The Financial Statement Schemes According to the New Accrual Accounting for Italian Local Authorities

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***Abstract*—The National Recovery and Resilience Plan (NRP) Italy Tomorrow, approved by the European Commission on April 22, 2021, is part of the Next Generation EU (NGEU) program. The NRP is, therefore, not just a traditional investment program but is designed as a truly transformative project in which resource allocations are accompanied by a substantial package of reforms needed to overcome the historical barriers that have held back the development of public and private investment in the past decades. The success of the NRP, alongside the proper design of interventions and their practical implementation, depends crucially on a broad spectrum of structural reforms. Among the enabling reforms, Reform 1.15 plans to "implement an accounting system based on the single accrual principle" for the entire Italian public sector by 2026, in line with the path outlined at the international and European level for the definition of accounting principles and standards in public administrations (IPSAS/EPSAS), and in implementation of the European Union Council Directive 2011/85/EU. One of the first Italian accounting standards (ITAS) to be approved is Itas 1, which governs the structure, content, and presentation of the statements comprising the financial and consolidated financial statements of governments. This paper investigates how such financial statement formats can improve the comparability and comprehensibility of financial statements and enhance a culture of accountability.**

***Keywords*—accrual accounting, accounting change, local government, public sector accounting reform, National Recovery and Resilience Plan (NRP), ITAS**

I. Introduction

The discourse on accounting harmonization, which began over a decade ago with the introduction of enhanced financial accounting into the accounting system of local governments, does not yet seem to be concluded. Therefore, providing a single (accrual-based) accounting system for the public sector seems necessary to achieve the social, environmental, technological and cultural objectives that are the core of the National Recovery and Resilience Plan (NRP).

The National Recovery and Resilience Plan (NRP) - Italy Tomorrow, approved by the European Commission on April 22, 2021, is part of the Next Generation EU (NGEU) program.

It is not just a traditional investment program but is designed as a genuine transformative project in which resource allocations are accompanied by a substantial package of reforms needed to overcome the historical barriers that have held back the development of public and private investment in past decades and the structural weaknesses that have long slowed growth and resulted in unsatisfactory employment levels, especially for young people and women.

The Plan includes three types of reforms (governo.it):

- Horizontal - or "contextual" - reforms that lead to improving equity, efficiency and competitiveness and, with them, the country's business climate, among which the NRP identifies public administration reform and justice reform;
- "Enabling" reforms, which are instrumental in ensuring the implementation of the Plan and enable the removal of barriers to public and private investment, among which the main actions are a regulatory and bureaucratic simplification program and a plan to promote competition through the adoption of the annual market and competition bill;
- Sectoral reforms, which consist of regulatory innovations related to specific policy areas or economic activities and are contained within individual Missions (e.g., simplification of procedures for approving projects on renewable sources).

These reforms are aimed at administrative and regulatory simplification, such as reducing PA payment times and simplifying public contracts.

The NRP envisages an integrated set of investments and reforms to improve the country's equity, efficiency and competitiveness, facilitating the attraction of investment and generally increasing the confidence of citizens and businesses.

Among the enabling reforms, Reform 1.15 plans to "implement an accounting system based on the single accrual principle for the public sector," in line with the path outlined at the international and European level for the definition of accounting principles and standards in public administrations (IPSAS/EPSAS), and in implementation of the European Union Council Directive 2011/85/EU.

The purpose of this paper is, therefore, to investigate whether the current accounting system of local governments is ripe to incorporate this radical reform, whether the financial statement formats approved in ITAS 1 standard can improve comprehensibility and comparability among financial statements, and what the difficulties may be for local governments in implementing this accounting system.

The qualitative analysis of the regulatory framework and the national and international scientific literature on the subject makes it possible to highlight both the potential benefits found in the new financial statement formats and the possible difficulties related to the complexity of implementing the reform.

II. Literature Review

Over the past three decades, reforms in public administration, particularly the accounting system, in Italy

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have been grounded in New Public Management theories, which were based on the idea that public institutions are regarded as companies producing and delivering services.

Therefore, in the management of public institutions, in addition to the legal-formal approach, an economic-business approach was introduced, aimed at meeting the needs of citizens with the same accuracy and rationality in the use of resources as required by competition in the private sector (Hood, 1995), optimizing the relationship between resources used and results obtained (Guthrie *et al*., 2017) giving more attention to the quantitative data and the final result (Lapsley *et al*., 2009).

This reforming approach tended to overemphasize the private components of the corporate world (Mellor, 1996), and abandon bureaucratic operational logics by exaggerating the concepts of efficiency, effectiveness and economy (Mussari & Sorrentino, 2017) in order to meet needs through a flow of resources that is economically and socially sustainable (Comite, 2013) and remains at the heart of the public sector reform debate to this day (Mussari *et al*., 2021).

Other new elements concern the enlargement of the information system from the traditional financial dimension to the economic one by reinterpreting the budget as a budget (Heald & Georgiou, 1995), i.e., as a tool of managerial responsibility as well as forecasting; the system of controls is profoundly modified and improved (from Legislative Decree 286/99 to Law 15/2009 and finally to Legislative Decree 174/2012) in implementation of the ever-increasing needs of accountability and a significant reorganization of the governance models of companies and public administrations following a new logic of management by results.

Therefore, great emphasis is placed on the issue of measuring and evaluating the results achieved: output, outcome and performance (Ricci & Serluca, 2013).

It is necessary, in order for change to be effectively implemented, for there to be a balance between principles of legality (administrative constitutional law), political legitimacy and credibility (rethinking forms of people's participation), balance of public finance (necessary to maintain the country's legitimacy and credibility internationally and vis-à-vis financial markets), and autonomy and managerial responsibility of individual administrations (corporate or public management model) (Borgonovi *et al*., 2018).

As pointed out by several authors (Guthrie *et al*., 2005) the crux of the reforms that started with the NPM and continued with the New Public Governance aims to promote accountability (Dunleavy & Hood, 1994), control (Pollitt & Bouckaert, 2017) and empowerment (Clune & O'Dwyer, 2020), internal and external transparency (Guthrie, 1998) and participation, integrating the environmental and social aspects of the complex public activity in the management and therefore, in the strategy, in order to also improve economic performance financially (Comite, 2024).

The accounting system plays a vital role in this reform process.

The Italian legislature has already implemented the obligation to harmonize PA accounting systems with Legislative Decree 118/2011. Having homogeneous, aggregable and comparable budget data, as they are processed using the same methodologies and criteria, is an unavoidable necessity to meet the pressing information needs related to public finance planning, management and reporting. More generally, it is a condicio sine qua non for ensuring access and clarity for anyone who wants to independently inform themselves and understand how public finance is planned, managed and controlled (https://openbdap.rgs.mef.gov.it).

III. Materials and Methods

Although major accounting reforms have taken place in Italy over the years, the fundamental and primary system remains the financial system, which is flanked by the economic asset system.

Financial (authorizing) accounting is an accounting system that records the authorizing aspects of management and the financial flows analyzed in the various components.

It is an instrument of predetermined allocation of resources, which is made explicit through the approval of the budget by the deliberating body, an instrument of authorization for the use of resources through the mechanism of commitments/disbursements. The public budget estimate, drawn up by the criteria of financial accounting, expresses the values of revenues of expenditures that are expected to occur in the following year. These values represent a legal-administrative constraint for the realization of revenues and expenditures, both for the political body that approves the budget, and for the administrative body that is called upon to manage it.

The limitation of financial accounting is, therefore, that it does not record the facts of operations but only the use in financial terms, precisely, of resources and thus the ability of the entity to meet the financial requirements necessary to deliver services. Simple recognition does not allow judgments to be made about the substantive nature of operations, thus assessing inventories, income depreciation, provisions for future expenses and any temporal interdependence of processes (Borgonovi, 1996).

In this system, accrual accounting complements, for cognitive purposes, financial accounting as established by the decree of accounting harmonization, Legislative Decree 118/2011.

Such unitary recognition seems to outline "a joint integrated accounting system in which, in terms of the faithful representation of the financial, economic and patrimonial situation of the entity there is no prevalence of one accounting over the other" (Grandis & Mattei, 2023).

The income statement and balance sheet are currently prepared through the integrated chart of accounts and a correlation matrix (Anzalone, 2017).

However, accrual accounting remains a derivation of financial accounting with the consequence that "any error in enhanced financial accounting, automatically produces an error in accrual accounting as well, inevitably limiting its cognitive value" (Grandis & Federici, 2020).

The introduction of accrual accounting, as envisaged by reform 1.15 of the NRP, will come into force in 2026 and will make it possible to overcome the limitations of financial accounting, which does not allow for the identification of costs and the use of resources, the measurement of efficiency and in general of the performance achieved, to direct management to think in terms of costs and not expenses. By correlating costs with results achieved, one can obtain the information needed to improve planning and resource management in decision-making processes (Christiaens *et al*., 2015), just as financial accounting (Carlin, 2005) does in businesses.

The accounting reform envisages a single body of accounting standards, which in turn are inspired by IPSAS (International Public Sector Accounting Standards) and EPSAS (Heald, & Hodges, 2018), (Manes Rossi & Caperchione, 2018) and drafted by the governance structure envisaged by Decree Law 152/2021 and established at the Department of the General Accounting Office of the State.

The process begins with adopting of an initial foundational document (Oct. 10, 2022) of the Conceptual Framework that defines the principles of economic, asset and financial reporting for general government information purposes. It represents the theoretical or conceptual framework, for the functionality of an economic and financial accounting system based on the accrual principle.

This is followed by the ITAS accounting standards, which are the applied accounting principles in which the "applicative accounting rules" are defined to which all entities must conform in managing and representing business events.

The status of the approved Itas is summarized in the Table 1.

Table 1. The status of the approved Italian Accounting Standards (ITAS)

NUMBER	OBJECT	
ITAS 1	Composition and formats of the financial statement	Approved
ITAS 2	Accounting policies, changes in accounting estimates, correction of errors, and events occurring after the end of the reporting period	Approved
ITAS 3	Foreign currency transactions, assets, and liabilities	Approved
ITAS 4	Tangible assets	Approved
ITAS 5	Intangible assets	Approved
ITAS 6	Service concession arrangements: grantor	Approved
ITAS 7	Leases	Under consultation
ITAS 8	Impairment of assets	Under consultation
ITAS 9	Revenues and income	Under consultation
ITAS 10	Inventory	Approved
ITAS 11	Financial instruments	Under consultation
ITAS 12	Consolidated financial statements	Under consultation
ITAS 13	Funds, potential liabilities and potential assets	Approved
ITAS 14	Holdings in controlled or related entities and joint control agreements	Under consultation
ITAS 15	Employee benefits	Approved
ITAS 16	Cash social benefits	Approved
ITAS 17	Accruals and deferred items	Approved
ITAS 18	Costs and fees	Under consultation

Source: https://accrual.rgs.mef.gov.it/ (June 2024)

The Itas will be accompanied by general guidelines for developing operating manuals with summary directions for applying the standards in the context of financial statement preparation, accompanied by illustrative examples for specific accounting entries.

The process (due process) for the enactment of the Conceptual Framework and Standards (ITAS), contained in the Regulations of the Governance Structure, stipulates that the proposed enactments developed by the Standard Setter Board are subject, prior to final approval by the Steering Committee, to a Public Consultation phase aimed at all stakeholders interested in the future implementation of the accounting reform, in order to acquire any opinions and input.

IV. Result and Discussion

Financial documents for general information purposes are a tool for meeting the information needs of the generality of users. The centrepiece of reporting is the annual financial statements. The financial statements must provide a true and fair view of the financial position, results of operations, and cash flows of a government at the end of an administrative period. This information shall be determined based on an economic and financial accounting system from the perspective of intergenerational equity and sustainability.

Standard Itas 1 - Composition and Format of Financial Statements governs the structure, content and presentation of the statements that make up the financial statements and consolidated financial statements of governments.

The annual financial statements include:

(1) The balance sheet;

(2) The income statement;

(3) The cash flow statement;

(4) The statement of changes in equity;

(5) The comparison of budgeted and actual amounts (for governments that prepare their budgets or budgets on an income statement and balance sheet basis);

(6) Explanatory notes to the financial statements.

The balance sheet shows the administration's assets, liabilities, and shareholders' equity as of the end of the fiscal year.

The layout of the balance sheet has divided and opposing sections, referred to as assets and liabilities, respectively.

Assets and liabilities are divided into current and non-current.

An asset is current when it meets one of the following requirements:

(a) It is expected to be realized or is held to be sold or consumed during the normal operating cycle of management;

(b) It is held primarily to be traded;

(c) Is expected to be realized within twelve months after the end of the fiscal year;

(d) Consists of cash or cash equivalents, unless it is prevented from being exchanged or used to settle a liability for at least twelve months after the end of the fiscal year.

An asset is non-current when it does not meet these requirements.

A liability is current when it meets one of the following requirements:

(a) It is expected to be settled during the normal operating cycle of administration;

(b) It is held primarily to be traded;

(c) It is expected to be settled within twelve months from the balance sheet date of the administration;

(d) The administration does not have an unconditional right to defer its settlement for at least twelve months after the balance sheet date.

A liability is non-current when it does not meet these requirements.

Shareholders' equity is determined by the difference between total assets and liabilities, consists of the endowment fund, available and unavailable reserves, and net income for the year.

The income statement includes income/revenues and expenses/costs for the year and the economic result for the year.

The income statement format is in scalar form with a classification of costs by nature and identifying interim results of operations.

The areas of the income statement are:

- Operating management, includes all income-revenues and expense-costs of administration;
- Financial management, includes costs resulting from borrowing capital and income from holding cash and cash equivalents;
- Extraordinary management, includes income-revenues and cost charges resulting from transactions or other events of an unforeseeable or non-repetitive nature.

The cash flow statement represents cash inflows and outflows from operating, investing and financing activities. It is prepared using the direct method.

The explanatory notes to the financial statements supplement and explain the information in the schedules that make up the financial statements.

About the first research question, whether the financial statement formats approved in ITAS 1 standard can improve comprehensibility and comparability among financial statements, the consideration in Section 1.18 of the Conceptual Framework is supportable. Considering "that the institutional purpose of general government is to meet the community's needs, the financial statements represent only some aspects of the overall results of public action, namely the economic, capital, and financial results. The results and, in general, the information presented in the annual financial statements should be placed in the context of an overall assessment of a public administration's ability to achieve the objectives related to the delivery of public services. It is therefore necessary to accompany the information provided in the annual financial statements with information regarding the resources consumed (inputs), the type, volume and quality of services provided (outputs), and the social, economic and environmental impacts produced (outcomes). This information is usually presented through indicators and other forms of performance representation, useful for measuring efficiency, effectiveness and impact."

The current accounting system after the accounting harmonization reform initiated by Legislative Decree 118/2011, hinges on a systemic approach to budgeting, the system of planning, management and reporting, and the enhanced accrual basis, which brings financial accounting closer to asset and liability accounting by providing that accounting entries are made considering the collectability of expenditures.

In the current local government accounting system, operating results are demonstrated through the statement of management, which includes the financial report, the balance sheet and the income statement.

The financial report demonstrates the final results of management concerning the authorizations contained in the first year considered in the budget. For each type of revenue and each expenditure program, the financial report includes, separately for residuals and accruals:

a) for revenue the amounts established, with a distinction between the part collected and that yet to be collected;

b) for expenditure the sums committed, with a distinction of the part paid and that yet to be paid and that committed with allocation to subsequent years represented by the restricted multi-year fund.

The Balance Sheet and Income Statement, required by Articles 227 et seq. in the Consolidated Local Authorities Act (Legislative Decree No. 267 of 18 August 2000), are prepared through the integrated chart of accounts and the correlation matrix.

In light of the above considerations, the new accounting framework provides greater information on costs and thus on political choices in resource allocation (Mazzoleni & Paredi, 2022), on greater accountability and transparency in the use of public resources finally a greater measurement of the value of capital assets, e.g. a more timely valuation of public assets.

No less important result will be the international comparability of the financial statements of Italian public administrations, finally abandoning financial accounting and its summary documents in favor of accounting documents shared with other European countries.

V. Conclusion

The answer to the second research question: What may be the difficulties for local governments in implementing such an accounting system? Two crucial factors can be identified.

The first is know-how and staff training. This project is planned to implement a new information system to support public accounting processes, based on an ERP (Enterprise Resource Planning) type architecture and structured in interconnected and integrated modules. This system will be able to capture, through a single record, the financial, economic-asset and analytical aspects of the same management transaction.

The new system, called InIt, will be provided to public administrations by the State General Accounting Department (RGS) as a single integrated IT platform to support accounting processes, replacing the numerous applications currently used in central administrations. In addition, the platform will be able to manage all of an organization's processes (administrative, production, and financial), enabling the integration of all functions in the organization and making information available simultaneously to all processes and actors involved.

The second is the need for users to understand the actual potential regarding information.

The political body that has to make resource allocation choices not only in order to meet the needs of the administered community but also based on accounting findings should understand the real scope of the introduction of the new accrual system, which should not be limited to a mere fulfillment derived from financial accounting as it is today.

It is a continuous evolution of this application. A trial period is planned for its introduction, which should give feedback to fine-tune the system better.

Future research developments will be precisely aimed at verifying the actual application to the experimenting entities and the informational reach to improve accountability, transparency in the use of resources, and comparability of budgets over time and space.

Conflict of Interest

The authors declare no conflict of interest.

Author Contributions

Alba Maria Gallo wrote the introduction and literature review, Maria Carmela Serluca wrote the other paragraphs.

All authors had approved the final version.

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