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DUTCH PRIVATE SECTOR AND LOCAL GOVERNMENT ACCOUNTING REGULATIONS: A COMPARISON

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ABSTRACT. This paper addresses the Dutch Regulations on Government Accounting as far as local governments are concerned. These regulations have undergone several changes in the past. The actual set of regulations has been developed with the Dutch private-sector-accounting-legislation as a reference. In 1931, the first serious local government accounting regulations came into place. The transfer from modified cash accounting into accrual accounting in 1985 was an important reform and the continued adaptation of the regulations to private sector accounting in 1995 constituted the state of the art, which will be analyzed. This will be done by a comparison between private sector accounting legislation and local government accounting regulations and an explanation of the still existing differences. A next adaptation is expected in the near future. Comments will be placed in the light of the desirability of some further changes.

INTRODUCTION

Dutch local-government-accounting regulation was introduced in 1931. Since then it has undergone a gradual development and it has now reached a high consistency with private sector accounting regulation. Financial reporting has to answer requirements as to the quality of information. Because the private sector and the public sector have important different characteristics, it is in the perspective of quality of information impossible that legislation for the private sector can be implied in the public sector without adaptation. Nevertheless

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harmonization is useful for users. So it can be stated: "Harmonize where possible but differentiate where necessary."

The aim of this paper is to give insight in the backgrounds as well as the essentials of the still existing differences between private sector accounting legislation and local government accounting regulations. This study begins in 1931 and follows developments in the municipal area because the municipal regulation is older than the provincial rules. Not until 1947 the provinces did get their accounting regulation and in 1995 one set of rules for municipalities and provinces was made up. In order to prevent confusion, this article will not enter into provincial issues until the common set of rules is at stake.

HISTORICAL EVOLUTION

The first Dutch municipal accounting rules were promulgated in 1931, because the activities of municipalities had increased in diversity and in size during the preceding decades. Furthermore, there was a need for possibilities to aggregate the figures of individual municipalities, to totals per policy area for the whole of the municipalities of the Netherlands. This was important for estimations of the impact of the financial policy and management of all the Dutch municipalities on the Dutch economy. This total impact, together with that of the provinces and the national government, influenced the development of the Dutch national economy. The beginning of the 1930s marked a period of increasing attention of the macro-economic impact of government involvement in the national economy.

The preceding decade had shown local government involvement in non-core-business activities of a business-like type, like water distribution, and gas and electricity production and distribution. Other examples were port-management and marketplace-management. For these types of activities accounting systems comparable to those in business were allowed.

For the core activities of local government, a cash accounting system was introduced which intended to harmonize the accounting conduct of the community of Dutch municipalities. The cash accounting system of that period differentiated between a current account and a capital account. For investments accounted for in the capital account, specific loans were taken for exactly the amounts of the investments concerned. In this way the capital account balanced each year. The interest and redemption on loans was accounted for in the current account. The accounts for a certain budget year remained open during one year after the year-end. In this way the disadvantages of the cash system with respect to matching aspects were mitigated. Payments and receipts referring to years, which had been closed, were accounted for in the oldest year still open. The accounting system was very prescriptive as far as formats were concerned and the regulations also contained bookkeeping instructions.

The existing accounting system gradually failed to satisfy the information needs of public administrators. That is why the existing system was adapted, be it at first modestly. As far as the capital account was concerned, in the beginning of the 1950s it developed into a statement giving more insight into the assets and liabilities. This was reached by means of introducing total financing instead of specific financing of each new investment, combined with the introduction of depreciation. Total financing opened the opportunity to better fit the total need of financing (new investments minus depreciation plus redemption on old loans) and to better adapt to contract periods usual in the capital market as well as to depreciation periods with an economic rationale. This implied also the accounting for loans in the capital account and the differentiation between depreciation and redemption. Also, the possibility of accounting for general and special funds in the capital account was introduced. This implied in the first place that the capital account did no longer automatically balance at the end of a fiscal year, because of the fact that new loans for new investments may have been taken just after the year-end and been financed temporarily with short term money. In the second place, it became relevant not to transfer the balance of the capital account from one year to the next in one amount, but to specify it by policy-area. This meant that the balance at year-end implied the book value of the investments per policy-area separate from the total balance of loans. In the same way the balances per year-end of funds were transferred by policy area. Mandatory statements with mandatory formats specified these book values per individual asset, giving insight into the original investment, depreciation, depreciation period and book value. This has been of enormous importance when, over thirty years later, the balance sheet was introduced. Other countries had serious problems, which the Dutch municipalities did not have, in identifying their assets at such reform events.

The current account was gradually adapted into a modified cash accounting type of financial statement. Nevertheless the adaptations of the old cash system and the "upgrading" towards a modified cash system, increasingly the old rules proved to be inadequate in the support of a uniform classification of public service functions as well as for comparative budget analysis. It did not answer the need to simply determine the levels of cost per each service function, because payables and receivables were not really accrued. It may be concluded that important steps had been made in the direction of accrual accounting, because the information on an accrual basis could after some elaboration be derived from the accounting system. Nevertheless it would last more than 30 years before the changeover to full accrual accounting would be made, because of the discussions between statistics professionals (Ministry of Finance) and accounting professionals (Ministry of Internal Affairs) among government officials. A long period of debate and deliberation ensued. The development of information technology opened possibilities to serve several different goals with one accounting system. This marked the period in which differences in opinion could be bridged.

After the introduction of new accounting rules for provinces (applicable from the fiscal year 1982) new accounting rules for municipalities were promulgated (applicable from the fiscal year 1985). The most important change existed in the application of accrual accounting, which could be seen as the technical consolidation of the adaptations of the old system. This implied the introduction of a balance sheet (with the inherent valuation questions) as well as the recognition of payables and receivables at year-end as cost and revenue.

A second major change consisted in the replacement of detailed prescriptions for bookkeeping and models for the format of statements, by regulations aiming more for quality of information than for strict compliance to detailed rules. The philosophy substance over form, already laid down in Dutch Civil Law on Financial Reporting, more or less came into view in the municipal accounting regulations, be it more implicit than explicit.

These major changes resulted in a cultural shock for the financial officers in the municipal bureaucracy. Most of these people had been educated and trained in performing accounting in a strict system with prescribed bookkeeping structures and mandatory statements with a mandatory format. The intended advantages of the accounting reform could only be realized when financial officers could successfully be changed into professionals able to deal with qualitative requirements instead of detailed prescriptions. So the reform contained extensive training programs.

A second result of this expected phenomena was retaining models for certain statements, not as a mandatory format but as a helping hand to financial officers still seeking assistance in the choices which had to be made.

A third result of this circumstance was the introduction by the Ministry of Internal Affairs and Kingdom-relationships, together with the Association of Dutch Municipalities and the Association of City-managers, of a stimulation program for the improvement of Dutch financial reporting, the so-called BBI-process. This project aimed at the improvement of Policy and Management Instruments in and around municipal financial management and reporting, on behalf of a better support of the municipal government's decision-making. The BBI-process has had a huge amount of influence on the qualitative improvement of Dutch municipal financial reporting. A kind of competition emerged from this project because some front-line innovators among financial managers in municipalities became ambitious to lead as innovators. Although a lot of municipalities participated in this competition, the city of Tilburg especially became well known all over the world because of its financial management and financial reporting.

In 1995 the next step in the reform was set. This reform was based on four basic assumptions:

- The Civil Code on Financial reporting, applicable to the private sector should be used as a reference, as much as possible and justifiable.

- The democratic principle should be supported along with the constitutional principle of autonomy of the provincial and municipal governments.
- The rules should be harmonized.
- The change should increase information value.

The characteristics of the new regulations will be elaborated on in the following paragraphs. In this reform still a limited number of compromises remained or came up, which will be dealt with in the next section as well.

DIFFERENCES BETWEEN THE 1995 LOCAL GOVERNMENT ACCOUNTING RULES AND PRIVATE SECTOR ACCOUNTING LEGISLATION

To start with the fiscal year 1995 the applicable accounting rules for local government in the Netherlands are intended to be harmonized with private sector accounting legislation. The Civil Code still contains on a number of topics, legislation, which has not been followed in the local government accounting rules. An inventory of these differences shows the following:

Valuation Aspects

- Capitalization of deficits as a separate category of the fixed assets,
- Capitalization of grants in fixed assets owned by third parties as a category of the intangible assets,
- Exclusion of valuation standards other than historical cost

Determination of Financial Results

- Deposits of interest in reserves,
- Deposits and withdrawals in or from reserves and accounted for in the income and expenditure statement,
- Result-dependant depreciation.

Presentation of Capital

- Equalization accounts as a category of appropriated reserves,

- Voluntary consolidation with third party entities

The first question to be posed is which consequences the specific characteristics of government entities ought to imply for financial reporting. The second question is whether and if so why these differences are justified. The next paragraph analyzes these questions.

GOVERNMENT CHARACTERISTICS AND THEIR CONSEQUENCES FOR FINANCIAL REPORTING

Attention shall be given to those characteristics, which lead to differences between private sector and public sector financial reporting. Experience has learned that arguing these differences is continuously necessary, because people not familiar with the public sector, often do not understand why Civil Law Regulation on Financial Reporting has not been declared completely applicable in local government, now that it has been taken as a reference.

Comprehensive Financial Accounts for the Complete Authority

In the past and also in the period between 1985 and 1995 the financial accounts of a province or a municipality consisted of a set of financial accounts for its different organizational entities, such as housing, land use, public works and social security payments. Usually these were independent departments of a single public legal body. Separate financial accounts were prepared for each of these entities. Under the old regime the official accounts, concerned what is called the "General Service". The financial accounts of all the "subsidiary" entities had to be presented with the official accounts of the General Service as supplements. Additionally, if such an entity was classified as a government-sector organization, its financial accounts were also integrated into the accounts of the general service on a gross figure basis. This means that the figures were to be included per public service function and under distinction between revenues and expenditures. If such an entity however was classified as a government-enterprise-sector organization, its financial accounts were integrated in the accounts of the general service on a net-figure basis. This meant that on the respective public service function only the balance between revenues and expenditure was to be included. For entities of a government-enterprise character already since 1985 Civil Law on

Financial Reporting was a reference. For government-sector entities this reference was not introduced till 1995. The choice for this different method of integrating figures of organizational subsidiaries had an economic rationale and stemmed with private sector accounting practice. Being that the government was a revenue-spending organization, the government-enterprise-sector entities could be defined as non-core-business activities, now that they were at least partly income-generating. As in the private sector this is an argument for not consolidating figures. In income-generating organizations even being part of government-specific mandates are not necessary for control and do not frustrate the allocation process.

After the 1995 reform, not only government-enterprise-sector entities but also government-sector entities were subjected to an accounting rules regime that had taken Civil Law on Financial Reporting as a reference. This was for the legislator an argument for ceasing this different way of integrating figures. A choice was made for the public-finance budget principle of universality of the budget. This principle requires encompassing all activities of the government in the budget on a gross figure basis, in order to facilitate an optimal allocation of resources. A direct consequence of this principle is a comprehensive set of financial accounts.

This transfer from an economic criterion to a public finance budget principle is certainly a loss in the quality of financial reporting because it neglects the different economic characteristic of these two types of entities.

Matching Principle

Since 1985 the chosen matching criterion is full accrual accounting. The bookkeeping methodology is double-entry bookkeeping. Together with the circumstance that regulation does not contain any bookkeeping prescriptions anymore at all, this opens the opportunity to freely shape the accounting system and make it suitable for management accounting as well. Matching happens on the basis of taking cost in the period in which the usefulness of the expenditure will be experienced. This principle remained unchanged at the 1995 reform.

Reporting per Function

Government organizations are as far as the core government activities are concerned revenue-spending organizations. This implies that these organizations allocate a given amount of available resources over vast numbers of possible policy-areas. The budgeting process results in a number of chosen policy-areas with the amounts reserved for the planned policy. The only effective way of reporting on realization or budget-execution will be functional and not categorical, as the latter is the usual way of reporting in the private sector.

The changes of 1982 and 1985 brought two tailor-made sets of functions (policy areas), defined for, respectively, the provinces and the municipalities. Of course these sets differ substantially because of the differences between the two levels of government with respect to their tasks. In contrast with the situation around the economic categories, a harmonization of the different sets of functions would not have been a logic development.

Economic Categories

For provinces, from1982 and for municipalities from 1985, slightly different sets of economic categories have been defined. These categories not only concern traditional cost categories (like cost of personnel, cost of capital, cost of goods and services, and especially relevant in the government sector: transfers), but also macroeconomic categories (like purchases of property, plant and equipment, granting of credits, lending and financial participation). Their revenue counterparts are sales of property, plant and equipment and reductions in granted credits and participation as well as borrowed capital.

These sets were unchanged and transferred to the common regulations, which came in 1995. The regulator missed a chance to harmonize them. At the occasion of this putting together of the regulations, an analysis of the two different sets does not offer any good reason for the differences, except perhaps for the sake of longitudinal comparisons of figures.

Information Requirements instead of Mandatory Statements

The most important evidence of the move of the 1995 accounting rules towards "civil law on financial reporting" can be found in Article

27 of the rules which states: “The statement of income and expenditure with the explanatory notes give truly, fairly and consistently the magnitude of all income and of all expenditure, as well as their balance.” Previously, the information concerned was prescribed by means of mandatory statements with a fixed format. The new rules go together with some illustrative statements, but one is in general free in choosing the method of producing and presenting the information as seen in the following examples.

At the occasion of the 1985 reform three different formally mandatory accounts were introduced or maintained. These were the current account (containing real current income and expenditure), the distribution account (containing income and expenditure transactions which had to be distributed over several different functions or policy areas) and the capital account (containing real capital investment expenditures and capital revenues).

The distinction between the current account and the capital account was important in order to give meaning to the so-called “golden financing rule.” These accounts are residuals from the old cash-accounting system. They reflect the budget-authority of the elected representatives regarding capital expenditures and capital revenues. The former sets of rules (provinces 1982 and municipalities 1985) had made a well-considered choice for maintaining a recognizable regime for the officials who had to work with it, in the provision of the guidance of a mandatory format of the capital account.

After 10 years of development, new criteria can be used in the choices of the mandatory elements of financial reporting. There is no doubt that authorization of capital expenditures and capital revenues cannot be abolished. Nevertheless, it is not necessary to maintain a separate statement in the financial reports. So at the 1995 Reform, an Investment Statement and a Financing Statement were introduced as a mandatory element of the explanatory notes to the financial accounts. These statements give information on position and changes in book values of property, plant, equipment and work in progress as well as on book values and changes in borrowed capital. It has been discussed whether it would be acceptable only to authorize the consequences of investment and financing, such as depreciation and interest, in the current account. This option was not chosen, because it was felt that the depreciation figure would not help elected representatives enough to understand the structural aspects of investments.

In the new situation, after the investment decision is made and the budget is authorized, their consequences are processed in the middle-long-term budget and in the annual budgets. The annual figures are then presented in the Investment and Financing Statements at the end of the fiscal year. The format for such an Investment and Financing Statement is free for choice.

This more flexible approach appeals to the professional ambition of the financial officers. It is evident that the quality of information outweighs rigid standards.

The distribution account, which was introduced in 1985 in order to prevent blowing up income and expenditure totals because of transitions from one function to another, was a part of the series of accounts, which together constituted the financial accounts. This, which is essentially a bookkeeping problem, could as well be solved in the accounting system without visualizing them in a separate account. That is why after the 1995 reform; this separate account was replaced by a mandatory statement being part of the explanatory notes, with the format of a cost-allocation-sheet.

Beginning with the 1995 Accounting Rules, complete allocation of the administrative expenditure (cost of the official staff and of political management) to the functions or policy areas became required. It may be questioned whether this provision deserves a positive judgment. Cost allocated should be separated in terms of controllable cost and non-controllable cost in order not to disturb the usefulness of the financial accounts for the judgment of accountability of individuals within the organization. Moreover it is also better to consider whether extreme cost divisions perhaps are not cost-efficient. The cost allocation sheet can perform a useful function in making these cost allocations transparent.

Budget Compliance

Government-organizations are budget-controlled organizations whilst private companies are market-controlled. This implies that the confrontation of realized amounts with the originally budgeted amounts is an important aspect of financial management and of course of accountability. This is why financial reports of governmental organizations should contain information on budget-compliance. The income and expenditure statement must therefore contain a column with budgeted amounts and an analysis of the differences between budget and realization. Such is not usual to be done in private sector financial reports.

Performance Control

Government-organizations, being revenue-spending organizations, characterize themselves as organizations in which performance is not measured in financial terms but in sometimes quantitative and sometimes only qualitative policy-area dependent criteria. This implies that the balance of the income and expenditure statement is not at all indicative for the success of governmental gestures during the fiscal year. It could be stated that the ideal balance of the income and expenditure statement approaches zero, because in that case the available resources have been totally spent for the well being of the community. If the execution of the budget has been under the condition of efficiency and effectiveness government spending has optimally contributed to the creation of societal usefulness. The performance information should therefore be presented at the level of the policy-area, which is at the budget paragraph dealing with that policy-area. This implies an explicit attention for performance information in the explanatory notes to the financial report.

Financial Reports in Relationship with Budget and Middle-Long Term Budget

In the private sector, two remarkable situations different from the public sector are relevant in this respect. In the first place the balance sheet and especially the capital shown in it can be seen as an indication of the potential of the company to survive future difficult periods and of the relative success in the past. In the second place the historical financial reports (and intermediary bulletins) are the only information published.

In the public sector not only the financial reports are published but also the budget and the middle-long-term budget are. Thus it is not really the balance sheet that indicates the potential to survive nor does it reflect success in the past. This information can better be derived from the budget and the middle-long-term budget and especially from the last one. As a result of the fact that not only financial reports are published but that budget and middle-long-term budget as well are accessible for the general public, very often discussions emerge whether certain information has to be "repeated" in the financial reports. It proves out that several financial managers or controllers in the public sector, being responsible for the financial reports, think it sufficient that certain information already has been dealt with in the budget. They forget that there is an indispensable difference between authorization and realization and that the financial reports have to be an adequate expression of accountability in itself.

The 1995 Accounting Rules have introduced a middle-long-term budget, as a mandatory complement of the budget for a fiscal year. Such a budget should be structured by function or policy area, in order to facilitate a transparent view on the future expectations at the service-level and on the space of governmental decision-making.

The budget should present the foreseeable consequences of existing policy that form the basis of the budget of the fiscal year on the middle term. It should contain an educated guess of the extrapolated cost and revenue and the size of the provisions and reserves. The reasons for the differences between the fiscal year's budget and the middle-term should be commented on. They may concern already anticipated reallocation of resources and expected changes in prices and wages. Higher-level government could also use the analysis to find out whether the projected service levels could be achieved with a balanced budget. A deficit position on the middle-long-term budget may lead to measures to prevent the deficit.

The explanatory notes to the 1995 Accounting Rules suggest to additional information to the middle-long-term budget as to presumed policy in the years concerned too. This could be informative indeed but should clearly be separated from the hard-core information referring to the existing policy. It is preferable to introduce in the explanatory notes to the financial accounts, a paragraph dealing with an analysis of the results in comparison with the fiscal year's budget and the consequences thereof for the middle-long-term budget. Such a comment may offer insight in the consequences of recent findings on the middle-long term financial perspective of the organization. The budget might also have an addendum giving assurance that the budget does not contain hidden reserves.

Mandatory Risk Disclosure

The 1995 Accounting Rules also prescribe a paragraph on risks in the explanatory notes to the fiscal year's budget as them to the middle-long-term budget. Risks here mean dangers that threaten to inflict damage or losses as a consequence of internal or external circumstances. The budgets should give reliable information on the relevant risks at the moment of presentation of the budget. Of particular concern are the risks for which no provisions have been made in the financial accounts. If the risks are not quantifiable, it is impossible to say which part of the general reserve cannot any longer be used as a normal buffer for unexpected losses or deficits.

The relationship between provisions and the risk paragraph can be shown in Figure 1. It indicates when a liability should be recognized, a provision should be made or comment should be given in the risk paragraph, which is a part of the explanatory notes.

Of course the information rendered should not cause damage to the organization. So the type of information given may be influenced if third parties would take unreasonable advantage of it. In extreme cases the information can be given in a closed meeting of the elected representatives.

FIGURE 1
Relationship between Provision and Risk Paragraph

			Magnitude	
		Known	**Uncertain**	
			Accessible	Not Accessible
	Uncertain	Provision	Provision	Risk Paragraph
Consequences	**Certain**	Liability	Provision	Risk Paragraph

It is regrettable that the 1995 accounting rules do not indicate that a risk paragraph should also be used for the financial accounts. It is clear that the reserves shown in the balance sheet may need additional information on risks in order to be judged as good as possible. This additional information could perhaps be logically combined with the disclosure of hidden reserves.

An increasing number of provinces and municipalities are voluntarily adding a risk paragraph to the financial accounts as well. A change in the regulations to this point may be expected.

Improved Distinction between Reserves and Allowances

The 1995 Accounting Rules introduce a much clearer distinction between reserves and provisions than was usual under the former regime. Furthermore the treatment of these capital components is shifted in the direction of civil law on financial reporting.

Under the new rules, funds no longer exist as a category. Provisions are only allowed if they are quantifiable financial liabilities or financial risks. The magnitude of a provision must be at level with that liability or risk. Additions to or extractions from provisions originate exclusively from changes in the necessary magnitude of the provision or from expenditure on the purpose of the provision. Therefore adding interest to a provision is explicitly prohibited.

The 1995 accounting rules describe reserves as capital components with the character of equity and which are available for free spending. Decision-making authorities in organizations may earmark parts of this equity in advance, by indicating a specific appropriation. This constitutes the first category of so-called appropriated reserves. Other appropriated reserves may originate from the outside, when special conditions for spending have been made on receipt of resources (legacies or subsidies). A third category is the equalization accounts against rate fluctuations and equalization accounts for investment funds to be amortized. They also belong to the appropriated reserves, because they are not liabilities or provisions in the way defined above.

Deviating from civil law on financial reporting, the adding of interest to reserves is not prohibited. Attention to this will be paid hereafter.

Distinction between Notes and General Report

Another change that occurred in the 1995 reform, that deserves some attention, was the distinction between the explanatory notes to the financial accounts and the presentation letter of political management to the council. Recently this has been completed with a mandatory general report. The Provincial Act and the Municipal Act require political management to report on financial management in their presentation letter. The mandatory general report differs from the explanatory notes in the level of objectiveness of the information. In the general report, information of a lesser objective character may be given. Here information of a more speculative character, for instance concerning expectations, is allowed. In this report policy-evaluative statements can be made. Because no misunderstanding can be accepted about the character of the information given, it is required that a clear distinction between the general report and the explanatory notes must be visible.

Capitalization of Deficits

In the private sector, deficits of whatever character are to be subtracted from Equity. If Equity is insufficient, aggregated loss is shown under the assets as the negative balance between assets and liabilities. In government-organizations this could be done as well, but because it concerns non-income generating entities, future surpluses only will result when the allocation explicitly reserves space within future available resources. This is to be shown in the middle-long-term budget. In order to let the balance sheet also show the future consequences of this circumstance the possibility has been created to capitalize such deficits, which are to be depreciated (amortized) in the planned period. This means that a proper coverage plan should be required before this option can be used. This is a very government-specific solution for a government-specific phenomenon.

Capitalization of Grants in Fixed Assets Owned by Third Parties

Government-organizations in contrast to private companies regularly contribute grants for investments of third parties, which execute an activity, which the government esteems politically relevant. This concerns the facilitation of desired infrastructure on behalf of a certain policy area. The government could sometimes also create the infrastructure on its own behalf and put it available for rent, but often it is esteemed to be more effective to let the user be formally the owner. It is expected to be in favor of a careful use of the facilities.

Where the matching criterion in government-organizations concentrates on matching cost and usefulness created in periods like fiscal years, it is well defendable to capitalize the grant and depreciate it over the expected useful time of the infrastructure made available.

Historical Cost as the only Acceptable Accounting Principle on Valuation

In the private sector, valuation of assets may be at actual cost. The depreciation of the assets thus valued ascertains that profit can be distributed without the risk that continuity of business can be endangered. In government, assets usually are financed with borrowed capital. This implies that when historical cost is taken as the valuation criterion every period pays for its own cost. Valuation at actual cost would imply that a generation would be paying its own cost as well as be saving for the next generation. Fees calculated on this basis would then be too high. For new investments, new borrowed capital will be attained.

So under the 1995 Accounting Rules, governments can no longer value their assets on a replacement cost basis. Only historical cost is allowed now. This measure has to do with the removal of the difference between the government sector and the government-enterprise sector. Since all the entities of a public legal body are now consolidated, it is important to have one uniform valuation standard for the whole budget and for the whole of financial accounts.

Although this standard has been justified by the removal of the sector distinction, it is the logical consequence of insisting on one consistent valuation standard. So, in the new rules, a choice has been made for historical cost or acquisition cost.

The second aspect of the valuation of assets deals with the method of depreciation. The depreciation period may differ according to the types of assets. The useful period for an office building will be much longer than that for an ambulance. The rules state that the depreciation period has to be in line with the expected useful life of an asset.

Intangible assets cannot be depreciated over periods of more than 10 years, in contrast to the private sector's five-year period. An exception is allowed for two special cases of intangible assets. Firstly the cost of debt capital contracts can be depreciated over the period of the contract, because it is seen as a part of interest. Secondly for capital grants or assets owned by third parties the matching of usefulness and cost implies the possibility of capitalization and depreciation over the period of expected usefulness.

The balance sheet of a government shows other specific fixed assets, such as streets. A period of usefulness can be defined and historical cost can be indicated and depreciation can be calculated. However, the representation of the book value is completely different from that of for instance an office building. Streets and bridges in general do not have realizable values, which to a certain extent are comparable to the book value. In such cases the valuation standard is adequate for the purpose of matching of cost and usefulness on the current account only. The value on the balance sheet of a government may contain some book values with a valuation-significance, but in general it will be a statement of remainders not yet amortized. As a result, the 1995 Accounting rules require in article 33: "The balance sheet with the explanatory notes gives truly, fairly and consistently the financial position and the composition thereof in assets and liabilities at the end of the fiscal year." This is different from the situation in civil law, which states "the size and the composition of capital at the end of the year" (Civil Law, Book 2, Title 9, article 362). Compromises were made in the area of asset valuation: Some are understandable such as carrying as an asset of losses and the use of appropriated reserves; and some others are less justifiable or understandable like the preservation of "old" book values for assets no longer in normal use, and result-depending depreciation. The latter will be dealt with later.

Deposits of Interest in Reserves

Dutch private sector financial reporting legislation in accordance with the 4th European Community Directive does not allow deposits of interest in reserves before calculation of profit. Deposits like these are considered to be allocation of profit. This relates to the primary purpose of financial reporting in the private sector, that is, to report the investment results, on one hand, and the allocation of profit, on the other hand. For the Dutch public sector, there is an exception to this rule: the deposits in reserves are seen as an allocation of resources, not of profit. The primary purpose of financial reporting in the public sector is after all to account the use of taxpayers' money.

Deposits and Withdrawals in or from Reserves

In the public sector, policy makers can decide to save available resources (budget surpluses) in "reserves" for future uses and to spend accumulated reserves in the current year. This would not be acceptable in the private sector because there a calculation of profit must be made which is comparable to such calculations in other entities and in comparison with former years. This is so, because in private sector companies the profit (the result of operations) is expected to indicate the company's success. Since that could not and should not be the purpose of the income and expenditure statement of a government-organization, these deposits in and withdrawals from reserves from or to the income and expenditure statement are allowed and rational.

Result-Dependent Depreciation

The explanatory notes to the new accounting rules continue the possibility of depreciation without an economic basis. Depreciation without an economic basis takes place whenever the depreciation period differs from the useful period. If this is accepted, conduct against the requirement of consistency has to be feared. Although explanatory notes advise against this option, there is no clear indication of the number and character of cases in which application would be supposed acceptable. This opens doors in the direction of abuse. Extra depreciation can only be acceptable in an economic way of judging if and when circumstances have arisen that cause a shorter useful period than originally expected. The only condition that the Rules set for such conduct is deciding on it in a proper democratic decision-making procedure.

Equalization Accounts

The 1995 Accounting Rules differ from private sector legislation also with respect to the admittance for the application of equalization accounts for certain cost, e.g., maintenance or certain tariffs such as garbage removal. Earlier was indicated that the Accounting Rules provide the possibility for this type of appropriated reserves. Using equalization accounts may contribute to the control of claims on available resources in a certain year. This is usually used for areas in which cost covering fees are operated. Differences between a year's total cost and total income in that policy area are neutralized with respect to influence on the other policy areas and general resources by using an equalization account.

Voluntary Consolidation with Third Party Legal Entities

Leading for consolidation in the private sector is the size of the control that can be executed by top-management of a certain conglomerate of companies. A high level of control implies consolidation. After taking into account the level of control, a second question has to be answered. This question refers to whether the controlled entity is seen as a part of the economic entity, which the conglomerate operates. Controlled entities with purposes really different from the main mission should not be consolidated, but mentioned apart.

In government the way of measuring control is different. In the private sector it depends of the percentage of the shares that are held. In the public sector, control may also be acquired by other means, e.g. by appointment rights of board members or even by being the only subsidy-provider. Secondly, government will not ask itself whether such third party legal entities can be seen as belonging to one economic entity but as belonging to one administrative entity. Because of the complex answers that can be given to this last question, the legislature has decided to give room for free definition of the borders of an administrative entity.

The new regulations offer the possibility to encompass in the consolidated accounts not only all the different component entities of the government itself, but also other legal bodies to which it has granted credits or to which it is entitled to appoint board members. The activities assigned to such legal bodies will be assumed to be government's activities at arm's length. These include:

- Real participation in government-owned limited companies,

- Cooperating institutions of different governments, and
- Government-controlled foundations

Since government operates simultaneously from several structures, good coordination and a good insight into what is happening are essential. Consolidated accounts may be useful instruments in this respect.

In general, this option should be restrictively used, namely, in such situations in which it is undoubtedly clear that the quality of decision-making will be strongly improved. It is advisable to limit this type of consolidation to 100 % participation or majority participation in which the control of the "owner" entity is significant.

The difficulties in a well-executed consolidation process should not be underestimated. Good consolidation procedures and agreements are needed. Government is not yet accustomed to such procedures at all. This is the reason that we previously spoke of integration of figures instead of consolidation.

The differences with private sector legislation as mentioned above are that consolidation will be in some cases mandatory and in other cases optional. Because of the legal principle that a specific rule goes over a general rule, mandatory rules have to be followed. So if the public sector good reasons have led to optional consolidation, this specific rule "overrules" the general rule of mandatory consolidation. When an option may be chosen, however, proper economic consideration should underly the decisions to make use of the option.

SUMMARY

The Accounting Rules for provincial and municipal government in the Netherlands have gone through a long evolution, starting in 1931 and now, after the 1995 reform, have reached a certain level of maturation. The rules have been established according to the philosophy that deviations from civil law on financial reporting should happen only if necessary because of the demand for information of high quality. This implies however that differences in character between private sector organizations and public sector organizations force to necessary adaptations of financial reporting regulations, just because of the same

demand for information of high quality. This means: "Harmonize where possible but differentiate where necessary". The 1985 as well as the 1995 Accounting Rules gave an interpretation of what, with respect to harmonization, at these moments in time, was possible on the evolution line, whilst not fully losing sight of what was not really necessary with respect to the differences.

In the foregoing an indication of the level of success in this harmonization process has been discussed. Evolution never really stops so good attention to the character and sequence of adaptations is necessary.

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