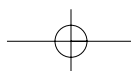
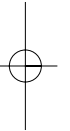
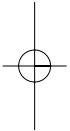
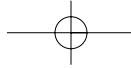


Editorial

Local Authority Accounting – Past, Present and Future
Imperfect – A Reflection

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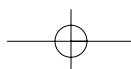


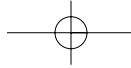


'Life at the ledger' has become significantly more demanding for the local authority accounting profession over recent times. This form of accounting has become increasingly complex as it has adopted the ever-rising number of professional and legal requirements that have as their objective increasing 'accountability'. Today we have had a raft of legislation (particularly post 1979) affecting local authority accounting practice and a variety of CIPFA codes of practice on, for example, capital accounting and best value. The shelf life of these codes is also growing shorter and adding to pressures with, for example, the relatively new system of local authority capital accounting already under review. An increasing emphasis on performance measurement also seems to have displaced the published accounts as a measure of accountability, although it could of course be argued that there was little interest in these documents anyway. There is an attraction to performance measurement in that it seems to offer a simple measure of accountability. As with any new science, however, it offers the opportunity for manipulation and smoke and mirrors to disguise the real situation. It could also be claimed that managers are forced to indulge in 'heroic micro management' rather than planning the strategic evolution of their services. Technically we are able to do anything with a system of debits and credits but have we 'lost the plot'? The criticism of FRS 17 and the action taken by companies as a result of its promulgation (and subsequent suspension) might well be a case in point in a wider context. This editorial takes a broad look at the development of local authority accounting, examines the present day and speculates on the future. It then attempts to draw some conclusions which readers may find challenging.

A wide range of factors have played their part in the development of local authority accounting although these factors and developments have had limited exposure. By 1935 the accounting system that lasted local authorities until almost the end of the previous century had been established. The municipal corporations created by the 1835 Municipal Corporations Act were the drivers for these developments as, over time, innovation and expansion demanded accounting change. They were faced with dealing with the problems of not only managing the growth of the more traditional local authority services but also significant challenges through acquiring or developing large trading undertakings such as electricity, gas, tramways and water. While central government had established the basic framework of fund accounting in the 1835 Act (Sec. 92 and 93) and audit (Sec. 37), change was then driven by a variety of factors as legislation generally failed to keep pace with (or lacked interest in) changes in local authority accounting practice. Loans had to be raised to finance extensive capital expenditure and were required by legislation of the 1860s to be repaid. This then led to the rather unique variation on the double accounts system which local authorities themselves adapted from the railway companies to avoid the creation of permanent debt and meet the legal requirements. Ratepayers expressed concern over the levels of rates they were required to pay and demanded little in the way of accounting change but had the power to elect councilors sympathetic to their views. In other authorities a more enlightened attitude was taken to developing services which led to increased expenditure (admittedly cyclical) activity. These elected members demanded more and better financial information whether they wished to curtail expenditure ('economisers') or expand and develop services ('expansionists')ⁱ.

Technical developments to improve financial information for control purposes required champions. The drivers for accounting change included officers, the professional accounting body for local authority treasurers, professional accountancy firms employed as consultants and the audit (both internal and external). While space does not allow there to be full recognition of the role of each driver it is worth stating the contribution made by individuals within both the professional body for local authority accountants and the authorities themselves. CIPFA's predecessors were composed of strong personalities who drove through change both within their own organisations and promulgated their views through the professional body. In addition certain individual authorities acted as 'beacon' authorities for change. In their day these authorities received financial advice from such leading treasurers as Arthur Collins (Birmingham), William Bateson (Blackpool) and





John Alcock (Cardiff). The government allowed these developments to take place establishing a number of committees of inquiry to look at local authority accounting and audit but they either recommended the status quo or ignored their findings indicating satisfaction with this 'self regulation'. An external body which complained about the state of local authority accounting was the press. This can be divided into two elements – the technical press and the general press. The technical press such as *The Accountant* was highly critical in some of its editorials although this may have been motivated by the desire to seek extra work for the developing private sector. Technical support was provided by journals such as *Financial Circular*. The general press was critical of activities such as municipal trading on a political basis. Treasurers also used the general press to seek extra publicity for the accounts through short articles in local newspapers.

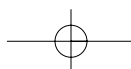
In the post 1935 (and from the evidence pre 1918) to 1979 period relatively little development took place in accounting practice - the main exception being the IMTA standard form of local authority accounting of 1955. Speculation as to reasons for relative stagnation might include the loss of a generation of potential accountants in the First World War, that local government accountants felt that they had achieved everything necessary by 1935, and the decline in local government services. This might be given further emphasis by the loss of trading undertakings beginning with electricity and gas after 1945. It could also be that practice out-ran theory and as such there was almost no place to go.

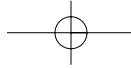
It has been pointed out that today's system of local authority accounting is complex. One only has to think about AMRA, the minimum revenue provision and the capital financing reserve to realize how difficult this is for a wide variety of stakeholders to understand it. Does then accountability through performance measurement and its audit provide an answer?

In this context we have all heard or read about the concept of joined-up government but what about the concept of joined-up audit? Given the pressures on the public sector there is a duty on audit to achieve economy, efficiency and effectiveness in carrying out its function. Yet managers in local government are faced by audit or inspection by (inter alia) the National Audit Office, the Audit Commission, OFSTED, the Social Services Inspectorate and their own internal audit staff. While there were some attempts at co-ordination between the bodies the impression given is equivalent to a highway being continually dug up to the mutual inconvenience of all parties but especially the audit client.

Nor is the actual process of audit immune to criticism. The audit of public sector activities has seen almost exponential growth in recent years with performance audit especially becoming an industry in its own right. It is probably no exaggeration to state that some public sector managers can spend more time dealing with questions from auditors on performance rather than the delivery of service and that this has almost become a full time job. Some managers have even been driven to massaging or manipulating figures to demonstrate apparent delivery of key performance indicators. Additionally the Audit Commission's best value inspections have been subject to extensive criticism most notably in a report by the Society of Local Authority Chief Executives (SOLACE). While changes are taking place in this system perhaps a model based on a desire for partnership exists (or could be refined) in Wales that would benefit the UK.

In Wales the Welsh Assembly Government is committed to more open government, increased transparency and greater closeness to the people. Indeed, it could be argued that unless it achieves these aims then it fails as a solution and will widen the democratic deficit. Thus are audit systems and processes, which are based on a Westminster solution suitable for Wales in the twenty-first century? They might be regarded as English problems posing as Welsh solutions. In Wales, however, the modernising agenda includes greater flexibility in government, clearer



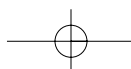


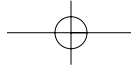
accountability, greater use of IT, more cross cutting of traditional disciplines and closer working relationships with the private sector. While the National Audit Office and Audit Commission have a great tradition, history should be used to inform change and not paralyse it.

The Assembly and audit have a strong symbiotic relationship. The stronger and more effective is the audit process then arguably the more effective will be the Assembly in delivering its policies and programmes. The two democratic dimensions in Wales of central government and local government could be satisfied by a full-time Auditor General for Wales (rather than the present part-time appointment) and an Audit Commission for Wales with delivery of the audits through Audit Wales. This should allow a strategic planning environment, the maintenance of current practice, where desirable, and the development of forward thinking through a highly co-ordinated approach. It should enhance the role of audit to face new challenges through one body. In the Wales Programme for Improvement the Assembly has partly advanced down this road by the suggestion of creation of a Wales Inspectorate Forum. Its objective being as suggested above to co-ordinate inspection through local authority representatives and National Assembly officials.

Even more iconoclastic for a small country such as Wales could be to combine the roles and functions of the NAO and Audit Commission (and other inspection bodies) in one new body with suitable guarantees on independence. This should see improved effectiveness and better value for money. It would also lead to an increased role and profile for the Audit Committee of the National Assembly where at present its role is to work in conjunction with the Auditor General for Wales. In addition the Assembly could consider taking on board the audit of such substantially public funded bodies as housing associations where, although their activities are currently monitored by the Assembly, they are still subject to the more restricted 'true and fair view' private sector audit regime as regards published accounts. The application to housing associations (both individual and intra-association) of wider performance audit criteria can only lead to improved management and better accountability for public funds. This should lead to better policy decisions through more informed decision-making both at the Assembly level and by individual housing associations. Similar arguments could be extended to England where it would be equally possible to combine audit and inspection functions in one body and the partnership agenda between the Assembly and local government might be welcomed in England.

As the past can be a guide to the future and to widen the debate, it is not possible to isolate change in one country from those in another as the international exchange of ideas turns the global village into the global street. It must, however, be remembered that accountability has cultural implications and a brief exploration is therefore made of the potential for public sector accounting under Islam. While the development of a theory of Islamic public sector financial reporting is beyond the scope of this editorial it is clearly relevant to question whether western 'solutions' on public sector accountability provide answers to the problems of the Islamic world in this respect. In the context of public sector reporting it could be argued that all members of a society are significantly influenced by government actions and as such there is a need to be able to measure and assess the performance of the State in delivering outcomes and the benefits accrued. This is consistent with the emphasis in the Holy Koran that would demand social accountability through the focus in Islam on the unity of God, the community and the environment and, leads on to full disclosure. This can be defined as the disclosure of any information which should rightfully be given to members of the community in accordance with the principles of Shari'a law. In general such disclosure does not take place in Islamic countries at present.





The objective of Islam is the establishment of a just society (Al Hadid, Sura LVII, 25)ⁱⁱⁱ. In this context, accounting actions under Islam can be viewed as no different to the political, economic and social actions of each individual as they will be held accountable for their actions at the end of their days. Within this view promoting justice, welfare (both social and economic) and protecting property are a justifiable objective of accounting and its application. Building on this, it can be suggested that the objective of accounting (and by implication for those who have control of accounting information) is to provide (or at least improve the quality of) information about the discharge of the individual's trust to Allah and to society in general. This information can then be used to judge and enhance efficiency and effectiveness in the achievement of socio-economic justice and/or internally for the better management of resources. In addition the Koran is against the waste of resources (An'am S.vi, 141; A'raf S.vii, 31) suggesting that performance measurement can be a legitimate goal of Islamic public sector financial reporting as waste represents profligacy of society's resources. It could be thus argued that the more effective management and use of public sector assets could improve the ability of the economy to perform and may have implications for the charitable contribution required under Islam known as Zakat. The proper recording of assets and liabilities can also be justified. (Baqara, Sii, 282)

Thus for a public sector body operating under Islamic principles an appropriate definition might be:

'the duty of a public sector organisation is to account for its use of resources to society and to demonstrate that these resources have been used economically, efficiently and effectively for the benefit of society within the principles of Islam.'

Given the sustainability argument this would also include an emphasis on appropriate qualitative measures and the long term strategic goals of the State. It is also consistent with a view that social accountability requires full disclosure.

In conclusion, this editorial has covered a considerable amount of ground. It has shown in the early days of local authority accounting that a wide range of catalysts played an important part in the development of local authority accounting but that this development was ad-hoc and lacking any conceptual framework. These catalysts varied in importance at any individual local authority depending on the circumstances existing in that local authority at the time. Increasingly today change is driven by concerns to measure performance within a government-controlled 'one size fits all' financial reporting framework. It has been suggested that Wales provides an alternative approach to consider how the audit of performance measures is approached. Finally it was indicated that there is nothing contradictory about the spread of western accounting techniques, particularly performance frameworks, within cultures such as Islam. It should however be remembered that that techniques are not ends in themselves. It is important how information produced is used and analysed if resources are to be directed effectively, efficiently and economically and the future is not to be imperfect.

ⁱ The text for this editorial is taken from a lecture given at the University of Glamorgan entitled Local Authority Accounting Past Present and Future Imperfect. This lecture was sponsored by the South Wales and West of England Region of CIPFA. A full copy can be obtained by emailing hcoombs@glam.ac.uk

ⁱⁱ A much fuller explanation of the history and development of local authority accounting can be found in Coombs H.M and Edwards J.R. (1996) Accounting Innovation in Municipal Corporations 1835-1935, Garland, New York.

ⁱⁱⁱ All references to the Holy Koran are taken from Ali, Yusuf A.'s The Holy Koran – Translation and Commentary, The Holy Koran Publishing House (1934).

