# Intergenerational equity in municipal accounting: New Zealand 1910s

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# Intergenerational equity in municipal accounting: New Zealand 1910s

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## Abstract

Accounting for fixed assets by municipalities has been discussed in the accounting history literature previously. This paper addresses two issues related to accounting for fixed assets not previously discussed; the influence of the principle of intergenerational equity on local government accounting, and the influence of users of accounting information in accounting policy making in government accounting. The paper identifies that users of accounting information have had significant influence in a debate on government accounting policy, and that the principle of intergenerational equity was given a position of high importance in the debate, but not an unchallengeable position. The motivation of the users of accounting information to engage in the debates is identified as a form of civic duty, which is consistent with the ethical imperative in ensuring intergenerational equity.

## Intergenerational equity in municipal accounting: New Zealand 1910s

# 1. Introduction

The management of and accounting for local government assets has generated considerable debate in the accounting literature. Using archival records of calls for change to accounting practices, this paper discusses the accounting practices adopted by the Wellington City Council trading departments in the 1910s. The paper focuses on the use of separate funds for non-cash-transactions while using a cash-based accounting system. The use of the separate funds was either successfully challenged in the courts in 1916 or deemed illegal by the auditor. Similar funds were subsequently authorised in 1917 by the *Wellington City Trading Department's Reserve and Renewal Funds Act 1917*. The paper analyses how the new accounting policies were formed within the judicial, legislative and political process, furthering our understanding of a contestable area of local government accounting in a social context. The paper identifies the importance of intergenerational equity in debates on local government accounting policy. This paper uses a variety of archival sources, including submissions by an individual ratepayer and a ratepayers' association, voices not previously been heard in the accounting history literature.

The historical accounting literature on local government focuses on those close to the entity and/or the accounting establishment – the preparers' perspective; accounting firms, management, accountants, technical experts and texts written by and for account preparers. In the late nineteenth – early twentieth century there were significant debates on local government accounting including on the appropriate approach for assets and depreciation in both Britain and the US. These debates took place in the professional literature, the academic literature, in official papers and in the local authorities themselves (for Britain see Coombs and Edwards (1992) and for the US see Potts (1982)). To the participants it seemed that they had resolved the debate surrounding accounting for local government assets, in Britain by 1914 (Coombs and Edwards 1992) and in the USA by 1935 (Potts 1982).

In recent years, the reporting basis for public sector entities has in many countries shifted from a cash basis to an accrual basis, and/or the recognition of long term assets has been introduced in the accounting system. These changes have introduced new ways of accounting and altered the need for the creation of special funds. For example, within US state and local government the introduction of Statement 34 by the Governmental Accounting Standards Board has seen accounts "include for the first time information about the government's public infrastructure assets - such as

bridges, roads, and storm sewers" (GASB 1999). In spite of the creation of new accounting technologies and/or the transfer of technologies from the private sector we can expect continued debate on how 'best' to account for local government assets. This debate is due in no small measure to the multiple objectives of local government. The multiple objectives include managing and accounting for both financial return and service provision, and responding to the needs and desires of the current generation and planning for future generations. As Coombs and Edwards (1992) note, these are "recurring problems" in government accounting and in particular for local authorities (182).

This paper addresses two issues; the influence of the principle of intergenerational equity on local government accounting, and the involvement of users of accounting information in accounting policy debates in government accounting. The paper identifies considerable involvement of users in debates on government accounting policy and that principle of intergenerational equity has received a significant position of importance in debates, but not an unchallengeable position. The voices of the users and preparers have been located in a number of archives and official documents. Because this study is centred on litigation instigated by users and users involvement in determining new rules for accounting practices the voice of users are found in the preparers' archives as well as in the records associated with the legal and legislative processes. In particular the archives of the Wellington City Council, the Department of Internal Affairs, the Legislative Department (parliamentary archives) and the Audit Office were consulted. Official records of parliamentary debates and court judgements were also consulted for this study.

The paper commences in section two with a review of the literature. This is followed by a discussion on the background to the municipal trading activities in early 20$^{th}$ century Wellington, New Zealand. Section four outlines the issues and debate regarding the special funds identified as illegal by the court and the Wellington City Council's auditor in 1916, and the special funds introduced in 1917. The following section discuss the underlying issue in these debates; intergenerational equity. Section six discusses the role of users of accounting information in the debate, with the final section drawing the themes together to form the conclusion.

## 2. The Literature

In the under-researched world of public sector accounting history (Funnell 2007) local government accounting and auditing has received more attention from researchers than most areas. This attention reflects the interest both historically and currently in accounting for local government. Studies to date have focused on a preparers' perspective. This is not surprising given that two of the most influential works in this area have indicated that there are few incentives for users of

government accounting information to seek changes to it (Jones 1992) and that there is little evidence that users have engaged in debates regarding accounting policies (Coombs and Edwards 1995). Furthermore users of accounts are less likely to leave evidence of their engagement in accounting debates than preparers. This focus on preparers has resulted in literature that is rich in discussion of the technical debates and practices, and indicates the diversity of opinion amongst practitioners, academics, and regulators during these debates.

Historically accounting for depreciation and fixed assets in Britain and the UK local government "received more attention, over the years, than any other single financial reporting issue" (Coombs and Edwards 1995, 101), "aroused the greatest controversy" (Jones 1985, 154) and "became a matter of fierce public debate" (Coombs and Edwards 1992, 188). These debates have been well recorded the accounting history literature. At the heart of these debates is how to record the assets and the decrease in their value over time. Generally the debate has been framed around the choice of basis for reporting; cash, accrual, modified cash or modified accrual. With the focus on the preparers, the relative importance of various subgroups of preparers have been identified as dominant in various places and times; Coombs and Edwards (1995) using archival resources of five British municipal corporations identified that the "dominant force bringing about improvement (towards full accrual accounting), seems to have been the members and officers (particularly the treasurer) of the corporation" (105). Coombs and Edwards (1992) also identified changes to capital accounting being developed by individual municipal corporations rather than professional bodies or the government (199). Coombs and Edwards (1993), using "published results of government investigations and the contemporary literature" identified a significant involvement of the local authority orientated professional accounting body in the changes to nineteenth century municipal corporations' accounts (29).

Across the Atlantic, Potts (1982) covers the debate between 1895 and 1935 on the inclusion in the accounts, or otherwise, of permanent property and the associated recording of depreciation for municipal bodies in the US. Within these debates the focus was on municipal debt and borrowing, leading to the conclusion, by 1935, that the focus of municipal accounts should be on the liquidity of the authority and therefore permanent property should not be recorded in the accounts. These debates were lead by "prominent accountants" and a national municipal accounting body (Potts 1982, 25).

While there has been a focus on the technical issues and on the preparers' perspective, the literature has not focused on the "golden rule of public finance" (Robinson 1998, 447) – intergenerational equity. The literature identifies specific applications of the principles such as ensuring loans for the creation of assets did not extend beyond the life of the asset (Coombs and

Edwards 1995, 96), and that the recording of depreciation could create double counting and thus force the present generation to gift assets to the next (Coombs and Edwards 1992, 189). Jones (1985, 156) indicated that intergenerational equity was a part of the discussion of the *Departmental Committee on the Accounts of Local Authorities* 1907, albeit with a relatively short discussion;

> The issue of equity between current and future ratepayers, which undoubtedly played an important part even if it could be more cynically be put in terms of the impossibility of financing urgently required capital expenditure from current ratepayers, never want beyond very general groupings of thirty-year 'generations'. The burden borne by each year was not at issue. (Jones 1985, 156)

Elsewhere Jones (1985) notes that the expectation that Councils should not rate for a deficit (a key part of intergenerational equity) is part of local government's statutory control mechanisms. This discussion takes place in the context of the "irrelevance of the matching concept" for local government accounting (139-142). Nowhere in the accounting history literature is there reported a significant debate on intergenerational equity.

In contemporary government accounting literature the issue of intergenerational or inter-period equity has had a limited airing. Robinson (1998) refers to intergenerational equity as the "so-called 'golden rule' of public finance" where "taxpayers in each time period should as a group contribute to public expenditures from which they derive benefits in accordance with their share of the benefits generated by those expenditures" (447). Inter-period equity, which is more frequently used in relation to the pronouncements of the US based Government Accounting Standards Board (GASB), is seen by Vinnari and Näsi (2008, 99) as the way to operationalise the abstract concept of intergenerational equity, other authors make little of the distinction between intergenerational and inter-period equity (for example Surdick 2002). The GASB Concepts Statement No. 4 *Elements of Financial Statements* defines inter-period equity as "the state in which current period inflows of resources equal current period cost of services". A number of authors have suggested the newness of the intergenerational / inter-period equity principle. For US based authors (for example Surdick (2002) and Marks and Raman (1996)) this reflects the work by GASB on measuring and reporting financial performance in Statement 11 *Measurement Focus and Basis of Accounting* and Statement 34 *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments* (Surdick 2002). Barton (2009, 225) suggests that intergenerational equity is a more recent additional to the role of government, as a result of review of government operations. In fact intergenerational has a long tradition in government accounting, especially in local government. As noted above, the *Departmental Committee on the Accounts of Local Authorities* in 1907 discussed this issue (Jones 1985, 156) and at the same time the same

debate was also taking elsewhere, including in *The Accountant* in 1907 (Coombs & Edwards 1991, viii).

The literature on intergenerational equity covers two areas, the theoretical discussions and the literature that connects intergenerational equity with a particular accounting technology. The theoretical literature has focused on ethical concerns about accounting, intergenerational equity, and in particular government accounting. Pallot (1991) locates intergenerational equity as part of an ethical dimension to accounting, especially in relation to the accountability function and specifically related to government accounting. Because much of the public sector is held in common ownership rather than private ownership, the model that accounting is traditionally based on, Pallot argues for a new perspective for accounting that focuses on accountability and distributive justice (207). This new perspective could, according to Pallot, provide the framework for better accounting for intergenerational equity (206). Mahoney (2002) also takes an ethical approach to his discussion of intergenerational equity. Using Rawls (1971) he makes comparison between Rawls' concept of "justice between generations" and intergenerational equity, especially as provided for by GASB (Mahoney 2002, 204). Intergenerational equity provides a real world example of Rawls' abstract ideas, yet as Rawls notes determining how intergenerational equity will be operationalised is the ethical problem (289). It is this operationalisation of intergenerational equity that the majority of the literature focuses on. The literature is framed around the introduction of accrual or business models of accounting to the public sector and how it aids or hinders the reporting of intergenerational equity. Surdick (2002, 54) advocates the use of accrual accounting as an aid for users in determining if current revenue are sufficient to pay for current services, and Christensen (2007, 56) identifies improved intergenerational equity as an argument in the literature supporting accrual accounting in the public sector. Barton (2007, 81) argues that long term cash budgets are better at reporting on intergenerational equity than accrual accounting. However Barton (2009) suggests that while some form of accrual accounting may be relevant for determining intergenerational equity, the adoption of the business form of accrual accounting does not meet the needs of the public sector (229), a view shared by Robinson (1998) and, as noted above, by Pallot (1991).

Both historical and contemporary accounting literature has focused on intergenerational equity as an adjunct to discussion on the debate surrounding cash versus accrual basis for accounting. Relying on preparer based sources, including professional publications, reports and promulgations, and the archives of the bodies preparing the accounts, the literature has only provided a cursory look at intergenerational equity. This paper, using archival sources that include a users' perspective, focuses on the implication for intergenerational equity of accounting treatments for

fixed assets. This debate, initiated by users, was not focused at the technical level but at the principle level, with the key principle being intergenerational equity. As a result of the focus this paper has a stronger emphasis of the principle of intergenerational equity than previous literature that focused on technical issues and from a preparers' perspective.

The following section provides the context in relation to Wellington city, the litigation regarding the legality of the special funds and the proposed legislation specifically introduced to regulate the accounting by, initially, three of the Council's trading activities.

## 3. Background

The locale of this study is the Wellington City Council in early twentieth century New Zealand. Formalised European settlement of Wellington city began on the decks of the first New Zealand Company ships, *Aurora*, *Adelaide* and *Oriental*, as they prepared to leave Gravesend, England in September 1839. The code of law agreed to and signed on the decks of these ships was the beginning of New Zealand local government administration (Dalziel 1992, 87). By 1900, New Zealand had a two tier government structure with a dominant central government and dispersed local government including municipalities, boroughs and a variety of other bodies. Local government operated without a general power of competency and thus were limited to the powers and functions provided for in legislation. This limited power included what was included in the accounting records and how they were recorded. Local government activities included infrastructure services such as water and sewage services, provision and maintenance of local roads, and refuse collection and disposal; social services such as recreation facilities and libraries and operating a range of trading activities. In comparison with a number of jurisdictions considered similar to New Zealand policing, health and education were not functions of New Zealand local government (Bush 1995, ch 1).

Wellington's geography and population growth are important in understanding the call for particular accounting practices for the city's tramways, abattoir and street lighting. Wellington's harbour foreshore quickly rises up to the steep hills that surround it, making a sharp divide between the small inner city basin and the rural land behind that would become the inner suburbs of the city. The growth of the city from the early European arrivals in 1840 to 43,000 people by 1900[1] put pressure on *inter alia* public health and control of public nuisances, land for development and housing. This paper has as its backdrop the development of public transport to enable the development of residential accommodation beyond the hills of the inner city, the provision of electric lighting for the city and residents and by way of note the control of the public nuisance caused by the unregulated slaughtering of livestock.

In 1917 the Wellington City Council (WCC) arranged for the introduction of a local bill to the Parliament entitled the *Wellington City Trading Department's Reserve and Renewal Funds Bill 1917* (the Bill). The Bill initially related to three trading activities undertaken by the WCC; the city tramway, the city electricity generator and retailer, and the city abattoir. The Bill was the result of pressure from three quarters; a court case brought in 1916 by a local resident which found that the accounting practices in relation to part of the Wellington City tramway to be illegal, a pending court case brought by the Wellington Live-Stock Butchers' Association and opinions given by the Council's auditor on the accounts between 1913 and 1917[2]. All three were based on allegations that the Council did not have the legislative authority to charge amounts to accounts of these trading undertakings. During the parliamentary process references in the Bill to the city abattoir were removed due to the pending court case. A separate Act dealing with the accounting for the city abattoir was later enacted[3]. The remainder of this section provides the background to the tramway and the electricity undertakings, with the following section focusing on the nature of the funds in dispute and the funds authorised by the Act.

### *3.1. Tramway and Power Supply Undertaking*

Owning and operating trading activities was core activity for the large New Zealand municipalities at the start of the twentieth century (Bush 1995, 19). The Wellington tramway service began operating in 1878 as a private sector horse drawn venture. The WCC purchased the undertaking in 1900, at a price of £19,800. Funding for the tramway purchase was by a loan authorised by a poll of ratepayers[4]. With the central city quickly becoming overcrowded due to both commercial and residential property growth, the expansion and electrification of the tramway was seen as essential to allow further growth of the city. An expanded tramway system would encourage residential property growth in the new suburbs, beyond the inner city. The municipalisation of trading activities was politically a good idea[5]. Public ownership and thus public profits was considered better than private profits especially when the roads that the tramways used were public and the water for the generation of electricity was provided by the Council. Furthermore the limited private funds available for such undertakings in the growing colony meant that the necessary development required could not be financed by the private sector. The heavy demand for financing of infrastructural projects was exacerbated by technical advances, such as electrification.

In 1901 the council polled ratepayers to approve a loan for the electrification of the tramway, which was passed by a margin greater than four to one[6]. Over the following years the Council expanded the tramway service opening up areas at the city boundaries and into the neighbouring boroughs for residential development. Most of the expansion was funded by loans authorised by ratepayer polls. The polls were held in the area to be serviced by that 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. Special rates would only be required if the profits from the undertaking were insufficient to make the interest and sinking fund payments required for the loan. One such extension with a related poll and loan was for the extension to Wadestown in 1909, with a poll that was passed by 186 votes to 25 votes[7].

In 1912 the accounting regulations and requirements for municipal tramways were contained in the Tramways Act 1908 and the 1911 Amendment Act. The requirements were, in keeping with all local government accounting requirements at the time, based on a cash basis with separate accounts for each undertaking showing cash in and out as authorised in the legislation. All cash received from the operations were to be recorded in the tramway account as was the cost associated with the provision of services including "maintaining the tramway in good repair" (Tramways Act 1908, Second Schedule, 11). Provision was also made to allow the transfer of any surplus to the General Fund, permitting profits to be used for general purposes of the council. The later transfer would be merely a book entry authorising the expenditure of the cash, whereas the receipts and payments would reflect actual cash movement. There was no requirement for a separate bank account to be operated for the tramway. The use of the cash basis for the accounts was acknowledged in the legislation as less than ideal, with two specific provisions overriding the cash basis. Firstly in line with municipal practices at the time (Dicksee 1903 59-60), money for the repayment of principal and for interest payments on related loans was to be set aside in a sinking fund for that purpose irrespective of when the interest and principal was due for payment. The sinking funds were required to have a bookkeeping account and a bank account separate from the accounts of the tramway, with the funds managed by independent Commissioners. Secondly in the 1911 Amendment Act (s 7) individual tramways operators could seek authorisation from the Governor to create a depreciation fund for the replacement of the plant, machinery and other property of the undertaking. Operators were required to keep separate bookkeeping and bank accounts for depreciation funds, but control of the funds remained with the tramway operator. The WCC did not have the authorisation to use a depreciation fund.

### *3.2. Electrical Lighting and Power Supply Undertaking*

In 1907 the WCC acquired the city's street lighting operation from a private firm that previously provided electric street lighting to the Council under contract[8]. In addition to lighting the city streets the Council began supplying retail electricity to the city residents and businesses. The undertaking was authorised by the 1900 Municipal Corporations Act which required that a separate bookkeeping account for the undertaking be kept but did not specify what could be charged against the revenue for the undertaking (s 162(2)). The presumption in the Act was that it

was a cash-based system and only cash receipts and payments and transfers to loan sinking funds would be recorded. Like the tramway, the loans sinking funds required separate bookkeeping and bank accounts (Local Bodies Loans Act 1901 s 26).

## 4. Funds

The accounting practices at the centre of this paper fall into three categories: funds that were legally in place before the enactment of the *Wellington City Trading Department's Reserve and Renewal Funds Act 1917* (the Act), funds that were deemed illegal either by the Court or the auditor before the Act, and funds that were authorised by the Act. This section outlines the illegal funds as identified by the auditor and the Court and the legislative solution provided for in that Act by authorising the creation of three types of separate funds. Table 1 outlines the nature of each of these accounts.

The use of separate funds as provided for the Act was not unique. Within New Zealand both the Christchurch tramways and Dunedin City trading undertakings had their own legislation authorising renewal and depreciation funds, and renewal funds respectively[9]. The WCC in arguing for the provisions in the Bill mentioned a number of authorities supporting their practices including "The Glasgow Tramway System, under a Mr McColl considered the Leading authority in Britain"[10]. *The Report* of the Departmental Committee on Accounts of Local Authorities (1907) indicated that creating renewal or depreciation funds in addition to payment of maintenance changes and setting aside money for repayment of loans was accepted practice at the time, even though it was doubtful that the practice had any legal authority (para 60). What is new in the literature is recording of the debate around the authorisation of these funds especially focusing on intergenerational equity and the inclusion of users in these debates.

Insert table 1 about here

Table 1: Types Funds

| Type | Purpose | Required/permissive | Separate bank account | Control mechanisms |
|---|---|---|---|---|
| General fund | Everything not in a separate account. | Required | Required | |
| Special funds | Any accounts that are required to be kept, separate from the general fund. The following funds are all types of separate funds. | As specified | As specified | |
| Sinking funds | For repayment of loan and associated interest. | Required for all loans. | Required | Independent commissioners |
| Tramway undertaking fund | All moneys received and payments for cost of maintaining tramway in good repair, and payments to the sinking fund (interest & principal). | Required | Not required | |
| Electricity undertaking fund | Not specified | Required | Not required | |
| Pre 1917 WCC Depreciation fund for tramway | Future expenditure on undertaking beyond maintenance. | Illegal from court case – could have obtained permission but did not. | Kept | |
| Pre 1917 WCC Accident fund | Self insurance for future accident claims for trading undertakings. | Illegal from court case | Kept | |
| Renewal fund – 1917 Act | Renewing or replacing the plant of the undertaking, due to being worn out, obsolete or otherwise incapable of being useful. | Required | Required | Independent commissioners |
| Reserve fund – 1917 Act | Extensions and improvements in the undertaking as council thinks fit. | Required | Required | none |
| Accident fund – 1917 Act | To meet claims for accidents arising in connection to the undertaking. | Permissive | Required | Amount to be set aside is limited |

### *4.1. The Depreciation Funds for the Tramways*

In 1915 a Wellington ratepayer living in the suburb of Wadestown, G Carwell Cooke, took the WCC to Court over the way they kept the accounts for the extension of the tramway to Wadestown. Previously Cooke had led a delegation of Wadestown residents in 1913 to the WCC on number of issues including the tramway accounts. Cooke was an accountant living in Wadestown, employed by the Audit Office[11].

The case[12] related to three legal questions:

1. Is the Wadestown extension to the city tramway a separate undertaking and therefore requires the Council to maintain a separate account for the Wadestown undertaking?
2. Is there any hierarchy of (permitted) expenses to be credited against the tramway revenue in the relevant provision of Tramway legislation, or are all expenses of equal priority?
3. Does the Tramway Act authorise/permit the establishment of a depreciation fund?

Cooke's concern was that the WCC had struck a special rate for the Wadestown ratepayers to cover the repayment of the loan for the extension. The Council was charging 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 for the interest and the required appropriation to the sinking fund for the loan. When there were insufficient funds to cover the required appropriation to the sinking fund, the Council sought payment of a special rate from the Wadestown ratepayers[13].

The outcome that Cooke sought from the court was one of three. Firstly to declare that the extension was not a separate undertaking and therefore there was no need for the special rate to be struck as overall the tramway was making a profit. Secondly, to declare that the WCC should take money out of the tramway fund for the sinking fund prior to other expenses, thus reducing the chance that a special rate shall be required to pay the required sinking fund appropriation. Thirdly to declare that the creation of a depreciation fund was illegal and therefore reduced any special rate payable by the Wadestown residents.

Justice Chapman in the Supreme Court ruled in favour of the Council. The judgment stated *inter alia* that the extension was a separate activity and thus a separate account was to be kept (987). 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" (987). 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" (986). The Court also saw no special hierarchy of accounts, concluding the WCC approach was correct.

On appeal, the Court of Appeal reversed the decision, stating the extension was part of the whole tramway undertaking, thus the Council was not permitted to operate a separate account for the Wadestown extension (993). The legality of a depreciation fund became unimportant because the 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. Such a situation at the time was unlikely given the profitability (with or without the depreciation charge) of the undertaking. However the Chief Justice did recommend 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" (994).

### *4.2. Accident Funds for the Tramway and Electric Lighting undertakings*

In 1909 the WCC decided to 'self-insure' itself for accidents to the public and its employees. For both the Tramway and Electric Lighting undertakings the WCC had set an annual appropriation to their accident funds at £1,000 each, plus the premiums that the Council would have otherwise paid to insurance companies.[14] The rationale for such a decision was the inadequacy of the cover that councils were able to purchase from private sector insurance companies at the time. Insurance companies limited the cover they 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.[15] Between 1909 and 1916 the WCC had appropriated £25,700 to the various accidents funds, paying out £8,200 in claims.[16] The funds were accounted for separately but at times were used as loan finance for the Council's general fund[17].

The audit report for WCC's 1912-13 Balance Sheet contained qualifications relating to the accident funds. The WCC auditor, the Audit Office, stated that the Council had no legal authority to create the accident funds. The auditor also stated that the use of accident funds to provide temporary loans for the Council's General Fund was unacceptable practice. In response the WCC resolved to deposit the accident funds in an 'approved institution'. However the WCC resolved to ignore the Audit Office's concern relating to the existence of the accident funds.[18] Ignoring the Audit Office did not make the funds legal nor make the auditor's concerns disappear.

### *4.3. Legislative Authority*

In 1917 the Audit Office suggested that the WCC should obtain legislative authority for both the depreciation fund for the tramway and the accident fund.[19] As a result of the auditor's suggestion

and the legal moves undertaken by Cooke and Wellington Live-Stock Butchers' Association the WCC had a Bill drafted and introduced into the Parliament entitled the *Wellington City Trading Department's Reserve and Renewal Funds Bill 1917*. Excluding the deletion of references to the city abattoir from the Bill, there were few minor changes following consultation during the parliamentary process[20]. The key feature of the Act was the requirement or authorisation to set up three accounts for the tramway and the electricity undertakings. The accounts were to record non-cash-transactions in a cash based system, with the purpose of setting aside cash for use in future periods.

The three accounts were:

- Renewal funds were required to be created, with money being used to "replace plant or material that has become worn out, or obsolete, or is incapable from any other cause of further usefulness" (s. 9(2)). The amount to be allocated to this fund was fixed in the Act based on a percentage of the value of the depreciable assets of the undertaking. The funds were to be transferred to the control of independent commissioners, operating in a similar fashion to sinking fund commissioners.
- Reserve funds were also required to be created, the money being used in this case for "such extensions and improvements in the undertaking … as the Council thinks fit." (s 13(3)). Like the renewal fund the amount to be allocated to this fund was fixed in the Act based on a percentage of the value of the depreciable assets of the undertaking. However control of the fund was left in the hands of the Council.
- An accident fund was permitted although unlike the other funds not required, its purpose was "to meet claims for accidents arising in connection with undertaking" (s 14(2)). The amount allocated in any one year was not allowed to "exceed the amount that at current rates would have been payable for insurance of workers and insurance against public risk" (s 14 (1)) and the Act included a maximum value that each fund could reach at which point appropriations to it would stop. The money from each fund would be kept in separate bank accounts controlled by the Council.

The result of the Act was no change to the cash basis for recording, but the creation a number of funds based on non-cash-transactions, some of which provided for the cash to be held separately from the Council's general fund. The Act legalised much of what the WCC was currently did and ratepayers and auditors objected too, but importantly it raised a spirited debate about intergenerational equity; the focus of the next section.

## 5. Intergenerational equity

While the court case was concerned with the legality of keeping a separate account for the Wadestown extension and the creation of a depreciation fund, the courts also debated arguments for and against the creation of funds for non-cash transactions by municipal trading undertakings. During the parliamentary scrutiny of the Bill there was significant discussion on the appropriateness of providing legislative authority for the creation of funds. The fundamental principle of municipal finance is that councils should fund current activity from current revenue – i.e. maintaining intergenerational equity. The Municipal Corporations Act 1876 included the requirement that expenditure estimates be produced prior to the striking of the rates and the total rates struck should equal the amount required in the estimates (s109), this principle continues in subsequent municipal/local government legislation. The creation of funds in the 1917 Act were counter to this principle as they required the setting aside of current revenue for either future capital work or future operational expenses both of uncertain magnitude for use in unspecified future periods.

The debate in the courts and during the parliamentary process was never about the primacy or utility of the principle of intergenerational equity. Rather, it was about the application of the principle. Unlike the present day debate over the better way to ensure intergenerational equity, i.e. through cash or accrual accounting (see Christensen (2007) and Barton (2009)), this debate was about ensuring another outcome from the accounting system, namely aiding the community to develop its capital. The logic by those proposing the development of future capital was that as a business undertaking it was appropriate and sound business practice to keep such funds. This view was proposed by the WCC during the court case, winning support in the Supreme Court as noted above with the court finding a "depreciation fund is, … a prudential measure to provide in time against loss of capital" (987). This view was rejected in the Court of Appeal, with Justice Denniston arguing differences between public and private sector activity:

> 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 (997).

Furthermore the Judge referred to the inequity of one generation's profits being used to the possible benefit of the next.

> The generation that advanced money to construct the one (currently in use) may not unreasonably object to having the profits held for the possible benefit of the next (997).

The judge continued by stating that "maintaining the tramway in good repair … does not involve depreciation outside physical requirements", with the maintenance being included in the current year's expenditure. Although the case did not hinge on this issue, the Court of Appeal was clearly of the opinion that depreciation and other funds were not provided for in the current legislation, either directly or implicitly. What is important from the Court of Appeal decision was the affirmation that the principles of municipal finance, that ensure intergenerational equity apply to trading undertakings.

When it came time for parliamentary scrutiny of the Bill the same debates were played out again. The major contributors to the debate were The Greater Wellington Town Planning and Municipal Electors' Association (the Electors' Association) and the Controller and Auditor-General (CAG), together with the WCC. The Electors' Association stated that any profits from trading activities should provide rates relief for the present ratepayers or a price reduction for consumers rather than the creation of special funds as proposed in the Bill. The response of the WCC was that depreciation should be included in the accounts before determining the profit, as it was a cost of the business. The Council was not against the cross-subsidizing of rates by 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.[21]

The CAG argued against the creation of funds. His focus was not just on this Bill but also on similar moves across many local authorities. The CAG suggested that while there may appear to be good reasons for creating such funds, such reasons do not apply to municipal corporations.

> 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.[22]

He stated that the creation of funds by councils was inappropriate because of the lack of any relationship between those that created or contributed to the funds and those that benefited from the funds. He went further to discuss the possibility of intergenerational inequity by the creation of such funds.

> If Municipalities are permitted to pile up funds this benefit is not only filched from (current) 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.[23]

Finally the CAG outlined his concerns relating to official's behaviour if they were permitted to create the reserve funds. Outlining what in 40 years becomes known as the public choice problem, he suggests that such funds will benefit the Council management but not the 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 in 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.[24]

The lead adviser to the government on local government, the Department of Internal Affairs agreed with much of what the CAG said, but qualified that agreement, and supported the legislation with what it saw as the practical considerations of the day. The Department only partially 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. [25]

The Department stated that the issue hinged on what to do with the profit; using it to provide relief for rates or using it for improvements and/or renewing the undertaking. Although the relief of rates may be in principle "sound … in the case of a small borough", the Department suggests that due to the financial constraints and growth required in larger authorities profit bearing services should be self-renewing.

Unlike either the late nineteenth century British experience (Coombs and Edwards 1995) where there was a move away from cash basis to some from of accrual basis or in the more recent experience where full accrual accounting has become the standard (Christensen 2007), in this situation the use of the cash basis for reporting was not questioned. A cash basis was seen as essential to ensure intergenerational equity; however some modifications were accepted. Sinking funds were always acceptable as they ensured intergenerational equity with the repayment of loans. While there was no debate on the creation of the accident funds, most likely because of the upper limits on the size of the funds, there was considerable debate on the renewal and reserve funds. The non-cash-transactions for the renewal and reserve were accepted even though they created intergenerational inequity and some resulted in some double counting, because they allowed capital maintenance and accumulation by the municipalities. Thus intergenerational inequity was an acceptable cost for capital maintenance and accumulation. As the Department of Internal Affairs said in summing up its advice to the Minister of Internal Affairs on the Bill

> it is … 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.[26]

A form of wealth creation and capital maintenance was introduced that meant that trading undertakings would be able to support their own renewing and growth, even when the assets could no longer be maintained, but were required to be replaced and/or upgraded.

Minor safe guards were put in place regarding the management of these funds because they were a blatant breach of the principle of intergenerational equity. As a result of the Electors' Association submission on the Bill[27] a requirement that the commissioners responsible for the renewal fund

were not members of the Council or council employees was incorporated in the Act (s 5). The application of the renewal funds was limited to the replacement of depreciated assets with the same or similar asset (s. 8). The control on the use of renewal funds always involved judgement concerning whether the expenditure was for renewal or for the purchase a new item. For example, the Audit Office agreed that trolley buses replacing the 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”.[28] The Commissioners themselves, during the operation of the Act, rejected some requests from the WCC to use the renewal fund. The rejections were based on a judgement that the purchase of a particular item was not renewing an existing depreciated asset but rather purchasing a new asset.[29] While the Act included controls on the use of the renewal funds, there were no similar controls over the reserve and accident funds.

## 6. The role of users in accounting debates

Historical studies of government accounting have focused on the impact of groups associated with the preparation of the accounts. Colquhoun’s (2009) survey of public sector accounting history literature does not include discussion of any users as agents of change; rather the survey identifies government bodies, quasi public bodies, and professional associations as the main agents of change (549-550). Parker (1979) in his study of private sector international accounting identified five possible change agents; accounting firms, accountants’ organisations, government agencies, companies, and teachers and their textbooks (126), all of which are part of a wider preparers group. In this study similar preparer groups to those identified above were identified as having significant impact on the change to the accounting practices of the WCC. The WCC identified the major influences on the development of the Bill as similar existing New Zealand legislation, and texts, reports and experts from the UK and USA.[30] Advice and opinion also came from within the WCC and from the CAG. All of these parties are involved in the process of preparing the accounts, either directly or as part of the accounting establishment that aids the preparers.

In addition to the preparers’ perspective this study has seen significant influence of a small number of users of the accounts in the development of new accounting practices. This study illustrates something relatively unusual; that an individual challenged and obtained changes to the accounting policies of the WCC; G Carwell Cooke challenged the Council’s accounting policies and achieved change. Similarly a ratepayers’ association engaged in debate with the WCC on the appropriate accounting practices for the Council.

The level of public involvement seen in this study is counter to what Jones (1992) suggested, and Coombs and Edwards (1995), following Jones, found in the archival sources relating to British

municipal corporations accounting. Jones using an "economic model of human behaviour" (1992, 126) argues that it would be highly unlikely that anyone would seek changes to accounting practices and policies for other than economic reasons. The cost for a voter to use accounting information, even if they were competent in accounting, would outweigh any benefit gained, especially given the limited ability of individual voters to make a difference. Pressure groups may seek to influence accounting practices and policies for their economic benefit, especially when they can charge the cost of lobbying to businesses or trade unions (130). Coombs and Edwards (1995) stated that they "found virtually no empirical evidence to suggest that innovation was a response to the demand from ratepayers for more or better information" (104). They note that ratepayers and their associations complained about the accounting methods employed councils, but they "did not see the content of published accounts as relevant in reinforcing their objections" (104).

What motivated Cooke and the Electors' Association to engage with the WCC, the Courts, and the Parliament to seek changes to the accounting practices at the WCC? Records for Cooke and the Electors' Association have not been located and so any discussion of motivation must be treated with caution. The default motivation in accounting research is economic self interest (Chua 1986, 609) but for both Cooke and the Electors' Association this is not convincing. The cost of the court case would out weigh any financial benefit accruing to Cooke himself as a ratepayer, a position consistent with Jones (1992). The cost of the court case can be estimated at £180[31]. The special rate for the Wadestown extension in 1915/16 for Cooke's two properties was in total £1-16-5[32]. While Cooke was the named plaintiff, there were another 127 residents who were signed on to this case[33]. We do not know the agreement between these parties and their solicitor regarding fees, especially if they lost the Appeal case. It was possible that Cooke and his 127 associates could have be required to pay out £180 to their own solicitor and to the WCC as costs. The most Cooke could have won was the £1-16-5 he had paid in the current year. Even with the support of fellow residents, an obliging solicitor and certainty of outcome of the case (which you never have) Cooke was never going to be significantly financially better off from this case, especially if you add the time he must have spent on the issue.

As an accountant Cooke may have been interested in the issues and/or had sufficient professional concerned for the issues to take the court case. Although given his employer was the auditor of the WCC, it is questionable that taking the case privately would have helped his career in the Audit Office. As a citizen with some political aspiration, Cooke could have been interested in the affairs of the WCC beyond this case, although there is no evidence of Cooke seeking any political role for himself in Wellington city. For Cooke there were two outcomes of the court case; firstly the WCC

was to engage in 'better' accounting practices, secondly the Wadestown residents were not required to pay the special rate. Given the amount Cooke was to pay for the rate, economic self interest is not a plausible explanation. There is little personal benefit for Cooke other than the satisfaction of doing something worthwhile for the community. It is plausible that a man trained in accounting felt a civic duty to engage with the WCC on these issues for the benefit of the wider community.

The Electors' Association involvement cannot be explained by self interest alone either. While they argued for relief from rates rather than creating the funds, once the establishment of the funds was certain they argued against the use of the renewal funds to pay off any loans related to the undertaking if the sinking funds were insufficient[34]. The outcome of their position was that they, as ratepayers (the prime qualification for being an elector), would be required to fund the shortfall in the sinking funds despite the possibility of healthy renewal funds. If the Electors' Association were purely concerned with the economic self interest of their members they would have argued to use the renewal fund instead of increasing rates to pay the sinking fund shortfall. Without further evidence the most likely interpretation of the Electors' Association motivation was that they saw a civic duty to engage with the Council on the accounting requirements and policy.

As Pallot (1991) and Mahoney (2002) argue, intergenerational equity has an ethical foundation. It is reasonable to interpret the actions of both Cooke and the Electors' Association as part of doing what is just for current and future generations. It is difficult to determine how much of Cooke and the Electors Associations' actions can be attributed to civic duty. Jankowski (2002, 60) identifies two forms of civic duty; strong and weak. For strong civic duty the duty is considered a moral obligation; i.e. the impact of acting for the actor is independent of the costs to the individual. Weak civic duty relates to the satisfaction the actor receives from performing the act, and thus can be seen to be more closely connected to the costs for the actor. The lack of archival material regarding Cooke and the Electors' Association means that we can not attribute a particular form of motivation to them. For Cooke, the independent ratepayer and the government accounting specialist at the Audit Office, both forms provides a plausible explanation of his behaviour. Perhaps he saw some duty in (and received some pleasure from) engaging with the WCC on public issues, especially those related to his area of professional expertise; a weak form of civic duty.

Irrespective of the form of civic duty that we could ascribe to Cooke and the Electors' Association their action highlights the political in accounting. Exercising ones civic duty is essentially a political act; in this study accounting numbers (the special rate struck) and accounting policy (the authorisation of the funds) were central in this political act. Whereas mainstream accounting seeks to deny the political in accounting (Brown 2009, 316), this study has shown that engagement in an

political act, the court case, and more importantly in a political process, submissions on behalf of a wider community, can result in changes to accounting policy and numbers. The voice of users of accounting information especially in public sector accounting is one place where the political in accounting can be located. Cooke and the Electors' Association were not involved in a 'big' political event, such as redefining the actions of the state or seeking redress for previous hideous actions of the state. But Cooke and the Electors' Association were involved in altering accounting to cause changes in distribution of wealth, in this study, between generations.

## 7. Conclusion

This paper has responded to calls for more research into public sector accounting history (Carnegie and Potter 2000, 104). Early twentieth century trading activities in New Zealand municipalities operated under a cash basis. This was not subjected to debate or criticism during this study. The expected operation of a cash accounting system is that only cash transactions are recorded; yet in this study non-cash transactions were included in the accounts. This was not unusual, as transfers to sinking funds to pay off loans have always been permitted. The difference between the sinking fund and the funds introduced in the Act is that sinking funds can be verified by reference to an external transaction at a later date, i.e. the repayment of the loan. Whereas the funds created by the Act have a degree of arbitrariness. The new funds can not be aligned with any particular expense relating to current year's revenue or benefit to current year's consumers or ratepayers. There is a disconnect between the recording of the expense for the fund and any benefit gained from that expense; this creates the likelihood of intergenerational inequity.

Intergenerational equity has been a central feature of local government finance and was central in the discussion about the appropriateness of the funds provided in the Act. While the passing of the Act authorised a system that would generate intergenerational inequity, no where was there any complaint or disagreement with the principle of intergenerational equity or how it was operationalised, i.e. through the use of a cash-based accounting system. No party sought to argue against intergenerational equity; rather they introduced another principle in conflict with intergenerational equity, capital accumulation and maintenance. A degree of intergenerational inequity was an acceptable outcome if the WCC trading undertaking assets were to become partly self-renewing.

These debates were not technical, rather they were held at a principle level, which in part can be attributed to the significant involvement in the debates of users of government accounts. The voice of users is rarely heard in public sector accounting debates. Within the archive their voice is less likely to be heard, especially as most records surviving are from those involved with the

preparation rather than using the accounts. Also as noted by Jones (1992) and Coombs and Edwards (1995) we would expect little involvement by users in these debates. This point was also raised by the Controller and Auditor General in terms of the limited ability of ratepayers to seek address for intergenerational inequity created by an accounting system.

> 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. [35]

Yet in this study Cooke and the Electors' Association, both users of WCC accounting information, protested in an effective manner; through the legal and political processes. The focus on users in this study has caused us to look beyond economic explanations of engagement in accounting debates. The actions of Cooke and the Electors' Association are best explained by reference to some form of civic duty. This discussion has taken us to ethical concerns in accounting and the political nature of accounting policy and practice. The users' perspective has provided some insights into the often called for social context of accounting (Napier 2006, 454). This study has located accounting in the context of debates about equity and fairness between generations. The acceptability of having an 'unfair' aspect in the accounting system was driven by the need to develop the fast growing country's infrastructure. An inequitable outcome from the accounting system was acceptable as there was another principle involved; development for the community. Like Cooke and the Electors' Association, the WCC had a civic duty, in their case to build up the city's infrastructure for future generations; the creating of a small amount of intergeneration inequity through the accounting system was an acceptable price.

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[1] Statistics of New Zealand, 1900 page 478

[2] WC Archive TC 50/352 Part 1

[3] Wellington City Abattoir Charges and Renewal Fund Act 1919

[4] Evening Post 22 August 1900

[5] Evening Post 17 November 1899

[6] Evening Post 20 April 1901

[7] Evening Post 12 February 1909

[8] Evening Post 26 January 1907

[9] Christchurch Tramways District Amendment Act 1912, Dunedin City Council Empowering Act, 1914.

[10] WC Archives CS 1917/16

[11] WC Archives WCC Correspondence 1913/1089

[12] Attorney-General *ex relatioe* G. C. Cooke *v* Wellington City Corporation [1916] NZLR p 981-1002 (SC & CA).

[13] Attorney-General *ex relatioe* G. C. Cooke *v* Wellington City Corporation [1916] NZLR p 982-985

[14] WC Archives WCC minutes book 20, pp 473 & 475.

[15] WC Archives CS 1917/16

[16] WC Archives WCC Correspondence 1916/881

[17] WC Archives WCC Correspondence 1914/893

[18] WC Archives WCC Correspondence 1914/105, Council Minutes 11/12/1913

[19] WC Archives TC 50/352 Part 1

[20] The Bill as Reported from the Local Bills Committee 31 August 1917

[21] WC Archives CS 1917/16

[22] Archives New Zealand – IA 1 105/30

[23] Archives New Zealand – IA 1 105/30

[24] Archives New Zealand – IA 1 105/30

[25] Archives New Zealand IA 1 105/30

[26] Archives New Zealand IA 1 105/30

[27] WC Archives CS 1917/66

[28] WC Archives TC 44/48 Pt 1 (1952)

[29] WC Archives TC 209 Pt 1 (1965)

[30] WC Archives CS 1917/16.

[31] WC Archives 00233.301 1916/1515

[32] WC Archives Rate Book No. 11 Wadestown and Northland 1915-1916

[33] WC Archives 00233.301 1916/1515

[34] WC Archives CS 1917/66

[35] Archives New Zealand – IA 1 105/30