


# Chapter 7

## The Case of Accounting Information for Infrastructural Assets Reporting: Local Government Borrowings and Investment Choices in the Context of Moral Hazard and Local Government Politics

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### ABSTRACT

*In a civil society, citizens require information to assist them in understanding and monitoring how public resources are managed. Accounting information produced by public managers allows such monitoring and helps citizens to participate in the political process when it comes to election or re-election of the politicians. This chapter discusses the case of investments in infrastructural assets and local government borrowing in New Zealand, with an emphasis on the role of accounting information in the context of moral hazard and fiscal accountability of local government politicians and leadership. The evidence in this chapter shows that New Zealand local governments tend to invest significantly more in visible infrastructural assets such as roads, land, and buildings. This confirms the moral hazard theory that local politicians may be prioritizing infrastructure investments that can be seen by their electorate as evidence of their performance in government, presenting a more favourable picture that leads to politicians' election or re-election on local government bodies.*

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## **1. INTRODUCTION**

In a civil society, citizens require information to assist them in understanding and monitoring the management of public resources. Accounting information produced by public managers allows such monitoring and enables transparency and accountability in the public sector. Such information also helps citizens to participate in the political process when it comes to election or re-election of politicians or other citizen representatives. Accounting information, therefore, has both social and economic influence on the political process. At local government<sup>1</sup> level, the information about infrastructural assets and borrowing is of particular interest to citizens. This is because local government borrowing, and infrastructural investment priorities can be of large magnitude and can evoke issues around intergenerational equity as well as managerial accountability and moral hazard. Local government politicians often use the rhetoric around debt conservatism, and the state of infrastructural assets and investment in them, as election platforms. However, both issues can be fraught with moral hazard.

This chapter reviews and discusses the case of investments in infrastructural assets and local government borrowing in New Zealand. It emphasises the role of accounting information in the management of both issues in the context of moral hazard and fiscal accountability for local government politicians and leadership. The research evidence reviewed and discussed in this chapter shows that the supply side of credit through central government funding agencies can strongly influence and control local government borrowing and investment. It is argued that government policy can be effective in controlling moral hazard for local government, since debt, and the related investment in infrastructural assets, are based on accounting measures that must be met before local governments can access debt financing from suppliers of credit.

The evidence reviewed in this chapter also shows that there are shortcomings in the accounting information communicated by New Zealand local governments in annual reports regarding infrastructural assets. However, a case is made that some form of condensed information about the annual net investment in infrastructural assets and the sources of funding of infrastructural assets should be provided in local authorities' annual reports. It is argued that this information is more useful for assessing the level and the type of infrastructural investment for public asset management, especially in comparison to the net book values (NBVs) of the infrastructural assets that usually provide estimations in local authorities' annual reports. Users of local authorities' financial statements could then deduce the priorities of their local councils' infrastructure investment strategy, while evaluating the net investment figures; and citizens could evaluate the performance of their representatives/politicians, particularly for the purpose of electing or re-electing them.

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