



## Law 196/2009 on public sector accounting and finance in Italy: future scenarios for the public sector accounting systems

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### The current scenario of the accounting and finance reform for the public sector

The Italian accounting and finance system for the public sector has undergone a reform through Law no.196 of 31 December 2009, effective since first of January 2010. Law 196 follows two other regulatory enactments occurred in 2009 concerning the functioning of important sectors in the public administration.

The first one is Law no. 15 of March 4, 2009 including provisions aiming at optimizing the productivity, efficiency and transparency in public sector. This Law has introduced the consideration of performance in the public administration, conceived not only in a financial but also in a qualitative perspective.

The second regulatory enactment is Delegation Law no. 42 of 5th May 2009 on fiscal federalism, which has opened the last stage of the federal government organization in Italy (begun 10 years ago with Constitutional Law no. 3 of 18 October 2001). Such enactment aims at providing local governments with full autonomy on management of tax revenues.

Common objective of the mentioned enactments is to enhance effectiveness and efficiency of public finance operations and set up a plan to modernize the functioning of the State. Such process has overlapped with the most recent developments of the international financial field.



As known, the deep financial crisis started in 2008 has had a great impact on the real economy of major industrialized Countries, and has resulted in worse public finance balances in many European Countries, as dramatic events occurred especially in 2010 have shown.

This is the scenario in which the discussion on the implementation of State accounting and finance Law is taking place. In my view, Law 196/09 plays a pivotal role in the modernization of public administration as it:

- contributes to enhance the overall *accountability* of the system;
- ensures better quality, quantity and timeliness of financial information on the public administration;
- provides information relevant to the evaluation of performances;
- aims at establishing a single accounting system for all levels of government.

Innovations in the accounting system of the public administration: cash- and accrual-basis accounting

The intent of my contribution is to highlight a specific aspect of the Law 196/09, i.e. the restructuring of the recognition and bookkeeping systems of public sector accounting that will be carried out by a decree of the Italian Government.

Reference is made to the regulatory enactments that provide for the State accounting:

- to adopt a cash-basis accounting system;
- to use, along with the traditional accounting systems, an accrual-basis system for information purposes.

These two aspects - strictly related to accountancy - play a crucial role in determining the success and the correct functioning of the whole system, also in the light of the overall restructuring processes mentioned above.

With the public accounting Law, the Lawgiver has made a fundamental choice and has outlined the structure of the accounting recognition system, providing for the shift from the current commitment basis accounting (defined in Italy as “sistema di contabilità finanziaria per competenza”) and cash-based system, to a strictly cash-based accounting system.

This choice will allow to simplify both the processing of accounting information and the preparation of provisional statements, eliminating the phase of arrears account management and highlighting the cash balance (surplus/deficit) for each period.

Moreover, cash based accounting will allow to provide information that are more consistent with the current structure of control systems of public financial balances and of management of financial flows (communication of informations for the preparation of State financial statements, processing of SIOPE –



Information System on Public Entities' Operations - , control of the national Court of Auditors and Ministry of the Interior for the local governments).

The shift from the current commitments- and cash-based system to a cash based one will be regulated by a decree to be issued within three years from the effective date of Law 196/09. The decree will need to provide for the methods of preparation of a reconciliation statement of historical data prepared following the commitments based accounting. Moreover, the extension of a cash based accounting to all public authorities will be carried out only after an experimentation period not exceeding 2 years.

These two provisions prove some reluctance shown among the Italian public bureaucrats to abandon the commitments based accounting.

In fact, the commitments based accounting is more consistent with the objective to provide a formal legal control on the use of financial resources, compared with the cash based accounting systems (stronger limitations are attached to the accrual accounting systems).

It also allows to register each phase of the management of financial resources, from the decision in the provisional phase to the actual expenditure/revenue.

Keeping the authorisatory function of provisional financial statements and the possibility of recognizing the phases of public resources' management are the underlying reasons for the skepticism of public actors on the adoption of accounting systems other than commitments based accounting.

The consideration of the experiences gained on public accounting reforms in other EU and international countries may provide help and inspiration for defining operating solutions that will favour the process of implementation of a cash based accounting system in Italy.

The other accounting innovation provided for by the Law 196/2009, which in my view deserves some reflections, is the introduction of accrual accounting in the public administration, to be adopted for information purposes.

The adoption of of accrual accounting in the public sector allows to overcome some informational limitations retained by the cash basis systems.

Through accrual accounting it is possible to:

1. appropriately measure the *performance* of the public entity or organization with regard to their balance sheet and financial position, and represent the economic value of their assets, all of which is not recognized and represented in the cash-basis systems.
2. achieve more easily and in a more relevant way the consolidation of State financial statements of the several branches of the public administration.



To support the considerations above I would like to point out the poor usefulness of accounting statements prepared with recognitions made in the commitment basis accounting. Reference is made to the reconciliation statement prepared by the local governments which proved rarely timely and a poorly reliable instrument for the representation of the surplus or deficit for the period.

The adoption of accrual accounting is crucial in the stage of assessment of historical data and reporting of the operations performed by the public entity or administration, also in view of the a posteriori valuation of the implemented policies and of the public management.

An accounting system inquiring management operations only from the cash perspective, according to an authorisatory rationale, can only certify the compliance (or non-compliance) with formal and legal procedures on the usage of public funds, following the modalities and limitations established in the provisional stage, with no (or very limited) representation of the issues related to the dynamic evolution of the financial position and performance resulting from the managerial decisions.

I believe that the shift to accrual accounting is necessary for the assessment of historical data and results achieved by public entities and administrations. In this light we should interpret, in my view, the choice made by the lawgiver to introduce, along with the cash based, the accrual based accounting system, albeit only for information purposes.

In other words, the introduction of accrual accounting addresses the need to monitor the performance trends of public management which are not systematically monitored through the current recognition system.

The Italian Government has lately addressed these issues by approving a decree for the harmonisation of the accounting systems of local governments. The Decree Proposal provides for the adoption of an overall accounts statement in order to enable the consolidation of public financial statements. This overall accounts statement is made up of the branches of single elementary units of management accounts based on commitment data and accrual based general accounting, and is defined so as to allow a single recognition of management operations.

#### Accrual accounting: issues for its future adoption in the public sector

The introduction of an accrual accounting system is the most interesting issue of State accounting. CNDCEC (Consiglio Nazionale dei Dottori Commercialisti e degli Esperti Contabili) has vigorously supported over the last years the need to adopt rationals and methods of the accrual accounting also in the public sector, being convinced that such accounting system allows to enhance the overall *accountability* of public



administration and the quality of the information disclosed, providing opportunities to control the use of revenues within the single organizational units forming the different State departments.

Coming to the conclusions, I would like to point out three issues related to the introduction of this rationale in the Italian public sector. I believe that these issues will be at the core of political and academic debate in the next years.

In the first place, the set of accounting standards and methods to be adopted should be identified. A first solution is the adoption of International Public Sector Accounting Standards (IPSASs), that have already been adopted in other countries. Such choice would be consistent with the harmonisation of international financial reporting standards which has already been introduced in the private sector. An alternative solution is to develop, on the basis of the Italian accounting tradition, a set of independent standards for the public sector through the adaptation of national accounting standards of the private sector. In this case, it would nevertheless be appropriate to let the national standards interact with IPSASs, in order to avoid high transition costs should the adoption of IPSASs be established at EU level.

The second issue regards the choice of the recognition method to be adopted. The existence of a cash basis system along with an accrual system one requires necessarily to coordinate accounting recognitions which allows *on one side* to measure the financial aspects of the management and *at the same time* to ensure the control function on the formal process of collection and expense of revenues. A first solution could be to provide for a single recognition system based on the double entry recognitions while memorandum accounts could serve for following the stages of the cash basis accounting that are relevant to legal/formal purposes. An alternative solution could be that of using an integrated accounting system originated by the cash basis accounting which, taking its start from the recognition of the cash aspect, should be able to recognize also the resulting economic and financial effect. A further solution could be to use a double accounting system based on the principle of splitting of records, or a registration system for the cash basis accounting and a system of double entry recording for the accrual based recognitions which would allow at the same time to reconcile the two accounting systems and also to detach the cash basis accounting from the general one.

The solution adopted by the Italian lawgiver in the “Decree Proposal on the harmonisation of accounting systems and financial statements of Region, local governments and related entities/organizations” is definitely inclined for an integrated system of the second kind, as it textually provides (see para. 4, clause 4) for an “integrated plan of accounts, inspired by common recognition methods, (...) made of the list of the



single units of the management accounts based on commitment data and accrual based general accounting, defined so as to allow the single recognition of operations". In support of this approach, it should be highlighted that the general accounting standards mentioned in Appendix 1 of the Decree Proposal include referring each single operation to the cash basis and accrual basis systems.

The Decree Proposal seems insufficient with regard to management accounting as it does not explicitly provide for its adoption which, on the contrary, seems essential not only for the management and the assessment of the performances of the public entity but also for the determination of the so-called "standard costs" which form the architrave of the federal tax system.

The last issue I would like to bring to your attention regards the need to harmonize the accounting systems of the various governmental levels and in particular the harmonization of the accounting systems adopted in local governments with those of State departments; the Decree Proposal mentioned above seems to have given a positive response hereto as far as such entities are concerned, as they will have to adopt a harmonized financial statements model.

The Decree Proposal accurately addresses the questions that have led to the current "accounting Babel", which has characterized the Italian public administration. The text of the Decree proposal provides for the adoption of consistent accounting rules, of a common integrated plan of accounts, of common financial statements outline and a common financial statements outline for the consolidated financial statements of the entity with its controlled firms, companies and organizations. This should allow to overcome the heterogeneity of financial statements of local governments due to the differing powers in the accounting field granted to Regions, local governments of provinces and municipalities. Regions, for instance, have legislative power on the definition of their accounting systems; thus they have established their processes for approval, contents and outline of financial statements, as well as their own accounting standards, also after the experimentation provided for by Para.35 of the Decree Proposal. It is desirable that this approach is confirmed or even strengthened in the final version of the Decree which will definitely become Law.

Finally, the current simplification of sources of the law and harmonisation of accounting standards and methods for the public sector form a work that accounting professionals and academics in the public sector should monitor and support, by participating to the academic debate and to the preparation of the relevant accounting standards.