



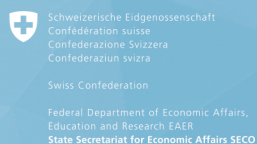
PULSAR Community of Practice

# Consolidation of Financial Statements at Different Levels of Government

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Dmitri Gourfinkel, World Bank Group, [dgourfinkel@worldbank.org](mailto:dgourfinkel@worldbank.org)  
Durlandy Cubillos, ZHAW, [durlandy.cubillos@zhaw.ch](mailto:durlandy.cubillos@zhaw.ch)  
Andreas Bergmann, ZHAW, [andreas.bergmann@zhaw.ch](mailto:andreas.bergmann@zhaw.ch)  
Maiara Sasso, USP, [maiara\\_sasso@usp.br](mailto:maiara_sasso@usp.br)

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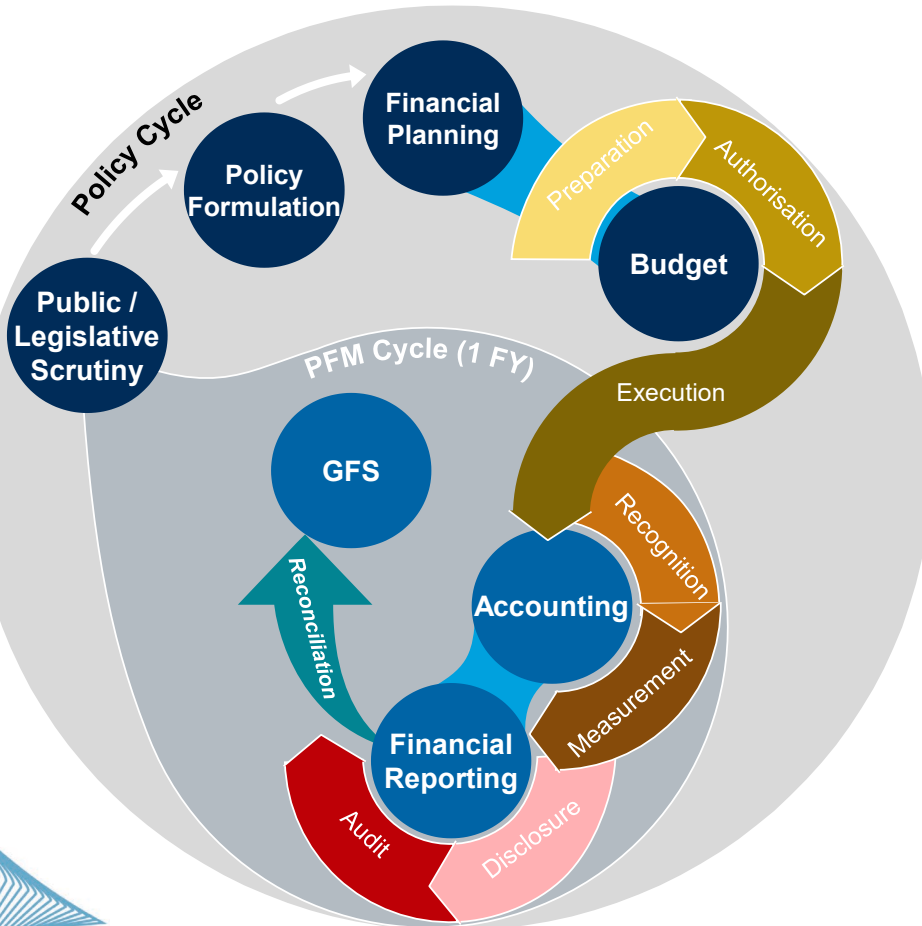


# Agenda:

- 01** Context
- 02** Consolidation and compiling according to IPSASs and GFSM 2014
- 03** Examples of international practices
- 04** Proposal for a generic and comprehensive consolidation and compiling process
- 06** Challenges and mitigating strategy
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# Context

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Source: World Bank, 2019

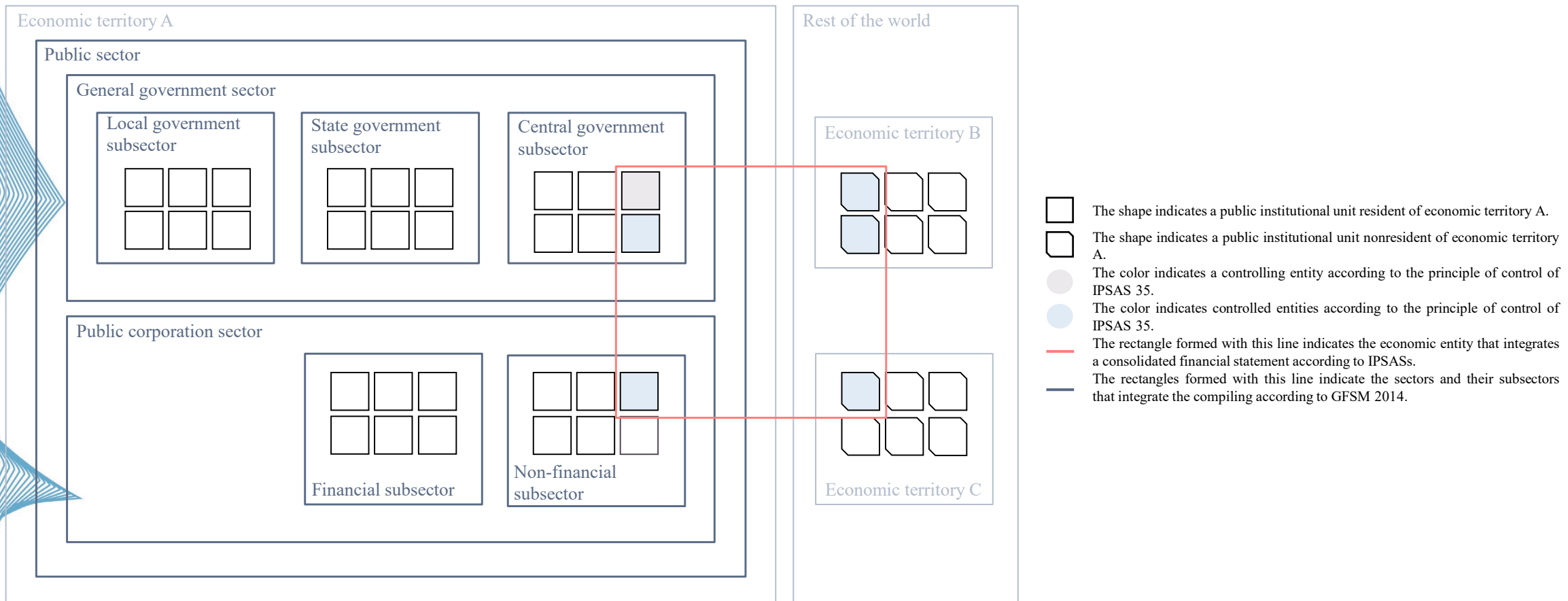
- Public financial management (PFM) improvement has been discussed for at least more than 30 years - once New Public Management's ideas, in which PFM fits, spread out in the late 80s and early 90s.
- A good PFM system is one that can accurately and reliably reflect the complex economic reality of governments (Ball, 2020).
- In the PFM cycle, the public sector accounting (PSA) generates the financial reporting that is used as input data for Government Finance Statistics (GFS) preparation.
  - GFS production is dependent on a constant flow of data from the PSA (Bergmann, 2009).
- However, a reconciliation process is necessary due to the different underlying paradigms between the frameworks used in PSA and GFS: Among these differences are the scope and procedures of consolidation.



# Consolidation and compiling according to IPSASs and GFSM 2014

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The scope of consolidation under IPSAS considers an economic perspective that is based on the concept of control. In turn, GFS compilation under GFSM 2014 follows a statistical perspective and delimits the scope by grouping institutional units into sectors and subsectors:



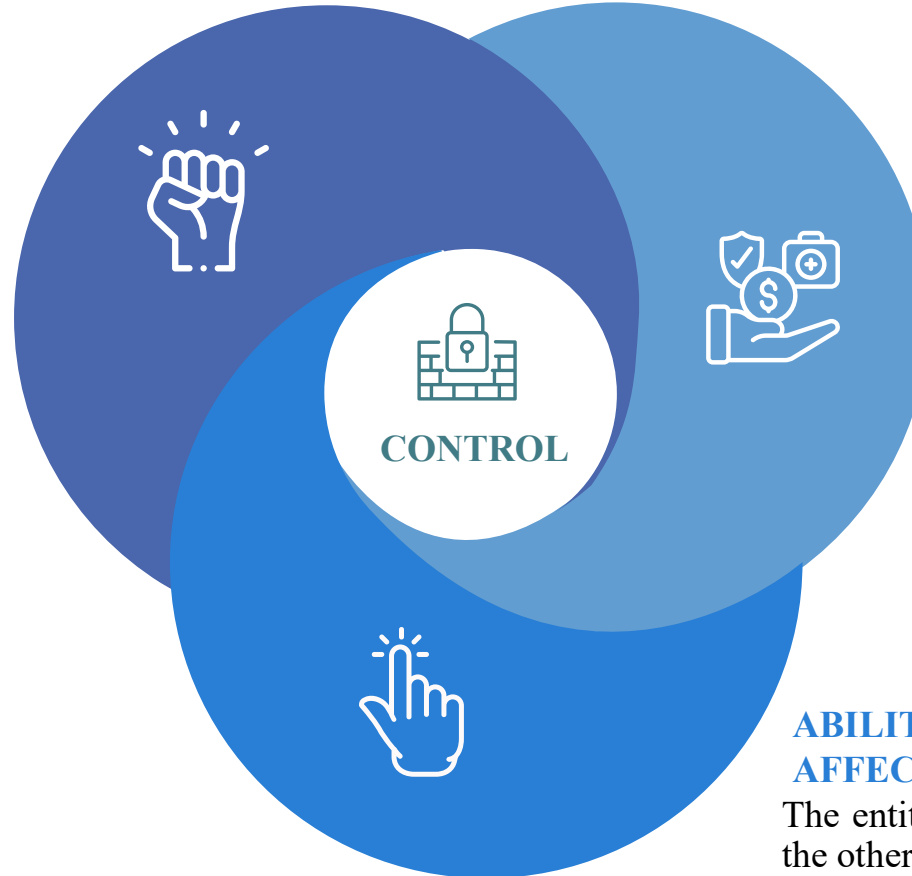
Source: World Bank, forthcoming

# Consolidation and compiling according to IPSASs and GFSM 2014 (2)

Under IPSASs, the delineation of the economic entity is accomplished by assessing and applying the principle of control:

## POWER

The entity has power over the other entity.



## EXPOSED TO BENEFITS

The entity is exposed, or has rights, to variable benefits from its involvement with the other entity.

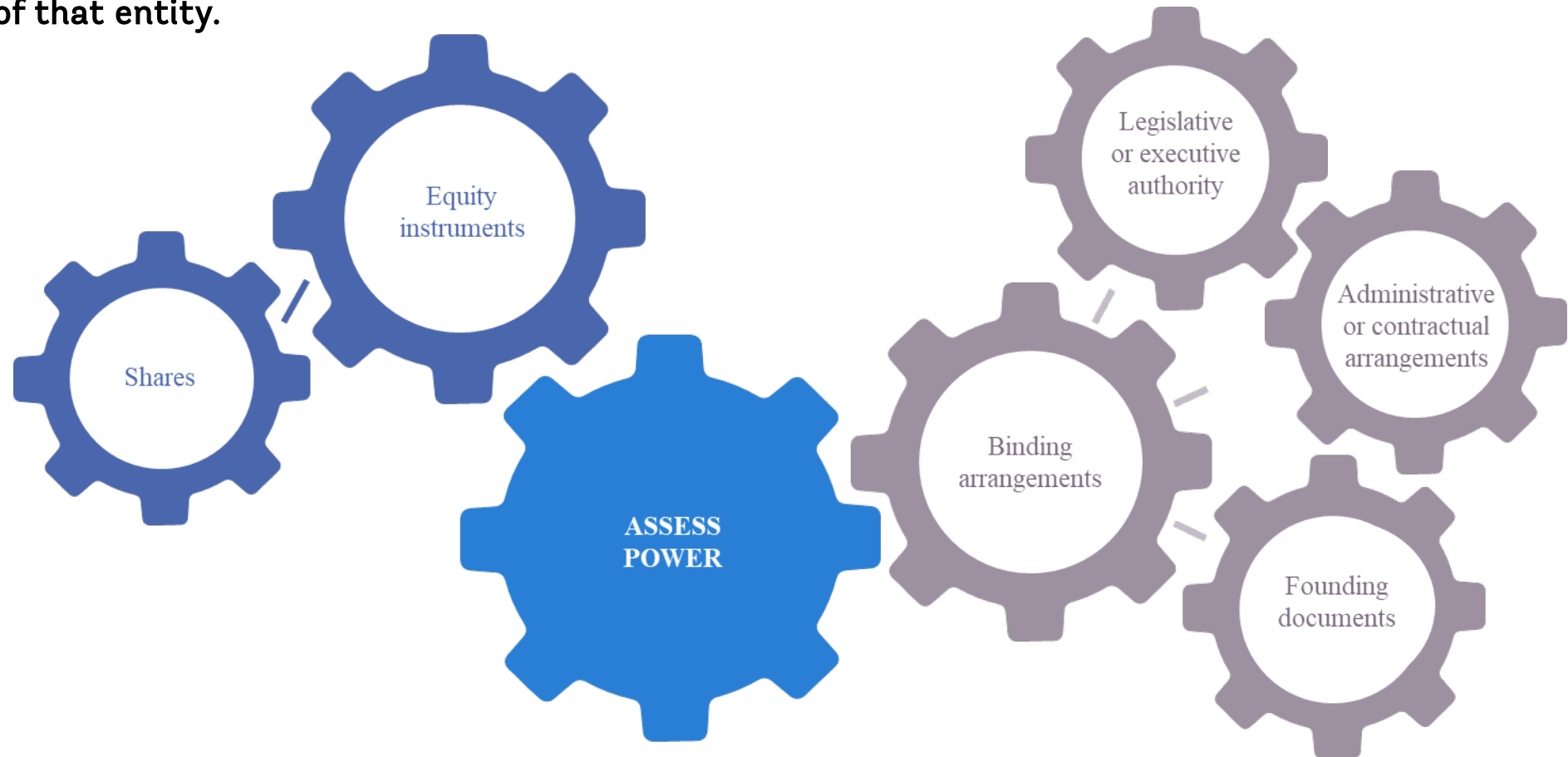
## ABILITY TO USE THE POWER TO AFFECT BENEFITS

The entity has the ability to use its power over the other entity to affect the nature or amount of the benefits from its involvement with the other entity.

# Consolidation and compiling according to IPSASs and GFSM 2014 (3)

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To determine whether a government has power over an entity, it is required to verify if such government, or a related party defined under IPSAS 20, has rights that confer to it the current ability to direct the relevant activities of that entity.

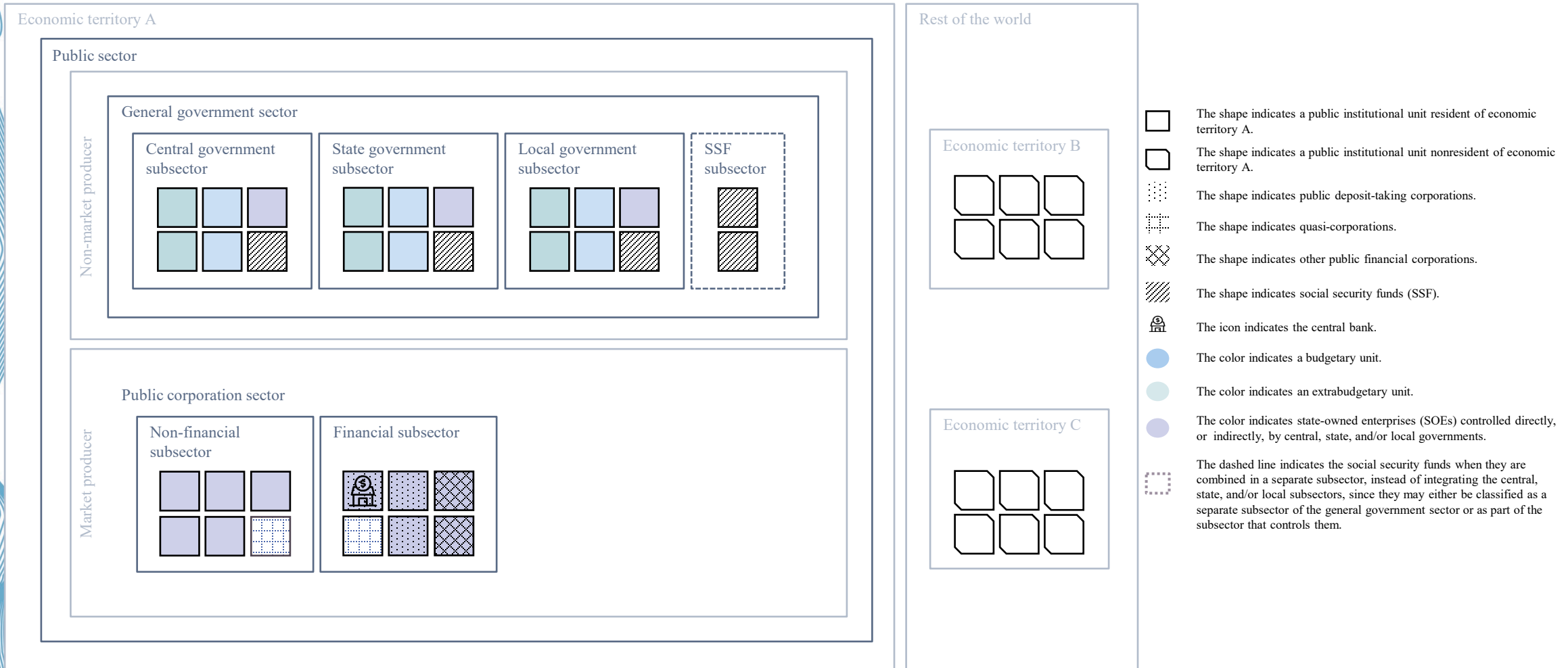


Source: World Bank, forthcoming

# Consolidation and compiling according to IPSASs and GFSM 2014 (4)

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According to GFSM 2014, statistics should be compiled for the public sector, the general government sector, the public corporation sector, as well as for all the subsectors that constitute the general government and the public corporations:



Source: World Bank, forthcoming



# Consolidation and compiling according to IPSASs and GFSM 2014 (5)

The consolidation process according to IPSASs requires the application of a sequence of steps that involve administrative and operative aspects:

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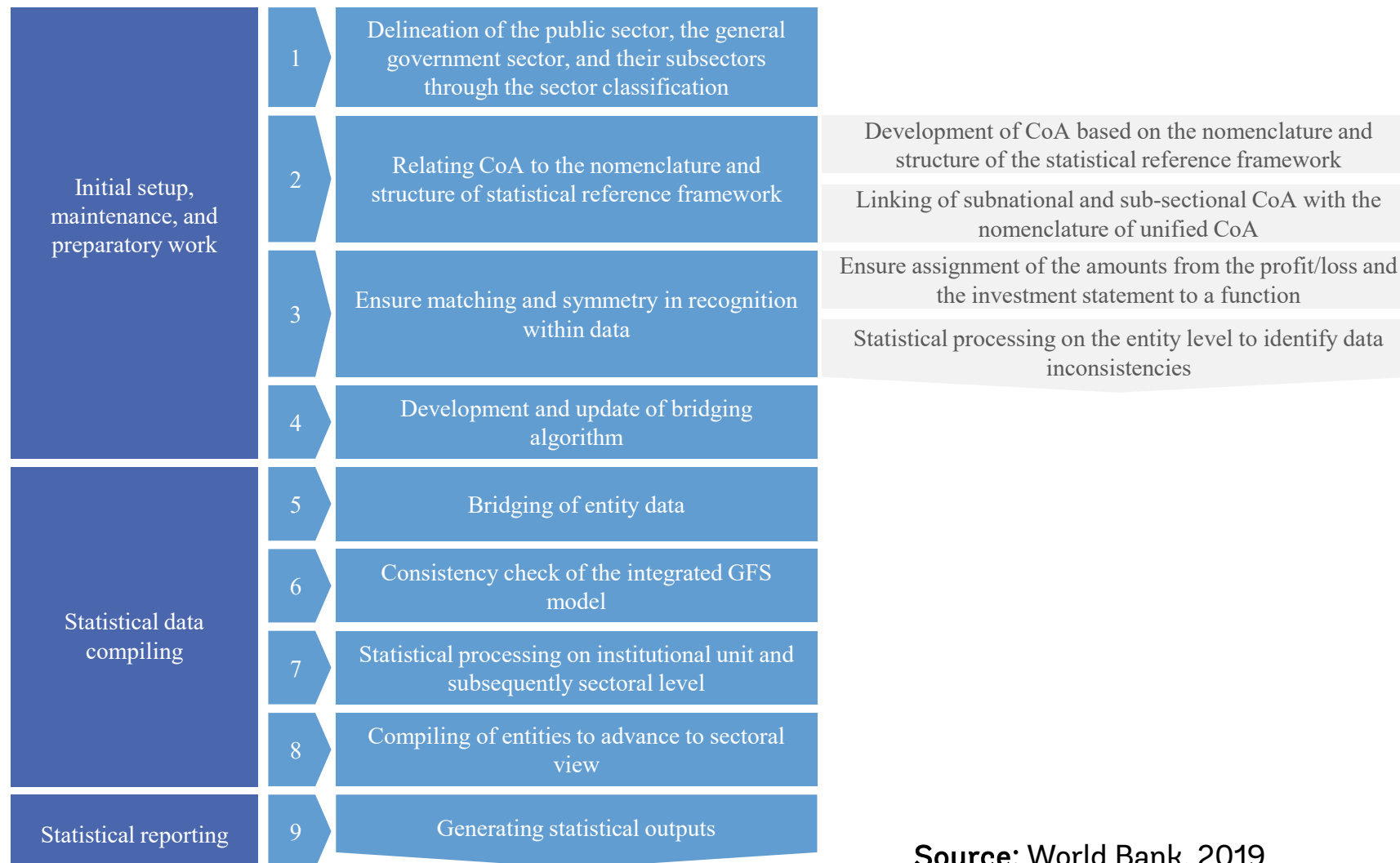
Source: World Bank, forthcoming



# Consolidation and compiling according to IPSASs and GFSM 2014 (6)

The compiling process also requires the application of a sequence of steps that involve administrative and operative aspects to generate statistical outputs:

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Source: World Bank, 2019

# Examples of international practices

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» Countries applying accrual IPSAS (directly or indirectly) and accrual GFSM/ESA

» Brazil



» Georgia



» Spain



» Switzerland



# Examples of international practices (2)

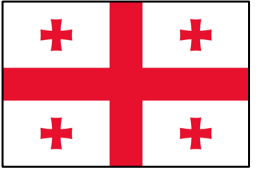


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## » Brazil

- » Federal republic, with three levels of government: The Union, 26+1 autonomous states and 5568 autonomous municipalities
- » Consolidated financial statements
  - » Consolidated financial statements of the Federation:
    - » Covering the Union (including all three powers) and federal level non-market producer SOEs. Federal market producer SOE are included using the Equity Method.
    - » Applying BPSAS
  - » Consolidated financial statements of each subnational entity: Same requirements as for the Federation.
  - » Consolidated financial statements of the Public Sector:
    - » Covering all three levels of government (including all three powers) and their non-market producer SOEs. Market producer SOE are included using the Equity Method.
- » Compiling GFS
  - » General Government Sector (GGS)
    - » Covering budgetary and extra-budgetary government entities of all three levels. Social security funds are included in the respective budgetary entities. Statistical extrapolation for lacking municipalities.
    - » No public sector statistics are produced.
- » Consolidation and compiling through SIAFI, SICONFI and Microsoft Excel. I.e., semi-automatic.





# Examples of international practices (3)

## » Georgia

- » Unitary republic with two levels of government: Central (including 9 regions) and local (including 2 autonomous republics and 69 municipalities)
- » Consolidated financial statements
  - » Consolidated financial statements of the Central Government:
    - » All central government units based on fiscal arrangements: budget organizations, Legal Entities of Public Law (LEPLs), and Non-Entrepreneurial (Non-Commercial) Legal Entities (N(N)LPs). Market-producer SOEs are not covered in the consolidation.
    - » Consolidated financial statements of the Local Governments: Same as at central level. Published as appendix to the Central Government.
- » Compiling GFS
  - » General Government Sector (GGS)
    - » Covering budgetary and extra-budgetary units at central and local governments. Social assistance is included in budgetary subsectors, but there are no social security funds.
    - » High frequency data only covering budgetary subsectors.
    - » No public sector statistics are produced.
  - » Consolidation and compiling at central government level using Microsoft Excel, at local level partly using a consolidation software. I.e., mainly manual.



# Examples of international practices (4)

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## » Spain

- » Parliamentary monarchy. Decentralized unitary state, Central, 17+2 Autonomous Regional and 50+8129 self-governing Local Governments; Social Security institutions.
- » Consolidated financial statements
  - » Consolidated financial statements of national level:
    - » Covering the AGE (controlling entity), administrative and social security entities, non-profit institutions, and both the market and non-market producer SOEs.
    - » In compliance with IPSAS 35.
  - » Consolidated financial statements of each subnational entity: Consolidation only mandatory starting in 2022 and only for entities > 50'000 inhabitants.
- » Compiling GFS
  - » General Government Sector (GGS) according to ESA 2010
    - » Central, regional, and local governments, as well as the social security funds.
    - » No public sector statistics are produced.
- » Consolidation and compiling through different automated tools and Excel. I.e., mainly automatic.



# Examples of international practices (5)

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## » Switzerland

- » Federal state comprising the Confederation, 26 sovereign states and 2142 autonomous communes
- » Consolidated financial statements
  - » Consolidated financial statements of the Confederation:
    - » Covering the three branches of power and its special accounts, the decentralized administrative units, the market and non-market producer SOEs, and the social security institutions
    - » In compliance with IPSAS 35, published in official languages plus English
  - » Consolidated financial statements of each subnational entity: on a voluntary basis only
- » Compiling GFS
  - » General Government Sector (GGS)
    - » Central, regional, and local governments, as well as the social security funds.
    - » No public sector statistics are produced.
- » Consolidation process is performed by using automated tools, compiling is by automated tools, R and Excel. I.e., financial reporting mainly automated, statistics semi-automated.



# Examples of international practices (6)

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- » Good consolidation practices observed internationally
  - » Identification of the entities to be consolidated
  - » Using a harmonized CoA, including specific desegregations to identify more easily the reciprocal transactions
  - » Checking of data consistency
  - » Focus on entities whose amounts are material to the consolidated financial statements
  - » Homogenization of cut-off date of financial statements, accounting principles, and policies through adjustments
  - » Identification and elimination of reciprocal transactions
  - » Verification of the consolidated data
  - » Modification of consolidated data when individual financial statements of the consolidated entities change (e.g., after audit)
  - » Translation and publication of consolidated financial statements

# Examples of international practices (7)

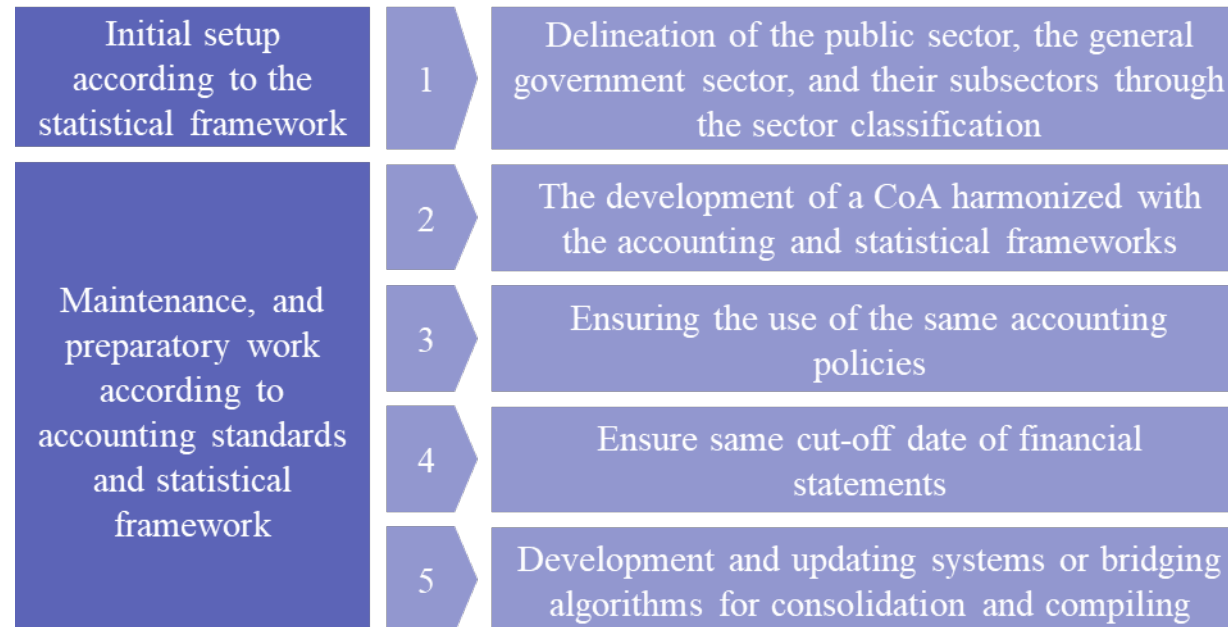
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- » Similarly, good compiling practices observed internationally
  - » Identification of the entities to be compiled
  - » Use of electronic tools to receive the data of the entities to be compiled
  - » Checking of data consistency
  - » Establishment of partnerships with other entities that handle supplementary data
  - » Using a harmonized CoA with GSFM
  - » Identification and elimination of reciprocal transactions
  - » Verification of the compiled data

# Proposal for a generic and comprehensive consolidation and compiling process

The proposed generic and comprehensive consolidation and compiling process integrates the necessary activities for the consolidation process according to IPSASs, without considering the principle of control, as well as the essential activities for the compiling process according to GFSM 2014.

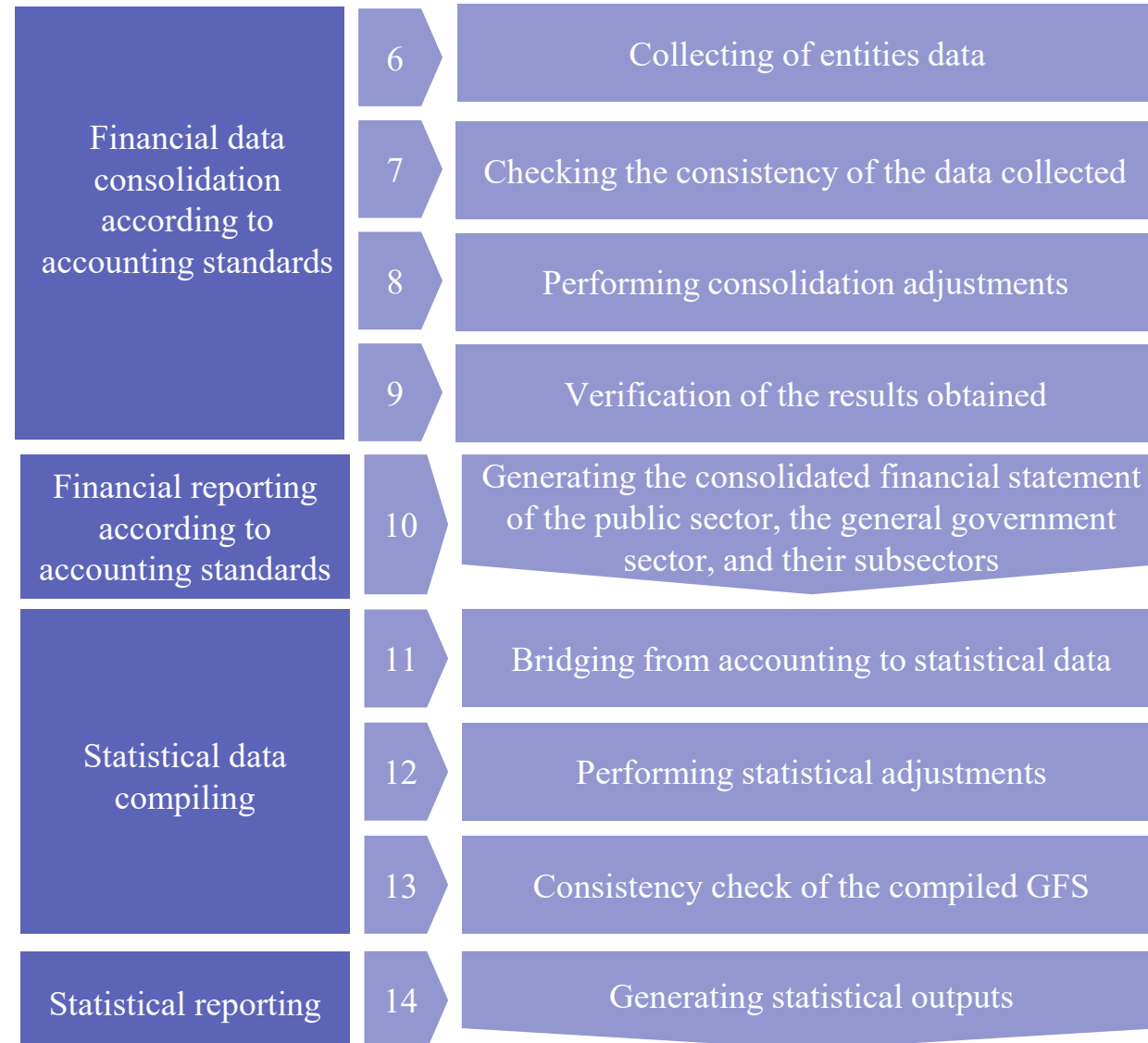
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# Proposal for a generic and comprehensive consolidation and compiling process (2)

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# Challenges and mitigating strategy

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#	Challenges	Mitigation Strategy
1	<b>Constitutional arrangements.</b> Obtaining subnational entities' data is difficult in federal and some decentralized countries	Starting off the implementation with the national level and extend the consolidation scope at subnational level.
2	<b>Legal requirements.</b> In some jurisdictions, the scope of consolidated financial statements and consolidation activities, methodologies, and procedures are already defined by law. Any change requires legislation approval, in some cases, even at the supranational level (e.g., European Union).	Showing to the decision makers the benefits of having an integrated consolidation and compiling process.

# Challenges and mitigating strategy (2)

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#	Challenges	Mitigation Strategy
3	<b>Different accounting policies.</b> In single jurisdiction, there might coexist several accounting frameworks and policies applicable to the government and other public sector entities (e.g. SOE)	Issuing specific instructions and guidelines for accounting closing to obtain the information under the same accounting framework and policies.
4	<b>Lack of a unified and harmonized CoA to report information.</b> Some jurisdictions have not yet issued CoA applicable to all public sector entities and harmonized with statistical reference frameworks	Issuing a unified and harmonized CoA to report information, adopting a structure and nomenclature that could meet the reporting requirements of budgetary, accounting, and statistical reference frameworks.

# Challenges and mitigating strategy (3)

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#	Challenges	Mitigation Strategy
5	<b>Lack of an IFMIS.</b> Some jurisdictions do not have an automated system, such as an IFMIS, or bridging algorithm to perform the consolidation and compiling processes.	Harmonizing accounting policies and CoA, and considering different financing mechanisms and system development modalities (COTS vs in-house development, use of open source software).
6	<b>Inconsistencies between accounting and statistic approach.</b> Usually there are differences in the recognition and measurement of economic transactions when using accounting standards and statistics rules.	Making sure that all necessary statistical adjustments are made.



# Conclusions

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- ✓ Consolidated financial statements include several entities, which are legally independent.
- ✓ Unlike individual financial statements, they do not respond to legal questions, but to economic ones.
- ✓ Consolidated financial statements provide additional information by including several legal entities in what is called an economic entity.
- ✓ Such additional economic information is necessary, because the organizational structure of governments includes various entities, which are legally independent but economically dependent.

## Conclusions (2)

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- ✓ The economic dependency can be related to:
  - Financing through tax revenues or debt, which is generally managed within a budget prepared and spent by the executive and approved by the legislative branch
  - Potential financial and operational risks that the governments are exposed to
  - Periodic or aperiodic transfers between the entities, which can create misleading/incomplete information at the level of individual financial statements.
- ✓ The scope of consolidation can vary between the countries and depends on the information needs of the users and the applied accounting or statistic standards.
- ✓ It is also possible that more than one scope and, therefore, more than one set of consolidated financial statement exists.

## Conclusions (3)

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- ✓ In turn, GFS are also a result of a consolidation process, although they do not apply the concept of economic entity, but the concept of economic sectors.
- ✓ This sectorial approach implies application of statistical estimations and adjustments, which lead to a higher level of materiality.
- ✓ In other words, GFS include entire sectors but are less precise than consolidated financial statements.
- ✓ The consolidation and compiling processes are therefore similar, but not identical.
- ✓ In summary, both consolidated financial statements and GFS respond to specific information needs.
- ✓ They present financial and economic information about a set of entities and sectors, respectively.

# Recommendations

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- ✓ Consolidation and compiling processes need to be actively managed.
- ✓ These processes are not a given, and their management may reduce their complexity and increase the quality of the information produced by taking the appropriate measures.
- ✓ Identify the entities to be consolidated/complied.
- ✓ Develop and use a harmonized CoA, including specific desegregations to identify more easily the reciprocal transactions.
- ✓ Homogenize the cut-off date of financial statements, accounting principles and policies.
- ✓ Develop and implemented an IFMIS.
- ✓ Double check consistency of initial data and consolidated information.
- ✓ Focus on the entities which amounts are material to the consolidated financial statements.
- ✓ Ensure that reciprocal transactions are identify and eliminated.
- ✓ Update the consolidated information when individual financial statements are changed.



**Thank you!**