

**Depreciation and Other Reserve Funds
for Municipal Corporations – Other Voices in an
Early Twentieth Century Accounting Debate**

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Abstract

The use of depreciation by municipalities has been discussed in the accounting history literature previously. Coombs and Edwards (1992) indicated that the issue of the accounting for fixed assets by British municipalities was “substantially resolved” by 1914. While Potts (1982) indicated the issue in the USA was resolved in 1935 by the National Committee on Municipal Accounting. Both of these key papers focused on the debates as recorded in various professional publications and/or academic publications at the time.

This paper provides an historical case study focusing on one municipality, and its accounting for depreciation and reserve funds for a sub-set of its assets. As a case study, the paper includes the perspective of many of the participants, including judges, politicians, auditors, local government officials, central government officials and the significantly under-heard voices of ratepayers and consumers.

Following a 1915 court case and concerns expressed by their auditor, the WCC sought legislation to permit it to operate a depreciation fund and create other funds. The appropriateness of such funds was debated, with the government and the Parliament receiving advice both in favour and against the creation of such funds. It is these voices, mainly from outside the accounting profession, that this paper discusses. Of particular note are the various views of capital maintenance and principles of financial management for local government.

Introduction

Accounting for municipal corporations' long term assets is a perennial issue. In recent years (by historical standards) the choice of the basis of reporting for the public sector has, in many countries, shift from cash to an accrual basis. This has lead to new ways of reporting for assets and depreciation and altered the perceived needs for the creation of special funds. Further developments in asset management for local authorities such as asset management plans continued to be added to the list of requirements under the general heading of accounting, financial management or accountability requirements. Despite the creation of new accounting technologies or the transfer of technologies from the private sector we should expect continued debate on how best to account for local government assets. This never ending debate is due in no small measure to conflicting objectives for the accounting for local authority assets.

This never ending debate is all the more interesting to the historian, for many times it appeared to the participants that they have resolved the debate. By 1914 the issue was "substantially resolved" for British municipalities according to Coombs and Edwards (1992) and according to Potts (1982) the issue in the USA was resolved in 1935. In more recent times many would suggest that the use of the private sector approach has resolved the issues. Others however see new or additional problems being created; for example see Pallot (2001) for a recent New Zealand discussion. This paper addresses the issue of depreciation and other funds for New Zealand municipal authorities circa 1917 from the perspective of one council and three of its trading activities. It includes views from many different participants or players in this discussion, many of whose voices have not been heard before.

Existing literature on the history of accounting for local government assets.

Of all the areas of public sector accounting history, local government accounting and auditing in UK is one of the most researched. Having said that, there are still only a small number of papers published. The lack of historical accounting research across all of the public sector is surprising given the relative ease of access to information regarding public sector activities, especially in the archives. Access to the archive provides the researcher with a greater depth of information and allows for more insights about the process around the accounting choices made by public sector entities.

Three articles deal specifically with accounting for depreciation in UK local government. All three indicate that depreciation has “received more attention, over the years, than any other single financial reporting issue” (Coombs and Edwards 1995 p. 101), that within accounting for municipal authorities the issue has “aroused the greatest controversy” (Jones 1985 p. 154) and “became a matter of fierce public debate” (Coombs and Edwards 1992 p. 188). All three papers discuss the issues in line with many of the themes discussed below. Themes such as the importance or otherwise of having depreciation funds, if together with sinking funds and renewal funds and on going maintenance they constituted double or triple counting of the cost of the assets, and the appropriateness of accounting treatments that could result in intergenerational transfers.

The only other major work on municipal assets and depreciation is that of Potts in the US. 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.

These histories have focused on the reporting practices across the local government sector in their respective countries. Potts (1982) was based on research into writings at the time in various professional journals and government/municipal accounting texts. Such writings, although including debates, are from within the inner circle of those affected by the accounting for depreciation, and in particular in the USA. Jones (1985) likewise uses professional journals and texts as well as official records for his discussion of the UK local government approach. Coombs and Edwards (1992) and (1995) used professional and official publications and archives of a small number of municipal corporations to develop their accounts of aspects of municipal corporations in the UK.

Historical Method

This study discusses depreciation and other funds for municipal corporations using a case study approach. It is the study of one incident in depth, as opposed to the broad aggregation applied in the previous studies noted above. It is a study of particular instance of debate surrounding depreciation and funds for one municipal corporation, and then only for a small part of the municipal corporation, predominately over a short period of time (although the flow on effects for the council are also discussed). In addition to being from a different jurisdiction from the previous studies (and a jurisdiction that has borrowed from both the previously mentioned jurisdictions), this study includes voices not previously heard. Key players in this history are members of the

public, ratepayers, judiciary, the government officials and politicians and commercial operators affected by the accounting treatment of long term municipal assets. These voices are set to complement those heard in the more official and professional literature and resultant histories. As such study this is not a negation of the earlier studies rather a supplement to it. (Williams 1999 p. 63)

Context

Formalised European settlement of Wellington 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. (Dalziel 1992 page 87) By 1865 Wellington had become the capital city of the colony of New Zealand with a population 190,000 (excluding Maori). The choice of Wellington as the capital reflected its geography; in particular having a safe harbour and being located near the centre of the country. Wellington's geography and growth from nothing in 1839 are important in understanding the call for certain 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 inner city and what would become the suburbs of the city. This geography left little room for development of the city without public infrastructure including making cuttings through the hills and introducing public transport to travel through the cuttings to the new suburbs. The growth of the city from the first arrivals in 1840 to 43,000 people by 1900 put pressure on *inter alia* public health and public nuisances, land for development and housing, and public services. 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 regulation of the public nuisance caused by the uncontrolled slaughtering of livestock.

In 1917 the Wellington City Councilⁱ (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 initially related to the three trading activities undertaken by the WCC; the city tramway and power-supply undertaking, the electric light and power-supply undertaking and the city abattoir.ⁱⁱ The Bill was the result of pressure from three elements; a recent court case brought

ⁱ At various times the Wellington City municipal body has been call either the Corporation or Council. For sake of consistency, unless directly quoting, I will use the term Council even if at that time Corporation was the preferred term.

ⁱⁱ At the time WCC was operating two distinct electricity generating undertakings, one to provide motive power for the tramway and the other for street lighting.

by a resident, a pending court case brought by a trade association and an opinion given by the council's auditor. All three were based on allegations that that certain accounting and financial management practices undertaken by the council did not have the necessary legislative authority, in other words they were *ultra vires*. This paper discusses the accounting practices instituted by that Bill and the subsequent Act of the same name and how the accounting policies were formed within the legislative process.

The remainder of the paper is organised in the following manner. The next section reviews the legislative environment relating to each of the trading activities that the 1917 Bill was concerned with at the time of its introduction. This section also provides background to the Council's involvement in each of the undertakings. Section six outlines the reasons why specific legislation for the accounting requirements was required in this particular case. The development of the Bill, as an example of accounting policy making, is discussed followed by a discussion of the subsequent changes to these requirements that were introduced by additional legislation. The paper concludes with a discussion on the technical accounting issues raised throughout the preparation and operation of the 1917 Act as well as non technical issues especially relating to the involvement of parties of the community that are not normally seen to participate in debates on accounting policy choices.

Trading Activities in Wellington City pre 1917 Act

1.a. *Abattoirs*

The WCC established the city abattoir just outside the city boundary in 1909 at a cost of approximately £13,700 funded by a loan. The legislative authority for the establishment of the abattoir was in the Slaughtering and Inspection Act 1908. The 1908 Act had a strong public health aspect to it, including a provision that all boroughs and towns with a population of 2,000 or more were required to establish an abattoir. (s5) While creating a monopoly for the slaughtering of meat for the local market, the 1908 Act only made provisions for charging for services in general terms, permitting each council or operating authority to "make such charges ... as it thinks fit". (s18(c)) However, the Act limited the total yearly revenue to be collected from the 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. (s27 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 1908.¹ The 1909 by-laws were replaced in 1912 by new by-laws that included a provision that any surplus generated by the abattoir was to be returned to the 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. ²

Thus not only were Councils required to establish abattoirs, for public health reasons, but they could not make or at least keep any profit made in any year. Avoiding the slaughtering of stock on private property in the cities and boroughs was a key feature of the 1908 Act, but councils could not financially benefit from this feature. What was to become a significant issue was the identification of appropriate costs, particularly (but not only) the non-cash costs, especially when the abattoir carried out services other than slaughtering (such as processing of the by-products of the slaughtering process) and therefore such services were not bound by the breakeven only requirement.

1.b. *Electrical Lighting and Power Supply Undertaking*

By the mid 1880s the private sector had started to provide electrical lighting to private houses and buildings in Wellington City, with the first city streetlights lit by electricity in 1889. A private sector firm, under contract to the Council, lit the city streetlights using its own infrastructure including the lights themselves and its own electricity, which it generated in the city. The contract between the WCC and the private sector company included provision for the Council to take over the lighting of the streets, including the purchase of the plant for both street lighting and electricity generation from the company at some latter stage.

In 1907 the Council acquired the street lighting operation, when it took over the business and plant of the Electrical Supply Company at a cost of £150,000. The purchase was funded via debentures that were approved by a ratepayer's poll on January 25, 1907. The ratepayer's interest in the poll was low. At a public meeting called to discuss the proposal "only a small gathering of ratepayers was present, numbering fifty or sixty"³ which was less than 1% of ratepayers. The result of the poll 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.^{4 i}

The legislative authority for Councils to establish and operate an electricity production and supply undertaking (for both public and private users) was first given in the Municipal Corporations Amendment Act 1887. Under this 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 was 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 connected with producing and supplying electricity, and (iii) any surplus which may be credited to the general account of the borough.

The 1900 Municipal Corporations Act still required 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.

1.c. Tramway and Power Supply Undertaking

A tramway service for Wellington City was first mooted by the private sector in 1873, with the inaugural service on August 24, 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% of the profits to the Council and provided the Council 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 a profit was never recorded. However, Council papers at the time indicated that the Council was less than sure of the accuracy of the accounts as presented. A report on the tramway company's operations to the Council by a council

ⁱ The £160,000 consisted of £150,000 for the purchase of plant and goodwill, with the addition £10,000 being for additions.

committee reported that the company had disclosed profits of £2,965 for 1885 and £1,942 for 1886, but when the interest expenses were included profits turned to losses. The committee went on to report:

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.⁵

The disparity over profit calculations is surprising given that the Council treasurer was the auditor of the Wellington Tramway Company.⁶

The 1888 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.⁷

The Council wanted to purchase both the electric lighting and the tramway undertakings in 1898. This was some five years prior to the end of the agreement with the owners of the tramway for the sale of that undertaking. The Council sought to expand and subsequently electrify the tramway service, which was only 3.8 miles long and horse drawn. The motivation for the Council to take over the tramway was a desire to extend and improve the service. It was hoped that this would encourage growth in residential accommodation in the new suburbs, away from the inner city. This was essential as the city was quickly becoming overcrowded with both commercial and residential property.

The municipalisation of trading activities was politically a good idea, with no indication of any dissent amongst local politicians at the time. 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 City Council. Furthermore the limited private funds available for such undertakings in the new and growing colony meant that the necessary development required could not be financed by the private sector. This heavy demand for finance for infrastructural projects was exacerbated by technical advances, such as electrical trams.

Following discussions with the existing tramway owners the WCC became the owner and operator of the system on 1 October 1900, at a price of £19,800 plus a penalty for cancelling the 1887

agreement prior to its completion. Funding for the tramway purchase was by a loan authorised by a poll of ratepayers on 21 August 1900.

In 1902 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 in April 1901 and was passed by a margin greater than four to one. By mid 1904 the Council began operating an electric tram service using overhead power lines. Over the coming years the Council expanded the tramway service opening up areas at the far end of the city boundaries and into the neighbouring boroughs. Most of the expansion was funded by loans authorised by ratepayer polls. Many of the polls were taken only 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 be from ratepayers in that area only. Such special rates would only be required if the profits from the undertaking were insufficient to make the interest and sinking fund payments. 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.

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 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 the 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 s14) The second change provided for depreciation to be charged against the tramway account for the replacement of parts of the tramway. The amount of depreciation was to be specified in the order from the Governor-General in Council that controlled the operation of the tramway. Instructions relating to the management of the depreciation fund were limited to the requirement that the money was to be paid into a separate fund managed by the local authority, and that it was for replacement or depreciation of the plant, machinery and other property of the undertaking. (Tramways Amendment Act 1911 s7.)

The Impetus for the Bill

1.d. *Tramways and a Wadestown Resident*

In 1915 a Wellington ratepayerⁱ living in the suburb of Wadestown took the WCC to Court⁸ over the way they were keeping the accounts for the 1909 extension of the tramway to Wadestown. The case related to three 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 items 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?

The concern of the ratepayer 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 account and the interest (after all the other charges) the Council sought payment of the special rate from the Wadestown ratepayers.

Justice Chapman in the Supreme Courtⁱⁱ ruled in favour of the City Council. The judgment stated *inter alia* that the extension was a separate activity and 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

ⁱ G Carwell Cooke was recorded in the 1915 Wise Directory as an accountant living in Wadestown, Wellington. Mr Cooke led a delegation from 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 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)

ⁱⁱ 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.

“originally instituted but as prudence may dictate”. The court was unmoved by the argument that a depreciation fund was duplication of 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.⁹

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 council was not permitted to operate a separate account. 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. A situation at the time that seemed unlikely given the overall 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”.¹⁰ The Chief Justice also note that while the current depreciation fund had a balance of £138,038 to its credit, there was only £20,762 on hand, and suggested a “separate fund” should be established.

Another member of the Court of Appeal discussed the nature of depreciation in relation to the Supreme Court judgment disagreeing with that judgment. The WCC in its defence used the arguments from previous court cases, that focused on 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 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.¹¹

Furthermore the judge referred to the intergenerational equity 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) many not unreasonably object to having the profits held for the possible benefit of the next (generation).¹²

The judge continued by stating that “maintaining the tramway in good repair ... does not involve depreciation outside physical requirements”.

The third judge, Stringer, in his judgment also commented that while the fund was recorded in the books at £138,038 there was no cash associated with it, but had “already been diverted from its original purpose and used for the purpose of constructing further extensions of the tramway system”. The judgment also noted that both Dunedin and Christchurch tramway systems had local Acts permitting funds to be set aside for replacement and renewal.

1.e. *The Abattoir and the Wellington Live-Stock Butchers’ Association*

In 1917 the WCC faced another legal challenge to the way it accounted for its trading activities.^{13 i} This time the challenge came from the butchers that used the city abattoir. The case was very similar to the Wadestown tramway case mentioned above; in this case the question related to the legality of various charges being made against the abattoir account. The argument was that these charges resulted in the cost of using the abattoir being higher than would otherwise be the case. The issue for the butcher’s association was that the abattoir fees schedule was too high or that the users of the slaughtering facility at the abattoir were not receiving a refund that they were entitled to under the city by-law, both scenarios being the result of the incorrect accounting. The costs that were included in the accounts that were objected to 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.¹⁴

In its defence the WCC stressed that depreciation was part of the cost of a business and that it considered that unless otherwise required the WCC was required to keep accounts in a business manner for its trading activities.

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

ⁱ While this case was held after the introduction and passing of the 1917 Bill (as a result of an adjournment of the case), it is clear that the Bill was an attempt to deal with the issues that had already being signalled in the preparation for the court case.

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.¹⁵

The judgment in the Court of Appeal reaffirmed what “annual cost” meant 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 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.¹⁶

Also worth noting is that the judgment pointed out the Slaughtering and Inspection Act 1908, which included the financial provisions, was concerned with more than just the abattoirs own/operated by municipal corporations. The Act applied to all abattoirs including those in private ownership outside the main centres. Thus the maximum return to private sector owners throughout the colony on slaughtering activities would be 5% on capital. Other activities undertaken at abattoirs however did not have the same restriction on pricing, permitting the Council to make a profit from those activities. Examples of such other activity include tripe-cleaning and the sale of offal by the abattoir.¹⁷

1.f. *The Accident Fund*

In 1909 the WCC decided to “self-insure” itself for accidents to the public and employees. For both the Tramway and Electric Lighting undertakings the WCC had set an annual appropriation to both accident funds at £1,000 each, plus the premiums that the Council would have otherwise paid to insurance companies.¹⁸ 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. The 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.¹⁹ Between 1909 and 1916 the WCC had appropriated approximately £25,700 to the various accidents funds, paying out £8,200 in claims.²⁰ The funds were accounted for separately but at times were used as loan finance for the Council's general fund. This practice was one of a number of issues raised by the auditors.

1.g. *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 story concerned the legality of certain practices, namely:

- The Audit Office contention that the Council had no legal authority to create the accident funds. Although it is worth noting that the Audit Office had not mentioned this in the previous three audits where the funds had existed.
- The use of the tramway and electric light undertaking accident funds to provide temporary loans for the Council's General Fund.
- The depositing of monies related to the abattoir and the tramway renewals and depreciation funds in unauthorised investments. This included with the WCC Sinking Fund Commissioners.

In response to the Audit Office's tags the WCC resolved to deposit the accident funds and tramways renewal and depreciation fund money in approved institutions, namely on term deposit in the bank. However it resolved to ignore the Audit Office's concern relating to the existence of the accident fund.²¹ This approach did not make the issue disappear. In 1917 the Audit Office suggested that the WCC should obtain legislative authority for both the creation of the depreciation fund and the accident fund for the tramway.²² As a result the WCC had a Bill drafted and introduced into the Parliament entitled the Wellington City Trading Department's Reserve and Renewal Funds Bill 1917.

The Bill

1.h. *The Preparation*

The major influences on the construction of the Bill were the two pieces of local legislation already in place for tramways 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 and contributing to both renewal and depreciation funds obligatory for the Christchurch Tramway Board. The Board was required to put aside two percent

of the total cost of the undertaking for depreciation and a further two percent 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 required that Council to set up five renewal funds, one each for its trading activities. Half of each fund was to be controlled and invested by commissioners with the other half kept in a separate bank account to be controlled by the Council. No specific amount to be set aside was provided for by the Act. The use of the funds was restricted to renewing plant prematurely worn out or that had become obsolete. The 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 their Bill be based on the powers given to Dunedin City Council and the Christchurch Tramway Board.²³ In addition to the Dunedin and Christchurch legislation, Council officials identified seven “authorities” on the creation of funds in support of such legislation, these were:

A Select Committee of both Houses of Parliament

Palgrave Dictionary of Economics

Collins on Accounts of Local Bodies

Guthrie on Depreciation

Dickie on Depreciation and Reserve Funds

Montgomery (American) on Auditing

The Glasgow Tramway System, under a Mr McColl considered the Leading authority in Britain.²⁴

1.i. *The Introduction of the Bill*

The Wellington City Trading Department’s Reserve and Renewal Funds Bill was introduced to the House of Representatives on July 19, 1917. The Bill included the following provisions:

- That renewal funds be set up for each trading activity; Abattoir, Tramway and Electrical 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 to be made.
- That commissioners be appointed to hold in trust the renewal funds.

- That the renewal funds may be used to repay due debentures if the relevant sinking fund was insufficient.
- That reserve funds be set up for the Tramway and Electric Lighting undertakings, and a mandatory appropriation of £1-10-00 per centum on the value of depreciable assets per year be made.
- That the reserve funds be used for extensions and improvements to the undertakings, although if renewal fund is insufficient the reserve fund may be used for renewals.
- That accident funds be 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. There were three submissions to the committee on the Bill. These were 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 from the Audit Office).

1.j. *Local Bills Committee & Public Submissions*

The Wellington Live Stock Butchers' Association's submission²⁵ was based on the effects of the increase in costs that the butchers would be faced if a renewal fund was set up for the abattoir. The argument was strengthened because the Wellington City abattoir was a legislatively created monopoly. While this Bill was before the Parliament the WCC had received an adjournment to the court case mentioned previously regarding what constitutes annual cost for the abattoir. The result of the submission of The Wellington Live Stock Butchers' Association was that all references to the city abattoir in this Bill were removed when it was reported back to the House of Representatives for its second reading.ⁱ Thus the Bill only dealt with issues relating to the tramway and the electric lighting undertakings.

The Greater Wellington Town Planning and Municipal Electors Association's (the electors association) reasons and motivation for being involved with 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 point,²⁶ with the Council agreeing 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

ⁱ A separate local act was enacted two years later entitled the Wellington City Abattoir Charges and Renewal Act 1919, that dealt with the issues relating to the city abattoir.

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.²⁷

Perhaps the most significant change agreed to by the WCC related to inclusion of a priority for the payment of charges to be included in the legislation. The WCC agreed to have the renewal and reserve funds appropriation being charged after provision for the sinking fund and interests on loans were made. As a result of these changes, any shortfall in funds to cover the required appropriation to pay back the loan would be calculated excluding any appropriation to the renewal and reserve funds. Therefore any special rate required to be struck to cover the short fall would also be for this lesser amount. Thus the reserve and renewal funds were only to be contributed to if there were surplus funds available. This is despite the comments from the WCC quoted above regarding the necessity of depreciation.

The WCC also agreed to the electors association's objection 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 on the Bill was a requirement that the commissioners responsible for the renewal fund were not to be members of the Council nor council employees. This amendment resulted in an additional level of control over the renewal funds and this would become the norm in future legislation relating to such funds.

An on-going problem for the Council became the requirement that a specified amount is to be appropriated to the reserve and renewal funds. The electors association wanted to change the specified amount to a maximum amount to be appropriated without a minimum. The Council rejected this, stating that this would give any Council in the future the ability to withhold payment and thus diminish the funds especially during hard 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.

1.k. *Submission on the Bill by Central Government*

The submission from 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 governments' 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 Affairs' own commentary on the Bill.

The Audit Office argued against the creation of funds as proposed in the Bill. The focus was not just on this Act but also on similar moves across many local authorities. The Controller and Auditor-General suggested that while there may appear to be good commercial 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 – 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.^{28 i}

He went on to say that the creation of funds by councils, as envisaged by the proposed legislation for WCC, 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.

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

ⁱ 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.

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 – 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.²⁹

Finally the Controller and Auditor-General outlined his concerns relating to official's behaviour if they were permitted to create the reserve funds. Outlining what in another 40 years will become known as the public choice problem,ⁱ 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.³⁰

On these issues the Department of Internal Affairs agreed with much of what the Controller and Auditor-General said, but qualified that agreement, and thus supported the legislation, with what it saw as the practical considerations of the day. The Department clearly agreed with the distinction between accounting for local authorities and private sector companies.

ⁱ Boston et al (1996) has Downs (1957) *An Economic Theory of Democracy* as the earliest in their list of seminal works on public choice theory.

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 unproductive 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.³¹

The Department of Internal Affairs went on to say the issue hinges on what to do with the profit; using it to provide relief for rates or using it to make improvements to and/or renewing of 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.

A few minor practical issues were covered by the submissions from the central government agencies. Regarding the reserve fund, as opposed to the renewal fund, the Department of Internal Affairs agreed with the Audit Office and says 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 the Municipal Conferences in the past 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.³²

The Controller and Auditor-General also noted the lack of provision outlining the priority of interest and sinking fund charges over the reserve and renewals funds. The electors association had similarly queried this issue and the Bill was amended in the Local Legislation Committee.

On the 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.

Subsequent Amendments

From the time the Act was passed in 1917 to the demise of the funds in 1981, there were fifteen acts amending the main Act. The amendments included:

- The suspension of appropriations to the Tramway renewal fund between 1934 and 1940 and between 1964 and 1975. The suspension in the 1930's was initially (the first three

years) a response to the economic impact on the 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% of total revenue, and by the mid 1930's it had risen to nearly 30%.³³ As the depression ended the wages expenses increased and the WCC sought to continue with the suspension of the renewal fund to allow the payment of the additional costs of the wages without raising the fares.³⁴ The 1960s saw the WCC transport department starting to make very significant losses. With the trams phased out in the 1960's the need for the renewal fund (now covering the replacement of trolley buses and the other infrastructure relating to the transport department including the overhead lines) was considered less than had been previously required (for the tramcars and their permanent way). The suspension of the appropriations thus reduced the losses. However by the early 1970's both the City Treasurer and the General Manager of the transport department were expressing concerns about the renewal fund. The General Manager in 1974 noted his continuing opposition to moratorium on renewal fund appropriations (which began under his predecessor) and noting that as a result of the moratoriums the fund was in a "precarious position".³⁵ He also commented that the renewal fund calculations had been made on the purchase price rather than on the replacement cost. He stated that the required rate of depreciation would be close to 6 $\frac{2}{3}$ % as opposed to the existing rate of 2%. The City Treasurer was similarly 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.³⁶

- There were also suspensions, provided for in legislation, of appropriations to the Electric Light renewal fund between 1934 and 1938, also due to the depression and between 1975 and 1981. The WCC had initially wanted the 1934 suspension to continue to 1940 as was the case for the Tramway undertaking, however the Department of Internal Affairs argued, on advice from the Audit Office, prior to the introduction of a bill that would authorise the continuation of the suspension, that it was not required as 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.³⁷ The 1975 suspension was on

the understanding that the monies that 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 a sufficient level for future renewals. It was argued that borrowing externally for further capital expenditure while still appropriating to the renewal fund, especially given the high rate of inflation and loss of purchasing power at the time, was not good practice.

It seems incongruous to depreciate assets, tie up funds in outside investments and at the same time borrow money to create assets.³⁸

- The WCC obtained authorisation in the 1938 Local Legislation Act to use the Electric Light Undertaking Renewal Fund 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 the provision of the additional supply that was required for the hosting of the New Zealand Centennial Exhibition in 1940. The same authority was again obtained in 1974 for use between 1974 to 1981, with the limit set at \$1,000,000.
- In 1950 the limits, upper and 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 seeking 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.³⁹

The final Act that altered the operation of the 1917 Act was not an amendment, rather a provision of the 1977 Local Government Amendment Act No. 3. Section 213 (6) stated that Councils shall not appoint any renewal or depreciation fund Commissioners from 1st April 1978. The renewal fund ceased to exist as outlined in the 1917 Act in 1981, following the death of one commissioner and the resignation of a second. The third commissioner resigned subsequently having no quorum and thus ability to act.⁴⁰ The management of the fund was taken over by the Wellington City Council. With the changes to both the structure arrangements for council's trading activities (into stand alone companies called LATEs) and the introduction of new accounting requirements in 1989 what was left of the responsibilities under the 1917 Act became irrelevant. The Act was finally removed from the statute books in 2002.⁴¹

Accounting Issues

This study has highlighted three accounting issues; the control of local government financial management, the desire for a form of capital maintenance, and the control of the Council through controlling cash flow.

1.1. Municipal Financial Management Control

The 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 total rates struck should be for the amount required in the estimates. (s109) Similar provisions 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 were also enacted. The objective was to both limit the funds available to councils and to ensure that the current years expenditure and thus benefit is connected with the current years revenue, which is predominately the land tax. This principle has continued in subsequent municipal/local government legislation. The creation of both the renewal and reserve funds in the 1917 Act were counter to this principle as they permitted/required the setting aside of current revenue for use in the future for either capital work or to cover operational expenses.

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 required yearly percentage was contributed to the funds, which were to be used for "extensions and improvements in the undertaking" (s12(4)). A subsequent amendment in 1950 removed any limit, upper or lower, on the amount of the yearly appropriation to the reserve fund. Thus both the size of any contribution to the fund and the timing of the use of the funds (including between generations) were totally left to the decision of the WCC without control.

The renewal funds were created specifically for the replacement of depreciated assets with the same/similar asset. From the outset there was debate regarding how to control the renewal funds in this unusual arrangement. The elector's association suggestion, which was agreed by the WCC, that the 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 was in neither the Dunedin nor Christchurch tramways legislation, which were used as the starting point for the development of the 1917 WCC Act. Another change made in the Local Bills Committee was to place a minimum on the amount that could be withdrawn from the renewal fund, on the belief that this would deter the WCC from withdrawing funds for maintenance and repairs.

The on going control to ensure proper use of the renewal funds had a number of aspects. The most technical check on the use of the funds was that only assets that were subjected to a depreciation charge were to be replaced by monies from the renewal fund. Yet such a rule was only a necessary rather than sufficient condition for use of the funds. At times a number of different parties were “checking” on the appropriate use of the renewal funds. Following an Audit Office instruction, requests by the Council for renewal funds from the commissioners were required to be made subsequent to Council resolutions to that effect.⁴² The commissioners, the City Treasurer, the Town Clerk, and the Audit Office were all involved in checking (either pre or post the release of the funds) requests for funds from the Renewal Fund. At times the requests were questioned and/or rejected because the item being replaced had not been depreciated. 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.⁴³

The Commissioners themselves rejected certain requests; making judgements about the differences between renewing previously purchased equipment and purchasing new equipment. For example a request in 1965 for a “kango” hammer was rejected by the Commissioners because the “new item had greater capacity than the article replaced”. The fact that the price differential was £75 for the new hammer compared to £15 for the old one was clearly part of the discussion.⁴⁴

While the Act contained a minimum amount to be requested, this minimum was as a total amount to be provided from the fund in one transaction and not a minimum for each item that was to be renewed. Some of the amounts for individual items requested were very small. For example a request in 1961 totalling over £3,000 included specified amounts for a concrete mixer at twelve shillings and eleven pence, and a radical drill for three shillings and five pence.⁴⁵

The other area of control of the renewal funds related to the proceeds from the sale of depreciated assets, replaced from the renewal funds. In 1968 the Commissioners sought a WCC policy that would have all proceeds from the sale of assets that were to be replaced from the renewal fund credited to the renewal fund. Although it was not required under the legislation, the Council agreed to this additional control. Thus the trading departments managers had their ability to fund additional assets from the proceeds of assets sold and replaced by the renewal funds removed, thereby reducing their flexibility. This provision safeguarded against the use of funds intended to replace existing plant and infrastructure, but used to increase the size and/or nature of the

undertaking. The public choice problem that the Controller and Auditor-General warned about in opposing the 1917 Bill was to some degree dealt with by this 1968 change.

The 1917 legislation and the amendments did ensure 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 was totally managed by the WCC. The only control over the reserve funds was a requirement that it should be used for expenditure 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 their financial management of the trading activities than would otherwise be the case. They were knowingly counter to the principles of local government financial management.

1.m. *Capital Maintenance*

At the centre of the discussion of the 1917 Act are questions concerning the nature of capital or equity in the public sector and the need for capital maintenance in local government. The debate can be viewed as two conflicting approaches to capital for local government.

The first position states that local government has little interest in capital. In this view there was no difference between the trading activities of local authorities and their activities funded by rates, fees or charges. Capital is viewed as the previous generations' wealth, which has been transferred to the current generation. Most capital is the result of a surplus of revenue (i.e. rates, charges or fees for local government) collected over expenditure paid within one period. Because local government is expected to collect only what is necessary for the current year the accumulation of capital in this manner is counter to the principle of local government financial management. Capital is thus considered the result of excessive charging of 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 on loans, operating costs and maintenance of assets at a steady state given its age (thus avoiding any need for depreciation). What could be considered as the boroughs assets, such as infrastructure, are viewed as items that need to be maintained and therefore are seen as a constant source of expenditure. The initial costs of such assets are recouped via the repayment of the loan and associated interest, however capital or wealth for the council can be generated when the loan period (which should be the expected life) is less than the actual life of the asset.

The alternative view sees capital as something that should be developed. For trading activities the cost of items or services produced by trading departments should include a return on the capital.

This is held even if the consumers are still also paying off a loan and interest used for the creation of the item via the fees charged, remembering that most services were monopolies. This second view has an additional aspect that says accounting and financial management of trading departments should practice the same “best practices” as in the private sector. In particular a return on the capital would not only be expected but would be required to ensure the continued investment in the business by the owners. Depreciation would be a normal business expense unrelated to either profit or interest paid, and whose usage (if there was associated cash) would be unrelated to the accounting for it. For non-trading activities the creation of capital is achieved by the payment of assets out of current revenue rather than loans or by paying off the associated loan over a period less than the assets expected life.

The WCC took the view that it should be developing its capital base for future generations, remembering that Wellington was a city of over 43,000 people that 60 years previous did not exist. The arguments in the court cases were phrased in terms of depreciation being part of the operating expenses of the trading activities. This line of argument reflected the way the various acts were written; with the amounts that were permitted to be charged against the revenue were limited to the operating expenses. The issue was the desire of the WCC to ensure that after the loans were paid off, either funded by users of the undertakings or if not them, then by ratepayers, the assets of the undertaking 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 the Council would be making a loss on the trading undertaking. The WCC also believed that any capital invested by the WCC into an undertaking should either earn an appropriate profit or the cost of the capital should be included in the cost of the service if it was in a legislatively enforced breakeven environment (e.g. the city abattoir). For example in 1937 the City Solicitor considered a return on assets of 3⅓% on the assets of the electricity undertaking hardly satisfactory as it was “due to the fact that the Corporation fostered this undertaking in its early stages and has practiced the utmost economy in dealing with the whole business”.⁴⁶ Thus the Council believed that users of the electricity undertaking should be paying more to cover both the depreciation on the undertaking and to provide a return on the capital generated by past generations. Over the years the WCC has 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 view expressed by most other parties was that permitting or requiring 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, indicate his desire for cash/liquidity to be in the hands of the ratepayers and his concern for intergenerational equity. The Court of Appeal only saw

the need to ensure that current physical assets should be maintained as they deteriorate, which it considered would have been achieved by the normal maintenance outgoings. The end of the life of the asset meant it was time to replace the asset, the replacement to be funded by the 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 accumulate wealth and assets, especially when funded by generations that will not receive the benefits from the assets. The outcome of this debate was a partial win to those in favour of the formation of capital by the WCC, and ultimately all municipal authorities. Department of Internal Affairs summed up 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 unproductive 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.⁴⁷

Thus a form of wealth creation and capital maintenance was introduced that meant that trading undertakings would be able to support their own renewing, even when the assets could no longer be renewed but where required to be replaced. Yet the nature of this capital maintenanceⁱ is confusing; it related to operating capacity. But was it a financial or physical measure of operating capacity? The discussions in the Court of Appeal surrounding concern about the lack of specific funds and the subsequent requirement for separate accounts with additional controls suggests that their focus was on financial capital maintenance. That is the Court was concerned to see that the monetary value of the assets (including the funds) was being kept and not used for purposes other than maintaining the value of the relevant assets, either within the undertaking or being transferred to other Council activities. However, there is strong evidence to suggest that a physical capital maintenance approach was favoured as well. The use of the tramway renewal fund for replacing the withdrawn trams with trolleybuses, with the proviso that the capacity remains the same, clearly reflects physical capital maintenance rather than financial. That is, the focus was on ensuring that the funds were used in a manner that allowed the undertaking (only) to continue doing what it was required to do, in this case to provide a public transportation system at the current level. The WCC

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. Physical capital maintenance “concentrates on maintaining the productive capacity of” (page 227) the entity.

was primarily concerned with physical capital maintenance. It wanted to ensure that the undertakings were on-going reflecting their concern with keeping the undertaking operating. However at times the Council officials expressed concern for the rate-of-return of some of the undertakings, this generally occurred when they wanted to use the profits from the undertaking for other purposes or for expansion.

This confusion between financial and physical capital maintenance may well reflect the requirement that the cash 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 it came time to use the funds a physical capital maintenance view was applied, so that the physical capacity of the undertaking would be maintained. The most likely reason for this switch in approach would be an appreciation of the public choice theory problem (before it was called that) of uncontrolled expansion by local authorities having used money collected from previous generations, as first alluded to in 1917 by the Controller and Auditor-General. Controlling how the money was spent was intended to place a restriction on the unnecessary collection of the funds in the first place. Councils knowing the limits on the spending of the renewal fund would be less likely to attempt to both spend beyond the purposes of the fund and collect from current ratepayers and/or consumers (many of whom were voters) more than they could spend.

1.n. *Control through Cash*

The creation of the renewal and reserve funds meant more than the creation of separate bookkeeping accounts for each fund. Separate bank accounts were required as well as the independent commissioners for the Renewal Funds. Despite the use of the income and expenditure basis (accrual accounting) for accounting for most trading activities, cash controls were employed to manage the use of the funds. Similarly the auditing of the funds included comparing the balances in the bank accounts to the bank records, together with the checking of the legality of the appropriations to and from the fund.

This use of cash and the requirement for separate bank accounts, as control mechanisms created inefficiencies for the WCC. On occasions councils operating under such regulations were required to obtain overdrafts from the bank to ensure they had enough cash in their general fund to enable them to appropriate (and deposit) the required sums of money into the renewal funds (and those bank accounts) as required in the legislation.

Another example of the inefficiency of the use of cash as the control mechanism can 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 a local Member of Parliament was to question the wisdom of the Council obtaining another loan while the Council had a number of funds, containing in total a sizeable amount of money, already in existence.

What puzzles me is why a wealthy Council such as this with substantial reserves in several accounts needs a Special Loan for so small (to it) 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.⁴⁸

On the positive side this continued use of cash as the main form of control also restricted the ability of the WCC to engage in new/different activities that were outside the undertaking from which the funds were generated. Thus this ensured that the Council did not use funds from different periods to finance other activities or set up different activities without the consent of ratepayers and electors. Such controls meant that at least some of the principles of local government finance were upheld while still permitting the continued development of the Council's trading undertaking.

Non-Technical Accounting Issues

In addition to the technical accounting issues mentioned above this paper highlights a number of issues relating to how accounting operates in its broader context. The first relates to the involvement of a single member of the public to force change to accounting policy, secondly the role that many of the players took in the process of establishing the legislation and thirdly a degree of flexibility permitted or taken from the principles of local government financial management to meet the needs of a particular time.

1.0. 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 1920's show that about one-third of eligible votes turned out to vote in Wellington City Council elections whereas for central government elections would see "most Wellingtonians" turned out to vote. (Brookes 1970 pages 114-5). Brookes however does suggest that voter turnout, despite its popularity, can be a misleading proxy for citizen participation. This case study illustrates something relatively unusual; namely the involvement of a single person in challenging the accounting policies of the Council. G

Carwell Cooke did take on the Council and won! Similarly a business associations (the Wellington Live-Stock Butchers' Association) took the Council to court and an elector's association (the Greater Wellington Town Planning and Municipal Electors Association) argued, before the Bill became law, with the Council regarding what was appropriate accounting practice for the Council. While the motivation of the business association can be explained by a desire to see their member's costs reduced, the motivation of both the individual to go to Court and the resident's association is less unclear. Records of both Cooke and the Greater Wellington Town Planning and Municipal Electors Association's have not been located and so their motivation is unclear. However, it is seems likely that the cost of the court case would out weigh any financial benefit accruing to Cooke himself as a ratepayer. Personally as an accountant Cooke may have been interested in the issues or had enough of a professional concerned enough about the issues to take the court case. As for the electors' association, their involvement cannot be explained by "self interest" alone, as why would they argue against the use of the Renewal Funds to pay off any loans related to the undertaking if the sinking funds were insufficient. The outcome of their position was that they, as ratepayers, would be required to fund the shortfall in the sinking funds despite the possibility of healthy renewal funds. Without further evidence I am left with the view that the most likely interpretation of both Cooke's and the electors' association is that they saw a "civil duty" to engage with the Council on the accounting requirements and policy.

Perhaps most interesting is that this is counter to what Jones (Jones 1992) suggested, and how Coombs and Edwards, following Jones, interpret the archival sources relating to British municipal corporations accounting (Coombs and Edwards 1995 page 104). Jones, using an "economic model of human behaviour" (page 126), theorises that the cost to ratepayers of understanding the accounting so they are able to become involved in debates surrounding accounting policy would be prohibitive. Coombs and Edwards said they

"found virtually no empirical evidence to suggest that innovation was a response to the demand from ratepayers for more or better information." (Coombs and Edwards 1995 p. 104)

Although Coombs and Edwards did say that some ratepayers associations did complain about the accounting methods employed by their local council. The 1917 Act was the result of actions by a single ratepayer and an electors' association as well as a trade association. It was not restricted to just complaining, but included suggestions to modify both existing accounting policies and proposed accounting policies.

1.p. *The Players*

The second issue of interest from this case study of the *Wellington City Trading Department's Reserve and Renewal Funds Bill 1917* and the subsequent act and its amendments was the role of the players involved in issues. This discussion will focus on four players, namely central government, the community (i.e. a resident, and electors' and trade associations), the Courts and lastly the Wellington City Council.

The role taken by the various players from central government alternates from assisting the WCC with their intention in the Bill to attempting to have the Bill rejected. The key players were the Department of Internal Affairs and the Audit Office. However they did not take on particular roles such as "good cop-bad cop", rather they argued the issues. The Audit Office, although initially against such legislation was equally constructive in its advice on the Bill if it were to proceed, and subsequently on the amending acts. The Department of Internal Affairs similarly did not take just one side, rather at different times arguing for and against such legislation and thus accounting practices. Although both agencies were aware of the principles of local government financial management, and believed that they should be adhered to, they did not let these principles blind them from possible solutions to particular problems, in this case faced by the Wellington City Council.

The involvement of a resident, and resident and trade groups is essential. Their motivation as mentioned above was economic for the trade association and "civic" for the individual and the resident group. They were part of the negotiated change to the accounting practices of the WCC. As noted above their involvement in accounting policies and practices were unusual and their motivation did not fit in to the standard economic paradigm of accounting research. It was the negotiated element of this involvement that is particularly interesting. The community groups were very involved in the forming and debating of accounting policies and practices that affected them. The records show that they were part of a negotiated settlement, with some of their suggestions taken on board, while others were rejected. For them local government accounting and financial management was very much a negotiated process.

The third player is the Courts. The five judgesⁱ involved in the Wadestown tramway case all offered some comment on the case. The distinction between the lower court and the Court of Appeal covers 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 is a matter of law, which need not concern us here. Of interest here is

ⁱ One judge in the Supreme Court and four judges in the Court of Appeal.

acceptance by the Supreme Court of commercial accounting practice logic for the WCC undertaking (as proposed by the WCC City Solicitor) and the rejection of that logic unanimously by the Court of Appeal. However not all judges of the Court of Appeal agreed that such accounting was not the best or most appropriate accounting practice for local government argument. The Chief Justice, Stout, appears to give some support for the practice of the WCC while ruling it as illegal based on the legislation, although Justices Denniston and Stringer both rule it as 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 on what was good practice for the day outside the Court.

The final group is the WCC; their role reflects what we could expect from most municipal corporations, namely to get the greatest freedom for the Council. This freedom has two aspects that are in conflict with each other. The first is the predictable freedom from the constraints of the accounting requirements that will enable the Council to act in ways that it sees as in the best interest of the Council and the city. Thus the ability to set up the funds for the continued benefit of ratepayers and residents, to contribute appropriate amounts to those funds given the state of the city's economy at the time, and the ability to make sensible use of the funds are powers that the Council wanted.ⁱ The second set of freedoms that the Council wanted, although only at times, was the freedom from making decisions that the local ratepayers would be in favour of, but that the Council considers not to be in the long term interest of the City. For example, as discussed above, the discussion in the early 1970s regarding changing legislative arrangements that would make contributions to the Renewal Fund smaller for the electricity department. While such arrangements could have been made legal and would have been desirable for existing ratepayers and electricity consumers, the Council rejected such a move on the bases of long-term interest of the City. Rather the Council maintained the existing legislative arrangements, thus providing itself with an "excuse" for the level of appropriation to the Renewal Fund.

While all of participants in the accounting policy making process have taken various positions, it has not been possible to single out particular roles for each of the participants, rather they have all, at different times, discussed and/or argued for and against the proposals and the amendments. The adopting of different positions at different times leads to the final issue of identifying best practice.

ⁱ 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.

The following section discusses that all parties appear to be attempting to identify what ‘best practice’ means at the particular time and for the particular city.

1.q. *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 over the period of the case study has been considered to include the following:

- Not having a local act – rather the use of the sector wide legislation (e.g. Municipal Corporations Act) for issues of long-term financial management of boroughs.
- Ensuring intergenerational equity by avoiding the creation of reserves where the benefit will accrue in a different time period from its creation.
- Where the creation of reserves is seen as appropriate (not withstanding above comment) that the funding be equitable, fair and ongoing.
- The adherence to the fundamental principles of local government finance at the time, i.e. that you fund this year’s expenditure with this year’s revenue and fund long term assets with long term debt over the life of the asset.

This paper has seen all of these principles being overturned/rejected at some stage, from the passing of the Bill and the creation of the funds, to the 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 never totally fixed. Allowing such flexibility can be interpreted as either a lack of rigour or displaying an understanding of the role of accounting as being to help rather than hinder the management of local government. It is this latter interpretation that I believe reflects the actions of all parties in this case. The WCC, the Audit Office, the Department of Internal Affairs and the local residents and associations, while not all wanting the same thing, they all expressed a desire to “accept” outcomes that were workable for the City. Accounting principles and “best practices” were not sacrosanct, but rather were needed to be related to the environment, in this case a new and fast growing city. Accounting was used to aid management in achieving the goals of the day.ⁱ

ⁱ Such an approach could be contrasted with the (official) approach at the end of the twentieth century when accounting rules were required to be followed because they were best practice. Perhaps this approach could be called “letting the accounting rules manage” or “management by accounting rules”. I suspect the 1917 Act and its amendment reflected a much more pragmatic approach to financial management of Councils, while still ensuring some degree of control.

Conclusion

The catalyst for the Wellington City Trading Department's Reserve and Renewal Funds Act 1917 reflected a mixture of self-interest, public interest and perhaps professional interest of the trade association, electors association and an individual ratepayer who was also an accountant. At the heart of the issues in this paper is a debate regarding the appropriateness of providing a form of capital maintenance for local authorities. The concern was that capital maintenance could mean that the principles of local government financial management of the time that were to ensure intergenerational equity was maintained could be broken. The principles were to ensure that current funding by ratepayers covered current expenditure, and only that expenditure. Such principles are in contrast to the private sector model where some form of capital maintenance was seen as sound practice, as a way to build up the business and provide a return for the owners. However the form of the capital maintenance envisaged by those proposing it for the WCC trading undertakings was unclear. While physical capital maintenance was the primary concern, at time financial capital maintenance became important especially when the idea of shift money from the entity was considered.

Beyond the technical accounting issues this case study has shown that at times the public has had a great deal of interest and impact on the accounting policies. Arguments based on economic model of human behaviour that suggest that such activity is unlikely due to the cost-benefit considerations have failed to incorporate other facts such as a public service ethos. Furthermore this case study has shown that while the parties involved in this regulation of accounting understood the principles that underpinned local government financial management, they were happy to be flexible for the sake of the environment without rejecting the principles themselves.

This paper has introduced new voices and perspectives into the debate on municipal accounting and in particular depreciation for long term assets and reserve funds. It has given voice to many of the participants involved. Issues surrounding the public's involvement in the debates may not have surfaced had it not been for the approach taken. What this paper has not been able to do is to give a voice to those outside the archive. Those whose livelihoods were affected by the way the accounts were prepared and costs were thus calculated. It has not touched on the voices of many others involved in the accounting for depreciation, such as the clerk and minor officials. But by giving voice to the various participants in the debate it has increased our understanding of accounting at least for the Wellington City Council and possibility across many parts of public sector accounting.

Endnotes:

- ¹ Wellington City By-Law No. 6 (Abattoir) 1909 s32
- ² Wellington City By-Law No 12 (Abattoir) 1912 s32 (7)
- ³ Evening Post 17 January 1907
- ⁴ Evening Post 26 January 1907
- ⁵ WCC Minute Book Vol 7 1885/87 p. 467 30/6/87
- ⁶ WCC Minute Book Vol 7 1885/87 p. 12 29/1/85
- ⁷ New Zealand Times 27 January 1888
- ⁸ Attorney-General *ex relatione* G. C. Cooke v Wellington City Corporation [1916] NZLR pages 981-1002 (SC & CA).
- ⁹ Attorney-General *ex relatioe* G. C. Cooke v Wellington City Corporation [1916] NZLR p 981, 987 (SC & CA) Chapman J.
- ¹⁰ Attorney-General *ex relatione* G. C. Cooke v Wellington City Corporation [1916] NZLR p 981, 994 (SC & CA) Stout CJ.
- ¹¹ Attorney-General *ex relatione* G. C. Cooke v Wellington City Corporation [1916] NZLR pages 981, 997 (SC & CA) Denniston J.
- ¹² Attorney-General *ex relatione* G. C. Cooke v Wellington City Corporation [1916] NZLR pages 981, 997 (SC & CA) Denniston J.
- ¹³ Wellington Live-Stock Butchers' Association v. Wellington City Corporation [1917] NZLR pages 965-979 (CA)
- ¹⁴ Wellington Live-Stock Butchers' Association v. Wellington City Corporation [1917] NZLR 965, 974 (CA) Stout CJ.
- ¹⁵ Wellington Live-Stock Butchers' Association v. Wellington City Corporation [1917] NZLR 965, 970-1 (CA).
- ¹⁶ Wellington Live-Stock Butchers' Association v. Wellington City Corporation [1917] NZLR 965, 975 (CA) Stout CJ.
- ¹⁷ Wellington City Corporation v John Rod and Others [1919] NZLR 599, 603 (CA) Sim J.
- ¹⁸ WCC minutes book 20, pp 473 & 475.
- ¹⁹ WC Archive CS 1917/16
- ²⁰ WCC Archives – WCC Correspondence 1916/881
- ²¹ WCC Archives – WCC Correspondence 1914/105, Council Minutes 11/12/1913
- ²² WCC Archives – TC 50/352 Part 1 (City Solicitor to Town Clerk 5 February 1917)
- ²³ WCC Archives – CS 1917/16 City Solicitor to Town Clerk 5/2/1917
- ²⁴ WCC Archives – CS 1917/16 (undated and author identified file note from the WCC).
- ²⁵ Archives New Zealand – LE 1 1917/8
- ²⁶ WCC Archives – CS 1917/16 (CS to Hon. J.G.W. Aitken MLC 10 September 1917)
- ²⁷ WC Archives CS 1917/16
- ²⁸ Archives New Zealand – IA 1 105/30 (Audit Office memo to Minister of Internal Affairs 7 August 1917)
- ²⁹ Archives New Zealand – IA 1 105/30 (Audit Office memo to Minister of Internal Affairs 7 August 1917)
- ³⁰ Archives New Zealand – IA 1 105/30 (Audit Office memo to Minister of Internal Affairs 7 August 1917)
- ³¹ Archives New Zealand IA 1 105/30
- ³² Archives New Zealand – LE 1 1917/8 box 494D (Letter to Local Bills Committee from Minister of Internal Affairs 13 August 1917).

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- ³³ New Zealand Local Authorities Handbook 1928 to 1936
- ³⁴ Archives New Zealand – IA 1 105/30
- ³⁵ WCC Archives – TC 44/48 Pt 3
- ³⁶ WCC Archives – TC 44/22 Pt 2 (Memo from City Treasurer to Town Clerk 24 April 1972)
- ³⁷ Archives New Zealand – IA 1 105/30 (Memo from Audit Office to DIA 8 November 1937)
- ³⁸ Archives New Zealand – AAWR W4351 37/113 box 42
- ³⁹ Archives New Zealand – IA 1 105/30 (Statement by City Solicitor)
- ⁴⁰ WC Archives – CS 1979/472
- ⁴¹ Local Government Act 2002 schedule 19.
- ⁴² WC Archive TC 44/48 Pt 1 (1949)
- ⁴³ WC Archive TC 44/48 Pt 1 (1952)
- ⁴⁴ WC Archive TC 209 Pt 1 (1965)
- ⁴⁵ WC Archive TC 44/48 Pt2
- ⁴⁶ WCC Archive CS 1938/91
- ⁴⁷ Archives NZ IA 1 105/30
- ⁴⁸ Archives NZ IA 1 105/308 H E Combs M.P. to Minister of Internal Affairs 12/7/1944.

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