

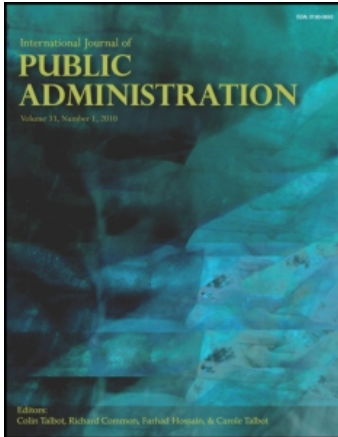
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Analyzing Governmental Accounting and Financial Reporting: Italy, European Union, and the United States

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Globalization has revealed a need for accounting language simplification and harmonization, both for business and Public Administration. However, many countries have recently undertaken governmental accounting and financial reporting reforms in order to increase transparency and accountability towards taxpayers and, more generally, all stakeholders. Given that a standardized model does not exist, this study compares Italy, the European Union, and the United States in order to highlight similarities and differences between their current accounting and financial reporting models, to understand if common elements exist, and to verify if they are coherent with international trends concerning public sector accounting reforms.

Keywords: accrual accounting, government financial reporting, Italy, European Union, United States

INTRODUCTION AND THEORETICAL BACKGROUND

Nowadays, business accounting models are undergoing a harmonization process: internationalization and integration of real and financial markets imply an increasing information need for a large number of operators, to support the adoption of aware choices. Therefore, the accounting language has to be more clear and understandable for the largest number of people. This demand has been taken in by the EU, which required of all listed companies of its member states adoption of IAS/IFRS (the accounting standards issued by the IASB, International Accounting Standards Board). A project to bridge the differences between the US GAAP (Generally Accepted Accounting Principles) and IASB's standards is under development.

What about Public Administration (PA)? The last few decades have been characterized by deep transformations which have involved the public sector, determining relevant changes in its working models and in the role played within the society. These reforms have been worked out within the New Public Management paradigm, with the task of public

action's efficiency and effectiveness recovery: rationalization processes of government's working models have been realized concerning organizational, managerial, and financial point of view, introducing or improving some typical business principles and instruments (Hood, 1991).

In these processes, public sector accounting systems reforms have also taken place: within New Public Financial Management, changes in financial reporting systems are considered one of the key elements of financial reforms. Kettl (2005: 47) notes that "budgeting and financial management are the bedrock on which most other reforms have been built". In fact, financial resources are an essential condition for PA working: controlling how these resources are used is an endless discussion topic for academics and professionals.

So, what is the state of accounting and financial reporting harmonization in PA? Accrual-based accounting introduction is one of the most significant lines of recent reforms.

While cash accounting (the accounting basis traditionally used by government) records transactions only when cash is received or paid, accrual accounting recognizes transactions when they occur, and not only when cash or its equivalent is received or paid. The elements recognized under accrual accounting are assets, liabilities, revenues, and expenses/costs: measuring and monitoring them, accrual accounting captures the long-term consequences of current decisions (Chan, 2002). Therefore, main accrual

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accounting advantage seems to be a more accurate measurement and communication of government's financial position and performance, to assess outputs and outcomes. On the other hand, cash accounting lacks do not fit into public resources management control: providing only information about money flows, it is not able to highlight connections between resources consumption and achieved results.

But some authors also argue problems arising from accrual accounting implementation in PA, linked to theoretical aspects, as well as operational ones (Antony, 2000). Some authors talk about an *evaluatory trap*: it concerns the risk in developing accounting and performance measurement models more and more advanced, elaborated and expensive, undervaluing the difficulties to measure and represent government's results only from a financial perspective, considering measuring activity as an aim and not as a mean (Olson, Humphrey, & Guthrie, 2001). Then, also, some difficulties have come out drawing up the opening balance sheet, such as identifying and evaluating assets and liabilities at the starting point of the accounting reform: the market absence causes problems concerning definition, valuation, classification, depreciation, and presentation of capital assets.

RESEARCH DESIGN: GOALS AND METHODOLOGY

The purpose of this study is to analyze central government accounting and financial reporting systems of Italy, the EU and the United States, in order to compare them, emphasizing similarities and differences, to understand if common elements exist and to verify if they are coherent with international trends. The focus is only on the accounting system and financial reporting, whereas other aspects (such as budgeting, auditing, management control) haven't been considered.

These cases were chosen for two main reasons:

1. Italy and the United States have more than one difference in accounting culture and traditions: is it true that NPFM reforms are leading to public sector accounting harmonization?
2. Taking into account the selected countries' institutional natures, it was necessary to enlarge the investigation field and consider the EU case too: Italy is an EU member state and, even if it is currently autonomous in shaping its own government accounting model, it has to report financial data to the supranational organization to which it belongs.

Within the selected cases, the focus is:

- for Italy, on central government;
- for the EU, on the European Commission (EC): it plays a role of utmost importance vis-a-vis EU accounting

model, defining accounting principles and rules to be applied by other EU institutions and having the task of consolidating the various EU bodies' accounts;

- for the United States, both the federal and the state level.

The employed method, is the multiple case study. In order to compare the selected cases, their analysis was carried out taking into consideration some accounting models' key elements:

1. the accounting systems basis;
2. the accounting principles and standards: principles refer to qualitative characteristics of financial reports information, while standards contain detailed requirements and criteria for measuring and evaluating specific items;
3. the financial reporting, with particular focus on financial statements.

This is a document analysis: in addition to literature review, the empirical materials used concern government financial statements, accounting rules and regulation, accounting standards, accounting manuals, and other working documents produced by government offices.

DISCUSSION ON RESULTS: COMPARATIVE ANALYSIS

Accounting Systems Basis

The accounting reform process recently undertaken by the Italian central government is focused on budget. With regard to the accounting system, Italy made a choice that seems to depart from international trends: the reform starting in 1997 maintained cash accounting (full and modified). Without introducing accrual-based financial accounting, a cost accounting system was created, based on cost measurements to be referred to cost centers, in order to obtain information about public resources employed by different organizational units. But the system's main role is to support their budgeting process, not to draw up financial statements. Then, cost accounting recording, made on a six-month base, does not arise from a financial accounting system based on double-entry bookkeeping, but it derives from cash-based single-entry bookkeeping, with extra-accounting system adjustments: this can be the source of data limitations and low reliability.

The EC reform process started in 2000 with the white paper publication (European Commission, 2000). It was based on the principles of accountability, efficiency, and effectiveness of actions put in place and transparency within the Commission, as well as toward external actors (Levy,

2004). Among several intervention areas (such as the implementation of an activity-based management system for the budgeting process, the reassessment system for the budgeting process, the reassessment of human resources policies, and the reform of financial management, control, and audit systems), also the EC accounting modernization project—called ABAC: accrual based accounting—finds its place: it concerns accounting systems and financial reporting, as well as EU consolidated financial statements. Begun in 2002, it is not fully completed yet, but it has achieved one of its most important steps in the preparation of the annual accounts 2005, only based on accrual accounting book-keeping. The main tools used to realize ABAC reform are Financial Regulation and Implementing Rules.

The EC chose to introduce accrual accounting basing on IPSAS (International Public Sector Accounting Standards), the accounting standards issued by the International Federation of Accountants. IPSAS are developed adapting IAS/IFRS to a public context, when it is possible, apart from some specific government aspects that have not comparison in profit-oriented companies.

The current communitarian accounting system is a dual system: accrual accounting, in fact, was implemented without leaving from cash accounting, used to manage budget appropriations. Within the EU budgetary accounting, expenses are recorded under a modified cash basis and revenues under a cash basis; with regard to financial accounting, it is accrual-based and realized with double-entry book-keeping. The coexistence of the two accounting systems is possible thanks to budget and financial reporting software integration.

The choice to maintain cash accounting is probably due both to a more gradual introduction of these accounting changes—for costs' transition project and for historical tradition and habits of administrative staff in dealing with cash accounting—and to peculiarities of EC activities, mostly made of fund transactions.

As for the United States, there are some little differences between single states and the federal government. In fact, federal agency and government financial reporting is based on full accrual accounting, while US states are different with an accounting system based on fund accounting (funds are the amount of resources dedicated to specific purposes). Different kinds of funds exist (Chan, 2002): for government-type activities, a modified accrual accounting is used, while for business-type activities (proprietary funds), financial statements are based on full accrual accounting (see, Table 1).

Accounting Principles and Standards

Italy has not issued accounting principles and standards concerning financial reporting, because it does not produce complete financial statements. Rules issued by the Minister of Economy and Finance contain technical data to draw up the balance sheet.

TABLE 1
Accounting Systems Basis

	Italy	EC	US States	US Federal Government
Cash accounting	X	X (revenues)		
Modified cash accounting	X	X (expenses)		
Accrual accounting		X	X	X
Modified accrual accounting			X	

As for the EC, the *Financial Regulation of the European Union* (Art. 124) states that financial statements are drawn up in accordance with generally accepted accounting principles which are: going-concern basis, prudence, consistent accounting methods, comparability of information, materiality, no netting, reality over appearance, and accrual-based accounting. The *Implementing Rules* provide an interpretation of the principles with reference to the EU's peculiar features and activities.

In the United States there is a quite homogeneous situation: even if the boards in charge of issuing accounting principle for states and the federal government are different, accounting principles are substantially the same. Understandability, reliability, relevance, timeliness, consistency, and comparability are indicated both in the *Concepts Statements* issued by the Government Accounting Standards Board (GASB) and in the *Statements of Federal Financial Accounting Concepts* issued by the Federal Accounting Standards Advisory Board (FASAB).

As for specific accounting standards, the EC Accounting Officer, supported by an Accounting Standards Committee, issued 16 accounting rules, regarding main financial statements' items, their measurement rules and disclosure requirements, with which the EC has taken into account communitarian activities and peculiarities. Within these standards the EC 1) has identified which IPSAS can be directly applied without integration need; 2) has detailed and adapted some IPSAS to the EU features; 3) has created some new standards regarding areas left uncovered by IPSAS: for instance accounting rule no. 5, dedicated to pre-financing, one of the EC activity's peculiarities.

The United States, on the other hand, has numerous documents, very technical ones, issued by GASB and FASAB: their purpose is to assist in a very detailed way the preparers as well as the users of financial reporting, to make transparent the final documents as well as the drawing up process (see Table 2).

Financial Reporting

The Italian annual report is made up of two main statements: in addition to the *budget account*, based on cash and modified cash accounting (mirror image of the budget), the *balance sheet* is also drawn up. It gives information about the state financial position resulting at the end of the year, highlighting changes in capital assets and equity, even if they

TABLE 2
Accounting Rules and Standards

Italy	EC Accounting officer	US States GASB	US Federal Government FASAB
	<ul style="list-style-type: none"> • Accounting rules (16) 	<ul style="list-style-type: none"> • Statements (56) • Interpretations (6) 	<ul style="list-style-type: none"> • Statements of Federal Financial Accounting Standards (32) • Interpretations (7) • Technical Releases (9) • Technical Bulletin • Staff Implementation Guidance

do not come from financial accounting, as explained above. The annual report also includes transition tables to clarify the link between cash accounting results and the final balance sheet and, since 2007, the correspondence between cash accounting and cost accounting, showing integrative and rectification items. In spite of these efforts, Italian assets and liabilities measurement and disclosure seem to not be sufficient yet: beyond problems concerning valuation rules and financial representation requirements for all public sector entities (for instance about capital assets), the main negative element is that figures shown in the balance sheet do not derive from a systematic double-entry bookkeeping, but from inventory recording, used to adjust modified cash accounting data. This way to produce financial information causes doubts about the figures' reliability and it forces, sometimes, to extreme simplification.

According to GASB Statement 34, US states' financial reporting, composed of a lot of reports, is divided into three main parts:

- Management's discussion and analysis*, with the role of introducing the basic financial statements and providing an analytical overview of the government's financial activities;
- Basic financial statements*, which include *government-wide financial statements* (statement of net assets and statement of activities), *Fund financial statements* (they consist of a series of statements based on accrual or modified accrual accounting, according to different funds' nature: *governmental* funds, *proprietary* funds, and *fiduciary* funds) and the *Notes*;
- Required supplementary information*, including budgetary comparison schedules.

Comparing the EU and the US federal government, consolidated financial statements are not obviously the same, neither in structure nor in denomination, but a quite homogeneous situation stands. However, in some cases contact points are only formal, referred to representation in the statements: think about the balance sheet, a statement included in both the analyzed cases' annual reports, but drawn up with data deriving from different accounting systems and standards. Diverse behaviors concerning some items exist, such as measurement rules for assets (for instance heritage assets, military assets and infrastructure assets) and

TABLE 3
Consolidated Financial Statements

EU Consolidated Financial Statements	US Consolidated Financial Statements
Balance sheet	Balance sheet
Economic outturn account	Statement of net costs
Cash flow table	Statement of changes in net position
Statement of changes in net assets	Statements of budgetary resources
Notes	Statement of financing Notes

provisions (including those ones arising from employee benefits), that are some of the most important critical aspects related to government peculiarities. These differences are very relevant, because they directly influence valuation and presentation of public assets and liabilities, in their wider meaning, as to intergenerational equity also (see Table 3).

CONCLUSION

The comparative analysis shows accounting systems that seem to be in harmony with international trends: government accounts quality improvement has been carried out through the introduction of an accrual-based financial reporting, with the exception of Italy. This country is in a rather difficult situation, because its accounting system is mainly devoted to monitor budget execution: at the moment, it does not provide data explaining the government financial performance and it produces a balance sheet not based on double-entry bookkeeping.

As for the research results, even if at a formal level many analogies came out, there are some important differences at a substantial level of the analyzed accounting models: diverging measurement rules adopted—rather than differences in technical vocabulary—arising from different accounting standards and different reform process fulfillment phases also. Full accrual accounting application is very expensive for wide and complex public entities like central and federal governments.

However, considering that EU has adopted IPSAS that IPSAS are based on IAS/IFRS and that a convergence project between US GAAP and IAS/IFRS is in progress, the path of public sector accounting harmonization seems

tracked, although it could take a long time. The convergence between public sector accounting models is important for different reasons: first, to realize consolidation of PA expenditures and achieved results, in particular as for the EU, as a supranational organization; then, in order to increase transparency, improving accountability toward taxpayers and all stakeholders; finally, to realize performances comparisons among different countries' PA. Public sector accounting is not only a technical topic, it shows how public resources are used and to achieve what results, so it's linked to managerial and strategic issues concerning government and, lastly, to countries' competitiveness.

Moreover, public sector financial reporting harmonization should achieve simplification aims: "It is not enough to keep the books accurately; the books have to be open to the public. When the public does not have the time or ability to inspect the accounts, governments have to make the task easier by preparing comprehensible—as well as comprehensive—financial statements" (Chan, 2003, p. 18).

However, some problems remain, outlining ideas and suggestions for further research. The analyzed cases confirm that the international trend of government accounting is moving to accrual accounting. Nevertheless, is there a real need of accrual accounting in all public sector levels (local, federal, supranational) and all fields (health, education, etc.)? Some authors, for example, suggest accrual accounting use "when government engages in businesslike activities", while cash accounting should be applied when PA "provide social services without business like or profit objectives," hoping a combination of the two systems when different kinds of activities coexist (Christiaens & Rommel, 2008, p. 59–75).

Moreover, it is important to point out that a single kind of accrual accounting does not exist: full cash accounting

and full accrual accounting may be considered as two limit points of a wide range of different alternatives, being hybrid solutions. Finally, a really relevant theme is investigating accrual accounting reports' influence on improvement of politicians and other stakeholders' decision processes: do public sector decision makers find such information useful, relevant, and understandable? Is the production of this kind of information linked with better government performance?

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