expenditure	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
b. The budget includes a management executive plan, where the goals to be achieved by each manager are stated	x				x							x				x			x		x	
c. Cost estimates are integrated into the budget	x	x		x				x	x	x	x	x	x	x	x						x	x
d. Targets and objectives are integrated into the budget	x							x	x		x	x			x	x		x	x		x	
e. The budget includes non-financial performance data, such as performance indicators	x								x						x	x			x			
f. The budget focuses on results, such as outcomes	x									x	x	x			x				x			
g. The budget is always balanced, revenues and expenses are equal	x	x	x	x	x		x	x		x	x	x	x	x	x	x	x		x	x	x	x

Figure 14. Characteristics of the budget

Seven countries stated that the budget is focused on the outcomes: Albania, Greece, Hungary, Italy, the Netherlands, Russian Federation, Slovenia. In the Netherlands, the modified accrual basis is used and cost estimates are integrated in the budget. This is more typical of Anglo-Saxon countries than European countries, where the allocation of resources to inputs, or economic expenditures, is not sufficient, and the budget is used for the improvement of the performance of local entities. Sweden and the United Kingdom have also an approach close to this, but they do not use outcome information.

The traditional idea of receiving resources and deciding what to do with them is complemented. The new budgetary philosophy also aims to answer the following questions: what do we wish to achieve? How are we going to achieve it? And what will the cost be?. This requires delimiting the objectives and targets of different activities of the entity, as well as the forecasted costs, that should be compared with the achievements and the actual costs.

Classifications by function and by economic class are usually used in the budget. However, countries that use a modified or full accrual basis for the budget do not use economic class. In the Netherlands, the budget itself does not contain function or economic class information, but the local government financial system does. As the budget uses modified accrual basis and is focused fundamentally on results, these classifications are not used for the budget. A classification by programme, where costs are estimated is used instead. Other countries where the classification by program is used are Albania, Croatia and Russian Federation.

Budget classification includes the following	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
- By function		x	x	x	x	x	x	x	x			x	x	x	x	x	x	x	x	x	x	x
- By economic class	x	x	x	x	x	x		x				x	x	x	x	x	x	x	x	x		
- By organization or administrative unit					x		x	x	x	x	x	x	x	x			x	x	x	x		
- By programme	x				x										x							
- Capital/current expenditure breakdown	x	x	x	x	x	x	x	x		x		x	x	x	x	x	x	x	x	x		x

Figure 15. Classifications used in the budget

The classification by organisation is used in Croatia, Denmark, Germany (B and N) Greece, Hungary, Italy, Luxembourg, Moldova, Portugal, Russian Federation, Slovakia, Slovenia and Spain, although in the latter it is voluntary.

Comparisons of the budget to actual data are usually prepared yearly, although in Croatia, Italy, Luxembourg, Norway and Sweden they are prepared twice a year; in Denmark, Germany B, and Slovakia comparisons are quarterly; and in Czech Republic, Moldova, Slovenia and United Kingdom monthly.

Comparisons of budget to actual data are prepared:	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
- Yearly	x	x	x	x					x	x	x			x	x	x				x		
- Twice a year					x							x	x			x					x	
- Quarterly	x						x	x						x				x				x
- Monthly						x								x					x			x

Figure 16. Frequency of budget to actual data comparisons

In any case, it should be understood that local entities can draw up comparisons for internal purposes whenever they need them.

With respect to the time horizon, there is no homogeneity. Yearly forecasts are prepared by Belgium Brussels Capital, Belgium Wallonia, Greece, Hungary, Luxembourg, Moldova, Norway, Portugal, Russian Federation, Slovakia, Slovenia and Spain. In Croatia the budget plans expenditures and revenues for one year but also includes two yearly projections for revenues and expenditures. In Albania, Belgium Flanders, Denmark, Italy, Norway, Sweden, the Netherlands and United Kingdom the previsions are for three years, and are probably revised yearly. In Belgium Flanders the budget includes a forecast for a year but also contains a multiannual plan for at least three years, and in Czech Republic the budget covers five years. As can be seen, all the countries that use the modified or full accrual basis for the budget use a long time horizon for the budget, because it is more useful for planning and for management.

The budget includes a forecast of:	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
- A year	x	x	x	x						x	x		x	x		x	x	x	x	x		
- Two years									x													
- Three years	x		x		x		x					x			x	x					x	x
- Five years						x																

Figure 17. Time horizon of the budget

4.4. Distinction between ordinary and extraordinary revenue and expenditure

As a rule, local authorities observe a relatively clear distinction between current ordinary revenue and expenditure (i.e. that which is current, recurring and occasioned by operational requirements, such as staff costs, loan interest and charges) and capital or extraordinary revenue and expenditure (i.e. one-off expenses or items of revenue that significantly alter property value, such as investments or loans).

With regard to expenditure, 21 respondent countries (a large majority) regard staff and operational costs as ordinary expenditure, whereas fewer countries put transfers, investments and debt in this category. Typically, "ordinary" expenditure covers procurement, wages and salaries, interest on loans, and grant payments, whereas early debt retirement and lending to other public authorities are generally classed as "extraordinary" expenditure.

Likewise with revenue, while operating revenue and transfers are classed as "current", income from loans and investments is registered as "capital". Items of revenue regarded as "current" fall under the headings of operating revenue and operating subsidies, financial revenue and tax revenue. Capital subsidies, on the other hand, as well as income from the sale of fixed assets and loan recovery are classed as capital.

Ordinary and extraordinary revenue and expenditure	Albania	Austria	Azerbaijan	Belgium-BXL	Belgium-F	Belgium-W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Hungary	Italy	Lithuania	Luxembourg	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
1. Current expenditure																												
1. Staff	x	x	x	x	x	x	x	x		x		x	x	x	x	x	x			x	x	x		x	x		x	
2. Operating	x	x	x	x	x	x	x	x		x		x	x	x	x	x	x			x	x	x		x	x		x	
3. Transfers	x	x	x	x	x	x	x			x		x	x	x	x	x	x			x		x		x	x		x	
4. Debt		x	x	x	x	x	x					x		x	x	x	x			x		x		x			x	
2. Capital expenditure																												
1. Transfers	x		x	x	x	x	x	x				x	x	x	x	x	x			x				x	x			
2. Investments	x	x	x	x	x	x	x	x		x		x	x	x	x	x	x			x	x				x			
3. Debt			x	x	x	x	x	x		x		x	x	x	x		x		x	x	x				x			
3. Current revenue																												
1. Services	x	x	x	x	x	x	x	x		x		x	x	x		x	x			x	x	x			x		x	
2. Transfers	x	x	x	x	x	x	x			x		x	x	x		x	x			x		x			x		x	
3. Debt			x	x	x	x							x	x		x	x			x	x	x			x		x	
4. Capital revenue																												
1. Transfers	x	x	x	x	x	x	x	x				x	x	x		x	x			x					x			
2. Investments	x		x	x	x	x	x			x		x	x	x		x	x		x	x	x				x			
3. Debt		x	x	x	x	x	x			x		x	x	x		x	x			x					x			

Figure 18. Distinction between ordinary and extraordinary revenue and expenditure

4.5. Expenditure

With regard to expenditure, the stages in the budgetary process are:

a) appropriation budgeting – mainly done by item (in 16 countries) but also by appropriation (in eight countries) or cost centre (in six countries). Clearly, in the countries using a "by item" system, detailed expenditure and revenue forecasting is required in order to facilitate supervision and control; in the countries that work by appropriation the concept of detailed forecasting is eclipsed by a need for realistic management; appropriation budgeting is done by cost centre in those countries where cost accounting has become the norm and there is a need to determine net costs by centre;

b) commitment of expenditure (reserving a sum of money for a precise purpose), which takes place mainly upon order (in 13 countries), although also upon receipt of invoice (in eight countries) or, rarely, upon payment (in three countries). It is more logical to commit expenditure upon order than upon payment;

c) charging of expenditure, which takes place upon receipt of invoice in 14 countries, upon order in four countries, and upon payment in six countries. It is similarly logical to charge expenditure (ie to register the invoice) when the invoice is received rather than when it is paid (otherwise the essence of the system will essentially be one of cash rather than accrual accounting);

d) the final stage before payment is either authorisation (where the authority issues an order to make payment) – the practice in 14 countries – or invoice checking, which is the practice in 12 countries.

4.6. Revenue

Revenue entitlements (certain revenue) and established entitlements (revenue entitlements recorded in the accounts) are most commonly registered on receipt, although other approaches (registration upon notification or upon realisation) also exist.

It is logical that established entitlements should be registered as soon as they are notified rather than when they are collected.

4.7. Responsibility for different steps in the revenue and expenditure processes

Responsibility for the different categories of current and capital revenue and expenditure is shared in most countries between the elected municipal council (the local assembly) and the executive (the management body), with collectors playing a very minor role.

Responsibility for different types of revenue and expenditure	Albania	Austria	Azerbaijan	Belgium-BXL	Belgium-F	Belgium-W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Hungary	Italy	Lithuania	Luxembourg	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
1. Current expenditure																												
Elected municipal council (UK term = district council) or assembly	x	x	x		x		x		x			x	x	x			x				x	x			x		x	
Executive (board or management)			x	x	x	x		x		x			x	x	x	x	x			x				x			x	
Collector or Secretary					x	x								x														
2. Capital revenue																												
Elected municipal council or assembly		x	x				x		x			x	x	x			x				x	x			x		x	
Executive (board or management)	x		x	x	x	x		x		x			x	x	x	x	x			x							x	
Collector or Secretary					x	x								x			x							x			x	
3. Current expenditure																												
Elected municipal council or assembly	x	x	x		x		x	x	x			x	x	x			x				x	x			x		x	
Executive (board or management)			x	x	x	x				x			x	x	x	x	x			x				x			x	
Collector or Secretary					x	x								x														
4. Capital revenue																												
Elected municipal council or assembly	x	x	x		x		x	x	x			x	x	x			x				x	x			x		x	
Executive (board or management)			x	x	x	x				x			x	x	x	x	x			x				x			x	
Collector or Secretary					x	x								x			x										x	

Figure 19. Responsibility for different types of revenue and expenditure

If the process is broken down into its different steps one can find that in most countries it is the deliberative assembly, the municipal council, which makes budget appropriations, with the executive (board or senior management) taking charge of the following stages: commitment and charging of expenditure, authorisation and invoice checking prior to payment. Actual payment is made either by the executive (in eleven countries) or by the collector (in eight countries).

Responsibility for the different steps	Albania	Austria	Azerbaijan	Belgium-BXL	Belgium-F	Belgium-W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Hungary	Italy	Lithuania	Luxembourg	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
1. Budget appropriations																												
Elected municipal council or assembly	x	x	x	x	x	x	x	x	x	x		x	x	x	x	x	x		x	x	x	x			x		x	
Executive (board or management)																	x					x		x			x	
Collector																												
2. Commitment of expenditure																												
Elected municipal council or assembly		x	x		x			x					x			x						x			x		x	
Executive (board or management)	x	x	x	x	x	x	x	x	x	x		x	x	x	x		x		x	x	x	x		x			x	
Collector																												
3. Charging of expenditure																												
Elected municipal council or assembly	x	x	x																			x			x		x	
Executive (board or management)			x				x	x	x	x		x	x	x	x		x			x	x	x		x			x	
Collector				x	x	x										x			x									

Figure 20. Responsibility for the different steps

4.8. Budgetary documents

These questions aim to find out what documents are used in each country for preparing the budget, that is, the content of the budget. In most countries there is a regulation both for the form and the content of the budget. In Belgium F, Slovenia, the Netherlands and United Kingdom only the content is regulated.

Regulation of form and content of the budget	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
a. There is a regulation of the form and contents of the budget	x	x	x	x	x	x	x			x	x	x	x	x		x	x	x		x		
b. There is a regulation only of the contents															x				x			x

Figure 21. Regulation of the form and contents of the budget

In all responding countries, the budget contains a Statement of Income and Expenditure, where the forecast of expenditures and revenues for the planned time horizon are stated. When this document is drafted using the modified cash basis, it includes the forecast of investments and borrowings for the year, and consequently the capital expenditure and investments plan is there.

In other countries where the Statement of Income and Expenditure does not include investments or loans, because they use an accrual approach, this statement is completed with a capital expenditure and investments plan. It also includes a long-term financial plan with a statement of borrowings that states where the funds are coming from for financing investments. In this case, it is similar to the budgetary process in a company, where together with the forecast income statement and forecast balance sheet a capital plan and a borrowing plan are also necessary. In any case, the long-term financial plan is used also in countries where the budget is drafted for mid-long term period, such as in Norway, Denmark, Italy or Albania.

However not many countries that use a modified cash basis use a forecast of cash flow. That is, if countries use a pure cash basis, the budget includes only payments and receipts, which are the forecast cash flows. However, when a modified cash basis is used, the budget does not reflect cash flows but receivables and payables. For example, Albania, Belgium, Denmark, Italy Slovakia, Slovenia and Spain include this information in a complementary form. Other countries that use the accrual basis for the budget also do not prepare a forecast statement of cash flow, where cash payments and receipts are reported.

Finally, most countries accompany the budget with explanatory notes, where some expenditures or revenues are explained. The statement of budgetary policies, that is the criteria used for the elaboration of the budget is not very usual. the Netherlands, Norway, Slovenia, Slovakia, Moldova, Italy, Hungary, Czech Republic, Belgium W, Belgium BXL and Albania respond affirmatively.

Budgetary Documents	Albania	Austria	Azerbaijan	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Germany B	Germany N	Greece	Hungary	Italy	Lithuania	Luxembourg	Malta	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
Statement of income and expenditure	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
A capital expenditure and investments plan	x	x	x	x	x	x	x	x	x	x	x	x					x	x		x	x	x	x	x	x	x	x	x	x	x	x	x
A long term financial plan with a statement of borrowings	x		x	x	x	x			x								x	x		x		x	x				x	x		x		x
Information on Cash Flow	x			x	x	x		x	x	x			x	x	x		x							x			x	x	x			
Statement of Budgetary Policies	x			x		x		x								x	x				x	x	x				x	x				
Explanatory notes	x	x	x	x	x	x	x	x	x	x	x	x			x	x	x	x	x	x	x	x			x	x	x	x	x		x	

Figure 22. Budgetary information

5. Financial accounting and the financial report

5.1. Objectives of financial reporting

Practically all the experts surveyed agree on the fact that the accounting system of their respective countries has four basic objectives: prove that the resources have been obtained in accordance with applicable regulations and for the budget, report on the sources, allocation and uses of financial resources, show how the government financed its activities and met its cash requirements, and prove the entity's capacity to finance its activities and display its financial condition. Only Czech Republic does not agree with this. Moreover, the Greek accounting system has only two fundamental objectives: to inform about the sources, allocation and uses of financial resources and about the financial condition of the government and changes in it. In Denmark only the first three are stated explicitly.

However, there is not so much agreement about the last objective in Figure 23, that of informing about the government's performance management in terms of service cost, efficiency and effectiveness, although is one of the key aspects of the New Public Management.

The Account or Financial Report is designed to disclose information about	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
a. Whether resources were obtained and used in accordance with the legally adopted budget	x	x		x	x	x	x	x	x		x	x	x	x	x	x	x	x	x	x	x	x
b. Whether resources were obtained and used in accordance with the legal and contractual requirements established by the appropriate legislative authorities.	x	x	x	x	x		x	x	x		x	x		x	x		x	x	x	x	x	
c. The sources, allocation and uses of financial resources.	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
d. How the government financed its activities and met its cash requirements.	x	x	x	x	x		x	x	x		x	x	x	x	x	x	x	x	x	x	x	x
e. The government's ability to finance its activities and to meet its liabilities and commitments	x	x	x	x	x	x	x					x		x	x	x	x	x	x	x	x	x
f. The financial condition of the government and changes in it.	x	x	x	x	x	x	x			x	x	x		x	x	x	x	x	x	x	x	x
g. The government's performance in terms of service costs, efficiency and accomplishments.	x											x							x			

Figure 23. Objectives of Financial Reporting

5.2. Accounting principles and procedures

Most of the respondent countries to the first questionnaire use virtually all of the accounting principles listed in the questionnaire, namely the "going concern", "entity", "historical cost", "true and fair view" and "comparative information principles". Only some ten countries, however, recognise the "accrual basis of accounting" principle. Many countries see similarities between local-government accounting and private-sector accounting systems in terms of how transactions are recorded, the valuation rules used, annual accounts and auditing.

The types of accounting records produced are the journal, general ledger and balance of general accounts. In several countries a system of subsidiary accounts is used, producing more detailed and longer-term accounts in respect of individual liabilities and assets. This system is not necessarily useful for recording expenditure and revenue over a single financial year but, as can be seen, some countries use it in this way.

Use of the three most common accounting documents	Albania	Austria	Azerbaijan	Belgium-BXL	Belgium-F	Belgium-W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Hungary	Italy	Lithuania	Luxembourg	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
1. Journal	y	y	y	y	y	y	y			y	y	y	y	y	y		n	y	n	y			y	y	y	y		n
2. General ledger	y	y	y	y	y	y	y			y	y	y	y	y	y		n	n	y	y			y	y	y	y		n
3. Trial balance of general accounts	y		n	y	y	y	y			y	n	y	y	y	y		y	n	y	y			y	n	y	y		n

Figure 24. Use of the three most common accounting documents

5.3. Financial statements

Only three respondents stated that they do not have regulations of the form of the financial statements, but only of the contents: Belgium F, Czech Republic and the Netherlands. In the others both the content and the format are regulated.

Regulation of form and content of the financial statements	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
a. There is a regulation of the form and contents of Financial Statements	x	x		x	x		x	x		x	x	x	x	x		x	x	x	x	x	x	x
b. There is a regulation only of the contents			x			x									x							

Figure 25. Regulation of the form and content of the financial statements

Concerning the statements presented, it must be mentioned that only Turkey and Luxembourg said that local entities do not elaborate the balance sheet, although logically the countries that use cash basis for the preparation of financial statements in local governments will present a balance sheet different to the countries where the accrual or modified accrual is used. The income statement is presented by all the countries, although of course the statement of countries that use cash basis or modified cash basis, would be more like a statement of cash flow than a real income statement.

The cash flow statement is presented by 53,12% of the countries, but the following countries that supplied information based on the total or modified accrual basis do not present it: Belgium F, France, Greece, Italy, Lithuania, Malta, Norway, Russia Federation, Slovakia and the Netherlands.

The statement of changes in net assets is presented by 12 countries and the three Belgian Regions, while the other 17 state that they do not present one.

Content of the Financial Report	Albania	Austria	Azerbaijan	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Germany B	Germany N	Greece	Hungary	Italy	Lithuania	Luxembourg	Malta	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
Statement of Financial Position (Balance Sheet)	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x	x	x	x	x	x	x	x	x	x		x
Statement of Financial Performance (Income Statement)	x	x	x	x	x	x	x	x	x	x	x	x		x	x	x	x	x		x		x	x	x	x	x	x	x	x	x	x	x
Cash Flow Statement	x			x		x	x	x	x	x	x		x	x		x								x	x			x	x	x		x
Statement of Changes in Net Assets	x			x	x	x	x		x							x	x			x		x	x	x				x		x		x
Statement of Budgetary Execution (comparison of budget to actual)	x			x	x	x			x	x			x	x		x	x		x		x	x	x	x				x	x	x		x
Statement of Accounting Policies	x			x		x			x						x		x							x				x	x	x		x
Explanatory notes	x	x		x	x	x	x	x	x	x	x	x			x	x	x	x	x	x	x	x	x	x	x		x	x	x	x		x
Statement of Borrowings	x			x	x	x	x		x							x	x		x		x	x		x				x	x	x		x
Performance indicators and outputs	x													x		x	x					x		x				x		x		

Figure 26. Financial reporting for external purposes

The statement of budgetary execution, although logically prepared by practically all local entities, does not form part of the financial statements in all cases. For example, this statement is not one of the accounting obligations of local entities of Croatia, Czech Republic, Greece and Slovakia.

The statement of accounting policies is not included as an obligatory statement for 21 local entities, while complementary notes or explanatory notes on financial statements are presented in most cases (27). The statement of borrowing is presented only by 16 entities, corresponding fundamentally to countries that use accrual or modified accrual basis.

Finally, there are only eight countries where information on the different activities, entity outputs and performance indicators is provided: Albania, Greece, Hungary, Italy, Portugal, Slovenia, Sweden and the Netherlands. The last two also use non-financial performance information in the budgetary process and use the accrual basis in the budget, so it can be said that together with Finland and the United Kingdom, they are the countries where local reforms and New Public Management have had most emphasis.

With respect to the presentation of the balance sheet and income statement, in most cases they follow a general statutory layout and they are rarely laid out by function. Only in half the respondent countries do balance sheets follow the traditional layout of fixed assets, current assets, current liabilities and invested capital. In the great majority of cases the income statement classification is based on nature of income (operating items, financial items and unusual items). Classification by purpose is rare. This is another respect in which certain countries can be seeing to be aiming for standardisation in order to facilitate comparison and control.

Financial statements produced for the rendering of accounts	Albania	Austria	Azerbaijan	Belgium -BXL	Belgium-F	Belgium-W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Hungary	Italy	Lithuania	Luxembourg	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
1. The balance sheet exists as a statutory layout																												
General	x		x	x			x		x	x	x	x		x	x			x	x	x	x	x	x	x		x		
By function				x							x				x							x						
2. The income statement exists as a statutory layout																												
General	x		x	x	x	x	x		x	x	x	x		x	x				x	x		x	x	x		x		
By function				x		x	x			x	x																	
3. The notes exist as a statutory layout																												
General	x			x		x	x		x		x			x					x	x	x	x	x	x		x		
By function				x						x					x													
4. The funds flow statement exists as a statutory layout																												
General	x								x	x	x			x						x	x	x		x		x		
By function											x																	

Figure 27: Presentation of the financial statements

5.4. Subsidiary accounts

Several countries (including Azerbaijan, Moldova, Estonia, Italy, the Netherlands and the Russian Federation) use systems of subsidiary accounts allowing for individual monitoring of assets and liabilities as well as expenses and revenue.

Specifically, 12 or 13 countries use such a system for asset and liability accounts, and rather fewer (eight or nine) for expense and revenue accounts.

5.5. Accounting criteria

5.5.1. Treatment of non-financial assets

In local entities, fixed assets show some differences with respect to business entities which makes this subject controversial, and this is why a question about it has been included.

Firstly, the normal thing is that fixed assets (tangible and intangible assets) will be considered as expenses in those countries where cash basis is used, while in the countries that use the total or modified accrual basis, they will be recognised as assets in the balance sheet.

Nevertheless it is very usual in local entities that some types of assets are not capitalised due to some specific characteristics. Denmark, Germany B, Italy, Lithuania, Luxembourg, Malta, Moldova, Slovenia, Spain and the Netherlands state that there are some assets not capitalised or included in the balance sheet.

In Denmark, the assets not capitalised are infrastructure and heritage assets, while in Lithuania at least heritage assets are not capitalised. In Malta it seems that neither infrastructures nor heritage assets are in the balance sheet.

Assets not capitalised	Albania	Austria	Azerbaijan	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Germany B	Germany N	Greece	Hungary	Italy	Lithuania	Luxembourg	Malta	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
There are some assets not capitalised (included in the balance	n		n	n	n	n	n		y	n	n	n	y	n	n		y	y	y	y	y	y	n	n	n		n	y	y	n	y	n
Infrastructure assets									y								y			y	y	y*							y			
Heritage assets									y								y	y		y	y	y										

***Preferable**

Figure 28: Capitalisation of assets

In Spain, there is a very specific situation, because assets for public use, especially infrastructures, are recognised in the balance sheet while they are in construction. Nevertheless, when they can be used by citizens, they are taken out of the balance sheet and appear as a negative item in net assets or equity.

In the Netherlands, assets that can produce economic benefits are capitalised, but assets without economic benefits are not capitalised. Usually heritage assets (cultural-historical) are not presented in the balance sheet, and investments in public space are not recognised if they have no future economic benefits.

In countries where heritage assets are capitalised, it is usual to show them under a separate heading.

Other assets that are not recognised on some occasions are leased fixed assets, although in many countries they are considered as tangible or intangible assets. In the second case, leased fixed assets are listed under a separate heading in some countries, but are included with other assets in others. In Czech Republic leasing assets can not be utilised.

Only in a minority of countries is research and development expenses capitalised at cost.

Saleable fixed assets are included with other assets in most cases.

Finally, preliminary expenses are recorded at the top of the assets column and not capitalised in many countries.

5.5.2. Recording of provisions

This entails providing for likely or certain future liabilities the nature of which is closely defined but the extent of which is unknown. In other words, it involves forecasting future expenditure and setting aside a sum of money in order to cover a future liability. The most usual are provisions for risk and charges.

The recognition of funds for probable but uncertain expenditures is made both in budget and the income statement in countries where the full or modified accrual basis is used. In the United Kingdom a provision is created where there is a present obligation based on a past event, which it is probable, which will probably require a transfer of economic benefits. In the Netherlands, provisions are created for possible commitments and losses, for equalisation of expenses, and for the part of specific grants from third parties that has not been spent in the year. In Belgium the provision created is for risk and charges.

Recognition of Provisions	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
a. Provisions are recognised in the Income Statement	x	x	x	x			x		x	x		x			x	x	x			x	x	x
b. Provisions are recognised in the Budget	x	x	x	x					x	x		x			x	x		x	x		x	x

Figure 29: Recognition of provisions

In Greece a provision for bad debts and a provision for staff living indemnity are recorded both in the budget and in the income statement.

In Italy, there are provisions for depreciation of inventories, for bad debts and for unforeseen expenditure under the heading concerning current expenditure. The budget uses, at the same time, recording of cash and modified cash basis, as has been said before.

In other countries, provisions are recorded only in the income statement because the budget uses cash or modified cash basis. This is the case of Spain and Portugal, where there are provisions for risk and charges, for depreciation of inventories and for bad debts. In Denmark a provision for extraordinary expenditures is recognised in the income statement.

5.5.3. Recording of reserves

Together with provisions in some countries reserves are registered. In fact most countries recognise reserves in the income statement. Only Czech Republic, Germany, Hungary, Italy, Luxembourg, Portugal, Slovakia, Spain and Sweden do not recognise them. For example, in Spain, although they are not included in the Income Statement all the surplus or deficit from the income statement is transferred to reserves because it is the usual destination.

Recognition of Reserves	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
a. Reserves are recognised in the Income Statement	x	x	x	x	x		x			x					x	x			x			x
b. Reserves are recognised in the Budget	x	x	x	x	x		x			x				x	x				x			x

Figure 30: Recognition of reserves

Some countries, such as Albania, Belgium, Croatia, Denmark, Greece, Moldova, Russian Federation, Slovenia, the Netherlands and United Kingdom include reserves even in the budget. The type of reserves varies widely: in Croatia current reserves, in Denmark cash and securities, in United Kingdom general balances and earmarked reserves (authorities are largely free to decide what reserves to establish) and in the Netherlands general reserves and earmarked reserves.

5.5.4. Treatment of pension liabilities (municipal pension fund)

The contributions of local entities to employers can differ. Some local governments can have obligations to pay for retirement or pension commitments, but in others the responsibility is of central government and local government only has to make current payments.

Current pension liabilities are registered in the budget in some cases, reflecting the expenditure for the year. Only Denmark, Moldova, Norway and United Kingdom recognise pension liabilities on actuarial basis, the information about accumulated pension liabilities being on the balance sheet in all cases. Belgium BXL, Belgium F, Hungary, Russian Federation and Sweden also show accumulated liabilities for pensions, while in other countries they are not applicable because the local government does not have the responsibility for pensions to employers.

Pension Liabilities	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
a. They are recorded as they accrue to employees in the budget		x	x	x	x		x				x	x			x	x	x			x		x
b. They are recorded as they accrue to employees but only in the financial report							x															
c. They are recognised on actuarial basis							x							x		x						x
d. Information on accumulated pension liabilities is recorded on the balance sheet		x	x	x			x				x			x		x					x	x
e. Information on accumulated pension liabilities is recorded in the notes to financial statements														x		x						x

Figure 31: Pension Liabilities

5.6. Valuation rules

Valuation criteria are always a controversial subject, both in business and in the public sector.

The following points refer to valuation criteria of assets, both financial and non-financial and of liabilities. Capital is usually determined by the difference between assets and liabilities in the initial balance sheet.

5.6.1. Non-financial assets valuation

Methods used to value non-financial assets vary widely. They can be differentiated according to the type of assets.

Firstly, for assets other than heritage and public usage or infrastructure assets, the criteria used in 76% of the cases is the historical cost net of depreciation, although historical cost prevails in some countries where cash or modified cash basis are used in the accounting and financial system. Only United Kingdom and Albania differ by evaluating these assets at their cost of replacement depreciated. In Moldova and Slovenia both are used.

Secondly, for infrastructure assets, all the countries that capitalised them on the balance sheet use historical cost net of depreciation, except Albania, which uses the cost of replacement depreciated.

Valuation base of physical assets	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
Assets apart from heritage & public usage assets																					
Historical cost						x		x													
Historical cost net of depreciation		x	x	x	x		x			x	x		x	x	x	x	x	x	x	x	
Cost of replacement depreciated	x												x					x			x
Net realisable value											x							x			
Infrastructures																					
Historical cost						x															
Historical cost net of depreciation		x	x	x	x			x		x	x			x	x	x		x		x	x
Cost of replacement depreciated	x																	x			
Net realisable value																		x			
Heritage Assets																					
Historical cost																		x			
Historical cost net of depreciation			x		x						x				x	x				x	x
Cost of replacement depreciated	x																				
Symbolic values			x							x											
Insured Values		x	x	x																	
Estimated value by an expert																			x		

Figure 32: Asset valuation rules

Finally, there is more variety in the valuation of heritage assets, which are perhaps the most difficult to value. Some countries use only symbolic values, while in Spain a value estimated by an expert is used. There are however some countries that maintain historical cost net of deprecation for these assets.

In Italy, the criterion used is historical cost net of depreciation. If the asset derives from activities and resources of the local authority, the said asset has a value which results in direct costs incurred by the local authority in the execution. Nevertheless if this kind of asset is available on the market, its value is recorded as the lowest between the cost value and market cost. If a loss of value happens, the asset is recorded in the net realisable value. All mentioned criteria of the valuation base of physical assets are increased only on the value of additional maintenance. It is supposed that additional maintenance increases the life span of the assets or the capacity, productivity and safety of said assets.

5.6.2. Depreciation

The depreciation of assets can be considered as a process that allows the systematic allocation of the depreciable amount of an asset over its useful life to the income statement.

Usually in all the countries with a full or modified accrual basis limited life assets should be depreciated in a similar way to which they are in the business sector. Countries where only cash basis accounting is used do not usually allocate depreciation. Such is the case of Austria, Turkey, Luxembourg or Czech Republic. Assets subject to depreciation include buildings (in 87% of cases), infrastructure (in 72% of cases) and cultural property (in 28% of cases). As a rule, it is linear rather than graded, and depreciation rates are based on asset-life guidelines laid down in general regulations (the guideline period being divided into 100).

Obviously, infrastructures and heritage assets are not depreciated in countries where they are not capitalised. Moreover, heritage assets are not depreciated in some others.

Depreciation of different categories of asset	Albania	Austria	Azerbaijan	Belgium -BXL	Belgium-F	Belgium-W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Hungary	Italy	Lithuania	Luxembourg	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
Buildings	x		x	x	x	x	x		x	x	x	x	x	x	x		x	x	x	x	x	x	x	x	x	x		x
Infrastructure (roads, sewage…)	x		x	x	x	x	x			x	x		x	x			x	x	x	x		x	x	x		x		x
Heritage assets (Cultural property)	x			x		x					x			x			x		x	x						x		x
Other			x				x				x			x				x					x	x				x

Figure 33: Depreciation of different categories of assets

The level of agreement diminishes with respect to the recognition of depreciation in the budget. Only Finland, France, Italy, Norway, Sweden, the Netherlands and United Kingdom include it in the budget. This implies that budgeted revenues should cover this expenditure, increasing the needs of current financing. However, in the United Kingdom, for the moment depreciation does not need to be financed: it is removed and replaced by a charge that depends on how the authority has decided to finance its capital expenditure. It is now being considered whether authorities should be required to finance depreciation charges.

Depreciation of Assets	Albania	Austria	Azerbaijan	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Germany B	Germany N	Greece	Hungary	Italy	Lithuania	Luxembourg	Malta	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
The depreciation is included in the budget	n	n	n	n	n	n		n	n	n	y	y			n	n	y	n	n	n	n	y	y	n	n		n	n	n	y	n	y

Figure 34: Depreciation of assets in the budget

In Italy, the depreciation is included in the budget as a provision but it is not compulsory for local authorities.

5.6.3. Financial assets valuation

With regard to financial assets, cost is the only criteria used for their valuation in most countries when they are acquired, such as Albania, Belgium, Portugal, Russian Federation, Slovenia, Sweden and United Kingdom.

There are five countries where cost is compared with current value and whichever is lower is adopted for the end of the period, transferring differences to the Income Statement. This is derived from the application of the prudence principles, where only losses are recognised. It is the option adopted in Norway, Spain and the Netherlands.

On the other hand, market value is used in Denmark, Moldova, Slovakia and Sweden.

Valuation base of financial investments	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
- Cost	x	x	x	x		x								x			x		x		x	x
- Market Value							x							x				x	x		x	
- Cost or net current value, whichever is lower												x			x	x	x			x		
- There is a provision established for doubtful accounts		x		x			x			x		x			x		x			x		x

Figure 35: Valuation of financial investments

Another question asked about the recognition of provisions for doubtful accounts or bad debts. It is also derived from the principle of prudence, although a fair value valuation will require it also. Most countries create this type of provision: Belgium BXL, Belgium W, Denmark, Greece, Italy, Portugal, Spain, the Netherlands and United Kingdom. In Belgium, provision exists for bad debts, rather than doubtful debts.

5.6.4. Long-term debt and borrowings

In the valuation of long-term debts and borrowings there is a high level of agreement, most countries use face value.

Long Term Debt and Borrowings	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
- Face value	x	x	x	x		x	x					x		x	x	x	x	x	x	x	x	x
- Market value																						

Figure 36: Valuation of long term debts

The balance sheet has in almost all cases information about amounts of debts outstanding, where the amount payable within a year or current liabilities and amounts payable after a year or non current assets are usually differentiated.

The balance sheet contains information about:	Albania	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Germany B	Germany N	Greece	Hungary	Italy	Luxembourg	Moldova	Netherlands	Norway	Portugal	Slovakia	Slovenia	Spain	Sweden	United Kingdom
- Amounts outstanding	x	x	x	x			x				x	x		x	x	x	x	x	x	x	x	x
- Amounts payable within a year	x	x	x	x							x	x			x	x	x	x	x	x	x	x
- Amounts payable after one year	x	x	x	x							x	x			x	x	x	x	x	x	x	x

Figure 37: Information about liabilities

6. Consolidation of financial statements

One of the aspects that has characterised most of the European countries local governments in last years is the strong process of decentralisation in service provision. Local entities have seen their competencies considerably increased, occasioning in many cases the appearance of dependent bodies with their own legal entity. This has opened a debate about the necessity of carrying out a consolidation of financial statements within the local context. However, the interest in and the regulation of this question has been very different in the different countries.

In some countries consolidated statements are drawn up applying the same standards as in the business sector, while in others consolidated statements are not drawn up and neither have initiatives been taken in this field.

As can be seen in figure 38 several countries affirm that they draft consolidated financial statements, namely Albania, Croatia, Denmark, Estonia, Finland, Germany N, Hungary, Italy, Lithuania, Moldova, Norway, Slovenia, Sweden and United Kingdom. Nevertheless this is pending development in other countries: Spain, Portugal, Belgium or the Netherlands.

Consolidation of Financial Statements	Albania	Austria	Azerbaijan	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Germany B	Germany N	Greece	Hungary	Italy	Lithuania	Luxembourg	Malta	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
a. Financial statements of entities controlled by local government are consolidated	y	n	n	n	n	n	y	n	y	y	y	n	n	y	n	y	n	y	n	n	y	n	y	n	n	n	n	y	n	y	n	y
b. Associate entities of local government are consolidated	y										y												n							y		y

Figure 38: Consolidation of financial statements

In some cases, consolidated statements are prepared using the modified cash basis of accounting, such as in Moldova. It is more a budgetary consolidation than a financial consolidation.

In some countries where consolidated financial statements are elaborated they do not include associate entities of local government by the equity method, maintaining them as financial investments. Only Albania, Finland, Hungary, Sweden and United Kingdom consider specially these entities for consolidation.

7. Publication of the financial report

Somewhat surprisingly, while annual financial statements based on accrual accounting (balance sheets, income statements and notes) are produced in many of the countries having replied to the questionnaire, they are published in only half of them. However, the budget is published in most countries.

In 22 countries the accounts may be consulted by any interested party who contacts the public administration.

Publication of year-end accounts	Albania	Austria	Azerbaijan	Belgium -BXL	Belgium -F	Belgium-W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Hungary	Italy	Lithuania	Luxembourg	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
1. The budget is published	x	x		x	x	x	x		x	x	x	x	x	x				x		x		x	x	x	x	x	x	x
2. The balance sheet, income statement and notes are published	x			x	x	x	x	x	x	x	x	x	x	x				x	x	x	x	x	x	x		x		x
3. Publication takes place through the central bank																												
4. The accounts may be consulted by any interested party who contacts the public administration	x	x		x	x	x	x	x	x	x	x	x	x	x	x	x		x	x	x	x		x	x		x	x	x

Figure 39: Publication of year-end accounts

In rather fewer than half the countries, financial analysis of the annual accounts is practised. A full range of reasons is given for such analysis: to assess the financial equilibrium of local-government institutions, as well as their liquidity, solvency and efficiency. Nevertheless, although financial analysis is not compulsory for the local governments of some countries, usually local governments apply methods and techniques for financial analysis, as in the case of Belgium-F.

8. Users of the information

It is difficult to define the concept of user, because we can refer to users according to the regulation definition or a more general concept of user including all persons supposed to be interested in the information. According to this more general idea, it can be said that the information contained in municipal accounts is used by the Auditor General's Department in 17 countries; by the Ministry of the Interior or other ministry in charge of local government in 24 countries; by higher-level (provincial, county or regional) authorities in 13 countries; by banks in 18 countries; by suppliers in 16 countries; and by the general public in 24 countries.

Users of the information	Albania	Austria	Azerbaijan	Belgium -BXL	Belgium-F	Belgium-W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Hungary	Italy	Lithuania	Luxembourg	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
1. Auditor-General's Department	x	x					x			x	x	x	x	x	x		x	x		x	x	x	x	x	x			
2. Ministry of the Interior or other ministry in charge of local governments	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		x	x		x		
3. Higher level authorities (provinces, counties, regions)		x			x						x	x	x	x	x		x	x	x		x		x			x		
4. Banks	x	x		x		x	x	x		x	x	x	x	x	x			x		x	x		x	x		x		
5. Suppliers	x	x					x		x	x	x	x	x	x				x	x	x	x		x	x		x		
6. General public	x	x	x	x		x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x		

Figure 40: Users of the information

The main users of the information in order of frequency are thus: Ministries of the Interior and the general public, Auditor General's Departments and banks, and higher level authorities and suppliers. One of the most important uses of information is for consolidation with other government levels or for macroeconomic propositions. For example, in the United Kingdom there is an intention to produce all Government Accounts on a consolidated basis as from 2006/07, where the data from all local authority accounts will be incorporated.

9. Auditing

No clear pattern emerged with regard to auditing authorities, the task of auditing being shared between Auditor General's Departments, Ministries of the Interior, provincial authorities and private and statutory auditors. In other cases the Ministry of Finance carries out the audit, as for example in the regions of Czech Republic. The main reported purpose of auditing is to ensure legality. Areas audited include budgetary reporting and to a lesser extent financial statements and cash position.

Auditing authorities	Albania	Austria	Azerbaijan	Belgium -BXL	Belgium-F	Belgium-W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Hungary	Italy	Lithuania	Luxembourg	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
1. Auditor-General's Department or Supreme Audit Institution	x	x										x	x	x	x		x			x	x			x	x		x	x
2. Ministry of the Interior				x	x	x	x					x				x				x		x					x	
3. Province		x						x										x									x	
4. Private or Statutory auditors	x		x					x	x	x	x		x	x	x			x	x		x		x	x				
5. Other								x																		x		x
6. This audit covers:																												
1. Budgetary reporting	x	x	x	x	x		x	x	x		x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
2. Financial Statements	x	x	x	x	x	x	x	x	x		x	x	x	x	x		x	x	x	x	x	x	x	x	x	x		x
3. Cash position	x	x	x	x	x	x	x	x	x		x	x		x	x		x		x	x	x		x	x	x	x		x
7. Which type(s) of audit is used?																												
1. Legality audit		x	x	x	x	x	x	x	x		x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x	x
2. Financial audit	x	x		x	x	x	x	x	x				x	x			x	x	x	x	x			x	x	x		x
3. Performance or Value for Money Audit		x							x					x			x				x			x		x		x

Figure 41: Auditing authorities

10. A brief summary of the state of the art

In recent years, most European Council countries have carried out a profound reform of their local accounting systems, many of them still ongoing. Although in some countries the reforms started in the 1990's there are many countries whose present accounting system has been established in the 2000´s.

The intention of the reforms is to go beyond mere legal control through budgetary information, increasing the importance of financial accounting and, especially, of financial statements. In most cases the business accounting model has been taken as a point of reference in the reforms with an ever-closer approximation.

Moreover, it can be highlighted that in general the local governments of countries in the study have the same accounting rules for the whole national territory. Only Belgium and Germany have different accounting standards for municipalities of different regions, and this is why each Belgian and German region responding has been included separately. In these countries, accounting standards for local government stems from the regional government.

The responsible body for accounting regulations is usually a Ministry, sometimes under the guidance of a governmental or professional body.

The most important direction of the reforms is a tendency to introduce the accrual basis of accounting for drawing up the financial statements. The budget is considered insufficient for the accountability and transparency of local governments. Only five countries do not use full or modified accrual for drawing up financial statements and maintain cash basis both in the budget and in accounting systems. Nevertheless, countries adopting accrual basis differ in some aspects, such as the statements drawn up, accounting criteria or the valuation of assets. In general, all the latter countries present a balance sheet and a statement of income, most of them also presenting a statement of cash flow. However, the budgetary reporting is not in the financial report in all cases, which is surprising because it is the key for accountability and transparency.

The treatment of non-financial assets shows a certain level of diversity, most of the countries capitalising all kind of assets. Nevertheless, some countries do not capitalise infrastructures or heritage assets. With regard to the evaluation, the most frequent method is the historical cost depreciated, although two countries use cost of replacement. For heritage assets, the values used varied from historical cost to symbolic values, estimated values or insured values.

Local governments are conscious of the limited useful life of assets and, in general, they depreciate them, with some exceptions for infrastructures and heritage assets. However, only a few countries include the depreciation in the budget. They include it in the Income Statement, which often has little importance. A similar situation is observed with regard to provisions, and although most countries include them in the income statements, only a few consider them in the budget.

On the other hand, information about economy, efficiency and efficacy is scarce. Only eight countries include this information in the financial report. Two of them are countries that use an accrual approach in the budget.

The budget is maintained as the principal document, and it is usually prepared using the traditional cash or modified cash basis of accounting. It is a medium for allocation of funds and for the authorisation of expenditures. Usually, the process used is the allocation of resources to economic expenditures. Most countries respond that they use allocation to activities, although there is no performance budget in most cases. Cost estimates are integrated into the budget in some countries, but few include non-financial performance data, such as performance indicators, which could be used to understand the achievements of the local government and the level of accomplishment of the objectives.

In any case, the budget is always seen as a tool for management and control.

Four countries adopt a modern approach to the budget: Finland, Sweden, the Netherlands and United Kingdom. In these countries the budget is drafted using the full or modified accrual basis and real costs are used in the budgetary process. The reasons that these countries give for adopting the accrual budget are that it is easier for accountability purposes, it shows not only true cost but also service efforts and accomplishments and, above all, it allows improvement of decision-making. Some of them integrate targets and objectives into the budget, but only the Netherlands and Finland use non-financial performance data, such as performance indicators.

Moreover, Denmark is planning to change the basis of the budget with the intention of adopting the accrual basis. The introduction of accrual accounting principles in the budget in the period from 2006-2007 will be tested among a number of municipalities.

As the budgetary and accounting systems are usually two subsystems of the Information System, most countries state that there is integration of the budgetary and accounting systems through the use of budgetary procedures. When budgetary and accounting rules are equal there is no major problem because a single system can be sufficient, and a comparison between forecast and real data may appear even in the same financial statements.

However, when countries use different bases for budget and accounting, they usually use the budgetary process to establish a link between them. On occasions, there is a simultaneous double register of transactions: usually a single-entry in the budgetary system and a double-entry in the accounting system. Nevertheless, in other cases during the year the system registers the execution of the budget and at the end of the year accrual accounts are adjusted to obtain the final data. Reporting on the conciliation process between the budget and accounting variables can be very useful in these cases.

Moreover, most local governments do not consolidate the accounts of public bodies that gravitate around the municipality with those of the municipality itself. Virtually all the respondent countries are guilty of this failing, which makes it impossible to obtain a comprehensive and realistic view of the municipal property situation. The fact is that, in some cases, important municipal functions are assigned to bodies especially constituted and funded for that purpose. Failure to combine information about these bodies with information about the municipality itself means there cannot be a true picture of what the municipality owns and how its resources are managed.

Finally, some local governments produce accounts but do not publish them.

In spite of the differences between accounting systems at European level, it can be said that the accounting systems in many countries currently tend towards convergence on a formal plane, based on the common objective of implementing accrual accounting and new public management. In the end, institutional environments or global developments can lead accounting reforms to take the same direction and in consequence to converge.

III. THE IPSASs AND THE MODERNISATION OF LOCAL GOVERNMENT ACCOUNTING

11. Efforts of the *International Public Sector Accounting Standards Board* (IPSASB) (formerly the Public Sector Committee (PSC) of the *International Federation of Accountants*).

An important characteristic of Public Sector Accounting during recent years, and probably the most important one, is the dynamism of the International Federation of Accountants (IFAC) Public Sector Committee.

The International Federation of Accountants (IFAC) is a worldwide organisation for the accountancy profession, founded in 1977 and comprised of 163 member bodies in 119 countries.

Although at first the IFAC was created essentially to harmonise audits, fortunately it has not limited its work to this field but, in the public sector, has worked both in auditing and in accounting information. In this way, the gap left by the International Accounting Standard Board (IASB) with respect to accounting information in public administrations is filled.

To this end, a standing committee of the Council of the IFAC (Public Sector Committee (PSC) was created, whose objective was to develop programmes aimed at improving public sector financial management and accountability. Therefore, its role can be compared to that of IASB in business accounting. Today it is called the International Public Sector Accounting Standards Board (IPSASB).

In order to achieve its objective, in 1996 the IFAC-PSC embarked upon a project to develop a set of accounting standards for public sector entities referred to as International Public Sector Accounting Standards (IPSAS) based on the earlier International Accounting Standards (IAS) or the International Financial Reporting Standards (IFRS) issued by the IASB. The objective included: developing accounting and auditing standards and promoting their acceptance, as well as encouraging and facilitating the exchange of information among member bodies and other interested parties.

Moreover, the IPSASB publishes International Public Sector Guidelines and Studies. The Guidelines recommend practices to be followed in the public sector on financial reporting. The IPSASB issues these guidelines to improve public sector financial management and accountability.

The International Public Sector Studies are intended to provide advice on accounting and financial reporting issues in the public sector. They are based on the study of the best practices and most effective methods for dealing with the issues being addressed. Recent papers have focused on the definition and recognition of revenues and expenses and on the transition from cash basis to accrual basis accounting.

There are also occasional papers, which provide information that contributes to some segment of the body of financial reporting knowledge. Typically these papers feature case studies based on a particular country's experiences.

The impact of IPSASB work (studies, guidelines and accounting standards) on the modernisation of governmental accounting will no doubt be decisive.

12. The International Public Sector Accounting Standards (IPSASs)

The IPSASs are authoritative requirements established to improve the quality of financial reporting around the world as well as to achieve consistent and comparable financial information across jurisdictions. They are applicable to national governments, regional governments, local governments and related governmental entities. They are not applicable to Government Business Enterprises since the PSC´s Guideline nº1 Financial Reporting by Government Business Enterprises resolved that these entities should apply IASs.

The standards try to enhance the comparability of financial statements around the world, but neither the Committee nor the accounting profession has the power to require compliance with IPSAS. Moreover, IPSASs do not override the regulations of general purpose financial statements in a particular jurisdiction. Each regulatory body has to decide about the adoption of IPSASs, and the Committee strongly encourages their adoption and the harmonisation of national requirements with them. The success of the Committee's efforts is dependent upon the recognition and support of its work from many different interested groups acting within the limits of their own jurisdiction.

At first the Committee developed exposure drafts of IPSASs that contained recommendations for each of the four defined bases of accounting (cash basis, modified cash basis, accrual basis and modified accrual basis). However, submissions received by the PSC from different groups questioned and criticised this approach, and as a result the Committee proposed developing standards for the cash basis accounting and the accrual basis accounting only.

For the moment, the IFAC has published 21 standards for the accrual basis of accounting and one for systems based on the cash basis of accounting. They are summarised in the following table including the IPSAS issued to date. Each of them is based on the corresponding standards of IASB, except that of cash basis.

IPSAS 1	Presentation of Financial Statements
IPSAS 2.	Cash Flow Statements
IPSAS 3.	Net Surplus or Deficit for the Period, Fundamental Errors and Changes in [2] Accounting Policies
IPSAS 4.	The Effects of Changes in Foreign Exchange Rates
IPSAS 5.	Borrowing Costs
IPSAS 6.	Consolidated Financial Statements and Accounting for Controlled Entities
IPSAS 7.	Accounting for Investments in Associates
IPSAS 8.	Financial Reporting of Interests in Joint Ventures
IPSAS 9.	Revenue from Exchange Transactions
IPSAS 10.	Financial Reporting in Hyperinflationary Economies
IPSAS 11.	Construction Contracts
IPSAS 12.	Inventories
IPSAS 13.	Leases
IPSAS 14.	Events After the Reporting Date
IPSAS 15.	Financial Instruments: Disclosure and Presentation
IPSAS 16.	Investment Property
IPSAS 17.	Property, Plant and Equipment

IPSAS 18.	Segment Reporting
IPSAS 19.	Provisions, Contingent Liabilities and Contingent Assets
IPSAS 20.	Related Party Disclosures
IPSAS 21.	Impairment of Non-cash generating Assets
CASH BASIS IPSASs	Financial Reporting under the Cash Basis of Accounting

Figure 42. International Public Sector Accounting Standards

Through the standards issued so far, IFAC is extending the IAS/IFRS to public entities, with some minor adaptations to their specificities. This shows yet again the interest in approximating the public accounting system to the business accounting system in such a way that homogeneity can be achieved both between the two types of entities and between the entities of different countries. It is a very important decision in the international context of public accounting, which has already been adopted by many regulating bodies at national level.

Nevertheless, although this first phase has simply adapted the IAS/IFRS to the public sector context, in the future it is intended to develop other standards specially focused on the financial information of the public sector which are not dealt with by the IASB.

In conclusion, the role of the IPSASs can be definitive in the modernisation and harmonisation of public sector accounting. On the one hand, IPSASs may assist standard-setters in the development of new standards or in the revision of existing standards in order to contribute to greater comparability and, on the other hand, they may be of considerable use to jurisdictions that have not yet developed accounting standards for governments and public sector entities.

13. Opinion and initiatives about the IPSASs in local government accounting

At the moment IPSAS are undergoing a debate with supporters of all different positions taking part. Some people consider that the direction of the IFAC is adequate. However, there are also some academics and professionals that think that public administrations have characteristics that justify accounting systems that are different to those of the business sector and thus they criticise the position adopted by the IFAC.

It must be said that there have already been some international organisations that have adopted the IPSAS. For example, the OECD adopted the IFAC´s standards for its own financial reporting and its 2000 financial statements were audited against these standards. European Union Institutions are modernising their accounting system and they are trying to adopt IPSAS too. Perhaps shortly other organisations will follow their example. Furthermore, even local governments of different countries are making some efforts to adapt their accounting system to the IPSASs, as is the case of New Zealand and Australia.
A very positive factor toward the adoption of IPSASs in European countries is the recent strategy of the European Union in the accounting area, where it appears that IASs/IFRS are going to prevail in the near future, and in consequence businesses are gradually going to adopt them. This will mean an approximation between business accounting systems and also between public accounting systems, due to the enormous influence of the former, and at the same time facilitating the adoption of IPSASs by public administrations of different countries.

With the aim of finding out the opinion of the different CDLR members and above all to ascertain whether any country of the Council of Europe has made any efforts to adopt the IPSASs, a series of questions related to the IFAC standards and to international accounting harmonisation have been included. Most of these questions were asked in the supplementary questionnaire, so few countries have replied to them.

The harmonisation of public sector accounting and IPSASs of IFAC	Albania	Austria	Azerbaijan	Belgium BXL	Belgium F	Belgium W	Croatia	Czech Republic	Denmark	Estonia	Finland	France	Germany B	Germany N	Greece	Hungary	Italy	Lithuania	Luxembourg	Malta	Moldova	Netherlands	Norway	Portugal	Romania	Russian Federation	Slovakia	Slovenia	Spain	Sweden	Turkey	United Kingdom
a. Do you know the IFAC public sector accounting standards (IPSAS) ?	y	n		n	y	n	y	y	y		n	n	y	y			y	n	y	y		y	y	y		y	y	y	y	y	n	y
b. In your opinion, have IPSAS adopted the adequate strategy ?	y						y	n									y		y			y					y	y	y	y		n
c. In your opinion, would it have been better to issue specific standards for public entities, without adopting the business standards (IAS) so faithfully ?	n				y		y	y	y								y		y			y	y				y	y				y
d. Alternatively, do you think the public sector needs specific standards (other standards than businesses)?	y				y		y	y	y				y	y			y		y			y	y	y			y	y	n			n
e. Has your country put into practice initiatives to adopt IFAC IPSAS ?	y	n			n		n	n	n	n	n					n						n	n				y	y	n			n
f Does your country have accounting rules similar to IPSAS ?	y				n		y	n									y					y	y				n	y	n			y
g. Do you think that accounting harmonisation is necessary ?	y				y		n	y	y								y		y	y	y	y	y				y	y	y			y
h. Do you think IPSAS are the right way towards harmonisation?	y						n	y									y		y			y					y	y	y	y		n

Figure 43. International Public Sector Accounting Standards

Of the thirty two replies received, the majority acknowledge that they know of the existence of IPSASs. Only seven stated the contrary. Among the first group, nine consider that the IFAC has adopted an adequate strategy, while two did not share this opinion and the others either did not know or did not answer.

However, eleven of the replies consider that it would have been preferable to issue specific accounting standards for public administrations, instead of extending the accounting standards of the business sector, which is not in line with the general trend towards the approximation of the public accounting system to the private. For example, the UK Government would have preferred the IPSASB to have concentrated on areas where specific public sector standards were required and on publishing interpretations of IASs [ie the

International Accounting Standards, primarily aimed at the private sector], rather than amending all IASs.

Furthermore, a question has been included related to the initiatives undertaken in each country for adapting the local accounting standards to the IFAC standards. Only three countries reply that they have taken steps to approximate their local accounting standards to those of IFAC: Albania, Slovenia and Slovakia. Nevertheless, Croatia, Italy, Norway, Slovenia the Netherlands and United Kingdom affirm that they have accounting rules similar to IPSASs. Moreover, the United Kingdom public sector follows UK-GAAP to the extent appropriate, but where it is necessary to adapt or interpret them, IPSASs can be a source of guidance.

Lastly, the opinion of the respondents was sought on international accounting harmonisation, and all twelve respondents having replied to the question are in favour and consider it necessary.

IV. GUIDELINES TO THE COUNCIL OF EUROPE COUNTRIES BASED ON THE IPSASs AND OTHER DEVELOPED ACCOUNTING SYSTEMS

Observations

The aim of this report is not to advocate any particular system that has been observed to work well in any particular country. It should be kept in mind that each country has its own history, is subject to its own particular economic, social and political constraints and needs to develop its accounting system in a manner tailored to its own context.

Nevertheless, past and present experience are capable of informing the future and, on the basis of the practices observed and analysed in this survey, as well as generally accepted best practices in accounting, it can be concluded that any accounting system should embrace a certain number of principles.

Systems of accounting often presented the same set of failings:

– they are essentially cash based and concerned only with revenue and expenditure, or more precisely cash inflows and outflows;
– they therefore fail to address property valuation and to monitor property values;
– in some cases, in order to facilitate ongoing supervision, several different types of cash accounting are actually practised within a single municipality – ie estimate-based accounting and accounting that records the management of monies;
– not infrequently, even where there is a budget (forecasting revenue and expenditure) and a budget account (recording actual revenue and expenditure), the two documents are not compared with a view to examining discrepancies.

The practices suggested below could be applied in a general way at all levels of local government (municipal, provincial, etc) for they constitute an essential framework for any accounting system and represent what is effectively a basic threshold.

Local government accounting systems should try to adopt generally accepted accounting principles and, in fact, they have been adopting this orientation. As it is not easy to decide what is the best practice, a reference to international organisation pronouncements can be a help. International accounting standards applicable to the public sector could contribute significantly to the provision of comparable, relevant and understandable financial information by local governments.

The report refers to the IPSASs in order to propose in the next part some recommendations for the future development of local government accounting systems. It should be noted that the convenience and problems associated with the implementation in each country may be different because of the social, cultural and economic environment.

General recommendations

Although more details will be given later, the following recommendations to local government information systems can be highlighted:

– Accrual accounting for drawing up financial statements, which should record the changing value of property and reflect how the municipality is being managed both internally and externally. In order to function as a simple source of information, local government accounts should be published and will be available for any interested people, such as citizens, politicians.

– A budgetary system that is linked to the management accounting and the financial accounting with the aim of aiding decision-making and control. The ideal situation would be that the budgeting and the financial accounting system use the same basis for the recognition of transactions, and therefore the information could be used to maximum benefit. Accrual budgets can be a key tool for the implementation of performance budgeting, together with accrual financial statements. In any case, accrual is not a universal panacea for improving performance, it is only a tool for getting better information, especially about the true cost of services delivered. To be effective, this information should be used in the management and in the decision making process.

– The management process also requires a management accounting system, especially cost accounting, which allows the cost of specific services or activities to be calculated. This should be accompanied by a system for performance measurement, where objectives and targets can be compared with achievements. Information about efficacy, efficiency and effectiveness is necessary. The management system should be linked to the budgetary system, because there is a feedback process.

– Consolidation of accounts, bringing together the accounts of bodies that gravitate around the municipality (housing authorities, social welfare agencies etc);

– Financial analysis of accounts in order to furnish the authorities with information about various aspects of the way the municipality is managed;

– A cohesive system under which each type of accounting can pursue its specific aim and produce its own annual accounting documents while, at the same time, the budgetary and the financial accounting system are linked.

Features of the new accounting system thus introduced will be, on the one hand, significantly improved effectiveness, i.e. its capacity to offer a clear view of the state of the municipal finance and, on the other, integration of property and borrowing-related aspects, providing those who manage the municipality's resources with precise information about the value of its assets and any changes in that value.

14. The budget and budgetary reporting

In local government, the importance given to the budget constitutes without a doubt a peculiarity of the information and accounting systems, because their functions are very different to those of the business sector. In fact, public entities have traditionally had an information system whose only objective was the control of budgetary execution. This system has been shown to be insufficient for present objectives, which has led to reforms. However, the budget is still a key element for public entities.

The budget reflects the financial characteristics of the government's plans for the forthcoming period. Monitoring and reporting on budget execution is essential for measuring compliance with legislation and the authorised budget.

If the budget is to be effective, it is generally recognised that the budget needs to be comprehensive and encompass all government expenditures for all budget dependent entities.

As has been seen, there is no homogeneity in the budgetary basis. Some countries use the cash basis while others adopt a modified basis. A few have moved or are intending to move to the full accrual basis for budgeting, so that they can plan for the use of total resources.

It is not easy to choose a basis for budgetary reporting. There is much greater acceptance of accruals for financial reporting than for budgeting purposes. Most governments want to prepare their budget reports on the cash basis because the cash information is more readily available. In addition, some argue that information about only cash is more readily understandable than information about all assets and liabilities. Further, cash systems are simpler to implement and costs are low due to the lower level of accounting skills required.

Additionally, in some cases, an accrual budget can be believed to risk budget discipline. The traditional imposition of balanced budget requirements is often interpreted as contradictory to the full accrual basis of accounting. The political decision to spend money should be matched when it is reported in the budget. It should not be forgotten that legislatures have often shown resistance to the adoption of accrual budgeting, due in part to the sheer complexity of accruals.

However, accrual budgeting can be a key element for implementing performance budgeting. The adoption of the accrual basis in the budget can be more useful for the evaluation of performance, because it changes the focus of budget-making to the cost principle. In this case the revenues are recorded when they are earned and not when they are received, and expenditures are recorded when liability is incurred and not when paid. The accounting of investment is also different in the two systems. Accrual budgeting spreads these costs during the useful life of the asset (through depreciation), while the cash budget records the whole expenditure in the year of investment. The OECD (2001) recommends that non-financial assets should be recognised under full accrual based accounting and budgeting. This will require the valuation of such assets and the selection of appropriate depreciation schedules.

In fact, some governments are using the accrual basis together with a performance budget, where the emphasis is on outputs and outcomes, instead of on inputs. It is though that the focus on allocations is very limited and information about cost is need.

In performance budgeting the outcomes and outputs that policy makers desire are defined as well as the expenses that can be incurred. The essential purpose of the outcomes and outputs framework is to answer three questions: what governments want to achieve (the outcomes); how they want to reach those achievements (outputs); and how the achievements can be evaluated (efficiency and efficacy indicators).

Under the New Public Management, there is a desire to hold managers responsible for outcomes and/or outputs while reducing controls on inputs. In this context, it is expected that managers should be responsible for all costs associated with the outcomes and/or outputs produced, not just the immediate cash outlays. Only accruals allow for the capture of these full costs, and so enhance decision-making by managers.

Another important reason for moving toward accrual accounting is to achieve consistency in reporting between accounting and budget systems. In fact, international organisations, such as the IFAC or the OECD encourage entities to operate their budgeting and accounting systems on the same basis. If they are on different bases there is a risk that accounting statements will not be considered sufficiently or will be undervalued in their usefulness. If the budget is on a cash basis, this will attract the attention of politicians and users and therefore accrual statements will no receive attention.

The adoption of an accrual budget must be a decision of the legislature and it needs to be convinced, because first a cultural change is necessary, which includes changing the way government thinks and operates and changing people's mentality. On the one hand, the leaders, managers and employees have to change the manner in which they manage the organisation. The emphasis of management should change from focusing on inputs to focusing on the cost and performance of the programmes and objectives.

In any case, it seems that the introduction of a focus on results and performance in budgeting will be the future trend. This implies focusing on outputs and outcomes, where it is determined what and how much will have to be produced and the amount of money available is indicated per product. This should be accompanied by performance indicators that allow us to see if the forecast has been achieved or not.

If governments have different bases for the budgetary system and for the accounting system, an important question is the link between both systems. In this case, the Information system should be broad enough to support the integration of budgetary and accounting systems through the use of budgetary accounting procedures. A statement should be developed to reconcile key differences between the two systems.

When the financial statements and the budget are on the same basis of accounting, the inclusion in the financial statements of comparison with budgeted amounts for the period is recommended.

Other recommendations about the budget and budgetary reporting can be the following[5]:

– The legally approved budget should be published with the appropriate supporting budget documentation.

– Some commitment procedures should be used to assure that budgetary funds are available prior to release of a purchase order or contract.

– The budget should include a medium-term perspective illustrating how revenue and expenditure will develop during at least the two years beyond the next fiscal year.

– Budgetary data should be reported on a gross basis, distinguishing revenue, expenditure, and financing from expenditure classified by economic, functional, and administrative categories. Data on extra budgetary activities should be reported on the same basis.

– Budgetary reporting reflecting budget to actual comparison should be part of the general-purpose financial statements of the year.

– The comparative budget to actual statement should include the original budget as approved by the legislative body as well as the final adopted budget.

– A statement of objectives to be achieved by major budget programs (e.g., improvement in relevant social indicators) or a plan for management should be provided.

[5] Some of these are based on those established by the International Monetary Fund (IMF) *Code of Good Practices on Fiscal Transparency* (2001) and the OECD (2001) *Best Practices for Budget Transparency*

– The budget should include non-financial performance measures about the targets and objectives proposed for each programme, and budgetary or financial reporting should inform on the achievements of these objectives, including a comparison of performance targets and actual results achieved where practicable.

– Budgetary reporting should achieve the qualitative characteristics of financial reporting, such as in terms of stability, relevance, reliability and comparability.

– Budget execution should be internally and externally audited, and audit procedures should be open to review.

15. Management accounting systems

A local government also needs a management accounting system that allows it to take correct decisions about the management, objectives and achievements of the organisation, as well as performance measurement. For example, a cost accounting system that provides information on the cost of services, programmes and functions of the entity. A breakdown by function would entail more precise charging of transactions and would introduce into municipal accounting the concepts of direct and indirect and fixed and variable costs. Similarly, the more active involvement of those in charge of different centres of activity will allow operational unit costs to be determined, e.g.:

– the cost of a local policing operation;
– the cost per square metre of road refurbishing.

Moreover, the information of cost should be compared with forecasted or standard cost. But information about cost is not enough, the management system should also make it possible for the outputs and outcomes or results of the programmes of the organisations, i.e. what has been achieved with those costs, such as metres of roads constructed, improvements in public safety or successful fire brigade interventions. Management should be focus on performance and results, what the entity wants to achieve and how.

The management and the budgetary system can be joined in a unique system, because management information is a necessity for drawing up the budget. The execution of the budget is the key to management in local government, so the budget and management systems should be linked. There is a tendency to use techniques and tools from business management, such as the balance scorecard, and some local governments in the UK and Spain have had some experiences in this.

16. Financial accounting and the financial report

Together with budgetary reporting, local governments need a financial accounting system, in which the accrual basis of accounting should be adopted. The financial statements provide information about the entity's assets; liabilities; net assets/equity; revenues; expenses; and cash flows.

Specifically, the objectives of general purpose financial reporting in the local government should be to provide information useful for decision-making, and to demonstrate the accountability of the entity for the resources entrusted to it by:

– providing information about the sources, allocation and uses of financial resources;
– providing information about how the entity financed its activities and met its cash requirements;
– providing information that is useful for evaluating the entity's ability to finance its activities and to meet its liabilities and commitments;
– providing information about the financial condition of the entity and changes in it; and
– providing aggregate information useful in evaluating the entity's performance in terms of service costs, efficiency and accomplishments

To meet these objectives, the following financial statements should be elaborated:

– *Statement of financial position or balance sheet;*
– *Statement of revenues and expenses or income statement*
– *Statement of changes in net assets/equity;*
– *Cash flow statement; and*
– *Accounting policies and notes to the financial statements.*

The accounting policies applied should try to ensure that the financial statements provide information that is:

- relevant to the decision-making needs of users; and
- reliable in that they represent faithfully the financial performance and financial position of the entity; reflect the economic substance of events and transactions and not merely the legal form; are neutral, that is, free from bias; are prudent; and are complete in all material respects.

In particular, the following accounting principles should be followed:

Going Concern: financial statements should be prepared on a going concern basis.

Consistency of Presentation: The presentation and classification of items in the financial statements should be retained from one period to the next unless there is a significant change in the nature of the operations or if a change is advisable in order to give a faithful representation of the financial situation.

Materiality and Aggregation: Items that are material by their nature should be presented separately in the financial statements. Items that are material by their sise but which have the same nature may be aggregated. Immaterial amounts should be aggregated with amounts of a similar nature or function and need not be presented separately.

Offsetting: Assets and liabilities should not be offset except when offsetting is required or permitted in an exceptional form.

Comparative information: comparative information should be disclosed in respect of the previous period for all numerical information in the financial statements.

Timeliness: The usefulness of financial statements is impaired if they are not made available to users within a reasonable period of the reporting date. An entity should be in a position to issue its financial statements within six months of the reporting date.

Publicity and Availability: Financial Statements must also be seen to be transparent and the accounting statements that it produces must be publicly available. They should thus be published by an official body, but perhaps could be published on the web. A specific report for citizens can be a useful tool.

Presentation of the Balance Sheet or Statement of Financial Position

Local governments should present current and non-current assets and current and non-current liabilities as separate classifications on the face of the statement of financial position. Moreover, an entity should disclose the amount of assets expected to be recovered or liabilities to be settled after more than twelve months.

As a minimum, the balance sheet should include line items which present the following information: property, plant and equipment; intangible assets; financial assets; investments accounted for using the equity method; inventories; recoverables from non-exchange transactions, including taxes and transfers; receivables from exchange transactions; cash and cash equivalents; taxes and transfers payable; payables under exchange transactions; provisions; non-current liabilities; minority interest; and net assets/equity.

Presentation of the Statement of Revenues and Expenses or Income Statement

As a minimum, the statement of revenues and expenses should include line items, which present the following information: revenue from operating activities; surplus or deficit from operating activities; finance costs; surplus or deficit from ordinary activities; that is the difference between expenses arising from current or ordinary activities and revenue arising from current activities; non current or extraordinary items; net surplus or deficit for the period, which comprises surplus or deficit from current activities; and not current items.

As for presentation of expenses, a classification based on either the nature of expenses or their function within the entity can be used, as appropriate. Entities classifying expenses by function should disclose additional information on the nature of expenses, including depreciation and amortisation expense, salaries and employee benefits, and finance costs.

Presentation of the Statement of Changes in Net Assets/Equity

An entity should present, as a separate component of its financial statements, a statement showing:

– the net surplus or deficit for the period;
– each item of revenue and expense which is recognised directly in net assets/equity, and the total of these items; and
– the balance of accumulated surpluses or deficits at the beginning of the period and at the reporting date, and the movements for the period; and
– to the extent that components of net assets/equity are separately disclosed, a reconciliation between the carrying amount of each component of the net assets/equity at the beginning and the end of the period, separately disclosing each movement.

Presentation of the Cash Flow Statement

The cash flow statement should report cash flows during the period classified by operating, investing and financing activities.

Financing activities are activities that result in changes in the size and composition of the borrowings of the entity.

Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

Operating activities are the activities of the entity that are not investing or financing activities.

An entity should report cash flows from operating activities using either:

– the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or
– the indirect method, whereby net surplus or deficit is adjusted for the effects of transactions of a non-cash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of revenue or expense associated with investing or financing cash flows.

17. Accounting criteria

A number of specific recognition issues arise when accruals are applied in the financial statements of a local government, because of the differences and peculiarities that their assets can have compared to business assets, such as the treatment of infrastructure assets or heritage assets.

Accounting treatment for infrastructure and heritage assets

As has been seen, there is no homogeneity in the treatment of infrastructure and heritage assets. It is in fact one of the most controversial aspects in local government accounting. The diversity of practices and positions illustrates the complexity of the subject and the absence of agreement on it.

Examples of infrastructure assets include road networks, sewer systems, water and power supply systems and communication networks. These assets usually display some or all of the following characteristics: they are part of a system or network; they are specialised in nature and do not have alternative uses; they are immovable; and they may be subject to constraints on disposal.

Examples of heritage assets include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art. The characteristics often displayed by these assets are: their value in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value based purely on a market price; legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale; they are often irreplaceable and their value may increase over time even if their physical condition deteriorates; and it may be difficult to estimate their useful lives, which in some cases could be several hundred years.

The treatment of these assets should be based on the consideration of whether they meet or not the definition of asset. The IFAC, in its IPSAS 17, *Property, Plant and Equipment*, considers that infrastructure assets meet the definition of property, plant and equipment and should be accounted for in accordance with this standard. So, the IFAC does not give any special consideration to these assets. However, the standard does not apply to heritage assets, and for the moment there is no standard that requires recognising heritage assets that would otherwise meet the definition of, and recognition criteria for, property, plant and equipment.

So it can be said that infrastructure assets meet the definition of asset and as a consequence should be in the balance sheet. Their consideration as expenses in the income statement can make the determination of the cost of services delivery difficult. Furthermore, sometimes these assets are financed with debt, so it cannot be recorded as a debt on the balance sheet and an asset in the income statement. It could be more convenient to display infrastructure assets in the Statement of Financial Position separately.

Nevertheless, in heritage assets there can be some valuation problems that make their recognition in the balance sheet difficult. In this case, it can be appropriate not to record it on the balance sheet.

Valuation of assets

If it is difficult to reach an agreement as to which assets should be registered on the balance sheet, it is no less so to arrive at conclusions about their valuation. However, this is not a controversy specific to the public sector, given that in the business sector it has also been the object of various proposals, without a general agreement having been reached.

The different alternatives of valuation with which one is faced are historical cost, replacement value, realisable value and present value. Historical cost is the most accepted method in the business world although its use is not without its critics. In the public sector, it is also the method that has received the most support, although there are situations in which various options for different types of fixed assets can coexist.

The IFAC establishes that an item of property, plant and equipment which qualifies for recognition as an asset should initially be measured at its cost. Where an asset is acquired at no cost, or for a nominal cost, its cost is its fair value as at the date of acquisition. Subsequent to initial recognition as an asset, an item of property, plant and equipment should be carried at its cost less any accumulated depreciation and any accumulated impairment losses. Alternatively an item of property, plant and equipment should be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. The fair value is usually its market value, determined by appraisal, but where no evidence is available to determine the market value, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location. For example, in the case of specialised buildings and other man-made structures, fair value may be estimated using depreciated replacement cost.

So the international standards allow both the historical cost net of depreciation and the fair value for measurement subsequent to the initial recognition.

As for depreciation, the IPSAS states that the depreciable amount of an item of property, plant and equipment should be allocated on a systematic basis over its useful life. The depreciation method used should reflect the pattern in which the asset's economic benefits or service potential is consumed by the entity. The depreciation charge for each period should be recognised as an expense of the period. So, all local governments' assets should be depreciated, including infrastructure assets.

Provisions

A provision is a liability of uncertain timing or amount. According to the IPSAS 19, *Provisions, Contingent Liabilities and contingent Assets*, a provision should be recognised when:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision should be recognised. For example, provisions should not be recognised for net deficits from future operating activities.

The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the reporting date.

18. Consolidation of financial statements

Different forms of service delivery by local governments have led them, in order to achieve their objectives, to the creation of other entities, which depend on the local government, giving rise to the concept of group of entities or economic entity. Consequently, in order to obtain a global vision of the financial impact of local government policies, it would be advisable to draft consolidated financial statements.

The consolidated financial statements should include all the entities included in the economic entity, the group of entities comprising the controlling entity and any controlled entities.

A controlled entity is an entity that is under the control of another entity, which has the power to govern its financial and operating policies so that it can be benefit from the activities of the entity. In some cases it may be clear that an entity is controlled, and hence should be consolidated. In other cases it may not be clear.

Some ways that the control may be exerted are: the entity holds direct or indirect title to the net assets/equity of the other entity with an ongoing right to access these; the entity has a right to a significant level of the net assets/equity of the other entity in the event of a liquidation or in a distribution other than a liquidation; the entity is able to direct the other entity to co-operate with it in achieving its objectives; the entity is exposed to the residual liabilities of the other entity. For example, the entity may benefit from its ability to direct the other entity to work with it to achieve some of its social policy objectives.

Some examples of entities that should be considered as controlled entities are: Independent public organisations that are created by the government, local government enterprises or business (100% municipality owned or majority participation) and public or private organisations with the total or majority participation of a municipality.

In preparing consolidated financial statements, the financial statements of the controlling entity and its controlled entities are consolidated with full (line by line) consolidation, that is combining on a line-by-line basis by adding together like items of assets, liabilities, net assets/equity, revenue and expenses.

Balances and transactions between entities within the economic entity and resulting unrealised gains should be eliminated in full. Unrealised losses resulting from transactions within the economic entity should also be eliminated unless cost cannot be recovered.

Moreover, on occasions some local governments can agree to create a local government partnership for the delivery of some services. If the arrangement establishes joint control and confers similar rights and obligations on the parties to it as if it were in the form of a contract, the partnership can be considered a joint venture, and so the local government should include the joint controlled entity in consolidated statements, using the proportionate consolidation.

The application of proportionate consolidation means that the consolidated statement of financial position of the local government includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible. The consolidated statement of financial performance of the local entity includes its share of the revenue and expenses of the jointly controlled entity.

Consolidated financial statements should include also the associate's entities. An *associate* is an entity in which the investor has significant influence and which is neither a controlled entity nor a joint venture of the investor. The existence of significant influence by an investor is usually evidenced in one or more of the following ways: representation on the board of directors or equivalent governing body of the investee; participation in policy-making processes; material transactions between the investor and the investee; interchange of managerial personnel; or provision of essential technical information. If the investor's ownership interest is in the form of shares and it holds, directly or indirectly through controlled entities, 20% or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case.

An investment in an associate should be accounted for in consolidated financial statements under the equity method except when the investment is acquired and held exclusively with a view to its disposal in the near future, in which case it should be accounted for under the cost method.

19. Performance indicators

A broad view of governmental accountability implies that the objectives for Information Systems extend beyond reporting traditional accounting information. In order to be accountable, a governmental entity should provide information about the essential aspects of its performance to citizens and other interested users.

The use of performance measures in local government, such as performance indicators, is being driven by increased citizen demands for government accountability, by greater interest on the part of local legislators in performance-related information to assist in programme evaluation and resource allocation decisions, and by the efforts of various organisations and professional associations to make governments more results-oriented.

The advantages of the use of performance measures are recognised worldwide. They can help in setting goals and objectives, in planning and acting in their accomplishment, and in the control and evaluation of the results, the quality and the effectiveness of government services. In fact, performance measures are usually used together with performance budgeting. They allow the improvement of the quality of services provided by local government, the increase of efficiency and effectiveness and provide a customer focus. They allow the comparison of the same type of service between different local governments and comparisons over time, identifying trends and analysing the causes of the differences. Moreover, performance reporting can provide more complete information about an entity's performance than traditional budgets or financial statements do. Their presence can encourage the interest of citizens in public entities and the interest of managers in providing better quality services. They facilitate the identification of gaps between what the citizens desire and the real level of services.

Performance measurement allows policy makers, managers, and citizens to evaluate the quality and effectiveness of government services. Performance measures include inputs (resources used), outputs (programme activities), efficiency measures (ratio of inputs to outputs), and outcomes (the actual results of programmes and services).

Entities are encouraged to include this information in the budgetary reporting or in the financial reporting, in order to assist users in assessing the performance of the entity. For example, the presentation of performance indicators of the different services or programmes carried out by the government is useful. They should be also incorporated into the budget documents.

20. Financial analysis

There is a need to monitor the quality of information provided by the annual accounts to outside users.

While a municipality is obviously an administrative structure, it should also be remembered that it is an economic entity, just as a private company is, although it is distinct in several respects.

The following examples illustrate how this approach can be useful, while pointing out the differences between municipalities and companies:

– just like private companies, local authorities have to render accounts and manage resources;

– just as private companies have their tools of production, local authorities have a range of movable assets (ie trucks, office equipment etc) and fixed assets (municipal buildings, schools, roadways, drainage systems etc) which they use in their operational activities, make available to local residents or manage to generate various types of revenue (from timber sales, property rentals etc);

– while companies derive their resources chiefly from the input of private capital and from revenue earned on their commercial or industrial activities, the financial structure of local authorities is different, with the emphasis on transfers both from individuals (ie tax revenue), and from regional or federal institutions (in the form of local-authority funding and grants of various types).

It should also been noted that local authorities regularly borrow in order to finance non-subsidised investment.

Municipalities are major employers. In many areas the local authority is the largest employer, and staff levels in big city authorities (some of which employ thousands of people) are comparable to those of large companies.

Required as they are to provide a growing range of services on an ever tighter budget, local administrators need to prioritise their objectives. In order to improve the performance of the management, they must be able to appraise the changing financial position of the administration they serve and, most importantly, to assess the impact of their choices on the local finances.

The wide range of information generated by accounting systems and annual accounting statements (budget accounts, balance sheets, income statements and notes) must be used to make the management of local administrations more reliable and rigorous.

Financial analysis can be based on the calculation of various ratios:

– structural ratios, enabling an administration to position itself in a chosen reference group;

– debt/equity or financial capacity ratios, indicating the level of the administration's borrowings and its ability to service the debt;

– liquidity ratios, measuring the administration's capacity to meet its short-term commitments;

– financial ratios indicating specific relationships such as the rates of cover of staff costs, operational costs or transfer charges;

– turnover ratios, indicating the rate of turnover of the inventory and current receivables and liabilities;

– financial growth ratios, measuring the growth of commitments and established entitlements in relation to appropriations.

There are two ways of analysing ratios:

1. by comparing two values of a given ratio for the same administration but at different times;

2. by comparing values of a given ratio at the same time for a group of administrations of the same size and type.

The second type of analysis enables a municipality to position itself in relation to a reference group. Where the mean value is not satisfactory, the administration – having recognised the discrepancy – can then examine why its own performance does not match that of the reference group.

Ratios thus function as management warning lights, drawing the attention of local administrators to certain situations.

The values used to calculate the ratios may be drawn from the budget, budget account, balance sheet or income statement and may be grouped or aggregated.