A HISTORY OF NEW ZEALAND MUNICIPAL ACCOUNTING AND AUDITING
1876 TO 1988

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Abstract

Public sector accounting has become more visible in recent years in both the accounting world and academic literature. The New Zealand public sector has, according to some commentators, been at the forefront of international developments since the 1980s. Yet discussion and analysis of current New Zealand public sector accounting is generally devoid of reference to its historical antecedent. This thesis addresses part of the lack of historical understanding of public sector accounting, auditing and financial management by providing an historical discussion of accounting and auditing by New Zealand municipalities between 1876 and 1988.

Local government has always been central to the development of New Zealand's infrastructure and economy – efficiency and equity being crucial attributes of the sector. Essential to achieving efficiency and equity have been key financial and accounting principles. This thesis identifies and discusses the operation of these principles. While the principles informed most decisions relating to local government, they were not sacrosanct. Discussed in this thesis are instances where the principles were cast aside by legislation for particular situations, either for all municipalities or for a specific council.

The accounting and financial management requirements were to ensure that councils were held to account for the use of ratepayers' money. This thesis identifies and discusses changes regarding whom the borough or city councils were accountable to. In the early period, accounts were clearly prepared for the local community. From the 1880s to the early 1970s, council gave account to the Audit Office, which received the account on behalf of a local community. In the early 1970s, lead by the Audit Office, this attitude changed back to the community, which held its council to account. This thesis traces the technical and philosophical changes to the accounting, auditing and financial management requirements imposed on municipalities by Parliament and central government. It also discusses the relationships between the parties involved in choosing between different levels of central oversight and local autonomy, and in choosing between different accounting policies.
Acknowledgements

_Daddy why don’t you go back to work in your pyjamas, so if you fall asleep you will be comfortable?_

An historian’s nightmare must be unfriendly, incompetent and/or obstructive archivists. Fortunately I have encountered none of these. I would like to thank the staff at Archives New Zealand, head office, Wellington, and the staff at Wellington City Archives. Their helpful assistance in tracking down documents is gratefully acknowledged. The assistance of other repositories, the Parliamentary Library, Wellington, Archives New Zealand, Christchurch, Victoria University of Wellington Library, and New Plymouth City Council and Puke Ariki, is also acknowledged. I would also like to thank the Office of the Controller and Auditor-General for providing complete access to the restricted files at Archives New Zealand.

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<td>Court of Appeal of New Zealand</td>
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<td>New Zealand Society of Accountants</td>
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<td>SC</td>
<td>Supreme Court of New Zealand</td>
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<td>Wellington City Council Archives</td>
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Preface

Richard Seddon had reputedly joked in the 1890s that every second person he met was an elected member of a local authority. (Gilling and Henderson 2000 p. 39)

Decades after their compatriots left Britain for North America and later Australia the first wave of new settlers arrived in New Zealand. They travelled half-way around the world in expectation of something better – for why else would they go – imagine their feelings as they stepped ashore, or more likely waded ashore, for the first time. Irrespective of their standing in the home country, the level of public infrastructure available for settlers would almost certainly have been worse in New Zealand. Roads and bridges, however dark, dirty and dangerous at home were better than the tracks they came to, presuming that tracks existed. The public spaces and amenities at home, however poor and limited, were better than nothing.

Arriving in the 1840s and 1850s at the beach in Petone, Lyttelton, Nelson, Auckland or any other of the numerous ports and being greeted by “a beggarly collection of stricken huts and wooden houses” in “a horrid place always raining ... everything dirty and shabby” what the settlers left behind must have been seen as better. Arriving later, in the 1860s and

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i Bush (1995 p. 12) has this quote as “every fifth man”.

ii This thesis does not specifically refer to the involvement of or by Maori in local government. This thesis focuses on urban municipalities, whereas the majority of the Maori population remained in the more rural areas until after the Second World War. (Walker 1992 p. 498) Research focused on aspects of the history of accounting and auditing in counties, where specifically labelled Maori or native land was more common, would likely find interesting issues for discussion.

1870s, they would have been greeted with a wharf, some streets and a few amenities, yet the infrastructure and amenities could barely have coped with the existing residents, let alone the increasing numbers arriving on the constant stream of immigrant ships. Finding land on which to build a house may not have been difficult, but the roads and/or other infrastructure may have stopped at the last house previously built. Not only were decades or even centuries of infrastructural development non-existent, but also lacking was money for such development. Towns and their need for infrastructure grew and expanded with the arrival of every ship.

The need for a form of government that could deal with the immediate local infrastructure concerns of each community was evident. So obvious was such a need that even before the first New Zealand Company ships bound for Wellington left Gravesend, England, the emigrants waiting to set sail were required to agree to a code of law for that new settlement that included the need for rating to fund infrastructure. (Dalziel 1992 p. 87) Not only was rating going to be required for the financing of the new settlement, but the associated management of the finances and infrastructure would need to be efficient and frugal and ultimately accountable. The need for efficiency and frugality was highlighted when the provincial government system collapsed in 1876; the inability of provincial governments to fund themselves was seen a major reason for their collapse. (Morrel 1964 p. 270)

Participation in local government in those early days of European settlement was relatively high. Perhaps not as high as Richard Seddon, Premier between 1896 and 1906, suggested. However, Gilling and Henderson (2000 p. 39) suggested that approximately 1 in 15 adult males might have been involved as elected representatives in some form of local government. Small and geographically dispersed communities called for the establishment of numerous local authorities, and fierce parochialism ensured that the numbers remained higher than necessary.

Seddon’s statement indicates a second aspect of local government behaviour; that of an almost constant dialogue between local government officials (elected and employed) and central government. The creation of local authorities by statute without a power of general competency and the constraining effects of the *ultra vires* doctrine together with their limited ability to raise revenue, in practice, meant that local authorities had no option but to create what was to become a well-trodden path to the doors of central government politicians and officials. This path was essential for local authorities as they sought
changes to existing rules and policies or the introduction of new rules and policies covering every aspect of local government activity and administration. While New Zealand does not have a tradition of significant revenue sharing between central and local government – rather, local government relies almost exclusively on property rates – other issues were always discussed between central and local government. Central government was petitioned, formally and informally, for changes to existing powers and for new powers relating to everything from water, rates, rabbits, roading and rubbish to airports, abattoirs, accounts and auditing.

This thesis tells a story, predominantly using central government archives, about the requirements for the accounting and auditing of local government, in particular municipalities, in New Zealand, between the end of the provincial government era in 1876 and the beginning of the reforms to local government that started in 1989.
Chapter One: Accounting History

1.1 Introduction

Prior to beginning a history of New Zealand's local government accounting and auditing environment, this chapter will locate that history within existing accounting history literature, especially local government and New Zealand public sector accounting histories. The chapter begins with a brief overview of accounting history in general followed by a review of literature on the purpose of accounting history. Section four provides a series of rationales for engaging specifically in government or public sector accounting history. Section five looks at the general visibility of public sector accounting history within accounting literature. Sections six and seven review all New Zealand public sector accounting history literature and English language literature on local government accounting history worldwide. The chapter concludes with an outline of the structure of the thesis.

1.2 An Overview of the State of Accounting History

Until recently a large proportion of accounting history literature began with a statement on the state of accounting history. These statements have changed over the years, reflecting the changes in accounting history literature. Three eras can broadly be identified in accounting history literature from these statements: a scant era, a growing era and an era of diversity.
Writings until about 1980, in general, decry the lack of work done and trumpet the vast possibilities that existed for research in accounting history. Baladouni (1977), while commenting on the growth in accounting research in general, lamented the level of accounting history research being undertaken at the time; "historical inquiry in the accounting system appears to be singularly neglected". A survey of accounting professionals and academics reported in 1978 that practitioners, and academics to a lesser degree, saw accounting history as irrelevant to the work of accountants. (WSUARS 1978)

By the 1980s, comments were more likely to focus on how interest in accounting history had grown; for example, Gaffikin (1981) in 1981 commented that "there has recently been an increased interest in accounting history". Similarly, Hopwood (1987) stated that "a great deal of attention has been devoted to the history of accounting", although Hopwood added a major qualifier that will be discussed shortly.

Brown's 1996 citation analysis of the top 100 accounting articles in all paradigms between 1963 and 1992 included six that were identified as accounting history. All six were from the 1980s; in fact they were published in either 1986 or 1987. As with any selection, the choice of journals and articles may call into question the validity of specific results. For example, the journals that publish a large number of accounting history papers were not included in either the list of citing journals or the original article journals. However, the general hypothesis that little serious academic accounting history was undertaken until that time is sustainable.

Hopwood's (1987) qualification to the observation, regarding the attention that accounting history had received, was that research had focused on the technical and "antiquarianism was the norm". Although he identified some movement away from such an approach, first referencing such a move to 1982, Hopwood suggested that the big movement came in the period immediately preceding the publication of the article. More recent literature reflected the third stage in the development of accounting history – the diversity era or stage. This material answered Hopwood's criticism of previous work by providing greater analysis, and this analysis had come from a number of methodological schools. The variety of research approaches now used and the greater acceptance of the possibility of different

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1 One exception from this is the opening line from Solomons' "Historical Development of Costing" where he writes "So much has been written about the early history of double entry bookkeeping...". Solomons goes on to provide a brief history of costing, which he saw as missing from the literature. (1968)
approaches demonstrate this maturity in more recent accounting history literature. For example: Fleischman and Tyson (1997) referred to an increase in the debates on the evolution of accounting theory and practice, which had lead to a richer accounting historiography. Miller et al. (1991) stated that within a decade accounting history had “come to occupy a significant position within” accounting and that a “proliferation of methodologies” had been used by accounting historians. Carnegie and Napier (1996) commented that the number of accounting history researchers had become large enough, together with the accepted use of different approaches, to allow accounting history to be divided into various schools based on modes of study and questions asked. Oldroyd (1999) noted that “research directions have become an issue in the 1990s”, identifying between 1990 and 1999 twelve articles that discussed historiographical classifications in the accounting history literature – double the number of the preceding 10 years and three times that of the previous two decades.

In addition to the increase in number of acceptable methodological approaches used in accounting history there was an increase in the number of outlets for the publication of such research. (Carnegie and Potter 2000)

This thesis examines a part of the history of accounting that to date has been largely absent from the general increase in accounting history literature. Public sector accounting history has not been well covered either as an area of accounting history research literature or in literature on public sector management. Both Carnegie and Potter’s (2000) and Anderson’s (2002) review of accounting history publications identified the lack of public sector accounting history literature. This point will be revisited in section five.

1.3 Why Engage in Accounting History?

Throughout the past 30 years of academic interest in accounting history, the justification for engaging in historical research has been part of the literature. The intended audience for these justifications appears to be both members of the accounting historians community and colleagues in academia who prefer other research approaches and questions. Justifications can help other members of the community to judge both the success and appropriateness of research. For colleagues working outside accounting history, especially those in the area of positive accounting theory, accounting history is often seen as a pastime rather than a legitimate activity. For the positivists, the archive often means a
computer stored database of historical prices and volumes relating to share-market transactions, with little relation to the wider environment from which the numbers were derived. Research such as Mills (1993) and Merino et al. (1987) highlight the importance of accurate historical research informing all accounting research.

As far back as 1904, Haskins (of Haskins & Sells and New York University) noted that understanding and appreciating accounting history would allow people to “better ... understand our present and to forecast or control our future” (Previts, et al. 1990b). In 1955 Murphy (1955) extolled the virtues of historical research in accounting. She saw such research as a way of reversing the “prolonged preoccupation with principles of theory and practice” that accounting at the time suffered from. For Murphy, accounting history could assess and describe the cultural, business and economic impacts of accounting and, in particular, the development of the accounting profession.

In more recent literature, aspects of the ideas of Haskins and Murphy can still be found. Generally the literature identifies both a ‘useful’ aspect and a ‘knowledge’ aspect to the research. Some literature separates them while others, especially some critical literature, regards the two parts as indistinguishable.

For example, Parker (1999) provides both utilitarian and intellectual arguments for the study of accounting history. From a utilitarian perspective Parker suggests the role of accounting history is to identify and inform us of what is different between then and now, as well as differences between various times in the past. The intellectual perspective has two parts: the first requires no justification other than it is interesting and worthwhile to engage in accounting history. Secondly, accounting history is about gaining fresh insights about the past, especially by applying various and new approaches to old material.

Thirty years previously, the American Accounting Association’s Committee on Accounting History also used the twin perspectives of the utilitarian and the intellectual to outline the role of accounting history (AAA 1970). However, their utilitarian approach was one of looking for solutions to current problems and possible solutions based on predictions generated, using an analysis of past events. The intellectual basis of accounting

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1 It should be noted that the idea of using history to ‘forecast’ the future has generally been rejected by historians, including accounting historians.
history for them was rooted in the notion of change and development and through history being able to know why and how “accounting thought, practices and institutions develop”.

Baladouni (1977) also suggested both utilitarian and intellectual reasons for engaging in accounting history. He saw two ‘essential results’ from the study of accounting history:

“a deeper and broader understanding of ourselves and our role as accountants and, on the other, a greater intellectual curiosity and sensitivity which can advance the positive knowledge of our field.” (p. 8)

Previts et al. (1990b) suggest that accounting history will support research in policymaking and practice and support standard setting. They also suggest that it will provide an explanation of where we are today and provide the scholar with an interdisciplinary view of accounting.

Bryer (2000) sees accounting history as serving two objectives: firstly, as a way of understanding more about modern accounting practices, and secondly, as a window to understanding social history in general.

Merino et al. (1987) illustrated the importance of historical analysis when undertaking event studies in accounting research. When they examined an awarding winning article on the impact of the 1933 Securities Act, they concluded that the lack of proper historical analysis “made the results of the empirical tests subject to various interpretations” (p. 760). Furthermore, their research thus calls into question a range of research and publications that were based on the ‘suspect’ original research.

Authors supporting ‘critical accounting’ research often view historical research as an essential part of the process. In such literature, the use of historical research is part of conceptualising the topic. Within accounting history there are is similarly a ‘critical’ tradition¹ whereby interest is in historical accounting research per se, yet the focus of that research is wider than traditional historical research. Such research has as its focus “the social, political and ideological contexts of accounting”. (Stewart 1992) The reasons or justifications for engaging in this type of work are often couched in terms of emancipation and/or providing a voice for the unheard or silenced.

¹ I do not suggest that there is one ‘critical accounting’, rather it is used as a lose term to encompass a range of methodological schools, including but no limited to historical materialism, Foucaultian, and postmodernism.
The various justifications provided above reflect aspects of the methodological schools and existing research activities that are prevalent in accounting history. None of the justifications was identified as relating to a particular sector, although the literature showed a preference for the institutional or technical environment relating to the private sector. The following section builds a case for a unique justification for public sector accounting history.

1.4 Rationales for Public Sector Accounting History

Public sector accounting is different from both the private sector and the not-for-profit sector. This is still the case even in jurisdictions, such as New Zealand, where the official rhetoric is that the same accounting rules apply to both private and public sectors. The use of the information gathered by the accounting system and the environment that the information came out of are different, even if the accounting (external reporting) policy arrangements are the same. This section discusses three reasons to engage in research into the history of public sector accounting: first, the insights to be gained from studying something different; secondly, the relative ease of access to primary and secondary material; and thirdly, the need in democracies to have past governments’ actions reviewed. It should be noted that these reason are in addition to those discussed briefly in the previous section, as applying to all accounting history.

1.4.1 The Difference Factor

One of the benefits of accounting history already noted is that it can help identify differences, both between the present and the past, and between various pasts, both chronological and environmental. Historical studies of public sector accounting can provide insights into accounting as both a technical and a social activity. Such insights on their own and when compared with existing literature can further our understanding of accounting across all sectors.

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1 The environment is taken to include geographical, cultural and sector (public, private etc.).
Public sector accounting has predominantly had different accounting methods, especially for capital and assets, the use of the cash basis as opposed to an accrual basis, and the use of funds. These different methods can be used to help highlight issues in all accounting. For example, notions of capital maintenance or the importance or relevance of concepts such as ‘going-concern’ may vary over time and/or in different environments. Different accounting treatments and practices can shed light on different understandings of key issues in accounting, such as accountability, stewardship and decision usefulness. Different accounting treatments and practices can result in different incentives, economic and other, and different behaviour; analysing various treatments from various sectors may provide insights into how accounting affects behaviour, and how universal, or otherwise, responses are to the accounting treatments and practices.

Beyond the technical, there is much to be gained from studying various accountings in the environments or contexts in which they have operated. (Hopwood 1983) The study of the development, creation and adoption or rejection of new accounting policies in a variety of different environments and periods can tell us much about the subject. Such analysis can help to understand better how accounting has been considered by many parties – its perceived relevance, how contestable and debateable it was at various times, how important accounting has been considered within the sector or industry it operated, and so on. In addition, as the following two sections will also cover, the involvement of accounting in public policy, via public sector management or as a policy tool, can further our understanding of all accounting. Reviewing the use of accounting may well be easier in the public sector because more of the available ‘evidence’ of its use is in the public domain. Such analysis of various accountings in their contexts can provide insights to further our understanding of and research in all accounting.

As noted, this difference factor can be seen in both comparative and stand alone work. Studies that tell a comparative story between similar activities in different sectors, such as between private sector and public sector or between the not-for-profit and the public sector, can help highlight and illustrate accounting issues generally. Similarly, histories that focus on aspects of public sector accounting alone can tell different stories from those that focus on accounting for or in the private sector. These public sector histories can become part of

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i Private sector accounting is also involved in public policy but is generally not as visible.
the literature for future use by accounting historians and other researchers and, thus, be used for comparison at later dates.

However, Burke (1993) highlights two major obstacles or dangers of comparisons, which ought to be noted. Firstly, comparisons can lead to evolutionary models designed to use history to predict stages of development. Many historians and philosophers of history have rejected such notions, given the vast array of influences on any one event. Such models merely say 'given these conditions occurred, then we predict the same will happen elsewhere, following the same path', yet not all of the factors can be incorporated into a model, nor will they be fully duplicated in another period. Secondly, Burke warns of ethnocentrism, imposing the norms of one (dominant) culture on to another while attempting to compare the cultures. In accounting history there needs to be a warning against the danger of 'private-sector-centrism'. Strong research in public sector, private sector and not-for-profit sector accounting history, at times referenced to each other, would avoid such problems. However, given the current state of accounting history research, I suspect that private-sector-centrism already has a lead in this arena.

1.4.2 Access to Archive Information in the Public Sector

One of the biggest secrets in accounting history must be the extent of historical resources held by various parts of the public sector in a variety of jurisdictions and the ease of access to such information. Resources already in the public arena (although many are likely to have been relegated to the stacks) include parliamentary debates and reports, legislation and regulations, official reports, news media accounts, court cases and, of course, published financial reports and statements of a range of public sector organisations. Apart from the legislation and regulations, and the published accounts, most of this material is likely to indicate more than what was decided; debates, disagreements and developments are likely to at least be hinted at in these other records. Because much of public sector activity occurs in the public eye, the level of primary source material available is far greater than other research sites. Equally or even more important is the access to the internal communications within the public sector. This material includes communications

\[1\] This does not discount the concern of many researchers and historians about a bias in the records based on who controls the record keeping and the archive. I am not in any way suggesting that the volume of material available should be equated with the full representation of all views. However, with the political process one can hope (perhaps naively) that a greater number of voices may have been heard and recorded.
between the government officials and the elected executive, where advice and discussion of policy choices originally occurred out of the public arena. Much of the internal material has been hidden from public gaze and scrutiny until the researcher uncovers the file in the archive. Furthermore, the significance of previously published material, including legislation and regulations, may not be understood until viewed with hindsight and/or in conjunction with the internal information. With the passage of time more information is released and/or identified, offering the researcher the chance to revisit their- work or others’ in the knowledge that more information is now available, enabling them to tell or revisit other stories.

Public sector archives provide multiple layers of material: technical, accounting policy decisions, and political. Firstly, there is the technical accounting material, both the records and the instructions on how to account for various transactions of the government. From such information the researcher can delve into the technical practice of accounting in the public sector. As mentioned above, the technical material can be compared with the private sector accounting practices and/or other periods or sites of public sector accounting. Debates and controversies within accounting can be illustrated by reference to these debates as recorded in the public sector accounting archive. The government in most cases was also the regulator of its own accounting policies. Thus the archives may help to show why government accounting developed in a certain way or why it took certain paths at particular moments in time. Often the discussions between decision-makers and officials/advisers will provide a window into the development of certain government accounting policy choices. Secondly, those with research interests in the motivations for certain policy choices will find that historical research in the public sector will provide different insights from those of the private sector. The new insights will come from the different relationships between the preparers and the regulators in the public sector compared to the private sector, and from access to a paper trail that is more likely to be complete in the public sector than in the private sector. Finally, for those interested in the use of accounting in the political arena, the archive can lead to insights into the awareness of the subjectivity of accounting information and its political role. To date, little historical research has been undertaken on the use of accounting in the public sector as a public policy tool. With the growth in use of accounting as a tool in management of the state (Hopwood 1984 p. 167) there is plenty to research. Such research could cover both the explicit use of accounting via the visibility given to accounting in reports and similar
material, and the implicit use of accounting in the way accounting calculations have become a large part of both public sector management and public policy making.

1.4.3 Public Sector Accountability and Information

The existence of the archives points to the third reason for engaging in public sector accounting history. The activity of the government in a democracy is legitimated by the accountability to the electorate/public.\(^1\) Actions that would otherwise be considered arbitrary or without a basis become legitimate, and proper actions of the state, due to the accountability relationships, that are part of the mechanisms of the state. (Stewart 1984 p. 13) In this era of questioning most activities of the state, especially in the name of efficient government, “the call for accountability of administrative decisions and bureaucratic actions seems to be one of the few demands that are not seriously contested in democratic societies”. (Wirth 1991 p. 71) Central to the ability to ensure such accountability is offered is the ability of the public to know and understand what is or was occurring and being undertaken in the name of the state. For these reasons, dissemination of and, thus, access to information by the public is integral to most concepts of democracy. (Butterworth, et al. 1989)

The nature of the accountability relationship between the state and the community/public/electorate is varied, complex and multifaceted. For example, Wirth, following Etzioni, discussed the distinction between symbolic, political and formal uses of accountability (1991 p. 72), while Stewart discussed accountability in terms of “a ladder of accountability” that had ‘rungs’ of accountability based on the type of decision for which one is held to account. The rungs move from decisions that applied set or specified standards to decisions requiring (good) judgement (1984 pp. 17-18). This section discusses one facet or dimension of accountability, that is, the accountability provided by reviewing actions or policies of the state with the benefit of time. This approach is based on a simple dichotomy of accountability for current (recent) activity of the state and accountability for the historical activity of the state.

\(^1\) This section uses the language of the central government/parliamentary section of government in its analysis of the accountability relationship between government and the public; however, the same analysis applies equally to other parts of the public sector, including local government.
The key feature of accountability for democratic states involves the electorate responding at election time via the ballot box to the policies and/or actions of the elected representatives and the government. Between these elections, and for different measures and remedies, the parliament and official bodies such as the courts and Auditor-General, as well as pressure groups and the media, provide checks on actions of the government and the state. Without the electorate reviewing and scrutinising the government and the official and unofficial channels of accountability, the government's actions would fail to gain legitimacy, as noted by Stewart. Central to this accountability is the ability to gain information about the current goings-on of the government. In the normal course of events the information is made available through institutions such as parliament, legislation governing the access to official information, public sector financial management legislation (both appropriations and ex-post reporting), together with the less formal means of information gathering as undertaken by pressure groups and the media.

The focus on the current elected representatives is normally considered to be the electoral cycle, which is relatively short-term. Issues that the government is called to give account of are predominantly those that others believe they can make political capital from (in the positive sense – that the public does not give approval of the government's actions) or that offended parties can seek redress for actions (for example, through the courts) taken by the state. However, the actions that receive such attention are only those for which values are questionable within the current hegemony or dominant culture and/or are visible enough to be raised above other competing issues for inclusion in the current accountability discussion. Some actions of the state are not reviewed because those controlling the official or unofficial accountability channels (for example, the parliament and the media) do not deem them worthy of questioning the state or because the public does not hold enough information about them.

Elected representatives come and go; however, the state continues to act and to require legitimisation by the public. The implications and effects of policy decisions and the actions of governments are sometimes only fully realised and appreciated many electoral cycles or even generations after the implementation of a policy or action. Similarly, the values that are questionable according to the hegemony or dominant culture at any point in time change. Thus, the accountability of state is also required to cover past actions and past policies of governments. To enable this, the past needs to be reviewed both to hold the
state to account and to justify its continuance. Such a review is not merely viewing the past again but viewing it anew. Access to and accessing sources of past information, whether official or otherwise, is essential to this process. With this past information held in the archive, the archive becomes “ arsenals of democratic accountability and continuity” (Eastwood 1993 p. 36). Past accounts and records of the state need to be reviewed in light of the current hegemony or dominant culture to allow both the state to be continually legitimatised and to ensure that redress is made for any past actions of the state if required.

A fundamental difference between current and historical accountability relates to the focus of the accountability. Current accountability has become very much focused on the accountability of the individual, such as the individual minister or bureaucrat. Reforms of the public sector in recent years have strengthened the focus on the accountability of the individual, with the use of agency theory and associated literature to inform the debate on public sector changes and the new modus operandi of many reformed public sectors. For example, key players in the New Zealand reform process, Bushnell and Scott, state from their economic/agency theory perspective that “each agent must have one principal” (1988 p. 22). The corollary of such a position is the phrase that you are only accountable for what you can control. Thus, most discussions on accountability relate to individuals who can be held accountable (which tends to mean sanctioned or rewarded) for their own actions. However, when thinking about the accountability of the state, the state ought to be thought of as something that exists in perpetuity. As such, to hold it to account does not mean only in a recent period, but should cover all past actions.

Thus, archival information forms a triangle of information for public sector accountability: current information which is non-financial, current financial information, and information no longer held for the day-to-day management of the public sector entity (archival). While many parts of the community, including the academic community, are interested in the current information (both financial and non-financial) the archival material is predominantly the preserve of the historian. The historian’s craft allows for fresh insights into the activity of the state, calling into question policies and activities of previous

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1 This division between financial and non-financial current information reflects both historic and practical issues, whereby legislative arrangements for public finance including reporting are kept separate from arrangements for access to other official information.

2 Although not only the preserve of the academic historian.
periods, providing various interpretations of the relationship between citizens and the state. In recent years the archive has been used to reinterpret aspects of the state’s roles in a number of countries. Areas where the state has been held accountable for its past activities include the treatment of indigenous peoples and segments of society, and a number of situations relating to the treatment of citizens during periods of conflict and war.

The power of archive as an ‘arsenal of accountability’ can be illustrated by the means that less democratic regimes (as well as sections of otherwise democratic regimes) have sought to keep certain people out of the archive or certain material unobtainable from the archive. For example, during the apartheid years the South African archives withheld access to archival information from certain people to ensure the maintenance of the official propaganda; in a similar vein, presumably to avoid review and thus the accountability, the South African National Intelligence Service destroyed 44 tons of paper and microfilm records in the last days of the apartheid regime. (Harris 2002 pp. 134, 136)

It is important to note that such accountability, both for current and past actions is not purely a negative activity but, rather, has the potential to enhance the performance of the state, with the elected and appointed officials keeping the ‘shadow of the future’ in their eyes. According to Bogdanor (1998 p. 7), the experience in New Zealand following the freeing up of access to information in the early 1980s had a positive impact on officials’ behaviour and work due to a concern with their reputation. Furthermore, as already noted, the accountability protects the state from claims of lack of legitimacy. (Stewart 1984)

In accounting history literature the use of accounting by government has had little attention in terms of holding the government accountable for previous actions. The nearest work to accounting history in New Zealand that has used historical material to hold the government or state accountable for past accounts is Murphy’s work on the *Chinese Immigrants Act 1881*. (Murphy 2002) Under that Act and its replacements, Chinese immigrants (only) were required to pay tax on arrival initially of £10, becoming £100 in 1896. The legislation was only finally repealed in 1944. As a result of Murphy’s research, an apology and reparation was given to the Chinese community in New Zealand in 2002. Hooper and Kearins’ (2003; 2004) work on the Crown’s monopoly power of purchase of Maori land is another example of this type of work.

Accountability does not mean finding scandal or inappropriate actions or policies. Such findings are one result of the accountability process, but not the most common or generally
desired one. The re-viewing of the material is the key issue – finding scandal is not. Accounting has always been important in public sector and public policy; however, in the past 25 years, accounting has come to hold an even greater role in public management and public policy. Accounting historians studying the public sector\(^1\), both its more recent history\(^2\) as records became more freely available, and those studying earlier periods, have a role to play in the accountability of the state. This role will grow as the use of accounting technology in the public sector increases and information about that use becomes more available.

1.5 The Visibility of Public Sector Accounting History

Public sector accounting history straddles two set of literature – the public sector accounting literature and the accounting history literature. This section will review both sets of literature for insight into how public sector accounting history is perceived and the visibility given to it in the accounting literature.

1.5.1 The Public Sector in Accounting History Literature

Review of the accounting history literature will be two-fold. First to be reviewed is the literature supporting, encouraging or discussing accounting history, especially its comments on public sector accounting history. Secondly, a selection of general or meta accounting history literature will be reviewed in terms of the visibility of the public sector in these works.

The American Accounting Association’s 1970 committee on accounting history was established to provide objectives for accounting history research. In doing so they listed “examples of historical studies which deserve attention”. The list (albeit only provided as examples) had nine general topics covering most areas of accounting; however, the list did not include any government accounting or public sector accounting topics. Thus, the first major push in the English-speaking world for accounting history ignored the public sector.

\(^1\) If the literature on the social responsibility of private sector firms (see for example Gray et al. 1996) is held to be accurate then some of what has been said here would also apply to private sector firms. Examples of where accountability of the private sector has been demanded through the opening up of their archives include the tobacco and chemical industries. (Cox and Wallace 2002)

\(^2\) As is discussed in the following chapter, studies of the more recent public sector reforms are susceptible to problems regarding gaining access to material, as much is still held by the agencies rather than being deposited in the archive.
In his 1977 Selected Bibliography of Works in the History of Accounting 1969 – 1977, Parker, using the same schema as in his 1969 bibliography, had “government accounts” as a sub-set of “Early English and Scottish Accounting”. The only other place where there was any reference to a work of public sector accounting history was classified under the taxonomy of “Ancient Accounting”, the work being Fu’s “Governmental Accounting in China During the Chow Dynasty”. Parker’s later bibliographic work (1988) similarly does not have a specific category for public sector research. However, the number of articles on public sector accounting history increased, with a smattering being recorded under various headings, including the ‘miscellaneous’ section.

In a series of two articles, Previts et al. (1990b; 1990a) raised issues central to the undertaking of accounting history, including relevance, subject matter and various methodological choices. However, they provided no reference to the existence or the relevance of public sector accounting or the public sector accounting archive. Responding to Previts et al., Parker (1993) noted Previts et al. lack of attention to public sector accounting. Parker commented on the long history of public sector accounting and that “much work still remains to be done” in terms of public sector accounting history.

Carnegie and Napier (1996) provided one of the few and longest (at just on one page) discussions of the possibilities and avenues for engaging in public sector accounting in accounting history literature. While commenting on the lack of public sector accounting histories, they offered two types of explanations for this situation; first, all the bias in accounting history towards financial reporting and professional organisation – they saw both topics as less relevant to the public sector; secondly, they suggested the traditional economic models for providing explanations in accounting research, including accounting history, had focused on the private sector (although they did not say why this was the case).

In the editorial for the first issue of Accounting History (new series), Carnegie identified public sector accounting history as one ‘approach’ that the journal supported and encouraged. (1996)

\footnote{I suggest that the public sector is not an approach but rather a location of accounting.}
Yamey’s (1981) comments or ‘reflections’ on the problems and structure of writing a general history of accounting failed to include any mention of accounting in or by the public sector that would impact, influence or have any relevance to a general history of accounting. For example, under the title of “how accounting information was used” Yamey saw the first question as “How did the owners of businesses use their accounts?” (p. 132). Nowhere did Yamey ask ‘how did the government (whatever form) use their accounts?’ or any similar question. The public sector appeared to remain hidden.

The History of Accounting — An International Encyclopaedia, edited by Chatfield and Vangermeersch (1996), reflected the growth of interest in accounting history as mentioned above. The encyclopaedia has approximately 650 pages of entries on various topics relating to the history of accounting. Yet the coverage of public sector accounting is limited to less than 20 pages or approximately three per cent of the volume. Most references to the public sector deal with legislative/institutional arrangements in the US.

Previts and Merino’s 500 plus page A History of Accountancy in the United States (1998) provided some coverage on public sector issues. The history was arranged in chronological order, with most chapters having a few pages on government accounts, taxation and related areas. Although granted separate headings for the topic, the relative number of pages for the public sector is still very small.

This lack of visibility in both the literature about accounting history and in general accounting histories reflects the state of public sector accounting history. Two recent reviews of the supply of published accounting history research demonstrated the limited amount of material published on public sector accounting history. Anderson’s (2002) review of one accounting history journal (Accounting, Business and Financial History) over a ten year period indicated that only five per cent of published material related to the public sector. Carnegie and Potter (2000) reviewed four years (1996-1999) of publications from the three specialised English-speaking accounting history journals and found that only 2.7 per cent of papers were public sector based.

1.5.2 Accounting History in Public Sector Accounting Literature

Until recent years, public sector accounting literature has been reasonably scant in all areas and approaches. Perrin (1981) noted that in the 1970s only one per cent of UK academic accounting literature related to the public sector. Lapsley, (1988) nearly a decade later, in
an appraisal of the public sector accounting research similarly commented on the numerous areas of public sector research not undertaken to date by accounting researchers, especially in the more theoretical areas. Lapsley refers neither to public sector accounting history literature nor its absence from that paper. In 1988 Swanson and Gardner (1988) stated that “developments of accounting concepts and procedures in governmental, religious, and eleemosynary organisation have received scant attention in the literature”. Since that time academic interest and publications in public sector accounting has increased. The more recent increase in accounting history relating to the public sector may well be mirrored by the 1980s increase in interest of public sector accounting generally within the academy that followed the “period of unwarranted neglect”. (Pallot 1992 p. 38) This increase can at least be partly attributed to an increase in academic activity, an increase in publication opportunities and an increase in the visibility of accounting in the new public sector as a result of reforms during the 1980s and early 1990s.

Broadbent and Guthrie reviewed alternative accounting research into the changes that the public sector had undergone in during the 1980s and early 1990s. They noted that alternative accounting research “movement to actual empirical investigations of accounting actuality in specific settings has recognised that the history of the subject is an important issue”. (1992 p. 6) According to the authors, a number of the public sector accounting published papers they reviewed included some ‘history’ element. The focus of these papers was on the reform period, with the historical aspect (pre reform eras) used as part of the environmental setting of the reforms.

The analysis is consistent with Scott et al. who also pointed out the increase in public sector accounting research, including history. They noted that the historical research generally began with the period immediately preceding the reforms using that ‘earlier’ material as context for the discussion of the reforms and its history. Scott et al. noted that despite or because of the focus on research into more recent public sector accounting activity or history “little research has focused on the longer history” of the public sector accounting. (2003 p. 104)

This section has demonstrated the lack of visibility of public sector accounting history in both the accounting history literature and the public sector accounting literature. This situation is likely to be both a contributing factor to and a result of the lack of published
public sector accounting history literature. The following two sections review the existing literature directly related to the topic of this thesis.

1.6 New Zealand Public Sector Accounting Histories

This section will briefly look at the accounting history literature published on the New Zealand public sector. As can be seen, this literature is extremely limited, with none relating to local government.

Van Peursem et al. (1996) provided a very brief overview of the external financial reporting by New Zealand public hospitals between 1872 and 1993. Their method was to compare the reporting requirements in 1990-93 with all other periods. Their conclusions were based on a comparison between the health policy of the time with the accounting reporting practices at the same time, indicating that the accounting requirements and practices followed the health policy of each period.

The only other published New Zealand public sector history in the accounting literature are two articles by Hooper and Kearins (2003; 2004) mentioned earlier. However, these studies are not so much about accounting but, rather, about taxation policies and public finance.

In addition to these works is McKinnon’s (2003) institutional history of the New Zealand Treasury between 1840 and 2000. The history is divided into three chronological sections: clerks 1840-1910, Accountants 1910-1961, Economists 1961-1993 (with an afterword for the remaining seven years that this history covers). As such, the history covers the role of accountants in The Treasury, especially during the period when they were key players in that department. However, the history is not one of public sector accounting but, rather, it is about the institution.

Finally, there are a few studies that include New Zealand as part of a larger study. Clarke’s (1998) work on the use of deprincipal value and optimised deprincipal value, although covering both Australia and New Zealand, is predominantly about Australia. Flesher and Zarzeski’s (2002) work on the roots of operational auditing in a number of English-speaking countries includes a brief discussion on the use of value-for-money audits in the New Zealand public sector. This discussion on NZ was limited to only one paragraph and the paper focuses on US private sector use of such technology.
1.7 Local Government Accounting Histories

In addition to the New Zealand public sector, the second location for this thesis is that of local government. As noted above, none of the New Zealand public sector accounting histories deals with local government; however, there have been a few histories written on local government accounting in other countries. The themes in each of these histories are briefly discussed in this section. Like the previous section, this section does not seek to categorise, organise, or systemise the histories, rather the intention is to indicate very briefly the type of research undertaken to date.

1.7.1 UK Local Government

The literature on the history of UK local government comes from two sources: Rowan Jones, and Hugh Coombs and John Edwards (plus the occasional additional co-author).

Jones' work originated with a thesis (1986) that was later published as a book (1992). This work covered both pre 1835 and post 1835 eras. The main analysis in the work applied an economic model of the role of information in government, following the work of Downs. The analysis was used to understand the incentives affecting the various parties involved in formation of local government accounting policy. Following the model, the history of local government accounting illustrated an overriding incentive by most parties to ensure that statutory financial control was imposed on local bodies.

Coombs and Edwards (1995) discussed the history of financial reporting between 1835-1933 for British municipal corporations. The article was based on both archival and contemporary sources. It provided a description of what happened and an analysis of factors that lead to the various innovations during the period studied. Similarly, Coombs and Edwards (1993) discussed the history of financial reporting for municipal corporations; however, in this article they continued the analysis up to 1974.

Coombs and Edwards (1992a) and Jones (1985b) both dealt with the issue of accounting for capital for local government, together with the related issues of depreciation, sinking funds and accrual accounting. Jones (1989) looked at how local government in the UK allocated costs, especially during the early part of the twentieth century, and the lack of uniformity across various local authorities on that issue. Jones (1985a) provided an overview on accounting in local government up to 1835. This article focused on charge/discharge accounting and its replacement by double entry, as well as a discussion of
local government accounting prior to the introduction of government regulation. Coombs and Edwards (1994) also discussed the introduction of double entry bookkeeping. That work evaluated the work by Jones (1992), supporting that work as being "fully consistent" with their findings.

Specifically on audit, Coombs and Edwards have two articles (1990b; 2004). The earlier work provided a description of the development of the District Audit up to 1933, although it included a brief discussion of developments after 1933. The later work analysed the debates surrounding the choice of auditor for municipal corporations. The article framed the debates as power struggles between the various parties seeking to be or, in the case of certain municipal officials, to have their preferred choice as auditors for municipal corporations.

Edwards (1992) provided a comparison between the accounting activities of private companies and municipal corporations over a one-hundred year period. Edwards concluded that while similar practices sometimes occurred simultaneously, at other times there were transfers of accounting practice in both directions, and in other areas accounting practices remained distinct.

Coombs and Edwards (1996) brought together some of their earlier work, looking at factors that introduced or caused changes in accounting by municipal corporations between 1835 and 1935.

In addition to the published analysis, Coombs and Edwards edited a number of volumes of original materials on local government accounting in the UK between 1831 and 1935. (1990a; 1991; 1992b)

One piece of micro-history on local government accounting in the UK is that of Brackenborough, where she discussed the use of accounting by both the Newcastle Corporation and its opponents regarding the management of the River Tyne. (2003)

A number of older texts on local government accounting included sections on the history of local government accounting followed by the main body of the work on current practice. For example, Helmore's (1961) The District Auditor, spent 100 pages going through "His (the district auditor's) History and Development". The section began at 1601 and went through to 1961, the date of publication.
While not dealing with local government as covered in this thesis or the above studies, Walker (2004) looked at the poor laws and the association administration and accounting in the 1830s. The relief provided by the poor law legislation was administered at the local level. The administration and accounting for the poor were found to be consistent with the analysis of Foucault, regarding the use of measurement and classification (including by accounting) of individuals to enable the disciplining of the individual.

1.7.2 USA Local Government

The key USA local government accounting historian is James H Potts. Potts’ first piece of work is his PhD completed in 1976. The thesis discusses the changes to municipal accounting, predominantly in the US, up until 1935. Potts’ sources are published works from which he compares the various positions put forward by different authors/experts at the time. Potts identifies two phases in the early part of the twentieth century for municipal accounting; the first, 1900 – 1920, is where similarities to commercial accounting were highlighted, and the second, 1920 – 1935, is where dissimilarities between municipalities and commercial activities and thus accounting were highlighted. For Potts, municipal accounting evolution was not random or disorganised, but rather the result of beliefs of key people at the time, which were often related to views of the differences between municipalities and commercial activities.

Potts (1977a; 1977b) discussed the evolution of budgetary accounting for municipalities from approximately 1870 in both the US and UK. Potts’ paper on developments between 1900 and 1935 (1978) followed on from the work in the PhD discussed above. The particular issues discussed included the adoption by most states of some uniformity for the accounts of municipalities within the state, and discussion of possible use of accrual accounting and the related issues of accounting for capital and the notion of the going-concern as used in the private sector.

Potts (1982) discussed the debate between 1895 and the early 1930s on the inclusion in the accounts, or otherwise, of permanent property and the associated recording of depreciation for municipal bodies. This debate had run its course by 1935 with the conclusion at the time that permanent property should not be recorded in the accounts, and that the focus of municipal accounts should be on the liquidity of the authority.
Easterling's (1999) discussion of budgeting in Florida included a description of the various attempts of reforms from the beginning of the twentieth century.

Williams (2003) discussed performance measurement activity in the first two decades of the twentieth century in relation to the US public sector. A key part of this discussion was the role of the Bureau of Municipal Research in developing the use of empirical data to determine the performance and productivity of municipalities as well as other parts of the public sector.

Remis (1982) provided a description of the institutional arrangements for the development of accounting standards in the US public sector. The paper highlighted the importance of the municipal based organisations (such as the national Municipal League and the Bureau of Municipal Research) in the early development of the government accounting standards.

Related to the work of the Bureau of Municipal Research is the reform during the Progressive Era. The role and status of municipal accounting\(^1\) in the Progressive Era has received some attention from accounting historians. Fleischman and Marguette (1987) discussed the impact of accounting and accountants on the Progressive Era in the state of Ohio. During this period, accounting for local government made significant advances in "budgeting, cost accounting, uniformity of accounting methods, centralization, and accrual accounting". Elsewhere they (1986) noted that historians of this period failed to take into account the accounting changes that the Progressive Era brought about when evaluating the era. While most (non-accounting) research noted that many professionals were involved with the progressive movement, the accounting profession seemed to have been ignored in that literature. Yet, according to Fleischman and Marguette, the contribution to municipal reform through the accounting reform of the period and the reduction of "room for extensive corruption or inefficiency" should not be overlooked. Their 1992 work (Marguette and Fleischman) linked the reforms of municipal accounting and in particular budgeting during this period with the use of budgeting and other management accounting techniques in both the public and private sectors at that time.

\(^1\) Other authors have written about the Progressive Era, focusing on other parts of public sector management.
1.7.3 Other Countries’ Local Government

Monsen and Näsi (1996) discussed the impact of Cameral accounting thinking in local government in Finland and Norway. Cameralism, with origins in the sixteenth century, focused on the control of public money, with less importance given to other assets. In addition to cash management and control, the system had a focus on budget control rather than on *ex-post* control and determining profit. Both Finland and Norway had seen attempts at replacing the Cameral system with ‘business’ method – Finland adopting both approaches while the more centrally controlled Norwegian local government used the business method. Filios (1983) provided a more general historical account of the Cameralistic method.

Bergevärn and Olson (1989) provided an historical analysis on changes in Swedish municipal accounting using the concept of myth. The analysis showed that the development in accounting practices occurred when one myth was replaced by another myth after a process of conflict and transition. Their research identified three myths that represented aspects of Swedish municipal accounting: the myth of uniformity, the myth of uniformity and justice, and the myth of uniformity and businesslike methods.

1.8 Conclusion

Like many private sector accounting history papers during the 1980s, this chapter praises accounting history and exhorts academics to engage in it. Well over a decade after praise and exhortations stopped being the norm in accounting history publications, I believe it is still useful for public sector accounting history. As is the norm in the relationship between accounting research and public sector accounting research generally, public sector accounting history lags behind in volume compared with private sector accounting history research. While not surprising, given the general preference in accounting research for the private sector over the public sector, certain factors make it somewhat surprising for accounting history.

Access to material for any historical work is essential, and for this issue the public sector has a significant advantage. Not only is it more likely that public sector records will have been kept, but also the completeness of the records and the ease of access to them make this part of the research assignment easier. The lack of interest in public sector accounting history has meant the field of questions is wide open. Documenting the past, as well as
explaining and analysing what happened (as is the case in this thesis) in public sector accounting (or part thereof), is needed for many areas before more specific analysis can be provided. With the pre-existing body of private sector material already explored, comparative studies with the public sector is another area that is wide open for research. The differences and similarities of accounting in the public sector vis-à-vis the private sector and/or the not-for-profit sector will provide a helpful framework for many potential research questions.

Public sector accounting history can help to hold the government accountable for decisions made in the past. The passing of time and the releasing of information previously restricted will provide the public with a further avenue to understand the activity of the state in their lives. The very existence of historical research into the actions of the public sector provides a level accountability and a service to democracy. Such research can complement the various short-term accountability measures currently in place.

With the increasing use of accounting in the public sector, the opportunity and need for public sector accounting history in coming decades will increase. As more archives become available and/or discovered, the issues and depth of analysis will likewise increase. The increased analysis will bring an increase in understanding of accountability, the state, and their relationship, as well as an increase in the accountability of the state. The understanding of accounting will also be enhanced by looking at its practice in different and new environments such as the public sector.

Despite these benefits of studying public sector accounting history, the existing body of literature in this area is small, as noted by both Carnegie and Potter and Anderson. In particular, the material on local government is very limited. Nothing has been written on New Zealand local government. While the most developed material is from the UK, there is also a smattering from the US and other countries. Perhaps surprising is the absence of material on local government from New Zealand’s most comparable country, Australia, given the relatively healthy state of accounting history in Australia, including work on other aspects of the public sector.

1.9 Structure of the Thesis

Chapter two outlines the methodological choices made for this history. The chapter begins with a brief discussion of the decision to focus on this story of local government
accounting and auditing, and not to attempt to test, prove or apply some theory or to develop generalisations from the specific situation of this history. The following section outlines the numerous agencies whose archives were accessed in writing the history as well as other primary material used. The problems, and ways of limiting those problems, associated with using archival material are also discussed. The chapter concludes with the contribution that this thesis makes to our understanding of public sector accounting in New Zealand.

Chapter three begins the story, outlining the context of municipalities in New Zealand. It provides the structural background to the thesis, including discussion of other parts of local government, and franchise, functions and financing of local government in New Zealand during the period 1876 to 1988. The chapter also provides brief details of the local government environment before 1876 and after 1988, so as to provide context for the start of the history in 1876 and the context for current day reading by briefly discussing what has happened post 1988.

Chapter four outlines the accounting requirements for municipalities from 1876 to 1988. These requirements were contained in 29 statutes and 10 regulations, excluding the large number of regulations and statutes that relate to specific activities undertaken by municipalities, and excluding the similarly large number of regulations and statutes that were specific to individual municipalities.

Chapter five discusses the debates surrounding the accounting requirements and includes discussion of both successful and unsuccessful proposals for changes to the requirements outlined in chapter four. Specific issues discussed are:

- the principle of funding current year's expenditure with current year's revenue,
- changes to the way the accounts were drawn up from input base to activity base,
- the desirability of standardisation of the accounts format,
- a cash versus accrual basis for recording transactions, and
- the use of accounting to constrain the activities of local authorities.

The chapter concludes with a reflection on how the accounting requirements changed from a focus on accounting for management and constraining the financial behaviour of authorities, with external reporting by council using that information, to a focus on external
reporting to ratepayers, and an expectation that internal or management accounting information will be kept separately, or at least reported differently as a result of the different needs of different users.

Chapter six looks at the role of audits and the auditor, in particular the Audit Office, in relation to accounting for municipalities. The chapter begins with the requirements for auditing, including the period before the Audit Office became the auditor. It also covers the requirement regarding surcharge by the Audit Office, various aspects of the relationship between the Audit Office and local authorities, including fees, independence, calls for local authorities to use private sector auditors, and issues surrounding the lateness of accounts and the Audit Office’s response to this issue. The chapter also looks at the Effectiveness and Efficiency Audits begun by the Audit Office and other non-compliance audit work under taken by the Audit Office. It concludes with the unique, positive nature of the relationship between local authorities and the Audit Office. This positive relationship was in spite of the occasional skirmishes between auditor and auditee, the Audit Office’s policy role for central government, which often meant constraining local authorities, and in later years the Audit Office’s desire to help (or push) local authorities towards what they considered to be best or better practices.

Chapter seven reviews the operation of one piece of local legislation, namely the Wellington City Trading Department’s Reserve and Renewal Funds Act 1917, and the amendments made to that Act. The Act was established in response to both auditor concerns and public disquiet, which lead to a court case, regarding how the Wellington City Council funded (and therefore accounted for) its trading activities. At the centre of the Act lies the principles of only spending each year what you collect and that capital costs should be allocated to users/ratepayers over the life of the asset. The application of these principles becomes more complex where infrastructural assets have an intended infinite life and where councils seek to self-insure against accidents. This chapter serves as a case study of these issues.

Chapter eight provides conclusions to this story about accounting and auditing in local government in New Zealand. It concludes with future areas of historical research relating to public sector accounting history.
Chapter Two: Research Approach

2.1 Introduction

This chapter discusses the approach taken in this archival-based history of municipal accounting and auditing. Discussion begins with the current key issue in historiography, namely the use of theory and generalisations in historical research. The following section outlines the material accessed in bringing together this history, and the final section discusses some concerns about using historical sources; in particular, how the use of triangulation has helped lessen some of those concerns.

2.2 Generalisations and Theory versus the Individual

According to McCullagh (1998), one of the key issues currently debated by philosophers of history relates to the use of generalisations and theories in historical accounts versus a focus on the individual history of an event or topic. According to Tosh’s second edition of The Pursuit of History, the relationship between history and social science is the “real debate for the present generation” of historians. (1991 p. 152) Yet a decade later, in the third edition of the same book, Tosh no longer refers to such a debate but, rather, sets out the positions as choices historians can make. Historians’ choices range from the “great many (that) reject the use of theory completely” to those that marshal “an impressive collection of individual instances to fit the desired pattern” of their chosen theory. (2002 pp. 207-8) This section outlines the position taken in this thesis regarding the use of generalisations and theory versus a focus on the individual history.
2.2.1 Generalisations

This thesis takes the approach of neither seeking to apply theoretical generalisations nor using an existing social science research methodology, theory or model to tell the story; rather, I shall focus on the individual situation – in this case, municipal accounting and auditing in New Zealand between 1876 and 1988.

The focus on the individual event does not mean that no generalisations will be employed. Clearly, I shall use generalisations; a number of individuals will be seen as groups, and individuals’ behaviour will be generalised, depending on the groups to which they belong, for example, Audit Office staff, ratepayers and electors, local government officials, central government politicians – government members and opposition members, local government politicians etc. Various discrete accounting activities will be grouped together, for example, auditing will often include probity, compliance, and efficiency. Time periods will be linked together, for example, the depression era, post-war, mid nineteen-eighties onwards, etc. Such generalisations are essential to allow the historical facts to be understood so that an historical account or story might follow from them. (2002 p. 213)

However, the thesis will not adopt generalisations about human behaviour, such as the usual ones in accounting research regarding economic motivation, nor will it adopt models used in some accounting histories and other accounting research regarding the accounting phenomenon.

2.2.2 Theory

The decision not to employ agency theory, public choice theory, institutional theory, historical materialism or any other theory in telling this story about municipal accounting and auditing in New Zealand is both practical and philosophical. At a practical level, as noted in the previous chapter, there are no existing histories of New Zealand local government accounting and auditing or other New Zealand accounting and auditing works to indicate what theory might be imposed on the sources and historical facts for this accounting history. At the philosophical level, I wish to tell a unique story, rather than have it fit within, or test, some predetermined theory or set of generalisations.

This thesis provides the first history of local government accounting and auditing in New Zealand. In doing so, it is the first attempt to ‘discover’ the contents of the official archives that relate specifically to municipal and generally to local government accounting and auditing; and it is also the first collation of the associated legislation, regulations and other
requirements. To develop a hypothesis with which to test the history from an existing theory, or to build the history around a chosen theory, could result in material being interpreted in additional limiting ways. (Tosh 2002 p. 208) Use of theory does not avoid the bias of the individual historian in selecting material to review and analyse, rather it adds another level of bias – that belonging to the theory. Given the lack of any existing literature on the history of local government accounting and auditing in New Zealand, I believe the use of theories in this thesis would result in material being ignored or interpreted as irrelevant before its possible relevance or importance could be established. The lack of existing literature means there could be no rational way to determine which theory to choose.

Therefore, from the beginning, no theory has consciously been used to select sources, identify facts or to develop the historical account. Although I mentioned ‘consciously’, I have no doubt that my underlying assumptions about accounting, truth and objectivity, together with my views, ideas and conceptualisation of the world shall inescapably be present in this thesis via the decisions made in both researching and writing this history. (Tosh 2002 p. 208) While rejecting the use of preformed generalisations and theories, I also reject the view of historians as empty vessels waiting to be filled with the past so as to tell everyone how it was, à la Ranke and Elton. This history is influenced by preconceptions, but they are mine rather than those resulting from the choice of some social theory or theories from a theory catalogue.

2.3 Archives and Sources Used

An outline of the choice of archives and other sources used in this thesis forms the second part of this chapter. Researchers generally classify sources as primary or secondary. Primary sources are usually taken as having been created by those with first-hand experience of the event or created as a result of the event. Secondary sources are created by non-participants. It is the proximity to the event that has made primary sources the preferred source for most historians. (Scott 1990 p. 23) It is worth noting that for the post-modern historian the distinction between primary and secondary sources is not so important, for proximity to the event does not necessarily lead the researcher any closer to a truth. Primary sources do not provide direct links to the past, but rather, like secondary sources they must be interpreted. (Jenkins 1991 pp. 47-8)
This thesis focuses on primary sources, especially archival material and official publications. A few other forms of primary sources such as media reports are briefly used. Secondary sources have been used to provide background and context in areas outside the strict topic for the thesis, such as New Zealand histories.

As will be discussed in the next section, the use of records from a number of agencies has assisted in providing assurances of the authenticity, credibility and representativeness of the records used.

2.3.1 Archives Reviewed

From Archives New Zealand, Wellington, I reviewed the complete finding aids for seven departments/agencies, selecting and reviewing all files that were likely to include references to local government accounting and auditing, irrespective of actual file creator or title. This search was intentionally broad. At the time of the research, none of this was possible electronically. Thus, searching was not based on key words but on reading the description of each file in the paper-based finding aids.

Archives New Zealand is the New Zealand equivalent of other jurisdictions' Public Record Office or National Archives. Under the Archives Act 1957 all "public archives as are considered worth permanent preservation shall, ... be deposited and preserved" at Archives New Zealand. (s. 5) Access to these records is open, except where restrictions are placed on access, to individual documents. The only restrictions encountered were on certain Audit Office files. Access was provided to the restricted files by the Office of Controller and Auditor-General, with the only proviso that personal information relating to individuals still living was not included in the thesis.

The departments or agencies reviewed, some of the names they used, and their roles in relation to local government accounting and auditing, are now outlined:

- **Audit Office** – Variously known as The Audit Department, Office of the Controller and Auditor-General, Auditor-General. The Audit Office first audited local government accounts in 1878. In addition to its audit role the Audit Office has been central government's major policy advisor on local government accounting and auditing matters. Of all departments involved with local government the Audit Office had the closest and (as will be discussed in chapter six) arguably the best relationship with local authorities. In addition to probity,
compliance and efficiency or operational audits, the Audit Office had a number of quasi-judicial roles in relation to local governments. Over the years, approximately 50 per cent of the Audit Office's work related to local government.

- **Department of Internal Affairs**\(^1\) – Known as the Colonial Secretary’s Office until 1907. Since 1876 the Department of Internal Affairs was the major advisor to central government on local government issues and the main line of communication between central and local government. In most cases the Department acted as the hub for providing advice to the executive wing of government on local government matters. Other departments and agencies, including those listed here, as well as the Crown Law Office, would provide advice to the Department that was then collated and forwarded to the Minister of Internal Affairs or Minister of Local Government. The Department of Internal Affairs administered most legislation relating to local government. The notable relevant exception was legislation relating to the Local Government Loans Boards, which The Treasury administered. Work on local government issues was an important and large part of the Department’s activity. A key part of that activity related to the desire across the political spectrum and in the bureaucracy to bring about structural change to local government. Yet as Bassett noted, the Department failed generally to achieve any significant impact on that issue. For example, Bassett made the following comment concerning the failure of proposals to reform local government in 1912:

> Once more, hundreds of hours spent by departmental officials drafting papers and legislation seemed to have been wasted. (Bassett 1997 p. 61)

Archival files from the Department of Internal Affairs reflect the breadth of the relationship between local and central government, including material from both successful policy implementation and aborted initiatives. In addition, correspondence between local authorities and their representative organisations

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\(^1\) Details about the Department are taken from Bassett’s (1997) history of the department.
(for example, the Municipal Association) and central government is also found in the files. Most official inquiries into local government were managed through this Department.

- **Statistics Department**\(^i\) – Previously Census and Statistics Office/Department. The Statistics Department collected statistical data from local authorities relating to everything from financial information to physical descriptions of infrastructure, to details about staffing levels. The importance of such material for this thesis is not great; however, the Department’s passing interest in financial information and its authority to demand it from local authorities meant that at times its interests coincided with issues relating to the accounting requirements. The archival material in Archives New Zealand from the Statistics Department was very limited. As will be evident in chapter five, this lack of information is not so concerning, given that copies of Statistics Department papers relating to local government statistical returns were located in the files of other agencies. Of three histories\(^ii\) of the Department of Statistics that were identified, none has gone into detail regarding local government statistics. It appears that within the Statistics Department, local government statistics were not important, especially vis-à-vis other statistics, such as price movements and census data.

- **Office of the Clerk/Legislative Department** – Contains files from the House of Representatives, Legislative Council (the Upper House) and committees of the House of Representatives. Files were accessed to track the progress of various bills through Parliament. Included in this material were copies of bills at various stages in both Houses, some submissions to select committees, and committee minute books.

- **The Treasury** – The Treasury’s role in relation to local government is limited. As noted above, legislation relating to local government borrowing was administered in this Department, reflecting The Treasury’s interest in local government finance. The Local Government Loans Board, an independent body

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\(^i\) Details about this Department were taken from Cook (1987), Wood (1976) and Krsinich (1999).

\(^ii\) None of these would be considered official histories.
created in 1926 to regulate the supply of loan money to local authorities (Scott 1979 p. 68), was located in The Treasury. The role of The Treasury in relation to the Local Government Loans Board was strengthened in 1954. (McKinnon 2003 p. 206) In the context of this thesis on local government accounting and auditing, The Treasury is of secondary importance.

- **Standards Association of New Zealand**
  - Previously New Zealand Standards Institution, and originally a private sector initiative of the New Zealand Society of Civil Engineers in 1932. The New Zealand Standards Institution became part of the Department of Scientific and Industrial Research in 1936. It was subsequently transferred to the Department of Industries and Commerce in 1939. 1966 saw it become independent of government (although not financially) as the Standards Association of New Zealand. Reflecting its origin, the Standards Association focused predominantly on providing standards for building (a key issue for local government), mechanical and scientific items. As will be noted in chapter five, it became interested in standards for all local government activity, including office management and accounting.ii

- **Local Government New Zealand**
  - Formerly New Zealand Local Government Association, Municipal Association, Counties Association. The Municipal Association of New Zealand was formed in 1891, and the New Zealand Counties Association in 1894. The urban-rural division in New Zealand local government was evidenced by the different associations. In 1988 these two organisations formally merged to form the New Zealand Local Government Association, which subsequently re-branded itself as Local Government New Zealand in 1996. The archive under the name of Local Government New Zealand includes the records of the two forebears, Municipal Association and Counties Association.

Both organisations existed to represent the interests of local authorities through the eyes of the elected representatives, especially the mayor or chairman. An

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i This section is based on Galbraith (1939) and Standards Association of New Zealand (1982)

ii It also developed material relating to standards for the costing of goods.

iii This section is based on Gilling and Henderson (2000).
important part of the activities of both associations were their annual conferences. These conferences often debated proposals that sought changes to relevant legislation, including legislation relating to accounting and auditing. The importance of these conferences and the associations can be seen by the serious consideration that passed conference remits were given by central government, although not all remits approved at the conferences were subsequently accepted by government. Copies of material relating to the remits were found in these archives, as well as in the archives of the Department of Internal Affairs and the Audit Office.

Separate associations were created for some local government employees, including town clerks and engineers. The archives of these organisations were not located; however, many of their materials were located within the archives of the Department of Internal Affairs, the Audit Office and/or Local Government New Zealand.

While this thesis focuses on the municipalities, some material relating to counties in the archives is included to illustrate issues that affected both boroughs and counties.

- **Wellington City Archives** – In addition to the above archives of central government, parliamentary and national organisations, I reviewed files at the Wellington City Archives, the archive of the Wellington City Corporation/Council. The files included those from the Town Clerk, City Solicitor, City Treasurer and from the management of the trading activities. A selection of material in those files was also found in the files of the Audit Office, the Department of Internal Affairs and the Legislative Department. Material from Wellington City Archives was used especially but not exclusively in chapter seven.

### 2.3.2 Official Publications

In addition to the above sources a number of official publications were accessed. These included:

- Appendix to Journal of House of Representatives, including reports by the Audit Office and the Department of Internal Affairs.
• Journal of House of Representatives.
• Journal of Legislative Council.
• New Zealand Parliamentary Debates.
• Court Records – New Zealand Law Reports and Gazette Law Reports.
• New Zealand Statutes.
• Official inquiries into local government activities.
• Statistics of New Zealand.

2.3.3 Other Primary Sources

Finally, the third type of primary sources used were journals of associations that were closely connected with local government accounting and auditing in New Zealand; namely New Zealand Local Government and The Accountants’ Journal (later the Chartered Accountants’ Journal). Generally, these sources were of limited use, as they tended to report on material found in the archives or in official documents and reports. The articles frequently reported, almost verbatim, the contents of reports from the Audit Office or Department of Internal Affairs to Parliament or the proceedings of annual municipal or counties conferences. The level of independent analysis in these journals and in the media was found to be low.

2.4 Sources – a Risk Assessment

Scott (1990 pp. 19-35) raises four concerns regarding the assessment of documentary sources for use in research: the authenticity, credibility and representativeness of the sources and, lastly, the meaning and understanding to be gained from the sources. This section will focus on the relevancy of the first three concerns for this thesis, and how I have addressed them. The three concerns are discussed separately, focusing on risks that could be encountered in the sources used. Discussion of each concern is prefaced with an illustration of the specific issue for that concern by reference to the following fictitious example of material that could be found in an archive:

An auditor’s report that included criticism of the entity for its accounts being somehow deficient.
2.4.1 Authenticity

Two questions under the authenticity heading relate to the soundness of the record and the authorship of the record. In the above example, did the auditor actually say/write that the accounts were deficient (soundness), and who was the actual auditor of the accounts and/or writer of the report (authorship)? (Scott 1990 pp. 19-22)

The greatest risk to the soundness of documents used in this thesis, I believe, comes from unintentionally inaccurate copies of documents being placed in files while the files were still in use. From the files reviewed it was clear the copying of documents and placing of copies in various other files was widespread practice. Papers, reports and file-notes often covered a multitude of topics, with copies of the same document placed in many different files. The copying of documents was not restricted to those generated within the organisation; inward correspondence and externally generated reports were copied for inclusion in other relevant files within the agency. In the days before carbon paper (and photocopying), copies of documents were retyped or hand copied for placing in other files. Such forms of copying must have created some errors. However, as these were working files I believe most significant errors would have been picked up when the files were reviewed.

I do not consider authorship of the documents to be a significant issue in this thesis. Given the official status of the many documents used, and the relatively non-political\(^1\) nature of most of the material, I have assumed that authorship when provided is accurate. There seemed little incentive for incorrect authorship to be attributed to the documents when placed in the files. Clearly, actual authorship for official documents would be different in many cases from the nominal author. In most cases the nominal author would have been either the Minister or head of the department/agency, with the actual author being an official in the department. However, I believe it can be presumed that the nominal author agreed with what was written in his or her name.

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\(^1\) This does not suggest that there was not political debate going on; there was, and the political debate enhances the credibility of the documents, as discussed in the next section. However, I suggest that the political debates were not significantly informed by the official papers in files, but rather by ideological positions. In terms of the authenticity of the records I see little likelihood of 'cover-ups' or 'spin' for political reasons in the material used for this thesis.
A small percentage of documents were unnamed and/or undated; for these, the dating and authorship could normally be ascertained from corresponding documents in the same or related files. The files were generally maintained in chronological order, thus assisting with dating, and papers frequently had signed, handwritten comments that assisted in determining authorship of other documents. The ‘official’ status of some documents was unclear; was the document a draft, working paper, one official’s view, or was it the final output of the policy process? While I was interested in all types of material, not just the final version, the status of documents could be important in understanding the document. As will be discussed shortly, the use of multiple sources helps identify the provenance of documents.

2.4.2 Credibility

Two questions concerning the example that could be asked under this heading are: was it the auditor’s view that the accounts were actually deficient or did he/she only say that (sincerity), and were the accounts actually deficient when measured against some external criteria (accuracy)? (Scott 1990 pp. 22-24)

Such questions seek to interrogate the source records for their accuracy in (re)presenting a/the truth at the time they were written or created. As noted, this ‘truth’ relates to both the truthfulness of the document and the author’s belief in the truth of the documents. These are not the same, as it is possible to have a document that was proved/considered to be inaccurate but whose authors believed in its accuracy.

Issues of credible information in the archive, both in terms of accuracy and sincerity, can be overcome, to some degree, by triangulation with other sources. Within official documents, as in this history, this can be more difficult (although the same information may be presented in many reports it is likely to come from the same source within the bureaucracy). The official documents provide records from the official standpoint. Yet in a political environment, which is also the case in this history, diverse analysis of official material ensures either the accuracy of the official material or that another voice or truth is provided to counter the official material. Alternative opinions are likely to be heard in parliamentary debates and correspondence between various parties. Where differences existed, it is likely that at least one of the files reviewed would provide an alternative view, thus raising the issue of the credibility of the official material. A degree of comfort can be
gained regarding the credibility of information if, during its use, issues relating to the credibility of the source were not raised.

2.4.3 Representativeness

Using the audit example, a concern could be: were enough records reviewed to tell the auditor’s full story? Was there a proviso in the auditor’s report that modified his/her opinion that was either not retained (survival) or was held back or hidden from the researcher (availability)? (Scott 1990 pp. 24 -28) For example, the audit report might include unusual disclaimers on the auditor’s performance or might note special circumstances that lead to the preparation of the report and could explain its content.

Representativeness appears to be unresolvable in many cases. For many documents and files I cannot know what has not survived; there are few clues of their existence and even fewer of their content. Similarly and just as importantly I cannot know what has survived that I have not located, chosen not to reviewed (for example, based on the finding aids description) or been denied access without being informed of the denial of access. As noted above, some files I sought to review were restricted; however, access was gained to all files after discussion, and I know of no files that were deliberately withheld.

However, this discussion has referred only to records that could have been kept. No doubt there are stories that could be told from other perspectives where records of participants and their perspectives on issues have not been kept – at least in the archive of the official institutions. This thesis was set up expressly to tell a story from the official archives. It does not attempt or pretend to give voices to those not represented in the official archives.

2.4.4 Sources – Triangulation

To aid the evaluation of sources, I have sought and used multiple files both from within the same agency and from different agencies. When files indicated the existence of related files in either the same or other agencies I intentionally sought those files. Those additional files often provided no benefit in terms of significant material; however, on other occasions the additional files provided confirmation of dates, authorship and document status as well as, some times, additional useful material. This use of multiple files and sources provided a form of data triangulation, which provided additional clarity regarding the authenticity, credibility and representativeness of the sources.
Also, the use of other sources, such as parliamentary debates, added to the triangulation and therefore confidence in the sources used. The lack of any significant previous historical work on this topic meant that meaningful reference to previous work was not possible.

2.5 Conclusion and Contribution

This thesis tells a story of municipal accounting and auditing in New Zealand after the end of the provincial government era until the beginning of the reform of local government, which began in 1989.

This thesis is not the final word on this topic. It has been written in the hope that it is not the defining word on New Zealand local government accounting and auditing history; there should be many histories on this topic from different perspectives. This thesis does not seek to prove or disprove any theory, using the history of local government accounting and auditing as its laboratory. Nor does it attempt to demonstrate or establish any theory’s utility to understand or explain accounting or subsets thereof, such as accounting in New Zealand, the public sector or local government.

The thesis is based around primary documents and, in particular, documents from the official central government archive, which relate to local government accounting and auditing. This privileging of primary sources is essential because of the lack of secondary material and any previously written histories. The possibility of obtaining accurate ‘official’ records from the archives was increased by the use of multiple archives and files for the same and similar topic areas. This triangulation provided a degree of assuredness regarding the authenticity, credibility and representativeness of the records used in this thesis.

The contribution by this thesis to our understanding and knowledge of accounting and auditing in New Zealand local government is that (i) it documents the accounting and auditing requirements (legislation, regulations and practice requirements) over the period covered, (ii) it ‘opens’ for the first time the New Zealand central government archives for material related to government accounting, especially relating to local government, (iii) it develops and tells a story about changes over a period in local government accounting and auditing, and (iv) it discusses various roles that different players took. This story focuses on the relationships between different central government agencies and between central
government and local government, predominantly through their national organisations. None of these contributions has previously been made for New Zealand local government or any other part of the New Zealand public sector.
Chapter Three: The Structural Context of Municipalities in New Zealand

Whereas it is necessary that provision should be made for the good order health and convenience of the inhabitants of towns and their neighbourhoods; And whereas the inhabitants themselves are best qualified, as well by their more intimate knowledge of local affairs as by their more direct interest therein, effectually to provide for the same: And whereas the habit of self-government has been found to keep alive a spirit of self-reliance and respect for the laws, and to prepare men for the due exercise of other political privileges. Be it therefore enacted ... (Municipal Corporations Ordinance 1842 – Preamble)

As a fundamental principle it is agreed that local or regional government should be selected only where the net benefits of such an option exceed all other institutional arrangements. (Bassett 1987 p. 63)

3.1 Introduction

This chapter outlines the New Zealand local government structure with special reference to the place of municipalities\(^1\) in that structure. Section three covers the years between 1876 and 1988, dealing with municipalities as part of the larger local government sector, the system for the election of councils, the functions that councils were authorised to undertake, and the financing of municipalities. Sections two and four deal briefly with some issues relating to municipalities before 1876 and after 1988, respectively.

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\(^1\) There was only one form of major urban local authority – that created under the Municipal Corporations Act 1876 and its successors. These are referred to as municipalities, boroughs, and cities. I will use these three names interchangeably. Local authorities/local government will be used to include municipalities as well as counties and a host of other smaller bodies.
Unlike most countries that New Zealand is compared with in the accounting world, New Zealand in 1876 was still a very young country. Organised European settlement began circa 1840, although European contact with Maori dated back to Abel Tasman in 1642, and small European settlements in New Zealand, predominately of traders, began at the end of the eighteenth century. (Gardner 1992) Pre European settlement by Maori was based around kinship of the hapu or iwi. Although not generally nomadic, hapu or iwi would move about when required for food or safety reasons. These communities would vary in size from a small extended family to “hapu groups of up to and over 500 people”. (King 2003 p. 84) As noted earlier, the majority of Maori did not move to urban areas until after the Second World War. According to Thorns et al., in 1936 only 17% of Maori lived in urban areas, but by 1966 the figure had risen to 62% and in 1986 it had risen to 80%. (1997 p. 54) Table 3.1 shows the estimated New Zealand population between 1851 and 1988 and the concentration of the population in municipalities.

Table 3.1: Population Living in Boroughs

<table>
<thead>
<tr>
<th>Year</th>
<th>Total New Zealand Population</th>
<th>New Zealand Population Living in Boroughs</th>
<th>Number of Boroughs</th>
<th>Average Population of Borough</th>
</tr>
</thead>
<tbody>
<tr>
<td>1851</td>
<td>26,707</td>
<td>111,919</td>
<td>34</td>
<td>3,292</td>
</tr>
<tr>
<td>1854</td>
<td>32,554</td>
<td>194,981</td>
<td>65</td>
<td>3,000</td>
</tr>
<tr>
<td>1855</td>
<td>37,192</td>
<td>245,612</td>
<td>74</td>
<td>3,319</td>
</tr>
<tr>
<td>1860</td>
<td>83,919</td>
<td>270,503</td>
<td>87</td>
<td>3,109</td>
</tr>
<tr>
<td>1865</td>
<td>190,607</td>
<td>307,294</td>
<td>95</td>
<td>3,235</td>
</tr>
<tr>
<td>1870</td>
<td>248,400</td>
<td>350,202</td>
<td>101</td>
<td>3,467</td>
</tr>
<tr>
<td>1875</td>
<td>375,856</td>
<td>505,595</td>
<td>110</td>
<td>4,596</td>
</tr>
<tr>
<td>1880</td>
<td>484,864</td>
<td>681,888</td>
<td>127</td>
<td>5,369</td>
</tr>
<tr>
<td>1885</td>
<td>619,323</td>
<td>880,850</td>
<td>122</td>
<td>7,220</td>
</tr>
<tr>
<td>1890</td>
<td>667,477</td>
<td>938,170</td>
<td>127</td>
<td>7,387</td>
</tr>
<tr>
<td>1895</td>
<td>740,699</td>
<td>1,209,300</td>
<td>134</td>
<td>9,025</td>
</tr>
<tr>
<td>1900</td>
<td>808,132</td>
<td>1,488,850</td>
<td>143</td>
<td>10,410</td>
</tr>
<tr>
<td>1905</td>
<td>1,050,410</td>
<td>1,969,087</td>
<td>137</td>
<td>14,373</td>
</tr>
<tr>
<td>1910</td>
<td>1,257,611</td>
<td>2,264,284</td>
<td>129</td>
<td>17,553</td>
</tr>
<tr>
<td>1915</td>
<td>1,522,700</td>
<td>2,338,460</td>
<td>116</td>
<td>20,159</td>
</tr>
</tbody>
</table>

Sources: Population 1885-1987 from New Zealand Official Yearbook 1990
Other Data: 1970-1987 Local Authority Statistics
1930-1960 Local Authorities Handbook
1875 - 1920 Statistics of New Zealand

Notes: Population before 1885 excludes Maori
Population for 1930 is 1931 figure (1930 not available)
Clearly, the establishment of formalised towns, boroughs, cities and counties (on the British model) in New Zealand after the 1840s was from scratch. Much was brought from Great Britain, but conditions were different, and the specific New Zealand challenges were the result of the newness of the colony, the small and geographically dispersed population, and the lack of sufficient financial resources.

3.2 Pre 1876

As noted in the preface, before setting sail from Gravesend, the New Zealand Company attempted to set up a form of local government for Wellington. However, it was not long lasting, for “in June 1840 Hobson (the Governor) despatched an armed force to disband the ‘illegal and treasonable’ body”. (Bush 1995 p. 2) The first attempt at a legally sanctioned local government structure similarly lasted only a short period. The Municipal Corporations Ordinance 1842 allowed districts of more than 2,000 people to be proclaimed a borough with certain unoccupied land becoming part of the borough. The Ordinance also provided for the election of a council, which was able to rate property owners for the creation of roads, the provision of water and sewage systems, the improvement of harbours and rivers in the borough, plus a small number of other tasks. The Imperial Government subsequently disallowed this Ordinance as it was seen to take over certain prerogatives of the Crown and Admiralty relating to ownership of property and harbour management respectively. Three years later another attempt at setting up local government was introduced via the Public Roads and Works Ordinance 1845. This Ordinance had similar powers to the 1842 Ordinance without the granting of unallocated land to the boroughs and without powers to improve or control the harbours and rivers. Yet not a lot happened. Even after the New Zealand Constitution Act 1852 (UK) set up a General Assembly, provincial governments and local government in New Zealand, little happened at the local government level until the mid 1860s. Momentum for formalised local government finally began with the Municipal Corporations Act 1867. This Act of 390 sections, plus eighteen schedules, included:

- provisions authorising the incorporation of any borough or city,
- provisions for the election of a council and its auditors,
- requirements to keep and present accounts,
• provisions authorising rating and loans, and
• identifying functions that municipalities could undertake.

The arrangement for New Zealand local government in these early years had three major influences: first, the *Municipal Corporations Act* 1835 in the UK; secondly, the urgent need for local infrastructure to permit the continuing development of the settlement; and thirdly, the continuing lack of a large enough population base to support, financially and administratively, development of the local infrastructure. The situation in early Wellington was indicative of the general situation throughout the colony.

Wellington town itself subsisted until 1862 on an *ad hoc* arrangement whereby small committees of civic-spirited citizens solicited donations for improvements. (Bush 1995 p. 6)

With an increasing population, as a result of immigration, infrastructure needs grew and the *ad hoc* solutions, especially relating to financing, could no longer solve problems of the lack of infrastructure. The introduction of formalised structures, the ability (in practice) to rate, and the capacity to plan for infrastructural works meant that municipal government finally arrived in New Zealand in the mid to late 1860s. Many of the new settlers, from both the early wave up to the 1850s and those more recent, would have been familiar with the basic tenets of the 1865 Act by referring back to the *Municipal Corporations Act* 1835 in England, especially if they had lived in any existing incorporated boroughs prior to emigration. The principle of the 1835 UK ‘reforming’ Act was openness or transparency, including reforms such as “an elected council, open proceedings and publicly audited accounts”. (Pearce 1980 p. 13) According to Fraser, at the time “most corporations were corrupt, inefficient, and insensitive to real local needs.” (1982 p. 4) Like the system in the home country, the New Zealand 1867 Act was an attempt at providing for uniformity in all boroughs. Like its English equivalent, the New Zealand Act provided for universal franchise, based on individual property ownership (with plural voting based on value of property), the auditing of annual accounts, open meetings, and (only) a few ‘powers’ for the borough. Additional powers were granted over the years by amendments to the principal Act, local legislation (borough specific), and ‘wash-up’ legislation (legislation that covers a multitude of areas, normally seeking to rectify minor inadequacies in legislation identified in the preceding year).

According to Bush, (2002 p. 1) the major difference between the 1835 Great Britain Act and the 1867 New Zealand Act was that New Zealand (by necessity) was more focused on
the goals of efficiency and the provision of a responsive local government. Whereas in nineteenth century Great Britain the objectives of local government reform were of a higher level where “the reformers were primarily concerned with public participation and official propriety rather than with function”. (Fraser 1982 p. 3)

In the same way that this desire for efficiency and the financial pressures were central to the creation of local government in the 1860s, in the mid 1870s the provincial government structure was disestablished as a result of a desire for better efficiency and, more importantly, because a number of the provinces were close to insolvency, unable to perform their essential functions due to insufficient funds. Other reasons for the disestablishment of provincial government that have been offered include, the lack of work undertaken by the provinces, a public feeling against the extra layer of government, and the introduction of better communications between the various parts of the country, making the sub national provincial government system redundant. Despite calls for retaining the provinces because of their ability to be “fully responsible to the people, whereas the General Assembly was largely under the influence of the Crown” (Morrel 1964 p. 252 paraphrasing Sir George Grey) the provinces were abolished in 1876. In the new colony, pragmatism in the arrangement of government structures was not only evident but also essential. Although most remaining functions of the provinces were taken over by central government, new municipal and counties acts were introduced in 1876, granting additional powers to municipalities and counties.

3.3 1876 to 1988

The accounting and auditing issues around the 1876 Municipal Corporations Act – its amendments and replacements, the associated regulations and other related goings-on until 1988 – is the subject of the story told in this thesis.

3.3.1 Municipalities – Part of Local Government

Between 1876 and 1988 one of the defining characteristics of the New Zealand local government system was the large number of institutions (see table 3.2), especially given, as noted above, New Zealand’s small and geographically dispersed population. Within this system the municipalities and counties were cornerstones, with a number of minor (although large in number) other local authorities. The default position in the system was the essentially rural counties, with the boroughs being separated from the counties they
were situated in when they reached a certain size. This size related to both the population and geographical area covered by the township part of the county. Both criteria for the creation of a municipality (population and size) increased as the colony grew.\textsuperscript{1} The most significant minor territorial local authorities were Town Boards, although Road Boards were the most numerous. The Town Boards were often seen as a half-way position for a distinct albeit still small urban area within a county that wished to be apart from its ‘mother’ county, but was not large enough at the time to be a borough in its own right. The title of city was given to certain ‘important’ boroughs, but with it came no additional powers or rights. (Bush 1980 p. 60)

\begin{table}
\centering
\caption{Number of Local Authorities}
\begin{tabular}{|l|c|c|c|c|c|c|c|c|c|}
\hline
Councils & & & & & & & & & \\
\hline
County Councils & 45 & 90 & 111 & 120 & 134 & 143 & 138 & 129 & 116 \\
\hline
Other Authorities & 63 & 78 & 110 & 125 & 125 & 119 & 108 & 92 & 79 \\
\hline
Total & 348 & 413 & 392 & 395 & 590 & 755 & 742 & & \\
\hline
\end{tabular}
\end{table}


The reorganisation of the boundaries of local authorities and the change of form (for example, from part of a county to a separate borough) were constant features of New Zealand local government until 1989. The growing population meant that new communities formed and separated from their original county into boroughs. Parochial interests plus the ‘odd’ financial incentive, as discussed below, meant that small local communities flourished as independent local authorities. From the beginning the consensus was that too many local authorities existed. The problem was that most were not an efficient size, spending a large percentage of their revenue on administration. However, the real problem across the country was that there was no consensus on which counties should amalgamate.

Between 1946 and 1984 six Local Government Commissions\textsuperscript{ii} all had the task of the reorganisation of local authorities, especially the amalgamation of the numerous

\textsuperscript{1} In 1876 it was a minimum population of 250 resident householders and an area not larger than nine square miles (s 17); in 1920 this was 1,000 residents and nine square miles (s 3(c)); in 1954 the population requirement increased to 1,500 with the size remaining the same (s 4(c)).

\textsuperscript{ii} The seventh and most successful commission began in 1985, with its reorganisation of all of New Zealand local government happening late in 1989.
authorities. Because of political and parochial interests, at both local and central
government levels, none of these commissions could be called a success. Following a
change to the legislation in 1974, the formation of new boroughs by splitting from existing
counties became more difficult. (Palmer 1978 p. 4) The motivation for this legislative
change was to encourage the rationalisation of local authorities. This was to occur firstly
by stopping the creation of more authorities. The second way that legislative change would
increase the rationalisation of local authorities was by ensuring that proposed changes were
required to be part of a wider reorganisation scheme that would include an overall
reduction in the number of local authorities in a region. Yet it was not until the seventh
Commission reported late in 1988 that much needed changes to the structure of local
government in New Zealand occurred.

3.3.2 Franchise, Elections and Participation

Despite parochial reactions against any suggestion of the amalgamation of local councils,
participation by electors in local government has always been relatively low. Although, as
noted in the preface in relation to the opening quote by Seddon, the large number of
elected local authorities meant that many people were involved in elected positions,
compared with central government, election participation rates for local body elections
have always been low. For example, the average voter turnout for Dunedin City Council
elections between 1913 and 1927 was 53%, (McDonald 1965 p. 341) while for the same
period the average turnout for the four general elections was 86%. Across the country the
average for municipal elections in 1965 was 45%, whereas for central government it was
90% in 1963 and 86% in 1966. This reflects what local government political scientist
Graham Bush called the “mass apathy and abstentions” of local government voters. (Bush
2002 pp. 37-8) ii

Initially, the criteria to be eligible to vote in local government elections related solely to
property ownership. However, this changed to include residents as eligible voters. By 1910
a three-month residency was sufficient to become an elector. Property owners qua
ratepayers were entitled to vote until 1986 when residency was the introduced as the only
criteria for inclusion on the electoral rolls. However, such a policy was never accepted

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i This section is based on Bush (2002) and Palmer (1978 chapter 2)
across the political spectrum and in 1991 saw franchise returned to non-resident ratepayers and the nominees of corporate ratepayers. (Palmer 1993 pp. 138-9)

In 1876 elections were held annually for one-third of the council, with each elected councillor being elected for a three-year term. This changed to biennial elections in 1900 and triennial elections from 1935 onwards. Provisions also existed for polls relating to proposed amalgamations or separations of territorial authorities and for the raising of loans.

While formal participation in elections has always been low, there has always been some involvement by the community in local body affairs. Often, as will be seen through the pages of this thesis, individual members of local communities would use the official channels to raise issues and concerns about the actions of council and their elected members. A few members of the public have effectively kept the local authorities on guard for all — some for political interest, gain or ambition, while others for community interest and others for their economic benefit.

3.3.3 Functions

As creations of statute, without a general power of competency¹, municipalities could only perform tasks that they had a legislative authority to undertake. Part XI of the Municipal Corporations Act 1876 provided councils with the authority to *inter alia* form and maintain streets, create and maintain drains (including on and under private property), control public nuisances (on streets, in business premises and most other places other than inside private houses), collect and supply water to the borough, build and operate gas works to light the borough streets, and to set up market places. Over the years, changing and new technology, the demands of a growing population, an increase in the available leisure time, and changing expectations of residents resulted in an increase in demand for and supply of services from councils. This included airports in certain centres, the provision of milk supplies, and the establishment of abattoirs, public transport systems, swimming pools, libraries, sports fields and many other facilities.

The legislative authority for the functions undertaken by municipal authorities has been both permissive and required. Although most have been permissive, giving the local

¹ As will be noted below such a power was granted in the Local Government Act 2002.
authority the power to undertake the activity if desired, many of these were in fact required by the local community and/or its circumstances. The need and the call for the expansion of a borough would result in the need for more roading and other infrastructure; although no legal requirement existed for the council to provide for growth, growth was very rarely optional. On the other hand, other activities of local authorities were optional and their inclusion or otherwise in council operations reflected the political and social frame of mind of the time, and often of that particular council. The building of new public facilities such as swimming baths and town halls, the provision of services such as community advisory bureaus, and the payment for hosting festivities for visiting (often royal) dignitaries all came within this group.

Of services that councils were required by legislation to undertake, most had some public health benefit and or safety rationale. Councils were, for example, required to establish at various times milk treatment facilities and abattoirs for the production of safe food for their community. Public nuisance, food preparation, noise and dog control have also been required of local authorities.

Three major public sector functions that have not been the responsibility of territorial local authorities are policing, education and health. These functions, as public sector functions, were undertaken by central government, although both health and education have at times been special categories of local authorities. Education was always funded by central government, with separately elected local education boards having some minor role in the oversight of education. (Colquhoun 1993 pp. 3-8) Until 1957 local bodies were required to fund partially local hospitals (with most funding coming from central government), the hospitals themselves being run by ad hoc local authorities (Hospital Boards). (Ashby 1956 p. 47)

The growth of functions and activities undertaken by local authorities was at best a mixed blessing. New tasks meant that councils became more important within their communities, financially they became bigger, and arguably their communities received services they needed. However, additional tasks also meant the councils became more complex organisations with associated risks and management problems. Additional tasks were

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*some local authorities undertook traffic policing until the early 1980s. By 1970 most authorities had given up this work, when it was taken over by the Ministry of Transport. (Bush 1995 p. 41)*
always wanted by certain parts of the community, even if impractical or there was no legislative authority to undertake such tasks. And, of course, as will be discussed shortly, funding of capital expenditure, loan repayments and on-going costs for new tasks had to be found.

Central government (via Parliament) rarely gave authority to local government to undertake any activity without a series of conditions, constraints and requirements to ‘protect’ a local community from its local representatives. The more activities local government was permitted to undertake (and they increased over time) the more that central government oversight or control was imposed on local bodies. The Local Bills Committee made this point in 1960:

There is no doubt that territorial local authorities are now concerned in some degree with many more aspects of the life of the citizen than they were upon their establishment and from this point of view they have gained a considerable increase in function although they are clearly more subject to Central Government control. (May 1960 p. 134)

Often, part of these controls was seen in the accounting and auditing requirements that councils operate under (as discussed in remaining chapters) and in the associated requirements and conditions on funding.

3.3.4 Financing Municipalities: Revenue and Borrowing

According to Bush (1980 p. 156) “more words have been spilled on finance than all other topics in local government put together”. However, the means of financing municipalities has been predominantly stable between 1876 and 1989; the need for the numerous commissions and reports was not doubted, nor was their lack of success. Sources of revenue for municipalities have been property taxes (rates), other charges, trading activities revenue and grants from central government. Of these, the major item has always been the property taxes, with trading activities’ revenue at times large but always off-set by the associated expenditure (if not more than); in a similar manner the charges collected by municipalities have been small and relate to particular items requiring associated expenditure.

Grants from central government have been limited. Grants were normally specifically tagged to certain activities and/or intended to provide incentives for local authorities to engage in certain works. Infrastructural works, such as road and water supply, were the main areas to receive government grants. During the 1970s central government provided
more funding for local authorities for social and community facilities, although most were still tagged to particular projects and many were in the form of a partial subsidy, matching either directly or proportionally contributions towards specific projects by the local authority. The actual level of central government grants to local authorities is difficult to determine, due to inclusion of other funding from central government, such as grants in lieu of rates, in the data recording government grants.¹ (See (Bush 1980 p. 168) and (Scott 1979 pp. 26-30).) Table 3.3 shows municipal receipts from central government in relation to total municipal revenue. The table shows that the subsidy was normally below 10% of total revenue. For a discussion of central government financial assistance to local authorities between 1840 and 1960 see May (1960 Part III).

Table 3.3: Revenue from Central Government

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Borough Revenue (££)</th>
<th>Government Grants to Boroughs (££)</th>
<th>Percentage from Government</th>
</tr>
</thead>
<tbody>
<tr>
<td>1875</td>
<td>211,994</td>
<td>14,534</td>
<td>6.9%</td>
</tr>
<tr>
<td>1880-81</td>
<td>354,005</td>
<td>22,074</td>
<td>6.2%</td>
</tr>
<tr>
<td>1885-86</td>
<td>421,245</td>
<td>29,178</td>
<td>6.9%</td>
</tr>
<tr>
<td>1890-91</td>
<td>425,800</td>
<td>23,700</td>
<td>5.6%</td>
</tr>
<tr>
<td>1895-96</td>
<td>482,529</td>
<td>13,331</td>
<td>2.8%</td>
</tr>
<tr>
<td>1900-01</td>
<td>604,819</td>
<td>17,401</td>
<td>2.9%</td>
</tr>
<tr>
<td>1910-11</td>
<td>1,766,952</td>
<td>48,137</td>
<td>2.7%</td>
</tr>
<tr>
<td>1920-21</td>
<td>5,092,173</td>
<td>41,283</td>
<td>0.8%</td>
</tr>
<tr>
<td>1930-31</td>
<td>7,819,037</td>
<td>130,019</td>
<td>1.7%</td>
</tr>
<tr>
<td>1940-41</td>
<td>9,558,961</td>
<td>190,727</td>
<td>2.0%</td>
</tr>
<tr>
<td>1950-51</td>
<td>16,437,128</td>
<td>309,282</td>
<td>1.9%</td>
</tr>
<tr>
<td>1960</td>
<td>38,778,533</td>
<td>2,868,481</td>
<td>7.4%</td>
</tr>
<tr>
<td>1970-71</td>
<td>220,782,114</td>
<td>16,035,135</td>
<td>7.3%</td>
</tr>
<tr>
<td>1980-81</td>
<td>949,755,000</td>
<td>76,191,000</td>
<td>8.0%</td>
</tr>
<tr>
<td>1987-88</td>
<td>2,315,705,000</td>
<td>126,941,000</td>
<td>5.4%</td>
</tr>
</tbody>
</table>

Sources: 1970-1987 Local Authority Statistics (yearly)
1930-1960 Local Authorities Handbook (yearly)
1875 - 1920 Statistics of New Zealand (yearly)

Notes: Government grants from 1960 include funding by National Roads Board.
Decimal currency was introduced in 1967.

Until 1953 the funding for roading saw central government pay a direct subsidy on the rates received by each council. (May 1960 pp. 114-119) For most municipalities the grants were not significant as there was an upper limit (and lower limit) on the amount to be received by individual authorities. This created the obvious incentive, as noted above and

¹ This section has ignored any discussion of the Local Authorities Petroleum Tax, which was introduced in 1971. This tax was collected centrally for distribution to local authorities. The amount collected was very small.
contained in the following 1940 report from the Department of Internal Affairs to The Treasury:

For some years there has been a tendency for local authorities to split up and multiply, and to a great extent this is encouraged by the manner in which the Government subsidy on rates is paid. This subsidy is limited by both a maximum and a minimum, with the result that the bigger counties receiving the maximum are claiming that it is too little for them to develop their large territory adequately, while the subsidy paid to some of the smaller counties seems to be devoted more to administration expense than to land development ... Obviously this system encourages a county when it is receiving the maximum, to subdivide and eventually obtain from the Government twice the amount it would have received had it remained one county.¹

Despite numerous inquiries into other sources of funds, including greater revenue sharing with central government, there have been few changes over the years to methods of funding local authorities. Property taxes have remained the most important source of revenue for municipalities.

As the major source of revenue, and almost the only source of funds that councils could make choices, regarding what revenue was used on, rates have been central in both the political and policy debates for local authorities. (Other revenue sources were either tagged to specific projects or had an associated expense to a similar amount.) Residents, electors and ratepayers all paid attention to the rates paid and/or the services provided by councils from the rates collected. Changes to rating have been limited over the years to providing options on how to calculate the value of rateable land, the introduction of power to apply a differential rate based on different land usage, and changing the activities for which a flat annual fee or a direct user charge could be charged, such as water supply. Councils have had the power, and in some cases the obligation, to introduce rates to specific parts of the district or borough when functions or works are undertaken that will be of benefit to that part(s) only. (See Palmer 1993 Chapter 11.)

The second and equally important aspect of local authority financing relates to borrowing. Central to discussions on borrowing by local authorities is the assumption (and later a legal requirement) that a current year’s expenditure is matched with a current year’s revenue. Added to this requirement was that any expenditure intended to provide long-term benefit should be funded over the period that the benefit was to be enjoyed. In the majority of

¹ The report notes that while “it refers throughout to counties, ... the same considerations apply in principle to other local bodies receiving a subsidy on rates” including boroughs.
cases, ratepayers had the right to veto loan proposals and thus an effective veto on the associated capital works. Following the creation of the Local Government Loans Board (later the Local Authority Loans Board) by the *Local Government Loans Board Act* 1926 (s. 4), councils were required to seek the approval of the Board prior to seeking to raise a loan. The Board did not lend, but rather authorised local authorities to do so, as well as placing certain conditions on the raising of loans. The initial impetus for the Board’s creation was, according to a Treasury report, because:

immediately following World War I many local authorities indulged in imprudent borrowing. Some borrowed beyond the capacity of their districts and in numerous cases provision was not made for repayment of loans within the lifetime of the assets created.²

In 1956 an additional task was added to the Board’s role, that of ensuring that all local government loans approved considered the “interest of the national economy”. (*Local Authorities Loans Act* 1956 s. 9)

Authorities were required to set up separate sinking funds to set aside the necessary funds to repay loans and associated interest when due, ensuring that ratepayers at a loan’s due date were not left to fund repayment of a loan beyond their share.

Disputes regarding rating, special rates, the adherence to the annual financing principle (funding this year’s expenditure with this year’s revenue), and the funding of loan repayments all relate in part to how the authorities account for money. The public (as ratepayers, electors and/or residents), the central government overseers (politicians and bureaucrats) and the courts have all seized on inappropriate accounting treatments and practices or inappropriate accounting requirements when criticising local authority actions. At the same time, the constraining nature of the accounting requirements and practices were criticised by those seeking to manage efficiently and effectively local authorities, and by those who seek to help managers to do so. This thesis covers the issues surrounding the accounting and auditing requirements, while the history of financing is left for another day.

### 3.4 1989 and onwards

This thesis finishes at the start of reforms in 1989. These reforms could be considered the most significant since the end of the provincial era in 1876. The reforms introduced the structural changes that had been called for since 1876, namely the reduction of the number of local authorities to a manageable number, replacing approximately 620 local authorities
(many of whom were very small ad hoc authorities) of the time. (Gilling and Henderson 2000 pp. 119-120) By 1995 there were 87 territorial local authorities, together with 27 licensing trusts and 6 ad hoc boards, making up local government in New Zealand. (Bush 1995 p. 112)

Other reforms concurrently made to local government in New Zealand administration were similar to those undertaken in central government, including the separation of trading activities from other council activities, the separation and clarification of management and governance roles with a chief executive responsible for the former and the elected council for the latter, and significant changes to accounting regulations. Existing accounting regulations were replaced by provisions in the Local Government Amendment Act (No. 2) 1989 that were headed "Accountability and Accounting". These provisions focused on councils creating plans and reporting against those plans, the use of non-financial reporting, and the introduction of reporting according to GAAP (in New Zealand GAAP is the same for both the public and private sectors), including the use of full accrual accounting. The requirements for borrowing were simplified, with associated greater reporting on long-term financial plans of councils. Local authorities also received a power of general competency in the Local Government Act 2002. The 2002 Act further changed the requirements for borrowing, planning and reporting by local authorities.

3.5 Conclusion

The two quotes at the beginning of this chapter reflect two approaches to the role of local government; the first reflects a desire for strong and fully active local government, while the second reflects a minimalist role for local government. These approaches are at two ends of a continuum: at one end, local government is an important and preferred partner with other forms of government, delivering services to its local community; at the other end, local government is only to be used when other forms of government or other arrangements are unable to deliver services.

The preferred model in New Zealand has been based on a strong central government, with a corresponding weaker local government. Under this model, serious and respectful sharing of revenue (taxes collected by central government) and work between central and local government, on the basis of being equals, was not going to happen. Local government has always been the poor relation to central government. This is despite many
calls for a strong local government, including from the occasional senior government minister, often the Minister of Internal Affairs/Local Government. Despite this secondary role, local government has been important, touching the lives of citizens and commerce, providing infrastructure for business and pleasure, and taxing (directly or indirectly) everyone through property rates. Local government has had two sets of struggles—power and money.

Municipalities and all local government bodies have struggled over the years as a result of the lack of real power. Everything that local authorities did was first authorised by the legislature, essentially central government. The rules and conditions relating to local authorities’ functions, financing and franchise were determined by central government. Almost every time local authorities, collectively or individually, received additional powers they received additional requirements to keep check on the use of those powers—often in the form of accounting requirements and/or monitoring by the auditor. The other set of struggles that municipalities have faced relate to size and lack of financial wealth, both in terms of their existing infrastructure and their ability to create the necessary new infrastructure as required.

The following chapters discuss the accounting and auditing requirements for municipalities and the discussions surrounding them. The above-mentioned struggles that local government and municipalities have faced, together with their structure, will be central to understanding the discussions.
Chapter Four: The Accounting Requirements

4.1 Introduction

This chapter outlines the accounting requirements for municipal corporations/territorial authorities between 1876 and 1988. The requirements were predominantly contained in municipal corporations/local government acts (including amendment acts) and regulations authorised by those acts. This chapter covers only the requirements contained in municipal corporations/local government statutes and associated regulations. Examples of legislation excluded from this review are those for trading activities that operated under separate statutes, and legislation covering requirements for the striking and collection of rates and the raising of loans. An example of requirements for a specific trading activity is discussed in chapter seven in relation to an act specific to the Wellington City Council’s tramway and electric lighting undertakings. In addition, at various times very minor amendments were made via provisions in a number of other types of acts; generally, such amendments are discussed when they are consolidated into municipal corporations/local government legislation.

Also discussed in this chapter are the principles that underpin most financial management issues for municipal authorities. Discussion includes a brief outline of the rules for borrowing and associated spending of loan money; however, a full discussion of these issues (and the accounting for them) is outside the scope of this thesis. Similarly, the issues

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1 The statutes covering the accounting requirements in 1988 were repealed by the Local Government Amendment Act (No. 2) 1989. The regulations were officially revoked in 1991, although the 1989 Act effectively made them redundant.
relating to rating are included only where they impact on the general accounting requirements. Issues relating specifically to the appointment and role of auditors are discussed in chapter six, however brief comments regarding audits and auditors are included in this chapter. Discussion of auditing and borrowing will include references to public revenues and local government borrowing legislation.

Initially, all accounting requirements were contained in the Municipal Corporations Act 1876. In 1901 (under the 1900 Municipal Corporations Act) some of the accounting requirements (and other issues) were included in statutory regulations. From that point the accounting requirements were contained in a mixture of statutory regulations, principal acts, and acts that amended principal acts. Between 1901 and 1965 the accounting requirements were included with other regulations relating to the governance of municipal corporations (for example, regulations relating to the holding of elections for councils) under the municipal corporations legislation. From 1965 the accounting requirements were separated from these other regulations and issued as accounting specific regulations. In 1974 the regulations had, for the first time, the same accounting requirements for all territorial local authorities (boroughs and counties). As noted below, the regulations, and to a lesser extent the legislation, became larger and more complex through the years, peaking in 1974. The following chapters will discuss why this phenomenon occurred and why many other changes in accounting requirements also happened.

This chapter is organised along a mixture of chronological and thematic lines. As the starting point of this thesis, the following section outlines the accounting requirements in the Municipal Corporations Act 1876. The requirements at that time are discussed along eight themes: the Auditor, the Balance Date, Preparing Estimates, the Keeping and Format of the Accounting Records, Half Yearly Accounts, Annual Accounts for External Parties, the Provision of Accounts to Central Government, and Public Access. The significant changes and/or additions to the 1876 requirements, in the subsequent regulations and statutes up to 1988, are discussed in section three under the eight themes mentioned above, plus one not found in the 1876 Act, namely Creating Specific Funds. Where no comments are made on particular issues, either no changes were made or I considered the changes made to be insufficient. Section four discusses the requirements in the municipal corporations/local government legislation that relate specifically to trading activities. Section five outlines requirements in the related area of the provision of statistical
information by councils. Section six outlines the principles behind local government financial management as contained in the statutes and regulations. The chapter concludes with brief comments on changes to the requirements that will be developed in the following chapter.

4.2 Requirements of the Municipal Corporations Act 1876

Auditor – Sections 92–96 provided for the election of two people as auditors of a borough’s accounts. The qualification of those eligible for election was the same as for elected members of council, except that elected councillors were not eligible for election as auditor.

Balance Date – 31 March.

Preparing Estimates – Prior to the striking of rates, councils were required to prepare estimates of proposed total expenditure, showing where the funding of expenditure would come from and the rate required to be struck. The Act required that the total rate struck would equal the amount required for the expenditure, less monies already on hand. These estimates were required to be “publicly notified in the borough one week before making the proposed rate”. (s. 109)

The Keeping and Format of Accounting Records – The Treasurer, an officer of the council, as opposed to an elected position (s. 102), was required to “keep full and true accounts”, recording “every sum received into and every sum paid out of the Borough Fund Account” (that is, on a cash basis). The accounts fell into two groups: the general account and other accounts. The general account was for recording the ordinary expenditure of the borough, with the form and classification determined by the Governor. The other accounts were of four types:

- Separate Accounts for recording transactions where there was separate funding or rating, for example, waterworks and tramways,
- Special Funds Accounts which related to monies raised by loan or from the general account that was to be spent for a specific purpose, for example, a specific capital expenditure item,
• Interest Accounts for the crediting of interest (from general fund, trading revenue or special rate) on loans due but not yet paid and from which the interest was to be paid out of, and

• Sinking Fund Accounts for loan repayments (one account per loan). (s. 126)

**Half Yearly Accounts** – Following the end of March and end of September the balances of all accounts (being an abstract of the receipts and payments) were required to be sent to the auditors within 15 days. Within 15 days of receiving the accounts the auditors were then required to certify the accounts, with the Treasurer subsequently presenting them before council. (s. 128)

**Annual Accounts for External Parties** – Within 15 days of the end of the financial year the accounts for the entire year were required to be provided to the auditors, with the auditors having until the end of April to complete that audit. (Almost the same as for the half yearly accounts, except the auditor was given a fixed date of 30 April rather than 15 days.) The accounts included the balances of all the accounts (the same as half yearly accounts) as well as statements showing assets and liabilities, public debt and associated sinking funds for repayments, and the real estate of the borough. Once audited, council was required to publish the accounts and the auditor’s report. (s. 132) Subsequent to their publication, council was required to hold a special meeting to consider the accounts and the auditor’s report if council thought that the accounts failed to “show fully and truly all the dealings with the borough funds, (they shall) may make such alterations therein, (within the law) … as they think fit, … (then the accounts) shall be deemed to be the true accounts of the borough.” (s. 133)

**Provision of Accounts to Central Government** – The balance sheet (that is, the balances of the accounts) was to be sent to the Colonial Treasurer together with any other information that the Colonial Treasurer requested. The balance sheet and other information were to be tabled in Parliament by the Colonial Treasurer. (s. 135)

**Public Access to the Accounting Records** – The accounts (as opposed to only the balance sheet) were to be open for inspection and copying by councillors, burgesses, the town clerk or any person holding any security against borough property. (s. 138)
4.3 Changes to the 1876 Requirements

4.3.1 Auditor

The Public Revenues Act 1878 gave permissive powers to the Governor to deem the Audit Office\(^1\) the auditor of any local authority that was receiving public (central government) money. Eight years later the Municipal Corporations Act 1886 made the Audit Office the auditor of all municipal corporations. That situation has remained from that time onwards. It seems likely that the move to appoint the Audit Office as auditor arose from a combination of concern regarding the auditing of central government grants to local authorities, and the need for an effective system of surcharging elected representatives for unlawful expenditure by their councils. The role of the auditor and the Audit Office is fully discussed in chapter six.

4.3.2 Balance Date

The balance date remained 31 March throughout the period covered by this thesis.

4.3.3 Preparing Estimates

The time frame for public notification of proposed estimates to be used for the striking of rates was increased to not less than fourteen days in the 1953 Amendment Act. The 1977 Local Government Amendment Act saw provisions relating to the preparation of estimates altered; they were still required to be prepared, although now “as soon as practicable”, and the direct link with the striking of rates was removed. Once approved by council they were to be publicly notified.

4.3.4 The Keeping and Format of Accounting Records

The 1900 Act gave the Audit Office responsibility to prescribe how councils were to keep accounts. The 1920 Act included the requirement that a “profit and loss account” (which would mean the use of accrual accounting) for each trading activity should be kept by a council; this was in addition to a borough’s general account and any number of other accounts for activities where funds were “raised or levied for or appropriated or allocated to be held in trust for, any special purpose” (s. 111 (b)), with special rates or loans being

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\(^1\) Documents and legislation over time have used the terms the Audit Office, Controller and Auditor-General, The Auditor, and the Audit Department; unless context or accuracy requires it, the term Audit Office is used.
the most common. The 1933 Act, while maintaining the Audit Office’s role in prescribing the form of the accounts, also made the Audit Office the final judge of the correctness of charging to each account.

The Municipal Corporations Amendment Act 1974 introduced the first major change to these requirements. The role of determining the manner in which accounts were to be kept, which had been held by the Audit Office, was placed in regulations. However, the Audit Office remained the judge of the correctness of charging to each account. The Act maintained the principle of requiring that separate accounts were created for monies collected for particular purposes, rather than leaving such a provision for inclusion in a regulation. The 1974 Municipal Corporations Amendment Act and 1977 Local Government Amendment Act¹ explicitly permitted the setting up of any number of accounts for particular purposes, either as a result of other legislative requirements or subsequent to a council resolution creating such accounts.

However, the 1974 regulations were very brief on the manner in which accounts were to be kept, leaving essentially the detail “subject to the requirements of the Audit Office” (para 11).

The 1979 regulations finally removed the Audit Office from the role of directly making rules for the keeping of accounts when they required that in addition to records that “support the annual (financial) statement” the following information was also to be kept: information about rates levied – collected and not collected, debtors and creditors, property owned or controlled by council, public debt, other assets (mainly stores, plant and equipment), and loans and advances.

In the 1980 Amendment Act, the requirements became even less specific, although the Act still pointed to following requirements in regulations. The Act removed the Audit Office’s power to determine if the appropriate accounts were correctly charged, replacing that provision with a gentler requirement that financial records be kept “in a manner acceptable to the Audit Office”. This change is further discussed in chapter six in relation to the changing role of the Audit Office.

4.3.5 Half Yearly Accounts

Half yearly accounts were not required after 1900.

4.3.6 Annual Accounts for External Parties

4.3.6.1 Time Lines

Although the end of April remained the due date for the returning of audited accounts by the auditor in the 1886 Act, the requirement was modified by adding "or as soon thereafter as may be possible" (s. 170). The main provision of the Local Bodies' Audit Act 1888 was to extend the time available for councils to meet and approve the accounts when the auditor was late returning the accounts. This 1888 provision was repealed in 1900 and not replaced. The 1956 regulation removed any time limit for the preparation of accounts and their forwarding to the Audit Office, as well as removing any time frame for the auditor to audit the accounts. Both requirements were required to be fulfilled "as soon as possible". An amendment to the regulations in 1976 saw the reintroduction of a time limit for the preparation of the accounts (but not for the auditing of the accounts); this time it was six months after balance day. There was provision for this to be extended by the Secretary for Local Government.

The 1979 regulations required the Secretary for Local Government to consult with the Audit Office prior to giving an extension. In the Local Government Amendment Act (No. 2) 1981, the Minister of Local Government was given authority to appoint the Audit Office or another person or firm to prepare the accounts of any council that failed to prepare annual financial statements for two consecutive years. The removal of the ability to grant an extension was the sole change introduced in the 1982 amending regulation.

4.3.6.2 Adoption and Modification

Councils, when considering making alterations to audited accounts in 1886, were limited to making alterations that were not "contrary to the report of the Auditor" (by then the Controller and Auditor-General). The 1956 regulation required councils to adopt the accounts within a month of receiving them from the Audit Office; however, the previous provision, permitting modification of the accounts after the audit report was received, was no longer included. 1965 saw the period for the adoption of the accounts extended to within two months of receiving the accounts from the auditor.
4.3.6.3 Content of the Accounts

The 1901 regulations included the first requirement to provide external parties with information relating to the striking, collection and non-collection of rates. Those regulations also placed the determination of the presentation of external accounts under the control of the Audit Office; however, this was limited only to headings to be used. The 1956 regulations saw inclusion in the annual accounts of more accounts and information specifically relating to operations of trading activities, as discussed below. The only change relating to the accounts in the 1962 amendment to the 1956 regulations was to permit the exclusion of shillings and pence from the accounts.

The 1965 regulations spelt out that the Plant and Machinery Operating Account and bank reconciliation statement were to be included in annual accounts. The second schedule to the 1965 regulations provided forms, for the first time, that showed the format and gave instructions on how the accounts were to be filled out. That schedule covered 15 pages, with the largest account being the General Account, which included 43 different headings or sub headings for receipts and 92 headings or sub-headings for payments. Sixteen different categories of prescribed accounts or statements were required; councils were expected to have a number of accounts or statements for each category. There was also provision for these prescribed forms to be varied by the Audit Office. A council could decide whether or not to include comparative figures for the previous year.

The 1974 regulations continued the practice of specifying the accounts required and how they should be formatted. The regulations replaced the large General Account with a number of smaller accounts, reflecting various activities that councils undertook, such as “Roads, Streets and Bridges”, “Water Supply”, and “Traffic Control”. The second schedule of the 1974 regulations became even larger, covering 19 pages of prescribed format and associated instructions.

1979 saw a reduction in detail in the regulation, with the schedule being two and a half pages. The regulation had only three requirements: a cash basis receipts and payments, a statement of money owing, and a note on accounting policy, stating that a cash basis was used. While most accounting records were no longer required to be part of the published accounts, the 1979 Local Government Amendment Act slightly modified requirements for the keeping of accounts introduced in the 1977 Act so that councils were still required to keep many accounts previously published, but not publish them.
4.3.6.4 Publication

Provision for publication of the accounts, in one form or another, has remained a feature of the regulations. However, from 1888 there was some concern about the cost of publication. In *Local Bodies' Audit Act* 1888 the requirement to publish the accounts could be modified by the Governor on the grounds of cost. Similar provisions were in the 1901 regulations with an amendment in 1912 specifying that the alternative, still to be authorised by the Governor, was publication in newspapers that accounts were available for inspection and available on application. Three years later, that provision, allowing for alternative publication of the accounts, was excluded from the regulations.

1921 saw inclusion of a provision that required a copy of the audited accounts to be “posted free of charge to any ratepayer making application”. The requirements in the regulations remained essentially the same until the 1974 regulations, when ratepayer was replaced with “elector”, although this minor change had already been made 20 years previously in the 1954 Act.

4.3.7 Provision of Accounts to Central Government

In the 1886 Act the Colonial Treasurer (changed in 1911 to the Minister of Finance) was to be sent a statement of assets and liabilities as well as balances of the accounts. However, the 1901 regulations did not include the requirement for the statement of assets and liabilities to be sent¹, but the provision for balances of the accounts and “such other accounts and particulars as the Colonial Treasurer directs” remained. The 1921 regulations introduced a requirement that a copy of the published accounts, together with the auditor’s (the Audit Office) report, be sent to the Controller and Auditor-General. These accounts would be those audited and not the “true accounts of the borough”, that is, those that may have been modified by a council, post auditing.

Requirements were altered in 1956 to include two copies to the Minister of Finance, and the requirement to table accounts in Parliament was removed.

¹ Councils were still required to complete such statements but they were not to be sent to the Colonial Treasurer.
Requirements for providing copies of annual accounts to central government were greatly increased in 1965. Although the Minister of Internal Affairs was no longer to receive a copy, the following were:

Secretary for Internal Affairs (later the Secretary for Local Government),
Secretary to the Treasury,
The Controller & Auditor-General (now only one copy),
The Government Statistician,
The National Roads Board, and
The General Assembly Library.

The 1974 regulations saw little change, other than two copies for the General Assembly Library, and in the 1979 regulations, the Controller and Auditor-General was removed from the list of those receiving copies of the annual accounts.

4.3.8 Public Access to Accounting Records
The first significant change to the ability to access accounting records of a borough was introduced through the 1977 Amendment Act (No. 3). Under this Act, access was limited to those accounts and statements issued by a council and those presented to a council by the treasurer, other than in closed meetings. Electors no longer had access to all accounting documents. (s. 204)

The 1979 regulations gave council up to two months to have audited financial statements printed for the public. Also included was the requirement that council “shall distribute to all current ratepayers a copy of the audited annual statement”, although distribution was to include publication in a newspaper of the financial statements.

4.3.9 Creating Specific Funds – other than trading undertakings
With the requirements that accounts should be kept on a cash basis and that the rates struck each year were to be equal to the estimated cash requirements, there was no provision for accumulating cash reserves for either large items of expenditure (such as assets) or for the funding of recovery, following any type of emergency (for example, a flood). Most expenditure that required large cash outlays was funded through loans, with repayments
spread over the life of the item of expenditure. In 1910 the first of many provisions allowing the creation of funds for specific future use was enacted in an amendment act.

4.3.9.1 Fire

The 1910 Amendment Act provided for the creation of a fire insurance fund, to be used for the “re-erection, repair, or reinstatement of any buildings or other property” of a council damaged by fire (s. 17). The 1953 Amendment Act permitted use of the fire insurance fund for the replacement of an asset destroyed or damaged by fire with approval of the Audit Office. The amount to be used from that fund could not exceed the insurable value of the original asset to be replaced.

4.3.9.2 Accident

The 1920 Act included a provision for the creation initially of accident funds for trading undertakings, as discussed below. The 1928 Amendment Act expanded this authority to include the establishment of accident funds for any activity engaged in by a council. The yearly contribution to this fund was limited to the amount that a council would otherwise pay for such insurance.

4.3.9.3 Repair, Renewal, Replacement or Improvement

The 1933 Municipal Corporations Act introduced provisions that allowed councils to create funds for the “repair, renewal, replacement, or improvement of any property, plant, fixtures or appliances of the council” other than those relating to trading activities (which had their own provisions). (s. 130) No specific requirements were enacted regarding accounting for this fund, although the general provision requiring separate accounts for separate funds (as noted above) would have applied.

This relatively loose arrangement for setting aside money was tightened in the 1972 Amendment Act. Under that Act, councils were required to deposit money allocated for the funds into a separate bank account within 3 months of the end of the financial year. Thus, a council’s ability either to “dump” unused money (but not previously allocated to any fund) at the end of the financial year into a fund or not deposit money allocated, due to over-commitment in other areas, was greatly diminished. (s. 3)
4.4 Accounting Requirements for Trading Activities

This section provides a brief overview of the specific accounting regulations for trading activities operated by municipal authorities. These requirements were often overridden for a particular council by local legislation. Chapter seven provides an example of such legislation that relates to the renewal and reserve funds of the tramways and electric lighting trading activities of Wellington City Council from 1917. As mentioned earlier, this section reviews the accounting requirements in municipal corporations/local government legislation and associated regulations for trading activities; it will not cover specific legislation enacted either for an individual council or to govern a particular type of trading activity.

4.4.1 Accounts and Reporting

As mentioned above, since the 1876 Act councils were required to keep separate accounts for activities that generated or received separate funding – this included trading activities. The 1920 Act stipulated that for each trading activity councils were required to prepare a profit and loss account. Thus a partial form of accrual accounting was introduced.

Regulations in 1956 increased the external reporting about each trading activity by councils. In addition to the profit and loss account previously required, an appropriation account and a balance sheet (being assets, liabilities and equity) were required to be prepared for each trading undertaking. A statement of assets was also required to be prepared, showing value (by class) and depreciation for each trading undertaking.

The 1974 regulation no longer required the asset statement, but the balance sheet, Operations Account (income and expenditure), appropriation of surplus and capital funds accounts, and if appropriate a Capital Account, were still required.

The 1979 regulations removed the requirements to produce accrual accounts for each trading activity in the annual statements of a local authority. All that councils were required to provide was one line for receipts and one line for payments for each trading activity in the main receipts and payments statement. This was in line with the philosophy of the 1979 regulations that aimed to simplify accounts. The Audit Office still encouraged councils to prepare full accrual accounts for their trading activities and would then audit them as a separate engagement, keeping them separate from the audit required for statutory purposes.2
4.4.2 Funds

The 1920 Act permitted councils to make appropriations to a number of “funds” relating to trading undertakings. Councils were permitted to establish an accident fund for each undertaking; the upper limit for the appropriation to each fund could be no more than the cost of taking out insurance for the same. The appropriation to accident funds was from the general borough fund, as opposed to coming from an undertaking’s separate account. Councils were also permitted to create Renewal Funds and Reserve Funds. Renewal Funds could be created for any trading undertaking after making provisions out of revenue from an undertaking for relevant interest and sinking fund charges relating to loans for that undertaking, and for maintenance and repairs of that undertaking, or for new parts to the undertaking. The purpose of the fund was for renewing or replacing the plant of an undertaking or any parts thereof, as opposed to maintenance and repairs. Councils were required to appoint commissioners to manage the fund and to keep accounts, thus removing the fund from direct council control. For a council to use money in these funds, commissioners needed to be satisfied that the use was appropriate (that is, for the renewal or replacement of an undertaking’s existing plant). The legislation provided for commissioners to employ the assistance of engineers and other qualified people to help make decisions regarding appropriate use of the funds. Councils that created a Renewal Fund could then create a Reserve Fund for the same undertaking. The Reserve Fund was to be used for extensions and improvements of an undertaking as the Council thought fit, with no commissioners required. If the Renewal Fund was insufficient for the renewal or replacement of an undertaking’s existing plant then council could use the Reserve Fund. Accounts for both funds were required to be kept and audited.

The 1928 Amendment Act altered the 1920 Act significantly for the management of funds of trading undertakings. The section permitting the creation of a Renewal Fund was changed to require that councils “provide for full and proper depreciation of the assets of the (trading) undertaking” by setting up a Depreciation Fund, to be managed by commissioners. With the Audit Office acting as judge of councils’ decisions about what is “full and proper”, any disputes between a council and the Audit Office were decided by the Minister of Internal Affairs. Monies in the fund were to be used for “the purpose of renewing or replacing the plant of the undertaking ... as a result of it being worn out, obsolete or incapable ... of further usefulness”. Councils were still permitted to set up a Reserve Fund similar to the provisions in the 1920 Act.
The 1977 Amendment Act replaced earlier requirements/provisions regarding Depreciation and Renewal funds for trading activities. Both funds were replaced by a Renewal and Extension Fund. Also, commissioners were no longer to be used, with a council assuming responsibility for management of the fund.

4.5 Statistical Information Requirements

Although not specifically accounting information, the information required from councils by the Government Statistician is included here because much of the statistical information was financial information, and the statistical requirements had a large impact on the development of the accounting requirements. This impact will be discussed in conjunction with other factors that impacted on changes to the accounting requirements in the next chapter.

The first regulation issued, which specifically outlined the requirements for information to be provided to the Government Statistician from each municipal corporation, was in 1923. Such regulations were, apart from “a few minor alterations, ... the same as those that have been in use for several years” although previously without being specified in regulation or statute. (Explanatory Note to the Regulations 1923) The regulations were based on a 31 March reporting/financial year and required more than accounting information. The information required statistics about ratepayers and dwellings, roads and bridges in the borough/city, licences granted by councils (for example, for publicans) and council employee information. The financial information required was: rates levied (according to type), Receipts and Payments for the year, a listing of Assets and Liabilities and “Other Loans”. Under each of these headings, very prescriptive requirements existed of how groups were to be itemised, including their order. For example, there were 19 separate categories of assets, with additional information specifically required for some items. The assets categories were in two broad groups: “Cash assets at date of balancing” and “Estimated assets”. Estimated assets would now be termed non-current assets, while cash included money outstanding to a council, such as rates and fees.

The 1923 regulations (which were specially for the provision of statistical information) were revoked by the 1956 regulations (which covered a number of areas). The 1956 regulations did not provide any replacements for the provision of statistical information.
Thus between 1956 and 1965 there were no regulations relating to the provision of statistical information.

The 1965 accounting regulations required that “a statement of general statistics” should be prepared and attached to the annual accounts; however, they were not part of the accounts and therefore were not subject to audit. The actual statement comprised both financial and other information. Financial information was similar to some of the information provided in the annual accounts, albeit in a different format. Non-financial material was similar to that in earlier regulations. In total, almost 150 items were to be included in the statistical return. As noted above, one set of the accounts, which included the statistics, was to be forwarded to the Government Statistician.

The 1974 regulations reduced the amount of statistical information to be provided. The items required were fewer than 25, and most of the accounting information (as well as other information) was no longer required.

4.6 Expenditure Controls

4.6.1 Principles

Much of the need for the accounting requirements and reasons for their alteration (which will be elaborated on in later chapters) can be traced to three principles that underpin the financial management/administration of local authorities. The principles are:

- Expenditure for any given year should be funded by revenue generated/collected during that year,
- Only borrowing authorised by statute is permitted, and this should be for the creation of assets to be used over the length of the borrowing, and
- Only expenditure authorised by statute is permitted.

The legislative enactments, which gave rise to these principles and permitted their modification, are now discussed.

4.6.2 Funding Current Expenditure

As mentioned above (under the estimates), when striking a rate, councils were first required to prepare estimates that would determine expenditure for the period. Once expenditure was determined, the amount of money required to be collected from rates was
calculated, taking into account any monies held, with that amount determining the strike of the rates. Essentially, a balanced cash position was required, although provisions allowing the creation of certain "funds" was enacted to override this principle in particular circumstances or for particular purposes.

This principle was enacted in the legislation covering borrowing by local authorities, namely the Local Authorities Loans Act 1956 and previously the Local Bodies' Finance Act 1921-22. Section 23 (1) of the 1956 Act stated that:

Every local authority shall provide for its ordinary obligations and engagements in any year out of its revenue for that year. (s. 23 (1))

The reference to "ordinary" ensured that the liabilities owed by a council and the debts due to the council were included. However, this section excludes money raised by loans and the payment for the creation or purchase of assets funded by loans and the repayment of a loan.

4.6.3 Overdrafts and Loans

The principle of funding each year's expenditure with revenue from that year has two corresponding principles relating to loans (short and long term), namely:

- that loans should not be used to pay for current expenditure, and
- that long-term assets should be funded normally via loans, to be repaid, including interest, over their expected life.

The need to manage cash flow meant that the first principle was modified to allow the use of overdrafts to pay for day-to-day expenses under certain circumstances. While administration expenses for a local authority may have been relatively constant throughout a financial year, both revenue from rates and a large percentage of a council's infrastructural work were unevenly spread over the year, which required short-term borrowing facilities. The 1876 Municipal Corporations Act permitted borrowing by way of overdraft, having a maximum of the total income (including from trading undertakings) received in the previous financial year, excluding government grants, special or separate

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1 The development of this historically important Act is discussed fully in chapter five.

2 This section will ignore the provisions that allowed councils to use money held temporarily in loan accounts in place of obtaining overdrafts. For an example of such provisions, see Local Bodies' Loans Act 1926, section 46.

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rates and loans. (s. 156) Ten years later, the ability to operate with an overdraft was further limited so that total liabilities, excluding loans and debentures, could not be greater than ordinary revenue for a council (s. 201). The 1900 Act included the provision that the maximum interest rate a council could pay for an overdraft was six per cent per annum. (s. 154)

Modifications to these provisions occurred in two 1921 acts, namely the Finance Act 1921 and the Local Bodies' Finance Act 1921-22. The 1921-22 Act introduced three limitations:

- that the overdraft should not exceed “three-fourths of total revenue for the preceding year” (which would have included government grants) at any time of the financial year,

- that the overdraft for any account should not exceed “three-fourths of its revenue for the preceding year” for the account that the overdraft relates to (e.g. general account), and

- that at the end of the financial year the overdraft should equal no more than the “revenue of the year (for that account) then ended as remains outstanding and unpaid” for that account. (s. 3(2))

The 1956 Local Authorities Loans Act removed the first limitation above (which seemed redundant), but left the limitation on borrowing related to requirements for specific accounts and revenues.

Legislative arrangements for the use of long-term loans first appeared in the Municipal Corporations Act 1876 and were transferred in 1886 to legislation specifically concerned with local government borrowing. In the first instance this was the Local Bodies' Loans Act 1886. This trend of separate legislation for borrowing by local authorities continued until the 1956 Local Authorities Loans Act was repealed in 1996. Prior to 1926 the requirements for raising a loan were limited to gaining the approval for the loan from ratepayers and setting up the correct accounts. The main accounting requirement was to keep separate accounts for each loan and separate accounts for the repayment of each loan, whether or not using a sinking fund. The Local Government Loans Board Act 1926 provided for the establishment of the Local Government Loans Board whose sanction was required before any loan was sought. The Board was required to ensure the repayment period of the loan was “reasonable, having regard to the probable duration and continuing
utility" of the item. (s. 6(3)) The Act also made provision for the Board to impose additional requirements or conditions on a council, seeking approval for a loan. These conditions included the date when monies could be borrowed and the interest rate to be paid.

As noted above, the Local Authorities Loans Act 1956 was repealed by the Local Government Amendment Act (No. 3) 1996, including the abolition of the Loans Board. The 1996 Act gave local authorities a general power to borrow, as they considered appropriate.

4.6.4 Authorised, Unauthorised Expenditure and Illegal Expenditure

As creatures of statute without a general power of competence, local authorities were unable to spend any money other than that authorised by legislation "or for a purpose which is reasonable incidental to or consequential upon the authorised purposes" (Palmer 1993 p. 306). The first time that items of "authorised expenditure" were specified was in the 1900 Municipal Corporations Act. However, the vast majority of local authority expenditure did not need to be separately identified in legislation as authorised expense because its authorisation could be implied by or was consequential to an existing piece of legislation. The authorisation, both implicit and explicit, is found in a vast array of legislation, including the Municipal Corporations/Local Government acts and in ‘wash up’ type legislation, such as finance acts and local legislation acts.

A list, at any one time or over time, that showed items of "authorised expenditure" would be vast, and could constitute the background for a social history of what was valued at the time or could constitute an outline for a history of local government in New Zealand. The list of authorised expenditure would include the core activities of a council (itself very temporally bound), as well as specific events or causes such as royal visit, visits of armed forces, erection of public monuments, supporting specific charities or events, even expenditure on fighting the passage through Parliament of legislation affecting the borough.

The exception to the requirement that all expenditure must be authorised has been in the Municipal Corporations/Local Government or Public Revenues legislation since 1900. The exception permitted councils to expend a small amount on items for which they otherwise had no legislative authorisation to do so. Such expenditure is referred to as "unauthorised
expenditure”. The 1900 Municipal Corporations Act allowed for one per cent of general rates or £50, whichever the greater, for unauthorised purposes (s. 159) in any year. The 1913 Public Revenues Amendment Act increased the minimum amount for boroughs with a population between 5,000 and 10,000 to £100, and those with a population over 10,000 to £250. The 1952 Public Revenues Amendment Act introduced a maximum amount of £7,000 while keeping the provisions providing for the one per cent of general rate revenue. That maximum was raised to $20,000 in the Public Revenues Amendment Act 1972. The provisions allowing unauthorised expenditure were not intended to override provisions elsewhere, be that in municipal/local government legislation, loans legislation or any other legislation or regulation. Thus, where legislation forbade expenditure (either outright or above a certain level), such expenditure would not be permitted as “unauthorised expenditure”. While these sections may appear to authorise any expenditure, “a distinction should be recognised between expenditure which is not authorised by any Act or law, and expenditure which is illegal or mala fides.” (Palmer 1993 p. 308)

In the case of illegal expenditure or expenditure incurred in order to avoid legislative restrictions or other forms of inappropriate expenditure, the Controller and Auditor-General would be expected to reject such transactions and to surcharge a council or sue to recover a council’s (ratepayer’s) money. Provisions for recouping illegal expenditure were first introduced in the Municipal Corporations Act 1886 (s. 176), allowing either the Auditor or any ratepayer to sue for loss of funds. The issue of surcharge is dealt with further in chapter six in relation to activities of the Controller and Auditor-General.

4.7 Discussion

Between 1876 and 1988 the accounting requirements for municipal authorities were frequently changed. However, these changes were always done with at least one eye on the principles that underpinned local authority finance. The essentials remained the same; cash was all-important both in terms of budgeting and thus striking the rates for a council and for the reporting of a council’s activities. The cash basis for reporting was not dislodged as the main technology – to be discussed in the following chapter – despite the efforts of many people.

The requirements for internal accounting and external reporting grew over the years. As every piece of legislation giving local authorities additional powers or freedoms was
enacted, a corresponding check or balance or constraint on councils was simultaneously enacted. The power to raise a loan was granted with a series of controls and accounting requirements relating to a loan and its repayment. The power to create funds to safeguard the future of a borough was granted with additional accounting and management requirements. Over the years the requirements for reporting to the public or ratepayers became greater and greater, reflecting the growing size and breadth of activity of local authorities. Only in the late 1970s was a reversal to the trend to increase the amount of accounting information pro forma, required for publication, begun.

In the earlier years, ratepayers were given a more important role in overseeing the financial management of their council. The most obvious demonstration of this was the election of the auditor in the very early days. The provision of the accounts, the use of public meetings, and the ability to review accounting records all illustrated the close connection between a council and its ratepayers or voters. As the colony and then the country, as well as municipalities/boroughs grew, the accounting requirements changed, focusing much more on central government agencies, with less direct involvement from the local community. As will be seen in the remaining chapters, central government has always played an integral part in local government accounting and auditing.

The changes noted above are only a small indication of the amount of discussion regarding changes to the accounting requirements for municipalities. As stated already, chapter six will discuss issues relating to the auditor and the Audit Office, including attestation audits, efficiency audits, surcharge and the appointment of the auditor. Prior to that, chapter five will discuss much of the debate surrounding the accounting requirements discussed in this chapter.
Chapter Five: Changes to the Accounting Requirements

While they liked the accrual concept they did not want it made mandatory.1

5.1 Introduction

Many changes to the accounting regulations, and the discussion surrounding the introduction of possible changes to them, reflected the above comment by county clerks in 1985. There was acceptance of the need to change and ‘improve’ local government accounting in theory; however, there was not always a willingness to do so in practice. Reasons for the lack of willingness reflected both practical considerations and inertia at various times by those involved with accounting for local authorities.

The previous chapter began with the accounting requirements for municipal corporations in 1876, based on the Municipal Corporations Act of that year. After discussing the contents of that Act, the focus shifted to discussing themes across time. The issues often over-lapped with previous discussions referred back to; for example, the requirements for the keeping of accounts were connected with separate requirements that identified statements required to be published. This over-lapping illustrates the artificial nature of any divisions employed.

Section two deals with specific moments in the history of local government accounting and financial control – times when changes or events were singularly important. There was no inevitability about the happening of those moments; they could almost, equally, have not occurred, yet without them the accounting and financial control in local government would
be very different. Section three covers a number of accounting issues that were discussed and debated over the years in local government. Whether or not a change occurred, or even how significant any change was, is not the criterion for the inclusion of a topic in this chapter. For example, discussion on the use of accrual accounting would be excluded from this chapter if I included only actual changes to the regulations. Rather, the presence of an interesting dialogue (as recorded in the archive) between many of the parties involved in local government accounting is the criteria for inclusion. Section four discusses the constraints on local government financial management introduced by legislation and the principles behind these constraints. Section five concludes the chapter by discussing the changing purpose of accounting in local government and the changes to financial management controls.

5.2 Moments in the Reporting Requirements

This section discusses three key moments when significant changes or discussion regarding the accounting requirements for local government took place. The issues discussed in this section will be revisited in the following sections when discussion focuses on specific issues. The events or moments discussed are the Local Bodies’ Finance Act 1921-22, the adoption in 1974 of an activity based format for publication of the accounts, and the release in 1987 by the New Zealand Society of Accountants of the Public Sector Accounting Statements.

5.2.1 The Local Bodies’ Finance Act 1921-22

I believe that for several Parliaments no Act of greater value in providing for sound and sane finance in this country has been passed by the Legislature.²

The importance of the Local Bodies’ Finance Act 1921-22 is that the key constitutional constraints on local authority expenditure were enacted explicitly in this one Act. Previous legislation permitted the use of overdrafts, essentially to tie over local authorities between ongoing expenditure and the collection of rates for that year. The provisions permitted councils to obtain overdrafts “in anticipation of its revenue” up to “the income of the Council for that year”.³ The practice in the years leading up to 1921 was for councils to maintain an overdraft at the maximum amount permitted (that is, equal to total revenue for the year), including at the end of a financial year. In the case of councils with trading activities, revenue was taken to include the trading activities revenue but it was not netted off against the expenses of the trading activities. Thus, a council at the start of the financial
year (often some months before rates were received) could be left with no legal authority to raise temporary finance to tie it over until the revenue from rates was received, because the overdraft was already at the maximum permitted level. Also, future years were burdened with excessive overdraft repayments as a result of council using either an overdraft for long-term expenditure, instead of raising a loan, or using an overdraft to fund current expenditure; thus, the overdraft was not repaid in the same financial year.

The historical context of the Act of 1921-22 helps to explain why this situation occurred. In a period that New Zealand historian, James Belich (2001), refers to as “Trouble in Paradise”, the years 1913 to 1921 unleashed a number of events that came together to create hitherto unprecedented social and economic pressures on New Zealand. These pressures in turn placed financial strain on local authorities. 1913 saw the first major industrial action in New Zealand, with a general strike following a lockout at the Wellington wharfs, that created associated costs for councils in terms of productivity and price of materials. Once New Zealand was over the industrial strife, it sent nine per cent of its entire population to the Great War on the other side of the world; which reduced manpower, production for the war meant that the physical resources required for carrying out council work were in short supply leading to high prices for any resources available, and loan finance was also in short supply. The end of the First World War saw the Spanish influenza pandemic cause further havoc to the social and economic life of New Zealand. Local authority finances were not immune to that havoc. During those ‘troubled’ times of high prices, high wages and a shortage of workers, many local authorities chose to spend more than they were to receive to ensure the continued (and needed) development of their communities. The cost of essential maintenance and development work was often beyond the normal income of a number of councils during this period. The added difficulty of raising loans saw some councils fund long-term capital work by overdrafts, rather than using the legal and normal method of raising loans over the life of the asset created.

While most speakers during parliamentary debate on the Bill agreed that the above factors were the principal causes of overspending, one speaker, Mr Craige, argued that it was more a matter of general extravagance by councils, even prior to the troubles. In addition, some speakers spoke of the political nature of much of the expenditure by councils. ‘Problem’ expenditure was viewed either as pre-election spending in addition to normal
expenditure or as expenditure that was the result of promises made during the campaign leading up to elections.\footnote{In the course of debate (NZPD 1921) on this Bill, speakers comparing the practice in central government and the practice in local government made two interesting observations. One observation was that in Parliament no private member could introduce a bill that would spend public money (it had to be from the government), while in local government any member of council could put forward resolutions spending council money. (p. 781) The other observation was a suggestion that similar legislation forcing a balanced budget on central government could be introduced as well, given central government's failure to spend within its revenues. (p. 765)}

The solution in the \textit{Local Bodies' Finance Bill 1921} to the problem of excessive borrowing by councils was twofold. The first solution was for a one-off authority for councils to convert their existing overdrafts into loans, without requiring the approval of ratepayers, but then requiring that loan be paid off over a maximum of seven years. The second solution was longer term, with the introduction of limitations on overdrafts and limitations on spending. Clause three of the Bill authorised councils to obtain overdrafts, limiting the size of the overdraft to two-thirds of revenue at any time of the financial year, and limiting the overdraft at the end of the financial year to outstanding revenue for that year. This clause was to replace section 99 of \textit{Municipal Corporations Act 1920}, which authorised overdrafts up to the total revenue for that year. Clause seven introduced formally, for the first time, the principle that "every local authority shall provide for its ordinary obligations and engagements in any year out of its revenue for that year".

The discussion surrounding the Bill\footnote{In the course of debate (NZPD 1921) on this Bill, speakers comparing the practice in central government and the practice in local government made two interesting observations. One observation was that in Parliament no private member could introduce a bill that would spend public money (it had to be from the government), while in local government any member of council could put forward resolutions spending council money. (p. 781) The other observation was a suggestion that similar legislation forcing a balanced budget on central government could be introduced as well, given central government’s failure to spend within its revenues. (p. 765)} and the resulting Act created some complaints regarding what was considered interference in local government business by central government. In the parliamentary debate on the Bill, beyond comparison between central and local government spending and spending rules, as noted above, criticism focused on the stifling of local government and its development.

It is often most difficult to get suitable men to take up positions on the local bodies, and it will be still more difficult if they are going to be subjected to the censure of the public, as indicated in this instance, when Parliament is being asked to put a wall around such men so that they cannot launch out on a progressive policy for the good of the citizens. If this kind of legislation is encouraged it will be found even more difficult to carry on in the future than it has been in the past.\footnote{In the course of debate (NZPD 1921) on this Bill, speakers comparing the practice in central government and the practice in local government made two interesting observations. One observation was that in Parliament no private member could introduce a bill that would spend public money (it had to be from the government), while in local government any member of council could put forward resolutions spending council money. (p. 781) The other observation was a suggestion that similar legislation forcing a balanced budget on central government could be introduced as well, given central government’s failure to spend within its revenues. (p. 765)}

A further criticism of the Bill was that it reinforced a perception that central government (parliamentary and/or the bureaucracy) did not trust those involved in the administration of local government.
In bringing down this Bill, what the Government is doing is to express a vote of want of confidence in every local-government body in the Dominion. To men who in many instances have given ten or twelve years, perhaps the bulk of their lives, to the study of public questions, and have served the public faithfully on local bodies, the Government is saying, 'You gentlemen do not understand your business. We cannot trust you. You are incapable of properly supervising the finances of your local bodies, and we are going to lay down new provisions to govern you in your administration.'

Opinion on the Bill by local authorities was mixed. According to a report on the Bill, as introduced to the House of Representatives by the Municipal Association, more local bodies were unconditionally in favour of the Bill than were entirely opposed to it. Overall, the report stated that most local authorities accepted the basis of the Bill. However, as might be expected, there were a number of minor suggestions aimed to make the provisions of Bill easier to manage.

The Act was passed in early 1922; only minor changes were made to the Bill before it was passed. The most notable change saw a new clause permitting expenditure beyond the limits in times of emergencies. However, some disquiet existed among pockets of local government interest groups. In a report to the Minister of Internal Affairs, the Audit Office wrote about the disquiet in a relatively dismissive manner:

Judging from the clamour made in certain quarters, it is a reasonable assumption that there is a more or less common impression that this statute is of an entirely new and somewhat punitive principle.

The Audit Office went on to describe the Act as merely providing safeguards for councils. There was much clamour in certain quarters relating to both the Bill and the Act. This was not surprising, given that numerous members of both chambers of Parliament had spent many years in local government politics and therefore understood local government administration, and given that the Act curtailed the ability of some local authorities to spend in the short-term without rating or raising loans. Behind the politics of the debating chamber and the protests of the local authorities there was a resignation towards the introduction of further constraints on local government by Parliament/central government. Yet the principles in the Act were not new and it is hard to imagine they were punitive; however, it was the positioning together in the same legislation of the overdraft rules and the principle of 'spending within one's means' (for that year) that was new. This new legislative arrangement created a moment in the history of local government financial management that flows through all the issues that will be discussed in the remainder of this chapter, as well as in other parts of this thesis. Specific issues that followed from the Local
Bodies' Finance Act 1921-22 and their impact on the accounting practices of municipalities are dealt with in section four of this chapter.

5.2.2 Activity Based Reporting

As discussed in chapter three, a number of inquiries into local government finance were concerned primarily with the raising or sourcing of finance for local authorities. Accounting and financial control issues were not overly visible in those inquiries. Of the five major inquiries\(^{10}\) held between 1958 and 1977, only the 1973 Report contained references to accounting and financial control issues. This should not be considered a surprise; in spite of the influence accounting has on local government financial management it was not considered so relevant in the process of attempting to find new sources of finance for local authorities. What is surprising was that accounting became an issue in the 1973 Report.

The 1973 Report was the work of the Committee on Local Authority Finance, which was established in 1968 with a general mandate to continually examine issues relating to the financing of local government. The Committee consisted of personnel from the Department of Internal Affairs, The Treasury, municipal and counties associations and the Valuer General;\(^{11}\) note that the Audit Office was not directly involved in the Committee. The Committee disbanded after the release of its Report in 1973, although it was reconstituted in 1976 with a modified membership.\(^{12}\)

References to accounting in the 1973 Report were brief. The Report’s introduction listed the major achievements of the Committee, the final achievement being “the introduction of functional accounting in territorial local government as from the 1974-75 financial year”.\(^{13}\) Those 16 words are the sum total of any significant reference in the Report to accounting. Two issues are associated with the statement: first, why did the Committee become involved in the area of accounting, and secondly, what was the impact on local government accounting of the introduction of functional accounting?

The initial impetus by the Committee to look at accounting requirements was the result of dissatisfaction with information provided to the Committee from both the accounting reports and the statistical information collected by the Department of Statistics.\(^{14}\) The provision of better financial information in the future from local authorities was not
relevant to the terms of reference of the Committee. However, the Committee discussed
the issue and set out a process to change the accounting requirements.

The process for changing the requirements was driven by The Treasury, in particular by an
assistant secretary, J D Lang – himself an accountant. The Treasury prepared and presented
a paper on the accounting requirements for local authorities, which had included
suggestions for changes to current regulations. Involvement of The Treasury with
accounting for local government was unprecedented, and not repeated in the period up to
1989. The Treasury’s normal role and reason for its involvement in the Committee related
to its control of the Local Government Loans Board and, behind that, the impact of local
government borrowing on the economy, and management of the economy by government.

The Treasury suggested in a paper prepared for the Committee that the way accounts were
prepared should be altered so that expenditure was reported according to activity or
function (such as water-supply, library, roads), as opposed to the expenditure item (such as
wages, interest, and office expenses). Additional suggested changes included reducing the
size of reports and obtaining better integration between accounting requirements and
statistical requirements. A working party was formed by the Department of Internal
Affairs, including representatives of local authorities, The Treasury, the Department of
Statistics and the Audit Office, to develop new regulations along the lines proposed by The
Treasury. The Committee determined that the accounting working party would report back
to the Committee\textsuperscript{15} – somewhat surprising given that accounting requirements were outside
the Committee’s terms of reference.

The working party did not take long to develop new regulations; it appears there was little
disagreement on the introduction of activity based reports. However, there was not total
acceptance of ceasing to provide a breakdown of expenditure according to the type of
expenditure, such as wages and materials. Some local authority people considered that this
type of information was still useful and therefore, as a compromise, both types of
information should be required.\textsuperscript{16} The focus would be on the activity, with the expenditure
type information to be provided as sub-headings under each activity type. As will be seen
below, such a compromise increased the size of the accounts.

A constant refrain during discussion on the new regulations was that the accounts should
be prepared for a ‘reasonably informed and intelligent ratepayer’. The focus was shifting
from how the accounts of the council were to be kept, to how the financial reports were to
be presented. A member of the working party commented, I believe correctly, that this was:

the first major change in Local Authority published accounting since the institution of audited Local Government Accounts in New Zealand.17

The importance of this moment was that it had allowed a different way of regarding the role of accounting in local government, and began the reform of accounting practices. The key issue was a change in focus of the accounts, to accounts should be prepared for ratepayers. This change in mindset did not totally inform the preparation of the regulations, but it did greatly influence them. As will be discussed further, there was still too much detail in the accounts for them to be useful for any ‘reasonable use’ by a ratepayer.

A second motivation for the introduction of activity based reporting, at least for the Minister of Local Government (and presumably the Department of Internal Affairs), was that it would allow a greater comparison of the efficiency of local authorities.18 As will be discussed further in the following chapter, such comparisons could be used by central government, alongside the introduction of the operational audits, to help identify efficient and inefficient local authorities. Central government would then have the information, at least politically, to refuse some local government claims for revenue sharing between central and local government.

Returning to the question of why the Local Authority Finance Committee became involved in the changing of accounting requirements, and in particular why The Treasury, which had no previous involvement with local government accounting, took such a pivotal role in the development of accounting policies, the answer remains unclear. Two possibilities will be discussed shortly, but first some background. At the same time that work on local authority accounting regulations was being discussed The Treasury was involved in a similar project in central government. Starting in April 1970, central government began using SIGMA (System of Integrated Government Management Accounting), which is a coding system for accounting transactions specifically designed for governments. (Preston 1980 p. 68) As part of the introduction of SIGMA, the accounts and estimates for central government were reorganised along functional lines, as The Treasury later proposed (and were adopted) for local government. Yet that does not explain why the Committee took the lead in promoting such reforms to the accounting regulations (which were previously undertaken by the Audit Office and/or the local government associations), or especially
why the Committee sought to maintain ‘control’ over the process, in spite of being outside its brief.

The most likely explanations for the role of the Committee appear to be one or both of the following:

The Committee (and predecessor committees and inquiries into local government finance) had been relatively unsuccessful in providing substantial solutions to the question of local government financing. In contrast, the introduction of the new accounting requirements was a measurable achievement of the Committee. As noted above, the Committee included the new accounting requirements in its list of achievements:

... some of the major developments initiated by the Committee being the institution of differential rating in counties, the local authorities petroleum tax, a revision of the water and sewerage subsidy scheme, and the introduction of functional accounting in territorial local government as from the 1974-75 financial year.19

In spite of the importance to some councils of other developments by the Committee, especially differential rating, there were risks associated for the Committee using these other developments as measures of their success, because not everyone in both central and local government saw them as positive outcomes. Whereas, the change to the accounting requirements was a much easier issue to record as a success, allowing the Committee at least one success.

A second possible explanation relates to The Treasury wishing to become further involved in the choice of accounting policies for local authorities. Although the Audit Office was involved in the working party and took the lead in development of the new format for the accounts,20 the working party reported effectively to The Treasury (via the Committee). The Audit Office’s traditional role of being primary provider of advice to central government (via the Department of Internal Affairs) on accounting matters relating to local government was being challenged by The Treasury. The Treasury had worked on (or at least lead) the introduction of SIGMA for central government1 and then applied such

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1 The Treasury had made significant ‘investment’ in such technologies for central government during the late 1960s and early 1970s, such as PPBS and SIGMA as well as COPE (Committee of Officials on Public Expenditure). The intention and expectation was that such technologies would allow for better management of government expenditure. (McKinnon 2003 pp. 262-4) I presume that The Treasury saw similar advantages for local government, although whether they saw such benefits implemented and managed through central or local government would be subject to debate.
knowledge to local government, but was The Treasury to ‘take over’ from the Audit Office?

Two related issues happened in the Audit Office that may give credence to this view. First, within a year of The Treasury taking the lead role in the development of new accounting regulations for local government, the Audit Office set itself up for a more important task in local government by beginning the operational or non-financial audits. It was not obvious that the Audit Office should have this role, as the State Services Commission provided a similar service for central government at the same time. If any government department was to mirror the State Services Commission’s work in central government for local government it would be expected of the Department of Internal Affairs, not the Audit Office. Secondly, the Audit Office began to question the professional relationship between itself and local government clients. Throughout its history the Audit Office always worked closely with local government, both at a sector level and at the level of individual councils. By the early 1970s the Audit Office was grappling with the virtues of a very close relationship with all aspects of the local government sector versus the virtues of ensuring that a ‘professional’ distance between auditor and client was maintained and was seen to be maintained. Some discussion queried the level of involvement the Audit Office should have in promoting and developing new accounting regulations, as well as querying issues relating to the Audit Office’s involvement in the preparation of individual councils’ accounts for audit by the Audit Office.

It seems most likely that by being involved in accounting changes the Committee was ensured of at least one achievement, and that The Treasury, because of its recent experience with SIGMA, was in a position to lead the process. What remains unclear is the reaction of the Audit Office to The Treasury taking over what was traditionally the Audit Office’s role. The Audit Office’s experience and understanding of local government enabled the regulations to be written behind the scenes in a workable fashion.

5.2.3 The Release of Public Sector Accounting Statements

The third moment in this history of municipal accounting concluded with the release of the *Public Sector Accounting Statements* by the New Zealand Society of Accountants (NZSA). In July 1987 three documents were released that signalled a possible new approach for accounting in the public sector, including local government. These were:
• Explanatory Foreword to the Statement of Public Sector Accounting Concepts and Public Sector Accounting Statements (Ex Fwd/PS)\textsuperscript{21}
• Statement of Public Sector Accounting Concepts (SPSAC),\textsuperscript{22} and
• Public Sector Accounting Statement No. 1 – Determination and Disclosure of Accounting Policies for Public Sector Service Oriented Activities (PSAS-1)\textsuperscript{23}

The direct impact of these documents on practice was limited, as a result of changes introduced to public sector financial management two years later in 1989. The documents were \textit{de facto} withdrawn in February 1992, and formally withdrawn in 1994 by the NZSA. However, the documents signified a very important change in the way that accounting for the public sector, including local government, was viewed and understood.

The issue of the three documents by the New Zealand accounting profession was the first serious entrance into the arena of public sector accounting issues. While public sector auditors (mainly Audit Office staff) were usually members of the accounting profession, there were few accountants in other parts of the public sector. The New Zealand Society of Accountants (NZSA) had not shown interest, until 1982, in developing public sector accounting standards or shown much interest generally in the public sector. In 1982 the Public Sector Special Interest Group was established by the NZSA, with the three documents being the result of work began by that group. (Pallot 1991a p. 199) There were other occasions when the NZSA had involvement with public sector issues; however, they were usually related to the interests and/or endeavours of a single member of the NZSA or the (private sector) accounting community. For example, when the NZSA became serious about financial reporting standards for New Zealand in the late 1960s, a strong public sector subcommittee existed. However, on the death of its chair the subcommittee lost momentum and was, eventually, formally disbanded by the NZSA in 1975. (Zeff 1979)

Other significant times when interest was shown in the public sector were when the NZSA considered that its members in public practice should undertake public sector work, especially the auditing of public sector entities, which will be discussed in the following chapter.

The second important impact of the \textit{Public Sector Accounting Statements} was that the NZSA identified a number of practices it believed were the "accounting principles that should be adopted in preparing external financial statements for public sector entities."\textsuperscript{24}
Thus, a new way of thinking about accounting in the public sector, including local government, was introduced. The release of those statements can be compared to the impact of introducing activity based reporting; both situations changed how accounting was discussed. By the very involvement of the NZSA, and promotion of the use of private sector accounting methods, although modified, public sector accounting was changed.

The major practices suggested were:

Commercially oriented activities were to follow private sector practice.

Service oriented activities were expected to prepare the following:

- A statement of objectives
- A statement of accounting policies
- A statement of service performance
- A statement of cost of services
- A statement of cash flows
- A statement of financial position
- A statement of resources
- A statement of commitments.

Accounts should be consolidated.

A focus on the expenditure rather than on income.

Accrual accounting should be used.

Budget information should be provided.

Fixed assets should be depreciated.

Community assets should be recorded separately and not depreciated.\(^{25}\)

While most of these proposed changes in public sector accounting did not have their origin in the preparation of the three statements but, rather, had been debated over many years, it was publication in that format which created the moment. Its impact was seen for a very large part in the years that followed 1988 and the associated reforms.

Most of the suggestions in the documents were well discussed over many years prior to their publication in 1987. Particularly important in the development of the Public Sector Accounting Statements was the work by staff from the Audit Office and elsewhere during the preceding 15 years. A key document was the 1978 report of the Controller and Auditor-General into the financial management of government departments (the Shailes Report).\(^{26}\)

Despite some of the radical changes (by historical standards) proposed by the documents,
they were generally well received.\textsuperscript{27} The success of the implementation of the reforms to local government financial management, post 1988, can be partly attributed to the work carried out on the \textit{Public Sector Accounting Statements}. It was a moment that was many years in the making – the building of ideas and agreement among many people involved in public sector accounting.

Behind the release of the \textit{Public Sector Accounting Statements} were many individual accounting issues. The following section examines relevant accounting issues that were discussed in relation to the documents, as well as other issues that were debated between 1876 and 1988.

\section*{5.3 \textbf{Specific Issues}}

This section discusses the five perennial issues relating to the financial management of municipalities. These issues featured regularly over the years, often going into recess, then later resurfacing. As will be noted, none of the issues was finally resolved in the period covered by this thesis. The five issues to be discussed are: the case for and against the standardisation of the format of the accounts; the use of cash or accrual basis; the role of the statistical returns; the balance date; and the timeliness of the accounts.

\subsection*{5.3.1 \textbf{The Standardisation of the Accounts}}

\textit{The Deputy C. \& A.}

Long experience has proved the desirability of the various local authorities, accountable to the Audit Office, being brought into line as to such accounting. I believe that such an opportunity now occurs as the Consolidated Statutes Committee is dealing, or likely to deal, with the question. ‘It is a consummation devoutly to be wished’ having amongst its objects uniformity of accounts and the consequent abolition of ‘tags’ which are wearing and wearisome. I shall be glad to assist.

\textit{C. \& A.}

22/5/06\textsuperscript{28}

This memo from the Controller and Auditor-General to his Deputy in 1906, including a quote from Hamlet, about the possibility of having the accounts of local authorities prepared in a standard format, represents one of the recurring issues in local authorities financial management. Some six years previously, both Parliament and the Municipal Association discussed the issue of standardisation of bookkeeping and accounting practices for local authorities. The major reason for calls for standardisation at that stage was to improve the reporting, either in terms of reducing the number of audit tags or reducing the occurrence of fraud in the accounts, especially when not detected by the auditors.\textsuperscript{29} Standardisation was seen as the cure for poor accounting by local authorities. In spite of
the discussion in favour of changes and the fact that other changes to relevant legislation occurred concurrently, thus creating the opportunity to change the requirements with little additional effort, no move to standardise the accounts occurred.

The second major push for standardisation happened in the late 1930s. The key motivation for this call for standardisation was different, in that it was only indirectly connected with accounting. In 1936, a number of municipalities and unions representing most clerical workers\(^1\) signed agreements whereby remuneration of council clerks would be based on the duration of employment.\(^3\) An increase in wages would be gained by the passing of time rather than the employee being given additional responsibilities, which was previously the case. This was viewed by many as unsatisfactory and unfair.

It is unfair to the employees that he should reach a dead-end as a Junior Clerk on a comparatively high salary, and it is unfair to expect a Local Authority to pay more for a particular position than it is worth.\(^3\)

The solution offered was to have a greater movement of staff between councils (with so many local authorities such mobility would not be difficult). As staff become more experienced they would shift councils, moving to more senior levels that would better reflect both skill level and pay rate (in other words, years of service). The suggestion was for a nationwide commission responsible for managing staff movements. While the concept of a local government staff commission was not supported, the second part of the plan was that all councils would share a standardised set of procedures for their offices, including the accounting systems and financial reporting requirements. Thus, staff transferring between authorities could easily pick up new jobs as required.

This call for standardisation gained a degree of momentum, tapping into a desire by various parties for uniformity across the entire local government sector and for various other reasons. These other reasons included in the debate at the time for wanting standardisation were:

- the ability to compare various authorities with one another,
- providing better systems to lessen the chances of loss or wastage of resources, and
- a general expectation that standardisation would result in greater efficiencies.

\(^{1}\) The Local Body (or Authorities) Officers Industrial Union of Workers.
Thus, the calls for the standardisation of financial reporting and accounting systems were part of a larger call for standardised office practices in municipalities. Three papers were prepared for the Municipal Association, identifying where standardisation could be introduced, what the standardisation would be, and how to introduce the standardisation. There were:

- *Presentation of Accounts of Municipalities Including Trading Undertakings* October 1937 by C L Bishop and B O Peterson pp. 18.


The paper on stock control outlined ‘established practice’ as defined by the authors, and then proposed that these practices should become ‘standard practice’ throughout all local authorities. Thus, the standardisation of the control of stock documents was viewed as not causing any cost or disruption to local authorities, rather it was seen as codifying existing practice by most authorities. There was always one eye on legislative requirements and constraints under which local authorities operated. For example, under the heading of “Abattoir – Stocks” the following was written:

> Accurate costing depends upon accurate stock-taking and reports of stock movements. Stock Ledger Accounts incorporated in the financial books of the authority should be kept for coal, casks, drums, sacks etc., and also for runners, tripes, bungs and wesands, tallow and manure. The balance (in money) of the particular stock account in the Stocks Ledger must be agreed each month with the corresponding Control Account in the General Ledger.32

While “accurate costing” may be perceived as good practice, in the context of legislation of the day it was essential to ensure correct charging. As will be discussed further in chapter seven, abattoirs were required not to make a profit, and if they did, they could be (and after the Meat Act 1939 would be) required to make pro rata refunds of any profits to users of the abattoir for that financial year.33

The paper on *Office Organisation of Municipalities* focused on the physical arrangements and processes used in municipal offices. The paper covered such practical details as the covering of inkwells to avoid wastage due to evaporation, the quality or thickness of paper to be used for various reports and receipts, and the value of creating a consistent filing
system across all local authorities. This paper was full of practical advice, and suggested procedures aimed at the most efficient way of running an office.

The paper on the presentation of accounts identified the issue of whether to use an income and expenditure basis or a receipts and payment basis as the main point for discussion. That issue is discussed in the following section. Irrespective of the outcome of the discussion regarding which basis to use for the accounts, greater standardisation was seen as achievable and desirable. However, in contrast to other documents at this time, the authors were less adamant regarding the need to achieve complete uniformity, both the desirability of uniformity and the ability to achieve full uniformity.

With regard to standardisation of accounts generally it is desirable that there should be more uniformity in the system on which the accounts of local authorities are kept and also as regards the form of presentation, but the system laid down should conform to general principles leaving elasticity to permit of (sic) adaptation to the particular needs and requirements of the local body.

Uniformity in published accounts can, of course, be obtained but the differences in local conditions are so varied on account of the operation of local acts, in rating methods and in circumstances which cannot be explained on the face of the accounts that direct comparisons may be misleading and fallacious and it is felt that it is both impracticable and unnecessary to insist on a strict stereotyped uniformity and the adherence to and observance of general principles is what is really required.²⁴

The authors' enthusiasm for the use of the income and expenditure basis was not shared by all colleagues in local government (as will be discussed shortly); however, their limited enthusiasm for the standardisation of both accounting systems and financial reporting received a more favourable response. During 1938 and 1939, the Municipal Association expended a reasonable amount of effort on the possibility of greater standardisation of municipal accounts. This included discussions with the Audit Office, the New Zealand Standards Institute, Department of Internal Affairs, and the Town Clerks Institute.

The view of the Audit Office at this time was mixed. In his 1937 report, the Controller and Auditor-General wrote very favourably on the endeavours of the Municipal Association:

There has been a need for more uniformity in the form of presenting local authority accounts, and the Audit Office has notified the (municipal) association that it is prepared to give any necessary assistance in connection with the matter. The question of standardization could be extended to other classes of local authority with considerable advantage.²⁵

However, by 1939 the Audit Office had become less keen on the standardisation of the accounts, at least, as proposed by the Municipal Association. While the Audit Office gave support to the model put forward by the Municipal Association, as a good example and
possible standard, the Audit Office was not prepared to support legislation that saw the format become compulsory.\textsuperscript{36} Shortly after this, the issue appears to have gone into recess, most probably because the focus of the country and government was on the Second World War effort.

After the Second World War, the issue of standardisation of local authorities' accounts re-emerged. In 1948, the Institute of County Clerks discussed the possibility and desirability of having county accounts standardised.\textsuperscript{1} These discussions continued until the Counties Accounting Regulations 1958 were promulgated. These regulations specified for the first time the format of the various accounts and statements that were to be prepared by counties. The development of the new accounting regulations (the first time the counties' accounting regulations were published separately from non-accounting regulations, although still specific to counties) involved a large number of groups from both local and central government. From local government, the Institute of County Clerks was the main force behind the idea of standardisation; the Counties Association, as the leading association, supported them; without their active support it would not have happened. Within central government, the Department of Internal Affairs sought input from The Treasury, the Audit Office and the Department of Census and Statistics.\textsuperscript{37}

The 1965 \textit{Municipal Accounting Regulations} were the first municipal regulations that specified the format of the accounts to be used. This was in the second schedule, and covered 15 pages (the first schedule related to the format for the statistics that were required to be produced). The opinion of the Audit Office on the regulations appears to be contradictory. In his 1965 report, the Controller and Auditor-General wrote of the regulations, setting "out the various accounts and statements ... and the form in which they should be presented", and then went on to state:

\begin{quote}
There is no intention that regulations should be regarded as an absolute standard of preparation of the final accounts of municipalities. It is considered, rather, that they should be looked upon as setting out the minimum requirements for financial reporting.\textsuperscript{38}
\end{quote}

Clearly, the Audit Office would accept some deviation from the format in the regulation, provided they saw it as an improvement.

\textsuperscript{1} This was not the first time this Institute was involved in this type of discussion, for example, in 1939 the Auckland District Branch wanted County balance sheets standardised by regulation. See Archives New Zealand ST2 72/72.
Having obtained standardisation across the accounts of the municipalities in 1965, the 1974 accounting regulations replaced those and the 1958 counties accounting regulations with one set for both counties and municipalities. While maintaining the requirement that all accounts were prepared in a uniform or standard manner, these 1974 regulations (as mentioned above) significantly altered the manner in which the accounts were to be presented. The accounts were to be prepared on an activity or functional basis. The regulations included both requirements regarding how the accounts should be set out and under what activity headings the accounts should be prepared.

The 1979 regulations maintained the activity based reporting, but moved away from a standardised format for the accounts. The regulations no longer expected that the format in the schedule would always be followed, but viewed the schedule as the minimum amount of information to be included in the accounts. There was a strong consensus that the format should change; essentially, the size of the accounts would be reduced dramatically in an attempt to make the accounts more readable for ratepayers and electors. However, local authorities did not universally welcome the idea of the removal from the regulations of a standardised format for the accounts. The New Zealand Counties Association wanted a format provided in the regulations, although did not wish it to be compulsory, rather, "available on an optional basis for those who wish to follow a set pattern". Essentially, this was what happened, although the format provided in the regulation was relatively brief and required that councils expand on the format to ensure they fully complied with the regulations. Each council was expected to undertake the required extension of the format to suit the needs of its constituency and environment.

Perhaps ironically, following the introduction of the new accounting requirements in 1979, which heralded the start of more flexibility in the requirements and allowed councils to report in ways to suit their communities, local government organisations developed their own code of practice for the preparation of accounts. The code of practice was developed in conjunction with the Audit Office; its purpose appears to be to provide a 'risk free' approach to preparing accounts for those councils that wished to do the minimum required by the regulation but still be acceptable to the Audit Office. In spite of the Audit Office's involvement in the development of this 'standardising' code of practice, the Audit Office was more interested in further development of practice rather than codifying the status quo.
The Audit Office, while working with local government representatives towards a not released\textsuperscript{i} 'laissez-faire' regulation in the mid 1980s, used its position to encourage the continuing development of new practices by local authorities with the intention of developing better practices for the entire sector. Yet the Audit Office did not expect better practices to come from its actions, or instructions or directions (that is from central government), but rather, such changes were expected to originate from local authorities.

The Audit Office is prepared to actively encourage individual local authorities who wish to experiment with their stewardship reporting. The aim is to have local authorities develop reports which fairly reflect the outcome of the activities undertaken in the year concerned.

The Audit Office is flexible both as to form and content within what would be regarded as 'normal' accounting principles with the overall criteria being the need to fairly reflect both the activities undertaken and the financial position at the end of the period.\textsuperscript{41}

Thus, the Audit Office was supportive of attempts to do 'new' things in the accounts, with the proviso that the accounts would still fairly reflect activities of a council. This flexibility of the Audit Office included the information presented and its format, as well as the technical question of whether councils should adopt accrual accounting or continue using the cash basis.

The 1985 working party of local government representatives and Audit Office staff wished to remove any form of standardisation of the presentation of the accounts from the next set of regulations (such regulations were not released but were superseded by the major reforms of 1989). Although it was accepted that there would be a minimum content requirement in the regulations, this requirement was to be included as a narrative rather than in an illustrative form (thus ensuring no particular format was privileged). In an attempt to further reduce the size of the regulation\textsuperscript{ii} and, more importantly, its prescriptive nature, the 1985 working party proposed the use of a code of practice (outside the regulations), similar to the one created in 1979. Such a move could allow the auditor to accept a greater variety of interpretations of the regulations while still maintaining a minimum standard, which would be the code of practice. With the large number of local

\textsuperscript{i} The major changes to New Zealand public sector management, including local government and financial management, beginning in the late 1980s, overtook the process; for local government this specifically began in \textit{Local Government Amendment Act (No. 2) 1989}.

\textsuperscript{ii} The 1979 regulations covered only 8 pages, compared with 26 pages in the 1974 regulations, and 24 pages in the 1965 regulations.
authorities, many very small, with limited resources in terms of both staff and their abilities, the production of anything more than the minimum for the accounts would be unexpected and unrealistic from some councils. When the regulations had neither a set format nor an illustrative format, the Audit Office, as auditor, could encourage and support able and willing councils to develop their own practices and formats. Such developments, it was hoped, would in turn improve the standard of reporting, first, for the individual council and then, ultimately, across the sector.

The irony of the desire for standardisation was that in spite of calls for it to be introduced from the early days, it lasted for only a relatively short period. The failure to achieve standardisation appears to be more about failure to obtain the final signing off than lack of interest. There was little resistance to any proposal for standardisation until the late 1970s. But, there were always other more important issues; the most important, cash versus accrual, is covered in the following section. The end of standardisation was caused by a strong desire for better management and financial management practices throughout government. Standardisation was seen as locking in existing practices, while the Audit Office was looking, particularly, for new ideas and practice — something a standardised format could not provide unless the format was new and revolutionary. That was unlikely at the time to be acceptable, politically and practically; politically, because of the inertia noted at the start of this chapter, and practically, because of the lack of technical know-how in many councils.

5.3.2 Receipts and Payments versus Income and Expenditure (Cash versus Accrual Basis)

5.3.2.1 Introduction

Throughout the period covered by this thesis the standard practice of local authorities was to use the cash basis (or the usual phase of receipts and payments) for recording transactions. Apart from trading activities, the requirement was to use the cash basis, although during the 1980s, use of the accrual basis was an option accepted by the Audit Office for all accounts. Significant debate on the possible adoption of the accrual basis (or more correctly until the 1980s, an income and expenditure model) first occurred in the late 1930s and then again in the late 1970s and throughout the 1980s.
There had always been calls for the use of the income and expenditure basis for local authority accounts. In 1899, the Institute of Municipal Treasurers and Accountants (in England) said:

The (Executive) Committee are fully convinced that the proper plan of keeping the whole of the accounts of every corporation is that of including the income and expenditure of each year.\(^{42}\)

And again in England, a government committee reported in 1907 that:

The most efficient system of account keeping suitable for general application to local authorities is a system of income and expenditure on which all incomings and outgoings pertaining to any given period whether actually received or disbursed or not are included in the accounts of that period.\(^{43}\)

In his 1930 report, the Controller and Auditor-General raised the issue of continuing to use both the receipts and payments basis as well as introducing the income and expenditure basis for local authority accounts. While not directly supporting such a change, he was advocating consideration of the idea.\(^{44}\)

According to Bishop and Peterson's 1937 paper, at least one New Zealand municipality, Christchurch City Council, prepared their accounts at that time on both income and expenditure basis and receipts and payments basis. They also reported that the State of New South Wales required municipalities to use income and expenditure basis, and that in New Zealand some of the public sector bodies were required to prepare accounts on an income and expenditure basis, such as hospital and harbour boards. Within New Zealand central government the use of accrual accounting for government departments began in 1921, including accounting for interest, depreciation, outstanding revenue and expenditure and inter-department transactions.\(^{45}\) The use of accrual accounting was stopped by The Treasury in 1939\(^{46}\), according to Boston \textit{et al.} (1996 p. 289) as a result of paper and accountants being in short supply due to the Second World War.

\textbf{5.3.2.2 Bishop and Peterson's Initiative in 1937}

In 1937, as part of the discussion regarding standardisation of local authorities' accounts, as discussed above, the debate for New Zealand municipalities to use an income and expenditure basis first gained serious momentum. In the paper relating to the standardisation of local government accounting, Bishop and Peterson identified the basis for reporting as the key issue.
The main point for consideration in connection with method of presentation of local body accounts is whether the accounts are to be based on receipts and payments or on income and expenditure.6\(^7\)

The paper was very clear on the application of income and expenditure basis; trading activities were already required to present their reports in this format, and no changes to that were envisaged. What was subject to debate was the use of the income and expenditure basis for the general account of the local body. The inclusion of that issue in the paper, which was ostensibly about the standardisation of accounting practices (rather than proposing new, even radical ones), suggests that at least in some parts of local government the use of an income and expenditure basis was a real concern.

The differences and the relevant merits of each system were compared in the paper. In favour of the current receipts and payments system, the authors argued the following merits:

- It was a simple system,
- It allowed for prompt preparation of accounts and the following year’s estimates,
- It avoided the apportionment of incomings and outgoings such as rent,
- Cash accounting was sufficient, as the activities of a local body were not for profit,
- Local body finance was based around the annual estimates and revenue cycle, and any accruals at end of year were part of the following year’s transactions,
- Estimates still needed to be cash based due to the requirement in the *Local Bodies’ Finance Act* 1921-22 for a balanced budget,
- There was less risk of exceeding estimates for spending (which were cash based) because a non-cash surpluses could be interpreted, incorrectly, the a council had further funds to spend while still complying with the 1921-22 Act,
- A change from receipts and payments to income and expenditure would create an increase in rates in first year of operation, and
- Income and expenditure would require additional and better-qualified staff in councils.

In favour of a proposed income and expenditure system they argued:

- It afforded a proper basis for a full system of accounts and fairly sets out the financial results of the year’s operations,
Reduced the risk of fraud and manipulation, especially of stores, as it required all items to be included in the accounts, and

Allowed for the production of a profit and loss account.

The report clearly favoured the income and expenditure basis over the existing receipts and payments basis, albeit with some tinkering.

There is no question that from an accounting point of view a change to the income and expenditure system is advisable but some modifications seem to be necessary on account of the nature of local body operations.**

The suggested modifications related to assets and to ensuring matching between rate revenue and expenses for that period. For those assets funded out of revenue (as opposed to loans) the authors suggested that they were recorded as expenses, and any proceeds from a later sale were to be recorded as revenue for that period (and therefore able to be spent in that period). For expenses, the suggestion was to include only those items that were due for payment at the end of year, ignoring any accrued part. Those suggestions were intended to ensure that principles in the *Local Bodies' Finance Act 1921-22* were honoured.

Both the Municipal Association and the Town Clerks Institute rejected the proposal for the introduction of the income and expenditure basis. Reasons given for the rejection were:

- It would be expensive, and required additional specialised labour,

- Working from the presumption that a receipts and payments basis would still be required for the estimates, the use of the additional system would be cumbersome, and

- It would not perform what was considered the primary function of the accounting system, that of readily identifying overspending (in cash) at any stage of the year.

The proposal for the introduction of the income and expenditure basis, like the Trojan horse it had come – standardisation of accounts, faded away at the beginning of the Second World War. The debate on the use of accrual accounting only gained momentum again in the late 1970s.
5.3.2.3 Central Government's Initiative in the late 1970s

Although the issue of accrual accounting did not entirely disappear, it was in the late 1970s that the issue surfaced again. This time, the promoters were central government organisations and, in particular, the Audit Office.

Three events had triggered the renewed interest in accrual accounting: the developments in central government accounting practices in the late 1960s (which lead to the 1974 activity based reporting for local government); the 1978 Shailes Report; and the release of a 'best practice' document by the Audit Office.

As noted above, in relation to the adoption by local government of activity based reporting in 1974, the late 1960s to early 1970s saw the introduction of changes to the financial management and accounting practices in central government. Perhaps more importantly the changes began a process that allowed further changes to take place, beyond the tinkering performed to date. The lack of a history of New Zealand central government accounting hinders our ability to understand the influences of this period on individual events, such as the renewed interest in accrual accounting for both central government and the flow on to local government. However, the period between the late 1960s and mid 1970s can be described as a renaissance in interest in government accounting, when new ideas were encouraged and implemented, following a reasonable long period of stability. It was during this period that interest in accrual accounting had gained momentum.

The second event to impact on the renewed interest in accrual accounting was the release in 1978 of the Shailes Report. Although not directly concerned with local government, that report raised the possibility of the use of accrual accounting by central government. The report was the catalyst for a range of writing and discussion within the public sector and the accounting profession, promoting accrual accounting for adoption throughout the public sector, including local government.

The third event relates to the release in February 1981 of the Suggested Criteria for Good Management Practice in New Zealand Territorial Local Government (the Criteria). The Criteria was an attempt by the Audit Office to develop guidelines for good management practice in local government. While the Criteria did not include specific accounting

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¹ The Criteria is discussed fully in Chapter 6.
requirements, such as the use of accrual accounting, in the course of its development the use of accrual accounting was raised in terms of appropriate accounting practices for local government. In spite of the Audit Office’s official position of not wanting to introduce accrual accounting ‘at this stage’, as a result of discussions surrounding the Criteria, many local authority personnel believed that the imminent introduction of accrual accounting for local authorities was part of the Audit Office’s agenda. This belief was part of the reason that the Criteria was not totally accepted by all local authority personnel.

The Criteria had its genesis in the other two events, mentioned above, that relate to the renewed interest in accrual accounting for local government – the Shailes Report, and the introduction of activity based reporting. The effect of these three events was to raise for discussion the issue of the adoption of accrual accounting by New Zealand local government in the future, at least at a theoretical level. As the introductory quote of this chapter highlighted: “while they liked the accrual concept they did not want it made mandatory”\(^50\) – that there was often a gap between theoretical acceptance of ideas and a willingness to achieve practical implementation.

Although the 1979 regulations still provided for accounts to be prepared using a cash basis, the Audit Office was keen for local authorities to use accrual accounting. The requirement to use cash basis was relatively hidden in the small print of the regulations.\(^1\) The requirement was referred to as the minimum and, as accrual accounting was considered to provide more information (as opposed to different), it was considered within the regulations to use accrual accounting. The view taken by the Audit Office was:

> it is my intention to urge authorities to adopt an accrual basis in future ... it may take some time\(^2\)

By the early 1980s, the Audit Office was the major driver for the use of accrual accounting by local authorities. It promoted the use of accrual accounting from the perspective of preparing the accounts so that they would fairly represent the activities of an authority. At the rhetoric level, at least, the Audit Office saw accrual accounting as a better way to fairly represent the activities of a council; however, forcing accrual accounting on all local authorities was not considered appropriate by the Audit Office. Unlike the majority of local authority employees preparing the accounts, Audit Office staff were predominantly trained

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\(^1\) In the First Schedule – Note on Accounting Policy.
and qualified accountants to whom accrual accounting was considered the better technology. Following the 1978 Shailes Report, Audit Office staff were increasingly convinced and vocal of the need to move towards full accrual accounting. The Audit Office began to regard cash accounting as a technology no longer appropriate for use in the public sector. However, the need to take local authority accounting staff with them in any move to introduce accrual accounting meant that a gradual process was required. In advice to senior Audit Office staff regarding the adoption of accrual accounting by local authorities and/or the promotion of accrual accounting in the early 1980s, the Audit Office Head Office outlined its attitude to accrual accounting as follows:

1) It is considered that accounting for an authority’s activities on a receipts and payments basis will not necessarily fairly reflect those activities.

2) The incorporation of debtors, creditors and changes in stocks would provide a more appropriate base on which to report financial activity.

3) The incorporation of these three elements is seen as the first step toward accrual accounting in this area of the public sector and is the extent to which initial progress should be encouraged.

4) The question of depreciation is an issue for further consideration but should not inhibit progress on 2.\textsuperscript{52}

While the use of accrual accounting was encouraged, it was only part of a move to increase the standard of local authority reporting. The Audit Office did not want the possible introduction of accrual accounting to be interpreted as an imposition by it of a new technology on every part of local government. Nor did the Audit Office have a legal mandate to insist on its adoption. The Audit Office approach was to let each council come to its own decision regarding the use of accrual accounting.

... our policy (is) that councils should be allowed to develop financial statements that best serve their own information needs.\textsuperscript{53}

Having said that, if the Audit Office could have introduced accrual accounting across all local authorities at no political or technical costs, they surely would have.

5.3.2.4 Specific Accounting Issues that Pushed Local Government Towards Accrual Accounting

In spite of the rejection of a move to accrual accounting, until the mid 1980s there was always some concern about the accuracy and appropriateness of using the receipts and payments system and the ability of councils to manipulate the accounting numbers using that system. Concerns were predominantly about allowing local authorities to operate
effectively and efficiently while, at the same time, ensuring they complied (sometimes only just) with the principles of local government finance, as encapsulated in the 1921-22 Act (and subsequent legislation). Specific areas of concern were the accounting for stores, dealing with the funding of irregular one-off payments, dealing with current assets and liabilities other than cash, and more recently, recording non-current assets and liabilities. The issue of accounting for stores will be dealt in section four, and the other three issues, in this section.

5.3.2.4.1 Accounting and Funding Irregular One-off Payments

The creation of special funds, reserves and separate accounts was often used as a way of working around some constraints of the 1921-22 Act and/or manoeuvring around the limitations of the receipts and payments basis. This issue will be covered again in relation to the 1921-22 Act and constraints on local government financial management, but here the focus is on accrual accounting. For example, in 1968 the Audit Office sought an opinion on the legality of the practice of councils putting aside money for such things as retirement gratuities (where the actual payment was acknowledged as authorised expenditure). The gratuities were to be paid in some future financial year, on retirement of an existing employee. Practice at the time included the creation of a gratuity fund by the council only when it was known that the gratuity was to be paid in a year preceding a triennial council election.\(^1\) The fund was created two years prior to the payment date. Thus, the effect of creating the gratuity fund was to spread the cost of the gratuities over the preceding years (or enabling other work to occur), with the subsequent cushioning of the rates demanded immediately prior to a triennial council election.\(^5\) This example illustrates both the reasonableness of creating the special funds, reserves and separate accounts and the inappropriate behaviour that could occur when they were created. To allow a council to spread the cost over the years that the expenses were incurred, even though not paid, seems good financial sense, but the associated games seem inappropriate. The example also illustrates that the general principle of funding current expenditure with current revenue was not adhered to while such funds were in use.

\(^{1}\) It should be remembered that for the many very small territorial councils this cost could be relatively high compared to discretionary total expenditure.
The general condition on the creation of funds was that they required specific legislative authority, without which they could not legally be created. Chapter four identified how, over the years, a number of funds, for such things as insurance and renewals, were permitted by various acts to be created. Councils required legislative approval for such funds, both to authorise the expenditure and, initially, to create the fund. The creation of such funds opposed the basic tenet of the receipts and payments basis of accounting because there was no payment at the time.

5.3.2.4.2 Current Assets (excluding cash and stores) and Liabilities

In response to the question of whether to include accruals in the accounts, the Audit Office suggested in 1970 that it should be ignored, as recording them would be immaterial due to the recurring nature of the payments. A week’s wages due at the end of the financial year was likely to be matched with a payment at the start of that same year for a week’s wages from the previous year. Similarly, the balance of outstanding debtors, creditors and prepayments at the end of a financial year were likely to be similar to other years. 55

Ten years later, in the early eighties, the Audit Office approach changed when auditors began to query the practice of the cash books remaining open for a period after the end of the financial year in order to record as many transactions as possible that related to the year just ended – essentially, a form of modified accrual accounting. The problem for auditors was not so much the practice, but that accounting policies stated the accounts were prepared on a cash basis. The common practice was that, for two or three weeks, certain transactions would be included in the previous financial year’s accounts if they related to that year. The response from the Territorial Local Authority Accounting Committee to the possibility of the Audit Office then qualifying accounts that used this practice was twofold; first, it requested that existing practice be allowed to continue without a qualified audit report, and secondly, it admitted the inevitably of accrual accounting, but stated ‘not now’.

You have asked for my initial reactions to the problem and, quite frankly, I am deeply concerned that if we are unable to let sleeping dogs lie meantime (and that is, in my opinion, the best policy) that we may have to open the whole concept of accrual accounting for Municipal accounts a whole lot earlier than I, for one, would have wished. 56

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1 This committee consisted of representatives of county, borough and city councils and the Audit Office. On occasions it included representatives from other government departments, such as Statistics and Internal Affairs, as necessary. It was not a formal government committee. The committee was working towards new accounting requirements to replace the 1979 regulations.
The solution suggested by the Audit Office and supported by the Municipal Association was to include the receipts 'in transit' on 31 March, and payments for which invoices were received by 31 March were also to be included; this often meant that payments made on 20 April were included in the previous year's accounts.

5.3.2.4.3 Accounting for Long-Term Assets and Liabilities

Most comments regarding the usefulness of accrual accounting related to short-term assets and liabilities, as discussed above, or to central government in terms of cost allocation, as per the Shailes Report.57 The Controller and Auditor-General's report in 1984 placed, for the first time, the emphasis of the adoption of accrual accounting on long-term assets and liabilities, while also noting the other failings of the cash basis in relation to short-term assets and liabilities. Discussion concerned the financial position of local authorities, especially in relation to the ability of the ratepayers "to determine the extent to which future revenue has already been committed" and "the distinction between capital outlays, that is, expenditure used to generate future benefits, and current operating costs".58 As will be discussed below, the singular focus on cash was beginning to be modified to include assets and liabilities.

5.3.2.5 Accrual Accounting – Concluding Comments

Finally, in addition to the work of the Audit Office, some parts of the wider public were to a degree also involved in debate regarding the use of accrual accounting by local government. For example, in 1982 the Chamber of Commerce reviewed the rating methods used by local authorities and found the use of cash accounting 'unsatisfactory'. The Chamber of Commerce compared local body practices with that of private-sector companies, especially the use of accrual accounting. They addressed their concerns to the Auditor-General, seeking, essentially, improvements (that is, alignment with their constituency's practices) in the accounting practices of local authorities that rated.59 Although this particular intercession by the Chamber of Commerce had no real impact on the use of accrual accounting or otherwise, it illustrates the occasional interest in accounting policy from the wider community and its pressure groups.

Accrual accounting is the one technical area of accounting that can make accounting unintelligible to those outside the discipline. Cash accounting is relatively easily understood, while accrual accounting requires specialist skills and training both to prepare
the accounts and to interpret them. The failure to introduce accrual accounting, in spite of frequent pressures to do so, can be attributed to the additional costs, in terms of effort, time, and monetary costs for both preparers and users. However, even the Audit Office was not keen to introduce accrual accounting at the expense of other aspects of the accounting function. In his 1976 report, the Controller and Auditor-General stated his support for the introduction of accrual accounting, yet qualified his comments by expressing concern if the introduction of accrual accounting were to divert the attention of councils from preparing accounts in a timely manner.60

The push to introduce accrual accounting was based on the belief that it was a better technology than the cash basis. The Audit Office was adamant that the introduction of accrual accounting should only occur when it would provide ratepayers with better information. The Audit Office expected that accrual accounting, on its own, would provide better information, but the cost of introducing accrual accounting in terms of loss of other valuable attributes of information provided by councils, such as timeliness and relevance and understandability, needed, first, to be safeguarded against. Ultimately, it was not until after 1988 that accrual accounting was introduced for all local authorities.

5.3.3 Statistical Returns

As noted in the previous chapter, statistical returns were a constant feature of local government administration. The purpose of statistical returns was not accountability, but for planning and economic management of the country.1 While much of the data in the statistical returns was taken directly from the accounting system, the collection of statistics was always a distinct arrangement and process. At various times there were calls for closer alignment of the requirements for statistical returns and the requirements for accounting reports. For example, in 1985 the Department of Statistics fended off calls for better alignment with the accounting requirements on the basis that the statistics were part of the wider Systems of National Accounts (based on guidelines developed by the United Nations), and could not easily be altered.61

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1 The statistical information was compiled into yearly volumes. First they were published as part of the Statistics of New Zealand, then separately as The Local Authorities Handbook of New Zealand and then as the Local Authority Statistics. These volumes contained the individual returns for the boroughs and counties and some of the smaller local authorities.
Other calls for better alignment with the accounting requirements included one in 1939 that sought to have the accounting requirements standardised, as discussed above, thus allowing that the "irksome (statistical) Return be eliminated and the Balance Sheet and summary substituted" for the statistical return.\textsuperscript{62}

The success in 1958 of the Counties Association and the County Clerks to introduce a standardised accounting reporting system was marred, almost solely, by the lack of appropriate reforms of the statistical requirements.

The correlation of the form of statistics (Stats. L.A.1) with the form of the Regulations so that each item in the annual accounts could be correctly placed in the form of statistics without having to be broken into components, has not been achieved.\textsuperscript{59}

From the beginning the requirements and forms for statistics were standardised for each part of the sector (separate forms for municipalities, counties, harbour boards etc). Detailed forms were provided for each authority to fill out, almost along the lines of ‘fill in the boxes’. However, the accuracy of the information provided was questionable, as such tight specification of requirements often required them to be interpreted by the clerk who was responsible for completing the form. For example, the decision to attribute wages or salaries to general council work or to attribute them to the cost of particular jobs, especially the creation of infrastructure, could make a significant difference to the values of assets of the authority and the perceived efficiency of projects and/or general operations. This was particularly obvious when there were large amounts of labour intensive works undertaken by a single authority, or in any of the smaller authorities where single staff members worked across various statistical categories and wages were a high proportion of total costs.\textsuperscript{64} While the statistics were expected to be prepared on the standard receipts and payments basis, the Department of Statistics knowingly accepted and included data from councils that by the 1970s used accrual accounting, along with cash based data.\textsuperscript{65}

The statistical returns did not generate the same level of discussion as the accounting returns, no doubt because they were not audited and publicised locally to the same degree and, perhaps most importantly, the statistics were not used to determine spending and rating levels for a council. Local government did not usually use the statistics, although the statistics were occasionally recommended to local government to help identify best practices or the most efficient councils. The completion of the statistics was an inconvenience with little return to the local authority. The attitude of local government
appears well summed up by a member of the Territorial Local Authority Accounting Committee (1985), when, using the logic of the time of comparing public sector bodies with private sector bodies, he asked a Department of Statistics official in relation to the provision of statistics:

What Private Enterprise were required to do and how often?  

Local authorities saw statistical returns as an additional burden, placed on them by central government, with the added insult that statistics were referred to on occasions by central government in the same sentences when determining and or comparing the efficiency of councils.

5.3.4 Setting Balance Date

The balance date for municipalities\(^1\) has always been 31 March. Yet this date makes little sense, transplanted from the Northern hemisphere, where 1 April is close to the beginning of another climatic year, with lambs, melting snow and longer days. In the Northern hemisphere (with similar climate to New Zealand), there would be limited outside activity at the end of March, other than emergency, makeshift repairs until the weather improved. Whereas, in New Zealand, the best weather for outside work, such as roading and drainage, is from late January until the end of April. Thus, at the end of March, local authorities are still active with major capital and maintenance work. Under the cash basis, the deterioration of infrastructural assets, such as roads, would not be recorded, and the expenditure on both maintenance and capital work would be recorded as outgoings during that year. The need for balanced budgets and striking rates to cover expenses created both an incentive and a practical need to 'plan' expenditure based on the artificial balance dates, rather than the best use of resources. Unseasonably good or bad weather in February and March could create spending problems for a local authority; good weather could result in additional outside work performed (before the weather changed), such as roading, and a council exceeding budget for the year; bad weather could mean similar work is not performed, requiring a council to show under performance and under spending and/or perhaps an excessively large rate take. The weather in the following month of the construction season (namely April) could be the reverse, but would be for a different

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\(^1\) While the majority of local authorities have had a similar balance date, some have had different dates including the Harbour Boards, which used 30 September.
financial year. Thus, April could show the over or under spending; however, there was no guarantee that the same pattern would occur each year. Another influence on local government behaviour around balance date was the yearly grants for roading from the National Roads Board, whose balance date was also 31 March. Those grants were not easily carried over to the next year, forcing local authorities to speed up work to ensure they used up the grant.

Therefore, it was not surprising that local government often sought to change its balance date. This was a reasonably regular remit in local authority conferences, although change was never successfully achieved. The largest obstacle for such change was the National Roads Board’s balance date, as it was considered a necessity that the balance date for the National Roads Board also be changed. Because the National Roads Board was part of central government, to change its balance date was expected to create additional problems if it were out of alignment with most other central government entities.

There was wide support for change to the local authority balance date from most central government agencies, including the Audit Office\(^1\), the National Roads Boards, and the Department of Internal Affairs. However, there was less support to change the National Roads Board’s balance date. The Audit Office in its 1986 report commented on the problem of the 31 March balance date for local authorities:

> The result is an artificial constraint on the roading works season which, it has been suggested, causes an inefficient use of public funds through (for example) works not being scheduled in an orderly manner and excessive overtime being worked – all to get the work completed by 31 March.\(^6\)

In spite of calls from local government, as far back at least as 1974,\(^6\) and more recent calls from the Controller and Auditor-General, such as the one quoted directly above, as late as April 1987, any change in balance date for government (both local and central) was, according to the Minister of Finance, “not under consideration by the Government at the present time”.\(^6\) However, as part of the reforms of 1989 the balance date for both central and local government was changed to 30 June.

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5.3.5 Timeliness of the Accounts

Between 1956 and 1976, the date by which the accounts were to be sent to the auditor was unspecified, being required to be sent only 'as soon as possible'. The Audit Office was the major force behind introducing a six-month statutory deadline in 1976. The 1979 amendment to the regulations introduced a requirement for the Secretary of Local Government to consult with the Audit Office prior to authorising the late submission of accounts by local authorities. Yet, by late 1980, both the Audit Office and the Department of Internal Affairs sought to alter or remove the section. A major catalyst for the removal of the extension provision was the continual seeking of extensions by one local authority, Silverpeaks County Council. Their last request was rejected in October 1980, at which time the accounts for years ending 31 March 1978, 1979 and 1980 had not been prepared. The Department of Internal Affairs wanted the Audit Office to take over the role of granting the extension—something the Audit Office was not keen to do, as it "would conflict with the professional relationship of the auditor with his client". The Audit Office suggested deleting the provision from the regulation, and making provision in other legislation for the Minister to appoint someone to prepare accounts when the local authority had failed to prepare them for two successive years. While that suggestion was ultimately taken up, the initial response of the Department of Internal Affairs was that it "is not, in our opinion, practical, either politically or otherwise". The argument made by the Audit Office was in terms of the need to have accounts produced to demonstrate the stewardship of the council to ratepayers, and if councils failed to do so, then legislation should provide for preparation of the accounts. The acceptance that preparation of accounts was the responsibility of council was viewed as being only secondary to the need that accounts should be prepared (by someone) to ensure the accountability of council. It appears that the introduction in 1976 of a six-month time limit for the production of accounts, after 20 years of the "as soon as practicable" requirement (until 1956 it was 15 days), was part of a desire for more accountability to ratepayers. As has already been noted, by the 1970s, the focus of accounting regulations was shifting from the accounts being used to provide control by the auditor to the use of accounts by ratepayers, or at least that the primary function of accounts was to fulfil an accountability function between council and ratepayers/electors.
5.4 Constraints on Local Authority Financial Management

The major constraints on the financial activities of a municipality were the principles discussed above in relation to the *Local Bodies’ Finance Act* 1921-22 and subsequent legislation. At a practical level, other constraints were imposed to monitor or control the activities of local authorities. This section will look at a number ways that legislation was used to control local authorities, and their responses to the constraints.

5.4.1 Reserve Funds

Earlier I discussed reserves and funds in terms of the debate surrounding cash versus accrual basis; this section focuses on them as part of the constraints on local authorities. When the *Local Bodies’ Finance Act* 1921-22 sought to ensure that expenditure in any year should be funded by rating in that year it aimed to control two things: too much cash expenditure, and too little cash expenditure\(^1\) (both related to current rating). Both concerns could result in transfers between ratepayers this year and ratepayers in future years. If either scenario were to occur, some form of intergenerational inequity (depending of the time frame) could develop, whereby future generations would either be burdened by the current generation or the current generation would be supporting future generations. The next section describes a situation where future years would benefit from the current year’s cash payments in relation to accounting for stores. This section deals with the use of ‘reserve funds’ to provide for expenditure that is both irregular and uncertain. Such funds were generally established to spread the cost of one-off events over the good and bad years, rather than burdening ratepayers with the total amount in the year of payment.

In 1923, the Hawke’s Bay County Council criticised the 1921-22 Act because it did not allow councils to go into overdraft in the case of excessive damage to roads and bridges in any year. The initial concern was framed as damage caused by, for example, floods; however, when it was pointed out there was an emergency provision in the Act (added during the Bill’s passage through the Parliament) that permitted greater overdrafts in the

\(^1\) Although it was never legislated that councils were required to spend all moneys received in a financial year, the legislation for the striking of rates meant that only the amount estimated could be struck, and the existing cash position would need to be taken into account.
event of “flood, earthquake\(^1\), fire or other accident” (s. 7(1)), the county chairman altered
the example to ‘heavier than normal rain’ as opposed to ‘floods’. He estimated that his
county would have such rain, one in every four years. The chairman suggested that every
year the council should be required to strike a rate to cover the one in four occurrence, or
they would be unable to keep the roads in repair in those years when heavy rains occurred.
Following correspondence with the Minister of Internal Affairs, which concluded by the
Minister giving a short ‘no’ to the request to increase the overdraft limit, the chairman
changed tack. He suggested that provisions authorising the creation of a reserve fund out of
unspent revenue in any year, for use in situations such as heavy rain, should be enacted. He
also wanted councils to be able to treat the reserve fund as outstanding revenue that could
be borrowed against (by overdraft). He concluded his letter to the Minister:

   All Banks and Companies recognise that no business can be conducted on
sound lines unless the savings of a good year are set aside to meet the losses of
a bad year.\(^3\)

The response to that point by the Department of Internal Affairs was:

   This statement is, of course, perfectly correct, but a local body is in an entirely
different position to a Trading Company, in that it has a practically
ascertainable revenue while a Trading Company has not, and it would
obviously, I think, be unfair, as above stated, to compel ratepayers to pay a
rate greater than that required for the current year’s expenses.\(^4\)

The response to the proposal, based on Audit Office advice, was to reject it, reaffirming the
principles in the 1921-22 Act. The argument against the proposal was based on the three
parts of the Hawke’s Bay County Council proposal, each of which was considered
unacceptable:

- The creation of reserves for uncertain expenditure – the correct use of the funds
could not be assured.
- The collection of revenue (especially rates) in the current year for future years’
  use – this was counter to the main principles of local government finance.
- The authorising of obtaining further overdrafts – the problem that the 1921-22
  Act sought to solve.

\(^1\) It is perhaps a quirk of history that in 1931 a major earthquake hit Napier, the urban centre of Hawke’s Bay.
Only two significant buildings survived the earthquake, one being the Hawke’s Bay County Council building.
The Audit Office summed up its response to the proposal in advice to Department of Internal Affairs in the following manner:

Heaven protect ratepayers (also Internal Affairs and Audit) from financial wizardry of this description.75

Not to be deterred by two rebuffs, the Chairman of the County Council approached the government for a third time. The approach was to the Minister of Public Works, as opposed to the Minister of Internal Affairs. This time he was also unsuccessful, thus the principles of the 1921-22 Act remained intact.

The Hawke’s Bay County Council’s case was based on a desire to spread expenditure over a period longer than a financial year because of ‘acts of god’, especially the weather, and the subsequent expenditure was to make good (either repairing or replacing) those structures affected by an ‘act of god’.

Another situation where separate funds were considered and in some cases used, related to the funding of one-off payments, such as staff retirement gratuities, as noted above. The normal rule of funding current cash expenditure out of current cash revenue would mean that when staff retired the full gratuity paid would be charged to that year’s accounts/ratepayers. The concern that local authorities would build large reserves for future, poorly defined purposes meant that such funds were not generally seen as appropriate.

By the late 1960s, a number of such funds were created by councils. Some councils had local legislation that permitted them to create their own fund according to certain rules.ii However, other councils created such funds without such legislative authority. Councils ending the financial year with larger than expected surplus were seen to create such funds so as to transfer the funds from the general account to the special funds. Thus, the general account would not show a surplus. The creation of these reserves by way of special funds can be attributed to three motives: first, as an attempt to smooth income over the years, especially if abnormally large outgoings were forecast for any year in the future (for

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1 The division between repairing and replacing structures such as bridges is important. In the normal course of operations, repairs were funded from normal revenue, as and when required. Replacement would normally be funded by a loan, as it was considered a new asset whose cost should be paid for by all ratepayers over its useful life.

ii For example see Masterton Borough Council Staff Retiring Fund Act 1962.
example, gratuities when more than one staff member was to retire in a financial year); secondly, as a serious attempt to match payment with the year that expenses were incurred; this would avoid a single year or group of ratepayers paying what could be a cost related to council activity over twenty or more years. However, the Audit Office\textsuperscript{76} identified a third motive in practice by some local authorities; the creation of the separate funds would occur in relation to the three-year election cycle for a council; the fund would be created and increased in rating years that did not coincide with the election of a council. Thus, councils would not be required to rate (in an election year) to cover the cost of any ‘extra’ costs leading up to the election. These extra costs were likely to be related to specific ‘requests’ from individual or small groups of electors for council activities, often received by a council via an elected councillor. Alternatively, a council would use the fund to pay for expenses that would otherwise be paid out of the general account, thus leaving more funds available to undertake projects with some immediate ratepayer/elector payback.\textsuperscript{1}

5.4.1.1 Funds for Trading Activities

In chapter four I noted that the requirements for trading activities to account for depreciation were changed by an amendment in 1928 to the 1920 Municipal Corporations Act. The 1928 Amendment Act made compulsory a separate account for depreciation for each trading undertaking, with the appointment of commissioners to ensure correct allocation of money in each fund. This was in response to the Controller and Auditor-General stating in his report for 1927 that without depreciation being provided for, the accounts of trading activities would not give a “true statement of profit and loss”. Not only was the Controller and Auditor-General concerned about incorrect profit, but he was also concerned that the loans raised to fund items being depreciated were often taken out for periods longer than the life of the asset. For trading activities, the concern of the Audit Office was to ensure that loans, generally funded by special rates, were for the period of

\textsuperscript{1} Given the nature of local government activity, as discussed in chapter three, such work could be as small as having pot holes outside a constituent’s residence repaired, the removal or clearance of rubbish from a vacant site, or the council financially supporting a local community project or event. The amount in any of these cases could be very small. Of course, more significant work may have been undertaken, such as street and drainage upgrades.
the use of the assets (especially not longer), and that appropriate depreciation was charged against current users of the trading activity to allow for money to replace the items, once worn out or obsolete.

Otherwise new loans will be required to be raised for replacing the plant or machinery during the life of the original loans, and the burden of debt will thereby be increased unaccompanied by any corresponding increase in the earning capacity of the undertaking. 77

Chapter seven will discuss the principles for local authority finance when dealing with trading activities, which were modified from those applying to non-trading activities. Also, the view in his 1927 Report differed from the advice the Controller and Auditor-General gave in 1917 in relation to the specific local legislation, and will be covered in chapter seven. The Controller and Auditor-General in 1927 viewed trading activities as being much closer to private sector activity than advice from the Audit Office in 1917.

5.4.2 The Meaning of Expenditure and Outstanding Revenue – Stores

The previous section dealt with increasing expenditure in a current year by paying monies into reserves or special funds. This section looks at attempts to reduce ‘ordinary’ expenditure recorded in order to permit additional expenditure while still ensuring that current expenditure was funded by current revenue as per the Local Bodies’ Finance Act 1921-22. This section does not look at the holding-over of payment of accounts to the following financial year, as was discussed above in relation to accrual accounting, rather it deals with how to record stores or inventory. Section 3(2)(c) of the 1921-22 Act limits overdrafts at the end of the year to an amount equal to the revenue outstanding at that point; this follows from the general authority for borrowing by overdraft in anticipation of revenue. Section 9(1) of the Act requires expenditure to be funded from revenue collected that year.

Soon after the passing of the 1921-22 Act, local authorities sought relief from the constraints of the Act in relation to stores of consumable stocks held by them. Stores were the only significant current assets, other than cash, held by most local authorities. The volume of stores could be large at times relative to total expenditure for an authority. Legislative changes were not introduced in spite of the request of the 1924 Municipal Association in relation to section 3(2)(c), which would have seen consumable stocks on hand treated in the same manner as outstanding revenue when determining the level of
overdraft permitted. The Department of Internal Affairs was surprisingly not that concerned with the issue.

This is a question of bookkeeping and balance sheets. We do not press that, but think it should be given effect to.\textsuperscript{78}

This was surprising because the Department was normally accommodating to changes suggested by the Municipal Association. Furthermore, as the Audit Office was clearly in favour of the effect of the proposal, because its audit policy gave effect to it, the Department of Internal Affairs’ lack of interest was doubly surprising. Until 1955, the audit policy was to accept a trading undertaking’s stock (inventory) as equivalent to cash for the purpose of the Act. Thus, the stock of trading undertakings, such as an abattoir, milk treatment plant, and tramway operations, could result in a reasonable amount of inventory on hand.

It was the stock and stores on hand for use by council in 1955 that caused concern for local authorities. Again, they sought a modification of the 1921-22 Act, this time in relation to section 9(1). The early to mid 1950s saw the beginning of the New Zealand economy’s “long slow boom” (Belich 2001). The development of more land for farming, the increasing population, the beginning of many large central government infrastructure and works projects, together with (and most importantly for local government) the associated demand for local infrastructure, saw supply of many materials for the work of local authorities on roads and other infrastructure increase in price and become more difficult to obtain. To ensure their ability to operate at all times, councils bought stores and stock in advance and in larger quantities than previously considered necessary. Stores were often bought when available, rather than when needed. Thus, the value of stores and stock on hand could become substantial. Furthermore, with the balance date during the busy construction/repair season it was essential to have enough stores to ensure that work was done before winter.

A remit at the Municipal Association conference called for legislative changes that would see all “stocks and stores purchased for future use treated as the equivalent of cash assets and trading stocks”. Without changing the legislation the Audit Office agreed to account for stock and stores in that manner. The Audit Office made it clear that this change did not affect the provision relating to overdrafts in section three. It appears the Audit Office was less than entirely enthusiastic about the change that it had agreed to.\textsuperscript{79} In agreeing to treat
all stores and stock as cash equivalents, the Audit Office placed a number of conditions on accepting the value of stock and stores in the accounts:

- Items such as tools, plant, and equipment are shown separately in the accounts.
- Stocks purchased from loans are shown separately from revenue stocks in the accounts.
- The values are not overstated and due provision must have been made for obsolete or old stock.
- The value of stores shown in the accounts is supported by properly prepared and certified stock sheets.\textsuperscript{80}

When the 1921-22 Act was repealed and replaced by the \textit{Local Authorities Loans Act} 1956, the year after the Audit Office had agreed to a liberal interpretation of section 9, the new legislation contained no significant changes to the relevant sections. I suggest that the Audit Office was satisfied with the status quo in the 1921-22 Act, allowing the Audit Office to continue its liberal interpretation of section 9 (now section 23 in the 1956 Act) and, at the same time, was able to enforce the rigorous standards on accounting for stock and stores, as outlined above. Section 3 in the 1921-22 Act (now section 20 in the 1956 Act) regarding overdrafts, still applied and ensured that the principle of funding current expenditure with current revenue remained in force.

\textbf{5.4.3 Cash Management and Control}

With a cash based system of both accounting and financial control it is not surprising that an important part of the control mechanisms for local authority finance related to cash and, specifically, the use of bank accounts. This section will briefly review three aspects of cash management: the depositing of money, the use of imprest accounts, and the use of separate accounts. These mechanisms are not particularly technical or innovative aspects of local government financial management, but they serve to illustrate the level of control at various times on local government.

The requirements for banking cash were reasonably straightforward and very prescriptive for most of the history of local authorities. The 1876 \textit{Municipal Corporations Act} contained ten sections that dealt with procedures for cash management or control (s. 116-125). Perhaps the most prescriptive was that every person holding council cash should deposit any money held when (if) directed by the council and, irrespective of any direction from the council, deposit all money held every Saturday (s. 117). Rules for the management and control of cash were transferred to the 1901 regulations made under the
Municipal Corporation Act 1900 (s. 168). The regulations continued the strong prescriptive requirements, especially in relation to regular depositing of cash; although this was modified to once every 7 days, then later further modified to once every 7 days only when cash held was greater than £5, then £10, and then $20. It was not until the 1979 regulations that the regulation was substantially changed, leaving the decision on when cash should be banked to the discretion of a council.

Councils were permitted to operate an imprest account from 1928 for wages and emergency expenditure, with rules determining the maximum balance of the imprest account. The maximum balance was to be set by the Audit Office in cases where two signatories were required; in cases where only the treasurer’s signature was required, the maximum balance was set at £75. (s. 9) In 1968, councils were given the authority to operate a number of imprest accounts, provided they obtained prior approval of the Audit Office. Those individual accounts were to be for specific purposes, and the condition of a maximum balance for such accounts continued. (s. 6) By 1976, the Audit Office further reduced its involvement in some of these issues of local government financial management control, believing that the exercise of many administrative controls over local government was no longer appropriate. The Audit Office transferred approval for imprest accounts (as well as other functions) from Head Office to the local auditor, stating:

The decisions required are considered to be within the competence of responsible local government management and the need for external approval is no longer apparent.81

As will be discussed in the following chapter, this move followed the inclusion into statutes of the Audit Office’s duty to audit the systems of internal control for local authorities.

In the 1977 Local Government Amendment Act (No. 3), provisions requiring Audit Office approval were removed, allowing decisions on the setting up of imprest accounts and the maximum balance permitted, where more than one signature was required, to be left to each local authority. (s. 207)

While the requirements concerning the banking of council money and the management of imprest accounts were straightforward, the issue of which bank account money was to be deposited was more complex. Councils were required to have a general account, which was to contain most funds; however, some funds were required to be banked into separate accounts.
As mentioned above, in 1968, certain councils created funds for retirement gratuities, leading the Audit Office to seek an opinion from the Crown Law Office on both the legality of the funds creations (as discussed) and, if such funds were legal, whether the money could be deposited into separate bank accounts and, if so, under what conditions. The issues included where councils could deposit money, and when could councils could transfer money from the general bank account to a special gratuity fund bank account. This last issue included whether a council could pay money into the fund when taking the general fund into (further) overdraft, or if it was necessary for the cash to be available.\textsuperscript{82} Such levels of scrutiny reflected both the doctrine of \textit{ultra vires} and the degree of control at the time over local authority finance.

The requirement to use separate accounts was normally associated with money related to loans and/or special rating or the creation of special reserves. As noted in the previous chapter, a large number of accounts were required to be kept separately, within the accounting records of a local authority. The keeping of separate bank accounts was reserved primarily for those funds whose creation were contrary to the general principle of this year’s revenue paying for this year’s expenses.

The first legislative provision, requiring that loan monies were to be deposited in a separate account, was in the \textit{Municipal Corporations Acts Amendment Act 1880} (s. 8). Since then, that clause has remained in all loan specific legislation for local authorities, beginning with the \textit{Local Bodies’ Loans Act 1886} (s. 17).

Over the years, various types of accounts were added to the list of separate bank accounts required, either by statute or by Audit Office instruction. Bishop provided the following list of classes of separate bank accounts required in 1978, (Bishop 1978 pp. 103-4):

\begin{itemize}
  \item Loans
  \item Sale of assets purchased out of loan
  \item Advances to ratepayers for housing, gas and sewerage
  \item Accident Fund
  \item Cemetery Trustees Account (although there is no specific statutory requirement, where funds or any amount are held, a separate bank account is considered desirable).
  \item Domain Board Account
  \item Fire Insurance Fund
  \item Imprest Account
\end{itemize}
Insurance (loss on Mortgage) Fund, Separate Investment required

Land Account (Sale or Exchange of Trust Land). This is a case where audit direction would be issued.

Land Subdivision Account

Reserve Fund for trading undertaking

Reserves – Cash in lieu of land

Depreciation Fund for trading undertaking

Special Funds

For control and audit purposes, keeping cash physically separate in a different bank account can be viewed a helpful practice. The inappropriate use of money set aside or collected for one purpose or another can be traced relatively quickly and easily when monies are kept in separate bank accounts. Spending over limits by ‘dipping into’ other funds could also be identified when using separate bank accounts. As will be discussed in chapter seven, withdrawals from separate accounts can be carefully scrutinised to ensure correct use of funds. The list of accounts above was altered over the years with the addition of accounts when councils sought to undertake activities or arrange their finances that could have jeopardised the relationship between current year’s expenditure and revenue.

Today it seems predictable that the creation of separate accounts at the bank may create some concern for local authorities. The major problem was when councils had their main account, the District Fund, in overdraft (duly authorised), and at the same time had many other accounts (for example, from loans and reserves) open with credit balances. The accounts in credit were not paying interest, while a council was required to pay interest on an overdraft.

In 1924, the Controller and Auditor-General brought a court action against the mayor and individual councillors of the Masterton Borough Council for using loan account money to discharge a current overdraft. There was no disagreement on the facts of the case. Money set aside for particular work provided by a loan was transferred to the general account to take it out of overdraft until the loan money was required for its specific purpose. The defence was that the object of the illegal action was to reduce the interest paid by the Borough, which the judge referred to a “laudable one”. However, the judge rejected it as a defence, saying:

In these circumstances it was clearly the duty of the Auditor-General to take action against the defendants, and it now becomes the duty of this Court to fix a penalty in each case.83
They were all fined £5 each, after the judge rejected a called from their counsel for any penalty imposed by the Court to be a nominal one.

This case highlighted the problem with legislation that required separate bank accounts, and a number of complaints against the legislation and/or the court case followed. The Manurewa Town Board was one body that took great exception both to the bringing of the case against the Masterton Borough mayor and councillors and to the law.

In the opinion of the members of my Board a state of the law which allows such a thing to take place cannot be characterised as anything less than disgraceful. My Board considers that it is a scandalous state of the law when members of a Local Body, who give their time and energy to public service without any reward, can be haled before the Court and fined a fairly substantial sum, like any common criminal, their offence being the fact of having saved for the benefit of their rate-payers a substantial sum of money.  

And again:

The protest of my Board re the above matter is directed against the law which places in the hands of any Government Official the power to have members of Local Bodies brought before the Court and fined for saving their rate-payers substantial sums by way of interest.  

The complaints continued, with the Municipal Association conferences leading to delegations made to Ministers and the Controller and Auditor-General in 1926 and 1927 seeking resolution of the problem of multiple bank accounts.  

The first response from central government was to suggest to local authorities that they approach their bankers, seeking the pooling of account balances for each local authority when determining interest to be charged on overdrawn accounts. Given that such a request would have meant no interest was paid by many, and less by every council, it was not surprising that banks did not agree to such measures. Secondly, it was suggested to councils that they seek authority (under section 46 of the Local Bodies' Loans Act 1926) to transfer from accounts in credit, such as loan accounts, money to the general account as a temporary transfer in lieu of an overdraft. Any monies transferred were required to be repaid within the financial year. Authority to transfer such funds was from the Governor-General in Council and was granted with certain conditions. The most common condition appears to be obtaining assurance from the bank that it would guarantee an overdraft to cover the repayment of the transfer required at the end of the financial year. Thus, with such an assurance, section 3(c) of the 1921-22 Act would not be broken. Not every request to the Governor-General in Council for such authority was successful. Presumably, the
reason was the likely inability of some councils to redeposit the money into their loan accounts within the financial year.

In response to the suggestion from the Manurewa Town Board that the law be changed, the Prime Minister replied 'no':

> The requirement of the Act that loan moneys be kept in an account apart from other moneys is fundamental to safe finance and notwithstanding that there may be balances in these accounts not immediately required, the principle of separation of bank accounts cannot be departed from, and I do not think Parliament would consider any alteration of the law that would weaken that rule.⁸⁷

Again, in 1927 the question was raised in Parliament, to which the Minister of Finance reaffirmed the importance of keeping separate bank accounts.

> To alter the present law and allow local bodies to keep one bank account only for loan-moneys and general revenue would involve a change in the fundamental principles governing local body finance.⁸⁸

The number of bank accounts required continued to increase over the years. Bishop’s list of the thirteen categories of separate bank accounts required (as listed above), from his 1978 edition, can be compared with only three categories in the original 1937 edition. (Leese and Bishop 1937 pp. 78-9) There was an acceptance by the Audit Office and Department of Internal Affairs that the ongoing cost of the separate bank accounts was a problem. As the number of accounts grew, the problem became twofold: the cost of an overdraft in the general account while other accounts were in credit remained a problem, and the increasing bank charges for an increasing number of accounts. The overdraft charges were regarded as an unsolvable problem — a cost of local government finance principles. However, a solution to the bank charges problem proposed by the Department of Internal Affairs in 1933 was to allow in some circumstances the combining of what would normally be separate bank accounts into one (or more) bank accounts, although always separate from the general account.⁸⁹ In 1956, changes to the Municipal Corporations Act 1954 were finally introduced, via the Local Authorities Loans Act 1956 that permitted the use of one bank account for all monies received by loans. This enactment reduced the number of accounts local authorities were required to operate, while still keeping loan money separate from the general account.

### 5.4.4 Unauthorised Expenditure

The impact of the doctrine of *ultra vires* on local government included limiting the areas of expenditure by local authorities to those that were provided for in legislation. For the
majority of local authority expenditure, this was straightforward; for example, the
Municipal Corporations Act 1900 contained explicit authority to expend money on inter
alia roads (s. 212), drainage (s. 267), and the provision of pure water (s. 290). As noted in
chapter four, legal authority for other types of expenditure was contained in a variety of
legislation. Some of the legal authorities were passed retrospectively to authorise
expenditure already incurred. In 1936, the Audit Office provided its inspecting staff with a
list of grants, contributions or similar payments that could be made by local authorities.
The list was ten pages long, covering more than 140 headings and referring to 37 different
pieces of legislation. At the front of the list, the Audit Office wrote, “it will be obvious that
such (a list) can be by no means exhaustive”.

While determining the status of many items was straightforward, as ‘authorised’,
‘unauthorised’ or ‘illegal’, there were many cases when the status was unclear. The courts
interpreted the ultra vires doctrine for local government so that ‘authorised’ included those
activities that were incidental to the activity specified in the legislation. According to
English Lord Selborne:

... this doctrine (ultra vires) ought to be reasonably, and not unreasonably,
understood and applied, and that whatever may fairly be regarded as incidental
to, or consequential upon, those things which the legislature has authorised,
ought not (unless expressly prohibited) to be held, by judicial construction, to
be ultra vires.

Over the years, the definition of ‘incidental’ became more liberal, following the decisions
of English courts. For example, the New Zealand Court of Appeal and the Privy Council
upheld the adding of fluorine to otherwise ‘pure water’ so as to improve the water, in spite
of the Act only authorising expenditure for ‘pure water’. (Palmer 1993 p. 50)

A significant change in practice occurred in 1972 when the Audit Office sought a Crown
Law opinion on the concept of ‘unauthorised expenditure’. The opinion reviewed the Audit
Office’s practice to date, and identified two areas of application where the term
‘unauthorised expenditure’ had been misinterpreted.

The first misinterpretation related to confusion between determining the legality of the
payment, with reference to the organisation receiving the funding or the grant, versus the

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1 The involvement of the Audit Office in this particular topic relates to the obligations to surcharge councils
that spent illegally. At times the Audit Office held the position of investigator, prosecutor, judge and jury for
such work. This topic is covered in the following chapter on the work of the Audit Office.
nature of the item for payment. For some situations the legislation specified that payments to certain organisations were authorised. However, in most cases the legislation specified the purpose, and not an organisation. The Audit Office had erroneously applied a test, in many cases, based on the organisation rather than the purpose. If not directly authorised, the Audit Office was also required to check if expenditure was incidental or consequential to some other authorised expenditure.

The second area of misinterpretation related to the Audit Office applying a test to 'reasonable' expenditure. The Audit Office declared 'illegal expenditure' any expenditure it considered extravagant or inappropriate because of its size. The Crown Law opinion was that such a criterion was not provided for in statute and therefore should not have been applied. This practice appears to have been widespread. For example, in 1938 the Audit Office's policy on the use of air travel by local authority personnel required the Audit Inspector to make value judgements.

The Audit Office is not prepared to lay down a general rule that Audit Inspectors should regard travelling by air as unjustified, but considers that each claim for reimbursement of such travelling expense should be treated on its merits. In cases where the circumstances appear to warrant it, and in particular where the use of air travel by a member or official is justified by the economy in the time resulting from it, it does not appear that the expense could successfully be challenged.

While such a practice was not legal there appears to have been no complaints from local authorities regarding its use by the Audit Office. It was only the result of the Audit Office seeking a legal opinion in 1972 that caused a change in its use. The Audit Office would likely have been pleased for such a change to its function in 1972, because by that stage the Audit Office sought a new relationship with local authorities. Making decisions, such as the 'reasonableness' of expenditure, were beginning to be regarded as outside the appropriate role of an auditor.

A final note regarding unauthorised expenditure; during discussions regarding the possible raising of the limit, the Controller and Auditor-General pointed out that the limit was an aid for many councils when rejecting causes that sought donations and financial assistance.

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i Many cases in volume, but in value, generally, they were small.

ii As will be discussed in the following chapter, public sector auditing is wider than private sector work and would still include checking for legal authority; however judgements about reasonableness of expenditure would not be part of such audits. Such judgement did have a role in the operational audits and reporting on the efficiency and effectiveness of the authority – but not the legality per se of the expenditure.
To raise the limit was likely to mean that councils would need to find other reasons for turning down ‘worthy’ requests from constituency groups or individuals or, alternatively, they would need to find more ratepayer funds to accede to requests. Blaming the inability to fund ‘unauthorised expenditure’ on Wellington appeared to be a convenient excuse for many councils to decline the numerous requests by ratepayers, electors, and their local communities.

5.4.5 Constraints on Local Authority Financial Management – Conclusion

The principles of local authority financial management remained in force throughout the period covered by this thesis. At times they were reinforced, following difficulties such as those that came to a head in 1921, and at other times they were relaxed when less intrusive measures were able to achieve the same end, such as the introduction and/or reliance on internal control systems. The removal of all constraints was first discussed in 1987 when Audit Office staff responsible for local government mused on the effect of a proposed general competence for local authorities. The constraints were regarded as part of the way that local authorities had operated. The costs incurred in operating in that way (such as extra bank charges) and the differences between private sector practice and the practice of local authorities (such as reserves for rainy days) were considered ‘just the way things were’. There was no blanket acceptance of calls for ‘what business does is best’; rather, altering at times a practice for better efficiency or management, while maintaining the principles, was encouraged. This issue of the tension between efficiency and good management and the principles will be further discussed in chapter eight.

5.5 Conclusion – The Changing Focus of the Accounts of Local Authorities

Until the early 1970s, the format of the accounts, the requirements to keep certain accounts and other requirements contained in both legislation and regulation, relating to the general area of financial management of local authorities, were all aimed at ensuring that the

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1 In effect such a general competence was not included in legislation until the Local Government Act 2002 (s. 12). This Act reduced the constraints on local authorities’ financial management, although the principle of funding current expenses with current revenues is still in the legislation, albeit with provisions for not following the principle in certain circumstances as determined by a council. (s. 100)
general principles for control of local government finances were maintained. The principles stated: spend only what was collected in each year, and fund current expenditure with current revenue, with the proviso that current expenditure for future generations should be paid for by those future generations.

The rules for the financial management of local authorities were in effect financial control, whereby barriers were placed in the path of any local authority that was likely to violate the principles mentioned above. The changes to the regulations and legislation relating to financial control had one or more of the following three aims: tightening up the principles to ensure better adherence to them, loosening the requirements where the current situation was perceived as providing excessive control; and finally, a way to avoid the requirements without formally removing them. The 1921-22 Act is clearly the case of the first situation where excesses by some local authorities resulted in clearer rules for the financial management of authorities. Significant reductions in the financial management control of authorities only began in the 1970s, particularly with the 1974 and 1979 regulations. The decision to remove the controls was made because they were seen to no longer be required, as opposed to being inappropriate per se. In earlier years, arrangements to allow councils to work around the principles were the most common form of changes; the vast majority of those changes are not discussed in this thesis as they relate to authorising the activities of individual authorities – some after the event. Some of the generic approvals for setting up special funds, such as depreciation funds, are also in this class. In spite of this apparent division between loosening the requirements and working around them, the appropriate level of control via legislation and regulation was not clear at any point. The following comment from 1950 is one perspective in a discussion between The Treasury and the Department of Internal Affairs on increasing the maximum permitted level of rates to be struck by local authorities; the author is the Under Secretary for Internal Affairs:

I think that there has perhaps in the past been too great a restriction placed on the activities of territorial local authorities in the collection of money by way of rates to carry out their legitimate functions. After all, the members of local authorities are in general nowadays elected by the electors to carry out a stated policy. The election of these Councillors is their authority to carry out this policy, and it seems only right that they should, within fairly liberal limits, be able to raise by way of rates, if desired, whatever moneys are considered necessary to carry out their policy.96

This quote is referred to not because it is a normal or common view, but to illustrate two issues. First, that the level of control changes over time, and secondly, that the appropriate level of control at any time is subject to debate and disagreement. The requirements and
changes to them reflect a negotiated status quo in what was appropriate at various times. As already noted, by the 1970s the Audit Office was already reducing central oversight and control on local authorities, believing that many decisions made centrally were within the competency of the local authorities and should have been made locally.

The accounting requirements were aimed at ensuring the financial control measures were upheld and that only lawful transactions were entered into. The accounts were prepared predominantly for the auditor, so that the auditor, on behalf of the ratepayers or electors, could attest to the lawful application of the local authorities' money. Although public access was always guaranteed, this was only secondary. The rights of the ratepayers or electors were taken care of by the work of the auditor. This is shown by the quote mentioned earlier when the Controller and Auditor-General referred to councils as “accountable to the Audit Office”.97 Many of the changes to requirements were aimed at improving the ability of councils to determine what the auditor could rule as legal or otherwise. Those improvements were for both the council’s and the auditor’s benefit, reducing, essentially, the uncertainty for both parties. A comment often made was that the accounts were not interesting, or were too detailed, or were not read by the public.1 For most of the period such comments were not a concern, as the public was not the focus of accounts and regulations. The auditor existed to provide the financial oversight for the public.

During the early 1960s, the Controller and Auditor-General wrote encouragingly in his reports about reporting to ratepayers. He suggested that by better reporting to ratepayers the apathy he saw in local government democracy could be reversed. However, he was supporting the attempts of a few councils to provide summary information, rather than suggesting changes to requirements so that accounts might serve the needs of ratepayers as readers.98 It was not until the 1970s that a paradigm shift occurred regarding the accounts. While there were changes in technical practices, such as the change from a cost category to activity based reporting in 1974 and then the move away from a prescribed format in 1979, the change was much more significant than those – the focus on the accounts moved from

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1 For example see Archives New Zealand ST2 7/2/7/2 where the accounts were called “uninteresting documents” in 1939.
the auditor, essentially a central government department, to the ratepayers and electors. The changes mentioned above are, in part, reflections on the more significant change. The move to activity based reporting provided information along lines that may be of use (as opposed to of interest)\(^1\) to ratepayers and electors, and the removal of a standardised format allowed councils to report in a format based on the needs of their communities. Earlier calls for standardisation were for the benefit of councils and council workers or to allow comparisons by central government between various councils.

As mentioned above, the cry behind the 1974 regulations was to make the accounts:

more readable for the local, reasonably informed and intelligent ratepayer\(^9\)

At the same time the Controller and Auditor-General reminded councils that the accounts would no longer be sufficient for management use, and they would need to prepare separate accounts for use of the management of their local authority.\(^{10}\) For the first time the distinction between external and internal reporting became relevant for all councils.

By 1979 the size of external accounts became an important matter, and reducing the size was regarded as making the accounts more useful to users,\(^{11}\) which, by then, meant ratepayers. Essentially, all that accounts were required to do was to show, in as little detail as possible, while still making sense, what money was received and how it was spent.

The latest Regulations [1979] are close to the ideal (as far as the ratepayer is concerned) – i.e. concise, only one or two pages, summarised into ‘What comes in’ and ‘What goes out’ style of things, relevant grouping of expenditure with minimal headings for income.\(^{10}\)

The most important central government agency in this chapter and the preceding one is the Audit Office. The following chapter looks at the role of the auditor and the role of the Audit Office. Most of the proposed changes discussed in this chapter were either initiated by the Audit Office or were sent to the Audit Office for comment before central government gave a response to them. As auditor, the Audit Office was the enforcer of the

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\(^1\) The distinction between “of use” and “of interest” can be illustrated by the fact that how much a council spent on wages overall compared to how much was spent on office supplies may be of interest to ratepayers, but what should be more useful information is how much money was spent on administration and how much on roads. The fact that the 1974 regulations included the provision of the cost category expenditure within each activity reflects that cost category information was still considered to be of interest to some people.

\(^{10}\) An interesting choice of words during work on the proposed (but never released) new accounting regulation in 1985 saw the term “users” changed to “target”. There was no debate on this change recorded – a possible reflection on the lack of use by ratepayers. Archives New Zealand AAUA 6915 9/17/1
constraints that are the basis of much of this chapter, and until the mid 1970s it was seen as the guardian of ratepayers.

Finally, as mentioned earlier, the five perennial issues for discussion, regarding accounting for municipalities, were the standardisation of the accounts, cash versus accrual basis, the relationship between the statistical returns and accounting requirements, the balance date and the timeliness of the accounts. Of note is that no enduring closure on these items was achieved during the time covered by this thesis. Equally of note was that debate and working towards a consensus were continual processes. Yet, for each issue there was no right or correct answer, rather arguments for both sides of a debate. The failure to definitely address many of these issues may appear as inertia, as commented at the beginning of this chapter, but I suggest that a degree of consensus between central and local government was seen as a requirement before changes to the accounting requirements could be implemented. Consensus meant that those at the forefront of change always wanted to improve the system because they believed that would create better local government, while at the same time needing to take other parties, other parts of both central and local government, with them.
Chapter Six: Audit and the Audit Office

I say that with this Bill we will assist the Controller and Auditor-General very much in the conduct of his office. From what practical experience I have — although the Government accounting system still remains a mystery to me — I feel there are no safeguards that will be lost … \(^1\) (emphasis added)

We leave these matters largely to the Controller and Auditor-General. He is an independent officer and he initiates these changes.\(^2\)

### 6.1 Introduction

The official debates and discussion surrounding the legislative arrangements for the audit of local authorities and the operation of the Controller and Auditor-General/Audit Office/Audit Department\(^1\) have always revolved round the two issues alluded to above by Rae (1952) and Muldoon (1970) in their Parliamentary speeches. The first issue concerned the standard criteria for judging proposed legislative changes relating to financial management issues; the criteria were to ensure the maintenance of appropriate safeguards against undesirable revenue collection and undesirable expenditure, and also the maintenance of the accounting and financial management principles as discussed in relation to local government in the previous chapter. The second issue was that the Audit Office held a great deal of power. This power was principally the result of the inaccessibility of much material by both members of the legislature and various groups that aimed at influencing government policy on such matters. The Audit Office’s power was acceptable to most people due to three factors: its constitutional position, its specialist

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\(^1\) As noted earlier, unless context or accuracy requires otherwise I will use the term Audit Office.
knowledge, and the perceived professionalism of Audit Office staff. In understanding the Audit Office's role it is impossible to separate those three factors. It was its constitutional role in combination with the policy role and operational work (that is, the audit function), which gave the Audit Office a breadth of involvement and understanding, and hence power that could not be rivalled. However, this power was not unbridled, due to the presence in debates of various informed stakeholders and commentators.

This chapter begins with a discussion of the changes to legislative arrangements for the audit of local authorities, including the appointment of the auditor, his\(^1\) tasks, and the objectives of audits. Section three covers significant issues that the Audit Office dealt with during the period covered by this history, concerning its independence, fees charged for audit work, the right of local authorities to appoint their own auditors, and timeliness of audits. Section four examines local authority operational audits performed by the Audit Office. Sections five and six look at the relationship between the Audit Office and local government in terms the Audit Office's other roles with local government and its general attitude to local government.

### 6.2 Legislative Arrangements

Legislative provisions for the audit of municipal authorities and the role of the Audit Office are contained in two types of legislation: public revenues/public finance acts, and municipal corporations/local government acts (until 1920). In most periods the acts ran parallel without contradicting each other, but with different emphases, as illustrated in Figure 6.1 below. However, at times the two streams of legislation became inconsistent when the legislature took time to amend one act subsequent to changes in another act. Additional requirements were often provided in regulations that were issued under municipal corporations/local government legislation.\(^{ii}\)

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\(^1\) All Controller and Auditor-Generals in New Zealand have been male to date.

\(^{ii}\) The *Local Bodies’ Audit Act 1888* despite its name was not about audit, but rather about extending the time permitted for a local authority to meet to pass the audited annual accounts.
6.2.1 The Requirement to be Audited and the Selection of the Auditor

As mentioned in chapter four, the 1876 Municipal Corporations Act provided for the election of two auditors by the burgesses. Eligibility for election as auditor was open to anyone, except bankrupts, criminals, those of unsound mind, elected councillors and the mayor, and those who had close financial connections with a council (employees and business). Those disqualifications, apart from sitting councillors and the mayor, were the same as those for election of councillors. (s. 92-93) Election of the auditor was to be held annually. Remuneration for the elected auditor was also to be set annually by the council prior to election of the auditor. (s. 95) If the office became vacant between elections, the appointment of an auditor was the duty of the council. (s. 94) In addition, there was provision for the appointment of a special auditor, by the Governor of the Colony, to audit the borough accounts if one-fourth of ratepayers petitioned for such an appointment. (s. 135) Thus, an elected auditor’s work became contestable if 25 per cent of ratepayers sought to challenge it.

The 1878 Public Revenues Act provided for the Audit Office to perform an audit on any borough (and any other body) that received a grant from central government, if required by the Governor. (s. 33) The Act also specified that this was the only situation where the Audit Office was to audit a borough, unless required by other legislation. Section 33 of this Act, which related to the audit of local authorities, remained in force until 1892, while the remainder of the Act was repealed by the Public Revenues Act 1891. The reason for not repealing the local authority audit material at the time of the 1891 Act is discussed below.
in relation to the *Local Authorities' Accounts and Audit Bill* 1891 and the Bill of the same name in 1892.

The 1886 *Municipal Corporations Bill* initially contained clauses that would continue the process of electing auditors. However, during Committee stages in the Lower House a change was introduced that made the Audit Office the auditor of all boroughs. This Act gave the Controller and Auditor-General the same powers for boroughs as those he held from the *Public Revenues Act* 1878 that related to central government. The Controller and Auditor-General also had the right to undertake a special audit, either on specific direction of the Governor or on his own authority. Although the nature of special audits was not discussed in the legislation, they would have been viewed in terms of probity and compliance, which was the focus of audits at that time. Specific provision for special audits did not last long, as it was in neither the *Municipal Corporations Act* 1900 nor the *Public Revenues Amendment Act* 1913.

Two key factors can be attributed to the appointment of the Audit Office as auditor of local government. The first, which will be discussed more fully below, relates to the need to control and prosecute illegal expenditure by local authorities. The second reason relates to the use of central government funds by local government.

Concern about the use of central government money cannot be attributed to the amount or growth of funds from government. Between 1878 and 1886, when the Audit Office audit of local authority accounts became permissive, central government grants to boroughs doubled, while central government total expenditure remained constant. However, by 1886, when the Audit Office became the auditor, the grant dropped below the 1876 amount both in absolute terms and as a percentage of central government expenditure. By 1886 the percentage of total borough funds from central government funding dropped below 10 per cent, whereas in 1879 it was 21 per cent.³ In spite of the reducing value of grants, the need to ensure correct use of government grants by local government was still an important issue.

The “Report on the Audit of Public Revenues” (the Report) was a significant nineteenth century document in developing the role of the Audit Office in local government auditing, as well as other aspects of financial management for local government and central government. The Report was prepared and presented to Parliament by the Controller and Auditor-General in 1881 at the request of the Premier.⁴ It was the result of a study
conducted by the Controller and Auditor-General into relevant practices in Australian colonies. In his report, the Controller and Auditor-General made a series of comments relating to the experiences in both Australia and New Zealand. In relation to the need for a local authority’s auditor to come from outside a district or city, he wrote:

Where subsidies of public money are granted to local bodies the necessity of an independent audit becomes of additional importance. As an example of this, a case was mentioned to me by the Secretary to the Treasury in one of the colonies, of a Road Board which was said to have for years obtained the subsidy from the Government payable in proportion to the rates raised, and to have subsequently repaid the ratepayers their rates, and so secured the subsidy without the required local taxation.  

Thus, the concern was for an auditor to be independent of a local community and council, especially where an auditor might benefit financially as a result of his position as a local ratepayer and/or resident, should certain accounting/financial practices be undertaken. The Controller and Auditor-General considered the existing system of electing auditors from local ratepayers relied on the “accident of finding individuals of sufficient public spirit and independent position to become prosecutors for the wrongs affecting all.” But the Controller and Auditor-General was also aware of the tension between the autonomy of local authority/community and the imposition of an external auditor (to that community). His argument was based on the role of the auditor being only to ensure strict compliance with the law.

It may be objected that any interference by a central authority with the proceedings of local institutions, violates the principle of local self-government, and removes from the people themselves that responsibility for the due care of their own interests which constitutes its chief value. But, on the other hand, it should be remembered that the powers vested in local bodies are not general or arbitrary, but are defined by law, and are granted for specific purposes. So long as the administration of the local authorities within the sphere of the duties imposed on them is left uncontrolled, it can hardly be said to be an interference with local government, if provision is made for restraining them from exceeding those duties.  

The 1892 Public Revenues Act altered the provision in the 1878 Public Revenues Act, making the Audit Office the auditor of any corporation or institution receiving grants from public money or “rates, tolls, fees, or fines”. Thus, that legislation was brought in line with the Municipal Corporations Act 1886. No longer was use of public (central government) money the criterion in public revenues legislation, it was the use of the public’s money, including the collection of rates, that became the criterion. The clause in the 1892 Public Revenues Bill relating to the auditing of local authorities was introduced during committee stages of debate in the House of Representatives. Its inclusion was the result of
Parliament’s failure to pass either the 1891 or 1892 Local Authorities’ Accounts and Audit Bills.\textsuperscript{7}

The 1900 Municipal Corporations Act defined the Controller and Auditor-General as ‘the auditor’, (s. 3) and repealed both the 1886 Municipal Corporations Act and the sections relating to the auditing of boroughs of the 1892 Public Revenues Act. For the first time, provision was made for the use of regulations to govern the auditing of the accounts, which meant that this Act contained little detail regarding the audits. The regulations provided further detail concerning how the Audit Office was to undertake its task; this material is discussed below.

The 1913 Public Revenues Amendment Act saw city and borough councils brought under the provisions of the Public Revenues Act 1910. From 1900 to 1913, public revenues legislation specifically excluded those councils from coverage in such legislation, while all other local authorities continued to be included. The only recorded complaint about the 1913 Bill was that legislation concerning the audit of municipalities should have been with municipal legislation rather than ‘elsewhere’, such as public revenues legislation.\textsuperscript{8}

The 1920 Municipal Corporations Act and subsequent local government legislation made no references to the auditing of accounts or the auditor. In contrast, the 1926 and 1953 Public Revenues Acts and the Public Finance Act 1977 continued the practice of the Controller and Auditor-General being the auditor of all local authorities. The Public Finance Act 1977 continued to be the legislation that governed the Audit Office, including both central and local government audits, until the enactment of the Public Audit Act 2001. Following enactment of the Public Finance Act 1989, all sections in the 1977 Act were repealed except those concerning audit.

While the Audit Office has been auditor of local authorities since 1886, there has been some disagreement, over the years, regarding the competency of the Audit Office to perform all audits, the cost of audits, and philosophical issues concerning the right of local authorities to choose their own auditors and/or the importance of using the market place to select auditors. These issues are discussed in section three.

\textbf{6.2.2 The Objectives and Functions of Audit}

Under the 1876 Municipal Corporations Act the duties of the elected auditors were to audit both the six-monthly and yearly accounts and required statements (see chapter four).
Auditors were required to “certify to the correctness (of the accounts) either wholly or with such exceptions as they think fit” after they examined the council’s accounts, bank records and other documents. Those accounts and the audit report were to be published in the borough. (s. 129 and s. 132) Council was also required to sign off the accounts after making any changes it (the council) decided necessary if they thought that without the changes the “balance sheet fails to show fully and truly all the dealings with the borough funds”. (s. 133) There was no provision or requirement for a council either to refer their changes to the auditor or to take notice of the auditor’s report, although it was, of course, required to act within the law. The post audit accounts became the “true accounts of the borough for all purposes”. (s. 133) Auditors were also required to make further audits of accounts if required by a council to do so. (s. 96) They were expected to perform their task by reviewing all sources and supporting documents for transactions.

The 1886 Municipal Corporations Act continued the same requirements of true, full and correct accounts, although in that legislation the Controller and Auditor-General was the auditor.

As noted above, the 1892 Public Revenues Act (and subsequent public revenue/finance legislation) provided the Controller and Auditor-General with the same powers and duties for the audit of local government as for central government. Thus, changes over the years in audit practice in central government also occurred in local government, although there was no significant discussion in the parliamentary process regarding the impact of any of the legislative changes on local government.

Between 1892 (and earlier for central government) and 1922, the core description of the role of the Audit Office in relation to auditing the accounts of local government was “to audit all accounts relating to the receipt, custody, or expenditure” of public (or borough) money. The 1922 Finance Act included an amendment to the 1910 Public Revenues Act that expanded the core description to include public (or borough) stores.

Between 1901 and 1913, regulations under the municipal corporations legislation regulated the role of audit. As noted below, the regulations focused on ‘correctness’ of the accounts, and the use of original documents as a means of checking the accounts.

Changes in the Public Revenues Act 1910 did not impact directly on local government, but they influenced development of the role and operation of the Audit Office. The Act introduced the use of vouchers by central government and a change in audit approach from
pre-payment audit to a post-payment audit. Such changes were considered at the time as bringing New Zealand in line with most other countries, to which it wished to compare itself, and with commercial practice. The 1926 Public Revenues Act made no significant changes relevant to this topic.

The Public Revenues Amendment Act 1952 and the Public Revenues Act 1953 introduced significant changes to the obligations of the Audit Office. Not only were they required to inspect, examine and audit the books relating to the collection, receipt, custody and expenditure of public (or borough) money and stores (1953 s. 20(1)), but the Audit Office was also required to determine the “correctness of the accounts and transactions” (1953 s. 20(4)). Both acts introduced a new focus on testing and sampling, with more emphasis on reviews of procedures and rules for accounting practices, expenditure authorisation and stores records. The days of auditing by checking every transaction and voucher had passed. The 1953 Act strengthened the first steps made the previous year. At the time, there was a general consensus in Parliament of the wisdom of such an approach.

There are several clauses [in the 1952 Bill] which, from the accountant’s and auditor’s point of view are progressive. It is interesting to note that government today is becoming increasingly progressive.10

And

It is very gratifying to me that, speaking out of his knowledge, the leader of the Opposition has given general endorsement to the provisions of the Bill. 11
(Associate Minister of Finance)

By the 1960s the Audit Office credited this new approach, together with the introduction of better systems by many councils, with reducing the overall costs of audits.12

The 1970 Public Revenues Amendment Act increased the focus on internal controls as part of the role of the auditor. The amending Act also introduced the term ‘tests’ to the practice of auditing in the public sector. The Act altered the form of the audit report from a certifying of the accounts to presentation of a report based on the Audit Office’s opinion of the accounts. As noted in Parliament, such changes followed private sector practice at the time.

[The clauses relating to internal control and audit report] seem to be in line with modern practices; in fact, if anything the State is considerably behind private companies in adopting these forms. Therefore, there is not much to be said about them as innovations.13

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1 Eric Henry Halstead, a government member of House of Representatives, was an accountant.
The government replied that such changes were provided on the recommendation of the Controller and Auditor-General.\(^{14}\)

The 1977 *Public Finance Act* introduced or at least clarified an additional role for the Audit Office concerning the conduct of 'effectiveness and efficiency audits' in relation to the resources of both the Crown and local authorities. (s. 25(3)) Given their importance in the relationship between the Audit Office and local authorities effectiveness and efficiency audits are discussed in section four.

### 6.2.3 Unlawful Expenditure and Surcharge

The 1886 *Municipal Corporations Act* allowed both the Controller and Auditor-General (by then the only auditor of local bodies) and any ratepayer to take before the courts any councillors involved in the misappropriation of council funds. Similar provisions were not in the earlier 1876 *Municipal Corporations Act*. Misappropriation was either paying out money unlawfully or incurring a liability unlawfully. The Controller and Auditor-General was required to determine whether misappropriation had occurred. Any ratepayer taking action under this provision could demand that the Controller and Auditor-General provided the necessary information for such an action to take place. (s. 176) Only limited discussion of this matter was recorded in the parliamentary debates, with the focus of debate being on other parts of the large *Municipal Corporations Bill 1886*.

The 1892 *Public Revenues Act* introduced the authority and the requirement for the Audit Office to surcharge members of a local authority if expenditure was made without the necessary legislative authority. This compared to the powers of the 1886 *Municipal Corporations Act* by which council members involved with misappropriation could be sued. The Legislative Council debated this new power, with two members criticising the clause on the basis that it might deter men of financial means from standing for office, as they would be liable to such a surcharge. The 'joint and several' liability of councillors could have meant that wealthy councillors might be required to pay the entire surcharge. One member of the Legislative Council suggested that suitable men would not stand for council.

Legislation of this kind will have the effect of throwing the whole management of local bodies into the hands practically of men of straw, and into the hands of a class of men whom it is not desirable to have.\(^{15}\)
The 1900 Municipal Corporations Act, while repealing both the 1886 Municipal Corporations Act and the sections applying to municipal audits and surcharge in the 1892 Public Revenues Act, continued and expanded the provision for surcharge. The Act restricted the right to surcharge for unlawful expenditure to only the Controller and Auditor-General. These provisions continued in the 1913 Public Revenues Amendment Act and the 1926 and 1953 Public Revenues acts. The 1977 Public Finance Act added a third category of the unlawful loss subject to surcharge, that of wilfully or negligently failing to enforce the collection of money due. (s. 31)

The 1953 Public Revenues Act gave the Minister of Finance discretion to reduce the amount surcharged (s. 90(2)), while the 1977 Public Finance Act gave this discretion to the Controller and Auditor-General. (s. 31(7))

In 1969 the Audit Office sought and obtained changes to legislation, regarding notification to the Audit Office of misappropriations in local authorities. The resulting legislative change in the Public Revenues Amendment Act 1969 permitted the use of regulations to specify the form of such notification. The associated regulations\textsuperscript{16} were intended to avoid situations when the Audit Office was only informed of an offence at the time of the audit, which may have been some months after the offence had occurred.\textsuperscript{17} The ability of the Audit Office to take action for a misappropriation that had occurred some months prior limited the effectiveness of the Audit Office’s role in protecting local authority money and stores. Such changes were intended to bring requirements for local authorities in line with those for central government departments.\textsuperscript{18}

6.2.4 Charging for Audit Services

Under the 1876 Municipal Corporations Act, remuneration for the (elected) auditors was to be determined by council (s. 95), with no further guidance provided on the limits of payments.

Between 1878 and 1886 no explicit provision enabled the Audit Office to charge local authorities for the audit work. However, the 1886 Public Revenues Act (s. 9) (a minor
amendment act) and the Municipal Corporations Act 1886 (s. 163) both\(^1\) permitted charges to be fixed by the Governor in Council. From that time until 1953 the charges were fixed by the Governor/Governor-General in Council. The 1953 Public Revenues Act changed the fee-fixing regime by giving the Minister of Finance authority to set fees. (s. 31) This remained the case in the Public Finance Act 1977.

6.2.5 Regulations under Municipal Corporations/Local Government Legislation

As noted earlier from 1901, regulations were used to regulate the financial management/control of local authorities. Regulations between 1901 and 1956 provided for the auditing of end of year accounts by the Controller and Auditor-General; the focus was on examination of original documents and correctness of the accounts, as determined by the various pieces of legislation noted above. From 1956 until 1979, the only commentary on auditing in the regulations concerned the power of an officer of the Audit Office to examine the books of a local authority any time. In the 1979 accounting regulations, references to auditing were no longer included.

6.2.6 Lapsed Bills – a Dark Moment for the Controller and Auditor-General?

In 1891 and 1892, the Government introduced two bills (the second after the first failed to be passed) to the Lower House, both entitled Local Authorities’ Accounts and Audit Bill. The Premier, John Balance, introduced both bills. The intention was for the bills to replace the provisions in the Public Revenues Act 1878 relating to local government auditing, as well as extending the Audit Office’s role in local government.

The 1891 Public Revenues Act was initially intended to repeal all the 1878 Public Revenues Act; the 1891 Act would cover all aspects previously covered in the 1878 Act, except those relating to local government, which were to be covered by a specific piece of local government legislation, that is, the Local Authorities’ Accounts and Audit Bill (1891 or 1892). As noted above, because these bills were not passed the sections relating to local government remained the only sections in force in the 1878 Public Revenues Act until the passing of the 1892 Public Revenues Act. The 1892 Act, a short act of seven sections, amending the 1891 Public Revenues Act, dealt predominantly with local authorities audit.

\(^1\) These two 1886 acts received the Governor’s ascent one day apart; the Public Revenues Act on 17 August, 1886 and the Municipal Corporations Act on 18 August, 1886.
The debates surrounding both bills provided many interesting insights into views at that time of those involved with local government finance, accounting and auditing.

6.2.6.1 The Local Authorities' Accounts and Audit Bill 1891

Introduced on 8 July 1891 and first debated on 17 July 1891, the 1891 Bill contained 36 clauses. The Bill applied the same rules for the auditing of and accounting for city, borough and county councils, as well as the various boards that constituted local government and

... every corporation or institution maintained or supported in whole or in part by grants of public money, or by the proceeds of endowments of Crown lands, or out of rates, tolls, fees or fines which any such body is empowered by law to levy, claim, receive, or enforce, and includes the corporation of which the local authority is the government body. (clause 2)

Essentially, the Bill aimed at capturing every organisation that used public money (excluding central government itself) or local government money. It proposed that significant powers be assigned to the Audit Office, including:

- Surcharging elected representatives for excessive overdraft borrowing (clause 6)
- Surcharging elected representatives for other illegal borrowing (clause 7)
- Auditing yearly and half yearly accounts and certifying them as correct (clause 12)
- Determining the form of accounts (clause 13)
- Ability to require local authorities to alter accounts if the Audit Office said the accounts were not correct (clause 13)
- Applying to Supreme Court to compel local authority to make changes (clause 13)
- Power to make special audit at any time for any period (clause 15)
- Auditing accounts of Sinking Funds (clause 16)
- Directing which accounts are to be sent to the Audit Office (clause 17)
- Auditing of claims for travelling expenses (clause 18)
- Power to examine under oath any individual in relation to local authority finance (clause 20)
• Recovering money on behalf of local authority (clause 21)
• Prosecuting in the case of fraud (clause 22)
• Surcharging council members for illegal expenditure, including expenditure prior to the Act coming into force (clause 23)
• Charging for audit services according to a scale fixed by Governor in Council.

Much of this content had been foreshadowed in the Controller and Auditor-General’s Report to Parliament in 1881, following his trip to Australia.19 The focus on altering accounts so that they were true as determined by the auditor, and the power to surcharge, both had their roots in that Report. That Report and the Bill (ten years later)1 had a strong emphasis on fraudulent and illegal activities and inappropriate accounting. The response of the local government community (via Parliament) to the proposed legislation was forceful and direct.

Debate in Parliament on the Bill was fierce and almost unanimously against the Bill, at least in its initial form. Significant complaints against the Bill concerned the additional powers to be given to the Audit Office, the requirement that separate bank accounts be kept for every account (clause 5), and the retrospective aspects of the Bill regarding the application of the surcharging provisions. However, the greatest complaint related to the additional role of the Audit Office in the running of local authorities and, in particular, municipalities. The majority of speakers against the Bill were representatives of electorates in cities and large boroughs.

The most forceful speech against the legislation was by Mr Fish, member for Dunedin City, who was acknowledged during the debate “as an authority on municipal matters”. Fish had previously been a Dunedin City councillor, then mayor for six years, and had held elected positions in other local authorities. (Sinclair 1993) In a style he was noted for, Fish lead the attack on the Bill and the Controller and Auditor-General in the following words:

This Bill appears to be a Bill of the most monstrous description ever presented to the House. I feel certain the Premier has never read the Bill; if he has read it he has not profited by the reading. It is not the Premier’s Bill; it is the Auditor-General’s Bill; he has drafted every line of it, and every line bristles with tyranny and autocracy of the most disgusting nature. Knowing that gentleman,

1 The Controller and Auditor-General was the same person through the period – Mr James Edward FitzGerald.
however, as well as I do, I am not surprised that he has given us a Bill of this kind. I have no hesitation in saying, especially so far as Municipal Corporations are concerned, that the Bill is framed effectually for no other purpose than to hamper the finance, irritate the bookkeeping, and utterly demoralise the proper carrying-on of municipal functions.\textsuperscript{20}

Fish criticised various parts of the Bill and the person of the Controller and Auditor-General, objecting to both in very strong terms. He saw such legislation (and the likely interpretation of it by the current Controller and Auditor-General) as constraining the activity of local authorities, and claimed that legislation should be used to “extend, and not to cramp, the powers of local bodies”.

Other speakers were less damning of the Bill, but even those indicating support, did not give it without some qualification. The Controller and Auditor-General’s concerns regarding the state of local body accounts and audit, which had lead him to prepare and submit the Bill to the government, were shared by many of the speakers.

That there is reason for a more strict audit than we have had in the past none of us, I think, will deny; but I hold at the same time, that the present Bill is too sweeping.\textsuperscript{21}

The Bill was read a second time and then sent to the Public Accounts Committee for review.

In the Public Accounts Committee a number of public submissions were received. The voting patterns from the clause-by-clause deliberations of the Committee showed there was a far from universal approval for the Bill even as it was being modified. Discussion on the Bill, only 36 clauses long, was held over five days. The debate, although not recorded, would have been heated at times, with members requesting that their disapproval of particular clauses be noted.\textsuperscript{22}

The Committee reported the Bill back to the Lower House after making minor modifications. The power and influence of the Audit Office in the operation of local authorities was not altered in the reported back version of the Bill. After being reported back from the Committee, the Bill stalled in the parliamentary process and lapsed.

\textbf{6.2.6.2 The Local Authorities’ Accounts and Audit Bill 1892}

The following year, the Premier introduced a new bill by the same name. This Bill was similar to the Bill returned from the Public Accounts Committee the previous year. The major differences between the 1891 Bill (as modified) and the 1892 Bill (as introduced) were the removal of provisions providing for retrospective surcharging and the inclusion of
provisions that increased the maximum permitted overdraft level to include trading income (as opposed to only rates revenue). The Bill was introduced on 6 July 1892, received its second reading on 12 August 1892, and was referred to the Public Accounts Committee.

During the second reading, the only speech recorded was made by Mr Fish, who wanted major changes made to the Bill in the Public Accounts Committee. Compared with the previous year’s debate, this speech was a ‘non-event’. However, the Bill was clearly expected to undergo dramatic changes in the Committee.23

The Committee sought the view of local authorities from the Secretary of the Wellington Harbour Board and the Wellington City Council Town Clerk, via a report on discussions held at a recent Municipal Conference. Their submission to the Committee recommended that the Bill not proceed, stating that the provisions in the Public Revenues and Municipal Corporations Acts were sufficient. The major stumbling block for the legislation was the surcharge provisions. The Secretary of the Wellington Harbour Board suggested that the penalties were too severe and a disincentive to people to stand for election on boards and councils.

Businessmen give their time and abilities gratuitously, to the service of the public, on local bodies, and so long as they act in good faith they ought not to be subjected to the possible infliction of fines or of surcharges or have the onus cast on them of moving the Supreme Court for remission thereof.24

On the 17 August 1892, the Public Accounts Committee set the Bill aside, and again a local authority accounts and audit bill lapsed.

As noted above, the 1892 Public Revenues Bill included a clause that made the Audit Office the auditor of local authorities (mirroring provisions already enacted in the Municipal Corporations Act 1886). This clause was included in that Bill by the Public Accounts Committee on the motion of the Premier on 23 September 1892,25 a month after the second attempt had failed for a specific local government audit act. The inclusion in the Public Revenues Act was clearly the best alternative available if the local government audit provision were to be included in legislation other than specific local government acts. Since 1892, the Audit Office mandate for local government auditing was always in public revenues/finance legislation, apart from a brief period between 1900 and 1913 when boroughs and cities were explicitly named as being outside the operation of the legislation, during which time they relied solely on provisions in the municipal corporations acts.
6.2.6.3 Discussion

Was the failure to pass either of the bills, and the associated debate in and around Parliament, a ‘dark moment’ for the Audit Office, especially in terms of its relationship with local government? Either way, historical records outside the official records of Parliament at this time do not tell a story. There were no calls to repeal the provisions of the 1886 Municipal Corporations Act that made the Audit Office the auditor of local authorities. The nature of discussion and the failure of the bills to be passed through Parliament appeared to rest with the person of the Controller and Auditor-General rather than the position. By 1892, James Edward FitzGerald neared the end of his 30 years in the position of Controller and nearly twenty years as Auditor-General. His background in central and provincial government politics prior to becoming Comptroller in 1867 may also help to explain the attitude towards ‘his’ legislation.

James Edward FitzGerald, who died in office in 1896 in his seventy-ninth year, had a diverse life, reflecting his many abilities as a newspaper owner and editor, a Canterbury runholder, a provincial and central government politician, and Comptroller and Auditor-General. (McIntyre 1990) He was a superintendent of the Canterbury Province and a member of the House of Representatives. He was also chosen to lead the first members from the House of Representatives in the Executive Council (for which some historians have called him the first New Zealand premier) during the period leading up to responsible self-government. It was perhaps during those days in particular that FitzGerald made a number of adversaries, given his sharp wit and powerful oratories and, as his biographer described, “his erratic behaviour and outbursts of temper”. (Bohan 1998 p. 294) As comptroller, after his time in politics, he frequently questioned the actions of government and Parliament. His sharp intellect was accustomed to detailed review of legislation, regulations and government spending, which would have annoyed those who had initially given him the job. (Bohan 1998 p. 304) Local government may well have had reason to worry if FitzGerald had turned his mind to local government, as envisaged in the 1891 and 1892 bills.

Essentially, these two bills were examples of local government exercising, predominantly through allies in Parliament, some degree of power over its affairs and the controls that were to be imposed. It might have been a dark moment for FitzGerald in his final years,
but for the Audit Office and its relationship with local government, no harm appeared to have been done.

6.3 The Audit Office at Work

Legislation and parliamentary debates tell only a limited story of the role and position of the Audit Office with local government. Parliamentary debates, like all records, are aimed at a particular audience, but in particular they are generated in an artificial environment that requires conflict and opposing positions. This was well illustrated in the above situation with the Local Authorities’ Accounts and Audit bills. This section leaves behind the parliamentary and legislative material and will now focus on a number of key aspects relating to the audit function in local government, in particular, the role of the Controller and Auditor-General and the Audit Office.

6.3.1 Audit Office – Independence while Working with Local Bodies

For any auditor, the appearance of independence is considered important, yet for the Audit Office, independence can be viewed as both a necessity and a luxury. Independence in the context of local government audit has traditionally related to the Audit Office’s independence from political issues of local government rather than managerial issues. In fact, for most of the period covered in this thesis, the Audit Office worked alongside local bodies, including helping them to prepare their accounts as well as auditing the same accounts.

In 1924, the Controller and Auditor-General outlined the role that his officers often took in the preparation of the accounts prior to performing the audits.

In many cases the Audit Inspector is relied on by the local-body clerk for assistance in the compilation of the annual accounts, which leads to delays, and casts upon the inspectional staff duties other than those which strictly pertain to the actual auditing of the accounts.26

Yet, the problem with this practice was the additional time spent on the audit by Audit Inspectors, rather than concern regarding the independence or professionalism of the auditors.

Before the Public Revenues Act 1953 made the audit of local body stores mandatory, the Controller and Auditor-General encouraged local bodies to keep accurate records, even offering the Audit Office’s services to assist in such matters. In a report to Parliament, the
Controller and Auditor-General highlighted the provision of such services without any hint of possible conflict of interest or that such work by an auditor\(^{1}\) could be inappropriate.

The services of the Audit Inspectors are available to local authorities desirous of introducing systems of stores control into their accounts, and a number of local bodies have already sought their advice in this matter.\(^{27}\)

Time spent by Audit Inspectors working with local bodies was considered well spent, reducing the number of situations where the Audit Office was required to take exception to the accounts or to amend them. Such work was done without charge; the payback for the Audit Office was the closer cooperation with local bodies, generating savings in costs for local authorities as a result of advice given, and reducing the total time taken for the audit.\(^{28}\)

By 1970 the Controller and Auditor-General was concerned about the use of Audit Office staff to prepare the accounts of small local authorities, in terms of both effort and appropriateness:

Apart from the wider issue of the economic viability of the small local authority, it is not a function of an auditor to do such work nor are the present resources of the Audit Office sufficient to bear the additional time involved.\(^{29}\)

However, in 1976/77 the Controller and Auditor-General highlighted again what most private sector auditors would have considered an inappropriate level of involvement with the accounts\(^{ii}\), yet practical considerations of the local government sector meant that it was necessary in order to achieve the aims of greater accountability.

In the case of the smaller units, we still have a share of inefficient administration to cope with, with the result that, if any finally is to be reached, the auditor himself has to balance off the accounts and produce them in a fit state for reporting on if he is to bring the audit to a conclusion.\(^{30}\)

Acceptance of the need for an auditor to go beyond the normal role of auditing was not confined to the mid 1970s, with evidence of it happening throughout the years. By the late 1970s the Audit Office wished to distance itself from helping management in that way.

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\(^{1}\) It would be more than likely that the Audit Inspector providing the advice would also be responsible for the audit of the local authority.

\(^{ii}\) Such practices were not disallowed in New Zealand but were generally seen as an impediment to actual and/or perceived independence of the auditors. See Porter (1993 pp. 66 – 76) for New Zealand based discussion on auditor independence and Mautz and Sharaf (1961) for a more general discussion on auditor independence in the early 1960s.
The Audit Office continued to encourage the use of chartered accountants by local authorities in the preparation of accounts and to provide financial management assistance. In a process that began in the previous decade the Audit Office sought to be regarded as the independent auditor of local authorities – independent from both the political and managerial aspects of local government. In spite of its desire to be more ‘independent’, the practicalities of working with some local authorities meant that the Audit Office was still required to prepare accounts. Following the introduction of the new accounting regulations in 1979, the Audit Office anticipated a need for its auditors to still be involved in the preparation of some accounts.

It should be acknowledged that there are clients who will prove to be quite incapable of producing the requisite Statements, and, as a matter of policy, the auditor, with the approval of the Regional Director concerned, should produce the Annual Statements himself. This change in policy will be the subject of a separate Circular.31

Because the Audit Office’s role and influence, including some legislative requirements, extended beyond audits, both financial/probity and operational, the Audit Office’s position was always more than an independent external auditor *qua* private sector auditing. These other roles are discussed later in this chapter.

### 6.3.2 Audit Office Audit Fees

Since 1886 the appointment of the auditor was determined by legislation, while the fees to be charged were determined by Governor/Governor-General and later the Minister of Finance, it was therefore not surprising that complaints were made regarding the fees charged by the Audit Office to local government. From 1889, local government was the largest group of audits performed by the Audit Office and the major client group to be charged. Most central government audits were funded through the appropriation to Audit Department rather than charging the ‘client’. The number of complaints regarding the cost of audits was relatively small, usually associated with general economic conditions at a particular time, rather than any issue of being ‘overcharged’.

Charges were first gazetted on 23 October 1888, at an amount of £2 per day, with each day being six hours of work. By January 1891 the Controller and Auditor-General had received complaints relating to the fee and, in particular, the apparent variability of the amount that councils were charged in different years’ audits. The Controller and Auditor-General’s solution was to introduce invoice type slips to be submitted on completion of an audit and to be signed/agreed by the council at that time.32
In protest over a charge for the 1915-16 audit, the Wellington City Council would not pay its audit account of £260. The Council was concerned over the charge for the junior auditor, which totalled £70. The response of The Treasury, as collector of money owed to the Crown, was to deduct that sum from the amount to be paid by the Crown as the Government’s subsidy on rates.\(^\text{33}\)

The first increase in the audit rate after 1888 was 33 years later on 13 June 1921. On that occasion the rate increased from the £2 to £3-3-0. The justification for the increase was the comparative cost of private sector audits and the availability and cost of staff, especially given the increased complexity of the work of auditors, following the introduction of additional responsibilities for the audit of trading activities and their profit and loss accounts.\(^\text{34}\)

In response to the depression in the early 1930s, all government departments were required to reduce expenditure, to assist in balancing the government’s budget. Pay cuts to public servants were a major part of the economy drive, including a 20 per cent cut in salary of the Controller and Auditor-General and Audit Office staff.\(^1\) Local government wanted part of the savings! During 1932, approaches were made on this issue by the Municipal Association and from individual local bodies. Questions were also raised in Parliament on behalf of local authorities. The problem of the cost of audits was exacerbated for some local authorities by the increased audit work required as a result of additional stamp taxes collected by local government. Thus, while the hourly charge remained constant, the cost of the audits rose due to their increased complexity and size. The response of government to the criticism was twofold: firstly, by pointing out that the objective of balancing the books of central government would not be achieved if savings were passed to the local authorities as reduced charges, and secondly, the Controller and Auditor-General compared the audit fee rate with the scale of fees fixed by the New Zealand Society of Accountants (NZSA). The fee scale for the NZSA at the time was £7-7-0 per day compared to the £3-3-0 for the Audit Department.\(^\text{35}\)

In 1959 the Minister in Charge of the Audit Department introduced a fees setting policy, stating that fees in principle should cover costs, although the government acknowledged

\(^{1}\) It is interesting to note that the judiciary fought (and won) an argument that this pay cut should not apply to them, on the basis of their constitutional independence from the actions of the government. This issue was never raised in relation to the Controller and Auditor-General.
that costs not attributed to the Audit Office were not covered (such as rent and contribution
to the government superannuation fund). Yet political considerations, including
government restraint during times of national fiscal constraint and the impact on local
authorities of the fees, were always part of the picture. Furthermore, because
disbursements and travelling costs were not included in the charge there was an implicit,
although acknowledged, subsidy by the larger cites and boroughs to the smaller and rural
councils. 36

While there were some complaints regarding the fees charged and the monopoly of the
Audit Office (discussed below), there were few complaints about the need and value of
audits. The columnist, ‘Scrutineer’, in The Accountant’s Journal made an interesting and
slightly unusual complaint in 1962, regarding the Audit Office fees for local authorities.

One aspect of local body auditing which is a source of amazement to
accountants in practice is the low value which the Audit Office appears to
place on its services. 37

The Controller and Auditor-General responded in his report to Parliament that year saying:

On occasions surprise is expressed at the modest fee charged to particular
organisations. Such expressions are made without an appreciation of
contributory factors, e.g. the full cooperation of executives in instituting and
maintaining reliable internal controls, and the appointment of full-time internal
auditors who work in close cooperation with District Auditors. Full advantage
is taken of these conditions when they apply, and the cost of audit is reduced
accordingly. 38

The fees, after 1974, reflected the introduction of a new public sector occupational class
for accounting staff, which resulted in increased salary levels for most Audit Office staff. 39
The fees in the late 1980s also increased substantially due to the shortage of accountants
and the historically high salary levels for accountants in the public sector as a result of state
sector employment reform. 40

An interesting endnote to the issue of audit fees was the continued poaching of Audit
Office staff by local authorities. It was an issue often discussed by the Controller and
Auditor-General in relation to the salary differential between what he could pay his staff
and what local authorities could pay their accounting staff. In 1961, the Controller and
Auditor-General noted that losses of staff to local authorities, due to pay and conditions,
had “gone on for over 20 years”. In 1970, it was noted that a pay differential between local
government and Audit Office could be “up to $2,000 or more”; at that time the Controller
and Auditor-General himself earned approximately $11,000 per annum. 41
6.3.3 Performing Audits - Audit Office versus Other Auditors

Although the Audit Office had the sole mandate to be the auditor of local authorities since 1886, the issue of who should be the auditor has been a recurring theme in the history of local authority accounting and auditing.

As mentioned earlier, the decision to make the Audit Office the auditor of local authorities related to two concerns:

- the need to have a reliable system to surcharge local authority members, and
- that monies provided by central government as grants to local authorities should be audited from central government.

At the same time, two related but additional rationales for the Audit Office’s mandate were given:

- that the audit was only concerned with detecting illegal activity, and not involved with council’s legal activity, thus not counter to the right of councils to perform those activities for which it had authority, and
- that the auditor should be independent from the local community whose local authority he was auditing.

This section looks at discussions on the use of the Audit Office as auditor in terms of policy, practice, and one particular case where the use of a private sector auditor was called for from both the courts and the accounting profession.

6.3.3.1 Performing Audits - Audit Office versus Other Auditors – Policy Issue

An incident in 1900, which could have raised concerns about the Audit Office being the auditor of local authorities, had an airing in the House of Representatives. In a question to the Premier, the member for Invercargill, Josiah Hanan, raised concerns about the state of municipal accounts. The reply of the Premier pointed out some of the failures of audits, including the failure to detect fraud. Yet there was no record that other auditors should be used instead of the Audit Office, rather a commitment to change the system was given.42

As was often the case where members of Parliament queried local government issues, Hanan himself was an experienced local body politician, having being mayor of Invercargill borough. (Lee 1996 pp. 197-8)
The major body to raise the issue of using private sector auditors was the accounting profession. In 1923, and again in 1931, the New Zealand Society of Accountants wrote to the Minister of Finance and Prime Minister, respectively, to seek approval for public accountants to undertake audits of local authorities.¹

The 1923 argument related to the newly formed Auckland Electric-power Board (Bush 1971 p. 228). The Board was created under local legislation enacted specifically for the Board.⁴³ Provisions in the Act included that the Audit Office was to be the auditor of the Board (s. 50(2)). The NZSA erroneously complained that this was a change in policy and practice; in fact for all local authorities, even those with their own legislation, it was standard practice to have the Audit Office as auditor. However, more importantly, was the logic used to discuss the issue that the NZSA adopted:

such work can be better undertaken by experienced practising accountants without additional expense to the Dominion and that the practical commercial training of Public Accountants is of considerable value to Local Bodies engaged in trading operations.⁴⁴

It also pointed out that the Controller and Auditor-General had informed the Auckland Electric-power Board that the Board’s appointment of a private sector auditor in addition to the Audit Office was illegal and that the Audit Office would surcharge individual members of the Board for the cost of the private auditor. The Minister of Finance replied that the Audit Office was the appropriate auditor of the local authorities for the following reasons:

- Local authorities, in general, asked for the Audit Office to be the auditor,
- The Audit Office was as efficient, if not more than, as private sector auditors used under the previous arrangement,
- Audit Office staff were better equipped to deal with the implications of statutory requirements, especially with access to the experience of the Audit Office Head Office and the knowledge of the Crown Law Officers, and
- That the Audit Office staff were removed from any possible professional or personal advantage from their work.

¹ The Incorporated Institute of Accountants of New Zealand in 1957 also argued for the certain public sector audits to be carried out by private sector auditors. In that case it related to the audit of public sector corporations rather than local authorities.
It was the last point that the Minister noted (quoting directly from Treasury advice), that

This feature may well have largely influenced the creation and maintenance of
the present system.45

The 1931 approach to the Prime Minister (who was also the Minister of Finance) was based
on comments made by the Chief Justice in New Plymouth in January that year.1 During the
sentencing of a man responsible for the theft of funds from a local authority, the Chief
Justice suggested that when the Audit Office was not available to audit local authorities in
reasonable time, then private sector auditors could perhaps be employed, either to audit the
Council’s accounts as an intermediate audit or instead of the Audit Office audit. The
NZSA suggested that private sector accountants should audit any accounts not audited by
the Audit Office within six months of the end of financial year and the audits be accepted
by the Audit Office, or alternatively the Audit Office should be authorised to employ
public accountants to perform the audits. The response of the Controller and Auditor-
General was that the lateness of the audit in this and many other cases was the result of the
lateness of councils in preparing the accounts rather than the Audit Office’s tardiness.
However, he did indicate that on occasions, due to staff shortages, the Audit Office was
late in conducting some audits. On the policy issue of use of private sector auditors the
Controller and Auditor-General said that he could not (due to the legislation) accept
anybody other than one of the Audit Office officers certifying the accounts. The same
arguments previously presented were reiterated with two further points added concerning
cost and the desire of local government itself. The difference in cost per day of the auditor,
as mentioned above in relation to the depression years, was shown as £3-3-0 for the Audit
Office, compared with the fixed fee of £7-7-0 for the New Zealand Society of Accountants.
Furthermore, as noted above, the Audit Office did not charge for travel (until the 1980s)
whereas the NZSA rate was exclusive of travelling time. Secondly, the Controller and
Auditor-General stated that:

I very much doubt if the local bodies themselves desire any alteration. They
have never, as far as I know, expressed a desire for a change.46

Again, in 1968 the Controller & Auditor-General responded to the idea of local body
audits being carried out by public accountants. In a review of the Audit Office he stated the
same reasons as above, plus a further two:

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1 This case should not be confused with the New Plymouth court case in 1951 discussed below.
• Other non-audit roles, performed in conjunction with audits, such as ruling on conflicts of interest by elected representatives and legality or otherwise of actions were unlikely to be handed over to the private sector by the legislature.

• Inquiries from both local authorities and the public about the legality of actions of authorities would still need to be handled by the Audit Office. ⁴⁷

In 1982 the Audit Office suffered again from a lack of necessary resources to perform audits. The possibility of using private sector auditors was considered, this time in an internal Audit Office forum, but was again rejected by some Audit Office staff.

Due to the specialised nature of these audits, it is not considered that the utilisation of resources outside the department, i.e. Chartered Accountants is warranted unless such individuals were ex-members of the department whose learning curve would be at a minimum. ⁴⁸

As will be discussed shortly, in the same year, the Audit Office began to use a few private sector auditors in a controlled setting.

Between 1984 and the mid 1990s (at least), the political discourse in New Zealand changed dramatically. The election of the fourth labour government in 1984 altered policy preferences, public administration, and government fiscal and monetary management policies. The impact of those changes on local government was most evident in the changes legislated by the Local Government Amendment Act (No. 2) 1989, the point of closure for this thesis. However, between 1984 and 1989 (only indirectly related to changes in the 1989 Amendment Act), the role of the Audit Office as auditor of local authorities was debated. The philosophy of the day, variously termed Rogernomics, New Public Management, New Right Philosophy as well as other names, can be described for current purposes as having its basis in the following beliefs:

• contestability and the use of the market to obtain the most efficient delivery of services,

• a preference for private sector provision over public sector provision, and

• the desire for a reduction in the role of the State.

Reforms undertaken between 1984 and 1989 focused on central government, but local government was not immune to those changes or isolated from the momentum of changes that occurred in Wellington. Changes in central government departments forced local government to make changes to the manner in which it carried out business, especially in
relation to subsidies and infrastructural projects. Individual councils and the national body representing them, the then Territorial Local Government Council, raised the issue with government of the appointment of auditors of local authorities. The issue was raised in terms of cost effectiveness, ‘that the user should also choose who it will pay’ (an extension of the government’s ‘user-pays’ policy), and in terms of the Audit Office having a monopoly on such services. The reply was written by the Minister of Local Government (Michael Bassett) in consultation with the Minister of Finance (R O Douglas) and the Minister in Charge of the Audit Department (R J Tizard). The reply indicated a difference of opinion between Ministers Bassett and Tizard. The Minister of Local Government indicated sympathy for the concerns of local government. However, he stopped short of supporting the Territorial Local Government Council’s argument by referring to his colleague’s comments. He wrote:

However the Minister in Charge of the Audit Office points out that the role of the Audit Office in public accounting has wider ramifications than the ordinary supply of a service within the public sector.

He notes that constitutionally the Audit Office is an integral part of the public accountability process ...

I accept the points made by the Minister in Charge of the Audit Office. Nevertheless I also acknowledge that the whole question of local authority freedom from statutory constraints is one that must be addressed.69

While the Minister in Charge of the Audit Department argued successfully against the local authorities and the Minister of Local Government’s view on the use of private sector auditors, the Audit Office was still under attack. In briefing papers to the incoming (reelected) government, later in 1987, the Audit Office again discussed the use of private sector auditors in the public sector, including local government. The briefing paper took the view that it was less than desirable to use private sector auditors, but a necessity, due to lack of staff. The major problems of using private sector auditors were the additional monitoring of audit work and the associated costs, and ensuring that the Audit Office maintained its relationships with the entities being audited. According to the briefing paper, the “initiative [to use private sector auditors] was not taken lightly”.50 The practice of using private sector auditors is reviewed in the following section.

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1 However, the Audit Office’s Minister changed to G W R Palmer, whose designation was “having responsibility for the Audit Department”. References to ministers are from Wood (1996).

- 157 -
1988 saw a major challenge to the role of the Audit Office in relation to all audits, not only those for local authorities. The Finance and Expenditure Select Committee, as part of its review of Vote: Audit, commissioned a report (The Strategos Report) on the Audit Office.\textsuperscript{51} The Strategos Report, costing $3,960 and consisting of five pages, reflected political philosophy of the mid 1980s. At its most extreme, the report recommended disbanding the Audit Office, having another state agency take on the controller function, and having \textit{ex-post} audits performed by private sector auditors. While local government would have been greatly affected by the recommendations of the Report, it was only once referred to, and even then, only as the last client on a list of Audit Office client groups. No analysis was made of why local government should or shouldn’t have had the Audit Office as auditor, other than an unwritten presumption that because audits could be performed by the private sector, then they should have been performed by the private sector. The Controller and Auditor-General at the time said the Report lacked an “understanding of constitutional practices and relationships”,\textsuperscript{52} reflecting a focus on central government. Equally, the comment reflected the lack of acknowledgement of the issue of local body audits, because constitutional issues relevant to the Audit Office were more connected with Parliament, appropriations and central government accountability. The practical issue of who could best serve the audit needs of local government was answered in the Report by reference to the political beliefs in vogue at that time (‘obviously the private sector’), but with no discussion. Similarly, the response of the Controller and Auditor-General to the Report did not address the issue; he had the more important argument relating to central government audits with which to deal.

In spite of the challenges, the policy continued of the Audit Office being the auditor for local government. At best, most attempts to change the policy were half-hearted, or involved only a small number of significant players. What might have happened if the Municipal Association had taken on the issue, or if the 1980s approach of the Territorial Local Government Council had been more forceful and prolonged? If local government, itself, had been more interested in using private sector auditors, it could possibly have achieved such a change in policy.

An interesting twist in the interest shown by private sector accountants in auditing local authorities occurred during the 1950s when the Incorporated Institute of Accountants of New Zealand sought to have additional reports prepared by auditors for local authority
management. Although the Incorporated Institute’s motive was unclear, its tenacity suggests an important aspect may have been the involvement of its members. The request was based on the practice of auditors of private companies providing Boards of Directors with a report that supplemented the audit report. The response of the Secretary for Internal Affairs, based on the advice of the Controller and Auditor-General, was that the Audit Office already performed such a task under its mandate, which was wider than its private sector counterpart’s mandate. Furthermore, the Controller and Auditor-General stated at the time that safeguarding local authority finances was largely at the level of ensuring statutory restrictions on spending were fulfilled, thus a matter of the law. The key role of audits was to ensure that expenditure was legal (and to a certain extent appropriate), and therefore additional reports, as provided in the private sector, were not required. 53

6.3.3.2 Performing Audits – Audit Office versus Other Auditors – Practice

Following the introduction of the requirement in Municipal Corporations Act 1886 that all local authority accounts were to be audited by the Audit Office, the Controller and Auditor-General used ‘outside inspectors’ for the audits in 1887 and 1888. This was clearly an unsatisfactory practice in his eyes. In 1891 he petitioned both the Colonial Secretary 54 and the Premier 55 to provide additional resources to employ the necessary staff.

Another 93 years were to pass before private sector auditors were used again in 1982 by the Audit Office for the audit of local authorities. In 1982, the Audit Office began a pilot project of fifteen audits, including local government audits, which were contracted out to private auditors. The pilot was originally planned to last until 1987, but the audits continued beyond 1989. The major change introduced in 1987 was that instead of the private sector auditor reporting to the entity, as was the case until 1987, he or she reported to the Audit Office, which then issued the audit report. 56 The delegations were not viewed by the Audit Office as the commencement of a transfer of audits to the private sector, but rather as a means of increasing the private sector’s knowledge of local authorities and of assisting the Audit Office with a backlog of audits. At this time there was some disquiet regarding the use of private sector auditors, both within the Audit Office and within local authorities. 57 In 1988, the Audit Office contracted out a total of 31 audits to private sector accountants; fourteen of these were for audits of local authorities, including four that were either city or borough councils. 58
6.3.3.3 New Plymouth Court Case – Another call for Private Sector Auditors

During the late 1940s the audit of the New Plymouth Borough Council accounts fell behind schedule. The audit of the 1945 accounts was completed two years after the end of the financial year, while the 1946 audit was thirteen months after the end of the financial year. During the following financial year the Council’s cashier began to misappropriate council funds to fuel a gambling habit. By May 1948, more than £17,000 had been stolen by the cashier.

The New Plymouth Borough Council sought damages from the Crown for the failure of the Audit Office to audit the accounts in a reasonable timeframe. The reason given for the delay in auditing was the workload of the Audit Office staff. This workload problem was due both to a lack of staff and illness of the audit inspector. The Audit Office appears not to have contested its liability, although it queried the amount. The judgment resulted in the Crown being ordered to pay the Council £5,645-14-0. The amount was calculated as the sum stolen (less money recovered) after a date the judge considered the auditor should have commenced the audit. The court also noted that the work of the Audit Office was deficient, as it should have recognised the signs of the misappropriation from the limited work performed on the accounts, prior to the appointment of a new audit inspector, who identified the theft almost immediately.

As a result of the theft and court case there was a call for private sector involvement in audits. During the court case, the judge suggested the Audit Office should use private sector auditors. The New Zealand Society of Accountants passed a motion at its AGM that the Society’s council should approach the government to alter legislation that would provide a definite date for completion of audits, as opposed to “as soon as possible after April 30”, which was the current regulation. The NZSA also sought changes to the legislation so that the Audit Office’s audit work could be undertaken by public accountants if necessary. The president of the New Zealand Society of Accountants noted that:

> the real object of this motion was to ensure that local body audits were completed in good time, and not to gain additional work for members of the Society.

In the parliamentary debate for Supply to the Audit Department, the New Plymouth case was the most discussed item. However, no one spoke ill of the Audit Office. The opposition member who led the discussion said:
That he thanked God that there was an Audit Department responsible only to Parliament and not to a Minister. ... The Department was doing a good job.  

Essentially, discussion focused on how the Audit Office could engage more staff, with no reference made to the use of private sector auditors. Problems regarding staff in the Audit Office were threefold: the lack of a full workforce following the second world war, the significant number of Audit Office staff who sought employment with local authorities, and uncompetitive salaries compared with private sector auditors.  

6.3.3.4 Performing Audits - Audit Office versus Other Auditors – Conclusion

Since 1886 no serious challenge had been made to the Audit Office’s mandate in relation to local government. On occasions there were queries regarding the use of private sector audits, particularly when the Audit Office was under stress and/or under performing. The most serious challenge was in 1988, yet that was not concerning the audit of local government per se but concerned the existence of a central government agency that performed audits. With no significant challenge from local government itself, the Audit Office’s mandate remained barely questioned.  

6.3.4 Who is the Client?

For the period of the elected auditors (that is up to 1886) it was unclear for whom the elected auditors were working – a council, or those who elected the auditors. The determination of the remuneration and the appointment of a replacement suggested the council, yet the mere fact of election by the burgess suggested the auditors were working for the ratepayers. Such an obvious comment on the 1876 legislation suggests that this was not an issue at the time. The distinction between community and council might not have been as sharply defined as is possible today. Relatively small communities, even in the largest municipalities, ensured that any conflicts of interest were more visible than later, when cities and boroughs became larger. The largest municipalities in 1876 were Dunedin city and Wellington city, having estimated populations of 23,365 and 16,130 respectively; the average estimated population of New Zealand’s 41 municipal boroughs at that time was little more than 3,000.  

In 1881, the Controller and Auditor-General saw the Audit Office as auditor of local government would be in terms of ensuring that local authorities kept within parameters set by Parliament, for whom the Controller and Auditor-General considered that he worked.
However, since that time, the focus of the Audit Office was on working for the local community, described as either ratepayers or electors.

In 1968, the Controller and Auditor-General positioned the work of the Audit Office and, in particular, the audit report in the sphere of reporting to the community. In his report to Parliament, the Controller and Auditor-General outlined his expectation of how local authorities could deal with a qualified audit report from the Audit Office:

... the Audit Office requests that both the qualified audit report and the accompanying letter be tabled in open meeting (of the Council), and that a copy of the resultant minute be sent to this Office.64

Once tabled, it was expected that local media would report on the contents of an audit report to the local community. The Controller and Auditor-General went further, stating that if an audit report and associated communication were not tabled that he himself might release the report to the press. However, he also distinguished between a qualified audit report, which ought to be tabled in public meetings, and any report to a local authority chief executive that need not be made public. A qualified audit report was very much a final step, about which a local community had a right to become aware of any issue or concerns of the auditor.

The Audit Office saw that its main responsibility was to ratepayers and elected representatives, rather than to management. In 1969, the Controller and Auditor-General wrote to the Municipal Association on this issue, using an analogy of the relationship between private sector management and shareholders:

In company affairs the auditor addresses his report to the shareholders, each of whom receives, by law, a copy. The Audit Report on the accounts of a municipality is addressed to the Mayor and Councillors, but unless it is tabled, with accompanying correspondence, in open meeting, the ratepayers will have no means of knowing of the strictures which it contains as there is no requirement that each of them should be sent a copy.65

Until about this time, the Audit Office considered its role as auditor to be holding a council to account on behalf of ratepayers/electors and the local community. However, as commented in the previous chapter, by the early 1970s the focus of thinking on reporting by councils altered from ‘reporting to the Audit Office’ to ‘reporting to its community’. By the end of the 1970s, this thinking had become the sole purpose for the external accounts for local government. Thus, auditing by the Audit Office was for the local community, giving the local community some certainty about the accounts it could use to hold their
council to account, as opposed to the Audit Office performing that task on a community’s behalf.

6.3.5 Lateness of Accounts and Audits – Don’t Blame the Auditor.

As mentioned in previous chapters, at various times the Audit Office had both implicit and explicit roles in monitoring the lateness of accounts. Essentially, monitoring was based on when accounts were provided to the Audit Office for auditing. Any accounts that were presented late for auditing were likely to be audited ‘late’. Therefore, the Audit Office risked being perceived as late or inefficient with the auditing. How to avoid such a perception was a constant concern of the Audit Office. As noted above, the Audit Office was under staffed at times which lead it to undertake audits later than specified either in legislation or than normally expected. However, the Audit Office was not always at fault, and was not pleased when accounts arrived late and the audit was consequently late.

As noted above, in 1891 the Controller and Auditor-General indicated to the Colonial Secretary and the Premier that staff numbers were not sufficient to perform all the audits required. In an associated memorandum, the Controller and Auditor-General wrote that four boroughs (as well as 140 other local authorities) accounts had not been audited.\(^{70}\) That was in spite of legislation that required accounts to be audited and returned to the local authority “on or before the thirtieth day of April, or as soon as thereafter may be possible”.\(^{71}\) The Public Accounts Committee agreed that such lateness was not appropriate and that more staff should be employed.

The committee, recognising the impropriety of allowing the arrears in the audit of the local bodies to accumulate, are not prepared to incur the responsibility of objecting to the temporary appointment of the additional Inspector, which the head of the department asserts to be necessary.\(^{72}\)

One of the most striking examples of the Audit Office’s sensitivity to lateness attributed to them concerned the audits of Wellington City Council (WCC) during the early to mid 1970s. In a letter acknowledged by the WCC as “somewhat hard-hitting”\(^{73}\) the Controller and Auditor-General lambasted the Council for its lateness, and wanted to ensure that blame was taken by the Council and not attributed to the Audit Office.

It has become a matter of convention that the Wellington City accounts receive instant attention in the Audit Office as soon as they are received … The consequent disruption of normal work flows and other priorities in my Office would be acceptable if it were matched by an equal resolution on the part of the Council staff to present the accounts for audit promptly, but the summary time-table which appears as an appendix to this letter shows no evidence of this.
If Councillors, in receiving the accounts for adoption, should question their relevance to management decisions, considering that the latest transaction they record occurred twelve months ago, I would hope that you will make a proper acknowledgement of responsibility for delay. For myself and for the Audit Office I can disclaim any part of it ... on a previous occasion, ... when a Councillor questioned the late tabling of the audited accounts, the blame was incorrectly stated to be that of the Audit Office. One object in writing to you on this occasion is to express the hope that a similar misapprehension will not arise.  

Yet two years later the Wellington City Council and the Audit Office discussed again the same issues, this time in relation to the 1975 accounts. The Controller and Auditor-General wrote to the Town Clerk:

In the Evening Post issue of 8 July 1976, an article on proceedings at a meeting of the Council’s transport committee held the previous day included reference to certain comments made by the City Treasurer stating that presentation of accounts for the 1975 financial year in June (1976) was not possible as the accounts were only audited in October (1975).

The Audit Office is concerned that the reference to audit may have implied or be taken as implying that delay in this case is in some way attributed to staff of this Office.  

In reply the WCC Town Clerk said there was “no such suggestion at the meeting”, and attributed the problem not to the lateness of the accounts but, rather, the availability of the “glossy [annual] report”. Perhaps the final comment on the Wellington City Council accounts during this period comes from the Audit Office’s audit report, dated 14 March 1977 for the WCC accounts, year ended 31 March 1976, which had an additional line of type at the bottom of the report:

these accounts were received for Audit in February 1977

As noted in chapter four, accounts from 1976/77 onwards were subject to a new deadline for preparation and audit – six months after balance date (30 September). The Audit Office took this change in requirements very seriously, giving priority to the accounts received within the correct timeframe to ensure they were audited without delay. To this end, instructions were given to district offices that their focus was to be on the accounts of territorial authorities that were received on time, and that the audit should be signed off by 30 November. The instructions stated that such speed in auditing would require “a substantial reduction of the coverage of the 1977 audit on these accounts”.

In 1981, the Controller and Auditor-General commented in his report to Parliament on the lateness of some local authority accounts, noting that there was no sanction for lateness. He
took the unprecedented step of identifying two authorities (one borough and one county) whose accounts had not been audited for three years.\textsuperscript{79 i}

6.4 Operational Audits / Effectiveness and Efficiency Audits\textsuperscript{ii}

Those involved with local government, from both central and local government, always discussed and showed interest in the efficiency of the sector. Attempts at standardising office procedures and accounting practices of local authorities, as discussed in chapter five, were aimed at improving the efficiency of local authorities, either by using ‘best practice’ or by identifying better performing councils so as to identify ‘best practices’. However, it was not until the 1960s that the Audit Office began to be seriously considered as a means to increase local government efficiency.

6.4.1 Pre-Beginnings

In 1963 the Public Expenditure Committee (of the House of Representatives) issued a one-page report on the power of the Controller and Auditor-General concerning the efficiency of local authorities. The report stated:

The Audit Office has at present no duty to enforce efficiency in local authorities under the Public Revenues Act 1953.\textsuperscript{80}

Although the focus of that report was on so-called local authorities that received most of their funding from central government, such as hospitals, rather than on territorial authorities, the report raised the issues of the Audit Office’s authority for reviewing local authorities and its responsibility for improving the efficiency of all types of local authorities. The Committee recommended that where a local authority failed to act on the Controller and Auditor-General’s recommendations to improve its efficiency, the Controller and Auditor-General should report this to the Parliament.

While the first formal operational audits began in 1974, the Audit Office previously undertook some ‘special investigations’ into local authority practices. For example, in 1964 the Audit Office undertook two reviews that could be viewed as ‘operational’. The

\textsuperscript{1} In 1967 the Controller and Auditor-General named three Councils that were “serious or persistent offenders in terms of qualified audit reports or irregularities. AJHR 1967 B1 [Pt. II] p. 49.

\textsuperscript{ii} The names given to these audits have changed over years with the two most common being operational audits and efficiency and effectiveness audits. Throughout this section I will use the first name given to them, i.e. operational audits, unless context requires otherwise.
first was into the wage and salary systems used by local authorities, and the second concerned the use (and misuse) of motor vehicles. The first review identified few problems, while the review on use of motor vehicles resulted in the Audit Office providing suggestions for better practice to a number of local authorities. The criteria used by the Audit Office to judge the practice of local authorities were the practices of central government.  

6.4.2 Beginnings

With the introduction of activity based reporting in both local and central government, as part of the Planning, Programming and Budgeting System (PPBS) based financial management reform that began in 1968 for central government (Pallot 1991b p. 168), auditing for the efficiencies of specific activities was an idea whose time had come. Much of the conceptual impetus for introducing value-for-money auditing in New Zealand had its origins in similar developments that were happening in the public sectors of other countries, in particular, the United States. Support for operational audits for both central and local government came from The Treasury; it wanted the Audit Office to move beyond financial and compliance audit, and to perform auditing for economy and efficiency, and auditing for programme results.

In 1973, an assistant secretary to The Treasury wrote in *The Accountant’s Journal*, with reference to central government financial management:

> Obviously, the next logical step before the PPB system can be developed further is to organise or create a capability for conducting programme analysis and evaluation studies on a systematic basis.

The movement towards systematically reviewing the efficiency of parts of the public sector began in 1973 when the government decided that private sector specialists would be employed with some existing public sector staff to form a ‘management audit group’ within the State Services Commission. The intention was for this group to perform audits, initially, on the efficiency of at least two central government departments. That role of reviewing central government departments’ efficiency and economy belonged to the State Services Commission under section 12 of the *State Services Act* 1962. Section 12 (b) of that Act stated that the State Services Commission should be responsible for “reviewing the efficiency and economy of each Department.” It could have been argued that the Audit Office also had such a mandate under sections 20 and 25 of the *Public Revenues Act* 1953, as discussed below. Following those initial reviews, major management reviews in central
government began in 1976. (Davis 1977) The reviews of central government agencies were different in approach (and their reception) from earlier reviews carried out by the State Services Commission’s predecessor, the Public Sector Commission and its ‘inspectors’. The previously feared inspectors were replaced by the “merely resented” Management Audit Section. (Henderson 1990 p. 335)

At the same time as the initial central government reviews began, the Minister of Local Government, Henry May, began the process of obtaining Cabinet approval for similar audits in local government. May attributed his inspiration for the idea from the then newly introduced efficiency inspections by the State Government of South Australia of its local councils, which May visited in 1973. May’s concept of operational audits of local authorities was that they should be performed for the benefit of central government. The aim was to identify inefficiencies in local government, with the Controller and Auditor-General reporting on these audits in the course of his normal reports to Parliament. A major concern for government at that time was the increased call by local authorities for additional funding (or revenue sharing) from central government. The audits were regarded as a way of identifying inefficient authorities and perhaps providing justification for decisions not to fund such authorities’ requests – if not as a way of rejecting all calls, justified by reference to a perception of inefficiency across the entire local government sector. This perception would be supported the ‘objective’ work of the Audit Office on operational audits.

The above understanding of the beginnings of operational audits differs from that provided by Jacobs (1998), and to a lesser extent, Skene (1985). Jacobs used a left-wing ‘welfare’ Labour government / right-wing ‘business like’ National government distinction to explain the introduction of operational audits. Under his theory, a right wing government was expected to introduce ‘business like’ methods and would have attempted to constrain government expenditure; operational audits would have been included in the type of technologies that employed by the government. Left wing government would have focused on increasing government expenditure on social welfare and public goods. However, that theory fails, as the original impetus came from the Kirk/Rowling (1972-75) Labour government (of which May was a Minister) and not the Muldoon National government that took office in December 1975. At the political level, the impetus for the audits was to
identify and broadcast the inefficient councils and/or inefficiencies throughout local government, and to avoid revenue sharing.

6.4.3 The Philosophy

The introduction of new legislative provisions, giving authority for the local government reviews, were not considered necessary, as the Audit Office had access to records under section 20 of the Public Revenues Act 1953 and could report on anything it considered desirable under section 25 of the same act.85

The Audit Office began the audits, initially as two pilot projects, receiving Cabinet approval in August 1974. The philosophical difference between the Minister’s objectives for the audits and the Audit Office’s policy was significant in three areas. Firstly, the Audit Office viewed Cabinet approval for operational audits86 as a request from the government to the Audit Office to undertake operational audits to which the Audit Office agreed. It was not considered a directive from the government. Essentially, the Audit Office conceptualised its relationship with the government in such a manner that it retained power and initiative.

Secondly, the Audit Office stated it would undertake the audits on its own initiative.

These audits will be undertaken by the Office, or by persons reporting to it, on its own initiative and not on the directions or at the request of any Minister of the Crown or Department of State.87

And thirdly, reporting would be to executive officers of the council, perhaps to elected council members, and then, if sector wide issues were found, they could be reported in the Controller and Auditor-General’s report to Parliament. The Audit Office policy, however, stated:

It is not envisaged at this stage that reports will be made to any Minister or Department.88

In writing to the First Assistant Auditor-General in Canberra, the Controller and Auditor-General wrote:

As regards reporting, time will no doubt produce a difference of opinion between us and the Minister. I suspect the Minister would like our activities to be directed to some extent to the chopping off of heads. Our interest will be in attempting to establish whether the standards of performance in a local authority’s undertaking fall short of those which, from our pilot studies, we have found to be of an acceptable level. If such is the case, we would draw the attention of the local authority to those areas which we considered offered scope for improvements. Our attitude would also be one of problem-finding, not problem-solving. The latter would be left to a local authority’s own
Operational audits were undertaken by Audit Office staff, who were often from outside a district in which an audit was conducted, and assisted in specialist areas by personnel who were employed from outside the Audit Office. The specialists employed were usually engineers, predominantly retired senior public sector engineers, because so much local authority work related to infrastructural and engineering activities.

The Audit Office warmly welcomed the enthusiasm of the Minister (Henry May) for the operational audits. However, the nature of the audit was moulded into what the Audit Office thought its relationship with local government should be based on, and not a central government desire to constrain, monitor or even attack local government. Without the initial support of the Minister of Finance\(^1\) and the Minister Responsible for Local Government, the approval and funding for the operational audits would not have been forthcoming and the audits would not have happened. Notes to the Audit Office appropriations between 1972 and 1979 stated that the Audit Office was working on the development of its capability to undertake operational audits in addition to financial audits in local authorities.\(^\text{90}\) Yet, in spite of this support from The Treasury and the Ministers, the Audit Office chose its own path and philosophy for the audits.

When the *Public Revenues Act* 1953 was rewritten to form the *Public Finance Act* 1977, the opportunity was taken to be more specific about the legislative authority with which to engage in such audits. Contrary to Jacobs, who considered it "the most radical innovation in the function of the Auditor-General since the establishment of the office in 1840s", (1998 p. 348) the 1977 Act made only minor differences to the existence and process of operational audits in local government. However, as happened during previous years, the use and methods of operational audits changed. The changes were not a result of the legislation but, rather, the experience of the Audit Office and its growing confidence in undertaking the audits.

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\(^1\) Advice to the Minister of Finance from The Treasury supported the Audit Office engaging in such work and suggested an even greater role for the Audit Office in this type of audit. This advice was under the name of an Assistant Secretary to the Treasury, A Shailes, who became the Controller and Auditor-General two years later.
One change in Audit Office thinking that occurred after the enactment of the 1977 Act was a stronger line taken by the Audit Office when it saw (potential) areas of inefficiency and ineffectiveness during the course of a normal compliance audit. In such cases the Audit Office would suggest:

   to the local authority that it either agree to a value of money audit being carried out, engage management consultants to carry out a review of the organisation or carry out some sort of in-house review.\footnote{91}

If the ‘suggestion’ was not taken up, the Audit Office would consider publicly reporting on the apparent inefficiency or ineffectiveness. The new wording for these provisions in the 1977 Act meant that the Audit Office could not ignore effectiveness and efficiency issues. While audits were generally performed with the permission of the local authority concerned, the Controller and Auditor-General maintained the right to undertake them from his own mandate.

In his 1982 report the Controller and Auditor-General outlined this position and his logic on the issue. The logic clearly placed the ratepayer at the centre of the Audit Office’s focus.

   ... it is clearly unsatisfactory for the Audit Office to continue to carry out these audits only when it is requested to do so. The Office’s prime role is to act as a watch-dog for the taxpayer and ratepayer on the expenditure of all public funds. To use the powers of the Audit Office only when the client wishes is clearly a negation of that role.\footnote{92}

There was also development in the thinking about whom reports were intended; initially, they were only intended for management to act on. However, by 1981 the Controller and Auditor-General noted that he expected the reports (performed under the 1977 Act) to be published “in complete or summary form”. It was now not only a matter of good management but also a matter of accountability.\footnote{93}

The final effect of reaffirming the Audit Office mandate to conduct such audits in the Public Finance Act 1977 was the development of a methodology for conducting the audits. This lead the Audit Office to be very specific about what it regarded as good practice in local government management.

6.4.4 Methodology and the Suggested Criteria

At the beginning of the process for developing a methodology for undertaking operational audits, the Audit Office outlined what it considered to be the purpose of the audits.
To assure the ratepayers that funds have been properly raised and properly spent.

To assist local government in improving the standard of management of public funds.¹

Perhaps the most acrimonious moment in an otherwise reasonably harmonious relationship between local authorities and the Audit Office related to the preparation and publication of the *Suggested Criteria for Good Management Practice in N.Z. Territorial Local Government* (the *Criteria*) in the early 1980s.¹ The disagreement was principally between smaller (in terms of both population and finances) councils and the Audit Office. While not universal, this division could also be seen between the rural county councils and the urban borough and city councils.

The *Criteria* arose from the work on operational audits where the Audit Office sought to make more transparent examples of good management and how such concepts could be applied in operational audits. The *Criteria* was, essentially, an attempt to make transparent the rules for judgements that were to be made in operational audits. Three drafts existed prior to the release of the final version on 20 February 1981; the first was commented on by Audit Office staff, the second version was sent to a few selected local authority personnel for review, and the third draft was released to local authorities for general comment. During and after the third stage, certain sections of local government took strong umbrage at parts of the document. The two key issues were: the application of the *Criteria* across all territorial local authorities, and questions concerning the Audit Office’s involvement.

The *Criteria* shared similarities with many of the Audit Office’s concerns regarding central government that were expressed three years earlier in the *Shailes Report*, particularly the focus of objectives. The *Criteria* specified that sound management (within the existing legislative framework) should provide clear lines of accountability within an organisation, provide for a separation of responsibilities between elected councillors and employees of a council, and set and review performance measures. Accounting was regarded as a major part of this management process.

¹ Aspects of the *Criteria* that relate to the possible use of accrual accounting were discussed in the previous chapter.
The NZ Institute of County Engineers was critical of the *Criteria* on the basis that it recommended a single Chief Executive for each council. The practice in many county councils at the time was to operate a triumvirate system in which an elected county chairman worked with the county clerk and the county engineer; the latter two being of equal status. The Institute's argument was that the system worked well in smaller councils and that a 'one-size-fits-all' approach should not be applied to the entire territorial local government sector. However, its motives may have been 'closer to home'. In the penultimate sentence of the NZ Institute of County Engineers comment on the *Criteria* to the Audit Office, it wrote:

The Institute considers the Engineers, because of their training, are well fitted in the NZ scene to occupy major managerial positions.\(^6\)

The genie was out of the bottle! The rise of a local government managerial class to the relegation of the city/county engineer was nearing culmination, and certain engineers were not pleased. Individual county/city engineers were concerned about their career promotion prospects and part of their professional association was also concerned for the status of the profession within local government. Public sector management reforms that began in New Zealand in the late 1980s, especially the application of managerialism, (Boston, *et al.* 1996 chapter 4) had been foreshadowed by the work of the Audit Office, including the *Criteria*.

The second complaint was that central government, Wellington, or 'Big Brother', was becoming too involved in the affairs of local government. A senior local government official responded directly to the *Criteria* and was reported in the press:

Taranaki's local bodies should beware of giving the Audit Department 'another club to thump local government with,' warned the Mayor of New Plymouth and president of the Municipal Association.\(^7\)

In response, the Deputy Auditor General\(^1\) presented the Audit Office's view:

Audit Office has two responsibilities:
(a) To taxpayer for central government funds,
(b) To ratepayers for local government funds.

Note: The two should not be confused. When dealing with local government Audit Office is not a central agency, merely a Parliamentary appointed agency for auditing local government and reporting thereto to ratepayers. Only responsibility to parliament is to report that local government audits in the

\(^1\) Jeff Chapman, who had been involved in the operational audits from the start as the leader of the first pilot project in 1974.
efficiency and effectiveness area have been done. All reporting is to council and to ratepayers. This is not a 'big brother' central government imposition, this is the ratepayers representative reporting to them. 98

By 1984 the Audit Office appeared to have weathered the storm over the Criteria. However, there were some residual concerns about the Criteria, principally from the engineering profession. In response to a proposed article submitted to New Zealand Engineering, the Audit Office made the following comment to the editor (in a private letter, as opposed to a Letter to Editor):

[The author of the article] appears to exhibit the prejudices one used to hear from some engineers who because they had placed engineering excellence over management performance had missed out on general management opportunities. As increasing numbers of Chief Executive Officers are being appointed from professional engineering ranks these sorts of comments are rarely heard from the engineering profession in local government. 99

In the same correspondence the Audit Office stated that it “considers that the publication [the Criteria] … a success”. It measured the success in terms of discussion generated as a result of suggestions in the Criteria. That local authorities adopted many suggestions in the Criteria was not considered by the Audit Office to be the key outcome of its publication; rather, the fact that local authorities discussed management practice (as defined by the Audit Office) was regarded as the more important result.

6.4.5 Operational Audits – Conclusion

While the practice and philosophy of operational audits were developed, the Controller and Auditor-General pondered where they would lead local government. His view was that current operational audits were only a stepping-stone to an environment where specification and measurement of performance would be part of an accountability system for councils. From that new position he saw the role of auditor would not be to undertake reviews, but rather, to attest the validity and fairness of data, thus performing specific reviews would not be necessary. 100

Local government had little if anything to fear from operational audits performed by the Audit Office. The Audit Office saw operational audits as another way to work with local authorities, ensuring better management in the interests of ratepayers, as opposed to any purpose for central government. While the Audit Office did not obtain agreement from everyone on what constituted good management, it succeeded in raising the level of discussion on appropriate/good management practice for local government. The Audit Office would not permit central government using the results of operational audits to
criticise local government. Furthermore, the Audit Office did not want that role for itself; rather, the Audit Office wanted operational audits to be used by councils to improve management for the benefit of ratepayers.

6.5 Other Areas of Audit Office Involvement in Local Government Activity

6.5.1 Auditing of Legislative Authority and Surcharge

Auditing in the public sector has an additional level of complexity not seen in the private sector when reviewing expenditure and activities to ensure appropriate legislative authority. As mentioned in chapters four and five, councils could only spend money when they had the legislative authority to do so, and they could only engage in activities that were permitted by legislation. The Audit Office mandate included the checking of council’s activities for such legislative authority.

As local authorities grew in size and the range of activities in which they engaged increased, their accounting practices became more complex, but also more professional and more predictable for the auditor. However, at the same time as the accounting improved and the audit of the accounts became more straightforward, councils often moved or strayed into areas where they did not have the appropriate legislative authority, thus creating a new set of issues for auditors.

While the audit of the large units can be somewhat less exacting from an ‘accountancy’ auditing point of view, the increase in problems arising from the ‘authority’ audit is very marked with the tendency, in many cases, for these bodies to stray into areas beyond their powers as understood by us and our legal advisors.101

Thus, the Audit Office was the investigator, prosecutor, judge and jury for those issues. Of course, there was always recourse to the courts. As noted above, the role in relation to surcharge was one of the principal reasons in 1886 for making the Controller and Auditor-General the auditor of all local authorities. In addition to that role, the Audit Office was given a range of other quasi-judicial roles in relation to local government.

6.5.2 Audit Office in Other Quasi-Judicial Roles

The Controller and Auditor-General, in his 1936 annual report, highlighted a number of quasi-judicial roles undertaken that year. In addition to actions taken on cases of misappropriation of monies and the disallowance of unlawful expenditure, the Audit Office
had ruled on disputes between councils in relation to cost allocations. An example of these rulings was the appropriateness of the costs charged by a primary local authority, such as a city council, to a secondary local authority, such as harbour boards, which held elections simultaneously with the primary local authority. However, a similar example, based not on additional costs but on cost apportionment, was where two or more bodies used the same electoral roll for their separate elections. Both these examples required the Audit Office to determine the amount each council should pay; in addition, the Controller and Auditor-General was required to determine what were ‘reasonable’ costs, thus the apportionment was much more than a technical activity, particularly when one council used its normal operating capacity to undertake the task.  

In 1968 the Controller and Auditor-General noted that some of the Audit Office’s functions did not fit with the role of the auditor. In a briefing paper to the Minister in Charge of the Audit Department, the Controller and Auditor-General singled out the Audit Office’s responsibility in relation to disqualified elected members of council. Under section 57(3) of the Municipal Corporations Act 1954, if an elected representative continued in office (as councillor or mayor) after that person had been disqualified, the Audit Office was required to institute legal proceedings for his/her removal from office. The causes of disqualifications related to becoming one of the following while holding office: no longer being eligible as an elector, being mentally defective according to mental health legislation, being a bankrupt, or being convicted of an offence punishable by imprisonment. (s. 57(1)) The comment from the Controller and Auditor-General was:

Why such a duty was placed on the Audit Office is not clear – it is so remote from its normal functions. A possible reason is that of all departments the Audit Office has the longest close association with local authorities.  

By the mid 1980s the Audit Office had become more focused on what it considered its role in relation to local government to be. In a submission on the Rating Powers Bill 1987, the Audit Office sought to remove the provision that forced it to act as arbitrator in disputes over costs to be charged by one council to another when a council collected rates on behalf of another. The Audit Office objected to being assigned this role, although noted that the parties should be allowed to use any third party to help settle such disputes, which could include the Audit Office. As a result of the Audit Office’s submission that provision was not in the Rating Powers Act 1988.
Another quasi-judicial role for the Audit Office related to situations where individual council members might have some pecuniary gain as a result of policies or actions of a council and would therefore normally be disqualified from acting as a member of a local authority. The legislation was entitled *Local Authorities (Members' Contracts) Acts or Members' Interests Acts*. Enforcement of this legislation was an important part of the role of the Audit Office in local government. This enforcement included giving exemptions from disqualifications in certain situations, and prosecuting a disqualified person who continued to act as a member of a local authority. (Palmer 1993 chapter 5)

The long-standing and close relationship between local government and the Audit Office meant that non-auditing roles, such as dealing with conflicts of interests and disqualifications, were often given to the Audit Office. Those roles were another way that the Audit Office looked after the interests of electors/ratepayers/residents. In spite of the Audit Office's desire to focus on the 'core business' of auditing, even in more recent years the perceived need to have a central agency deal with issues such as those noted above has meant the Audit Office has retained quasi-judicial functions.

### 6.5.3 Audit Office Approval for Administrative Procedures

The Audit Office was required by the *Municipal Corporations Act* 1954 (and previous acts) to provide prior approval for a number of administrative procedures if an individual local government body wished to adopt them. They included the operation of imprest accounts (s. 88), the use of cheque signing machines (s. 87(3)) and the authorisation of cheque signatories (s. 87 (1)). On that issue the Audit Office had a change of opinion between 1968, when it reconformed its belief in the appropriateness of such provisions, and 1976, when the Audit Office no longer wanted involvement in such administrative decisions. In 1976 it argued that:

> its [the Audit Office’s] involvement in such matters should not be a statutory prerequisites ... The decisions required are considered to be well within the competence of ... local government.\(^\text{106}\)

Until the 1980 *Local Government Amendment Act*, the Audit Office was essentially required to judge the correctness of the charging or posting to various accounts. The legislation stated that the Audit Office was the sole determiner of correct charging. From the legislation, it was clear that the Audit Office could (and should) force local authorities to alter their accounts if it believed the accounts were incorrectly charged. In 1980 the Controller and Auditor-General argued successfully that the role was “in conflict with the
role of his office”. It was proposed that the appropriate role for the Audit Office in such situations, where money was incorrectly charged, was to report the issue either in the audit report or the Controller and Auditor-General’s report to Parliament.107

As has been identified throughout this chapter, dramatic changes occurred in the 1970s and 1980s in how the Audit Office saw itself, its role, and how it regarded local government. The Audit Office was seeking what might be termed a more professional relationship with local government. It wanted local government to take responsibility for its management (including its accounting), and the Audit Office wanted the role of auditor clarified and limited where possible to that of auditing the accounts, in which it would have included compliance, attestation and performance audits. Apart from the auditing of legislative authority and authorised expenditure, the quasi-judicial roles were viewed by the Audit Office as inappropriate tasks for auditors and as unnecessary constraints for properly managed local authorities.

6.5.4 Audit Office as Adviser

As mentioned above, the Audit Office was the government department that had the strongest relationship with local authorities, and certainly one of the longest relationships. Its advice was often sought on a range of matters outside both the normal work of an auditor and the statutory roles of the Audit Office. One of the unofficial roles the Audit Office appeared to fulfil frequently was that of adviser on the suitability for employment by local authorities of personnel working in other local authorities, especially for finance and management positions. Councils contacted Audit Office staff, asking for opinions on the suitability or otherwise of candidates.108 The knowledge and expertise of Audit Office staff were seen as valuable resources to be tapped. The openness and probity of Audit Office staff undertaking this role were confirmed by acknowledgement of the practice in the Controller and Auditor-General’s 1956 report to Parliament. The Audit Office’s view of the importance of that service was summed up as:

... it [using the Audit Office in these situations] can on occasions be a safeguard against appointing individuals who through lack of experience or for any other reason are unsuitable.109

This was only one of many activities the Audit Office engaged in as a result of its close and long relationship with local authorities. Other activities included assisting the development of management and accounting systems, advice on presenting local legislation, and dealing with various legalisation.
6.5.5 Audit Office as Promoter and Supporter of Better Practice

In chapter five, the importance of the Audit Office in promoting and supporting better practice in local government was noted. Most changes that occurred in local government accounting and financial management somehow included the Audit Office in the process, as promoter, discussant or adviser. Without the Audit Office, many changes would not have happened.

As also noted above, the increasing importance of independence for the auditor was at times in conflict with the role of the Audit Office in setting the requirements. Yet the experience and resources of the Audit Office were such that this was not considered a problem, even in later years. The following, from the 1985 Territorial Authority Accounting Committee, illustrated the position of the Audit Office in local government accounting:

The remaining members of the Committee [after Audit Office staff left the meeting] expressed no feeling of pressure or embarrassment at the current involvement of the Audit Office in the deliberations of the Committee but felt that it was important that a degree of independence be seen to exist. The Audit Office involvement was seen to be of importance and to have definite advantages.\(^{10}\)

There was no clear mandate for the Audit Office to act as agent for better practice, yet it was a role that no other body in either central or local government could have fulfilled as well. While the Audit Office wanted someone to perform the role, it wished at times that it had not undertaken the role because of conflict with the audit role; regardless, the Audit Office remained committed to acting as the major agent for better practice. Local government and improvement in local government was important to the Audit Office.

6.6 The Importance of Local Government to the Audit Office

The Audit Office had an unusual or unique relationship with local government compared with any other central government agency. Its primary role was that of auditor, of both financial and non-financial material, yet equally important at various times was a range of other roles. Those roles included the Audit Office's quasi-judicial roles in various areas, its contribution to central government's policy/legislation formulation process on local government, and the Audit Office's support, advice and goodwill towards local government. The relationship between local government and the Audit Office was mostly a good relationship, based on the Audit Office's respect for the activities and functions of
local government (although not always for their accounting practices), and a local authority’s appreciation of the Audit Office’s experience and knowledge of the local government sector.

From early days, the Audit Office gave highest priority to the auditing of accounts of boroughs and counties.\(^{111}\) Clearly the size, the political visibility and risk, had it not given full attention to these ‘clients’, helped to explain the priority given to boroughs and counties, yet the Audit Office appeared to have valued it relationship with local government even more than that. Perhaps the often-recorded complaints about local government financial management practices by the public and politicians obliged the Audit Office to take more interest in the sector.

The importance of local government audit work to the Audit Office was often highlighted in documents relating to the appointment of a Controller and Auditor-General. In 1983, the retiring Controller and Auditor-General wrote to the Prime Minister, suggesting a process to nominate his successor (to the Governor General). He had two suggestions for the process; that the “main qualification being that applicants be members of the New Zealand Society of Accountants” and

> That any panel set up to interview applicants should include a representative from Local Government (the largest client of the Audit Office, accounting for over two thirds of the workload).\(^{112}\) [brackets included]

Previous Controller and Auditor-Generals made similar comments about possible candidates to succeed them:

> local body auditing and Head Office experience is a distinct advantage (1975)

> [this candidate] is widely and favourably known for his ability and experience, especially in local body auditing, accounting and statute law [compared with other candidate] (1970)

> held in high regard ... by local body clientele ... have such a knowledge of local government law and accounting together with the necessary experience so as to be familiar with the problems of these bodies and to be in a position to receive interviews and deputations concerning matters in which the Audit Office has a vital interest. (1965)\(^{113}\)

Work with local government was always important to the Audit Office, not only because of the volume of work but, clearly, the senior Audit Office staff had an affinity with the sector and a desire to see improvements.
6.7 Conclusion

In 1876 the auditor of municipal accounts was elected from the community and served the community, which included its council. The appointment of auditor was similar to the election of council officials such as a mayor and councillors.

In 1886, following concerns about the spending of central government money and compliance with legislative constraints on local government spending, the central government auditor (the Controller and Auditor-General) was appointed as auditor of all municipalities. For the next eighty to ninety years, the auditor and the legislation were the reasons for the accounts. Local bodies were, in the words of one Controller and Auditor-General, ‘accountable to the Audit Office’. Effectively, the Audit Office took over the concerns of local communities and acted as their trustee. Not only was it auditing the accounts and checking that expenditure was legal, but the Audit Office controlled many financial management practices, including at times the number of bank accounts local authorities could operate, the maximum amount to be kept in impret accounts, how much they could charge another authority for shared resources, and which accounts should be kept.

By the early 1970s the Audit Office’s approach and understanding of its role in relation to local authorities began to change. Those role changes mirrored changes to the external reports. The previous accounting requirements created very detailed accounts that enabled the auditor to ensure compliance with relevant legislation; they were replaced with regulations that created accounts that could provide enough information for ratepayers/electors to hold a council to account. Audit Office philosophy changed from holding a council to account on behalf of ratepayers and electors, to providing assurance to the ratepayers/electors who used accounts to hold a council to account. Audit reports and adverse comments of an auditor were made public; councils that failed to prepare their accounts could be and were publicly named, and councils that failed to prepare accounts could find an external party preparing them – all for the benefit of the ratepayers/residents/electors.

The introduction of operational audits in the early to mid 1970s and the subsequent publication of the Criteria was a success in spite of the introduction of a new level of external oversight. Had the Minster of Local Government of the day had his way, operational audits would have been loathed by local government and, I suggest, would
have been discontinued for political reasons. Instead, they remained, in their various forms, part of the means by which the Audit Office helped local authorities to deliver better and more inefficient service and management to the communities that they served. From the Audit Office’s position, that was always the intention.

While this chapter often focuses on times of conflict between the Audit Office and local government, the exceptions — the 1891 and 1892 Bills, the *Criteria*, court cases, and fees — were aimed at illustrating other issues. Overall, local government and the Audit Office had a good relationship. The Audit Office’s relationship with its local government client cannot be explained in terms of a purely client-professional engagement. Local government was important to the Audit Office, and any support for improving financial management of the sector, which the Audit Office could provide, was provided. The Audit Office regarded enabling good financial management practices as part of its role in local government, in which compliance and assurance audits were only one part of this bigger role.
Chapter Seven: Accounting for Trading Activities

A Case Study – Wellington City Trading Department’s Reserve and Renewal Funds Act 1917 and Amendments

The Wellington City Trading Department’s Reserve and Renewal Funds Act, 1917, gives the City Council power, in respect of its tramway, electric-light and power-supply undertakings, to make annual appropriations to provide renewal and reserve funds, after making provisions for interest and sinking fund of loans and for maintenance and repairs. This Act is significant of the growing tendency of local authorities to make their trading undertakings self-contained and self-supporting businesses. With adequate safeguards such as are provided in this Act nothing but good can result from it. A further power contained in this Act is that enabling the City Council to establish accident funds in connection with the above-mentioned undertakings.¹

7.1 Introduction

In 1917, the Member for Wellington Suburbs and County District, introduced a Bill to Parliament on behalf of the Wellington City Council¹ (WCC), specific to the Council, entitled the Wellington City Trading Department’s Reserve and Renewal Funds Bill. The Bill related initially to the three trading activities undertaken by the WCC: the city tramway and power-supply undertaking, the electric light and power-supply undertaking,

¹ At various times the Wellington city municipal body has been called both the Corporation and the Council. For sake of consistency, unless directly quoting, I will use the term Council even if at that time Corporation was the preferred term.
and the city abattoir. The Bill was the result of pressure from three sections of the community: a resident’s recent court case, a trade association’s pending court case, and the auditor for the Council. All three contestants had alleged that certain accounting and financial management practices undertaken by the Council did not have the necessary legislative authority. In essence, they argued that certain measures, relating to setting aside money, were *ultra vires*.

The legislative authority for municipal councils to be involved in these three trading activities, together with the accounting rules, was provided in three acts. This chapter reviews the background to the Council’s involvement in each of these trading activities, following this introduction. Section three outlines factors that lead to the 1917 Act, and section four covers the preparation of the Bill and its passage through Parliament. Section five discusses the amendments made to the 1917 Act until the 1980s, after which the funds created by the Act were disestablished. Other legislative developments relating to funds for trading activities are briefly outlined in section six. Section seven reviews the accounting issues, and section eight reviews salient issues of the case study.

Municipalities could only engage in activities and practices for which they had specific legislative authority, as discussed in previous chapters. While most legislative authorities were provided in the principal municipal legislation (for example, *Municipal Corporations Act*), others were provided in legislation relating to a particular activity (for example, *Slaughtering and Inspection Act*). Another category of legislation is local acts, which are enacted for a specific entity such as a municipality. The *Wellington City Trading Department’s Reserve and Renewal Funds Act 1917*, the focus of this chapter, is an example of this type of legislation.

As mentioned in the preface and in chapter three, formal European settlement of Wellington began as the first New Zealand Company ship left Gravesend in September 1839. By 1865 Wellington had become the capital city of the colony of New Zealand. Wellington’s choice as capital reflected its geography of a safe harbour and its central location in the colony. Wellington’s topography is also significant for part of this case study; the harbour’s foreshore rises quickly to steep surrounding hills, making a sharp

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1 At the time WCC operated two distinct electricity generating undertakings, one to provide motive power for the tramway and the other for street lighting and limited electricity for sale to the residents.
divide between the inner city and land beyond that was suitable for suburban development. This topography provided only limited area for development of the city unless cuttings were made through the hills that would enable public access and transportation to new suburbs. The growth of the city, from the first arrivals in 1840 to 43,000 in 1900, put pressure on *inter alia* public health and management of public nuisances, land for development and housing, and public services. As a backdrop, this chapter has the provision of meat for local consumption, the development of a public transport system that would enable development of residential accommodation beyond the hills of the inner city, and the provision of electric lighting for the city and its residents.

### 7.2 Trading Activities in Wellington City prior to the 1917 Act

This section reviews the legislative environment at the time the Bill was introduced, relating to each trading activity with which the 1917 Bill was concerned. It also provides background to the Council’s involvement in each undertaking.

#### 7.2.1 Abattoirs

The WCC established the city abattoir immediately outside the city boundary in 1909 at a cost of approximately £13,700; like most new council activities, it was funded by a loan. The legislative authority for the establishment of the abattoir was the *Slaughtering and Inspection Act* 1908.

The 1908 Act and its predecessor, the 1900 Act, had a strong public health aspect, including a provision that all boroughs and towns with a population of 2,000 or more were required to establish an abattoir. (s. 5) The funding for such an undertaking could be provided from the general fund or by a loan. Because the setting up of abattoirs was compulsory, the requirement of the time that local authorities obtain the consent of ratepayers via a poll, prior to raising a loan, was waived for the establishment of the abattoir under the 1908 Act. Local authorities were permitted to delegate the setting up of the abattoir to any person or persons, excepting five authorities named in the act, which
included the City of Wellington. (s. 15) The five councils were required to operate their city abattoir.

While creating a monopoly for the slaughtering of meat for both the local and export markets (s. 17), the 1908 Act made provision for charging for services only in general terms, permitting each council or operating authority to “make such charges ... as it thinks fit”. (s. 18 (c)) However, the Act limited the total yearly revenue to be collected from an abattoir to an amount equal to the annual cost of the abattoir, including a five per cent capital charge.

The moneys paid in fees ... shall not be in any one year more than sufficient to defray the annual cost of such abattoirs, inclusive of five per centum per annum on the capital expended in establishing and erecting such abattoirs. (s. 27 part-of)

The original WCC by-laws for the abattoir, produced in 1909, provided for the Council to determine fees, which were required to be charged in accordance with the Slaughtering and Inspection Act 1908.² The 1909 by-laws were replaced in 1912 by new by-laws, which included a provision that any surplus generated by the abattoir was to be returned to users of the abattoir on a pro rata basis.

If there is in any year ending on the 31st day of March a surplus of revenue after defraying the annual cost of the Abattoir, inclusive of five per centum per annum on the capital expended in establishing and erecting the Abattoir, the Corporation shall credit the persons paying ... with a share of such surplus in proportion to the amounts ... so paid. ³

Thus, not only were councils required to establish abattoirs for public health reasons, but they could not make, or at least keep, profit made in any year. Rather, they were required to return pro rata any profit made during that year to users of the abattoir. The avoidance of stock slaughter on private property in the city was a key feature of the 1908 Act, but councils could not benefit financially from it. ²² The identification of appropriate costs, particularly but not only non-cash costs when the abattoir carried out services other than

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¹ This provision was in the 1900 Act, although the Council did not comply with the requirements until 1909. Legislation prior to the 1900 Act permitted councils to establish and run abattoirs, but without the compulsion provided for in the 1900 Act. (See the Abattoirs and Slaughterhouses Act 1877 (s. 8) and the Abattoirs and Slaughterhouses Act 1894 (s. 6)).

²² The keeping of livestock within boroughs was not uncommon in New Zealand at this time. In their larger sections on the outskirts of boroughs, some working class households would keep sheep or cows (as well as smaller livestock) for grazing and eventual consumption. (Fairburn 1989 pp. 100-101)
slaughtering and therefore these services were not bound by the breakeven requirement, and non-cash costs for services required under the Act became significant issues.

7.2.2 Electric Lighting and Power Supply Undertaking

By the mid 1880s the private sector began to provide electric lighting to private houses and buildings in Wellington City. The middle of 1889 saw the first of Wellington’s streets lit by electric lights, beginning a process that replaced the existing gas-lit lights. A private sector firm, under contract to the Council, lit the city streetlights using its own infrastructure, including streetlights and electricity that was generated in the city. The contract between the WCC and the private sector company included provision for the Council to take over the street lighting after 14 years, including purchase from the company of the plant for both street lighting and electricity generation.

In 1898 the council wanted to take over production of electricity for street lighting (and the ownership of the horse-drawn tramway), with the intention of using electricity from the company’s plant for electrification of the tramway service and for sale to private consumers as well as for street lighting. Yet that was five years before the Council could demand transfer of ownership of the infrastructure from the private sector. The private sector company turned down the request. The Council finally acquired ownership of the street lighting operation in 1907 when it took over the business and plant of the Electrical Supply Company at a cost of £150,000. Funding the purchase was via debentures that were approved by a ratepayers’ poll on 25 January 1907. Ratepayers’ interest in the poll was quite low. At a public meeting, called to discuss the proposal, “only a small gathering of ratepayers was present, numbering fifty or sixty”\(^4\), which was less than 1 per cent of the city’s ratepayers. The poll result was reported in the press as follows:

Yesterday 651 ratepayers of Wellington City, out of 8743 on the roll, showed that they were sufficiently interested in municipal undertakings to record their opinions on a proposal to borrow £160,000 for the purchase of the business and plant of the Electrical Supply Company and additions to the existing machinery. Of those who voted 415 were in favour of the proposal, and 238 against, so the poll was carried.\(^5\)

\(^4\) The £160,000 consisted of £150,000 for the purchase of plant and goodwill, and £10,000 for additions.
The legislative authority for councils to establish and operate an electricity production and supply undertaking (for both public and private users) was first granted in the *Municipal Corporations Amendment Act* 1887. The authority mirrored the existing powers, obligations and requirements to operate gas undertakings provided in the *Municipal Corporations Act* 1886.

Under the 1887 Act, councils were required to keep a separate electricity undertaking account. The Act specified that the account should record the money received from the undertaking and the amounts charged against the undertaking. The amounts to be charged against the undertaking were limited to three types: (i) payments of interest and to sinking funds for loans, (ii) the cost of maintaining the system in good repair and all expenses associated with producing and supplying electricity, and (iii) any surplus that may have been credited to the general account of the city.

The 1900 *Municipal Corporations Act* continued to require a separate account for the undertaking but did not specify what could be charged against the revenue for the account. A new feature of the Act was to allow councils to fund deficits in the electricity accounts from the general fund. The ability to take surpluses, after all lawful expenses had been accounted for, to the general fund, was not carried over to the 1900 Act. This provision was reinstated in the 1902 *Municipal Corporations Act Amendment Act* 1902. (s. 33) Its exclusion from the 1900 Act appeared to be a drafting error/oversight, and its inclusion in the 1902 Act was a last minute action, taking place after the select committee had reported back on the Bill; the provision was inserted at the end of the Bill immediately prior to the third reading in the lower house. The 1908 *Municipal Corporations Act* made no changes relevant to this chapter.

### 7.2.3 Tramway and Power Supply Undertaking

A tramway service for Wellington City was first mooted by the private sector in 1873, with the inaugural service operating on 24 August 1878. Under the *Tramways Act* 1872, prior to receiving approval from the Provincial Superintendent, the promoters of a tramway were required to obtain the consent and agreement, including any terms and conditions, of the local authority in whose area it was to operate. The agreement between the Wellington City Council and the promoters of the tramway included a payment of 10 per cent of profits to the Council and that the Council had the right to purchase the tramway operation
after 10 years. In 1887 the Council did not seek to purchase the tramway and sought a new agreement with the owners. The Council had not, to that date, received any commission from the operation, as no profit was recorded. However, Council papers at the time indicated that the Council was less than sure of the accuracy of the accounts presented. A report on the tramway company’s operations to the Council by a council committee stated that the company had disclosed profits of £2,965 for 1885 and £1,942 for 1886, but when interest expenses were included, profits turned to losses. The committee went on:

The Committee ... also (had) an estimate of the annual receipts and expenditure, which the Committee were given to understand was reliable. This statement of receipts and expenditure differs materially the one supplied by the Tramway Company in that the former shows larger profits.\(^6\)

The disparity of profit calculations appear surprising, given that the Council’s treasurer had looked at the tramway company accounts when it gave permission for the “City Treasurer to accept the appointment as Auditor to the Wellington Tramway Company.”\(^7\) The profitability of the company (or rather, the lack of) was illustrated by the repeated selling of the undertaking prior to the eventual purchase by the Wellington City Council. One sale appeared so urgent that the advertisement read:

Absolute Unreserved Sale of the Wellington City Tramways, in Order to Close the Partnership Accounts.\(^8\)

The 1888 agreement (replacing the 1878 agreement) between the tramway promoters and the WCC gave the right to operate the tramway to the private sector company for another 15 years, but with no right of renewal. Rather than providing for a concession based on profits, a flat fee concession was introduced. The amount to be paid per year was £100 for the first 5 years, £150 for the next five years and £200 per year for the last five years.\(^9\)

As mentioned above, the Council wanted to purchase both the electric lighting and the tramway undertakings in 1898, some five years prior to the end of the agreement with owners of the tramway. The Council wanted to expand and subsequently electrify the tramway service, which at the time was only 3.8 miles long and horse-drawn. The Tramway Company had earlier removed its steam motive power, replacing it with horses. The motivation for the Council to take over the tramway was a desire to extend and improve the service; it was hoped that would encourage growth in residential accommodation in new suburbs away from the inner city, which had quickly become overcrowded with both commercial and residential property.
The municipalisation of trading activities was politically a good idea, with no indication of dissent among local politicians at the time. Public ownership and thus public profits were considered better than private profits, especially when the roads that tramways used were public and water for the generation of electricity was provided by the City Council. Furthermore, the limited private funds available in the new and growing colony for such undertakings meant that the necessary development could not be financed by the private sector. The heavy demand for finance for infrastructural projects was exacerbated by the expansion of technology, such as electricity.

Following discussions with the existing owners, the WCC became the owner and operator of the tramway system on 1 October 1900, at a price of £19,800, plus a penalty for cancelling the 1887 agreement prior to completion. Funding for the tramway purchase was by a loan, authorised by a poll of ratepayers on 21 August 1900.

In 1901 the council sought another ratepayers' poll to approve a loan to fund the change from horse-drawn to electric powered trams. The poll for the loan of £225,000 was held on 19 April 1901, and was passed by a margin greater than four to one.\(^{10}\) By mid 1904 the Council began operating an electric tram service using overhead power-lines. In later years the Council expanded the tramway service, opening up areas at the far end of the city boundaries and into neighbouring boroughs. Most of the expansion was funded by specific loans authorised by ratepayer polls. Many polls were taken only in the area to be serviced by an extension, with the proviso that any special rate required to be struck to pay the interest and sinking fund for that loan would only be from ratepayers in that area. Such special rates were required only if profits from the undertaking were insufficient to meet the interest and sinking fund payments. One such extension with a related poll and loan was for the Wadestown suburb in 1909; the poll was passed by 186 votes to 25 votes.\(^{11}\)

When the WCC took control of the tramway, the legislative authority and accounting requirements were contained in the *Tramways Act* 1894. The accounting requirements mirrored those in the *Municipal Corporations Act Amendment Act* 1887 for operating an electricity undertaking. As mentioned above, the requirements limited the charges against the revenue for the trading activity to the sinking fund and interest for loans, the cost of the service, and the transfer of any surplus to the district fund. Two sets of minor changes to accounting requirements took place before 1917. The first was a requirement that a yearly abstract of the tramway account be sent to the Minister of Public Works. (*Tramways
Amendment Act 1910, s. 14) The second change provided for the possibility of depreciation being charged against the tramway account for replacement parts of the tramway. The amount of depreciation was required to be specified in the Order from the Governor in Council that authorised the operation of the tramway if it was to be charged. Instructions relating to the management of the depreciation fund were limited to the requirement that money be paid into a separate fund, managed by the local authority, that was for replacement or depreciation of the plant, machinery and other property of the undertaking. (Tramways Amendment Act 1911 s. 7.)

7.3 The Impetus for the Bill

7.3.1 Tramways and a Wadestown Resident

In 1915 a Wellington ratepayer\(^1\) living in the suburb of Wadestown took the WCC to Court\(^2\) over the way it kept accounts for the 1909 extension of the tramway to Wadestown. The case related to three questions:

1. Was the Wadestown extension to the city tramway a separate undertaking, which therefore required the Council to have a separate account for the Wadestown undertaking?

2. Was there any hierarchy of (permitted) expenses to be credited against the tramway revenue in the relevant provision of tramway legislation, or were all expenses of equal priority?

3. Did the Tramway Act authorise/permit the establishment of a depreciation fund?

The concern of the ratepayer was that the WCC had struck a special rate for repayment of the loan for the extension on Wadestown ratepayers.\(^3\) The Council charged all direct expenses relating to the Wadestown route and a proportion of the indirect expenses from the entire operation against the account for the extension, including depreciation, prior to charging the interest and the required appropriation to the sinking fund for the loan. When

\(^{1}\) G Carwell Cooke was recorded in the 1915 Wise’s Directory as an accountant living in Wadestown, Wellington. Mr Cooke led a delegation to the City Council of Wadestown residents in 1913 on number of issues including the tramway accounts. Letters to Mr Cooke from the WCC in 1913 were addressed to him at the Audit Department, (WCC Archive Inward Correspondence 1913/1089). An Audit Office report on an unrelated matter, presumed to be 1922, to the Minister of Internal Affairs was signed by G Carwell Cooke as the Supervisor Local Government Audit. (Archives New Zealand IA 1 128/1)
there were insufficient funds to cover the required appropriation to the sinking fund account and the interest (after all the other charges), the Council had sought payment of the special rate from Wadestown ratepayers.

Justice Chapman in the Supreme Court\(^1\) ruled in favour of the City Council. The judgment stated that the extension was a separate activity, thus a separate account was to be kept. Also the Supreme Court stated that the creation of the depreciation fund was legal. The Judge considered the Council’s approach to creating a depreciation fund “a prudential measure to provide in time against loss of capital”. In terms of the *Tramways Act* 1908, the Court said that depreciation was part of “maintaining the tramway”, although not restricted to the manner it was “originally instituted but as prudence may dictate”. The Court was unmoved by the argument that a depreciation fund duplicated the payment for the sinking fund, rather:

> A sinking fund is a statutory fund which in equity is the property of the security-holder, and is created as an assurance to him that his money is safe.

> ... A depreciation fund is, as I have already pointed out, a prudential measure to provide in time against loss of capital.\(^{13}\)

On appeal, the Court of Appeal reversed the decision that the extension was a separate activity, stating that the extension was part of the whole tramway undertaking, thus the Wellington City Council was not permitted to operate a separate account for the Wadestown section of the tramway undertaking. The legality of a depreciation fund became unimportant because Wadestown residents would not be subjected to a separate special rate unless the entire tramway system was unable to provide for the interest and sinking fund for the Wadestown extension. That situation seemed unlikely at the time, given the overall profitability (with or without the depreciation charge) of the undertaking. However, the Chief Justice recommended to the WCC that “if this depreciation fund is to be continued, [it would] be wise to have statutory authority for its existence and for the mode in which it is to be administered”.\(^{14}\) The Chief Justice also noted that while the current depreciation fund had a balance of £138,038 to its credit, there was only £20,762 on hand, and he suggested a “separate fund” should be established.

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\(^1\) At the time New Zealand’s court hierarchy was Magistrates Courts, Supreme Court, Court of Appeal and final appeal to the Judicial Committee of the Privy Council.
Another member of the Court of Appeal discussed the nature of depreciation in relation to the Supreme Court judgment, also disagreeing with that judgment. The WCC, in its defence, used arguments from previous court cases, involving private sector firms, stating that it was imperative to provide for depreciation. Yet the Judge (Denniston) rejected such a defence on the grounds of the differences between public and private sector activities:

A commercial company is in most cases bound to keep the subject-matter of the business which represents its assets in up-to-date condition. A municipality controlled by specific regulations need not be under the same obligations. 15

Furthermore, the Judge referred to the intergenerational equity of one generation’s profits being used for the possible benefit of the next.

The generation that advanced money to construct the [asset currently in use] may not unreasonably object to having the profits held for the possible benefit of the next [generation]. 16

The Judge continued, stating that “maintaining the tramway in good repair [reflecting the words in the Act] … does not involve depreciation outside physical requirements”; in other words, looking after the physical requirements of the undertaking was required by the Act.

The third judge, Stringer, also commented in his judgment that while the fund was at £138,038, the cash was not there, but had “already been diverted from its original purpose and used for the purpose of constructing further extensions of the tramway system”. The judgment noted that both the Dunedin and Christchurch tramway systems had local acts that permitted funds to be set aside for replacement and renewal.

Thus the Wellington City Council was required to cease operating the separate account for the Wadestown section and, therefore, could not strike a separate rate in relation to the Wadestown extension loan. More importantly, if the Council were to operate depreciation funds, it would need legislative authority.
7.3.2 The Abattoir and the Wellington Live Stock Butchers’ Association

In 1917 the WCC faced another legal challenge on how it accounted for its trading activities.\(^1\)\(^{\text{ii}}\) This time the challenge was from butchers who used the city abattoir. The case was similar to the Wadestown tramway case mentioned above; in this case the question related to the legality of various charges made against the abattoir account. The argument was that the charges made the cost of using the abattoir’s slaughtering facilities higher than they should otherwise have been. The issue for the butchers’ association was that the abattoir fees schedule was too high, or that users of the slaughtering facility at the abattoir were not receiving a refund they were entitled to under the city by-law – both scenarios being allegedly the result of incorrect accounting. The costs objected to in the accounts were:

(a) For renewal and depreciation fund: that is, a sum or fund to provide for new abattoirs at some far-distant time. (b) Redemption of the loan: that is, to pay interest and to pay back capital. (c) To repay capital (provide by WCC for initial establishment of abattoir) ... (d) To pay for additions and extensions and a cottage.\(^1\)\(^{\text{viii}}\)

In its defence, the WCC stressed that depreciation was part of the cost of a business and, unless otherwise stated in statute, that the WCC was required to keep accounts for trading activities in a business-like manner.

The Corporation is entitled to run the abattoirs without incurring a loss. ... The question in this case is, What is proper, as in a commercial undertaking, to charge against the abattoirs? Unless a sum is set aside annually to meet depreciation a loss is incurred, and if not met out of revenue it must fall on the ratepayers. ... A municipality in its trading capacity, except in so far as it is expressly or impliedly restricted by statute, must be governed by the same principles as a trading corporation. ... If there is no express statutory provision governing the matter the accounts may be kept in a proper business method.\(^1\)\(^{\text{viii}}\)

The judgment in the Court of Appeal reaffirmed the meaning of ‘annual cost’ in terms of the judgment from the Wadestown tramway case. The Court found that all items challenged were ‘capital expenditure’. The rationale of the Court was (referring to the above list of challenged items):

(a) If the abattoirs are always kept efficient and in repair, together with machinery and implements connected with the abattoirs, there would be no

\(^1\) Note this case went directly to the Court of Appeal.

\(^{\text{ii}}\) While this case was held after the introduction and passing of the 1917 Bill (as a result of an adjournment of the case), the Bill was an attempt to deal with the issues that had already being signalled in the preparation for the court case.
necessity to create a fund for renewal at some future time. (b) As to the
sinking fund, that also is not an 'annual cost.' Such a fund is created so that
the capital may be paid off. The 5 per cent that is to be charged assumes that
the capital or loan will always be on the property and not paid off. (c)
Regarding the writing-off of part of the capital, which is called 'preliminary
expenses,' that is also a repayment of capital, and is not authorised under the
phrase of 'annual cost.' (d) The payment for expenditure on extensions and
additions is also a payment of capital and properly comes that heading. 20

The judgment also pointed out that the Slaughtering and Inspection Act 1908, which
included the financial provisions, was concerned with more than only abattoirs
owned/operated by municipal corporations. The Act applied to all abattoirs, including
those in private ownership outside the main centres. Thus, the maximum return on
slaughtering activities to private sector owners throughout the colony would be 5 per cent
on capital. However, other activities undertaken at abattoirs did not have the same
restriction on pricing, permitting the Council to make a profit from those activities.
Examples of other such activities included tripe-cleaning, and the sale of offal by the
abattoir. 21

7.3.3 The Accident Fund

In 1909 the WCC decided to 'self-insure' for accidents involving the public and/or its
employees. For both the tramway and electric lighting undertakings, the WCC set an
annual appropriation to both accident funds at £1,000 each, plus premiums that the Council
would otherwise have paid to insurance companies. 22 The rationale for such a decision was
the inadequacy of cover that councils were able to purchase from private sector insurance
companies at the time. Insurance companies limited the cover offered to £2,000 per year,
with a premium of £400 and a requirement that half of all claims were to be paid by the
Council. 23 Between 1909 and 1916 the WCC appropriated approximately £25,700 to the
various accidents funds, paying £8,200 in claims. 24 The funds were accounted for
separately, but on various occasions they were used as loan finance for the Council's
general fund. This practice was one of a number of issues raised by the auditors.

7.3.4 The Auditor

The audit report for WCC's 1912-13 Balance Sheet contained a number of tags by the
Audit Office. The tags relevant to this chapter concerned the legality of certain practices,
namely:
• The contention that the Council had no authority to create the accident funds, although the Audit Office had not raised that concern in the previous three audits when the funds also existed.

• The use of the accident funds for tramway and electric lighting undertakings to provide temporary loans for the general fund.

• The depositing of money relating to the abattoir and tramway renewals and depreciation funds in unauthorised investments. This included monies managed by the WCC Sinking Fund Commissioners.

In response to the Audit Office’s tags, the Council resolved to deposit the accident funds and tramway renewal and depreciation funds in approved institutions, namely bank term deposits. However, it resolved to ignore the Audit Office’s concern relating to the existence of the accident funds. That approach did not make the issue disappear. In 1917 the Audit Office suggested the WCC should obtain legislative authority for both the creation of the depreciation fund and the accident fund for the tramway.

7.4 The Bill

7.4.1 The Preparation

The major influences on the construction of the Bill were the two pieces of local legislation already in place for tramway trading undertakings in other parts of New Zealand. These were the Christchurch Tramways District Amendment Act 1912 and the Dunedin City Council Empowering Act 1914.

The Christchurch Act made the creation of and contributing to both renewal and depreciation funds obligatory for the Christchurch Tramway Board. The Board was required to put aside two per cent of the total cost of the undertaking for depreciation and a further two per cent for renewal. Monies in the renewal fund were to be used for prematurely worn-out or obsolete plant, while the depreciation fund was for plant worn out during the normal course of the undertaking. Control of the renewal fund remained with the Board, while the depreciation fund was to be managed by independent commissioners appointed by the Board.

The Dunedin Act provided for that Council to set up five renewal funds, one for each trading activity. Half of each fund was to be controlled and invested by commissioners and
the other half held in a separate bank account to be controlled by the Council. The Act did not specify an amount to be set aside. Use of funds was restricted to renewing plant that prematurely wore-out or had become obsolete. Funds could also be used to pay off debentures relating to that trading activity if the sinking fund was insufficient.

The Wellington City Solicitor suggested that its Bill should be based on the powers given to Dunedin City Council and the Christchurch Tramway Board. In addition to the Dunedin and Christchurch legislation, Council officials noted that a Select Committee of both Houses of the English Parliament were in favour of such funds, that the Glasgow Tramway System, under a Mr McColl (considered the leading authority on local government tramway accounts in Britain) had such funds, and that five accounting ‘authorities’ supported the creation of them. The authorities were:

(1) Palgrave Dictionary of Economics
(2) Collins on Accounts of Local Bodies
(3) Guthrie on Depreciation
(4) Dickie on Depreciation and Reserve Funds
(5) Montgommery (American) on Auditing

7.4.2 The Introduction of the Bill

The Wellington City Trading Department’s Reserve and Renewal Funds Bill was introduced to the House of Representatives on 19 July 1917. The Bill included the following provisions:

- That renewal funds were set up for each trading activity: Abattoir, Tramway and Electric Lighting. The purpose of each renewal fund was for renewing or replacing worn-out or obsolete plant. A mandatory appropriation of £1-10-00 per centum of the value of depreciable assets per year was be made.

- That commissioners were appointed to hold in trust the renewal funds.

- That the renewal funds could be used to repay due debentures if the relevant sinking fund were insufficient.

- That reserve funds were set up for the Tramway and Electric Lighting undertakings, and a mandatory appropriation were made of £1-10-00 per centum on the value of depreciable assets per year.
• That the reserve funds were used for extensions and improvements to the undertakings, although if the renewal fund were insufficient the reserve fund could be used for renewals.

• That accident funds were set up for the Tramway and the Electric Lighting undertakings.

Following the first reading in the House of Representatives, the Bill was sent to the Local Bills Committee for discussion and revision. Three submissions to the committee on the Bill were received from: the Wellington Live Stock Butchers’ Association, the Greater Wellington Town Planning and Municipal Electors Association, and the Minister of Internal Affairs (based on advice from the Department of Internal Affairs and the Audit Office).

7.4.3 Local Bills Committee and Public Submissions

The Wellington Live Stock Butchers’ Association’s submission\(^29\) was based on the effects of increased costs that butchers would face if a renewal fund were established. This argument was more relevant because the Wellington City abattoir was a legislatively created monopoly. While the Bill was before Parliament the WCC had received an adjournment to the court case mentioned above, regarding what constituted annual costs for the abattoir. The outcome of the submission of the Wellington Live Stock Butchers’ Association was that all references to the city abattoir in the Bill were removed when it was reported back to the House of Representatives for the second reading. Thus, consequently, the Bill (and later the Act) only dealt with issues relating to the tramway and electric lighting undertakings.

The reasons and motivation of the Greater Wellington Town Planning and Municipal Electors Association’s (the electors’ association) for being involved in the proposed legislation are less obvious than those of the butchers. Following discussions between the City Solicitor and the electors’ association, agreement was reached on every issue raised by the electors’ association.\(^30\) The Council agreed to some changes and convinced the electors’ association of the merits of the Council’s position on other issues. The fundamental difference between the electors’ association and the WCC related to the existence of a fund in any form. The electors’ association stated that any profits from trading activities should provide rates relief for present ratepayers or a price reduction for
consumers rather than the creation of funds, as proposed in the Bill. The WCC’s response was that depreciation should be included in the accounts before determining profit, as depreciation was a cost of the business. The Council was not against subsidising rates by the trading undertaking, but only after depreciation was included in the cost of the undertaking.

It is inconsistent to ask that profits should go for the reduction of rates and at the same time to stipulate that undertakings could be run at a loss. To have no depreciation in a trading concern is to insure a loss.11

Perhaps the most significant change proposed by the electors’ association, and agreed to by the WCC, related to inclusion in the legislation of a priority for the payment of charges. The WCC agreed to have the renewal and reserve funds appropriation charged after provision was made for the sinking fund and interests on loans. The effect of this was that any special rate required to be struck to pay back loans on the trading undertaking, as a result of insufficient profit to fund the repayment, would be struck at an amount that did not include any appropriations to these funds. Thus, the reserve and renewal funds were to be contributed to only if surplus funds were available. This was despite the comments from the WCC, quoted above, regarding the necessity of depreciation.

The WCC also agreed to the objection by the electors’ association to the proposal to give authority to the Council to use the renewal funds to repay any loan relating to the undertaking if the loan sinking fund was insufficient. This clause was removed at the committee stage.

The third change, as a result of the submission of the electors’ association, was the introduction of a requirement that the commissioners responsible for the renewal fund should not be members of the Council or be council employees. This amendment resulted in an additional level of control over the renewal funds and became the norm in future legislation relating to such funds.

The requirement that a specified amount was to be appropriated to the reserve and renewal funds became an ongoing problem for the Council. The electors’ association wanted to change the specified amount to a maximum without a minimum. This was rejected by the Council, which stated that it would give any future Council the ability to withhold payment, thus diminishing funds during especially difficult financial times.
Finally, the electors’ association also wanted to limit the maximum amount the accident fund could reach. The WCC replied that only time would tell what the appropriate amount should be and therefore no limit to the fund should be set.

### 7.4.4 Submission on the Bill by Central Government

The submission by central government on the Bill was in the name of the Minister of Internal Affairs. As with all local bills the Department of Internal Affairs coordinated central government’s response to the Bill on behalf of the Minister of Internal Affairs. This involved comments from Audit Office and further information for the Minister from WCC, as well as the Department of Internal Affair’s own commentary on the Bill.

The Audit Office was not in favour of this Bill. The Controller and Auditor-General objected to a number of features. He considered the Bill gave powers to the WCC that should not be provided via a local bill; rather, if such provisions were to be enacted, then all municipalities should be given the same powers via an amendment to the *Municipal Corporations Act*. Apart from a philosophical argument regarding providing the same powers for the same class of entity, the use of local legislation would create an additional problem for the Audit Office, as it would be obliged to stop some municipal authorities from undertaking activities that were permitted to be undertaken by other municipal authorities.

The Department of Internal Affairs disagreed with the Audit Office regarding the appropriateness of local legislation. The Department was prepared to have local legislation where “local conditions warrant[ed] special treatment” and saw it as a precursor of general powers that would be given to similar authorities once the operation of local legislation proved manageable and useful in the specific authority.\(^32\)

The Audit Office also argued against the creation of funds proposed in the Bill. The focus was not just on the Act but also on similar actions across many local authorities. The Controller and Auditor-General suggested that while valid commercial reasons may have existed for creating such funds, such reasons did not apply to municipal corporations.

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Finally, and as the questions at issue are of Dominion importance, I feel impelled to point out that the plea so constantly being urged in favour of the creation of various funds, namely that high authorities on accounting recommend them is not so sound as it might appear; in fact hardly applicable, for the reason that these authorities refer in the main, if not wholly, to the responsibilities of Directors as to the keeping alive of the Assets of proprietary Corporations. Any attempt to base an argument on an analogy between a
proprietary Company and a Municipal Corporation must however fail to succeed, because the responsible functions are essentially different – a view specifically expressed recently in the Court of Appeal by their Honors Mr Justice Stringer and Mr Justice Sim, and I believe also by Mr Justice Edwards – certainly endorsed by him.\(^1\)

He said further that the creation of funds by councils, as envisaged by the proposed legislation for WCC, was inappropriate, because of the lack of relationship between those who contributed to the funds and those who would will benefit from the funds. He discussed the creation of intergenerational inequity by the creation of such funds.

The grounds of this conclusion are clear enough, inasmuch as a proprietary Company is formed for the express purpose of deriving profits from the general public for the benefit of the private shareholders, and Funds, reserve or otherwise, created in relation to proprietary ventures are the inalienable property of the individual shareholders to the degree of their holding, and realisable by them in relation to the sale of their shares. On the other hand, a Municipal Corporation's trading functions were conferred with the specific object of retaining to ratepayers the profits which would otherwise be extracted from them by private enterprise. If, however, Municipalities are permitted to pile up funds this benefit is not only filched from ratepayers, but they suffer the additional drawback of having no realisable asset-right in such funds – (they) are in fact providing funds for others than themselves; and as the ancestry of the present generation did not provide the present system and leave funds in addition, it seems hardly just to impose any such obligation on this generation to provide for that which is to follow.\(^4\)

Finally, the Controller and Auditor-General outlined his concerns relating to officials' behaviour if they were permitted to create the reserve funds, outlining what would become known, in another 40 years, as the public choice problem;\(^i\) he suggested that such funds would benefit Council management but not ratepayers.

To keep all matters in good condition, pay interest and Sinking Fund on loans and hold a working margin, is all that is requisite, as the general revenue is available is case of extreme emergency. That Municipal functionaries should be so insistent with regard to these additional funds is easily understandable, as it affords greater and practically uncontrolled spending power for them, enhances their importance, and probably increases their salaries also: and the average ratepayer, while puzzled and dissatisfied over what he feels to be unjust, is yet too poor or too bewildered to make his protest in the only manner in which it would prove effective.\(^3\)

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\(^1\) The Controller and Auditor-General did not identify which case he was referring to; however, all three judges were judges of the New Zealand Court of Appeal at the time.

\(^i\) Boston et al (1996 p. 17) has Downs (1957) *An Economic Theory of Democracy* as the earliest in their list of seminal works on public choice theory.

\(^3\) As noted in chapter five, by 1927 the Controller and Auditor-General had altered his view on depreciation. In relation to all trading activities, as they had started to use accrual accounting for trading activities, he wanted to include depreciation in the trading accounts, else the accounts would fail to be "a true statement of profit and loss". However he did not at the time mention the creation of separate funds and was happy seeing
The Department of Internal Affairs agreed with much the Controller and Auditor-General said on these issues but with some qualification, thus supporting the legislation with what it regarded as various practical considerations of the day. The Department clearly agreed with the distinction between accounting for local authorities and private sector companies.

The local body not being under the necessity of paying dividends does not in theory, at any rate, need to concern itself with any question of capital. In the case of unreproductive work such as water supply, this theory works out well enough in practice. ... But in the case of profit-bearing service, e.g. tramways, the local body in practice can no more neglect proper business precautions to ensure some measure of profit than a business corporation can utterly neglect the service merely for the sake of profits. 36

The Department of Internal Affairs said the issue hinged on what to do with the profit – using it to provide relief for rates, or using it to make improvements to and/or renewal of the undertaking. Although the relief of rates may have been “sound ... in the case of a small borough”, the Department suggested that due to financial constraints and the growth required in larger authorities, their profit bearing services should be self-renewing.

A few minor practical issues were covered by submissions from central government agencies. Regarding the reserve fund, as opposed to the renewal fund, the Department of Internal Affairs agreed with the Audit Office that such a fund should not be permitted; rather, any surplus generated by the undertaking should be credited to the district fund at the end of that year. The Department also disagreed with the inclusion of an accident fund, reminding the Minister that requests for legislative authority for the creation of such funds from past municipal conferences had been declined. The Minister of Internal Affairs agreed with his department on all issues and forwarded such comments (as prepared by the Department) to the Local Bills Committee. 37

The Controller and Auditor-General also commented on the lack of a priority of interest and sinking fund charges over the reserve and renewals funds. As noted above, the electors’ association had similarly queried this issue, and an amendment creating the priority was made in the Local Legislation Committee.

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the depreciation charged waived when the loan on the depreciated item was still being paid back. (AJHR 1927 B1 [Pt II] p. xiv)
7.4.5 From the Local Bills Committee to Enactment

As a result of the submissions from both central government and those involved with Wellington City, a number of changes were made to the Bill in the Local Bills Committee. The main changes were:

- Removal of all references to the abattoir, leaving the Bill to cover the tramways and electric lighting undertakings.
- Requiring interest and sinking fund charges to be credited prior to reserve and renewal funds charges, thus avoiding special rates being struck to include the appropriation to the reserve and renewal funds.
- No Wellington City councillor or Council employee was to be appointed a renewal fund commissioner.
- Removal of the ability to use renewal funds for paying off of a loan when the sinking fund was insufficient.
- Limiting the yearly appropriation to the accident fund to the amount that would otherwise have been paid to a private sector insurance company.
- Limiting the maximum amount in the accident funds for tramway to £20,000 and for the electric lighting to £7,500.

On return from the Local Bills Committee, the Bill passed without further changes through the remaining stages in the House of Representatives and then through all stages in the Legislative Council. The Bill received the Royal Assent on 27 October 1917.

7.5 Subsequent Amendments

From the time the Act was passed in 1917 to the demise of funds in 1981, fifteen acts had amended the main Act. The amendments included:

- An increase in 1922 in the percentage to be charged to the renewal and reserve funds, from 1 pound ten shillings to two pounds.

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\(^{1}\) Seven of these acts were local acts while the remaining acts were incorporated into Local Legislation Acts.
• Repealing, in 1924, the limits on the size to which accident funds could grow. The reason for the amendment was because of the increased liability the WCC faced under the *Workers Compensation Act* 1922, the increased damages awarded by juries, and the increased size of the tramway and electric lighting undertakings.  

• Suspension of appropriations to the tramway renewal fund between 1934 and 1940, and between 1964 and 1975. The suspension in the 1930s was initially (the first three years) a response to the economic impact on trading activities of the Depression. While the WCC had reduced operating costs in response to calls for increased economy in the public sector, and the income from tramway revenue was similarly down as a result of the Depression, the capital charges for the tramway remained high, continuing to grow as a proportion of the decreasing tramway revenue. At the end of the 1920s the capital charges accounted for 20 per cent of total revenue, and by the mid 1930s it had risen to nearly 30 per cent. As the Depression ended, the wages expense rose, and the WCC sought to continue the suspension of the renewal fund to allow payment of the additional costs of the wages without raising fares. The 1960s saw the WCC transport department starting to make very significant losses. With the phasing out of trams in the 1960s the need for the renewal fund (by then, covering the replacement of trolley buses and other infrastructure relating to the transport department, including overhead lines) was considered less than had previously been required (for tramcars and their permanent way). The suspension of appropriations thus reduced the losses. However, by the early 1970s both the City Treasurer and the General Manager of the transport department expressed concerns about the renewal fund. In 1974 the General Manager noted his continuing opposition to the moratorium on renewal fund appropriations (begun under his predecessor), stressing that as a result of the moratorium the fund was in a “precarious position”. He also commented that renewal fund calculations had been based on the purchase price rather than on the replacement cost. He stated that the required rate of depreciation would be close to 6½ per cent, as opposed to the existing rate of 2 per cent. The City Treasurer was concerned at the practice:
[the] suspension of depreciation [is] contrary to sound financial principles, but the transport cost is such that these recommendations are one way of relieving part of the burden on the ratepayer.  

- Legislation also provided for suspensions of appropriations to the electric lighting renewal fund between 1934 and 1938, due again to the Depression, and between 1975 and 1981. The WCC initially wanted the 1934 suspension to continue until 1940, as had occurred for the tramway undertaking; however, the Department of Internal Affairs argued, on advice from the Audit Office, prior to the introduction of the Bill, which would have authorised continuation of the suspension, that it was not required because the electric lighting undertaking was making a sizeable surplus. A further concern expressed by the Audit Office, at that time, was that the surplus was being transferred to the general fund for other Council activities or to the WCC Unemployment Relief Account. The 1975 suspension was made on the understanding that money, which would have been appropriated for the renewal fund, would be used to fund capital work. At that time the renewal fund was considered to be at an adequate level for future renewals. It was argued that to borrow externally for further capital expenditure while still appropriating to the renewal fund was not good practice, especially given the high rate of inflation and loss of purchasing power at the time.

It seems incongruous to depreciate assets, tie up funds in outside investments and at the same time borrow money to create assets.

- WCC obtained authorisation in the 1938 Local Legislation Act to use electric light undertaking renewal funds for extensions to the undertaking between 1939 and 1941, provided that at least £100,000 was kept in the fund. This authorisation was to provide for the infrastructure to ensure provision of the additional supply required for hosting the New Zealand Centennial Exhibition by Wellington in 1940. The same authority was again obtained in 1974 for use between 1974 and 1981 – the limit being set at $1,000,000.

- Provisions that permitted the WCC to increase by a further two per cent the reserve and renewal funds appropriation for both undertakings were enacted in 1943. The rationale for this wartime enactment was that ongoing maintenance was not being undertaken at a level that would maintain the infrastructure at a constant (and appropriate) state of repair due to shortages of labour and materials. Greater maintenance was expected to be undertaken after the war.
(making up for the lack of maintenance during the war years), which would require more funds.

- In 1950 the limits, upper or lower, on the amount to be appropriated to the reserve funds were removed. At the time, the tramway was making a loss but was required to appropriate monies to the reserve fund. This necessitated the council to seek funds via an overdraft to pay into the reserve fund. According to the City Solicitor:

  It is submitted that this is a wrong principle and an appropriation should only be made out of profits. For this reason it is desired that the authority (to appropriate money to a reserve fund) be permissive.45

The final act that altered the operation of the 1917 Act was not an amendment, but rather, a provision of the 1977 Local Government Amendment Act No. 3. Section 213 (6) stated that councils should not appoint any renewal or depreciation fund commissioners from 1 April 1978. The renewal fund ceased to exist as outlined in the 1917 Act in 1981, following the death of a commissioner and the resignation of a second. The third commissioner resigned, having no quorum and therefore no ability to act.46 Management of the fund was then taken over by the Wellington City Council. After the changes to both structural arrangements for the Council’s trading activities (into stand-alone companies called LATEs) and the introduction of new accounting requirements in 1989, any remaining responsibilities under the 1917 Act were irrelevant. The Act was finally removed from the statute books in 2002.47

7.6 Other Legislative Developments

Subsequent to the passing of the 1917 Act, a number of other pieces of legislation were enacted that reflected some intentions of the 1917 Act or Bill, but did not alter the 1917 Act.

The Wellington City Abattoir Charges and Renewal Fund Act 1919 gave the WCC the right to set up a renewal fund for the abattoir. As noted above, the original 1917 Bill included provisions for the city abattoir, but all references to the abattoir were removed when the Bill was reviewed in the Local Bodies Committee. The 1919 Act provided for the creation of a renewal fund for which the associated appropriation was included in the annual costs of the abattoir. This meant that the renewal fund charge was part of the cost that users of the abattoir were required to pay. The amount permitted to be charged for the
cost of capital for establishing the abattoir was set at seven per cent by the 1919 Act (a local act), which was two per cent higher than that permitted in the industry wide 1908 Slaughtering and Inspection Act. The 1919 Act was subsequently repealed by the Meat Act 1939 (which also replaced the 1908 Act) when renewal and depreciation accounts became mandatory for local authorities that operated abattoirs.

The 1920 Municipal Corporations Act included provisions for municipal councils to set up accident, renewal and reserve funds for trading activities, including tramways and electric lighting undertakings. The provisions for accident funds were the same as those in the 1917 WCC Act. However, provision for the creation of a renewal fund was permissive, as opposed to the mandatory provision for WCC that was provided in the 1917 Act. The renewal fund was limited to a maximum of 1½ per cent of the value of depreciable assets. In the following year that limitation was removed by the Municipal Corporations Amendment Act 1921-22. In 1928, ‘renewal funds’ created under the 1920 Act became ‘depreciation funds’, and it became a requirement (rather than the permissive 1920 requirement) for each undertaking that the Council should:

make a charge against the revenue of such undertaking to provide for full and proper depreciation of the assets of the undertaking (1928 s. 47(1) part of).

The WCC was not required to set up depreciation funds, because the renewal funds created under the 1917 local Act were regarded as sufficient. (1928 s. 47(2))

Councils were also permitted to set up reserve funds under the 1920 Act. The contribution to the fund was capped at 1½ per cent of depreciable assets, but that limit was removed in 1921. At no stage was it mandatory to set up the reserve fund.

In the early 1970s the WCC considered repealing the 1917 Act and transferring the electric lighting and tramway undertakings to the provisions of the Municipal Corporations Act 1954, which had replaced the 1920 Act and its 1928 Amendment Act. The Audit Office suggested such an approach. However, the City Treasurer believed that securing special legislation to suspend the legislative requirement to contribute to a renewal fund (which would become a depreciation fund) would be easier if provisions were in the local 1917 Act rather than the Municipal Corporation Act. The General Manager of the WCC’s electricity department in 1971 believed that under the Municipal Corporations Act 1954 a

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1 No reason or justification for this increased capital charge rate just for WCC was found in the archives.
smaller appropriation would be required. He considered that reducing the renewal (depreciation) fund appropriation would reduce the financial stability of the electricity department. In effect the 1917 Act gave the electricity department more reserves than it would otherwise have been able to access. Ultimately, the Council did not seek to repeal the 1917 Act, remaining content with its position under its own local legislation.

While the debate and discussion that created the 1917 WCC Act were somewhat specific to the practices at WCC at those times, they were also part of the wider discussion concerning accounting for the trading activities of local authorities. Many of these issues have been covered in earlier chapters, yet what is significant was the greater willingness to regard the trading activity as if it were a private sector commercial activity, and at the same time be concerned with both public policy issues and public (local authority) money issues.

7.7 Accounting Issues

This case study highlights three accounting issues: the control of local government financial management, the accounting for fixed assets, equity and depreciation, and the use of cash to control funds.

7.7.1 Control of Financial Management

As discussed in earlier chapters, a fundamental principle of municipal finance was that councils should fund current activity from current revenue. The Municipal Corporations Act 1876 included the requirement that estimates were to be produced prior to the striking of the rates, and the rates struck should be for the amount required in the estimates. (s. 109) Similar provisions were also enacted to ensure that special rates struck to cover loans’ sinking funds and interest, and other special rates, were limited to the current year’s requirements. The objective was both to limit the funds available to councils and to ensure that current expenditure, and thus benefit, was connected with current revenue. That principle was continued in subsequent municipal corporations/local government legislation. However, the creation of both the renewal and reserve funds in the 1917 Act were counter to that principle.

While the 1917 Act included controls on the use of the renewal funds, no similar controls over the reserve funds were provided. The reserve funds were created so that a set percentage was contributed to the funds yearly, and were to be used for “extensions and improvements in the undertaking”. (s. 13(1)) A subsequent amendment in 1950 removed
any limit, upper or lower, on the amount of the yearly appropriation to the reserve funds. Thus, decisions on both the size of any contribution and the timing of the use of funds (including between generations) were left to the WCC.

Renewal funds were created specifically for the replacement of depreciated assets with the same/similar asset. How to control the renewal funds in this unusual arrangement was debated from the outset. The electors' association suggestion – agreed to by the WCC – that commissioners should be independent of the Council, was one of the most important steps in providing some degree of control over the fund. Such a provision that provided for independent commissioners was in neither the Dunedin nor the Christchurch tramways legislation, which had been used as the starting point for drafting the 1917 WCC Act. Another change made in the Local Bills Committee had placed a minimum on the amount that could be withdrawn from the renewal fund. That provision was enacted in the belief that it would reduce opportunities for the WCC to withdraw funds for maintenance and repairs.

The ongoing control that ensured proper use of the renewal funds had a number of aspects. The most technical check on the use of funds was that only assets subject to a depreciation charge were to be replaced by monies from the renewal fund. Yet this was only a necessary rather than sufficient condition for use of the funds. At times, various parties were 'checking' the appropriate use of the renewal funds. Following an Audit Office instruction, requests by the Council for funds from the Commissioners were required to be made subsequent to Council resolutions to that effect. The Commissioners, the City Treasurer, the Town Clerk, and the Audit Office — all checked requests for funds from the renewal funds. Some requests were questioned and/or rejected because the item being replaced had not been depreciated. Control on the use of renewal funds always involved judgements on whether the expenditure was for renewal of part of the plant and equipment or for the purchase a new item. For example, the Audit Office agreed that trolley buses that replaced trams were a renewal

to the extent that the seating capacity of trolley buses does not exceed the seating capacity of trams as capitalised in the books of account.

The Commissioners rejected certain requests, making judgements that differentiated between renewing previously purchased equipment and purchasing new equipment. For example, a request in 1965 for a 'kango' hammer was rejected by Commissioners because the "new item had greater capacity than the article replaced". The fact that the price
differential was £79 for the new hammer compared with £15 for the old one was clearly part of the discussion.\textsuperscript{52}

While the Act contained a minimum amount to be requested, that minimum was the total amount to be provided from a fund in one transaction and not a minimum for each item to be renewed. Some amounts for individual items requested were very small. For example, a request in 1961 totalling more than £3,000 included specified amounts of twelve shillings and eleven pence for a concrete mixer and a radical drill for three shillings and five pence.\textsuperscript{53}

The other area of control, concerning funds especially managed by the Commissioners, related to proceeds from the sale of depreciated assets that were replaced from the renewal funds. In 1968 the Commissioners sought a WCC policy that would have had all proceeds from the sale of assets, which were replaced from the renewal funds, credited to the renewal funds. Although it was not required under the legislation, the Council agreed to this additional control. Thus, the trading department managers had the ability to fund new assets from the sale of assets removed, thereby reducing their flexibility. This safeguarded the use of funds that were intended to replace existing plant and infrastructure from being used to increase the size and/or nature of the undertaking. The ‘public choice problem’ that the Controller and Auditor-General warned of in opposing the 1917 Bill was to some degree addressed by this change in 1968. In addition, this measure removed the possibility of treating the sale of assets as revenue.

The legislation ensured that some control was maintained over the funds and their management by the WCC. The requirement to appoint independent commissioners for the renewal funds provided more control over inappropriate expenditure than for the reserve funds, which were managed entirely by the WCC. The only control over the reserve funds was a requirement that they should be used for expenditure that related to the undertaking. By their nature, both funds provided a degree of intergenerational funding of the trading undertakings (and thus the possibility of intergenerational inequity) and gave the WCC greater control over its financial management of the trading activities than would otherwise have been the case.
7.7.2 Assets, Equity and Depreciation

The nature of capital or equity in the public sector, and the need for capital maintenance in local government, were central questions in discussions of the 1917 Act. The debate can be viewed as two conflicting approaches to capital for local government. Both views give primacy to cash; neither has an interest in unrealised gains nor the possibility of gains from sale of the assets (other than at the end of their useful life), as the assets were not intended for sale but, rather, for the borough’s use.

The first approach states that local government has limited interest in capital. In this view there is no difference between the trading activities of a local authority and its activities funded by rates. Capital is viewed as the previous generations’ wealth, which has been transferred to the current generation. The capital is generated by a surplus of revenue (that is, rates or fees for local government) over expenditure collected within one period. Because local government is expected to collect only what is necessary for the current year, the accumulation of capital is counter to that principle. Thus, capital is considered the result of excessive charging/taxing by one generation to the benefit of following generations. The division between payments for capital items and for expenses is considered irrelevant, as the total cost in any year includes interest and principal for loan repayment, operating costs, and maintenance of assets at a steady rate, given their age (thus avoiding any need for depreciation). What might be regarded as the borough’s assets, such as infrastructure, are viewed as items that must be maintained and are therefore seen as a constant source of expenditure as well as a resource for use by the borough.

The alternative approach regards the development of capital as important. For trading activities, the cost of items or services produced by trading departments should include a return on capital. This is held, even if consumers are also paying off a loan, and interest is used for the creation of the item via the fees charged. This second view has an additional aspect that implies accounting and financial management of trading departments should practise the same ‘best practices’ as the private sector. In particular, a return on capital would not only be expected but be required to ensure continued reinvestment in the business by owners (in lieu of dividends). Depreciation would be a normal business expense that is unrelated to either profit or interest paid, and use of the resulting cash from incorporating a depreciation charge in the price of services provided would be unrelated to the depreciation charge.
The WCC took the approach that it should develop its capital base for future generations; Wellington was a city of more than 43,000 people, which only 60 years earlier had not existed. Arguments in the court cases were phrased in terms of depreciation being part of the ‘operating expenses’ of the trading activities. That line of argument reflected the way various acts were written; the amounts permitted to be charged against revenue were limited to the ‘operating expenses’. The issue was the desire of the WCC to ensure that after loans were paid (funded either by users of the undertakings or if not by them, by ratepayers), the undertaking as a whole would still be in use and in good condition. As noted above, the WCC believed that a failure to provide for depreciation would result in a situation where it would make a loss on the trading undertaking. The WCC also believed that any capital invested in an undertaking should either earn an appropriate profit or the cost of capital should be included in the cost of the service if it were in a legislatively enforced breakeven environment (for example, the city abattoir). For example, in 1937 the City Solicitor considered a return of 3½ per cent on assets of the electricity undertaking as barely satisfactory, “due to the fact that the Corporation fostered this undertaking in its early stages and has practised the utmost economy in dealing with the whole business”.

Thus, the Council believed that users of the electricity undertaking should have paid more to cover both the depreciation on the undertaking and to provide a return on the capital generated by past generations. Over the years, councils used the profits from trading undertakings as relief from rates (through transfer to the general fund) and for the continued development of the undertaking concerned.

The counter approach expressed by most other parties was that to permit or require the WCC to create funds from trading activities for use in other periods was inappropriate. The comments of the Controller and Auditor-General, quoted above, indicated his desire for cash/liquidity to be in the hands of ratepayers and his concern for intergenerational equity. The Court of Appeal saw only the need to ensure that current physical assets were maintained, which it considered could have been achieved by normal maintenance outgoings. The end of the life of an asset meant it was time to replace it; that replacement being funded by current ratepayers and/or consumers, most likely via another loan for the life of the new asset. Those opposed to the funds believed that councils need not and perhaps should not have accumulated wealth and assets, especially when funded by generations that would not receive the benefits from the assets.
The outcome of this debate was a partial win to those who favoured the formation of capital by the WCC and, ultimately, by all municipal authorities. Department of Internal Affairs appraised the situation in 1917 when advising the Minister of Internal Affairs on the Bill:

it is becoming clearer every day that where any of the four cities is in question the burden of general rates on the development of unreproductive services to an extent that is not necessary in smaller boroughs, makes it almost a necessity that profit-bearing services should, in the interests of the ratepayers themselves as well as of the local body itself be as far as possible self-renewing.  

Thus, a form of wealth creation and capital maintenance was introduced that meant trading undertakings were able to support their own renewal even when the assets could no longer be renewed but were required to be replaced. Yet the nature of this capital maintenance\(^\text{i}\) is confusing. The capital maintenance related to operating capacity; but was it a financial or physical measure of operating capacity?

Clearly, the WCC was focused on the ability of an undertaking to continue. It wanted to avoid the need to obtain new finance to replace the existing system, even when that system's plant and equipment (and resultant initial loan) had expired. There was no discussion regarding the financial value of the system and ensuring that value was maintained. The focus was on the operating capacity of an undertaking and its maintenance.

As time progressed, the focus of the Act was on the physical operating capacity of the undertaking. For example, the use of the tramway renewal fund for replacing withdrawn trams with trolleybuses, on the proviso that the capacity remained the same, clearly reflected physical capital maintenance. The focus was to ensure that funds were used in a manner that would allow the undertaking to continue what was required – in this case, to provide a public transportation system at current capacity.

\(^{\text{i}}\) Gamble (1981) identified five forms of capital maintenance; financial, purchasing power, physical, prospective income, and time value of capital. Of relevance here are the financial and physical forms of capital maintenance. Financial capital maintenance is intended to ensure that the monetary value of the assets is maintained within the entity. Physical capital maintenance "concentrates on maintaining the productive capacity of" (p. 227) the entity.
However, not all discussions reflected concern for the physical capital of the undertakings. Discussions in the Court of Appeal, regarding the lack of identifiable cash funds from previous years' depreciation charges and the subsequent requirement for separate accounts with additional controls, suggests that the focus was on financial capital maintenance; the Court was concerned that the monetary value of the cash was maintained, as opposed to the purchasing power of that cash, for the renewal of the undertaking.

This confusion between financial and physical capital maintenance reflects the requirement that cash was to be held in separate accounts, something that would not be expected under a private sector model. It seems likely that until the point of applying the money collected in the fund, a financial capital maintenance view was taken whereby the funds were seen as a means to maintain the value of the assets. When the time came to apply the funds, a physical capital maintenance view was used so that the physical capacity of the undertaking would be maintained. The most likely reason for this change in approach would be an appreciation of the 'public choice theory problem' (before it was known as such) of uncontrolled expansion by local authorities, having used money collected from previous generations. To control how money was spent was intended to restrict, at the outset, the unnecessary collection of funds. Once councils knew the limits on spending renewal funds, they would be less likely to attempt to spend beyond the purposes of a fund and to collect more than they could spend from current ratepayers and/or consumers (many of whom were also voters).

7.7.3 Control of the Funds

The creation of the renewal and reserve funds meant more than accounting book entries. Separate bank accounts were required, as well as independent commissioners for the renewal funds. In spite of using the income and expenditure basis of accounting for most trading activities, as outlined in chapter four, the management of cash was still the most important control mechanism. Similarly, auditing the funds required checking that balances in bank accounts were correct compared with bank records, together with checking the legality of the appropriations to and from the funds.

The inefficiency of the system of separate bank accounts, in terms of cash management by the Council, was well known. As mentioned in chapter five, councils were required on
occasions to obtain bank overdrafts to ensure they had enough cash to appropriate (and deposit) the required monies into the special funds required by various legislation.

A similar example could be found in relation to a proposal in 1944 from the WCC to obtain permission via a new piece of local legislation to raise a loan for £13,000 for the Wellington City Abattoir. The response of the local Member of Parliament was to question the wisdom of the Council obtaining another loan while it had a number of funds that already contained in total a sizeable amount of money.

What puzzles me is why a wealthy Council such as this with substantial reserves in several accounts needs a Special Loan for so small a sum as £13,000. Could not one department out of funds borrow from another with a surplus and thus save the interest and the starting of another amortization account.56

Yet, for reasons discussed earlier, cash remained an important part of the control of municipal finance, including trading departments’ renewal and reserve funds. The use of cash as the main form of control also restricted the ability of the WCC to engage in new/different activities that were beyond the scope of the undertaking from where funds had been generated. This ensured that the Council did not use funds from different periods to finance other activities or to set up different activities without consent of ratepayers and electors via loan polls. At least some principles of local government finance were upheld, while still permitting the continued development of the Council’s trading undertakings.

7.8 Conclusions

This chapter highlights a number of issues in addition to the specific accounting issues of the preceding section. The three major issues are the involvement of a single member of the public to force change in accounting policy, the role that many players took in the process of establishing the legislation, and the degree of licence permitted or taken with the principles of local government financial management to meet the needs of a particular time.

7.8.1 Public Involvement in Determining Accounting Policies and Practices

The level of New Zealand ratepayer participation in the activities of local government has been considered low. For example, voter turnout during the late 1920s (being the closest figures sourced to 1917) showed that about one-third of eligible voters voted in Wellington City Council elections, whereas turnout for central government elections saw “most
Wellingtonians still vote for a Member of Parliament”. (Brookes 1970 pp. 114-5). This was in spite of the relatively significant involvement by many people in elected positions in local authorities, as noted in the preface to this thesis.

This WCC case study illustrates a relatively unusual phenomenon – namely, a single person challenging the accounting policies of a council. G Carwell Cooke took on the Wellington City Council and won! Similarly, a trade association (the Wellington LiveStock Butchers’ Association) took the Council to court and an electors’ association (the Greater Wellington Town Planning and Municipal Electors Associations) argued with the Council (before the Bill became law) regarding appropriate accounting practice for the Council. While the motivation of the trade association can be explained by a desire to see the cost to its members reduced, the motivation of both the individual and the electors’ association to litigate is less clear. Records for both Cooke and the Greater Wellington Town Planning and Municipal Electors Associations were not located. However, it seems likely that the cost of litigation would have outweighed any financial benefit accruing to Cooke. As an accountant, Cooke may have been personally interested in the issues or sufficiently concerned professionally about the issues to litigate, but economic self-interest could not explain his actions. As for the electors’ association, its involvement could not be explained solely by ‘self-interest’ either; why would it have argued against the use of renewal funds to pay off any loans related to the undertaking if the sinking funds were insufficient? The outcome of its position was that ratepayers would have to fund any shortfall in the sinking funds in spite of the possibility of healthy renewal funds. Without further evidence I am of the opinion that the most likely motivation for both Cooke and the electors’ association was a sense of ‘civil duty’ to challenge the Council on its accounting requirements.

Interestingly, perhaps, this counters Jones’ (1992) suggested interpretation, also Coombs and Edwards, following Jones, of the archival sources relating to British municipal corporations accounting. (1995 p. 104) Jones, using an “economic model of human behaviour” (p. 126), theorises that the cost to parties, seeking to change accounting policies, would outweigh anything other than an economic motivation for such behaviour.

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¹ It is worth noting that Brookes suggests that voter turnout, in spite of its popularity, can be misleading regarding participation of citizens. However, it is the best proxy available.
Furthermore, when using an economic analysis, Jones argued that the cost to ratepayers to understand the accounting sufficiently so as to become involved in debates about accounting policy would be prohibitive, even for "those trained in accounting" (p. 128). Coombs and Edwards said that they:

found virtually no empirical evidence to suggest that innovation was a response to the demand from ratepayers for more or better information. (1995 p. 104)

However, they also commented that some ratepayers' associations complained about the accounting methods employed by their local councils.

The 1917 Act was the result of actions by a single ratepayer, the electors' association, and a trade association. While Cooke understood accounting and therefore would not have incurred costs relating to the presenting the technical material to the court, there would have been other significant costs to him for initiating proceedings against the Wellington City Council. The involvement of these three parties was not restricted to just complaining about current practice and economic costs of WCC's accounting policies, but included suggestions to modify both existing and proposed accounting policies. On both counts — existing and proposed — all three parties were successful.

7.8.2 The Players

The second issue from this case study was the role of many players involved in the creation and/or the alterations of the 1917 Act. Most players have already been discussed in earlier chapters. This discussion will focus on three players not discussed earlier — namely the community (that is, a ratepayer, and electors' and trade associations), the courts, and thirdly, the Wellington City Council.

The previous paragraphs referred to the involvement of a ratepayer, and electors and trade groups as players in this case study. They were essential to the story; their motivations as mentioned were economic for the trade association and 'civic' for the individual and the electors' group. They were part of the negotiated changes to the accounting practices of the WCC. As noted above, their involvement in accounting polices and practices was unusual, and their motivations did not fit the standard economic paradigm of accounting research. It was the negotiated element of their involvement that is particularly interesting. Community groups were very involved in the formation and debate of accounting policies and practices that affected them.
A second player that was not discussed in previous chapters is the Courts. The five judges involved in the Wadestown tramway case all offered some comment. However, the lower court and the Court of Appeal were divided on two aspects: the separateness of the Wadestown undertaking, and the application of commercial accounting practices for municipal corporations’ trading activities. The separateness of the Wadestown undertaking was a matter of law, which need not concern us here. Of interest, however, was the acceptance by the Supreme Court of commercial accounting practice logic for the WCC undertaking (as proposed by the City Solicitor) and the unanimous rejection of that logic by the Court of Appeal. However, not all judges of the Court of Appeal agreed that it was not the best or most appropriate accounting practice for local government. The Chief Justice, Stout, appeared to give some support for the practice of the WCC, while ruling it illegal, based on the legislation, while Justices Denniston and Stringer ruled it both illegal and inappropriate accounting practice for municipal corporations. This divergence of opinion within the Court of the appropriateness of commercial practices reflected the divergence of opinion in the wider community on what was considered ‘good practice’ at the time.

The final group is the WCC; its role reflected that of most municipal corporations, as discussed earlier in respect of the activities of the Municipal Association – namely, to obtain the greatest freedom for the Council. This freedom had two aspects that conflicted with each other. The first was the predictable freedom from the constraints of accounting requirements that would enable the Council to act in ways it regarded as in the best interests of the Council and the city. Thus, the ability to set up funds for the continual benefit of ratepayers and residents, to contribute appropriate amounts to those funds, depending on the state of the economy, and the ability to make sensible use of the funds, are powers that the Council wanted. The second set of freedoms the Council wanted, although only at times, was from making decisions that local ratepayers would favour, but which the Council did not consider in the long-term interests of the city. For example, as discussed above, discussion in the early 1970s regarding changing legislative arrangements

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i One judge in the Supreme Court and four judges in the Court of Appeal.

ii A vast majority of accounting research begins (and ends) with neo-classical economic assumptions regarding the behaviour of those involved. Under such a paradigm one would expect that the Council would seek to either maximise the benefit to the elected councillors or the employees of the Council. However in this case study no action that could be interpreted as such has been identified.
would have made contributions to the renewal fund smaller for the electricity department. While such arrangements would have been legal and would have been desirable for existing ratepayers and electricity consumers, the Council rejected such a move on the bases of long-term interests of the city. Instead, the Council continued with the existing legislative arrangements, thus providing an ‘excuse’ for the level of appropriation to the renewal fund.

7.8.3 Best Practice

The final issue for discussion in this chapter relates to the identification and subsequent adoption or rejection of what was considered ‘best practice’ at the time. Best practice during the period of the case study was considered to include the following:

- Not having a local act – rather, the use of sector-wide legislation (for example, Municipal Corporations Act) for issues of long-term financial management of boroughs.

- Ensuring intergenerational equity by avoiding the creation of reserves where the benefit would occur in a different period from its creation.

- Where creation of reserves was seen as appropriate (noting the above comment) funding should be equitable, fair and ongoing.

- The fundamental principle of local government finance, as outlined in chapter four, that a year’s expenditure was funded from the same year’s revenue.

This chapter has witnessed the overturning / rejection of all these principles at some stage, from the passing of the Bill and the creation of the funds, to frequent changes to the appropriation requirements due to ‘other financial considerations’. This is an important part of the story; while the principles were important in guiding discussion they were not permanently adhered to. Allowing such licence in the application of the principles could be interpreted either as a lack of rigour by the creators of the rules or it could show an understanding that accounting rules were intended to assist rather than hinder the management of local government. This latter interpretation, I believe, reflects the actions of all parties in this case. The WCC, the Audit Office, the Department of Internal Affairs, the local residents and associations, while not necessarily wanting the same ends, all expressed a desire to accept outcomes that were workable for the city. Accounting
principles and 'best practices' were not sacrosanct, but could be modified to take account of the context in which they occurred.\textsuperscript{1}

\textsuperscript{1} Such an approach could be contrasted with the (official) approach at the end of the twentieth century (the period after the end of this thesis) when accounting rules were required to be followed because they were best practice. Perhaps that approach could be called 'letting the accounting rules manage' or 'management by accounting rules'. The 1917 Act and its amendment reflected a much more pragmatic approach to financial management of Councils, while still ensuring some degree of control.
Chapter Eight: Discussions and Concluding Remarks

8.1 Overview

This thesis has told a story about the history of local government, and specifically municipal, accounting and auditing in New Zealand between the end of the provincial government system (1876) and the beginning of the New Public Management reforms that were applied to local government from 1989 onwards.

The establishment of formalised local government in New Zealand coincided with the beginnings of local communities. This contrasted with developments in many other countries, especially the UK, where formalised local communities evolved from existing, often long existing, informal and often close-knit communities with long histories. In New Zealand local communities had little or no history without their legal framework. As pointed out by Debnam, New Zealanders have little attachment to their local community and its council. (1979 p. 300) As such local government has been viewed as a purely functional tool to deliver services and infrastructure to their communities. This functionality can be seen in many of the decisions regarding the accounting and auditing for local government.

At the centre of New Zealand local government has been rural counties and urban municipalities as either boroughs or cities. Municipalities have been important not only because of the percentage of the population residing in them, but also because the large municipalities, their councils and mayors, have had leading roles in many of the discussions and debates surrounding local government, including those relating to accounting and auditing for all of local government.
The existence of local government and the roles that councils undertook were neither for councils nor their local communities to decide. Parliament both established the councils and authorised the activities they could undertake and the activities they were required to undertake. At the same time as authorising their activities, Parliament generally placed some form of control and/or accountability mechanism on local authorities. Many of these mechanisms were in the form of accounting rules and requirements and/or items to be verified by the auditor. As a technology, accounting has been used to monitor local authorities, both on behalf of central government and on behalf of the local community.

This technology was embodied in legislation, with 29 acts and ten regulations in force at various times, which controlled the accounting and auditing of municipalities between 1876 and 1988. This figure ignores many minor changes not discussed in the thesis and a multitude of local acts authorising the activities of individual councils. An example of such local legislation was discussed chapter seven, in relation to one principal act and fourteen amending or related acts. These fifteen acts dealt with one small part of the accounting for two of the trading undertakings of one city council.

This legislative activity reflects central government and Parliament’s continual use of accounting and auditing to control and hold accountable the activities of local authorities. The number of acts and regulations in force at different times, and the frequent changes to them, reflects an ongoing desire to ‘improve’ the accounting and auditing requirements. Such improvements can be seen in terms of both better accounting and a better balance in the responsibilities of central and local governments. These two issues are discussed in the following section.

8.2 Seeking Better Accounting

Chapter five included a discussion of a number of changes and proposed changes to the accounting requirements for municipalities. Because local government accounting was treated, like local government itself, as a merely functional mechanism to be changed whenever something better appeared, new accounting practices were often suggested and debated, some of which were subsequently implemented. Making accounting function better was an ongoing activity. This section briefly reviews three of the most important debates in local government accounting.
8.2.1 Standardisation

Proposals for standardising the format of the accounts were seriously considered on a number of occasions during the twentieth century. Despite a considerable effort by many parties the format for the external reporting was only in a standard form for fourteen years (1965-1979). The calls for standardisation were based a number of concerns; predominant was a desire for clearer reporting, improved efficiency in the accounting departments of local authorities and a resultant easier task for the auditors. Other reasons included a desire to make comparisons between local authorities’ performance and to allow more efficient transfer of staff between local authorities due to the local authorities having the same or very similar accounting systems.

Perhaps ironically, the decision to abandon the requirement to follow a standardised format was also in the name of better accounting. This time it was based around the idea of encouraging the development new ideas and ways of reporting. As will be commented on below, the focus moved to how individual councils could report in ways that were ‘better’ in relation to their own community.

8.2.2 Cash Accounting versus Accrual Accounting

Like the debate for standardisation the debate over the possible replacement of the cash based accounting system with an accrual based system was ongoing. Unlike the standardisation of accounts, accrual accounting was never formally introduced for municipalities except for their trading activities. The arguments for introducing accrual accounting included both the general belief that it was better accounting and the more specific technical discussion relating to accounting for non-cash items such as depreciation and the recording of accruals.

Depreciation and accounting for fixed assets have always being fraught with difficulties in local government. Full adoption of accrual accounting à la the private sector model, including the recording and depreciation of long-term infrastructural assets, was never really on the agenda for adoption at ‘this stage’ during any of the debates on the introduction of accrual accounting. Accrual accounting for infrastructural assets was always going to be a difficult issue and it was, implicitly at least, recognised that it would be a second step in any proposal for a movement away from the cash or the receipts and payments system. However, opponents of accrual accounting often used the impact on
infrastructural assets as a major reason not to adopt any form of accrual accounting, or to move away from the cash based system.

Councils were known to employ accounting treatments (or tricks) when accounting for stores, other non-cash short-term assets and short-term liabilities. These treatments allowed local authorities to avoid the legislative restrictions on expenditure and/or borrowing. Stopping such practices, as discussed below, was the main justification used when calling for the introduction of accrual accounting.

The failure to introduce accrual accounting can be attributed to a perceived lack of benefit compared to the cost, especially for small boroughs and counties. The costs were not only the cost of producing the accounts but also the likely loss of other desirable attributes of the reporting, especially the timeliness. Timely cash based reporting was seen as more desirable than late and perhaps incomplete accrual based reports. Accrual accounting was an idea whose time did not quite come. This is not to suggest that local government was processing towards the adoption of accrual accounting in an evolutionary manner but, rather, that at a number of times accrual accounting could have been adopted but was not. A final 'push' at any of these times could have seen its introduction.

8.2.3 Reserve Funds

The most significant issue arising from local government's use of a cash based accounting system relates to the creation of reserve funds. The creation of reserve funds requires the use of accounts that do not exist in a cash accounting system; as no cash is transacted there is no transaction to record. To use reserve funds required the principles of the cash basis system to be either modified or suspended. The second issue relating to the creation of reserves is that they are counter to the principle of current expenses being paid by current ratepayers, as appropriations to the reserve funds are unrelated to any current expenditure. Some reserve funds were only created on the chance of being needed (insurance) in some future period. The reserves were established to cover a number of areas, both for trading activities and for general council business. It was acknowledged that the creation of the reserve funds was counter to the otherwise sound principles behind local government financial management, as revisited in the following section. However, there was an acceptance of the use of reserves. For general activities this acceptance was based on 'saving a little for a rainy day', either as an alternative to insurance or in addition to insurance purchased. For trading activities the purpose of many of the reserve funds was as
a form of capital maintenance. The intention was to ensure that the trading activities of the relatively young and poorly resourced country could be self-renewing and create an ongoing infrastructure for future generations.

Reserve funds were permitted and at times required, despite both being inconsistent with the cash based accounting system and being counter to the principles of local government financial management.

8.3 Responsibilities of Local and Central Government

Throughout this history there have been two underlying themes about the responsibilities for the accounting and auditing requirements for local government. These two themes are intertwined, both relating to the relationship between central government (including Parliament) and local government. The first is the tension between controls on local government behaviour, which are imposed by Parliament, and the right of elected councils to act in the best interests of their communities as they see fit. The second relates to whom the local authority is accountable and, perhaps more importantly, to whom it gives account. This section discusses these two themes.

8.3.1 Control versus Autonomy

The most obvious example of central or parliamentary control over local government in the accounting and auditing arena relates to the financial management principles. The principles were:

- That current expenditure should be funded by current revenue.
- That long term assets should be funded by long term borrowing, with each loan to be paid off over the life of the associated asset.
- That short-term borrowing should comply with the first principle, and should be no greater than the recoverable amount of unpaid rate income.

These three principles were first explicitly included in legislation in the Local Bodies’ Finance Act 1921-22. While that Act brought together the principles, they were not new but had been the principles for local body finance from before 1876.

The principles have been central to most calls for changes to the accounting and financial management regulations. A large part of the accounting regulations were not so much
accounting but rather financial management or, more precisely, financial control regulations. The overseeing of these financial controls were generally added to the functions of the auditor, with the Audit Office being responsible for a host of functions including authorisation of cash management procedures and the auditing of the control of stores. The majority of the controls were aimed at eliminating potential or actual breaking of the principles. The focus of these principles was to ensure each council applied practices that provided intergenerational equity. That is, that one generation of ratepayers and residents neither unduly paid for benefits for future generations, nor received benefits paid for by past generations or to be paid for by future generations.

There were occasions where these principles were not maintained. However, in any decision to adopt practices that were counter to principles, the suspension of the principles was always explicitly discussed. The setting up of reserve funds, as discussed in the previous section, was one such situation. Clearly, local government was not to be straight-jacketed by the principles but they were constrained, although at times only loosely. Decisions to allow suspension of the constraints reflect the tension between central government looking after the interests of ratepayers and the local community versus acknowledging that councils were elected by their local communities to serve them. There was no doubt that the constraints existed for the protection of local communities (current and future) from inappropriate financial management by their elected councils. Most debates on the principles centred on where the constraints should be overseen from and where the authority to suspend the principles should be located, rather than on the principles per se.

A related issue was the appropriateness or otherwise of the Audit Office closely monitoring local authorities' compliance with the numerous rules relating to the principles. Similarly, questions were raised regarding the appropriateness or otherwise of the requirement that the approval of the Audit Office was needed for councils to undertake certain administrative procedures, such as operating imprest accounts. In most cases the question related to the perceived competency of councils to undertake the task and the appropriateness of a central government agency being involved. The level of monitoring and auditing did change as the pendulum swung between control and autonomy. As will be discussed below, it was not always the councils seeking local autonomy and central
government agencies seeking central control, rather all parties at times supported both approaches.

While this section has discussed the need for centrally created and enforced controls (on behalf of the local community) versus giving local councils the ability to manage their own activities as they see fit, the following section reviews to whom councils should give the account, so as to fulfil the accountability obligation to their local communities.

8.3.2 Giving Account To – Central versus Local

Other than in relation to local government borrowing where 'the interest of the national economy' was an important consideration in approving the raising of a loan by local authorities and in situations where central government subsidies were provided, there was little doubt that the individual municipality was responsible and accountable to its local community. The more important question however is to whom the account was given/received on behalf of the community.

The focus of reporting to the community swung between two points over the period discussed. In 1876 the accounts were prepared for the local community, and the community had free access to the accounting records. The community appointed the auditors from within the community. Central government involvement was limited to a few short sections in the Municipal Corporation Act 1876. Within 15 years the focus had shifted. The Controller and Auditor-General, was appointed by statute to audit the accounts. The ability to surcharge councillors for illegal expenditure was given to the Controller and Auditor-General, exclusively by 1900. The accounts were prepared to meet the requirements of the auditor, who took care, almost benevolently, of the accountability of council for the local residents/ratepayers/electors. This benevolent activity of a central government agency continued until the early 1970s when the focus shifted back to ratepayers.

In the early 1970s two important innovations in local government accounting occurred. The first was the move to activity-based reporting for the external reporting requirements. The second was the introduction of operational audits to be undertaken by the Audit Office. Both of these changes are significant in their own right; one for changing the form of the accounts, the other for introducing a new technology into local government and ultimately the public sector. However, their significance is greater than that; coinciding
with both of these changes was a change in focus for the accounting and auditing requirements. The change saw the rendering of accounts by a council being moved back to its community.

Both changes were introduced with two sets of agendas. The Minister of Local Government was keen to see both changes introduced, essentially as a central government tool to control or at least monitor local government. The activity-based reporting was seen as a way to allow comparisons between the efficiency of various councils, based on the operations that they undertook. As not all councils engaged in the same activities, comparisons using cost categories such as wages, even if adjusted for the different sizes of councils, could not be used to identify the better (financially) performing councils. Whereas the cost, for example, of the provision of water by different councils could be obtained from activity-based prepared accounts, and this information could (possibly) be used to identify the more efficient councils. The Minister’s objective in putting forward the introduction of the operational audits of local government was similarly about identifying the better performing councils and, hence, also the poorer performing councils. For the Minister of Local Government both changes were aimed at providing central government with better information about the efficiency and performance of local authorities. As noted in chapter six, the Minister’s motivation was, at least in part, to use the information to fend off requests from local authorities for revenue sharing on the basis of local government’s inefficiencies as identified by the new technologies.

On the other hand, the Audit Office’s agenda was almost the reverse of the Minister of Local Government’s agenda. The Audit Office’s focus was on the use of the information by the local community and/or its council, not central government. The introduction of activity-based reporting began a process that was intended to change the focus of the external reporting by local authorities. Rather than the reports being prepared for the auditors, this period saw the start of a drive that had a strong focus on the use of the accounts by the local community. This process was to continue to include the simplification of the reports so that the average informed and interested ratepayer could understand them. The Audit Office was even more direct and open (although not to the Minister of Local Government) about its agenda for the operational audits. The audits were not intended for central government’s use (as was the Minister’s agenda), and the results of the audits were not for the use of central government. The Audit Office saw the client as
the individual local authority, with the operational audits’ primary objective being to help the management of a council for the benefit of its community.

In this tussle the Audit Office’s view won. The operational audits continued and increased in frequency, although where local authorities were not acting on the findings of the audits the Controller and Auditor-General would release the findings, sometimes through his report to Parliament, but the desired audience was the relevant local communities, not central government, elected or the bureaucracy. The external reporting requirements were further modified in 1979 to continue the process of making them understandable and useable to the target audience, that is, the ratepayers/electors/residents.

This change in philosophy, lead by the Audit Office, as seen in both external reporting requirements and the philosophy of the operational audits, was the biggest change in local government accounting between 1876 and 1988. The change was to put the local community and democracy back into local government financial management, accounting and auditing.

This shift of focus from a central government agency receiving the accountability to the local community has also illustrated the importance of the various parties involved in both the regulation and the formulation of policies relating to local government. This is the final issue to be considered.

8.4 The Players

This section discusses how the key players have influenced the accounting and auditing requirements for municipal councils. The players discussed in this thesis have been:

- Associations for local authorities, in particular the Municipal Association

- Central government departments:
  - Audit Office
  - Department of Internal Affairs
  - The Treasury including Local Government Loans Board
  - Department of Statistics

- Central government politicians

- The courts
- Local authorities bureaucrats
- Local communities
- Local government politicians
- The Parliament.

The previous section was based around the relationship between central government (including the Parliament) and local government, and the associated responsibilities of the various parties. The two issues discussed reflect how much or how little central government was to be involved in accounting and auditing and other aspects of local government activities. For central government it related to the degree of flexibility given to local government. For local government it reflected the degree of autonomy it had. One of the most striking aspects of this story or history is the way that all the parties involved dealt with the issue of control versus autonomy. As noted above, every party identified in this thesis argued at times for both sides of this issue. Sometimes they sought the reduction of the controls' requirements on local authorities, and at other times they all suggested and/or supported an increase in controls on the financial activities of local authorities.

The 1921-22 Act, the creation and use of reserve funds, the requirement (and its later removal) to seek Audit Office approval for certain office procedures, the treatment of stores, creditors and debtors, the surcharging of councils and the determination of unauthorised expenditure are all examples of the suggested and/or supported changes that the various parties were involved with. The important point is that every party, including local authorities and their representative associations, who could have been expected to want only more autonomy, and central government, who could have been expected to want greater central control over local government, all supported both positions at different times.

The relationship between central and local government for the accounting, auditing, and financial management of local authorities has been relatively successful and honest over the years. I believe that there are two major causes for this. The first is the ability to see merit in both sides of the autonomy/control debates, sometimes seeking to control and restrict local authorities and at other times seeking to increase their autonomy. Every party at times aimed to increase the control and accountability of local authorities and at other times they sought to increase the flexibility and autonomy given to local authorities. The
balance between control and autonomy of councils was mainly operationalised through accounting, auditing and the auditors. If all parties could not have seen merit in both sides of the debates, then I believe I would have told a story of aggressive posturing by many parties, and a history of unhappy or tense relationships between the various parties.

Secondly, as mentioned at the end of chapter six, the relationship between local government and the Audit Office, especially given its key role in the sector, has always been productive. The Audit Office's professionalism as public sector accountants/auditors and its concern for local government has come through in this story. This has not been a story of conflict, power or economic self-interest; rather this has been a story of cooperation, including the acceptance of two opposite and irreconcilable objectives, namely control and autonomy, which nevertheless were able to co-exist.

Finally, on the question of the importance of the various parties involved in discussions on municipal and local government accounting, financial management and auditing; from the archives reviewed it is clear that the Audit Office was the most important party. The Audit Office acted as a conduit between central government and local government on policy issues. When seeking authorisation and/or advice on changes for the accounting and auditing regulations, both local government and the central government (specifically the Department of Internal Affairs) would enlist the knowledge and experience of the Audit Office. While most changes from central government were managed through the Department of Internal Affairs, the experience and influence of the Audit Office was behind the management of the process. Although local government proposed many changes, most needed the support of the Audit Office to be implemented.

8.5 Limitations and Contribution of Study and Future Research

An archival based history on the New Zealand public sector.

It seems almost obligatory at the end of a PhD thesis to mention three areas: the limitations of the study, the contribution to our understanding or knowledge of the study, and thirdly, possible further or future research. This final section combines the discussion of these three

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1 This comment is made while acknowledging that the archives reviewed were heavily focused on and generally created by central government, especially the Audit Office.
issues. Although not common to combine them, it seems to me more efficient to do so, on
the basis that they are interrelated.

8.5.1 Archival Based

This research has enhanced our understanding of public sector accounting in New Zealand
by providing a history of the accounting and auditing of municipalities between 1876 and
1988. The history has been based on archival material, predominantly central government
archives. The thesis has told a story about the accounting and auditing by municipalities
from the position of the regulators and auditors; these are the voices in the central
government archive. As discussed in chapter one, the study and understanding of the
history of New Zealand public sector accounting is very underdeveloped. This thesis has
made a contribution to the study of accounting history by opening up the archive, for the
first time in New Zealand, with the study of a particular section of New Zealand’s public
sector accounting.

In chapter two a number of concerns were raised about the use of documentary source
material. These were discussed under three headings. Firstly, the authenticity of sources
was discussed in terms of the soundness and authorship of records. Secondly, the
credibility of the sources was discussed in terms of their sincerity and accuracy. Thirdly,
the representativeness of the records was discussed both in terms of their survival and
availability. Most of these concerns were lessened by a form of triangulation between files
within agencies, using sources from multiple agencies, and by reference to other primary
material. The issue of the representativeness of the archival sources is unresolvable, as
discussed in chapter two. I do not know what official material was not included in the
archive or was not located during the searches. However, the more important limitation
relates to what information cannot be covered by an archival study based on central
government archives.

The thesis has not told a story about the life and trials and tribulations of accountants and
accounts clerks in municipalities. Such goings-on are not recorded in the central
government archives, nor was it an intention of this thesis to undertake such research. A
brief look at an aspect of this type of research can be gleaned from the material covered in
chapter seven from the Wellington City archive.
Also missing from study is a story of those affected by the policies but who did not have a voice in the government archive. Who were most affected by the municipal accounting and auditing requirements? Who was affected by the way estimates for striking property rates were prepared, the cash accounting rules and the creation of reserve funds? Who benefitted from decisions about raising revenue from charges versus property rates, and so on? These people do not appear in the central government archive. Once again, a glimpse of these people may have been seen in the ‘public’ involvement with the Wellington City Trading Department’s Reserve and Renewal Funds Act 1917, as discussed in chapter seven. Yet even then, the people involved with the Bill, the various related acts and the court cases could not be termed the marginalised, or they would not be in the archive.

Our understanding of accounting and auditing of New Zealand local government would be enhanced if we were to hear from the archives of local authorities, from the preparers of the accounts, from those attempting to comply or otherwise with the legislation, and from those whose day-to-day working life involved the accounting and auditing of local authorities. Similarly, our understanding of accounting and auditing would be enhanced if we were to tell stories ‘from below’ about the use of accounting and auditing in New Zealand local government. While obtaining sources for such a history may be difficult, it would provide insights into the nature of the public sector accounting and auditing.

8.5.2 History

Chapter two Research Approach began with an outline of the approach taken for this history. This history has been told without the help of or without seeking to prove any pre-existing theory. No theory was consciously used to interrogate the archive; rather I reviewed the material, selecting what I saw as interesting and relevant. In writing up the history I neither sought to apply some theory to the archival data nor did I test the fit of some existing theory to the archival data. This methodological choice, as discussed in chapter two, represents part of the contribution to our understanding of accounting and auditing for local government in New Zealand. It also provides both the limitations of the history and possibilities for future research.

The story in this thesis is only one story; there are many other stories that could have been written on the same topic. The actions of many of the players could be discussed in terms of their economic incentives (although I found little evidence for this) in terms of agency theory and public choice theory. Examples of these works from accounting history
literature include Blankley and Forgione's (1993) discussion of medieval English finance and Jones' work on the UK local government (Jones 1992 for example). Maybe (again I found no evidence of this) the helpful attitude of the Audit Office staff was an attempt to maintain their importance and that of their office, with an eye to increase their economic situation. Changes sought by local authorities could be framed as seeking to increase the economic rewards for elected council members and/or local authority staff as discussed by public choice theorists. For a general discussion on the use of public choice theory in accounting research see Chan and Rubin (1987). For an example of non-historical but local government accounting literature, discussing the use of a number of theories under the title 'positive accounting research', see Zimmerman (1977). Key issues of power and control in the relationships between the various parties (central government-local government, Audit Office-Department of Internal Affairs, politicians-bureaucrats, etc.) could be discussed using the work of critical theorists such as Foucault. Examples of this type of approach include Hoskin and Macve's work in the public sector (US military) (1986; 1988) and more general historical work in accounting such as Loft's work on cost accounting in the UK (1986). The accounting and auditing arrangements could be discussed in terms of any number of theories dealing with structural arrangements including contingency theory, institutional theory, Marxism and so on. This list is only meant to be illustrative. As argued in the start of chapter two, the use of a theory is not necessary; someone coming to the material without a theoretical framework, in a similar fashion to this thesis, would tell a different story. I would welcome any such works, covering either the whole period or only selected parts of the thesis. I hope that both my story and the accounting and auditing requirements set out in chapter four and elsewhere will aid future accounting historians to tell another or many other stories about New Zealand municipal accounting and auditing between 1876 and 1988.

8.5.3 On the New Zealand Public Sector

As discussed in chapter one, public sector accounting history has a role in both assisting our understanding of current practices and helping to legitimate the state by providing a degree of accountability/check on its past decisions and activities. The opening of the archive and the telling of this story of part of the New Zealand public sector has aided our understanding (as noted above) and helped with the accountability of the state. The fact
that no scandal or problems have been identified is irrelevant, in the same way that the
unqualified audit report aids the accountability of the entity being audited.

Because of the focus on New Zealand archival material, the history has not focused on
material or situations outside New Zealand. Issues relating to the transference of
accounting technology between countries (including New Zealand) and comparisons
between countries are appropriate future research topics. As mentioned in chapter one, the
most widely published area of local government accounting history relates to the UK.
Although untested in this thesis, it seems a reasonable hypothesis that many of the ideas
and technologies in the New Zealand local government accounting and auditing arena
came from the UK. This hypothesis and the reasons for transference of some and perhaps
not other ideas and technology is worthy of study. The more recent (late 1960s and early
1970s) use in New Zealand of ideas and technology from the USA is similarly worthy of
study, as is why there appears to be some change in where New Zealand looked for
developments in accounting and auditing.

The second point to note from chapter one is the lack of any Australian history of local
government. New Zealand and Australia share many common legal, social and economic
features, as well as geographical distance from the ‘old world’. Comparisons between the
New Zealand and Australian systems, both in terms of how the accounting and auditing
requirements developed and were debated (as this history has discussed for New Zealand),
and where ideas for local government accounting and auditing came from could be fruitful
areas if future research. Clearly, these issues could be expanded to other countries,
especially but not limited to comparisons with countries with similar historical, legal,
social, and economic systems.

Within New Zealand local government there are a number of related areas outside the
scope of this history, which could be subject to study. This thesis has not discussed the
financing of local bodies, both rating and the financing through loans. The history of local
government accounting and auditing from the start of European settlement to the end of the
provincial era, as well as since 1989 are also areas for future research that were not
covered in this history.

In chapter five I lamented the lack of a meta history of government accounting in New
Zealand, as I attempted to understand what happened in central government in the late
1960s and early 1970s, due to its influence on local government at the same time. There is
more than any researcher’s lifetime of work available in public sector accounting history in New Zealand (and the same goes no doubt for other countries as well). Possible areas for future research at both the micro and meta levels across the whole of the New Zealand public sector include:

- The early period of colonised New Zealand almost directly corresponds with the birth of the modern accounting profession – the study of this period may provide insights into the growth of both the use of accounting in the public sector and the accounting profession. Such studies could cover any number of institutions of a variety of sizes both located in the fledgling colony or aspects of the management of the colony from afar (London or Sydney).

- The relatively stable period of life in New Zealand during most of the twentieth century, a period of large public sector activity and influence, must provide a rich and well-documented source of accounting history. The government’s involvement in trading and non-trading operations, in social welfare, housing, military and other activities can all provide areas of research.

- The reforms of the 1980s, where New Zealand heralded itself as ‘a’ or ‘the’ leader in public sector accounting reforms, calls out for historical analysis. Stories need to be told about what happened, who should take the credit or blame, and what and why it happened in New Zealand. As has been hinted in this thesis to understand that period such a history needs to include the history from at least the late 1960s.

- As these final remarks are being written, further changes to accounting and financial management in the public sector are imminent; with the adoption of international accounting standards for the private sector, with the associated ramifications for the public sector under the one GAAP philosophy in New Zealand, and the introduction of further legislative changes in the form of the Public Finance (State Sector Management) Bill 2003. In addition to evaluating the changes per se, an historical analysis and understanding of the features the changes seek to replace, reform or modify is required to inform policy makers.

Public sector accounting history contributes to the accountability of the public sector and to our understanding of both the public sector and accounting. This thesis has made such a
contribution in relation to local government in New Zealand between 1876 and 1988. There are many related areas of research, with stories waiting to be told, with many government archives waiting to be opened by the accounting researcher. However, a final word of warning; the huge volume of original material to be located and consulted in such research could result in months of dust related allergies, strained eyesight from reading faint, hand-written documents and from scanning kilometres of documents – just looking for the often-illusive record and insight. But then that’s the fun part!
Notes

Chapter Three
1 ANZ T1 40/70; file note “Subsidies to Local Bodies” nd c1938.
2 ANZ AALR w4446 T80/3/2; file note “Local Authorities Loans Board” nd c1976.

Chapter Four
1 Relevant guidance on the requirements at the time were the legal texts such as Palmer (Palmer 1978) and the long serving accounting/administration text by Leese and Bishop (Leese and Bishop 1937; Bishop 1959; Bishop 1966; Bishop 1978).
2 ANZ AAWR w4351 36/19; Deputy Controller and Auditor-General to various 20 April 1979.

Chapter Five
1 ANZ AAUA 6915 9/17/1; Local Government Accounting Committee (minutes) 15 March 1985.
2 NZPD January 1922, p. 296. Sir Francis Bell speaking in the Legislature Council on the Local Bodies’ Finance Bill.
3 Municipal Corporations Act 1920 s. 99
4 NZPD October 1921 p. 783.
7 NZPD October 1921 pp. 774-5. Mr Sullivan, an opposition member for Avon, and a member of Christchurch City Council at various times including during the time of this debate. (Watson 1988)
8 ANZ LE 1 1921/10; Secretary Municipal Association to Minister of Internal Affairs 13 December 1921.
9 ANZ IA 1 128/1; G C Cooke (Audit Office) to Hon. W Downie Stewart 14 July 1922.
10 Royal Commission on Local Authority Finance 1958; Committee on Local Authority Finance 1963; Local Authority Finance Committee 1973; Interdepartmental Committee 1975; and Local Authority Finance Committee 1977.
11 (Local Authority Finance Committee 1973 p. 6)
12 (Local Authority Finance Committee 1977 p. ii)
13 (Local Authority Finance Committee 1973 p. 6)
14 ANZ T1 w2591 40/48/18; Local Authority Finance Committee (notes) 21 March 1972.
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16 ANZ AAUA 6915 9/17/1; Audit Office Accounts of Territorial Authorities nd c1971.
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ANZ IA 1 103/338; Acting Secretary for Internal Affairs to Minister of Internal Affairs 5 November 1957.


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83 (Shailes 1973 p. 15)
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5. Evening Post 26 January 1907

6. WCC Archive Minute Book Vol 7 1885/87 p. 467; Council meeting 30 June 1887.

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