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Accounting and accountability: Concepts and perspectives

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*ACCOUNTING AND ACCOUNTABILITY:
CONCEPTS AND PERSPECTIVES*

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I INTRODUCTION

Money has been described as the lifeblood of government.¹ In 2002, local government and its financing were reformed in order to increase transparency, accountability and fiscal responsibility.² This paper examines the Wellington City Council's "Greening of the Quays" project to illustrate the role of accounting in facilitating the accountability of local authorities. First, this paper reviews the development of financial controls on local authorities in New Zealand. I submit that, from the day local government was established, its financial autonomy has been eroded by central government. Secondly, this paper reviews the statutory, and policy, framework governing the financial accountability of local authorities. In doing so, it examines the role of accounting from the perspective of the main actors in local government.

Thirdly, this paper analyses whether the potential for personal liability in the Local Government Act 2002 ("the LGA 2002") facilitates accountability within local government. Finally, this paper evaluates the ability of accounting, as a discipline, to facilitate citizens participating in policy debate. I submit that financial reports make a positive contribution, but ultimately do not enable citizens to assess whether local authorities are acting in the best interests of their locality. Thirdly, this paper examines the English approach to accounting in local authorities. I submit that New Zealand should consider introducing performance indicators for local government similar to those existing in England.

II THE DEVELOPMENT OF FINANCIAL CONTROLS

The notion of local government is essentially that citizens in a locality elect representatives to make governmental decisions about their locality.³ In 1842, Governor FitzRoy established the first modern local self-government in

¹ Colin Scott "Accountability in the Regulatory State" (2000) 27 J Law and Soc 38, 45.

² Local Government Act 2002, s 3.

³ International Union of Local Authorities Declaration of Self-Government - European Charter of Local Self-Government (1993), art 1.

New Zealand.⁴ Hobson modelled that structure on the English system existing at that date.⁵ The origins of New Zealand's modern local government framework, and the financial controls on it, are in post-industrial England.⁶ As with England,⁷ New Zealand is a unitary state: local government is legally (and constitutionally) subordinate to central government. Local government is a creature of statute. Finance is essential to good governance and cannot be isolated from other aspects of local government.⁸

A strategic approach to decision-making requires symmetry between decisions relating to expenditure and decisions relating to revenue.⁹ This paper focuses on the expenditure side of the equation. It addresses the rating and other funding mechanisms available to local authorities when doing so is relevant to the financial controls on local government. The following discussion traces the development of those financial controls from 1842 till 2008. In doing so, I illustrate that the finances of local government were subject to increasing legislative oversight during that period. I also illustrate New Zealand's growing independence from England in the development of local government law.

The funding and spending decisions of councils have always been subject to some form of control. The municipal councils that were established in 1842 only existed for four years,¹⁰ but had constraints placed on their power to make financial decisions. Municipal councils could only levy rates, and spend funds, for purposes expressly permitted by ordinance.¹¹ Supervision of that limit on their finances by central government was minimal. Municipal councils were not required to record

⁴ Maori had a well-established system of local self-government that pre-dated the Colonial system. See Claudia Orange *The Treaty of Waitangi* (Bridget Williams Books Limited, Wellington, 1987) 37.

⁵ Christine Cheyne "Public Involvement in Local Government in New Zealand – A Historical Account" in *Empowering Communities?: Representation and Participation in New Zealand's Local Government* (Wellington, Victoria University Press, 2002) 116, 118.

⁶ Claudia Scott and others "Positioning New Zealand Local Government" (Working Paper, October 2004, Local Futures, Victoria University of Wellington) 2.

⁷ CD Foster and others *Local Government Finance in a Unitary State* (George Allen and Unwin, London, 1980,) 21.

⁸ Graham Bush *Local Government and Politics in New Zealand* (2 ed, Auckland University Press, Auckland, 1995) 73.

⁹ Scott, above n 6, 9.

¹⁰ See generally the New Zealand Constitution Act 1846 (UK), which provided for an alternative regime.

¹¹ Municipal Corporations Ordinance 1842 5 Vict 8, cl 11.

the financial cost of their decisions, and many did not.¹² In contrast, many English local authorities were voluntarily producing robust financial accounts.¹³ Central government in New Zealand, however, considered that England's relatively minimalist approach to regulating local government was appropriate.

In 1876, central government reformed the structure of local government by dividing the country up into a series of counties.¹⁴ As with municipal councils, the ultimate decision-makers in each county were elected by the citizens of that locality.¹⁵ For the first time, New Zealand had a system of local government that was intended to work together in unison, and be actively supervised by central government.¹⁶ In terms of financial controls, the Municipal Corporations Act 1876 ("MCA 1876") may be an early example of central government's juridification of the financial controls on local government. Loughlin used the term "juridification" to describe the English trend of central government codifying, in statute, the traditional practices of local government.¹⁷ New Zealand followed England in requiring local government institutions to prepare financial reports; best practice (in 1842) evolved into the only lawful practice (in 1876).

The MCA 1876 is also notable, in terms of financial controls, because it required councils to prepare budgets of proposed spending before setting rates.¹⁸ New Zealand followed England by also requiring councils to balance their budgets;¹⁹ that obligation has subsequently been re-enacted and now applies to local authorities.²⁰ Proposed expenditure had to equal proposed revenue. The amount of expenditure in the budget therefore provided the upper limit for local rates in the upcoming year. Councils could source additional finance from central

¹² Bush, above n 8, 63.

¹³ Foster, above n 7, 28.

¹⁴ This discussion has the provinces established under section 72 of the New Zealand Constitution Act 1852 (UK).

¹⁵ Municipal Corporations Act 1867, s 6.

¹⁶ Cheyne, above n 5, 119.

¹⁷ Martin Loughlin "The Juridification of Central-Local Government Relations" in Martin Loughlin, *Legality and Locality: The Role of Law in Central-Local Government Relations* (Clarendon Press, Oxford, 1996) 364, 372.

¹⁸ Municipal Corporations Act 1876, s 12.

¹⁹ Foster, above n 7, 23.

²⁰ Local Government Act 2002, ss 98-102.

government if they wanted to perform an activity not listed in the budget.²¹ The operation of the Slaughtering and Inspection Act 1908 illustrated, however, that obtaining funding from central government may come at a cost. Councils contractually received government funding on the basis that it can only be used for specified services,²² and that those services are performed to a standard that benefited the community.

Indeed, in the early 20th century, councils were not statutorily required to act in the best interests of their locality. Councils were required to deliver specified services,²³ but it was a political decision by Councillors as to how those services were delivered. Bush suggests that political pressure at this time was particularly effective at ensuring that decision-makers acted wisely.²⁴ Significant regulation of local government finances was therefore unnecessary. The small population in New Zealand at the time meant that a close connection existed between those persons who paid rates, and those who spent the rates.

In that sense, local government in New Zealand initially operated pursuant to a political, rather than legal, constitution.²⁵ The behaviour of actors in local government was shaped by political, rather than legal, pressure. Councillors were encouraged to respond to the needs and wants of citizens by the prospect of re-election. Councils therefore borrowed extensively to finance significant expenditure on infrastructure assets.²⁶ As the population grew, councils' financial decision-making began to illustrate the weaknesses of relying primarily on a political constitution. Debt spiralled out of control. In 1918, councils' expenditure amounted to twenty per centum of New Zealand's gross domestic product. To lessen the impact on interest rates, central government capped the

²¹ Indeed, many local authorities in the present day also lobby central government for funding. See, for example, debate concerning the Government's proposed contribution to the Transmission Gully road redevelopment.

²² Slaughtering and Inspection Act 1908, s 16.; See also Philip Colquhoun "Depreciation and Other Reserve Funds for Municipal Corporations – Other Voices in an Early Twentieth Century Accounting Debate" (Working Paper 22, School of Accounting and Commercial Law, Victoria University of Wellington, 2005) 6.

²³ Slaughtering and Inspection Act 1908, s 16(1)(c).

²⁴ Bush, above n 8, 67.

²⁵ Adam Tomkins *Our Republican Constitution* (Hart Publishing, Oxford, 2005) 3.

²⁶ Bush, above n 8, 27.

amount of money that local government could borrow from non-government entities.²⁷ In doing so,²⁸ central government adopted the English approach to handling excessive spending.

However, in 1974, the financial controls on local government developed a uniquely New Zealand flavour. The Local Government Act 1974 (“the LGA 1974”) significantly reformed the structure of, and controls on, local government to increase co-ordination and cohesiveness. The LGA 1974 formalised several reporting practices that many local authorities had already been undertaking. Local authorities (as the entities are now called) had to prepare and publish annual plans, and report against those annual plans. Central government set out to encourage local authorities, and small ones in particular, to strategically plan. At this point, England was also writing legislation to achieve that end. The fact that the LGA 1974 was frequently amended, however, illustrates that the juridification of those financial controls did not appease central government. The LGA 1974 was only the beginning of the modern form of local government as it is known today.²⁹

The next step in the evolutionary chain was a gradual change of attitude rather than a climatic event. In 1987, the Right Hon Roger Douglas identified five principles that were applicable to local authorities.³⁰ Greater efficiency and effectiveness were the key principles. This change in emphasis formed part of the economic reform that was known as “Rogernomics”. The state (both central and local) was seen as being far less effective than the private sector. The Lange Government therefore established the Local Government Commission to investigate, and report on, all changes necessary to improve the effectiveness and accountability of local government.³¹ Those changes were enacted in 1989, and marked a significant change in the nature of local authorities. Several local authorities were combined, which led to increased resources available within those

²⁷ Municipal Corporations Loans Act 1920.

²⁸ Foster, above n 7, 78.

²⁹ Geoffrey Palmer and Matthew Palmer *Bridled Power* (4 ed, Oxford University Press, Melbourne, 2004) 232.

³⁰ *Ibid*, 235.

³¹ Local Government Amendment Act (No. 2) 1989.

entities for financial reporting. Those resources were channelled, however, into ensuring that local authorities attempting to act efficiently and effectively.

In 1996, and in an effort to harmonise financial reporting in the public sector, central government purported to equip local authorities with the tools to report on their efficiency and effectiveness.³² Local authorities were required to report on an accruals rather than on a cash basis. The significance of that change, and the new duty to prepare a Funding Impact Statement, will become clearer later in the discussion. For now, it is sufficient to note that these changes placed New Zealand at the forefront of international public sector accounting. New Zealand was the first country to report in that manner. Thus, New Zealand had obtained legislative independence from England. We certainly take our lead from England when considering potential amendments to legislation, but are free to go our own way- that is the New Zealand model of local government.

III LEGISLATIVE AND POLICY FRAMEWORK

A Policy

We are now traced through to the present legislation. The primary entity in local government at this point is the local authority. The purpose of local authorities, according to the Local Government Act 2002 ("LGA 2002"), is to act in the best interests of their locality.³³ Councillors are primarily elected to assess ratepayers' conflicting interests and make decisions that benefit most of their community.³⁴ This paper does not address the financial accountability the other multi and single purpose bodies in local government.

Madison stated that:³⁵

The aim of every political constitution is, or ought to be, first to obtain for rulers men who possess most wisdom to discern, and most virtue to pursue, the common good of

³² Local Government Amendment Act (No. 3) 1996.

³³ Local Government Act 2002, s 13.

³⁴ Colin Scott, above n 1, 38.

³⁵ Madison *Federalist*, No. 57.

the society; and in the next place, to take the most effectual precautions for keeping them virtuous whilst they continue to hold their public trust.

The separation between those who pay taxes and those who make decisions about how taxes should be spent,³⁶ creates the need for mechanisms of accountability. Madison's principle, which was directed at central government, therefore applies to local government. Local authorities should therefore respond to the needs of their locality rather than implement personal agendas. Accountability is the process by which ratepayers understand and challenge decisions made by local authorities on their behalf.³⁷ Trust in mechanisms of accountability is a central precondition to the legitimate delegation of authority by citizens to the state.³⁸ The LGA therefore places great emphasis on ensuring that elected members of local authorities make transparent, and fiscally prudent, decisions and communicate those decisions to citizens.

B Statutory Objectives

Central government has set out a series of general principles that, in its view, will guide local authorities to make good decisions on behalf of their communities. Section 13 essentially notes that local authorities should:³⁹

- (i) promote the social, economic, environmental, and cultural well-being of communities, in the present and for the future.
- (ii) conduct its business in an open, transparent, and democratically accountable manner; and
- (iii) give effect to its identified priorities and desired outcomes in an efficient and effective manner;
- (iv) collaborate and co-operate with other local authorities and bodies as it considers appropriate to promote or achieve its priorities and desired outcomes, and make efficient use of resources; and

³⁶ Irene S Rubin *The Politics of Public Budgeting* (5 ed, CQ Press, Washington, 2006) 183.

³⁷ *Ibid.*

³⁸ *Ibid.*, 39.

³⁹ Local Government Act 2002, s 13.

(v) undertake any commercial transactions in accordance with sound business practices; and

(vi) ensure prudent stewardship and the efficient and effective use of its resources in the interests of its district or region.

The emphasis on managing assets efficiently and effectively reflects the fact that elected councilors are caretakers of local resources. Much like directors of companies in the private sector,⁴⁰ elected councilors must maintain and develop resources to achieve their objectives. Many governments in Australasia and Europe have recognized the parallels,⁴¹ in this regard, between the public and private sector. Private sector-style objective measures of performance have therefore been introduced into the public sector. In 1994, New Zealand required central government to be fiscally responsible.⁴² Local authorities have, for years, voluntarily prepared accounting reports solely for internal consumption.⁴³ The duty to be fiscally responsible was nevertheless extended to local authorities in 1996.⁴⁴ Local authorities were, and still are required to prepare policies on rating and funding, investments and liabilities. These policies, which are subject to the unreasonableness test in judicial review, set out the financial limits within which local authorities can operate and are discussed below in relation to the Greening of the Quays. Indeed, local authorities were also required to prepare publicly available financial reports that satisfied the same standards as those in the private sector.

C Reporting Obligations

Today, the LGA lists the accounting reports that central government has deemed local authorities must prepare at defined intervals. The list includes both financial (quantitative) and non-financial (qualitative) reports. Most of local authorities' financial reporting obligations are simply carried forward from the oft-amended Local Government Act 1974. Local authorities must still adopt

⁴⁰ R Watts and J Zimmerman *Positive Accounting Theory* (Prentice Hall, Englewood Cliffs, 1986) 7.

⁴¹ IASC Foundation 2002, *Foundation Constitution*.

⁴² Fiscal Responsibility Act 1994. See also Public Finance Act 1989.

⁴³ Bush, above n 8, 77.

⁴⁴ Local Government Amendment Act (No. 2) 1996, s 5.

accounting procedures that are consistent with generally accepted accounting practice (“GAAP”).⁴⁵ The accounting profession created a series of standards to guide accountants on the accepted accounting practice for frequently recurring transactions. The standards were primarily designed for private sector entities,⁴⁶ but adequately cover most transactions in the public sector. The presentation of financial reports in the public and private sectors are therefore substantially similar.

In addition to the budgeting process, the following are the main financial reports that local authorities prepare:⁴⁷

- (a) The Statement of Financial Position (which measures assets, liabilities and ratepayers’ equity);
- (b) The Statement of Financial Performance (which measures revenue, expenditure and surplus[“profit”]/loss); and
- (c) The Statement of Cash Flows.

These backwards-looking documents record the efficiency and effectiveness of local authorities in financial terms. Performance is assessed by comparing the figures to previous time periods, or to other local authorities. A “good” local authority is one that increases assets and ratepayers’ equity [wealth] and makes a surplus. It therefore applies private-sector language and values to the public sector. Do most political ideologies consider an administration that makes money out of its citizens to be a “good” government? The LTCCP and local authorities’ other reports are used by many sectors of society. Different users of accounting information may have different perspectives on the purpose of local authorities’ preparing financial reports, and the strength of the nexus between accounting and accountability. This paper therefore examines the Wellington City Council’s “Greening of the Quays” project, and illustrates that the perceived strengths and weaknesses of accounting as a method of accountability varies among the key players in local government.

⁴⁵ Local Government Act 2002, sch 10.

⁴⁶ IFAC, NZIAS 1, para 1.12.

⁴⁷ Local Government Act 2002, s 93, sch 10.

IV PERSPECTIVES

A Actors

From local authorities' perspective, the preparation of externally-orientated accounting documents has three purposes. First, the documents are a means of involving citizens in debate about the proposed allocations of resources.⁴⁸ Use as an instrument of financial accountability is an important, but secondary, objective. Secondly, preparing the reports is intended to buttress local authorities' internal accounting systems,⁴⁹ and facilitate efficient and effective and efficient decision-making. Thirdly, local authorities prepare the documents to discharge their reporting obligations to central government. The diligent preparation of reporting documents is perceived as a means of staving off further government regulation.⁵⁰

From central government's perspective, local authorities' decision-making during the Project (and in all other instances) must be monitored to ensure compliance with the law. Despite local authorities having their own democratic mandate,⁵¹ the public occasionally holds central government politically responsible for systemic failings in local government.⁵² The LTCCP, in particular, further demarcates the circumstances when local authorities can be held primarily responsible (and therefore) accountable for particular decisions. Loughlin might suggest that requiring the preparation accounting reports in this manner is the quid pro quo of granting local authorities the general power of competence.⁵³ The task of providing of providing certain welfare services has been devolved to local authorities. Councilors have more autonomy. Perhaps,

⁴⁸ New Zealand Society of Local Government Managers *Dollars and Sense: Financial Management Under the Local Government Act 2002* (New Zealand Society of Local Government Managers, Wellington, 2007) 3.

⁴⁹ Wellington City Council "Project Update 9" (15 June 2007) 2. (Obtained Under Official Information Request to the Wellington City Council).

⁵⁰ Loughlin above n 17, 372.

⁵¹ Eugene Meecham, et al, "The Constitutional Legal Status of Municipalities 1849-2004: Success is a Journey, But Also a Destination" (2007) 22 National Journal of Constitutional Law 1, 11.

⁵² See citizens' response to the shortcomings of the Resource Management Act 1991.

⁵³ Martin Loughlin, above n 17, 378; Local Government Act 2002, s 12.

because of distrust, central government has juridified the reporting relationship. Practices which once occurred as a matter of good judgment are now required by law.

Elected councilors are accountable to all citizens residing in a locality.⁵⁴ It is irrelevant whether those citizens voted for them, or even voted in the election or are even ratepayers.⁵⁵ Citizens therefore need to be informed of local authorities' decision-making, and be able to challenge it.

B Case Study: Greening of the Quays

The "Greening of the Quays" project ("the project") undertaken by the Wellington City Council ("the Council") illustrates the value of non-financial reporting. In May 2005, after public consultation, the councillors resolved that Jervois and Customhouse Quays should be redeveloped and a new median barrier with evergreen trees be installed. In the Long Term Community Consultative Plan ("LTCCP") and 2005/06 annual plan,⁵⁶ \$2.5m had previously been approved for redeveloping the waterfront. The Council allocated the full amount to the Greening the Quays project, and tenders were duly sought from the private sector to complete the project.⁵⁷ All tenders exceeded the allocated funds and, after negotiations, the Council agreed to pay \$3.3m. Mayor Kerry Prendergast exercised strong leadership to ensure that the Council's's flagship project was completed in despite the budget shortfall. \$800,000 was diverted from a capital expenditure item that had stalled to pay for the project.

The Greening of the Quays project has had, and will continue to have, an impact on the financial statements of the Council. Funds for waterfront redevelopment first appeared in the Council's LTCCP for the decade beginning 2005/06. The Council allocated it funds in response to a series of studies commissioned in the 1990s, which examined ways of improving the city. The

⁵⁴ Local Government Act 2002, s 13.

⁵⁵ See generally *Roberts v Hopwood* [1925] AC 578.

⁵⁶ Wellington City Council *Annual Plan 2005/06* (Wellington City Council, Wellington 2005) 177.

⁵⁷ Wellington City Council "Project Update 7" (15 April 2007) 2. (Obtained Under Official Information Request to the Wellington City Council).

studies identified that the waterfront region needed developing and estimated the cost of doing so. Upon construction, the project caused the account labelled “waterfront assets” to increase from its 2005/06 level by \$1.9m. Construction was ultimately financed by rates collected during that period.⁵⁸ The “cash” account was therefore \$1.9m lower than if the project had not occurred. Does that mean the Council was held financially accountable by the public for the project? Did the Council act in a financially prudent manner? This paper analyses the Council’s accountability for the project in light of the various players of local government.

C LTCCP

Since 2002, local authorities have been legally required to prepare and publish Long Term Community Consultative Plans (“LTCCPs”). Central government introduced the long-term budgets after it adjudged successive local authorities to have made short-sighted and ill-advised spending decisions. For example, the Auckland Regional Council failed to prepare a cost benefit analysis for the Britomart project, New Zealand’s largest and most expensive public work. The Council’s financial analysis “not comprehensive” and “there were weaknesses in the consultative process”.⁵⁹

Local authorities have acknowledged that it is important for them to engage with the other actors in local government. Local Government New Zealand noted that local authorities must be responsive to the needs of ratepayers if they are to make efficient and effective decisions for their locality. Local authorities may identify those needs and wants by engaging with ratepayers. The LTCCP is one form of dialogue between the actors in local government. It provides ratepayers and central government with information about the cost of decisions proposed by local authorities. Proposed service delivery is identified, together with the cost of delivery, and Councillors’ views on the appropriate sources of funding.⁶⁰ All are presented in one document, which is intended to

⁵⁸ Wellington City Council *Annual Report 2006/07* (Wellington City Council, Wellington 2007) 10.

⁵⁹ Auditor-General

⁶⁰ Local Government Act 2002, s9, sch 10.

bring home the trade-off to readers.⁶¹ Local authorities' duty to balance their budget means that greater expenditure must be matched with greater funding. That funding may come from higher rates or converting more services to user-pays. The document thus records, in financial terms, Councillors' initial attempt at balancing the conflicting interests of ratepayers.

Draft LTCCPs (and annual plans) are intensely political documents. Ratepayers can therefore, in theory,⁶² assess whether a local authority has appropriately matched the burden of rating (or other charges) with those who have the ability to pay. The LTCCP is one form of dialogue between ratepayers and local government. Ratepayers can comment on proposed allocations and Councillors use their political judgment in deciding whether to action any suggested changes. Once a local authority has formally adopted an LTCCP, that document becomes a political agreement between the local authority and its citizens.

Many local governments around the world prepare long-term planning documents. Pallot considers the LTCCP to be particularly robust in comparison to those other documents.⁶³ First, the LTCCP span ten years whereas the reports prepared in other countries are rarely for more than three years. Secondly, expenditure is often provided in detail for only the first year in reports by other countries. Pallot suggests these features of New Zealand's reporting regime contribute to New Zealand's local authorities being more transparent than most institutions of local government around the world. Placing New Zealand's financial framework in an international context is beyond the scope of this paper. However, the features of New Zealand's system that she highlights/identifies suggest that

The Project estimates in the LTCCP, and the actual figures in the annual reports, were prepared using accrual accounting principles. The LGA now

⁶¹ New Zealand Society of Local Government Managers, above n 48, 55.

⁶² Alley and others *New Zealand Taxation 2006* (Thomson Brookers, Wellington, 2006) 13.

⁶³ J Pallot "Accrual Accounting in the Public Sector" (Working Paper No. 10, Canterbury University, 2005).

requires local authorities now account on an accrual rather than cash basis.⁶⁴ Accrual accounting divides the life of the entity into distinct periods, typically a year but it may be shorter. Transactions are therefore recorded when the legal obligation to pay, or right to be paid, arises rather than when cash is paid or received. This allows revenue to be recorded when earned, and expenses deducted when incurred.

The significance of accrual accounting for the purposes of accountability is two-fold. First, in terms of planning it allows the cost of particular decisions to be forecasted with greater accuracy.⁶⁵ Councilors and citizens can more accurately identify when costs will be incurred. The two accounting methods ultimately record the same amounts over the life of the entity, but differ on timing. The use of accrual accounting in the Greening the Quays project does therefore have a second real effect. Councilors find it more difficult to 'shift' the cost of a project, using accounting, until after the relevant triennial election.⁶⁶ In terms of the Project, this meant the final million dollar payment fell due days before the election. Accrual accounting therefore makes the information contained in the LTCCP and other financial documents more timely and relevant, which aids users holding local authorities to account. Rubin notes that there can be a tension between budgets promoting accountability, on the one hand, and communicating a message that is acceptable to local government actors, on the other. That may mean obscuring the nature or cost of a particular decision.

From local authorities' perspective, the LTCCP is an important cog in the wheels of accountability. The LTCCP is intended to ensure that local authorities act in citizens' best interests when exercising those functions.⁶⁷ It, together with accounting more generally, is a tool for generating debate about the proper allocation of resources. Most local authorities therefore undertake the costly, and time-intensive-task, of ensuring that the LTTCP is as realistic as possible. Councilors receive draft budgets from departments within the organisation, which

⁶⁴ Local Government Act 2002, sch 10.

⁶⁵ Janet Mack and Christine Ryan *Is there an Audience for Public Sector Reports?* 20 IPJSM 2, 6.

⁶⁶ *Ibid.*

⁶⁷ New Zealand Society of Local Government Managers, above n 48, 1.

must justify departments' funding requests.⁶⁸ In addition to encouraging greater financial awareness at the point of delivery, receiving budgets from service-providers is also likely to result in the most realistic forecasts reaching the LTCCP. Ratepayers are therefore provided with the information, and opportunity, to ask Councilors the right questions: Is it appropriate to spend millions redeveloping the Quays? Should current ratepayers bear most of the funding burden? Is the WCC complying with its policies and the LGA? Local authorities assume that citizens are sufficiently financially literate to understand and process the information contained in the LTCCP.⁶⁹ Unfortunately, that assumption may be misguided.

D Flaws in Policies

Ratepayers (and other readers) failed to identify two fundamental flaws with the Project. First, the Council contravened its "Liabilities Policy" when it decided how to fund the project. The policy states that capital expenditure should "primarily" be financed from long term borrowing rather than current rates. The project is capital expenditure according to the relevant accounting standards.⁷⁰ The redevelopment satisfies the definition of an "asset" because it has significantly improved Jervois Quay and it is likely to benefit the community for many years to come. Long-term borrowing provided only 25% of funding for the Project, and thus cannot be considered the "primary" means of financing the redevelopment. The Council acted ultra vires. Indeed, the second flaw with the Project also concerns financing. The Council exceeded, by 25 percent, the \$2.5m budget for the Project set out in the LTCCP. If accounting was a fully functioning accountability mechanism, ratepayers (or, at least, the media) would have identified these issues,⁷¹ and made the appropriate people aware of the errors.

The particular accounting flaws with the Project may be isolated incidents. Aside from smaller local authorities failing to adequately prepare LTCCPs, it is

⁶⁸ Wellington City Council "Project Update 1" (15 May 2005) 1. (Obtained under Official Information Request to the Wellington City Council).

⁶⁹ New Zealand Society of Local Government Managers, above n 48, 78.

⁷⁰ NZ IAS 7, para 7.17.

⁷¹ The Council was not aware of the issue until I discussed the issue.

rare for local authorities to material misstatement their accounts.⁷² Systemic weaknesses in local authorities' accounting systems may, however, exist. The WCC has acknowledged that, in relation to the Project, there may have been an error with their accounting systems.⁷³ The head of the accounting department failed to ensure that Councilors' decision to reallocate funds from another project was reflected in the accounts. No documents were formally altered to reflect the increased funds that the WCC awarded the project. Accurate information is crucial to good decision-making.⁷⁴ Inaccurate information may reduce citizens' ability to participate in debate with Councilors and hold their elected representatives to account.

V ACCOUNTING ACTORS

A Auditor

Citizens (and some in central government) may legitimately expect published and audited financial documents to be free from such errors. LTCCPs and other financial documents are audited by, or on behalf of, the Auditor-General. Most local authorities receive "unqualified audit opinions",⁷⁵ but it does not follow that the financial statements are therefore free from error. The auditor only expresses her unqualified opinion that the reports were free from material misstatement or fraud.⁷⁶ She does not undertake that the reports are, in fact, free from all errors. The Auditor-General has stated that any breach of the law or local authorities' policy is automatically material whatever the dollar amount.⁷⁷ Jacobs suggests the high threshold is fully justified.⁷⁸ Citizens' expect officials to spend

⁷² Office of the Auditor General *Rates Inquiry* (Office of the Auditor General, Wellington, June 2007) 72.

⁷³ Wellington City Council "Project Update 11" (15 July 2005) 1. (Obtained under Official Information Request to the Wellington City Council).

⁷⁴ AH Marshall *Financial Administration in Local Government* (George Allen and Unwin Ltd, London, 1960) 14.

⁷⁵ Office of the Auditor General *Rates Inquiry* (Office of the Auditor General, Wellington, June 2007) 13.

⁷⁶ Wellington City Council *Annual Report 2006/07* (Wellington City Council, Wellington 2007) 137.

⁷⁷ *Rates Inquiry* (Office of the Auditor General, Wellington, June 2007) 13.

⁷⁸ Kerry Jacobs "Value for Money Auditing in New Zealand: Competing for Control in the Public Sector" 30 *British Accounting Review* 342, 344.

public money in a manner that benefits the public and is lawful. It is therefore problematic that the WCC's breach of its Liability Policy remained undetected.

It is unsurprising, however, that the auditors did not discover the Project's cost was understated given there was no breach of law or policy. The WCC's audited 2005/06 Annual Report incorrectly reported that the Project was within its budget of \$2.5 million. The extra \$800,000 was not mentioned. Auditors generally consider changes of more than five percent of total expenditure are material. \$800,000 is only a fraction of the WCC's \$350 million budget. Auditors do expressly inform readers of their audit opinion that immaterial errors or fraud may still be present in audited reports. Unqualified audit opinions, however, do provide some confidence that local authorities have accurately reported transactions. In contrast, a set of accounts that is subject to a qualified audit opinion is almost definitely inaccurate and therefore of little value to ratepayers in discussing matters with authorities.⁷⁹ A qualified opinion therefore signals to citizens and central government that the particular local authority could be more financially accountable. Local authorities have a political incentive to obtain an unqualified opinion.

B Accountants' Judgment

Indeed, financial statements that receive an unqualified audit opinion may still contain fishhooks for readers to overcome before the document becomes an effective accountability mechanism. From an accounting perspective, there are some strains on the nexus between local authorities preparing financial statements and users holding those authorities to account. Accounting standards may provide the tools for a local authority to appear well within the thresholds set out in financial policies and the LGA when, in substance, it is close to breaching the threshold.⁸⁰ Accounting does not always involve the mechanical application of rules. The standards afford considerable scope for judgment to be legitimately exercised in the preparation of accounts. When faced with choices as to the

⁷⁹ Deegan and Samkin *New Zealand Financial Accounting* (2 ed, McGraw Hill, Auckland, 2004) 12.

⁸⁰ *Ibid*, 37.

appropriate accounting measure, local authorities have tended to adopt the measure that puts them within, rather than outside, the relevant threshold.

C Councillors' Judgment

A local authority (and in particular, the Councilors who are responsible for preparing the reports) may occasionally encounter incentives to adopt accounting techniques that it would not normally adopt.⁸¹ For example, local authorities face political and legal pressures to maintain a balanced budget.⁸² In light of the public perception that rates are too high, local authorities that run a surplus may face public criticism and, ultimately, punishment at the polls. Local authorities have responded to this, and other, pressure by deciding to frequently revalue the land under roads.⁸³ The value under such land is difficult to determine. Accounting standards require land assets to be valued at the price that a willing buyer and seller would agree in an arms length transaction.⁸⁴ As with many unique assets in the public sector, there is no relevant market. Valuation is therefore inherently subjective. As the land under roads is a billion dollar asset for the WCC, changes in value may significantly alter its financial position. Users of financial statements need to be aware that the figures in the financial statements may legitimately be managed. Earnings management places significant strain on the nexus between accounting and accountability because it is difficult to detect from outside local authorities.

D Readability

It is difficult to assess from financial reports whether local authorities are acting efficiently and effectively. It is particularly difficult for citizens to trace a particular project or transaction through the accounts and thereby assess whether a local authority has acted in a fiscally responsible manner. A publication listing all transactions may stretch for thousands of pages. It may also reduce readers' awareness of particularly important issues. The Annual Report necessarily

⁸¹ Local Government Act 2002, sch 10.

⁸² Local Government Act 2002, s 100.

⁸³ Office of the Auditor General, above n 72, 79.

⁸⁴ IFAC, *NZIAS* 6, 6.1.

provides a very general picture of the financial position and performance of local authorities. The technical nature of financial reports forces many citizens to rely on the commentary accompanying the Annual Report. As demonstrated earlier, the commentary to the annual report is not the most reliable guide to the reports. It is written by those responsible for preparing reports: the elected Councillors.⁸⁵ The commentary is intended to highlight those points that Councillors wish the public to know. One therefore returns to the criticism levelled early in this part. Local authorities are naïve in assuming that most citizens will be able to trace through the financial reports and contribute to the funding and expenditure debate.

Financial reports fail to fully inform citizens and central government whether local authorities have made progress towards achieving their statutory objectives. Financial statements primarily provide information concerning the profitability and financial stability of entities. Local authorities are not profit-orientated. For example, the fact that a library operated within budget does not necessarily mean it stocks the books that the public wants to read. Problems arise because the social, economic, environmental, and cultural well-being of a locality cannot be adequately measured in money.⁸⁶ Local authorities' objectives are expressed as qualitative outcomes rather than objectively measurable criteria. The Act does not expressly provide a mechanism for determining which decisions are in the best interests of the public.

E Qualitative Outcomes

Accountants responded to this criticism by developing the Statement of Service Performance specifically for the public sector.⁸⁷ It measures the outputs that a local authority said it would deliver against the level of output that it actually achieved. For example, a local authority may plan to put 5,000 people in Council houses, but actually only house 4,600. The shortfall implies that the authority did not achieve its qualitative outcomes. Output is measured as a proxy to the qualitative outcomes. The Auditor-General has acknowledged that

⁸⁵ Local Government Act 2002, sch 10.

⁸⁶ Office of the Auditor General, above n 72, 79.

⁸⁷ *Ibid*, 1089.

measuring outputs may be the most effective means of ensuring that local authorities are acting in the best interests of their locality.⁸⁸ The Project illustrates that, while a positive step forward, it has inherent limitations. Measuring service performance may be sufficient when the expenditure in issue relates to services. Accounting obviously relies on numbers. If something cannot be numerically measured, however, it does not exist for accounting purposes. Capital expenditure projects may contribute to the achievement of statutory objectives, but one cannot quantify the extent. The public is still left without an objective yardstick around which they can debate the merits of certain proposals.

VI JUDICIAL PERSPECTIVE

From the perspective of the judiciary, accounting is a key element in holding local government accountable. Rating and expenditure decisions are routinely questioned in courts.⁸⁹ Those claims have included challenges to the appropriate level of rates, the allocation of the rating burden, and proposed expenditure. In the leading case on rates, the Court of Appeal in *Woolworths v Wellington City Council* recognised that cases concerning local authorities' finances are likely to raise issues inherently political issues.⁹⁰ For example, is it just that corporate ratepayers invariably bear a rates burden that exceeds the resources that they consume? The court effectively noted that, subject to unreasonableness, rating decisions are political matters to be decided by democratically elected Councillors. Dissatisfaction should be expressed in the political, rather than legal, arena.

The effect of the decision, for present purposes, is that it places a greater onus on accounting reports to effectively hold local authorities to account. Prior to *Woolworths*, courts had firmly stated that local authorities owed citizens a fiduciary duty to act in the best interests of their community.⁹¹ In assessing whether a local authority had breached that duty, courts were asking intensely

⁸⁸ Office of the Auditor General, above n 72, 188.

⁸⁹ Kenneth Palmer *Local Government Law in New Zealand* (2 ed, The Law Book Company, Ltd, 1993) 330.

⁹⁰ *Woolworths v Wellington City Council* [1996] 2 NZLR 537, 544 Richardson P.

⁹¹ *Ibid.*

political questions about the merits of particular decisions. By displaying a deferential attitude to local authorities in *Woolworths*, the Court of Appeal appears to have significantly narrowed the scope of the fiduciary duty owed to citizens.⁹² The judicial deference in *Woolworths* appears to mix policy with pragmatism. If courts regularly entertained the possibility of rating or expenditure decisions being challenged, the floodgates may open.

Further, from a more principled point of view, this paper has demonstrated that it is particularly difficult to assess whether particular conduct is in the interests of a locality. It would be intellectually dishonest to suggest that the judiciary can identify the conduct that is in the best interests of a locality: people legitimately disagree about the best course of action. The retrenchment that occurred in *Woolworths* was therefore consistent with the notion of representative democracy. Indeed, Griffiths notes that a key tenet of political constitutionalism is that political decisions are made by political actors.⁹³ *Woolworths* does, however, mean that if New Zealand is to improve the accountability of local authorities, any significant reform must be done by the legislature.

The current law and policy governing local authorities' financial management does communicate the business of local authorities to citizens and ratepayers, but it also has significant flaws. The key weaknesses are two-fold. First, the inability to link the qualitative outcomes that are expressed in the LGA with an objective measure of performance. It is a barrier to ratepayers and central government understanding the information presented and therefore a barrier to supervising the appropriateness of local authorities' decision-making. The actors in local government find it difficult to engage in a debate about whether particular expenditure has achieved particular statutory objectives. The second flaw is related. Uncertainty over the content of local authorities' statutory objectives has permitted successive Councilors to pass underinvestment off as justifiable as a matter of political ideology. In light of these flaws, it is advisable to consider mechanisms to improve local authorities' financial management.

⁹² Andrew Butler (ed) *Equity and Trusts in New Zealand* (Brookers, Wellington, 2003) 1108.

⁹³ J A G Griffith "The Political Constitution" (1979) 42 MLR 1, 16.

VI PERSONAL LIABILITY

A Introduction

In 1867, central government introduced the surcharge provisions into local government. Those provisions meant that Councillors may be personally liable if they abuse the power conferred on them by the citizens in their locality. The following discussion analyses whether that potential for personal liability effectively ensures Councillors, and local authorities, make decisions that are in the best interests of their locality. I submit that there are political and practical justifications underpinning the provisions, but the threshold is too high for the provisions to be engaged.

B Justifications

Provided Councillors are not acting in their personal capacity, they are agents of their local authority when incurring these decisions. Local authorities are body corporates and therefore legally distinct entities from their members. There are political and practical reasons for imposing personal liability on Councillors even though they act as agents. The political justification is rooted in representative democracy, a concept that was introduced earlier in this paper. The statutory power conferred under the LGA 2002 (and other Acts) for public purposes is conferred on trust.⁹⁴ The power can only be exercised without legal impunity if it is used in the way that Parliament intended. Councillors cannot unilaterally confer on themselves more jurisdiction. Lord Bingham of Cornhill has stated that Councillors who exercise their power in an unlawful manner betray the trust of their citizens and commit misconduct.⁹⁵ Personal liability, on that approach, exists to punish Councillors for their misconduct, and deter other Councillors from engaging in such conduct.

The practical justification for holding Councillors personally liable for unlawful conduct focuses on the effect that conduct has on their locality. The

⁹⁴ *Porter v Magill* [2002] AC 357, para 14 Lord Bingham of Cornhill.

⁹⁵ *Ibid.*

justification is based on the premise that unlawful transactions are not in the best interests of localities. Given that local authorities are creatures of statute,⁹⁶ decisions become unlawful if they are outside of the jurisdiction conferred by relevant statute. Parliament has purported to confer on local authorities the power of general competence. Transactions therefore only become unlawful if they breach an express or implied limit on the power of general competence.⁹⁷ Parliament has considered those matters so central to effective decision-making that it clawed-back some of the autonomy conferred under the general power of competence. Personal liability exists, on this approach, to encourage effective and efficient decision-making that is in the interests of localities.

The justifications for the surcharge provision are complementary. The surcharge provision (and the financial reporting obligations discussed throughout this paper) illustrate that administrative law sets out to achieve multiple and, at times, conflicting aims. Harlow and Rawlings express the tension about the appropriate role of the law in terms of the colours on a traffic light.⁹⁸ The orthodox view of administrative law dates back to Dicey; administrative law exists to ensure that the state does not unduly interfere with the rights of citizen.⁹⁹ That view is termed “red light theory”. “Green light theory” is a more recent development. It holds that, in order to facilitate effective decision-making, the law should permit decision-makers, such as Councillors, to have some lee-way. “Amber light theory” is the most recent theory. It suggests that administrative law can aim to regulate and facilitate good decision-making at the same time. The multiple justifications for the surcharge provision illustrate that section 46 of the LGA 2002 attempts to serve both functions. The following discussion illustrates, however, that in practice the surcharge provision is primarily explained by red light theory.

Section 46 of the LGA 2002 provides that Councillors can be liable if:

⁹⁶ Local Government Act 2002, s 12.

⁹⁷ Note that some limits on the power of general competence (such as the consultation provisions) may impose significant obligations on local authorities.

⁹⁸ Carol Harlow and Richard Rawlings *Law and Administration* (2 ed, Butterworths, London, 1997) 58.

⁹⁹ *Ibid.*

- (a) money belonging to, or administrable by, their local authority has been unlawfully expended;
- (b) an asset has been unlawfully sold or otherwise disposed of by their local authority;
- (c) a liability has been unlawfully incurred by their local authority; or
- (d) their local authority intentionally or negligently failed to enforce the collection of money it was lawfully entitled to receive.

The Auditor-General and the Minister of Local Government are, together, the gatekeepers for liability under the provision.¹⁰⁰ Each person has a distinct role under section 42 of the LGA 2002, and councillors can only be personally liable if both of those people agree that that is appropriate. In 1912, after significant budget blow-outs by local authorities, New Zealand's central government enacted provisions that expressly permitted Councillors to be held personally liable in exceptional circumstances. These provisions (known as the surcharge provisions) were identical to the English ones existing at the time. The provisions applied to Councillors and senior public servants in central government. England recently abolished all surcharge provisions. New Zealand still retains the surcharge for elected Councillors.

During every audit of a local authority, the Auditor-General must determine whether any of the transactions listed in section 46 of the LGA 2002 have occurred, and the financial cost of those transactions. Subject to unreasonableness, the Auditor-General's interpretation of the law is conclusive. The ambit of the provision therefore depends, in part, on the Auditor-General's understanding of the LGA 2002 and policies made pursuant to it. The Auditor-General has published numerous reports,¹⁰¹ and run a series of workshops,¹⁰² on its understanding of the obligations that the LGA 2002 imposes on local authorities. Councillors, and local authorities, therefore ought to be aware of the Auditor-General's interpretation of the operative provisions of the LGA 2002. Those people should act accordingly to reduce the probability that the Auditor-General will impugn one of their

¹⁰⁰ Local Government Act 2002, s 46.

¹⁰¹ See, for example, the Rates Inquiry above n 72.

¹⁰² See, for example, the presentations on the LTCCP.

transactions. Indeed, most local authorities do adhere to best practice as outlined by the Auditor-General,¹⁰³ and thereby minimise their Councillors' exposure to potential liability.

C Ambit

It is difficult, however, to gauge the Auditor-General's working interpretation of the surcharge provision itself. The provision has never been applied in New Zealand, and the equivalent English provision was applied only once.¹⁰⁴ Moreover, the Auditor-General has not publicly released a robust analysis of its approach to the surcharge provision. That may be due to the Auditor-General's limited resources, or its belief that Councillors' are unlikely act in a manner that would engage the provision. The Auditor-General is yet to formally explain the lack of commentary.

Regardless of the reason for it, the lack of commentary from the Auditor-General leaves key questions about the surcharge provision unanswered. For example, can Councillors be personally liable if their local authority does not act consistently with a statutory objective set out in section 13 of the LGA 2002? Put another way; is inefficient or ineffective decision-making sufficient to trigger the surcharge provision? The legal effectiveness of statutory provisions that set out general objectives for entities has not been judicially determined. Those provisions may, however, be analogous to purpose sections in statutes. Statements of purpose are expressed too generally to impose legal obligations on parties.¹⁰⁵ Section 13 of the LGA 2002 is also expressed particularly generally and is largely "aspirational" in nature.¹⁰⁶ In the LGA 2002, both types of provision in substance convey the social, economic, and cultural,¹⁰⁷ ends that Parliament intended local authorities to achieve.

¹⁰³ Ibid.

¹⁰⁴ Foster, above n 7, 88.

¹⁰⁵ JF Burrows *Statute Law in New Zealand* (3 ed, Lexis Nexis, Wellington, 2003) 166.

¹⁰⁶ *Domain Nominee Ltd v Auckland City Council* (1 September 2008) HC AK AP 68/08 para 79.

¹⁰⁷ Burrows, above n 105, 166.

The provisions are relevant in that they colour the interpretation of other parts of the LGA 2002.¹⁰⁸ Neither the purpose provisions, nor the statutory objectives set out in section 13 of the LGA 2002, are purely objective criteria. The statutory objectives contained in the LGA 2002 may legitimately conflict. The notion of efficient decision-making is often associated with making decisions as quickly as possible. The extensive consultation procedures in the LGA 2002 may,¹⁰⁹ at times, be inconsistent with efficient decision-making because of the time consuming nature of consultation. The Auditor-General is likely to find, for example, that notions of efficiency and democratic participation are inherently subjective and essentially political, rather than legal, questions. When one recalls the difficulty of measuring those criteria in quantitative terms, the Auditor-General may find that the issue is not appropriate for judicial or quasi-judicial resolution. The potentially conflicting objectives in the LGA 2002 suggest that the Auditor-General should not regard alleged breaches of section 13 as being capable of triggering the surcharge provisions. To the extent that such conduct is unlawful independently of section 13, however, a literal reading of the surcharge provision suggests that Councillors may be personally liable.

For Councillors' decisions made prior to August 2001, liability under the surcharge provisions arose once the Auditor-General decided the funds should be recovered from the Councillors.¹¹⁰ That decision could be appealed to the Minister of Finance.¹¹¹ It was the Auditor-General, however, who had the power to initiate court proceedings to recover the funds if Councillors were unwilling to pay.¹¹² Since 2001, liability arises upon the Auditor-General recommending to the Minister of Local Government that the Crown should recover the relevant funds from Councillors.¹¹³ It is now the Minister for Local Government, however, who may bring proceedings to recover funds if Councillors do not voluntarily pay.¹¹⁴ Subject to judicial review, the Minister's decision is final. A member of the political

¹⁰⁸ See, for example, Local Government Act 2002, ss 9 and 10.

¹⁰⁹ Local Government Act 2002, ss 76 to 82; Such consultation may, however, promote effective decision-making.

¹¹⁰ Public Finance Act 1977, s 76(1).

¹¹¹ Public Finance Act 1977, s 76(2)

¹¹² Note that the last potential causes of action under the old approach became statute-barred in January 2008: Limitation Act 1950, s 4(1)..

¹¹³ Local Government Act 2002, s 46(1).

¹¹⁴ Ibid.

executive therefore has responsibility for deciding whether legal steps should be taken to recover the funds from Councillors.

On orthodox principles, it may be constitutionally problematic for the Minister of Local Government to be involved in the decision to bring proceedings. Montesquieu identified that the three forms of governmental power should be exercised by different people in order to reduce the probability of that power being abused.¹¹⁵ Under the surcharge provision, a member of the Executive Council exercises a quasi-judicial function, and therefore "wears two hats". The propriety of conferring that quasi-judicial power to the Minister depends upon whether that person will act impartially, and be seen to do so, rather than abuse their position.

The Minister of Local Government's gatekeeper function under the surcharge provision is justified by the existence of the recommendation from the Auditor-General. Receipt of the recommendation is a pre-condition of the Minister's power to issue proceedings. It also provides a platform from which the Minister can refute allegations of politically interference. The Auditor-General is an Officer of Parliament, and is therefore independent from the political executive. A recommendation of the Auditor-General therefore provides an objective basis upon which the Minister of Local Government can make their decision as to whether proceedings are appropriate under the surcharge provisions. It is also a means by which to share responsibility for the decision to hold Councillors liable, and thereby cushion any potential strain to the central-local government relationship. The existence of the Minister's quasi-judicial power is thus problematic in theory, but positive in practice.

There is a real probability that the relevant Minister would take their role seriously and act independently when deciding whether to launch proceedings. Other statutes have conferred quasi-judicial powers, and well-made claims of political interference in the exercise of those powers have been rare.¹¹⁶ For example, several criminal statutes require the consent of the Attorney-General, the

¹¹⁵ As translated in G H Sabine *A History of Political Thought* (3 ed, London, Harrop & Co, 1963) 551-553.

¹¹⁶ J J McGrath "Principles for Sharing Law Officer Power: The Role of the New Zealand Solicitor-General" *New Zealand Universities Law Review* 212, 217.

head law-officer in New Zealand, before a prosecution can be brought. Those provisions generally relate to politically sensitive matters, including espionage.¹¹⁷ In such cases, the political experience of a Minister is precisely the quality that is required. Some provisions, including the surcharge provision, are expressed broadly in order to capture relevant unwanted conduct. A side-effect is that conduct that may not be deserving of censure can fall within the literal meaning of the provision. The role of the Minister is therefore to act as a gatekeeper and ensure that proceedings are only launched in appropriate cases.

It is not clear from the text whether the conduct in question was sufficiently blameworthy to trigger the surcharge provisions. McGill was an English Councilor who set up, and chaired, a council housing committee. As a local body election approached, McGill proposed that the housing committee resolve to sell most of the flats the council owned. The Committee agreed, and the houses were duly sold. Crucially, however, the sales were unlawful because the committee lacked the power to sell the assets. McGill knew that the sale was probably unlawful when she proposed it. She pushed the sale purely to obtain a political advantage. Their Lordships held that, "McGill's willful disregard for the lawfulness of the transaction" was sufficient to engage the surcharge provision.

It is not clear, but one could argue that the fact that the Councilors were held personally liable to picture the scale of misconduct required.

- (a) The enactment of ultra vires bylaws;
- (b) The failure to adequately prepare an LTCCP;
- (c) The Britomart project exceeding its budget by around \$5m;
- (d) The posting of multi-million dollar budget blow-outs.

The lack of case law regarding the threshold for the surcharge provisions may be due to Councilors making imprudent decisions. Another more plausible explanation is that most proceedings under the surcharge provision would be successfully defended in court. Although proceedings under the surcharge provisions are civil rather than criminal in nature,¹¹⁸ the LGA 2012 sets out a series

¹¹⁸ *Parsons v McGill*, above n 74, para 10; *Lead v Bishop of Crediton*.

¹¹⁷ Crimes Act 1961, s 78B.

D Threshold

According to the jurisprudence of the old Commonwealth, at least, there appear to be few situations that are sufficiently blameworthy to trigger the surcharge provisions. If the facts in *Porter v MaGill* are indication of the level of blameworthiness required, the threshold for triggering the provision is particularly high. In *Porter v MaGill*,¹¹⁸ their Lordships held, for the first in an old Commonwealth country, that a Councillor had engaged in conduct that was sufficiently blameworthy to trigger the surcharge provisions. MaGill was an English Councillor who sat on, and chaired, a council housing committee. As a local body election approached, MaGill proposed that the housing committee resolve to sell most of the flats the council owned. The Committee agreed, and the houses were duly sold. Crucially, however, the sale was unlawful because the committee lacked the power to sell the assets. MaGill knew that the sale was probably unlawful when she proposed it. She pushed the sale purely to obtain a political advantage. Their Lordships held that,¹¹⁹ MaGill's wilful disregard for the lawfulness of the transaction was sufficient to engage the surcharge provision.

In contrast, one only need examine conduct that has not led to Councillors being held personally liable to picture the scale of misconduct required:

- (a) The enactment of ultra vires bylaws;
- (b) The failure to adequately prepare an LTCCP;
- (c) The Britomart project exceeding its budget by around \$3m;
- (d) The posting of multi-million dollar budget blow-outs.

The lack of case law regarding the threshold for the surcharge provisions may be due to Councillors making impeccable decisions. Another, more plausible, explanation is that most proceedings under the surcharge provisions would be successfully defended in court. Although proceedings under the surcharge provisions are civil rather than criminal in nature,¹²⁰ the LGA 2002 sets out a series

¹¹⁸ *Porter v Magill*, above n 94, para 16 Lord Bingham of Cornhill.

¹¹⁹ *Ibid.*

¹²⁰ *Ibid.*

of statutory defences to liability. Once the defendant Councillor has established the defence on the balance of probabilities, the proceedings must be dismissed. It is a defence that the act or failure to act resulting in the loss occurred:

- (a) without the Councillor's knowledge; or
- (b) with the Councillor's knowledge but against the Councillor's protest made at or before the time when the loss occurred; or
- (c) contrary to the manner in which the Councillor voted on the issue at a meeting of the local authority; or
- (d) in circumstances where, although being a party to the act or failure to act, the Councillor acted in good faith and in reliance on reports, statements, financial data, or other information prepared or supplied, or on professional or expert advice given, by any of the following persons:
 - (i) an employee of the local authority whom the Councillor believed on reasonable grounds to be reliable and competent in relation to the matters concerned;
 - (ii) a professional adviser or expert in relation to matters that the Councillor believed on reasonable grounds to be within the person's professional or expert competence.

The particular defences listed in section 46(4) of the LGA 2002 effectively mean Councillors can be liable only if they are morally culpable. If Councillors voted against the relevant transaction, or reasonably believed that the transaction was lawful, they are not personally liable. The surcharge provision does not prevent unlawful policies being enacted. It does, however, provide Councillors with a financial incentive to voice concerns about transactions that may be unlawful, and seek legal advice on the legality of those transactions. The incentive is personal to the individual Councillor. Political rivals may be subject to negative public comment if they are perceived to have "breached the rules".¹²¹ The incentive therefore does not extend to persuading other Councillors that the transaction is unlawful. Those Councillors who vote for a relevant transaction will prima facie be jointly and severally liable, and may negative face political consequences.

¹²¹ See the negative reaction that Councillor Goulden of the Wellington City Council received following alleged breaches of the Council's Code of Conduct.

E Utility of Section

If the Auditor-General exercises its power of recommendation under the surcharge provisions, the relevant Councillors are prima facie jointly and severally liable for the entire loss incurred by the local authority in respect of their unlawful decision. It is therefore irrelevant whether all, or part, of that loss was not reasonably foreseeable. Although tortfeasors are largely immune from unforeseeable losses, that limit on liability is absent from the LGA 2002. The surcharge provisions are not a statutory tort and apply only to decisions made by local Councillors. Personal liability under the provisions can therefore exceed the amount that a corresponding decision-maker in central government or the private sector could receive for equally unlawful conduct. Local Councillors are exposed to greater personal liability than actors in central government and in the private sector, and therefore have a greater legal incentive to act lawfully.

The surcharge has the potential to impose a significant financial burden on Councillors. It is impossible to define the offence precisely, so the law goes wider than the mischief aimed at.¹²² Palmer states that the surcharge provisions are not a penalty. Councillors are liable only for the amount of the loss and nothing more. That view, however, ignores the fact that Councillors very rarely financially benefit from unlawful decisions. The policy underlying the surcharge provisions cannot therefore be a restitution of benefits personally received. The pragmatic view is that liability under the surcharge provisions is a penalty for acting unlawfully. Liability exists to deter Councillors from acting unlawfully. How real is that deterrent effect? Almost all New Zealand local authorities set out the potential for Councillors' personal liability in their Code of Conduct. It either forms part of the substantive Code or is attached as an appendix.¹²³ Councillors receive a copy of the Code of Conduct upon election, and are therefore aware of the potential for their personal liability. The potential for personal liability is therefore an indirect control on Councillors' decision-making.

¹²² McGrath, above n 116, 127.

¹²³ Note, however, that the Code of Conduct published by the Hutt City Council in 2008 has not been updated to reflect the 2001 amendments to the surcharge provision.

Central government recently affirmed that a provision imposing personal liability on Councillors may have a marked influence on Councillors' decision-making. The Hon Paul Swain MP stated that a surcharge provision in the Local Government Act 1974 discouraged Councillors from entering into risky transactions to borrow funds. The provision had achieved its aim of discouraging local authorities therefore achieved its aim. Local authorities only borrowed from well-established financial institutions. The provision, however, made Councillors too cautious. It discouraged Councillors from authorising local authorities to enter into debt securities altogether. Only a single bond had been issued to the public since the amendment was introduced in 1996. Provided that long-term debt is used to finance long-term assets, issuing securities can in fact be a prudent financial policy. The annual interest cost ensures that future ratepayers who benefit from the asset contribute to its cost in addition to current ratepayers. As a result, the ratepayers of today were literally paying the cost of Councillors' caution in the form of higher rates. In light of the upward pressure of rates country wide, the review queried whether Councillors were reluctant to permit local authorities to borrow funds in case they became personally liable for the debt. In April 2008, central government abolished the surcharge because of its overzealous bite.

If one compares the position of Councillors to directors (or other agents in the public sector), it is clear that a higher standard is expected of Councillors. Directors, like Councillors, are separate legal entities from their companies. Personal liability attaches when the agent has acted outside the scope of his or her authority.¹²⁴ The veil that separates director and company can, however, be pierced in exceptional cases. The corporate veil is created by statute, and it can be pierced by some other statute if that other statute so provides.¹²⁵ Any Parliamentary intention to pierce the corporate veil must be expressed in clear and unequivocal language. Personal liability may be warranted where the transaction is a sham, or if the agent was fraudulent. Those circumstances are far more demanding than the threshold under the surcharge provisions.

¹²⁴ Reynolds *Bowstead and Reynolds on Agency* (14 ed, Sweet & Maxwell, London, 2003) 78.

¹²⁵ *Dimbley & Sons Ltd v National Union of Journalists* [1984] 1 WLR 427, 435 (HL) Lord Diplock.

The surcharge provision in the LGA 2002 now sits in a rather anomalous position. The Public Audit Act 2001 abolished the surcharge provisions that applied to public servants in government departments and to other governmental agents. Members of Parliament in New Zealand have never had a surcharge provision that applied to their decisions. When the surcharge provisions were reviewed in 2000, the Local Government Commission supported the retention of the surcharge provision in the LGA 2002 in its amended form. It did not even query central government obtaining greater control over the surcharge provision, and the potential strain that triggering the provision might place on the relationship between central and local government.

The English Government abolished the surcharge provisions because of that anomaly.¹²⁶ The surcharge provisions were perceived as a disproportionately harsh means of holding local Councillors to account and an unwanted aspect of local government. The fear of personal liability for decisions, whether real or imagined, discouraged some English citizens from standing for election.¹²⁷ Central government in New Zealand has also recognised that the cost of surcharge provisions can outweigh the benefits, as noted above. Perhaps the time has come to review whether New Zealand genuinely needs the surcharge provision in the LGA 2002.

¹²⁶ Ministry for Local Government "Lyons Inquiry into Local Government" (21 March 2007, Ministry for Local Government, London) para 3.3.

¹²⁷ Ibid, para 3.7

VI REFORM

In July 2006, the Government established the Royal Commission on Auckland Governance to review the effectiveness of the current local government framework in wider Auckland.¹²⁸ In mid-2008, the Royal Commission released a discussion document that identified areas of concern within the framework. The document also invited submissions on possible methods of improving, amongst other things, the accountability of Auckland local authorities. The concerns expressed in this paper about the financial accountability of local authorities are largely directed at the LGA 2002, and may therefore apply to Auckland's local authorities. In light of the possibility that the LGA 2002 may be amended in the medium term, the final part of this paper therefore addresses a method of reform

Local authorities in England, just like those in New Zealand, have encountered difficulties in accurately communicating their proposed, and actual, performance. Citizens and central government have expressed frustration at the lack of transparency within local authorities. Central government responded to that lack of openness by introducing "best-value" system. Local authorities, and their subsidiaries, must make decisions that provide the best value for their communities.¹²⁹ "Best-Value" is defined in the Act.¹³⁰ It essentially comprises the statutory objectives set out in section 13 of the New Zealand LGA. Local authorities demonstrate they are providing the "best value" by performing well in a series of indicia administered by the English Audit Commission. The Commission is statutorily required to assess the performance of local authorities based on 198 performance indicators.¹³¹ The indicators cover a range of matters. In addition to measuring the internal efficiency and effectiveness of a local authority, the indicia attempt to take a wider snapshot of life in the particular locality. For example, the indicia assess the quality of local amenities, and rate the health facilities available in that locality.

¹²⁸ Royal Commission on Auckland Governance <<http://www.royalcommission.govt.nz>> (last accessed 21 September 2008).

¹²⁹ Local Government Act 1999 (UK), s 6.

¹³⁰ Local Government Act 2000 (UK), s3. The definition was altered a year after initial enactment.

¹³¹ Local Government Act 1999 (UK), s 6 (2).

To an extent, some local authorities in New Zealand already set out to achieve the essence of the Best Value system. Most of the main cities prepare customer satisfaction surveys that attempt to measure the quality of life in that city.¹³² The results of those surveys are recorded in their annual reports so that interested citizens can compare the attitudes of people living in those cities. The surveys themselves are similar, but not identical in content. Citizens are therefore not comparing like with like. Comparability is the primary advantage of adopting a model similar to "Best-Value". Granted, interested citizens can compare the numbers in annual reports, but those numbers only reveal part of what it is like to live in a particular locality. The performance indicators analyze a broader range of matters than accounting reports. The Indicators may give a more rounded picture of the performance of local authorities than purely financial controls.

Performance indicators do not purport to objectively measure the progress towards qualitative outcomes. The English central government considers, however, that the presence of performance indicators is likely to pressure local authorities into making decisions that do provide best value for their communities.¹³³ The information provided to the actors in local government is therefore more likely to enable them to contribute to any policy debates. Adopting the English model would essentially juridify the existing practice in the main centres. Adopting this course of action is consistent with performance monitoring in the private sector, which also looks at the financial and non-financial performance of local authorities.¹³⁴

On balance, however, enacting English-style performance indicators into legislation is likely to achieve more harm than good. Local authorities must internally report against each of the criteria and pass that information to the Audit Commission each quarter. It therefore imposes a significant administrative burden on local authorities. The benefits, however, are twofold. As noted above, small local authorities already struggle at prepare the LTCCP. Imposing

¹³² See the annual reports of the main centres.

¹³³ Local Government Act 2007 (UK), s 44.

¹³⁴ Garrison and others *Managerial Accounting* (11 ed, McGraw Hill, Melbourne, 2004) 112.

additional regulation is an unnecessary juridification of the relationship between local authorities and other actors in local government. There is no evidence that it would increase citizens' ability to contribute to debate in local government. Rather, further regulation may harm the relationship between central and local government. Imposing additional regulation is likely to send a message of distrust rather than partnership. It is fitting to return, at the end of this paper, to the other theme that flowed through the paper: New Zealand's legislative independence from England. As Hammond J has recently stated,¹³⁵

VII CONCLUSION

The financial management of local authorities reflects a balance between the interests of the main actors in local government. The LGA 2002, together with the Local Government Rating Act 2002, sets out the guiding financial framework within which local authorities must act. Discretion is afforded to local authorities in the form of finance policies. Local authorities set their own limits in terms of borrowing and investment. The Greening of the Quays project, however, illustrates that it is important to remember the purposes of accounting. It performs a red light function in that it helps regulate decision-making. If Councillors wilfully or deliberately act unlawfully, the Auditor-General may use accounting information to hold that person to account. Accounting also performs a green light function in that it may enable citizens to have the information and opportunity to be involved in the funding and rates-setting process. Only when accounting reports do that will the documents be an effective conduit for local authority accountability.

¹³⁵ *Lab Tests Auckland Ltd v Auckland District Health Board and others* (25 September 2008, CA154/07, CA, Arnold, Ellen France and Hammond JJ) para 391 Hammond J.

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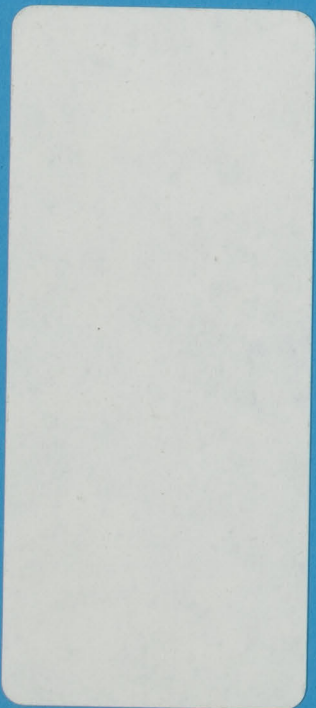
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