LOCAL AUTHORITY FINANCIAL REPORTING — Communication, Sophistry or Obfuscation

W Collins, D Keenan and I Lapsley
LOCAL AUTHORITY
FINANCIAL REPORTING

COMMUNICATION, SOPHISTRY
OR OBFUSCATION

W. Collins, D. Keenan and I. Lapsley
FOREWORD

This book reports the results of the second of a two-part research investigation into Scottish local authority accounts. The work was funded jointly by the Chartered Institute of Public Finance and Accountancy and The Institute of Chartered Accountants of Scotland.

The first part of the research, published in 1988, evaluated accounting practices and reporting by Scottish local authorities to provide evidence on how authorities prepared their accounts. This second part explores the use made of Scottish local authority annual reports and accounts and the possible need for their reform.

Constructive suggestions are made for improving the use made of the annual report and accounts. We particularly welcome the suggestions for more timely reporting and the introduction of layering of financial reporting information.

Although the research was conducted on Scottish local authorities, we believe it has relevance to local authority financial reporting throughout the UK and the indeed throughout the world. We commend this book to all parties interested in local authority accounts; the opinions expressed by the authors are, of course, their own and do not necessarily represent the views either of ICAS or CIPFA.

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Convener, ICAS Research Committee

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Director, CIPFA
AUTHORS' PREFACE

The nature of local authority annual reports is a matter which has always been of importance, but one which has assumed even greater importance with recent and prospective changes in the system of local authority taxation. These changes in taxation seek to encourage the electorate to make decisions informed by the financial consequences of their actions. While local authority financial information may be reported in a variety of ways (e.g. the media, comparative statistics of professional and other bodies) the originating source of such information is the accounting data collected routinely for the preparation of local authority reports and accounts. Recognition of the actual and potential importance of local authority financial reports has resulted in local authority finance officers as providers of such information, in conjunction with professional institutes and associations such as the Chartered Institute of Public Finance and Accountancy, the Local Authority (Scotland) Accounts Advisory Committee (LASAAC) and local authority auditors, seeking to improve the content of such reports and the consistency of the accounting practices used in their compilation. Most recently, for example, a statement of recommended accountancy practice, the GB SORP, has been issued with the aim of improving consistency in the compilation of accounting numbers in local authority finance reports in Scotland, England and Wales. Also, the most recent Accounting Code of Practice seeks to improve the clarity of financial information made available to electors, taxpayers, members of local authorities and other interested parties.

Unfortunately, little is known about the actual usage of this information. Indeed, the diversity of the activities undertaken by local authorities results in the production of a somewhat complex financial report which seeks to portray the activities of the local authority as a single entity and which may militate against its more general use. For the elector, taxpayer, or member with limited expertise in public sector finance, the most obvious focus of attention may be specific services which they use and this in terms of availability of service and quality of delivery, rather than their costs and their impact on the tax burden. This study seeks to explore these issues and gaps in our knowledge of the role and use of local authority financial reports. This study is quite distinctive in that it explored these issues by undertaking field studies involving detailed interviews with a variety of actual and potential users of
local authority financial reports. Its findings suggest that the quality of local authority financial reporting is continuing to improve, but that reforms of existing practices will be necessary to reach those groups who are assumed to be typical users of such reports.

The views expressed in this report are those of the authors alone. However, they wish to acknowledge the comments on an earlier draft of this report from John Broadfoot, Controller of Audit, Ian Doig of CIPFA in Scotland, Grant Macrae of Peat Marwick McLintock and Cyril Tomkins (Bath University). We also wish to acknowledge the helpful comments on interim findings from participants at a European Institute of Advanced Studies in Management Workshop on public sector accounting at Maastricht. The authors also gratefully acknowledge the financial support of the Research Committee of The Institute of Chartered Accountants of Scotland and the Chartered Institute of Public Finance and Accountancy, who sponsored this research project.

EDINBURGH, 1991
AUTHORS' PREFACE

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1. CONTEXT OF THE STUDY
This study examines the use made of local authority annual reports and accounts and the possible need for their reform. The scope and nature of the study are described below. The significance of, and rationale for, this study are examined here. The extent to which these reports communicate the financial results of local authorities effectively, or whether they merely serve to confuse and obscure financial messages to potential users is a matter of considerable importance. The significance of this study can be seen on two levels: (a) the need for local government to be, and to be seen to be, publicly accountable for the (publicly–financed) resources at its disposal and (b) the relative neglect of this aspect of public sector accounting. Both of these are explored below.

Public Accountability
As regards (a), public accountability in the local authority context can be seen as the process/processes by which local authorities are held to account for their resources. This process of being held publicly accountable for these resources takes a variety of forms: (i) local authorities are obliged to make financial information available for public inspection both by providing access to routine accounting information, if requested, and by disseminating annual reports and accounts to interested parties (in addition, local authorities provide details of budget and previous year’s outturns on their demands for local taxes and they may also provide financial information as part of a local authority newspaper), (ii) local authorities are subject to external audit, under the auspices of the Accounts Commission, a public body which oversees local authority audit in Scotland, (iii) members of the elected, ruling party must explain its budget proposals to the council of elected members, a meeting at which the media and the general public are admitted and over which central government might exercise some restraint, for example, by capping the level of local taxes, (iv) from time to time the ruling party may be challenged on its policies by its opponents and this may lead to an exchange which extends beyond the council chamber to the media, possibly including auditors, central government, pressure groups and the general public, (v) ultimately, the ruling party will face re-election and will be held accountable to the electorate for its policies although, as examined further below, the role of financial information in the voting process is not as straightforward as might be expected.

The particular focus of this study is that of local authority annual reports and accounts. Traditionally, their role in the process of the public accountability of local authorities has been the limited one of ensuring local authorities are held accountable for the probity and legality of their expenditure. However, with the development of the value for money trend in the public sector, generally, there has been an increased focus on the ways in which accounting information can play a role, not only in the assessment of probity and legality of local authority activities, but also in explaining/ensuring the efficiency and effectiveness of their activities.
CONTEXT OF THE STUDY

(see, for example, Tomkins, 1987). There are difficulties in extending this role for accounting information from ‘probity/legalit’ to taking account of policies and programmes (see, for example, Stewart, 1984). These arise particularly over the definition (and measurement) of policy aims and objectives in operational terms and the integration of financial and non-financial information in the construction of widely accepted, meaningful, performance indicators.

Nevertheless, despite such difficulties, the potential role of local authority reports and accounts and the information derived from them (whether purely accounting numbers or hybrid performance indicators) has received considerable impetus from recent and prospective changes in systems of local authority taxation, which have sought to emphasise the financial dimension of public accountability, particularly with regard to ultimate decisions on voting preferences by the electorate. This can be seen in the change from the former rating system (a property tax) which was replaced by the community charge (a flat-rate or poll tax) and which, in turn, is to be replaced by the Council Tax (a hybrid form of tax which will be based on numbers of residents in a household and (banded) property values). The initial impetus for the introduction of the community tax charge/poll tax was the aim of improving public accountability by making voters more aware of the expenditure policies of local authorities (Department of the Environment, 1986). While the new Council Tax has softened the flat-rate aspect of the community tax charge by relating tax liability to the value of property held it, nevertheless, retains the concept that, unlike the former rating system, the tax liability is not to be borne by a single householder. It remains to be seen if this local tax will be more successful than its short-lived predecessor. However, reservations can be expressed over policies which seek to inject a financial dimension into the process of public accountability on two grounds (a) the behaviour of the electorate may confound such ideas and (b) the nature of the financial information available to actual and potential voters will be a major determinant of whether or not they respond to it in their voting preferences.

As regards (a) above, the implicit assumption in these changes of local taxation systems is that of economic rationality. This might be described in its simplest form as follows: the typical voter will base his voting preferences on proposed programmes of public expenditure in which he trades off the marginal utility of additional public expenditure against the marginal cost of extra taxes (see, for example, Stiglitz, 1988). Indeed, an early study by Tiebout (1956) suggested that mobile individuals will move to cities where their preferences for public services (and the level of taxes which they are willing to pay) are satisfied. However, there is evidence from a number of studies of voting behaviour which suggests that voting decisions, particularly at local government elections, are not simply a function of local budgetary plans and expenditure but may reflect voter reaction to national events and policies (see, for example, Lewis (1979), Heath et al (1985), Rose and McAllister (1985), Miller (1986)).

A crucial factor which may have influenced the results in the above studies is that of
(b) above, i.e. the nature of the financial information available to intending voters. If this was, in some sense, inadequate or defective, this may be a contributory factor in explaining the lack of attention paid to financial information by voters in the above studies. However, as discussed above, the process of the public accountability of local authorities is complex. There are a variety of potential sources of financial information, apart from a given local authority’s annual report and accounts, for intending voters. As noted earlier, these include press reports, attending significant (in financial agenda terms) meetings of the local council, reading the financial information attached to their tax demand. The extent to which these various strands of financial information enter into the decision making process of the typical voter and inform his/her decision represents a major research study in its own right. A detailed evaluation of this process is outwith the scope of the present study. Nevertheless, prima facie, there is potential for a significant role for the information contained in financial reports and accounts of local authorities. In general, the alternative sources of financial information tend to be somewhat fragmentary. For example they tend to provide (a) broad overviews (e.g. information on tax demands) or to be partial/focused on specific issues (e.g. the media); (b) insufficient detail for comparative purposes, whether over time for a single authority or in comparison to other authorities; (c) little or no information which relates levels of expenditure to policy statements, to provide indications of accomplishment or effectiveness and (d) is often derived, in any event, from versions of (draft/budget/final) financial information which is or will be contained in the local authority annual report and accounts. Indeed, the American Accounting Association Public Sector Committee has gone so far as to state that the basic objective of such accounting is “to provide information on which constituents can base a decision to retain or replace incumbents” (AAA, 1977, p.43).

However, as noted above, there are caveats to such a strong statement, given the need for further research in this area. Nevertheless, it is interesting to note that local authority annual reports and accounts are potentially a source of rich information, whether for intending voters or intermediaries such as the media or elected representatives. This is particularly so when compared to the information embedded in the tax charge. The tax charge (whether rates, community tax charge or council tax) provides the taxpayer with a single lump sum payment (or a series of periodic lump sum payments) which do not relate to his/her consumption of specific public services (see for example Kilgour and Lapsley, 1986). While it is recognised that this information constitutes part of the picture on which an intending voter might make an assessment of the financial performance of a given local authority, this information does not permit an accurate, comprehensive assessment of a given local authority’s efficiency and effectiveness, even if defined in narrow financial terms.

The approach adopted in this study is that of examining actual usage of local authority annual reports and accounts, where at all possible. Much of the above
discussion of the potential/likely impact of such information on voting behaviour is necessarily deductive/speculative in the absence of detailed evidence. However, in the face of the complex process of local authority public accountability, the above discussion does demonstrate the need for further research on the actual or potential usage of local authority annual reports and accounts, not only by potential voters, but also by intermediaries (the media, pressure groups) who might use such information to inform/influence intending voters.

*Previous Research on Users Needs*
There has been very little previous research on the issue of users’ needs in the public sector in general and, specifically, in the local authority context. Such studies as have taken place are considered below. However, there are lessons to be obtained from previous private sector research. There have been numerous previous studies of the use made of the financial statements of *private sector organisations* by a variety of potential user groups (see, for example, studies of different accounting techniques (Dyckman, *et al* (1978); studies of investors – Lee and Tweedie (1977 and 1981), Reckers and Stagliano (1980), Arnold and Moizer (1984), Day (1986); studies of bankers – Estes and Reimer (1977), Libby (1979); and more general studies – Chang and Most (1979)). These studies have been criticised as being inconsistent, partial, overly narrow in focusing on shareholder needs and framed on the basis of a limited theoretical framework (Cooper and Sherer, 1984). Also, these studies have been criticised on the grounds that conflicting evidence has been presented in them and that no structure or hierarchy of user needs has emanated from them (see Griffin, 1982).

However, at a somewhat lesser level of importance than a well-defined set of informational priorities for all users, there have been consistent messages about contrasts between ‘sophisticated’ and ‘naïve’ users of accounting information (see, for example, Lee and Tweedie *(op.cit.)*, Dyckman *et al.*, *(op.cit.)*). As explored further below, this finding has important implications for local government. In the case of private sector organisations, these findings have been drawn upon to make recommendations that the user group to which financial statements should be addressed is that of the ‘sophisticated’ user (see, for example, Buzby (1974), Beaver (1978 p.46)). In this respect, financial analysts assume an important role as intermediaries in the sifting, screening and dissemination of financial information.

In the public sector, there has been a comparative neglect of these issues. Exceptions to this are early postal surveys of specific user groups, principally in the US (see, for example, Patton (1976), Engstrom (1978); Maschmeyer and Van Daniker (1979)). These studies concentrated on the format and style of municipal information. Given the nature of these studies (postal surveys) it was not possible to explore wider issues in greater depth. There have also been public sector studies which have sought to establish, from first principles, who the main user groups of financial statements would be. These include Drebin *et al*’s (1981) study for the
CONTEXT OF THE STUDY

National Council in Governmental Accounting; Jones et al's (1985) study for the Governmental Accounting Standards Board; and the Canadian Institute of Chartered Accountants (CICA) study of local government financial reporting (1986). In the Drebin et al and the CICA study there was no primary data collection. Instead, potential user groups were identified on the basis of extensive literature reviews and investigations of the structure of state and local government. The Jones et al study included a postal survey to potential users of local government financial statements. However, the major thrust of this study was on different types of accounting techniques (for example, full versus modified accrual; consolidated versus fund-type statements).

There are three questions raised by the above literature which are addressed by the present study:
1. To what extent are local authority annual reports and accounts used by potential user groups?
2. How well do users understand the information conveyed in the accounts?
3. What reforms, if any, would benefit users?

This present study differs from previous public sector studies, in its methodology and in the issues which it addresses. As noted above, the context in which this financial information is reported is a critical element of this study. Also, this study is broader as it explores usage, understanding and the nature of information provided in local authority annual reports and accounts, as discussed further below.
2. A MODEL OF POTENTIAL USERS

As noted above, a number of studies have attempted to identify potential users of local authority annual reports and accounts. In an early study, Sidebotham (1966) cited councillors, council officers and the electorate as key potential users of such information. More recent studies (CICA, 1986; Drebin, 1981; Jones et al, 1985) also identify these potential user groups, but also extend the possible categories to include oversight officials (eg central government, auditors); investors and creditors and also intermediaries acting directly or indirectly on behalf of the general public (eg the media, pressure groups). This broader set of possible users has also been endorsed by professional bodies (see, for example, CIPFA, 1983).

However, despite general agreement over a possible set of potential users, there is no indication from these studies of the relative importance of the various users. Some insight into the relative importance of local authority annual reports and accounts to potential users can be gauged from part of the findings of a survey of local authority finance officers and auditors (Kilgour and Lapsley, 1988). It had a response rate of 78% of finance officers and 75% of auditors. This was a survey of technical accounting issues. In addition, finance officers and auditors were asked for their views on the extent to which they thought potential users read local authority reports and accounts. At first sight, a survey of finance officers and auditors might seem an unusual point of reference for assessment of the usage of local authority annual reports and accounts. However, in the local authority context, both finance officers

<table>
<thead>
<tr>
<th>Extent of Use</th>
<th>Read Thoroughly</th>
<th>Read Briefly</th>
<th>Do Not Read</th>
<th>Uncertain</th>
</tr>
</thead>
<tbody>
<tr>
<td>User Groups</td>
<td>No of finance officers (max=52)</td>
<td>No of finance officers (max=52)</td>
<td>No of finance officers (max=52)</td>
<td>No of finance officers (max=52)</td>
</tr>
<tr>
<td>1. General Public</td>
<td></td>
<td>2 (4%)</td>
<td>40 (77%)</td>
<td>10 (19%)</td>
</tr>
<tr>
<td>2. Pressure Groups</td>
<td>9 (17%)</td>
<td>15 (29%)</td>
<td>12 (23%)</td>
<td>16 (31%)</td>
</tr>
<tr>
<td>3. Media</td>
<td></td>
<td>21 (40%)</td>
<td>19 (37%)</td>
<td>12 (23%)</td>
</tr>
<tr>
<td>4. Central Government</td>
<td>7 (13.5%)</td>
<td>12 (23%)</td>
<td>7 (13.5%)</td>
<td>26 (50%)</td>
</tr>
<tr>
<td>5. Other Local Authorities</td>
<td>1 (2%)</td>
<td>28 (54%)</td>
<td>11 (21%)</td>
<td>12 (23%)</td>
</tr>
<tr>
<td>6. Councillors</td>
<td>5 (10%)</td>
<td>43 (82%)</td>
<td>2 (4%)</td>
<td>2 (4%)</td>
</tr>
<tr>
<td>7. Officers</td>
<td>15 (29%)</td>
<td>30 (58%)</td>
<td>4 (8%)</td>
<td>3 (5%)</td>
</tr>
</tbody>
</table>

TABLE 1
The Use of Local Authority Annual Reports and Accounts:
The Views of Finance Officers
A MODEL OF POTENTIAL USERS

and auditors have roles which might entail considerable interaction with a variety of potential user groups. For example, finance officers can monitor both (a) the use of annual reports and accounts lodged for public inspection and (b) monitor those who request copies of annual reports and accounts. In addition, the finance officer is a possible point of contact by intermediaries such as pressure groups and the media and by oversight groups, such as central government and the Accounts Commission. Similarly, auditors may have contact, not only with full-time local government officials and elected members, but also with interested members of the public and/or pressure groups and with the Accounts Commission. The results of this survey are set out in tables 1 and 2. These are classified according to the simple and straightforward categories of ‘thoroughly’, ‘briefly’, and ‘not at all’, as in the Lee and Tweedie studies (op.cit.) of private sector usage of reports and accounts.

As table 1 shows, the general view (77%) of finance officers is that the general public does not read local authority annual reports and accounts. This view is shared by 94% of auditors (see table 2). Both of these interested parties reported a potential interest on the part of intermediaries acting on behalf of the general public. In the main, this took the form of the view that these potential users read local authority reports and accounts briefly. This was supported by 29% of finance officers and 64% of auditors as regards pressure groups although, significantly, 17% of finance officers and 18% of auditors thought that such groups might read the report and accounts thoroughly. As regards the media, there is also a convergence of views on the part of both finance officers (40%) and auditors (53%) that, while the media may

<table>
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<th>TABLE 2</th>
<th>The Use of Local Authority Annual Reports and Accounts: The Views of Auditors</th>
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<tbody>
<tr>
<td>Extent of Use</td>
<td>Read Thoroughly</td>
</tr>
<tr>
<td>User Groups</td>
<td>No of auditors (max=17)</td>
</tr>
<tr>
<td>1. General Public</td>
<td>–</td>
</tr>
<tr>
<td>2. Pressure Groups</td>
<td>3 (18%)</td>
</tr>
<tr>
<td>3. Media</td>
<td>–</td>
</tr>
<tr>
<td>4. Central Government</td>
<td>2 (12%)</td>
</tr>
<tr>
<td>5. Other Local Authorities</td>
<td>2 (12%)</td>
</tr>
<tr>
<td>6. Councillors</td>
<td>1 (6%)</td>
</tr>
<tr>
<td>7. Officers</td>
<td>7 (41.2%)</td>
</tr>
</tbody>
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use local authority accounts as a source of information, this is likely to be a limited use.
Most interestingly, the role of central government as a potential user of local authority annual reports and accounts appears to be shrouded in mystery for many finance officers (50%) and auditors (41%) who declared that they were uncertain as to the extent of such use. However, there is also considerable support for the view that, within central government such information is read, at least briefly. Overall, the weight of both the finance officers’ and auditors’ views suggest that it is user groups which might be regarded as *internal* which were the most likely users of this information. These were officers (whether using their own authority’s or other local authorities’ reports and accounts) and councillors. However, even here,
A MODEL OF POTENTIAL USERS

both auditors and finance officers are of the view that councillors tend to read such information briefly (82% of finance officers; 58% of auditors). This survey suggests that, in the main, it is the officers themselves who would appear to be the most likely users of this information, with 29% of finance officers and over 40% of auditors stating that they thought that officers read such information thoroughly.

On the basis of the above information, it is possible to construct a tentative model of potential users of local authority accounts. In previous studies (e.g. FASB, 1980; Anthony, 1978), the concept of ‘resource providers’ has been advanced as a critical factor in the determination of entitlements to financial information. Thus, taxpayers, employees, creditors, and central government might be considered to be providers of resources and, thereby, entitled to financial information. However, a further aspect of this is that of resource availability, on the part of the potential users, to access and make use of financial information. Such a model is depicted in figure 1.

In terms of the different layers in that schema, the members of the general public (or as members of a pressure group or the media) have the right to inspect local authorities’ internal financial records. However, this would require considerable expertise on the part of interested parties and reliance on this alone is likely to marginalise these categories as potential users. On the other hand, the central government (and, indeed, the Accounts Commission, which receives copies of all local authority annual reports and accounts) has direct access to the final report and accounts and, further, interim information and the expertise to scrutinise such information. These user groups are represented by the second outer layer of figure 1.

Finally, there are the potential internal users, as identified above. Both officers and councillors have been cited frequently as potential users of financial information. This has been supported by the above survey which suggests a primacy within any hierarchy of user needs attaches to these two categories of user groups. This raises questions over (a) how accurately this model depicts the flows and uses of such accounting information and (b) the desirability of pinpointing such user groups as the major users of such information. The extent to which this model holds in practice is tested in the following chapters. The extent to which it is feasible or desirable to use this model as a basis for recommendations on financial reporting practices is assessed in the final chapter of this study.
3. EXTERNAL USERS
The categories of potential external users included in this study are set out in table 3. This follows the model of potential user groups depicted in figure 1 above. However, the category of pressure groups has been expanded beyond that single category shown in figure 1. This set of possible pressure groups includes employees (identified in the literature cited above), but also a number of organisations which are not only interested in the public sector generally, but which are also routinely given the opportunity of commenting upon draft statements of recommended accounting practice for local authorities, as promulgated by the Local Authority (Scotland) Accounts Advisory Committee (LASAAC), prior to their recommended adoption by local authorities in the preparation of their annual accounts. As indicated for each of the potential user groups set out in table 3, a variety of methods (including semi-directed interviews, formal sets of questions and use of publicly-available data) was adopted to pursue the questions addressed by this study, viz:
- the extent to which these external user groups actually use local authority annual reports and accounts,
- and, if they are used, the extent to which the information contained in them is understood,
- the extent to which such user groups saw potential areas of improvement in the content and/or dissemination of such reports.
Each of the user groups listed in table 3 and the methods used to investigate the research questions are discussed, in turn, below:

Table 3 Potential External Users Included in Study

1. General Public
2. Media
   - local newspapers (4)
   - national newspapers (2)
3. Pressure Groups:
   Trade unions: – National Union of Public Employees
   – National and Local Government Officers Association
   – Scottish Trades Union Congress
   Confederation of British Industry
   Scottish Consumer Council
   Association of Scottish Chambers of Commerce
   Commissioner for Local Administration in Scotland
   Institute of Directors in Scotland
   Scottish Council Development and Industry
   Federation of Scottish Ratepayers
4. Central Government
5. Accounts Commission

General Public
The question of the extent to which the general public makes use of local authority annual reports and accounts is virtually a major research project in its own right.
EXTERNAL USERS

One measure of the general public's interest in local authority financial information can be obtained by indirect means. Part of the Accounts Commission's role is that of investigating formal objections (under S.102 of the Local Government (Scotland) Act of 1973) against local authorities' handling of financial matters. In practice, there are few such formal complaints (see Accounts Commission annual reports) and these need not be referred to the Commission by members of the general public.

Table 4: Summary of Informal Complaints to Accounts Commission, 1985–88

<table>
<thead>
<tr>
<th></th>
<th>Regions</th>
<th>Islands</th>
<th>Districts</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1985</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Assistance re miners strike</td>
<td>38</td>
<td>–</td>
<td>68</td>
<td>106</td>
</tr>
<tr>
<td>Publicity material</td>
<td>1</td>
<td>–</td>
<td>11</td>
<td>12</td>
</tr>
<tr>
<td>Members expenses</td>
<td>1</td>
<td>–</td>
<td>8</td>
<td>9</td>
</tr>
<tr>
<td>Expenditure</td>
<td>3</td>
<td>–</td>
<td>8</td>
<td>11</td>
</tr>
<tr>
<td>Income</td>
<td>2</td>
<td>1</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td>Other</td>
<td>–</td>
<td>–</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td></td>
<td>45</td>
<td>1</td>
<td>103</td>
<td>149</td>
</tr>
<tr>
<td>1986</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Council publications</td>
<td>2</td>
<td>–</td>
<td>7</td>
<td>9</td>
</tr>
<tr>
<td>Expenditure items</td>
<td>3</td>
<td>–</td>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>Sale of property</td>
<td>–</td>
<td>–</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Control of contracts</td>
<td>1</td>
<td>–</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Members expenses</td>
<td>–</td>
<td>–</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Management of hostels</td>
<td>–</td>
<td>–</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Access to information</td>
<td>–</td>
<td>–</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>Other</td>
<td>2</td>
<td>–</td>
<td>4</td>
<td>6</td>
</tr>
<tr>
<td></td>
<td>8</td>
<td>–</td>
<td>30</td>
<td>38</td>
</tr>
<tr>
<td>1987</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Political publicity</td>
<td>4</td>
<td>–</td>
<td>9</td>
<td>13</td>
</tr>
<tr>
<td>Expenditure items</td>
<td>5</td>
<td>–</td>
<td>3</td>
<td>8</td>
</tr>
<tr>
<td>Housing</td>
<td>–</td>
<td>–</td>
<td>7</td>
<td>7</td>
</tr>
<tr>
<td>Other matters</td>
<td>2</td>
<td>1</td>
<td>6</td>
<td>9</td>
</tr>
<tr>
<td></td>
<td>11</td>
<td>1</td>
<td>25</td>
<td>37</td>
</tr>
<tr>
<td>1988</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Expenditure items</td>
<td>1</td>
<td>–</td>
<td>9</td>
<td>10</td>
</tr>
<tr>
<td>Fraud and illegality</td>
<td>–</td>
<td>1</td>
<td>6</td>
<td>7</td>
</tr>
<tr>
<td>Political publicity</td>
<td>–</td>
<td>–</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Trading undertakings</td>
<td>–</td>
<td>–</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Other matters</td>
<td>2</td>
<td>1</td>
<td>5</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td>3</td>
<td>2</td>
<td>26</td>
<td>31</td>
</tr>
</tbody>
</table>


However, in addition to this, the general public may make informal complaints to the Accounts Commission. An indication of the kinds of objections made and the extent of them can be seen from table 4. This shows that, over the period 1985 to 1988, there
were a number of informal complaints about policy matters (eg the use of local authority newspapers as means of expressing a particular party viewpoint, support for strike action), but also complaints concerning local authority finances. In general, the latter complaints were about items which may not have been disclosed or reported upon in sufficient detail (ie to satisfy the complainant) within a given local authority’s report and accounts. However, in terms of the scope and coverage of local authority financial transactions, and the numbers of residents whom they serve, the frequency of such complaints does not imply a significant body of the general public has an active interest in reported financial information by local authorities.

An opinion poll of the general public’s usage of local authority annual accounts, based on a representative number of the general public would be one means of substantiating this view, but this was outwith the scope of this research study. It is interesting to note, however, that one in three of the general public indicated that they had read an audited set of financial statements in such an opinion poll on the use of private sector financial accounts, which was sponsored by an international firm of accountants (Steen, 1990). This was attributed, at least in part, to the government’s privatisation programme. However, if anything, the extent of usage by the general public is liable to be even lower in the case of local authority accounts. Unlike the annual reports and accounts of organisations in which the general public has shareholdings and for which they receive, automatically as shareholders, a free copy, the annual report and accounts of local authorities are not distributed free of charge. Even the nominal charge made, which is essentially to recover the production cost, may be enough (for example £5.00 would be a typical charge) to deter all but the most singleminded of potential readers of local authority accounts. The evidence from the survey of finance officers and auditors (see chapter 2 above) confirms this view.

However, apart from the purchase of local authority annual reports and accounts, the general public also has an opportunity to read local authority accounts at no charge. Local authorities have a statutory responsibility to make these available to interested persons. This requires the intending reader to visit local authority premises to obtain this access. It would appear that little use is made of this facility. Informal discussions with local authority finance officers support this view. As part of this study, it was decided to concentrate on four local authorities (two regional councils and two district councils) to investigate the usage of local authority accounts by internal user groups. In these local authorities there was no reported use of the general public using this method of gaining access to local authority reports and accounts. All of this points to, at best, limited use being made of local authority annual reports and accounts on the part of the general public.

**Media**

Discussions were held with the four local and two national journalists responsible for local government affairs whose newspapers were located in the four local authorities
EXTERNAL USERS

selected for inclusion in this study. These journalists were asked a series of open-ended questions (How do you obtain financial information on your local authority? Do you have access to its annual report and accounts? Do you make use of this information? How important is this source of financial information? Do you have any suggestions for their reform/improvement) and this revealed the following situation:

- financial information (in the form of budget statements, final accounts, interim papers) is made available to journalists both in original format and in the form of press releases,
- members of the media have access to agendas and formal meetings,
- members of the media included in this study indicated limited expertise to challenge or scrutinise financial issues in great detail,
- finance departments are willing to discuss and explain financial issues with the media.

Overall, local authority annual reports and accounts were not regarded as a most important and frequent source of information. In part, this was attributed to their length and inaccessibility of the terminology employed in reports and accounts. However, a major factor in this was the typical method of operation by journalists. This was described as having an informal network of contacts within with interests in a given local authority. This - and press releases - was the prime source of information (including financial issues) for stories reported upon by both local and national sections of newspapers.

Pressure Groups

A similar series of questions to those addressed to journalists (see above) was asked of spokesmen of the pressure groups set out in table 3. For each of these organisations, we requested a discussion with a spokesperson who had an interest in the financial affairs of local authorities. As the results below indicate, many of these organisations do not make direct use of local authority reports and accounts, for a variety of reasons.

Of the potential users described as ‘pressure groups’ in table 3, trade unions have limited interest in the annual reports and accounts of specific local authorities. The major focus of this group of potential users is on information at the national level – amount of central government support, overall spending plans for local government – and the potential impact of this on the overall employment position and the settlement of national wage negotiations.

The CBI indicated that they had a lack of resources to scrutinise the accounts of specific local authorities. Such scrutiny was made more difficult by the distinctive nature of local authority accounting which meant that, for example, conventional financial ratios could not be calculated. This difference in accounting practices from commercial organisations was seen as making local authority accounts inaccessible for lay persons without a background in local authority finance. Specific accounting issues raised included the need for standardisation; the ‘grey area’ of what
EXTERNAL USERS

constitutes capital and what is revenue; the potential impact of creative accounting – all of which made it difficult to disentangle an accurate level of actual expenditure by a given local authority. Given these difficulties, the major focus of this organisation was on regional councils and on the overall picture of expenditure as outlined in the CIPFA Rating Review for Scottish local authorities. In general, it was noted that the quality of local authority annual reports and accounts had improved substantially in recent years, although there was still need for greater historical, comparative and performance-related value for money information. There were a number of potential users within the ‘pressure group’ category in table 3 which indicated little or no interest in local authority annual reports and accounts, for a variety of reasons. The Institute of Directors had a lack of resources. The Commissioner for Local Administration for Scotland is devoted to administrative issues and the issue of local authority accounts is outwith this organisation’s sphere of influence. The Scottish Council for Development and Industry is concerned with local government matters but its focus is on national issues. It does this by obtaining financial information on local authority (and other public) expenditure from the Scottish Office and possibly from COSLA, but not from individual local authority reports and accounts. Similarly, while the Consumer Council has a general interest in the quality of financial reporting information made available to consumers of local authority services (indeed, it has published a report on this very issue – Scottish Consumer Council, 1984) its role was not that of monitoring the accounts of individual local authorities. The Association of Chambers of Commerce did not have the role of scrutinising local authority annual reports and accounts in general, but local associations were encouraged to take part in statutory consultations held by local authorities on levels of local taxation.

However, the final organisation from this potential user group – the Federation of Scottish Ratepayers – had a number of interesting observations to make. This organisation had read the accounts of specific local authorities whose pattern of spending had given it cause for concern. However, it found that this information was of limited value because it was (a) too late and (b) not in sufficient detail to permit a careful analysis of expenditure on specific issues. In such exercises, this organisation had benefited from supporters who had both financial expertise and who were actively involved in local government as elected members. Overall, the view from this organisation was that the information contained in the annual report and accounts was of limited value to the general public, unless they had access to such expertise.

Central Government

Central government, in this case the Scottish Office, is depicted in figure 1 as a particular category of external user of local authority annual reports and accounts. It is an organisation which not only has access to wider forms of information, but which also has professional expertise which makes local authority financial
information understandable and accessible to potential users within that organisation.

The information on the extent to which central government uses local authority annual reports and accounts was gathered from a number of sources (a) an open-ended interview with a senior finance specialist within central government, (b) the collection of the various forms and sources of information supplied to central government by local authorities and (c) answers to a checklist of questions (which followed broadly those asked of journalists – see above) which was completed by finance specialists within the Scottish Office. This particular approach gave useful insights into the actual and potential use of local authority annual reports and accounts but, as noted below, although this could have been extended by a survey of all potential users within the Scottish Office, it was outwith the scope of the present study.

A major financial role for the Scottish Office is that of the monitoring and control of the Scottish Office local authority cash limit. It also gathers financial information to update the Scottish local authority component of the Public Expenditure Survey records. In terms of information requirements, the Scottish Office gathers provisional outturn information (for the previous year), budget estimates (for the following year) and final outturn figures. The main source of this information is quarterly returns from local authorities which, in aggregate form, provide quarterly outturn figures for the Treasury. During this quarterly cycle the Scottish Office finance division can monitor initial outturns, assess the extent of any likely underspend and provide final outturn figures to the Treasury. At this latter stage of the reporting cycle, the detailed returns provide outturn information which is broken down into sub-programmes and economic categories. This provides financial information, not only for the Treasury, but also for the preparation of the new form of Departmental Report for the Scottish Office (formerly the Scottish Commentary to the Public Expenditure White Paper).

Local authority annual reports and accounts are not part of the above activity. The information which annual accounts contain is too late for the Scottish Office’s management of its cash limit position. However, this is not to say that the information contained in local authority annual reports and accounts is not used at all by officials within the Scottish Office. For example, the annual accounts of Direct Labour Organisations and Direct Service Organisations are subject to an annual examination. In addition, there is a wide range of potential users of various parts of local authority reports and accounts. For example, the housing revenue account may be of interest not only to local government finance specialists but also to local government administration and to those with a special responsibility for housing. Similarly, members of the Scottish Office with a particular responsibility for functions such as education or social work may find relevant sections of the reports by regional councils to be of interest. It was outwith the scope of the present study to identify all such potential users and the extent of their use of such
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information. While it is clear that the annual reports and accounts of individual authorities are not a prime source of information for the Scottish Office, given its access to more timely and detailed financial information, nevertheless it would appear that these reports and accounts may serve as an important supplementary source of information in the monitoring of local authority activities.

On the matter of possible reforms to local authority reports and accounts, the Scottish Office's views can be gleaned from the updated code of practice on the publication of financial and other information. The first such code was issued in 1982. The updated code was issued in 1988. This places particular stress on the need for a combined annual report and audited financial statements; the augmentation of this by the inclusion of service objectives and explanations of variations from budgets and the publication of financial and non-financial performance indicators indicating achievement against targets. However, it is notable that, in its code of practice for the publication of financial and other information, the Scottish Office identifies the key potential user groups as (a) council members and (b) the general public (Scottish Office, 1988, p.3), implying that these reports are of particular value to, and should be aimed at, local communities.

Accounts Commission
The Accounts Commission occupies a unique position with regard to the annual reports and accounts of local authorities in Scotland. It is the statutory organisation charged with responsibility for scrutinising these accounts and all local authorities deposit their annual report and accounts with the Commission. The reports and accounts of local authorities provide a broad overview of a given local authority's financial situation and all of these are subject to annual examination. However, this is not the Commission's sole source of information. In addition to the formal audit report which accompanies the annual report and accounts, its Controller receives a copy of (a) the reports which auditors make to councillors and (b) the management letter which auditors give to Chief Officers. The first of these may identify specific issues of financial management within a given local authority. This would present a more detailed picture than that obtained from the annual accounts for specific issues of concern to the auditor. The second of these is a technical report on specific issues of accounting practice. All of this information provides a comprehensive basis for scrutinising the financial circumstances of local authorities.

In terms of possible reforms to existing practices, the Accounts Commission endorses the (1988) Code of Practice for the Publication of Financial and Other Information by Local Authorities which was promulgated by the Scottish Office as best practice in financial reporting (Accounts Commission, 1989, p.9). It encourages local authorities to adopt this code (as most have done) and monitors the quality of financial reporting by those which have not fully adopted this code.
4. INTERNAL USERS

This part of the study is based on interviews which were held with the two categories of potential internal users of local authority annual reports and accounts depicted in figure 1 above. Four local authorities (two regional councils and two district councils) were included in this study. These authorities were selected to provide a fair cross-section of the regional and district councils in Scotland. The four authorities selected included (a) a major regional council (b) a medium sized regional council (c) a district council for a predominantly rural area and (d) a district council for an industrial area. The potential user groups included were councillors (elected, lay members of local authorities) and officers (full-time officials). The officers were senior officials (the Chief Executives and their Directors of major services). The councillors represent a mix of the various political parties holding office within these local authorities. These two categories of potential user have been identified by other studies (see, for example, CICA, 1985) as potential user groups of annual reports and accounts. Indeed, the survey of all Directors of Finance within local authorities in Scotland highlighted these two categories as the major users of local authority annual reports and accounts. Also, as potential users who influence policy-making within local authorities, they assume a greater importance (see Jones, 1988).

Informal discussions were held with the Directors of Finance on the financial information which they supplied to councillors and local government officers and copies of these reports were obtained by the researchers. Given the greater number of discussions to be held with these two potential user groups, the research questions were addressed by formal interviews with the use of questionnaires, rather than the open-ended discussions with specific external users. Draft questionnaires were constructed and tested with colleagues and with local government councillors. Revised questionnaires were prepared in the light of their comments. These questionnaires were structured, to aid comparability of interview results. The interviews were conducted by the researchers. Each interview took approximately one hour. The interviewees were given copies of the questionnaires in advance of these interviews. The questions asked are described below.

As noted above, a fundamental distinction is drawn in much of the existing literature of private sector surveys of user needs between the ‘naive’ and ‘sophisticated’ potential users of such information and this is reflected in this analysis. Also, previous private sector studies have gathered evidence on the importance, usage and understanding of financial statements. Given the lack of knowledge of what happens in the public sector, information was gathered on these facets of user needs. Finally, as noted earlier, previous public sector surveys or field studies have been limited to issues of a technical accounting nature, such as alternative bases of accounting measurement, or the appropriateness of the funds concept. Given the categories of potential internal users selected for inclusion in this study, it was not considered appropriate to do this. Instead, this study gathered data on users’ views on their preferred format, style and types of financial information. The questions asked of
potential users (and their rationale) to explore: (a) their use of annual reports and accounts, (b) their understanding of accounting practices and (c) the nature of local authority annual reports and accounts are set out below. The actual questionnaires are reproduced as Appendices 1 and 2.

(a) Use of Annual Reports and Accounts

Three questions were asked of potential users to determine the extent to which they used annual reports and accounts and the importance of this information to them. The first question asked to which extent the interviewee read (thoroughly, briefly or not at all) the various sections of the annual report and accounts as displayed at the interview (report by the Director of Finance, Statement of Accounting Principles, Notes to the Accounts, Service (ie revenue expenditure classified by service) Accounts, Capital Accounts, Loans Fund, Consolidated Balance Sheet, Auditors Report). The above categories (‘thoroughness’, ‘brevity’ or ‘not at all’) represent a simple three point scale which could have been extended to allow for a more sensitive gradation of levels of use. However, it was felt that, in this self-reporting situation, the interviewee’s responses could be classified appropriately on this three point scale. Indeed, such a classification has been used successfully in previous studies, (see, for example, Lee and Tweedie, op. cit.) Similar three point scales were utilised to categorise other findings: the use of other sources of information (‘frequently’, ‘occasionally’, ‘never’); levels of understanding (‘none/little’, ‘fair’, ‘good’). Illustrative examples of how interviewee responses have been classified into these three broad categories for the differing aspects of this study are set out in the relevant text, below. This gave insights into reported usage of this information. To place this into context, interviewees were then asked where else they typically sought financial information. Specifically, interviewees were then asked, when requiring or looking for financial information do you:

(i) consult the abstract of accounts?
(ii) consult the management budget?
(iii) consult specific committee papers? (councillors only)
(iv) refer to the Rating Review?
(v) ask an officer to provide the information?
(vi) consult other sources?

The first of these, the abstract of accounts, is the traditional form of publishing local authority annual accounts. There is little or no narrative, and voluminous, detailed financial information on the transactions and ledger balances at the year end. The annual report and accounts draws on this document to present abbreviated financial information in a more accessible document, as recommended by the Scottish Office Code of Practice and the Accounting Code of Practice. Item (iv), the Rating Review, is a publication from a professional body which sets out detailed comparative statistics and financial information on all local authorities. Finally, to assess the importance of the various sources of
information, interviewees were asked, ‘of all the data sources mentioned, which is of most use to you, in your role as a Local Government Councillor/Officer?’

(b) **Understanding of Accounting Practices**

To test this, the understanding of information within local authority annual reports and accounts was assessed in two ways: councillors and officers were invited to (a) comment on specific accounting practices and (b) briefly describe certain government controls of local authority expenditure and then to comment upon the effect of these controls on the annual accounts. The three accounting practices which interviewees were to comment upon were: the distinction between capital and revenue expenditure; the treatment of central administrative expenses; and the use of reserves and provisions. As noted above, these accounting practices were identified in a previous study (Kilgour and Lapsley, 1988) as being the most significant areas of accounting practice in which there is considerable variation in accounting practice. This flexibility of accounting practice may lead to manipulation of accounting numbers (so-called ‘creative accounting’) to distort financial results. The method of testing users’ understanding was indirect. Open-ended questions were asked of respondents, with an invitation to cite examples and to relate these practices to their local authority. Thus, on the capital/revenue distinction, interviewees were asked, ‘There is often confusion and overlap between capital and revenue expenditure. Have you had experience of any particular situation where it might be difficult to make a distinction between the two?’ On the other accounting practices, interviewees were asked: ‘Do you have any views on the treatment or method of allocation of central administration expenses?’ and ‘Do you have any views on the use of reserves and provisions in local authority accounts?’

Apart from the discretion of directors of finance in the selection of accounting practices, a major factor identified in the variability of accounting practice (or ‘creative accounting’) was that of central government financial controls (Kilgour and Lapsley, op.cit). Specifically, local authority finance officers had the opportunity to circumvent these controls by alternative accounting treatments. For example by the classification of expenditure as revenue or capital; by the basis and extent to which central administrative expenses are allocated across services; and by the creation and elimination of, and adjustments within, reserves and provisions. Therefore, interviewees were asked ‘What do you think of:—

(a) Revenue Spending Guidelines?
(b) Rate Capping?
(c) Capital Consents?

Please briefly describe and comment on these. In your opinion do these ‘controls’ affect the report and accounts and, if so, how? Do they affect your use of these figures?’ In this way, interviewees were afforded an opportunity to demonstrate their knowledge of these controls, how they affected their authority and the impact which they made on the accounting numbers included in the annual accounts.
(c) **Nature of Reports and Accounts**

In addition to exploring potential usage of, and understanding of, local authority annual reports and accounts, interviewees were queried on their desired format and style of annual reports. This aspect of local authority annual reports and accounts was tackled by asking the following questions. Firstly, interviewees were asked which type of information within present annual reports and accounts they found to be of most use (ie what type of information is of most use: (a) budget comparisons? (b) narrative explanations? (c) performance indicators? (d) statistical information? (e) others?) Interviewees were also asked what information they would like (In your view, what would an ‘ideal’ set of Local Authority annual accounts contain?) and how this should be regulated (In your view, should the format and contents of the report and accounts be (a) prescribed by Central Government, (b) at the discretion of Directors of Finance, (c) other?). In addition to the above questions which related to the specific research questions of this project, additional questions were asked which had the dual purpose of gathering background data and setting the interviewee at ease at the beginning of the interview. These questions included (a) length of office and (b) previous accounting experience, ie ‘How many years have you served as a councillor?/How many years have you been employed as a Local Government Officer?’ and ‘Do you have any previous experience in accounting matters – including any formal training?’ Two further questions were asked of local government councillors: ‘which (local authority) committees do you serve on? (Please give details of offices held).’ Also, councillors were asked if constituents query them on the accounts and figures.

It should be noted that the interviewees included in this study do not represent a random sample of local government officers or councillors. Therefore these results cannot, strictly speaking, be generalised beyond the local authorities included in the study.

### 4.1 COUNCILLORS

The results of the interviews with the councillors are grouped below, as follows:

1. use of reports and accounts,
2. understanding of accounting practices, and
3. the nature of reports and accounts.

However, before considering these results in detail, some general comments on these findings can be made. A number of background factors were identified as possibly influencing usage and understanding of accounting information. This included the extent of accounting training and the experience or background of the interviewees. In practice, the numbers of interviewees who had formal training were very small. Two of the councillors had professional qualifications; seven had had some limited exposure to accounting or bookkeeping as part of early studies (at schools, college or university) or as part of short courses which they had attended;
eight had some bookkeeping experience. The impact of these differences between potential users is commented upon, as appropriate, below. Furthermore, the background factor of length of service was examined. This was not found to be of importance in the analysis of results. However, as shown below, the kind of experience (committees, length of experience) of councillors was found to be an important background factor in explaining understanding and use of local authority annual accounts.

1. Use of Reports and Accounts
The results of the interviews with councillors which relate to the use of local authority annual reports and accounts are contained in tables 5, 6 and 7. Interesting patterns are noticeable in the response in table 5 on the use of the various sections of the report and accounts. One major source of information was the report made by the Director of Finance (with 57% of councillors declaring that they read this thoroughly and 26% reading it briefly). This is the first section of the annual report and accounts: it is a narrative, annual financial review, with key facts and statistics. A similar level of importance was attached to the use of the service accounts, with 55% reading these thoroughly and 30% reading them briefly. In many instances, ‘thorough reading’ referred to a specific service for which the councillor was on a key committee. A typical pattern was to read this particular service account thoroughly and briefly scan over other service

| TABLE 5 |
| The Use of Local Authority Annual Reports and Accounts: Councillors |

<table>
<thead>
<tr>
<th>Extent of Use</th>
<th>Thorough</th>
<th>Brief</th>
<th>Not at all</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Section of Reports and Accounts</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Director of Finance Report</td>
<td>30 (57%)</td>
<td>14 (26%)</td>
<td>9 (17%)</td>
</tr>
<tr>
<td>2. Auditors Report</td>
<td>14 (26%)</td>
<td>24 (45%)</td>
<td>15 (29%)</td>
</tr>
<tr>
<td>3. Service Accounts</td>
<td>29 (55%)</td>
<td>16 (30%)</td>
<td>8 (15%)</td>
</tr>
<tr>
<td>4. Capital Accounts</td>
<td>16 (30%)</td>
<td>19 (36%)</td>
<td>18 (34%)</td>
</tr>
<tr>
<td>5. Loans Fund</td>
<td>7 (14%)</td>
<td>23 (43%)</td>
<td>23 (43%)</td>
</tr>
<tr>
<td>6. Consolidated Balance Sheet</td>
<td>10 (19%)</td>
<td>22 (42%)</td>
<td>21 (39%)</td>
</tr>
<tr>
<td>7. Notes to Accounts</td>
<td>18 (34%)</td>
<td>19 (36%)</td>
<td>16 (30%)</td>
</tr>
<tr>
<td>8. Statement of Accounting Principles</td>
<td>10 (19%)</td>
<td>24 (45%)</td>
<td>19 (36%)</td>
</tr>
</tbody>
</table>


**TABLE 6**  
The Use of Other Sources of Information:  
Councillors

<table>
<thead>
<tr>
<th>Source of Information</th>
<th>Extent of Use</th>
<th>Frequently</th>
<th>Occasionally</th>
<th>Never</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No of councillors (max=53)</td>
<td>No of councillors (max=53)</td>
<td>No of councillors (max=53)</td>
<td></td>
</tr>
<tr>
<td>1. Abstract of Accounts</td>
<td>4 (8%)</td>
<td>11 (21%)</td>
<td>38 (71%)</td>
<td></td>
</tr>
<tr>
<td>2. Management Budget</td>
<td>11 (21%)</td>
<td>8 (15%)</td>
<td>34 (64%)</td>
<td></td>
</tr>
<tr>
<td>3. Committee Papers</td>
<td>16 (30%)</td>
<td>13 (25%)</td>
<td>24 (45%)</td>
<td></td>
</tr>
<tr>
<td>4. CIPFA Rating Review</td>
<td>12 (23%)</td>
<td>15 (28%)</td>
<td>26 (49%)</td>
<td></td>
</tr>
<tr>
<td>5. Finance Officer</td>
<td>44 (83%)</td>
<td>5 (9%)</td>
<td>4 (8%)</td>
<td></td>
</tr>
</tbody>
</table>

accounts. It is also interesting to note that councillors interviewed expressed considerable interest in the auditors report (although 45% of those interviewed only read this briefly) and also the capital account and notes to the accounts. From the point of view of these councillors interviewed, the major background factor which appears to explain this degree of interest is the role of the individual councillor within the local authority. In particular this is so if she/he holds senior office (chairman, vice–chairman) or is on important committees in terms of resource allocation (such as finance committee, planning and resources).

The role of the finance officer in providing accounting information is given prominence in the results summarised in table 6. For many councillors, their first approach in seeking financial information is to obtain explanations or details from the finance department. In terms of hard data, an interesting pattern emerges in which councillors prefer to read committee papers (with user specific financial information), the CIPFA Rating Review (which gives a broad overview for comparative purposes) and the planned financial information, as represented by the management budget. There is little use made of the abstract of accounts, which is not readily accessible to non–sophisticated users of accounting information.

It is also interesting to note that, when asked to identify their most useful source of information (see table 7), the majority of councillors opted for the finance officer. Also, in terms of outright preference for hard data, it was planned information contained in the management budget and committee papers for which councillors opted. Table 7 is indicative of these users’ reliance on the finance department to explain their most important source of data: planned information. It is evident from table 5 that councillors do read (at least sections) of the annual report and accounts. However they regard it as being of little importance in the overall scheme of things.
TABLE 7
Most Useful Source of Information: Councillors’ Views

<table>
<thead>
<tr>
<th>Sources of Information</th>
<th>Councillors Preferences* (n=52)**</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Finance Officer</td>
<td>27</td>
</tr>
<tr>
<td>2. Management Budget</td>
<td>13</td>
</tr>
<tr>
<td>3. Committee Papers</td>
<td>11</td>
</tr>
<tr>
<td>4. Rating Review</td>
<td>5</td>
</tr>
<tr>
<td>5. Abstract of Accounts</td>
<td>3</td>
</tr>
<tr>
<td>6. Annual Report and Accounts</td>
<td>3</td>
</tr>
</tbody>
</table>

* Multiple responses: ten councillors offered two items of equal importance, rather than a single, most useful source of information
** One incomplete response

2. Understanding of Accounting Practices

As noted above, the understanding of accounting practices was tested by exploring interviewees’ knowledge of specific accounting practices: the treatment of (a) capital expenditure, (b) central administrative expenses and (c) the use of reserves and provisions. This is a fairly rigorous test of understanding. Both (a) and (b) are the subject of continuing debate among academics and practitioners. Item (c) can become a matter of some complexity (see, for example, Kilgour and Lapsley, 1988, p.15). Also, in the present study, in response to the above mentioned questions on these practices, interviewees were given an opportunity to cite examples of such practices and how they affected that local authority. This was the basis of the classification of these user groups’ understanding of accounting practices (see table 8).

TABLE 8
Understanding of Accounting Practices:
Councillors

<table>
<thead>
<tr>
<th>Level of Understanding</th>
<th>None/Little</th>
<th>Fair</th>
<th>Good</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting Practice</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital/Revenue</td>
<td>29 (55%)</td>
<td>14 (26%)</td>
<td>10 (19%)</td>
</tr>
<tr>
<td>Distinction</td>
<td>(max=53)</td>
<td>(max=53)</td>
<td>(max=53)</td>
</tr>
<tr>
<td>Allocation of Central</td>
<td>28 (53%)</td>
<td>11 (21%)</td>
<td>14 (26%)</td>
</tr>
<tr>
<td>Administrative Expenses</td>
<td>(max=53)</td>
<td>(max=53)</td>
<td>(max=53)</td>
</tr>
<tr>
<td>Use of Reserves and</td>
<td>24 (45%)</td>
<td>17 (32%)</td>
<td>12 (23%)</td>
</tr>
<tr>
<td>Provisions</td>
<td>(max=53)</td>
<td>(max=53)</td>
<td>(max=53)</td>
</tr>
</tbody>
</table>
Three broad categories are used in this table. The first of these ‘none/little understanding’ was straightforward. In response to these questions, those interviewees who responded, for example, as follows – ‘No, I have nothing to say’ – clearly came into this category. However, in the case of those interviewees who simply asserted that they had no difficulty with the use of reserves and provisions and with central administrative expenses or in distinguishing between revenue and capital and were unable to explain further (by citing examples or by explaining concepts) were also classified in this way. Similarly, those interviewees who simply stated that having reserves or allocating central administrative expenses were good things to do, without explaining why, were classified in this group. Interviewees who demonstrated a clear understanding of these concepts, particularly by illustrating their response with examples, were classified as exhibiting a ‘good’ understanding; for those interviewees who had some understanding of these concepts, but clearly had some difficulties, the ‘fair’ classification was used.

Overall, as table 8 shows, the majority of the councillors interviewed had little or no understanding of the accounting practices on which they were questioned. Those councillors interviewed who were classified as exhibiting a ‘good’ understanding of these accounting practices were not those who had had some formal training or practical experience of accounting. Instead, as noted earlier, the major determinant of this knowledge was the responsibilities undertaken by councillors. Thus, involvement in key committees, such as planning and resources, or the holding of senior positions, such as convenor or vice-convenor of the finance committee, were important factors.

In addition to exploring users’ understanding of specific accounting practices, an attempt was made to elicit their views on, and knowledge of, a set of central government financial controls viz, revenue spending guidelines, rate capping and capital consents. This further test of understanding is also fairly rigorous. Councillors might reasonably be expected to have a sound knowledge of these controls. But, in this case, an understanding of the concept/mechanism involved and how it affected their local authority was expected as evidence of ‘good’ understanding.

The classification system used was the same as that for accounting practices. Again, the first of these ‘No/little understanding’ was relatively straightforward. Thus, interviewees who responded, for example, ‘no views’ or ‘not sure what capital consents are’, were classified in this way. Similarly, those interviewees who deplored these government controls, but were unable to explain what they were or how they affected their authority were classified in this category. An example of a councillor who demonstrated a ‘good’ understanding of one of these controls is as follows:

‘Capital consent does not equal getting money. It only tells a local authority how much of its own money it can spend, but the government wants to control borrowing in the UK as a whole and therefore controls capital expenditure. Local
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authorities now have discretion as to how to allocate total capital expenditure across departments. I don’t think that they affect the report and accounts because clawback (ie by central government) is usually provided for in the budget. Also the local authority knows what the capital consents are and can budget accordingly.’

An example of a response from a councillor which was categorised as ‘fair’, is as follows:

‘The new section 94 (reference to statute) format has problems. For example, in this local authority there is a problem with land held in trust. The local authority should be responsible enough to decide for themselves. I am sure this affects the accounts but I leave this problem to the officers.’

Overall, the understanding of central government controls was less than that of accounting practices (see table 9). Again, where there was evidence of higher levels of understanding this was task–oriented (eg Chairman and Vice–chairman of finance committees) rather than related to an accounting background. Only seven of the councillors interviewed could provide examples of the kinds of effects which these controls had on year end adjustments to the annual accounts. However, it is acknowledged that a high level of knowledge would be necessary to assess the impact of such controls on the annual accounts.

3. Nature of Reports and Accounts

The annual reports and accounts prepared by the four local authorities included in this study were consistent with what might be regarded as ‘best practice’ within local authorities. That is, these were modern–style, corporate reports which complied with professional guidance in accounting practices and central government guidance (the above mentioned Scottish Office code of practice) on the disclosure of financial and other information on the progress of their various programmes of expenditure. These kinds of reports have benefitted from the relaxation of central government prescription, by statute, of the exact detail and format of annual accounts. Nevertheless, to the casual reader, or even to

<table>
<thead>
<tr>
<th>Level of Understanding</th>
<th>None/Little</th>
<th>Fair</th>
<th>Good</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government Control</td>
<td>No of councillors (max=53)</td>
<td>No of councillors (max=53)</td>
<td>No of councillors (max=53)</td>
</tr>
<tr>
<td>1. Revenue Spending Guidelines</td>
<td>34 (64%)</td>
<td>12 (23%)</td>
<td>7 (13%)</td>
</tr>
<tr>
<td>2. Rate capping</td>
<td>43 (81%)</td>
<td>7 (13%)</td>
<td>3 (6%)</td>
</tr>
<tr>
<td>3. Capital Consents</td>
<td>35 (66%)</td>
<td>11 (21%)</td>
<td>7 (13%)</td>
</tr>
</tbody>
</table>
commercial accountants, the (fund) structure and contents of local authority accounts may appear difficult to read. On this basis, it might be expected that most potential users would prefer a simpler, narrative-type report of the activities of the local authority.

Indeed, as table 10 shows, most councillors did express a preference for narrative type reports. There was also significant interest in budget comparison information. However, most of the councillors favoured combinations of information, particularly budget comparisons, narrative explanation and performance indicators. Of these councillors who had some practical experience of, or training in, accounting, a particular preference was expressed for budget comparisons and narrative explanations (sometimes with performance indicators). Only three of the councillors who had no practical experience or formal training in accounting favoured simple narratives on their own as their preferred type of information. These findings are supportive of the current Scottish Office code of practice (op.cit) on disclosure requirements in local authority reports and accounts. However, the above caveat that this potential internal user group tends to favour planned rather than ex post information, still applies.

**TABLE 10**

| Preferred Type of Information within Local Authority Annual Reports and Accounts: Councillors |
|---|---|
| Sources of Information | Councillors Preferences (n=44) |
| 1. Narrative explanations | 29 |
| 2. Budget Comparisons | 27 |
| 3. Statistical Information | 16 |
| 4. Performance indicators | 12 |

1. This includes multiple responses as most interviewees were unable to select their single most important type of information
2. Excludes seven non-readers of accounts
3. Excludes one incomplete response and one response from a councillor who expressed no preference for any one type of information.

When questioned on their views on what an ‘ideal’ set of local authority annual accounts should contain, the majority of the councillors favoured reports which were simpler and more readable. However, a significant number of councillors also chose the present style of annual reports and accounts (see table 11). This may be a reflection of the limited response which might be expected from persons who are not professionals within this field. On the other hand, it is also a reflection of the significant improvement, generally, within local authority annual
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TABLE 11
Proposals for the Reform of Local Authority
Annual Reports and Accounts: Councillors

<table>
<thead>
<tr>
<th>Comment</th>
<th>Councillors Preferences* (n=53)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Simpler/more readable</td>
<td>23</td>
</tr>
<tr>
<td>2. As presently produced</td>
<td>21</td>
</tr>
<tr>
<td>3. More narrative explanations</td>
<td>8</td>
</tr>
<tr>
<td>4. More diagrams</td>
<td>5</td>
</tr>
<tr>
<td>5. More year-to-year comparisons</td>
<td>5</td>
</tr>
<tr>
<td>6. More detailed accounts</td>
<td>4</td>
</tr>
<tr>
<td>7. More timely</td>
<td>2</td>
</tr>
</tbody>
</table>

* Multiple responses

reports and accounts and, specifically within the four local authorities included in this study.
Indeed, councillors interviewed commented favourably upon the improvement which had taken place in the form of their authority's annual report and accounts. Within the councillors interviewed who suggested simpler, more readable accounts would be appropriate, there was no consistent pattern of views between those who did/did not have previous practical accounting experience or training.
The last aspect of the nature of annual reports and accounts on which councillors were interviewed was the question of who they felt should determine the nature, scope and content of local authority annual reports and accounts. As table 12 shows, there is overwhelming support for the Director of Finance, and little support for other alternatives, including central government. This can be seen as recognition of the Director of Finance as an authority figure in this matter. It

TABLE 12
Regulation of Format and Contents of Local Authority
Annual Reports and Accounts: Councillors' Views

<table>
<thead>
<tr>
<th>To be decided by:</th>
<th>Councillors* (n=52)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Director of Finance</td>
<td>34</td>
</tr>
<tr>
<td>2. Director of Finance and Councillors</td>
<td>9</td>
</tr>
<tr>
<td>3. Director of Finance and Other Directors</td>
<td>5</td>
</tr>
<tr>
<td>4. Central Government</td>
<td>3</td>
</tr>
<tr>
<td>5. Director of Finance and Central Government</td>
<td>1</td>
</tr>
</tbody>
</table>

* One councillor did not answer this question
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underlines perceptions identified earlier, in relation to councillors’ use and searching for information. It confirms the way that finance is seen as dominating not only in the provision, but also in the style, format and contents of this disclosure.

Overall, the results of these interviews suggest that, while councillors would prefer simpler, more readable annual reports and accounts, the situation is more complex than this. Indeed, the message to emerge from these findings is that of attempts made (both by those with some prior exposure to accountancy and those without) to come to grips with the level of information made available to them. However, in this regard, it should be noted that significant improvements have been made in the format and contents of these local authorities’ annual reports and accounts in recent years. This may have prompted these users to attempt this.

4.2 INTERNAL USERS: OFFICERS

While the annual report and accounts of local authorities are prepared for elected members and outside interested parties, local authority officers have been identified by a number of studies, including this one, as a major potential user group. This can be explained, in part, by the importance of their role as professional advisers to elected members, but this also may be an indication of local authority managers using such information to examine and assess their own performance. The results of the interviews with officers employed in the four local authorities included in the study are set out below, as follows:

(1) use of reports and accounts,
(2) understanding of accounting practices,
(3) the nature of reports and accounts.

In terms of background information, it should be noted that the numbers of officers interviewed who had formal training was very small. Of the 32 officers interviewed, three had professional qualifications; four had some limited knowledge of accounting or bookkeeping as part of studies at school, college or university; two had some practical experience. This was not an important factor in the explanation of these officers’ use of local authority annual reports and accounts. This may be attributed to the fact that all such previous accounting experience or training related to private sector accounting and not to the distinctive practices of local authorities.

1. Use of Reports and Accounts

The results relating to local authority officers’ use of the annual report and accounts are contained in tables 13, 14 and 15. While this user group also signalled the particular importance of both the Director of Finance’s report and the service accounts, it is noticeable that a higher proportion of officers read the service accounts (particularly their own) thoroughly than is the case with councillors. This is indicative of more councillors seeking a broad overview (obtained from the Director of Finance report) as well as an examination of the services with
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TABLE 13
The Use of Local Authority Annual Reports and Accounts: Officers

<table>
<thead>
<tr>
<th>Extent of Use</th>
<th>Thorough</th>
<th>Brief</th>
<th>Not at all</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section of Reports and Accounts</td>
<td>No of Officers (max=32)</td>
<td>No of Officers (max=32)</td>
<td>No of Officers (max=32)</td>
</tr>
<tr>
<td>1. Director of Finance Report</td>
<td>16 (50%)</td>
<td>13 (41%)</td>
<td>3 (9%)</td>
</tr>
<tr>
<td>2. Auditors Report</td>
<td>8 (25%)</td>
<td>21 (66%)</td>
<td>3 (9%)</td>
</tr>
<tr>
<td>3. Service Accounts</td>
<td>21 (66%)</td>
<td>9 (28%)</td>
<td>2 (6%)</td>
</tr>
<tr>
<td>4. Capital Account</td>
<td>16 (50%)</td>
<td>14 (44%)</td>
<td>2 (6%)</td>
</tr>
<tr>
<td>5. Loans Fund</td>
<td>5 (16%)</td>
<td>16 (50%)</td>
<td>11 (34%)</td>
</tr>
<tr>
<td>6. Consolidated Balance Sheet</td>
<td>2 (6%)</td>
<td>19 (60%)</td>
<td>11 (34%)</td>
</tr>
<tr>
<td>7. Notes to Accounts</td>
<td>8 (25%)</td>
<td>17 (53%)</td>
<td>7 (22%)</td>
</tr>
<tr>
<td>8. Statement of Accounting Principles</td>
<td>4 (12%)</td>
<td>19 (59%)</td>
<td>9 (29%)</td>
</tr>
</tbody>
</table>

which they are most closely concerned, whereas officers identify more strongly with their particular aspect of local authority services. It is also interesting to note that this group attaches importance to the audit report, with 91% of them reading it, at least briefly. This group has a limited interest in the year end position, with the exception of the capital account.

This forward-looking focus of officers is reaffirmed by the evidence in table 14.

TABLE 14
The Use of Other Sources of Information: Officers

<table>
<thead>
<tr>
<th>Extent of Use</th>
<th>Frequently</th>
<th>Occasionally</th>
<th>Never</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source of Information</td>
<td>No of Officers (max=32)</td>
<td>No of Officers (max=32)</td>
<td>No of Officers (max=32)</td>
</tr>
<tr>
<td>1. Abstract of Accounts</td>
<td>6 (19%)</td>
<td>6 (19%)</td>
<td>20 (62%)</td>
</tr>
<tr>
<td>2. Management Budget</td>
<td>24 (75%)</td>
<td>5 (16%)</td>
<td>3 (9%)</td>
</tr>
<tr>
<td>3. CiPFA Rating Review</td>
<td>4 (12%)</td>
<td>14 (44%)</td>
<td>14 (44%)</td>
</tr>
<tr>
<td>4. Finance Officer</td>
<td>16 (50%)</td>
<td>13 (41%)</td>
<td>3 (9%)</td>
</tr>
</tbody>
</table>
INTERNAL USERS

TABLE 15
Most Useful Source of Information:
Officers’ Views

<table>
<thead>
<tr>
<th>Sources of Information</th>
<th>Officers’ Preferences*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Management Budget</td>
<td>23</td>
</tr>
<tr>
<td>2. Finance Officer</td>
<td>10</td>
</tr>
<tr>
<td>3. Abstract of Accounts</td>
<td>4</td>
</tr>
<tr>
<td>4. Annual Report and Accounts</td>
<td>2</td>
</tr>
<tr>
<td>5. Rating Review</td>
<td>1</td>
</tr>
<tr>
<td>6. Committee Papers</td>
<td>1</td>
</tr>
</tbody>
</table>

*Multiple responses: nine officers offered two items of equal importance, rather than a single, most useful source of information.

This reveals a marked contrast with the views of councillors. Officers make most use of the management budget and, while there is reliance on the explanations and support of finance officers, it is not so strong as in the case of councillors. Their limited use of comparative information (CIPFA Rating Review) and historical data (Abstract of Accounts) underlines their preoccupation with plans and planned financial information. Further evidence of this can be seen in table 15, in which local authority officers cite the management budget as their most useful source of information. As in the case of councillors, while local authorities may make use of their annual report and accounts, it does not assume major significance in their overall sources of information.

2. Understanding of Accounting Practices

As noted above, the understanding of accounting practices was based on interviewees’ knowledge of the same accounting issues (viz (a) capital expenditure (b) central administrative expenses and (c) the use of reserves and provisions) as those which were used with councillors. The results of these interviews with officers are shown in table 16.

The same basis of classifying responses by councillors was used with officers. Thus, the first category of ‘none/little’ knowledge was straightforward. This included officers who declared no understanding but also those who were unable to explain further, by citing examples or by explaining the concepts. The classification of responses into the ‘fair’ and ‘good’ categories can be illustrated by the following responses to the capital/revenue distinction. An example of one response in the ‘fair’ category is the following response by one local government officer to the question on the distinction between revenue and capital expenditure:

‘Not really. I know that you can switch minor items between revenue and capital.
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TABLE 16
Understanding of Accounting Practices:
Officers

<table>
<thead>
<tr>
<th>Level of Understanding</th>
<th>None/Little</th>
<th>Fair</th>
<th>Good</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounting Practice</td>
<td>No of Officers (max=32)</td>
<td>No of Officers (max=32)</td>
<td>No of Officers (max=32)</td>
</tr>
<tr>
<td>1. Capital/Revenue Distinction</td>
<td>14 (44%)</td>
<td>5 (16%)</td>
<td>13 (40%)</td>
</tr>
<tr>
<td>2. Allocation of Central Administrative Expenses</td>
<td>8 (25%)</td>
<td>10 (31%)</td>
<td>14 (44%)</td>
</tr>
<tr>
<td>3. Use of Reserves and Provisions</td>
<td>17 (53%)</td>
<td>5 (16%)</td>
<td>10 (31%)</td>
</tr>
</tbody>
</table>

For example, we got a delivery van last year which came out of capital, this was a surplus from repairs and renewal funds. We made a bid and we got this. This can be confusing but it doesn’t bother me if I get it. But the general idea of what should be revenue and capital is confusing.

An example of one local government officer who had a good understanding of capital accounting practices on his services explained it, as follows:

‘In the past, half a million pounds of general maintenance and equipment was capitalised in order to get it from capital receipts and projects had to be adjusted. Now, at pre-budget stage, they must define what is capital and revenue. If it is over £6,000 it is capital, if it is over £20,000 on building maintenance it is capital. We are renewing a roof, if it costs £21,000 it will be capital, if it costs £19,700 it will fall into revenue. Another example is the purchase of 40 computers at £5,000 each. Individually they are revenue or jointly they are capital.’

Overall, these officers exhibited a moderate understanding of the capital/revenue distinction and the issues surrounding the treatment of central administrative expenses. However, the use of reserves and provisions – which, as acknowledged above – can be a most difficult area to understand, caused them difficulties. Nevertheless, there was clearly a significant minority of the officers interviewed who had difficulty in understanding all of these accounting practices.

The second test of understanding was the same as that for councillors viz the nature of central government controls and their potential impact on financial information. The responses to this part of the interviews with officers are shown in table 17. The classification system into (a) ‘none/little’, (b) ‘fair’ and (c) ‘good’ was the same as that used for councillors and described above. Overall, this indicates a lower level of understanding of those controls and how they affect accounting reports. Only a small number of officers suggested that these
controls do affect the figures in the annual accounts (although one did so, in some detail, correctly identifying year end adjustments and possible ‘creative accounting’), none of them felt able to adjust these figures in any way. The majority view of these officers was that they had no clear idea of how such controls would affect, or be reflected in, the annual accounts.

3. Nature of Reports and Accounts
As noted above, the annual reports and accounts of the four local authorities are all of a high standard, consistent with best practice in local authority accounting. The views of the officers interviewed on (a) their preferred type of information within local authority reports and accounts (b) proposals for the reforms of reports and accounts and (c) their views on how such information should be regulated, are contained in tables 18, 19 and 20. These show quite different perspectives from that of councillors. Table 18 shows

| TABLE 18 |
| Preferred Type of Information within Local Authority Annual Reports and Accounts: Officers |

<table>
<thead>
<tr>
<th>Type of Information</th>
<th>Officers Preferences (n=28)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Budget comparisons</td>
<td>21</td>
</tr>
<tr>
<td>2. Performance indicators</td>
<td>20</td>
</tr>
<tr>
<td>3. Narrative explanations</td>
<td>13</td>
</tr>
<tr>
<td>4. Statistical information</td>
<td>12</td>
</tr>
</tbody>
</table>

Notes:
1. This includes multiple responses as most interviewees were unable to select their single most important type of information
2. This excludes four officers whose answers were vague/ambiguous
### TABLE 19
Proposals for the Reform of Local Authority Annual Reports and Accounts: Officers

<table>
<thead>
<tr>
<th>Comment</th>
<th>Officers Preferences* (n=32)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. As presently produced</td>
<td>17</td>
</tr>
<tr>
<td>2. Simpler/more readable</td>
<td>7</td>
</tr>
<tr>
<td>3. More diagrams</td>
<td>4</td>
</tr>
<tr>
<td>4. More detailed accounts</td>
<td>4</td>
</tr>
<tr>
<td>5. More year to year comparisons</td>
<td>2</td>
</tr>
<tr>
<td>6. More timely</td>
<td>2</td>
</tr>
<tr>
<td>7. More narrative explanations</td>
<td>1</td>
</tr>
</tbody>
</table>

**Notes:**
1. Comments exceed numbers interviewed because of multiple responses
2. Seven of the officers interviewed were non-committal

A strong preference for budget comparisons and performance indicators. This ties in with the management orientation of this particular user group. It is interesting to note that those officers who had no practical experience or formal training did not opt for narrative type information.

When questioned on what an ‘ideal’ set of local authority annual reports and accounts should contain, the majority of the officers favoured the present form of

### TABLE 20
Regulation of Format and Contents of Local Authority Annual Reports and Accounts: Officers’ Views

<table>
<thead>
<tr>
<th>To be decided by:</th>
<th>Officers* (n=28)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Director of Finance</td>
<td>12</td>
</tr>
<tr>
<td>2. Director of Finance and other Directors</td>
<td>4</td>
</tr>
<tr>
<td>3. Director of Finance and Central Government</td>
<td>3</td>
</tr>
<tr>
<td>4. Central Government</td>
<td>2</td>
</tr>
<tr>
<td>5. Central Government and all Directors</td>
<td>2</td>
</tr>
<tr>
<td>6. Councillors</td>
<td>2</td>
</tr>
<tr>
<td>7. Director of Finance, other Directors, Councillors and CIPFA</td>
<td>1</td>
</tr>
<tr>
<td>8. CIPFA</td>
<td>1</td>
</tr>
</tbody>
</table>

* Four officers did not have views on this issue
INTERNAL USERS

reports and accounts (see table 19). As was the case with councillors, those
officers commented favourably on the improvement in the quality of the
information contained in their local authority’s annual report and accounts.
Within those interviewees who suggested simpler, more readable accounts would
be preferable, there was no consistent pattern of views between those who
did/did not have previous practical accounting experience or training. Indeed,
there was an example of one officer, with no previous background in
accountancy, describing these reports as ‘an accountant’s document prepared for
accountants’, but, on the other hand, those interviewed with the highest
(professional) level of accounting background also stressed the need for simple,
readable annual accounts.
The final aspect of the nature of such reports – the basis of regulation – achieved
near unanimity in the responses of officers and councillors (see table 20). This
shows that there is strong support for the Director of Finance as the key figure
overseeing financial information. There is also some shared (by officers and
councillors) antipathy towards central government’s role in this situation.
However, it is somewhat ironic to note that the code of practice which has
influenced the quality of financial reporting by local authorities and upon which
both of these user groups commented favourably, was, in fact promulgated by the
Scottish Office.
5. SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

The perspective taken in this study was that of an exploratory investigation of an aspect of financial reporting which has been neglected in local authorities and, indeed, in the public sector in general. The issue of whether the information contained in local authority annual reports and accounts meets the needs of potential users is a matter of considerable importance. This is particularly so given the onus on public sector bodies, such as local authorities, to be publicly accountable for the resources at their disposal. This has assumed a greater potential importance with changes in the system of local authority taxation which hinge on assumptions about voters’ sensitivity to the costs and financial consequences of their choices.

This study of the annual reports and accounts of local authorities examined these issues by addressing three main questions:

1. To what extent are such reports used by potential user groups?
2. How well do users understand the information conveyed in the accounts?
3. What reforms, if any, would benefit users?

To investigate these questions a simple model of potential users’ needs was established. This was based on a survey of experts’ (finance officers and auditors) views on the use of local authority reports and accounts. It also drew on the existing literature in the area. However, this model differs from previous studies which highlight the entitlements of resource providers (eg financiers, employees), by recognising the rights of potential users but also by identifying their capability to access and use local authority accounts. In this way, three layers of potential users were established: (a) external parties with limited resources to access this information (general public, pressure groups, media) (b) external parties with direct regular access to local authority financial information (central government, the Accounts Commission) and (c) internal groups of potential users (full-time officials and lay, elected members).

Of the external users identified in chapter 3, there was little evidence of substantial use of local authority annual reports and accounts, with the exception of the Accounts Commission and, to a lesser extent, central government. As regards the media, the annual report and accounts was seen as lengthy and offputting and, with limited time available to investigate issues, local government correspondents tended to use other sources of information, notably press releases. In the case of pressure groups the lack of usage was partly because certain of these potential users had a national rather than a local perspective. It was also a function of the lack of resources available to scrutinise what were regarded as somewhat complex documents. The evidence on the extent to which the general public might make use of local authority reports and accounts was indirect, but consistently negative. Indeed, it is interesting to note the response of councillors to a question on whether their constituents ever queried them on the accounts and the figures in them. Of the
SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

53 councillors interviewed, 41 were firm that this never happened. Of the remaining 12, the typical response was that such queries were very occasional and usually related to specific organisations, such as community councils, local ratepayers groups or political parties.

In terms of the financial dimension of public accountability, the implications of these findings are not supportive of the underlying rationale for systems of local taxation. The basic concept underpinning such taxes is that all users of local authority services will take a greater interest in the financial affairs of their local authority. At a superficial level, voters may base their decisions on the level of tax charged. However, this will not provide the comprehensive picture of planned programmes of expenditure and actual performance achieved, both in terms of financial outturns and service delivery, which appears in local authority annual reports and accounts. If the assumption of rational economic analysis is pursued, it might be expected that voters will seek out this information. However, the above evidence suggests that, not only is this not the case, but also that key intermediaries (pressure groups, the media) who may influence the general public are not seeking out this information either.

These findings are supportive of the model depicted in figure 1 (chapter 2) which recognises the limited resources of such potential users of local authority annual reports and accounts. This suggests that for such groups to be informed fully of the financial dimension of public accountability they need different forms of financial information, which preferably satisfies not only the needs of probity and legality of such expenditure but also efficiency and effectiveness. In this regard, for example, from the perspective of a taxpayer the financial information attached to the tax charge (essentially an abbreviated budget statement) may be seen as satisfying notions of probity, but not of efficiency and effectiveness. Similarly, from the perspective of an intermediate group, such as the media/pressure groups the information contained in, for example, the CIPFA Rating Review may appear on the one hand, too detailed (with information on all other councils) and insufficiently detailed (with limited information on value for money and performance indicators). Therefore, there is a need for statements which address the needs of the outer layer of potential users (which approximate to the private sector concept of the 'naive' user) in figure 1. This matter is addressed further, below.

As far as internal user groups were concerned, there was evidence of use of local authority reports and accounts by both councillors (lay, elected members of authorities) and officers (full time officials). However, both of these groups exhibited only limited to moderate understanding of specific local authority accounting practices and of the potential impact of central government controls on their local authority's accounts. Also, the reports and accounts were not regarded as the most important source of information by these potential users. The officers expressed a preference for managerial, planned information, particularly the management budget, budget comparisons and performance indicators. While
councillors also expressed interest in the management budget, they tended to regard the finance officer as their key source of information. Indeed, the Director of Finance and the finance department played an important role in analysing, explaining and reporting financial information – often on an informal basis. This circumstance, in which the electorate do not utilise this financial information and in which councillors may place reliance on council officers, has been criticised by Sidebotham (1966) on the grounds that this is 'bureaucracy with a democratic facade'. In his view, accounting statements should be accessible to the electorate and not just to councillors and officers. However, another notable feature of this study was the emergence of a dichotomy in the behaviour of councillors. There was one group which had only a limited interest in finance. However, there was also a further, key group of councillors i.e. those who hold important roles (e.g. chairman, vice-chairman of finance committees, planning committees) with major responsibilities for finances and resources and these were not only extremely knowledgeable but a counterweight to the finance officer. In this way they did not merely endorse the advice of officers but could challenge and engage in dialogue on issues of finance.

Nevertheless, from the perspective of practising accountants, the reservations raised by Sidebotham raise questions about the nature of local authority reports and accounts and how these might be improved. In fact, the majority of users (in effect, internal users) expressed satisfaction with the quality of their local authority’s annual report and accounts, which were consistent with the Scottish Office code of practice on disclosure (Scottish Office, 1988). However, it is worth emphasising the kinds of disclosure which can and do facilitate the greater use of such reports:

1. Precise statements of service objectives, tied to actual levels of attainment.
2. Greater use of performance indicators (there is still a need for their further development) to enhance the use of 1 above,
3. Statements which seek to identify the impact of central government’s activities (financing, intervention) on local authorities.
4. More timely information specifically, annual reports and accounts (even if unaudited) should be made available to potential users within two months of the financial year end to which they refer (i.e. by the 31st May). This may be seen as unrealistic, at least initially, by local authorities, but it could be introduced as a phased target to be achieved over, say, a two–to three year period. Indeed, a case could also be made for the production of interim financial statements to improve the overall timeliness of such information.
5. Enhance the understanding and use of local authority annual reports and accounts by, for example (a) including glossaries of terms and expressions used (b) offering training courses for elected members with little or no financial expertise.
6. LAYERS of financial reporting information should be introduced. This would include a variety of reports with simpler narrative type stewardship
information for the outer layer of the model exhibited in chapter 2 and more
detail (with management information, including budgeted and ex post
performance information) for internal users and those external users who wish
to access this.

Item 4 above was not raised by any of the interested parties whom we contacted, but,
in our view, earlier dissemination of reports would improve their relevance. The
other recommendations are in line with recent proposals. For example, ICAS (1988)
has emphasised the matter of including objectives in financial statements. Indeed,
the current code of practice for local authorities (Scottish Office, 1988) also
identifies a number of the above issues. In this regard, it should be noted that this
study provides confirmation of an earlier study’s findings (Kilgour and Lapsley,
1988) which identified a significant improvement in the quality of financial
reporting by local authorities.
Furthermore, from a policymakers’ perspective, given both the success of its earlier
code of practice and the nature of the above recommendations, it would be
appropriate for early consideration to be given to the revision of the (1988) Scottish
Office Code of Practice on the publication of Financial and Other Information by
local authorities.
Finally from the viewpoint of researchers, the above study has addressed an issue
of comparative neglect viz. the needs for, and the use of, local authority reports and
accounts by potential user groups. In so doing it has, unlike previous private sector
studies, constructed a hierarchy of user needs (see figure 1). This needs further
refinement and research, in a variety of ways. In terms of information needs of
specific user groups, a need was identified for further research into the use of local
authority financial information by central government. Given the size and scale of
central government activity and the variety of sources of information at its disposal,
this represents potentially a major research project in its own right. Also, this study
has made recommendations for the reform of local authority reporting practices,
specifically by addressing the issue of different styles of reports to different layers of
potential user groups (as depicted in figure 1). There are, of course, some different
reports aimed at some of those different user groups, but the point here is that there
is need for carefully articulated layers of reports of financial and non-financial
information which have an overall coherence in the messages which they convey. If
such practices are adopted, it would be useful to investigate the usage of such
information to determine if user needs are better met.
Furthermore, in addition to the above research, this project has identified two
fundamental issues which require research (a) the need for local authority
performance indicators and (b) the need to understand more closely the role of
financial information in the process of public accountability i.e. specifically, how
such information can, might or does impinge on the voting decisions of the
electorate. The first of these is a crucial element in the development of forms of
reporting which extend beyond probity and legality. However, there is a need for a considerable effort directed not only at the construction of such performance indicators, but also at the establishment of a database of performances achieved to provide reference points for meaningful comparisons to be made by policymakers, officials, the general public and other interested parties. Also, the issue of how financial information does impact on the voting behaviour of the general public should be recognised as a substantive project, in its own right, which needs to be tackled with due sensitivity not only to the construction of accounting numbers and the manner of their reporting, but also to the socio-political context in which such decisions are made. In the absence of such a study, there is an inescapable speculative element to the actual/potential role which such information might/should/does play in voting decisions and this is a matter of considerable significance which should be recognised, not only policymakers in framing, for example, changes in local taxation systems, but also by local government officials and elected members as they seek to discharge their obligation of public accountability for the resources at their disposal.
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APPENDIX 1

Councillors’ Questionnaire

1. How many years have you served as a councillor?

2. Which committees associated with Regional/District Council work do you serve on? Please give details of offices held.

3. Do you have any previous experience in accounting matters – including any formal training?

4. Do you read your Regional/District Councils’ annual report and accounts? YES/NO
   
   If NO please give your reasons and proceed to question 8.

   If YES please continue below.

5. To what extent do you read each of the following sections of the annual report and accounts? (please tick)

<table>
<thead>
<tr>
<th>Sections of Report &amp; Accounts</th>
<th>Thoroughly</th>
<th>Briefly</th>
<th>Not at all</th>
</tr>
</thead>
<tbody>
<tr>
<td>Report by Director of Finance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Statement of Accounting Principles</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes to the Accounts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Service (Revenue) Accounts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(please specify)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Capital Account                                      |            |         |            |
| Loans Fund Account                                   |            |         |            |
| Consolidated Balance Sheet                           |            |         |            |
| Auditor’s Report                                     |            |         |            |
| Other                                                |            |         |            |
APPENDIX I

6. Within these sections, what type of information is of most use?
   (a) Budget comparisons
   (b) Narrative Explanations
   (c) Performance Indicators
   (d) Statistical Information
   (e) Other.

7. Do you feel that the annual report and accounts as currently produced satisfies your needs for information?

8. When requiring or looking for financial information do you
   (i) consult the abstract of accounts?
   (ii) consult the management budget?
   (iii) consult specific committee papers?
   (iv) refer to the CIPFA Rating Review?
   (v) ask an officer to provide the information?
   (vi) consult other sources (please specify).

9. Of all the data sources mentioned, which is of most use to you, in your role as a Local Government Councillor? Why?

10. In your view, what would an ‘ideal’ set of Local Authority annual accounts contain?

11. In your view, should the format and contents of the report and accounts be:–
   (a) prescribed by Central Government
   (b) at the discretion of Directors of Finance
   (c) Other

12. Do constituents query you on the accounts and figures?

13. What do you think of:–
   (a) Revenue Spending Guidelines
   (b) Rate Capping
   (c) Capital Consents

Please briefly describe and comment on these. In your opinion do these ‘controls’ affect the report and accounts and, if so, how? Do they affect your use of the figures?
APPENDIX I

14. There is often confusion and overlap between capital and revenue expenditure. Have you had experience of any particular situation where it may be difficult to make a distinction between the two.

15. Do you have any views on the treatment or method of allocation of Central administration expenses?

16. Do you have any views on the use of reserves and provisions in Local Authority accounts?
APPENDIX 2

Financial Statement Users (Officers’ Questionnaire)

1. How many years have you been employed as a Local Government Officer?

2. Do you have any previous experience in accounting matters – including any formal training?

3. Do you read your local authorities’ annual report and accounts? (please tick).

<table>
<thead>
<tr>
<th>Sections of Report &amp; Accounts</th>
<th>Thoroughly</th>
<th>Briefly</th>
<th>Not at all</th>
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<tr>
<td>Service (Revenue) Accounts (please specify)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital Account</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loans Fund Account</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consolidated Balance Sheet</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Auditor’s Report</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4. What type of information is of most use to you?
   (a) Budget Comparisons
   (b) Narrative Explanations
   (c) Performance Indicators
   (d) Statistical Information
   (e) Other.
5. When requiring/looking for financial information do you:--
   (i) consult the abstract of accounts?
   (ii) consult the management budget?
   (iii) refer to the rating review?
   (iv) ask a member of the finance department?
   (v) consult other sources (please specify).

6. Of all the data sources mentioned, which is of most use to you in your role as a Local Government Officer? Why?

7. In your view, what would an 'ideal' set of Local Authority annual accounts contain?

8. In your opinion should the format and contents of the report and accounts be:--
   (a) prescribed by Central Government?
   (b) at the discretion of the Director of Finance?
   (c) other?

9. What do you think of:--
   (a) Revenue Spending Guidelines
   (b) Rate Capping
   (c) Capital Consents

   Please briefly describe and comment on these. In your opinion do these 'controls' affect the report and accounts, and if so how? Do they affect your use of the figures?

10. There is often confusion and overlap between capital and revenue expenditure. Have you had experience of any particular situation where it may be difficult to make a distinction between the two.

11. Do you have any views on the treatment or method of allocation of Central administration expenses?

12. Do you have any views on the use of reserves and provisions in Local Authority accounts?
ISBN 1 871250 16 1

is available in an accompanying volume:

Reporting by Local Authorities in Scotland, Part 1 of the Research
Financial Statements of Scotland and the Institute of Chartered
Public Finance and Accountancy and The Chartered Institute of

The study was sponsored jointly by The Chartered Institute of

IPSAF.

Accounting at the University of Edinburgh and is Director of
research assistant at IPSAF. Irvine Lapsley is Professor of
Accounting Research (IPSAF). Debbie Keenan has worked as a
Associate Research Fellow in the Institute of Public Sector
and an Associate Research Fellow in the University of Strathclyde

Bill Collins is a Lecturer in Accounting at the University of Strathclyde.

authority accountability.

accounting, will be of interest to all those involved with local
Scotland, although the results of the study, although relating to
detailed interviews with a variety of actual and potential users of
that is explored the issue by undertaking field studies involving
and the possible need for their reform. It is quite distinctive in
examinations the use made of local authority annual reports in Scotland

This study is the second of a two-part research investigation,

informed by the financial consequences of their actions.

These changes seek to encourage the electorate to make decisions
and prospective changes in the system of local authority taxation.
important but it has assumed even greater importance with recent
decree of consumers' concerns about the way in which they

do local authority accounts communicate effectively or do they

Communicated, Sophisticy or Obscuration

LOCAL AUTHORITY FINANCIAL REPORTING