The materiality of consolidated financial reporting – an alternative approach to IPSASB

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Abstract: Today, municipalities can make use of different organisational models and legal entities in order to perform their duties and services towards their citizens. Several scholars and standard setters, e.g., IPSASB, argue that the picture of a municipality’s financial position and performance is affected by the definition of the reporting entity and that there is a need for consolidated financial reporting in order to give the whole-of-government picture. Sweden is one of the few countries that actually have introduced consolidated financial reporting. By using data from annual reports, we analyse how consolidated reporting affects the financial picture and the comparability of financial data between different municipalities.

Keywords: comparability; consolidated financial reporting; CFR; IPSASB; materiality; municipalities; Sweden.


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Giuseppe Grossi holds a PhD in 2000 and since 2002 he has been an Associate Professor in Public Management and Accounting at the University of Siena in Italy. Currently, he is serving as Docent (Associate Professor) at the University of Kristianstad. His research focuses on public sector management and governance, management control, performance budgeting, and whole of government financial reporting.

1 Introduction

Over the last two decades, many western countries have been engaged with managerial reforms inspired by new public management (NPM). The influence from NPM has been extensive and has resulted in an increasing use of market-like mechanisms and a corporatisation trend in the public sector (Osborne and Gaebler, 1992; Pallot, 1999; Lane, 2000; Grossi and Reichard, 2008). The changes introduced have not only related to the individual public administrations, but also to the procedures with which they provide or delegate the provision of public services. Local governments have gradually reduced direct forms of management and have favoured corporations, public and private partnerships, privatisation and outsourcing. As the result of this process many municipalities can be characterised as complex conglomerates made up of different kinds of companies controlled completely or partly by the local government itself (Grossi, 2001). The growing development of corporations has led to the fact that the traditional annual reports of local governments, disclose only a partial view of their economic and financial activities, because the financial consequences of subsidiaries, joint ventures and associates are not necessarily considered (Grossi and Srocke, 2005; Tagesson, 2009). Thus, the corporatisation and decentralisation process has led to a great lack of information (Walsh, 1995). Hence, the annual accounts of local governments do not give a true and fair view of the whole of local government (Rhodes, 2000; Osborne and Brown, 2005; Bundred, 2006). This organisational change requires accountability systems in order to allow government to steer the external entities towards the fulfilment of public interest, to be accountable for the ‘whole basket’ of services provided and for their financial impact (Grossi and Mussari, 2008). This has also been recognised by IPSASB (2010, p.47) who states that “… service recipients and resource providers will often require information about the group of separate entities that make up the government as a whole…” Thus, CFR is recognised and promoted as essential to support decision-making processes and to ensure public accountability (IPSASB, 2010). As a result, accountability and decision usefulness is not guaranteed by the traditional annual reports of local governments anymore. Internal (e.g., politicians, managers, auditors and employees) and external users (e.g., citizens, voters, taxpayers, suppliers, other public administrations, banks and rating companies) of financial information are not able to base their decisions on reliable and relevant information about the financial position, financial performance and cash flows of the whole local government.

Hence, the increased use of municipal corporations has led to a debate about the need for consolidated financial reporting (CFR) as a necessary step in order to avoid this lack of accountability (e.g., Lande, 1998; Wise, 2006; Chow et al., 2007; Grossi and Tagesson, 2008). According to the Swedish Federation of Local Authorities (Svenska Kommunförbundet, 1989), CFR can contribute to a more comprehensive analysis of the...
whole municipality’s economy. However, CFR is a relatively recent development within the public sector, and still there are only a limited number of countries that actually have introduced CFR in the public sector at the central and local level (e.g., Grossi and Pepe, 2009). Sweden is one of the few countries that actually have introduced CFR. By using legislations, national accounting standards and data from annual reports from Swedish municipalities, the aim of this paper is to illustrate how CFR actually affects the financial picture and the comparability of financial data between different municipalities.

This paper is organised as follows: The following section discusses and describes theoretical perspectives to consolidation and definitions of the reporting entity by comparing the different approaches used by IPSASB, IASB and the Swedish Council for Municipal Accounting (SCMA). This section ends with the overall research questions of this paper. We follow up with a section that in more detail describes the Swedish regulation and legislation regarding consolidation reporting in the local government sector. In the following section, we describe the methods used in collecting empirical data. A subsequent section presents the statistical analysis and the implications from the statistical analysis. In the last section, we present the concluding remarks.

2 Theoretical framework and CFR

CFR represents financial data about a set of related yet separate business entities that are referred to collectively as an economic entity. One entity is assumed to be at the head of another economic entity and is generally referred to as the holding or parent entity (parent). All other entities in the economic entity are subsidiary to the head entity and are referred to as subsidiary entities.

The definition and delimitation of the reporting unit is a significant problem for business accounting and even more significant for public sector accounting. According to Eriksson (2002), the identification and definition of the accounting unit is dependent on the area of economic interest to identified stakeholders.

The practice of compiling CFR in the private sector has long been established in many countries including the USA, the UE countries and Australia. However, the adoption of CFR did not precede the development of any theoretical concepts and accounting standards that supported their use (Walker, 1978). There are several theories on how to present and define CFR (Jones and Pendlebury, 2000; Eriksson, 2002; IASB, 2008; Beams et al., 2009). According to Eriksson (2002), the method of consolidation is decided by the definition of the group as well as the theoretical perspective. The definition of the group concerns the matter of including or excluding non-controlling interest in the subsidiaries. The theoretical perspective concerns whether a proprietary, entity or parent company perspective should be used (IASB, 2010).

Under the entity perspective, where there is no distinction made between the controlling entity and the other owners, the non-controlling interest is included in the consolidated financial statements, and treated as equity. Under the parent company perspective, the non-controlling interests are included in the financial statements but they are separated from controlling interest and treated as debt. Under the proprietary approach only the investor’s proportionate share of the investee’s assets, liabilities and activities are included, hence, the non-controlling interest is excluded from the consolidated financial statements (IASB, 2008). An alternative to proportional method of consolidation is the equity method where only owned share
of the subsidiary’s net assets and share of net income are included in the consolidated financial statements. 

*Proportional* consolidation, for example, stresses the ownership interests of the parent company shareholders. Consolidated statements are viewed as a modification of the parent company financial statements in order to account for the ownership interests of the parent company in other entities (Heald and Georgiou, 2000).

**Figure 1** Theoretical frameworks and consolidation methods

A third issue that ought to be considered is the objectives and characteristics of a reporting entity (Lande, 1998; Grossi and Tagesson, 2008). According to IPSASB (2010, p.54), “The key characteristic of a reporting entity is the existence of users who are dependent on General Purpose Financial Reports (GPFRs) of the entity for information for accountability purposes and for making resource allocation, political, and social decisions”.

These objectives are somehow different from the objectives of IASB which in the IASB Framework ED ‘Objective and Qualitative Characteristics’ state that “The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. Information that is decision useful to capital providers may also be useful to other users of financial reporting who are not capital providers” [IASB, (2008), p.1].

Despite differences in objectives and also regarding users - IASB focuses on investors and other capital providers while IPSASB focuses on recipients of services, providers of resources and other parties including special interest groups and the legislature – IPSASB come to the same conclusion as IASB regarding the criteria for inclusion within the reporting entity!

According to IPSASB (2010, p.52) a reporting entity will comprise when the government:

- has the power to govern the strategic financing and operation policies of the other entities (a ‘power criterion’)

can benefit from the activities of the other entities, or is exposed to a financial burden that can arise as a result of the operation or action of those entities; and can use its power to increase, maintain, or protect the amount of those benefits, or to maintain, information needs and the characteristics of the public sector reduce, or otherwise influence the financial burden that may arise as a result of the operations or actions of those entities (a ‘benefit or financial burden/loss’ criterion).

The crucial questions, which is not dealt with in the Exposure draft 1 of the conceptual framework, is how the power criterion will be interpreted in a public sector context and what theoretical perspective and method of consolidation IPSASB will advocate.

In the private sector, the obligation to compile CFR as well as the consolidation area will be defined according to concept of control. If a company controls another company, the controlling organisation is obliged to present consolidated financial statements (IFRS 27).

According to IPSASB the ‘benefit element’ and the ‘power element’ have to be considered (IPSAS 6.26). The benefit element signifies that the controlling entity has to receive a financial or non-financial benefit from the activities of the decentralised organisation. This can also be a financial risk (IPSAS 6.27). The power element signifies that the government or the parent of a subgroup must be able to exercise the power to govern the financial and operational policies of the decentralised organisation. This does not require a majority of voting rights but the power must be conferred by law or another formal agreement. The formal agreement must presently exist. If the ability to exercise the power requires changing law or renegotiating agreements, the power is not presently exercisable. The existence of power to control does not mean that the controlling government or parent of a subgroup has to use this power. It is sufficient that the controlling entity is able to use it. It is possible that the controlling entity never gives any instruction to the decentralised organisations (IPSAS 6.28). If control does not exist it is necessary to investigate whether the decentralised organisation might be a joint venture or associate.

Depending whether control, a joint venture or an associate exist, the consolidation method is determined and therefore the effect of the decentralised organisation will be presented in the consolidated financial statements regarding the influence the local government is able to exercise.

The consolidation methods should represent the different influences the public sector entity has on its subsidiaries. If a public sector entity is under control of another public sector entity, it shall be fully consolidated (IPSAS 6.17). If it is a joint venture, the entity should be consolidated proportionally or by using the equity method (IPSAS 8.36). If a public sector entity has just a significant influence on another public sector entity, the equity method shall be used (IPSAS 7.18).

IPSASB’s standards are essentially based on standards issued for the private sector by IASB. This means that the fundamental feature of the standards is based on a decision-making approach that aims to produce information primarily for investors (Grossi and Tagesson, 2008). The colonisation of private sector practices can be found in the process of development of international public sector accounting standards (IPSAs), which have been defined on the basis of private sector standards (Benito et al., 2007; Ellwood and Newberry, 2007). According to Grossi and Tagesson (2008), the fundamental difference between IPSASB and SCMA is that IPSASB’s standards are
primarily based on a decision-making approach while the SCMA standard is based on an accountability approach.

According to Lande (1998), the scope of accounting in the private sector is not relevant to the public sector due to the differences in objectives. The public sector differs from the private sector in organisational goals, financing, ownership, users of accounting information, etc. (Grossi and Tagesson, 2008). These objectives also influence the scope of consolidation (Lande, 1998). Considering these aspects, the decision-making approach does not seem to be so relevant for public sector accounting. The Swedish Federation of Local Authorities (Svenska Kommunförbundet, 1989) argues that a proprietary approach with proportional method of consolidation much better meets the information needs for municipal stakeholders.

3 The introduction and regulation of consolidated reporting in Swedish municipal sector

3.1 Legislation

Sweden was one of the first countries in Europe that introduced accrual accounting and reporting in the public sector (Lüder and Jones, 2003). Under the threat of legislation the Swedish Federation of Local Authorities elaborated an accounting model that was based on accrual accounting. In 1986, this accounting model (KFLF-86) was voluntarily introduced in the municipal sector in Sweden. In the latter part of the 1980s, CFR was also introduced on a voluntary basis. The introduction was encouraged by the Swedish Federation of Local Authorities who 1989 published a booklet with instructions and ideas about objectives and techniques for consolidated reporting in a municipal context. This booklet was prepared in cooperation with Dr. Lennart Eriksson from Gothenburg University, one of the leading scholars within the field of consolidated reporting. The basic ideas in this booklet are still dominating praxis as well as accounting standards regarding CFR in the municipal sector.

According to the Swedish Association of Local Authorities:

“The compilation of consolidated accounts, therefore, can be justified in term of democracy (public insight). Elected representatives should be given a clear picture of the financial state of the municipality and its commitments, not least because municipality can be looked on as a financial decision-making unit in which, ultimately, the municipal council has a great deal of responsibility. This also includes real political responsibility for the economic commitments of enterprises” [Swedish Association of Local Authorities, (1989), p.1]

In 1992, CFR became mandatory when the legislator introduced a demand on consolidated financial statements in the municipal act. In connection with the statutory demand of CFR, the Swedish Federation of Local Authorities’ reference group in accounting (Referensgruppen i redovisningsfrågor), issued a guideline about CFR.

In connection with the financial crises in Sweden in the 1990s, the central government legally defined a requirement of budgetary balance for local governments from the year 2000 onwards. The municipal act now states that if a deficit occurs it must be taken into account and handled in the budget for the following three year period. However, the central government worried that the requirement on budgetary balance would lead to ‘creative accounting’ among local government practitioners. Hence, a
special law for local government accounting was implemented and from 1998 the accounting of the municipal sectors is regulated in the Municipal Accounting Act. A standard-setting body – the SCMA – was also formed to develop generally accepted accounting standards for local governments and to help local governments to interpret the law.

The municipal accounting act is in all essential based on accrual accounting. However, there is one exception, pension obligations accrued before 1998 are reported as contingent liability in the memorandum items, while pension obligations accrued in 1998 and afterwards are reported as debts in the balance sheet. Critics assert that this accounting solution does not give a true and fair view; besides which, it diverges from the concept of prudence and accrual accounting, which is so fundamental for municipal accounting (e.g., Cassel, 2000; Falkman, 2002). Even representatives for the Council for Municipal Accounting are critical. Some municipalities are even filibustering by breaking the law and including all pension obligations in the balance sheet. The common apprehension is that this regulation of the reporting of pension obligations was done for political reasons in order to facilitate the implementation and use of the budgetary balance requirement stated in the Municipal Act (Brorström, 1998, 2007).

3.2 Accounting standards

The municipal accounting act includes a paragraph that lay down that municipalities should establish a consolidated accounting report including a balance sheet and an income statement. In the more detailed issues about CFR the law refers to GAAP and standard-setters. SCMA have issued a standard (RKR 8.1) which is essentially built upon the same fundamental presumptions as earlier GAAP and guidelines. Recently, SCMA presented a draft for a revised standard regarding consolidated reporting. The draft is built on the same main principle RKR 8.1, but contains some clarifications. The new draft from SCMA, has started a debate about the use, materiality and comparability of CFR (e.g., Pettersson, 2009).

According to the standard (RKR 8.1) subsidiaries should be included in the consolidated reporting if the municipality directly or indirectly has a materially/significant influence. A rule of thumb is that the municipality control 20% of the number of votes. However, according to the standard there are situations when the numbers of votes come short of 20% but the ownership involving a materially economic commitment for the municipality. In these cases, the subsidiary should be included in the consolidated accounting. However, there are also situations when the municipality has a significant influence and still do not have to include a company in the consolidation. According to the standard you also have to consider if a consolidation will provide any material information compared with the information that the municipality’s annual report give. According to the new draft, municipalities do not have to establish a consolidated accounting report if the subsidiaries turnover is less than 5% of the municipality’s turnover or balance sheet total. An individual subsidiary can also be excluded if the subsidiary’s share of turnover or balance sheet total is less that 2% of the municipality’s turnover or balance sheet total. However, if a number of subsidiaries go below the 2% limit but together exceed the 5% limit, they have to be included. Thus, in Sweden it is the economic concept rather than the legal concept that decide if a company should be consolidated or not.
According to the standard, the general rule is that the proportional method should be used when consolidating the companies. The standpoint is based on the fact that it is quite common that several municipalities form jointly owned companies with a fragmented ownership in order to run different activities and operations serving the inhabitants in all the neighbouring municipalities (e.g., regarding waste management, water and sewage) a full consolidation method may imply that a company that is jointly owned by several municipalities only can be included in the consolidated reporting of one of the municipalities. The trend to create inter-municipal corporations is quite common also in other UE countries (Dexia, 2005). Considering the specific aspects of municipal operations, where service delivery rather than profit is the goal (cf. Brorström et al., 2005) and where the costs for service delivery and the obligations for the municipality rather than cash flow and return on investment is of importance, full consolidation based on the concept of control would not give a true and fair view. It is acknowledged that proportional consolidation presents a more comprehensive view of a company’s operations and its incumbent risks and rewards (Kothavala, 2003).

Even if the general rule is the proportional method of consolidation for each company, the present standard allows one exception. If an intra-group has been consolidated with a full consolidation method, and it due to time and cost reasons is not justifiable to consolidate each company one by one, the intra-group’s annual accounts even if it is prepared according to the full consolidation method can be used in the preparation of the municipality’s consolidated statements. This alternative to the general rule has been criticised because it could mean that the consolidated annual accounts of the municipality become over- or underestimated depending on ownership structure (Falkman, 2005). In the recently announced draft on a revised standard regarding CFR this exception from the use of proportional consolidation has been removed.

The main contents of the standard 8.1 from SCMA about consolidated reporting can be summarised as follows:

- It is the material information about the municipality’s obligations rather than control that determine whether a company should be included in the consolidated reporting or not.
- The proportional method should be used when consolidating the companies.

4 Method

The empirical data in this study is based on annual financial statements relating to the 2007 financial year. The selection consists of 33 municipalities from the Skåne region in the south of Sweden. Hence, the selection amounts to slightly more than 11% of the total population of 290 municipalities. The selection includes one of the three big cities in Sweden (Malmö) as well as medium size and small municipalities. All the 33 municipalities state that they comply with the SCMA standard on consolidated reporting.

In order to calculate solidity and result for the municipality as well as the municipal group the following data has been recorded for both entities:
The materiality of consolidated financial reporting

- total assets/balance sheet total
- equity
- earnings before extraordinary items (and taxes)

The fact that the municipalities used different format for the income statements in their consolidated accounts can affect the validity some what. For municipalities that used the standard format for municipalities in the consolidated accounts, we have recorded earnings before extraordinary items and for municipalities that used the standard format for corporations in their group account we have recorded earnings before taxes.

Whereas five of the municipalities in the selection include all pension obligations in the balance sheet and in order to get comparable data, all the equity and earnings variables have been adjusted for pension obligations that the other municipalities accrued before 1998. Data regarding pension obligations accrued before 1998 and the change in obligations compared to the financial year 2006 was calculated based on data from the compulsory disclosures in the memorandum items.

5 Analysis

In order to analyse how consolidated reporting actually affects the financial picture and the comparability of financial data between different municipalities, we will present bar charts were the accounting data between each municipality and municipal group is compared. In order to analyse the effect on a more aggregated level we will also use a paired sample T-test to examine if the differences between the municipal accounting figures and the accounting figures from the CFR are significant.

Figure 2  Total assets reported in the municipal accounting respectively in the CFR (million SEK)
5.1 Total assets

From Figure 2, we can establish that the effect of CFR differs between different municipalities. Hence, differences between the municipalities in organisational solutions and legal entities in order to perform their duties towards their citizens are reflected. In some municipalities, e.g., case 23, the majority of the assets are to be found within the subsidiaries while in other cases, e.g., case 24, almost all assets are under the control of the municipal parent organisation.

5.2 Solidity

As shown in Figure 3, the picture of the solidity is affected a lot by considering the subsidiary entities. In the majority of the cases the solidity is lower in the consolidated entity than in the municipal parent entity, which indicates that it is normally the subsidiaries not the municipality that raises loans. However, in 30% of the cases (e.g., cases 1 and 2) the situation is reversed, the solidity improves if you consolidate the subsidiary entities.

5.3 Financial result

Figure 4 shows the reported financial results. In the majority if the cases the difference between the municipality’s financial result and the municipal group’s financial result is not material. This is probably explained by the fact that most of the municipal corporations’ sales are regulated by the restriction of cost price. However, there are also cases where there are a big differences between the municipality’s and the municipal group’s financial result. In some cases, e.g., cases 6 and 12 the consolidation of
subsidiaries deteriorate the financial result, but in other cases, e.g., cases 7, 16, 17 and 27 the reported results are significantly better in the group accounting than in the municipality’s accounting.

**Figure 4** Financial result based on the municipal accounting respectively in the CFR

![Graph showing financial result based on municipal and consolidated accounting](image)

### 5.4 Statistical analysis

In order to analyse the data, we will run a paired samples correlation test in order to see the correlation between the data from the municipalities’ accounting and the consolidated accounting. However, even if there is a strong correlation, the difference can be significant. This is tested in a paired sample t-test (Aronsson, 1999; Djurfeldt et al., 2007). Table 1 show the paired sample statistics. The descriptive statistics indicate material differences between the data from the consolidated accounting and the municipalities’ accounting. Regarding the financial results, the standard deviation is high.

Table 1 show the paired sample statistics. The descriptive statistics indicate material differences between the data from the group accounting and the municipalities accounting. Regarding the financial results, the standard deviation is high.

Table 2 shows the correlation between the variables in the pairs. Between the total assets variables as well as the solidity variables there is a very strong and significant correlation. The correlation between financial results in the municipalities’ accounting and the consolidated accounting is not significant.

However, a strong correlation between the variables in the pairs does not mean that the differences are not material and significant. Table 3 shows that the differences between total assets in the municipal accounting and in the consolidated accounting is significant (p = 0.001). There is also a significant difference between the solidity in the municipal accounting and in the group accounting (p = 0.016). The differences between
financial result in the municipal accounting and in the group accounting is however not significant.

**Table 1** Paired sample statistics (n = 33)

<table>
<thead>
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<th></th>
<th>Mean</th>
<th>Std. deviation</th>
<th>Std. error mean</th>
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<tbody>
<tr>
<td>Pair 1 Municipalities’ accounting</td>
<td>1,983.7678</td>
<td>3,265.33141</td>
<td>568.42124</td>
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<td>Total assets Consolidated accounting</td>
<td>3006.4903</td>
<td>4,710.77870</td>
<td>820.04131</td>
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<td>Pair 2 Municipalities’ accounting</td>
<td>21.3600</td>
<td>17.17922</td>
<td>2.99052</td>
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<tr>
<td>Solidity Consolidated accounting</td>
<td>17.0409</td>
<td>10.30539</td>
<td>1.79394</td>
</tr>
<tr>
<td>Pair 3 Municipalities’ accounting</td>
<td>–42.4303</td>
<td>89.01474</td>
<td>15.49548</td>
</tr>
<tr>
<td>Financial results Consolidated accounting</td>
<td>–17.4697</td>
<td>59.23721</td>
<td>10.31187</td>
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</table>

**Table 2** Paired samples correlations (n = 33)

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<th></th>
<th>Correlation</th>
<th>Sig.</th>
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<td>Total assets Consolidated accounting</td>
<td>0.863</td>
<td>0.000</td>
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<tr>
<td>Pair 2 Municipalities’ accounting</td>
<td>0.124</td>
<td>0.491</td>
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<tr>
<td>Solidity Consolidated accounting</td>
<td>0.124</td>
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<td>Financial results Consolidated accounting</td>
<td>0.082</td>
<td>0.000</td>
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**Table 3** Paired sample test (n = 33)

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<tr>
<th></th>
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<th>Std. deviation</th>
<th>Std. error mean</th>
<th>t</th>
<th>Sig. (2-tailed)</th>
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<td>Pair 1 Municipalities’ accounting</td>
<td>1,022.72245</td>
<td>1625.70084</td>
<td>282.99819</td>
<td>–3.614</td>
<td>0.001</td>
</tr>
<tr>
<td>Total assets Consolidated accounting</td>
<td>1,022.72245</td>
<td>1625.70084</td>
<td>282.99819</td>
<td>–3.614</td>
<td>0.001</td>
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<td>1.70485</td>
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<td>9,79363</td>
<td>1.70485</td>
<td>2.533</td>
<td>0.016</td>
</tr>
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<td>Pair 3 Municipalities’ accounting</td>
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<td>100,60590</td>
<td>17.51324</td>
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<td>100,60590</td>
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6 Conclusions

Today, municipalities make use of different organisational models and legal entities in order to perform their duties and activities towards their citizens. Several authors argue that there is a need for CFR in order to give the whole picture of a municipality’s economic position and performance (e.g., Lande, 1998; Wise, 2006; Grossi and Tagesson, 2008; IPSASB, 2010). However, consolidation takes time and consumes resources and still it is only a few countries and IPSASB that actually have introduced accounting standards for CFR (Grossi and Pepe, 2009). One of these countries is Sweden, where consolidated reporting was already compiled during the ‘80s and became mandatory for municipalities already in 1992.

As already highlighted in a previous study there are several differences, but also similarities, between IPSASB and SCMA in their standards for consolidated reporting (Grossi and Tagesson, 2008). The fundamental difference is that the IPSASB standards are based on a decision-making approach while the SCMA standard is based on an accountability approach (ibid.). Common to IPSASB and SCMA is that both standard setters believe that CFR contributes to a more comprehensive picture of the whole of local government. Thus, the aim of this paper is not primarily to compare the effects of different consolidation approaches, but to illustrate how CFR actually affects the financial picture and the comparability of financial data between municipalities.

Our empirical analyses on Swedish data confirm that CFR has a significant influence on the picture of the municipality’s economic position and performance. The wide variety of organisational forms and local adjustments affect the comparability of the municipalities’ accounting data in a negative way unless subsidiaries and other legal entities, that perform municipal activities, are included. A CFR that captures all activities, directly and indirectly run by the municipalities, need in order to perform their duties towards their citizens, no matter what organisational and legal form, contribute to a better comparability and a more comprehensive analysis of the municipality’s economy. Hence, from an accountability perspective it is also important to include subsidiaries and other legal entities that are not directly run by the municipality. Otherwise, there is an opening for political opportunism and a risk that voters demand political accountability based on false grounds. For example, if activities with negative results are run by subsidiaries, and these results are not included in the financial reporting, the image of the municipality’s financial position will be overestimated. At least in the short run.

However, completeness and comparability are not only a question of accountability but also affect the ground for efficient resource allocation. A significant proportion of municipalities’ resources come from government grants. Hence, CFR reporting in the municipal sector will also provide central government with a more comprehensive and proper basis for decisions regarding allocation of government grants.

In sum, our study shows that CFR significantly influences the picture presented of the municipalities’ economic position and performance. This must be taken into consideration both regarding accountability and allocation decisions in the municipal sector.
References


The materiality of consolidated financial reporting


