Accountability in local government: a principal-agent perspective

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Abstract

Purpose – In Sweden there is an ongoing debate on ways to enhance accountability and transparency in order to avoid future scandals both in private companies and local government. Until now the debate has had clear political overtones, and there are no generally accepted methods for analysis of this issue. The purpose of the article is to survey and analyze the chain of accountability to be reviewed by the auditors and through the use of principal-agent (PA) theory to identify the problems that may arise in holding persons accountable.

Design/methodology/approach – The paper shows how PA theory can be used to structure and analyse the intricate situation in Swedish local government. The model is particularly suitable in complex systems of accountability. Therefore, the paper explores two cases where the outcomes were discharge from liability. Based on the two case studies, the paper extends the empirical investigation to a list of 63 qualified audit reports in local government for 2002 and 2003.

Findings – PA theory facilitated the understanding and structuring of the complex accountability situation and helped to identify important weaknesses in the system. The analysis underscored that neither better accounting nor better auditing systems alone will resolve the dilemma in improving accountability. The link between auditors and elected officials and civil servants needs to be investigated and clarified. Among other things, this means that the focus of today’s debate should shift toward the lack of clear responsibilities within local governments.

Research limitations/implications – This paper explores an area of research where few studies have previously been conducted – therefore, the paper is to some extent exploratory. In the future the number of empirical examples could be increased, and the different problems in the system of accountability in local government could be discussed in more detail.

Practical implications – This research paper is based on an empirical investigation – as far as we know no such study has previously been performed in Sweden. The principle of public access to information in Sweden provides unique opportunities for openly studying the work of auditors in the system.

Originality/value – The research shows that PA theory may be used to structure complex issues of accountability. In addition, the study recommends a new focus for the debate on accountability.

Keywords Management accountability, Local government, Sweden

Paper type Research paper

Introduction

In recent years, we have read about many companies and other organizations that have been creative, sometimes even manipulative, in accounting for their operations. For example, the Skandia affair, widely publicized in Sweden, has highlighted the need for greater control and transparency in business. For public authorities as well, the importance of providing more control and transparency has been brought to the fore. Olsson (2003) has raised the appropriate question of whether better accounting systems and more sophisticated auditing could prevent future scandals.
In Sweden, a government study has proposed a code of corporate management, and a similar code is also being drafted in the public sector. Together with well-functioning audits, such codes are important instruments for increasing transparency. In major companies – as in municipal, county, and regional government – there are several links in the chain of delegation, and when so-called “soft” values are reviewed, there is a substantial risk that information will be concealed, both intentionally and unintentionally (Bontis, 2003). In Sweden, local government auditors are charged with examining not only finances but also performance in regard to the “soft” values of appropriateness, effectiveness and productivity. The study of local government auditing and its role in the review of such values is an interesting area of research.

The point of departure for this article is that local government auditing, like traditional corporate auditing, is intended to reduce the asymmetry of information between principal and agent. In this sense, the audit can be considered a signal to the principal in the principal-agent chain (Yandell, 1988). For this signal from the auditors to be reliable, a thorough understanding of the system of accountability and of the flaws in the system is required. The purpose of the article is to survey and analyze the chain of accountability to be reviewed by the auditors and through the use of principal-agent (PA) theory to identify the problems that may arise in holding persons accountable. While the analysis concerns conditions in county council districts and municipalities in Sweden, in our view the findings are also applicable to the corporate world.

Previous research
The use of principal-agent (PA) theory has previously proved fruitful in studies of auditing in private firms (see, for example, Power, 1997; Baiman et al., 1987; Yandell, 1988). Several of these studies use that theory in analyzing the role of the auditor as an agent in relation to a principal. Some international groups of researchers have highlighted how auditing in a public-sector environment can help to reduce the asymmetry between principal and agent in regard to information (see, for example, Laughlin, 1996; Payne and Jensen, 2002). Other researchers have used PA theory to analyze accountability and delegation in central government (see, for example, Strøm, 2000; Müller, 2000; Lupia and McCubbins, 2000; Venton, 1997). These scholars, however, have not studied the role of auditing in central government as a source of information in the system of accountability, but have focused on issues of delegation and democracy. They also provide valuable contributions concerning the importance of the contract and mechanisms of selection in principal-agent relationships.

Yandell (1988) has used PA theory to examine auditing as one element in the system of signals to principals. In his article, he assumes a relationship involving one principal and one agent. In our article, the audit is also regarded as a signal to the principal, but we assume a situation where there are several principal-agent relationships. This complexity in the chain of accountability makes it possible to conceal information from the principal. The audit can therefore help to improve transparency and to provide the principal with valuable information on the agent’s performance.

In summary, there are few studies – to our knowledge – where PA theory is applied to auditing in municipalities and county council districts. Swedish research in the field of local government auditing is not very extensive and is devoted primarily to issues of democracy and law (see Ahlbäck, 1999; Lundin, 1999; Sveriges Kommuner och Landsting, 2005). Few groups of researchers studying local government auditing have focused on auditing as a tool for providing information. Thus, there is presently a shortage of empirical studies and analyses of the effects of information asymmetries in an environment like that of municipalities and county council districts. Moreover, there
is little knowledge about what auditing could contribute to the identification of problems that may arise in a complex accountability relationship (with many principal-agent relationships). For example, what does it mean to have both management by civil servants and management by elected officials? The contribution of this article is that it identifies and analyzes these types of complex accountability relationships and the problems that they cause.

**Local government auditing and corporate auditing**

In Sweden, local government auditing is based on a system where auditors are politically appointed by the municipal or county council for a period of four years. These appointed auditors issue an audit report to the council, which thereafter decides on discharging boards and committees from liability (Local Government Act, chapters 5:25a-b and 5:31). As the council’s instrument of review, the auditors’ independence in relation to boards, committees and drafting committees is critical. Local government auditing is similar in design to the organization of municipalities, county council districts and regions, in that elected officials are responsible for operations and have civil servants to assist them. Unlike elected members of boards and committees, however, auditors are empowered by law to choose the experts that will assist them (Local Government Act, chapters 9:8).

The assignment of appointed auditors in local government is broader than that of the certified accountants who audit corporations. Thus, auditing of local government companies also involves non-certified auditors (often appointed from among local government auditors), who review operations from the standpoint of the owners’ directives and of the mission given to the company by the local government. The duties of local government auditors are set forth in the Local Government Act (chapter 9:9), which provides among other things that their examination is to be conducted in accordance with Good Auditing Practice. In this respect, the situation of local government auditors is the same as that of the certified accountants who audit corporations. But there are also many differences. The Local Government Act provides that the auditors are to examine whether operations are conducted in accordance with their purpose, whether they are conducted in a financially satisfactory manner, whether the accounts provide a fair financial picture and whether the internal control for which the boards are responsible is adequate.

The duties of certified accountants are governed primarily by the Companies Act. This Act provides that the auditors are to review the administration of the managing director and the board of directors and to determine whether the accounts provide a fair financial picture of the company. These provisions permit broad interpretation of the appropriate scope of the administrative audit. In practice, certified accountants focus their review more on financial accounting than do the appointed auditors in local government. One possible reason is the difference in the aims of the organizations to be examined. To put it simply, the aim of corporations is to earn money and to provide a return to the shareholders, and the purpose of local government operations is to use tax revenue in an optimal manner in conducting operations for the public good. In regard to the financial audit, local government auditing can gain useful knowledge from corporate auditing; in regard to examination on the basis of “soft” values, corporate auditing can learn much of value from local government auditing.

**The system of accountability**

In a municipality, the citizens elect councillors to represent them between elections: this is a principal-agent relationship where the council is the agent of the citizens, who are
the principals. In the next stage, the council becomes a principal when it appoints members of boards and committees, who thereby become agents of the council. Under the Local Government Act, the council is obligated to hold accountable those required to report to them, i.e. the municipal executive board and the various other boards. These are to be held accountable for what they have done or failed to do on the basis of the mission and objectives that they have received from the council. The council is obligated to formulate the mission of the boards in statements of general aims and plans. In addition, the council prepares guidelines and delegates power for its term of office – at the same time, the council is fully free to deny discharge from liability and to dismiss any person or persons who have not performed their duties satisfactorily. The council is responsible to the citizens for requiring an accounting for operations as well as for finances from those obligated to render such an accounting (Svenska Kommunförbundet, 2004).

The preparation and carrying out of decisions is performed to a substantial extent by civil servants, although the final word formally rests with elected officials. If accounting for operations and finances in a democratic system is to function properly, those in power/decision makers must be sure that their decisions are based on comprehensive and accurate documentation and are carried out so that the intended effects are achieved. In this connection, it should be noted that civil servants in local government, even at a very senior level, are not required to render an accounting and are therefore not answerable in the audit on accountability.

The local government auditors are charged on behalf of the local government council with reviewing and evaluating the liability of those who are accountable. The auditors thus fulfill their mission from the council, which finances the audit and issues the rules that govern it. The system is based on the auditors’ lack of power to hold any agents accountable; rather, their duty is to present their opinion to the council on the question of accountability. The decision on accountability is then taken by the members of the council, who may not always be impartial in such decisions. Since council members frequently sit on boards and committees as well, there is a danger that their loyalty to members of the same political party may outweigh their loyalty to the citizens. The citizens, in turn, hold officials accountable in general elections every four years. In these elections, however, these officials are not accountable individually, as votes are totalled at the party level. On the other hand, improper behaviour by one or two elected officials may lead to fewer votes for their party as a whole, which will then win fewer seats on the local government council.

In the opinion of most people, an agent who fails in the performance of her/his mission should also be held accountable. In a corporation, the decision on accountability is taken by general meeting of shareholders, based on the auditors’ recommendation; in local government, too, the council decides on accountability after obtaining the opinion of the auditors on this question. The difference is that in a corporation the decision makers have a direct interest in the determination of accountability, whereas in local government council members have an indirect interest in the matter – it is the citizens who have a direct interest. Since the political parties in power form the majority on the council, the determination of the issue of accountability will naturally be the subject of partisan political discussion (Nyman et al., 2005).

According to chapter 3 of the Local Government Act, local governments must have a council and an executive board (kommunstyrelse), a board of elections (valnämnd), as well as a supervisory board (myndighetsnämnd), which, however, may be a committee of the executive board. Often local governments are organized with one or more boards appointed by the council. According to the Local Government Act, local governments
may also include drafting committees (beredningar) in their organization. These bodies are often charged with analyzing external developments and formulating goals for the future. The function of drafting committees may be most accurately regarded as relieving the executive board and other boards of some of their workload and enabling the council to be more active in municipality or county government. All of the boards, including the executive board, answer directly to the local government council. According to the Local Government Act (chapter 6:1), the local government executive board is charged with managing and co-ordinating local government affairs and supervising the operations of the other boards. As a practical matter, the executive board may serve as a general body that governs the entire municipality or county while also leading/co-ordinating the work of the other boards for the council. The chain of accountability is illustrated in Figure 1, where the black arrows indicate by whom (the principal) and to whom (the agent) the mission is given, whereas the dashed line shows to whom the agent is responsible. As shown in Figure 1, there are several principals and several agents in the system of accountability, and thus multiple principal-agent relationships. The basic assumption, in accordance with the Local Government Act, is that there is a primary principal (the citizen) and a primary agent (the council) in all local governments. The double arrow between the executive board and the other boards/committees indicates the co-ordinating function of the executive board and its obligation to supervise the other boards. As a consequence of this obligation to provide co-ordination and supervision, the executive board can serve as a superior board in local government. Thus, in certain local governments the executive board may in practice function as a principal in relation to the other boards, which in turn function as agents. According to the Local Government Act, the executive board is not superior to the other boards, but as a practical matter it often holds a stronger position relative to them.

The chain of accountability

In a situation of only one principal and one agent, the principal can control the agent’s behaviour through actions, measurements and follow-up of the assignment (Laughlin, 1996). This means that by their behaviour both actors may influence each other so that the assignment is performed satisfactorily. Social interplay and control would thus
function as a mechanism of review in itself. The basic values and the conscience of the agent, as well as the relationship to the principal, would then serve as a control mechanism assuring that the assignment was being performed satisfactorily. Thus, through the relationship the principal has “committed” the agent to acting in a desired manner. This would be particularly clear in situations where the actors have recurring contact over longer periods – in other words, in a situation where “repurchasing” is important, openness is also important. The business relationship then begins to resemble a relationship between friends (Behn, 2001). In situations with complex accountability systems, where there are numerous links involving principals and agents, the relationship alone does not suffice as a control mechanism. The reason for this is that it becomes too difficult to obtain an overview of the system of accountability, thus making it possible to conceal information from the principal in furtherance of the agent’s interests (Laughlin, 1996; Tarschys, 2002).

As shown in Figure 1, the system of accountability in local government is multiple. The system of signals in this delegated chain of accountability is therefore complex. The duty of the auditors on behalf of the primary principal is to examine, clarify and expose the flaws in this chain of accountability. It should be obvious that doing so is no easy matter, and that the risks of error are considerable. When several principals and agents are involved, there is also a danger that shortcomings in the system of signals will lead to serious consequences for the organization (Rapp and Thorstensson, 1994). These consequences are described in greater detail later in this article. The chain of accountability which the auditors are charged with reviewing consists of a number of agency relationships as well as relationships involving several principals. Some of these are described in Figure 2.

The chain of accountability in local government is divided into the organization of civil servants (P4/A3a and A3b/A4 in Figure 2) and the organization of elected officials (P2/A1, P3a/A2a and P3b/A2b in Figure 2). As mentioned previously, civil servants are not subject to audit and are thus outside the scope of the auditor’s review of accountability, but they nevertheless affect what happens in the chain of accountability by carrying out and preparing political decisions for elected officials and by serving those officials. Figure 2 illustrates this situation with a dashed line; the organization of civil servants is below the line and the organization of elected officials is above it. As noted earlier, the auditor’s opinion on discharge from liability applies only to local

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**Figure 2.**
The system of accountability from a principal-agent perspective
government officials who are required to present accounts. This situation leads to interesting relationships in the chain of accountability.

The office of local government often serves as the highest level of the civil servant organization. The municipal, county or regional director is then the highest-ranking civil servant, who prepares decisions and acts as the link from the executive board and the council to operations. Sometimes this director also occupies a position as the superior of the other administrative directors. This means that the local government administration is delegated additional power from the executive board and is the agent (A3a) in this link. Thereafter, it functions as a principal (P4) in that it delegates assignments further to the administrative staff of various other boards (A3b). The administrative staff of a board is subordinate to the board and is thus its agent (A4). In total, this means that the administrative staff of a board can have two principals and potentially two conflicting sets of objectives to consider.

The local government leadership may have made a decision that the administrative director must follow as a subordinate of the director of local government, who in turn is subordinate to the local government executive board. A board may then reach a decision that is inconsistent with that of the local government executive board. The administrative director of the first board then faces a conflict between the decision of the local government administration and the political decision of her/his board. Another situation may be one where the local government executive board, for example, prepares the budget and changes the budget proposals of the other boards before they are submitted to the council for approval.

The auditors and the system of accountability

The traditional audit review is focused on the financial accounts and their conformity to law. We customarily refer to accounts that provide a fair financial picture. In a municipality or county council district, which does not operate for a profit, there is an additional component: namely, how operations are conducted, i.e. their effectiveness and appropriateness to their purpose. The former may be termed “tangible” values and the latter “intangible” values.

It is a classic truth that what is measured in an operation is also what is performed. This means that the system of rewards is of central significance. If local government is to be operated and reviewed in accordance with democratic principles, the system of accountability as a whole must also be designed to permit control and transparency. Problems arise when the agent does not choose to act in the service of both the principal’s and the agent’s own interests. This can happen in a situation where information is asymmetric and there is little risk of detection. It might also occur in systems that are so complex that it is difficult to determine who is the primary principal and what is the purpose of the operation for the primary principal. When the intentions of the council with regard to the operation are not clearly specified or are defined too broadly, there is a danger than the agent will formulate her/his own mission, which may not necessarily be the one intended by the primary principal. There is also a risk that the agent may act defensively by performing what will be rewarded and measured. In such a case, an agent further down the chain of accountability may act in a manner incompatible with the best interests of the whole.

In our material, we can see tendencies toward such behaviour, where audit reports state that boards have consistently neglected to manage their operations within the budget limitations set by the council. In these cases the boards have probably judged that they can run their operations at a deficit and still get by. In our material, there is much to indicate that this judgment is correct, as the council very rarely denies
discharge from liability for failure to conduct operations according to the objectives and guidelines set by the council. For 2002, two boards were required to resign for such reasons, but in these cases the election had produced a new majority. That same year a local board of engineering was denied discharge, but at this time that board was abolished. Also, in 2003, discharge was denied to a board that ceased to exist, and in yet another case that year a board failed to observe the rules of delegation. Another reason could be that a board has formulated its own objectives or that the objectives of the council have been in focus but have been allowed to take precedence over the budget targets of the council. A more thorough study of the relationship between council and board is needed to verify hypotheses of this kind.

Controlling the agent

Basically, there are two alternative ways for a principal to control an agent. One is to invest in an information system to study the behaviour of the agent. The other is to reach a result-oriented agreement with the agent, i.e. to make the agent’s compensation dependent on the results of the operation. However, with a result-oriented contract, the cost of control to the principal may be very high. If the principal designs a system that does not affect the agent, and if the agent does something that the principal had not anticipated, a situation that could benefit both parties will not be achieved. Achieving that situation is often rendered more difficult by the fact that the agent has received the assignment because of her/his unique competence. Thus, the agent has knowledge that the principal lacks. Such a relationship leads to asymmetry of information that can allow the agent to deceive the principal. The principal must therefore design the system so that the common objective is fulfilled. In local government, this means that the council must take responsibility for providing clear objectives and guidelines for operations. If the council does not do this, there is a risk that the mission will be unclear and that the board itself or the executive board will take over the role of the council. In a relationship, costs of control arise because the parties do not have perfect information about each other – in other words, there is asymmetry of information (Rapp and Thorstensson, 1994).

If systems of internal control are lacking, and if the council does not formulate clear missions for boards and committees, both the costs of incentives and the costs of discrepancies are likely to increase. If the council does not assume its civic responsibility to formulate objectives and missions for boards and committees, some other body will take over this duty. The natural consequence will then be that the local government executive board, which lacks such a legal mandate, assumes the duty. Moreover, if the council “abdicates”, it will be difficult to impose accountability. Basically, it is essential that the mission is clear and that properly functioning control and management are present in local government, and that there are established procedures for follow-up and control of operations. The system of internal control should function both directly and indirectly as a signal to the principal concerning the behaviour of the agent. In municipalities and county council districts, the system of internal control should include procedures for attestation, rules for delegation, systems for reporting discrepancies, etc. According to the Local Government Act, the auditors have a duty to perform a special examination of the system of internal control.

Method

From the discussion so far, it is apparent that the complex system of accountability results in a lack of clarity that may create problems in the determination of accountability. One of the main reasons is that information can be concealed and that it
is often not clear who the principal really is. When the local government council neglects its responsibility to set clear objectives and missions for boards and committees, the determination of accountability becomes more difficult. This is also the case when council members have other loyalties to consider besides loyalty to the primary principal – the citizen.

We studied the determination of accountability in two cases, one from 2002 and one from 2003 (see also Nyman et al., 2005). The cases were chosen because they led to a recommendation by the auditors against granting discharge from liability, with the council in both cases following that recommendation. In Swedish municipalities, county council districts and regions, discharge for 2002 was denied in three different cases: one of these is our first case (a county council district). For 2003, discharge was also denied in three different cases, one of which is our second case (a municipality). We interviewed the council chairman, the chairman and vice chairman of the auditors at the time, and the chief auditor in the county council district. We interviewed the council chairman, one council vice chairman, the chairman and vice chairman of the auditors, and the chief auditor in the municipality. In addition, we read and analyzed minutes of meetings, memoranda, notes and other relevant documentation. Both cases involved an extended period, and thus relevant material covering a considerable time in the past was also studied for the purpose of providing an understanding of what had happened.

As a result of the case studies, we decided to conduct a broader study, where we read and analyzed “unclean” audit opinions for 2002 and 2003. We used information from the “accountability bank” of the Swedish Association of Local Authorities (Sveriges Kommuner och Landsting) on the internet (see www.skl.se/revision), where all “unclean” audit opinions are stored. An “unclean” audit opinion is one where the auditors present criticism and/or recommend denial of discharge from liability. When reviewing the “accountability bank”, we discovered additional cases that were not included in the bank. Thus, our empirical material is richer than the material in the “accountability bank”. However, since we have not read the audit reports for all 290 municipalities, 18 county council districts and two regions for the two years, we do not know whether we succeeded in capturing all “unclean” audit reports.

Our review is based on audit reports, other reports on audits conducted and on the minutes of council meetings. Good Auditing Practice, according to the Swedish Association of Local Authorities (Svenska Kommunförbundet, 2003) stipulates nine criteria[1] for recommending denial of discharge or for presenting criticism. We determined which criterion or criteria were used most often in 2002 and 2003. We also compared the boards/committees concerned, the outcome in the council, the role of civil servants and whether there was clear partisan political influence. Since the auditors have not always clearly indicated the criterion for recommending denial of discharge, we interpreted the text to permit classification.

Case studies[2]
In one larger mid-Swedish municipality, the council denied discharge for 2003 to the executive leadership of the arts and leisure board. The reason was that the board had decided on improvements for a public bathing facility and that the cost control for this project had been unsatisfactory. The auditors criticized the board for totally inadequate internal control and management control of this investment. The board had gone ahead with the investment during the year without any financing at all and in conflict with the strict standards of budgetary control set by the council. No reports were available from the purchasing representatives or the project manager. By
granting delegation to the chairman with no limitation on amount, the board had also violated the Local Government Act and the general rules of the municipality for its boards. Moreover, invoices had been attested after budgeted appropriations had already been used up. The executive leadership of the board was considered to bear a greater responsibility than the other members of the board since the former received annual compensation, which is associated with more extensive responsibility. The council was unanimous in denying discharge to the executive leadership of the board. In this case, the executive leadership can be considered to have violated the operating guidelines set by the council.

In the county council district, the council was denied discharge for 2002. In the council, the review on the question of accountability was the subject of a long and intense debate, and a divided council denied discharge. The reasons were the continually growing deficits and the passivity of the county council in regard to management control. These shortcomings were allowed to persist without any action being taken to remedy them, and the deficits grew. In the opinion of the auditors, the council’s preparation of budgets was not correct, as deficits were present from the outset and the equalization subsidy was reported separately. This increased the financial deficits and decreased the equity capital of the county council district. For several years the auditors had been criticizing the management control of the county council district, and the auditors unanimously recommended that discharge from liability be denied for 2002. The 2002 election gave the county council district a new political majority, and the departing board was not granted discharge for 2002.

“Unclean” audit opinions for 2002 and 2003

In 2002, the auditors’ opinion (see Table I) included criticism and/or recommended discharge from liability in at least 35 Swedish municipalities and county council districts/regions; in 2003, this was the case in at least 28 municipalities and county council districts. We examined and analyzed these cases more closely. It should be noted that auditors could present criticism and recommend denial of discharge for several boards/the executive board in the same municipality/county council district.

It should be noted in this connection that 2002 was an election year. Whether that situation affected the number of criticisms, or “cases”, is difficult to determine. It is clear, though, that the number of cases where the auditors recommended denial of discharge and the council followed the auditors’ recommendation was fairly constant in the two years. In all cases where the audit opinion was “unclean”, we closely examined the auditors’ reasons. Our purpose was to identify any weak links in the chain of accountability, to the extent that this was possible. We can see that in 2002 the election affected the outcome in two cases where discharge was an issue, with the new majority denying discharge to the old majority following the recommendation of the auditors in the audit report.

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Good Auditing Practice stipulates nine criteria (see the “Method” section) for denying discharge or providing criticism. In our study, we more closely examined which criterion or criteria were used, and how often, for 2002 and 2003. The most frequent reason for criticism was “Deficient management, follow-up and control”, but other criteria were also used, alone or in combination. The other criteria used were “Inadequate goal achievement, failure to observe the objectives and guidelines set by the council or in regulations”, “Previously criticized shortcomings”, “Damage to the public trust or other intangible injury”, “Unauthorized decision-making” and “Deficient accounting”.

We analyzed more closely those cases where the auditors recommended that the council deny discharge. The findings are shown in Table II, distributed by the criteria stipulated in Good Auditing Practice, by the board concerned, and by whether the objectives and guidelines of the council were followed. We note that in surprisingly many cases, the auditors indicated that the objectives and guidelines of the council had not been followed. However, the auditors did not always specify this shortcoming as a reason for their decision to recommend denial of discharge.

In those cases where the auditors chose to recommend denial of discharge, the objectives and guidelines of the council had not been followed in six cases in 2002 and in eight cases in 2003. For 2002, the council denied discharge to three boards: an engineering board that subsequently ceased to exist and two other boards (one executive board of a county council district and one executive board of a region). In the latter two cases, the departing board was denied discharge, and a change in political majority had occurred at the latest election. For 2003, discharge was denied for three boards:

1. one executive leadership of a board of arts and leisure;
2. one engineering board; and
3. one social welfare board.

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<td>11</td>
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<td>Inadequate goal achievement, failure to observe the objectives and guidelines set by the council or in regulations</td>
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<td>3</td>
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<td>Previously criticized shortcomings</td>
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<td>Deficient accounting</td>
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<td>Damage to the public trust or other intangible injury</td>
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<td>1</td>
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<th>Which board?</th>
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<td>Executive board of municipality, county council district or region</td>
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<td>Engineering, environment and service</td>
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</tr>
<tr>
<td>Child care, schools and education</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>Arts and leisure</td>
<td>0</td>
<td>2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Have the objectives and guidelines of the council been followed?</th>
<th>2002</th>
<th>2003</th>
</tr>
</thead>
<tbody>
<tr>
<td>No</td>
<td>36</td>
<td>23</td>
</tr>
</tbody>
</table>

Note: All cases in the study

Table II.
Boards for which auditors recommended denial of discharge, reasons for recommendation.
In two of these three cases, the actions of civil servants were considered in connection with the issue of accountability. In one case, the board was criticized for not having questioned the documentation provided by administrative staff to support the assessments and reports that had been made. In the other case, civil servants and elected officials had exceeded the delegation limits and guidelines set by the council.

From analysis of the complete material for the two years, it is clear that there is considerable debate in local government councils on decisions regarding discharge. In several cases, partisan political differences are quite apparent, while in other cases such differences have probably influenced decisions – i.e. council members have not voted against members of their own political party. A further reflection is that on the issue of accountability, council members may have decided to vote for discharge rather than against it on the ground that the mission was viewed as unclear.

Discussion

The ultimate purpose of the auditors in local government is to provide an annual review of accountability and an auditors’ opinion on discharge preparatory to the determination and decision by the council on that question (Sveriges Kommuner och Landsting, 2005). In local government, the auditors’ opinion usually recommends that discharge be granted, but in some cases the auditors present a critical opinion and/or recommend that the council deny discharge. Where there are problems with a board/committee, the auditors most often choose to criticize rather than recommend denial of discharge. A critical opinion is not subject to decision by any board/committee; the auditors themselves make the decision. Consequently, criticism arouses less turbulence and often has beneficial and intended effects. A recommendation that discharge be denied is usually made by the auditors when previous criticism has had no effect and the board/committee in question has obviously ignored the criticism. A government study (SOU 2004:107, 2004) has proposed that local government councils also take a position on criticism and that in the determination of accountability that the council states the reasons for any decision at variance with the auditors’ opinion on accountability. The aim of this stricter provision is to counteract any tendency toward partisan politics on the issue of accountability.

For the accounting year 2002, a number of audit groups chose to include in their audit opinion a recommendation against discharge, the reason being deficient control. In the case of the “county council district”, the council also followed the auditors’ recommendation in denying discharge to the county executive board. In cases where discharge is denied on the ground of deficient control, the consequences are unclear. Our empirical material suggests that it is politically difficult to deny discharge for reasons of an intangible nature, such as deficient control or management, or damage to the public trust. Decisions to deny discharge have also been based on other grounds. In two of the cases that we studied, the denial of discharge accompanied a change in political majority, and the issue was coloured by partisan politics. In other cases, the board had obviously not observed the guidelines and delegation rules of the council, with strongly negative effects on the finances of the board. Except for purely criminal cases, the decision on consequences is left to the council. According to chapter 5 of the Local Government Act, the council may decide to relieve elected or appointed persons of their assignment when discharge is denied. Such a step should be considered extremely drastic and has rarely been taken. Therefore, denial of discharge can also be a “black mark” on a person’s political career, an unfortunate consequence for the individual, but in some cases also for a political party as whole.
The system of accountability is complex
The complexity of the system of accountability makes it difficult to review and
determine accountability, and also to hold persons and governing bodies accountable.
In this article we have discussed the system and chains of accountability in municipal
and county government. We have also provided an overall picture of the relationship
between principal and agent. In the empirical study, we can see signs that the council
(the principal) has not had a clear view of objectives to guide boards and committees
(the agents). At the same time, auditors have cited failure to follow council decisions. In
several cases we have also seen indications that the objectives and guidelines set by the
council have not been observed. In the study, we have focused only on the mission and
role of the auditors, and on the traces of various views of objectives that they have
identified. Through study of the different views of mission objectives held by principal
and agent, it is possible to identify how the audit can focus its review as well as how
the system of signals can be designed.

Costs resulting from asymmetric information
Various costs can arise from asymmetric information owing to the complex nature of
the system of accountability. The costs that arise and that may even be transferred to
the citizens are a result of this complexity. If the budget is overrun because of deficient
control and follow-up of operations by a board, tax revenue is probably not being used
in a way that is effective and appropriate in the long run. This may mean that the
operation provided for the citizens is a good one in the short run, but that it will need to
be limited in the long run.

The audit can be viewed as a signal
If we regard the auditors’ review as a signal to the council, it must be clear and precise
if it is to be credible. In several cases, auditors have identified and criticized a board or
committee for a number of years before deciding to recommend denial of discharge.
The auditors are required to perform a balancing act between not being too hasty in
recommending denial of discharge, on the one hand, and not simply continuing to
criticize and possibly being ignored as boringly repetitive on the other. Yandell (1988)
has shown that an audit can be viewed as a signal to the principal, reducing the risk
that the principal will be deceived. This is only true, however, if the audit successfully
identifies undesirable behaviour by the agent or shortcomings in the system of
accountability. The signal from the auditors is based on their analysis of risk and
materiality, and on their assessments. Improvement in the planning phase, and
identification there of the weaknesses in the chain of accountability, is of central
importance if the auditors are to improve the transparency of operations and provide a
clear signal of weaknesses in the chain.

An audit conducted with and based on a good analysis of risk and materiality may
provide a clear signal to the principal, but this signal will be pointless if the principal
ignores the auditors’ assessment. It is therefore essential that the principal, i.e. the
council, gives the reviewing body due recognition and in case of an “unclean” opinion
decides in accordance with the auditors’ recommendation more frequently than today.
One possible reflection based on the empirical material is whether the current injection
of more politics into the review of accountability by the council may be due to the
observation that many council members occupy “more than one chair” and may
therefore be reluctant to decide against members of their own party. If a council
consists substantially of persons with accountability subject to review, the review
process will naturally be weakened. For this reason, the proposal in the government
study that the council state the reasons for any decisions inconsistent with the auditors' recommendations is a positive one. It will probably tend to strengthen the process of reviewing accountability.

Reviewing accountability on the basis of "soft" values
In our study we clearly see that when auditors have cited “soft” values, i.e. deficient management, control or follow-up, or damage to the public trust or other intangible injury, as reasons for recommending denial of discharge, councils have nevertheless chosen to grant discharge. On the other hand, when auditors have cited “hard” values as reasons to deny discharge, it is easier for councils to follow their recommendation. In the determination of accountability, there is thus a built-in conflict in denying discharge for shortcomings that cannot be calculated and confirmed quantitatively in some form. There may be several reasons for this, one being that it is politically impossible to deny discharge; another would be the fear that elected officials would be reluctant to accept a position where they would risk criticism for errors of judgment. Auditors and councils must therefore agree on the content and strength of the criteria used in the review of accountability. Moreover, persons whose accountability is examined need to know the criteria on which they are judged.

Conclusions
On the basis of our study, we have shown that neither better accounting systems nor better auditing methods will make it easier to determine accountability. The system of determining accountability is flawed in other, more fundamental respects. The unclear and complex system of accountability makes it hard to achieve radical improvement of auditing methods or resort to professional accountants as means of correcting the problem. Using the framework of PA theory has facilitated the analysis of the chain of accountability. The theory has proved so useful that in our opinion it will be more frequently employed in analyzing local government auditing in the future. In our view, our study and its conclusions are also applicable, in appropriate parts, to the business world. In multinational firms, there is complexity similar to what we have studied in local government. The advantage of studying the phenomenon in Swedish local government, rather than in large companies, is that in local government the Swedish principle of free access to information makes it possible to obtain all necessary information in an organization. The broader scope of the mission of appointed auditors in local government, compared to that of certified accountants, also makes it possible to study the audit review and determination of accountability on the basis of “soft” values.

Notes
1. These nine criteria are: “Inadequate goal achievement, failure to observe the objectives and guidelines set by the council or in regulations”, “Deficient management, follow-up and control”, “Damage to the public trust or other intangible injury”, “Financial injury”, “Unauthorized decision-making”, “Operations not conforming to law, criminal conduct”, “Insufficient preparation of decisions”, “Deficient accounting” and “Previously criticized shortcomings”.

2. The material is based on a previous study by the authors (see Nyman et al., 2005).
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Svenska Kommunförbundet (2003), God revisionssed i kommunal verksamhet 2002 (Generally Accepted Auditing Standards), Ordföräradet AB, Stockholm.


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