Implementing the International Public Sector Accounting Standards for Consolidated Financial Statements: Facilitators, Benefits and challenges

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Abstract

Portugal and Spain have reformed their national standards to adapt them to the International Public Sector Accounting Standards (IPSASs), which is a new trend in the European Union. This paper shows the process of implementing IPSASs for consolidated reporting in the two countries and the advantages and disadvantages which have emerged. The results highlight the role of IPSASs in improving the quality and use of consolidation financial statements which can be of interest to other countries that aim to implement IPSASs.

Introduction

The harmonization of public sector accounting is, at present, considered an objective in the framework of the European Union (EU) (European Commission, 2013). Recent developments show that it is important to achieve comparability of public administrations' financial statements (Christiaens *et al*, 2015; Manes-Rossi *et al*., 2016), and the International Public Sector Accounting Standards (IPSASs) have been considered a useful reference for this aim (European Commission, 2013). Many countries have made efforts to bring their accounting systems into line with international standards (Brusca *et al*., 2015). This is the case of Spain and Portugal: both have reformed their accounting standards taking IPSASs as a reference, although Portugal is still in the process of implementing the new accounting standards (Gomes *et al*., 2015; Jorge, 2015).

At the same time, the elaboration of individual financial statements is not considered sufficient to show the financial picture of an entity, whether public or private, when it has dependent entities (Walker, 2009). To overcome this limitation, standard setters have regulated the elaboration of consolidated financial statements (Brusca et al., 2018) In particular, the International Public Sector Accounting Standard Board (IPSASB) states the criteria for elaborating consolidated statements in IPSASs 35 to 37, which have undergone minor changes in comparison to the corresponding International Financial Reporting Standards (IFRSs) (Lombrano and Zani, 2013). As concluded by Christiaens *et al*. (2015), one reason for using the IPSASs is to facilitate the consolidation of financial statements. In the international context, many countries have regulated the elaboration of CFSs for central and local governments (Brusca *et al*., 2015; Bergmann *et al*., 2016). The European Commission has issued recently two papers related with this: one about the definition of control and another one about consolidated financial statements (European Commission, 2018a, 2018b).

Considering that both Spain and Portugal have reformed their national standards taking IPSASs as a reference, the aims of this paper are to analyse how the international standards for consolidated statements have been incorporated into the national standards and the main implications of this process. In Portugal, the first consolidated statements became compulsory in 2008, and local governments elaborated this information using national standards that took business standards and IPSASs as their reference (Order number 474/2010). In Spain, in spite of some previous attempts to introduce consolidated statements, they are not compulsory at the moment. In 2013, the public sector accounting standard setter passed national standards for the elaboration of consolidated statements in the public sector considering the IPSASs as a reference. The standards are compulsory for central government and voluntary for local government. In this paper, these standards will be considered as a reference.

As a consequence of these developments, both countries now have standards for Consolidated Financial Statements (CFSs) based n the IPSASs. Our first aim is to analyse the facilitators for implementing the new standards based on the IPSASs for preparing consolidated statements..

In that context, the first part of the paper will compare the process for the development of consolidated standards in Spain and Portugal, analysing the main drivers and the objectives for introducing consolidated statements based on IPSASs**.**

The study is based on documentary analysis, complemented by interviews with standard setters and practitioners.

The second aim of the paper is to determine if the standards fit well into the Spanish and Portuguese contexts and to examine the main advantages of consolidated reporting and the main barriers and problems which their implementation can have. We show the perspective of the standards setters and of the financial directors through interviews conducted in both countries.

Literature Review: IPSAS implementation and consolidated statements

Accounting systems play a fundamental role as a mode and instrument of representation, coordination and organisation for accountability purposes in the public sector. Furthermore, financial and accounting reforms transform and implement public policies as well as reshaping the working of public administration (Biondi, 2014). In recent years, many countries have made important efforts to reform and modernize public sector accounting systems, with a trend towards accrual accounting and mimicking private sector accounting (Biondi, 2016). In this framework, the IPSAS (elaborated on the basis of IFRS) have been a reference for many countries that wanted to move to modern accounting systems (Brusca et al., 2015; Manes Rossi et al., 2016). One model used is the implementation through the incorporation of the IPSAS in national standards which means that local regulatory frameworks and standards are modified to converge towards international standards. Public sector accounting must be considered in the specific context of public finances in general, and in the case of the European Union, the monetary union is important (Biondi, 2017). In this framework, the European Union (EU) has engaged its own modernization process in order to improve accountability by member states and for European citizenship (Biondi & Soverchia, 2014).

According to Mussari (2014), the harmonization of public sector accounting through the development of EPSAS is the expected effect of accrual-based accounting adoption in the European public sector, inspired by New Public Management (NPM) philosophy. IPSAS have also been chosen as a reference in the EU because these accounting rules are specifically dedicated to the public sector, meaning that they are expected to be more appropriate for the EU than the IAS/IFRS (Biondi & Soverchia, 2014).

As a consequence of the reforms and the adoption of accrual accounting standards, consolidated statements have also been translated to the public sector. From the perspective of accountability theory, consolidated financial statements could be used for accountability purposes, so managers and politicians could use them to discharge their accountability for government resources under control.

Consolidated statements can be analysed from three different perspectives:

- Consolidated budgetary reporting, which includes the budgets of all the entities that are part of the group, aimed at controlling and monitoring the use of the resources of all government entities. In many EU countries, such as the UK (Biondi, 2016), this information is prepared using the modified cash criteria.

- Consolidated National accounts, elaborated in accordance with National Accounting criteria, that is, in the case of the European Union Members, the European System of National and Regional Accounts- ESA (2010). From this perspective, entities included in a level of government (central, regional or local) comprise three sectors: The General Government Sector, the Public non-Financial Corporations sector and the Public Financial Corporations sector. Consolidated statements are prepared for each of the sectors, so that the General Government includes all institutional units which non-market producers are (institutional units whose sales do not cover more than the 50 % of the production costs) and financed by compulsory payments made by units belonging to other sectors (and in particular it includes central and local government and social security funds).

- Accrual-based consolidated statements, prepared on the basis of individual accrual financial statements of all the entities controlled by the main entity.

This paper is focused on the third type of consolidated reporting, which is regulated by IPSAS 35 to 37. They are based on the international Financial Reporting Standards 10 to 12, including amendments up to December 2014. The latter standards have been amended in 2011 to be effective for annual periods beginning on or after 1 January 2013. The most important aspects introduced by these new standards were: (1) new definition of control, which is used to determine which entities are consolidated (IFRS10); (2) new approach for the accounting description for joint arrangements that have led for the elimination of proportionate consolidation (IFRS11) and, (3) inclusion of all disclosure about interest in other entities for subsidiaries, joint arrangements, associates, and structured entities (IFRS12) (Ernst & Young, 2011). Therefore, the

IPSAS have not included recent amendments to the IFRS, such as the contained in the Annual Improvements to IFRS Standards 2015–2017 Cycle.

The IPSAS define the entities that must be included in the financial statements under the basis of the concept of "control". This concept is applied in the inclusion of an entity in the scope of consolidation and to choose the related method to include the entity in consolidated statements (Biondi & Soverchia, 2014). According with Santis et al. (2018), academics have emphasised two opposite trends about CFS concerning the application of private sector accounting standards or public sector accounting standard. This dichotomy shows distinctive applications of CFS standards between countries. For example, the UK applies private sector accounting standards for accrual-based public sector accounting (Biondi, 2016; Santis et al., 2018) but for defining the perimeter in the Whole of Governments Accounts, that represent the meta-consolidation of the CFS, the System of National Accounts (ESA 2010) is applied (Jones & Caruana, 2014). In Sweden, at local level, specific rules are applied for CFS; IPSAS are also applied in other countries like USA and Canada (Santis et al.,2018).

In sum, the harmonization of CFS in Europe and other countries is still an issue that must be explored. This paper tries to understand the facilitators, benefits and challenges of the implementation of IPSAS for CFS.

Research design

This paper is based on a comparative analysis between Portugal and Spain. We have selected these two countries because of the similarities between them in the public sector accounting standardization. We can highlight the strong centralization, high bureaucracy and legalistic tradition which characterize the public administrations in both countries. Consequently, their public sector accounting reforms are highly centralized and imposed by law.

Furthermore, in both countries, a national accounting standard setting committee has been created to develop the new public accounting system based on IPSASs; these committees are dependent on the respective ministries of finance. The development of the business accounting systems has been a reference for the public systems in the two countries, as we explain in the following sections.

To carry out the study, documentary analysis of the official documents has been complemented with semi-structured interviews to gather information on the opinions of interviewees concerning the assessment of CFS in both countries.

We have simultaneously considered the perspectives of two groups: the standards setters and the financial professionals in the local governments. We conducted interviews with members of the standard setter groups (two in Portugal, one in Spain), and with seven financial professionals in large cities (four in Portugal, three in Spain, see Table 1). The interviews were carried out from February to April 2017.

Table 1: Interviewees details

Country	Portugal	Spain
Standards setter	Coordinator of the Portuguese accounting standards setter committee (CNCP) CNCP member who represents local governments	Coordinator of the Commission that elaborates the standard for CFS
Municipalities	Porto (237,591 inhabitants), interview with the financial department director; Sintra (377,835 inhabitants), interview with the financial director; Cascais (206,479 inhabitants) interview with the head of accounting area; Vila Nova de Gaia (302,295 inhabitants) interview with the financial director.	Madrid (3,228,319 inhabitants), interview with the head of accounting department. Barcelona (1,621,537 inhabitants), interview with the head of CFS; Vitoria (244,634 inhabitants), interview with the head of accounting department.

We have used semi-structured interviews in order to allow a complete discourse where both sides use their own terms and perceptions. The interviewees gave their personal opinions about the following issues: the facilitators of CFS, the use of CFS, the benefits of CFS based on IPSASs and the problems and challenges of using CFS.

Consolidated statements in Portugal and Spain: the influence of the IPSAS

The process in Portugal

The reform of public sector accounting in Portugal has been characterized by a long process in which external pressures during the financial crisis and developments in the business sector have been determinant in those introduced in the Portuguese context (Gomes *et al*., 2015).

The first accounting reform came with the Official Public Accounting Plan (POCP) passed in 1997, which created an integrated system between cash-based budgetary accounting and accrual-based financial and cost accounting (Jorge, 2015). However, it did not establish the principles for an adequate consolidation of accounts. As a result, a new law was approved in 2007 for local governments which requires '*municipalities holding the capital of business entities that provide municipal services'* to prepare consolidated accounts. This law defines the scope of the consolidation and the methods to be used and became compulsory in 2008.

The accounting reform in the private sector that led to the compulsory adoption of IFRS in 2010, had brought an inconsistency between the standards applied for CFS in private sector and public sector. To resolve this problem, the Order 474/2010 was approved for the public sector and was the solution to the standardization and homogenization of the consolidation process. Since the order 474/2010 was based on IPSAS[1] the control concept is the criterion used to establish the entities which are within the consolidation perimeter. The consolidation methods are simple aggregation (effective administrative control), full consolidation (interest of more than 50% in the controlled entity) and the equity method (20% to 50% interest in the controlled entity). A requirement to prepare a consolidated management report is part of the CFS

In practice, by Order 474/2010, a set of guidelines, principles and requirements was established which should underpin the consolidation of accounts of entities integrated into the public sector. In the preamble, it is stated that the standard for the consolidation of accounts for the public sector should be based on the IPSASs. Thus, this was really the first step towards the introduction of the IPSASs for consolidation purpose.

At the same time, in 2010, the Portuguese government evidenced interest in introducing an IPSAS-based accounting system as a result of various external and political pressures from different actors. Firstly, the new IPSAS-based accounting system is an answer to external demands, such as those of the International Monetary Fund (IMF). The strong financial crisis that affected Portugal after 2010 weakened the economy and made it dependent on money lenders, e.g. the IMF, which asked for the reformulation of the existing financial information systems in accordance with international requirements (Gomes *et al*., 2015).

Secondly, internal pressure from the government and the Ministry of Finance also contributed to the introduction of international accounting practices (Gomes *et al*., 2015) for public sector entities.

Thirdly, the advance of the IFRSs-based accounting system for the private sector, in January 2010, also influenced the need to adapt the public sector to an international accounting context. Since the adoption of the IFRSs-based system

[1] It is important to note that the IPSAS used at this time were IPSAS 6 to 8 which were replaced in 2015.

accounting in the business sector, the preparation of CFS became more difficult because governmental business units applied the new business accounting systems which led to several adjustments in the consolidation process both for individual entities and the Government as a whole (Jorge, 2015).

As a consequence of these pressures, the Portuguese government created a working group called the Public Accounting Standard Setter Committee that issued the new Public Sector Accounting System (SNC-AP) based on IPSASs and approved by law decree 192/2015.

With the introduction of the SNC-AP the consolidation methods and the definition of control will follow the IPSAS as reference. In the Portuguese context, an entity that controls another entity must present consolidated financial statements accordingly the public accounting standard 22 (NCP22) which is mainly based on IPSAS 35-37. The control is verified when: (1) the controlling entity has the right to obtain benefits deriving from its involvement with the controlled entity, and (2) has the ability to affect the nature or amount of those benefits through the exercise of power. An entity controls another entity if, and only if, it has cumulatively:

(1) power over the other entity;

(2) exposure, or rights, to benefits arising from your involvement with the other entity;

(3) the ability to exercise its power over the other entity in a manner that affects the nature and amount of benefits arising from engaging with that entity (NCP 22, § 11 and 12). The methods to recognize elements in the consolidated statements are the full consolidation, the equity method and the cost, accordingly the type of entity and involvement.

Dependent or controlled entities are included in CFS using the full consolidation, while the equity method can be used for joint ventures and for associates. The only exception to the obligation to prepare consolidated reporting is when the entity is dependent on another entity that prepares consolidated reporting (subgroup).

So, in the Portuguese case the accounting standard can be summarized with the following elements:

- The criterion of control is used to define where CFS must be presented;
- The criterion of control is used to define the controlled entities that must to be included in the CFS;
- Full consolidation it is used for controlled entities and equity method for associated and joint ventures.

The process in Spain and the criteria for consolidated statements

In Spain, accrual financial statements were introduced into local government in 1992. A characteristic of public sector accounting in Spain is that it is influenced by the evolution of business accounting standards. The EU requirement to apply the International Accounting Standards (IASs) and the IFRSs to consolidated statements of quoted groups in stock market lead to the convergence of national standards with the IFRSs. For local governments, the new Chart of Accounts, adapted to IPSASs, has been applied since 2015. However, the chart does not refer to consolidated accounts because they are not compulsory for local governments.

In 2013, the standard setter passed a general standard for consolidated statements, which takes as a reference the IPSASs. One of the main arguments in favour of IPSASs is that they are based on the business sector, making easier the harmonization between the public and private sectors. The standards are compulsory for central government but voluntary for local government.

Consolidated statements are not compulsory for local government, but as the general standard is voluntarily applicable for local government, we focus on this as a reference framework for local governments that voluntarily decide to elaborate consolidated statements.

In Spain, the general standard for consolidation in the public sector differentiates three types of entities: the economic entity (including the controlling and controlled or dependent entities), joint ventures and associates. The definition of dependent entities is based on the previous IPSAS 6 and focuses on the concept of control for defining the group contained in the financial statements, and includes some particularities of public sector consolidation (Walker, 2009).

Control is defined as the power to direct the financial and operating policies of another entity in order to obtain economic benefits or service potential. Control is presumed to exist when at least one of the conditions of power and one of the conditions of equity are fulfilled, unless there is clear evidence of control being held by another entity.

- *Power conditions:*
  - The entity has, directly or indirectly through controlled entities, more than 50% of the voting rights of the other entity.
  - The entity has the power, either through legislation or formal agreements, to appoint or remove a majority of the members of the board or governing body.

- The entity has, either through legislation or formal agreements, the majority of the voting rights on the board of another entity.
- The entity has the power, either through legislation or formal agreements, to cast the majority of the votes in meetings of the board of directors or governing body and the control is exercised by that board or by that body.
- The entity has appointed the majority of the members of the governing body when consolidated accounts must be formulated and for two years before.

➢ *Benefit conditions:*

- The entity has the power to dissolve the other entity and obtain a significant level of the residual economic benefits or bear significant obligations.
- The entity has the power to extract distributions of assets from the other entity, and/or may be liable for certain obligations of the other entity.

Dependent entities are included using the full consolidation, while the proportional and the equity methods can be used for joint ventures and the equity method is used for associates.

The standard contains some exceptions to the obligation to prepare consolidated reporting:

- The entity is dependent on another entity that prepares consolidated reporting (subgroup)

- None of the dependent entities has significant interest, individual and taken together (materiality)

- For reasons of size of the controlling entity (the limits are yet to be established)

There are also some exceptions for including dependent entities in the CFS:

- They have no significant interest (materiality).

- Restrictions for the exercise of control

- The information necessary requires disproportionate costs or delays with respect to the timing of CFR required by the law.

The main contents of the Spanish accounting standard can be summarized in the following:

- The concept of materiality is used to define where CFR should be presented.

- The concept of control is used for defining what entities must be included in the consolidated financial statements. Nevertheless, the concept of materiality allows the

non-inclusion of entities that do not have significant interest or with restrictions in the cost of obtaining the information.
- The full consolidation is used for dependent entities, while joint ventures are included using the proportional or equity methods and associates with the equity method.

A comparative analysis

The comparison of the process between Spain and Portugal shows that there are great similarities in the process, even though some differences exist between them. An important similarity is that the private sector accounting is always considered the most important reference in reforming public sector accounting in both countries. As a consequence, the compulsory adoption of the IFRSs for consolidated statements of listed groups in the private sector, required by EU regulation, has become a driver to adopt IPSASs in the public sectors of both countries. This is a clear example of the translation of private sector accounting tools to municipalities (Grossi and Steccolini, 2015).

As for the differences between them, it can be mentioned that, in Portugal, the financial crisis, which has affected the country since 2010, and the consequent dependence on lenders money also represent drivers for IPSASs adoption, motivated by coercive isomorphism (imposed by the IMF and the Troika).
About the criteria for elaborating consolidated statements, Table 2 compares the Spanish and Portuguese criteria for consolidated statements and the IPSASs.
Table 2: Comparative analysis

	IPSAS 35 to 37	**Spain**	**Portugal**
Definition of the reporting entity	- Economic entity (controlling+controlled) - Joint ventures -Associates	-Economic entity (Controlling+controlled) - Joint ventures - Associates	-Economic entity (Controlling+controlled) - Joint ventures - Associates - No requirements for levels of government consolidation - Accounting gaps related to sovereign transactions (e.g., taxes, PPPs, investments, financial instruments)
Definition of dependent entities	Concept of control: power element, benefit element, link between power and benefits	Concept of control: power conditions, benefit conditions	Concept of control: power element and benefit element

Exemption from the obligation of consolidated reporting	Entities controlled by other controlling entities that prepared consolidated statements	- The entity is dependent of another entity that prepares consolidated statements; - Materiality; - Size reasons	- When it is not materially relevant to the objective of a true and fair view of the financial position, results and budget execution of the public group - If the sum of the entities is material, a duty of inclusion - It is not defined what is materiality
Exemption from including dependent entities	No exemptions	-Materiality; -Restrictions for control, - Cost or delay reasons.	- Materiality; -Restrictions for control
Methods for consolidation	Dependent entities: full consolidation Joint ventures: equity method Associates: equity method	Dependent entities: full consolidation Joint ventures: proportionate or equity methods Associates: equity method	- Simple Aggregation - Integral Consolidation - Proportionate consolidation method - Equity

It must be highlighted that the Spanish standards were passed using as a reference the IPSAS 6 to 8, and as the IPSAS were replaced later, some of the differences are due to the changes. In the Portuguese case the new IPSAS have been used. An important difference appears about the exemption from including dependent entities, which has been removed in recent IPSAS.

Benefits, problems and challenges of consolidated reporting standards harmonized to IPSASs

The benefits of CFS

Financial statements are a tool for accountability and for the decision-making of different stakeholders, and they are designed to communicate information that is useful for assessing the financial position, results of operations and cash flows of the whole of government. Governments should be accountable for the resources they control, and the boundaries of the financial reporting entity should be widely drawn to encompass all the resources which the government controls (IFAC, 1996).

The whole of government accounts is the cornerstone of the move for greater financial transparency and accountability of the government (Barrett, 1997). Consolidated statements can be used as a critical element for the accountability process because they show what public managers and politicians have done with public money. The government will give a comprehensive account of its use of resources and its assets and liabilities, and, more importantly, any public sector entity will be accountable to the controlling entity. This can have a positive effect on the bureaucratic culture of public administrations and can be seen as coordination and integration strategies after the fragmentation which takes place with New Public Management (Christensen and Lægreid, 2007). As concluded by Cîrstea (2014, p. 1295) CFSs ‘improve and bring value to the public sector reporting system regarding the financial performance and thus allow increased the accountability on public resources’.

In the opinion of the members of the Portuguese standards setter committee (CNCP), the use of CFSs is important to control the debts and expenditures of the entity and to provide information for the preparation of the national accounts. However, in practice, some efforts are necessary to increase the use of this information. For example, the CNCP coordinator emphasizes the profile of managers, as well as their training and sensibility to the use of this type of information, as an important determinant in the use of CFSs for internal purposes.

From the perspective of the Spanish standards setter, CFSs can be useful to control the level of debt and the level of expenditure, but the interviewee recognized that the legal framework does not assign this role to the statements. This is the main reason that consolidated statements are not compulsory.

With respect to the opinion of the professionals of the local governments, in the case of Portugal, we have different opinions:

- Porto municipality—the financial director is very optimistic about the assessment of CFSs. He highlights that ‘with CFSs it is possible to know the level of indebtedness of the group and control the expenses of the group’. In his opinion, the concepts of control and the definition of dependent entities is clear for the municipality, and this helps to provide adequate information. The reduced use of CFSs is attributed to the decentralization of decision-making (other tools and internal control systems play a central role in that decision).
- Cascais municipality—the head of the accounting departments says, ‘We control the level of debts and expenditures of the group. Undoubtedly CFSs help to inform about the financial position of the group’. With regard to expenditures, the head states, ‘We believe that consolidation has an important role, but the problem is the information that we can’t obtain from the dependent entities. For example, we try to control expenditures at municipal enterprises level, but we didn’t have success’.

- Vila Nova de Gaia municipality—the financial department director believes that ‘CFSs provide a true and fair view of the group and can be used for management purposes. However, at the moment, she continues, ‘there is no clear identification of the entities that must be included in the consolidation perimeter’, and this reduces the use of information for accountability purposes and decision-making.
- Sintra municipality—the financial director is more sceptical about the use of CFSs than the colleague from Porto. In his opinion, ‘The truth is that our politicians and other stakeholders give more attention to individual accounts than CFSs’, and the consequence is the reduced use of CFSs. One reason for this reduced use is the ‘difficulty to control the indebtedness of the group through CFSs because there is an exemption for some business entities that do not integrate the consolidation perimeter’.

The main reason for differences is the high institutionalization of the consolidation process reported by the interviewees of the municipalities of Porto and Cascais, where the preparation of CFSs became a natural process (a routine) and no significant barriers have been noted. This favourable context is associated with the implementation of CFSs standards in 2010 that became obligatory in the preparation of consolidation information.

In general, the professionals agree that more attention should be paid to the quality of information provided by CFSs and to the use of this information for accountability purposes and decision-making.

To ascertain the Spanish perspective, we collected the opinions of three financial directors who voluntarily prepare consolidated statements. In spite of the differences, the Spanish accounting professionals consider that the information has limited usefulness due to the old debate about accrual accounting and budgetary reporting. The three consider that real budgetary reporting is used in the legal framework for decision-making and accountability purposes, and, as a consequence, this information is considered to be more useful. For example, budgetary reporting is considered as a base to assess the financial stability and sustainability of governments. About the control of the level of debt, which must be done for the total debt of the general government and public enterprises with majority ownership, the problem is that this does not coincide with the perimeter of the group for preparing consolidated reporting, so the information is not actually considered for this purpose. The financial directors do not consider that consolidated statements have a value added for decision-making. They recognize, however, that they can increase accountability, but, as the political debate is focused on the budget, both individual and consolidated financial statements lose relevance. This would recommend maintaining consolidated statements as voluntary reporting. In Portugal, there is more optimism about the use of CFSs, considering the great experience which exists in preparing the accounts; however, more efforts are necessary to improve the use of the information.

Problems and challenges of CFSs

The elaboration and interpretation of CFSs also present some problems and inconveniences that must be noted. These are summarized by European Commission (2018a) in practical implementation issues and technical complexity, which fits totally with the challenges identified in the countries studies. The first problem pointed out is the definition of the entities which must be consolidated and the use of business accounting-based criteria. The second difficulty to overcome in the elaboration of CFSs is homogenisation of financial statements which have been elaborated on the basis of different accounting norms (for example, municipalities and local public corporations in Portugal). We will consider these further.

The definition of the entities which must be consolidated versus national accounting

The definition of the concept of control is a key issue for CFSs (Lombrano and Zanin, 2013). The standards for consolidated accounts, both the IPSASs and the national standards in Spain and Portugal, have considered the criteria for the business sector as their reference. However, as stated in European Commission (2018a, 2018b) another possibility for defining the financial reporting entity is to focus on the European System of Accounts (ESA, 2010) and the Government Finance Statistics Manual (IMF, 2014), where the general government consists of all government units and all non-market non-profit institutions (NPIs) which are controlled[2] by government. The public sector could be divided from the perspective of national accounting into three sectors: the general government sector, the public non-financial corporations sector and the public financial corporations sector. Furthermore, the "*General Government Sector does not include*

[2] In ESA (2010) control is defined as the ability to determine the general policy or programme of other entities. The following are the five indicators of control: (a) the appointment of officers; (b) other provisions of the enabling instrument, such as the obligations in the statute of the non-market institutions; (c) contractual agreements; d) degree of financing; and (e) risk exposure.

institutional units primarily engaged in market activities" (European Commission, 2018b, p. 23).

In Portugal, the standards setter considers the consolidation process highly institutionalized in the context of the public sector because CFSs became obligatory several years ago. However, the accounting professionals identify some barriers in practice. In general, they agree that the criteria to define dependent entities which should incorporate CFSs are not very clear, and this is a very real problem (Sintra and Vila Nova de Gaia). The problem is exacerbated by entities that are included in the whole of government for financial accounting, but excluded for national accounting. This shows that one of the problems is the divergence from national accounting criteria.

For the three Spanish local governments, the existence of the three different sectors in national accounts is considered as one problem. In fact, the municipality of Vitoria takes into account the criteria defined by the central government for national accounting purposes. They consider only entities where they have more than 50% of the equity. The municipality of Barcelona, which follows the national standards for consolidated statements, considers that the definition of the concept of group is the main problem, and that it really would be simplified if it were based on national accounting. This is an important shortcoming for consolidated statements, which consider only private sector criteria. In fact, this has been pointed out as an important question by European Commission in the recent paper about consolidated financial statements (European Commission, 2018b).

A good solution could be a combination of the two possibilities, although this option is not directly contemplated in the paper of the European Commission (2018b). In this case, the group should be defined in terms of control from an economic perspective, but the CFSs should also be prepared for the perimeter of the general government in accordance with the SEC.. This would require also the reconciliation of data of ESA and consolidated reporting.

Logically, there would have to be a harmonization and conciliation between the two types of information[3]. This perspective can enhance the transparency of financial reports and provide a better understanding of the relationship between the market and non-market activities of the government and between financial statements and the

[3] Although accrual accounting is applied under National Accounting, some principles for recognition, measurement or classification rules differ from Generally Accepted Accounting Principles (IPSASB, 2005; 2014).

statistical bases of financial reporting (IPSAB, 2012). Moreover, information about public non-financial corporations and public financial corporation sectors should be disclosed.

The homogenization of accounting criteria with dependent entities and elimination of reciprocal items

One of the problems that emerged is that the accounting principles of the dependent entities and the principal are not the same, especially when the dependent entities are business entities, which follow private sector accounting. This has been pointed out in Portugal by the financial directors of two municipalities (Sintra and Vila Nova de Gaia), highlighting that there are entities that apply international standards or the standards adopted by the business sector, which makes it necessary to make some adjustments to obtain CFSs of the municipality as whole.

There are two main options for addressing all the differences among the various entities being consolidated. Alignment can be achieved either by making consolidation adjustments or by moving towards common accounting policies across the public sector.

With the adoption of the IPSASs, it seems that this problem has been reduced, as the accounting criteria of the business and public sectors are now essentially homogeneous. However, the three interviewees in Spain considered that this is still a problem because it is sometimes difficult to harmonize the two accounting frameworks. For example, public corporations use budgets for management purposes, but do not have a budgetary accounting system for external reporting, so the preparation of the consolidated budgetary reporting presents some difficulties.

Having homogenised the financial statements of the entities to be consolidated, it is necessary to eliminate the operations carried out among these entities so that the CFSs only reflect transactions with third parties external to the group. Only in this way can fictitious results and reciprocal items be avoided. An important aspect is that different entities have had to process inter-entity transactions at the same moment and with the same amount because, otherwise, problems emerge for the elimination of these transactions. Moreover, many difficulties may arise with the identification of nonreciprocal transfers, that correspond to inter-entities transfers that will affect the consolidated results, especially where there are a significant number of entities to be consolidated. The Spanish interviewees argued that, sometimes, it is difficult to have all the information of dependent entities. In fact, one of the municipalities sometimes uses the year X-1 of some dependent entities because, when they prepare the consolidated statements, they have not prepared the statements of year X. They are aware that this is not correct, but they consider that it is the only solution.

This indicates that, in the case of Spain, there are still some problems to be solved before introducing compulsory consolidated statements; above all, it is important to note that financial directors consider that the cost is greater than the benefits. The Portuguese interviewees also emphasised this difficulty in order to obtain information from the dependent entities needed to prepare CFSs (Sintra, Cascais and Vila Nova de Gaia). However, this barrier seems to be mainly associated with inadequate accounting systems implemented in dependent entities and not with the use of different standards and accounting principles. Moreover, the perspective in Portugal is more optimistic than in Spain with respect to the context and experience in the consolidation process. This could be the result of the greater experience working with CFSs.

Conclusions

During recent years, the IPSASs framework have become a reference for the modernization of accounting standards in many countries and for facilitating the consolidation of financial statements, and these can even be a tool for achieving the harmonization of accounting. In fact, they seem the more likely reference in the framework of the EU. Many countries have made efforts to bring their accounting systems in line with international standards. This is the case for Spain and Portugal: both have reformed their accounting standards taking IPSASs as a reference, although Portugal is still in the process of implementing the new accounting standards. Both countries have used accrual accounting in the public sector for more than twenty years.

In this framework, consolidated statements have also been developed based on IPSASs, considering that they fit in well with the public sector characteristics, in spite of criticism which they have received in the literature because of their proximity to the business sector. In this line, the Spanish standard setter published a general standard for consolidated statements, which is based on the IPSASs and which is applicable to local governments. Initially, it was supposed that this would be compulsory for 2017; however, it has been postponed, and consolidated statements are voluntary.

On the other hand, in Portugal, local governments have elaborated consolidated statements since 2008, and, from the start, they have considered business standards as their reference. In the framework of the recent reforms, aiming to adapt public sector accounting to the IPSASs, the international standards for consolidation have also been introduced.

The introduction of the IPSASs can be explained in both countries by institutional theory, as a process of isomorphism with the private sector, considered a reference in both countries. This is also the case of consolidated statements. The introduction of IFRSs for the private sector has been an important stimulus for introducing IPSASs. In the case of Portugal, the financial crisis which has affected the country since 2010, and therefore the requirements of Troika, was also an important stimulus (Gomes *et al.*, 2015).

However, one of the main findings in the case of Spain is that consolidated statements are not used for management or for decision-making. Even if the standard setter states that these statements can be very useful for controlling the debt and expenditures of a group of entities, it recognizes that the legal framework does not have room for this application. The professionals who voluntarily prepare consolidated statements note that budgetary reporting is used for accountability and decision-making. In addition, accrual accounting and, as a consequence, consolidated statements provide limited benefits. This is one negative feedback in the traditional debate about accrual accounting in the public sector and is probably the main reason why the Spanish government has postponed the requirement to elaborate consolidated statements. In the opinion of the financial directors interviewed, the financial statements add only a limited value, and so the costs are higher than the benefits.

The context in Portugal is more favourable according to the interviewees' opinions, especially if we look at the standards setters' perspective. In their opinion, the consolidation process is highly institutionalized, and the main obstacles to the preparation of CFSs have been eliminated in the past. However, the accounting professionals see only a limited use of consolidated information in practice. Despite the optimistic vision of the financial department director of Porto and Cascais, all of the interviewees recognize that consolidated information is not used for managerial purposes and decision-making. To take decisions, politicians and managers usually use other tools and control systems.

In conclusion, it is important to note that this paper is innovative in the study of the consolidation process in the Iberian Peninsula, not only because two European continental countries which are in the process of IPSASs implementation, with a similar cultures and legal systems, are studied, but also because it studies the question from a double perspective: that of standard setters and financial professionals. It represents a starting point for further studies which can investigate the operational changes in practice after the implementation of consolidation standards that are IPSASs-based and the strategies to be implemented to assure a greater use of the information.

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