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<u>Item 5 of the Agenda</u>

EPSAS issue paper on consolidation of financial statements

Paper by PwC on behalf of Eurostat
- for discussion

Consolidation of financial statements with a view to financial reporting requirements under the future European Public Sector Accounting Standards (EPSAS)

October 2018

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1 Objectives of the issue paper

The aim of this issue paper is to analyse the issue of consolidation for EPSAS purposes, in particular from a true and fair point of view and the usefulness of consolidated financial statements for accountability and decision-making purposes, including for whole-of-government accounts (WGA). It is also to summarise the approaches taken at the accounting standard level concerning the treatment of consolidation in at least three Member States with high accounting maturity, and the approaches that are being used under the existing international financial reporting frameworks (IPSAS, IFRS, EU AR, European Accounting Directives and ESA 2010 and, where relevant and applicable, also MGDD), or are likely to be developed.

Based on the request from Eurostat, the issue paper addresses the following questions:

- What is the purpose of consolidation of financial statements? What are the benefits that consolidation provides for accountability and decision-making?

- What are the most important issues in consolidation (e.g. consolidation of financial statements of controlled entities, consolidation to Whole of Government or its sub sectors) for which may problematic points/ issues arise?

- Which accounting guidance is available for consolidation in IPSAS, EU Accounting Rules, national accounting standards in three EU MSs, IFRS and ESA 2010 and, where relevant and applicable, also MGDD?

- How do the analysed approaches in the three MSs differ from the treatment under IPSAS (please list the main elements/ aspects)?

- What are the advantages and disadvantages of the existing approaches to the most important issues of consolidation under the existing standards (IPSAS, EU AR, national accounting standards in EU MSs, IFRS and its equivalent under ESA 2010 and, where relevant and applicable, also MGDD)? Please analyse these approaches from a true and fair point of view and in the light of accountability and decision-making.

- What are the main difficulties/ issues when addressing the most important issues in consolidation?

- If/ how consolidation ought to be addressed for the purposes of fiscal transparency and comparability both from a European and an international point of view?

- Taking into account costs and benefits, what way forward in practice would PwC recommend for EPSAS on consolidation of financial statements?

- What were the consequences of the recommended way forward for a possible convergence between IPSAS / EPSAS and ESA 2010 (and if relevant and applicable, also MGDD)?

Based on the analysis performed, and taking into account the conclusions of the issue paper on the notion of control, an approach for organising the future discussion on the treatment of consolidation of financial statements with the EPSAS stakeholders is proposed.

2 Background of the issue

In many cases, several entities work together for a common purpose, under one organisation (the economic entity). Consolidation is the process of presenting financial statements of all entities that make up the reporting entity on a consolidated basis, i.e. as if they were the financial statements of a single economic entity. In effect, consolidation brings together several related sets of (individual or sub-consolidated) accounts into one overall version.

Consolidation of financial statements provides useful financial information and delivers benefits both for accountability and decision-making purposes. This is in addition to the benefits brought by the production of the financial statements at the level of each individual entity.

For example, consolidated information at the level of a central government can provide useful information on the execution of the policies by that government while financial information related to one ministry reflects the contribution of that ministry in the whole central government policy. Information prepared at the consolidated level may therefore serve the needs of users who are different from the users of information prepared at the individual entity level. Political and managerial responsibilities at the two levels are different and financial statements that reflect the impact of the decisions taken for each level are useful for accountability and decision making.

Three main types of issues seem to be linked to the preparation of consolidated financial statements:

- Determination of the level at which consolidated financial statements should be prepared.
- Determination of the scope of consolidation. The first two topics are of a conceptual nature and are key aspects in serving accountability and decision-making needs.
- The cost and complexity linked to the preparation of consolidated financial statements, which is more of an organisational nature.

Under international accounting standards such as IPSAS and IFRS, determining which accounts are included in the consolidated financial statements is based on the concept of ‘control’. Under these standards, the notion of control is thus crucial for the preparation of consolidated financial statements as it determines the scope of consolidation, which includes the controlling entity and all entities that it controls. In contrast, the ESA 2010 reporting for governments is based on the economic characteristics of entities and includes the accounts of all entities included in the general government sector (GGS), which consists of all government units (at whatever level) and all non-market producers and NPIs controlled by government units. In addition, whole-of-government accounts (WGA) comprising the accounts of all tiers of government within one country may also be prepared to serve accountability and decision-making objectives, without the need to have any control relationship existing between the various levels of government. The reporting entity is then defined at the level of the country’s government/public sector as a whole.

The Staff Working Document accompanying the report from the Commission to the Council and the European Parliament COM(2013) 114 assessing the suitability of IPSAS for the EU Member States, in Annex 7.1, points out that IPSAS 6 ’Consolidated financial statements’ are among the "Standards that are seen as needing to be amended for implementation". A somewhat "lighter" assessment was given for IPSAS 7 ’Investments in associates’ and IPSAS 8 ’Interests in joint ventures’. More specifically, the document mentions in Annex 6.1 (page 112) "The scope of consolidation and the control criteria under IPSAS lead to the inclusion of the results of all controlled entities in reporting entity statements, which would entail the consolidation of public corporations. This would require a potentially large number of government-controlled entities to provide timely and accurate financial data in a suitable format for consolidation, when they may use IFRS (as GBEs do)".

The report commissioned by Eurostat and prepared by PwC in 2014 mentions that the issue of the scope of consolidation is "the most cited technical/conceptual comment" by Member States and points out (on page 126) that "The scope of EPSAS reporting needs to be clarified: what entities should be included in the scope of EPSAS? [...] Most Member States are in favour of an alignment with the ESA scope of reporting". The PwC report further highlights that "Would the ESA scope of reporting be followed, the accounting treatment of GBEs would need to be determined. The appropriateness of preparing whole-of-government accounts may also be examined at a later stage".

The issue regarding preparation of consolidated financial statements is related to the efforts and costs of preparation. The PwC report of 2014 indicates a relatively low accounting maturity across the EU (page 96): 54%. In that same context, the PwC report also mentions the practical challenges (page 97): "One of the biggest challenges of the consolidation process is to make sure that all entities that should be included in the scope are effectively consolidated" and "The practical challenge of gathering information across a series of entities with different financial systems should not be underestimated…".

Finally, the report of the cell on FTI mentions that consolidation "…is mainly an issue for later, even if it is useful to take note during the process of compiling the first accrual opening balance sheet of what information would be needed for consolidation at a later point in time. Issues for the presentation and preparation of consolidated financial statements such as the scope of consolidation and the notion of control are to be dealt with in the future EPSAS standard-setting process"[1].

[1] Report of the EPSAS cell on first-time implementation (5 April 2017), page 17, https://circabc.europa.eu/d/a/workspace/SpacesStore/d1b2b587-c4b8-4fdf-a2e2-5735ae362b15/First%20time%20implementation%20guidence.pdf

3 Description of accounting guidance available in international accounting frameworks and in statistical rules

Accounting guidance available is discussed below, successively for IPSAS, IFRS, EU Accounting Rules (EAR), European Accounting Directives (applicable to private companies) and ESA 2010 (including references to the MGDD, if applicable).

IPSAS rules are explained more in-depth, because IPSAS has been viewed a reference framework for the future EPSAS. As IPSAS, IFRS and EAR are largely similar, IFRS and EAR rules are only briefly dealt with. European Accounting Directives are explained to the extent they address additional notions compared to IPSAS, IFRS and EAR.

3.1 International Public Sector Accounting Standards (IPSAS)

3.1.1 Applicable standards

We first address the concept of reporting entity in the IPSASB Conceptual framework and then explain the rules included in the various standards dealing with consolidation:

- IPSAS 35 'Consolidated financial statements'.
- IPSAS 36 'Investments in associates and joint ventures'.
- IPSAS 37 'Joint arrangements'.
- IPSAS 38 'Disclosures in other entities'.

We then explain the transitional exemptions relating to consolidation under IPSAS 33 'First-time adoption of accrual basis IPSAS'. Finally, we summarise the rules included in IPSAS 22 'Disclosure of information about the general government sector'.

3.1.2 IPSASB Conceptual framework

Chapter 4 of IPSASB Conceptual framework (CF) addresses the concept of reporting entity.
A public sector reporting entity is a government or other public sector organisation, program or identifiable area of activity (hereafter referred to as an entity or public sector entity) that prepares general purpose financial reports (GPFRs) (CF 4.1). A public sector reporting entity may comprise two or more separate entities that present GPFRs as if they are a single entity—such a reporting entity is referred to as a group reporting entity (CF 4.2).

Under CF 4.3, key characteristics of a public sector reporting entity are that:

- It is an entity that raises resources from, or on behalf of, constituents and/or uses resources to undertake activities for the benefit of, or on behalf of, those constituents; and
- There are service recipients or resource providers dependent on GPFRs of the entity for information for accountability or decision-making purposes.

A reporting entity can be defined at various levels to meet the accountability and decision-making objectives of financial statements. For example, financial statements can be prepared and reported at the individual level for each Ministry and each government agency; they can be prepared and reported at a consolidation level, for example at the level of each Ministry and the agencies that depend on it (there is thus a consolidation at that level that includes the financial information related to a certain government function) and at the central government level including then all entities that are part of the central government (there is thus an additional consolidation at that higher level). At the highest level, the reporting entity would be defined as the public sector for the whole country and WGA would be prepared for that reporting entity.

In the public sector, many controlling entities that are themselves controlled by an entity at a higher level represent key sectors of activities of a government. In such situations, presenting only the consolidated financial statements at a whole-of-government level would not be sufficient to meet the needs of certain users and the objective of accountability and decision-making. The intermediate controlling entities can for that reason be required by law or regulation to publish consolidated accounts at their level.

3.1.3 IPSAS 35 'Consolidated financial statements'

The standard addresses two main issues related to the preparation of consolidated financial statements are:

- The determination of the consolidation scope, which aims at defining which entities are included in the consolidated financial statements.
- The technique and procedure that apply in the preparation of the consolidated financial statements.

<u>Determining the consolidation scope</u>

Determining which entities are included in the consolidation scope is based on the concept of control. Consolidated financial statements should include the accounts of the controlling entity and those of all controlled entities.

Key definitions are the following:

- Control: an entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature and amounts of those benefits through its power over the other entity.
- Controlling entity: an entity that has one or more controlled entities.
- Controlled entity: an entity, including an unincorporated entity such as a partnership, that is under the control of another entity.
- Economic entity: a group of entities comprising the controlling entity and any controlled entities. Other terms sometimes used for 'economic entity' include 'administrative entity', 'financial entity', 'consolidated entity' or 'group'.

Under IPSAS 35, an entity should meet three conditions in order to have control over another entity.

It should:

- Have power over the other entity.
- Have exposure, or rights, to variable benefits from its involvement with the other entity.
- Be able to use its power over the other entity to affect the nature or amount of its benefits from its involvement with the other entity.

Power	***Exposure or rights to benefits***
• Power arises from rights. Power exists when the entity has rights that give it the current ability to direct the relevant activities of another entity. Such rights can be voting rights (e.g. arising from shareholdings) or other types of rights conferred by binding arrangements (administrative or contractual arrangements, founding documents, rights conferred by a legislative or executive authority, etc.). • Substantive rights are considered in assessing whether an entity has power, however not protective rights which are designed to protect the interests of their holder without giving them the ability to direct the relevant activities of the other entity.	• Benefits that the entity can derive from its involvement with other entities can be financial (e.g. dividends, exposure to increases or decreases in the value of an investment in another entity, residual interests in another entity's assets and liabilities on liquidation, exposure to loss from agreements to provide financial support, cost savings, etc.) or non-financial (e.g. activities of the other entity that assist the entity in achieving its objectives, more efficient or effective production and delivery of goods and services, higher level of service quality, improved outcomes, etc.).

Use of power to generate benefits
• In order to have control, the entity's ability to use its power to generate benefits from its involvement in the other entity is key. An entity that acts as an agent on behalf or for the benefit of another entity does not control that entity, as its decision-making power benefits the other entity.[2]

[2] It is common for public sector entities to be responsible for carrying out government policy. In some cases they may have the authority to act in their own right (and be the principal), in other cases they may act as an agent for a Minister or another entity. For example, a government department, which is authorised by a Minister to act on the Minister's behalf, might act solely as an agent of the responsible Minister in relation to another entity. In such cases the department would not control the other entity and would not consolidate it. Paragraphs AG62–AG74 provide guidance on determining whether a decision maker is an agent or a principal.

Determination of the consolidation scope for public entities often focuses on the regulatory framework and governance structure rather than on the financial stake. In the public sector environment, control is often established through law (governments) or a regulatory framework (financial rules and regulations). The controlling entity may have no financial investment in the controlled entity. Typical power indicators are power enacted by law, strong presence in decision-making governing bodies, and veto rights on strategic decisions or budget approval. Financial and economic dependency through yearly contributions by an entity to the operational budget does not in itself demonstrate control. Where such a situation arises however, the power and benefit indicators of IPSAS 35 should be analysed with great care.

Additional considerations:

- The existence of potential voting rights (e.g. purchased call options) that are presently exercisable should be considered in assessing the ability to control.

- The power to establish the regulatory framework within which entities operate and to impose conditions or sanctions on their operations does not constitute control. For example, a pollution control authority that can impose sanctions on entities that do not comply with environmental regulations does not control them.

- An investment entity[3] measures its investments in controlled entities at fair value through surplus or deficit, but does not consolidate them. In other words, it does not include all assets, liabilities, items of income and expenses and cash flow items of the entities in which it has invested in its consolidated financial statements; rather, it measures its investments at fair value and presents changes in fair value in surplus or deficit.

<u>Consolidation procedures</u>

Once the scope of consolidation is agreed, procedures apply to bring together separate financial statements into one set of accounts. In short, the consolidation process is as follows:

Step 1 - Harmonise accounting policies throughout the economic entity. Restate the accounts of all entities included in the scope of consolidation using uniform accounting policies for like transactions and other events in similar circumstances.

IPSASB staff considers that the use of IPSAS for non-profit-seeking entities should not give rise to significant compatibility issues when state-owned enterprises (SoEs) reporting under IFRS, or a similar national framework, are consolidated into a government's financial statements. Provided that the same accounting policies are adopted where there are the same or similar choices under IPSAS and IFRS, the preparation of consolidated accounts should not present significant problems.[4]

[3] Under IAS 35, an investment entity is an entity that: (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) has the purpose of investing funds solely for returns from capital appreciation, investment revenue, or both; and (c) measures and evaluates the performance of substantially all its investments on a fair value basis.

[4] IPSASB, Staff questions and answers, State-owned Enterprises and IPSAS-based consolidated financial statements, May 2018, 6 pages

Step 2 - Align reporting dates of controlled entities to that of the controlling entity. When they are different, provide additional information or make adjustments to the financial statements of the controlled entity to reflect its assets, liabilities, revenue, expenses and cash flows at the controlling entity's reporting date.

Step 3 - Translate financial statements of foreign operations into the presentation currency of the entity.

Step 4 - Combine line by line the statement of financial performance, the statement of financial position items and the cash flow statement items of the controlling and controlled entities.

Step 5 - Eliminate balances and transactions between entities within the economic entity in full, including revenues, expenses and dividends or similar distributions. Intra-group surpluses or deficits that are recognised in assets (e.g. in inventory or fixed assets), are eliminated in full except where a deficit indicates an impairment loss that must be recognised.

Step 6 - Account for non-controlling interest (NCI)[5] in the consolidated statement of financial position within net assets (equity), separately from the controlling entity's net assets (equity), and disclose the NCI in the surplus or deficit of the economic entity. NCI is the portion of the interest in the consolidated financial statements of the economic entity that is not controlled by the controlling entity.

Step 7 - Eliminate the investment of the controlling entity in the controlled entity against the net assets (equity) of the economic entity. Recognise any resulting goodwill or negative goodwill[6].

3.1.4 IPSAS 37 'Joint arrangements'

Public sector entities may conclude arrangements with other public sevtor entities or private sector entities whereby they engage in a jointly controlled activity. Those arrangements are joint arrangements.

A joint arrangement is an arrangement of which two or more parties have joint control. Joint control is the agreed sharing of control of an arrangement by way of a binding arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

Under IPSAS 37, a joint arrangement is either a joint operation or a joint venture. The classification depends upon the rights and obligations of the parties to the arrangement. It is important because it impacts the accounting treatment in the consolidated financial statements.

[5] Non-controlling interest is also often called minority interest (as was the case in the previous consolidation standard IPSAS 6, which is superseded by IPSAS 35).
[6] For further detail, please see IPSAS 40 'Public sector combinations' which explains that goodwill or negative goodwill should be recognised upon a public sector combination which is an acquisition, and not an amalgamation.

Joint arrangements not structured through a separate vehicle are joint operations. When a joint arrangement is structured through a separate vehicle, the entity should determine its classification considering the following:

- the legal form of the separate vehicle;
- the terms of the binding arrangement;
- when relevant, other facts and circumstances such as rights to assets, obligations for liabilities, allocation of revenues and expenses or share in the surplus or deficit, and guarantees given to third parties in relation to the joint arrangement.

Joint operations

When an entity has rights to the assets, and obligations for the liabilities, relating to the arrangement, the arrangement is a joint operation.

A joint operator accounts for assets, liabilities, revenues and expenses arising from its interest in a joint operation.

Joint ventures

When an entity has rights to the net assets of the arrangement, it is a joint venture.

A joint venture recognises its interest in a joint venture as an investment, using the equity method.

3.1.5 IPSAS 36 'Investments in joint ventures and associates'

In some cases, an entity (the investor) may have an interest in another entity (an associate) that neither gives rise to 'control' nor 'joint control', but it can still exercise significant influence on it.

An associate is an entity over which the investor has significant influence.

'Significant influence' is the power to participate in the financial and operating policy decisions of another entity but is not control or joint control of those policies. Significant influence is presumed where the investor holds 20% or more of the voting power of the investee. The existence of significant influence by an investor can be evidenced by one or more of the following: representation on the governing body, participation in policy-making, interchange of managerial personnel, provision of essential technical information, etc. All facts and circumstances have to be considered in determining if an investor has significant influence, also taking into account potential voting rights as well as rights owned by other investors.

In the consolidated financial statements of the investor, an investment in an associate should be accounted for using the equity method as from the date on which significant influence is obtained.

Under the equity method, the investment in an associate is initially recognised at cost, and then adjusted to recognise the investor's share of surplus or deficit of the associate after the date of acquisition. The accounting policies of an associate should be harmonised with those of the reporting entity (the investor).

Investments in associates are classified as non-current and presented as one line item in the statement of financial position. They are tested for impairment as single assets[7] if there are impairment indicators under IPSAS 29 'Financial instruments: recognition and measurement' or IPSAS 41 'Financial instruments'[8]. In such case, the impairment test is carried out in accordance with the rules included in IPSAS 21 'Impairment of non-cash generating assets' or IPSAS 26 'Impairment of cash generating assets'.

If an investor's share of its associate's losses exceeds the carrying amount of its investment, the carrying amount is reduced to nil. Recognition of further losses is discontinued, unless the investor has incurred obligations on behalf of the associate.

3.1.6 Disclosures

Disclosure requirements in relation to consolidated financial statements are included in IPSAS 38 'Disclosure of interests in other entities' and aim to provide information on:

- the nature of, and risks associated with an entity's interests in controlled entities; unconsolidated entities and structured entities that are not consolidated;
- the effects of those interests on its financial position, financial performance and cash flows.

Key disclosures under IPSAS 38 include:

- a list of significant controlled entities;
- the fact that a controlled entity is not consolidated as it meets the presentation exemption (if applicable);
- summarised financial information of controlled entities that are not consolidated.
- significant judgments and assumptions in determining whether control exists;
- information about controlled entities that have noncontrolling interests that are material to the reporting entity;
- qualitative and quantitative information about an entity's interests in structured entities that are not consolidated, including how the structured entity is financed;
- significant restrictions on the entity's ability to access or use the assets or settle the liabilities of the economic entity;
- information about non-quantifiable ownership interests;
- information about interests in entities that are acquired with the intention of disposal.

Specific disclosures requirements of IPSAS 38 in respect of joint arrangements and associates include:

- significant judgments and assumptions in determining whether an entity has joint control of an arrangement (and the type of joint arrangement when it has been structured through a separate vehicle) or significant influence over another entity;
- the proportion of interest held by the entity and, if different, the proportion of voting rights held (if applicable);

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[7] The carrying amount of associates includes goodwill (note: goodwill on associates is not presented separately on the balance sheet). That single asset amount (thus also including goodwill) is tested for impairment.

[8] IPSAS 41, which replaces IPSAS 29, is effective for financial statements covering periods beginning on or after 1 January 2022. Earlier application is encouraged.

- the nature of the entity's relationship with the joint arrangement or associate;
- the method used to recognise the entity's interests in the joint venture or associate;
- summarised financial information about joint ventures and associates (individually or in aggregate for individually immaterial joint ventures and associates);
- the amount of the contingent liabilities;
- commitments in relation to the entity's joint ventures.

3.1.7 Transitional provisions

IPSAS 33 'First-time adoption of accrual basis IPSAS' allows early adopters to apply certain exemptions in order to enable a smoother move towards IPSAS.

In respect of consolidation, an entity is not required to perform consolidation eliminations (balances, transactions, revenue and expenses), eliminate its share in the associate's surplus and deficit resulting from upstream and downstream transactions between the investor and the associate, eliminate all balances and transactions between itself and entities that are jointly controlled, for reporting periods beginning on a date within three years following the date of adoption of IPSAS. This is an exemption that affects the fair presentation of the financial statements and the entity's ability to assert compliance with accrual basis IPSAS. If this exemption is applied, full IPSAS compliance is hence only possible when the exemption is lifted.

Other exemptions do not affect the fair presentation of a first-time adopter's financial statements and the ability of the entity to assert compliance with accrual basis IPSAS. For example, a first-time adopter does not need to comply with the requirements for cumulative translation differences on the date of adoption of IPSAS and the cumulative effect of translation differences at that date may be set to zero.

3.1.8 IPSAS 22 'Disclosure of financial information about the General Government Sector'

The objective of IPSAS 22 is to disclose in the IPSAS financial statements information that relates to the general government sector and that provides a useful bridge between the IPSAS financial statements and the financial information prepared under statistical bases of reporting.

IPSAS 22 is optional; it applies only to those governments that elect to present information about the GGS in their consolidated financial statements.[9] The standard is only applicable to a government's consolidated financial statements. If a government elects to apply IPSAS 22, the standard requires that information about the GGS is disclosed in a manner that is consistent with the accounting policies adopted in the consolidated financial statements.

Financial statements prepared in accordance with IPSAS present financial information that is useful for decision making and serve to demonstrate accountability for the use of public resources. The consolidated financial statements include all entities for which the government has the ability to direct their financial and operating policies. These control criteria apply regardless of organisational structures and institutional units.

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[9] We refer here to the consolidated financial statements prepared under IPSAS, which include the controlling entity and all entities it controls, whether they are part of the GGS or not (such as for example commercial public sector entities).

For statistical reporting purposes, the public sector is divided into entities carrying out nonmarket activities, the general government sector (GGS), and market activities.

Nonmarket	The GGS includes central, state/provincial and local government units, social security funds, and those non-profit entities that undertake non-market activities and have their operations funded primarily by government units.

Examples of such public entities that are part of the GGS include government agencies, hospitals, public universities and research institutes, social security funds, and regulatory bodies.

Market	Public Financial Corporations (PFC) and similar institutions primarily engage in financial intermediation and the provision of financial services for the market. Public Non-Financial Corporations (PNFC) and similar institutions produce goods or non-financial services for the market.

Examples of PFC include State banks. Examples of PNFC include public utilities and railroads.

By disaggregating the consolidated financial statements according to the GGS boundaries specified in statistical accounts, these disclosures can enhance the transparency of financial reports and provide for a better understanding of the relationship between financial statements and statistical reports and between market (i.e. public corporations sector) and non-market (i.e. general government sector) activities of the government.[10]

Because GGS information is only relevant for governments as a whole (national/federal, state/provincial, local), IPSAS 22 does not apply for a government's individual controlled entities, international organisations, or similar public sector entities applying IPSAS.

IPSAS 22 requires disclosure of the major classes of assets, liabilities, revenues, expenses and cash flows reflected in the financial statements. It does not specify a mandatory presentation format, but some minimal GGS disclosure requirements.

Reporting entities must also disclose a list of the significant controlled entities included in the GGS. The GGS disclosure must exclude any financial information related to any entity in the GGS that is not included in the consolidated financial statements.

All IPSAS should be applied in the GGS disclosure, except IPSAS 35 'Consolidated financial statements' in respect of investments in public corporations sectors.

[10] Disclosing information about the GGS does not replace the need to disclose information about segments in accordance with IPSAS 18 'Segment reporting' whose objective is to report information for the purposes of evaluating past performance and making decisions about the future allocation of resources. The GGS is only a subset of government as a whole and is not likely to achieve the above objective. For further details, we refer to IPSAS 22 paragraphs 7 and 8. Please also see EY, EPSAS issue paper on segment reporting, EPSAS Working Group, Lisbon, 26-27 April 2017, 26 pages.

The GGS disclosures must be reconciled to the consolidated financial statements of the government, showing separately the amount of the adjustment to each equivalent item in those financial statements. This would be presented as follows for each line of the primary statements (statement of financial position, statement of financial performance, statement of changes in net assets/equity, and cash flow statements):

Primary statement items	*GGS*		*PFC and PFNC*		*Eliminations*		*Whole-of-government*	
	N-1	*N*	*N-1*	*N*	*N-1*	*N*	*N-1*	*N*
Line item 1								
Line item 2								
Line item 3								
...								

Given the lack of uptake of the standard, the IPSASB explored several options for the future of IPSAS 22 in a recent CP, including whether the standard should be revised, withdrawn without replacement or replaced with a new standard. Respondents' views were divided and the IPSASB classified the project as part of the projects considered but not prioritized for the IPSASB work plan 2019-2023. In its proposed strategy and work plan 2019-2023, the IPSASB further says that: 'This project would identify revisions to IPSAS 22 arising from changes to GFS and barriers to implementation, and could build on changes in segment reporting requirements arising from the proposed revision of IPSAS 18.'[11]

3.2 Draft EPSAS Conceptual framework

The draft EPSAS Conceptual framework (version dated May 2018) addresses the concept of public sector reporting entity.

"General purpose financial statements under the EPSAS basis of accounting should serve the public interest and be conducive to the European public good. This implies that every entity which is held accountable for receiving resources, and for the use it makes of them for delivering public goods, public services or public programmes, is considered as a public sector entity.

A public sector entity or group of entities meeting one or more of the following criteria:

- ability to take economic decisions and engage in economic activities for which it is responsible and accountable in law or otherwise accountable to service recipients or resource providers,
- entitlement to own and transact assets in its own right,
- ability to incur liabilities on its own behalf, to take on other obligations or further commitments,

and which compiles accounts, or for which accounts can be compiled on its behalf, is considered as falling within the scope of public sector reporting entities, unless, upon entry into force of the present framework, it was already reporting on the basis of national or international generally accepted private sector accounting standards.

[11] IPSASB, Proposed strategy and work plan 2019-2023, p 26.

The determination of which public sector reporting entities should provide GPFRs under the EPSAS basis of accounting should be based on decision-making and accountability considerations, and be specified at the level of EPSAS standards with due regard to the circumstances of smaller and less risky entities.

The criteria and the requirements for the inclusion of an entity into a reporting group of entities should be provided at the level of EPSAS standards.“

Similar to the IPSASB Conceptual framework, the draft EPSAS Conceptual framework insists on the importance of the accountability and decision making objectives of financial statements when determining at what level GPFRs should be produced and what should be the scope of the consolidated financial statements. In addition, the draft EPSAS Conceptual framework considers the characteristics of smaller and less risky entities and whether the public sector reporting entity was already reporting under generally accepted private sector accounting standards.

3.3 International Financial Reporting Standards (IFRS)

IPSAS standards dealing with consolidation issues (IPSAS 35 to IPSAS 38) have been aligned with their IFRS equivalent: IFRS 10 ‘Consolidated financial statements’, IFRS 11 ‘Joint arrangements’, IFRS 12 ‘Disclosures of interests in other entities’ and IAS 28 ‘Investments in associates and joint ventures’. The principles included in the two sets of rules are similar.

As IPSAS principles have been explained in detail in the previous section, IFRS rules are therefore not analysed here.

3.4 EU Accounting Rules

The topic is dealt with in EU Accounting Rule 2 ’Consolidation and accounting for joint arrangements and associates’. This accounting rule applies to accounting for controlled entities, jointly controlled entities and associates in the consolidated financial statements of the EU and establishes requirements for the preparation and presentation of consolidated financial statements by EU entities having interests in other entities.

EU AR 2 therefore acknowledges that consolidated financial statements may need to be prepared and presented at different levels (with different reporting entities being defined) to meet the accountability and decision-making objectives at those levels.

In order to determine the scope of consolidation in the EU consolidated financial statements, the "control concept" is applied. The definition and indicators of control are provided further in the section 4.2 of EU AR 2. The Rule also stipulates that determination of the scope of consolidation shall take into account the general principle of materiality.

In case it is assessed that the EU entity does not have an exclusive control over another entity, it should further consider whether it has joint control of and significant influence over an entity following guidance provided in sections 4.3 and 4.4 of EU AR 2.

The principles included in EU AR 2 are similar to IPSAS.

Indicators of control as applied in the EU context are listed below:

1) The most common control indicator - the majority of voting rights - is in most cases not applicable for the EU, as there are normally no capital links between entities. Therefore, other power and benefits indicators are usually more relevant to assess levels of control. The most common control indicators within the EU are: creation of an entity through founding treaties or secondary legislation; financing of an entity from the EU budget; the existence of voting rights within governing bodies; an audit by the European Court of Auditors; and discharge by the European Parliament. Nevertheless, all facts and circumstances should be considered while assessing the control criteria.

2) Within this context it is noted that the Art 141 of the Financial Regulation[12] (FR) requires that the EU consolidated financial statements include the financial statements of the institutions financed by the EU budget and of the bodies set up by EU under the TFEU and the Euratom Treaty, which have legal personality and which receive EU budget contributions (i.e. bodies according to art. 208 FR). Indeed consolidation of these entities (the institutions/advisory bodies, the decentralised and executive agencies and other EU bodies) is also in compliance with the concept of control, as defined in this accounting rule, as the criteria are met. In particular:

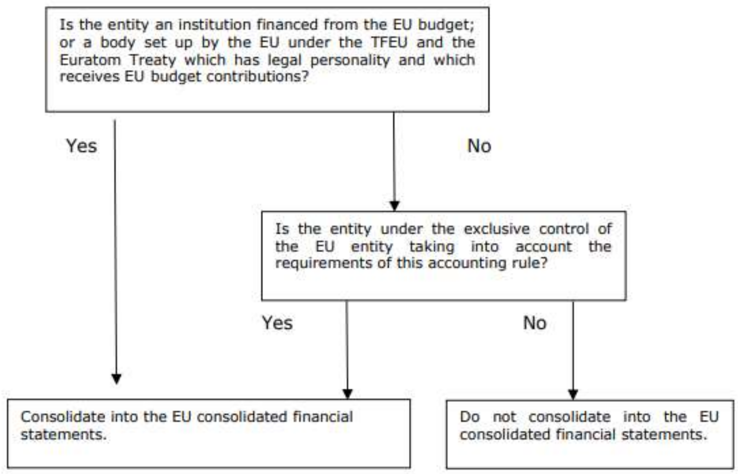
   - the Institutions have been created through their founding treaties (including modifications of their structure/statutes). They represent the basis of the organisational structure and contribute incontestably to the EU's objectives. The EU institutions (except for the European Central Bank (ECB)) receive financing from the general budget and are part of the discharge procedure. The ECB is fully independent from other EU institutions, is not audited by the Court of Auditors, nor does it undergo the discharge procedure by the European Parliament; and as such is not under control of the EU or is within the scope of consolidation;

   - the agencies, as they have been created through an act of secondary legislation, which in most cases includes a Council decision. These decisions stipulate precisely the nature and scope of the agencies' activities; their contribution to the EU objectives; procedures on how to execute activities; as well as a description of their organisational structure.

3) Furthermore, art. 141 of the FR also stipulates that other entities shall be included within the scope of consolidation if the control criteria, indicated in this accounting rule, are met. If, on the basis of analysis of the control indicators, the entity is considered to be under EU entity control, its financial statements are consolidated into the EU consolidated financial statement.

[12] Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002 (OJ L 298, 26.10.2012, p. 1).

The following decision tree is used to determine the entities to be included in the consolidation scope of the EU[13]:



3.5 European consolidation rules for private companies

Consolidation requirements related to private companies are included in Accounting Directive 2013/34/EU on the consolidated financial statements of certain undertakings[14].

The consolidation scope should include the controlling entity and all controlled entities. Some limited scope exclusions are possible.

One interesting rule is included in article 22.2 of the Directive: … 'Member States may require any undertaking governed by their national law to draw up consolidated financial statements and a consolidated management report if (a) … or (b) that undertaking (a parent undertaking) and another undertaking (the subsidiary undertaking) are managed on a unified basis by the parent undertaking.'

In addition, article 22.7 stipulates: '… a Member State may require any undertaking governed by its national law to draw up consolidated financial statements and a consolidated management report if:

(a) that undertaking and one or more other undertakings to which it is not related as described in paragraphs 1 or 2, are managed on a unified basis in accordance with: (i) a contract concluded with that undertaking, or (ii) the memorandum or articles of association of those other undertakings; or
(b) the administrative, management or supervisory bodies of that undertaking and of one or more other undertakings to which it is not related, as described in paragraphs 1 or 2, consist in the majority of the same persons in office during the financial year and until the consolidated financial statements are drawn up.'

[13] EU Accounting Rule 2, Consolidation and accounting for joint arrangements and associates, p. 12
[14] Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC.

This means that the European Directive leaves the possibility to Member States to require consolidation of certain entities based on the fact that they are considered as a single economic entity from a management point of view. Such financial statements may provide useful information for accountability and decision making. This possibility exists for entities included in the same consolidation scope (art. 22.2) and for entities that are not related (art. 22.7).

Another interesting approach in Accounting Directive 2013/34/EU is the one for defining the term 'government'. As per article 41 (3), government means any national, regional or local authority of a Member State or of a third country. It includes a department, agency or undertaking controlled by that authority as laid down in Article 22(1) to (6) of this Directive. Although the definition is given in relation to a very specific reporting purpose[15], it is interesting to note that European directives consider in the scope of 'government' all types of entities that are controlled by a government (whether central, regional or local), including thus commercial public sector entities.

3.6 ESA 2010

3.6.1 Rules relating to the scope of consolidation

The ESA 2010 framework includes various institutional sectors. One of them is the general government sector (GGS).

The general government sector (S.13) consists of institutional units which are non-market producers whose output is intended for individual and collective consumption, and are financed by compulsory payments made by units belonging to other sectors, and institutional units principally engaged in the redistribution of national income and wealth (ESA 2010 2.111).

The institutional units included in sector S.13 are for example the following:

(a) general government units which exist through a legal process to have judicial authority over other units in the economic territory, and administer and finance a group of activities, principally providing non-market goods and services, intended for the benefit of the community;
(b) a corporation or quasi-corporation which is a government unit, if its output is mainly nonmarket and a government unit controls it;
(c) non-profit institutions recognised as independent legal entities which are non-market producers and which are controlled by general government;
(d) autonomous pension funds, where there is a legal obligation to contribute, and where general government manages the funds with respect to the settlement and approval of contributions and benefits (ESA 2010.2112).

The general government sector is divided into four subsectors: (a) central government (excluding social security funds) (S.1311); (b) state government (excluding social security funds) (S.1312); (c) local government (excluding social security funds) (S.1313); (d) social security funds (S.1314) (ESA 2010 2.113).

[15] In order to provide for enhanced transparency of payments made to governments, large undertakings and public-interest entities which are active in the extractive industry or logging of primary forests should disclose material payments made to governments in the countries in which they operate in a separate report, on an annual basis.

Applicable rules for the government sector are explained in detail in chapter 20 'The government accounts' of the ESA 2010 manual.

3.6.2 Consolidation procedures

ESA 2010 allow for all sectors to be presented as either consolidated or non-consolidated. The usual approach for general government is to present consolidated data. The purpose of preparing a consolidated set of statistical data should be kept in mind. While financial statements are issued for accountability and decision making at an entity level, ESA 2010 statistics on the general government sector (GGS) are produced by governments for the purpose of macroeconomic analysis and decision making. For example, paragraph 20.153 of the ESA 2010 manual stipulates that 'to relate government aggregates to the economy as a whole as in revenue or expenditure to GDP ratios, it is better to eliminate the internal churning of funds and include only those transactions that cross the boundaries with other domestic sectors and with the rest of the world sector'.

Consolidation is a method of presenting the accounts for a set of units as if they constituted one single entity (unit, sector, or subsector). It involves eliminating transactions and reciprocal stock positions and associated other economic flows among the units being consolidated (ESA 2010 20.152).

Consolidation does not affect balancing items because the consolidated items appear symmetrically within each account. For example, a grant from a central government to a local government unit is consolidated by eliminating the expenditure from central government and the revenue from the local government, thus leaving unchanged the net lending/net borrowing of general government (ESA 2010 20.154).

Conceptually, the nature of consolidation is to eliminate all flows among the consolidated units, but practicality should be kept in mind. In concept, transactions in the production account, such as sales and purchases of goods and services, may not or cannot be consolidated. The decision about the level of detail employed in consolidation should be based on the policy usefulness of the consolidated data and the relative importance of the various types of transactions or stocks (ESA 2010 20.155). In practice, consolidation of data is thus done only when it is useful for the purpose of the ESA 2010 statistical reporting.

When drawing up the consolidated accounts of government, the ESA prescribes consolidating the following major transactions (in order of importance):

(a) current and capital transfers, such as central governments grants to lower levels of government;
(b) interest arising on intergovernmental holdings of financial assets and liabilities;
(c) transactions, other economic flows and stocks in financial assets and liabilities, such as loans to other governments or acquisitions of government securities by social security units (ESA 2010 20.156).

On the other hand, other transactions are not consolidated (e.g. purchases/sales of goods and services between government units, taxes or subsidies paid by one government unit or entity to another, acquisitions/disposals of non-financial assets, etc.).

3.7 Comparison between IPSAS and ESA 2010 rules

The table below provides an overview of the main rules applicable to consolidation included in IPSAS and ESA 2010 rules.

Figure 1: Outline of IPSAS and ESA 2010 rules applicable to consolidation

Application domains	*IPSAS*	*ESA 2010*
Scope of consolidation	The consolidation scope includes all entities over which the reporting entity has control. Three conditions should be met in order to have control: (1) power to direct the relevant activities, (2) exposure to the variable returns of the entity and (3) link between the two).	ESA 2010 reporting includes the accounts of all entities included in the GGS. The GGS consists of all government units (at whatever level) and all non-market producers and NPIs controlled by government units. It also includes other non-market producers.
Consolidation techniques	-Transactions and balances between entities that are part of the same reporting entity are eliminated in consolidation. -Accounting policies should be harmonised.	-Sectors may be presented as either consolidated or non-consolidated. General government data is usually presented on a consolidated basis. In principle, transactions and stock positions between GGS units are consolidated. In practice, transactions in the production account are not consolidated; consolidation is only prescribed for certain types of major transactions. -Harmonisation of reporting practices is achieved to some extent through meeting the requirements of the ESA 2010 manual.

IPSASB Consultation paper of October 2012 that compares IPSASs and GFS reporting guidelines underlines that in GFS reporting 'The reporting entity may be an institutional unit, but the primary focus is on a group of institutional units (consolidated sector or subsector). Control and the nature of economic activities determine consolidation and the scope of the reporting entity. The General Government Sector does not include institutional units primarily engaged in market activities.'

When it comes to IPSAS, the nature of economic activities is not considered in determining the consolidation scope. Entities that engage in market activities may be consolidated too. IPSASB CP states the following: 'The reporting unit for financial statements is an economic entity, defined as a group of entities that includes one or more controlled entities. Control is the main criterion that determines consolidation. The whole of government reporting entity, at the highest level of consolidation, may include, in addition to government departments, sub-national bodies such as state governments, and government owned businesses that primarily engage in market activities.' [16]

[16] See IPSASs and Government Finance Statistics Reporting Guidelines, Consultation Paper October 2012, IPSASB, p.11.

As far as consolidation techniques are concerned, ESA 2010 rules do not require consolidation of transactions in the production account, such as sales and purchases of goods and services. Consolidation is only required for some major types of transactions (current and capital transfers, interest arising on intergovernmental holdings of financial assets and liabilities, and transactions, other economic flows and stocks in financial assets and liabilities) where it is considered useful for the purpose of the ESA 2010 reporting.

Under IPSAS, all material intragroup transactions and balances should be eliminated.

4 Country comparison

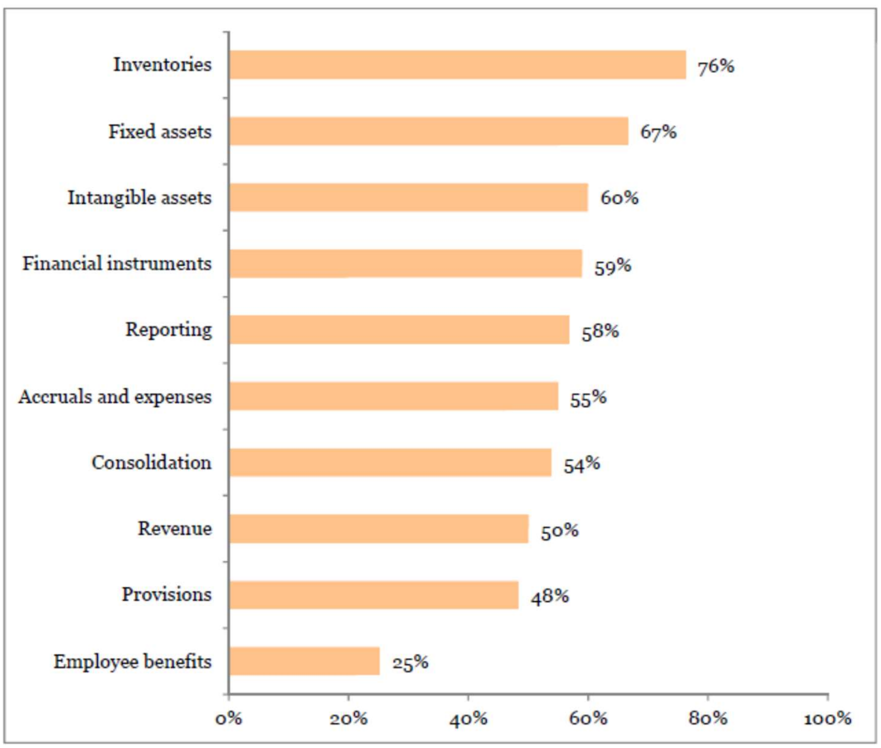
We first present the findings of the PwC study of 2014 in relation to the topic of consolidation, then the results of the country comparison performed in the context of the present issue paper and finally, we provide additional information based on a review of a research report published on the same topic.

4.1 Findings from the PwC 2014 EPSAS study[17]

4.1.1 Overall accounting maturity for consolidation in the EU

Figure 2 below is extracted from the 2014 PwC study. It gives an overview of the average accounting maturity score per accounting area across EU governments and highlights the areas which are more closely aligned with IPSAS requirements across the EU. It indicates an average maturity of 54% for consolidation.

Figure 2: Average accounting maturity per accounting area across the EU[18]



[17] See PwC, Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards, 2013/S 107-182395, 1 August 2014

[18] See PwC, Collection of information [...], p. 96.

The average score of 54% for consolidation reflects the average maturity in respect of:

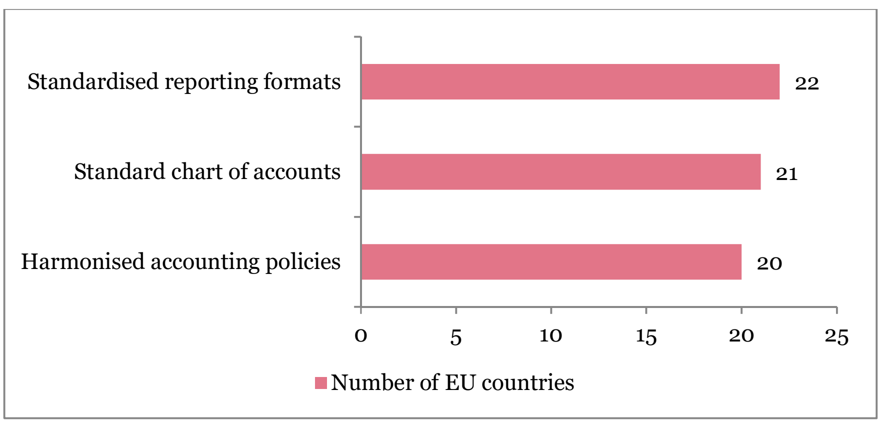
- the scope of consolidation, i.e. which entities are included in the scope of consolidation;
- the organisation of the consolidation process, especially the degree of harmonisation of accounting policies, the existence of useful tools such as reporting formats and standard chart of accounts, or procedures such as the elimination of intra-government transactions and balances.

One of the biggest challenges of the consolidation process is to make sure that all entities that should be included in the scope are effectively consolidated. Most EU countries (21 out of 28) declare to have included all government ministries/departments in their financial statements. Moreover, 16 central governments out of 28 take into account agencies in the scope of consolidation.

However, the procedure followed by central governments preparing their accounts under the cash basis or modified cash basis system differs greatly from the consolidation process under the accrual basis. This was taken into account when calculating the total accounting maturity for this accounting area, with adjustments made for governments reporting on a cash basis due to a lack of compliance with the accrual accounting principles.

Once the consolidation scope is defined, an efficient consolidation process that enables timely and reliable reporting by all entities in the consolidation scope needs to be put in place.

Figure 3: Harmonisation across entities[19]



As shown in the above figure, best practices such as the use of standardised reporting formats (22 Member States), a standard chart of accounts (21 Member States), as well as harmonised accounting policies (20 Member States) are already widely implemented.

As regards the reconciliation and elimination of intra-government transactions and balances, 18 countries out of 28 report applying such a procedure in order to prepare central government's consolidated financial statements.

[19] See PwC, Collection of information [...], p. 98.

4.1.2 Examples of approaches taken in producing consolidated accounts [20]

The following examples give an overview of the approach taken by some of the countries selected in the PwC study as a benchmark for assessing the costs and benefits of implementing EPSAS in the EU (Estonia, Sweden, and the United Kingdom) in producing a consolidated set of accounts at the central government level.

Estonia *A standard chart of accounts is used by all public sector entities, including 240 different accounts for assets, 340 for revenues and 450 for expenses. The State Shared Service Centre is in charge of the management of the consolidation software, which allows to get the financial reports within a very limited timeframe. All public sector entities have to input their financial information into the consolidation system during 30 days after the end of the month. The summarised Whole-of-Government Accounts (with limited notes) are prepared on a quarterly basis, and the annual Whole-of-Government financial statements prepared by 30 April. Thereafter, they are audited by the State Audit Office and presented to Parliament by 30 August.*

Sweden *Each accounting entity is required to produce financial information monthly and send it electronically to a database at ESV (normally not later than 12 days after the end of the month). Some information is aggregated monthly, while other information is aggregated quarterly or on a yearly basis. Each agency normally has its own accounting system and may also have its own chart of accounts. However, the monthly reporting needs to be done according to the compulsory reporting plan decided by the ESV. Whole of central government accounts are produced once a year on accrual basis and with internal transactions eliminated. The agencies are obliged to reconcile balances with other agencies; the reconciliation procedure is used for eliminating internal items e.g. receivables/payables, contributions, revenue/expenditure.*

United Kingdom *The UK produces Whole of Government Accounts (WGA), which is a consolidated set of financial statements for the entire public sector, as defined by ONS-based classification (central government, local government and public corporations). After completing the major task of converting to accrual accounting, the process of producing WGA for the UK public sector has been managed in a relatively simple way with limited resources. Sub-consolidations were used to leverage existing relationships with the related entities and, by pushing responsibility down to the individual entity level it was possible to carry out the consolidation within a small centralised team. The production of WGA which consolidates the individual accounts of approximately 5.000 entities is carried out by a 7-member team over a 3-month period; the accounts are then audited over a 4-month period. Key challenges for the production of WGA involve first getting the data from the various departments and entities and, second, dealing with the tens of thousands of inter-entity transactions that must be eliminated in the consolidated accounts. Secondary legislation for the year specifies which bodies fall within the scope of consolidation and, thus, are required to submit data for this purpose.*

When the consolidated accounts are prepared, only transaction streams and balances between WGA entities above £1 million are eliminated. WGA entities are required to report transaction streams and balances that are above £1 million with any counterparty within the WGA boundary. The £1 million threshold applies to the aggregate for each type of balance or transaction stream with a counterparty. For example, if an entity has a number of debtor balances with a counterparty which are each below £1 million but when aggregated exceed £1 million, then the aggregate balance must be reported. HM Treasury reviews the £1 million threshold annually. Agreements are in place with the departments such that inter-entity transactions are confirmed between the departments before submission to HM Treasury, thereby reducing the number of mismatches that require investigation during the consolidation process.

[20] See PwC, Collection of information […], pp. 98-99.

4.1.3 Examples of benefits achieved in producing consolidated accounts [21]

We present below some benefits highlighted by some of the benchmark countries selected in the 2014 PwC study in the area of accountability and transparency and that are achieved thanks to the production of consolidated financial statements.

Sweden *The reform to implement uniform standards at the individual entity level permitted production of consolidated financial statements for the central government by ensuring complete balance sheets and income statements for all government ministries and agencies and by establishing procedures for reconciling intra-governmental transactions.*

The consolidated financial statements are now one of the most important elements of the Central Government Annual Report submitted to Parliament and audited by the National Audit Office.

United Kingdom *Producing Whole-of-Government Accounts (WGA) based on IFRS as adapted for the public sector has provided a comprehensive view of government's financial position and performance. While liabilities such as public sector pensions were first recognised in the stand-alone accounts of individual entities following the initial introduction of accrual accounting; WGA has served to aggregate this information and provide a more complete view of the public accounts.*

Germany *Publication of the first accrual-based consolidated financial statements by the State of Hessen at 31 December 2009 was very well received by the media, rating agencies and German community. Despite the fact that these financial statements presented high negative net assets (because of the recognition of a large pension liability on the balance sheet), there was no negative impact on the credit rating of the State of Hessen. A well-thought communication campaign accompanied publication of these first consolidated financial statements to explain the new numbers to various stakeholders.*

4.2 Methodology

To analyse the approaches taken regarding consolidation practices in three selected Member States, PwC sent a specifically designed questionnaire to government representatives. The questions address respectively the level at which consolidated financial statements are prepared (whole-of-government accounts, central government, local governments, etc.) and the legal basis for the consolidation requirements, the scope of consolidation, the application of consolidation rules and the use of consolidated financial statements.

A summary of the results of our country-by-country analysis is presented in the next sections, structured in the same order as the topical questions referred to above.

[21] See PwC, Collection of information [...], pp. 44 to 47.

4.3 Estonia

4.3.1 Level at which consolidated financial statements are prepared and the legal basis for the consolidation requirements

Consolidated financial statements are prepared at different levels:

- At the central government level, including the state and entities controlled by the state consolidated.
- At the local government level, including all local government units and their controlled entities consolidated.
- At the general government sector (GGS) level, including all entities belonging to the GGS consolidated, without public corporations controlled by the central or local governments.
- And at the whole-of-government level, including all entities belonging respectively to the public sector consolidated (GGS plus public corporations controlled by the central or local governments).

Preparation of whole-of-government accounts (WGA) is required by accounting law. The objective is twofold: to give (1) an overview of the country's financial position, financial performance and cash flows and (2) the information required to complete the international financial reporting obligations.

WGA are published in Estonian on the following website:
https://www.rahandusministeerium.ee/et/riigi-raamatupidamine

Annual reports of the state are audited by the state audit office by 30 June of each year.

Monthly reports of entities and consolidated reports are publicly available in the special database of the state shared service centre:
https://saldo.fin.ee/rm_cas/login?mode=rm_saldo&TARGET=https%3A%2F%2Fsaldo.fin.ee%2Fsaldo%2FbalanceManagement.action

4.3.2 Scope of consolidation

At each government level (central and local), the consolidation scope includes all entities over which the controlling entity has control, in line with international accounting standards such as IPSAS.

Every local government entity has it's own reports, information of all local government units is consolidated within the annual statements of the state.

WGA are prepared and are composed of the accounts of the central government (including all entities it controls) and the accounts of the local government sector (including all local governments and the entities they control). They provide disaggregated information about the GGS (split between central government and local government) and public corporations in line with IPSAS 22 requirements.

No scope exclusions are granted for smaller or less risky entities.

4.3.3 *Application of consolidation rules*

Accounting policies are harmonised and intragroup balances and transactions are eliminated at each consolidation level.

Public corporations that carry out commercial (i.e. market) activities are included in the consolidation scope based on the notion of control, in conformity with IPSAS. Associates and joint ventures are reported using the equity method.

4.3.4 *Use of consolidated financial statements*

WGA for the whole public sector are produced once a year but the accounting software automatically generates some condensed financial statements (primary statements plus selected notes) for the GGS on a monthly basis and the public sector on a quarterly basis.

The consolidated financial statements that are the most used are the state government consolidated financial statements (i.e. at WGA level); those are the financial reports of the legal entity which also include budget fulfillment report.[22]

The benefits of producing consolidated financial information reported by the Estonian government are as follows:

- Increased transparency - better understanding of what the nation owns and what its obligations and how it manages its resources are.
- Helps to make long-term fiscal decisions.
- Has contributed to better financial discipline in the whole public sector.
- Basis for wider management reforms (cost effectiveness, results-based management).
- Used as a basis for Eurostat calculations - enables to assess compliance with Maastricht criteria in a short time period.
- High reputation in the eyes of international organisations.

4.4 *Slovak Republic*

4.4.1 *Level at which consolidated financial statements are prepared and the legal basis for the consolidation requirements*

Consolidation in Slovakia is organised on several levels. On the first level, consolidated financial statements are prepared for budget chapter (e.g. ministry) or higher territorial units (regional government) or local government units (municipalities). The second level is that of the central government and the third level is the whole of government level, comprising the central government plus local and regional governments plus other units, which are not consolidated on a lower level (public universities and other organisations with legal form established by special law adopted by the parliament).

The consolidation scope is not equal to the general government sector as it is known in ESA 2010 rules. Differences represent units which are not included in the general government sector but are

[22] Estonia moved to accrual budgeting from 2017.

reported in consolidated financial statements covering the public sector as a whole based on the notion of ’control’.

Under central government are included all units which have a legal form of budgetary organisations, semi-budgetary organisations and business corporations controlled (mostly owned or founded) by the central government. The definition of the central government reporting enity for the purpose of consolidated financial statements is not equal to the definition of central government under ESA 2010 methodology.

The local government reporting entity includes higher territorial units (regional government), towns and cities (local government units - municipalities) established by law with their own competences and funds. These units can establish budgetary and semi-budgetary organisations and hold shares in business corporations. Such business corporations are consolidated based on the concept of control.

Business corporations are reporting under IFRS. Their consolidated financial statements are included in consolidated financial statements at a higher level. For example, a public corporation that is controlled by the Ministry of Economy is included in the consolidation financial statements of the Ministry of Economy (first level), in the consolidated financial statement of the central government (second level, which includes the Ministry of Economy) and in the WGA (third level).

The legal basis for the preparation of WGA is Act No. 431/2002 Coll. on Accounting as amended. For all accounting units it is the basic main Act, which prescribes all requirements for bookkeeping, preparation of general purpose financial statements and also for consolidation in the public sector.

In addition, the Ministry of Finance issues guidance about consolidation methods and processes. Some terms and conditions are set by lower legislation form (Measure/Decree), which is binding for central government and local government units preparing consolidated financial statements.

Principles for consolidated financial statement preparation (including preparation of WGA) came into force at the same time as accrual accounting, as part of the public sector accounting reform (in year 2008).

The first consolidated financial statements in the public sector were compiled for the year 2009 and the first audit was performed on the 2010 consolidated financial statements (the reason of later audit was to have comparable data for two periods). The goal of the reform was to adopt IPSAS principles, apply ’best practice’ in financial accounting and to be closer to international trends and practices.

The objective of consolidated financial statements in the public sector was to provide further information on assets and liabilities of one unit representing a group of entities. In addition, it offers the opportunity to do an audit of these consolidated financial statements that also include units that are not required to have an audit of their individual financial statements.

Consolidated financial statements of Slovak governments can be found here:
http://www.mfsr.sk/Default.aspx?CatID=8800
http://www.mfsr.sk/Default.aspx?CatID=11350
http://www.registeruz.sk/cruz-public/domain/accountingentity/show/30893

4.4.2 Scope of consolidation

The consolidation scope includes all entities over which the controlling entity has control (in line with IPSAS). The rationale is to be as much as possible in line with IPSAS.

Exceptions can be used for corporations which are in bankruptcy procedures: these units are excluded from consolidation scope from the year after the year of decision not to continue in business activity. Left out of consolidation scope are also those entities which are held for sale and where the controlling entity has the intention to sale its shares within next 12 month and is active in finding potential investors.

The Slovak government does not use any thresholds for smaller or less risky entities. The consolidation scope includes all entities which are able to provide financial statements and other data for consolidation, are in a going concern and are under the control of the controlling public sector entity.

4.4.3 Application of consolidation rules

Accounting policies are harmonised within separate group of entities. Most of public sector entities have the same accounting policies and the same structure of government financial statements (budgetary organisations, semi-budgetary organisations, towns and cities as well as higher territorial units). Business organisations have however their own accounting standards and structure of financial statements. Furthermore, there is a smaller group of non-profit organisations (e.g. hospitals, universities and higher schools) and some entities established by law (e.g. social security agency) that have different accounting standards and financial statement design.

But for purpose of consolidation, entities other than budgetary and semi-budgetary organisations plus municipalities must prepare their financial statements in line with the format and accounting policies valid for central government and local-government bodies as applicable. This is done through accounting bridge and preparation of a consolidation package.

Intragroup balances and transactions are eliminated in line with usual consolidation practices. Specifically with respect to the third level of consolidation (WGA), intragroup eliminations are done only for the main balances and transactions: transfers, taxes, loans and some types of fees. Other balances and transactions are not eliminated for practical reasons.

Full consolidation is applied for fully controlled entities (subsidiaries). The equity method is applied for shares in associates and joint ventures on which significant influence, however not control, is exercised. Other shares (less than 20% stake) are reported at historical value.

Common shares between central and local-government are not eliminated in WGA.

4.4.4 Use of consolidated financial statements

The WGA report (i.e. the annual report) prepared for the Slovak public sector consists of three main parts:

1) ESA results and information about government deficit and debt;
2) Information required by Act on Fiscal Responsibility (on expenditures and revenues using ESA 2010 methodology, structural deficit/surplus, strategy of debt management, etc.);
3) Information on net worth concept and the most significant business corporations.

The appendix to the WGA presents a list of public corporations and summarised consolidated financial statements for the whole public sector. These summarised consolidated financial statements are a basic input to the calculation of the net worth concept (main inputs from WGA are net assets/equity and contingent liabilities).

The most used information from the WGA report is the 'net worth' concept, the amount of assets and liabilities, details about number of state corporations and their impact on public finances.

The benefits associated with the preparation and publication of consolidated accounts reported by the Slovak government are the following:

- For WGA: new analytical criteria for better public finance management ('net worth' concept, consolidated assets and consolidated liabilities, list of state owned corporations) and additional economic information from accounting which complements basic budgetary fulfilment.

- For both central and local governments: audit of consolidated financial statements has brought significant improvements to accounting policies and procedures, audit findings are progressively resolved and the quality of public accounting is increasing year on year.

4.5 United Kingdom

4.5.1 Level at which consolidated financial statements are prepared and the legal basis for the consolidation requirements

The UK government prepares WGA covering central and local governments, and public corporations (including the central bank).

At central government level, government departments prepare consolidated financial statements including their agencies, arm's length bodies and subsidiaries.

Devolved administrations, i.e. Scotland, Wales and Northern Ireland, also prepare consolidated accounts at their level.

Local government entities prepare consolidated accounts for their own groups (i.e. including subsidiaries).

Consolidated financial statements are also prepared by National Health Service trusts, state-owned enterprises and academy schools.

The Whole-of-Government Accounts (WGA) are financial statements prepared in accordance with IFRS (as adapted for the public sector). They are presented to the House of Commons (Parliament) pursuant to section 11 of the Government Resource and Accounts Act 2000.

The objective pursued by WGA preparation and publication are to:

- provide more complete data for fiscal planning by producing consolidated financial statements;
- better identify the United Kingdom's assets and liabilities and assess strengths and weaknesses of the UK public sector balance sheet.

WGA can be consulted at:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/720160/WGA_2016-17-print.pdf

4.5.2 Scope of consolidation

The WGA boundary is similar to the concept of a group under generally accepted accounting practice, but is based on control criteria used by the Office for National Statistics (ONS) to define the classification. In practical terms, this means that the scope of consolidation is based on the notion of control, with the exception of public banks which are excluded from scope.[23]

Use of national accounts framework for WGA allows for easier use of key measure for the public finances. Public Sector Net Debt (PSND) comprises government borrowings less liquid financial assets (such as bank deposits and foreign exchange reserves). PSND excluding the public sector banks is the government's preferred measure of fiscal health as it is consistent with the internationally agreed National Accounts framework.

At central government level, entities within central government departmental group boundary are determined by legislation.

At the local level, the consolidation scope includes all entities over which the controlling entity has control in line with IFRS as adapted for the public sector.

4.5.3 Application of consolidation rules

Accounting policies are harmonised and intragroup balances and transactions are eliminated within each consolidation level. One exception should be noted: WGA are qualified due to inconsistent accounting frameworks, i.e. central and local government infrastructure assets (i.e. roads) are valued on a different basis from each other (error estimated at over GBP 50 billion). Central government departments present group accounts based on consistent accounting framework.

[23] See also report of the Comptroller and Audit General on the 2016-2017 WGA on page 168: '… despite the government's controlling shareholding in Royal Bank of Scotland (RBS) which means I need to include it within the qualification on technical grounds, I support the Treasury's exclusion of RBS from the WGA as its scale and the nature of its activities would distort the reflection of government's core activities within the financial statements.'

Investments in public corporations are treated in line with IFRS and are fully consolidated (with the exception of the non-exclusion of Royal Bank of Scotland).

In the WGA and in the consolidated accounts of the central government, certain smaller and less risky entities are left out of the consolidation scope based on materiality grounds.

In the WGA, entities with assets, liabilities, income and expenditure below GBP 20 million are excluded. In the consolidated accounts of the central government, scope exclusions are determined by individual entities.

For local governments, no materiality thershold is determined centrally.

4.5.4 Use of consolidated financial statements

The UK government believes it is difficult to identify specific level of engagement by various user groups however, WGA is widely commended as a useful document. There is an annual hearing by Parliament's Public Accounts Committee to review and interrogate the WGA and there are calls for the information to be even more widely used. WGA also provide very helpful trend data as well as other information for decision making.

The main benefits reported by the UK government in relation to the production and publication of consolidated fianncial statements are:

- WGA are used to support government response of independent review of Fiscal Risks, and reviewed by Parliamentary Committee.
- Central government consolidated accounts provide opportunities for scrutiny by Parliamentary select Committees and trend data.
- Local government consolidated accounts provide useful opportunity for scrutiny by local taxpayers.

On 28 June 2018, the UK government published its 8th WGA. WGA can be found at: https://www.gov.uk/government/publications/whole-of-government-accounts-2016-to-2017

ICAEW comments[24] are as follows: 'The WGA incorporates central government, devolved administrations, local authorities and public bodies across the UK into a single financial report, consolidating the financial results of over 7,000 organisations. It provides a significantly more comprehensive analysis of the public finances than that presented using the 'official' numbers in the statistically-based National Accounts.

The WGA comprises a full set of primary statements prepared in accordance with International Financial Reporting Standards (IFRS), together with supporting financial information and commentary. This includes a balance sheet, which means that the WGA incorporates expenditures that are excluded in the National Accounts, in particular on long-term obligations that will be settled in the future, such as public sector pensions, nuclear decommissioning and clinical negligence.

[24] See https://www.icaew.com/en/about-icaew/act-in-the-public-interest/policy/public-sector-finances/icaew-analysis-of-wga-2016-17.

We were pleased to see improvements this year in the quality of the WGA as a financial report. There has been further progress made on the financial commentary, and on financial risks and how they are managed. The report now also includes information about how WGA is being used in government.'

Paragraphs 11 to 13 of chapter 3 are describing how WGA is used.

'WGA is now an established product, and it is used to support decision making and manage risks more effectively. Some examples are:

- The government launched a Balance Sheet Review at Autumn Budget 2017 to make more effective use of assets and liabilities, looking at areas such as estates optimisation, improving the return on investments, and reducing the cost of liabilities. WGA data was used to inform the scoping exercise for this Balance Sheet Review.

- HM Treasury has enhanced its approach to the management and scrutiny of contingent liabilities through the creation of stricter controls for approving new contingent liabilities. The department published the new contingent liability framework in July 2017. WGA was used as a source of data to help build the case for implementing the new framework.

- The Office for Budget Responsibility (OBR) independently reports on the future sustainability of the public finances in its Fiscal Sustainability Report and Fiscal Risks Report, drawing on the data published in WGA.

- The Office for National Statistics (ONS) used WGA data on pensions as comparison when preparing their publication on 'Pensions in the national accounts, a fuller picture of the UK's funded and unfunded pension obligations: 2010 to 2015.

Publication of WGA also supports the government transparency agenda to make more public data available. In their 2016 evaluation of the UK, the International Monetary Fund highlighted the strength of the UK's reporting, concluding that WGA and the government's other fiscal reports place the UK at the forefront of fiscal reporting practices worldwide.

WGA is independently audited giving both Parliament and the outside world greater confidence in the figures, and supports effective scrutiny by Parliament through the Public Accounts Committee. The most recent report from the Public Accounts Committee on 'Government Borrowing and the Whole of Government Accounts' was published in January 2018.'

One major area for improvement should however still be noted and it has to do with the long period of time needed before WGA are published, therefore impairing the usefulness of such accounts for supporting decision making. ICAEW comments on this aspect: 'Unfortunately, the WGA is still not timely. Published some 15 months after the end of the financial year to which it relates, the WGA takes much longer than the two to three months typical in the private sector.'

4.6 Country comparison

The table below provides a high-level comparison of the consolidation practices in the three governments selected for our analysis.

Figure 4: Government consolidation practices compared (Estonia, Slovakia and the UK)

	Estonia	*Slovakia*	*UK*
Level of consolidation	-WGA covering the whole public sector. -WGA covering the GGS. -Central government. -Local governments.	-WGA covering the whole public sector. -Central government. -Local governments.	-WGA covering the general government sector. -Central government. -Local governments.
Legal basis for consolidation requirements	-National law.	-National law.	-National law.
Scope of consolidation	-Based on control. Disaggregated information about GGS and public corporations is given as per IPSAS 22. -No scope exclusion for SLREs.	-Based on control. -No scope exclusion for SLREs. -An entity is excluded only if no longer a going concern or expected to be sold within one year.	-Based on control, except for the exclusion of public banks. -Small entities below a certain threshold are not consolidated at central government and WGA level.
Consolidation rules	-IPSAS	-IPSAS	-IFRS (as adapted for the public sector)
Use of consolidated financial statements	-State financial statements (i.e. WGA) closely looked at and compared to budget fulfilment reports. -Used in long-term fiscal decisions, in PFM reforms, to derive ESA 2010 reporting.	-Analysis of government net worth, complementary to budget analysis. -Improvements to accounting policies and procedures thanks to audit.	-WGA and central government accounts reviewed by Parliament and complement review of fiscal risks. -Possible public scrutiny at the local and central level.

In each of the three countries analysed, consolidated accounts are prepared at the level of each local government, at the central government level but also at the WGA level. The requirements are embedded in the national or local legislation.

The consolidation scope is determined based on the notion of control as applicable in international accounting/financial reporting standards (IPSAS or IFRS). The most noticeable exception is the exclusion of public sector banks from the scope of WGA and consolidated accounts of the central government in the UK in order to allow easier reconciliation with the ESA 2010 reporting.

In this respect it is interesting highlighting that Estonia provides disaggregated information on the GGS on the one hand and public corporations on the other hand in its consolidated accounts, which helps to derive ESA 2010 numbers more easily.

IPSAS (or IFRS) consolidation rules are largely complied with, both in terms of harmonisation of policies and elimination of intragroup transactions. Exemptions based on materiality grounds are only used in the UK.

Although the use of WGA and consolidated financial statements (based on IPSAS or IFRS) may differ in each country, it is interesting to note that they are either closely looked at when comparing actual numbers with budgets or are used as a complement to budget information. In all three countries, the robustness of the accounting and reporting prepared under international accounting/financial reporting standards is also seen as a foundation to support fiscal decisions or wider PFM reforms.

4.7 Additional research on consolidation

The ACCA (Association of Certified Chartered Accountants) published in May 2015 a report entitled 'Consolidated government accounts: How are they used?'. The report examines the use being made of consolidated government accounts in a sample of countries (the UK, Australia, New Zealand, Canada and Sweden) which prepare them. It highlights the importance of the information they provide to support policy decisions, fiscal transparency and accountability, and makes recommendations to promote their wider use in support of sustainable public services.[25]

Key findings of the ACCA study are also interesting in the context of the present EPSAS paper and are presented below.

All five countries examined in this study have well-established accounting systems for the purpose of parliamentary accountability and some have also adopted international norms such as the United Nation's System of National Accounts (SNA). The report suggests a need to move beyond rhetoric about usefulness of accounting reforms to consider global trends on what appear to be harmonising accounting practices among governments in countries with shared histories and ideas in public sector reform.

A factor causing considerable confusion is that many countries use similar terminology (e.g. the UK and New Zealand: Whole-of-Government Accounts; Australia: Whole-of-Government Reports) despite the very different meanings that each country attaches to the application of accruals-based consolidated government accounts. This confusion is symptomatic of a divergence between the use of commercial consolidated accounting techniques as a theoretical concept to represent boundaries of government accountability, versus the more established approach to defining what government does and/or is accountable for on a constitutional basis.

[25] ACCA, Consolidation government accounts: How are they used?, May 2015, 29 pages.

The table below illustrates the main differences in reporting boundaries.

Figure 5: Comparing the consolidation boundaries and notable exclusions

Country	Main institutions consolidated	Notable exclusions
United Kingdom	A single set of consolidated accounts including: • central government • all local governments • public corporations	• Parliament * • National Audit Office* • Nationalised banks
Australia	Individual consolidated accounts for: • Commonwealth (federal) government • each of the six state and two territory governments (eg New South Wales, Victoria) • all local government municipalities	• No consolidation for the whole of Australia as a single entity
New Zealand	Consolidated reports for: • central government (including Crown entities and state-owned enterprises) • all local government entities	• Central government consolidation separate from local government
Canada	Individual consolidated accounts for: • federal government • each of the 10 provincial and three territorial governments (eg Ontario, Yukon) • all local governments	• No consolidation for the whole of Canada as a single entity • Government business enterprises (GBE) excluded
Sweden	Individual consolidated accounts for: • central government • all local governments	• No consolidation for the whole of Sweden as a single entity

*Excluded to emphasise the importance of Parliament's role in holding government to account and hence it cannot be part of WGA-UK.

Key findings of the ACCA report are presented below:

- The move towards accruals-based consolidated accounting in governments across the five countries has been an effective stimulus in transforming the quality standards of accounting practices and systems across governments, which have historically been, and some still are, heavily cash-based.

- Reforms based on consolidated government accounting have highlighted limitations in existing systems of accounting and accountability, such as illuminating under-reported liabilities or inconsistent accounting practices and raising the awareness among government officials and auditors of the need for continuous improvement.

- Variations in the consolidation approach between countries limit its global appeal from a comparative perspective. The way in which consolidated accounting boundaries are determined within each country has a significant bearing on how consolidated accounts are being used. The study found that national governments draw the consolidation boundary on the basis of local specificities, either to fit in with existing constitutional notions of the public sector boundary or as a compromise with the political constraints of the day.

- Financial markets, credit rating agencies and other analysts make little use of consolidated government accounts. For example, credit rating agencies prefer global statistical reporting frameworks based on universal standards such as the UN/EU statistical accounts rather than consolidated government accounts. Also, there is little evidence to suggest that GAAP-based consolidation is generally useful for macroeconomic policy planning within government.

- An important factor determining the use and usefulness of consolidated government accounts is the political buy-in at the outset. Politicians' use of public accounts is heavily biased towards the budgetary process, which is the main arena where contests for resource allocation take place. Parliamentary scrutiny, which theoretically could benefit from the implementation of consolidated government accounting, is also conditional on greater financial literacy among politicians, which limits such work to specialist members of parliament.

- The infrastructure for ensuring that parliamentary committee recommendations are followed up is underdeveloped in many of the countries covered by the study. There is often little political will to push for increased scrutiny work and for improving financial literacy, given higher priorities elsewhere. This is especially the case when support for consolidated government accounts is not universal, but viewed mainly as an accounting-centric function for compliance reporting and auditing.

Findings per country are also presented and summarised in the executive summary of the report.

Particularly interesting conclusions are drawn from the analysis of the **New Zealand** situation, which was a pioneer with its accounting reform some 30 years ago and seems now to be the most mature country in terms of use of government accounts for accountability and decison-making purposes.

- New Zealand moved to new standards based on IPSAS. Given the range of users of the NZ consolidated accounts - but in particular the government itself, and credit rating agencies - perceptions are that the institutionalisation of consolidation may have led to some changes in behaviour and the practice of accounting, which are to the benefit of the operation of government.

- Participants in New Zealand were able to identify a clear link between the financial report and policymaking at the macroeconomic level, as well as improved planning for the capital maintenance of public sector assets. The long history of consolidation in NZ financial statements and reports has improved the focus of those involved in the preparation of the accounts as well as users of the report.

One of the respondents quote highlights that the accounting-based institutional change within the New Zealand government is driven by a strong political will at the local level, but such favourable landscapes are highly situational and not always transferable to other countries.

The Treasury publishes monthly and annual (year end) financial statements for the government reporting entity. The purpose of the government financial statements is explained on NZ Treasury's website.'[26] In addition, a specific section of the website includes a helpful chart and a table explaining how the government's reporting fits into the budgeting cycle.[27]

[26] See https://treasury.govt.nz/publications/financial-statements-government.
[27] See https://treasury.govt.nz/publications/guide/guide-public-finance-act-html#section-9.

Another non-European country which is interesting to look at is **Australia**. Key findings of the report are as follows:

- In Australia, consolidated reports are generally perceived as not being used or understood by parliamentarians; they attract limited media attention and public interest; and have limited use by credit rating agencies. Treasury officials interviewed focused mainly on compliance rather than on the rationale of the reports; and had little confidence that they met users' needs, particularly for parliamentarians, who they suggest favoured budget report aggregates, particularly the underlying cash-based deficit.

- In Australia several factors, other than user needs, have tended to drive the form of consolidation and development of consolidated accounts, including historical and constitutional logics. The Australian approach is to prepare Whole-of-Government Reports (WGR) and general-purpose financial reports for separate government jurisdictions to reflect the separate historical and constitutional boundaries of control and tiers of government. According to one respondent, the fact that financial reports are not prepared at the country level (i.e. WGR going beyond the boundaries of control by separate juridictions are not prepared) limits the potential use and usefulness of WGR-AU because the macroeconomic picture for the whole of the public sector cannot be represented, reducing interest from politicians, media, and credit rating agencies.

- In 2009, accrual GFS and GAAP converged into a single reporting framework for the purpose of preparing Whole of Government and GGS financial reports (as well as Final Budget Outcome reports), for each of the nine Commonwealth/ State/Territory government reporting entities. One respondent notes that this enables a set of financial statements to be prepared that broadly incorporate both statistical and accounting requirements along the two constitutional boundaries which ensures impact in the economy by the GGS sector, and the WGR with the bigger boundary based on the control concept of the accounting Standards'.

A recently published research paper by the AASB[28] which is part of an active project to look at how the preparation of financial statements in the public sector can be rationalised considering factors such as the cost of preparation and users' needs (especially regarding the requirement to produce financial statements for individual entities on the top of consolidated financial statements) without damaging actual or perceived transparency.

ACCA's recommendations are the following:

- There has to be a significant commitment by politicians and key government officials if consolidated government accounting reform programmes are to succeed and be used for their intended purpose. The government and preparers of consolidated government accounts must have a clear understanding of the accounts' potential users at the outset.

- To make consolidated accounts more relevant to users and more useful for decision makers, consideration needs to be given to incorporating budgeting and performance reporting and

[28] AASB Research report n°6, Financial reporting requirements applicable to Australian public sector entities, May 2018, 111 pages - http://www.aasb.gov.au/admin/file/content102/c3/AASB_RR_06_05-18.pdf

perhaps to convergence with an international statistics framework, rather than just their use in compliance reporting for accountability purposes.

- Both parliament and government need to be more proactive in using consolidated accounts to inform policy development, as this supports spending decisions and highlights the extent of intergenerational fairness. The accounts can also be a useful tool for driving change on fiscal management.

- The basic financial literacy of parliamentarians and government officials needs improving to facilitate the effective scrutiny of the consolidated government accounts. This could be achieved through induction and development programmes supplemented with guidance.

- Parliaments need to include mechanisms to ensure that recommendations made by parliamentary committees scrutinising consolidated government accounts are followed up.

- To improve the usability and accessibility of accounts, consideration should be given to simplifying the presentation of reports while retaining high-level and good quality information. Consolidated government accounts could be more meaningful if they included more forward-looking information and projected outcomes, as well as making more use of technology that allows summary information to be obtained and provides the opportunity to drill down to more detailed information.

- Public trust in the information provided requires the consolidated accounts to be free from audit qualification and produced in a user friendly format soon after the year end.

5 Difficulties/issues in consolidation

Based on the analysis of the international financial reporting frameworks, the findings of the PwC study of 2014 and of the country comparison presented in chapter 4, we have identified three main types of issues in connection with the preparation of consolidated financial statements:

- Determination of the level at which consolidated financial statements should be prepared.
- Determination of the consolidation scope.
- Cost and complexity linked to the preparation of consolidated financial statements.

5.1 Determination of the level at which consolidated financial statements should be prepared

The first question that arises when talking of consolidation relates to the level at which consolidated financial statements should be prepared. In other words, at what level should the reporting entity be determined? As a reminder, key characteristics of a public sector reporting entity under IPSAS are that:

- It is an entity that raises resources from, or on behalf of, constituents and/or uses resources to undertake activities for the benefit of, or on behalf of, those constituents; and
- There are service recipients or resource providers dependent on GPFRs of the entity for information for accountability or decision-making purposes.

The reporting entity may indeed be defined at different levels: at the central government level, at the local government level and even at lower level (e.g. at the department level), each level including in its scope the entities that are (deemed to be) part of that level.

In addition to this, the appropriateness of preparing whole-of-government accounts, i.e. presenting the accounts of all public sector entities within one country, should also be analysed. In that scenario, the reporting entity is either the government sector (ESA 2010 definition) or the public sector within one country as a whole (i.e. based on the notion of control).

As evidenced by the country analysis presented in chapter 4, the level at which consolidated financial statements should be prepared is often determined by national, state or local law or regulation.

5.2 Determination of the consolidation scope

Deciding the approach for determining the consolidation scope is 'the most cited technical/conceptual comment' by Member States in the report commissioned by Eurostat and prepared by PwC in 2014.

The key conceptual question is whether consolidated accounts should be prepared solely based on the notion of control, or based on both the notion of control and the nature of the activities of the entities. International accounting frameworks such as IPSAS and IFRS require the inclusion of all entities under the control of the controlling entity (including public corporations that carry out market or commercial activities) in the consolidation scope. Under ESA 2010 rules, the nature of the activities is considered and the consolidation scope includes entities that are part of the GGS only (this excluding the abovementioned public corporations).

Should the ESA scope of reporting be followed, the accounting treatment of investments in public corporations (which would then not be eliminated in consolidation) would need to be determined: possible accounting treatments include reporting the investments using the equity method, measuring them at cost or at fair value.

5.3 Cost and complexity of preparation

Technical and/or practical difficulties may arise in the application of consolidation rules under international accounting frameworks. These can happen in relation to the:

- Consolidation scope determination, including applying judgement in determining whether control exists and whether and to what extent materiality thresholds can be used in deciding which entities may be left out of the consolidation scope.

- Consolidation process, including gathering of information from all entities in scope, intragroup eliminations, harmonisation of accounting policies (including for public corporations that carry out commercial activities).

  Balances and transactions between entities within the economic entity should be eliminated in full, including revenues and expenses. Internal gains and losses on intra-government transactions, which have been included in assets or liabilities (e.g. in inventory or in fixed assets) should also be eliminated in full.

  The practical challenge of gathering information across a series of entities with different financial systems should not be underestimated.

6 Discussion of matters relevant for a European harmonisation

Matters for discussion are presented in the same order as the difficulties/issues identified in applying the notion of control under chapter 5.

6.1 Determination of the level at which consolidated financial statements should be prepared

As mentioned under 5.1, the level at which consolidated financial statements should be prepared within one country is often determined by national, state or local law or regulation. The requirements in this respect are justified by the local appreciation of the usefulness of consolidated financial statements with regard to the accountability and decision-making objectives of these financial statements. These are strongly influenced by the political landscape, including the government structure, organisation of areas of responsibilities and decision-making powers between the various government levels and/or government bodies, etc.

The primary objective of the EPSAS project is to implement robust accrual accounting systems in all Member States for all sub-sectors of general government that will generate comprehensive, comparable and reliable data that can be used for budget surveillance and fiscal monitoring in the EU[29]. It is also to produce EPSAS financial statements that can be used for accountability and decision-making objectives and build robust accounting systems that can serve as a foundation for wider public finance management reforms.

In order to achieve the above, the objectives of EPSAS financial statements have been set out in the Preface of the draft EPSAS Conceptual framework. It is in the public interest to prepare high-quality financial statements that:

- are transparent in that they provide a complete picture of the financial position, financial performance and cash flows of the public sector reporting entity (completeness of financial information is crucial to ensure transparency);
- provide the necessary level of comparability between and within Member States, thanks to the use of harmonised standards (EPSAS).

The question that can be discussed among Member States is: at which level should EPSAS consolidated financial statements be prepared to meet (some of) the above objectives?

- At the level of each sub-sector of general government (central government, state government if applicable, local government, social security)?
- And/or at a lower level?
- And/or at the whole-of-government level (i.e. at the level of the country as a whole)?

[29] Article 3 of Directive 2011/85/EU requires Member States to 'have in place public accounting systems comprehensively and consistently covering all sub-sectors of general government and containing the information needed to generate accrual data with a view to preparing data based on the ESA 95 standard'. Article 16 (3) of the same Directive requires that an assessment of the suitability of IPSAS (International Public Sector Accounting Standards) for the Member States be made by the Commission.

In making this assessment, Member States may consider the needs of the potential users of these consolidated financial statements.

6.2 Determination of the consolidation scope

Determination of the consolidation scope may either be solely based on the notion of control, as is required by international accounting frameworks such as IPSAS and IFRS, or considering only in scope those controlled entities that carry out non-market (i.e. non-commercial) activities in line with ESA 2010 rules.

To understand the differences in scope, it is important to understand the objectives of the two sets of rules.

Key for the determination of the approach in consolidation for EPSAS financial statements is then to compare these to the objectives of EPSAS financial statements as set out in the Preface of the draft EPSAS Conceptual framework.

Objectives of IPSAS financial statements

Paragraph 1 of chapter 2 of the Conceptual framework defines the objectives of financial reporting by public sector entities. These are to provide information about the entity that is useful to users of general purpose financial reports (GPFRs) for accountability and decision-making purposes. Paragraph 2 further clarifies that financial reporting is not an end in itself but that the objectives of financial reporting are determined by reference to the users of GPFRs, and their information needs. IPSAS financial statements prepared by governments are the main type of GPFRs.

Financial statements prepared under IPSAS[30] aim to reflect the financial position, results and cash flows of all entities comprised in the same economic group, i.e. the controlling entity and all other entities that it controls. By including in the consolidation scope all entities over which the controlling entity has power and which expose the group to the variability of their benefits, financial statements prepared under internationally recognised principles hold those in charge of the governance accountable for the public resources entrusted to all entities they govern and can be useful for the decision making.

Objectives of ESA 2010 reporting

Statistical reporting aims to provide information suitable for analysing and evaluating fiscal policy options and outcomes at macro-economic level and make national and international comparisons. In order to meet this objective, ESA 2010 reporting divides the public sector into the general government sector (GGS) and public corporations. The primary focus is on a group of institutional units (consolidated sector or subsector). The scope of ESA 2010 reporting thus only includes those public sector entities that constitute the GGS and do not primarily carry out market activities.

ESA 2010 reporting does therefore not have as primary objective to provide information that is useful for accountability and decision-making purposes at entity level.

[30] Similar objectives exist for financial statements prepared under internationally recognised standards such as IFRS.

Objectives of EPSAS financial statements

The objectives of EPSAS financial statements are set out in the Preface of the draft EPSAS Conceptual framework:[31]

"The specificity of public sector accounting mainly derives from the fact that public finance is about the use of the sovereign power for raising and spending tax payers' money for delivering public goods, public services or public programmes to their beneficiaries. Fully disclosing the financial position and financial performance of public sector entities, on a comparable basis, is in the public interest and therefore a key concern for its protection.

Financial reporting under the accrual basis of accounting provides stakeholders with a complete and reliable picture of the financial position, of the financial performance and the cash flows of the reporting entity in the referenced period.

Whereas this information is key for the functioning of the economies of the Union and its markets, the Internal Market in particular, the Union is aimed at harmonizing the financial information presented by public sector entities in the EU Member States by developing and implementing a Conceptual Framework and a set of European Public Sector Accounting Standards (EPSAS).

The key objective of EPSAS is to achieve the necessary level of financial transparency and comparability of financial reporting, between and within EU Member States. This should be achieved by developing and implementing a set of European financial accounting and financial reporting standards. Together with the Conceptual Framework, they lay down the necessary concepts and operational measures derived thereof for the financial statements to provide a true and fair view of the financial position, financial performance and the cashflows of public sector reporting entities under the accruals basis of accounting. This is subject to taking into account proportionality and subsidiarity requirements.

The EPSAS Conceptual Framework and the resulting standards should serve the overarching principle of public interest and be conducive to the European public good.“

In response to the Budgetary Framework Directive [32], the EPSAS project will facilitate the building of a robust accounting system that can serve as the foundation for the ESA 2010 reporting. As highlighted in the preface of the draft EPSAS Conceptual framework, it also aims at producing transparent financial statements that are comparable between and within Member States and can be used for accountability and decision-making purposes, in the public interest.

Should the ESA scope of reporting be followed, an additional question would need to be raised concerning the accounting treatment that should be adopted for investments in public corporations since those would not be fully consolidated and thus would not be eliminated in consolidation.

[31] EPSAS Conceptual framework, reflection paper for discussion, Preface, p.4
https://circabc.europa.eu/d/a/workspace/SpacesStore/f2d052e0-2821-4a25-96fc-6cbbc3ffcf07/Item%204%20-%20The%20EPSAS%20Conceptual%20Framework.pdf
[32] Council Directive 2011/85/EU of 8 November 2011 on requirements for budgetary frameworks of the Member States, articles 3 and 16.

Possible accounting treatments for investments in public corporations would include [33]:

- using the equity method,
- measuring them at cost,
- measuring them at fair value.

One possible approach is to make use of the guidance included in IPSAS 22 'Disclosure of financial information in the general government sector'. Consolidated financial statements could be prepared for the whole public sector, and the information disaggregated in the notes between information related to the GGS on the one hand and information related to commercial public sector entities on the other hand.

Based on the above analyses, we summarise below the possible approaches to the consolidation scope (with potential variations):

1. IPSAS scope of consolidation, solely based on the notion of control:

    a. Without application of IPSAS 22 (which is optional under IPSAS).
    b. With application of IPSAS 22.

2. ESA 2010 scope of reporting, based on GGS boundary, with investments in commercial public sector entities reported[34]:

    a. Using the equity method.
    b. At cost.
    c. At fair value.

Finally, the discussion may also include the need to reconcile the numbers included in EPSAS consolidated financial statements with the numbers included in the ESA reporting.

As mentioned in the PwC study of 2014, reconciliation of EPSAS figures with the ESA reporting is useful, especially in respect of the net assets, debt and surplus/deficit. Discussions can focus on what information is deemed relevant in the European context and should be disclosed.

6.3 Cost and complexity of preparation

Practical implementation issues may arise and a certain degree of complexity and judgment may be needed in applying the notion of control under international accounting standards.

These issues either are of an organisational nature, and are therefore not further discussed here, or are part of the normal process of preparing accrual-based (consolidated) financial statements. The exercise of judgment is indeed an integral part of the process of preparing (consolidated) financial statements and does not involve a degree of complexity that is much greater when applying the notion of control than in many other situations where judgment also needs to be exercised.

[33] As permitted by paragraph 12 of IPSAS 34 'Separate financial statements'.
[34] These are the accounting policies permitted under IPSAS 34 'Separate financial statements'.

One discussion point relates to the treatment of smaller and less risky entities in consolidation. The PwC study of 2014[35] states that materiality and pragmatism should be considered in applying the new EPSAS requirements to smaller and less risky entities and envisages two options to deal with a differentiated approach for such entities:

- either separate accounting rules are designed specifically for smaller and less risky entities;
- or specific guidance is given on how to apply the rules that are applicable to all entities, with specific consideration of the materiality aspects.

The EPSAS issue paper on relief for smaller and less risky entities also addresses the issue[36].

Another discussion point could be whether EPSAS rules should allow the same transitional exemptions as included in IPSAS 33, i.e. offer the possibility not to eliminate intragroup balances and transactions during a three-year transitional relief period as permitted by IPSAS 33.

Finally, a common discussion topic is how to deal with public corporations, which carry out commercial activities and apply IFRS, in IPSAS consolidated financial statements. The question is frequently asked whether accounting policies of public corporations should be adapted and the numbers included in the financial statements of these entities should be restated in order to conform them with IPSAS accounting policies of the government reporting entity.[37]

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[35] See PwC, Collection of information […], pp. 163-164.

[36] See EY, EPSAS issue paper on relief for smaller and less risky entities, EPSAS Working Group, Paris, 7-8 July 2016, 25 pages.

[37] The topic is discussed in IPSASB Staff questions and answers paper, State-owned Enterprises and IPSAS-based consolidated financial statements, May 2018, 6 pages. See also footnote 3 on page 10 of the present issue paper.

7 PwC's recommendations on the way forward

7.1 Determination of the level at which consolidated financial statements should be prepared

As already indicated, the requirements to produce consolidated financial statements within one country are very much dependent on how reporting entities have been defined within that country, which in turn may be linked to the institutional landscape of the country. Consolidated financial statements must for example generally be prepared for the central government reporting entity and at the level of each local government.

The most interesting question that arises in the context of the EPSAS project is probably whether, in addition to the above, WGA, i.e. consolidated accounts giving the full picture of the public sector of one nation, should be prepared. Preparation of such WGA might be made mandatory or might simply be encouraged.

The IPSAS Conceptual framework stipulates that preparation of financial statements should not be an end in itself but should be driven by users' needs. Chapter 9 of the PwC study of 2014 identifies groups of users for the future EPSAS reporting.[38] The draft EPSAS Conceptual framework also stresses that it is in the public interest to have comprehensive and complete financial statements providing a true and fair view of the financial position, financial performance and cash flows of the public sector reporting entity for accountability and decision making purposes. To achieve this, it is very important that all transactions and events of a public sector reporting entity be properly reported in the consolidated financial statements of that entity.

Governments included in the benchmarking exercise (Estonia, Slovakia, UK) have identified clear benefits linked to the preparation of WGA. These include:

- Increased transparency and comprehensive reporting of public sector assets and liabilities of the country, allowing balance sheet scrutiny.
- Better use of assets and better management of liabilities (what gets shown gets managed), and consequently better financial discipline in the whole public sector.
- Better management of risks (thanks for example to the reporting of contingent liabilities).
- Providing the foundation for (a) defining KPIs for better public financial management and (b) wider management reforms (cost effectiveness, results-based management).
- Providing useful source information for fiscal sustainability reports and statistical reports.
- Increased credibility towards fund providers and other interested stakeholders.

In addition, enhacing comparison between Member States is one of the objectives of EPSAS financial statements set out in the draft EPSAS Conceptual framework. Meeting this objective will be facilitated with the production of WGA.

Once harmonised accounting policies are used by all entities within one country, consolidation of the different government levels is also facilitated.

[38] See PwC, Collection of information [...], pp. 141 to 146.

The above findings and comments can provide a good starting point for the discussion between Member States.

7.2 Determination of the consolidation scope

Possible approaches to the consolidation scope have been presented under 6.2. Suggested pros and cons relating to these approaches are presented below.

Figure 6: Pros and cons of the IPSAS and ESA 2010 approaches to the consolidation scope

	Pros	*Cons*
IPSAS scope of consolidation, solely based on the notion of control	-Provides a comprehensive picture of the economic entity's financial position, financial performance and cash flows. -Complies with internationally recognised principles for consolidation (such as IPSAS and IFRS). -If IPSAS 22 (which is optional) (or similar rules) is applied, information about the whole public sector is disaggregated between GGS and commercial public sector entities and reconciliation with the ESA 2010 reporting is facilitated.	-Scope difference with the ESA 2010 reporting. If IPSAS 22 is applied, information about the ESA scope is provided in the notes to the accounts. -(Slightly) higher cost of preparation since more entities are included in scope (commercial public sector entities are also included).
ESA 2010 scope of reporting, based on GGS boundary, with investments in commercial public sector entities reported either using the equity method, or at cost, or at fair value	-Easier bridge to ESA 2010 reporting due to similar scope (similar information is however provided if IPSAS 22 disclosure is given with the IPSAS consolidation scope). -Cost of preparation is (slightly) less since less entities are included in scope.	-Does not comprehensively reflect the economic entity's financial position, financial performance and cash flows. -Does not comply with internationally recognised principles for consolidation (such as IPSAS and IFRS).

The accountability and decision-making objectives of EPSAS financial statements seem to be better addressed when the IPSAS scope of consolidation is used, that is by preparing a set of financial statements which covers in a comprehensive way the assets, liabilities, items of income and expenses and cash flows of the entities over which the reporting entity has control. Recognition of assets and liabilities on the balance sheet makes them apparent to the users and should trigger questions on how governments manage these.

Alternatively, leaving public corporations primarily engaged in market activities out of the consolidation scope and presenting the investments in those entities using the equity method would show the same impact on the equity and results of the reporting entity. However, it would not reflect comprehensively the reporting entity's assets, liabilities, items of income and expenses and cash flows. To mitigate this impact, governments might give separate information on the financial position, financial, performance and cash flows of those commercial public sector entities in the notes to the accounts.

Providing a reconciliation between the EPSAS consolidated financial statements and the ESA 2010 reporting is another important topic for discussion. We recommend to provide such a reconciliation to facilitate the understanding of the two types of reporting by users. If the IPSAS scope of consolidation is chosen, applying the principles of IPSAS 22 allows to present separately in the notes information for the GGS. Providing additional reconciliation between the IPSAS numbers (for the GGS scope) and ESA 2010 numbers (thus for the same scope) for key financial indicators (e.g. net assets, debt, surplus or deficit) is also recommended. Reconciliations that are performed by the countries selected for the benchmark may provide a useful source of inspiration for any future EPSAS requirement in this area.

Finally the question of the usefulness of consolidated financial statements is part of a wider debate on the usefulness of financial statements (consolidated or not) and is linked to the capacity of governments to produce relevant and understandable information. This includes the question of the content of the information, the link to other types of reports that are widely used in the public sector (i.e. budgets and statistical reports) and of the format that is used to communicate financial information.[39]

We note that the governments which make a greater use of consolidated financial statements are those that provide the necessary reconciliation or link to the statistical reporting or reports to budget execution.[40]

7.3 Cost and complexity of preparation

As already mentioned the cost and complexity linked to the preparation of the future EPSAS consolidated financial statements is part of the normal process of preparing accrual-based (consolidated) financial statements.

Accounting policy options that are foreseen under IPSAS 33 may however allow a smoother transition to the first EPSAS consolidated financial statements. We recommend to keep these options available under the future EPSAS standards.

Best implementation practices can also soften the difficulty of implementation and keep the EPSAS implementation cost under control. Examples of best implementation practices can be found in chapter 10 section 3 of the PwC EPSAS study of 2014. Although these are not specifically linked to the consolidation process, many of them can help in this process. Using a harmonised chart of accounts is also helpful to streamline and make the consolidation process more efficient.[41]

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[39] See also PwC, EPSAS issue paper ‘Principled approach to disclosures with a view to financial reporting requirements under the future European Public Sector Accounting Standards (EPSAS), March 2018, 47 pages.‘

[40] Budget reporting is outside the scope of the EPSAS project and is not further commented upon here. It should however be reminded that IPSAS 24 ‘Presentation of budget information in financial statements‘ requires either to present budget information in comparison with IPSAS figures or, if budget is not prepared in accordance with accrual basis IPSAS, to reconcile budget figures with the information included in the IPSAS cash flow statement.

[41] See also PwC, EPSAS issue paper ‘Member States approaches to harmonising charts of acounts for national purposes with a view to financial reporting requirements under the future European Public Sector Accounting Standards (EPSAS), March 2018, 48 pages.‘

In relation to the approach for smaller and less risky entities, the PwC study of 2014 highlights and recommends the following: 'The situation and the reporting structure for government entities vary in each Member State. The size and the nature of the activities of these public sector entities that are part of the general government sector can also differ significantly from country to country. We therefore believe that particular attention should be paid to the specific characteristics of government entities in each Member State when determining the rules that define what entities are considered as smaller and less risky entities and the rules that are applicable to them.'

Finally, we want to highlight that the challenge linked to the inclusion of public corporations applying IFRS in EPSAS consolidated financial statements should not be exaggerated. EPSAS rules will require the use of harmonised accrual accounting policies by all entities within the scope of consolidation to treat similar economic circumstances or phenomena in a consistent way. Since the activities of public corporations that are trading on the market (e.g. state-owned utilities, public corporations active in the telecommunications industry or in the railway industry) often differ from the activities of the entities that are part of the GGS, having specific accounting policies that address the specific characteristics of the activities of these entities best reflects the economic substance of their transactions. This is in line with IPSAS requirements, in particular with the rules applicable regarding the selection of accounting policies that provide relevant and reliable information under IPSAS 3 'Accounting policies, changes in accounting estimates and errors'. In many cases, the IFRS accounting policies of commercial public sector entities can be carried forward with no or little change in the IPSAS consolidated financial statements. In making this assessment, the materiality of the potential adjustment should be considered as well.

Illustrative example

Central government A prepares its consolidated financial statements under IPSAS and determines its consolidation scope using the concept of control as defined in IPSAS. One of the entities controlled by the central government is a commercial public sector company active in the telecommunications sector that prepares its consolidated financial statements under IFRS. The telecom company uses accounting policies for its revenue recognition that are specific to its activities with no equivalent in the scope of the government reporting entity. The central government can include the accounts of the telecom company in its consolidated financial statements without restating them. These are considered IPSAS compliant.

The telecom company also uses administrative buildings of a similar type, in similar locations and for a similar use as the administrative buildings used by other entities included in the central government scope. Depreciation rates used by the telecom company are more rapid than those used by other central government entities. Because these concern similar types of economic events, depreciation rates of the telecom company should in principle be aligned to those of the other central government entities in the IPSAS consolidated financial statements of the central government. If the restatements are not material in consolidation (e.g. because the value of administrative buildings of the telecom company is insignificant compared to the total value of buildings owned by the other central government entities), they can be ignored for practical reasons based on materiality grounds.