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1. INTRODUCTION

There is a widespread opinion that Italian local authorities are in a precarious state financially and that the public administrative structures in Italy are not really run economically, effectively or efficiently. Local authorities are the backbone of Italy's institutional activity. Any evaluation, therefore, of Italian public institutions' "state of health" must take into account their performance. Especially considering that not only are they the main investors in infrastructure (IFEL, 2009) ⁱ, but they are also – along with the Regions and other Italian local bodies – obliged to respect the criteria of the Treaty of Maastricht's Stability and Growth Pact, as far as minimum acceptable ratio of national debt to GDP is concerned.

In other words, the Italian local authorities – small or large – daily face questions relating to the quality of life of Italian citizens (e.g. local public services, jobs or local welfare). They are the ones who have to deal with critical situations of social integration and financial policies to encourage demand - all this, with ever decreasing resources.

Italian local authorities are many in number and have very varied characteristics deriving from historical, demographic and geographical differences.

In the current climate of financial and economic uncertainty, their performance and their maintenance of business stability are fundamental to hold the entire local economy "steady". This is the context in which the present study has been made.

Naturally, a purely financial count does not provide exhaustive information concerning the quality, effectiveness and timeliness of the administration. Nonetheless, we believe that Italy's local authorities are an essential motor of economic development in their area. It is well known that economic and social conditions influence the behaviour of public and private companies. There is no doubt that, in turn, the economic development trend of the market is closely linked to that of business and to public policy. The economic and financial crisis has hit not only private companies, but also the local authorities.

For this reason, local authority performance and business stability (financial, economic and assets) are crucial. A situation of imbalance not only automatically has serious economic and social repercussions on the local area, but also leads to management difficulties that, in the long run, put at risk the local authority's ability to satisfy the many, complex requirements of the local community.

2. REVIEW OF LITERATURE

The dynamics of company stability and their correlation with financial management trends have long been central to Italian business studies (e.g. Amaduzzi, 1949; Amodeo, 1970; Besta, 1920; Giannessi, 1960; Riparbelli, 1950). Renewed interest in local authorities in recent decades has led to the diffusion of specific studies aimed at improving communication between stakeholders involved in institutional activities (e.g. Farneti and Pozzoli, 2006; Mulazzani, 2006; Romolini, 2007). As far as the subject of the present study is concerned, some contributions exist towards the study of stability in local government for some geographic areas (e.g. Puntillo, 2007; Tenuta, 2007). The only detailed analyses available on a national level of local government per-

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* Even if this paper is a jointed work, § 1-2-3 and 4.3 are of Silvia Fissi; § 4-4.1-4.2 and 5 are of Elena Gori.

formance have been carried out by technical bodies such as the Court of Audit's Autonomous Organisations Department (2010) and IFEL (institute of local economy and finance) (2009).

At international level, many researchers have investigated the performance of public administration (e.g. Jarrar and Schiuma, 2007; Pestiau, 2009; Post et al., 2002) and the effects of its company policies (e.g. Arrow, 1973; Goodpaster, 1991; Marr, 2008). The common denominator of all research has been the attempt to identify, through specific drivers, the link between financial performance, means used and political choices made (e.g. Bach and Vesper, 2002; Bowsher, 1995; Gauthier, 2007).

An analysis of Italian and foreign works reveals a common methodology in the carrying out of empirical research. However, detailed studies have not been found of the Italian situation, with its extreme lack of social, geographic and dimensional uniformity. Furthermore, because of these characteristics, Italian local authorities are a unique case that cannot be compared to other situations worldwide.

3. BASIS AND METHOD OF RESEARCH

In the case of Italy, we believe that there is a significant connection between a local authority's year-end results and their ability to survive and keep on working over time. In our opinion, their trend, the means used to achieve financial stability or the formation of financial instability are all significant drivers for the evaluation of local authorities' state of health. Our research, therefore, is based on verifying two interconnected hypotheses:

1. that the ability to achieve a financially stable position is related to the demographic group and/or to the geographical location of the authority;
2. the drivers selected by government to signal critical situations (e.g. OBS – off balance sheet – debt and loss-making parameters) do not completely fulfil their purpose.

The *research question* we propose to answer is the following: Is the commonly held opinion true, that is, that Italian local authorities are in serious financial, economic and asset-management conditions?

Using empirical analysis, we decided to examine the local authorities' state of health by looking for any connections or links between balance sheet entries that are pertinent to achieving stability or provoking serious instability.

Considering the above, as unit of study, we could not fail to choose the Italian local authority. However, as previously mentioned, these are so numerous – 8,101 with 56,995,744 inhabitants at the 2001 general population census – that a sample group has had to be created that is, obviously, representative of the population.

Having examined the population make-up of the Italian local authorities, for their distribution per region and their demographic groups, we extracted a random sample, which was calculated by stratifying the authorities according to their classes of population.

We did this because random sampling:

- 1) is at any rate the least “risky” method, without prior information;
- 2) overestimates sample error, while with other techniques (same size sample) the error cannot exceed that of the random sampling itself.

As this was an empirical study of local authority finances, for slightly over 8,000 units, we decided to fix a confidence level of 95% (which means that the results can be totally wrong for a probability of 5% - error unavoidable in all sampling) with an accuracy of $\pm 4\%$. With these parameters and taking the most unfavourable case ($P = 50$, i.e. maximum dispersion), the sample was calculated at 563 examples.

In order to improve the estimate and achieve slightly better accuracy, considering the enormously varied demographic dimensions of the local authorities (Tables 1 and 2), the stratification was carried out based on the following categories of residents: from 0 to 5,000 inhabitants; from 5,001 to 20,000; from 20,001 to 50,000; from 50,001 to 100,000; from 100,001 to 150,000; from 150,001 to 250,000; from 250,001 to 500,000; from 500,001 to 1,000,000; over 1,000,000

But this classification – incidentally, the same as used by ISTAT (national institute for statis-

tics, ed.) – would have led to excluding, based on the percentage incidence of population and, in particular, of number of local authorities, all bodies with more than 250,000 inhabitants. We were consequently obliged to “force” the sample composition by inserting one authority in the last two bigger categories and two in that of 250,001-500,000 inhabitants. The number of units, therefore, rose to 567 (Table 3).

Having, in this way, obtained the sample, and taking into account demographic group and region, we used a systematic selection – with different logical steps – for the first four classes, noting the name of the local authority, while for successive classes, we made a purely chance selection.

We consequently think that it may be stated that a stratification process gives a more accurate sample. Sample error should be reduced by approximately $\pm 0.3\%$, thus giving an interval of $\pm 3.7\%$.

In our study, we examined the local authorities’ final balance results ⁱⁱ.

This choice of final, rather than budgeted, accounts was made with the intention of measuring and evaluating the stability actually reached by local bodies. In any case, as budget forecasts have to break even, we believe it would have made little sense to concentrate on budget stability.

Our initial idea of evaluating the financial, economic and asset status of the Italian local authorities immediately, however, came up against the difficulty of obtaining the necessary data. The Ministry of the Interior only collates and publishes, by auditing the budget and final results, the financial aspects of the running of local authorities. Consequently, the tables which certify the local authorities’ final results do not include economic or asset information.

This lacuna, in our opinion, results in a worrying lack of information. Local authorities are only obliged to turn in economic and asset information for the final balance. We believe it is an error that places the organisations’ stability at great risk, to continue to focalise on forecasting and authorising budgets, rather than on actual results obtained.

We think that this once again demonstrates the scarce attention paid to aspects which, instead, are fundamental for the success and development of any business’s strategies, and therefore necessary for good public administration.

To overcome these difficulties in procuring economic and asset-related data, there were several possibilities:

- sending a questionnaire to the authorities selected. This would, however, have certainly resulted in fewer replies with respect to the total number of units sampled, with a not insignificant loss of data. Furthermore, the figures would not have corresponded to the accounts and year-end results of the authorities analysed;
- gathering data from the regional offices of the Court of Audit – the local authority finance departments send them a report on the forecast budget for the year in question and the final results of the same year (as per Article 1, comma 166 et seq. of the 2006 Budget). But unfortunately informal enquiries made to these offices revealed that not all of them would be willing to divulge the information;
- reducing the sample to regional level. This was, however, an unacceptable solution, as our aim was to make an evaluation at national level;
- extrapolating some data from the report on local authority finances, issued every year by the Court of Audit’s Autonomous Organisations Department. The 2006-2008 report contains a great deal of very interesting data, relating to the main financial aggregates of local authorities. However this analysis could not be used for our purposes, as the sample selection process was notably different from ours.

Having established that, on the one hand, there were no alternative solutions and that, on the other, it was vital to construct a reasonably ample historic trend, we chose to use the information contained in the final audits, available on the Ministry of the Interior website. It is our opinion that a retroactive evaluation of local authorities’ financial results by means of an empirical analysis of 4 years (2005-2008) is a valid basis for judging their state of health. The following tables were studied and elaborated:

- table 9 – General overview of financial management;

- table 9b – Final results;
- table 9c – Use of surplus;
- table 10 – OBS debts at 31/12 as verified by certifying body;
- table 10b – Distraint actions;
- table 50 – Certification of objective parameters for local authorities, to ascertain if a structure is in deficit.

Tables 9, 9b and 9c give us a complete picture of how the results are compiled, composed and utilised. They therefore give a good synthesis of the authority's financial stability.

Tables 10 and 10b highlight any OBS debts occurring during the financial year, by type and function. They also distinguish the total of debts already financed from those not yet scheduled for repayment. They also indicate the amounts of distraint actions not yet legally contested. In our opinion, these two tables are symptomatic of the existence of critical situations that can disturb financial stability. OBS debts derive from costs that have not followed the regular financial procedure and that, in any case, have escaped accounting control. Distraint actions not yet legally contested are not so much anomalous, but rather a clear sign of the presence of a pathological situation.

Finally, table 50 sums up the trend of deficit parameters for every local authorityⁱⁱⁱ. Initially, we collated these parameters, looking for a connection between unstable authorities and the positivity or not of these parameters. In other words, we assumed that organisations with high debt would also have a high number of positive parameters. This supposition, as will be seen in the relevant analysis, was revealed to be incorrect.

4. RESULTS AND DISCUSSION

In order to verify the real state of health of Italian local authorities, we proceeded step by step, according to the hypotheses formulated.

The first step concerned the evaluation of the authorities' financial results, through analysis of data from tables 9, 9b and 9c of the final audit, dividing data by demographic group and geographical area.

The second step involved the analysis of the organisations' OBS debts, through elaboration of tables 10 and 10b.

The third and final step was the analysis of deficit parameters, from data contained in table 50 of the final audits.

4.1 Financial results

The financial results demonstrate the financial management of the year in question and derive directly from income and expenditure. Here, it is important to remember that, according to the principle of breaking even, which is associated with the principle of healthy financial management, the books must balance from the budget forecast, during the year and at the end (Observatory for local authority finance and accounting 2004)^{iv}.

Often, the end-year results show a surplus but sometimes they might also show a deficit for which it is obligatory to find adequate financial cover.

Negative results can derive either from unforeseen or unforeseeable events resulting in reduced income or increased spending with respect to budget, or from errors in the formulation of the forecast, or, worse, from a deliberately false forecast that naturally did not come true.

The end-year results are finalised up to 31st December and are of an accounting or financial nature^v.

In our research we examined only the final results and their composition. Table 4 shows an initial, "photographic" overview of important financial data relating to the period in question.

The first element to consider in the analysis of financial tables is the presence of errors on the part of many local authorities. These mistakes might also be caused by procedures used for data transfer^{vi}.

Under current regulations, local authorities must communicate their end-year results to the Ministry of the Interior. However, data are unavailable for the year 2005 for 0.3% of authorities (three out of the 567 in our sample); for the year 2006 the percentage rises to 1.59% (nine out of

567); for the year 2007 the occurrence of local authorities without data reaches the significant percentage of 3.17% (18 authorities out of 567) and for the year 2008 the percentage decreases to 2.65% (15 authorities out of 567) but it still results very high. We should specify that we suppose the authorities in question did not supply the data; however it is impossible to know for certain the reasons for this lack of information. For example, there might have been problems in reading the electronic format in which the final audits are sent, or in the Ministry's data input procedures. We believe that, if we were to take another look at these authorities without 2007 and 2008 data in another month or so, the percentage would probably be lower than it is at present. In other words, the number of missing local authorities would naturally diminish as time passes, as data input problems are solved and/or late information is received. The geographic areas containing the largest concentration of authorities without available data are the south for 2005 (1.61%), the islands for the following two years (11.11% and 12.96% respectively) and the middle for 2008 (6.85%). It is interesting to note that the majority of these authorities is small in size, with a population of fewer than 5000 inhabitants.

As far as financial stability is concerned, a general analysis of the statistical sample shows that the percentage of authorities in debt is fairly constant: in 2005 it was 1.42%, in 2006 – 1.25%, while 2007 peaked at 1.64% and in 2008 it was on average with 1.25%. The majority of local authorities showed a positive end-year result and, consequently, managed to maintain the balance stability initially forecast.

In the analysis of the “overall” end-year results, it is interesting to calculate the average surplus or deficit which, even taking into account the limitations of average values, are useful to understand the general trend. The organisations in our sample can, basically, be divided into two sub-groups: one formed of local authorities with a surplus and the other of those registering a deficit.

Note that the second sub-group is much less numerous than the first one, as only 1.39% on average of local authorities showed a deficit for the three years under examination.

The average surplus oscillated widely from one year to the next, going from €1,410,387,159 in 2005, to €2,505,625 in 2006, to €1,824,909 in 2007, then to € 2,173,186.09 in 2008. The same observation holds for the average deficit: €1,006,669.75 in 2005, €9,296,910.50 in 2006, €244,096.11 in 2007 and to € 147.80 in 2008.

An initial, summary analysis would seem to reveal that local authorities with a negative result must be in a highly critical situation. But in actual fact, here too, the average figure is influenced by extreme values. In fact, if we observe the average end-year result per inhabitant, this does not undergo big changes, going from €177.43 in 2005, to €162.41 in 2006 and to €123.85 in 2007. If we analyse the details of information from our sample, we see that the huge average deficits of 2005 and 2006 derive from the exceptionally negative results of Perugia (almost 4 million Euro in 2005 and approximately 14 million Euro in 2006) and Catania (almost 59 million Euro in 2006)^{vii}.

The end-year results give a combined total that does not show the “quality” of the information. We therefore found it interesting to verify its composition.

Any financial surplus must be divided, according to possible utilisation, into:

- restricted funds;
- capital expenditure funds;
- amortisation funds;
- unrestricted funds.

Restricted funds come from the difference between revenue destined by law to a particular purpose and relative expenses. Similar savings make a positive contribution to end-year results.

For example, if revenue has a specific destination deriving from regional funding, any saving must go back into the end-year results, maintaining the same destination. These funds can also derive from the partial or total cancellation of negative residual income caused by spending related to tied income: such cancellation, in fact, represents a saving under the negative residual heading, that goes to strengthen the final results, under the heading “surplus reserve”. Reserve capital also includes bad debt provision (Write-down Fund) and the Risk Fund containing sums set aside against potential risks, for the part unused at the financial year-end.

Under funds for capital expenditure are included sums destined for capital expenditure received by the local authority. These sums come from mortgages and are, in any case, destined towards investment.

More precisely, the funds in question may come from revenue that, under law or as decided by the authority, is destined to finance investments. These are revenues, which have been registered, but not yet entirely destined for spending, or revenues obtained by eliminating negative residual income from previous years that derived from revenues destined for cash spending.

Amortisation funds derive from applying amortisations of a financial nature to Section I of budgeted expenses. These involve savings and end up – as allocated funds – in the end-year results.

The amounts budgeted for financial amortisation are intended to create reserves to be used for the repurchase of the amortised tangible and intangible assets. In other words, the sums laid aside are not employed and go into the final results on the plus side. They must, however, find sufficient cover in the financial results. In fact, if the surplus is not sufficient to cover these amounts, a deficit is created.

It should be remembered that, at the time of writing, the government has postponed the obligation nature of financial amortisation. So many local authorities have chosen not to include them in their balance sheet.

It is obvious that what may appear to be an immediate liberation of resources is based on rather short-sighted reasoning and precludes the possibility of creating a reserve for the repurchase of capital equipment. It is equally clear that, by fixing financial amortisation quotas – which might be considered as a sort of “obligatory self-financing” – the organisation sets aside a quota of the final results for the purpose of recreating its assets. In this way, the bases are laid for maintaining the organisation’s long-term productive capacity and a contribution is also made to creating liquidity.

Unrestricted funds have a residual nature and they can be used also for current expenditure.

It should be pointed out that positive year-end results do not necessarily imply a favourable financial situation, as they might be, for example, the consequence of events of an extraordinary nature that are unlikely to be repeated in future.

Examination of the final audits reveals that, for 2005 and 2006, the majority of local authorities in our sample does not place any restriction on its results (the unrestricted parts are 68.39% and 73.49% respectively) while the figure improves noticeably in 2007 (with an unrestricted surplus of 42.44%) and in 2008 it improves once again (with an unrestricted surplus of 27.59%). We believe that the increase of restricted funds in general is due to the increasing controls of the Court of Audits. See tables 5 and 6.

On this subject, it is our opinion that the presence of organisations that end the year with a surplus without having placed any restriction cannot, in the majority of cases, correspond to the actual reality of the situation. In fact, the absence of any kind of restriction (reserve funds, funds for financing capital spending and amortisation funds) implies the non-existence of savings deriving from reserve funds, from amounts destined for capital spending or from amortisation funds.

We shall return to the last hypothesis in due course. Meantime, it is our opinion that there should be a restriction on savings included in an organisation’s final results, if only as a cautionary tactic. We refer, for example, to the fact that a surplus that is totally available implies a lack of funds set aside for write-downs or potential risks. In our view, some of the surplus should in any case be restricted (regardless of the provenance of these freed-up resources), to cover risks connected with the organisation’s activities – for example, regarding open court cases or possible cancellations of actions to recover unpaid taxes.

What is more, the lack of restrictions can encourage using the surplus to finance current ordinary expenses, which does grant ample room for manoeuvre but, at the same time, is questionable for the future development of the organisation’s activity. We actually hold that any surplus should be used as deriving from an extra-ordinary source and destined, in the first instance, to cover investment costs for organisational growth and development or for financing non-recurring expenses.

On this subject, we note that many small local authorities have considerable surpluses, which are not in any way restricted. This phenomenon evidently requires careful evaluation, both for our judgement expressed above concerning a total lack of restrictions, and because of the amounts involved that are indisputably high if measured against population levels. A large surplus might arise from the local authority's inability to reach its objectives, or it might signify an excessive burden placed upon the community with respect to real running costs.

One must then point out that the sample also contains particularly good organisations, which have repeated surpluses and which allot them entirely for capital expenditure.

Then there are organisations that show a considerable growth of surplus compared with previous years, from tens of thousands, to hundreds of thousand Euros. Here, too, no restrictions are found. Frequently these increases stem from residuals or extraordinary loans and this is another cause for attention. However, we are of the opinion that more often such sudden surges in end-year results are due to exceptional causes and therefore the surplus generated should in any case be restricted and used to strengthen the organisational structure.

Another critical element to note concerns the quota of surplus destined for amortisation. In our sample, in 2005 only 0.24% of final results went into an amortisation fund. In 2006 this percentage went to 0.25% , in 2007 to 0.44% and in 2008 to 0.57% but, overall, it remains tiny.

Our empirical research also highlighted another aspect which we believe to be significant: the presence of organisations that begin the year with zero cash and end it in the same condition, achieving barely positive results deriving from residuals management. Here we would seem to be in the presence of organisations with serious cash problems, which manage to break even by means of "adjusting" the values of residual profit and loss.

Finally, it is our duty to bring to the reader's attention those organisations that end year breaking perfectly even. We are convinced that perfectly balanced accounts, although theoretically possible, are not realistically achievable, as all present and past financial obligations would have to be exactly equal to end-year findings.

In the course of analysis, it was interesting to see if, in Italy, a trend could be identified for year-end results linked to geographical areas. We consequently divided the regions and their local authorities into the 5 geographical areas identified by ISTAT:

- NORTH WEST - Piemonte, Liguria, Lombardia, Valle d'Aosta;
- NORTH EAST - Trentino Alto Adige, Veneto, Friuli Venezia Giulia, Emilia Romagna;
- CENTRE - Toscana, Umbria, Marche, Lazio;
- SOUTH - Abruzzo, Molise, Campania, Puglia, Basilicata, Calabria;
- ISLANDS - Sicilia, Sardegna.

Table 7 presents findings relative to the above geographical areas, compared with those referring to the whole sample.

Local authorities in the north-eastern area had, for the quadriennim, a smaller average surplus than the sample; even looking at the average result per inhabitant, the difference is very marked and, for 2005 and 2006, is actually over 50%. A similar situation is also true of local authorities in the north-west with differences more evident than north-eastern area. We believe that this divergence from the national average is probably due to the enormous presence of small and very small organisations, with smaller average surpluses per head. In 2005, 2006 and in 2008 the north-eastern local authorities closed with a surplus, while in 2007 they had a tiny deficit of €19,081. These are organisations showing a good deal of financial stability.

The average final results and the average results per inhabitant of local authorities in central Italy are considerably higher than the national averages. In actual fact, it is the figures from the centre that inflate the general data, especially for 2005, 2006 and 2008. This anomaly is due to the presence of Rome, which strongly influences the overall results of its geographic area. As far as the analysis of financial balance is concerned, the centre is more or less in line with the general average of the sample.

For 2005, 2006 and 2008, the south is basically in line with the general findings, although its result per inhabitant remains approximately 20% below average. For 2007 the situation is greatly improved, with an average result per inhabitant that is much higher than that of other areas (€205.93 against a sample average of €123.85).

However, as will later be explained, the main difficulty of these local authorities is connected with the presence of OBS debts, while the average deficit is well below national average and maintains a constant trend over the three years.

An exceptional situation is found in the islands where, incidentally, are found the highest number of organisations for which we have no final figures (11.11% in 2006 and 12.96% in 2007). The average results plunged in 2006, as did the relative average per inhabitant (€123,635 and €8.32 respectively). However, these figures are strongly influenced by Catania's huge deficit – it was the only local authority with negative year-end results (over 58 million Euro). The situation improved considerably in 2007, to the extent that the geographic area in question is almost perfectly aligned, for the majority of data, with the sample's averages shown in the table.

An overall look at Table 7 shows a sort of “stagnation” in the results of the northern local authorities, who find it easier to achieve financial stability but, taking into account the average results per organisation and per inhabitant, are on average poorer than the rest of Italy. A completely different situation is seen in the south and in the islands, which show a clear improvement over the three years in question. Finally, the centre has a wide variety of results that lead to considerable oscillations of average figures. For example, the average results per inhabitant goes from € 302.20 in 2005, to € 283.21 in 2006, to € 142.28 in 2007 and to € 216.37 in 2008. The extreme dissociation of figures for central Italy is chiefly due to the presence of Rome and of Perugia.

The same type of analysis was then carried out, classifying the authorities by number of inhabitants, with the object of understanding whether there was any differentiation between small, medium and large organisations. For this purpose, the following four categories were chosen:

- up to 5,000 inhabitants;
- from 5,001 to 20,000 inhabitants;
- from 20,001 to 50,000 inhabitants;
- over 50,001 inhabitants.

Table 8 shows the results of the analysis and clearly demonstrates that, regardless of category, the majority of organisations has a surplus. The actual figure increases when the population under consideration is larger.

Table 8 also brings up another point: The medium-sized local authorities are the ones that achieve better performance – in absolute values – than all the other groups. In fact they show no deficit for the three years under consideration. It is probable that their very size is, in itself, the best one for managing the most common local questions: in other words, these organisations are not too small and not too big – they may have the right dimensions for achieving good financial results. Which gives rise to a further point connected with the need to group together very small local authorities that are unable to manage the complexity of their local area and, above all, to activate suitable financial resources. On the other hand, unwieldy ‘giant’ local authorities can have widely oscillating financial results.

In conclusion, as far as financial results are concerned, the empirical analysis shows that the majority of local authorities has positive end-year results. This fact should, however, be seen against the operating results of the year, which are not influenced by residuals.

In our opinion, many organisations manage to end with a stable balance sheet only by counting in the residuals. Indeed, if we observe the data in the Court of Audit's annual report on the financial situation of local authorities, the operating results of the year paint a much less optimistic picture (Court of Audit 2010)^{viii}. It is therefore important to intervene in checking how residuals are managed, in order to identify whether the final surplus actually exists or not. Put differently, incorrect management of residuals may undermine financial stability.

4.2 OBS (*off balance sheet*) debts

OBS debts are made up of unregistered, past liabilities; they may derive from extraordinary and unexpected occurrences, or from incorrect management of financial spending. They represent one of the main causes of financial instability in local authorities (Tenuta, 2007).

Article 194 TUEL grants town councils the possibility of identifying and registering OBS debts deriving from:

- executive sentences;
- coverage of debts owed by consortiums, local government companies and institutions, in observance of statutory obligations, agreements or deeds of incorporation;
- recapitalisation, within the bounds of Italian civil law and special regulations, of companies set up to carry out local public services;
- requisitions or urgent occupation, for public utility projects;
- purchase of goods or services contrary to regulations for indebtedness and spending, in the case of proven utility and profit for the organisation.

Regulation concerning OBS debt is closely linked to that of financial stability, and has as aim the existence and maintenance of such stability for the whole term of management. Deficit parameter 5 (*Presence of OBS debts recognised in Article 194 TUEL, for which the necessary financial resources have not been found*) is an example of the close link between OBS debts, financial instability and the creation of a fragile organisation^{ix}.

Our investigation into the period 2005-2008 highlights a growing trend of OBS debt (Table 9).

In fact, the percentage of organisations has gone from 4.48% in 2005, to 16.13% in 2006, to 18.94% in 2007 and to 22.28% in 2008, while the incidence per capita has remained more or less constant, reaching € 3.35 in 2008. We believe that this trend is connected with the generally growing complexity of administration. This increases the probability of organisations creating OBS debts, particularly in categories connected with the purchase of goods and services and in legal action for requisitions. Nonetheless, we point out that the increase in the number of organisations with OBS debts is not associated with an increase in absolute terms of value; in fact, the average percentage remains constant.

Another element worth noting is that, in our sample group, organisations with very large OBS debts often showed a financial surplus. Thus, it appears that there is no direct correlation between the amount of OBS debt and financial stability. On this subject, however, we emphasise that the lack of proper controls in spending procedures gives rise to considerable financial instability, which is highly dangerous because it suddenly appears in the form of OBS debts that need urgent and difficult-to-find financial cover.

The per capita percentage of OBS debt is very small and might induce us to think that, all in all, they are not a critical element for the maintenance of financial stability. A more detailed analysis, however, reveals some points worth considering: as Table 9 shows, the geographical distribution of OBS debts is significantly different from the sample average.

The areas concerned are the south and the islands, which have an occurrence and average percentage per capita that are growing fast and are well above the general average. In the south, the percentage of organisations with OBS debts went from 5.74% in 2005 to 36.44% in 2008. The situation is even worrying for the islands, who went from 3.7% in 2005 to 30.19% in 2008 (with a peak of 46.81% in 2007) of organisations with OBS debts, with a per capita average equal to € 9.78 per inhabitant. We may therefore conclude that the islands and the south qualify as clearly having problems in maintaining financial stability.

The north-west of the country was constantly below national average, with a percentage of organisations with OBS debt going from 0.47% in 2005 to 7.18% in 2008. The average percentage per head was also low. On the basis of data from the empirical analysis, we can therefore say that, on average, organisations in the north-west have reasonably good financial health, with a small percentage of OBS debts and a high percentage of surplus results.

The north-east and the centre of Italy, although with some oscillation, remain close to the general average of the sample group.

A study of trends for OBS debt by demographic group (Table 10) shows correlation between the presence of debts and the size of organisation: debts are found chiefly in the more populated areas. This trend may be connected with more complex management realities.

From one group to the next, the percentage of OBS debt increases constantly and, for 2008, in local authorities with over 20,000 inhabitants rises to well over 55%.

This increase in OBS debt proportional to the size of local authority is caused by the greater complexity of running large organisations and the consequent difficulty in controlling the formation of extraordinary debt.

Of the various types of OBS debt stipulated in Article 194, that relating to the purchase of goods and services contrary to spending regulations is the least risky for financial stability. It does imply incorrect financing of spending - but with the aim of increased usefulness and enriching the organisation itself.

There is no doubt that, in our empirical investigation, it would be interesting to be able to distinguish the type of OBS debt recognised, in order to identify what generated the debt. Unfortunately, such information is not contained in the final audits and can not, therefore, be analysed. We can only suppose that the majority of smaller amounts might be of the above-mentioned kind^x.

4.3 Deficit parameters

The Ministry of the Interior, with ministerial decree no.217/03, established deficit parameters to be enclosed with financial results^{xi}.

These parameters are intended to give an overall evaluation of an organisation's status, in order to highlight any negative structural trends, as well as the possibility of a swift return to financial stability. The decree identifies different parameters for provinces, local authorities and mountain communities and, for the local authorities, differentiates according to demographic group^{xii}.

More specifically, as laid down in Article 242 TUEL, organisations in deficit are those in serious and indisputable conditions of instability, i.e., having positive results for more than half of the parameters.

Local authorities in structural deficit are subject to central control over staffing levels and hiring of staff, by the Commission for Local Authority Finance. This control has the priority objective of checking that there is financial compatibility with the deficit situation.

Organisations in deficit must also comply with certain obligations regarding coverage of costs of services and they receive a reduced % of ordinary contributions from the State.

It was not possible to analyse the 2005 deficit parameters, as they are not published on the Ministry of the Interior website.

At present, eight parameters have been identified to express the critical financial status of an organisation. Most local authorities in our sample group, for the triennium 2006-2008, had at least one positive deficit parameter; a tiny percentage showed 5 positive parameters; and only one organisation (in 2007) exceeded those limits. Detailed results are shown in Table 11.

A summary follows of the parameters and the results of the empirical analysis. Tables 12, 13 and 14, for 2006, 2007 and 2008, respectively, show the percentage of positive results for local authorities, grouped by region, for each parameter.

Regardless of region or of year, rarely do organisations show positive results for parameters 1, 4, 5 and 8.

The first parameter concerns *Total end-year deficit more than 5 percent of spending, as in spending Sections I and III, and excluding reimbursement of cash advances*. If positive, this parameter is a clear sign of financial instability. A significant deficit in relation to an organisation's current income means that the organisation is incapable of correctly forecasting necessary spending. It also places a heavy responsibility on future administrations, if they are to break even again. As the Tables show, very low positive results were obtained for this parameter. We believe, incidentally, that this is because of the very serious situation used as parameter: organisations with positive results are obviously in a very grave state of financial instability. In our opinion, the limit should be lowered in order to catch critical situations, rather than instable situations that might be defined as pathological.

The second parameter concerns the *Volume of positive residuals deriving from the year, excluding ICI (rates) and transfers of revenue, over 21 percent of current income, as seen in Sections I, II and III of current income*. If positive, this indicator shows the organisation's difficulty in collecting its revenues and is a potential symptom of the presence of surpluses that are unlikely to be called in. The majority of organisations had a positive result for Parameter 2, with a percentage of about 50% in the triennium. Here, considering that the final result is tied to the delay

in receiving regional funding, we believe that the positive result depends mostly on the method and timing used by the regions to transfer funds to local authorities.

The third parameter identifies the *Volume of negative residuals deriving from the year of current expenditure, over 27 percent of expenditure, as seen in Section I of expenditure*. This indicator – which should be interpreted together with the preceding one – signals the organisation's difficulty in spending already-destined resources. That is, it suggests a situation of excessive debt in respect to the overall amount of current expenditure. The parameter could also be interpreted as symptomatic of the organisation's excessive slowness in carrying out its programmes and thus of scant efficiency in programming expenditure. Parameter 3 also shows a high percentage of positive results, around 22.5% in 2006, 30.97% in 2007 and 30.39% in 2008.

The fourth parameter is based on ascertaining the *existence of forced sale procedures against the organisation, for which no legal judicial defence has been undertaken*. This indicator shows an organisation's inertia in dealing with any legal actions open against them. In other words, it shows scant interest in the management of public resources, leading to losses deriving from *forced sale procedures*. A very small proportion of organisations have positive results for this parameter, showing the attention paid by Italian local authorities to safeguarding public resources.

The fifth parameter concerns the *Presence of OBS debts recognised in Article for which necessary financial resources have not been found*. This indicator shows a critical situation with two elements: on one hand, the existence of OBS debts without coverage in the current financial year and two years following, as laid down in Article 194 of TUEL, and on the other hand, the inability to cover these debts. The first element is, at the least, a symptom of irregularity during the financial cycle; the second element makes the situation more serious, since the organisation has been unable to find the resources necessary to cover OBS debts. For this parameter too – fortunately, for the preservation of stability - the percentage of positive results was very low.

The sixth parameter concerns the *Total volume of the authority's own income, as shown in Sections I and III, in ratio to the total volume of current income, as shown in Sections I, II and III, less than 27 percent for local authorities with up to 2,999 inhabitants, less than 35 percent for local authorities with between 3,000 and 59,999 inhabitants, less than 37 percent for local authorities with between 60,000 and 250,000 inhabitants and less than 32 percent for local authorities with more than 250,000 inhabitants*. This indicator measures the organisation's financial independence. The higher the value, the more independent it is from state and regional contributions. Values under a certain limit should be interpreted as a sign of excessive dependence on state and regional contributions^{xiii}. This parameter, however, is not complete, as it does not give information on the ratio between income deriving from provision of services and the relative expenditure. In other words, as the parameter is based exclusively on income volume, an organisation whose services show serious losses – that consequently absorb large resources – could appear to be in a better situation than a similar organisation whose services generate a large surplus. Furthermore, the high number of local authorities in Sardinia and Sicily with positive results for Parameter 6 should be noted. This highlights how difficult it is for small local authorities to procure their own revenues, with respect to the revenues overall. This indicates, therefore, great dependence on derivative finance and difficulty in collecting revenues, probably connected with the low income levels in some areas.

The seventh parameter measure the *total volume of personnel costs of any kind, excluding those financed by income from the region or other public bodies, in proportion to the total volume of current expenditure as shown in Section I, over 48 percent for local authorities with fewer than 2,999 inhabitants, over 46 percent for local authorities with between 3,000 and 59,999 inhabitants, over 41 percent for local authorities with between 60,000 and 250,000 inhabitants and over 44 percent for local authorities with over 250,000 inhabitants*. In recent years, numerous provisions have been made in order to control spending for personnel. In this sense, the parameter could give important information concerning the percentage of such spending over total expenditure. Not infrequently, the hiring of staff as 'favours' or not based on purely professional criteria has led to huge and unjustified costs in several Italian local administrations. And it is well known that personnel costs, which are particularly inflexible, place a heavy burden on future administrations and often hinder putting into practice more rational and efficient manage-

ment strategies. On this subject, we note that Basilicata and Sicily are the regions with the highest percentage of positive returns for Parameter 7.

Finally, the last parameter endeavours to identify local authorities with an *overall amount of interest on mortgages of more than 12 percent of current revenue as shown in Sections I, II and III*. This indicator, like the previous one, highlights levels of absorption of the organisation's ordinary capital for a particularly inflexible kind of expenditure. In past years, partly owing to inconsequential limits on indebtedness, many organisations indebted themselves financially by taking on mortgages for carrying out non-productive works. In these cases, the percentage of interest is now a considerable obstacle to achieving effective and efficient financial management.

If we consider the low percentage of organisations in deficit and the results of our analysis of deficit parameters, everything points to the overall financial stability of Italian local authorities. The empirical analysis shows that some parameters that the majority of organisations overcome can not, therefore, be still used as critical indicators. What is more, the analysis shows that even organisations with large deficits have more than acceptable deficit parameters. So the latter are not fulfilling their function as "critical alarms".

For these reasons, we believe that the deficit parameters are not suitable for current local authority administration. Even the recent revision of these parameters, which will apply to the 2010-2012 triennium, in our opinion, is insufficient. Measures concerning how debts and credits are formed, in fact, remain unchanged, although minimum levels have been significantly increased. There are no measures relating to the performance of outsourced services, nor to possible repercussions of decisions connected with particular means of funding expenditure – so-called creative financing.

Interesting, however, the new parameter concerning operating results and the renewed special attention towards the formation of indebtedness and applications for treasury advances.

5. CONCLUSIONS

At present, there is much discussion about the need to rationalise public spending. It is widely believed that Italian public bodies are not really run according to criteria of economics, effectiveness and efficiency.

The empirical analysis we conducted, though it found rather variable results, reveals that Italian local authorities are in a satisfactory state of financial stability.

An analysis of data shows, yet again, a wide difference between north and south. Northern local authorities have a more stable financial situation, while in the south there is a greater incidence of problems tied to financial stability. The analysis of deficit parameters further brought to light aspects which might be described as pathological. For example, the high rate of expenditure on personnel, which derives from policies that are far from economically or business based, but are rather founded on the workings of clientelism.

We believe that the greater presence of allocated surplus funds in the south is not due to particularly efficient management but rather derives from the huge amount of allocated European funding. The slowness of the authorities in carrying out the projects financed necessarily forms a surplus of allocated funds.

Moreover, the lack of a clearly defined trend in the performance of local authority financial administration points to a situation of great uncertainty. We imagine this may be connected to present economic circumstances, and also to marked differences in levels of services supplied, even between organisations in similar geographic areas and/or in the same demographic groups.

We have tried, without success, to find performance trends by dividing the results according to geographic area, demographic group and, in some cases, by region. Indeed, if we observe data for single authorities for the quadriennium, we find situations that, apparently similar in size and geographical characteristics, produce totally different results.

The results obtained in this present study show that any opinion on the performance of local authorities must be supported by detailed theoretical and empirical studies. The management of public authorities is undeniably more complex and diverse than that of most businesses. The question that has been discussed in this paper, of financial stability of the balance sheet, is only

one of many aspects in which public organisations, being more complex, differ from private business.

The respect of financial limits and stability should not threaten citizens' rights to receive adequate public services. Profitable management is not an autonomous principle, but part of a system of values on which the functionality and long-term development of the organisation are based. Profitability, efficiency and productivity serve as propellers for organisational growth, that is, for better achievement of the mission, which is the key element.

This double dimension – business and politics – of Italian local authorities makes for extremely complex planning, management and control of financial stability.

In the near future, the growing climate of uncertainty as to availability of resources will oblige public organisations more and more to plan, manage and consciously and carefully control the complex variables involved in supplying public services, the evolution and transformation of the area of local governance and consequent variation of the structure of demand for public services.

In conclusion, we believe that assessment of financial stability, governance and strategic control are functions which, in the public sector in general, and in local authorities in particular, require a fresh thrust towards finding new solutions that are suited to the real management models of local public utilities.

Notes

ⁱ During 2000-2006 investments made by local authorities represented 52% of the total made by the entire public sector. Cf. report "I Comuni italiani 2009", report on Italian local authorities by IFEL (Institute of Local Finance and Economy) available on www.portale.webifel.it, p. 68 et seqq.

ⁱⁱ Data deriving from final audits, easily available from the Ministry of the Interior website, are official, and approved by the Financial Service manager and by the Secretary. Furthermore, some interesting facts and indicators calculated from local authority end-year results for 2007 are available in the above-mentioned report "I Comuni italiani 2009", by IFEL (Institute of Local Finance and Economy).

ⁱⁱⁱ As far as 2005 is concerned, there are no data regarding deficit parameters on the Ministry website, as these parameters were not required for final auditing. These parameters have been updated (for the 2010-2012 triennium) by decree of the Ministry of the Interior on 24/09/2009, published in the Gazzetta Ufficiale no.238 dated 13/10/09.

^{iv} Cf. points 51, 52 and 53 of the framework of the Observatory for local authority finance and accounting. OBSERVATORY FOR LOCAL AUTHORITY FINANCE AND ACCOUNTING, Rome, Ministry of the Interior, 2004.

^v These are shown in the summary sections of accounting figures and are divided into:

- *financial results*. This is cash remaining at the financial year-end, plus surpluses and minus deficits. It indicates the overall effect of financial management;
- *operating results*. This is the difference between ascertained income and expenditure during the financial year. It marks the result of the year;
- *cash result*. This is made up of the initial cash in hand, plus cash-in (for the year and residuals), minus cash-out (for the year and residuals). It shows the final amount of cash in hand available to the organisation.

These categories measure, in three different ways, the difference between financial movements in and out.

^{vi} In fact the local authorities have to send the final audits in electronic format. In many cases, errors found refer to the totals of various results (allocated or free) that do not correspond to the total final operating results. In other cases, errors concern the deficit parameter tables: for example, some organisations say they have OBS debts to be financed, but do not return a positive result for Parameter 5 regarding OBS debts that are recognized but not financed.

^{vii} Nonetheless, in the sample group, there are some local authorities with small deficits that are, however, certainly pathological because of their totally negative trend. We cite, among others, Venafro (472 inhabitants) with a deficit of 821 thousand Euro in 2005, 438 thousand Euro in 2006 and 771 thousand Euro in 2007; another example might be Pignataro Interamna (2447 inhabitants) with a deficit of 2 million Euro in 2005, 181 thousand Euro in 2006 and 1 million Euro in 2007.

^{viii} The report reveals that 66.07% of the sample examined showed a deficit of the year for 2006. Cf. COURT OF AUDIT (2008) p. 266 et seqq.

^{ix} It should be remembered that the presence of OBS debts recognised and not financed is the equivalent of non-approval of the budget. This means the local authority cannot enter into obligations or pay expenses for services that are not expressly laid down by law, excluding obligations undertaken in previous financial years.

^x In fact, the above-mentioned report of the Court of Audit on the financial management of local authorities shows that, of the total amount of OBS debt:

- 68.66% derives from court definitive sentences or immediately executive sentences;
- 23.52% regards incorrect procedures in purchasing goods and services;
- 5.37% represents requisition or urgent occupancy procedures;
- 1.25% concerns coverage of debts by consortiums, local government companies and institutions;
- 1.2% reflects debts for refinancing companies set up to run public services.

^{xi} Deficit parameters were introduced for the first time in 1998. However, they were not a novelty, as they were entirely based on parameters created by the Commission for Research for Local Finance, published as a decree in December 1993.

^{xii} The local authorities and mountain communities of Valle d'Aosta are not required to present deficit parameters, as annually established in the technical note of the decree regarding certification methods of balance sheets, because regional accounting regulations do not require such information. The exclusion of local authorities in Valle d'Aosta is established by Article 1, comma 4 of a Decree by the Ministry of the Interior dated 25th July 2007, "Certification methods for the 2006 balance sheet of provinces, local authorities, mountain communities and unions of local authorities."

^{xiii} On this subject, it is striking that such an indicator is particularly significant in the current Italian political and financial context, which is decidedly orientated towards increased fiscal and financial autonomy for local authorities, with consequent progressive reduction of public funding.