Consolidation in the public sector: a cross-country comparison

Giuseppe Grossi and Francesca Pepe

This article analyses consolidated annual accounts in the public sector in six countries (Sweden, the UK, the USA, Canada, New Zealand and Australia) highlighting the differences and similarities in approaches. The authors also examine international trends and take an in-depth look at the International Public Sector Accounting Standards Board (IPSASB).

Giuseppe Grossi is Associate Professor in Public Financial Management in the Department of Business and Social Studies at Siena University.

Francesca Pepe is a PhD student in the School of Economics at Siena University.

The public sector's boundaries have been changing since the 1980s and so too its financing and management methods, governance structures, responsibilities, controls and accounting (Chan, 2003; Lüder and Jones, 2003; Johnsen and Lapsley, 2005; Guthrie *et al*., 2005). Accounting systems have adapted to the changing demands of public governance that have influenced their operating context as well as content (Broadbent and Guthrie, 2008). The growing need for financial and political accountability demands a broader and more complete accounting system—the consolidated financial report (CFR)—to provide feedback for decision-making and improves accountability (Humphrey *et al*., 1993; Broadbent *et al*., 1996; Chan, 2003; Chow *et al*., 2007). However, there are some problems with using the CFR in the public sector, including the difficulty of comparing consolidated information across different levels of government and defining consolidation boundaries (Heald and Georgiou, 2000; Robb and Newberry, 2007).

Although few countries have implemented the CFR (Benito *et al*., 2007), independent bodies and experts offer the necessary input to carry out the changes, for example the International Public Sector Accounting Standards Board (IPSASB). In some countries (Sweden, the UK, the USA, Canada, New Zealand and Australia), accounting standards for the consolidation of annual accounts have already been established.

In many countries, major auditing and accounting firms have played a crucial role in the process of implementing accrual accounting in the public sector. Methods and practice from the private sector have been copied and introduced in the public sector without any thorough analysis of the objectives and characteristics of the public sector (Ellwood and Newberry, 2007; Robb and Newberry, 2007). However, the stimuli behind these accounting reforms and the key factors in the reform process have varied between countries (for example see Lüder and Jones, 2003). Lüder (2002) suggests that change is either 'managerialism driven' or 'accountability driven'.

This article highlights the features of the consolidation approaches in the public sector, in terms of the accounting standards-setter, consolidation rules and accounting standards, the context for which the accounting standards have been established (public or private), and the criteria to identify the area of consolidation. We also compare the consolidated standards in different countries where these have been established.

Consolidation approaches

The countries that compile the CFR in their public sector (whole, federal/central, state or local government) are Sweden, the UK, the USA, Canada, New Zealand, Australia, Austria, Finland, France, the Netherlands and Switzerland. Only few countries (Sweden, the UK, the USA, Canada, New Zealand and Australia) have already established consolidation standards and these countries are the ones we analysed, in addition to IPSASB.

Sweden

At central and agency level, following private sector influence, the government agency for financial management—the Swedish National Financial Management Authority (ESV)—developed GAAP for the central government (ESV, 2001, 2002; Mattisson *et al*., 2003). The Swedish government, with professionals and academics, has also created a framework of rules specifically for Swedish local authorities. After the introduction of the Municipal Accounting Act 1998, a standard-setting body, the Swedish Council for Municipal Accounting (SCMA) was set up by the Swedish government and the Association of Local Authorities. The SCMA is responsible for developing and interpreting the generally accepted accounting standards within

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the municipal sector (Falkman and Tagesson, 2008). Regulation of the CFR for municipalities and county councils is provided by the Municipal Accounting Act 1998 and by SCMA's standard RKR 8.1.

To define the scope of consolidation, the control criterion is operationalized in central government as a majority control of the voting rights, the ability to approve the statute or similar documents, or the ability to appoint the majority members of the board of directors. At the local level, the criterion of control is met when ownership is at least 20% ,or if a municipal corporation affects the municipal economy.

UK

The compilation of whole of government financial reporting (WGFR) was introduced by the Government Resources and Accounts Act 2000. This establishes that the Treasury consolidate according to public nature and financial dependence, thus providing the basis for including local authorities and other entities, as was established by the Whole of Government Accounts (Designation of Bodies) Order 2007. Government departments and other entities, such as non-departmental public bodies (NDPBs), that fall within the WGFR boundaries, compile their own CFR. Government departments follow the current guide on financial reporting set down in the Government Financial Reporting Manual (FReM). FReM was prepared by the Treasury in 2005 and follows the UK GAAP, with some adaptations and interpretations appropriate to government. As a consequence of the convergence strategy proposed by the national Accounting Standards Board (ASB) in aligning UK accounting standards with International Accounting Standards (IAS), from 2009/10 FreM applies the consolidation standard IAS 27, replacing the UK Standard FRS 2, published by the Treasury in 1992.

At the departmental level the scope of consolidation is defined in two steps. Following, as a minimum requirement the budgetary control criterion (Treasury, 2008a: 4.2.3; 4.2.14) or the FReM's list of departmental accounting boundaries (Treasury, 2008a: 4.2.12-4.2.13), the control criterion of IAS 27 is applied. For IAS 27, control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In determining if control exists, this standard presents only a few indicators of control and does not list any benefit indicators. The executive NDPBs and trading funds, following FReM's requirements (Treasury, 2008a), and apply IAS 27 without adaptation or interpretation.

At local level, the Local Government Act 2003 requires local authorities to follow current accounting practices and to comply with the Code of Practice on Local Authority Accounting (Statement of Recommended Practice—SORP), which requires the compilation of group accounts in compliance with GAAP. This Code is published annually by the CIPFA/LASAAC Local Authority SORP Board. CIPFA/LASAAC has announced that the Code from 2010 will be based on IFRS and it will be prepared under the oversight of the Financial Reporting Advisory Board (FRAB) rather than the ASB (see www.cipfa.org.uk/pt/cipfalasaac/ifrs.cfm).

USA

The USA's Federal Accounting Standards Advisory Board (FASAB) was set up in the early 1990s. FASAB has been accepted by the American Institute of Chartered Public Accountants (AICPA) as the body that draws up accounting standards for federal entities. For the federal government, FASAB's *Statement of Federal Financial Accounting Concept 2. Entity and Display* (SFFAC 2) (1995) attributes the role of reporting entity only to the executive part of the federal government, including the departments and independent agencies. But the same standard affirms that federal government entities encompass all of the resources and responsibilities existing within the component entities, whether they are part of the executive, legislative, or judicial branches of government (although FASAB's recommendations pertain only to the executive branch). Although SFFAC 2 has an important role in determining the scope of consolidation, Congress and other authorities have rules for what to include in federal government consolidation boundaries (GAO, 2005).

The federal CFR includes organizations for which the federal government is financially accountable, as well as others (depending on the nature and significance of their relationship with the government). The reporting entity is defined according to the entities indicated in the 'Federal Program of Agency and Account' (SFFAC 2), such as a relationship of trust, administrative control, or the ability to carry out government objectives.

At the state and municipal level, the Governmental Accounting Standards Board (GASB) publishes standards for the public sector. The GASB, together with the Financial Accounting Standards Board (FASB), are part of the Financial Accounting Foundation (FAF). At this level, GASB (1991) Statement No. 14 'Financial Reporting Entity' is relevant because it was the first accounting standard (of those studied in this article) to be established for application to state and local governments. GASB 14 (1991) is based on the concept of 'financial accountability'. Accountability flows from the notion that individuals are obliged to account for their acts, including the acts of the officials they appoint to operate governmental agencies. The government is financially accountable if it:

- Appoints a voting majority of the organization's governing body and is able to impose its will on that organization.
- If there is potential for the organization to provide specific financial benefits to or impose specific financial burdens on the government.

Furthermore, the government may be financially accountable if an organization is fiscally dependent on it, regardless of whether the organization has a separately elected governing board, a governing board appointed by a higher level of government, or a jointly appointed board.

Canada

In Canada the Public Sector Accounting Board (PSAB) has been setting standards for the public sector since 2004. The PSAB is part of the Canadian Institute of Chartered Accountants. PSAB standards apply to all public sector authorities. PS 1300 (CICA, 2008) identifies control as a principal criterion for definition of the area of consolidation. Control is defined as the power to govern the financial and operating policies of another organization with expected benefits or the risk of loss to the government from the other organization's activities. Justification for such a choice lies in the vagueness of this criterion, which makes entities immune to the frequent legislative changes which are typical of the public sector. In any case there are numerous indicators of control in PS 1300 which highlight responsibility and power elements, such as responsibility for losses or power to define the mission, typical of strategic control.

New Zealand

The Financial Standards Reporting Board (FRSB) is part of the New Zealand Institute of Chartered Accountants (NZICA) and it promulgates accounting standards for both the public and private sectors adapted to IAS-IFRS. The Financial Reporting Act 1993 introduced neutrality of application of the standards. The FRSB submits its standards for approval to the Accounting Standards Review Board (ASRB), which is a Crown entity. When they are approved they take legislative effect. By virtue of the Public Finance Act 1989, the New Zealand government compiles a Whole of Government Financial Reporting (WGFR), and structures the reporting entity following the New Zealand GAAP. The Public Finance Act 1989 lists the entities that must be included in the WGFR. The inclusion of any other entities not specifically mentioned by the law is based on NZ IAS 27's control criterion. WGFR in New Zealand is not yet able to offer a representation of the whole public sector since neither the control criterion, nor the existing normative acts, include independent public bodies such as universities or local governments in the consolidation.

Local authorities compile their own CFR on the basis of the Local Government Act 2002 and the NZ IAS 27.

New Zealand, like Australia, has added paragraphs to IFRS in its application to the public sector. For the purpose of identifying the existence of control, the paragraphs added to NZ IAS 27 refer to the set of control indicators in the previous standard, NZ FRS 37 and/or to IPSAS 6 to determine whether control exists in the public sector. FRS 37's definition is: 'Control by one entity over another entity exists in circumstances where…(a) the first entity has the capacity to determine the financing and operating policies that guide the activities of the second entity; (b) the first entity has an entitlement to a significant level of current or future ownership benefits, including the reduction of ownership losses, which arise from the activities of the second entity'.

Australia

The Australian Accounting Standards Board (AASB) has promulgated accounting standards adapted to IAS-IFRS for private and all public sector levels from 2000. All levels of government—Commonwealth, state and local—follow AASB 127, which was established in 2004 to adapt the previous consolidation standard to IFRS and was subsequently modified in 2008 to receive the government standards AAS 27, 29 and 31. In addition to AASB 127, to compile WGFR government follows AASB 1049 (issued in 2007 for *Whole of Government and General Government Sector Financial Reporting*) which aims to harmonize micro-economic function of GAAP based WGFR with the macro-economic functions of reports based on the Government Financial Statistics (GFS) framework (ABS, 2006). The Australian case is interesting because it refers to both criteria of consolidation, i.e. control and financial accountability.

AASB 127 defines control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In determining whether an entity is in the area of consoldidation, consideration should be given to the controlling entity's ability to deploy the resources under its control. The ability of the entities to operate for the benefit of the controlling entity is a central characteristic of a group. If an entity is precluded from operating for the benefit of the controlling entity, it would not be included in the group.

International

The IPSASB is an independent standard-setting body of the International Federation of Accountants (IFAC) and it promulgates accounting standards for the public sector that are based on private sector standards (IPSASB, 2008). In July 2000, the Public Sector Committee (PSC) developed, on the basis of IAS 27, IPSAS 6, 'Consolidated Financial Statements and Accounting for Controlled Entities' (revised in 2007). This standard is applicable to all levels of government (national, regional, local governments and their component units).

IPSAS 6 defines control as the power to govern the financial and operating policies of another entity so as to benefit from its activities; power without benefit is insufficient on its own.

IPSAS 6 defines a set of power and benefit conditions and indicators which help to verify the existence of control. Power conditions or indicators refer to a government's influence on the financial and operational policies of controlled entities. Benefit conditions (IPSAS 6: 39) or indicators (IPSAS 6:40) involve financial and non financial, positives or negatives (such as responsibility for losses), outcomes from the government. Control is presumed to exist when at least one of the power conditions and one of the benefit conditions exist.

Comparative analysis of the consolidation standards

This section discusses the comparison of consolidation standards which were set in the seven cases analysed. Table 1 shows that in the majority of cases there is an accounting standards-setting body which promulgates consolidation standards. The first public sector consolidation standard issued was GASB 14 (in 1991), followed by the others. In 2007, AASB 1049 aligned macro-economic and statistically based functions with micro-economic based function of the consolidated whole-of-government financial reporting. From the comparative analysis, solutions emerged which were differentiated by sector of application (only public as in Sweden, USA, Canada and IPSASB; public and private, as in New Zealand and Australia; or referring to private sector standards, as in the UK). In terms of the level of government where standards are applied, in Australia, New Zealand, Canada and IPSASB, the consolidation standards can be applied to all levels of governments (including Australia and New Zealand's whole-of-government), instead in the other cases where there are different solutions (Sweden, the UK and the USA).

Table 2 looks at the criteria for determining the area of consolidation according to the accounting standards. There are two ways of defining the area of consolidation. The first (the more widespread) uses the existence of control, while the second requires the presence of financial accountability. In the criterion of control, the controlling entity needs to be able to govern decision-making of the controlled entity so as to be able to benefit from its activities (IPSAS 6:7, FRS 2:6, PS 1300:8, NZ IAS 27:4, AASB 127:4, IAS 27: 4). The control criterion is used by Canada, New Zealand and IPSASB. The financial accountability criterion was followed by the USA. Australia uses both criteria—AASB 127's roots seem to be derived from GASB 14 because it refers to financial accountability criterion as well as criterion of control, already used in the private sector. In the UK, the control criterion was used by government departments, executive NDPBs, trading funds and by local authorities. In the Swedish central government the scope of consolidation is defined by the ownership control whereas at the local level the substantial influence/ control criterion focuses on the effect on the municipal policy and economy.

A series of power and benefit indicators based on IPSAS 6 sub-divisions are used to establish the existence (or absence) of the chosen criteria in the various standards. The two types of conditions present in the IPSAS 6 definition of control, represent two macro-classifications in which the indicators for the concept of control are listed. Although there are differences across the criteria, the standards are quite similar. The majority of the standards include the government possessing a majority of the voting rights; having the power to veto the entity's decisions; the power to appoint administrators and top managers; and the ability to co-ordinate the entity's objectives. In addition, power to approve or veto the operating and financial budget, golden shares or equivalent mechanisms, ownership of at least 20% of the equity and possession of rights and obligations on property and financial results are all elements that represent a form of control of one entity over another.

The various accounting standards also

contain similar indicators for control. There are only a few elements of differentiation. For example, GASB 14 defines fiscal dependency as financing on the part of the controlling entity of an amount of resources which without the controlled operations could not be guaranteed. The IAS-IFRS standards (as modified in Australia and New Zealand) propose the same IPSAS 6 indicators, confirming the common root of the three standards. The Australian consolidation standard that refers to both control and financial accountability criteria, seems to have the same indicators as IPSAS 6, which does not reference an accountability approach, while the NZ IAS 27 refers expressly to IPSAS 6 or to FRS 37. Moreover, for the USA, Canada, New Zealand, Australia and IPSASB, even though the consolidation criteria (control and financial accountability) are apparently different, the consolidation criteria's indicators are very alike.

Conclusions

This article has analysed the standard-setting bodies, the consolidation rules and the accounting standards, the sector and the level of application, the criteria for determining the area of consolidation and the relative indicators in six different countries, and in the international context. We did not find any substantial differences between the various standards nor with the consolidation criteria indicators. As pointed out by Wise (2006), there is some subjectivity in interpreting control criteria in order to define the area of consolidation, thus leaving space for considerations other than those of an economic nature. Such subjectivity allows for the adaptation of a financial tool (objectively similar in every context) to the historical, political and social features of the context. For this reason each country has articulated its CFR according to different characteristics.

Our comparison identified two conflicting trends. The first trend, mainly in the Anglo-Saxon countries, consists of the convergence of the accounting standards toward a private sector approach. The second trend, present only in some countries, is characterized by an influential role of the government and the accounting standards are modified for application to the public sector.

While in some countries (such as Australia, New Zealand and the USA) the relationship between the accounting standard setting body and the government is more co-operative, in other countries the relationship is less co-operative (for example in the UK). In the UK although there is a convergence to adopt the private sector consolidation standards, the legislative requirements aim to carry on public sector approach. As highlighted by Ellwood and Newberry (2007), the convergence is clear, but the influence of government exists also where the standards seem to be neutral between private and public sector.

Table 1. Consolidation standards in the public sector.

	Sweden		*UK*		*USA*		*Canada*	*New Zealand*	*Australia*	*International*
Standard-setting body	SCMA	ESV	CIPFA + ASB	IASB	GASB	FASAB	PSAB	NZ ICA	AASB	IPASB
Year promulgated	1998		2004* +1992	1990	1991 1999 2002	1993 1995 2003	2004	2004	2004 2007	2000
Standards	RKR 8.1	ESV	SORP	IAS 27 + FRS 2	GASB 14	SFFAC 2	PS	NZ IAS 1300-	AASB 127 27	IPSAS 6 AASB 1049
Sector of application	Public	Public / private	Private		Public		Public	Public/ private	Public/ private	Public
Applicable to which governments	Local	Central + agency	Local	Departments NDPBs trading funds	State, local and special purpose governments	Federal	All	All	All	All

*SORP introduced the requirement for group accounts in local government in 2004.

Table 2. Area and criteria of consolidation.

	Sweden		*UK*		*USA*		*Canada*	*New Zealand*	*Australia*	*International*
Standards	RKR 8.1	ESV	SORP + FRS 2	IAS 27	GASB 14	SFFAC 2	PS 1300	NZ IAS 27	AASB 127	IPSAS 6
Area of consolidation determined by	Substantial influence/ control	Ownership control	Control	Control	Financial accountability		Control	Control	Control + financial accountability	Control

The article has identified two main features of the development of whole government financial reporting. First, the dynamics of WGFR continue to change; thus, nothing should be considered stable. Second, while the convergence process has brought harmonization, comparison and homogeneity, there still remains the problem of finding the appropriate combination of private and public sector approaches. ■

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