

Implementing Reforms in Public Sector Accounting

Susana Jorge
Editor



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IPSASs FOR A BETTER FINANCIAL DISCLOSURE. AN APPRAISAL ON THE AWARENESS OF ITALIAN LOCAL AUTHORITIES

Introduction

According to principles expressed by *New Public Management* and, in particular, by *New Public Financial Management* (Olson *et al.*, 2001), many countries have adopted significant innovations in their accounting systems (Hood, 1991 and 1995). This is mainly because public administrations have expressed increasing needs in their accounting systems accountability at both central and local levels. (Anselmi, 2006). Research directives concerning the development of public disclosure seem to be proceeding along two different, but highly inter-related, paths.

On one level research points towards the planning of informative accounting systems which must fulfil decision-making requirements (Caperchione, 2006) that have become increasingly articulate and complex due to 'corporate-style' management methods now present in the public sector and the wide variety of interlocutors public authorities come into contact with. On the other hand a need is emerging to express rising levels of accountability, meaning that public bodies holding positions of responsibility are required to account to society for their actions and dealings (Anselmi, 1990) .

Such thinking highlights the need for the public sector to deal with processes leading to itemized expenditure records with the aim of justifying, explaining and demonstrating in a transparent and unambiguous fashion the impact deriving from their managerial methods.

In Italy this need is very much felt at a local level where in many cases document records are drafted without the use of double entry book-keeping but by producing data at the end of the accounting year, through the conversion of cash flows into economic values.

Indeed the fulfilment of a more adequate accounting information system depends on the ability to combine organizational characteristics, informative aims, development techniques with the methods (bureaucratic, managerial, etc.) to be used during the introduction of accrual accounting.

The drawing up of a legal corpus of accounting principles could be a useful tool in achieving a greater unity and uniformity in the financial systems of local authorities.

It would also facilitate the introduction of business management logics, typical of private enterprises, into public administration. In other words, a process of accounting harmonization could lead to an improvement in public accountability.

In accordance with these trends accountability and, in particular, accounting systems have been modified by a profound evolution process which has transformed the nature, function, methodology and practice of said systems and has expanded reference standards that have crossed national borders to adopt procedures deriving from external sources impressing upon the various 'local' systems a clear need for harmonization. (Adhémar, 2006)

This paper concentrates mainly on the analysis of the process of change in accounting by analyzing the role of the issuing of international accounting principles for the public sector and thus entering into the debate on public accounting systems with which simple entry bookkeeping and full accrual accounting have been compared through the examination of targets, informative content and support in decision-making processes. These comparisons have played their part in the implementation of the latter in international public sector accounting standards, as strongly supported by national and international literature (Lüder and Jones, 2003).

At an international level, the professional organization that was most active in the area of public administrations has been IFAC (the International Federation of Accountants), which formed its own internal permanent committee, the Public Sector Committee (PSC), now International Public Sector Accounting Standards Board (IPSASB), in order to produce accounting standards for the public sector and encourage their application.

In 2006 a research team, backed by the Italian Ministry of Scientific Research, was set up to study and analyze accountability reform in public administrations and appraise the impact of changes in public administration accounting, driven by the aforementioned process of accounting harmonization through IPSASs. The team is involved in the identification and analysis of several significant procedures local authorities use when implementing accounting principles.

This study aims to understand the actual diffusion level and to extract methodologies which will improve the value of the information and accountability in the system of accounting surveys of public administrations.

This paper is organized as follows. Section 1 presents the theoretical framework, while Section 2 explains the main features of the accounting systems in Italian local authorities. In Section 3 the methodological approach is introduced, followed by Section 4 describing the research procedure and presenting the results. The paper concludes discussing the main findings.

1. Theoretical framework

The modernization process, which for the last fifteen years has been largely acknowledged in public administration, has involved the adoption of corporate business management tools and methods. (Jakson and Lapsley, 2003). The corporate business connotation of public administration, if the qualifying criteria of the phenomenon are applicable, confirms, as its final objective, the achievement and

conservation of the situation of economic equilibrium through time (Giannessi, 1961). The acknowledgement of public administration as a business organization cannot only concern the organizational and management aspects but it must also allow the harmonious development of aspects related to accounting data processing procedures. (Zappa, 1950).

The review of the literature shows that the transformation process in accounting methods emphasizes many changes. The phenomena of global integration and international merging have contributed to strengthen the area of study of international accounting shown by the claim of specific research methodologies elected to support comparative analysis (Di Pietra, 2000) and verify the proceedings leading to uniformity and/or differentiation between the various adopted accounting systems. (Caperchione and Mussari, 2000; Bourmistrov and Mellemvik, 2005; Pina and Torres, 2003; Caperchione, 2000; Mussari, 2005a). The development of the studies of international accounting has highlighted a double classification approach: the first has kept separate the areas of study regarding the public sector and the private one, confirming content and specific connotations (Belkoui, 1994). The second approach has tried to pinpoint a common matrix between the two sectors and from this single perspective the following fields of research have emerged:

- historic survey;
- comparative analysis between accounting systems regarding different countries;
- analysis of the level of harmonization;
- Issuing of regulations and accounting standards.

These fields of research, though dealing with specific features, cannot be considered as excluding other categories but they define research paths that nevertheless express a degree of mutual influence.

The inter-relations of these research spheres are supported in accounting literature by the different perspectives of analysis of the process of change.

Scholars take into account environmental influences such as social, political and economic circumstances (Hopwood, 1990; Robson, 1991; Lüder, 1992; Pollit and Bouckaert, 2002; Covalleski *et al.*, 1996), the development of the specific theoretical framework for public sector accountability (Stewart, 1984; Dubnick and Romsek, 1987; Grey and Jenkins, 1993), the variability and non-linear progression of change (Briers and Chua, 2001; Ferris *et al.*, 1995; Ogden, 1995), and the effect of harmonization and standardization on the evolution process of public accounting systems (Tricker, 1983; Caperchione, 2003; Gendrom *et al.*, 2001).

Other studies have investigated change from a managerial point of view and, in particular, the resistance to change (Broadbent *et al.*, 1996; Zangrandi, 2003), the role of accountants in disclosure change with particular focus on the kind and skills and competencies that the process of transformation require (Roberts and Scapens, 1985, Lapsley *et al.*, 2003; Mussari 2005b, Lie *et al.*, 2005) the importance of the role of internal context and the actions of all actors (Humphrey *et al.*, 1993; Hoopwood, 1995; Briers and Chua, 2001; Scott *et al.*, 2003) the impact of the work of management consultants in the public sector (Lapsley *et al.*, 2003).

This need entails the use and the analysis of accounting models capable of detecting the creation of wealth attained through management skills in coherence with the institutional goals acknowledged in each public body examined in the survey.

Accounting systems do not seem capable of meeting accounting principles belonging to the business world, even if similar terms are used. This is due to the fact that the public and institutional objectives of authorities cannot be the same as those of the corporate world, but the basic economic criterion which inspires them, and the relative consequences, is applicable to any type of administration regardless of its stated objectives.

From as far back as middle nineteenth century, Villa (1841) had understood that accounting principles should be a universal system for both private and public administrations. In this way the same reference benchmark for accounting principles would be applied both in private business (IAS/IFRS) and public administration (IPSAS) thus leading to uniformity rather than a dichotomic approach.

That is not to say that from an operational point of view the application of specific principles to the public sector be ruled out, but these should be none other than a variation of the same criteria used in business.

In Italy scholars have demonstrated some interest in the harmonization of the role of international accounting standards (Borgonovi, 2004; Farneti and Pozzoli, 2005; Zambon, 2003) but the regulators and public sector operators are slow in adopting their utilization (Jackson and Lapsley, 2003).

The review of the accounting systems of local authorities, put into practice by some Municipalities and Provinces, is still waiting to be completed. Original intentions aimed at performing the essential role of co-ordinating and unifying diverse business models and cultures.

Resorting to accounting principles could potentially represent an excellent time for creating fusion between practices actually being carried out in some local bodies and the introduction of accounting legislation within said bodies. The accounting system should be in a position to record and back up decision-making processes, acts and related results, which must be guaranteed in terms of transparency and reliability.

Up until now, with the exception of a few rare cases, the current system of many public administrations has not permitted, with an official budget used as an informative accounting tool, the knowledge of their economic-patrimonial flows, and thus cost sheets. Public administrations have made decisions without first, and often not even subsequently, being aware of the cost of each decision made and, naturally, consequences related to their decisions.

The possibility (and the ability) to perform calculations and gauging in an economic, financial and productive subject matter is fundamental to prove the worthiness of the information provided. The situation existing in Italian public bodies does not always consent the achievement of economic and financial situation. Not even by using 'official' information tools is the simple economic calculation of costs and revenue possible.

For a long time now the accounting information system (but it has not always been so and not for everyone) preserves a cash value and does not contemplate, in a systematic fashion, the economic value which in most cases is only 'recuperated' by means of a synthesized conciliation statement.

We can also notice the same data processing gaps regarding patrimonial elements deriving from inventories, the updates of which are often questionable, and as a result, it becomes difficult to assess degrees of reliability. This is the important aspect

concerning ‘principles’ spreading towards amortization and depreciation estimates, calculations for risk funds, etc.

The integrity, transparency and reliability of the procedures are essential to be able to check results deriving from the same process (economic-financial-productive situation) that influences the assessment and selection of the administrators (principle of responsibility).

This shows once again how much accounting, and above all accounting principles, should be fundamental for the political decision-maker providing reliable so that he is in a position to “know to be able to deliberate”.

Italian trends concerning accounting issues, and other matters, are closely linked to the new European tendencies. The IAS sees changes in accounting in Italian public administrations as a way of guaranteeing greater unity and uniformity of the financial systems throughout the whole public sector and a way of promoting the introduction of result management/evaluation logics typical of private companies.

The need of the public sector for an accounting standard with characteristics similar to those found in the private sector is strongly felt as an incentive to carry out changes in public administration; this necessity is even more important if we consider that accounting systems have recently taken on an economic-patrimonial nature.

The purpose of the setting up of accounting standards in public administration originates from the need to interpret and explain accounting and financial regulations. Such rules of conduct must also integrate the regulations for aspects not specifically considered and expounded.

The use of a strictly professional-technical tool in public accountability is an innovation that, if properly used by those who draft financial statement, could allow the issuing of reliable documentation with lasting uniform criteria, allowing comparisons between the results obtained by different organizations throughout the years. This is an important phenomenon for public bodies due to the importance of public finance results for political comparisons and, therefore, for decision-making processes, with inevitable social repercussions in terms of citizen satisfaction.

Within the reform processes involving public administrations, important innovations have been introduced into accounting information systems. As a result, measurement and quantification techniques have also improved and typical private business management patterns were introduced in order to be able to respond to the ever-growing need for accountability and cost-cutting procedures within public entities.

As in other countries, it is becoming common practice in Italy for those managing public resources to be asked for an explanation regarding their decisions and actions based on a new responsibility concept. The obligation to provide proof of their work is a potent instrument that promotes efficiency in the public sector. The pursuit of achieving efficient and profitable management objectives were once only part of the private business universe but is now being embraced by the public sector.

This new Italian concept of responsibility must face a strong and deep-rooted juridical tradition typical of public administrations and which reflects the predominant culture. The embracing of the current trend on a European level moves the concept of responsibility from formal to managerial and entailing a process of cultural renovation which most probably will come up against resistance and setbacks (Caperchione, 2003). The implications involve the information systems of public administrations

reaching out to the internal and external organization, management and regulation areas of the entire public administration system.

2. The accounting systems in Italian local authorities

2.1. Among harmonization, autonomy and standardization

In the field of national legislation, the main regulations that have marked out the shape of accounting systems used in local authorities can be traced back to the following:

- the act of Law 142/90 confirming the turning point in the business economics of our system;
- the act D. Lgs. 77/95 explicitly regulating the accounting systems of local bodies;
- the act DPR 194/96 establishing the content of documents deriving from accounting procedures;
- the local authorities consolidated act (D.Lgs. 267/2000) that retrieved and integrated into one body the system of regulations proclaimed until then.

The basic logic that has driven the legislative framework of the consolidation act is based on the right of local authorities to enjoy autonomy regarding their accounting systems. In this way, municipalities and provinces enjoy “statutory, legislative, organizational and administrative autonomy, as well as prescriptive and financial autonomy regarding their own statutes and regulations and laws concerning the co-ordination of public finances”.

Therefore, from an accounting point of view, Italy runs the risk of becoming extremely fragmented, influenced by local regulations that hinder any form of comparison, even when applied internally.

European integration encourages uniformity of accounting regulations while countertrend Italy still seems to be leaning towards locally orientated accounting systems risking further fragmentation in its heterogeneous system.

The Consolidated Act referring to economic accounting procedures establishes that “local authorities, in order to prepare management reports, may adopt the accounting system they consider most suitable for their needs”.

This clarification grants local authorities extensive autonomy when choosing their accounting system. The rule does not explicitly require the introduction of double entry bookkeeping, but it restricts itself to demand that the data expressed in the financial statement deriving from simple entry bookkeeping accounting, be revised to portray the economic aspect of the management (Caperchione, 1996; Anselmi, 1993).

This situation has nurtured a wide variety of operational solutions and data processing systems but they still manage to produce the documents required by the Act.

The proposed solutions can essentially lead to the possibility of using:

- Modified cash basis of accounting – during the fiscal year the public body uses solely a cash flow accounting system, while at the end of the year by using a schedule of conciliation it can carry out adjustments and integrations permitting the drafting of the necessary documents required by current accounting standards (Farneti and Pozzoli, 1995; Bertinotti, 1995);

- Integrated accounting system – this is based on two autonomous sub-systems; the first is cash based accounting and the second is accrual accounting but integrated in such a way that the same operation is recorded at the same time in both inter-linked sub-systems. Data is entered simultaneously into the two interfaces and at the end of the fiscal year, this consents the drafting of the required schedules with no further duplicating or subsequent operations (Anselmi, 1993; Marchi, 2003);
- Parallel accounting system – this is based on the joint presence of two parallel, autonomous and unlinked systems (one for public accounting and another for general accounting), immune to mutual repercussions and contamination. This set up is based on the assumption that cash basis accounting would produce data prone to ‘partiality’ not easily eliminated which consequently would pass into the general accounting system, hence invalidating its worth.

Therefore, accounting autonomy has been widely encouraged in the hope that the opportunity of being able to stipulate its own accounting structure would make each Italian local authority set up an accounting system most in line with its accountability requirements. Rather than this occurring, what we now have is a situation unable to forsake financial logic. At the same time, it has hindered the possibility of using comparative techniques with information contained in accounting documentation.

The comparison between different bodies, with reference to costs regarding services, programmes and various operation sectors becomes increasingly important in the light of the processes of internal decentralization, and also when taking into consideration the processes of supranational integration. International integration has contributed to accelerate further the need to harmonize accounting systems and in particular, it has urged the release of common accounting standards.

The use of different and heterogeneous accounting systems leaves the door open to cover-up policies, or the use of disguise tactics, of financial and patrimonial deficit situations even of considerable nature (Borgonovi, 2004; Mussari, 2006).

The need to make use of accounting principles has established itself in the public sector, where accounting regulations had the purpose of laying down the rules of data processing regarding administration operations.

However, accounting regulations reflect a set up based on the juridical phase concerned with the right to perform operations the moment in which the legal premise is established.

The predominance of logic based on formal respect has contributed to determine a clearly visible gulf between the undisputed equality of form, guaranteed by an established legal process, and the homogeneity of the content deriving from accounting procedures (Borgonovi, 2004).

From these preconditions rises the need to set up a harmonization process on a collection of homogeneous principles capable of providing a correct portrayal of the economic, patrimonial and financial position of the business.

The importance of accounting data in a political context and in decision-making processes involves the need to correctly interpret and apply in a uniform fashion the rules of the financial and accounting ordinance. From this derives the necessity for principles that make possible the preparation of reliable documents, drawn up on uniform-based criteria that express aptitude for comparison in space and time. (Zuccardi Merli, 2005).

The current trends regarding the setting up of accounting systems and financial statement appear to be leaning towards global harmonization which could develop into a process of accounting standard-setting (Zambon, 2003).

There are essentially two paths along which harmonization can proceed. The first one is of an 'external' nature which attempts to define a uniform body of postulates and standards allowing the true comparison between financial statement drafted in different countries. The second path, of internal worth, concerns the harmonization of accounting regulations within the system of national public administrations with the purpose of making accounting documents from the various public sector entities homogeneous.

The harmonization process necessarily passes through the explication of the technical problems that are inevitably involved (Pozzoli, 2005).

The first problem regards the definition of financial statement postulates that will have to express overall uniformity for the entire public administration system.

The second element regards the homogeneity, at least as far as macro items are concerned, of accounting estimate schedules and itemized expenditure records.

The final aspect regards the definition of applied accounting principles, bearing in mind that the legislative framework must provide further integration measures to meet the needs of the system's accountability.

Indeed, accounting principles are none other than technical rules through which postulates can be explicated and then put into practice.

2.2. The public sector accountability process, the financial reporting and the role of accounting standards

The activity of IPSASB focuses on the development of International Public Sector Accounting Standards (IPSASs) for financial reporting in the public sector.

In this perspective, the IPSASB has been established to deal with the needs of those involved in public sector accounting and auditing on a co-ordinated worldwide basis.

The IPSASB recognises the right of each nation to establish its own standard setters for the development of appropriate accounting standards and the setting up of national guidelines. The IPSASB is a constructive body that supports national standard setters in the development of new standards or in the revision of existing standards in order to contribute to the improvement of international comparability.

The global picture that emerges regarding the accounting system of Italian local authorities is particularly composite. It is undoubtedly influenced by regulations but at the same time it is affected by the activity of national and international standard setters.

The accounting standards in force at a national level, amongst others, are drawn up by the Observatory on the Finances and Accounting of Local Bodies.

To date the Observatory has drafted four documents, one of general principles and three of applied principles. At the end of 2006 the document named *Objectives and Postulates of Accounting Principles of Local Authorities* was drafted to meet the requirements of harmonization by integrating the principles laid down by the TUEL

act.162 and the postulates that characterise the accounting system put forward by the IPSASB/IASB.

The accounting standards that refer to the Observatory are known as technical interpretations of the standards contained in the financial and accounting system in compliance with legislation. These can be separated into accounting postulates or general accounting principles and applied accounting principles.

The accounting postulates make up the general foundations and rules that the entire reporting system must refer to. The applied accounting principles specify the single institutes set out in the ordinance and they identify the correct line of duty in compliance with the general terms of the postulates.

The objectives explicitly stated by the Observatory's accounting standards are as follows:

- interpret, explain and, where necessary, technically integrate the rules of law concerning the financial and accounting ordinance, in compliance with the will of the legislator;
- connect to said rules all others that directly or indirectly are involved;
- make uniform accounting behaviour patterns of local authorities.

The third objective explicates the necessity to make accounting behaviours uniform among operators in accordance with international accounting standards. The above-mentioned document establishes that the postulates and principles issued by the Observatory should take into account the financial and accounting systems used by local authorities and make them compatible with documentation issued by the IPSASB and the IASB.

This point explicitly refers to the intent of promoting a convergence of national and international standards aligning common objectives to improve public sector financial management and accountability.

The adoption of IPSASs allows, on the one hand, the assessment of accountability for the resources that the entity controls and the exploitation of those resources. On the other hand, accounting standards show the financial position and cash flows of the entity.

The IPSASs should be used for the general purpose financial statements of all public sector bodies made up of national, regional and local government including their departments, agencies, commissions, etc. The standards are not valid for Government Business enterprises that refer to the International Financial Reporting Standard (IFRSs).

General purpose financial statements are financial statements issued for users that are not able to acquire economic information to satisfy their specific information needs. These specific documents are defined as special purpose financial statements and, where appropriate, the IPSASB encourages the use of IPSASs for their preparation.

The basic goals set out by the IPSASs, the fields of application, the people involved, and the informative structure of the documents are pinpointed in IPSAS 1.

IPSAS 1 describes financial statements "as a structured representation of the financial position and financial performance of an entity". It declares that the objective of a financial statement is "to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making and evaluating decisions about the allocation of resources". IPSAS 1 recognises that financial disclosure plays another important role in predictive and prospective activity providing useful information about the level of resources required and the income that

may be generated by continued operations with particular attention to the connected risks. To accomplish this aim IPSAS 1 establish that financial statements have to provide information about an entity's assets, liabilities, net asset/equity, revenue and expenses, and cash flows.

A complete set of financial statements according to IPSAS 1 therefore involves:

- a statement of financial position;
- a statement of financial performance;
- a statement of changes in net asset/equity;
- a cash flow statement;
- a comparison between budget and actual amounts once the body makes its approved budget publicly available;
- a set of notes that include a summary of significant accounting policies and other explanatory notes.

The IPSASB assumes that the embracing of the IPSASs together with the disclosure of complying with them will make possible considerable improvement in the quality of financial reporting by public sector entities. This, consecutively, will “lead to better informed assessment of the resource allocation decisions made by governments, thereby increasing transparency and accountability” (Chistiaens and Van den Berghe, 2006).

The IPSASB distinguishes between two accounting systems, *accrual accounting* on the one hand and *cash accounting* on the other hand. In the beginning, the standard program also comprised the development of standards for the modified cash basis and modified accrual basis. Since 1999, the belief that it was unnecessary to draft standards for the two modified accounting systems intensified and the program leaned towards the exclusive compilation of standards concerning cash and accrual basis of accounting.

The Cash Basis IPSAS *Financial reporting under the cash basis of accounting* was issued in January 2003. The IPSAS is made up of two parts:

- Part 1 is mandatory. It sets out the requirements that are applicable to all bodies preparing general-purpose financial statements under the cash basis of accounting. It established requirements for the disclosure of information (IPSASB, 2007).
- Part 2 is not mandatory. It provides the identification and the encouragement (but not the requirement) of additional accounting policies and disclosure that an entity can adopt to increase its accountability (IPSASB, 2007; Chistiaens and Van den Berghe, 2006).

The accrual basis IPSASs have been developed to support authorities in the preparation of accrual based financial statements.

The IPSASs on the accrual basis are listed in Table 1.

Table 1 – IPSASs accrual basis of accounting

IPSAS	Contents	Standard publishing in 2006	Standard amended following the conclusion of IPSASB improvements project	Standard amended by the issuance of IPSASs 22-24 and the revised IPSASs
IPSAS 1	Presentation of Financial Statements		X	
IPSAS 2	Cash Flow Statements			X
IPSAS 3	Accounting Policies, Change in accounting Estimates and Errors		X	
IPSAS 4	The effects of changes in foreign exchange rates		X	
IPSAS 5	Borrowing costs			X
IPSAS 6	Consolidated and separated financial statements		X	
IPSAS 7	Investments in Associates		X	
IPSAS 8	Interests in joint venture		X	
IPSAS 9	Revenue from exchange transactions		X	
IPSAS 10	Financial reporting in Hyperinflationary economies			X
IPSAS 11	Construction contracts			X
IPSAS 12	Inventories		X	
IPSAS 13	Leases		X	
IPSAS 14	Events after reporting date		X	
IPSAS 15	Financial instruments: disclosure and presentation			X
IPSAS 16	Investment property		X	
IPSAS 17	Property, plant and equipment		X	
IPSAS 18	Segment reporting			X
IPSAS 19	Provisions, contingent liabilities and contingent assets			X
IPSAS 20	Related party disclosures			X
IPSAS 21	Impairment of Non-Cash generating Assets			X
IPSAS 22	Disclosure of Financial Information About the General Government Sector	X		
IPSAS 23	Revenue from Non-Exchange Transactions (Taxes and Transfers)	X		
IPSAS 24	Presentation of Budget Information in Financial Statements	X		

Source: 2007 IFAC Handbook (IPSASB, 2007).

Study n. 14 underlines that the adoption of an international accounting standard on an accrual basis is useful for both accountability and decision-making.

Table 2 summaries the principal benefits of using IPSASs on accrual basis of accounting.

Table 2 – Benefits of accrual accounting

Shows how a government financed its activities and met its cash requirements.
Allows users to evaluate a Government's ongoing ability to finance its activities and to meet its liabilities and commitments.
Shows the financial position of a Government and changes in financial position.
Provides a Government with the opportunity to demonstrate successful management of its resources.
Is useful in evaluating a Government's performance in terms of its service costs efficiency and accomplishments.

Source: Study n. 14, PSC, 2003.

The position of the IPSASB regarding the choice of an accrual basis accounting system seems to run along the same lines as the tendencies expressed by a consistent part of the national and international business economic doctrine.

In synthesis, in this period of transformation of public administrations, the adoption of standardised and comparable accounting principles seems to represent an important way to improve the public sector accountability (Zambon, 2003) and offer to public sector organisations the interpretative position to directing the accounting behaviours.

The research aims to verify and confirm the above-mentioned position by looking into the operational procedures of those working in Italian local authorities in accordance with the objectives of the research.

3. The structure and the purposes of the research: the methodological approach

Understanding the features of an accounting system from a managerial point of view requires an integrated approach which considers the sphere of doctrinal analysis:

The first is of a cognitive nature in which knowledge will be obtained through a single doctrinal corpus leading to the setting up of a theoretic system; the second is of a normative nature which embraces elements useful to the working needs of an organization (Miles and Huberman, 1984). The necessity to adapt this twofold need finds profitable cohabitation in the articulation of phases to be carried out by research activity.

The step between theory and hypothesis occurs by means of a deduction process (Merton, 1965) on the basis of which research then moves on to the operational stage (Bryman, 1984). After this phase research activity concentrates itself on the interpretation of the results and their subsequent induction (King *et al.*, 1994).

The focus of the research concentrated itself on Italian local authorities mainly because they express the innovative importance of changes in accounting in Italy better than any other public sector, in view of the process of international accounting harmonization. Due to their social and institutional importance, local authorities have understood the need to embrace changes in accounting as required by international standards.

In accordance with the interpretative approach (Kuhn, 1962; Boudon, 1984) this paper aims to expose the first significant results and answer three points put forward by the research, with reference to some qualified experiences:

1. Are local authorities fully aware of the limits of cash basis of accounting and the greater value of accrual basis of accounting?
2. If they are, do they think that IPSASs are able to provide support during the change process?
3. What practices, comments and suggestions came up within these local authorities?

The research questions numbers 1 and 2 are of an investigative nature (Yin, 1990) capable of understanding if the operators perceive a link between the technical-accounting facility proposed by IPSAS and the emerging need for accountability, as stated in the *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities*, Study n.14 PSC (2003).

It argues that international accounting standards increase accountability levels in public bodies encouraging the transition from cash basis of accounting to a more

efficient model of accrual basis of accounting based on an integrated method with complete economic-patrimonial items.

The hypotheses that the research aims to test, with reference to questions 1 and 2, are:

Hypothesis 1: local authorities perceive the limits of cash basis accounting and the utility of adopting an accrual basis to improve financial disclosure.

Hypothesis 2: local authorities perceive the utility of IPSASs as means of implementing accrual accounting.

Question number 3, on the other hand, provides a description (Yin, 1990) of the practices that the research activity has examined.

An empirical survey has been carried out in order to answer this inquiry and a critical analysis has been drafted distinguishing between coherent and fragmented factors that contribute to the development of public accounting disclosure.

The methodology consisted of the following research steps.

A sample was selected among Italian local authorities with the identification of relevant practices. A questionnaire was then submitted and a detailed interview was carried out. The results were processed to then select key examples. On completion of the identification process common trends were analyzed combining the empirical results with the theoretical background material.

The subsequent phases of research activity involved the sourcing and analysis of key practices of implementation of accounting systems in Italian local authorities and public bodies. The first phase of the research was concerned with the analysis of the theoretic-doctrinal framework of accounting systems and particularly with the process of accounting harmonization at both national and international levels. Emphasis was placed on political-administrative statements and approaches which have influenced the informative structures and the accounting technical frameworks of local bodies.

In this conceptual framework we have gleaned our hypothesis of research regarding the role of international accounting standards in increasing accountability in Italian local authority.

The survey tools and procedures, in accordance with the objectives of the research, have involved the drafting of a set of questions. These questions have been created to understand the architecture of the accounting systems used by local authorities and to extract fundamental characteristics in terms of the adoption of accounting principles. The questions explore and consider the different practices which have been established and used in the Italian system.

On selection the key practices are then examined in order to appreciate homogeneities and differences and to be able to outline the shape of the implementation of accounting standards.

On the one hand, the final research phase (the phase of the interpretation and induction of the results) synthesizes the critical factor regarding the adoption of accounting principles and, on the other hand, formulates an interpretation for the development of an informative accounting system. This paper intends to understand and analyze the problems and difficulties met by public bodies when implementing accrual basis of accounting systems.

The general guidelines of the research, therefore, aim to satisfy the fundamental business requirements of the research which can be divided into two types: the theoretic

stage of a cognitive nature and the normative stage, with the goal of extracting elements useful for solving problems.

4. The fieldwork

4.1. Research procedure

The results portrayed in these paragraphs are part of research activity carried out on a broader sample which aims to observe the emerging trends and innovations regarding accounting practices.

The administrations interviewed for the purposes of this study were chosen from a broad statistical sampling with the view to implement intensive research activity on that local authority in which administrative employees had participated with training course in accounting for a period of almost 40 hours. At the administrative managers of this small number of cases have been effectuated a series of ‘in deep’ individual interviews after by the handing out of a questionnaire.

In this way it was possible to attain a significant sampling not from a statistical point of view but from a functional one, with characteristics as to allow the development and the intensive testing of research hypotheses (Silverman, 2002).

This position paper is the result of a specific empirical survey with specific regard to the appraisal on the awareness of Italian local authorities and the degree of confidence expressed by the interviewees with regards to international accounting principles both directly and through the application of accounting practices in keeping with the positions expressed by the IPSASB.

The interviews examined 18 cases made up of 12 municipalities and 6 provinces from different areas in with the interest for training accounting are seemed significant. Table 3 shows the distribution of the sampling on the basis of population differences.

Table 3 – Theoretical sampling of the research

Municipality			
Population	North	Center	South & Islands
< 15.000	0	1	0
15.001 - 60.000	1	0	0
60.001 - 150.000	2	4	1
150.001 - 300.000	0	1	1
> 300.000	1	0	0
Province			
Population	North	Center	South & Islands
< 300.000	1	1	0
300.001 - 350.000	1	1	0
> 350.000	0	1	1

The survey was made up of five fields of study and analysis to meet the research requirements expressed in the Introduction:

A. *General information*

- a. regarding the administration
- b. regarding the accounting manager

This section firstly aims to gather information about the size of the administration and, secondly, about the level of education and work experience of the accounting manager.

B. *Accounting System of the Administration*

This part is made up of a series of questions from which to draw the elements defining the structure of the accounting system used by the administration, with a focus on accounting organisation (basis of accounting, entry system, etc).

C. *Data on the Accounting Role*

This part intends to gather data about the number of people who operate within the accounting departments, their background and the training programs provided by administrations.

D. *Performance-Based Accountability*

The first three sections of the survey are of a descriptive nature gathering elements to define the current situation of the interviewed bodies. The subsequent sections, on the other hand, aim to research the degree of confidence the bodies have regarding the accounting systems and also the personal propensity of the operators with broader and different approaches as opposed to traditional methods imposed by law.

E. *International Accounting Principles*

The final part of the survey specifically deals with the examination of how operators deal with the international public sector accounting standard. The research activity has been deployed in a series of preliminary questions to verify if, and which, accounting principles are adopted when drafting financial statement and the reasons for choosing them.

In the event that from the preliminary examination a substantial non-application of the IPSASs comes to light, then the interview was shaped to verify the degree of knowledge and their possible future adoption. If adoption is then intended the study moves itself towards application times and the procedures to make the project operational.

The survey develops IPSAS by IPSAS, to check that there is uniformity in behaviour towards all the items taken into consideration or if certain standards are preferred to others.

The principles have been grouped together into four sub-classifications to keep separate the different categories that each field deals with.

Indeed, the IPSASs are numbered by date of issue, whereas for the purpose of the survey, a different classification was used to express content homogeneity with reference to the items dealt with.

Therefore, the intensive analysis proposed the aggregation of standards classifications to the interviewee displayed in Table 4.

Table 4 – Classification of IPSASs used in the fieldwork

CATEGORIES		STANDARD
General principles		IPSAS 1 - Presentation of Financial Statements
		IPSAS 2 - Cash Flow Statements
Reliability of financial disclosure		IPSAS 3 - Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies
		IPSAS 4 - The Effects of Changes in Foreign Exchange Rates
		IPSAS 10 - Financial Reporting in Hyperinflationary Economies
		IPSAS 14 - Events After the Reporting Date
Accounting items	Financial transaction	IPSAS 5 - Borrowing Costs
		IPSAS 15 - Financial Instruments: Disclosure and Presentation
	Holdings	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
	Exchange transactions	IPSAS 9 - Revenue from Exchange Transactions
	Non-exchange transactions	IPSAS 23 - Revenue from Non-Exchange Transactions (Taxes and Transfers)
	Construction contracts	IPSAS 11 - Construction Contracts
	Inventories	IPSAS 12 - Inventories
	Tangible assets	IPSAS 13 - Leases
		IPSAS 16 - Investment Property
		IPSAS 17 - Property, Plant and Equipment
		IPSAS 21 - Impairment of Non-Cash generating Assets
Provisions, Contingent Liabilities and Contingent Assets	IPSAS 19 - Provisions, Contingent Liabilities and Contingent Assets	
Target information		IPSAS 18 - Segment Reporting
		IPSAS 20 - Related Party Disclosures
		IPSAS 22 - Disclosure of Financial Information About the General Government Sector
		IPSAS 24 - Presentation of Budget Information in Financial Statements

The first classification ‘*General Principles*’ includes the standards dealing with the purposes, main content and setting-up of the information system concerning the preparation of documents.

The second classification ‘*Reliability of financial disclosure*’ groups together the IPSASs regarding the reliability of information on the financial statements.

The third classification ‘*Accounting items*’ gathers the standards concerning the evaluation criteria to use for single items that make up the financial statements.

The fourth classification ‘*Target information*’ regards the IPSASs that aim to provide information about specific areas of the financial reporting.

4.2. The results

From the research carried out it has emerged that international accounting principles are not being applied by any of the bodies under examination. The analysis of the sample highlights the fact that 70% of accounting office managers have a university

degree in business studies and all have more than 5 years administrative experience. The choice of multiple cases is based on circumstance that in the last three years the administrative employees had taken part in at least one training/refresher course regarding accounting.

The set-up of accounting systems is fundamentally made up of two prevailing typologies.

The first one, regarding about 60% of the sample under observation, is founded on a book-keeping system known as simple entry book-keeping from which the operators obtain the economic-patrimonial report schedules at the end of the year meeting the compulsory requirements of Italian regulations by means of a conciliation prospectus.

The second typology can be defined in an integrated system that obtains its management information from both simple entry bookkeeping and double entry bookkeeping. In the latter case, the drafting of documents for financial statement derives directly from the integration of the two systems.

If we separate the samplings carried out in municipalities and provinces we can see that when a municipality is larger than 150,000 the integrated system is always the one used. As far as provinces are concerned, on the other hand, size does not influence the choice of accounting configuration.

The number of people employed in the accounting departments of all the administrations examined is between 6% and 10% of the total staff count. Managers believe this amount to be adequate considering the volume of tasks that the department has to deal with.

This staff shortage is felt more strongly in administrations that do not make use of integrated accounting systems with employees forced to obtain financial statement in a manual fashion.

With regard to the first research question asking if operators were aware of the limits of the Italian accounting system and the greater value of full accrual basis of accounting, it emerges that administrations using integrated accounting systems understand the informative management value of double-entry bookkeeping.

Within local authorities that do not use integrated accounting systems we encounter a situation of greater heterogeneity.

In some cases, it is particularly evident that decision-making processes are poorly supported by current accounting systems making it important to push forward change into full accrual basis. When the accounting system is used essentially for checking that expenditure limits are respected and not as a decision-making support tool the adoption of full basis accrual is not perceived as a priority.

Quite the contrary, financial performance statement are fundamentally perceived as being useless in these cases and very often employees draft these documents because they are obliged to do so while the statement of real importance remains the '*conto del bilancio*', that is the document that expresses the final equilibrium in terms of revenues and expenditures performed during the year. In this case, the resulting accountability is of a bureaucratic-authoritative nature complying with the constraints deriving from authoritative-type management.

Once ascertained that none of the systems under examination had officially implemented international accounting standards the research fieldwork, in accordance with the research questions, tested the degree of confidence and knowledge the operators possessed regarding IPSASs. All the operators interviewed declared that they knew of

the existence of public sector international accounting standards deriving from private sector standards (IAS/IFRS).

Only one province created a pertinent study group for the analysis of IPSASs with the purpose to assess their operational characteristics and implications deriving from their possible use.

In the other cases knowledge of international standards derives from a personal wish to understand further these problems. Therefore, the level of knowledge of IPSASs is not a result of planned study programs but a result of individual curiosity unlinked to the place of work.

In the light of the classification of the IPSASs (see Table 4), all the interviewees declared that they understood the standards in the first group – ‘*general principles*’ – with specific reference to the objectives set out by the IPSASs and the basic logic of their content.

Three municipalities and two provinces declared that they focused on the IPSASs concerned with tangible assets with the objective of extracting operational information to carry out evaluation on this type of asset.

However, the IPSASs in question did not turn out to be useful for the operators’ needs: fair value appraisal and, in particular, the impairment test procedure, has been perceived as especially complex, difficult and distant from traditional Italian accounting.

Another set of IPSASs that some interviewees had examined was the one regarding standards grouped together in the sub-classification of ‘holdings’. In this case, too they were interested in extracting information, from an international context, regarding evaluation and financial statement registration of the shares held.

The second research question regarded the appreciation level IPSASs enjoy as a tool for the improvement of public accountability and for the implementation of full accrual basis of accounting. The survey showed that the degree of appreciation expressed by the operators was modest.

The operators are aware of the general aspects of the IPSASs and of some standards regarding specific items that are, moreover, not of great use in terms of immediate application. Substantial appreciation of IPSASs elements emerged from only two particularly sophisticated accounting structures. These accountants expressed the belief that the diffusion of international accounting standards could back cultural growth thus planting the seed for future improvement in public accountability and better support for public accounting systems.

The operators interviewed clearly expressed their doubts concerning the immediate application of IPSASs firstly deeming them inappropriate for Italian public disclosure requirements and, secondly, believing them to be extremely complicated to implement.

Indeed, their application would require not only a specific training program but also a prominent and onerous re-configuration of the information systems currently in use.

5. Discussion

The focus of the research involved Italian local authorities because in the Italian public sector they are at the centre of national and international urging to remodel their accounting systems.

This paper discusses the significant results deriving from research activity regarding the examination of the following research hypotheses:

Hypothesis 1: local authorities are aware of the limits of cash basis accounting and recognize the usefulness of the adoption of accrual basis to improve financial disclosure.

Hypothesis 2: local authorities perceive the usefulness of IPSASs as means of implementing accrual accounting.

The methodology used in this paper is the multiple case studies. According with literature (Silverman, 2002) we have identified a thought-out choice sample based on its congruency with the theoretical framework of the research and on the significance with the research questions.

In this particular perspective of study the aims of the research assume an 'explanatory' purpose (Yin, 1990) turn to put in evidence the causality connections among several variables under the context conditions in which the empirical research is made.

The results seem to reflect the perception of the need for change from the basis of accounting in use in particular in administration in 'transition' from a simple entry bookkeeping to full accrual basis of accounting.

Only few local authorities recognized the usefulness of IPSASs as a profitable mean of implementing accrual accounting and the need to increase the degree of accountability in the public sector.

Some others are aware of the profitability of IPSASs but feel inadequate to develop the adoption process because of their dramatically demanding working load.

The accountants interviewed expressed substantial resistance towards the adoption of IPSASs deeming them difficult to implement and having little in common with the established Italian accounting systems.

It is clearly evident that the simple bookkeeping method on which accounting systems are based is strongly opposed to change with accounting innovations seen as further bureaucratic requirements to fulfil.

In other administrations where the evolution of accounting information systems appears to be more consistent and the informative benefits connected with full accrual basis of accounting have clearly come to light interest concerning IPSASs has been greatly superior. However, even in these latter cases, IPSASs are not considered for immediate application by the accountants interviewed but they are seen as useful tools to trigger cultural growth towards a general improvement in public accountability.

Conclusion

The feeling that emerges from the research carried out is that within Italian local authorities changes always require external influences and, in particular, normative measures that bring about and accelerate behavioural change. This aspect of the study seem to confirm previous empirical research (Jackson and Lapsley, 2003) that the most important motivation for accounting innovation in public sector organisations is statute, regulation or other external pressure.

The result of interviews showed that the accounting systems in use are mostly at the conformity of regulation. In other terms when accounting system change does

occur it takes place because it is put on by regulation, statute, or exhortation and only in few cases the innovation depends on internal motivations or autonomous experimentations.

The study underlines that the training is one of the hottest issues of an IPSAS conversion. The local authorities analysed had invested in education on accounting in the last three years, but nobody had organized specific IPSASs training courses. The contents of international standards are perceived very distant from the Italian local authority accountability needs and scarcely useful to involve the public disclosure. The knowledge of IPSASs is superficial and left to “individual curiosity rather than a systematic training process”.

The findings presented here demonstrate the importance of considering factors that influence the operating environment of the user of the accounting system.

The degree of appreciation expressed by the accountants about international standards as a tool for improving public accountability and to implement full accrual basis of accounting seems modest.

The accountants consider not easy the application of the IPSASs and furthermore based on presuppositions very different from Italian public accounting traditions.

In addition, also the practitioners more sensitive and interested in the utilization of the international standards, underwrite their difficulties to implementation and application because of the approach developed in the IPSASs (fair value; impairment text, value in use, etc.). They press for a carefully evaluation between the costs related to their eventual application and the real informative value generated from their implementation (value for money of IPSASs).

The practitioners interviewed perceive the role of accounting standards still related to the original function of integrating and specifying the process of estimating the various classes of assets in those cases in which the normative is too general or does not establish detailed behaviours. The role of accounting standards should be therefore ‘*ex-post*’, after the mandatory regulation, refining and completing its pragmatic valence.

The research underwrites the need to arrive at an ‘*ex-ante*’ harmonization at international level of the financial *accountability* and only after this one, establish the accounting standard more useful.

The international accounting standards are still perceived in a ‘top-down’ approach coming from abroad without a real usefulness and ‘dangerously’ uprooted from the Italian accounting context.

In Italy, like in the other countries of civil law, some obstacles do not allow a model of accounting regulation based on the general accepted accounting principles. Therefore, there is the need of a legislative recognition, even if some margins of accounting autonomy can be used by administrations to carry out the first national pilot experiences.

A true and proper organic study of IPSASs will most probably be deferred to a normative measure that will force authorities to adjust their accounting systems in order to fulfil requirements.

Our study seems to confirm observations of prior studies examining public sector reforms from a managerial, economic and social perspective that the accounting reform process was not restricted to technical aspect but extended to include the role of central government, the important tendency to the decentralization, the culture of the

operators and the decisional autonomy of public management. Likewise, a significant point that has emerged from this research based on multiple case studies is the possibility to understanding not only the level of diffusion of IPSASs in Italian local authority (well known very modest) but the reasons for which the international standards are perceived by accountants less useful for their work.

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