

Governance

Consolidation of Financial Statements - Subnational and SOEs

PULSAR Event, Vienna

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Governance

Nov 11, 2025

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Agenda

1. A Case Study
2. Key Issues in consolidation of subnational governments – global perspective
3. Scope of consolidation
4. Budget classification as the foundation for consolidation
5. Technology for consolidation
6. Lessons learnt

A Case Study – Key Challenges of Consolidation

1. Policy:

- Scope: 500 plus SNG; 70,000 villages
- 3 Different sources, systems, and timeline: same data is not used for unaudited, audited and analytical consolidation reports: multiple sources for consolidation – single source of truth?
- Transaction-level information required for consolidation
- Inter-entity elimination are not identified nor supported by consolidation systems

2. Technology/FMIS:

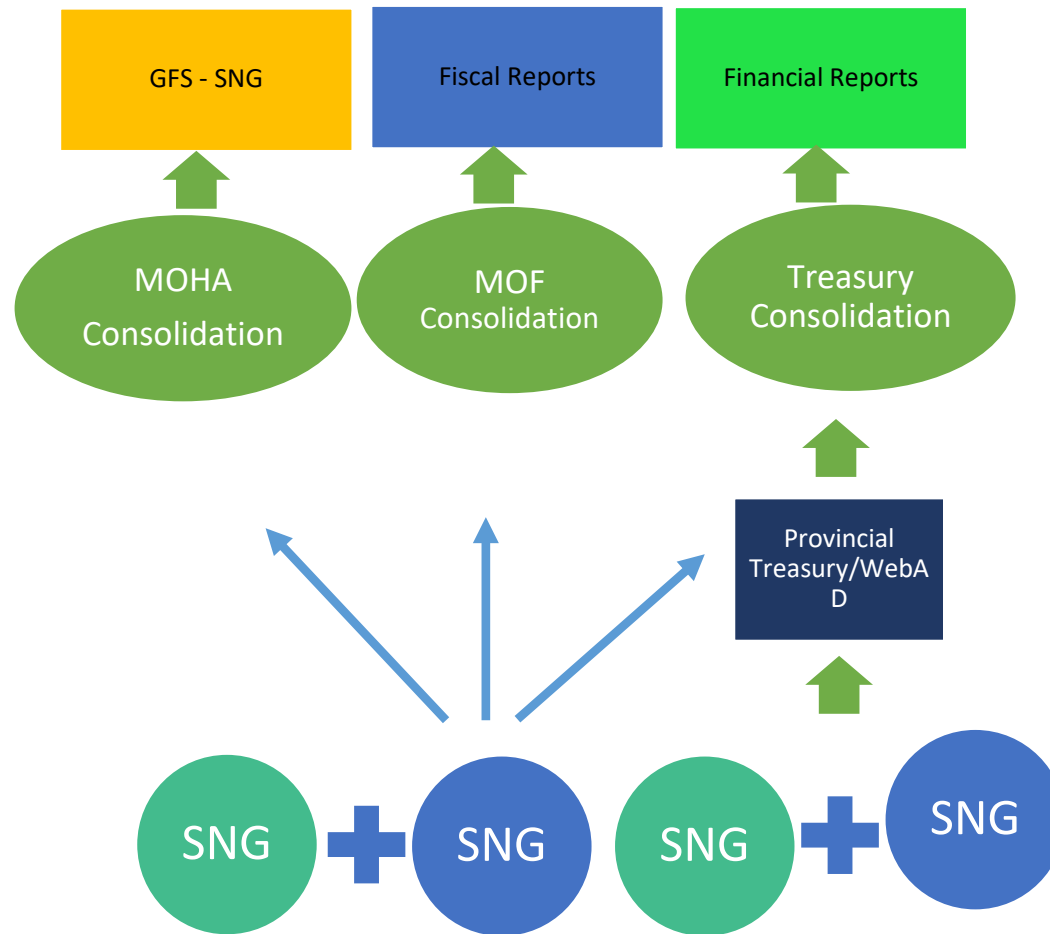
- Non-standardized FMIS for SNG
- FMIS at SN lack important information necessary for accounting: assets, liabilities, commitments

3. BC/COA:

- Standardization of chart of accounts at high level but codes at the lower level (level 3-6) non-standardized:
- Codes not mapped as per GFS classification

4. Capacity:

- 70,000 villages and their corporations do not have capacity, accountants and consistent chart of accounts



Key Issue on budgetary, statistical and financial reporting – Global Experience

1. Concept of consolidation entity is not clearly aligned with international standards: IPSAS, GFS? Control concept vs Fiscal Policy perspective

4. Accounting procedures are weak, and not complied: reconciliation procedures, closing procedures, intra-government clearing procedures

2. Separate systems for budget management and accounting: same transaction captured twice

5. Interpretation of special codes requiring guidance is not available as part of the classification manual

Reasons: Functionality gaps in IFMIS: non-monetary transactions like depreciation, write-offs, amortization, inventory management systems

3. Issues with chart of accounts: segments are not internally coherent – duplicative codes- too much detailed program classification, interpretation of certain codes, manual selection of codes

6. Multiple IFMI systems maintaining CoA and Budget classifications which are not standardized, consistent and harmonized

Consolidation System should support government's consolidation requirement - Statistical Bases of Financial Reporting and IPSAS

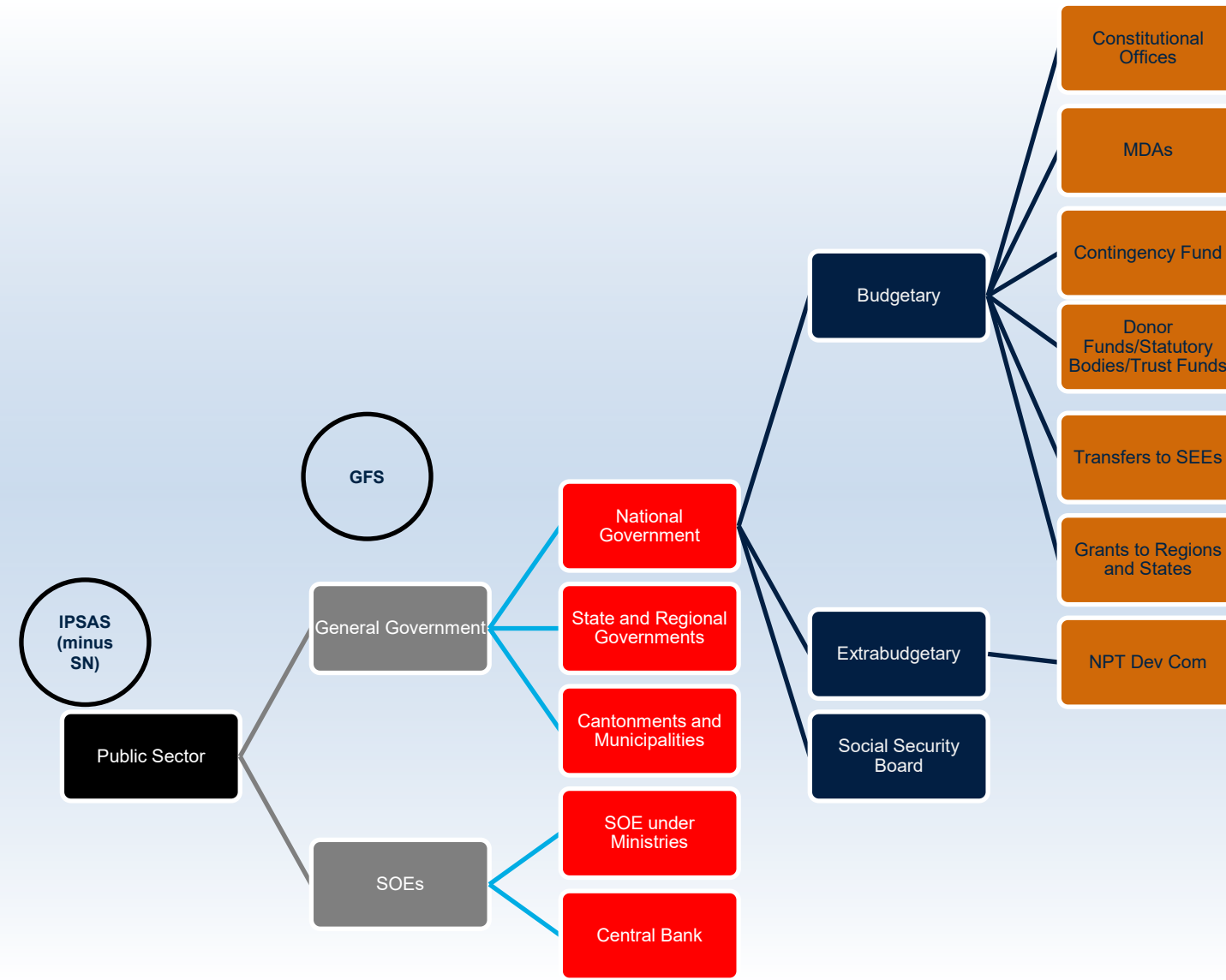
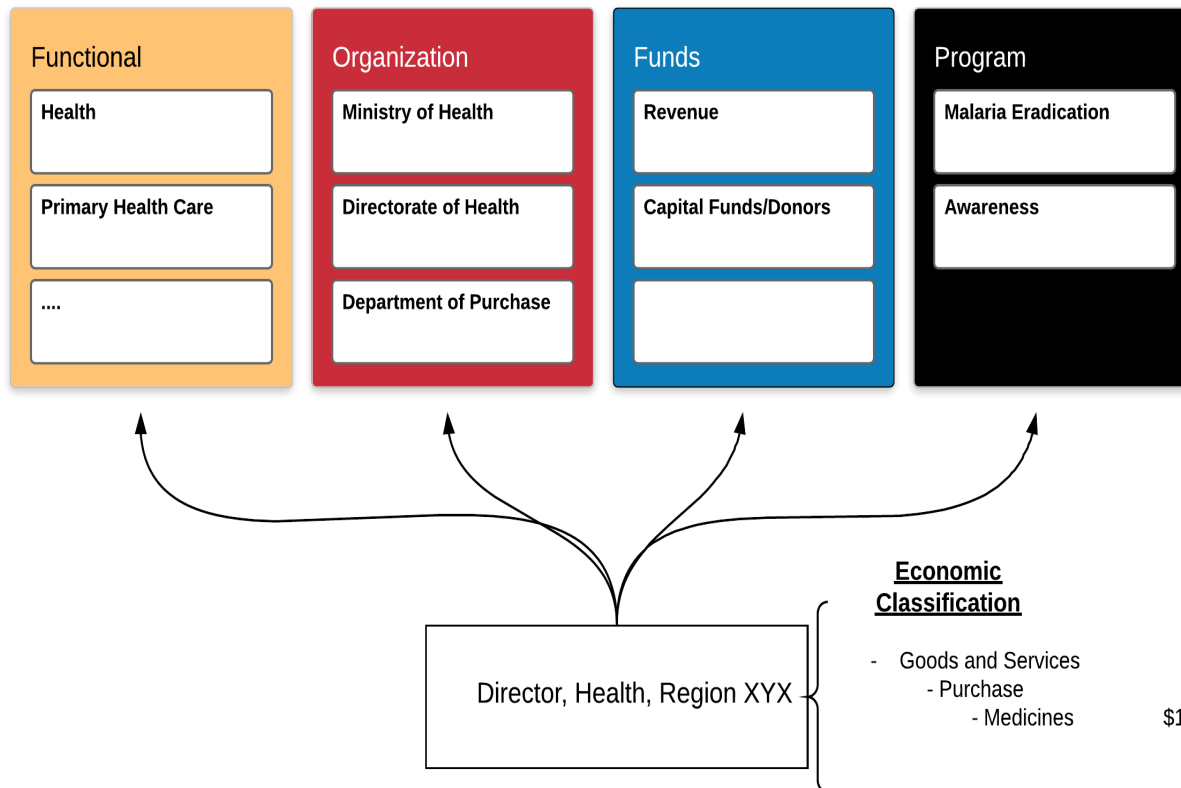


Chart of accounts provide the foundations for statistical and financial reporting:

- Source of Statistical reporting is accounting data
- Internal consistency of chart of accounts can minimize reconciliation issues



- **IPSAS** does not prescribe any classification but requires disclosures.
- **GFS Manual** prescribes classification, but only for two segments: function and economic
- **GFS economic classification** can be tailored to ensure capturing information on codes necessary for **IPSAS** disclosures

GFS Report on Government Operations has multiple sources of data

- Multiple source systems
- Consolidation of General Gov
- Unified CoA critical

| | 20X2 | 20X1 |
|--|-----------------|-----------------|
| Revenue | | |
| Taxes | X | X |
| Fees, fines, penalties and licenses | X | X |
| Revenue from exchange transactions | X | X |
| Transfers from other government entities | X | X |
| Other revenue | X | X |
| Total revenue | <u>X</u> | <u>X</u> |
| Expenses | | |
| General public services | (X) | (X) |
| Defense | (X) | (X) |
| Public order and safety | (X) | (X) |
| Education | (X) | (X) |
| Health | (X) | (X) |
| Social protection | (X) | (X) |
| Housing and community amenities | (X) | (X) |
| Recreational, cultural and religion | (X) | (X) |
| Economic affairs | (X) | (X) |
| Environmental protection | (X) | (X) |
| Other expenses | (X) | (X) |
| Finance costs | (X) | (X) |
| Total expenses | <u>(X)</u> | <u>(X)</u> |
| Share of surplus of associates * | <u>X</u> | <u>X</u> |
| Surplus/(deficit) for the period | <u><u>X</u></u> | <u><u>X</u></u> |
| Attributable to: | | |
| Owners of the controlling entity | X | X |
| Minority interests | X | X |
| | <u>X</u> | <u>X</u> |

Flexibility to define local codes under GFS standards

Do we need same account structure at all levels?

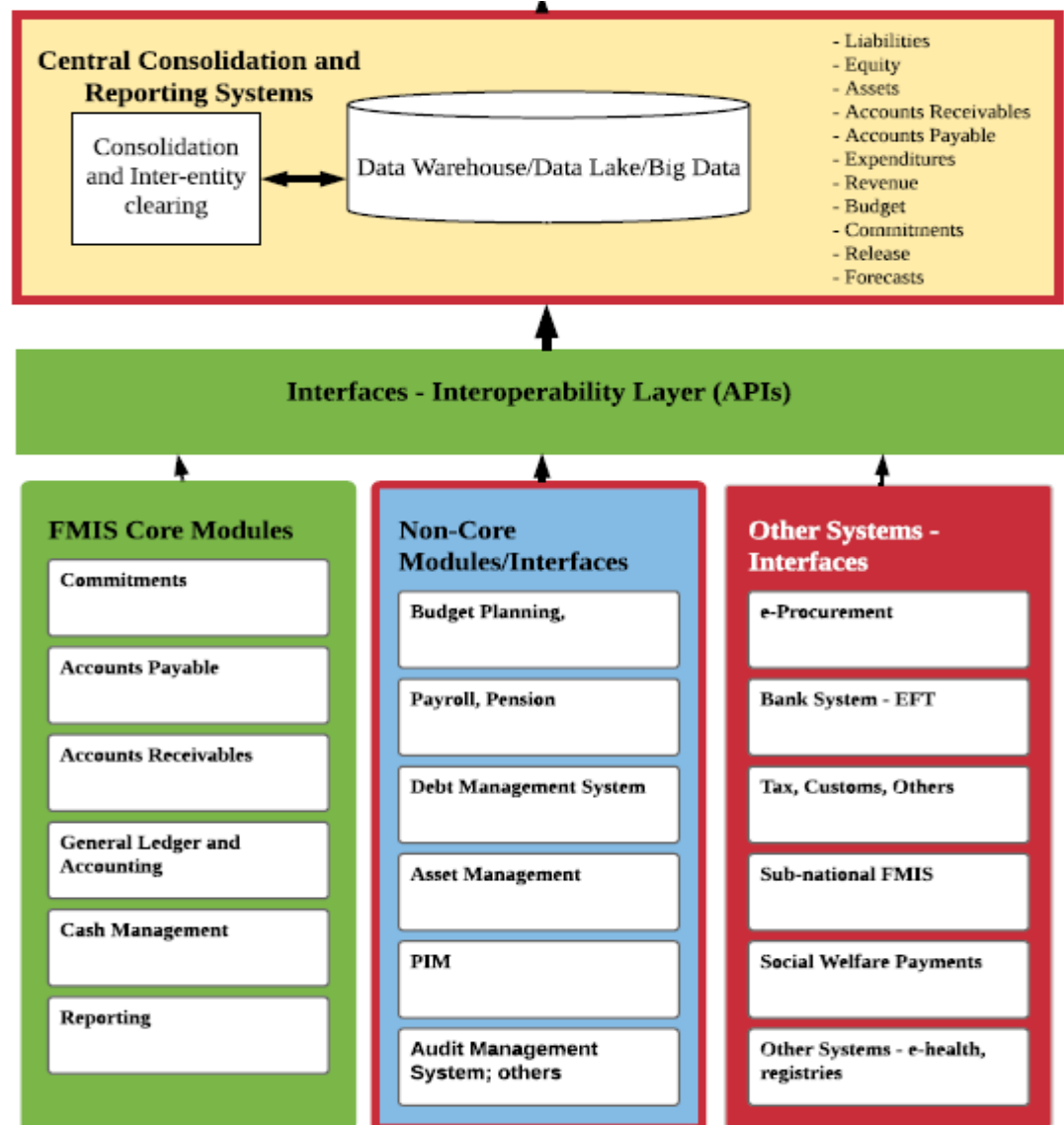
GFS provides minimum requirements, while allowing Governments to define details:

- ‘Expense classification structure provides guidance on the minimum requirements for internationally comparable classifications of expense.
- ‘Analytical needs may necessitate further detailed classifications to be added as subitems in national data presentations’
- ‘These additional subitems may be presented as a breakdown of the standard item’

| | | | |
|------|--|------|--|
| 2 | Expense | 27 | Social benefits [GFS] ¹ |
| 21 | Compensation of employees [GFS] ¹ | 271 | Social security benefits [GFS] |
| 211 | Wages and salaries [GFS] | 2711 | Social security benefits in cash [GFS] |
| 2111 | Wages and salaries in cash [GFS] | 2712 | Social security benefits in kind [GFS] |
| 2112 | Wages and salaries in kind [GFS] | 272 | Social assistance benefits |
| 212 | Employers' social contributions [GFS] | 2721 | Social assistance benefits in cash [GFS] |
| 2121 | Actual employers' social contributions [GFS] | 2722 | Social assistance benefits in kind [GFS] |
| 2122 | Imputed employers' social contributions [GFS] | 273 | Employment-related social benefits [GFS] |
| 22 | Use of goods and services | 2731 | Employment-related social benefits in cash [GFS] |
| 23 | Consumption of fixed capital [GFS] ¹ | 2732 | Employment-related social benefits in kind [GFS] |
| 24 | Interest [GFS] ¹ | 28 | Other expense |
| 241 | To nonresidents [GFS] | 281 | Property expense other than interest |
| 242 | To residents other than general government [GFS] | 2811 | Dividends ¹ |
| 243 | To other general government units [GFS] | 2812 | Withdrawals of income from quasi-corporations |
| 25 | Subsidies ¹ | 2813 | Property expense for investment income disbursements |
| 251 | To public corporations | 2814 | Rent |
| 252 | To private enterprises | 2815 | Reinvested earnings on foreign direct |
| 253 | To other sectors | | |
| 26 | Grants ¹ | | |

Implement a Consolidation and Reporting System to Produce Fiscal and Financial Reports

1. Major ERP vendors have a separate consolidation system: SAP BPC, Oracle Hyperion, PeopleSoft GL for consolidation
2. Potential use of AI to harmonize the codes
3. These systems take the load off the underlying IFMIS and protect its performance
4. Also have special purpose functionalities like inter-entity clearing
5. Trail Balance from underlying source systems could simplify the consolidation
6. Standardized Chart of Accounts at higher level critical for consolidation



Lessons learnt on consolidation

1. Policy to define consolidation perimeter – scope under GFS and IPSAS;
2. Institutional arrangement: A centralized consolidation and analytics unit work closely with the budget and accounting staff for consolidation and analytical reporting
3. Standardize BC/COA: Centralized Entity to prescribe the UCOA has the legal mandate; COA is internally consistent, with explanations for codes
4. Technology: Consolidation System – rather than IFMIS to perform the consolidation;
 - IT Systems to ensure compliance –
 - Use of adjusted trial balances for consolidation
 - Master Data Management, and Compliance Services (USA Model); backend mapping, requiring minimum selection of codes
 - Use of AI to harmonize the codes
5. Technology/ IFMIS for SN:
 - Under decentralized settings, issues standards Specs, prescribed by the central entity with QA for all the systems to ensure compliance – Portugal, China
 - Under centralized settings, uniform IFMIS which everyone uses – Russia and France Model

Discussion