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Accounting for Financial Sustainability. Different Local Governments Choices in Different Governance Settings

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1 Introduction

Starting in the 1980s, the so-called "New Public Management" (NPM) (Hood 1991) has heralded a new era for the public sector, but its rationale has rapidly been criticized for its lack of multi-organizational focus (Rhodes 2000). As response to the increasingly complex and plural nature of public policy implementation and service delivery, a New Public Governance (NPG) idea has emerged (Osborne 2009, p. 7), emphasizing the relationship with the external environment and the inter-organizational (between governments and, especially for the provision of services, between

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M.P. Rodríguez Bolívar (ed.), *Financial Sustainability in Public Administration*,
DOI 10.1007/978-3-319-57962-7_5

public- and private-sector organizations) relationships, called governance of networks (Kickert 1993; Considine 1999).

At the same time, some scholars (Guthrie et al. 1999, 2005) have concentrated their attention on "the technical lifeblood of NPM organizational structures" (Guthrie et al. 1999, p. 211), such as accounting techniques, financial management, and different tools that could be implemented to support managerial reform agendas, called New Public Financial Management (NPFM). Special attention has been paid to financial sustainability (FS), given the fact that no services will be properly delivered if governments do not have appropriate resources or if their accounting systems fail to play the central role of supporting decision-making processes.

One key point in the study of FS is the need to consider the blurring boundaries of public sector organizations and their relationships with other entities that are involved in policy implementation and service delivery. Nonetheless, nowadays most public organizations, especially local governments (LGs) still experiment difficulties in playing the game of networking, and appear more as stand-alone organizations. It seems to worth noting that some scholars have identified and characterized different institutional settings or governance models (Considine and Lewis 2003; Considine 1999, 2001) in this respect.

Although there is a wide literature discussing FS in the public domain (Brusca et al. 2015; Cohen et al. 2012; Navarro-Galera et al. 2016; Padovani and Scorsone 2011; Rodriguez-Bolivar et al. 2014, 2016; Zafra-Gomez et al. 2009) and studies have highlighted the connection between financial condition and service delivery (Jones and Walker 2007; Andersen and Mortesen 2010), there is a gap in the literature concerning the link between FS and the governance setting for service delivery adopted by LGs (Osborne et al. 2010). The chapter aims to fill this gap analyzing how specific accounting tools and techniques can assist in the control of an LG's FS based on the governance setting adopted for service delivery. More precisely, a standard accounting tool or technique (e.g., a set of indicators, a standard source of accounting information), to detect fiscal distress, would not be effective for all LGs. In contrast with previous literature, which has discussed FS measurement systems in LGs as an all-compassing tool, we stress the idea that measuring and promoting FS should be considered in the context of the

governance setting in use. Each governance setting requires the monitoring of different aspects, and therefore the collection of different types of accounting information, in order to keep FS under control, and at the same time to assure service delivery, at the required standards. To this end, the Italian setting represents an interesting condition, given that the Italian law offers the same accounting methodology for all LGs regardless of the chosen governance model. The aim of the research is to grasp a lesson to learn by some illuminating observations drawn from few cases suggesting highly useful conclusions about some important issues in controlling FS that can be suitable for a wide variety of municipalities. To this end, the chapter unfolds as follow: after this introduction, an overview of the literature concerning FS in local governments is presented, highlighting the extent to which accounting might be of help in the assessment and control of FS conditions. The discussion is connected to the consideration of the different governance settings for service delivery adopted in local governments, as they are categorized in literature. After having clarified the methodology (Sect. 3), five cases are presented (Sect. 4). Section 5 provides a discussion of the case studies by linking evidence to previous literature about accounting tools and techniques to face the different FS management problems, coordination, cooperation, and conflict, in the different governance models identified. Findings give evidence that a local government needs to avail itself of specific FS measurement systems and accounting tools and techniques that are consonant with the governance model it has adopted. Section 6 draws some conclusions and discusses possible consequences of the research for managers and legislators.

2 Accounting, Financial Sustainability, and Governance Settings in Local Governments: The Missing Link

The study of FS is a relevant topic nowadays: standard setter and professional bodies are providing several guidelines and documents in the aim of supporting public administration in gaining FS. In this sense, the IPSASB (the International Public Sector Accounting Standards Board founded

by the IFAC—International Federation of Accountants) has issued the Recommended Practices Guideline n.1 (RPG) in which three intertwined dimensions of long-term FS are settled: *service dimension* (including the volume and quality of services to recipients and beneficiaries), *revenue dimension* (including taxation levels and other revenue sources), and *debt dimension* (which consider the debt levels in a certain period, including the ability to meet financial commitments) (IPSASB 2013).

Also professional bodies contribute to develop some guidelines to monitor financial condition: the ICMA (International City/Country Management Association) published the Handbook for local government (2003), as well as the Canadian Institute for Chartered Accountant issued in 2009 a Statement of Recommended Practices (SORP) 4: Indicators of Financial Condition. Meanwhile, the main challenge is to determine how to measure FS.

Literature highlights problems related with a bad FS, focusing on "financial health," "fiscal distress," "financial risk," "fiscal crisis," or "fiscal strain." Although external forces, mostly socio-economic, could heavily affect an LG's financial equilibrium (Falconer 1991), we consider more useful to refer to the ability of a single entity to keep a financial equilibrium; to this end, in line with the IPSASB's point of view, we define FH more narrowly as *the condition in which an LG is regularly able to meet its payroll, pay its current liabilities, meet its debt service* (Downing 1991, p. 323), *and undertake service obligations as demanded by constituents* (Falconer 1991, p. 812; Krueathep 2010, p. 224).

Some authors have focused their research on LGs' credit ratings and solvency assessment (Manes Rossi 2011), others have concentrated their attention on the possible influential factors: thus, some have emphasized short-term solvency, represented by an LG's ability to meet its payroll and generally make payments in a timely manner, while others have focused on the long term, where the point of view is more on the trends in an LG's tax base relative to its expenditures and commitments (Brusca et al. 2015; Navarro-Galera et al. 2016; Rodríguez-Bolívar et al. 2014, 2016). The possibility to measure FS by using a set of indicators ranges from a limited number (Brown 1993) to a larger one (Ammar et al. 2001), almost focusing on financial aspects, even sometimes including socio-economic variables (Andersen and

Mortesen 2010; Cohen et al. 2012). They are all tightly intertwined with accounting data, meaning that the measure of FS depends on accounting information availability. These measures range from basic approaches such as accounting information and financial reporting analyses (e.g., Dothan and Thompson 2009) to qualitative analyses contained in audit reports. LGs often employ more sophisticated statistical modeling approaches (e.g., Murray and Dollery 2005). An important aspect of all the approaches is the proxy used in order to discriminate financially unhealthy LGs from the healthy ones. Several variables have been proposed for this purpose such as ratio indicators (ICMA 2003), the incidence of mergers or amalgamations, the quantity or quality of service delivery, and the cost of restoring infrastructure assets to satisfactory condition (Jones and Walker 2007; Zafra-Gómez et al. 2009). This wide array of options has determined a diversity of approaches to LGs' FS assessment by audit bodies throughout the world (Padovani and Scorsone 2011).

Moreover, since the late 1980s there has been growing pressure to implement accrual accounting, replacing or adding to the traditional budgetary cash-based or modified accrual accounting (Guthrie et al. 2005) to feed the need of measuring and monitoring economic quantities. Accrual accounting has been considered by IPSASB as the system more suitable to assure decision-makers with an accurate picture of the actual consumption of wealth and resources, and the real financial situation, which—in turn—would provide politicians and managers with a better support for monitoring FS (Pina et al. 2009; Padovani et al. 2010).

At the local level, fiscal autonomy has acted as the ultimate affecting driver, since the object of control has moved from the "correct use of governmental grants" to the "efficient and effective use of local citizens' taxes" (Caperchione and Mussari 2000). In this context, accounting systems have been more focused on managers' goals rather than on total outcomes, as well as on the possibility for compliance with standards rather than with stakeholders needs (Gray and Jenkins 1993; Cepiku et al. 2016).

During the last 20 years, a new trend in public service provision has emerged, the externalization of public services through corporatization, contracting out, public–private partnership, and privatization (Torres and

Pina 2002; Boivard 2004; Grossi 2007; Reichard 2002). The transformation of the public service system took place at all governmental levels even if the result of the institutional transformation is most visible at local level, as can be seen in Italy and Germany (Grossi and Reichard 2008). LGs have set up new organizational structures with public and private partners (Kettl 1993; Rhodes 2000; Osborne and Brown 2005), putting in place different governance settings that reflect their unique social, economic, and political interdependencies (Kooiman 2001, p. 72).

One result of these movements is the identification of six ideal-type structures for service provisions adopted by LGs (Grossi and Reichard 2008), namely (a) direct provision through an LG's organizational unit (direct provision); (b) the use of an autonomous entity belonging to the same local authority or to one or several other jurisdictions (corporatization); (c) collaboration of several public authorities like a consortium of municipalities (public–public collaboration); (d) partnerships with public and private entities (public–private partnerships); (e) outsourcing to a private for-profit company (contracting out); and (f) devolution to a private nonprofit (devolution).

This process of transferring the delivery of local public services to third parties (private and public) implies on the one hand a loss of involvement in the direct service provision, even if the overall responsibility for quality level of service delivery still remains on the LG (Kettl 1993). On the other hand, it implies the introduction of different kinds of players, where LGs need to coordinate concurrent activities delegated, balancing various interests that may conflict with the LGs' interests. There is a variety of institutional arrangements used to supply public services with external providers, ranging from intergovernmental agreements to franchises. The institutional landscape for service provision and delivery may vary within OECD countries (Considine 2001; Hodge and Greve 2005; OECD 2005). As a result, it seems clear that not all "not in-house" arrangements can be considered as outsourcing, i.e., those settings where the producer differs from the original arranger (the actor who assigns the producer to the consumer or vice versa). In countries, such as Italy, where new autonomous public sector organizations have been established at the LG level, that there is a "corporate governance model." Corporations, authorities, and agencies owned by

a municipality form the so-called "municipal group," in which the producer of service is a legally distinct jurisdiction, but still controlled by the same municipal government (Grossi and Mussari 2008).

At the local level a public service can be delivered by an LG department, by an autonomous entity belonging to the LG or to one or more other jurisdictions, by a collaboration between public entities or between public and private partners, or by contracting out the service to a private company. Lastly, a public service can be completely privatized, with the complete exclusion of public responsibility. All those variants for public service provision and delivery can apply in mixed forms, so that an LG has a considerable choice among all these institutional arrangements or governance settings.

Considine (2001) offers a systemization of conceptualizations concerning governance models of public services where the public retains some kind of managerial responsibility (Hutt and Walcott 1990; Pierre 1999; English et al. 2005). Each of the Considine's four models (procedural, corporate, market, and network) has a distinct source of rationality, form of control, primary virtue, and service delivery focus.

Considine's first three types of governance—procedural (PG), corporate (CG), and market (MG)—correspond to phases in the development of public governance in OECD countries, from its emergence to its periods of transformation in the 1990s. The fourth type, network governance (NG), is identified in a post-bureaucratic era (Considine 1996; Osborne and Gaebler 1992), and it is evident to some degree in specific policy fields such as city management (Considine and Lewis 2003, p. 133). NG functions even when there is no government to provide public services (Denters and Rose 2005); it is less frequent in unitary and regulatory countries, and more present in plural and pluralist ones (Osborne 2010).

Core attributes of PG are adherence to rules and protocols, high reliance on supervision, and an expectation that tasks and decisions will be well scripted, including information technology systems used in the organization. In this kind of institutional setting, a system of financial indicators (mainly on input and output, as well as on efficiency) can support the assessment and control of FS. Indeed, in PG, accounting systems support the possibility to provide standardized services at the lowest per-unit cost (Farneti et al. 2009, p. 256).

As Hood (1990) points out, in the 1980s a new CG model emerged in several countries, viewing public organizations as "corporations" run by business managers, with a perception that the PG did not fit with a variety of administrative requirements for outsourcing, mainly the need to maintain greater control over public expenditures (Pallot 1992; Pierre and Peters 2000). In addition, the PG model was not able to deal with the increasing complexity of government (Lapsley 1988), and the need to target some services for a subset of the population. In the CG model, planning, budgeting, and reporting have a considerable importance, and a public administration using it concentrates on outputs instead of inputs, focusing on specific groups of citizens who are receiving services. Great emphasis is on the shift from following rules to achieving results, and, consequently the accounting system has to produce data and information useful to monitor the condition of FS while politicians and managers are planning how to manage public service delivery. Management accounting data, standard costs, and other reporting tools, including consolidate accounts, have to be coordinated in order to support decision making in a FS approach, since the availability of appropriate information will facilitate the efficient allocation of resources (Coy et al. 2001).

In the market governance (MG) model, contracting out, competitive tenders, and principal–agent separation are employed to respond to financial signals and competitive pressures. In this model, competition among potential vendors is encouraged, and the LG develops contracts that stress quality as well as cost. Considerable emphasis is placed on meeting citizen needs (Pierre and Peters 2000) and defining relationships (English et al. 2005). To that end there is a need for arrangements with commercial companies, public authorities, and/or nonprofit organization (Pollitt 2003), whilst in other cases public institutions use their corporate habitus for directly running their business activities, or they sell relevant assets to external entities (Broadbent and Guthrie 2008). Since market dynamism and increased autonomy help to assure accountable managerial behavior, the MG model requires an appropriate set of reporting and feedback relationships to help assure that aim (Osborne and Gaebler 1992). Moreover, in many public entities, developing the requisite management control system runs contrary to their long-standing, input-based, managerial cultures, and therefore

is a difficult transition to make (Padovani and Young 2008; Padovani et al. 2014). Accounting figures have to sustain make-or-buy decisions, as well as assist with cost control and the quality of outsourced services. More specifically, to preserve FS, the accounting system has to focus on the LG's ability to maintain a certain level of public services in accordance with available resources and costs related to contracts already in place. The use (and not only the availability) of proper indicators, provided continuously, not only at the end of the year, becomes a key aspect of monitoring FS.

In the network governance (NG) model, a government continues to rely on outside agencies, but in the form of a strong strategic partnership. Competition and confidentiality of contracts is supplanted by joint action. This model aims to increase competition so as to help contain costs, and its contracts generally focus on just one service. It is inappropriate when some outsourced services need to be coordinated with others. The NG model is designed to achieve this coordination. With NG, LGs are interested in building trust, and clients, suppliers, and producers are linked together as co-producers. Instead of fixed organizational boundaries and roles, the system promotes a new rationality based on the creation of a shared organizational culture. In order to achieve FS, in this kind of governance model, consolidated budgeting and reporting have to be added to the tools already described: if one partner has a financial problem, it would necessarily affect the LG's financial condition. As a result, FS must be considered at network level (Grossi and Mussari 2009; Heald and Georgiou 2011).

In discussing governance of outsourcing, some authors (Farneti et al. 2009) have stressed the idea that a public entity should not be attempting to move from PG to NG for service delivery deliberately. Instead, Considine's framework is a contingent tool that helps to consider which model is appropriate to the nature of the service delivery being outsourced. Similarly, it seems clear that when a given model prevails, there are consequences for the FS measures that are used to detect financial conditions, and on accounting tools and techniques adopted to report on such FS measures.

In Table 1, each Considine's model (procedural, corporate, market, and network) and its features in terms of source of rationality, form of control, primary virtue, and service delivery focus, are matched with Grossi and Reichard's structures for service provision (2008, p. 600). The latter is defined in terms of kind of structures for service provision (LG's direct service provision, corporatization, contracting out, devolution, public–public collaboration, public–private partnership) and subjects involved, internal (a LG), external (corporation, private company or non-profit organization, other jurisdictions, other public entities), or both.

Even if the chapter is under a municipal's FS perspective, the discussion of the different case studies took place considering the interaction with other actors within the network, as suggested by Caglio and Ditillo (2008). When an LG participates in a network, it is because its own purposes are based on perceived financial costs and benefits. The municipality takes part in a network as long as it feels that network participation can serve its interests, even if participants can be driven by external motivation.

3 Methodology

The methodology adopted entailed the selection of several cases in connection with an evaluation of literature. In particular, we chose one case for each organizational structure for service provision as provided by Grossi and Reichard (2008) discussed above. The cases were selected because they addressed emblematic situations of FS mismanagement that compromise in the long-term FS due to the lack of specific accounting tools and techniques. The aim of the research is to draw some useful conclusions from illustrative cases which can suggest some important issues in controlling FS. Indeed, if the information obtained from the research can lead to some concepts that "resonate" with municipality managers, as we believe will be the case, then the conclusions have validity for improving FS control in a wide variety of municipalities.

Data were collected through on-line, publicly available resources. More specifically, financial statements for the year 2014, with all related documents, have been collected, and information about the

Table1 Governance models and structure for service provision

Models		Procedural governance (PG)	Corporate governance (CG)	Market governance (MG)		Network governance (NG)	
Features of governance models Considine 2001	Source of rationality	Law	Management	Competition		Relationships	
	Form of control	Rules	Plans	Contracts		Co-production	
	Primary virtue	Reliability	Goal-driven	Cost-driven		Flexibility	
	Service delivery focus	Universal treatments	Targets	Prices		Brokerage	
Structures for service provision Grossi and Reichard (2008)	Kind of structures for service provision	LG's direct service provision	Corporatization	Contracting out	Devolution	Public–public collaboration (PPC)	Public–private partnership (PPP)
	Entities involved in service provision	Internal: LG	Internal and external: LG and corporation (direct corporatization), eventually through other jurisdictions (indirect corporatization)	External: Private company	External: Nonprofit organization	Internal and external: LG and other public entities	Internal and external: LG and private partners

Source Elaborated from Considine (2001) and Grossi and Reichard (2008)

organizational structure, contracts, and partnership have been taken into account. Moreover, to better understand the dynamics underpinning the relationship with the different partners, for the same year the minutes of the city council meeting have been examined.

The five cases cover corporate, market, and network Considine's governance models, organized into Grossi and Reichard's division in corporatization (for corporate governance model), contracting out and devolution (for market governance model), and public–public partnership and public–private partnership (for NG model). We do not investigate cases about procedural governance (direct provision in Grossi and Reichard's terms), because in that model the structure of service provision, the FS problem, as well as the accounting tools and techniques used, depend on the LG itself and not on other subjects. In the PG model, the issue of controlling FS is a matter of internal control accounting tools and technique "package" (Malmi and Brown 2008) widely discussed in the literature.

The attention has been focused on Italian municipalities as in Italy there is a need to reframe the LG control systems to ensure FS, which has worsened considerably in the last years. In the early 1990s, the pressures stemming from public deficit and debt (large as annual GDP), the NPM ideas and the EU reform of structural funds, helped introduce new ideas about financial management, planning, and evaluation (Bouckaert and Pollitt 2005, pp. 264–269). With the reform process, municipalities were given greater financial and organizational autonomy, ensured by allowing municipalities to self-regulate within specific national rules and principles. One consequence of this organizational autonomy and the parallel impulse towards "liberalization" and "privatization" caused the increasing proliferation of outsourcing and the birth of new autonomous public organizations under the form of agencies, corporations, and authorities owned in majority or in total by LGs.

This latter pervasive phenomenon gave rise to the shift from direct service provision to direct and indirect corporatization, contracting out, devolution to nonprofit, public–public collaboration, and public–private partnerships. A recent study made by the Italian Audit Court (Corte dei Conti 2015) on the situation of corporations and companies, another kind of public–private partnership reveals that these kinds of

organizations have reached approximately 5000 units, totaling €6915 billion of current expenditures.

4 The Governance Setting Cases

The accounting tools and techniques for the governing of FS adopted in the five cases do not fit with Considine's governance models of service delivery. Instead, the municipalities considered in the present study adopted accounting tools and techniques that fit well with an idea of direct service provision or a PG model. Each case offers an example of different service provision settings where financial problems could have been better controlled if specific accounting tools and techniques had been implemented. The following cases help us to identify the broad accounting tools and techniques needed for each service delivery setting.

4.1 Municipality A: A Corporate Governance Case

Municipality A owned the totality of the shares of seven agencies through one wholly owned corporation, which acts as a holding corporation. These seven agencies are separate jurisdictions and are involved in several projects for new infrastructures for the town; each is devoted to specific areas and aims: exhibition center development, housing, university buildings and services, new subway, central station renewal, development of industrial areas, and arts and crafts centers. While these agencies were created to avoid limits on financial outflows established by the central government under the "internal stability pact" rules (Ministero dell'Economia e delle Finanze 2009), the holding corporation was created in 2009 with the specific aim to improve the financial management of the municipality's seven different corporations. The holding company prepares its own consolidated financial report but the municipality does not, so the net financial results of this sub-group of agencies are known but the financial situation of the overall municipal group is not.

Since its inception, the holding corporation was considered by the minority of the municipal council as a place where decisions were made without political debate and with an increasing opacity in terms of financial management. Only investments with a value of more than 500,000 Euros required a specific authorization by the municipality. In 2010, Standard & Poor provided its first rating assessment of the holding corporation. Even though debts were very high (the long-term debt/asset ratio was about 1), it received a moderately good rating assessment (BBB). This was mainly caused by letters of patronage that the municipality signed to guarantee creditors, so it was considered quite likely that the municipality would have supported the sub-group in case of financial difficulties.

During 2011, financial difficulties caused by increased debt worsened the financial status of the seven corporations, especially for two of them. First, the one responsible for the central station renewal, which was subject to a foreclosure for unpaid bills. Second, the agency responsible for the development of industrial areas and arts and crafts centers, which went through a negotiation with creditors. This compromised financial situation required the municipality to find resources, worsening its own FS, which had always been on an average level when compared to other municipalities of the same size. Consequently, on one hand, the municipality worsens its global financial situation, and on the other hand, it hampered its ability to fulfill its infrastructure-related goals.

4.2 Municipality B: A Contracting Out Case

Municipality B outsourced revenue management to a private firm. The activity outsourced is a pivotal municipal function of several towns and cities, especially in view of the need to increase the FS through the improvement of tax assessment, tax verification, and the effective management of other municipal revenues.

While the vendors' market is subject to a strict regulatory framework, there is no explicit specification about the pricing method for the revenue management activity. Italian municipalities are encouraged by the system of rules and by their accounting system to increase the amount

of receivables instead of the amount of cash inflows. In fact, budgetary accounting aims to balance, under the commitment-based logic, revenues and expenditures accounted when the obligations occur, instead of balancing cash inflows and outflows. Furthermore, the “internal stability pact” pushes municipalities to increase receivables, which may take some time to turn into cash inflows. This may have persuaded Municipality B to provide a pricing mechanism in the contract where the price it agreed to pay, and thus translated to cash outflows, was a percentage of the amount of receivables levied instead of cash inflows received. While this incentive system may have persuaded the vendor to improve its activity of municipal tax and fees verification, and thus to improve some of the financial indicators, this mechanism could be extremely risky in terms of long-term balancing of cash flows. Municipality B had a very high percentage of receivables not collected (within the lowest 0.15 percentile of municipalities of the same size). Therefore, it is very likely that the vendor would emphasize the increase of receivables, and place minimal attention on collecting activities. This would turn into two negative effects: the increase of financial outflows for the payment of the vendor, not covered by financial inflows; and the increase of expenditures that is possible by the increase of receivables, but without cash coverage. The municipality would have then the possibility to terminate the contract to limit negative effects, penalty for unilateral withdrawal included.

4.3 Municipal Consortium C: A Devolution Case

Municipal Consortium C is aimed at providing social services to its local communities, three nearby municipalities. It has been in operation since 1997.

In 2010, in conjunction with the need to make a general and thorough audit for the transformation of the legal status of the consortium following the new regional rules, the newly appointed audit body found out off-balance outlays and other accounting errors and misrepresentations for a total amount of nearly 9 million Euros. A board of inquiry was appointed by the municipal council of the majority shareholder (52%) to further clarify the work done by the new audit body, and to understand

the reasons underlying the deficit. It turned out that there were several issues not captured by audit reports, like unsupported account receivables, off-balance outlays, and payables shifting from one year to the next.

The most important part of this multi-million deficit resulted from off-balance outlays. According to the audit reports, this is due by several "open agreements" with nonprofit organizations providing more than 90% of the services (e.g., elderly care, in-home assistance, retirement homes, afterschool care for handicapped) on behalf of the consortium through contracts. The nonprofits had delivered the services properly but had not controlled costs and prevented expenditure overruns. In this setting, all nonprofit organizations had provided the services to users, at the same time had accumulated credits with the consortium. Even with periodical coverage of expenditure overruns, the result was not fully satisfactory. This constant overspending resulted in severe off-balance outlays for two reasons: (1) the increase of social expenditure due to financial crisis and (2) the related difficulty of the governments belonging to the consortiums to allocate further resources to finance the deficits.

4.4 Municipality D: A Public–Public Collaboration Case

Municipality D is one of the towns that managed social services through the Municipal Consortium C above. Municipality D had a share of 1% in this consortium, which gave it the least decision-making influence and no power to appoint any audit body member.

The board of inquiry (see Municipal Consortium C) found out that roughly 78% of the deficit was due by activities for which the majority shareholder's citizens were the beneficiaries. For this reason, while some council's members of the minority argued that 52%—the shareholding rate—was the right rate, 78% of the deficit has been taken on by the majority shareholder. For Municipality D, this unexpected deficit was fixed to a total of 45,000 Euros (0.5% of total deficit) in place of the regular rule of deficit covering based on the amount of shares owned, i.e., 1% or 90,000.

4.5 Municipal Consortium E: A Public–Private Partnership Case

The Municipal Consortium E represents a case where a "complex" public–private partnership occurred. It promoted, in conjunction with another nearby municipality, a new infrastructure project with the involvement of a private corporation.

The project was a 4-km tunnel designed to connect quickly and safely two towns separated by a mountain, but belonging to the same industrial district, and thus having several commuters and commercial relationships. The idea to build the tunnel originated in the late nineteenth century by local public officials. It finally became a project in 1988, and in 1989 a consortium between the two towns was created. This consortium used the project financing setting to build and operate the tunnel through a private contractor who was selected through a competitive bidding. According to the project financing contract, the winner of the competition would have had been required to build and operate the tunnel for 35 years and the right to collect user fees during the same time. The aim of such behavior was not to spend public money, other than what was already spent for the project and administrative expenses for the consortium. Therefore, the budgets of the two municipalities would have been untouched.

While the first plan demonstrated the financial feasibility of the arrangement, it subsequently turned out that the tunnel was not a profitable business for the contractor. The increasing construction costs, from an initial €53 million to €82 million (55%), and the overly optimistic assessment of users' willingness to pay fees were at the basis of the failure. The contractor resigned and left the business after only 9 years (instead of 35) of operation, asking the consortium to pay an amount of €17 million. This amount was paid in 2007 by a new consortium among the two municipalities and the provincial government. Only a political agreement between the two municipal governments and the province avoided requiring the two municipalities to pay for their failures of not having correctly computed the financial inflows and outflows. In 2008, the consortium was transformed into a wholly owned provincial corporation.

5 Dealing with Coordination, Cooperation, or Conflict?

From the consideration of the five governance settings settled above, it is possible to identify three main problems, a *coordination* problem in corporation settings, a *conflict* problem in market settings (contracting out and devolution) and a *cooperation* problem in network settings (public–public collaboration and public–private partnership). In this section, these three main problems are discussed, identifying the key factors that cause each of them. Then, starting from the evidence given by the five settings analyzed, some accounting mechanisms that would support FS are identified.

5.1 The Coordination Problem in Corporate Governance Settings

In the corporate governance setting, a coordination problem arises. It depends on the distribution of power and competencies, the structure of decision making (internal control), and the kind of relationships that each corporation establishes with other entities operating in the same environment (external control) (Grossi and Reichard 2008). Organizational theory suggests that several variables may influence the coordination problems, all of which are related to component complexity, due to the number of parties involved in the relationship, the number of activities carried out, and the level of interconnection among them (Grandori 1997; Ditillo 2004). When the number of transactions to coordinate becomes high, the control mechanisms are affected. This is because a high level of transactions requires that the information exchange is codified and formalized, and that the tasks are regulated by rules and procedures to ensure timing and interfaces among the respective entities (Grandori 1997). Another variable is related to the cognitional complexity which is a situation in which contributions (input) and outcome (outputs) are unmeasurable or unobservable. The control of this relationship must be based on social peer-based mechanisms, rather than on rules (Grandori 1997).

FS problems occurred in Municipality A (the corporate governance case) because of a lack of knowledge about the impacts on the overall municipal group's financial situation of the decisions made within a sub-group of municipal corporations and agencies. While the information about the substantial financial difficulties of the sub-group was evident from reading the Standard & Poor's reports, the lack of an overall financial (consolidated) report hindered the municipality council to fully understand the magnitude of the problem.

5.2 The Conflict Problem in Market Governance Settings

The conflict problem between profitability (in the case of for-profit organizations) or specific-related goals (in the case of nonprofits) of the external entity and the social goals of the LG arises under two perspectives. The first is the legal issues in the phase of preparing an appropriate contract, and the second is the measurement and reporting issues associated with monitoring the vendor's performance (Osborne and Gaebler 1992). The latter is not only a systematic procedure to monitor the performance of the contractor and compare it to that specified in the contract, but should also consider the possibility that some vendors engage in quality shading, attempting to save costs. Authors have highlighted that, due to a wide variety of arrangements, it is not possible to develop a single model that will serve all of a municipality's relations with its vendors equally well (Kettl 1993). Indeed, a municipality needs a risk assessment, which has three dimensions, citizen sensitivity, supplier market, and switching costs, the combination of which dictates an appropriate governance strategy (Padovani and Young 2008).

From the financial perspective, the conflict problem between the municipality and the third party is regulated by the contract and by other site mechanisms, such as meetings and joint commissions to agree on the amount of contractual penalties (Padovani and Young 2008). The price the municipality agrees to pay to the vendor might be predetermined in several ways. There are two basic situations (although a mix of the two is also possible): (a) a fixed amount to be paid for a specific

interval (e.g., one year of service delivery), or (b) a variable amount depending on the volume of service purchased from the vendor. Both possibilities have advantages and disadvantages. In a fixed-amount contract setting, the municipality pays but it needs to make sure that an appropriate volume of service is provided. In a variable-amount contract setting, the municipality pays only for the service received on a per-unit basis but it needs to keep under control of the total volume of service to avoid expenditures overruns (Padovani and Young 2011).

It is evident that two key accounting tools and techniques are needed for market governance settings. On one hand, cost behavior (fixed versus variable) may be useful to control the municipal financial situation in relation to variations in volume of service. On the other, performance measurement basics in the public sector may be useful to drive the selection of those performance indicators that best fit the performance-related payments to external providers.

In both the contracting out and devolution cases described (Municipality B and Municipal Consortium C), there was mismanagement concerning either the decision of the unit of volume used (contracting out case) or the lack of control of cost increases due to output units used by the contract to compute the contractual amount (devolution case). This hampered the municipality's ability to control the financial outcomes of these arrangements.

5.3 The Cooperation Problem in Network Governance Settings

The cooperation problem differs from coordination one since the entities involved in a corporate governance setting have the same goals as opposed to different goals in the network setting. The principal–agent theory suggests that the various autonomous entities may have incentives to cheat and free-ride in order to attain their own specific goals at the expense of the objective of the collective undertaking. There thus is a need for mechanisms to align their objectives, and the partners need to safeguard themselves against the others' opportunistic behavior. Consequently, the interdependencies resulting from this kind of

interaction require some form of harmonization, and the resulting joint action should be aligned across organizational boundaries to guarantee a match between partners' interface (Caglio and Ditillo 2008).

This cooperation problem depends and increases with growing asset specificity, uncertainty (level of trust, type of network, and level of interdependencies), and frequency of exchange (Williamson 1985; Park and Russo 1996; Zenger and Hesterly 1997). The organizational theory perspective suggests that the variables that play a role in controlling cooperation problems are referred to influence the level of interdependencies among entities (Tomkins 2001), and the type of network (Kajuter and Kulmala 2005). On the other hand, the management accounting literature has drawn on these theoretical domains to deal with the roles that control mechanisms can play in achieving cooperation (Dekker 2004; Cooper and Slagmulder 2004), focusing on control solutions. Dekker (2004) highlights some variables that are key in explaining control configurations. For example, in high asset specificity, the steam of control suggests the use of alternate models of control. They are based on trust (Langfield-Smith and Smith 2003), or on the use of formal behavioral and output control only mediated by trust (Dekker 2004). On accounting and cost controls perspectives, there is a focus on the use of inter-organizational accounting techniques, and the consideration of trust as a contextual factor of the relational environment (Cooper and Slagmulder 2004).

With reference to the use of management accounting practices, a common topic is the need of "accounting openness" between the parties. This translates into the use of open-book accounting practices in supplier–buyer relationships that demand transparency on cost information, including data that would traditionally be considered proprietary (Lamming 1993). Others suggest the use of target costing principles (Carr and Ng 1995) which again raises the idea of open-book of accounting. Nonetheless, existing evidence of the use of open-book accounting is rather sparse, and little is known on how to make it work (Kajuter and Kulmala 2005). Lastly, it should be considered that, paradoxically, openness could conceal opportunistic behaviors, and this might lead to the related issue of the need to standardize inter-firm cost accounting systems or at least to audit them (Kulmala 2002).

The two cases on network governance (Municipality D and Municipal Consortium E) present circumstances where the availability of financial and nonfinancial information (i.e., volume of service delivered, under the open-book accounting principle during the operation of the services) would have prevented or at least minimized the negative financial effects. In the public–public collaboration, the number of hours of service provided to users by the three different communities would have clearly identified that one municipality (the majority shareholder) was paying less for the services received than its counterparts. In the public–private partnership, the cost for infrastructure building, operation costs, and revenues information through open accounting practices would have improved the knowledge of the financial situation faced by the two municipal governments so they could address the financial unbalance problem before the contractor resigned. Thus would have given them the opportunity to anticipate the strategic decisions then made by the consortium.

Table 2 provides a synopsis of the accounting tools and techniques that would fit with each specific governance model.

6 Conclusion

FS assessment and control is a crucial topic for LGs. So far, while delivery settings have changed rapidly in several economies in the last few years, research has given limited importance to the accounting tools and techniques needed to keep FS under control in more complex service delivery situations than in direct provision. Previous literature has discussed FS measurement systems in local governments as an all-compassing tool. Instead, the analysis of the cases above stresses the idea that measuring and controlling FS cannot be done in the same way regardless of the governance setting. In other words, the traditional internal control package of accounting tools and techniques (budget, financial measurement systems, nonfinancial measurement systems, hybrid measurement systems) is not enough when the prevailing model of governance differs from direct provision. Out of the traditional set of financial indicators, which have been emphasized in literature, municipal

Table 2 Different accounting tools and techniques for different governance models

	Procedural governance (PG)	Corporate governance (CG)	Market governance (MG)	Network governance (NG)
Financial sustainability type of governance	Internal Control	Coordination	Conflict	Cooperation
Kind of structures for service provision	LG's direct service provision	Corporatization	Contracting out, Devolution	Public–public collaboration (PPC), Public–private partnership (PPP)
Accounting tools	Internal Control Package: Budget, Financial Measurement Systems, Nonfinancial Measurement Systems, Hybrid Measurement Systems	Consolidated Financial Statements	Management Accounting (Sensitivity analysis, Cost behavior) and Performance Measurement	Open-book of Accounting, extended to Nonfinancial Information (input, processes, output)

governments need to assess their FS based on different accounting tools. The accounting tools depend on the type of governance model used in service delivery: consolidated financial statements are needed to foster coordination among the different accounting systems in corporate governance models, so as to give an overall, coordinated view of the FS. Sensitivity analysis, cost behavior analysis, and performance measurement fit with the necessity to manage the potential conflict of interests in market governance settings. Open-book accounting extended to non-financial information is crucial in network governance service delivery since it supports cooperation among the network's members.

The main contribution of the present study is to show the extent to which FS control is not a one-size-fits-all exercise as it has been done so far by several central governments when requiring compulsory FS control tools and fiscal distress determination from their LGs in order to assess their FS. Instead, it requires a thorough examination of the prevailing governance model adopted so as to use the most suitable set of accounting instruments. Consequently, LG managers need to identify the directions in which investments in accounting information improvements must be made, in order to be attuned to the governance model in use for service delivery. This conclusion can be beneficial also for legislators, especially in those countries—like Italy—where "regulative forces play a fundamental role in shaping public sector organizations' structures, systems and behaviors" (Liguori and Steccolini 2011, p. 34). Accounting changes take place progressively and need to be consistent with the governance model adopted by each local government and be supportive for achieving FS condition.

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