LOCAL AUTHORITY ACCOUNTING

WITH SPECIAL REFERENCE TO ORDINANCE

25 OF 1974 (NATAL)

by

J.C.C. MACINTOSH

SUBMITTED IN FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE OF MASTER OF COMMERCE IN THE DEPARTMENT OF ACCOUNTING, UNIVERSITY OF CAPE TOWN.

FEBRUARY 1978.
The copyright of this thesis vests in the author. No quotation from it or information derived from it is to be published without full acknowledgement of the source. The thesis is to be used for private study or non-commercial research purposes only.

Published by the University of Cape Town (UCT) in terms of the non-exclusive license granted to UCT by the author.
ACKNOWLEDGEMENTS

I am indebted to Professor L Kritzinger, Head of the Department of Accounting, for his constant encouragement and assistance with this dissertation.

To Mr M R A McElligott, partner in Alex Aiken and Carter (Chartered Accountants), I express my gratitude for his able supervision, constructive criticism and whose expert knowledge on the topic proved invaluable.

I thank Mr P F F Cox and Mr K B Dickenson, City Treasurer and Deputy City Treasurer of the City of Pietermaritzburg respectively, for answering my numerous questions.

To Mrs V Rencken, who typed this dissertation in this and its draft form, I express my sincere gratitude.

Finally, to my wife and children, who have had to bear with me during the writing of this dissertation, I am the most indebted.

DECLARATION AND PUBLICATION CLAUSE

I declare that this dissertation is my own original work and that it has not been submitted for a degree at any other University.

I hereby grant the University of Cape Town the right to publish or reproduce, in whole or in part, the contents of this dissertation in any manner whatsoever for the purposes of research.

J.C.C. MACINTOSH

3rd February 1978
SUMMARY

Local Authorities form the third or lowest tier of government in the Republic of South Africa and are responsible for urban development and control. Although they appear to enjoy considerable freedom of action and enjoy responsible government (except in the case of the smaller Local Authorities) they operate within a system of strict Provincial supervision and control. Provincial legislation regulating their operations differs among the Provinces and only that applying in the Province of Natal has been considered.

The purpose of the Local Authority accounting system is to provide information on the economic activities of these units to interested parties. These activities involve the use of public resources and, consequently, the objectives of the accounting system are management control over, and accountability for, the use of these resources. However, neither of these objectives are fully met by current Local Authority accounting practices which are designed rather for legal compliance and stewardship accountability than providing information on their economic activities.

Local Authority accounting practices differ in many respects from those of private enterprise accounting. Fund accounting is employed to segregate and control resources, control over operating income and expenditures is through the statutory budget procedure and the use of capital finance is strictly controlled. Consequently, reporting is fragmented over the various funds, planning is usually on an annual basis and there is no proper fixed asset accounting.

Financial reporting by Local Authorities is mainly designed to meet their internal needs and to discharge their responsibilities to the Provincial Councils, and the information needs of the communities they serve has been given little attention. The actual reporting is through the presentation of financial statements on a fund-by-fund basis and in aggregate form prefaced by the treasurer's report and the report of the auditor. Certain Local Authority annual reports also contain a statistical section. However, the financial statements do not provide suitable information on the results of operations and
the financial position of the funds of the Local Authority as a whole. The treasurer's report and the statistical section are not required by law and their contents are purely at the discretion of the individual treasurers. The auditor's report is mainly an expression of opinion on the financial statements but may include additional information which is usually of a statistical nature. Considerable changes to the reporting system, including the use of popular reports and consolidated financial statements, have been suggested.

If the Local Authority accounting system is to meet its present and future needs then it should undergo considerable change and follow many of the accounting practices presently used by private enterprises. However, such changes should be developed by Local Authorities and in this respect, the responsibility to effect change rests with the Local Authorities, the Institute of Municipal Treasurers and Accountants S A and the Provincial Councils.
# CONTENTS

## LIST OF ILLUSTRATIONS

<table>
<thead>
<tr>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>(ix)</td>
</tr>
</tbody>
</table>

## INTRODUCTION

<table>
<thead>
<tr>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>(x)</td>
</tr>
</tbody>
</table>

## CHAPTERS:

1. **THE ROLE OF LOCAL AUTHORITIES IN SOUTH AFRICA**

   1. Introduction ............................................. 1
   2. The Structure of Government in South Africa
      (a) The Nature, Role and Function of Government ......... 1
      (b) The Development of the Form of Government in South Africa ............................................. 3
      (c) The Three Tiers of Government .......................... 5
   3. Local Authorities in Natal ............................... 9
      (a) Local Authorities in terms of the Local Authorities Ordinance, 1974 ............................................. 10
      (b) The Development Services Board Established in terms of the Development and Services Board Ordinance, 1941 ...... 12
      (c) Statutory Bodies Deemed to be Local Authorities for Certain Purposes ............................................. 13
   4. The Functions, Duties and Responsibilities of Local Authorities ............................................. 14
      (a) The Basic Responsibilities ............................. 15
      (b) The Extension of these Responsibilities ............. 16
   5. The Supervision and Control of Local Authorities 19
      (a) Provincial Control ..................................... 19
      (b) Central Governmental Control ........................... 21
   6. The Problems facing Local Authorities .................. 22
      (a) The Urbanisation of South Africa ...................... 22
      (b) The Financing of Local Authorities .................... 23
   7. Summary ..................................................... 24

2. **LOCAL AUTHORITY ACCOUNTING: ITS PURPOSES, OBJECTIVES, PRINCIPLES OR STANDARDS AND PRACTICES**

   1. Introduction ............................................. 26
   2. The Purposes of the Accounting System .................. 26
      (a) The Provision of Information on Economic Activities ............................................. 27
      (b) The Users of Local Authority Accounting Information ............................................. 30
### Table of Contents

3. The Objectives of Local Authority Accounting .......................... 31
   (a) Accountability .............................................. 33
   (b) Management Control ........................................... 36

4. The Principles or Standards of the Accounting System .................. 41
   (a) The "Principles" of the National Committee on Governmental Accounting ................................................. 43
   (b) The International Accounting Standards ....................... 45

5. Local Authority Accounting Practices .................................... 47
   (a) The Use of Fund Accounting .................................... 48
   (b) The Statutory Budget or "Estimates" .......................... 49
   (c) Accounting for the Financing of Capital Expenditure .......... 51
   (d) The Linking of Asset Lives with their Sources of Finance ................................................................. 53
   (e) The Failure to Apply Net Income Determination to Trading or Enterprise Activities ................................ 54
   (f) The Basis of Accounting ........................................ 54
   (g) Financial Reporting ............................................. 55

6. Summary ............................................................... 56

3. THE ACCOUNTING FOR LOCAL AUTHORITIES IN TERMS OF THE NATAL PROVINCIAL LEGISLATION AND THE RECOMMENDATIONS OF THE INSTITUTE OF MUNICIPAL TREASURERS AND ACCOUNTANTS S A

1. Introduction ............................................................ 58
2. General Accounting and Control Requirements ............................. 59
   (a) Accounting requirements ....................................... 59
   (b) Control requirements .......................................... 60
3. The Funds of Boroughs and Cities ....................................... 62
   (a) The General Fund ................................................. 62
   (b) The Housing Fund ............................................... 63
   (c) The Trading Funds .............................................. 65
   (d) The Loans Redemption Fund ..................................... 66
   (e) The Renewals Fund ............................................... 67
   (f) The Consolidated Loans Fund ................................... 68
   (g) Capital Development Funds ..................................... 70
   (h) The Trust Funds ................................................ 71
   (j) Other Funds ..................................................... 73
4. The Funds of Townships .................................................. 74
5. The Accounting requirements of Development Areas (Health Committees) and Local Affairs Committees ........................................ 74
6. The IMTASA Financial Statement Requirements ........................................ 76
   (a) The Income and Expenditure Statements ........................................ 77
   (b) The Balance Sheets ........................................................................ 82
   (c) The Provisions Statements ................................................................ 87
   (d) The Capital Statements .................................................................... 88
7. The Statistical Section ........................................................................... 89
8. The Treasurer's Report ........................................................................... 90
9. The Auditor's Report ............................................................................. 90
10. Reporting to the Public and the Administrator ....................................... 91
11. Summary ............................................................................................... 91

4. LOCAL AUTHORITY ACCOUNTING PRACTICES

   1. Introduction ......................................................................................... 93
   2. The Use of Fund Accounting .............................................................. 93
      (a) Its use for Administrative Convenience ........................................ 94
      (b) The Fund as the Legal or Accounting Entity .................................. 95
      (c) The Failure of Fund Accounting to Provide an Adequate Organizational or Reporting Structure ........................................... 96
      (d) The Segregation of Activities ......................................................... 98
   3. The Segregation of Activities into Separate Funds ............................... 99
      (a) The Funds Used to Account for General Government Activities ...... 99
      (b) The Trading or Enterprise Funds .................................................. 106
      (c) The Funds concerned with Capital Finance .................................... 108
   4. Accounting for Local Authority Capital Expenditure ............................ 115
      (a) Capital Expenditure in the Local Authority Accounting sense .......... 115
      (b) The Nature and Treatment of Local Authority Fixed Assets .......... 119
      (c) Why is Depreciation Accounting Not Applied by Local Authorities? .................................................. 125
   5. Control over Operating Income and Expenditure .................................. 128
      (a) The Budget as a Control Measure .................................................. 128
      (b) The Effective Use of the Budget .................................................... 131
   6. The Failure to Apply Private Enterprise Accounting Practices to Trading or Enterprise Activities .................................................. 137
   7. Summary ............................................................................................. 139
# 5. FINANCIAL REPORTING BY LOCAL AUTHORITIES

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Introduction</td>
<td>141</td>
</tr>
<tr>
<td>2. Financial Reporting in the Local Authority Sense</td>
<td>141</td>
</tr>
<tr>
<td>(a) Internal Reporting</td>
<td>142</td>
</tr>
<tr>
<td>(b) External Reporting</td>
<td>143</td>
</tr>
<tr>
<td>3. Local Authority Reporting and Disclosure Requirements</td>
<td>146</td>
</tr>
<tr>
<td>(a) The Dual Reporting Responsibilities of Local Authorities</td>
<td>146</td>
</tr>
<tr>
<td>(b) The Extent and Disclosure of Information</td>
<td>149</td>
</tr>
<tr>
<td>4. The Recommended and Statutory Financial Statements of Local Authorities</td>
<td>151</td>
</tr>
<tr>
<td>(a) The Statements Required to Reflect the Results of Operations</td>
<td>152</td>
</tr>
<tr>
<td>(b) The Statements Required to Reflect the Changes in Fund Balance or Net Changes in Financial Position</td>
<td>159</td>
</tr>
<tr>
<td>(c) The Statements Required to Disclose the Financial Position of the Funds</td>
<td>163</td>
</tr>
<tr>
<td>(d) The Aggregate Financial Statements</td>
<td>177</td>
</tr>
<tr>
<td>(e) The Notes to the Financial Statements</td>
<td>183</td>
</tr>
<tr>
<td>5. The Report of the Treasurer</td>
<td>184</td>
</tr>
<tr>
<td>6. The Auditor's Report</td>
<td>186</td>
</tr>
<tr>
<td>7. The Statistical Section</td>
<td>188</td>
</tr>
<tr>
<td>8. The Use of Forecasts in Local Authority Annual Reports?</td>
<td>189</td>
</tr>
<tr>
<td>9. Summary</td>
<td>191</td>
</tr>
<tr>
<td>6. CONCLUSIONS</td>
<td>195</td>
</tr>
</tbody>
</table>

## APPENDICES

A. The Thirteen Principles of Government Accounting of the National Committee on Governmental Accounting | 201  |
B. Statement by the Institute of Municipal Treasurers and Accountants S A on the Relevance of the International Accounting Standards to Local Authorities | 204  |
C. The Requirements of the National Committee on Governmental Accounting Regarding the Information to be Provided in the Statistical Section of the Annual Report of Governmental Units | 205  |

## BIBLIOGRAPHY

<table>
<thead>
<tr>
<th>Title</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>207</td>
</tr>
</tbody>
</table>
# LIST OF ILLUSTRATIONS

<table>
<thead>
<tr>
<th>Illustration</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. The Economic Activity of Governmental Units</td>
<td>28</td>
</tr>
<tr>
<td>2. The IMTASA Recommended Method of Detailing General Expenses in the Income and Expenditure Statement</td>
<td>78</td>
</tr>
<tr>
<td>3. The IMTASA Recommended Format for the Income and Expenditure Statement of the Electricity Fund</td>
<td>80</td>
</tr>
<tr>
<td>4. The IMTASA Recommended Method of Presentation of the Aggregate Balance Sheet of Local Authorities</td>
<td>83</td>
</tr>
<tr>
<td>5. The IMTASA Recommended Presentation of the Capital Statement of Local Authorities</td>
<td>89</td>
</tr>
<tr>
<td>6. Analysis of the Accounting Equations of Local Authority Funds</td>
<td>170</td>
</tr>
<tr>
<td>7. The Application of the Local Authority Accounting Equation and Generally Accepted Accounting Practice to the Balance Sheet of the General Fund</td>
<td>171</td>
</tr>
</tbody>
</table>
INTRODUCTION

Local Authorities are governmental units responsible for urban development and control. Urban communities elect representatives to serve on the legislative bodies of these Local Authorities, finance their operations by the payment of property taxes and service charges, and in many other areas their daily lives are affected by their activities. Yet, there is widespread apathy towards Local Authority affairs in South Africa. Few persons, other than those actively concerned with their management, direction or supervision, appreciate the nature and scope of their activities or have more than a superficial knowledge of their operations.

To what extent is this due to the Local Authority accounting system? Furthermore, are those persons actively concerned with the management, direction or supervision of Local Authorities provided with information in the most meaningful manner to enable them to carry out their duties and responsibilities? The purpose of this study is to examine the Local Authority accounting system in relation to these questions. In this respect, this study outlines the apparent weaknesses and shortcomings of the accounting system and makes suggestions how they may be rectified. However, in view of the differences in legislation applying to the four Provinces in South Africa, specific reference has only been made to the statutory requirements applying in the Province of Natal. In addition, although the effects of inflation or price-level changes on accounting are fully recognized, this aspect has not been considered.

The text of this study has been divided into four related parts. Chapter 1 deals with the role of Local Authorities in South Africa and provides information on the nature of these units and their supervision and control by the Provincial Councils. Chapters 2 and 3 cover the purposes, objectives and practices of Local Authority accounting; the statutory accounting requirements for these units in the Province of Natal; and the reporting recommendations for Local Authorities in South Africa of the Institute of Municipal Treasurers and Accountants S A. In Chapters 4 and 5, the accounting practices and financial reporting by these units are examined in relation
to the present Local Authority accounting system. Chapter 6 outlines the conclusions reached in this study.

Throughout this study the Local Authority accounting system has been examined with the view of providing a basis for reappraisal of existing practices and attitudes towards financial reporting by these units by those persons concerned with improving Local Authority accounting. In this respect, it is believed that this study has achieved its objective.
CHAPTER 1

THE ROLE OF LOCAL AUTHORITIES IN SOUTH AFRICA

1. INTRODUCTION

Local Authorities represent the third or lowest tier of government in the Republic of South Africa, and in this position they provide for urban control and development. Their functions are wide and varied and designed to improve the quality of life of the communities for which they are responsible. They are complex units and it is essential for a full understanding of the accounting for their operations that their position in the structure of government in the Republic and their nature and functions are fully understood. This Chapter, therefore, deals with these aspects of Local Authorities and other related matters.

2. THE STRUCTURE OF GOVERNMENT IN SOUTH AFRICA

(a) The Nature, Role and Function of Government

Probably one of the most comprehensive statements on the nature of government is that by Levy (1) who states: "The object of government is the preservation of justice and good order; to provide for the common defence and promote the general welfare. Today government means all the authority, rules and laws and customs whereby each individual in the nation, and the nation as a whole, is directed, ordered and ruled."

To be in a position to "order, direct and rule" the government "... must, therefore, have first, military power or the control of the armed forces; secondly, legislative power or the means of making laws; thirdly, financial power or the ability to extract sufficient money from the community to defray the cost of defending the State, or of enforcing the law it makes on the State's behalf. It must, in short,

have legislative power, executive power and judicial power, which we may call the three departments of government."\(^{(2)}\)

These powers, and in particular the power to pass laws and to levy taxes on the community, distinguish government units from those of the private sector.

The legislative power in democratic states is vested in elected representatives of the community; their duty is to make the laws of the land and exercise control over the executive. Being elected, these representatives are responsible for their actions to the community, and we refer to this type of government as being "responsible or representative government". The executive consists of those persons who are empowered by the legislature to administer and carry out the laws passed by it. There is often some overlap between the legislature and the executive because certain elected representatives act in an executive capacity by taking charge of departments of government and are responsible for the actions of the public officials employed in those departments. The judiciary is represented by the judges, magistrates and public officials whose duty it is to ensure that there is compliance with the laws of the land and that justice prevails.

The governing of a State is a complex matter and requires a vast organization, an efficient administration and an effective accounting system. It is primarily concerned with the provision of social needs and services to the community but also involves the economic regulation of the State by averting the extremes of depression and inflation, maintaining the balance of payments, the stability of prices,\(^{(3)}\) etc. As far as the provision of services to the community is concerned, there is delegation of responsibility and authority from the central government to the various tiers of regional government, of which Local Authorities form an important part.


\(^{(3)}\) Levy, op cit p 3.
(b) The Development of the Form of Government in South Africa

The constitutional development of the Republic of South Africa had its beginnings at a meeting of a National Convention held in Durban during 1908-1909 where delegates from the Parliaments of the four British Colonies of the Cape, Natal, the Orange River and the Transvaal agreed to unite into a single state and on the form of government to be followed. A draft Act was prepared which was accepted by three of the Parliaments and by a referendum in Natal, and passed by the British Government in the form of the South African Act, 1909, which came into effect on 31st May 1910, and constituted the Union of South Africa.

This constitution of 1910 provided for a unitary form of government whereby in terms of section 19 of the South Africa Act, 1909, "... the legislative power of the Union shall be vested in the Parliament of the Union ... which shall consist of the King, a Senate and a House of Assembly." There is an appearance of the perpetuation of some of the powers of the former colonies which formed the Union of South Africa in the constitution because the transfer of certain functions and powers from the colonial administrations to the Provincial Councils necessitated the inclusion in Section 70(1) of "... there shall be a provincial council in each province...." The powers of these Provincial Councils was covered by Section 85, which states, inter alia, that "... subject to the provisions of this Act, ... the provincial council may make ordinances in relation to matters coming within the following classes of subjects (that is to say):

(4) 9 Ed VII Ch 9.
(6) Op cit
4.

"...

(v) Municipal institutions, divisional councils and other local institutions of a similar nature [ie Local Authorities];

...(xiii) All other subjects in respect of which Parliament shall by any law delegate the power of making ordinances to the provincial council".

The legislative powers conferred upon these Provincial Councils were restricted by Section 86 which stated that "Any Ordinance made by a provincial council shall have effect in and for the Province as long and as far only as it is not repugnant to any Act of Parliament". This Section, therefore, rendered the powers of the Provincial Councils subordinate to Parliament. The South Africa Act, 1909, (7) therefore laid down a three-tier form of government consisting of the Central Government, the Provincial Councils and the Local Authorities. (8)

In 1960, the electorate of the Union of South Africa decided by means of a referendum to pursue a Republican form of government and not to continue as a self-governing Dominion in the British Commonwealth of Nations with the British Monarch as the Head of State. The Union of South Africa became a Republic on 31st May 1961 when the Republic of South Africa Constitution Act 1961 (9) came into operation. This Act repealed the South Africa Act 1909 plus a host of other legislation which had been passed from time to time since 1910. The new constitution "... apart from establishing a republic and replacing the King and Governor-General by a President elected by the Senators and members of the House of Assembly, ... did not purport on the face of it to introduce any radical change in the constitutional structure of the state". (10) For

(7) Ibid.

(8) Internationally the use of the term Local Authority or Local Government is confined to government at a lower level than that of the Central Government. In South Africa, however, because of the three-tier form of government, the term Local Authority or Local Government refers to any level of government below Provincial Government level.

(9) Act No 32 of 1961.

(10) Kahn, Ellison, The New Constitution, being a supplement to
example, Section 85 of the South Africa Act, 1909, merely became Section 84 of the Republic of South Africa Constitution Act, 1961.

Subsequently, the political party forming the "government of the day" has attempted to meet the political aspirations of the various ethnic groups within the Republic by creating consultative bodies with certain powers to represent some ethnic groups and independent self-governing territories for other ethnic groups. An example of the former is the Coloured Representative Council, (11) a consultative body within the Republic while the newly established states of Transkei and Bophuthatswana are examples of the latter. (12) At the present time there are proposals to radically change the constitution to provide for a State President with extended executive powers and to replace the present single parliament by three parliaments elected from the members of certain ethnic groups. However, these do not affect the position of Local Authorities in the basic structure of government in the Republic and are not considered in this study.

The role and structure of the three-tier form of government is outlined in the following sub-section.

(c) The Three Tiers of Government.

(i) The Central Government

The Central Government provides the supreme authority of the State. The Legislature consists of the State President and an Upper and Lower House of Parliament, which are known as the Senate and House of Assembly respectively. The State President is the Head of State, but has no executive power,

(10) (continued)

(11) This body acts as a consultative body between the Central Government and the Coloured Group and was constituted in terms of the Coloured Persons Representative Council Act, No 49 of 1964.

(12) The objective is to lead the various Territorial Authorities to independence, as in the case of the Transkei which became independent in 1976 in terms of a series of legislation culminating in the Status of the Transkei Act, No 100 of 1976.
the Senate acts as a body for legislative review and the House of Assembly is the principal legislative body. The Executive is headed by the Prime Minister and consists of a Cabinet of twelve Ministers of State who are normally selected from the elected representatives belonging to the political party having a majority of elected representatives in the House of Assembly. Each Minister of State has responsibility for one or more Departments of State which are headed by a senior public official known as the Secretary (ie the Secretary for Foreign Affairs) and are staffed by members of the Public Service. The Judiciary is independent of the Legislature and Executive insofar as the application of the law is concerned, but is administered through the Department of Justice. It consists of an Appellate and the Provincial and Local Divisions of the Supreme Court of South Africa and the various inferior Courts like the Magistrate's and Children's Courts, etc.

(ii) The Provincial Councils

The role of the Provincial Councils is to administer those functions delegated to them in terms of section 84 of the Republic of South Africa Constitution Act, 1961, (13) of which education (other than higher education) for the White Group, hospital services, local authorities, roads and the protection of flora and fauna are the most important. They also have the power to levy taxes, but this has been severely curtailed by the Financial Relations Act 1976. (14)

The legislative power is exercised by elected representatives through the passing of Provincial Ordinances which, when assented to by the State President, have the force of law within the Province for so long and so far as they are not repugnant to any Act of Parliament.

The Chief Executive Officer of a Province is the Administrator, who is appointed by the State President. The members of the Provincial Council who are elected by the community,

(13) Op cit.
(14) Act No 65 of 1976.
elect from among their number four persons who, together with the Administrator as Chairman, form the Executive Committee of the Province. The Executive Committee acts as the "Cabinet" of the Province, and each member of the Executive Committee takes charge of at least one Provincial Department. Certain powers are vested in the Administrator (e.g., proroguing the Provincial Council) while others are vested jointly in the Administrator and the Executive Committee, and in such cases the Administrator acts "in Executive Committee" or "on the advice of the Executive Committee". There is a substantial provincial service of which the Provincial Secretary is the permanent head. In practice, the heads of departments of the Provincial Administration are in very much the same position as the Secretaries of the various departments of state of the Central Government. There is a certain amount of overlapping between the Provincial and Public Service of the Central Government in the carrying out of their various duties and responsibilities. For example, the Director of Hospital Services is a member of the Provincial Services, whereas the Provincial Auditor is a member of the Public Service and is directly responsible to the Secretary of the Treasury.

(iii) Local Authorities

Local Authorities are purely "creatures of Statute" and derive their powers from the various Provincial Ordinances which regulate their activities in the four Provinces. The legislation varies considerably from Province to Province because after Union the differences in the legislative control over Local Authorities in the two British Colonies of the Cape and Natal and that applying in the Transvaal and Orange Free State prior to the Anglo-Boer War of 1899-1902 were perpetrated in the Provincial Ordinances regulating their operations in each Province. Basically, the legislation covers a fairly well defined pattern in each Province with control being exercised over similar functions and duties. However, the present position is aptly described by Roux (15) where he

---

states "... the bulk of South African local authorities shows up individual and group differences in almost every conceivable aspect: size, area, organisation, powers, functions and sources of revenue, etc. These differences obtain on a national scale while there are still further differences between the four provinces ... Local government and administration in the four provinces have been investigated by numerous commissions of enquiry and all the commissions have in some way or other deplored the lack of uniformity, especially the difficulties caused by it in the inter-governmental relations".

The differences between the legislation applying to Local Authorities in each Province tends to limit any research into the accounting for these units to a comparative study. As this is not the intention of this study, all references to Provincial legislation have been restricted to that applying to the accounting for Local Authorities in the Province of Natal.

The legislative function of Local Authorities is usually exercised by elected representatives on the various Councils, Boards or Committees according to an electoral process laid down in the various Ordinances regulating their activities. This follows the system of representative or responsible government of the higher tiers of government and the elected representatives are responsible for their actions to the community who elected them and not only to the Provincial Councils. In the case of the larger Local Authorities there is a Council made up of Councillors from whom the chairman, called the Mayor, is elected. In the case of the smaller Local Authorities it is usually the Board which exercises this function; the elected members are merely referred to as such and elect a Chairman who has no other title. Where Boards (e.g. the Development and Services Board in Natal or the Peri-Urban Board of the Transvaal) have been established in the various Provinces to administer the affairs of the smaller Local Authorities, this legislative function is undertaken by members appointed by the Administrator in the Province to the Board in question. The actual legislative function involves the passing of bylaws (which are subject to the Administrator's approval), the levying of taxes on immovable property (which
are known as rates) and other related matters but also involves the formulation of policies to be followed and the direction of the Local Authority.

The responsibility of the administration of the Local Authority rests with the senior officials, of which the town clerk is the principal administrative officer, the treasurer is the accounting officer and is responsible for the financial affairs and various heads of departments. This function is known as the executive function and is supervised by the elected representatives who form the legislative body of the Local Authority. The reviewing of operations and actions of the senior officials is through either the "Committee System" or the "Management Committee System". With the "Committee System" the elected representatives or appointees serve on various committees which make recommendations to the legislative body. However, with the "Management Committee System" the legislative body elects from its members a Management Committee to which certain powers and duties are delegated, and it is only on matters which have not been delegated to the Management Committee that the legislative body takes the final decision.

3. LOCAL AUTHORITIES IN NATAL

As this study is to a large extent concerned with the accounting requirements for Local Authorities as laid down by the Provincial legislation applying in the Province of Natal, it is opportune at this stage to examine the various types of Local Authorities which exist in this Province.


(17) For example, in terms of Section 58 of the Local Government (Administration and Elections) Ordinance, No 40 of 1960 (Transvaal), the delegation of the major powers of making of bylaws, the levying of taxes (rates) the charging of fees for services, and the raising of loans to the Management Committees is prohibited.
This Ordinance provides for four types of Local Authorities in Natal: Boroughs, Townships, Development Areas and Local Authorities for certain Group Areas. These are dealt with separately hereunder.

(i) Boroughs

These consist of those urban areas which have been constituted as townships, either in terms of this Ordinance or any previous Ordinance, which have 1000 or more voters enrolled on the current voters' list, and in which the rateable value of buildings is not less than R4 000 000 and which have been proclaimed boroughs by the Administrator. In such cases a town council must be constituted, a name assigned to the borough, and the boundaries of the borough defined.

In terms of Section 7(1) of this Ordinance "A town council may apply to the Administrator for the borough concerned to be accorded city status if the borough concerned is the dominant centre of influence for a significant area". The conversion to city status may only take place after approval by the Provincial Council and proclamation in the Provincial Gazette. In addition, in terms of Section 315 of this Ordinance, the Administrator may by proclamation confer upon any Local Authorities additional powers, exemptions, etc. This may be carried out in respect of any Local Authority depending upon the various circumstances but is normally restricted to the larger Local Authorities. For example, the City of Durban enjoys considerable extended powers in terms of the Durban Extended Powers Ordinance, 1953.

(ii) Townships

The Administrator may, by proclamation, declare any area not being or forming part of a borough to be a township,

(19) Ibid; section 3.
(20) No 10 of 1953 (Natal).
assign a name to it and define its boundaries. (21) Townships existing on the date of coming into force of this Ordinance continue as such.

The powers of town boards are similar to those of town councils, but more restricted. These townships may be newly created townships, or may have existed as Development Areas or Local Authorities for certain groups of persons (see below).

(iii) Development Areas

Development Areas, which were previously called Public Health Areas, are those areas in which there are few inhabitants but which require preventative health services and basic urban control like the maintenance of roads, drainage, etc. They may be constituted in a similar manner to boroughs and townships by the Administrator. Their powers and duties are essentially those conferred or imposed upon them by the Public Health Act, 1919, (22) for the supervision of matters relating to public health. In view of their small populations the powers and duties of these Development Areas are in accordance with their size and particular circumstances and they are administered by the Development and Services Board (see later).

(iv) Local Authorities for Certain Group Areas

The Administrator may constitute Local Authorities for areas in which a Local Affairs Committee has been established in terms of Section 28 of the Group Areas Act, 1956. (23) In terms of this Act areas may be set aside for the various racial or ethnic groups of persons in South Africa, and the various Ministers of State responsible for these groups may in terms of section 28 of the said Act, establish Consultative and Management Committees in any Group Area situated in any area under the jurisdiction of a Local Authority. Such Committees have such powers, functions and duties of the Local

(21) Ordinance No 25 of 1974, op cit, section 274.
(22) No 36 of 1919, op cit.
(23) Act No 36 of 1966.
Authority concerned as the Administrator of the Province in which the area concerned is situated determines. In addition, section 29 of the said Act provides for the various Ministers of State responsible for these Groups to establish Local Authorities upon the conditions determined by such Ministers after consultation with the Administrator concerned.

The establishment of these Consultative and Management Committees which are denoted Local Affairs Committees in terms of Ordinance 25 of 1974, are handled primarily by the Natal Provincial Administration through the Development and Services Board (see following sub-section) in terms of Sections 306 and 307 of this Ordinance.

(b) The Development and Services Board Established in terms of the Development and Services Board Ordinance, 1941. (24)

In terms of Section 2(1) of this Ordinance, a board to be known as the Development and Services Board was constituted "... for the management, regulation and control of matters affecting public health in areas which may from time to time be brought within the operations of this Ordinance ...." These regulated areas became Development Areas (25) in 1974 because it is specifically stated in Section 5(2) of this Ordinance that "The Board shall be deemed to be a local authority in respect of every development area for the purposes of any Ordinance insofar as such Ordinance applies to all forms of local authority ... existing in the Province of Natal".

(24) No 20 of 1941 (Natal). In terms of Section 25 of this Ordinance, this Ordinance may be cited as the Development and Services Board Ordinance, 1974.

(25) The Development and Services Board was known as the Local Health Commission until 12th September 1974, when the name was changed in terms of the Development and Services Board Designation Ordinance, No 14 of 1974. These Development Areas were known as Public Health Areas until 31st July 1975 when the Development and Services Board Amendment and Interpretation Ordinance, No 11 of 1975 (Natal), came into operation.
The Administrator is empowered in terms of Section 16 of this Ordinance to alter the status of any Development Area by proclamation and "... he may in the same proclamation constitute therefor any form of local authority or ... declare that the same shall form part of the area of any existing authority".

(c) **Statutory Bodies Deemed to be Local Authorities for Certain Purposes**

Certain statutory bodies are deemed to be Local Authorities for certain purposes. For example, the Water Services Ordinance, 1963,(26) provides for the establishment of the Water Services Advisory Board whose purpose is to undertake research into all matters relating to water resources and sewerage disposal and for the establishment of Regional Water Services Corporations. The duties and functions of these Regional Water Services Corporations, some of which have already been established, are laid down in Section 10 of the said Ordinance and comprise the provision of "... pure and adequate supplies of water to local authorities ..." and "... schemes for sewerage and the disposal of domestic and industrial sewage and effluents ...." These Regional Water Services Corporations are only deemed to be Local Authorities for the purposes of pension and superannuation funds for their employees.(27) In this respect Cowden's(28) viewpoint that they are considered to be Local Authorities is questionable; the reason given in his argument is that they should be considered as such is because "... they have general powers similar to those enjoyed by Town Boards".

Even though these and other statutory bodies may be similar in nature to Local Authorities they do not have the power to legislate nor levy taxes and they are not dealt with in this study.

---

(26) No 27 of 1963 (Natal).
(27) Ibid; section 11(4).
4. **THE FUNCTIONS, DUTIES AND RESPONSIBILITIES OF LOCAL AUTHORITIES**

Although there is considerable diversity in size, function, etc amongst Local Authority in the four Provinces, their role is basically similar throughout South Africa. Essentially, this role is to provide part of the "infrastructure" of the State. Obviously their contribution is limited to urban control and development in the areas under their control. This broad description of their activities covers all their functions, duties and responsibilities including the formation of economic capital (i.e., the building of roads, bridges, etc).

The term "infrastructure" refers to all those tangible and intangible attributes of the nation as a whole; the underlying foundation on which growth and development may take place. Hobart Houghton\(^{(29)}\) classifies these attributes into three broad categories as follows: "First there is the creation of politician institutions which will guarantee the maintenance of law and order, provide efficient and incorruptible administration, and give the mass of the population a sense of creative purpose. Then there are those social institutions such as education, both of the masses and the elite (which must provide the political and economic leadership) and health services and other aids to human welfare. Finally there are the more strictly economic institutions such as banking, transport, communications, power and water". With the exception of banking, this "infrastructure" is provided by the Public Sector in South Africa which consists of three broad areas, namely, the Central Government sector, the Public Corporations, and the Provincial, Local and Territorial Authorities and certain statutory bodies.

The Central Government sector provides the central government administration through the various Departments of State (e.g., Health, Defence, etc), the statutory bodies like

the Atomic Energy Board, etc and the State Enterprises like the South African Railways and Harbours, etc. The Public Corporations are those institutions which have been established by the State, but are autonomous bodies like the Electricity Supply Commission (ESCOM), the South African Coal, Oil and Gas Corporation Limited (SASOL), etc. The Provincial, Local and Territorial Authorities cover not only the Local Authorities in the four Provinces but also the various Territorial Authorities like the Kwa Zulu Territorial Authority and the Water Corporations, etc, and are responsible for regional government and development or specific duties like the provision of water supplies, etc. The essential feature of the Public Sector is that it is not market-orientated; even in the case of the Public Corporations, of which some appear to be market-orientated, their operations are designed to provide those goods and services which private enterprise is unable or unwilling to do.

The duties and responsibilities of Local Authorities are either contained in the Ordinances regulating their activities in the four Provinces or in specific Acts of Parliament which have imposed additional duties and responsibilities upon them. For convenience these are dealt with separately hereunder.

(a) The Basic Responsibilities

Local Authorities are responsible for a fairly well defined range of domestic duties which consist of urban planning and development, the control of the construction of buildings, road building and maintenance, kerbing, street lighting, drainage, sewerage and garbage disposal, the provision of parks, etc, and depending upon their size such services as the provision of water supplies, electricity, public transport, etc. Besides these rather utilitarian functions, Local Authorities may also provide recreational, cultural and other services to the community in order to improve the quality of life of the inhabitants. However, their activities in the Republic are not as extensive as those in other countries in the Western World, as certain functions undertaken by Local Authorities in those countries
are handled by the Provincial Administrations in the Republic. For example, education (other than higher education) is a Local Authority responsibility in the United Kingdom of Great Britain whereas in South Africa it is jointly handled by the Provincial Administrations and the Central Government.

(b) The Extension of these Responsibilities

The Central Government has from time to time, delegated certain duties and responsibilities to Local Authorities. For example, the Slums Act 1934,\(^{(30)}\) delegates to Local Authorities the duties of preventing or remedying nuisances and providing suitable land for residential purposes in the areas under their control. There are numerous such cases but the two most important areas are those relating to Public Health and Housing, which are dealt with hereunder:

**The Public Health Act, 1919.\(^{(31)}\)**

This Act made provision for the establishment of the State Department of Health whose functions are, inter alia, to prevent and guard against the introduction of infectious diseases and to promote the public health. It is a comprehensive piece of legislation which covers the provision of Isolation Hospitals, Mortuaries, Disinfecting and Cleansing Stations and Ambulances for conveying persons suffering from infectious diseases as well as the prevention of pollution of water supplies, the inspection of foodstuffs and the prohibition of the sale of milk from herds of cattle suffering from (or believed to be suffering from) tuberculosis, etc.

Although the provision of Section 7 of the said Act requires that "... the several local authorities shall within their respective districts carry out the provisions of this Act," the mandatory provisions only apply to those measures of a preventative nature as specified in Section 10 which states that "... every local authority is hereby required and empowered to take in respect of its district all lawful, necessary and under its special circumstances reasonably

\(^{(30)}\) Act No 53 of 1934.

\(^{(31)}\) Act No 36 of 1919.
practicable measures for preventing the occurrence or dealing with any outbreak or prevalence of any infectious, communicable or preventable disease, to promote and safeguard the public health and to exercise the powers and perform the duties in respect of public health conferred or imposed upon it by this Act or any other law". (Emphasis added). The balance of the provisions are discretionary but subject to Ministerial direction as in the case of the appointment of Medical Officers of Health and the provision of isolation hospitals, mortuaries, disinfecting and cleansing stations and ambulances. Where the Minister of Health directs that a Local Authority provide the services of Medical Officers of Health, isolation hospitals, etc, subsidies are payable by the State in respect of the salaries of such Medical Officers of Health, and the costs of providing the facilities are refundable by the Central Government. The Local Authorities concerned are, however, empowered to recover their operating or running expenses by the charging of fees.

Therefore, the requirements of this Act impose substantial responsibilities on Local Authorities in respect of public health depending upon their size, function, area, etc.

The Housing Act, 1966.

The long title of this Act is "To consolidate the laws providing for the construction of dwellings and the carrying out of housing schemes; ...; conferring certain powers upon local authorities in connection with the construction of dwellings, the purchase of dwellings and the carrying out of

(32) Ibid; Section 16 which provides that the State is given discretionary power to pay out of the Consolidated Revenue Fund up to one-third of the salary of any qualified Health Officer.

(33) Ibid; Section 48.

(34) Ibid; Section 26bis which provides that Local Authorities may recover certain costs for accommodation, maintenance, medical treatment, etc, from the persons concerned or their estates in the event of death.

(35) Act No 4 of 1966.
housing schemes, providing for the granting of loans to natural persons to enable them to purchase dwellings, ...." It is a comprehensive piece of legislation and like the Public Health Act (supra) it imposes considerable duties and obligations on Local Authorities which receive advances from the National Housing Fund.

The National Housing Fund is a fund which was created for the purposes of providing moneys to Local Authorities or other persons for the construction of dwellings or schemes for the provision of housing, the setting aside of land for occupation by persons for whom no suitable accommodation is available, etc.\(^{(36)}\) Where advances are made to Local Authorities they may be either for economic schemes or assisted housing schemes,\(^{(37)}\) but the spirit of the Act is best described by Section 11\(^{(4)}\) which states that "Before approving an advance in respect of any economic scheme, the [National Housing] Commission may require the local authority concerned to first make reasonable provision for the housing of the poorest section of the community in the area where the scheme is to be carried out".

Where any Local Authority has received an advance from the National Housing Fund it is required to maintain separate statements of income and expenditure, etc\(^{(38)}\) for each advance. In practice this means that the financial statements must include a Housing Fund balance sheet and income and expenditure statement (see Chapter 3).

\(^{(36)}\) Act No 4 of 1966, op cit Section 1. The definition of "scheme" in this section includes service centres, places of safety for children and the provision of facilities for community development.

\(^{(37)}\) Ibid; section 1. The difference between economic schemes and assisted housing schemes is that in the latter the National Housing Fund bears the loss in respect of interest (ie interest charged at a low rate), whereas in the former the National Housing Fund does not bear any such loss of interest.

\(^{(38)}\) Ibid; section 72.
5. **THE SUPERVISION AND CONTROL OF LOCAL AUTHORITIES**

Although Local Authorities appear to enjoy considerable freedom of action in the carrying out of their various duties and responsibilities, they are subject to strict control by the Provincial Councils and to a lesser extent by the Central Government. These two forms of external control and supervision are dealt with separately hereunder.

(a) **Provincial Control**

Local Authorities, being "creatures of statute" derive their powers and functions from the legislation covering their operations. Therefore, Provincial Control over Local Authorities, which is a constitutional responsibility, stems from the power to legislate on all matters affecting their operations and this control is embodied in the various Ordinances regulating Local Authorities in the four Provinces. The duties and powers of Local Authorities are strictly prescribed, and such matters as the proclamation of townships, the approval of bylaws, the salary payable to the Town Clerk, etc, are subject to either the Administrator's approval or that of the Provincial Council. In this respect, there is continual communication between the Provincial Administrations and the Local Authorities on matters which require the Administrator's or Provincial Council's approval. Although this control extends over all operations of Local Authorities, it is those control measures which are of a financial nature or which affect the accounting for their operations that concern this study and these are outlined briefly hereunder.

(i) **Financial Control Measures**

The financing of Local Authority operations forms part of the economics of public finance and involves the levying of taxes and the use of capital or loan finance. Consequently, the two most important areas of financial control are those concerned with these two aspects. The other financial control measures, like the use of the statutory budget, fund accounting, etc are those which form part of the requirements of the accounting system, and are covered in subsequent Chapters of this study.
The taxing powers of Local Authorities are mainly restricted to the annual levying of a tax or taxes on the value of immovable property which are known as the "rate" or "rates". Control is exercised by specifying in the Ordinance the type of rates which may be levied, how the valuation of the immovable property is to be carried out and how the rates are to be collected.

Control over the borrowing powers of Local Authorities varies from Province to Province and that applying in the Province of Natal is detailed here. The control measures are incorporated in the Ordinances applying to the regulation of Local Authorities and Development Areas. Boroughs and Townships may borrow, with the consent of the Administrator, a total amount of up to four times their annual income from activities (excluding that to which the provisions of the Housing Act 1966 (supra), apply) for specific capital expenditure. Should this amount be insufficient for their needs then, provided the Administrator agrees, they may obtain additional borrowing powers for specific capital expenditure by promoting a Special Loan Ordinance in the Provincial Council. In either case the Council or Board must comply with certain procedural matters and the application to the Administrator must be supported by details of the proposed capital expenditure. Approval is only granted after thorough consideration and in the case of Special Loan Ordinances, after the need, desirability, and ability to repay have been fully deliberated in the Provincial Council. With Development Areas, all borrowings for capital expenditure purposes are subject to the Administrator's approval.

(ii) The Audit Procedure

Overall review of the proper exercise of the financial operations of a Local Authority by the Provincial Council is through the audit review procedure. In this respect, considerable reliance is placed on the annual audit because the auditor's report represents an important review of the Local Authority's operations.

The audit is the responsibility of the Provincial Auditor and is either carried out by him or persons appointed by him for that purpose. It covers the audit of the Local Authority's
transaction, a review of the adequacy of the system of internal control, the verification of the assets and liabilities in the customary manner, and an examination of the financial statements and the reporting thereon to the legislative body of the Local Authority, the Provincial Council and the general public. It is also concerned with the special legislation to which Local Authorities are subject and the recovery of unauthorized expenditures or losses through the "surcharge procedure".

Where a person has caused a loss to the Local Authority through the failure to collect moneys, making an unauthorized payment or the failure to carry out his duties properly he may be surcharged and the amount of the loss recovered from him through the legal process. In certain cases where unauthorized expenditure has been made in, say, anticipation of a loan authority, etc, and no loss to the Local Authority has occurred, the surcharge procedure is used purely as a means of ensuring legal compliance to draw attention to some matter; provided the matter is rectified, the Administrator's approval to withdraw the surcharge is obtained and no further action is taken against the person concerned.

On completion of the audits of all Local Authorities in the Province, the Provincial Auditor prepares a report for submission to the Provincial Council. This report, which includes details of the overspending of authorised amounts, extravagant expenditure, losses, etc. and the steps taken to remedy them is referred to the Provincial Select Committee on Public Accounts. The Select Committee investigates these irregularities and reports thereon to the Provincial Council which may take further action if it so desires.

(b) Central Government Control

As outlined earlier in this chapter, the Central Government has delegated certain duties and responsibilities directly to Local Authorities by incorporating them in various Acts of Parliament. The reason for such action is that they usually involve matters of state policy or the national interest and require uniform application or centralized administration.
These Acts usually place the onus of ensuring compliance by the Local Authorities on the Provincial Councils or the Administrator. For example, in terms of Section 11 of the Public Health Act, 1919, \(^{(39)}\) if a Local Authority fails to carry out any duties imposed upon it by the Act, the Administrator may cause these duties to be carried out and recover the costs involved from the Local Authority concerned.

6. **THE PROBLEMS FACING LOCAL AUTHORITIES**

The problems facing Local Authorities relate to the financing of their operations and urban population growth. The demands of the public for services are increasing and it is possible that in the next decade the Central Government may have to assist Local Authorities in the form of substantial grants in order that they may carry out their responsibilities to the community for which they are responsible. The most important problems facing Local Authorities are:

(a) **The Urbanization of South Africa**

South Africa does not stand alone in the world with its problems of population growth, and the tendency towards rapid urbanization of its population. The 1970 census showed that the population of the Republic amounted to 21,402,000 persons which represented an increase of 33.82 per cent over the 1960 figure of 15,994,000. \(^{(40)}\) Hobart Houghton \(^{(41)}\) points out that in 1975 the population was in the region of 25 million which represents a further increase in the population of 16.88 per cent in a period of five years. For Local Authorities this population growth has been intensified by the move of the population from the rural to the urban areas. The 1970 census showed that 47.8 per cent of the total population was in the urban areas, \(^{(42)}\) and this figure may exceed 50 per cent by

---

\(^{(39)}\) Act No 36 of 1919, op cit.


\(^{(41)}\) Op cit p 254.

1980. This has placed a terrific strain on the Local Authorities in providing the necessary services to their communities, and reports of the impending inadequacy of water mains, sewage disposal schemes, etc, are commonplace.

(b) The Financing of Local Authorities

With the growth of the urban population in South Africa Local Authorities have found that they are faced with higher expenditures, and that their traditional sources of revenue are not adequate to finance their operations. In this connection, Botha (1970a)(43) states "As a result most big cities overseas - and practically all in South Africa - are clamouring for more financial assistance. The difference is that while cities in Europe are assisted substantially by the State, South African cities rely exclusively upon their own financing from property taxes and income from municipal trading .... With the fast growth of urban areas in recent years Municipalities in this country have found the tax (fixed property) too narrow, and productive of insufficient revenue. Rates on property being already high in many cities, this source of revenue is now being fairly fully tapped, and municipalities are eagerly looking for extra sources in the form of new taxes".

To date financial assistance to Local Authorities other than advances from the National Housing Fund and subsidies from the Department of Health, etc, has not been forthcoming from the State, and new forms of taxation for Local Authorities have not been developed. In addition, the raising of loans for capital development depends to a large extent upon the availability of funds in the capital markets; at present loans are only available at high interest rates, which places yet another burden on Local Authorities in meeting the high interest payments and loan redemption charges.

In 1969 Cowden(44) wrote: "During the next 30 years the urban population of South Africa will double and the number of licenced vehicles will treble. This is a formidable challenge to local government, and one which will call for long term economic and physical planning of the highest order. Existing techniques for budgeting, the allocation of priorities, the evaluation of capital projects and statutory provisions for town planning and finance will all need revision. Ad hoc decisions to satisfy current annual needs will have to give way to long-term and regional planning". This may well involve a complete revision or modification of the present approach and use of accounting by Local Authorities.

Pressures from the community shall continue to create an insatiable demand for more services and in turn create further financial problems. There shall have to be greater and more effective control over public resources by the use of an effective accounting system.

7. SUMMARY

Local Authorities play an important role in South Africa by providing the third tier of government. In this respect they provide the means by which the Provincial Councils can delegate power and responsibility for urban development and control to those bodies more suited to this role. This role, which may be simply stated as providing part of the infrastructure of the State, has been extended by the delegation to them by the Central Government of the responsibilities for preventative health measures and housing.

There is strict control over the operations and activities of Local Authorities by the Provincial Councils. This control is effected by prescribing their duties and responsibilities in the various Ordinances regulating their operations and ensuring that legislation of the Central Government is complied with. However, the historical development of local government and the autonomy of the Provincial Councils in South Africa

(44) Op cit, p 365.
has resulted in different Provincial legislation applying in each Province. Consequently, Local Authorities vary in nature, functions, powers, sources of revenue, etc from Province to Province. Irrespective of how they differ in nature, function, etc, their basic duties and responsibilities follow a fairly well defined pattern throughout the country.

All Local Authorities have the power to legislate (ie pass laws) and to levy taxes on immovable property (which are known as rates). Except in the case of the smaller Local Authorities, which are essentially concerned with preventative health measures, they all enjoy a representative or responsible form of government whereby representatives are elected to the legislative bodies of these units (ie the Councils or Boards) and who are responsible to the communities which elected them for their actions.

As it was not the intention to carry out a comparative study of the accounting for Local Authorities in the various Provinces, it is only those Local Authorities which may be established in the Province of Natal which have been considered. These consist of boroughs (which may be granted city status), townships, development areas, and Local Authorities for certain groups of persons. The distinction is essentially one of size and they rank in importance according to the order in which they are listed.

They face enormous problems in the rapid urbanization of the growing population of the Republic, which in turn has caused problems in the financing of their activities and development. In order that they fulfil their responsibilities Local Authorities must support their development with adequate planning and budgeting procedures and improve their accounting system.
CHAPTER 2

LOCAL AUTHORITY ACCOUNTING: ITS PURPOSES, OBJECTIVES, PRINCIPLES OR STANDARDS, AND PRACTICES

1. INTRODUCTION

In the previous chapter of this study it was established that Local Authorities form the third or lowest tier in the structure of government in South Africa and that they operate within a framework of strict legal control. Consequently, the accounting for these units can be expected to be along the lines of that applying to governmental accounting. In many respects this differs from that applying to enterprises of the private sector and the purpose of this chapter is to examine the purposes, objectives, principles or standards and the general practices of Local Authority or governmental accounting.

2. THE PURPOSES OF THE ACCOUNTING SYSTEM

One of the pioneers in the development of modern accounting theory was Professor A C Littleton(1) who stated in 1953 that the broad purpose of accounting was to supply significant information about the economic activities of an enterprise to all interested parties. This assessment of the nature of accounting, although it has been subjected to certain changes in emphasis, still holds good for both Local Authority and private enterprise accounting. It represents the fundamental purpose or main objective of accounting and the other purposes or objectives of an accounting system follow from this main objective and must be considered specific or ancillary objectives.

This main purpose of accounting which involves the measurement of the results of operations and the financial position of the enterprise, organization or unit is often taken

for granted probably because accounting thought and practice is dominated by refinements to private enterprise accounting. However, as this study is concerned with the accounting for Local Authorities which differ in many respects from organizations of the private sector, the main objective is examined in this section together with the users of the accounting information.

(a) The Provision of Information on Economic Activities

Local Authorities, being governmental and service units, are involved with the provision of numerous services to the communities for which they are responsible. These services include the building and maintenance of roads, the inspection of foodstuffs, garbage collection and disposal, the care of stray animals, the supply of electricity and water, the provision of leisure facilities, the administration of assets held in trust, etc. However, no matter how diverse these various activities of Local Authorities appear, they may be classified into two groups of activities, namely trading or enterprise activities and general government activities.

The trading or enterprise activities of Local Authorities are those activities which are essentially "business-type" in nature and provide services to the community on a user-charge basis (e.g., the supply of electricity and water, public transport, etc.). The general government activities, on the other hand, represent all those other activities (e.g., garbage collection and disposal, road construction and maintenance, etc.), which are mainly financed from the levying of property taxes (i.e., the rates) and the administration of assets held in trust for the community (e.g., parkland, art treasures, etc.). Both these types of activities require capital expenditure which relate to the raising and repayment of loan finance and the control of internally generated finance for these purposes.

From an accounting or administrative point of view, the receipt and disbursement of funds for capital expenditure purposes is usually treated as a separate economic activity of Local Authorities even though it relates directly to the two groups of Local Authority activities. The reason is that
it involves a complex area of public financial administration and is more easily dealt with as a separate economic activity and this treatment is followed for convenience in this study. However, it should be borne in mind that it relates to the control of finance used to provide the production resources for the general government and trading activities of the Local Authority. This area is dealt with fully later in this study but in this section it is the distinction between the trading or enterprise and general government activities which are of importance in the accounting system because they involve two distinct approaches to the measurement of activities.

The distinction between the trading or enterprise activities of Local Authorities or other governmental entities is economic in nature and "... involves the conversion by governmental organizations as producing entities of goods and services in one form into goods and services in another form." (2) This transformation process, which applies to all governmental economic activity, is diagrammatically represented as Illustration 1. The inputs of financial resources may consist of property taxes (ie the rates), service charges, loans for capital expenditure purposes, etc. which are converted into intermediate goods or services (eg stocks, labour, capital etc) and then into the final outputs of public goods or services. In some cases the conversion process may be directly from inputs to final goods or services.

Illustration 1

THE ECONOMIC ACTIVITY OF GOVERNMENTAL UNITS(3)

INPUTS
(Financial Resources)  Conversion of Financial Resources into Production Resources (Expenditure)  INPUTS
(Production Resources)  Conversion of Production Resources into Outputs (Expense)  OUTPUTS
(Public Goods and Services)


(3) Ibid p 7.
With trading or enterprise activities which are similar in nature to enterprises of the private sector, the outputs are in the form of goods and services which are saleable and give rise to significant inflows of financial resources into the entity. They are, therefore, to a large extent self-financing and the economic model can be regarded as a continuous activity; (4) outflows are converted into inflows which in turn become outflows in a continuous operation. From an accounting point of view these inputs can be matched against related expenditures and the accounting for these activities should be along the lines applying to enterprises of the private sector. In this respect, the National Committee on Governmental Accounting (NCGA) (5) state that "... the significant attribute of such enterprises is that they are financed primarily by charges to consumers and that the accounting for them must make it possible to show whether they are operated at a profit or loss similar to comparable private enterprises." Furthermore, the American Accounting Association (AAA)(1975) (6) state that for this type of economic activity "... the measurement focus is upon determination of net income, financial position, and changes in financial position."

As far as general government economic activities are concerned, the outflow-inflow relationship or loop of the economic model does not exist (7) because the goods or services produced are either not saleable or result in insignificant inflows of resources. As the AAA (1975) (8) point out, the result is that "... these organizations must constantly secure new inflows of financial resources in order to repeat the transformation

(4) Ibid.
(7) Ibid p 7.
(8) Ibid p 8.
cycle. Moreover, justifications for tax levies ... are usually based only in part, if at all, on the value of the final outputs of the organization to individuals or groups from whom such financial resource contributions must come." This means that the normal matching of income against related expenditures does not apply to general government activities and the measurement of performance must take on another form. This can only be achieved by comparing the results of operations against pre-determined goals or objectives. It is, to a certain extent, effected by comparing the financial activities (ie the income collected and amounts expended) with pre-determined budgeted levels of activity. However, this is only partially effective because many of these general government activities produce benefits which are qualitative in nature and bear little resemblance to the amount expended in achieving them (eg preventative health measures). Therefore, for these general government activities, "The measurement focus is upon determination of financial position and changes in financial position (...) - not upon net income determination."(9)

(b) The Users of Local Authority Accounting Information

As accounting is essentially a service activity, the information produced by the accounting system should be useful to all interested parties. Here, there are six groups of persons to whom such information is of interest.

First, there is that group of persons who are responsible for the management of the Local Authority. In this respect the NCGA(10) state that "Both at top and intermediate levels of government organization, management must rely on financial reports in evaluating past performance in decision-making and in planning future operations." Secondly, there are those elected public officials who are entrusted with the direction of the operations of the Local Authority and the use of public resources. This group of persons must be able to assess the

(9) Ibid p 9.
(10) Op cit p 1.
management of the Local Authority and the extent of attainment of their policies and programmes. Thirdly, there is the Provincial Council as the superior tier of government and who exercises legislative and other control over their activities. Fourthly, there are the ratepayers (ie the taxpayers) and the general public. This is the group most affected by the operations of the Local Authority because they pay for the services provided. They also elect the representatives to the legislative bodies of the Local Authorities and should be informed of the actions of these elected representatives. In addition, the ratepayers are those who foot the tax bills and in this capacity they have a right to be kept fully informed of the operations and activities of the Local Authority. The fifth group of users are those persons who invest in the loans raised by the Local Authority. The fact that in South Africa investors in Local Authority loans include few persons other than Local Authorities or statutory bodies is of no consequence, because those who do invest in these loans have a right to be kept fully informed of the financial position of Local Authorities. Finally, there are those "... educational and research organizations, statistical reporting agencies, and such individuals as accountants, financial analysts, economists, and political scientists whose professional activities embrace the study and improvement of public financial administration."(11)

The purpose of accounting is, therefore, not only to "supply significant information about the economic activities" of enterprises or organizations but, as pointed out earlier, also to convey this information to interested parties in an understandable manner.

3. THE OBJECTIVES OF LOCAL AUTHORITY ACCOUNTING

The nature of Local Authority economic activity and the needs of the users of the information which should be produced

by the accounting system were recognised by the AAA (1972)\(^{(12)}\) where it stated that the two objectives of governmental accounting were as follows:

"1) To provide the information necessary for faithful, efficient, effective and economical management of an operation and of the resources entrusted to it. This objective relates to Management Control.

2) To provide information to enable managers to report on the discharge of their responsibilities to administer faithfully, efficiently and effectively the programs and use of the resources under their direction; and to permit all public officials to report to the public on the results of government operations and the use of public funds. This objective relates to Accountability."

The reason put forward by the AAA (1972)\(^{(13)}\) for this classification of the objectives of government accounting is that it distinguishes between the use of accounting information by the managers of government programmes and those who use this information for evaluating management. This reason, therefore, stresses user requirements as the overall objective of government accounting and points out that user requirements should determine what information should be produced in fulfilment of these objectives.\(^{(14)}\)

These two objectives of governmental or Local Authority accounting are examined in the paragraphs that follow and for convenience accountability is examined before management control.


\(^{(13)}\) Ibid.

\(^{(14)}\) Ibid.
(a) **Accountability**

In all forms of government public resources are entrusted to the care of elected representatives or public officials for the good of the community. These persons are held responsible to the community to account for the management and control of these resources and this responsibility is known as accountability. It also applies in the private sector to any person who acts in a fiduciary or managerial capacity.

The concept of accountability is a complex one involving a number of different aspects of reporting and disclosure in accounting. A re-examination of the objective relating to accountability (given above) discloses that it comprises two parts; first "... to permit all public officials to report to the public on the results of government operations and the use of public funds ...", and secondly, "To provide information to enable managers to report on the discharge of their responsibilities to administer faithfully, efficiently and effectively the programs and use of the resources under their direction...." This dual definition of accountability emphasises that accountability is concerned not only with the reporting of government or Local Authority activities to the public but that it forms part of the managerial control over operations and programmes of the unit. These two aspects are complementary to one another because accountability also requires reporting to the public on managerial efficiency and effectiveness in the attainment of the objectives of the unit.

The most important aspect of accountability is, however, that it must be demonstrated to interested parties in an understandable manner. This requires the disclosure of relevant information in an understandable and intelligible manner. In this respect, financial statements are recognized as the vehicles for communicating financial information and to meet this objective they must be prepared in a manner that the general public, economists and other interested parties are kept informed of the financial activities of government or Local Authority units. Unfortunately, this aspect of reporting by Local Authorities has been given scant attention and the financial statements appear to be prepared mainly for internal reporting purposes. For example, when the financial statements
of a certain Local Authority in South Africa were described as "a cryptic document that serves a limited purpose", the City Treasurer replied that the reason for this description was that the person levelling the criticism did not understand the method of presentation and that specialised knowledge was required to understand Local Authority accounting. (15) Such statements indicate a lack of understanding of the fundamentals of accounting, and particularly that of accountability. As Mueller (16) states "The failure to deliver readable reports ... reflects an inexcusable arrogance on the part of those whose business it is to inform. All the mumbo jumbo about legal compliance and conformity to self-imposed rules only makes it worse. Accounting can provide for the legal requirements and still present lucid reports to those who must pay the bills."

Accountability may also be viewed as the ultimate aim of accounting. On this topic Ijiri (17) points out that "... accountability has clearly been the social and organizational backbone of accounting for centuries. Modern society and organizations depend upon intricate networks of accountability which are based on the recording and reporting of these activities. The process of accounting is essential to the proper functioning of society and organizations. Accounting therefore, starts with the recording and reporting of activities and their consequences, and ends with the discharging of accountability".

The various aspects of accountability are examined in the paragraphs that follow.


(i) **Stewardship Accountability**

Traditionally, accountability in the governmental or Local Authority sense has been equated with the demonstration of stewardship by public officials. The emphasis has been, and still is, on fiscal and legal accountability and in this respect, the AAA (1975)(18) states "This fiscal control - legal compliance accountability orientation, as contrasted with a managerial or other accounting emphasis, predominates current municipal accounting [or reporting] practice." To a large extent this is due to the influence of the controlling legislation.

(ii) **Accountability for Efficiency and Economy**

Many of the services provided by Local Authorities or other governmental units like preventative health measures, etc, are difficult to measure by conventional accounting methods and, consequently, the efficiency and economy in providing these services are also difficult to measure.

The accountability objective demands that efficiency and economy in operations be disclosed to interested parties. Here, the Chartered Institute of Public Finance and Accountancy (CIPFA)(1975b)(19) suggests that Local Authorities should produce an annual report wherein "... the authority's objectives and policies would be simply stated, supported by important indications of need for the various services. Relevant statistics would show the progress made during the year to the achievement of objectives, and supporting financial data would show the cost at which this was achieved. The general aim would be to show not merely the extent of achievement during the year, but also the effectiveness of current policies in meeting declared objectives".

---


This accountability requirement is now receiving considerable attention. For example, the Report of the Committee of Inquiry on Local Government Finance (Layfield Report)\(^{(20)}\) in the United Kingdom included this comment: "Accountability to the electorate is the essence of local democracy. The best safeguard against waste, extravagance and inefficiency remain the watchdog activities of the local electorate, whether acting in organized groups of as individuals". However, this is only possible when facts are presented to the electorate in an understandable form and in sufficient detail, and the present level of disclosure in the financial statements of Local Authorities reflects a complete disregard for this form of accountability.

(iii) Accountability for Programme Results

It is generally recognised that the measurement of the effectiveness of government or Local Authority programmes is a difficult task. In many cases the only means of establishing the effectiveness is by the production of statistics to show that there has been an increase or a decrease in some or other factor (ie the number of traffic offences, the incidence of diseases, etc). However difficult the task may appear to be, it is necessary to attempt to arrive at some measure of accomplishment to evaluate the costs of the programmes. Where costs are excessive in relation to accomplishments it may indicate that the resources may have been better applied elsewhere.

From an accountability point of view, the accomplishments should be matched with the programme costs, and the reporting should include information on the achievement of programme objectives.

(b) Management Control

Management control as used in the context of government accounting is a broad term and involves not only sound financial reporting but the efficient management of resources, the

elimination of waste, the improvement of productivity and the use of modern management techniques. (21) A system of management control requires methods and procedures to produce accurate and timely operating and financial information, as well as a formal plan to accomplish objectives and a continuous review of operations. It is closely connected with accountability because there must be overall control by the executive through a system whereby each official is responsible for his actions to a higher authority. In addition there must be an effective evaluation of government programmes, the choice of alternatives, long-term planning and a positive system of control in which the ultimate objective is efficiency in operations and the elimination of waste.

It is a fairly recent development in government or Local Authority accounting because as Hay (22) states "For literally thousands of years, in all civilizations of which we have knowledge, each government unit or agency was required to keep records of assets entrusted to it in order to be able to demonstrate that all assets were used as legally prescribed. The concept that government resources could be managed intelligently and not merely administered by rote did not attain much acceptance until recently and is still more of an academic idea than an operating practice." Moreover, the AAA (1972) (23) acknowledge that it is not easy to achieve this control in government by stating "Control is very hard to achieve in a positive sense in many areas of government, for the natural competitive regulator of the market-place is absent. The substituted competitive condition is for getting a larger share of the total budget; and it is only natural that many managers seeking to improve their own positions relative to others, pursue courses of action that at times seem to be counter to the concepts of efficiency and effectiveness." However, the

(23) Op cit p 84.
awareness of the need for management control in government is increasing. For example, the Third Report of the Commission of Enquiry into Fiscal and Monetary Policy in South Africa (24) recommended in 1969 that such planning aids as programme budgeting and cost-benefit analysis should be used in the Public Sector.

In this section the various methods of providing management with its information needs are examined in general terms. No specific method can be suggested because management needs vary depending upon individual circumstances. Three main phases of the management process are, however, recognised and used, namely planning, control and reporting. Planning is considered to be the initial phase, control as the execution process and reporting as accountability. (25)

(i) Planning in Government

The three distinct stages of planning which are recognised consist of long-, medium- and short-term planning. Each stage is necessary in a system of control from the definition of objectives through to the comparison of and reporting on the results of operations. The distinction is usually on a time basis because planning must precede the formulation of plans which, in time, are required for the direction and co-ordination of operations. Although there are no hard and fast rules, long-term planning is usually considered to be in excess of five years (and often more than ten years) and medium-term planning any period between the current or short-term. The short-term consists of the period immediately preceding the current year and the current year itself.

Long-term planning is essentially the strategic plan which defines the objectives or policies to be followed. It should, therefore, be concerned with issues or proposals and not with programmes which are the formal plans of intended operations. It should allow for flexibility and alternatives, because in effect it is a forecast of needs and how they are to be met.


(25) CIPFA (1975b), op cit, pp 5, 11 and 16.
Planning in the medium-term covers that area between the defining of objectives, policies or goals and the execution of programmes to attain them. It is concerned with the determination of the most appropriate methods of means of allocating scarce resources to the various programmes. In this respect the comments of Stewart\(^{(26)}\) provide a suitable illustration of this process where he states "If we have a Parks Department then the tendency is for it to be assumed that the allocation of resources to the activity must carry on and indeed grow lest the [local] authority fall behind. Parks are not seen as one alternative way of achieving adequate leisure and not necessarily the best way of achieving those objectives". It is, therefore, a stage which requires an appraisal of alternatives and should involve such aspects as re-organization and an objective assessment of priorities.

The short-term planning is primarily concerned with the execution of the programmes and operations in the current year. It should involve formal planning to indicate possible restraints and pressures which may arise. It is closely linked with budgeting to ensure that cash flows will be sufficient to meet expenditures and outlays, and that there is attainment of short-term objectives. In addition, there should be control of expenses, as opposed to expenditures, to ensure efficiency and economy of operations.

In recent times government accounting has developed what is known as Programme Budgeting (PB) or Planning-Programme-Budgeting Systems (PPBS) to assist in the planning and control of their operations. Essentially, it is a system which combines the entire plan of operations into a single formalized process. In this respect "PPBS relates three factors: a desired outcome (planning), the structuring of methods (programming) and the funds to accomplish the end result (budgeting)".\(^{(27)}\) As budgeting is an important feature of governmental accounting (see later), a programme budgeting system


provides continual executive control through managerial review and control of operations in relation to the actual budget. The single year cycle of government operations is replaced by a budgetary process which reflects programme operations over the long run rather than on an annual basis. Its logic is unquestionable; the objectives are stated, the most suitable, economic and effective programmes to achieve these objectives are decided upon by choosing amongst alternatives and the plan is drawn up to cover the programmes from start to finish. Executive control is therefore over the entire programme and not on an annual basis.

Unfortunately, PPBS has not been entirely successful in government accounting because it requires staff trained in "econometrics" and managerial techniques. And, to be successfully implemented requires a radical departure from present government accounting practices. However, it does provide the framework within which Local Authority planning can operate.

(ii) Executive Control

Executive control in government is concerned with the attainment of objectives in the short and medium-term. In this respect the AAA (1972)\(^{(28)}\) state "It is not enough simply to plan for efficient programs however good or complete the planning process may be. There must be an equally good management control system to ensure that planned accomplishment becomes actual accomplishment". It, therefore, requires a sound management organization and the use of managerial accounting techniques or methods.

Although a discussion on the use of managerial accounting techniques or methods is beyond the scope of this study, it embraces a wide field of planning, forecasting, decision-making and cost control measures. Basically, it involves the provision of a management information system. The use and importance of such a system in governmental operations is described by Wright\(^{(29)}\) where he states "... these types of

\(^{(28)}\) Op cit p 84.

systems attempt to cope with the problems of management and control. They include the development of work programs, the establishment of production and cost standards for each program, the development of systems or work reports which record what has been accomplished and what each unit of accomplishment cost, and how performance compared with established standards. Where such a system of control is absent it may usually be assumed that effective and efficient management is also absent.

(iii) Reporting

This part of the management process involves the communication of information for accountability purposes. For internal management purposes this reporting may be orally or through the presentation of formal reports regarding the management process. In the case of external reporting on the management of the Local Authority, reporting is normally through the presentation of formal financial statements and other reports which should disclose fully the results of operations and the effective, economical and efficient use of resources.

4. THE PRINCIPLES OR STANDARDS OF THE ACCOUNTING SYSTEM

The role of accounting principles or standards in the accounting system is described by the American Institute of Certified Public Accountants (AICPA) (1973) where it states: "Standards [or principles] should follow logically from objectives, and should provide guidelines for the formulation of accounting practices compatible with the desired goals". Although standards and principles are essentially similar in nature, they differ from practices which are the procedures followed. For example, if accountability is the objective,

---


(31) This matter was considered as far back as 1940 by Paton, W A, and Littleton, A C, An Introduction to Corporate Accounting Standards, American Accounting Association, Monograph No 3, 1940. On page 4 they state that as the term "principle" suggests a universality and degree of permanence which rarely exists in accounting, they are usually referred to as "standards" which implies a more limited application.
the principle or standard would be to provide a report on the activities involved and the actual methods followed in the presentation of the annual report would be the practices. When these principles or standards and practices enjoy the support of the majority of users they are referred to as being "generally accepted".

Unfortunately, this distinction between principles or standards and practices is a relatively recent development in accounting and it does not enjoy universal acceptance. In addition, these terms are used indiscriminately with the result that many accounting practices have been referred to as accounting principles, particularly in the case of governmental accounting in the United States of America. In fact, in 1974 the Committee on Government Accounting and Auditing (CGAA) of the AICPA discredited this classification and referred to principles and practices applying to governmental units as "principles".

There is a dearth of information on the development of accounting principles or standards for Local Authority or governmental accounting in countries other than the United States of America. One is, therefore, led to believe that, perhaps, until recently there was little or no regard for the development of sound accounting principles in these other countries. In fact, it appears that the various accounting practices or procedures prescribed by legislation or professional bodies for these units have been based more on traditional governmental reporting criteria than accounting requirements. This viewpoint is supported by Dean where he states that units or organizations of the public sector in the United Kingdom of Great Britain "... produce annual reports and accounts of a great variety according to ill-defined standards


of disclosure and accountancy." However, those principles or standards which have been developed to date and the moves towards the establishment of such principles or standards are outlined below:

(a) **The Principles of the NCGA**

In 1968 the NCGA formulated what are referred to as the thirteen principles of governmental accounting and stated that these principles are the "... specific fundamental tenets which, on the basis of reason, demonstrated performance and general acceptance by public administrators, accountants, and others concerned with public financial operations, are generally recognised as being essential to the correct analysis of financial operations and to the proper preparation and presentation of required financial statements and reports."(34) These thirteen "principles" of the NCGA appear as Appendix A of this study.

It is submitted that these "principles" consist of both accounting principles or standards and practices and on the basis of the classification of the AICPA they consist of two principles of accounting and a number of accounting practices. These two principles are given below:

(i) **Legal Compliance** -

A governmental accounting system must reflect compliance with legal requirements and in the event of there being a conflict between legal provisions and generally accepted accounting principles [or standards] and practices applicable to governmental units, legal provisions must take precedence.

(ii) **Financial Reporting** -

A governmental accounting system must reflect fairly the financial position and results of financial operations of the unit.

The balance of these thirteen "principles" are considered in the following section under the heading of accounting practices.

---

(34) Op cit, p 3.
In 1974, the CGAA adopted these thirteen principles of the NCGA, with certain modifications, as representing generally accepted accounting principles for governmental units. (35) The only modification which concerns this study is that which affects legal compliance. Here, the CGAA modified this principle by stating that where there is a conflict between legal provisions and generally accepted accounting principles (or practices) it is generally accepted accounting principles (or practices) which should take precedence over legal provisions and not vice versa. (36)

Soon afterwards, the National Council of Government Accounting (NCounGA)(37) was established as the successor to the NCGA under the sponsorship of the Municipal Finance Officers Association of the United States of America and Canada "... as a continuing, quasi-independent body to develop, promulgate and interpret principles of accounting, financial reporting and related financial management activities for governments in the United States and Canada". It is composed of government accountants, managers of government bodies, practising Certified Public Accountants and government accounting financial management educators, and "To assure that principles and procedures postulated for government are in accord with generally accepted accounting principles, the National Council on Government Accounting maintains close liaison with the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants". (38) Although the NCounGA accepted the modifications to the NCGA principles of governmental accounting by the CGAA, these principles are not hereinafter referred to as the principles of the NCounGA, because they are better known as the NCGA "principles" of governmental accounting.

(b) The International Accounting Standards (IAS)

In 1973, the Chartered Institute of Public Finance and Accountancy (CIPFA) which was formerly known as the Institute of Municipal Treasurers and Accountants (IMTA), in the United Kingdom of Great Britain became a founder member of the International Accounting Standards Committee (IASC). It recommended in 1975 that the accounting standards of the IASC should be adopted for the trading or enterprise activities of Local Authorities, and that the application of these International Accounting Standards (IAS) to their general government activities should be carefully considered as to compatibility with Local Authority or governmental accounting objectives. If found to be compatible then they should be applied. In fact, the CIPFA (1975a) recommended the adoption of International Accounting Standard No 1 "Disclosure of Accounting Policies" for their trading or enterprise activities and the financial statements for these activities by stating that they should be "... prefaced by a statement of the main principles adopted in compiling the accounts, and that statement shall draw attention to any changes of practice which in the opinion of the body have a significant effect on the results shown by the accounts". However, this recommendation was not accepted by the CIPFA. Nonetheless, this event represents a major departure from traditional thought on Local Authority accounting in that it is no longer considered to be completely divorced from private enterprise accounting.

At the same time CIPFA (1975a) put forward, by means of an Exposure Draft, recommendations for accounting principles for Local Authority accounting in the United Kingdom. These recommendations which may have been influenced by their membership of the IASC consist, inter alia, of the following:


(41) Op cit.
(i) The matching principle, wherever it applies to Local Authority activities, should be given high regard;

(ii) A full accrual basis of accounting should be applied as in the case of private enterprise accounting;

(iii) Depreciation accounting should be considered desirable in Local Authority accounting, and the link between assets and their source of finance should be broken (see later); and

(iv) That financial statements should be prepared in a narrative form similar to that applying to private enterprise accounting.

Unfortunately, the Working Party on Local Authority Accounting Exposure Drafts of the CIPFA (1977)\(^{(42)}\) only gave qualified support to these recommendations when it put forward certain objectives for a Local Authority Accounting system in the form of recommendations to the IASC. It stated that "By promoting this fresh debate on the subject of Local Authority Accounting the Panel hopes to affirm its view that the Working Party's comments provide a sound basis for making accounting recommendations which will have the support of a substantial majority of members of the Institute". The real reason for the rejection of these proposed principles appears to be that they represented too great a departure from present Local Authority accounting practice. However, they did stimulate discussion and re-appraisal of Local Authority accounting in the United Kingdom and resulted in the formulation of proposed objectives of Local Authority accounting for consideration by the IASC.

In November, 1976, the Institute of Municipal Treasurers and Accountants S.A. (IMTASA) issued a statement (which appears as Appendix B to this study) concerning the application of the accounting standards of the IASC to Local Authorities in South Africa. Paragraph 7 states that "Having regard

to the objectives of the International Accounting Standards Committee, the Institute of Municipal Treasurers and Accountants S.A. has undertaken through its Council and members that they will support the standards promulgated by the International Accounting Standards Committee and will use their best endeavours to ensure that financial statements of Local Authorities in Southern Africa comply with these standards, or that there is a disclosure of the extent to which they do not. In furtherance thereof, the Institute Council will arrange for copies of the International Accounting Standards, as and when they are published which are of relevance to local authorities, to be made available to members and interested persons for implementation". (Emphasis added). Thus, in the Republic of South Africa there is only qualified support for these IAS as in the United Kingdom.

Although the application of the IAS to Local Authorities have been accepted by the CIPFA and the IMTASA provided they are compatible with or relate to Local Authority accounting, no further comments on their application have been made and they cannot be considered as applying to Local Authorities. Therefore, the only accounting principles which have been formulated and accepted for Local Authorities are those of the NCGA. However, this position may soon be rectified.

5. LOCAL AUTHORITY ACCOUNTING PRACTICES

As outlined earlier in this study, accounting practices are the procedures which should flow from the accounting principles to attain the objectives of the accounting system. On the basis of the AICPA classification of objectives, principles and practices, and as the only recorded formulation of Local Authority or governmental accounting principles or practices are those of the NCGA, the accounting practices of Local Authorities in South Africa are related to these thirteen "principles" of the NCGA.

Local Authority activities involve the use of public resources and as the normal control mechanism of the profit-motive is lacking in the case of their general government activities, numerous control and accounting procedures are
imposed upon them by the legislation regulating their operations. These various procedures are designed to prescribe certain accounting practices, restrict the inflow of resources, limit their expenditures, etc. They have exerted a tremendous influence on the accounting practices employed and the financial reporting by these units. These various accounting practices are examined below:

(a) The Use of Fund Accounting

The inflow of resources, for both capital expenditure and operating purposes, is strictly controlled by the legislation covering such resources and they may only be applied for the purposes for which these resources were raised. These restrictions or limitations are extended to the use of surpluses or net income arising from their various activities. Here, such surpluses or net income do not form a common pool of resources as in the case of enterprises of the private sector and may only be appropriated for other purposes provided the legislation provides for such action; in such cases they can only be made through specific legal authorizations through the statutory budget (see following sub-section). These factors together with the diversity of Local Authority activities has resulted in the use of what is known as "fund accounting" by these units, which ensures that the various resources are accounted for separately through separate accounting entities called "funds".

A fund in government accounting is defined by the NCGA(43) as "An independent fiscal or accounting entity with a self-balancing set of accounts recording cash and/or other resources together with all related liabilities, obligations, reserves and equities which are segregated for the purpose of carrying on specific activities or attaining certain objectives in accordance with special regulations, restrictions or limitations". Therefore, in the context of Local Authority or governmental accounting, the fund is generally considered to be the accounting entity and differs from the commercial or private enterprise usage of the term which implies a store of reserves.

(43) Op cit p 161.
This practice features prominently in the thirteen "principles" of the NCGA (see Appendix A) and accounts for no less than four of these "principles". In fact, it appears to have dominated accounting thought on Local Authority and governmental accounting for some years because the means to an end has apparently been considered the end itself. It is purely the means employed by these units to comply with legal provisions relating to the segregation of resources.

(b) The Statutory Budget or "Estimates".

The principal control measure in Local Authority or governmental accounting is the statutory budget, or the "estimates" as it is referred to in Local Authority terminology. Its function is to regulate or control the operations of the unit by determining in advance the levels of financial activity of the unit to be followed and to ensure that these are not exceeded without prior approval. On approval by the legislative body of the Local Authority it becomes the formal plan of financial operations for the year in question and operates as a control measure by limiting expenditures to the amounts authorised in the budget. As with fund accounting, the use of the statutory budget forms one of the thirteen "principles" of governmental accounting of the NCGA.

This control function of the budget is inherent in all governmental accounting, and is outlined by the AAA (1972)\(^{(44)}\) where it states: "No funds can be spent except in consequence of legal authorization. Moreover, no government administrator can enter into an agreement, place an order, or otherwise commit the government to payment of funds without legislative authorization to do so". In cases where expenditures have been underestimated or where expenditures are to be incurred due to unforeseen circumstances, prior authorization for these amounts must be obtained from the legislative body by the approval of a supplementary budget or additional estimates. Failure to do so renders the person or persons responsible for such unauthorized expenditure personally liable for such amounts.

\(^{(44)}\) Op cit p 81.
There are four stages in what is known as the budget procedure, each of which contributes to this control function and these stages are outlined hereunder.

Preparation -

The preparation of the budget is the responsibility of a senior official in the Local Authority. He initiates the preparation by requesting draft estimates of income and expenditure for the fiscal year in question from all departmental heads some months before the commencement of the financial year. These are consolidated into a single draft budget which reflects the initial plans of operations for the entire unit for the next financial year.

This draft budget provides the basis on which the executive of the Local Authority can make recommendations to the legislative body on the extension or limitation of services and the financing of these activities. This often involves a reduction in proposed expenditures through the pruning of requests. The financing recommendations are those which relate to the rates or taxes to be levied on immovable property (ie the rates), the revision of service charges, etc.

On completion of this stage the draft budget is submitted to the legislative body for consideration and approval.

Authorization -

Although the budget preparation is by the executive, it can only be authorized or approved by the legislative body of the Local Authority. Therefore, formal adoption of the budget takes place after it has been considered by the Council or Board as the case may be.

The authorization stage of the budget procedure is usually preceded by the delivery of a budget speech by a member of the legislative body which sets out the policies to be followed by the Local Authority for the year. This includes recommendations on how the expenditure is to be financed; by adjustments to the rates of taxes to be levied on immovable property (ie the rates) or the revision of service charges. After debate and possible amendment, the budget is adopted and this fact together with any adjustments to the taxes to be levied or
service charges should be conveyed to the general public. On adoption, the budget becomes the legal authorization for expenditures for the year in question which are referred to as the "votes" in Local Authority accounting terminology.

**Execution** -

It is the responsibility of the executive to ensure that the budget as authorized by the legislative body is complied with. This requires effective executive control and not merely a series of accounting exercises to ensure that the votes are not overspent, or that income is collected as planned. There should be a constant review of operations and in cases where it becomes apparent that an authorization or vote is going to be overspent the causes should be established and immediate steps taken to have the budget revised.

**Review** -

This is the final and most important stage in the budget procedure because it is here that the detailed results of operations are compared with the estimated results. The executive should investigate the underspending of votes, any votes overspent and review the total operations in the light of experience gained during that year for improved planning, etc. This information should be presented to the legislative body to enable it to assess or evaluate the management of the Local Authority's affairs during that year and to assess the effectiveness of its budgeting. Unfortunately, the review of the budget is usually considered to form part of the audit procedure only.

(c) **Accounting for the Financing of Capital Expenditure**

As Local Authorities have no contributed capital (ie share capital or owner's contributed capital) as in the case of private enterprises to provide a pool of resources from which their real or economic capital (ie the elements of production like plant, equipment, raw materials, etc) is financed, they have traditionally relied on borrowed moneys to finance the majority of their capital expenditure. However, due to various problems connected with the raising of loans on the capital
market and the increased burden of loan service charges (from increased interest rates) greater reliance has, in recent years, been placed on the internal generation of funds for this purpose. Loans may be from both external or internal sources (ie a loan from one fund to another) and by the internal generation of funds is meant the accumulation of amounts set aside from income in specific funds for the purpose of making internal loans. Capital expenditure may, however, also be financed directly from income. These various methods of financing capital expenditure, other than expenditure made directly from income, are strictly controlled by the legislation applying to Local Authorities and the accounting practices are heavily orientated towards compliance with these legal provisions.

This practice is aptly described by CIPFA (1971) where it is stated: "In the accounts of a commercial concern expenditure which is not charged against production or current trading remains in the books until it is so charged, and so forms part of the assets, outlays, etc, the net proceeds representing the proprietors' 'capital' or outlay. With a local authority accountant, on the other hand, the law is uppermost in his mind. He has to consider how he can legally finance each outlay, for example, from revenue, loan or reserve...."

The loans raised or internally generated finance for capital expenditure purposes are considered to be liabilities which must be represented by the assets financed from that source until such time as the loan is repaid or the liability is discharged. In the case of assets financed directly from income, they are retained on the balance sheet until the expiry of a hypothetical loan period and then written off. Where the assets no longer exist and the source of finance has not been repaid, it is still reflected intact and represented by unexpired liabilities which are referred to as "deferred


changes" in Local Authority Accounting terminology. This practice, which has an important bearing on the financial reporting by these units, is discussed further in the following sub-section.

(d) The Linking of Asset Lives with their Sources of Finance

The control over borrowings and the traditional reliance by Local Authorities on loans raised to finance their capital expenditure has resulted in the practice, which is unique to governmental accounting, of the linking of asset lives with their sources of finance. This practice affects the accounting for fixed assets and there is a general lack of depreciation accounting (particularly in South Africa) by Local Authorities except for certain short-lived items of plant and equipment, etc.

This linking of asset lives with their sources of finance operates in the following manner. The consumption of wearing out of assets is linked with the period for which the loan raised to finance those assets is to be repaid. Here the depreciation charge is substituted by an annual loan redemption charge, which on accumulation provides an amount equal to the loan. On repayment or redemption of the loan the extinguished liability is set-off against the relative assets and these assets are written-off for accounting purposes, or the extinguished liability is transferred to an account entitled "loans repaid" if the asset exists in a usable form (ie immovable property).

This practice is justified on the basis that as the general government activities of the Local Authority or governmental unit are not subject to net income determination, depreciation accounting would serve no useful purpose. However, this is not the case with trading or enterprise activities yet this practice is applied to them in South Africa (see below). In addition, as was pointed out in the previous section, the practice of linking assets with their sources of finance necessitates the carrying of non-existent assets (ie "deferred charges") in the books of account merely to demonstrate accountability for the use of loan finance.

As far as the NCGA "principle" of governmental accounting are concerned this practice satisfies the "principle" applying to the valuation of fixed assets at original cost or estimated
value if the original cost is not available but only partially satisfies the "principle" applying to depreciation. Here the NCGA requires that depreciation charges should not appear in the accounting records of general government activities but allows the inclusion of such charges in the trading or enterprise activity accounting records. In South Africa, depreciation is not charged in any accounting records of Local Authorities.

(e) The Failure to Apply Net Income Determination to Trading or Enterprise Activities

In South Africa, Local Authorities do not distinguish between trading or enterprise activities and general government activities insofar as the results of operations are concerned. Both these types of activities are subjected to strict budgetary control and the measurement focus is upon the attainment of budgeted objectives. This practice differs from that applied in the United States of America and is examined further in Chapter 4 of this study.

(f) The Basis of Accounting

In South Africa, where the accounting for trading or enterprise activities is along similar lines to that applying to general government activities, Local Authorities have tended to apply a modified rather than a full accrual basis of accounting to all their activities. With such a modified accrual basis of accounting accrued or arrear interest on long-term loans is ignored and revenues whose receipt and accrual do not coincide are subjected to accrual only when the Local Authority is entitled to receive such revenues and they are material in amount (ie insignificant amounts are ignored). The reasons normally put forward for its use are that the general government revenues and expenditures of Local Authorities do not easily lend themselves to accrual, and items like prepaid expenses, accrued interest, etc are merely book entries which serve little purpose where the necessity for net income determination is absent. However, this does not apply in the case of trading or enterprise activities.
The modified accrual basis of accounting (i.e. where there is no accrual of charges or payments in advance) is not permissible in the Province of Natal even though it may apply elsewhere in South Africa. This differs from the NCGA "principle" which recommends a modified accrual basis of accounting for general government and similar activities.

(g) Financial Reporting

The financial reporting by Local Authorities is through a series of detailed Income and Expenditure Statements and Balance Sheets for each and every fund which are supported by schedules which reflect their capital expenditure and how this was financed. Although these various sets of financial statements are summarized into "aggregate" financial statements, from which items like inter-fund balances, etc have not been excluded, there is no single set of financial statements which reflect the operations and activities of the Local Authority as a whole. This position prevails in most countries as is evidence from the following statement by Hylton\(^{(47)}\) on the position in the United States of America: "The typical report of a municipality is a lengthy, detailed footnoted conglomeration of prose and figures. Page after page of tables, financial statements, charts and other data is the rule. Few accountants can draw basic conclusions from these statements without intense study, and to the typical non-accountant-taxpayer, this type of report is so much gibberish.... As a consequence, the average taxpayer must rely on hearsay or political oratory for information with which to form his judgment of those who operate his government for him".

To make matters even worse, Local Authority accounting terminology appears to have been developed as a means to confuse or mislead the readers of their financial statements. For example, Stone\(^{(48)}\) in dealing with the IMTASA recommendations for the preparation of financial statements of Local


Authorities in South Africa states that one of the problems "... was the need to modernise long accepted terminology and the introduction of modern phraseology which will be acceptable to all. It is natural that those of use who have been associated with municipal accounting for many years tend to resist changes in terminology and if we have been calling an accounting balance, a working balance reserve, all our working life, it naturally becomes hard to accept a recommendation that in future this should be called a tariff stabilisation provision". A "working balance" represents either an unappropriated surplus or retained income in generally accepted accounting terminology, and to suggest that a better or more understood term is "a tariff stabilisation provision" is difficult to accept.

When these financial reporting practices are examined in the light of the "principles" of the NCGA, there is little difference between South African and American practice. Here the income and expenditures are classified according to fund, function, etc, a common (though misleading) terminology is used throughout the accounting system, and annual comprehensive financial statements are prepared. Whether or not the financial reporting satisfies the objectives of the accounting system will be considered later in this study.

6. SUMMARY

The purposes of accounting is to supply significant information on the economic activities of an enterprise, organisation or governmental unit to all interested parties. This involves the measurement of the results of operations, the financial position and changes in financial position and the conveying of this information to interested parties in an understandable and useful manner. In the case of Local Authorities and other governmental units, the measurement of the results of operations for their trading or enterprise activities should be directed towards net income determination whereas for their general government activities this is not possible
because the results of operations can only be measured by comparing actual results with predetermined goals and objectives. The users of Local Authority accounting information consist of a wide variety of groups of persons of which the members of the general public are the most neglected group.

The objectives and principles or standards of Local Authority or governmental accounting have been examined in the light of a recent classification of these features by the American Institute of Certified Public Accountants. The objectives are accountability and management control. Accountability extends beyond stewardship accountability and embraces accountability for efficiency and economy, and programme results. Management control covers planning and executive control over operations and should be designed to ensure the efficient, effective and economical use of resources. The principles of the accounting system are basically to demonstrate legal compliance and to provide informative financial reporting. The principle of legal compliance has tended to dominate the accounting system and consequently the financial reporting is characterised by a "legal compliance - fiscal accountability" approach, and it is only in the United States of America that certain principles (and practices) of governmental accounting have been formulated.

The practices of Local Authority accounting have been examined in the light of the basic principles applying to these units. Here, fund accounting, the use of the statutory budget and the accounting for the financing of capital expenditure are designed to meet the principle of legal compliance. Insofar as the principle of financial reporting is concerned, legal compliance has influenced the reporting system and there is a general lack of depreciation accounting. Furthermore, financial reports consist of detailed statements on a fund basis which fail to provide readers with an overall picture of the financial operations of the Local Authority. In addition, certain terminology used is confusing or misleading, and financial reporting by these units fails to satisfy the accountability objective.
CHAPTER 3

THE ACCOUNTING FOR LOCAL AUTHORITIES
IN TERMS OF THE NATAL PROVINCIAL LEGISLATION
AND THE RECOMMENDATIONS OF THE INSTITUTE OF
MUNICIPAL TREASURERS AND ACCOUNTANTS S.A.

Note: As the majority of the accounting requirements
applying to Local Authorities in the Province of
Natal are those prescribed by the Local Authorities
Ordinance, No 25 of 1974 (Natal), or the 1974 Report
on the Standardisation of the Financial Statements of
the Local Authorities in South Africa by the Institute
of Municipal Treasurers and Accountants S.A., (1)
all references in this Chapter and subsequent Chapters
to the Local Authorities Ordinance, the Ordinance, etc,
and to the recommendations of the IMTASA ' (1974), the
IMTASA Report, etc, must be construed as references to
these two sources unless otherwise indicated.

1. INTRODUCTION

In the Province of Natal, the majority of the accounting
requirements are incorporated in the Local Authorities Ordi-
nance, 1974, but additional requirements are laid down by Acts
of Parliament, and in the case of the City of Durban, certain
additional powers are conferred on that City in terms of the
Durban Extended Powers Consolidation Ordinance, 1953. (2) In
addition, the Institute of Municipal Treasurers and Account-
ants (3) have recommended the method of presentation of the
financial statements of Local Authorities in South Africa.
These various requirements and recommendations are examined
in this Chapter.

(1) Institute of Municipal Treasurers and Accountants S.A.
(IMTASA), Report on Standardisation of Financial State-
ment of Local Authorities in South Africa, Johannesburg
1974.

(2) Ordinance No 10 of 1953 (Natal).

(3) IMTASA op cit.
2. GENERAL ACCOUNTING AND CONTROL REQUIREMENTS

Local Authorities in Natal, insofar as their accounting requirements are concerned, do not differ substantially from those in the other Provinces. There is strict legislative control over operations, fund accounting is employed and there is budgetary control over activities. Although the provisions outlined below apply specifically to boroughs they are extended to townships by Section 272 of the Ordinance. In the case of Development Areas (Health Committees) and Local Affairs Committees these matters are delegated to the Development and Services Board, or to the Local Authority having jurisdiction over the areas in which the Local Affairs Committees operate (see later).

(a) Accounting Requirements

The general accounting requirements are those contained in Section 104 of the Ordinance which states, inter alia, that they are required to maintain such books of account as are necessary to provide "... a proper record of all matters relating to the financial transactions of the council, including all cash receipts and cash payments, the revenue earned but not received, and expenditure incurred but not paid, clearly distinguishing in each case between capital and revenue and generally showing the assets and liabilities of the borough". It also requires the treasurer to prepare, within three months of the close of the financial year (unless an extension of time has been granted by the Administrator) "... separate income and expenditure accounts and balance sheets of the borough fund revenue account and of all other funds or accounts ...", and "... an aggregate balance sheet wherein shall be included in summarised form the whole of the liabilities and assets of the borough". These provisions are extended to townships but not to other types of Local Authorities (see later).

These requirements, other than the keeping of books of account, categorically specify that Local Authorities must employ fund accounting and distinguish clearly between capital and revenue transactions. The Ordinance requires a full-accrual basis of accounting because it states that a proper
record of "... the revenue earned but not received, and expenditure incurred but not paid ..." shall be maintained, there is no distinction between the accounting for general government and trading activities, and depreciation accounting is totally ignored.\(^{(4)}\) The financial reporting must be on the basis of an income and expenditure statements and a balance sheet for each fund, and the overall financial position of the borough is to be reported upon through an aggregate balance sheet.

(b) Control Requirements

Control over the operations and activities of the Local Authorities is through the statutory budget procedure and control over loan finance by the Provincial Administration.

In terms of section 105 of the Ordinance the Council shall "... frame estimates of revenue and expenditure for the current financial year in respect of the borough fund revenue account ..." and "... also frame estimates of revenue and expenditure in respect of all other funds or accounts, including those of any trading undertakings...." Therefore, the use of the statutory budget is obligatory for all funds. To ensure that the budget procedure is not unduly delayed, this section provides that the rates of local taxes\(^{(5)}\) must be set not later than four months after the close of the previous financial year (ie not later than 30th November) at a level that will ensure that no fund, on the basis of the

---

\(^{(4)}\) The word depreciation appears twice in the Ordinance as a heading to Section 146 of the Ordinance which covers the Renewals Fund as "Part 4 - Depreciation and Renewals" and as a requirement in the Auditor's Report that sufficient amounts have been set aside for depreciation of plant (vide Section 178(i)(e)).

\(^{(5)}\) Local taxation consists essentially of the "rates". These "rates" consist of levies on the community based on the value of the immovable property owned by them. It consists of a "general rate" (Section 148) to finance the operations of the Local Authority, a "water rate" (Section 149) to assist in the financing of the supply of water, and similarly a "sewerage rate" (Section 150) to subsidize the provision of water-borne sewerage.
expected income and expenditure, shall be operated at a deficit "... unless provision is simultaneously made for the excess expenditure to be met". If, on the preparation of the financial statements at the end of the financial year (ie 31st July), it is found that a fund has operated at a deficit or loss, the matter must immediately be reported to the Administrator giving reasons why the deficit arose and what steps are to be taken to remedy the position. This requirement allows the Local Authority concerned to set the rates of taxation at a higher level or to revise its service charges. The Ordinance also provides the authority to appropriate or contribute amounts, as part of the budget procedure, from one fund to another to meet deficits or expected deficits. This is possible, however, only to the extent that the contributing fund is not left in deficit.

All capital expenditure, irrespective of the source from which it is financed, must be in accordance with the capital budget or estimates. In this respect Section 106 of the Ordinance states that "The estimate of expenditure and the incurring of expenditure on capital account shall in no case exceed the amount of capital moneys available for the particular service [fund] including moneys still to be raised under borrowing powers to that service." Here, borrowings for capital expenditure purposes must be either authorized by the Administrator or by Special Loan Ordinances. Although all borrowings should be authorized by Special Loan Ordinances in terms of sections 115 and 116 of the Ordinance, the Administrator may authorize additional borrowings, in terms of section 117 of the Ordinance, for specified works or undertakings from all sources up to an amount not exceeding four times the total annual income from the general and trading funds of the Local Authority. The reason for these control measures is to ensure that Local Authorities have the necessary authorization and that funds are available for their capital expenditure purposes.
3. THE FUNDS OF BOROUGHS AND CITIES

Each and every borough or city is required to establish and maintain certain funds in terms of the Ordinance, whereas other funds are either discretionary or required by specific legislation. These legislative provisions are discussed in this section and, as cities are in reality large boroughs, no distinction between cities and boroughs is made.

At this stage it is opportune to point out that the IMTASA Report states (on page 12) that as the word "fund" usually implies that money is available for spending, the use of this word or description of these separate accounting entities should be restricted to those funds where this is actually the case. Consequently, the description of those entities not meeting this requirement should be referred to as "services" and not funds. However, for convenience they are referred to as funds throughout this study.

(a) The General Fund

The General Fund is the most important single fund of a borough and is used to account for a wide range of activities provided by the borough in the public interest or to improve the quality of life of its inhabitants (e.g. garbage disposal, sewerage facilities, streets and fire protection services). These activities comprise the general government activities of the borough which, as pointed out in Chapter 2, are mainly financed from property taxes. The establishment of the General Fund is obligatory in terms of Section 103(1) of the Ordinance which states, inter alia, that "All moneys consisting of rates, taxes, fees, duties and other charges ... levied or imposed or recoverable by or payable to the council in terms of this Ordinance or any other law shall, if not lawfully appropriated to any other fund or account of the borough, form a fund to be called 'the Borough Fund Revenue Account' ...."

A typical General Fund includes the following activities: administration (Town Clerk, Treasurer and Engineer), public works or engineers department (covering such activities as road and public works maintenance, sanitation and sewerage maintenance), estates and buildings department, and the departments of fire, licensing, traffic, public health and parks.
The public works or engineers department usually includes certain service activities like the provision of municipal workshops or garages which provide services to all departments or funds on a charge-out basis. For example, the municipal garage may service and repair all vehicles of the Local Authority although it is administered as part of the General Fund. It may also include certain activities of a trading nature which are provided in the public interest (e.g., recreational facilities like swimming pools or golf courses) and which generate insufficient income to be accounted for as trading activities.

The General Fund is the fund to which the taxes levied by the Local Authority (other than the "water rate"), the service charges (other than those applying to the trading funds), and other sources of income are credited, and normally involves the largest number of the transactions of the borough. It may also include transfers to and from other funds because this fund may finance a deficit in another fund, or receive a contribution or subsidy from one or other trading fund. In addition, the assets required by the General Fund to provide these general government services are accounted for in this fund together with their sources of finance.

(b) The Housing Fund

This fund is specifically required by section 72 of the Housing Act, 1966, which states that "Any Local Authority which is constructing or carrying out or has constructed or carried out a building or scheme by means of an advance out of the [National Housing] fund, shall, in respect of each separate advance establish and keep separate statements of income and expenditure and any other statements which it is required to keep by any law or the condition of the advance...." If any borough has not obtained any advance from the National Housing Fund then it is, of course, not required to maintain a separate Housing Fund, but this is seldom the case. For convenience and on the recommendation of the IMTASA (1974) (page 23) boroughs utilize this fund to account for the majority of housing provided by it. In this respect the IMTASA (1974) (page 32)

(6) Act No 4 of 1966.
restricts the use of this fund to approved housing schemes, and excludes such housing as employee housing, houses acquired for street widening purposes which have not been demolished, etc.; such housing should be accounted for in the fund to which it relates. Consequently, the financial statements of the Housing Fund are, as a result of the requirements of the National Housing Fund, an aggregation of the income and expenditures of the various housing schemes, advances from the National Housing Fund and other assets and liabilities.

Advances from the National Housing Fund may be used to acquire immovable property, lend money for the erection of approved dwellings where ownership may pass to the inhabitants, or to provide housing schemes where ownership remains with the borough. (7) These housing schemes may be either classified as economic or sub-economic schemes where the distinction is based on the extent to which the loans are subsidized by the State and the category of occupant; sub-economic schemes cater for the poorest sections of the community and economic schemes for the relatively more affluent inhabitants. (8) Income is in the form of interest on outstanding loans in the case of selling schemes and from rentals in the case of letting schemes. Restrictions are placed on the amounts of rentals charged on schemes provided from National Housing Fund advances and these are calculated in a manner to just meet the maintenance, interest, administration and other charges, but usually they are operated at a small loss. Any such deficit must be made good

(7) Ibid; sections 53 and 62.


This Report states that sub-economic groups "... are subsidized liberally in that only 4% rate of interest is levied on the loan funds spent on their housing and only 49% of the capital expenditure is recovered over a period of 40 years." Economic groups on the other hand, are subsidized by only 4% interest by the National Housing Fund.
by the General Fund and in cases where surpluses arise, these are for the credit of the fund itself. In the case of housing provided by the borough from its own resources, there are no such restrictions on the rentals charged.

(c) The Trading Funds

Where the borough is engaged in trading operations which warrant separate accounting treatment, separate funds may be established to account for these operations in terms of Section 103(1) of the Ordinance which states, inter alia, that "... subject to the approval of the Administrator a separate fund or account may be established by the council in respect of any trading or other undertaking, and all moneys received by or accruing to the council in connection with such trading or other undertaking shall not form part of the borough fund revenue account, but shall be appropriated to such separate fund or account...." This section, therefore, provides the authority to account for these trading activities through trading or enterprise funds.

Boroughs enjoy considerable freedom in the establishment of trading funds and besides the supply of electricity, the supply of water and the provision of the "Municipal Market", they may establish a number of other trading funds. In terms of Section 264 of the Ordinance they may, subject to the provisions of the legislation covering those activities for the country as a whole, establish a municipal transport service, aerodromes, abattoirs, refreshment rooms or cafés or restaurants in public parks, mines or quarries, radio or television stations, etc. Without doubt, the Electricity Supply Fund is potentially the most profitable trading fund of the Local Authorities and provided the service charges are set high enough they may be used to subsidize the operations of the General Fund. For example, the Electricity Supply Fund of the City of Pietermaritzburg subsidized the operations of the General Fund by R1 023 030(9) during the financial year ended 31st July 1977.

Any trading surpluses (or profits) may be appropriated or transferred to the General Fund without restriction (but subject to proper authorization) except in the case of the Water Supply Fund. In this respect section 243(2) of the Ordinance specifically states that the local tax on immovable property (i.e., the water rate), the service and other charges accruing to the Water Supply Fund may only be applied for the purposes of the Water Supply Fund. However, in terms of section 234 of the Durban Extended Powers Consolidation Ordinance, 1953, (10) this restriction does not apply to the City of Durban. Where any trading fund has operated at a deficit (or loss) this is normally made good by the General Fund.

(d) The Loans Redemption Fund

Where loans have been raised by the borough for capital expenditure purposes, and the loans are not annuity loans, provision must be made for their repayment on due date. This is achieved through the use of a Loans Redemption Fund established in terms of section 124 of the Ordinance except where the borough has been granted authority to operate a Consolidated Loans Fund (see later).

Section 124 states that "The council shall in every year pay into the Loan Redemption Fund by equal instalments ... such sum as will, with accumulations in the way of compound interest, be sufficient to pay off the loan within the period limited by such [Special Loan] Ordinance...." This section includes a proviso allowing for the payment into the Loans Redemption Fund of instalments which without interest would amount to a sum sufficient to repay the loan on due date; in such cases the interest accruing on these accumulations is paid into the fund which is responsible for the instalments.

In the case of instalments calculated with accumulated interest, section 124 requires that "... the instalments shall be computed on the basis of accumulating interest at the rate of four per cent per annum or at such other rate of interest as the Administrator may approve from time to time...." until the accumulations in the fund "... amount to a sum which, with

(10) Op cit.
the interest accruing, will be sufficient to redeem the loan at maturity". It is further provided that where the average rate of interest earned by the accumulations in the Loans Redemption Fund is either higher or lower than the four per cent (or other approved rate) "... an adjustment shall be made after every five years so as to equate for the remainder of the loan term the instalments to be annually contributed to the Loan Redemption Fund". The overall effect of these provisions is to compel the borough to pay larger than required instalments into the Loan Redemption Fund until the stage is reached when no further instalments are required. This is because these accumulations are normally invested at rates of interest in excess of four per cent per annum.

The accumulations in this fund are required to be invested in fixed interest securities (ie Government securities, Local Authority stock, etc,) by Section 124. However, this section specifically states that "... the council may borrow moneys from its loan redemption fund in exercise of the whole, or any portion of its authorised borrowing powers ..." with the approval of the Administrator and provided that sufficient moneys are available in this fund to redeem the loans on maturity date. This is, of course, a means of utilizing the accumulations in this fund for the benefit of the borough concerned, but because the loan repayment period must, by necessity, be shorter than the original loan period, the burden of loan debt is increased.

(e) The Renewals Fund

Where a borough has acquired assets from the proceeds of loans raised and the asset lives are less than the period for which the loans were raised, then the borough must, in terms of Section 146 of the Ordinance, establish and maintain a Renewals Fund. The reason is that as the annual loan repayment charges (which take the place of depreciation) must be spread over the period of the loan, and as loans raised must be represented by existing assets or deferred charges (see later), provision must be made to replace or renew the assets concerned at the end of their expected lives if this is less than the period of the loan. This is achieved by charging an
annual renewal charge against the fund concerned and accumulating this in the Renewal Fund so that the asset may be replaced during the tenure of the loan. For example, if a borough has borrowed R30 000 for 20 years to acquire an asset with an expected life of 10 years, then a renewal charge must be made for the first 10 years to ensure that R30 000 is available for the replacement of the asset after 10 years.

In terms of Section 146 any surplus arising on the disposal of the asset must be paid into the fund for which the asset was acquired where it retains its identity as a capital receipt, unless the borough maintains a Capital Development Fund (see later) and in such a case it must be credited to the latter fund.

The accumulations in the Renewals Fund must be invested in approved securities and the fund operated in the same manner as the Loans Redemption Fund, except that the borough may borrow up to 50 per cent of the fund balance for capital expenditure. Therefore, this fund is also used to provide a pool of finance for capital expenditure purposes. However, this fund is gradually being replaced by the use of Consolidated Loans Funds and Capital Development Funds (see following subsections).

(f) The Consolidated Loans Fund

The establishment of a Consolidated Loans Fund is restricted, in terms of section 132 of the Ordinance, to those boroughs which have been granted such authority by the Administrator and the date on which such fund is to be established has been proclaimed in the Provincial Gazette. The objective of this fund is given in section 133 and is "... to concentrate in one central fund all moneys borrowed by the council so as to facilitate control and management of such moneys". It provides, as the IMTASA (1974) point out (on page 35), a common "... pool of all moneys raised, including short call loans, bank overdrafts and temporary internal loans from which the capital expenditure of the Local Authority can be financed".
Where a borough has obtained authority to establish a Consolidated Loans Fund it must transfer, on the date specified in the Provincial Gazette, all amounts accumulated in and invested by the Loans Redemption and Renewals Funds to this fund. The amounts still owing by the individual funds for advances are deemed to be advances to the various funds from the Consolidated Loans Fund, and any surplus remaining in the Renewals or Loan Redemption Funds must be paid into either the Consolidated Capital Development Fund (or Capital Development Funds) or where a borough has not established such funds into the relative "Loans Redeemed and other Capital Receipts" Account (see later). From the specified date onwards the borough is required to pay all borrowings on capital account and all loan redemption charges from the various general government and trading funds into this Consolidated Loans Fund.

The use of Consolidated Loans Funds by Local Authorities represents a different approach to the operation of the financing of their capital expenditure. With Loans Redemption and Renewals Funds, the financing of capital expenditure is based on a rigid instalment or sinking fund basis whereas with Consolidated Loans Funds this is through making advances from a common pool of finance. It also allows the fuller use of resources because no amounts are required to be invested in approved securities. Other advantages of the Consolidated Loans Fund are that capital expenditure can be planned on an overall basis, advances may be made with repayment periods coinciding with the asset lives, and Loan Redemption and Renewals Funds are not required. As far as the Loans Redemption Fund is concerned, loans are repaid by the Consolidated Loans Fund, and with the Renewals Fund the contributions for renewals are treated as repayments of advances. The only requirement regarding the repayment of loans is that given in section 138 of the Ordinance which requires that the Council must ensure that sufficient moneys are available in the fund to repay the loans on due date. In practice, the requirement of having sufficient moneys available in the Consolidated Loans Fund is often met by repaying a loan from the proceeds of a new loan.

Interest is charged on advances to the various funds which is used to cover the administration expenses of the fund,
etc, and to pay the interest on the outstanding loans of the Consolidated Loans Fund. In the event of a surplus arising on the Consolidated Loans Fund in any year, then such surplus must be apportioned amongst the various funds on the basis of their contributions at the end of the previous financial year in terms of Section 142 of the Ordinance.

(g) Capital Development Funds

To assist boroughs to accumulate internal funds for capital expenditure purposes, boroughs shall or may, in terms of section 103(9) of the Ordinance establish either a single Consolidated Capital Development Fund or a number of separate Capital Development Funds. Where a single fund is established this is for the borough as a whole whereas with the latter case there is one for the General Fund and one for every trading fund. In those cases where the estimated gross revenue of the borough exceeds R50 000 the establishment of either a single or number of these funds is obligatory, but where the estimated gross revenue is less than R50 000 the establishment of these funds is at the discretion of the boroughs concerned.

With obligatory Capital Development Funds the Ordinance requires that the Council must pay into the fund or funds a minimum of three per cent and a maximum of five per cent of the total revenue of the General Fund and the trading funds, any surpluses remaining after the renewal of assets from the Renewals Fund, and the proceeds of any assets financed from loans which have been written off against the Loans Redeemed Account (see later under Balance Sheet). Here, the three to five per cent contributions may be varied with the approval of the Administrator. With boroughs where the gross revenue is less than R50 000 the three to five per cent contributions, surpluses, etc, may be paid into these funds, but there is no requirement that they must do so. This section also contains an interesting proviso that the contributions may be suspended "... when a capital development fund has reached an amount which is sufficient for the council's needs ...." Perhaps, such a situation may arise one day.

The purpose of these funds is to accumulate contributions and other sources of capital in a common pool which is then
used to make advances to the various funds to enable them to finance capital expenditure over the life of the assets concerned. In this respect, the contributions are designed to replace the financing of capital expenditure from income. Interest is charged on advances at a rate determined by the Council and applied by crediting one half of the interest to the Capital Development Fund and the other half to the funds making the contributions in proportion to their total investment in the Capital Development Funds. The retention of 50 per cent of the interest is designed to assist the fund to become self-supporting over a period of time. (11)

(h) The Trust Funds

Local Authorities often administer a number of trust funds to account for assets or resources which have been bequeathed or donated to the Local Authority for the use and enjoyment of the community. In this respect the National Committee on Governmental Accounting (NCGA) (12) defines a Trust Fund as "A fund consisting of resources reserved and held by a governmental unit as trustee to be expended or invested in accordance with the conditions of the trust". Insofar as the Ordinance is concerned, there are two types of trust funds, namely the general trust funds and the Public Improvement Fund.

(i) The General Trust Funds

These general trust funds may take many forms and are


often administered by the borough in terms of Section 264(38) of the Ordinance which empowers Local Authorities to "... hold and administer trust funds whether or not related to any of the functions of the Council ...." However, it is only those trust funds which are under the sole control of the borough and which form part of the borough's assets which are required to be accounted for in the financial statements of the borough; the other trust funds are accounted for separately. In this respect, the Ordinance does not specify their accounting treatment but the IMTASA (1974) recommends that they be accounted for separately in columnar-type financial statements.

(ii) The Public Improvement Fund

The establishment of a Public Improvement Fund is obligatory in terms of section 103(3) of the Ordinance. It is required to account for all moneys received by the borough from the sale of immovable property which was not specifically acquired for any fund (ie a grant of land from the State, donations of land, etc), the lease of any mineral rights, endowments payable to the borough by township developers in terms of the Town Planning Ordinance, 1949, and the proceeds of loans raised for the acquisition of immovable property by the fund.

The Public Improvement Fund is a trust fund of the Local Authority and in the Province of the Transvaal, the equivalent fund is referred to as the Lands Trust Fund. Its purpose is to retain the proceeds of all land sales of the Local Authority in perpetuity for the present and future benefit of the community, provide residential and industrial land to the community and account for all the townlands of the Local Authority not required for any specific purpose. To meet the objective of making residential and industrial land available it may utilize its own funds, or raise loans to acquire and sell land. Advances to other funds are made as and when moneys are available for this purpose.

The income of the fund is from land sales profits, interest on debtors for land sales, royalties from the exploitation of

(13) IMTASA (1974) op cit p 43.
(14) Ordinance No 27 of 1949 (Natal); section 16.
any minerals or quarry stone, endowments, and interest on its investments or advances to other funds. However, where any rentals are received from the letting of property held by the fund, these rentals are considered to be income of the General Fund and not the Public Improvement Fund. The fund may, in terms of section 103(3) of the Ordinance, pay up to 50 per cent of interest received to the General Fund but all other income must be retained in the fund. Any moneys in the fund not required for the provision of residential or industrial land or for the making of advances must be invested in approved securities in the same manner as with the Loans Redemption Fund.

(j) Other Funds

In certain circumstances boroughs may establish funds or enter into schemes for their employees. For example, in terms of Section 204 of the Ordinance they may, with the approval of the Administrator, establish a Medical Aid Scheme for their employees. In addition, in terms of the legislation prevailing prior to the commencement of the Ordinance (ie 9th January 1976) Local Authorities could establish Pension and Provident Funds for their employees.

The most important fund in this group is probably the Insurance Fund. The Ordinance provides, in Section 147, that boroughs may establish insurance schemes for a wide variety of risks and losses. These must be connected with their activities and include insurance of their buildings, vehicles and other movable assets, employees, cash in transit, public liability, claims under the Workmen's Compensation Act, 1941(15) etc. In addition, it may with the Administrator's approval and subject to the provisions of the Insurance Act, 1943,(15) include in the Insurance Fund a scheme for the benefit of any Councillor or employee (or their dependents) who are injured during the course of their duties. No specific requirements are laid down in the Ordinance in regard to the investment of premiums, the maintaining of reserves, the treatment of

(15) Act No 30 of 1941.
(16) Act No 27 of 1943.
surpluses, etc, and the borough is free to account for this fund as it wishes. Even the report of the IMTASA (1974) gives scant attention to this fund and only gives a recommended form or presentation of the financial statements.

As these other funds of Local Authorities usually represent completely different areas of accounting (ie insurance or pension fund accounting) they are not dealt with in this study.

4. THE FUNDS OF TOWNSHIPS

Section 272(a) of the Ordinance extends the application of the accounting requirements of boroughs to townships where it states that "Whenever any of the provisions of Section 1 and Chapters I to XII (inclusive) [sections 2-271], of this Ordinance are incorporated with or referred to in this Chapter [sections 272-293], such provisions shall be construed as, if for the terms "borough" ... or "council" ... there were substituted the terms "townships", [and] "town board" ... respectively." However, Section 285 prohibits townships from borrowing moneys from their Loan Redemption or Renewals Funds, and states specifically that a township may not borrow funds from its Public Improvement Fund for the financing of capital expenditure without the authority of the Administrator in each and every case.

Therefore the accounting requirements which are extended to townships are virtually identical to those applying to boroughs.

5. THE ACCOUNTING REQUIREMENTS OF DEVELOPMENT AREAS (HEALTH COMMITTEES) AND LOCAL AFFAIRS COMMITTEES.

In terms of section 5 of the Development and Services Board Ordinance, 1941, the Development and Services Board is empowered to "... perform the powers and duties conferred or imposed upon urban local authorities by the Public Health Act, 1919, ... and of any other law conferring or imposing

(17) Ordinance No 29 of 1941 (Natal).
(18) Op cit; section 7.
duties upon it in respect of such public health area [development area]." (19) In addition, section 29(4) of the Group Areas Act, 1966 (20) states that any Local or Management Committee shall "... for all purposes be a local authority properly established in terms of the laws in force in the province concerned." Therefore, these provisions are extended to both the Development Areas and the Local Affairs Committees.

The general accounting requirements are contained in section 6 of the Development and Services Board Ordinance, 1941, (21) which empowers the Board to collect moneys levied by the Development Areas and Local Affairs Committees in terms of the Public Health Act, 1919, (22) and the Group Areas Act, 1966, (23) respectively and states, inter alia, that the Board "... shall subject to the regulations made by the Administrator in that behalf, keep a full and correct account of all moneys received and expended in respect of every public health area [development area] within the operation of the Ordinance." Section 6 continues by specifying that the Board shall "... keep one full and true account of all moneys received and expended in respect of all regulated areas within the operation of this Ordinance". As a result of this legislation, separate accounting records and financial statements for all Development Areas and Local Affairs Committees need not be prepared provided they comply with this Ordinance.

The Local Authority Ordinance, 1974, does however provide for the accounting requirements of Development Areas in Section 299. The general accounting and control requirements are absent together with the necessity to prepare financial statements because these are covered by the requirements of

(19) Public Health Areas are now known as Development Areas in terms of Section 3 of the Development and Services Board Designation Ordinance No 14 of 1974 (Natal).
(20) Act No 35 of 1966.
(21) Op cit.
(22) Op cit; section 7(4) bis.
(23) Op cit section 30(2).
the Development and Services Board Ordinance, 1941. (24) However, it does specify that loans raised must be applied for capital expenditure only, a Public Improvement Fund may be established and that it may either create a fund or enter into a scheme for the insurance of its assets, cash in transit, etc. On the other hand these Development Areas are not permitted to establish Capital Development Funds, Renewals Funds, Loan Redemption Funds nor Consolidated Loans Funds.

As far as Local Affairs Committees are concerned, the accounting requirements differ according to whether they are separate Local Authorities or form part of an existing Local Authority. Where they are separate Local Authorities they are controlled by the Development and Services Board and when they form part of an existing Local Authority they are covered by Section 306(4) of the Ordinance which states, inter alia, that their powers and duties must be prescribed by regulation "... provided that any power to incur expenditure so delegated shall be limited to and shall not extend beyond the estimates of expenditure of the local authority". Therefore, the accounting requirements of Local Affairs Committees are also covered by the Ordinance.

6. THE IMTASA FINANCIAL STATEMENT REQUIREMENTS

In its report on Standardisation of Financial Statements of Local Authorities in South Africa, the IMTASA (1974) set out their recommendations for the preparation of the published financial statements of Local Authorities in South Africa. Although Stone, (25) in commenting upon these recommendations, stated that they provide only "... a guide to the form in which annual financial statements should be published..." and that "... no obligation is imposed on local authorities to

(24) Op cit.
effect the changes recommended..., they must be considered the basis for the preparation of financial statements of these units in this country because they are the pronouncements of a local professional and authoritative body. In this respect, these recommendations are pervasive, and, for the purposes of this study, they are considered to be the basis of Local Authority financial reporting in South Africa.

These recommendations provide that the financial statements for each fund should be made up of four separate statements, namely the balance sheet, a provisions statement, a capital statement, and an income and expenditure statement except where the nature of the funds are such that these statements do not apply, and the provision of these statements in aggregate form for the Local Authority as a whole. These statements are considered in this section together with the various items which are reflected in them. For convenience, the income and expenditure statement is dealt with first.

(a) The Income and Expenditure Statements

The recommended format of the income and expenditure statement is the two-sided traditional pattern where income is reflected on the right and expenditure on the left; the income and expenditures for each service are reflected opposite one another. Here income is normally only reflected as an aggregate figure for each service provided, whereas the expenditures are disclosed for each service under headings like "Salaries, Wages and Allowances", "General Expenses", etc. An example of what detail is required is given in Illustration 2. There is some difference in the presentation of these statements between the General, Housing, Trading and other Funds because of the differences in the nature of these funds.

With the General Fund, it is recommended by the IMTASA (1974) that the individual services be balanced off and the surplus or deficit transferred to a "Summarized Income and Expenditure Statement" which reflects the total income and total expenditure for each service and gives the overall deficit or surplus on this fund for the year. An appropriation section forms part of the income and expenditure statement
Illustration 2

THE IMTASA
RECOMMENDED METHOD OF DETAILING GENERAL
EXPENSES IN THE INCOME AND EXPENDITURE
STATEMENTS OF LOCAL AUTHORITIES. \(^{(26)}\)

General Expenses

<table>
<thead>
<tr>
<th>Item</th>
<th>R</th>
<th>R</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Electricity</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Administration Charges</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Insurance</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Legal Expenses</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Locomotion</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Postages and Telegrams</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Printing and Stationery</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Rates</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Rents</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Sanitary Fees</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Stores and Materials</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Sundries</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Telephones</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Transport</td>
<td>xx</td>
<td></td>
</tr>
<tr>
<td>Water</td>
<td>xx</td>
<td>xxx</td>
</tr>
</tbody>
</table>

and records the overall surplus or deficit for the year, any unappropriated surplus or deficit brought forward from the previous year, any appropriations made, contributions received or made and the surplus or deficit carried forward to the balance sheet.

The Housing Fund income and expenditure statement is drawn up in a different manner. Separation of the expenditure and income of the economic and sub-economic schemes for each ethnic group catered for (ie Whites, Coloured and Asians) is required and this information is disclosed for each scheme in either a columnar statement or the traditional type statement. There is, likewise, a summary income and expenditure statement with an appropriation section.

\(^{(26)}\) IMTASA (1974) op cit p 56.
In the case of the trading funds there is some recognition of the different nature of their activities because IMTASA (1974) state (on page 32) in their Report that the income and expenditure statement "... should disclose overall costs of the main subdivisions of the various services, for example, Generation and Distribution in respect of Electricity, Conservation of Bulk Supply or Distribution in respect of Water". The IMTASA recommended format of the Electricity Fund income and expenditure statement is given as Illustration 3.

Where other funds, like the Public Improvement Fund, account for their income and expenditure through such a statement, the presentation is in much the same form as with the other funds. However, because of the nature of the income of these funds, any surplus or deficit is transferred to and forms part of the accumulated funds of that fund.

The aggregate income and expenditure statement, which is not a statutory requirement, is a summary of the income and expenditures of the General, Housing and Trading Funds. Total income and expenditures as reflected in the individual income and expenditure statements are transferred to this statement and the total surplus or deficit from these operations is added to or subtracted from the surplus or deficit brought forward to give the surplus or deficit appearing on the aggregate balance sheet (see later). The objective of this statement is obviously to give a brief summary of the total operations of the Local Authority for the year.

There are certain items which appear in the income and expenditure statements of Local Authorities which require explanation as follows:

(i) **Capital Charges**

This heading covers interest and loan redemption payments in respect of external loans and interest and redemption charges for advances from the Consolidated Loans Fund, the Public Improvement Fund, etc.
**Illustration 3**

**THE IMTASA**

**RECOMMENDED FORMAT FOR THE INCOME AND EXPENDITURE STATEMENT OF THE ELECTRICITY FUND.** (27)

Name of Local Authority

**ELECTRICITY SERVICE**

**INCOME AND EXPENDITURE STATEMENT FOR THE YEAR ENDED ******

<table>
<thead>
<tr>
<th>ADMINISTRATION</th>
<th>SUNDRY INCOME</th>
</tr>
</thead>
<tbody>
<tr>
<td>Salaries, Wages and Allowances</td>
<td>xxx</td>
</tr>
<tr>
<td>General Expenses</td>
<td>xxx</td>
</tr>
<tr>
<td>Repairs and Maintenance</td>
<td>xxx</td>
</tr>
<tr>
<td>Capital Charges</td>
<td>xxx</td>
</tr>
<tr>
<td>Contributions to Capital Outlay</td>
<td>xxx</td>
</tr>
<tr>
<td>Contributions</td>
<td>xxx xxx</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>GENERATION</th>
<th>xxx SALE OF ELECTRICITY</th>
</tr>
</thead>
<tbody>
<tr>
<td>PURCHASE OF CURRENT</td>
<td></td>
</tr>
<tr>
<td>Electricity Supply Commission</td>
<td>xxx Private Consumers</td>
</tr>
<tr>
<td></td>
<td>xxx Municipal Depart-</td>
</tr>
<tr>
<td></td>
<td>ments</td>
</tr>
</tbody>
</table>

| DISTRIBUTION, MAINS, REPAIRS AND MAINTENANCE | xxx |
|                                              |    |

<table>
<thead>
<tr>
<th>CONTRIBUTIONS</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Bad Debts Provision</td>
<td>xxx</td>
</tr>
<tr>
<td>Provision for Repairs</td>
<td>xxx</td>
</tr>
<tr>
<td>Tariff Stabilisation Provision</td>
<td>xxx xxx</td>
</tr>
<tr>
<td></td>
<td>xxx</td>
</tr>
<tr>
<td></td>
<td>xxx</td>
</tr>
<tr>
<td>Balance to Summarised Income and Expenditure</td>
<td>Contribution from Tariff</td>
</tr>
<tr>
<td>Statement</td>
<td>Stabilisation Provision</td>
</tr>
<tr>
<td></td>
<td>xxx</td>
</tr>
<tr>
<td></td>
<td>Rxxx</td>
</tr>
<tr>
<td></td>
<td>Rxxx</td>
</tr>
</tbody>
</table>

Notes: 1. All items appearing under the headings of "Administration", "Generation" and "Distribution" are required to be detailed along the lines applying to "General Expenses" given in Illustration 2.

2. There are no comparative figures for the previous year.

(27) Ibid p 67.
(ii) Contributions to Capital Outlay

These contributions represent those amounts contributed by the fund concerned from income for capital expenditure. The financing of short-term assets directly from income is common practice by Local Authorities and is based on the belief that as short-term assets benefit the community contributing the income, no purpose would be served by spreading the repayment of loans for these assets over their expected lives.

Where contributions to capital from income are made they must be properly authorized in the budget.

(iii) Contributions

This heading covers transfers from one fund to another as well as appropriations of amounts from operating surpluses to provisions (or reserves) within the same fund. An example of the former type of contributions would be a contribution from the Electricity Supply Fund to the General Fund whereas the latter would be an appropriation of the operating surplus to a "tariff stabilization provision" (see below).

Where these items refer to a specific service they are usually included in the income and expenditure statement of that service and when they apply to the fund as a whole they are usually reflected as the last items in the appropriation section of the statement.

(iv) Tariff Stabilization Provision

The tariff stabilization provision is, in theory, a reserve to stabilize the rates levied or charges for services provided. Not only is the description misleading but in practice it is often used as the unappropriated surplus account. Furthermore, this reserve is classified as a provision by the IMTASA (1974) and may, in terms of the recommendations relating to the Provisions Statement (see later), be included in the Provisions Statement together with the

(28) For example, see City of Pietermaritzburg, The City Treasurer's Report and Financial Statements for the Year Ended 31st July 1977, op cit, where this is the case. To this City's credit, however, the Tariff Stabilization Provision is referred to as the Stabilization Provision and reflected as a separate item on the various balance sheets.
provision for doubtful debts, provision for maintenance, etc so that it need not be reflected on the balance sheet as a separate item. However, this matter is fully discussed in Chapter 5.

(b) The Balance Sheet

The recommended format of the balance sheet is the traditional "liabilities on the left and assets on the right" approach. No attempt is made to classify the items appearing on the balance sheets along the lines of the accepted classification in private enterprise accounting of equity, long-term liabilities, current assets, etc, nor is any attempt made to give any additional information by way of footnotes. The balance sheets vary from fund to fund depending upon their function and purpose, but as all the various items which appear on the individual balance sheets appear on the recommended aggregate balance sheet, this balance sheet is given in an abbreviated form as Illustration 4.

The various items appearing on the balance sheet which require explanation are discussed hereunder:

(i) Loans Outstanding

This item, which must be split into internal and external loans, usually represents the major item appearing on the liabilities side of the balance sheet of the General, Housing, Trading and Consolidated Loans (where applicable) Funds. The external loans are the loans raised by the Local Authority on the capital market or advances from the National Housing Fund. Included with the external loans are borrowings from the Loans Redemption Fund because, in terms of section 125(2) of the Ordinance, Local Authorities may utilize these accumulations in the exercise of their borrowing powers. Internal loans, on the other hand, are loans made by the Renewals, Consolidated Loans (where applicable), Capital Development and Public Improvement Funds to the General, Housing and Trading Funds. These internal loans are, in effect, investments of the funds concerned in other funds because they bear interest and are subject to the same repayment requirements as external loans.
Illustration 4

THE IMTASA
RECOMMENDED METHOD OF PRESENTATION OF THE
AGGREGATE BALANCE SHEET OF LOCAL AUTHORITIES. (29)

Name of Local Authority

<table>
<thead>
<tr>
<th>Aggregate Balance Sheet at</th>
<th>.........................</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Liabilities</th>
<th>R</th>
<th>Assets</th>
<th>R</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans Outstanding</td>
<td>xxxx</td>
<td>Capital Outlay</td>
<td>xxxx</td>
</tr>
<tr>
<td>Loans Redeemed and Other Capital Receipts</td>
<td>xxxx</td>
<td>Deferred Charges</td>
<td>xxxx</td>
</tr>
<tr>
<td>Accumulated Funds</td>
<td>xxxx</td>
<td>Investments</td>
<td>xxxx</td>
</tr>
<tr>
<td>(detail as required)</td>
<td>xxxx</td>
<td>(detail as required)</td>
<td>xxxx</td>
</tr>
<tr>
<td>Trust Funds</td>
<td>xxxx</td>
<td>Stores and Materials</td>
<td>xxxx</td>
</tr>
<tr>
<td>Provisions</td>
<td>xxxx</td>
<td>Unappropriated Deficit</td>
<td>xxxx</td>
</tr>
<tr>
<td>Unappropriated Surplus</td>
<td>xxxx</td>
<td>Sundry Debtors</td>
<td>xxxx</td>
</tr>
<tr>
<td>Sundry Creditors</td>
<td>xxxx</td>
<td>Cash on Hand and</td>
<td>xxxx</td>
</tr>
<tr>
<td></td>
<td></td>
<td>at Bank</td>
<td></td>
</tr>
<tr>
<td>Bank Overdraft</td>
<td>xxx</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Note:** There is a contingent liability of R... in respect of the Insurance Fund

*Comparative figures for the previous year.

(ii) Loans Redeemed and Other Capital Receipts

The item "Loans Redeemed" applies to those assets which are retained on the balance sheet under Capital Outlay which were financed from the proceeds of loans raised and which have either been partially redeemed (ie annuity loans) or wholly redeemed by the Local Authority concerned. It arises from the practice of using loan repayments instead of depreciation for the write down of assets which is explained by Stone (30) where he states "It is accepted practice for assets

(30) Op cit p 5.
to remain in the capital statement (ie on the balance sheet) at original cost until such time as they are disposed of, demolished or have lost all value...." For example, if a Local Authority raises a loan of R100 000 for 30 years to finance some asset, and after the maturity date of the loan the asset is still in use, the amount from which the asset was financed is retained on the balance sheet under the heading of Loans Redeemed. In this example, if the asset had been financed from an annuity loan then the balance of R100 000, reflected as Loans Redeemed, would have been accumulated over the repayment period of the loan as the loan indebtedness was reduced. When the asset is eventually written off, the amount standing to the credit of Loans Redeemed in respect of that asset is offset against the asset concerned.

The description "Other Capital Receipts" is a partial misnomer because it is mainly made up from revenue contributions for capital expenditure, but also includes any surpluses arising from the disposal of assets or any surpluses on the Renewals Fund (where Capital Development Funds are not maintained) and any other capital receipts. As with the Loans Redeemed, the same practice of writing assets off against this balance applies.

(iii) Accumulated Funds

This heading covers the contributions from the funds accounting for the general government and trading activities of the Local Authority to the Loans Redemption, Renewals, Consolidated Loans and Capital Development Funds. These accumulated funds are, therefore, the accumulated contributions or instalments of the Local Authority in these various funds. In terms of the Ordinance, these contributions or instalments must be paid into the relative funds and, consequently, they are represented on the assets side of the balance sheet by equal amounts under the heading of Investments (see later). For example, accumulations in the Loans Redemption Fund of R50 000 would be reflected under Accumulated Funds on the liabilities side of the balance sheet and an amount of R50 000 would appear as an asset under the heading of Investments (ie investment in the Loans Redemption Fund). Here, the
accumulated funds and investments are similar to the specific funds and specific fund investments of fiduciary accounting commonly used in the private sector, and it is difficult to understand why they are not segregated from the other assets and liabilities on the balance sheet and reflected as specific funds on the one side with the fund investments as a contra on the other.

In the case of the funds receiving the contributions or instalments (e.g., the Loans Redemption and Capital Development Funds), these contributions or instalments are described as the accumulated funds because they represent the equity of the funds concerned. With the general trust funds of the Local Authority, the capital accounts are also described as Accumulated Funds but are reflected separately under the heading of Trust Funds (see below).

(iv) Trust Funds

This item represents the balance of the "Accumulated Funds" of all the trust funds of the Local Authority and is represented by assets or investments on the assets side of the balance sheet. However, the trust assets are not always reflected separately on the balance sheet. And, as outlined earlier in this Chapter, it is only those Trust Funds which are under the sole control and whose assets form part of the resources of the Local Authority which are reflected under this heading.

(v) Provisions

As this item represents the amounts appearing in the Provisions Statement, it is fully discussed under that heading.

(vi) Unappropriated Surplus or Deficit

The unappropriated surplus or deficit applies only to those funds which provide general government or trading services. These items should reflect the operational surpluses or deficits but because of the practice of appropriating or transferring operational surpluses or deficits to or from the "tariff stabilisation provision," these amounts may appear as part of the provisions under that heading on the balance sheet (see earlier under Income and Expenditure Statements).
The correct reflection of these unappropriated surpluses or deficits is important as they represent amounts which may only be used for the purposes for which they were raised until such time as they are appropriated by the Council or Board through the budgetary procedure. Therefore, these balances are similar to those of private enterprise corporate accounting. In the case of the other funds of the Local Authority, any surplus or deficit arising from their activities represents an adjustment to the Accumulated Funds and is not reflected separately.

(vii) **Capital Outlay**

The term "Capital Outlay" covers those fixed assets of the Local Authority which are recorded in the records of the Local Authority and appear in the Capital Statement (see later).

(viii) **Deferred Charges**

This item arises from the manner in which loan finance and its use is accounted for by Local Authorities and other governmental units. Loan finance may only be applied for the purposes for which it was raised and at any one time the loan indebtedness must be represented by an equivalent amount in the form of assets or what are termed "deferred charges".

In Local Authority accounting these deferred charges may include loan raising expenses, discount on the raising of loans but may include those fixed assets which have been written-off or scrapped before the loan from which they were financed has been repaid. This latter item arises because in the absence of depreciation accounting there is no way of writing these assets off when they become redundant and they are merely transferred from the Capital Outlay account to the Deferred Charges account, and retained on the balance sheet as non-existent or fictitious assets until the loan from which they were financed is repaid.

(ix) **Investments**

Investments arise through the investment of contributions or instalments made by the general government and trading funds to the Loans Redemption, Renewals, Consolidated Loans and Capital Development Funds referred to in (iii) above.
(c) **The Provisions Statement**

According to Stone (31) "The idea of having a provisions statement is to avoid reflecting each of these balances separately in the balance sheet and the statement therefore constitutes a breakdown of the single balance reflected in the balance sheet". It is, therefore, a schedule to the balance sheet and its use depends upon the nature of the provisions. Here, the IMTASA (1974) states (on page 20) that "If the statement is included it should reflect all the provisions applicable to that service".

The recommended presentation of this statement is that it should be presented in columnar form for each fund and in aggregate form for the Local Authority as a whole. It reflects the opening balance to which the contributions, interest and other income for the year is added and the expenditure deducted from this total, to give the closing balance at the end of the year for each "provision". The use of an aggregate provisions statement is recommended and constitutes a summary of the provisions for all funds.

The IMTASA has defined, on page 13 of its Report, the word "provision" as representing "... any amount set aside for the purpose of meeting, either in whole or in part, some known or expected liability, the amount of which cannot always be calculated with substantial accuracy ..." and Stone (32) has indicated that this item should include "... the bad debts provision, repairs and maintenance provision (where no special statement is prepared)". However, many Local Authorities have interpreted this definition of a provision to include, or in certain cases only refer to, the Renewals Fund contributions because the IMTASA (1974) in dealing with the terminology to be used states (on page 12) that the use of the term "Renewals and Reserve Fund" should be replaced by the term "Provisions Statement" but makes no reference to the Renewals Fund when discussing this item. In view of this statement by the IMTASA (1974) and the absence of specimen financial statements.

---

(31) Ibid.
(32) Ibid.
for the Renewals Fund in their Report, it must be assumed that the IMTASA intend Local Authorities to include the Renewals Fund contributions in the Provisions Statement. Whether amounts set aside as specific funds to finance the replacement of an asset should be accounted for in a different manner from specific funds set aside to repay loans is open to debate. In addition, the inclusion of the "Tariff Stabilisation Provision", which represents appropriations from the surpluses arising from operations on the General, Housing and Trading Funds to "stabilize" the rates, rentals or service charges is questionable because in private enterprise accounting such amounts would be treated as reserves and not provisions. These matters are considered more fully later in this study.

(d) The Capital Statement

This statement is required for each fund and in aggregate form for the Local Authority as a whole to reflect the application of moneys raised for capital purposes. Consequently, this statement reflects the sources of funds for capital expenditure on the one side and the assets acquired on the other, and the recommended form of presentation of this statement is given as Illustration 5. It also serves to provide the breakdown of the "capital outlay" on an activity basis because no other details of this item is provided in the financial statements.

The items appearing on the expenditure side of the statement should agree with the balances of capital outlay and deferred charges on the balance sheet and those appearing on the income side of the statement should agree with the sources of finance appearing as liabilities on the balance sheet. However, this is not always the case because the moneys raised for capital expenditure may not have been fully utilized for that purpose or a shortfall on loans may have been met from revenue. For the same reasons the expenditure and income sides of the statement may also not balance without the inclusion of a balancing item which is described as a temporary advance, bank overdraft or balance as the case may be. As far as the aggregate capital statement is concerned, this is merely a summary of the Capital Statements of all the funds.
### Illustration 5 -

**THE IMTASA RECOMMENDED PRESENTATION OF THE CAPITAL STATEMENT OF LOCAL AUTHORITIES**

Name of Fund

**CAPITAL STATEMENT FOR THE YEAR ENDED ...............**

<table>
<thead>
<tr>
<th>EXPENDITURE</th>
<th>INCOME</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Capital Outlay</strong> (detail as required)</td>
<td>Loans Outstanding -</td>
</tr>
<tr>
<td></td>
<td>External xxxx</td>
</tr>
<tr>
<td></td>
<td>Internal xxxx</td>
</tr>
<tr>
<td><strong>Deferred Charges</strong> xxxx</td>
<td>Loans Redeemed and Other Capital Receipts</td>
</tr>
<tr>
<td></td>
<td>(detail as required) xxxx</td>
</tr>
<tr>
<td><strong>Other Items</strong> xxxx</td>
<td>Temporary Advances xxxx</td>
</tr>
<tr>
<td><strong>Temporary Advances</strong> xxxx</td>
<td></td>
</tr>
<tr>
<td><strong>Cash on hand or at Bank</strong> xxxx</td>
<td>Bank Overdraft xxx</td>
</tr>
<tr>
<td></td>
<td>Balance xxx</td>
</tr>
<tr>
<td></td>
<td>Rxxxxx</td>
</tr>
</tbody>
</table>

**Note:** Both sides of the statement list the various amounts under the following headings:

- Balance at ............... xxxx
- Expended/Received during Year xxxx
- Written off/ Redeemed, Transferred or Disposed of/Written off during Year xxxx
- Balance at ............... Rxxxxx

7. **THE STATISTICAL SECTION**

The inclusion of statistical information in the annual report of Local Authorities is common practice. In this respect, it is recognized that such additional information tends

(33) IMTASA (1974) op cit p 47.
to make the reporting on the operations and activities of the Local Authority more meaningful. However, the IMTASA (1974) do not provide any indication of what statistical information should be provided where they state (on page 16) that "No recommendations are made as to what statistics should appear with the Financial Statements as this is best left entirely to the discretion of each Local Authority".

The position of the IMTASA to the provision of statistical information is given by Stone, who served as a member of the sub-committee which prepared the 1974 Report of the IMTASA. Here, Stone\(^{(34)}\) states "Some local authorities embody in their published accounts statistical detail relating to the various services provided and try to relate this detail to the financial costs involved to provide some form of unit measurement .... It is presumed that the financial figures are supplemented in this way in an endeavour to make the published statements more meaningful, but with due respect for those who advocate this, there is much to be said for keeping the published statements free of any supplementary and confusing detail not specifically relating to finance".

8. THE TREASURER'S REPORT

The financial reporting by Local Authorities other than the presentation of the financial statements and the statistical report (when included) is by the treasurer who prepares a report on the financial activities for the year to preface the financial statements. It is addressed to the mayor or chairman of the council or board and gives a summary of the operations of the various funds, and any other matters on which the treasurer wishes to comment.

The treasurer's report is not a statutory report nor is its form and content specified by the IMTASA. Consequently, its use and the contents are purely at the discretion of the treasurer.

9. THE AUDITOR'S REPORT

With Local Authorities the auditor's report represents more than a statement of his opinion on the financial position,

\(\text{(34) Op cit p 11.}\)
results of operations and legal compliance, etc disclosed by the financial statements because it is a report to the Administrator and the Council or Board. In this respect, the auditor is not only required to certify, in terms of section 178 of the Ordinance, that the Local Authority has complied with the legal requirements and that the financial statements "... present a true and correct view of the financial position ... and results of trading ...." but "... shall at the same time furnish to the Administrator and the council concerned a report as to any matters of importance or interest arising out of the audit of accounts".

In practice the auditor's report usually includes additional information like the differences between budgeted and actual income and expenditure, the capital transactions of the various funds in summarized form, the unexpended borrowing powers of the Local Authority, the total loans outstanding, the rates of taxes levied, etc.

10. REPORTING TO THE PUBLIC AND THE ADMINISTRATOR

The making of the auditor's report and financial statement available to the general public and other interested parties is covered by section 178 of the Ordinance. Section 178 requires the treasurer, within 21 days after the receipt of the auditor's report, to notify the public that the financial statements of the Local Authority and the auditor's report thereon are available for inspection for a period of 30 days (during office hours), or that copies are available at a cost of up to 20 cents per page, by placing a notice on a public notice board for 30 days and by placing a single notice to this effect in a newspaper.

On receipt of the report of the auditor the legislative body of the Local Authority must report to the Administrator on any action it intends to take in rectifying any matters or irregularities disclosed by the auditor's report.

11. SUMMARY

The accounting requirements of Local Authorities in Natal are prescribed by the Local Authorities Ordinance No 25 of
1974 (Natal), and conform with the usual accounting requirements of governmental units in that there is strict legislative control over operations, transactions on capital and revenue are distinguished from one another, control over operations is through the statutory budget procedure and fund accounting is employed. Financial statements consisting of a balance sheet and income and expenditure account must be prepared for each fund and an aggregate balance sheet covering all funds must also be prepared.

The Ordinance makes provisions for nine different types of funds covering general government, trading, capital provision and redemption, the holding of resources in trust and other activities. In addition, a fund to account for loans for housing purposes is required in terms of other specific legislation. These provisions apply to boroughs and with certain restrictions to townships. Insofar as Development Areas or Local Affairs Committees are concerned, these provisions apply to a limited extent and the accounting responsibilities rest with either the Development and Services Board or the Local Authority in whose jurisdiction the Local Affairs Committees operate.

Recommendations for the preparation of financial statements have been made by the Institute of Municipal Treasurers and Accountants S.A. which are treated as the basis of financial reporting by Local Authorities in South Africa. These recommendations follow traditional lines and are designed more for internal purposes than external reporting. They differ in content from the requirements of the Ordinance only in that an aggregate income and expenditure statement is recommended.

The financial reporting is basically through the presentation of financial statements only. These are usually prefaced by a report of the treasurer, and supported by the report of the auditor which consists of the auditor's certificate and other information not contained in either the financial statements themselves or in the treasurer's report. The auditor's report and financial statements must lie open for inspection by the general public and other interested parties for 30 days, and the Local Authority must report to the Administrator on any matter requiring attention disclosed in the auditor's report.
CHAPTER 4

LOCAL AUTHORITY ACCOUNTING PRACTICES

1. INTRODUCTION

In the previous two Chapters of this study the purposes, objectives and practices of accounting applying to Local Authorities have been examined together with those specific accounting requirements applying to these units in the Province of Natal. In addition, the basis of reporting on the activities and results of operations of Local Authorities in South Africa has been outlined. What has emerged is that this accounting system is strictly prescribed by legislation and that reporting is on a "legal compliance - fiscal accountability" basis.

Why is this the position with Local Authority accounting? Is it because it is necessary to account for their activities or operations in this manner? Or, is it that public officials have operated in an environment of legal control for so long that they are unable to appreciate the purposes and objectives of accounting? The purpose of this Chapter is to examine the Local Authority accounting practices to see why this situation exists.

2. THE USE OF FUND ACCOUNTING

In Chapter 2 of this study it was pointed out that Local Authorities utilize the fund as the accounting or legal entity to assist them to comply with the legal provisions relating to the segregation of activities and resources. For many years the disadvantages of the system, particularly in the field of financial reporting, have been recognised but yet the system is still employed. Is it really necessary or is it maintained because it provides for administrative convenience and a suitable method for implementing statutory control? This question is examined in this section, together with the effects of fund accounting.
(a) Its Use for Administrative Convenience

The traditional stewardship emphasis of Local Authority or governmental accounting probably explains the development and use of fund accounting because the concept of the fund is necessary to segregate resources for legal compliance and stewardship accounting purposes. This essential feature of governmental operations is acknowledged by the National Committee on Governmental Accounting (NCGA)\(^1\) in their comments on the application of their "thirteen principles" of governmental accounting (which appear as Appendix A to this study) where they state that "... when adhered to will enhance fiscal control, [and] will denote compliance with legal requirements ..." (Emphasis added). In this respect, the legislation defines the legal scope of the activities covered by the fund and provides the means of accounting for these activities separately.

Is the use of fund accounting really necessary? Enterprises of the private sector often account for many diverse activities through a single legal entity, and there must be some reason why Local Authorities employ so many different funds. It appears that the reason is that it makes for easy external supervision and control.

As the overall responsibility for Local Authorities has been delegated to the Provincial Administrations by the Constitution of the Republic, the Provincial Councils must ensure that they operate according to the legislation regulating their activities. Consequently, the emphasis is on a system of strict control enforced through the audit and surcharge procedure. In this respect, the fund provides the legal boundaries for activities and control is exercised through what is known as the ultra vires doctrine.\(^2\) Activities are specified in

---

\(^1\) National Committee on Governmental Accounting (NCGA), Governmental Accounting, Auditing and Financial Reporting, Municipal Finance Officers Association, Chicago, 1968 p 233.

detail by the legislation and contraventions of the law are not tolerated. It is justified on the basis that as many smaller Local Authorities lack the expertise to operate successfully without strict legislative control, it is administratively sound to specify in detail how their activities should be separated and how they should operate. In the case of many larger Local Authorities, these expertise considerations do not apply and although strict control is still applied to many of their activities, they may be granted extended powers (e.g., the City of Durban).

Therefore, from an assessment of the use of fund accounting it appears that one of its main uses is for administrative convenience.

(b) The Fund as a Legal or Accounting Entity

An entity in the accounting or economic sense is defined by the American Accounting Association (AAA)(1965) as "... an area of economic interest to a particular individual or group"). The entity concept is fundamental to accounting because it defines the boundaries of economic interest in the unit or organization. Here, the AAA (1965) (4) points out that "When a definable area of economic interest exists, it is possible to identify, accumulate and report financial information about the entity as distinct from all other information". In Local Authority accounting the entity is usually considered to be represented by the individual funds.

The individual funds provide the areas of economic interest for internal reporting purposes because the activities covered by the funds usually co-incide with the individual responsibility centres within the organizational structure of the Local Authority. However, for external reporting purposes the area of economic interest is not restricted to the individual funds but extends over the entire unit. Consequently, the Local Authority represents a single legal and accounting entity made up of a number of sub-entities or funds.

(4) Ibid p 361.
The broader entity concept of Local Authorities is not generally appreciated. This is because the legislation regulating Local Authority operations has segregated their activities into separate funds and the accounting emphasis is on the individual funds. Consequently, Local Authority financial statements are prepared on a fund-by-fund basis and there is no single set of integrated financial statements for the unit as a whole.

The reporting emphasis on the basis of individual funds does not provide the necessary information on the economic activities of the Local Authority as a whole and although some attempt to do so is made through the aggregate financial statements, these are not suitable for this purpose because, in terms of section 104 of the Ordinance, the aggregate balance sheet is merely a summary of the assets and liabilities of the individual funds. Therefore, managers, elected representatives and other interested parties must sift through pages and pages of financial statements to obtain the significant information on the results of operations and financial position of the Local Authority. For those who do not possess the necessary skills, the financial statements of Local Authorities are a closed book.

(c) The Failure of Fund Accounting to Provide an Adequate Organizational or Reporting Structure

The use of fund accounting has failed to provide an adequate organizational or reporting structure for Local Authorities. As the objective area of economic interest is on the Local Authority as a whole, the individual funds must be regarded as forming segments of the unit. In this respect one would imagine that there would be one main fund of the Local Authority and that all other funds would be considered areas of economic interest relating to this main fund. However, this is not the case and all the funds are accorded equal status by the Ordinance.

This situation does not apply in the case of either the Central Government or the Provincial Administrations. In terms of sections 97 and 98 of the Republic of South Africa Constitution Act, 1961, \(^5\) all revenues of the Republic, other

\(^5\) Act No 32 of 1961.
than those applying to the Railway and Harbour Fund, are required to be paid into the Consolidated Revenue Fund. Similarly, in terms of section 88 of the Constitution Act (supra), all revenues of the Provinces must be paid into the individual Provincial Revenue Funds. Therefore, in the first and second tiers of government in South Africa there is one main fund and all other funds of the Central and Provincial Governments are ancillary to this main fund. Why does a similar situation not exist in the case of the third tier of government?

This feature is lacking in the case of Local Authorities because, although section 103 of the Ordinance states that "all moneys ... [of the Local Authority] shall, if not lawfully appropriated to any other fund ..., form a fund to be called 'the borough fund revenue account'...," this fund is equated with all other funds of the Local Authority. Therefore, there is a basic flaw in the organizational or reporting structure of Local Authorities because each and every fund enjoys equal status.

It is implied that this "borough fund revenue account" or General Fund is used only to account for those activities of the Local Authority which do not warrant separate treatment. This "left-over" attitude towards the General Fund is neither correct nor an adequate description of the fund. It is usually the largest and most important fund of the Local Authority and it is the fund which is the recipient of all the taxes levied by the Local Authority except those specifically raised for assisting the financing of capital expenditure for water supply purposes (i.e., the "water rates"). In this respect it is similar in nature to the Consolidated Revenue Account of the Central Government or the Provincial Revenue Funds and should enjoy a similar position in the Local Authority organizational structure. In fact, this position is implied in section 105 of the Ordinance where, in dealing with the use of the statutory budget, it is almost as an afterthought that it is stated that the statutory budget should be applied to all the other funds of the Local Authority.
This weakness in the organizational or reporting structure of Local Authorities also explains the fund-by-fund basis of financial reporting. Here, the controlling legislation accords equal status to each fund which, when coupled with the legal and accounting emphasis of the fund as a separate entity, does not provide a clear definition of what the accounting system is supposed to achieve. If, however, the General Fund was accorded its correct status as the main fund of the accounting system, all other funds could be viewed in their proper perspective. All other funds are only the means of achieving reporting emphasis on certain specific economic activities of the Local Authority as a whole.

(d) The Segregation of Activities

From the above assessment of the use of fund accounting, the main purpose appears to be the segregation of activities for administrative convenience. The legal responsibilities are defined by the legislation and, consequently, fiscal control and stewardship accountability are facilitated. This practice is also employed in fiduciary accounting in the private sector where specific or trust funds are accounted for in this manner as specific funds. This treatment is in itself not detrimental to the accounting system provided the functions of the funds are to separate essentially different activities and that the Local Authority operates according to an organizational or reporting structure conducive to both accountability and management control.

The Ordinance makes provision for no less than nine different types of funds and the Housing Act, 1966, provides for the establishment of an additional fund, namely the Housing Fund, by Local Authorities. Although the segregation of activities into these various funds is dealt with later in the Chapter, it should be noted that the NCGA state that "... only the minimum number of funds consistent with legal and operating requirements should be established". Whether or not the segregation of activities by Local Authorities is for operational reasons is fully examined in the following section.

(6) Act No 4 of 1966.
3. **THE SEGREGATION OF ACTIVITIES INTO SEPARATE FUNDS**

In Chapter 2 of this study it was pointed out that Local Authority economic activity only involves two different types of activities, namely general government and trading or enterprise activities although, for convenience, the financing of capital expenditure is considered to be a third category of economic activity. The various funds into which Local Authority activities are segregated are examined below in relation to their economic activities.

(a) **The Funds used to Account for General Government Activities**

The general government activities of Local Authorities are usually defined in the negative as those activities which do not fall into any other category of Local Authority economic activity. In this respect, the general government activities of Local Authorities may be considered those activities not forming part of either the trading or enterprise activities and those relating to the financing of capital expenditure.

From an accounting point of view, the general government activities should form those activities where the measurement of the results of operations is in relation to the attainment of pre-determined goals or objectives. However, this classification does not take into account those activities of the Local Authority which are of a fiduciary nature like the holding of assets or resources in trust. Therefore, the general government activities of Local Authorities should be considered those activities which are either measured against pre-determined goals or objectives or those which are of a custodianship nature. Insofar as the former group of activities are concerned, the measurement of activities is against the pre-determined levels of financial activity as laid down in the annual budget whereas the latter group consist of those resources held in trust by the Local Authority for the community.

Having defined the nature of activities which should be accounted for according to the criteria applying to general government activities, it is now possible to examine the individual funds or types of funds established for these purposes.
(i) The General Fund

The only activities which should be accounted for in the General Fund are, from an accounting point of view, those activities (not accounted for in any other fund) to which the measurement of results of operations is against pre-determined budget amounts.

The general government activities of Local Authorities are, as pointed out earlier in this study, designed to improve the welfare of the communities they serve. The measurement of the results of these operations is against pre-determined levels of financial activity because this is the only practical method of doing so. The problem is, essentially, one of providing services in the public interest without waste or excess. Consequently, the levels of expected activity on any service are set in advance and the results of operations are measured in relation to the attainment of those levels. How else can the results of a fire department or the public health department be measured? The only true measure of success or otherwise in the reduction of fires or the number of cases of disease is by statistically proven analyses spread over a number of years. However, as the financial statements cover only a period of one year, the measurement of the results of operations can only be by a comparison of projected and actual levels of activity expressed in financial terms. Although certain other departments like traffic may produce considerable income from traffic fines and parking meter fees, the level of income is not a means of establishing their success or otherwise in controlling traffic and similar measurement criteria must be applied.

With those activities which are handled by the public works or engineers' departments other than sanitation, the position is quite different. This department is involved with operations which, although they may be considered services in the broad sense of the word, are either of a maintenance or capital expenditure nature. Examples of the former are road, sewer, vehicle or equipment maintenance whereas examples of the latter are road or freeway construction, the laying of new water mains, etc.
Those activities of a maintenance nature are such that the cost of some work undertaken may be estimated with reasonable accuracy others vary in magnitude from year to year. For example, if the total cost of road or sewer maintenance averaged a certain figure for some years, a similar figure would probably be a fair estimate of expected costs in a subsequent year whereas it may not be possible to estimate the costs of vehicle maintenance from year to year with any degree of accuracy. This problem with maintenance expenditure is fully recognized in accounting in the private sector and as this item of expenditure seldom, if ever, varies in direct proportion to usage or output it is usually treated as a fixed expense in costing systems. Although fixed expenses can be measured against budgeted amounts, the possibility of exceeding the budget authorizations on such items as road or vehicle maintenance by Local Authorities may be averted by delaying expenditure from one year to another. Consequently, the budget does not provide a suitable means of measuring the results of operations for this type of activity and is used merely as a means of limiting expenditures to authorized amounts. Similarly, work of a construction nature carried out by the public works or engineers' department for the General Fund or for other funds on a charge-out basis represents expenditures which differ little in nature from maintenance expenditures insofar as measurement is concerned. In this respect, they both require skills and equipment which should be managerially accounted for on a unit cost basis.

Therefore, from both an administrative and managerial control point of view it appears that these maintenance and construction activities should be completely segregated from those general government activities where measurement of the results of operations can only be against pre-determined levels of financial activity. This could either be achieved by creating a separate interfund service fund or by creating a trust account for this activity in the General Fund which would allow these activities to be accounted for on a private enterprise basis similar to trading or enterprise activities. The use of a trust account is a method frequently applied in Australia where "... the credit balance of which represents the cash held by the undertaking and, in the books of the
undertaking, is its normal cash account". Here, as Levy points out, "The trust account device takes the financial arrangements outside the scope of normal departmental appropriation and leaves the undertaking free to adopt commercial accounting as its normal practice". The system of operation envisaged is that these maintenance and construction services should cover all funds and be operated on a charge-out basis in such a manner that the income from services provided would just cover expenditures; the time of motor mechanics, plumbers, operators and items of equipment could be costed and charged out on an hourly rate. This segregation of activities is quite common with central government operations and the government garage provides a good example of this type of activity.

The exclusion of these maintenance and construction activities from the General Fund would also provide the means of ensuring that the cost of capital projects are correctly reflected by the Local Authority. This problem arises because many works of a permanent nature are constructed by the engineers' department with the resources used for maintenance activities. For example, if a public building is constructed by the engineers' department, that department may also lay drains and sewers, alter the kerbing to allow vehicle entrance, etc. Although these expenditures should appear in the capital budget they are often ignored and many smaller items of expenditure on capital projects are considered part of their normal activities and are not charged against the project itself. If, however, the segregation of activities were such that all capital projects were handled by a centralized interfund service department or fund (including maintenance, electricity and water connections, etc) and charged against the project on a charge-out basis until the project had been completed this situation would not arise. Even in the case of major projects (e.g. freeway construction or sewerage disposal works) where the construction is often put out to tender, the cost of planning, etc. would not be lost amongst normal administration expenditures but charged against the project. In fact, this method of dealing with capital projects is a common feature in Local Authority accounting in the United

(9) Ibid.
States of America where all expenditures are accumulated in Capital Projects Funds until completion of the project and then transferred to the fund concerned. (10)

Finally, there are those trading or enterprise activities of the Local Authority which are included in the General Fund because they do not warrant treatment in separate funds (eg swimming pools, golf courses, etc). Essentially, the accounting for these activities represents a problem area, but because it has more relevance to trading or enterprise activities is fully discussed later in this Chapter. However, it should be noted that as the measurement focus for these activities should be on net income determination they should, in theory, not be accounted for in the General Fund.

In summary, therefore, the segregation of activities in the General Fund should be restricted to those activities where the only method of measuring the results of operations is against pre-determined levels of financial activity. At this stage it should be noted that agreement between estimated and actual levels of financial activity may not be an adequate measure of performance because departments may be overstaffed or that the budget allocations may cover unnecessary items. However, this matter is dealt with later in this Chapter.

(ii). The Housing Fund

The provision of housing for the community is an important general government activity of Local Authorities and provides an area to which the measurement of the results of operations against budgeted amounts is admirably suited. Rentals from letting schemes and payments received from the purchasers of houses in selling schemes are easily calculated in advance and lend themselves to budget comparisons.

The question is, however, whether these activities should be accounted for in a separate fund? Here, the answer should be in the affirmative because the activities are essentially similar in nature and the fund provides not only the legal

(10) NCGA, op cit pp 42-49.
scope of responsibilities for the carrying out of the provisions of the Housing Act, 1966, but from an accounting point of view it segregates activities for control, accountability and administrative purposes.

The only area of possible segregation of activities is that which applies to maintenance. Maintenance costs are provided by including in the rentals set, an allowance for this item which is accumulated in rental provisions and actual expenditure is charged against these amounts as and when it is incurred. Any balances on these maintenance provisions remaining at the end of the financial year are carried forward to allow for major maintenance items (like painting) when they become necessary. Control is easy and the considerations which apply to maintenance in the General Fund do not appear to apply because this type of maintenance is either of a "handy-man" nature or painting. However, should this not be the case, maintenance could easily be handled by an interfund service fund (or department).

(iii) The Trust Funds

As outlined earlier in this section, the general government activities of a Local Authority include the administration of those funds which are of a fiduciary nature because they involve the holding of assets or resources (eg parkland, art treasures, libraries, etc) in trust for the community as a whole. They usually arise from donations and form part of the general assets of the Local Authority. The accounting requirements are generally satisfied by the demonstration of adequate stewardship although there are cases where the accounting responsibilities extend beyond mere custodianship.

The Ordinance makes provision for general trust funds of the Local Authority and the Public Improvement Fund which are considered separately hereunder.

(aa) The General Trust Funds

The segregation of these assets or resources follows directly from the fiduciary nature of trust funds. They are

(11) Op cit.
accounted for in specific funds according to the requirements contained in the deeds of donation or trust.

These trust funds represent the means by which certain assets of the Local Authority are segregated from the other general assets (ie those not specifically acquired for any other fund) and may be treated as specific funds of the General Fund. In this respect, section 264(38) of the Ordinance does not require separate reporting on the administration of the individual general trust funds by Local Authorities.

(bb) The Public Improvement Fund

The reason for the segregation of the activities of the Public Improvement Fund is that its activities are of a fiduciary nature and the area of economic interest is on the amount of land held and the uses to which it is being put. Here, the ratepayers and other interested parties have a right to be kept informed of the Local Authority's efforts in making residential and industrial land available to the community. In addition, the Public Improvement Fund provides a useful source of finance for capital expenditure purposes and it appears that this may be considered by Local Authorities as being the main area of economic interest and probably accounts for the name given to the fund; the proceeds of land sales being available for the improvement of the Local Authority by means of loans.

In view of the above, it appears that the accounting for these activities through a separate fund is not only desirable but necessary. In this respect, it is accountability for land use rather than financing which is the important aspect because it is a normal feature for trust or specific fund resources to be invested outside the fund itself.

(iv) Other Funds

Local Authorities may, as outlined in Chapter 3, establish insurance schemes, pension, provident and other benefit funds, etc. These activities are all in some way or another directly concerned with the general government activities of the Local Authority although they may cover certain aspects of other funds (ie insurance of assets or employee benefits). Therefore,
they should be accounted for as part of the general government activities of Local Authorities unless they are required to be accounted for as separate funds. For example, pension funds established in terms of the Pensions Fund Act, 1956,\(^{(12)}\) must be accounted for as separate funds.

(b) The Trading or Enterprise Funds

As outlined in Chapter 2, the trading or enterprise activities of a Local Authority are those activities where the measurement of the results of operations should be on net income determination. This represents a completely different approach to that applying to the general government activities because the trading or enterprise activities are similar to enterprises of the private sector and the accounting emphasis should be on whether they are operated at a profit or loss. However, there are cases where although the nature of the activities make net income (or net profit/loss) determination possible it is considered impractical or undesirable to do so because of the insignificant amounts of income and related expenditure involved as in the case of swimming pools or golf courses provided in the public interest. Where these activities are not accounted for as trading or enterprise activities they are usually accounted for as general government activities in the General Fund even though they do not properly lend themselves to the measurement of results of operations against budgeted amounts.

It is for this reason that a trading or enterprise fund is defined by the NCGA\(^{(13)}\) as "A fund established to finance and account for the acquisition, operation and maintenance of governmental facilities and services which are entirely or predominately self-supporting by user charges". Therefore, the criterion in deciding whether or not an activity should be classified as a general government activity or a trading or enterprise activity is on the magnitude of the user charges. In this respect the NCGA\(^{(14)}\) states that "... if a substantial

\(^{(12)}\) Act No 24 of 1956.
\(^{(13)}\) Op cit p 159.
\(^{(14)}\) Ibid p 50.
amount of the revenues used to finance an activity or series of related activities in a single fund is derived from user charges the fund can be appropriately classified and accounted for as an Enterprise [or Trading] Fund. However, this is not necessarily the case because certain activities are classified as trading activities purely on the nature of the activity or expectations. For example, the IMTASA (1974)\(^{(15)}\) state that "In view of the general acceptance that airports should be self-supporting, it is recommended that the income and expenditure on airports should be reflected as a separate trading service". Here, it is difficult to believe that this facility would be self-sufficient for all Local Authorities.

The fear is that without some restriction on the establishment of trading funds every swimming pool or sports-field would be accounted for as a trading or enterprise activity along with the Electricity and Water Supply Funds. Therefore, the NCGA (supra) have provided the "entirely or predominantly self-sufficiency" principle. Generally speaking this principle does provide a working rule for the classification of activities into general government or trading (or enterprise) activities but ignores the classification for management control purposes.

From a management control point of view activities which are of a trading or enterprise nature should be accounted for through separate funds if this would enhance control over their operations. Here, the segregation of activities should be based on cost control and responsibility considerations. It is for this reason that it has been suggested in the previous subsection that all activities of a maintenance or construction nature should be excluded from the General Fund and any other fund where this activity is a prominent feature and made the responsibility of a separate interfund service fund. This could also be applied to the pooling of motor vehicles in transport pools to reduce expenditure on this item; vehicles would be drawn from the transport pool as and when required and the expenditures recovered by charges to users on a kilometer basis. Strictly speaking, the pooling of assets or activities into

\(^{(15)}\) Page 32.
separate funds, are referred to as interfund service funds and not trading or enterprise funds but the control considerations are the same. In this respect, maintenance charges and capital expenditure feature prominently in the Electricity Supply and Water Supply Funds and the comments made on this aspect in the General Fund apply equally to these and other funds where this is the case.

It is fully acknowledged that the decision to classify certain services as trading or enterprise activities is a difficult one because a conflict between the "entirely or predominantly self-sufficiency" principle and control may arise. Here, the only apparent solution is to apply the NCGA (16) "principle" that "Every governmental unit should establish and maintain those funds required by law and sound financial administration". (Emphasis added). In this respect, sound financial administration should be taken as meaning the administration of trading or enterprise and interfund service departments in the manner most conducive to management control and to ignore the "entirely or predominantly self-sufficiency" principle. Where activities lead themselves to net income determination they should be accounted for as trading or enterprise activities unless it can be convincingly proved that management control would not be enhanced and that accountability for operations would not be served.

(c) The Funds Connected with Capital Finance

In Chapter 2 it was pointed out that for convenience the use and application of capital finance is treated as a separate economic activity of Local Authorities. Therefore, before the individual funds used to account for this aspect of Local Authorities are examined, it is necessary that the importance of this feature in Local Authority operations is appreciated and that the nature of capital finance is fully understood.

The financing of Local Authority capital expenditure is an important part of their operations and involves considerable sums of money. This is because the rapid urbanization of the country demands the extension or improvement of existing services and the introduction of new services. These usually involve large investments in fixed assets because they are designed to cater for present and future needs.

The use of loan finance, whether from external or internal sources, is a convenient method of financing this expenditure, but it should, in theory, be restricted to those long-term assets which will benefit the community over the period required to repay the loan. If not, the burden of the loan repayments would fall on the shoulders of those persons not receiving the benefit of that expenditure. In this respect, financing should be matched with benefits but in practice, however, this is seldom the case because there are limitations on the repayment period for loans and many items of expenditure involve both present and future beneficiaries eg the acquisition of land for recreational purposes.

In many instances Local Authorities finance capital expenditure without raising loans at all. Here, although minor items of expenditure can be financed directly from "contributions from income/revenue", those items covering more than the immediate future must be spread over that period to ensure that the burden of financing is shared by those receiving the benefits of the expenditure. Consequently, additional demands for finance to cover capital expenditure are made on the community (ie the ratepayers) but are accumulated in what are referred to as the capital reserve funds (ie the Capital Development Funds of the Ordinance). This, then, provides a pool of finance to be used by the Local Authority for capital expenditure purposes when required. Jointly, loan finance whether it is from external or internal sources and the accumulations in the capital reserve funds are referred to as capital finance.

Having outlined the nature of capital finance in the Local Authority context it is now possible to examine the funds required to account for this item, under the headings of the loan finance funds and the capital reserve funds.
(i) **The Loans Funds**

There are three funds connected with loans which are dealt with separately hereunder:

(aa) **The Loans Redemption Fund**

This fund, which is the "sinking fund" of the Local Authority is obligatory for those Local Authorities which have raised loans from internal or external sources (which are not annuity loans) and which have not established a Consolidated Loans Fund (see later). It is used to ensure that on maturity date of the loan, the accumulations in the Loans Redemption Fund will be sufficient to repay the loan. It was, until fairly recently, considered a normal feature of Local Authority or governmental accounting to provide for the repayment of loans in this manner. However, as shall be outlined later in this sub-section, this is no longer considered necessary.

From an accounting point of view, the contributions from income made by a particular fund to the Loans Redemption Fund are amounts set aside to meet an expected liability (ie the amounts contributed are debited against the actual service and credited to a Loans Redemption account). This liability is of a known amount and, consequently, represents a reserve of that particular fund. (17) However, as section 124 of the Ordinance requires the actual payment of these contributions into the Loans Redemption Fund, the reserves set aside for loan redemption purposes are represented on the balance sheet of each individual fund by a corresponding investment and it becomes the equivalent of a specific fund in fiduciary accounting. The Loans Redemption Fund is, therefore, used as a convenient means of pooling these contributions for investment purposes because if it were not for this fund each individual contributing fund would be required to invest its contributions according to the requirements of section 125 of the Ordinance.

The reason for the establishment of the Loans Redemption Fund may have originally been to facilitate the investment of

---

(17) In this respect, a reserve is considered to be the opposite of a provision, and defined as an amount set aside to meet a commitment or liability, the amount of which is known.
amounts set aside for loan redemption purposes. However, with the Administrator's approval these contributions can now be used for making internal loans to the Local Authority and its use is to provide a common pool of money for loan finance. As the period of repayment of the internal loans from the Loan Redemption Fund is not stipulated by section 125 of the Ordinance and, provided the Administrator approves, loans can be made for periods which coincide with asset lives or shorter periods to increase its use as a revolving loan fund (i.e., amounts repaid may be loaned out again).

(bb) The Renewals Fund

This fund, as outlined in Chapter 3, is the result of the Local Authority practice of linking asset lives with their sources of finance and the need to demonstrate that loans raised are represented by either assets or deferred charges. However, as loans required to finance short-lived assets are now frequently made from the Loans Redemption Fund or the Capital Development Funds the use of this fund is gradually being reduced.

Contributions made by the individual funds to the Renewals Fund are provisions and not reserves of the individual funds, although they are treated in exactly the same manner as the reserves set aside in the Loans Redemption Fund. The reason is that section 146 of the Ordinance specifically states that these contributions are amounts set aside "... as shall be necessary for the purpose of meeting the cost of charges for renewing the existing assets..." and not to provide an amount equal to the original outlay. Therefore, the amounts set aside fall within the IMTASA (1974)(page 13) definition of provision which is an amount set aside to meet, either in whole or in part, some known or expected liability, the amount of which cannot always be calculated with substantial accuracy.

It should be noted, however, that the operation of the Renewals Fund is the same as that of the Loans Redemption Fund. This similarity even extends to providing up to 50 per cent of its accumulations for capital finance purposes to the Local Authority as a whole. Therefore, the question to be answered is whether or not there is any merit in treating the contributions by the individual funds to the Renewals Fund, and the
Renewals Fund itself in a different manner from that applying to the Loans Redemption Fund? From the point of view of the individual fund, the amounts set aside as contributions and their investment in the Renewals Fund represent amounts set aside in specific funds. Consequently, there is no valid reason, other than the fact that they are considered provisions and not reserves, why they should be treated differently from the Loans Redemption Fund contributions. Basically, the classification of these amounts as provisions or reserves is due to the annuity or sinking fund method of providing for the replacement of assets. Here, the contributions are based on the cost of the asset acquired and not the future expected replacement cost. Consequently, the amounts set aside are to meet an expected commitment expressed in terms of a known amount (ie the original outlay). Therefore, even though the wording of the Ordinance implies that these contributions are provisions they are, in reality, reserves and should be treated in exactly the same manner as the Loan Redemption Fund contributions.

(cc) The Consolidated Loans Fund

The basic purpose of the Consolidated Loans Fund is to account for all external borrowings of Local Authorities in a single fund irrespective of their sources. In this respect, it forms a common pool of finance for capital expenditure purposes.

In practice the authority to establish a Consolidated Loans Fund is only granted to the larger Local Authorities because, although it has some advantages over the use of individual Loan Redemption and Renewals Funds, the administration of such a fund requires expertise and can only operate successfully where there are substantial resources available for concentration in one fund. The reason is that no provision is required to be made for the repayment of loans raised on maturity date other than in terms of section 138 of the Ordinance, the administration of the fund should be such that "... when the holders of any stock or other security become entitled to claim redemption thereof, moneys sufficient for such redemption are available for that purpose". Although
most Local Authorities using this fund rely on the proceeds of new loans being available to repay these amounts, they must take into account the eventuality of such new loans not being available and should be able to suspend advances from the Consolidated Loans Fund until such amount is available to repay the loan. In similar circumstances, smaller Local Authorities may not have the resources available to accumulate the required amounts in time and would thereby default on their loan repayments.

The principle involved in the establishment of the Consolidated Loans Fund cannot be faulted. The pooling of borrowings in a single fund makes for enhanced control over loans and, if it were not for the possibility of small Local Authorities defaulting on the repayment of their loans, the use of this fund would also reduce the number of funds required to account for capital finance to two; this fund and the Capital Development Fund. Therefore, the use of this fund, even though it is restricted to the larger Local Authorities is a step in the right direction to reduce the number of funds used by Local Authorities.

(ii) The Capital Reserve Funds

The funds required to account for the capital reserves of the Local Authority are the Capital Development Funds. These capital reserves arise from surpluses on the sale of assets (vide section 146 of the Ordinance) and contributions by the community in the form of increased rates and service charges. The purpose of maintaining these funds is, as outlined earlier, to provide a pool of finance for capital expenditure purposes. Therefore, the individual Capital Development Funds provide or represent the "capital reserve account" for each individual fund, or the "capital reserve account" of the Local Authority as a whole where there is only a single Capital Development Fund.

From both an accounting and an economic point of view, the Capital Development funds provide a permanent pool of capital of the Local Authority. Therefore, the community becomes, in this way, the owner of the Local Authority and not merely, as the Chartered Institute of Public Finance and
Accountancy (CIPFA)(1971)(18) state, "... the proprietor of the local authority ... as the guarantor of its loans". In this latter respect, the debts of the Local Authority are the debts of the community.

The specific purpose of the Capital Development Funds of accumulating capital is contained in section 103(9) of the Ordinance where it is stated that these funds are established "... for the purposes of financing any capital expenditure..." of the Local Authority. Looked at objectively, the contribution of these amounts is nothing else but the means of providing capital for the Local Authority. The reasons usually given for the need to contribute part of the rates or service charges to these Capital Development Funds are that they are designed to replace the financing of capital expenditure from income or that these contributions take the place of loan service charges (i.e. interest and capital redemption charges) which would otherwise be necessary. However, capital expenditure is still financed from income and the latter argument ignores the fact that the loan service charges are present in addition to the contributions to the Capital Development Fund. Here, advances from these funds are made on the same basis as loans from the Loans Redemption, Renewals or Public Improvement Fund.

It is difficult to understand the reasoning behind the establishment of either a single Capital Development Fund or a number of individual Capital Development Funds unless the true nature of these contributions has been misunderstood. The contributions form the capital reserve accounts of the individual funds and with the fragmented nature of Local Authorities there is no such thing as a single capital reserve account of the Local Authority, and the establishment of a single Capital Development Fund does not make sense. In addition, why must the capital reserve accounts of the individual funds be accounted for in separate specific funds? Once again, there is no logical reason for this practice. It

appears that the preoccupation with the use of fund accounting for each and every activity of Local Authorities is the reason for this practice. Although the area of economic interest may be on the amount of resources available for capital expenditure purposes, such information is provided in private enterprise accounting by an adequate description of the item and, consequently, this cannot be regarded as a valid reason for this practice. However, the required treatment of these Capital Development Fund contributions is that applying to specific fund accounting.

4. ACCOUNTING FOR LOCAL AUTHORITY CAPITAL EXPENDITURE

In the section dealing with Local Authority accounting practices in Chapter 2 of this study, it was pointed out that the Local Authority or governmental accounting practice of linking asset lives with their sources of finance was due to the control over the borrowings and the traditional reliance on loans raised to finance capital expenditure by Local Authorities. The extent to which this practice has affected the Local Authority accounting system is little appreciated and is examined in this section.

(a) Capital Expenditure in the Local Authority Accounting Sense

Although capital expenditure is usually defined in accounting as that expenditure which has been deferred (ie not written off against related income) because either income or service benefits are expected to flow from that expenditure, Local Authorities in South Africa normally consider capital expenditure as any expenditure for which a loan authority could be obtained from a Provincial Council. (19) Therefore, capital expenditure must involve expenditure on items having a permanent or semi-permanent nature. The NCGA (20) refers to such expenditure as capital outlays which are defined as "Expenditures which result in the acquisition of or addition to fixed assets" and that fixed assets are "Assets of a long-

(19) Cowden op cit p 183.
(20) Op cit pp 155 and 160.
term character which are intended to continue to be held or used, such as land, buildings, machinery, furniture, and other equipment". Irrespective of which definition is preferred they both have the common feature that capital expenditure does not cover minor items of expenditure or those having limited lives. Here, the NCGA(21) goes so far as to specify that to be classified as a fixed asset the item must have three attributes, namely, a tangible nature, a life longer than the current financial year and a significant value. From a purely financing point of view the definition involving the obtaining of a loan authority is probably the one which best describes this expenditure because the Provincial Councils are not likely to sanction a loan authority involving trivial items; these would have to be financed from income.

The deferral principle of accounting for capital expenditure by Local Authorities is ignored because it is compliance with the legal restrictions applicable to loan finance which is the deciding factor. This is outlined by the Chartered Institute of Public Finance and Accountancy (CIPFA)(1971)(22) where it is stated that "...some local authority accountants think that... the practice of retaining expenditure in the books as capital or assets should be discontinued. If this were done - and the practice has already been adopted in some places - only expenditure met from loan would be retained in the accounts - and then merely temporarily as a bookkeeping necessity, the expenditure being gradually written out as the loans were repaid. Thus an authority [ie a Local Authority] which has met all its expenditure from revenue (or repaid all its debts) would show no capital outlay in its balance sheet, and the accounting problems of capital expenditure would disappear". However, CIPFA (1971)(23) does admit that it is unlikely that any Local Authority would present financial statements without any assets because a summary of the assets of a Local Authority "... must have some significance: for example, it gives the layman an idea of the size and importance of the

(21) Ibid p 93.
(22) Ibid p 12.
(23) Ibid.
... [local] authority's activities". Furthermore, it is acknowledged that a record of assets does facilitate control over the property of the Local Authority.

From an accounting point of view this attitude towards capital expenditure is totally unacceptable because not only do the fixed assets of an organization form part of its real capital but such an approach makes reporting on the financial position of the entity virtually impossible. However, this attitude towards fixed assets permeates the entire Local Authority accounting system. The reason is traditional in nature and stems from the belief that Local Authority assets, because they form part of the assets of the community, have no value and the only reason that they are temporarily maintained in the books of account is a book-keeping necessity or that it facilitates stewardship accountability. As far back as 1908 Duncan MacInnes (24) summed up this viewpoint by stating: "The wealth of a city is as seen from the hilltop. It is the collective wealth of the freeholders and their tenants. Every public building, park, street, and sewer has been paid for by the inhabitants, belongs to them in common, and enhances the value of every business and residential holding, which is taxed accordingly; while the municipal corporation, when considered as a separate entity and apart from the private estates within its territory is a penniless nonentity. As its balance sheet, therefore, can contain no assets but what belong to its inhabitants and no obligations but what are pledged to discharge, no significance attaches to the wealth held in common beyond what attaches to the wealth held by each and all individually".

At first glance, this viewpoint that the wealth of a city "as seen from the hilltop" is not incorrect. Assets are not acquired by the Local Authority for resale and it is only with the trading or enterprise activities where assets are acquired for the purposes of profit-making. The financial position has less significance with Local Authorities than with enterprises of the private sector because the debts of the Local Authority are those of the community. Why, then, is

this attitude towards capital expenditure by Local Authorities not acceptable from an accounting point of view? The reason lies in the objectives of the Local Authority accounting system. The viewpoint that the "wealth of a city is as seen from the hilltop" may well be true but it ignores the requirements of accountability and management control. In this respect Green (25) states "... developments in accounting have pushed the viewer off the hilltop ...."

How can a Local Authority provide accountability for its assets where inadequate records are maintained? No wonder the AAA (1972)(26) state: "For many governmental units, the investment in long-lived assets is substantial. It is imperative, therefore, in accordance with the overall objectives of accounting, that useful, reliable, and generally accepted principles be adopted for planning, controlling and reporting on the acquisition, use and disposition of such resources".

The proper accounting for the fixed assets of Local Authorities is fully recognized in the United States of America and the NCGA (27) are quite emphatic where they state that the proper accounting for fixed assets "... is a prerequisite to the preparation of satisfactory and complete financial reports". Without such records it is impossible for the Local Authority to provide stewardship accountability or accountability for the efficient and economical use of resources. Here, it is interesting to note that the CIPFA (1971)(28) state that "... the local authority system of financing projects by loans [is] merely spreading the impact of capital expenditure over a number of years ..." and that "... the expiration of

(27) Op cit p 93.
the loan is merely used as a rough and ready method of establishing a date for writing out [off] assets which are best not retained indefinitely in the books". From a management control point of view, the attitude that the fixed assets of the Local Authority are purely a deferral of expenses which, were it not for the method of financing them, would otherwise have been written off is equally unacceptable. However, this aspect is fully dealt with in the following sub-section.

(b) The Nature and Treatment of Local Authority Fixed Assets

Having examined the Local Authority approach towards capital expenditure it is now possible to consider the nature of Local Authority fixed assets and their treatment.

(i) The Nature of Local Authority Fixed Assets

Generally speaking, the fixed assets of Local Authorities do not differ in nature from those of any other type of organization. In this respect they form part of the real capital of the Local Authority which is necessary to enable it to provide its services to the community. However, in the case of enterprises of the private sector all assets are usually classified as production or operational assets whereas with Local Authorities there is an additional group of assets which are known as domain assets.(29)

Production or operational assets are those assets of the Local Authority which will not be converted into cash or sold in the production process but are used up or consumed in the production or transformation process. They usually consist of buildings, plant and equipment but can include land which is used for mining or quarrying purposes. In this respect King and Baron(30) state that these assets "... are typically replaced on a rhythmic basis as part of the capital replacement program ...." On the other hand, domain assets


(30) Ibid.
are those assets which are generally beneficial to the public at large (31) and include such items as flood control dams, forest reserves, parkland and the land on which roads and public buildings are built or erected. Although these domain assets may need to be replaced from time to time they are not consumed in the day to day operations of the Local Authority. This distinction between the assets is of particular importance in Local Authority accounting because it distinguishes between those assets which are involved in the matching process and those which are not. This aspect is dealt with below.

(ii) The Treatment of Local Authority Fixed Assets

For convenience this important area of the Local Authority accounting system is dealt with under separate headings below:

(aa) The Failure to Depreciate Operational or Productive Assets

As pointed out in the previous sub-section, the operational or production assets of the Local Authority are those that are worn out or consumed in the production of services or goods for the community. In this respect they constitute part of the cost of producing public goods or services and as the CIPFA (1975a) (32) state "The gradual wearing out, or consumption, of plant and equipment is as much an expense as the consumption of stores and labour". This statement applies equally to buildings, other works of a semi-permanent nature (ie water mains and road surfaces) and such items as traffic lights.

In private enterprise accounting this consumption or wearing out of the operational or production assets is accounted for by depreciating the assets over their useful lives and charging the annual or periodic depreciation charge against the relative income produced. In theory, the depreciation charge should represent the amount by which the service potential of the asset has been reduced but this is seldom the

(31) Ibid.
case in practice, and normally the depreciation charge is calculated by subtracting the residual value from its cost and apportioning this balance over its useful life. Irrespective of the fact that this practical method may not be theoretically correct it does provide a means of matching the consumption or wearing out of operational or productive assets against the related income.

With Local Authorities there is no such attempt to charge the costs of the consumption or wearing out of these operational or productive assets as an expense in the production of their goods and services, other than in certain instances with short-lived plant, furniture or equipment. Usually, the only endeavour to do so is to charge the loan service charges (ie interest and loan redemption charges), the renewals charges if applicable (ie the interest and redemption charges payable into the Renewals Fund) and the cost of assets financed from income against the service provided. In Local Authority accounting circles this practice is considered quite satisfactory and it is apparently believed that it takes the place of depreciation charges.

How can such treatment be a satisfactory method of establishing the costs of services or goods provided? The answer to this question is that it does not provide a suitable method no matter how it is viewed. First, the loan redemption charges have nothing to do with the assets themselves because they are merely the financial expenses incurred in the acquisition of the fixed assets. And, as the CIPFA (1971)(supra) have pointed out, the use of loan finance is purely the means of spreading the payment for the fixed assets over a number of years, and consequently, the period of the loan is purely a rough guide for deciding when the assets should be written off. Secondly, Renewals Fund contributions are sometimes levied in addition to the loan service charges. Here, the reason for these additional charges is to provide a sum of money to replace the worn-out asset if the original asset had a life of less than the repayment period of the loan. This is necessary because with the matching of assets with loans raised, the loan must be represented by capital outlay. In this respect, were it not for the provisions of section 146 of the Ordinance the loan raised could have been represented by deferred charges. Thirdly, the charging of the cost of assets with a life exceeding the current financial year against
income fails to distinguish between capital and income transactions because there is no deferral of service potentials.

Why is it employed? The reason normally put forward to explain its use is that as the general government activities of Local Authorities are service orientated and are measured in relation to the budget, and provided the amounts are authorized in the budget it provides a suitable method of dealing with its capital expenditure. It is the traditional Local Authority attitude towards the controversial question of depreciation accounting, and one which totally ignores the matching process necessary for the determination of the costs of programmes or operations.

Developments in Local Authority accounting relating to the acknowledgement that the consumption or depreciation of operational or production assets as a necessary component of the cost of general government operations are becoming more widespread. For example, the NCGA(33) state as one of their thirteen principles of governmental accounting that depreciation should not be recorded in the accounting records for general government activities but state that "The recommendation that depreciation not be recorded in general governmental accounts does not, of course, deny its existence as an economic fact of life in governmental operations". Similarly, in October 1975 CIPFA (1975b)(34) recommended in an Exposure Draft that depreciation accounting should be adopted by Local Authorities in the United Kingdom by stating: "We believe that ... a final break in local authority accounts, of the traditional link between assets and their source of finance, with the generation of cash flows to capital replacement by means of normal depreciation rather than by way of debt redemption, is simple to achieve, and would greatly improve the quality of local authority accounting". This recommendation was rejected by the Working Party on the CIPFA Exposure Drafts(35) in March 1977, on the most peculiar grounds. Here,

(33) Op cit pp 10-11.
(34) Op cit p 15.
(35) Chartered Institute of Public Finance and Accountancy (CIPFA), Report of the Working Party on Local Authority (continued on the next page)
the Working Party accepted the matching principle that expenditures should be matched against units of service provided, but stated that "... the exposure draft did not show the practical benefits of transferring a basis of loan charge repayment to depreciation repayment ...." The Working Party continued its reasoning by acknowledging "... that assets should be written down over time and that the revenue accounts should reflect this year by year ..." but recommending that the loan service charges be called capital charges and that the financing of all fixed assets should be dealt with on a consistent basis. That is, that these capital charges should be equated with the life of the assets and where fixed assets have been financed from income, the payment should be charged against the appropriation account. In order to match the cost of these fixed assets financed from income, an annual capital charge should be calculated as if the fixed asset had been financed from a loan and debited against the relative service and credited to the appropriation account.

This recommendation by the Working Party on the CIPFA Exposure Drafts is a very significant move towards the proper accounting for capital expenditure by Local Authorities. Not only has the matching principle in respect of general government activities been recognized but some attempt has been made to acknowledge depreciation as an economic fact in Local Authority accounting in the United Kingdom. However, it still confuses depreciation and financing transactions and fails to sever the link between fixed assets and their sources of finance.

Subsequent to the Report of the Working Party on the CIPFA Exposure Drafts, the question of depreciation accounting was examined, amongst other matters affecting State and Local Authority accounting, by Davidson et al. (35) of The Center for Accounting Exposure Drafts, Public Finance and Accountancy, Vol 4, March 1977, pp 78-82.

(35) (continued)

Management of Public and Nonprofit Enterprise of the University of Chicago and they came to the conclusion that proper depreciation accounting is necessary to establish the cost of Local Authority or governmental programmes. Therefore, there appears to be a movement towards the acceptance that depreciation accounting is not only desirable but necessary for the general government activities of Local Authorities in the United States of America.

Up to this point no mention has been made of the operational or productive assets used for the trading or enterprise activities of the Local Authority. Here, the economic activity model which was explained in Chapter 2 makes it quite obvious that the matching principle as used for the accounting for enterprises of the private sector applies equally to the trading or enterprise activities. Therefore, depreciation accounting should be applied to their operational and productive assets. However, this aspect is more fully dealt with later in this chapter.

(bb) The Treatment of Domain Assets

The domain assets acquired for the general benefit of the community are those assets of the Local Authority held in perpetuity or which require replacement only in exceptional circumstances. They vary in magnitude from Local Authority to Local Authority and usually represent a substantial investment because the roads and parkland of a Local Authority alone may represent hundreds or thousands of hectares of land.

The Local Authority accounting treatment of the domain assets varies according to whether they are identifiable or not. In this respect the IMTASA (1974) (page 21) state that "Assets such as roads and mains, which are not individually reflected in the accounting records, should be written off when the relevant loan or advance is redeemed .... Identifiable assets, no matter from what source they are financed, should only be written-off when they have been disposed of, demolished or have lost all value". This means that some domain assets are written off and others are retained in the books of account. In addition, items like the land upon which public buildings have been erected or the land on which roads
have been made are treated as part of the buildings or roads. From both economic or accounting points of view, the variation in treatment of domain assets is incorrect because they form part of the real capital of Local Authorities.

As far as land on which buildings have been erected is concerned CIPFA (1975a)(37) recommend that "The joint asset should be depreciated over the expected life of the buildings, making due allowance for the expected residual value of the land at constant prices in the depreciation calculation". However, as the introduction of depreciation accounting was rejected by the Working Party on the CIPFA Exposure Drafts (supra) this treatment is not applied, but it does provide an authoritative recommendation on the principle which should be applied to these domain assets. Here, a distinction should be drawn between the land and the improvements or developments on them. In this respect, the land should be considered the domain asset and the developments or improvements the operational or productive assets. This treatment would ensure that only those fixed assets used for particular services are charged against that service, and that the domain assets remain in the accounting records.

The financing of the domain assets does provide some accounting problems. First, as they are generally long-lived assets, how should they be financed? Loans in perpetuity are not available and, therefore, in most cases the asset life would exceed the loan repayment period. Here, the financing of these domain assets should be spread over as long a period as possible (ie 30-50 years). Secondly, although the General Fund is the correct fund to which the loan service charges should be charged, it is not always easy to decide against which activity these charges should appear. However, these decisions depend upon the nature of the domain assets concerned.

(c) Why is Depreciation Accounting Not Applied by Local Authorities?

Although depreciation accounting is applied to trading or enterprise and interfund service activities in the United

(37) Op cit p 15.
States of America it is not applied in the United Kingdom nor the Republic to any of their activities. Why is this the case? It appears that the reason is the traditional reliance on loans raised to finance their capital expenditure because the accounting system is more concerned with this aspect than the establishment of the costs of services provided.

As pointed out earlier in this section, loan service charges are of a financial nature and not connected with the consumption or wearing out of assets in the production process. Therefore, it should not be a case of whether depreciation accounting can or cannot be applied but how it should be applied if the accounting system is to meet its objectives. In this respect, the most disturbing feature of present Local Authority accounting practices is that the failure to apply depreciation accounting makes the use of costing systems virtually impossible by these units. Even where the NCGA recommendation of applying depreciation accounting in memorandum form to general government activities is applied, the system is not satisfactory. Here, the AAA (1971)\(^{(38)}\) point out that "By allowing only memorandum entries for depreciation, authoritative pronouncements have unwittingly encouraged 'non-accounting' for depreciation and thus have thwarted the development of adequate cost accounting for not-for-profit organizations".

The reason often given for the lack of depreciation accounting is that the accounting system must comply with the legislative provisions because the Ordinance requires, for example, in section 146 that loan redemption charges must be charged against the "revenue" of the fund concerned and the legal requirements override the accounting considerations. This then explains the basic problem with Local Authority Accounting. On the one hand it is a matter of accounting for the economic activities whereas on the other it is a case of demonstrating legal compliance irrespective of the accounting

implications. No wonder the Committee on Government Accounting and Auditing (CGAA) of the American Institute of Certified Public Accountants (AICPA)\(^{(39)}\) took exception to the NCGA "principle" (see Appendix A) that in the event of there being a conflict between legal provisions and accounting principles, legal provisions must take precedence. As illustrated in the previous sub-section with the CIPFA rejection of depreciation accounting in the United Kingdom, the desire to account for the consumption or wearing out of productive or operational assets properly and to provide proper cost-based accounting information must have the support of professional bodies like the IMTASA. Once such support has been obtained they have the responsibility to see that the legislation is changed.

On the assumption that Local Authorities would wish to apply depreciation accounting, the accounting treatment should be along the lines applicable to private enterprises because, in theory, the accumulated depreciation would, when deducted from the fixed assets, reflect the amount by which their service potentials would have been decreased. This transaction would be purely a book entry with the depreciation charge debited against the service concerned and credited against the accumulated depreciation account. Contributions from income for capital expenditure purposes would no longer apply and it is only in the case of loan finance that loan redemption contributions would be necessary. Here, the loan redemption contributions could be paid into the Loans Redemption Fund in the normal manner and accumulated in an investment account in the relative fund which, on maturity of the loan, would be offset against the loan.

Concern is often expressed that the depreciation of assets financed from loans would result in a double charge against the services concerned; one for depreciation and another for loan redemption charges. This would be correct if depreciation

charges were required in addition to loan redemption charges. Here, depreciation charges must be viewed in the light of a charge against income which is not expended in cash and consequently, that cash could be applied for loan redemption charges. The interest on loans raised is a normal expense relating to finance in the private sector and the position with Local Authorities should be no different. However, the difference between the financing of assets in the private sector and Local Authorities is that private enterprises rarely employ the annuity basis of repaying loans raised. If they did, the capital charge (i.e. the payment of the principal) would probably be appropriated from income as in the case of Local Authorities. Looked at objectively, the use of depreciation accounting by Local Authorities would generate additional cash flows and make the use of cost-based data possible.

In the previous sub-section it was pointed out that there is now some recognition of the need for depreciation accounting in Local Authority circles. Perhaps, in the not too distant future it may be introduced, together with proper cost-based systems of control.

5. CONTROL OVER OPERATING INCOME AND EXPENDITURE

The control over the operating income and expenditure of Local Authorities is an important area of the Local Authority accounting system. In Chapter 2 it was outlined that the statutory budget was the principal control measure for the operations of Local Authorities, and in this respect it is the prescribed method of control. Therefore, other control measures should operate within the framework of control set by the budget.

In this section the use of the statutory budget as a means of control and other related matters are considered.

(a) The Budget as a Control Measure

As stated earlier in this study, the budget operates as a control measure by limiting the expenditures on activities to predetermined levels, and in this respect it is considered
an essential feature of Local Authority or governmental financial control. However, the effectiveness of the statutory budget in this connection depends upon whether or not the budget forms part of the overall plan of operations of the Local Authority. If it does form part of the plan of operations then it can provide a most useful and effective plan of intended operations in the short-run. Here, it provides the monitoring system for the implementation of those courses of action which have been established as the most suitable means of achieving the desired goals or objectives. Where it does not form part of such a plan of operations, it is purely used as a means of limiting expenditures to predetermined levels.

Normally, the budgets prepared by Local Authorities are not part of an overall plan of operations. They are prepared on the basis of the previous year's levels of expenditure and the only real consideration is whether or not the requests are reasonable in relation to those amounts. Based on the historical levels of expenditure, a five per cent increase in expected expenditure may appear reasonable but unless it can be justified in relation to existing conditions it may lead to unnecessary expenditures because the competitive element in government often manifests itself in attempts to increase the importance of certain departments relative to others. In this respect, it is a well-known budget tactic to request double the increase to obtain the desired amount of additional funds. Unfortunately, Local Authority budgets are at times not vetted in practice on a justifiable basis (see later) and the apparent reasonableness of increases in requests is the only criterion which is applied. The effect is, as the AAA (1971)\(^{40}\) point out, that "This tends to perpetuate old and obsolete methods of performing tasks and does not stress the seeking of alternative means to achieve the desired objectives".

Although some measure of control may be exercised at the authorization stage, it is the executive stage where the major control function should be exercised. However, in

\(^{40}\) Op cit p 133.
practice this is seldom the case. Provided income collections conform with expectations and expenditures stay within the authorized limits little attention is paid to ensuring efficient and effective use of resources. The fault, as Ray (41) points out, lies in the tendency to emphasize expenditures rather than expenses in Local Authority accounting. Both expenditures and expenses incurred reflect the efforts or costs of attaining a given objective. However, expenditures consist of the total costs or sacrifices made in attaining an objective whereas expenses are the expired costs in using assets or resources to produce a benefit or accomplish a purpose. (42) Therefore, expenses involve the actual measurement of the cost of operations. This matter is considered in more detail later in this section.

The review stage of the budget is also an important area of control because it is here that the overall results of operations are compared with the estimated results. Similarly, this is seldom the case because the budgeted amounts are not included in the financial statements. Such comparisons may be included in the treasurer's report but only in aggregate amounts. Although, there may be internal review of the results of operations in relation to the budget, this information is not readily available to the legislative body. In fact, this information is often only available some months after the close of the financial year at the budget authorization stage. This is of particular importance in the Province of Natal because the budget need only be authorized some four months after the commencement of the financial year in question in terms of section 105 of the Ordinance.

Looked at objectively, the budget procedure, unless it is used in conjunction with a sound system of management control and adequate financial reporting, is merely the means of limiting expenditures to pre-determined levels. An examination of any statutory budget discloses ample room for the


(42) Ibid.
creation of hidden reserves and the incidence of such items as sundry expenses as a normal budget item for virtually every service is an example of this feature. Therefore, in the absence of a sound system of management control the statutory budget cannot be regarded as an adequate means of measuring the results of the general government activities of a Local Authority.

(b) The Effective Use of the Budget

As pointed out above, the budget as normally used in Local Authority accounting is of limited use. But, how can the effectiveness of the budget be improved?

In Chapter 2, the planning process was outlined together with the operation of Programme Budgeting (PB) or Planning-Programming - Budgeting Systems (PPBS). Here, it was pointed out that, although its logic was unquestionable, its introduction in Local Authority or governmental accounting had not been entirely satisfactory because it requires a radical departure from present Local Authority or governmental accounting practices. Essentially, these practices which require change are those relating to the planning process, the segregation of activities and the improvement of budgeting techniques. These three areas are examined below.

(i) The Budget as Part of the Planning Process

Basically, the budget should be considered the means of achieving the goals or objectives of the overall plan of operations in the short-run. Here, it should be that part of the planning process which ensures that operations are conducted according to the courses of action which were decided upon in the medium-term planning operation which, in turn, were based on the long-term plan of operations. In this respect, the AAA (1971)\(^{(43)}\) state: "Today, in theory if not in practice, the budget is considered incomplete and inadequate if the plans do not concentrate on functions, activities, and programs - not only in financial terms but also

\(^{(43)}\) Op cit p 101.
in terms of the services to be rendered to society".

In practice this is not the case because to use the annual budget as the major plan of operations allows a step-by-step approach in the planning process. Here, the use of such an approach "... reflects not merely bureaucratic caution but the built-in wisdom of making progress by small, sequential steps". The disadvantages of this annual budget approach is that the planning process does not allow for the establishment of priorities because planning is on the basis of the previous year's levels of financial activity and the planning process is based on the reasonableness or otherwise of the budget requests. It then results in short-term planning and does not "... prevent allocation decisions which have a long-term incremental effect being made purely in terms of the initial, short-term, incremental spending".

The introduction of PPBS appears to be the most satisfactory method of achieving the use of the budget as part of the planning process. In this respect it relates the three areas of planning, programming or the decision process of alternative courses of action, and budgeting. This viewpoint is supported by the AAA (1971) where it states "... PPB-supported systems or similar approaches appear to be the most promising avenue for progress in the immediate future".

Having established that the budget should form part of the planning process, the use of the budget as a means of assisting management and as a means of measurement may be examined.

(ii) The Budget as a Management Necessity for Trading or Enterprise and Interfund Service Activities

It was pointed out earlier in this Chapter that the activities of Local Authorities should be segregated in a manner


(45) Ibid.

that would facilitate management control and the measurement of the results of operations. These aspects are now examined in relation to the budget.

The statutory budget is a rigid budget because the levels of financial activity are set in advance and expenditure may only be exceeded provided the excess expenditure is authorized as part of the supplementary or additional budget. It presupposes that all activities of the Local Authority are similar in nature and lend themselves to this type of control. In this respect, it has already been pointed out that it is only those activities where the measurement of the results of operations are in relation to pre-determined levels of financial activity which are suited to this method of control. Yet, the statutory budget is applied to all the activities of the Local Authority irrespective of their nature.

Although some trading or enterprise activities lend themselves to more accurate estimation than others, and interfund service departments, where used, may use estimated levels of activity to establish their goals or objectives in financial terms, these activities are neither static nor can they be estimated with any substantial accuracy. Therefore, rigid budgetary control is not suited to these trading or interfund service departments. On this topic, the NCGA\(^{(47)}\) has this to say: "While the preparation and adoption of a comprehensive budget is essential for good management, this does not mean that the same degree of budgetary control must be exercised in executing an enterprise [or trading] budget, or that there be a formal system of budgetary accounting such as that required for the General ... Funds. On the contrary, since a utility or other enterprise is a self-supporting operation of a commercial nature, its expenditures should not be controlled by means of detailed and rigid appropriations. These expenditures will vary with the timing and level of demand for service, and if rigidly controlled may delay necessary expansion of activities or impede satisfactory performance. In the interests of managerial flexibility and practicality, therefore, it is recommended that no formal system of budgetary control be employed for enterprise [or trading] funds". This applies equally to interfund service departments (where used)

\(^{(47)}\) Op cit p 51.
except that the total income of these funds or departments is set externally by the amounts expected to be expended on these services by the individual funds.\(^{(48)}\)

The outputs of the trading or enterprise and interfund service activities of a local authority are charged-out on a user-charge basis because the goods or services provided are based on the quantity used. The outputs are, therefore, easily measurable because they are either based on determinable costs or units of inputs. Examples are that water consumption is measured in kilolitres and repairs are on the materials used and the hourly rates of the workmen involved. Similarly, the use of equipment may be costed on an hourly rate for the equipment and operator together. Here, the AAA (1971)\(^{(49)}\) have unequivocally stated that: "All costs are controllable at some point by someone ..." and "If budgetary accounting ... is to provide data that meet the standards for accounting information, cost-based data must be used in the decision-making and reporting processes based on that accounting".

Trading or enterprise and interfund service activities are ideally suited to costing systems either on the basis of standard costing systems (e.g. water and electricity supplies) or unit costing systems (e.g. maintenance and construction activities). However, this is only possible where the organizational structure provides for the segregation of activities to achieve proper management control, that the accounting system employs depreciation accounting for the measurement of the consumption of assets in the production process and that rigid budgetary control is not applied. As both the segregation of activities and depreciation accounting have already been examined, it is only the use of the budget for management control which requires comment.

Although a management control system for Local Authorities through the use of budgets would easily form a separate study, the type of budgeting most suited to the trading or enterprise and interfund service activities is that commonly used in private enterprise accounting. Here, the budget is used as a

\(^{(48)}\) Ibid p 70.

\(^{(49)}\) Op cit p 103.
continuous monitoring system to ensure that actual levels of activity correspond with expected levels of activity; where differences or variances occur they are highlighted on an exception basis and adjustment or corrective action taken. The application of such a system of budgetary control is well-suited to such activities as the supply of water and electricity, it also applies equally well to maintenance and construction activities, etc. Where the actual usages of plant and equipment for the maintenance and construction activities are based on expected levels of output, all that is required is a form of flexible budgeting. Flexible budgeting is a system of adjusting the budget to allow for different activity rates. For example, if the expected usage of a certain piece of equipment differed substantially from its actual usage, the budget is adjusted to allow comparisons between expected and actual costs at the actual level of activity. Such a system of budgetary control is essential for activities where, although the total level of activities may be estimated with substantial accuracy, the individual level of usages of the equipment, etc. depends upon the services they are required to provide (e.g., the maintenance activities).

It should also be borne in mind that as Local Authorities are not subject to competitive trading conditions, even though systems of cost-control through budgetary systems are applied, the cost at which services are provided should be compared with those applicable to other Local Authorities and, where possible, against those provided by private enterprise. A typical example of the latter applies in the case of road construction where the costs of asphalting and bridge construction are normally tendered for by private enterprise. Unless such self-monitoring is carried out how can Local Authorities account for the effective and efficient use of resources?

(iii) The Budget as the Means of Controlling and Measuring General Government Activities

The problem of measurement of the results of the general government activities of Local Authorities has been considered at various stages in this chapter and earlier in this study. What has emerged is that the only practical method of measuring and controlling their operations is by the use of the budget
which, unless prepared on a justifiable basis as part of
the overall plan of operations, is only a means of limiting
expenditures to pre-determined levels. Many general govern-
ment activities do not lend themselves to control on the
basis of cost-data and some method of establishing the ex-
pected levels of financial activity must be used.

The most suitable form of control, and subsequently
measurement, appears to be the technique of budgeting against
a zero base. Zero-based budgeting (ZBB) is a technique where-
by all budget requests must be justified in their entirety
each year starting from a zero or nil base. Each request
must be supported by details of the activities and how the
allocation is to be spent. In this respect ZBB overcomes the
shortcomings of the traditional budget where requests are con-
sidered in the light of their reasonableness or otherwise in
relation to the previous year's allocations. Therefore, full
control over expected expenditures can be effected at the
preparation stage of the budget. Furthermore, the detailed
analysis of operations provides the means of evaluating the
necessity of providing certain services. This aspect of ZBB
is admirably explained by Garbutt and Mimmer where they
state: "This review and evaluation must ignore the fact that
many activities may be of long standing. The fact that an
activity has traditionally been carried out for many years
should not absolve it from consideration. Similarly the fact
that many activities are statutory requirements should be ig-
nored because the aim of ZBB is to evolve priorities. If a
statutory activity is discovered to be of low priority then
spending on it should be minimised until such time as the
statutory requirement can be removed or modified". An add-
tional feature of ZBB is that the data produced in support of
budget requests provides a management information system for
planning purposes. The detailed activity descriptions giving
the estimated costs of operations provide a complete picture
of the financial activities of the organization. Operations
can be compared with one another, alternative course of ac-
tion considered, decisions reached without recourse to further
investigation and implemented immediately.

(50) For a full description of the application of ZBB see
McFarlane, John A, There's nothing to it : zero base
Once the annual budget has been prepared on the basis of ZBB, or any similar type of budgeting, where all expenditures have been fully justified in relation to the overall plan of operations it provides a means of measuring the results of operations. The pre-determined levels of activity are not merely the results of clerical exercises based on historical performance.

6. THE FAILURE TO APPLY PRIVATE ENTERPRISE ACCOUNTING PRACTICES TO TRADING OR ENTERPRISE ACTIVITIES

Local Authorities throughout the Republic do not distinguish between their general government and trading or enterprise activities insofar as the accounting practices are concerned. In this respect, depreciation accounting is not employed and control is through the statutory budget procedure. Consequently, there is no net income determination nor the establishment of the financial position with their trading or enterprise activities.

As pointed out in Chapter 2 of this study, the trading or enterprise activities of Local Authorities are similar in nature to enterprises of the private sector. Their income is in the form of service charges which, generally speaking, result in sufficient inflows of resources to allow the inflow-outflow relationship in the economic activity model to be considered a continuous activity. Even in cases where the income flows are insufficient to cover their expenditures, the making good of the shortfalls in income by transfers from the General Fund, is no different from the position in the private section where such activities as the baking of bread is subsidized by the Central Government.

Why, then, is the nature of trading or enterprise activities not recognised by Local Authorities and accounted for in accordance with the practices applying to enterprises of the private sector? There is apparently no logical reason why this is the case. Local Authorities in South Africa refer to these activities as either trading services or trading undertakings which implies to buy and sell or to carry on a business operation. Therefore, the nature of the trading or enterprise
activities are recognised but that is as far as the recogni-
tion of the nature of these activities goes. Thinking on the
topic by the IMTASA does not appear to be very clear. For
example, in their 1974 Report the IMTASA recommended (on page
32) that the financial statements of trading services or
undertakings should be "... drawn up on the same basis as the
Rate and General Services Statements". The financial state-
ments include an income and expenditure statement and one
would imagine that this statement would be used to show whether
the trading activities were operated at a profit or loss or
whether excess income or expenditure resulted. Yet the IMTASA
(1974) state (on page 16) that "... the final figure in a
statement - the surplus or balance - is of limited significance
in the case of local government".

The reason for the failure to distinguish between general
government and trading or enterprise activities is not due to
the accounting requirements as laid down in section 104 of the
Ordinance because here it is merely stated that the treasurer
must prepare financial statements for each fund and does not
specify the practices to be employed. Sections 124 and 146
of the Ordinance dealing with the Loans Redemption Fund and
Renewals Fund respectively do, however, provide some indica-
tion of why this is the case. Both these sections require
payments "from revenue" into the respective funds for the
redemption of loans or the renewal of assets and, as Local
Authority accounting in this country links asset lives with
their sources of finance, these provisions may have been in-
terpreted as requiring trading or enterprise activities to be
accounted for in the same manner as the general government
activities. If this is the case, is it a valid interpretation?

In view of the rejection in 1977 of the CIPFA recommenda-
tion that the link between assets and their sources of finance
should be broken in the United Kingdom, it appears that the
substitution of loan service charges and renewals contributions
for depreciation is so entrenched in Local Authority accounting
thought that it must be interpreted as a valid assumption in
Local Authority accounting circles. Therefore, the failure to
distinguish between the accounting practices for trading or
enterprise activities and general government activities is
yet another case of the influence of the use of loan finance on the accounting for Local Authorities.

7. **SUMMARY**

The accounting practices of Local Authorities have been examined and the "legal compliance - fiscal accountability" emphasis of the accounting system extends throughout the practices employed. This has resulted in the accounting system which, although it is stewardship accountability orientated, does not meet the objectives of management control and full accountability.

Fund accounting is employed for administrative convenience and stewardship accountability purposes. In this respect, the fund defines the legal scope of activities and provides a convenient area for control over Local Authorities by the Provincial Councils because it is administratively sound to prescribe exactly how Local Authorities must operate. Actual control is exercised through the application of what is known as the ultra *vires* doctrine and the surcharge procedure. From a purely accounting point of view, the fund provides the accounting or economic area of interest which for internal reporting purposes usually coincides with the area of responsibility. However, for external reporting purposes the Local Authority consists of a single entity made up of a number of sub-entities or funds. This latter feature is little appreciated in Local Authority accounting circles and accounts for the preparation of the financial statements on a fund-by-fund basis. A further feature of fund accounting is that the legislation covering Local Authority operations accords equal reporting status to all funds and, consequently the lack of a main fund or funds fails to provide a suitable organizational or reporting structure for these units.

The fund structure for Local Authorities in the Province of Natal has been examined in relation to their economic activities. Here, although fund accounting has provided a suitable separation of some activities from others, a rearrangement of the grouping of activities may improve management control and the measurement of the results of operations. Consequently, it has been recommended that only those activities where the measurement of the results of operations is in
relation to pre-determined levels of activity or which involve fiduciary accounting should be accounted for as general government activities, and that trading or enterprise and interfund service activities should be accounted for on the basis of net income determination. In the latter case, the use of separate funds should be based on management control and not the magnitude of operations. With the funds required to account for capital finance, which is treated as a separate economic activity in this study, the funds have been examined in the light of those used for loan finance purposes and the capital reserve funds of the Local Authority.

The Local Authority attitude towards capital expenditure has been outlined. Here, the shortcomings of the link between asset lives and their sources of finance have been examined together with the nature of Local Authority fixed assets and the need to account for the consumption or wearing out of fixed assets as a cost of producing public goods or services. In this respect, it is obvious that full depreciation accounting should be applied because in the absence of depreciation accounting cost-based information on the activities of Local Authorities cannot be provided. In this respect, a method of applying depreciation accounting has been suggested.

The use of the statutory budget as a means of controlling operating income and expenditure has been examined. It has been pointed out that unless the budget forms part of the overall plan of operations it is purely the means of limiting expenditures and does not provide a suitable method of measuring the results of the general government activities of Local Authorities. To this end, the use of the budget as part of the planning process is given. The disadvantages of applying rigid statutory budget procedures to trading or enterprise activities is outlined together with the type of budgeting most suited to these activities. Furthermore, the means of using the budget as an effective means of measuring the results of general government activities are suggested.

Finally, the failure to distinguish between the accounting practices applicable to general government and trading or enterprise activities is discussed. Here, the reason that net income determination accounting is not applied to trading or enterprise activities is due to the link between asset lives and their sources of finance.
1. INTRODUCTION

In the previous Chapters of this study, the objectives, principles and practices of the Local Authority accounting system have been examined and, although the statutory and reporting requirements of the Institute of Municipal Treasurers and Accounts S.A. (IMTASA) have been outlined, these latter requirements have not been subjected to close scrutiny. Therefore, in this Chapter the financial reporting by Local Authorities is examined.

2. FINANCIAL REPORTING IN THE LOCAL AUTHORITY SENSE

Although financial reporting may involve the entire accounting system, it is here considered to be that part of the accounting system concerned with the conveying of financial information on the operations and activities of an organization to interested parties. In this respect, as far as Local Authorities or governmental units are concerned, the National Committee on Governmental Accounting (NCGA)\(^1\) state that "Public Financial Reporting may be broadly defined as the total process of communicating any facts, events and judgments concerning the financial condition and operations of a governmental jurisdiction". (Emphasis added).

Financial reporting involves both the internal management of the Local Authority and the reporting to external parties. In the former, reporting may be either orally or through the presentation of formal reports, whereas with the latter financial reporting is usually through the medium of published reports. In this respect, the distinction between internal and external reporting is not always clear nor is it mutually

---

\(^1\) National Committee on Governmental Accounting (NCGA), Governmental Accounting, Auditing and Financial Reporting, Municipal Finance Officers' Association, Chicago 1968, p 104.
exclusive. Therefore, it is essential for a full appreciation of financial reporting by Local Authorities that these two aspects of the reporting system be examined.

(a) Internal Reporting

The process of financial reporting within the Local Authority involves the entire system of management control and accountability and is dependent upon the system in operation. Therefore, although specific requirements cannot be laid down it is possible to examine the broad requirements of internal reporting.

Essentially internal reporting should, as the American Accounting Association (AAA) (1975)\(^2\) points out, "... provide data not only for controlling funds flows but also for planning, managing and evaluating the resource-transformation process". Although the control over funds flows is a normal feature of the management process, the balance of the internal reporting function is dependent upon a system of accounting practices conducive to management control. As outlined in the previous chapter of this study, this is not always the case with Local Authorities in South Africa and, consequently, the internal reporting by these units is mainly restricted to monitoring the statutory budget. In cases where some Local Authorities do provide cost-based information on certain activities, this is a step in the right direction but as such information systems have to operate within a system of accounting practices based on a "legal compliance-fiscal accountability" reporting system, its usefulness must be impaired.

The shortcomings of the Local Authority accounting system must be accepted at this stage in order that internal reporting in relation to the statutory budget can be examined. Here the NCGA\(^3\) recommend that all Local Authority or governmental units prepare interim financial reports at appropriate intervals to reflect the actual and estimated income and expenditures for general government activities, comparative


\(^3\) Op cit p 104.
statements of income and expenditures for the trading or enterprise and interfund service activities, a combined statement of the receipts and disbursement of funds for all activities, and a cash forecast. On the local scene, similar statements should be prepared to monitor budget variances and allow corrective action to be taken. Cash management should be catered for by the statement of the present cash position and the cash forecast.

Besides these formal internal reports, all other internal reporting would be on an individual basis up and down the lines of responsibility within the organizational structure and are not subject to specific or general description. Consequently, this Chapter is more concerned with external reporting.

(b) External Reporting

The purpose of external reporting by Local Authorities is to provide information on the operations and activities of these units to interested parties. It involves that part of the accountability objective of the accounting system, outlined in Chapter 2, which relates to the reporting by public officials on the results of Local Authority operations and the use of public funds.

The discharge of their responsibilities for external reporting by Local Authorities in South Africa is through published financial statements prefaced by a brief report by the treasurer and supported by the report of the auditor. The attitude towards this reporting requirement is contained in the following statement by the Chartered Institute of Public Finance and Accountancy (CIPFA) (1971)(4): "Published accounts are compulsory only to the extent that boroughs must print an abstract of their accounts ..., a prescription which could be carried out by the baldest summary. Published accounts are, however, in practice almost universal in local government. They have been found to be desirable as documents

of internal management, providing council members and officers with information about their own and other local authorities. They are one of the media by which the press and public are informed about local services and by which local authorities 'account' to the public. They provide government departments with information about local services, whilst economists, historians and other interested parties can find in them concise summaries of local activities and their finances over the years". (Emphasis added). In fact, the IMTASA quoted this statement in their 1974 Report on the Standardisation of Financial Statements of Local Authorities in South Africa as an authoritative statement on the financial statements of Local Authorities.

This statement by the CIPFA is of interest in four areas. First, the assertion that the preparation of financial statements is necessary only because they are required by law to do so. As outlined in Chapter 3 of this study, this requirement is contained in section 104 of the Ordinance and this attitude towards reporting implies that only the minimum information need be disclosed. Secondly, the statement that financial statements have been found to be desirable documents for internal purposes is not difficult to understand because they are prepared in a manner which, as Botha (1970b)(5) points out, is understood by a few trained officials. How then is it possible for the elected representatives and the general public to assess and evaluate the operations of the Local Authority? Thirdly, it is stated that the published financial statements form one of the media by which the public is informed of Local Authority affairs. If the financial statements are understood by only those well versed with Local Authority accounting practices, what other media are available? Fourthly, the financial statements of Local Authorities are anything but concise summaries of their activities and finances. Page after page of financial statements concerning each and every fund cannot be considered concise summaries.

Essentially, the attitude towards external reporting by Local Authorities is that these financial statements are for the use of the Local Authority itself, other Local Authorities as a basis for comparison, and as a means of demonstrating legal compliance and fiscal accountability to the Provincial Councils. Should any outside party wish to examine the financial statements or obtain a copy for his own use then he is entitled to do so.

Why is this the position? Surely the community has the right to be kept fully informed of the operations and activities of Local Authorities and not merely afforded the opportunity to inform themselves. In this respect, it is the community to whom the reporting should be directed because it is the community which finances the operations and activities of Local Authorities and is most affected by all aspects of local government. The reason appears to be the attitude in Local Authority or government circles that they need only report to their own legislative bodies and other government departments. This attitude has led Dean (6) to state that "It often appears that [governmental] accounts are prepared by one set of civil servants to be scrutinized by another". The position is, in fact, implied by the CIPFA (1971) (supra) in their statement on the necessity of preparing their published financial statements.

From both a political and accounting point of view, this attitude towards financial reporting is unacceptable. Perhaps it is the failure to inform the community adequately on Local Authority affairs which accounts for the widespread apathy towards local government in this country. In this respect, the governmental nature of Local Authorities must be borne in mind because from a behavioural or normative approach to accounting the AAA (1977)(7) state that the basic objective of public sector accounting "... is to provide information on


which constituents [ie the community or electorate] can base a decision to retain or replace incumbents [ie elected representatives and public officials]. Here, the purpose of the information provided is to allow users to evaluate the performance of the elected representatives and public officials in directing the Local Authority and use of its public resources. Therefore, there should be full communication between Local Authorities and the communities to whom those in control are responsible for their actions. On this topic the AAA (1977) state:

"Accounting is a system for processing data into information about events and activities under the direction and control of incumbents. The system is likewise under the direction and control of the incumbents.... And the system can be used to communicate information to the constituents, but the valid use of the information to attain the basic objective can be questioned. Such information contains the representations of the incumbents. The degree to which these representations fulfill the requirements of accountability determines the qualitative content of the information communicated to the constituents and in-turn determines the extent to which the basic objective of accounting is attained.

"... Information which does not fully meet the [accountability] requirements may enable the incumbents to become the dominant faction of the group. However, the practice of providing constituents with information inferior in quality and/or quantity to the information available to the incumbents violates the superior-subordinate relationship between the constituents and the incumbents. The violation is counter to the two-way communication process fundamental in democratic systems".

Consequently, the external reporting responsibilities of Local Authorities are far greater than are generally believed.

3. LOCAL AUTHORITY REPORTING AND DISCLOSURE REQUIREMENTS

As reporting and disclosure involves the conveying of relevant financial information to interested parties in an understandable manner, these aspects are dealt with hereunder:

(a) The Dual Reporting Responsibilities of Local Authorities

Financial reporting is normally designed to cater for sophisticated or relatively well-informed users of accounting...
information. This is because accounting is by its very nature a technical discipline and to understand accounting, at least a working knowledge of the subject is required. However, in the case of Local Authorities, their accounting responsibilities involve reporting to the entire community of which relatively few are well-informed or relatively well-informed on accounting matters. Therefore, if Local Authorities are to meet their responsibilities in relation to the accountability objective of the accounting system they should employ a dual reporting system; one for sophisticated and relatively well-informed users and another for the lay public.

How can Local Authorities meet this dual reporting responsibility? Obviously, the annual financial reports of Local Authorities are unsuitable for meeting the financial reporting requirements of the lay public even though they may be suitable for sophisticated users. Therefore, some method of providing this information to the general public should be devised. It appears that the most suitable way in which this reporting requirement could be met is by the use of popular or summarized financial reports. These popular reports should provide the information contained in the annual financial reports in narrative, graphical or other form which is easily understood by laymen. They should be as brief as possible (say, no longer than five to six pages), freely available and published, preferably in local newspapers, by all Local Authorities. This means that the preparation and publishing of these reports should be a statutory requirement. In order to satisfy their objectives, they should contain a statement, prominently displayed, that the complete financial statements are available to, or for inspection by, any interested party. (9)

The use of these popular or summarised reports would be a welcome move but would still not fully meet the basic objective of public sector accounting. However, it would be a move in the right direction.

At present certain Local Authorities do publish similar types of reports (eg "The Municipal Purse" of the City of Port Elizabeth\(^{10}\)) but such reports are produced by very few Local Authorities because they are not required by law. Where they are produced, they are often more in the form of a statistical report of the Local Authority and are not specially designed to provide a financial report to the lay public. However, the fact that they are produced by some Local Authorities shows that the present reporting deficiencies of Local Authorities are recognised in certain quarters.

Insofar as the sophisticated users of accounting information are concerned, reporting by Local Authorities should be through the publishing of a comprehensive annual report. Basically, this is the case and the composition of the annual financial reports of Local Authorities appear to follow a fairly well-defined pattern throughout the Western World because they all seem to contain a report of the treasurer or chief financial officer, a report or opinion of the auditor, financial statements for each fund and in aggregate form, and a statistical section. Here, the NCGA\(^{11}\) state that "Although this report will be formally addressed to the chief executive and governing body of the governmental body of the governmental unit to which it applies, it must also function to meet the needs of all persons and groups who have a legitimate interest in the unit's financial operations". Furthermore, it is stressed by the NCGA\(^{12}\) that "Insofar as possible ... the governmental accounting system should make possible the full disclosure and fair presentation of financial position and operating results ...." Unfortunately, this American viewpoint does not apply to Local Authorities in Natal or elsewhere in South Africa.

\(^{10}\) See for example, City of Port Elizabeth, The Municipal Purse, June 1974.

\(^{11}\) Ibid p 106.

\(^{12}\) Ibid p 4.
(b) The Extent and Disclosure of Information

Although it is fully recognized that the measurement of Local Authority operations and programmes is difficult, the American Institute of Certified Public Accountants (AICPA) (1973)\(^\text{(13)}\) state that to serve users needs the information disclosed in the external reports of governmental units should provide information for assessing, first, past goals of the unit, secondly, the status of present efforts to attain goals, and thirdly, the probability of future goal attainment. To meet these reporting requirements, the annual reports of Local Authorities would have to disclose fully the plans and policies of these units in addition to reporting on past events. The extension of these reporting requirements is fully discussed later in this Chapter but before doing so it is necessary to examine the extent of the disclosure of information and how this information should be disclosed.

Lynn and Freeman\(^\text{(14)}\) state that "Because of the sensitivity of public expenditures ('that's my tax money you are spending') 'full disclosure' is a more accurate term for the disclosure principle in government than is adequate disclosure". Here, the criteria for deciding whether or not an item requires disclosure should be based upon "(1) an item of information should be disclosed if there is a reasonable probability that it might affect the judgments made or conclusions reached by a reasonably informed reader of financial statements; [and] (2) a mass of detailed information, overly condensed presentations, and highly technical or vague language that might be a barrier to effective communication should be avoided".\(^\text{(15)}\)

This full disclosure aspect of financial reporting is not met by the financial reports prepared by Local Authorities in South Africa. First, they are merely reports on past performance of the Local Authority prepared within the narrow


\(^{\text{(14)}}\) Op cit p 740.

\(^{\text{(15)}}\) Ibid.
constraints of a "legal compliance-fiscal accountability" orientated accounting system. Secondly, Local Authority accounting terminology is a definite barrier to effective communication.

How can the position be rectified? For a start, Local Authorities should abandon their specific accounting terminology which is misleading and prepare financial statements according to the format used in accounting in the private sector. In this respect, the following comments of Davidson et al\(^{(16)}\) are of particular interest: "The informed citizens in the general public are neither expert accountants nor trained financial analysts. However, many of them in their business activities, in their private investment decisions, and in various other ways, have developed some understanding of the terminology and meaning of the financial statements of commercial enterprises. Financial statements of governmental units are far more likely to be understandable to the general public if they are couched in the same language, presented in the same general form, and largely use the same accounting concepts that business does". In fact, in 1977 the Working Party on Local Authority Exposure Drafts of the CIPFA\(^{(17)}\) recommended that the balance sheets of Local Authorities should be presented in a narrative style, which is a move in the right direction.

The area of most concern is the apparent lack of appreciation of the accountability objective of the Local Authority accounting system. Here, the basic objective is to provide information which is relevant and understandable to those persons who are interested in Local Authority affairs, and the presentation of financial reports understandable by a select few does not satisfy this reporting requirement. In this respect, a great deal of the blame for this present position


must rest, not with the Local Authority accountants, but with those in the Provincial Councils and the IMTASA who have given inadequate time and thought to the modern requirements of accounting and financial disclosure. However, as Hylton (18) points out, it is better to have some sort of published report to which the community has access than no report whatsoever.

4. THE RECOMMENDED AND STATUTORY FINANCIAL STATEMENTS OF LOCAL AUTHORITIES

Having examined the Local Authority attitude towards financial reporting and the disclosure requirements for these units, it is now possible to subject their financial statements, which form an important part of the reporting process, to close scrutiny. Here, the examination is to determine whether or not they meet the requirements of providing "...information useful for evaluating the effectiveness of the management of resources in achieving the [governmental organization's] goals". (19) If not, how should these financial statements be prepared to achieve this objective. However, before doing so it is necessary to re-examine the reporting requirements arising from the economic activity model for governmental units given in Chapter 2.

The economic activity of Local Authorities comprises two distinctive types of activities - trading or enterprise activities and general government activities - to which different measurement criteria apply. Although both these types of activities require measurement in relation to their financial position and changes in financial position, they differ in relation to the measurement of the results of operations. Here, the measurement focus for the results of operations of trading or enterprise activities should be on net income determination, whereas this is not the case with the general government activities.

(19) AICPA (1973) op cit p 51.
The requirements of the IMTASA (1974) in relation to financial statements, as outlined in Chapter 3, are that an income and expenditure statement and a balance sheet supported by schedules of their capital outlay and provisions are required for each fund plus aggregate financial statements for the Local Authority as a whole. This reporting on a fund-by-fund basis is obligatory in terms of the Ordinance, and all these financial statements must be published together. In this section, the question of whether or not these financial statements meet the reporting requirements of Local Authorities is examined.

(a) The Statements Required to Reflect the Results of Operations

As outlined earlier the statements which are required to be prepared to reflect the results of Local Authority operations are income and expenditure statements. The questions to be answered in this section are whether income and expenditure statements, which are used for all Local Authority activities in South Africa, are the most suitable form of statements and, if not, what statements should be used.

(i) Do Income and Expenditure Statements Provide a Suitable Means of Disclosing the Results of Operations for the General Government Activities of Local Authorities?

At first glance, the use of income and expenditure statements appears to be suited to the disclosure of the results of the general government activities of Local Authorities. The income and expenditure for each activity is reflected opposite one another and, depending upon the size of the Local Authority, balanced off to reflect the surplus or deficit on each activity. The total income and expenditure for each activity is transferred to a summarized income and expenditure statement which discloses the overall surplus or deficit for the year. However, the use of income and expenditure statements for these general government activities fails to recognise the measurement of the results of these operations.
The general government activities of Local Authorities can only be measured effectively by relating them to the predetermined levels of financial activities as set by the annual budget. Consequently, any statement reflecting the results of general government activities should compare actual and budgeted results of operations. Although this information may appear elsewhere in the financial statements, there is no matching of actual and expected results of operations where it should appear and this fails to provide adequate disclosure (let alone full disclosure) on these activities. So important are these aspects considered in the United States of America that detailed statements reflecting income and expenditure are dispensed with and replaced by statements disclosing the differences between actual and estimated income and expenditure. (20) These statements are the "Statement of Revenue - Actual and Estimated" and the "Statement of Expenditures and Encumbrances Compared with Authorizations". (21)

Why is this budget information so important? First, it is necessary for measurement and disclosure purposes. The surpluses and deficits from operations are of great interest to the users of financial statements and are not, as suggested by the IMTASA (1974)(page 16), figures of limited significance. Although Local Authorities may not budget for a deficit in terms of Section 105 of the Ordinance, the extent of any surplus is of interest because, until such time as the surplus has been appropriated by the legislative body, the ratepayers can expect this surplus to be taken into account in the setting of future levels of rate income or service charges. However, the overall surplus or deficit from operations can only provide relevant information when it is related to the budgeted amounts. For example, an actual surplus of R15 000 only becomes significant when related to, say, a budgeted surplus of R10 000 and readers of the financial statements are provided with details of how the additional surplus arose (e.g. the delaying of certain expenditures until the following year).

Secondly, a comparison between actual and expected levels of

(20) NCGA, op cit pp 23-25.
(21) Ibid.
activity is necessary to provide full disclosure on the accuracy of the budgeting procedures, that authorizations have not been exceeded and that income collections have corresponded with expectations.

The local practice of preparing income and expenditure statements on the basis of actual results only without budget comparisons fails to meet both the accountability and full disclosure aspects of the accounting system and cannot be regarded as being a suitable means of disclosing the results of the general government activities of Local Authorities. Therefore, it appears that the American practice of disclosing budgeted and actual results of operations should replace the income and expenditure statements in South Africa when accounting for the general government activities of Local Authorities. In this connection, full disclosure and accountability could be achieved by explanations of the budget variances by the treasurer in his report, or by notes to the comparative statements themselves.

In the event of the income and expenditure statements being replaced by statements reflecting budgeted and actual levels of financial activity, how should this information be disclosed? The most suitable method of presenting this information would probably be to list the income and expenditure for each activity under the headings of estimated, actual and over/under estimated accounts in a single statement. However, to the unfamiliar, such a mass of figures would be confusing and it is probably for this reason that the NCGA have recommended the use of two separate statements. Therefore, it appears that this information can only be effectively disclosed as supporting schedules to the statement of changes in fund balance (see later).

What detail is required in these comparative statements? In order to provide a readable and understandable financial report, the amount of information provided in these comparative statements should be restricted to that which is necessary to provide readers with an understanding of the general government activities and the results of operations for the period covered by the report. Consequently, it appears that income need only be disclosed in total according to source
whereas expenditures need be disclosed according to function and activity. (22) In this latter respect, the function covers the broad purpose and the activity is the specific area of activity within the purpose. For example, if the function is preventative health, the specific activities would cover immunization, clinics, isolation hospitals, etc. This would, as Shailes (23) points out, place "... emphasis on the more major objectives of government, and attempts to summarize expenditure and receipts according to what government is doing, rather than on which department is spending the (most) money". The extent of the disclosure suggested here differs considerably from that required by the IMTASA (1974) because they require details of the actual items of expenditure under such headings as salaries and wages, general expenses, capital charges, etc.

The presentation of the information disclosed should be based on the full disclosure principle but in a manner that readers are provided with the important information in the body of the statements; detail should be provided by way of notes to these statements. In this respect, the mass of detailed information presently provided in the income and expenditure statements is more likely to be a barrier to effective communication than to assist readers to reach conclusions or make judgments about the management or operations of Local Authorities. In addition, if certain detailed information need be provided for comparative purposes between Local Authorities, then surely this information could be presented by means of tables as required by the NCGA in the statistical section of the annual financial report in the United States of America (see later).

To which funds should comparative data on actual and budgeted operations apply? This method of disclosing the results of operations should apply to all funds accounting for the general government activities of the Local Authority, namely, the General Fund, the Housing Fund, the Public Improvement Fund and to any general trust funds to which this measurement of the results of operations applies.

(22) This disclosure follows the pattern of that recommended by the NCGA, op cit p 13, except that the NCGA also requires classification of expenditures under objects which are defined on page 165 as "... the article purchased or the service obtained".

(ii) The Statements Used to Reflect the Results of Operations for Trading or Enterprise and Interfund Service Funds

As pointed out in Chapter 2, the measurement focus with trading and interfund service activities should be on net income determination because the economic activity for these operations results in a continuous input-output relationship. In fact, it is suggested by CIPFA (1975b)\(^{(24)}\) that this net income determination should be based on the capital maintenance concept of income measurement. However, this is not the position in South Africa and the situation must be examined in the light of strict budgetary control over operations and a lack of depreciation accounting.

The objective of presenting an income and expenditure statement for the trading or other similar activities (hereinafter referred to as trading activities) of the Local Authority is, according to the IMTASA (1974)(page 25), ". . . to show the costs of providing the various services. . . ." The results of operations is, no doubt, of importance even though the IMTASA (1974)(page 16) do not appear to share this view.

As far as the establishment of the costs of providing these services is concerned, it must be acknowledged that the Local Authority interpretation of what constitutes costs differs in many respects from its usage in private enterprise accounting. Essentially, costs in Local Authority accounting represent total expenditures and not the actual expenses incurred in producing some unit of output. In fact, this point is aptly made by the AAA (1971)\(^{(25)}\) where it is stated: "The public are rarely given cost-based data. Instead, when 'cost

---

(24) Chartered Institute of Public Finance and Accountancy (CIPFA), Local Authority Accounting I: Accounting Principles, Exposure Draft, London 1975a pp 3-7. Here, it is implied that in drawing comparisons between the economic activity models of Local Authorities and private enterprises it is stated that it is of prime importance that capital should at least be maintained intact.

data' are presented they are usually expenditures (either total expenditures, or, at best, non-capital outlays) divided by some activity unit without due regard for the input-output relationship. Essentially, the emphasis is on total inputs (ie total expenditures) and not on the utilization of inputs in the production process. In this respect, AAA (1971)\(^{(26)}\) state "Expenditure data serve a useful function ... but they are not necessarily related to the measurement of period expenses and tend to introduce noncomparability and bias into financial reports". Here, the substitution of loan redemption charges for depreciation does not always provide a true measure of the consumption or wearing out of assets in the production process because they are often based on the tenure of loans and not asset lives. Also, the practice of financing capital expenditure from income does not allow the cost of these assets to be spread over their useful lives. Consequently, the reason for presenting income and expenditure statements for trading activities given by the IMTASA (1974) that they provide information on the costs of services provided, must be interpreted as providing information on the total expenditures incurred in the provision of services.

As Local Authorities do not apply net income determination to their trading activities, the income and expenditure statements presented by these units do not provide information on the results of operations and their primary use appears to be the demonstration of fiscal accountability in respect of total income and expenditures in relation to the services provided. However, Local Authorities must present some form of statement reflecting their trading activities, and in view of the above, income and expenditure statements appear to be suitable for this purpose. However, such statements do not satisfy the full disclosure principle of Local Authority accounting.

Although rigid budgeting control is not suitable for trading activities, the full disclosure principle demands that the differences between budgeted and actual levels of financial activity be disclosed. This is necessary because

\(^{(26)}\) Ibid.
readers of the financial statements should be provided with full information on the variations between expected and actual levels of financial activities and the effects of changed conditions. In fact, this is the position in the United States of America, where a basic statement, namely the "Statement of Revenue and Expense - Actual and Budgeted," is presented for trading or enterprise activities, supported by two schedules to this basic statement reflecting details of actual and estimated income and expenditures. Here, it is the variations between actual results of operations and those estimated in the budget adopted for managerial purposes which are of importance.

In view of the above, it is suggested that the income and expenditure statements presently used for the trading activities of Local Authorities in South Africa be replaced by a single statement entitled the "Statement of Income and Expenditure - Actual and Budgeted". It is envisaged that such a statement would be prepared on a three-column basis (ie budget, actual and over/under budgeted), and that budget variations be adequately explained, either by notes to the statement, or in the treasurer's report. Here, the comments made earlier in this Chapter on the detail required for the disclosure of general government activities apply equally to trading activities.

(iii) Are Any Statements Required to Disclose the Results of Operations of any Other Activities?

Basically, the economic activity of the funds connected with capital finance is restricted to the receipt and disbursement of funds. In this respect, the AAA (1975) state that these funds are: "... used to establish accounting control of accountability for nonappropriable assets and unmatured principal of ... long-term debt of the municipality..." and, consequently, their operations result in changes in their fund balances. Therefore, the only statements which may be required are those relating to the financial position or changes in their net financial resources.

(b) The Statements Required to Reflect the Changes in Fund Balances or Net Changes in Financial Resources

In South Africa the statements reflecting the changes in fund balances or the net changes in financial resources are normally replaced by the appropriation section of the income and expenditure statements. The importance of the statement of changes in the fund balances in the reporting system is that, first, it forms the link between the balance sheet and the statements reflecting the results of operations, appropriations and contributions, and secondly, to reflect the changes in the fund balance (ie unappropriated surpluses or deficits), which discloses the net current financial resources of the individual funds. Insofar as the importance of these statements are concerned, the AAA (1975) (29) state that "Conceptually, the analyses of changes in financial position (fund balance) is the primary operating statement - revenue and expenditure statements merely itemize the major changes in financial position (fund balance)."

At this stage it should be stressed that in view of the rigid distinction between transactions on income and capital account, the fund balance in the case of the individual funds should represent the net working capital of each fund. However, where operational surpluses are transferred, in whole or in part, to "tariff stabilization provisions" and accounted for in the Provisions Statement, the fund balance cannot be established. Therefore, this aspect is considered before examining the statements required to reflect the changes in fund balances.

(i) The Discontinuance of the Use of "Tariff Stabilization Provisions"; a Pre-requisite to Disclosing the Changes in Fund Balances

As outlined in Chapter 3, the "Tariff Stabilization Provision" is, in theory, a reserve created to stabilize or equalize the rate or service charge income from year to year.

(29) Ibid.
However, in practice it is often used as the unappropriated surplus or deficit account and, as the IMTASA (1974) consider this reserve a provision, it is included in the provisions statement and no fund balance (ie unappropriated surplus) appears on the balance sheet. For example, on page 65 of the Report of the IMTASA (1974) the "Tariff Stabilization Provision" of the Electricity Fund is reflected in the Provisions Statement together with the Provision for Maintenance of Buildings, and no unappropriated surplus appears on the balance sheet (see page 64 of this Report).

No matter how these "Tariff Stabilization Provisions" are treated by Local Authorities, their use represents confusion regarding the nature of provisions and reserves by the IMTASA. A provision is defined by the IMTASA (1974)(page 13) as "... any amount set aside for the purpose of meeting, either in whole or in part, some known or expected liability, the amount of which cannot always be calculated with substantial accuracy". However, in giving suitable examples it quotes Bad Debts Provision, Repairs and Maintenance Provision, and the Tariff Stabilization Provision. This latter "provision" is in fact a reserve because no liability exists and it represents an appropriation from excess income or unappropriated surpluses.

The objective of creating provisions (or deferred credits) is to more correctly apply the matching principle by charging income with estimated expenses to perform some future service (ie repairs and maintenance) or to meet some future occurrence (ie the incidence of bad debts).(30) For liabilities to exist, Hendriksen(31) states that there must be some obligation to outside parties for the provision of money, goods or services. Neither the application of the matching principle nor an outside liability exist in the case of Tariff Stabilization Reserves (not Provisions), because, as pointed out above, this is merely an appropriation of what is acknowledged

(31) Ibid p 449.
by Stone\(^{32}\) to be nothing else than an accounting balance or a working balance reserve. In fact, it appears that the use of these "Tariff Stabilization Provisions" has been designed to allow the creation of hidden reserves. Not only does this treatment of surpluses or deficits violate the full disclosure principle but represents a failure to appreciate the nature of provisions and reserves. Therefore, if the Local Authority accounting system is to provide proper financial reporting, the practice of treating operating surpluses as provisions should be discontinued. In this respect, unappropriated surpluses should be described and reflected as such.

(ii). The Actual Statements Required to Reflect the Changes in Fund Balances

As outlined earlier, income and expenditure statements do not provide the necessary information on the results of the general government and trading activities of Local Authorities and should be replaced by statements reflecting the budgeted and actual levels of financial activity. It was also pointed out that it appeared that the only effective method of presenting this comparative information was as supporting schedules to a statement of changes in the fund balance. Consequently, it appears that a separate statement reflecting the changes in fund balance for all funds is not only necessary but desirable. It is, therefore, suggested that a statement reflecting these changes in fund balance entitled the "Statement of Operational Results, Contributions and Appropriations" be presented for all funds accounting for the general government and trading activities of Local Authorities. In the case of the funds connected with capital finance, any changes in the fund balance are due to changes in their investments (e.g., accumulated interest) which could be reflected on the balance sheet or in schedules or notes thereof unless it is specifically required that this information be disclosed in a statement of changes in fund balance.

\(^{32}\) Stone, W. B., The Standardised Financial Statements of Local Authorities, Address to the Annual General Meeting and Seminar of the IMTASA, held at Kempton Park, April 1975 p 1.
The "Statement of Operational Results, Contributions and Appropriations" is suggested because it would not only describe its contents more correctly but would also highlight this important information. This statement, as envisaged, would reflect the total surplus or deficit for the year plus details of contributions received (ie from the Electricity Fund for example), contributions made (ie to meet deficits on any other fund), and any appropriations made (ie payments into the Capital Development Funds or for other capital expenditure purposes).

In order to make the "Statement of Operational Results, Contributions and Appropriations" more meaningful and to meet the full disclosure principle, the estimated levels of income, expenditure, contributions and appropriations should also be included in this statement. If statements providing the actual and estimated levels of income and expenditure are provided, it could be argued that as this information is already provided, it need not be repeated. Such an argument only proves valid for the results of operations and not contributions or appropriations because these must be authorized by the legislative body as part of the appropriation process. This is necessary because, although surpluses on the Trading Funds (other than the Water Supply Fund) may be transferred to the General Fund to subsidize the rate income (see Section 105(6) of the Ordinance), interested parties should be informed of any changes in the budgeted transfers. The failure to do so may allow performance in relation to the budgeted and actual surplus or deficit on the General Fund to be boosted by varying the contributions. In addition, this information is necessary to ensure that the budget information disclosed is complete. Here, the ratepayers have a right to be kept fully informed of the budgetary policy of the Local Authority in its entirety.

Although the suggested format of the suggested "Statement of Operational Results, Contributions and Appropriations" may fit the requirements of the General and Housing Funds it may not be completely suitable for the general trust funds (where applicable) or the Public Improvement Fund and some simplification may be necessary within the broad framework suggested above. Similarly, in the case of the trading funds this
statement could either take the form of an appropriation section to the "Statement of Income and Expenditure - Actual and Budgeted" or as a separate statement. If the former method is employed a change of title would be necessary, but in other respects the format and content would be the same, no matter which method was adopted. Irrespective of the actual method of presentation, such statements should reflect the overall results of operations, contributions made or received and appropriations to give the final figure for the fund balance; this could be the balance on the statement or the amount to be either added to or subtracted from the fund balance appearing on the balance sheet.

The comments regarding the revision of the use of "tariff stabilization reserves" made earlier apply to all general government and trading activities. These amounts represent unappropriated surpluses and until such time as they are appropriated by action of the legislative body (i.e., by appropriation to subsidize general government activities or for capital expenditure purposes), the community is entitled to expect that they will be taken into account when the rates or service charges are revised. Furthermore, the full disclosure principle demands that this information be made available to the community.

(c) The Statements Required to Disclose the Financial Position of the Funds

The statements used to reflect the financial position of the various funds should be the balance sheet of each fund. In this respect, the CIPFA (1975b) state that the balance sheet "... should bring into focus the financial features of the concern to which it relates". In theory, therefore, there should be no differences between the balance sheets of Local Authorities and enterprises of the private sector because this feature is common to both of them. However, in practice there are differences due to the Local Authority accounting practices, the method of financing of their capital expenditure and the nature of the various funds. However, before

(33) Op cit p 19.
examining the reporting on their financial position by Local Authorities, the importance of this aspect must be examined.

Why is reporting on the financial position of Local Authorities important? First, information on the financial position of Local Authorities is necessary for planning purposes. In this respect full financial information is required for predictive or forecasting purposes to plan the capital requirements of intended Local Authority programmes in the medium- and long-term. This planning involves decisions on the priority of programmes in relation to the available financial resources as well as decisions on the acquisition, replacement or renewal of domain and operational assets. Secondly, the disclosure of information on the financial position is necessary for accountability purposes. Here, information on the effectiveness of the rate and financing policy should be provided. Thirdly, the financial position of the Local Authority is of great interest to investors and potential investors in the loans raised by the Local Authority. An important example of this requirement is that New York City, having experienced financial difficulties in 1975, is at present apparently unable to raise loans on the American capital market, and whose continued operations were only possible after the State of New York authorized loans to that city over three years amounting to $23,000,000. (34) Here, Arthur Anderson and Company (35) in reporting to the Secretary of the United States Treasury on the financial reporting requirements of New York City emphatically stated that "... if New York City is to have access to the capital markets again, its accounting records must be maintained on a sound financing reporting basis". This obviously includes reporting on the financial position because how else can investors form an opinion on the financial stability of a Local Authority?


Having outlined the necessity for reporting on the financial position of Local Authorities it is now possible to examine the financial reporting by these units on their financial position.

(i) The Effect of Local Authority Accounting Practices on Reporting on their Financial Position

Certain Local Authority accounting practices have far-reaching effects on their financial reporting and these are examined below.

(aa) The Failure to Disclose the Real Capital of the Local Authority

Capital in the economic sense is a store of wealth or a pool of resources which is required by an organization in order to be able to operate. In the Local Authority sense, it provides the elements of production used to produce the public goods and services for the community and is usually split into fixed and working capital. However, from an accounting point of view, the real capital of the general government and trading funds of Local Authorities should be the balance on the fund and the capital accounts which can be simply represented by the accounting model or equation of capital equals assets minus liabilities \((C = A-L)\). However, due to the accounting convention of recording assets at their historic costs, the real capital of an organization is rarely disclosed by its balance sheet because of the effects of price-level charges.

The importance of attempting to provide information on the real capital of a Local Authority or its funds is twofold in nature. First, from a planning point of view the total capital required for the implementation of Local Authority programmes or the extension of services in the medium- or long-term should be based on the present real capital of the Local Authority. Secondly, to provide cost-based data on Local Authority services, the costs must be based on the total capital employed (ie the elements of production) in providing those services. However, these information needs are not met by Local Authorities because they do not employ proper fixed asset accounting and their accounting is based on historic cost data.
The investment in fixed assets by Local Authorities is usually substantial and the failure of Local Authority accounting to disclose fully the extent of this investment makes effective reporting on the financial position impossible. There is, however, some recognition of the importance of disclosing the extent of the capital invested in Local Authority fixed assets (in historical terms) because the use of the "Loans Redeemed and other Capital Receipts" account is in accordance with the practice of only writing fixed assets off against their sources of finance until such time as they are disposed of, demolished or have lost all value. However, Stone in commenting on this practice states that "This practice is acceptable where assets are identifiable, but there are many assets of a bulk nature, such as roads and mains, that are not individually reflected in the accounting records and consequently it is pointless to allow the original expenditure to remain and be offset by a growing loans redeemed surplus". Therefore, the total cost of fixed assets is not reflected on the balance sheet and the real capital (in historical terms) of the Local Authority is not disclosed.

The failure to apply depreciation accounting to Local Authority fixed assets fails to provide information on the extent of the decrease in the service potential of fixed assets (where disclosed). The net value of fixed assets provides important information regarding the renewal or replacement of these assets which, in terms of present reporting practices, appear to be static in nature until written off. In fact, the CIPFA (1977) have recognized this aspect and recommended that, as depreciation accounting is not applied, the balance sheet of Local Authorities should be presented "... with capital discharged being deducted from fixed assets ..." and not as accumulations in various funds.

(bb) The Compliance with Legal Requirements Relating to Capital Finance

The traditional reliance on loan finance to finance the

(36) Stone op cit p 5.
(37) Ibid
(38) Op cit p 82.
bulk of their capital expenditure has affected Local Authority financial reporting in such a manner that a substantial part of the reporting process is designed to demonstrate legal compliance with the provisions relating to the use of capital finance. In this respect, capital expenditure on fixed assets is regarded as merely the means of demonstrating that capital finance has been used as required.

The overriding consideration of demonstrating legal compliance with the use of loan or other forms of capital finance appears to have given rise to the Capital Statement. This statement is, as the CIPFA (1971)\(^{(39)}\) point out, probably a legacy from the times that the "double account system" was employed and its use was discontinued in the United Kingdom from 1971.\(^{(40)}\) The "double account system" carried the distinction between income and capital to the lengths of presenting separate balance sheets for the income and capital transactions of each fund.

Is there any need to produce a Capital Statement? From an external or internal financial reporting point of view, the preparation and inclusion of such a statement in the financial statements appears to serve no purpose other than to provide information, in unnecessary detail, which does or should appear on the balance sheet or notes thereto. Here, the breakdown of the sources of finance should be disclosed on the balance sheet together with details of the fixed assets (ie capital outlay) and the deferred charges. The extent of capital expenditure incurred and capital repaid during the year should be obvious from the comparative figures and details of capital commitments relating to capital projects in progress should be disclosed by way of notes to the balance sheet as in the case of private enterprise accounting. However, from an internal accountability viewpoint, the Capital Statement may serve a useful purpose in ensuring that the fixed assets and deferred charges do agree with their sources of finance subject to cash adjustments (see Chapter 3) but need not be included in the financial statements.

\(^{(39)}\) Op cit p 14.
\(^{(40)}\) In terms of the CIPFA (1971) recommendations, op cit pp 14-16, the Capital Statement was replaced by two (continued on the next page)
(cc) The Failure to Present Fully Classified Balance Sheets

As pointed out in Chapter 3, the recommendations of the IMTASA (1974) for the presentation of the balance sheets by Local Authorities do not require classification of the items on the balance sheet into the recognised classification of fixed assets, current assets, long-term liabilities, current liabilities, etc, although there is some classification insofar as loans outstanding, accumulations and investments are concerned. In fact, besides these three exceptions the items appearing on the balance sheet are listed one below the other with little or no regard for their nature. For example, the unappropriated surplus appears on the liabilities side of the balance sheet between provisions and sundry creditors.

From an accounting point of view the lack of classification of the balance sheet items is unacceptable because, as Hendriksen (41) points out, "The classification of the resources and commitments ... into appropriate categories is needed in order to present relevant summaries of accounting information which can be understood and analysed by investors and other users of financial statements in their decision processes." In fact, the CIPFA (1971) (42) recognized the need to classify Local Authority balance sheets in the United Kingdom and recommended the use of such headings as fixed assets, current assets, long-term liabilities, current liabilities and other balances on the grounds that this had the advantage of making "... the accounts of local authorities more intelligible to those accustomed to reading and assessing commercial accounts."

As the classification of the balance sheet items affects the entire reporting on the financial position of Local Authorities, this aspect is fully discussed in the following sub-section.

(40) (continued)

schedules to the balance sheet reflecting the "Details of Capital Expended" and "Details of Capital Discharged" during the year. There are also additional schedules reflecting the details of deferred charges, capital projects in progress and completed capital projects.

(41) Op cit p 287.
(42) Op cit p 18.
(ii) How Should the Balance Sheets be Classified?

The classification and presentation of the balance sheets of Local Authorities should be based on the criteria applying to disclosing fully the financial position of the various funds because this is their purpose. Basically, this involves an examination of the accounting equations of models of the various funds.

From the economic capital approach, the basic accounting equation or model is capital equals assets minus liabilities \((C = A-L)\) which is also, as Hendriksen\(^{43}\) points out, the traditional accounting entity concept. However, for Local Authorities and similar organizations, the entity concept is usually expressed (under the Fund Theory) as assets equal restrictions on assets \((A = RA)\).\(^{44}\) Although this latter equation or model is theoretically correct because all assets of Local Authorities or governmental units are subject to legal restrictions, this equation or model does not provide a suitable basis for the examination of the classification or presentation of Local Authority balance sheets. In fact, the AAA (1974)\(^{45}\) disregarded the \(A = RA\) equation and substituted the equation \(FA + CA = NCL + CL + FB\) (ie fixed assets plus current assets equals noncurrent liabilities (ie external and internal loans) plus current liabilities plus fund balance) for governmental units. The analysis of this equation on a fund-by-fund basis and taking the specific funds into account (eg the Loans, Redemptions, Renewals and Capital Development Funds) for Local Authorities in South Africa is given in Illustration 6.

\(^{43}\) Op cit p 258.


ILLUSTRATION 6.

ANALYSIS OF THE ACCOUNTING EQUATIONS
FOR LOCAL AUTHORITY FUNDS

<table>
<thead>
<tr>
<th>Fund Type</th>
<th>Assets</th>
<th>Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>General Fund</td>
<td>( FA + CA + SFI ) = NCL + CL + FB + SF</td>
<td></td>
</tr>
<tr>
<td>Housing Fund</td>
<td>( FA + CA + SFI ) = NCL + CL + FB + SF</td>
<td></td>
</tr>
<tr>
<td>Other General Government Funds</td>
<td>( FA + CA + SFI ) = NCL + CL + FB + SF</td>
<td></td>
</tr>
<tr>
<td>General Trust Funds</td>
<td>( FA + CA ) = CL + FB</td>
<td></td>
</tr>
<tr>
<td>Public Improvement Fund</td>
<td>( FA + CA ) = CL + FB</td>
<td></td>
</tr>
<tr>
<td>Trading Funds</td>
<td>( FA + CA + SFI ) = NCL + CL + FB + SF*</td>
<td></td>
</tr>
<tr>
<td>Loans Redemption Fund</td>
<td>( SFI = SF* )</td>
<td></td>
</tr>
<tr>
<td>Renewals Fund</td>
<td>( SFI = SF* )</td>
<td></td>
</tr>
<tr>
<td>Capital Development Funds</td>
<td>( SFI = SF* )</td>
<td></td>
</tr>
<tr>
<td>Total Funds</td>
<td>( FA + CA + SFI ) = NCL + CL + FB + SF</td>
<td></td>
</tr>
<tr>
<td>Less: Amounts offset</td>
<td>( SFI* = SF* )</td>
<td></td>
</tr>
<tr>
<td>Aggregated Funds</td>
<td>( FA + CA + SFI ) = NCL + CL + FB + SF</td>
<td></td>
</tr>
</tbody>
</table>

**Legend:**
- FA = Fixed Assets
- CA = Current Assets
- SFI = Specific Fund Investments
- NCL = Noncurrent Liabilities (ie External and Internal Loans).
- CL = Current Liabilities
- FB = Fund Balance (ie CA - CL + FA - NCL or FA + CA - NCL - CL)
- SF = Specific Funds

**Notes:**
1. Where a Consolidated Loans Fund is maintained, the equation is \( CA + SFI = CL + SF \) because it would include cash balances from short-term borrowings.
2. The amounts offset occur on preparation of the aggregate balance sheet.

ILLUSTRATION 7.

THE APPLICATION OF THE LOCAL AUTHORITY ACCOUNTING EQUATION
AND GENERALLY ACCEPTED REPORTING PRACTICE TO THE
BALANCE SHEET OF THE GENERAL FUND

<table>
<thead>
<tr>
<th>CAPITAL ACCOUNTS</th>
<th>FIXED ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans Repaid</td>
<td>Land</td>
</tr>
<tr>
<td>Contributions from Income</td>
<td>Buildings</td>
</tr>
<tr>
<td>Capital Receipts</td>
<td>Plant and Equipment</td>
</tr>
<tr>
<td>Add: Unappropriated Surpluses</td>
<td>Vehicles</td>
</tr>
<tr>
<td>Less: Assets</td>
<td></td>
</tr>
<tr>
<td>Written-off, Loan Discount and Issue</td>
<td></td>
</tr>
<tr>
<td>Expenses</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>LOANS OUTSTANDING</th>
<th>SPECIFIC FUND ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>External Loans</td>
<td>Investments in:</td>
</tr>
<tr>
<td>Internal Loans</td>
<td>Loans Redemption</td>
</tr>
<tr>
<td></td>
<td>Renewals Fund</td>
</tr>
<tr>
<td></td>
<td>Capital Development</td>
</tr>
<tr>
<td></td>
<td>Trust Fund Assets</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CURRENT LIABILITIES</th>
<th>SPECIFIC FUND ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sundry Creditors</td>
<td>Investments in:</td>
</tr>
<tr>
<td>Payments in Arrear</td>
<td>Loans Redemption</td>
</tr>
<tr>
<td>Provision for Repairs and Main-</td>
<td>Renewals Fund</td>
</tr>
<tr>
<td>tenance</td>
<td>Capital Development</td>
</tr>
<tr>
<td></td>
<td>Trust Fund Assets</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CURRENT ASSETS</th>
<th>SPECIFIC FUND ASSETS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock on hand</td>
<td>Investments in:</td>
</tr>
<tr>
<td>Sundry Debtors</td>
<td>Loans Redemption</td>
</tr>
<tr>
<td>Less: Provision for Doubtful Debts</td>
<td>Renewals Fund</td>
</tr>
<tr>
<td>Prepaid Expenses</td>
<td>Capital Development</td>
</tr>
<tr>
<td>Cash on Hand</td>
<td>Trust Fund Assets</td>
</tr>
</tbody>
</table>

Note: The above information should be supported by notes to the individual items and comparative figures for the previous year.
An examination of the AAA (1974) equation shows that the fund balance is equivalent to the capital of the fund or Local Authority as the case may be. Therefore, if the distinction between the assets and liabilities and the incidence of specific funds are ignored, the equation could be restated according to the traditional accounting equation of \( C = A - L \) which is the basis of classification of balance sheets of Local Authorities recommended by CIPFA (1975b) (47) and adopted by the CIPFA (1977) (48) in the United Kingdom. However, the information disclosed in the balance sheets should be classified according to the elements of the various individual accounting equations as outlined in Illustration 5. An example of the balance sheet of the General Fund presented in this manner is given in Illustration 7. Here, Illustration 7 includes the general trust funds of the Local Authority because, as outlined in Chapter 4, these should form part of the General Fund.

The reasons for the classification used and the problem of accounting for the deferred charges are given below.

(aa) The Fund Balance

Essentially, the fund balance represents the capital of the fund. However, unlike enterprises of the private sector the fund balance does not consist of a common pool of resources but amounts made up of capital derived from operations (ie the working capital) and capital derived from capital expenditure transactions, except in the case of the general trust funds of the Local Authority where the fund balance corresponds with that applying to enterprises of the private sector. And, as can be expected, the composition of the fund balance varies depending upon the type of fund involved.

The fund balance derived from operations usually consists of the unappropriated surpluses which, until appropriated through the authorization process, represents the working capital of the fund and is represented by \( CA - CL \). On the other hand, the capital derived from capital transactions

(47) Op cit p 23.
(48) Op cit p 81.
represents the balance of the fund balance and is represented by FA - NCL. This latter proportion of the fund balance covers all the amounts used to finance the fixed assets not covered by the external and internal loans (non-current liabilities). Therefore, it includes loans redeemed, contributions from income for capital expenditure purposes and other capital receipts.

In order to disclose the fund balance correctly on the balance sheet, all these items should be reflected under a single heading which, for the sake of understandability, should be headed "Capital Accounts" or something similar. Such a heading would describe the amounts more correctly and be in accordance with generally accepted accounting practice in the private sector. An example of this classification is given in Illustration 7. It should be noted, however, that this recommended classification assumes that the misleading (and incorrect) practice of treating unappropriated surpluses as "tariff stabilization provisions" is discontinued.

(bb) Noncurrent Liabilities

The non-current liabilities of the fund consist of the external and internal loans raised or made by the Local Authority for the fund concerned. The external loans are those raised by Local Authorities in terms of their borrowing powers whereas the internal loans are nothing but advances from the funds accounting for amounts set aside for specific purposes e.g. advances from the Capital Development Funds (vide section 103(9)(c) of the Ordinance). From an accounting point of view, the only difference between these loans is that the external loans are repayable to outside parties except those loans raised from the Loans Redemption Fund in the exercise of the Local Authority's borrowing powers. However, the extent of external and internal borrowings should be disclosed. Consequently, it is believed that the present grouping of these external loans together with internal loans, as recommended by the IMTASA (1974), is a suitable means of disclosing them. Should any detail be required, as in the case of the Housing Fund with loans raised from the National Housing Fund, this detail should be provided in notes to the balance sheet and not on the balance sheet itself.
(cc) **The Specific Funds and Specific Fund Investments**

As outlined in Chapter 3, the accumulations or contributions to the Loans Redemption, Renewals and Capital Development Funds (including any other similar funds and the Consolidated Loans Fund where applicable) are made for some specific purpose, i.e., the repayment of loans or the accumulation of funds for specified purposes. In the accounting records of the funds setting aside these amounts, the accumulations or contributions are represented by equal amounts paid into the funds charged with the investment or control of these amounts. Therefore, the accounting treatment is that applying to specific fund or fiduciary accounting. They are specific funds of the funds setting aside these amounts and should be disclosed as such on the balance sheet as in Illustration 7.

In view of the requirements of the Ordinance, the accumulations or contributions must be transferred to the actual specific funds (e.g., the Loans Redemption and Capital Development Funds) where they are pooled and invested in either approved securities or internal loans to the various other funds of the Local Authority. Were it not for these legislative requirements, the funds setting aside these amounts would be free to invest these amounts outside the specific funds as they wished. This is the case where individual Capital Development Funds are maintained and in such cases, the actual investment in approved securities and internal loans should appear as Specific Fund Investments.

(dd) **Fixed Assets**

Basically, the readers of financial statements are interested in the extent of the investment of the enterprise, organization or governmental unit in the various categories of fixed assets and not in their various usages. This latter classification and disclosure is the pattern often followed in the Capital Statement, which as pointed out earlier is a legacy from the "double account system" and its use should be disregarded. Therefore, it is believed that the fixed assets should be classified according to their nature (i.e., land, buildings, plant and equipment) and disclosed in total...
on the balance sheet or notes thereto. In this respect, the investment in domain and operational assets should be disclosed.

The disclosure of fixed assets in total on the balance sheet would, however, still not provide the necessary information for establishing the financial position of the Local Authority because of the failure to apply proper fixed asset accounting. Therefore, looked at objectively, perhaps, it makes little difference how the fixed assets are disclosed on the balance sheet. However, classification according to their nature is used in Illustration 7.

There has been some recognition of the shortcomings of the present Local Authority accounting practices in the United Kingdom in relation to fixed assets, because the CIPFA have recommended the deduction of the aggregate loan repayments from fixed assets along the lines of accumulated depreciation. Here, the CIPFA (1977)(49) state that the deduction would only include the actual capital repaid and "... capital discharged would include only the annual capital contribution (ie the repayment of principal) and if expenditure were financed from internal resources, a capital reserve would have to be created". As the CIPFA is silent on the operation of such a "capital reserve", it is assumed that it would operate in the same manner as depreciation accounting in the private sector.


Insofar as actual current assets and current liabilities are concerned, the classification of these two categories of items do not pose any difficulties and it is recommended that they should be classified on the balance sheet according to the criteria applied in private enterprise accounting. Here, current assets are listed in descending order according to their lack of liquidity (ie stocks, debtors and cash balances in that order). In the case of current liabilities, these

(49) Op cit p 81.
are listed according to their similarity to the current assets and outstanding creditors normally appear above items like bank overdrafts. In addition, with the proper application of the full accrual basis of accounting required by section 104 of the Ordinance, payments in advance and accrued charges should appear as current assets or current liabilities as the case may be.

Provisions arise as the result of the matching principle because their establishment is designed to spread the eventuality of expected expenses over the period to which they relate. From an accounting point of view, those provisions which relate to some specific asset (ie provision for doubtful debts) are deducted from the relative asset (ie debtors) in order to disclose the net or approximately correct value of the assets, whereas those which do not relate to specific assets (ie provision for repairs and maintenance) are classified as current liabilities by accounting convention. Therefore, if the Local Authority balance sheets are to meet the objective of reflecting the financial position (insofar as a lack of proper fixed asset accounting allows) similar treatment must be accorded to the provisions of Local Authorities. This means that the use of the Provisions Statement by Local Authorities must be discontinued as reflected in Illustration 7.

(ff) Deferred Charges (or Assets Written-off Loan Discount and Issue Expenses)

In effect, the deferred charges represent either an expense relating to the financing of Local Authority capital expenditure (ie loan discount or loan raising expenses), or a decrease in the real capital of the unit, (ie assets which no longer exist). Consequently, they should be reflected on the balance sheet as a deduction from the "Capital Accounts". The reason is that expenses should be deducted from the unappropriated surpluses, and the decrease in real capital from the total capital of the Local Authority. Such treatment would ensure the disclosure of this item and also provide a better indication of the capital of the Local Authority and is reflected in this manner in Illustration 7. However, as
the term deferred charges is ambiguous, this item is described as "Assets Written-off, Loan Discount and Issue Expenses".

(d) The Aggregate Financial Statements

Obviously, the purpose of the aggregate financial statements is to provide a summary of the total income and expenditures of the Local Authority, the results of operations and financial position. In this respect, the IMTASA (1974) reporting requirements are that the aggregate income and expenditure statement includes the transactions of the General, Housing and Trading Funds, whereas the aggregate balance sheet is presented in a manner that gives the arithmetic totals of the assets and liabilities of all funds except the general trust funds and the investments in, and transfers to, the specific funds which are offset one against the other. Insofar as the aggregate income and expenditure statement is concerned, it correctly covers only those funds where results of operations need be reported upon, but it is interesting to note that the exclusion of the general trust funds from the aggregate balance sheet is not in accordance with the requirements of section 104 of the Ordinance, which specifies that the aggregate balance sheet shall include "... the whole of the liabilities and assets ..." of the Local Authority. Perhaps this is purely an omission by the IMTASA (1974).

For convenience, the reporting aspects of these aggregate financial statements are considered separately hereunder.

(i) The Aggregate Income and Expenditure Statement

In the context of present Local Authority financial reporting, the aggregate income and expenditure statement does provide information on the results of operations of the Local Authority as a whole and, as it is published with the financial statements of the individual funds, the detailed information on the various operations is also available. However, the aggregate income and expenditure statement does not provide information in aggregate form other than the total income and expenditures as reflected by the individual funds. In this respect, one would imagine that as the aggregate
income and expenditure statement is supposed to cover the Local Authority as a whole it would reflect total income and expenditures according to their nature ie total rates, service charges, other income and total salaries and wages, administrative expenses, capital charges, contributions, etc. In addition, it does not include budget information and the comments on the income and expenditure statements made earlier apply equally to this aggregate statement.

The disclosure of income, expenditures and contributions in total is necessary for both accountability and management control purposes. With the accountability requirements, the AAA (1975)(50) state: "Accountability for how [total] resources were employed ... is required. This implies a reporting network which indicates the magnitude of total resources committed to the entity and indicates the scope of the entity's operation". From a management control point of view, such information is necessary for overall planning purposes. Yet, such information is not disclosed.

Why are aggregated items of income, expenditure and contributions not reflected in the aggregate income and expenditure statement? Basically, the reason is that the recommended aggregate income and expenditure statement is designed to provide a summary of the operations of the Local Authority for the year in question and not to provide information in aggregate form. In effect, it is an admission that the broader entity concept of the Local Authority is not appreciated because this summary is provided on a fund-by-fund basis within these income and expenditure statements.

Does the aggregate income and expenditure statement serve any real purpose? Besides providing a summary of the income and expenditures for each fund and the figure agreeing with the surplus or deficit appearing on the aggregate balance sheet (see Chapter 3, point 6(a)), it apparently serves no other purposes. If, however, it provided information in aggregate form it could serve as a single income and expenditure statement (or "Statement of Operational Results, Contributions and Appropriations") which could, in time, possibly

(50) Op cit p 32.
serve as the means of discontinuing reporting on a fund-by-fund basis. In this respect, the aggregated information could be supported by suitably "disaggregated" information along the lines applicable to "segmented reporting" by private enterprises in the United States of America. (51) Here, relevant information is provided on income, profitability, assets and other matters like depreciation, capital expenditure, etc in columnar form so that interested parties may more fully understand the financial statements. (52) In the Local Authority sense, the information provided could consist of income, expenditures, contributions to capital outlay, other contributions, and appropriations on each general government, trading and interfund service fund. Presentation of information in this manner would provide readers with an adequate summary of operations, and other relevant information in a more suitable manner than the present reporting provides. It should, however, also include budget information to meet the full disclosure principle of the accounting system.

In suggesting the "segmented reporting" approach, it was stated that this form of reporting could, in time, replace the present fund-by-fund reporting system. Here, the belief that the individual funds represent the only accounting entities of Local Authorities appears to be so ingrained in Local Authority accounting circles that acceptance of reporting on the basis of a single set of financial statements would require a considerable period of time. However, this could only be established if some form of "segmented reporting" was introduced.

A further matter which requires attention is that if this information was disclosed in aggregate form, it would have to exclude certain interfund transactions (like interfund administrative charges) where relevant, to correctly reflect the total levels of income and expenditure. The result is that proper consolidated financial statements would have to be prepared by Local Authorities (see later).


(52) Ibid, pp 2-3, 14-17, 54 and 57.
(ii) **The Aggregate Balance Sheet**

From a disclosure of the financial position viewpoint, the aggregate balance sheets of Local Authorities suffer from the same reporting deficiencies as the balance sheets of the individual funds. Therefore, the first step in meeting this requirement would be to present the aggregate balance sheet along the lines suggested in Illustration 7. This would, as pointed out earlier, render both the Capital and Provisions Statements unnecessary. It would also segregate the various amounts set aside for specific purposes and their investments from the other liabilities and assets of the Local Authority.

The shortcomings of the aggregate balance sheet of Local Authorities, other than its method of presentation and a failure to account for fixed assets correctly, is due to the incidence of interfund balances arising from interfund service activities. Here, unless all outstanding balances are settled on the balance sheet date, these amounts are included in the assets or liabilities of the various funds and, upon aggregation, the assets and liabilities of the Local Authority are overstated because of the requirements of section 104 of the Ordinance.

In view of the possibility of the overstatement of the assets and liabilities of the Local Authority as reflected by the aggregate balance sheet, it does not provide a suitable statement for reflecting the overall financial position of the unit. Consequently, steps should be taken to rectify this financial reporting deficiency of the accounting system by the use of consolidated financial statements.

(iii) **Consolidated Financial Statements for Local Authorities?**

The suggestion that proper consolidated financial statements be prepared by Local Authorities is nothing new. In fact, the AAA (1971)\(^{(53)}\) recommended the preparation of consolidated balance sheets and operating statements in principle, on the grounds that the "... consolidating format is preferable

\(^{(53)}\) Op cit p 140.
as it lends itself to adequate disclosure since individual fund data, adjustments, and eliminations are displayed (and may be explained if necessary)." Although much research has subsequently been carried out on the matter by the AAA, the only reported practical application was the consolidation of the financial statements of the government of the United States of America for the fiscal year ended 30th June 1974, by Arthur Andersen and Company. More recently (ie 1977), Davidson et al, have provided guidelines on the method of consolidation of the financial statements of State and Local Authority units in the United States of America. However, the practice of presenting these consolidated financial statements for governmental or Local Authority units has, as yet, not been adopted as standard reporting practice by any governmental accounting professional body.

Essentially, the technique of consolidating financial statements is the aggregation of two or more sets of financial statements into a single set of financial statements to reflect the operations, results of operations and financial position as if the reporting was for a single entity. Consolidating techniques have been developed for accounting in the private sector and these could easily be adapted to suit Local Authority needs. Here, the consolidation of the financial statements of Local Authorities would involve the elimination of interfund balances, transfers and changes of an allocation nature (eg the changing of administration charges, etc), other than those applying to the specific funds of the Local Authority (eg the Loans Redemption, Renewals, Capital Development Funds and Consolidated Loans Funds) and should reflect the differences in economic activity between the general government and trading activities of the unit. This latter aspect was recognized by Davidson et al whose recommendations for the presentation of consolidated statements for these units is on a three-column basis; general government, trading and total.

(54) See the AAA (1975) op cit, pp 24-39 in particular.
(56) Op cit pp 74-82.
(57) Ibid.
There are, however, two approaches regarding the treatment of the internal or interfund loans of Local Authorities. The one approach considers that the amounts set aside in the specific funds of Local Authorities (i.e., the Loans Redemption, Renewals, Capital Development and Consolidated Loans Funds) are reserves of the Local Authority and, consequently, any loans made from these funds (or reserves) to other funds of the Local Authority are internal transactions and should be eliminated in the consolidation process. This approach is based on the fact that as no outside parties are involved, the only loans which should be reflected on the consolidated balance sheet are the external loans. The other approach is that as the legislation regulating Local Authority operations specifies that certain funds are to be set aside for specific purposes and invested in either approved securities or used for the purpose of making internal loans, the consolidated balance sheet should reflect these funds and their investments. In fact, this latter approach is the one supported in this study because it is submitted that were it not for the use of internal funds to finance the capital expenditure of Local Authorities, internal loans would have been replaced by external sources of finance. In addition, the purpose of the consolidated balance sheet is to reflect the financial position of the Local Authority and this includes the use of internal funds. Furthermore, even where it is argued that the elimination of internal loans from the consolidated balance sheet would reflect the Local Authority's success or otherwise in financing its capital expenditure from internal sources, the argument fails because this is information provided by the balance sheet and not the purpose of the balance sheet.

When viewed objectively, consolidated financial statements are required for Local Authorities to correctly reflect the levels of income and expenditure from operations and disclose fully the financial position of the unit as a whole. Therefore, they should replace the aggregate financial statements presently used. In this respect, the use of consolidated financial statements would also provide the means of replacing the fund-by-fund basis of reporting for external purposes, provided there was a suitable disaggregation and disclosure of relevant information. However, as with the introduction of proper fixed
asset accounting, there would have to be a desire to change Local Authority reporting by the Provincial Councils and the IMTASA.

(e) The Notes to the Financial Statements

Throughout this section frequent reference has been made to the use of notes to the financial statements. Insofar as these notes or footnotes are concerned they should not be considered a substitute for good accounting and should be used to disclose information which cannot be presented adequately in the body of the financial statements without detracting from their clarity.\(^{(58)}\) In this respect, they may be used to provide additional detail and elaborate or explain the information contained in the financial statements. However, it should be noted that the indiscriminate use of footnotes tends to make financial statements difficult to read and may detract from the importance of the information provided.

Although it is not the intention to discuss the type of information which should be disclosed in these footnotes, there is one area which requires comment. Probably the most important footnote should be that disclosing the accounting policies of the Local Authority. This is, in fact, the requirement of the International Accounting Standard No 1\(^{(59)}\) which has, as yet, not been adopted by the IMTASA (see paragraph 7 of Appendix B). Irrespective of the acceptance or non-acceptance of this International Accounting Standard, Local Authorities should disclose their accounting policies like the reporting on a fund-by-fund basis, their method of accounting for capital expenditure, etc. to make the financial statements more understandable to those not familiar with Local Authority accounting. Such disclosure is a Local Authority accounting requirement in the United Kingdom because the CIPFA (1975b)\(^{(60)}\) state that "Local Authority members will be

---

\(^{(58)}\) Hendriksen, op cit p 567.


\(^{(60)}\) Chartered Institute of Public Finance and Accountancy (CIPFA), Local Authority Accounting 2: Finance in Management, Exposure Draft, London 1975b p 19.
aware that disclosure of the main accounting policies adopted in the compilation of the accounts is already required under The Accounts and Audit Regulations 1974". However, this short-coming in the accounting system may soon be overcome if this International Accounting Standard is adopted by the IMTASA.

5. THE REPORT OF THE TREASURER

There is a dearth of literature on the form and content of the treasurer's (or chief financial officer's) report attached to the financial statements of Local Authorities in South Africa, probably because they are not required by law. From an examination of various treasurers' reports of Local Authorities in South Africa it appears that these reports provide little information which is not available in the financial statements themselves except information on budget variances, borrowings and borrowing powers, and the rates levied. In the United States of America the position is similar but there is greater recognition of the reporting responsibilities of the chief financial officer. Here, the NCGA\(^{(61)}\) specify that the chief financial officer's report "... should discuss briefly in narrative form the substantive highlights of the [financial] report. These would include significant aspects of financial operations during the year covered by the report; particular financial problems faced by the governmental unit; changes in financial policy and operating results with respect to revenues, expenditures and debt; the basis of accounting utilized by the unit; significant aspects of financial management, such as bond ratings, investment of cash balances and intergovernmental fiscal arrangements; and a preview of significant financial developments or changes contemplated in the ensuing fiscal year". Basically, the report is concerned with past operations but is designed to provide additional information on future operations and policies.

The question of what information should be disclosed in the treasurer's report must be examined in the light of the objectives of Local

\(^{(61)}\) Op cit p 107.
Authority financial statements and the objectives of the accounting system. In this respect, the objectives of the financial statements of Local Authorities, as outlined by the AICPA (1973)\(^{(62)}\), are that they should provide information for assessing the past goals of the unit, the status of present efforts to attain goals, and the probability of future goal attainment. The objectives of the accounting system are, as outlined in Chapter 2, accountability and management control. Therefore, the treasurer's report should provide information on the past, present and future goal attainment insofar as this information is available and not already provided by the financial statements.

In relation to the objectives of Local Authority financial statements, the financial statements, because they are based on historical data, are only concerned with provision of information on the attainment of past goals of the unit. However, not all goals, operations or benefits can be fully expressed in quantitative terms and to meet the accountability objective of the reporting system, these require elucidation in narrative form in the treasurer's report. Therefore, the first requirement of the treasurer's report is to ensure that the degree of attainment of the past goals of the Local Authority, as reflected by the financial statements, are fully explained and disclosed.

The provision of information on the status of present efforts to attain goals and the probability of future goal attainment both involve the planning process as applied by the Local Authority. Here, to meet the accountability objective of the accounting system and the objectives of the financial statements, information on the financial policies of the Local Authority in the long-term and how they are to be implemented in the medium-term should be provided. However, this information is not provided by Local Authorities in South Africa. In this respect, the treasurer is responsible for the financial affairs of the Local Authority and should, where possible, report on all matter affecting the present and future

\(^{(62)}\) Op cit p 49.
financial affairs of the unit. This means that the treasurer's report should, as its second requirement, provide information on the policies and decisions of the legislative body of the Local Authority insofar as they affect the present and future financial affairs of the unit.

Furthermore, to meet the full disclosure principle of the accounting system and its accountability objective, the treasurer's report should also include all relevant information not provided by the financial statements or notes thereto. This would include such information as the unexpended borrowing powers, details of capital projects in progress and any financial problems facing the Local Authority as well as details of the rates levied.

In some respects, the treasurer's report may not be the most suitable place to provide information on the decisions of the legislative body of the Local Authority affecting the future. However, besides the report of the auditor, it is the only report presently attached to the financial statements of Local Authorities in South Africa and, consequently, it may have to serve a broad purpose. Once the reporting responsibilities of Local Authorities are fully recognized, this information could be provided in an additional report of the Mayor or Chairman of the legislative body of the Local Authority concerned. In this respect, the following comments of the CIPFA (1975b)(63) are of interest: "We consider that Local Authorities should produce an annual report of their stewardship, with both a financial and managerial content, to be generally available. In the short-term, the report would probably be heavily finance orientated but it should be developed gradually into a corporate report". It is, therefore, also an area to which the IMTASA and the Provincial Councils should direct their attention.

6. THE AUDITOR'S REPORT

As outlined in Chapter 3, the report of the auditor of Local Authorities is a report containing not only his opinion on the financial statements but also information of a financial

(63) Op cit p 16.
nature. The reason for the inclusion of this additional information on financial matters stems from the extension of the audit function by section 178 of the Ordinance to provide a report on matters of interest or importance arising from the audit.

Insofar as the AAA (1977)\(^{(64)}\) is concerned, for Local Authorities and similar governmental units "The auditor's responsibility is clearly limited to an expression of an opinion on the fair presentation of the financial statements". Why, then, is this responsibility extended in the case of Local Authorities in South Africa? The reason is partly due to the supervisory responsibility of the Provincial Councils over Local Authorities and, in this respect, any additional information affecting the control over these units should be brought to their attention. However, this does not explain why information on budget variances, capital transactions, unexpended borrowing powers, etc which fall within the reporting area of the treasurer should be provided by the auditor's report. In fact, when viewed objectively, the only valid reason appears to be to ensure that this information is made available to the Provincial Councils and other interested parties. Therefore, the extension of the audit function in the case of Local Authorities appears to have been designed to overcome some of the present reporting deficiencies of the accounting system.

Besides the statutory requirements relating to the financial statements of Local Authorities, the only report required to be attached to the financial statements is the auditor's report. Therefore, in the absence of specific legislative requirements regarding the provision of additional information (eg the unexpended borrowing powers) in, say, the treasurer's report, this information appears in the auditor's report. It is a matter which requires attention by the Provincial Councils and the IMTASA. Furthermore, the failure of the accounting system to provide, as part of its reporting function, certain information (ie budget variances) also contributes to the inclusion of financial information in the auditor's report.

\(^{(64)}\) Op cit p 44.
7. THE STATISTICAL SECTION

The omission of statistical data from the annual report of Local Authorities is, as the NCGA\(^{(65)}\) point out, a failure to recognize the full disclosure principle of the accounting system. In this respect, statistical information is necessary to supplement the information provided in the financial statements, to assist in the prediction and forecasting of future events, and to satisfy the requirements of other users of the financial statements like the Department of Census and Statistics, various economic research organizations, the Provincial Auditor, etc. Therefore, this statistical information should not be restricted to the period covered by the financial statements.

The attitude of the IMTASA towards the publication of statistical information was outlined in Chapter 3. Although it is fully accepted that the publication of certain information in the statistical section may be meaningless, there is information which should be provided. However, to establish exactly what information would be required to satisfy users' needs could form a separate area of research and is beyond the scope of this study.

An indication of the type of information which should be provided in the statistical section is, however, provided by the NCGA\(^{(66)}\) where it specifies its requirements for governmental units in the United States of America. These requirements of the NCGA appear as Appendix C to this study. They consist of tables providing ten-year summaries of income, expenditures, tax levies, assessed and actual value of taxable property, ratios of loan debt to rateable values of property and population; extensive loan debt information; insurance cover; the salaries payable to, and the fidelity insurance cover over, senior officials; and other miscellaneous statistical data.

What information need be included in the statistical section of the annual report of Local Authorities is an area to which the IMTASA should direct its attention. Here, at least

\(^{(65)}\) Op cit p 233.
\(^{(66)}\) Ibid, p 114.
there should be an indication of what basic information should be provided because Local Authorities require guidance in this matter and it is insufficient to leave the provision of this information entirely to the discretion of Local Authorities.

8. **THE USE OF FORECASTS IN LOCAL AUTHORITY ANNUAL REPORTS?**

The examination of the financial reporting by Local Authorities up to this point has been concerned with an examination of existing practices. This has involved financial reporting through traditional annual reports which in many respects fail to provide users with the type of information they need. Basically, this shortcoming is that traditional financial reporting does not provide information on future events.

As outlined earlier in this study, the major purpose of financial reporting is to provide information for the making of economic decisions. As most economic decisions are, however, concerned with future events, the use of present financial statements is restricted to forecasting or predicting future events on the basis of the information provided. This forecasting or prediction of future events is left to the user of the financial statements provided he possesses the necessary skills. However, it is now recognized that all users of financial statements are not trained financial analysts or accountants and in the case of governmental or Local Authority units, the financial statements should provide information on the probability of future goal attainment. This may be achieved simply through the inclusion of financial forecasts as part of the annual report.

A forecast may be simply described as a formal projection or estimate of future events or courses of action. In the context of Local Authority accounting, forecasting may be considered the intended plan of operations in the medium-term of the planning process. Here, it should represent the formal plan of intended objectives or goals which are to be implemented by the Local Authority over a three to five year period in terms of its stated policies. In many respects forecasting is
similar to budgeting but, as Buckley and Lightner\(^{(67)}\) point out, the function of forecasting is to provide the precur-
sory data base for generating budget values. Therefore, the 
budget forms the means of accomplishing the goals or objec-
tives of the forecast. And, in the case of Local Authorities, 
the budget is the short-term plan of intended operations.

The inclusion of forecasts in the annual reports of Local 
Authorities in the United States of America was recommended 
in 1977 by Davidson \textit{et al}\(^{(68)}\) "... in order to remedy the 
citizenry's lack of awareness of the tax implications of their 
service desires and to disclose the projections of the tax or 
revenue base made by municipalities." It is, however, sub-
mitted that the need for the inclusion of forecasts extends 
beyond these reasons. If the annual budget was published in 
advance together with the forecast as part of the annual re-
port of Local Authorities then the financial reporting by 
these units would be future event orientated and would provide 
for full accountability. Reporting on the attainment of past 
goals would merely involve the explanation of budget variances, 
whereas the status of present efforts and the probability of 
future goal attainment could be represented by the explained 
performance of the Local Authority in relation to the fore-
cast.

The inclusion of budget information or forecasts in the 
financial statements of enterprises of the private sector is 
uncommon at present although it is recognized that such in-
formation would improve financial reporting.\(^{(69)}\) The reasons 
are that private sector enterprises operate in a competitive 
environment where the disclosure of future operations may 
affect the enterprise's position in relation to its competi-
tors and the reluctance of managers to commit themselves to 
future projections. These conditions are not present in the

\(^{(67)}\) Buckley, John W, and Lightner, Kevin M, \textit{Accounting: A} 
\textit{Systems Approach}, Dickenson Publ. Co, Encino, California, 
1973 p 953.

\(^{(68)}\) Op cit p 67.

\(^{(69)}\) See the Securities and Exchange Commission, Releases 
33-5581 dated April 28, 1975 and 33-5699 dated April 
23, 1976.
case of Local Authorities and, in fact, their operations are subject to considerably fewer income and expenditure fluctuations than enterprises of the private sector. In addition, Local Authorities and other governmental units have, as Davidson et al (70) state "... throughout this century, been leaders in the preparation and use of budgets". Therefore, there appears to be no reason why forecasts should not be included as part of the annual reports of Local Authorities.

No matter how radical these recommendations for the inclusion of forecasts in the annual reports may appear, it was acknowledged by the CIPFA (1971) (71) that "[Local] Authorities having only rate services may wish to ... amalgamate their annual budget for the coming year with the published accounts of the previous year". Therefore, as the concept of the inclusion of projected information in the annual reports of Local Authorities is nothing new and in view of its reporting advantages, it is submitted that this is an area which should be considered as a possible means of reporting on future events.

9. SUMMARY

Financial reporting in the Local Authority or governmental sense should be the total process of communicating financial information regarding the operations and financial position of the unit to all interested parties. It involves both internal and external reporting, but it is essentially with external reporting that this Chapter is concerned.

Internal reporting involves the provision of data for planning and control and is dependent upon the system of management control in operation. However, internal reporting by many of these units is mainly restricted to the monitoring of the statutory budget.

The discharging of their external reporting responsibilities by Local Authorities is through the publishing of a

(70) Op cit p 67.
(71) Op cit p 3.
comprehensive annual report. The Local Authority attitude towards this annual report is that it is prepared mainly for its own use, other Local Authorities as a means of comparison and to discharge its legal compliance and fiscal accountability responsibilities to the Provincial Councils. The general public may inspect or obtain copies of the annual report should they wish to do so. However, it is the duty of Local Authorities to ensure that the communities they serve are fully informed of their operations and activities. In this connection, the annual report is unsuitable for use by persons who are not sophisticated or well-informed users of financial information and it has been suggested that their reporting responsibilities can be met by publishing popular reports in addition to their annual reports.

The financial statements of Local Authorities should provide information to allow the assessment of the effectiveness of the management of resources and the attainment of the unit's goals. To achieve these objectives three basic statements are necessary to reflect the results of operations, the changes in net financial resources (fund balance) and the financial position. The income and expenditure statements presently used do not include budget information necessary to disclose the results of general government activities and in the absence of depreciation accounting the results of trading operations cannot be measured effectively. The changes in the net financial resources (fund balance) are provided by the appropriation section of the income and expenditure statements. Here, present Local Authority reporting practices exclude budget information and where operating surpluses are transferred to "tariff stabilization provisions", these surpluses are not adequately disclosed. This is due to confusion regarding the nature of reserves and provisions by the Institute of Municipal Treasurers and Accountants S A (IMTASA) whereby surpluses (which are reserves) are treated as provisions. The balance sheet is the statement which should reflect the financial position of the fund or Local Authority, as the case may be. However, in the absence of proper fixed asset accounting by Local Authorities in South Africa, this is not the position because the real capital cannot be established.
Furthermore, the balance sheets are not presented in a classified manner. Consequently, it is recommended that the income and expenditure statements be replaced by statements reflecting actual and budgeted amounts and that the balance sheets be presented according to the Local Authority accounting equations in a classified manner. The accounting equations for the various funds have been outlined and an example of the method in which the balance sheets of the various funds should be presented based on the accounting equation and generally accepted reporting practice has been given.

The aggregate financial statements are designed to disclose the results of operations and financial position of the Local Authority as a whole. However, the aggregate income and expenditure statement is merely a summary of the individual income and expenditure statements of the funds and does not provide information in aggregate form nor are interfund transfers eliminated in the aggregation process. The aggregate balance sheet is similarly not suitable as a means of disclosing the financial position of the Local Authority because it is an aggregation of the balance sheets of the various funds and as interfund balances are not eliminated, the total assets and liabilities may be overstated. Consequently, the use of proper consolidated financial statements by Local Authorities has been recommended. In this respect, proper consolidated financial statements may provide the means of discontinuing reporting on a fund-by-fund basis.

The treasurer's report is not a statutory reporting requirement and the IMTASA have not specified what information should be contained in this report. Consequently, the information provided is at the discretion of the treasurer. From an accountability point of view, the treasurer's report is an important document and should provide information on the past, present and future financial matters. However, in the absence of specific requirements this is not normally the case.

The report of the auditor is more than an opinion on the financial statements because the audit function is specifically extended by the Ordinance to provide a report on any financial matter of interest. While it contains certain financial
information not provided in the financial statements, it should not be the manner in which the deficiencies of the reporting system are rectified.

The entire financial reporting function of the annual report is impaired by the failure of the IMTASA to provide guidelines on what statistical information should be provided in this report. The matter is an area to which attention should be directed and an indication of what type of statistical information should be included is provided by the requirements of the National Committee of Governmental Accounting (NCGA) in the United States of America.

Finally, the inclusion of forecasts in the annual report of Local Authorities, as a possible future development, have been considered.
CHAPTER 6.

CONCLUSIONS

Present Local Authority accounting practices, although they may have sufficed to meet the accounting requirements of these units in the past, are no longer suitable for effective management and reporting purposes. Urban growth has created demands for additional and improved services which require effective Local Authority planning, resource allocation and reporting systems. This means that Local Authorities should operate within an effective system of management control. In addition, there should be effective communication between Local Authorities and the communities they serve.

These information needs relate to the main objectives of the accounting system which are management control and accountability. Unfortunately, neither of these objectives appear to be fully recognized by the Institute of Municipal Treasurers and Accountants S A nor the Provincial Councils. In this respect, Local Authority accounting in South Africa is mainly restricted to the demonstration of legal compliance and stewardship accountability. Reporting is mainly for internal purposes and Provincial Council needs and little attention is paid to providing information on their operations and activities in an understandable manner to the communities they serve.

One of the major shortcomings of the accounting system is its failure to provide cost-based data as part of its normal operations. In this respect, Local Authorities are more concerned with the total expenditures incurred than the actual expenses of providing services. The actual cost (ie the total individual expenses) of providing services cannot be established because the practice of linking asset lives with their sources of finance does not provide for the accounting for the consumption of assets in the production process. Here, some assets are written off in the year acquired (ie those financed from income) whereas with others the consumption charge is replaced by loan redemption charges which are linked with the tenure of loans and not asset lives. The additional
effects of this method of accounting for fixed assets are that the measurement of the results of trading operations (which should be on net income determination) are along the lines applicable to general government operations and that the real capital of Local Authorities cannot be established. The overall effect of the failure to account for the consumption of fixed assets in the production process is that the accounting system does not provide the information necessary for an effective system of management control without additional accounting records. Here, as cost-based data is not available there cannot be effective control over the day-to-day operations of Local Authorities nor efficient and economical management of resources without splitting the financial and managerial functions of the accounting system. Furthermore, how can there be adequate planning in relation to future capital needs if the present capital invested in the Local Authority cannot be established?

Equally disturbing is the Local Authority attitude towards financial reporting. Here, the only concern appears to be that of meeting their own internal and Provincial Council reporting requirements. Local Authorities are governmental units entrusted with the use of public resources, yet little attention appears to have been given to providing the public with information on their operations and activities. In this respect, their reporting responsibilities extend not only to the relatively well-informed members of the community but also the lay public. However, the annual reports of Local Authorities are presented in a manner that certain aspects are difficult to understand and interpret by even sophisticated users of accounting information. Not only is a misleading terminology used but the financial statements are prepared as much to demonstrate legal compliance as to provide information on their economic activities.

Financial reporting is through a comprehensive annual report consisting of the financial statements, a treasurer's report, a statistical section and the report of the auditor. The financial statements, which are prepared on a fund-by-fund basis and in aggregate form, do not provide full information on the results of operations nor the financial position of...
Local Authorities. The financial position is difficult to appraise because of the lack of proper fixed asset accounting. Furthermore, the results of the general government operations cannot be properly measured due to the failure to include budget information in the income and expenditure statements and the lack of depreciation charges in the case of trading activities is not conducive to net income determination. In addition, the aggregate financial statements do not provide the necessary information on the Local Authority as a whole.

Neither the treasurer's report nor the statistical section are required by law and, consequently, their contents are at the discretion of the Local Authorities themselves. The report of the auditor does, however, contain some financial information in addition to providing an expression of opinion on the financial statements.

Therefore, it is concluded that Local Authorities should:

1. Break the link between fixed assets and their sources of finance and introduce proper fixed asset accounting. Cost-based data could be provided as part of the normal operation of the accounting system and allow the establishment of proper systems of managerial control without the necessity of maintaining additional records for this purpose. Furthermore, it would permit net income or loss determination in the case of trading activities and enable the net investment in fixed assets to be established.

2. Operate within a system of management control based on the principles applicable to Planning-Programme-Budgeting Systems (PPBS). As outlined in Chapter 3; the objectives of policies should be stated, the most suitable, economic and effective programmes to attain these objectives should be established by choosing amongst alternatives and the plan of operations in the medium- and short-term to implement these programmes should be drawn up. Control in the short-term would be achieved by the use of the annual budget.
3. Recognize that their accountability responsibilities are to the general public and not only to the Provincial Councils. In this respect, they must account for their use of public resources in relation to past, present and future goal attainment in a manner which is understandable to both the lay public and sophisticated users of accounting information.

4. Meet their reporting responsibilities to the lay public by the use of popular or summarized financial reports. The publishing of these popular reports should be a statutory requirement and provide relative information (in summarized, graphical and narrative form) in a manner easily understood by the lay public and draw attention to the fact that the annual report is available to all entrusted parties. These popular reports should be freely available and preferably published in a local newspaper.

5. Produce a comprehensive annual report in a manner which discloses fully the results of operations and financial position of the various funds and the Local Authority as a whole. This annual report should provide full information on the policies and goals of the Local Authority and the attainment of these goals. This would involve:

(a) The presentation of financial statements where:

(i) The measurement of the results of operations is in relation to their economic activities. Here, the measurement of the general government activities should be in relation to predetermined levels of financial activity as set by the annual budget and that applying to trading activities on net income determination. To meet the full disclosure principle of the accounting system, trading operations should be compared with the budget adopted for managerial control purposes. This means that the income and expenditure statements should be replaced by statements reflecting actual and budgeted levels of financial activity and the results of operations, appropriations and contributions.
(ii) Disclosure of the financial position of the various funds is through fully classified balance sheets prepared along the lines applicable to accounting in the private sector. This requires that assets and liabilities are properly grouped and amounts set aside for specific purposes segregated from the other assets and liabilities of the Local Authority. Provisions should be either deducted from the assets to which they relate or reflected as current liabilities. And, fixed assets should be disclosed in a manner which reflects their unexpired service potentials (i.e., at cost less accumulated depreciation).

(iii) The disclosure of the results of operations and financial position of the Local Authority as a whole through the preparation of consolidated financial statements. Such statements should exclude interfund transactions and provide information on the income, expenditures, assets, and liabilities of the Local Authority in aggregate form.

(iv) Detail on income account be restricted to that required to meet the full disclosure principle of the accounting system. Here, income should be disclosed in total according to source and expenditures summarized into such categories that disclose fully the functions and activities of the Local Authority.

(b) The inclusion of a comprehensive report prepared by the treasurer on behalf of the Council or Board on the policies and proposed plans for future operations as well as explanations of the operations covered by the financial statements. This is necessary to fully meet the objectives of financial statements which are, as outlined in Chapter 3, to provide information for assessing the past goals of the unit, the status of present efforts to attain goals, and the probability of future goal attainment. Here, the criterion
for the inclusion of information should be based on the full disclosure principle of providing information which may affect the judgments made or conclusions reached by reasonably well-informed readers of financial statements.

This report should also include information on the unexpended borrowing powers, rates of taxes levied and any other information of interest to the readers of the annual report.

(c) The report of the auditor giving his opinion on the fair presentation of the financial statements and report of the treasurer. It should not contain any additional information of a financial nature because this should be provided in either the financial statements themselves or the treasurer's report.

(d) Contain a statistical section providing various statistical information on the Local Authority. However, what information should be provided is an area for further study.

6. Investigate the inclusion of forecasts in the annual report. This could provide for full accountability because in the event of including forecasts with the financial statements reporting need only be on an exception basis.

However, if these improvements in Local Authority accounting are to be made then change must come from within. The responsibility for improving the Local Authority accounting system rests with the Local Authorities, the Institute of Municipal Treasurers and Accountants S A and the Provincial Councils. It is for them to accept that the public are not adequately informed on the operations and activities of Local Authorities and there is need for improvement in the reporting by these bodies. It will also require their acceptance that certain accounting practices (eg the linking of asset lives with their sources of finance) need to be amended to meet modern accounting and managerial requirements.
Appendix A.

The Thirteen Principles of Governmental Accounting of the National Committee on Governmental Accounting

(1) A government accounting system must reflect compliance with legal requirements and disclose fully and fairly the financial position and results of financial operations.

(2) In the event of there being a conflict between legal provisions and generally accepted accounting principles applicable to government units, legal provisions must take precedence.

(3) An annual budget should be adopted by every government unit, whether required by law or not, and the accounting system should provide budgetary control over general government activities.

(4) All governmental accounting systems should be organized and operated on a fund basis.

(5) Eight different types of funds are recognized and used for government operations where applicable. There are:

(a) The General Fund - to account for all financial transactions not properly accounted for in any other fund.

(b) Special Revenue Funds - to account for the proceeds of specific revenue sources or to finance specific activities as required by law or administrative regulation.

(c) Debt Service Funds - to account for the payment of interest and principal on long-term debt.

(d) Capital Project Funds - to account for the receipt and disbursement of moneys used for the acquisition...

of capital facilities other than those financed by special assessment and enterprise funds.

(e) Enterprise Funds - to account for the financing of services to the general public where all or most of the costs involved are paid in the form of charges by users of such services.

(f) Trust and Agency Funds - to account for assets held by a government unit as trustee or agent for individuals, private organizations and other government units.

(g) Intragaovernmental Service Funds - to account for the financing of special activities and services performed by a designated organization unit within a governmental jurisdiction or other organization units within the same governmental jurisdiction.

(h) Special Assessment Funds - to account for special assessments levied to finance public improvements or services deemed to benefit the properties against which the assessments are levied.

(6) Only those funds required by law and for sound financial administration should be established and maintained.

(7) A complete fund accounting system must be established and maintained for each fund.

(8) Fixed assets should be maintained at original cost, or the estimated cost if original cost is not available, or at the appraised value of gifts at the time received.

(9) Depreciation should not be recorded in the accounting records for general government activities.

(10) A full accrual basis of accounting is recommended for Enterprise, Trust, Capital Projects, Special Assessment and Intragaovernmental Service Funds whereas for the General, Special Revenue, and Debt Service Funds, the modified accrual basis of accounting is recommended.
(11) Government revenues should be classified by fund and source whereas expenditures should be classified by fund, function, organization unit, activity, character, and principal classes of objects in accordance with standard recognised classification.

(12) A common terminology and classification should be used consistently throughout the budget, the accounts and the financial reports.

(13) Financial statements and reports showing the current condition of budgetary and proprietary accounts should be prepared periodically to control financial operations and at the close of the fiscal year, a comprehensive annual financial report covering all funds and financial operations of the governmental unit should be prepared and published.
APPENDIX B

STATEMENT BY THE INSTITUTE OF MUNICIPAL TREASURERS AND ACCOUNTANTS S.A., ON THE RELEVANCE OF THE INTERNATIONAL ACCOUNTING STANDARDS TO LOCAL AUTHORITIES

INSTITUTE OF MUNICIPAL TREASURERS AND ACCOUNTANTS S.A.
INSTITUUT VAN MUNISIPALE TESOURIERS EN REKENMEESTERS S.A.

INCORPORATED ASSOCIATION NOT FOR Gain

J.C.T. REYNDERS, F.K.M.P.A. M.A.
Secretary/Sekretaris

P.O. BOX/POSTBUS 8652
JOHANNESBURG
2000
November, 1976.

PREFACE TO INTERNATIONAL ACCOUNTING STANDARDS

INTRODUCTION

1. Annexed to this statement is a copy of "Preface to International Accounting Standards" published by the International Accounting Standards Committee (IASC).

2. The objectives of the IASC are summarised in paragraph 2 and in terms of the agreement referred to therein, Founder and Associate members have agreed to support the objectives of the IASC by undertaking the specific obligations listed in paragraph 3.

3. Paragraphs 4 to 7 refer to matters concerning audited accounts and financial statements. It should be noted that "when financial statements are issued to other persons, such as shareholders, creditors, employees, and the public at large, they should conform to International Accounting Standards."

4. Paragraphs 8 to 11 of the Preface are of particular relevance vis-à-vis the Institute’s 1974 Report on the Standardisation of Financial Statements of Local Authorities in South Africa.

5. Paragraph 12 of the Preface defines the scope of the standards and determines that the standards will apply from a date specified and will not be retrospective.

6. Paragraphs 13 and 14 set out in detail the working procedure agreed by the Committee regarding the preparation of exposure drafts, consideration of the same, and a subsequent issue of definitive International Accounting Standards. Close liaison has been established with the National Council of Chartered Accountants (S.A.), an associate member of the IASC, which has supplied all exposure drafts published by the IASC to the Institute for comment.

INSTITUTE STATEMENT

7. Having regard to the objectives of the International Accounting Standards Committee, the Institute of Municipal Treasurers and Accountants, S.A. has undertaken through its Council and members that they will support the standards promulgated by the International Accounting Standards Committee and will use their best endeavours to ensure that financial statements of local authorities in Southern Africa comply with these standards, or that there is a disclosure of the extent to which they do not. In furtherance thereof, the Institute Council will arrange for copies of the International Accounting Standards, as and when they are published, which are of relevance to local authorities, to be made available to members and interested persons for implementation from the effective dates prescribed by the International Accounting Standards Committee.

8. The Institute Council will issue statements of guidelines to assist treasurers in ensuring the financial statements of local authorities comply with the International Accounting Standards published from time to time.
"Although there will be significant differences in the statistical data to be reported by governmental units because of variations in legal authority, organization, and functions from one unit or class of units to another, there are, nevertheless, certain data which this Committee considers essential to adequate and full understanding of financial affairs. These data should be presented in the following tables:

I. General Government Expenditures by Function - Last Ten Fiscal Years.

II. General Revenues by Source - Last Ten Fiscal Years.

III. Tax Revenues by Source - Last Ten Fiscal Years.

IV. Property Tax Levies and Collections - Last Ten Years.

V. Assessed and Actual Value of Taxable Property - Last Ten Fiscal Years.

VI. Property Tax Rates and Tax Levies - All Overlapping Governments - Last Ten Fiscal Years.

VII. Special Assessment Collections - Last Ten Fiscal Years.

VIII. Ratio of Net General Bonded Debt to Assessment Value and Net Bonded Debt per Capita - Last Ten Fiscal Years.

IX. Computation of Legal Debt Margin.

X. Ratio of Annual Debt Service Expenditures for General Bonded Debt to Total General Expenditures.

XI. Schedule of Revenue Bond Coverage - Last Ten Fiscal Years."
XII. Debt Service Requirements to Maturity General Obligation Bonds (plus similar statements for revenue and special assessment bonds).

XIII. Summary of Debt Service Charges to Maturity.

XIV. Schedule of Insurance in Force.

XV. Salaries and Surety Bonds of Principal Officers.

XVI. Miscellaneous Statistical Information".(1)

BIBLIOGRAPHY

ACTS OF PARLIAMENT

1. South Africa Act (1909), 9 Ed VII Ch 9 (United Kingdom).
2. Public Health Act, No 36 of 1919.
5. Insurance Act, No 27 of 1943.

PROVINCIAL ORDINANCES

1. Development and Services Board Ordinance, No 20 of 1941 (Natal).

GOVERNMENTAL REPORTS

OTHER REFERENCE MATERIAL


