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**ACCOUNTING REGULATION AS AN
INSTRUMENT OF PUBLIC ACCOUNTABILITY:
A CASE STUDY OF NEW ZEALAND**

A thesis presented in partial
fulfilment of the requirements
for the degree of

Doctor of Philosophy
in
Accountancy

at Massey University

Gregory Dean Tower

1991

ERRATA SHEET

P. 46 [Add sentence to the very bottom of the fifth paragraph]

"It is noted, however, that losses could not be sustained indefinitely by a corporation."

P. 111 [Add sentence directly after the second sentence to the third paragraph]

"The participation rates are similar, albeit slightly lower, to the experience in other Anglo-American countries (see for example Redding & Miller, 1986)."

P. 141 [Add sentence directly after the third sentence to the fourth paragraph]

"Certain preparers may argue that from a narrower perspective corporate reports (or their intended readability) are not intended for non-sophisticated stakeholders."

P. 152 [Add sentence directly after the first sentence to the second paragraph]

"One useful proposal could be the mandated use of required insurance cover which would give aggrieved parties the assurance of some compensation if their case is proven."

P. 154 [Add sentence to the very bottom of the first paragraph]

"The thrust of the study remains on the private sector (Section 1.4.2) with public sector initiatives discussed as an influencing agent upon accounting regulatory arrangements. Universities are examined merely to provide an example of the application of explicit accountability tenets upon a sector."

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ABSTRACT

This thesis highlights the importance and privileges of corporations with the obligation to provide information to society about their activities. The primary reporting vehicle is seen to be the annual report with accounting regulation viewed as a significant quality control device. It is postulated that New Zealand accounting self-regulation has failed in delivering the latter protection. By way of providing a background to the discussion the Anglo-American accounting regulatory systems are critiqued and found inadequate. Special concerns are noted with the accounting standard setting due process procedures and enforcement mechanisms. Linkage of the New Zealand accounting system to the Anglo-American cluster is shown through various international classification studies.

Financial accounting paradigms are analysed with a view to determining the end-purpose of corporate reporting. It is concluded that the accountability paradigm is most closely aligned with a broad societal view of accounting. A Public Accountability Model of Accounting Regulation is evolved. The Model is based on efficiency and equity criteria, and emphasises the responsibility of preparers to communicate adequate financial and non-financial information to stakeholders.

The New Zealand accounting regulatory structures are empirically examined as a case study, with the New Zealand Society of Accountants, domestic and overseas systems compared. It is shown that the NZSA, overseas bodies (especially the British and International Accounting Standards Committee), and preparers exert the most influence, with non-accountant stakeholders shown to have the least impact. The regulatory mechanism under the Model incorporates the profession's expertise, stakeholder representation, and the coercive power of the state.

New Zealand corporate reports are found to be: difficult to read, lacking sufficient disclosure data, and imparting very little non-financial information. It is shown that these inadequacies are due mainly to the absence of a capital market overseer, critical lack of stakeholder input, lack of explicit objectives and ineffective enforcement mechanisms. External crises such as the 1987 sharemarket crash, company failures and publicised lack of compliance/enforcement have generated abundant public pressure leading to several governmental reviews. These reviews are deemed incomplete and unlikely to meet societal expectations.

The research provides insights into accounting regulation and its relationship with corporate reporting in New Zealand. It is recommended that more effective regulation be introduced to ensure greater disclosure, recognition of stakeholder needs, and a higher level of non-financial data. It is argued that the proposed Model would help increase stakeholder confidence in corporate reports as it is designed to address the issues of the under-production of accounting information and information asymmetry.

To my wife **Julie**
for her encouragement, love and support

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LIST OF ABBREVIATIONS

AAA	American Accounting Association
AASB	Australian Accounting Standards Board
AC	Auditing Committee (NZSA)
AcSC	Accounting Standards Committee (Canada)
AICPA	American Institute of Certified Public Accountants
APB	Accounting Principles Board (US, superseded)
ARSB	Accounting Research and Standards Board (NZSA)
ASAC	Accounting Standards Authority of Canada
ASB	Accounting Standards Board (UK; NZ, proposed)
ASC	Accounting Standards Committee (UK, superseded)
ASCPA	Australian Society of Certified Practicing Accountants
ASRB	Accounting Standards Review Board (AUS, superseded; NZ, proposed)
ASSC	Accounting Standards Steering Committee (UK, superseded)
CER	Closer Economic Relations (NZ:AUS)
CCA	Current Cost Accounting
CCGA	Canadian Certified General Accountants
CICA	Canadian Institute of Chartered Accountants
EC	European Community
FAC	Financial Accounting Committee (NZSA)
FAF	Financial Accounting Foundation (US)
FASB	Financial Accounting Standards Board (US)
FERF	Financial Executives' Research Foundation (US)
GAAP	Generally Accepted Accounting Practices
GAAT	General Agreement on Tariffs and Trade

GEISAR	Group of Experts on International Standards of Accounting and Reporting (UN)
GST	Goods and Services Tax (NZ)
IASC	International Accounting Standards Committee
ICAA	Institute of Chartered Accountants in Australia
ICAEW	Institute of Chartered Accountants in England and Wales
ICAS	Institute of Chartered Accountants in Scotland
IFAC	International Federation of Accountants
IOSCO	International Organization of Securities Commissions
IRD	Inland Revenue Department (NZ)
MNC	Multinational Corporations
NAFTA	New Zealand/Australia Free Trade Agreement (superseded)
NZLC	New Zealand Law Commission
NZSA	New Zealand Society of Accountants
NZSC	New Zealand Securities Commission (proposed)
NZSE	New Zealand Stock Exchange
OECD	Organisation for Economic Co-operation and Development
OSC	Ontario Securities Commission (CAN)
RC	Russell Committee (NZ)
SEC	Securities and Exchange Commission (US)
SC	Securities Commission (NZ)
SMA	Society of Management Accountants (CAN)
SOATTA	Statement of Accounting Theory and Theory Acceptance
SSAP	Statements of Standard Accounting Practice (NZ)
UN	United Nations

Unfortunately, the financial community's self regulation scenario developed into a mobocracy [sic] which was supported by uncontrolled creative accounting. Investor confidence will remain heavily 'chilled' while the establishment complicate and hinder progressive reforms, and cling to their own self style tribal witch doctoring.

Quote from disgruntled small New Zealand investors (Kincaid & Kincaid, 1988, p.1).

CHAPTER ONE: OVERVIEW OF THE RESEARCH PROJECT

1.1 INTRODUCTION

Corporations¹ are a massive economic force in New Zealand as in many other Western capitalist economies. They affect the society through the provision of employment opportunities and goods and services, and their impact upon the natural environment. Further, their policies influence a nation's balance of payments, rate of inflation, exchange rate and standard of living. To improve societal wellbeing, by increasing the possibility of the provision of investment capital, corporations are granted the privilege of limited liability. This dispensation, providing investor protection, has greatly encouraged the flow of funds into this form of business entity. It allows corporations to grow and acquire huge levels of resources. Their privilege to do so is accompanied by certain obligations (Gray, Owen & Maunders, 1987). This thesis focuses on the need of corporations to report back to society on their activities.

Corporate reports should not be viewed in isolation. Presently, New Zealand companies report to certain accountee groups under the regime of the Companies Act 1955. This Act is unquestionably out-of-date and incapable of monitoring business practices in the 1990s (Hickey, 1989, p.37). Due to the inadequacies of current law, greater expectations are placed on the New Zealand Society of Accountants' (NZSA) rules to ensure an adequate level of communication between corporations and the rest of society. Traditionally, annual reports largely emphasise financial activities of the entity and are thus strongly influenced by accounting procedures. The NZSA, the primary accounting rule-making body in New Zealand, provides supervision on accounting procedures. The NZSA's promulgations are known as Statements of Standard Accounting Practice (SSAPs). These SSAPs fill many of the gaps which exist in current law. However, the quality of accounting pronouncements and the present communication level of corporate reports are shown in this thesis to be deficient.

Within the accounting literature many criticisms are being voiced about corporate reports, regulation, and the accounting profession. Major concerns are expressed about due process, adequacy of regulation, equitable treatment, professionalism and

1. The terms 'corporations' and 'companies' are used synonymously in this thesis. The concept will refer to entities listed on a stock exchange unless specifically excepted.

the low level of communication contained within corporate reports (see for example Eglinton (1988), Hines (1989a), Lev (1988), Tinker (1985), and Zeff (1987,1988)). As the following quotations illustrate the accounting profession in New Zealand is amidst a perceived crisis.

... in the face of recent events, responsible business organisations are supporting and even demanding a greater degree of legal regulation of suspect business practices...A number of these [companies] have later collapsed with unfortunate consequences for thousands of New Zealanders (Report of the Department of Justice, 1977, pp.21-22).

If we do not get our professional house into proper order by our own efforts, Government will have no option but to yield to the pressure of public complaint... [written by a retiring branch chairman of the NZSA] (Pitcaithly, 1980, p.8).

The New Zealand Society of Accountants ... do not have active programmes for reviewing compliance with accounting standards (Craig, 1986, p.12).

Listed companies often flout the Listing Requirements regarding timely and adequate disclosure; accounts are often inadequately prepared; prospectuses often disclose little and are inadequately policed; accountants often fail in their responsibilities as auditors... (Farrar, 1988, p.5).

The New Zealand Stock Exchange has suffered the catastrophic loss of confidence of the investing public since the October 1987 crash...The essential problems have arisen because of a piecemeal approach by professional bodies and Parliament to the question of regulating capital markets...the large part of the investing public's disillusion with the Stock Exchange in the wake of the crash is due to a distrust of the market participants and an apparent lack of accountability... (Grove, Darlow & Partners, 1988, pp.1,3,4).

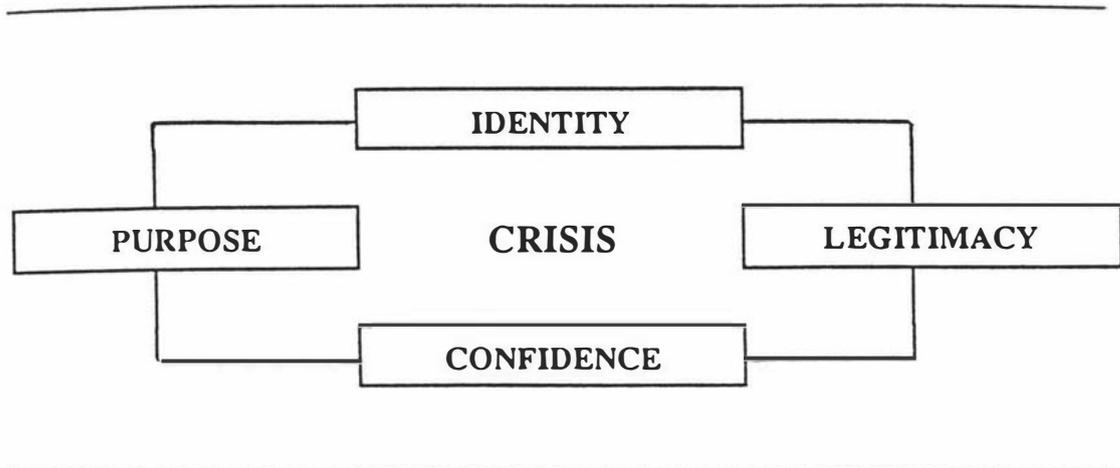
Lion's \$143m blunder revealed.... Pacific Sun accounting questioned.... Corporate Investments Ltd has gone against accepted accounting practice.... Strada again shows unusual accounting.... Terrace Project understated its \$915,000 annual net loss by \$131,000 by not following standard accounting practice (Porter, 1991a, p.1).

Truth: That the Society's Accounting Standards proved to be ineffectual in preventing faulty accounting practices (Hays, President of the NZSA, 1991c, p.6).

The state of corporate reporting referred to above can only be described as a crisis which signifies the inability of the accounting profession to supply efficient and equitable information through self-regulation. Figure 1.1 displays the features of the

crisis faced by the accounting profession and relates it to their purpose, identity, confidence and legitimacy.

FIGURE 1.1 ACCOUNTING: A PROFESSION IN CRISIS



This thesis will provide evidence documenting the crisis in accounting, critique the present accounting standard setting structure and offer an improved alternative model of accounting regulation from a New Zealand perspective.

1.2 AIMS AND OBJECTIVES OF THE RESEARCH PROJECT

It is noted that within New Zealand accountants face serious criticism as a result of failing to meet society's expectations. Major concerns are observed in the nature of corporate information currently disseminated and the ability of the regulators, especially the NZSA, to control and monitor the process.

With this background, the main aim of this research is to offer suggestions for improvement with the New Zealand accounting regulatory mechanisms and corporate reporting.

To facilitate achievement of this aim the research has the following specific objectives:

- 1) critique Anglo-American accounting regulatory mechanisms;
- 2) undertake literature-based research to develop a normative model of regulation based on accountability tenets and public interest theories of regulation;
- 3) evaluate the NZSA's accounting rule-making process;

- 4) scrutinise other domestic institutions to assess their impact upon New Zealand accounting regulation;
- 5) determine the extent of overseas influence on New Zealand accounting rules;
- 6) critique important proposals for reform in the area of company and securities law;
- 7) assess the present accounting regulatory system in relation to the alternative model of regulation; and
- 8) offer recommendations for improving accounting regulation and corporate reporting in line with the spirit of the true and fair view doctrine.

1.3 RESEARCH METHODOLOGY

The research is conducted in two phases:

- 1) a deductive literature-based analysis;
- 2) an empirical study using multiple research techniques.

1.3.1 Literature-based study

The relevant literature is reviewed in the areas of financial accounting paradigms, regulation theories, accountability concepts, accounting standard setting and other environmental, historical, political and economic issues.

The literature is primarily derived from dissertations, reports of various domestic and overseas committees set up by professional bodies, refereed journal articles, books, professional promulgations, other journal articles and conference papers. The literature is identified from the following sources:

- 1) online and CD-ROM database searches;
- 2) manual search of accounting-based indices and theses through PhD dissertation abstracts;
- 3) footnotes and references cited in financial accounting, regulation, political and economic literature.

Approximately 1200 refereed and professional articles, books, dissertations and reports are identified as worthy of closer scrutiny. These pieces are examined and critiqued for information content, rigour and applicability.

The literature-based research leads to: a) a structured examination of Anglo-American accounting regulatory arrangements (Chapter Two), b) an in-depth analysis on seminal works in financial accounting paradigms and regulation theories (Chapters Three and Four), and c) the deductive development of the Public Accountability Model of Accounting Regulation (Chapter Five).

1.3.2 Empirical research

The second part of the study is empirical in nature. Research is conducted on the various institutions that potentially affect the accounting standard setting process in New Zealand (Chapters Six-Ten). Finally, an evaluation of the current and anticipated accounting regulatory mechanisms is conducted in relation to the derived Model (Chapter Eleven).

A case study of the New Zealand accounting regulatory environment is offered. Three primary research methods are employed to provide evidence.

Institutional/environmental evaluation is applied to determine the role of various participants in the New Zealand accounting environment. Historical analysis supplements this approach by showing traditional trends and the changing patterns of interest group influence over time. These approaches help to set the stage and parameters for the project. Interviews are conducted with key personnel of the primary accounting regulation bodies in New Zealand (i.e. New Zealand Society of Accountants, New Zealand Stock Exchange, Securities Commission and the Registrar of Companies).

Regulatory events studies are then conducted on specific standards and activities to provided more definitive insights. For example, funding arrangements, respondent submissions, political and environmental variables are studied along with archival information such as news media reports, and NZSA documents and promulgations. Within a case study, a multiple approach to evidence gathering can improve the validity of the data (McKinnon, 1988, p.45; Ratcliff, 1989, p.10).

1.4 PROJECT CONSTRAINTS

Three major constraints need to be noted with the project. First, are the scope limitations of the project. Second, are the assumptions made in this thesis. Third, are problems with the lack of publicly available evidence, especially about the NZSA standard setting process.

1.4.1 Scope of project

The examination of accounting regulation within the New Zealand business environment is a dynamic process. A myriad of important changes to the present system are now under review. Especially problematic are the initiatives which have yet to be published or enacted which may affect New Zealand accounting regulatory structures in the near future. To complete this project in a timely fashion, an end cut-off date is needed. For the vast majority of the empirical work 31 March 1991 is viewed as the end of the study period. The literature component and updates on future proposals contains material through 31 August 1991.

1.4.2 Assumptions contained in the project

It is assumed in this thesis that accounting regulation, based on a broad societal viewpoint of corporate communication, offers net benefits. Consistent with historical patterns in New Zealand, accounting regulation is perceived as providing a positive influence upon corporate reporting. This is one of the most important continuing rationales advanced by the NZSA for the issuance of accounting standards. It is inferred that the broad needs of stakeholders should be considered when evaluating reporting practices of corporations and the societal impact of accounting regulation. This view can be defended when the overwhelming economic and social impact that companies have upon New Zealand is recognised.

Other limitations of the project relate to assumptions about the primary importance of: listed companies, the concentration on the annual report vehicle, and Anglo-American initiatives. An important focus of the project is on corporate annual reports because of their traditional importance as the primary communication device for companies. Other information sources such as interim reports, press releases, sharemarket price data, and so forth, although important, are seen as secondary and are not examined in-depth.

Companies are the primary focus of the study, especially those listed on the New Zealand Stock Exchange. Other economic entities such as non-public issuers, partnerships, joint ventures, charitable trust, proprietorships, and so forth are not examined in detail. This emphasis is in keeping with all the major Ministerial Reviews and is based on the enormous economic impact listed companies have upon the New Zealand social and business environment.

Another focus of this project is the emphasis on the private sector because of their historically large influence upon the New Zealand business environment and

populace. Whilst public sector initiatives are examined with regard to their impact on the private sector it should be noted that the thrust of the study remains on listed companies.

Finally, the accounting regulatory structures are viewed through Anglo-American lenses. Alternative regulatory mechanisms such as the Dutch Enterprise Court, French General Accounting Plan or German Companies Law are not heavily investigated. This position is justified because of the long historical association of New Zealand business enterprises with Britain and her colonies. It is felt that radical departures from Anglo-American regulatory norms are unlikely to be accepted in New Zealand.

1.4.3 Unavailability of certain forms of evidence

A traditional weakness of studies about accounting regulatory mechanisms is the lack of visible evidence. The New Zealand Society of Accountants, as the primary rule-making body in New Zealand, is no exception. The NZSA's accounting standard setting process is very private. The NZSA has a policy of not publicly disclosing minutes of meetings nor do they publish voting patterns of board members. The problem of data unavailability concerning the primary domestic accounting rule-making body and any other important regulatory initiatives is largely overcome by the multiple analytical approach discussed in Section 1.3.

1.5 OUTLINE OF THE THESIS

The thesis is presented in twelve chapters as follows:

- Chapter One*** **Overview of the research project.**
- Chapter Two*** **Critique of the Anglo-American approaches to accounting regulation:** Numerous classification studies categorise the New Zealand accounting system within the Anglo-American cluster. The various Anglo-American processes of accounting regulation are examined. Similarities, unique features and flaws of the present structures are identified.
- Chapter Three*** **An analysis of financial accounting paradigms:** The end purpose of corporate reports is studied through an assessment of financial accounting paradigms. The accountability perspective

is considered to be the most appropriate in explaining the function of corporate reports from a societal viewpoint.

- Chapter Four*** **An evaluation of regulation theories:** Various theories of regulation are evaluated. It is concluded that public interest theories are closely affiliated with accountability tenets. Regulation is seen to help in ameliorating both the under-production of corporate data and information asymmetry.
- Chapter Five*** **Public Accountability Model of Accounting Regulation:** A Public Accountability Model of Accounting Regulation is presented as a superior alternative. This normative Model is based on accountability principles. Preparer preferences are moderated by public accountability tenets with accounting regulation advocated as an instrument for achieving adequate communication of corporate reports.
- Chapter Six*** **A historical analysis of the New Zealand Society of Accountants:** The NZSA, as the primary rule-making body in New Zealand, is carefully scrutinised. The profession is found to be well meaning but does not have explicit objectives, generates ambiguous regulation, and its accounting standards are shown to be ineffective.
- Chapter Seven*** **An examination of the New Zealand Society of Accountants' standard setting process:** The NZSA's accounting regulatory arrangements are critiqued. Flaws are highlighted such as the absence of an outside vetting mechanism, deficiencies of enforcement and problems with due process and design.
- Chapter Eight*** **A review of the domestic influences upon the accounting regulatory mechanisms:** Important domestic institutions that influence the NZSA are examined. It is concluded that a complex set of interactions and influences from these groups affect the NZSA's standard setting process. Preparers are shown to have a large impact, whilst non-accountant stakeholder groups are found to have minimal influence.

- Chapter Nine* **Conflicts with law and the business environment:** Weaknesses in the present New Zealand legal and monitoring structures are presented and the growing perception of a crisis in accounting regulation is highlighted. Ministerial Review suggestions are critiqued with the conclusion that the proposed changes offer notable improvements, but several important issues continue to be ignored.
- Chapter Ten* **Overseas influences on New Zealand accounting:** The NZSA's historical trend of influence by overseas institutions is examined. The British rule-making bodies, other Anglo-American accounting standard setters and the International Accounting Standards Committee (IASC) are shown to have exerted a significant impact on the New Zealand accounting regulatory processes.
- Chapter Eleven* **Application of the proposed Model:** The Model, developed in Chapter Five, is contrasted to the current and anticipated present accounting rule-making structures in New Zealand. It is demonstrated that from a public accountability viewpoint the current regulatory system is inadequate.
- Chapter Twelve* **Accounting regulation as an instrument of public accountability:** The research project is summarised. Empirical evidence is reviewed showing the weaknesses in New Zealand's present accounting regulatory system. The crisis in accounting and failure of self-regulation is highlighted with causal explanations offered such as: the absence of stakeholder representation, market inequities, lack of enforcement, and ineffective accounting regulatory mechanisms. It is argued that the Public Accountability Model of Accounting Regulation is a superior model in that it specifically encompasses a broad societal view which emphasises the responsibility of companies to communicate information about their activities. Finally, the contribution of the research study is assessed and potential future research projects are identified.

1.6 SUMMARY

In this chapter concerns about the New Zealand accounting regulatory mechanisms are examined. The failure of self-regulation is postulated with the view that the problems arise from the inadequacy of present structures to meet the expectations of society. The stated purpose of the project is to offer suggestions for improvement by analysing current New Zealand and Anglo-American accounting regulatory structures. The discussed research methodology incorporates both a literature-based and empirical component. The chapter concludes with an overview of the thesis.

CHAPTER TWO: CRITIQUE OF ANGLO-AMERICAN APPROACHES TO ACCOUNTING REGULATION

2.1 INTRODUCTION

Information presented in corporate reports¹ is an important input for establishing and maintaining roles between an enterprise, citizens and the state (Puxty, Willmott, Cooper & Lowe, 1987, p.283). It helps form perceptions between business enterprises and society (Hines, 1988, p.253). The consequences of corporate reporting evolve from society's reactions and perceptions towards businesses. This is partially based on the generation of financial and non-financial information (Gray, Owen & Maunders, 1987, p.75). Superior communication could be seen as providing a benefit to the society as a whole (Stonier, 1984, p.193). Societal decisions, influenced by these reports, can directly impact wealth redistributions among its citizens (Zeff, 1979, pp.300-302). This is due in part to the phenomenon that financial accounting data creates a reality which shapes accountee group's responses to the enterprise (Hines, 1988, p.257).

2.2 THE REPORTING ENVIRONMENT

The annual corporate report is only one of many available sources of information about the performance and position of a business enterprise. Data relating to business enterprises has various origins: press releases, interim reports, prospectuses, future economic projections for the country, industry forecasts, inflation, unemployment trends, interest rates, exchange rates, balance of payments, changing consumer preferences, and so forth. Indeed, annual reports are not necessarily the most influential source for professional and individual investors (Financial Executives' Research Foundation (FERF), 1987, p.4). The provision of financial statements, however, is considered one of the more important sources of information for the capital markets (Chambers, 1976, p.85) probably because of their ready accessibility and wide coverage (FERF, 1987, p.5).

1. The term 'corporate reporting' is used in this thesis to describe the provision of information deemed necessary to society. Financial statements are thus considered an information subset of corporate reports. One of the premises of this thesis is that better communication, both financial and non-financial in nature, is needed to fulfil public accountability criterion.

The supply of corporate information is in the hands of managers and directors². The demand for this intelligence, however, is generated by many diverse groups within society³ possessing heterogeneous needs (Gray et al., 1987, p.81). The preferences and objectives of the producers of corporate information may well be very different from those of accountee groups; this can create a conflict and a knowledge gap between the nature of information supplied by the providers and what is deemed necessary by the accountee groups (Cooper & Keim, 1983, p.190).

2.2.1 Culture

The business world is rapidly becoming one global community with almost instantaneous telecommunications, movement and growing co-ordination between national equity markets, relative ease of purchasing foreign debt instruments and the rise of the multinationals. Choi & Mueller (1984, p.3) note the ability of these international relationships to grow effectively is hampered by the inability to compare and understand nation-specific business information. The difficulty stems partly through cultural diversity between countries (Choi, et al., 1983, p.126) and partly because of the generation of differing accounting information (Gray, 1980, p.70).

Each society has a unique culture which will influence the business climate and accounting is a product of the environment in which it operates (Enthoven, 1985, chap. 4). Culture is defined by Perera (1985) as "the distinctive way of life for a group of individuals" (p.24). Reporting and accounting disclosure systems are considered a direct product of a country's culture and environment (Belkaoui, 1985, p.49; Gaertner & Rueschhoff, 1980, p.36).

The specific features of the New Zealand accounting and business environment are discussed in Chapters Six-Nine. The impact of overseas initiatives upon New Zealand accounting systems is examined below and then explored in more depth in Chapter Ten.

2.2.2 Accounting classification systems

A discussion of the New Zealand business environment is incomplete without an examination of the historical and cultural links with other nations, international bodies, and regional ties. The development of New Zealand's accounting system can

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2. The news media and regulatory bodies also have an impact on the amount of information provided (Rahman, 1988, p.131; Watts, 1977, p.67).
 3. These different groups will be referred to in this chapter as 'accountees' instead of the somewhat narrow 'user' term. Usage of the more precise term 'stakeholders' is advocated in Section 3.5.1 to define those parties with a legitimate right to corporate reporting data.

be better understood by examining these global influences. One prominent analytical method is to classify countries into zones of influence (Choi & Mueller, 1984, chap. 2; Enthoven, 1980, p.76).

Two methodologies for comparisons of a country's accounting practices have evolved; one uses an indirect approach by studying environmental⁴ variables of countries, while the other utilises a direct study of the nation's accounting practices. These studies cluster countries into groups based on the closeness of fit of accounting practices. Use of country classifications has its limitations since they take a static view of any country's accounting system and thus ignore dynamic changes (Samuels & Piper, 1985, p.46).

Both the indirect and direct classification systems have reached the same general conclusions about New Zealand accounting practices. These studies link the accounting environment of New Zealand to the British model (see Table 2.1 and Figure 2.1).

Graham (1960, p.96) and Zeff (1979, p.76) argued that the single greatest impact to New Zealand's accounting practices was British practice initiatives. The above tables confirm this linkage. Table 2.1 shows that all of the listed studies classify New Zealand within the British cluster and Australia in the same group. Mixed support was exhibited for the linkage of New Zealand to a North American cluster. However, as shown in Figure 2.1 the American and British clusters are derived from similar business practices. Moreover, Porter (1991a, p.9) and the NZSA (1984, chap. 5) cite the American and Canadian standard setting bodies as also demonstrating significant influence upon the New Zealand accounting environment. Consequently, the Anglo-American accounting regulatory mechanisms are examined in the following section to garner insights for the New Zealand accounting environment, particularly to help the understanding of its past, present and probable future trends.

4. Most & Salter (1990, p.2) offers a useful review of these studies and argues that comparisons should initially concentrate on the legal systems of the countries.

TABLE 2.1 NATION-SPECIFIC ACCOUNTING CLASSIFICATIONS SYSTEMS

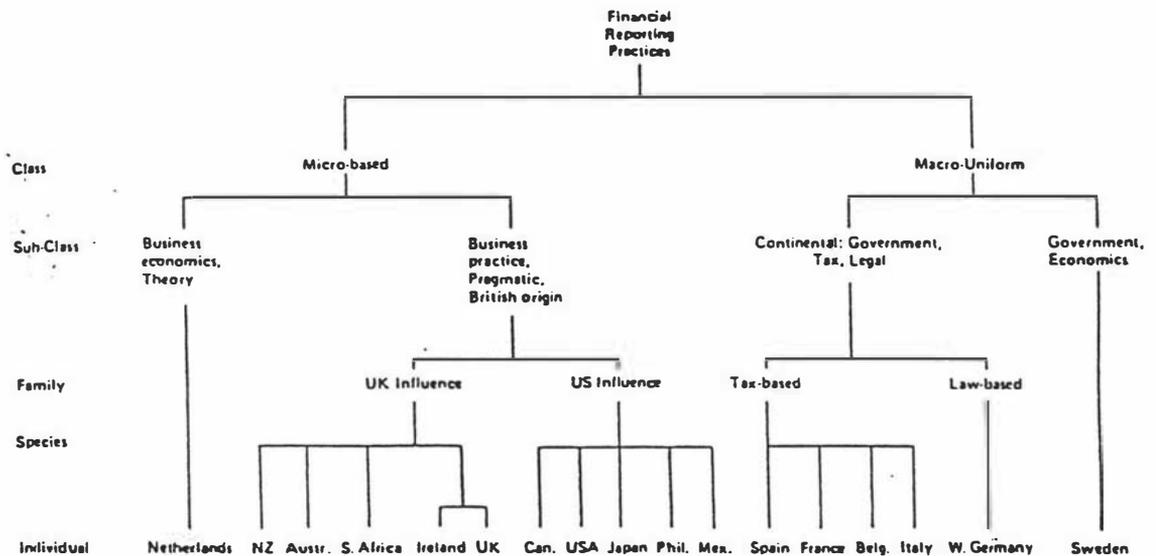
<u>Authors</u>	<u>Year</u>	<u>Methodology</u>	<u># of Zones</u>	Anglo-American countries in same group as New Zealand			
				<u>A</u>	<u>C</u>	<u>UK</u>	<u>USA</u>
Mueller	1967	Indirect	4	Y	Y	Y	Y
Seidler	1967	Indirect	3	Y	N	Y	N
Mueller	1968	Indirect	10	Y	N	Y	N
Abu-Jbarah	1972	Indirect	8	Y	Y	Y	U
American Accounting Association	1977b	Indirect	5	Y	U	Y	N
Watt, Hammer & Burge	1977	Direct	4	Y	Y	Y	U
DaCosta, Bourgeois, & Lawson	1978	Direct	3	Y	N	Y	N
Frank	1979	Direct	4	Y	N	Y	N
Nair & Frank	1980	Direct	4-7	Y	N	Y	N
Nobes & Parker	1981	Direct	6	Y	N	Y	N
Nobes	1984	Indirect	6	Y	N	Y	N
Ainajjar	1986	Indirect	4	Y	Y	Y	Y
Amenkhienan	1986	Indirect	3	Y	Y	Y	Y

Note: I=Indirect approach (ie using environmental and political variables),
D=Direct approach (ie using accounting practice information).

A=Australia,
C=Canada,
UK=United Kingdom,
USA=United States.

Y=Yes,
N=No,
U=Unclear or not applicable.

FIGURE 2.1 NOBES' (1984) ACCOUNTING CLASSIFICATION SYSTEM



Source: Nobes (1984, p.94).

2.3 ANGLO-AMERICAN ACCOUNTING REGULATORY MECHANISMS

The New Zealand accounting standard setting body has historically given strong consideration to the direction of Anglo-American regulatory agencies when determining their structure, agenda and specific rules. Accounting rule-making in Anglo-American countries is generally a blend of minimal legislative requirements supplemented by specific measurement and disclosure standards (Zeff, 1988, p.20).

These nations typically have highly developed capital markets and the financial accounting rules are for the most part divorced from tax law (Choi & Mueller, 1984, chap.3). The accounting environment in these countries often allows the accountant considerable latitude of professional judgement and consequently the accounting profession tends to have a high profile (Peirson, 1990b, pp.30-33).

Each of the countries examined below uses some form of accounting regulation to encourage the level of corporate reporting data deemed necessary (Zeff, 1987,1988). One of the most striking features is the wide range of regulatory structures adopted by these national bodies.

2.3.1 America

In America, before 1974, the regulatory mechanism was controlled by the accounting profession (Hussein & Ketz, 1991, pp.71-72; Moonitz, 1968, p.625). The accounting standard setting function was delegated by a government agency, the Securities and Exchange Commission (SEC), to the profession by a three to two vote in 1938 (Briloff, 1986, p.28). From 1938-1959, the Committee of Accounting Procedure of the American Institute of Accountants (the predecessor of the American Institute of Certified Public Accountants (AICPA)) was the standard setting body (Miller & Redding, 1986, p.47). In the time period 1958-1973, the Accounting Principles Board (APB), a committee within the AICPA, controlled the standard setting process (Gellein, 1986, pp.7-8).

Due to increasing public pressure⁵ major changes in the system of generating accounting standards have occurred. These changes can be linked to crises arising within the accounting environment such as company failures, shareholder lawsuits and concerns of collusion (Briloff, 1978, p.23; Stamp, 1979, pp.25-27). Largely based on the Wheat Committee report, a new rule making body was established in 1974 known as the Financial Accounting Standards Board (FASB). The present FASB configuration is unique; the board members are full-time, fully remunerated and are expected to sever past allegiances (Miller & Redding, 1986, chap.2). The FASB initiated a conceptual framework project to establish a set of specific guidelines in a comprehensive manner (for a summary see Solomons, 1986, chap.4).

The accounting standards issued by the FASB are numerous and detailed in nature, perhaps reflecting the litigious nature of the American culture (Carty, 1982, p.2). The fear of lawsuits may well serve as a strong restraint on companies' departures from accounting standards (Briloff, 1986, p.33). For example, Zeff (1988, p.20) feels that the burden of justifying departures from the FASB statements falls heavily on the auditor especially in court proceedings.

Ensuring compliance with the evolved rules is considered an important role of the American accounting profession (Zeff, 1988, p.20). For instance, professional self-regulation via AICPA Ethics Rule 203 stated that members must interpret generally accepted accounting principles by reference to pronouncements issued by designated standard setting bodies. Cohen & Turner (1990, p.42) further note that the AICPA Code of Professional Conduct has recently been extended to encompass both public

5. For example, both the Moss Committee and Metcalf Committee expressed their open criticisms of the American accounting profession (Mathews & Perera, 1991, p.103).

and company accountants. However, membership in the primary professional society, the AICPA, is voluntary.

America has no federal company law as such, instead it relies upon the 1933 and 1934 Securities Acts⁶. Consequently, government regulation of financial reporting for listed companies is primarily a function of the SEC which has exerted tremendous influence over the establishment of accounting standards (AlHashim, 1980, p.59). Under Section 19 (a) of the Securities Act of 1933 the SEC can standardise accounting terminology, accounting measurement and accounting reporting. One major weapon in their repertoire is the robust registration rules which can force listed companies to remake financial statements upon audit qualification or face delisting (Walker, 1985, p.1).

Hornigren (1973, p.62) described the American regulatory structure as a vertical system⁷ with Congress monitoring the SEC which oversees the APB (and now the FASB). An advantage of this system of delegated responsibility for the Congress and SEC is that the FASB becomes the focal point for discontent (Hussein & Ketz, 1991, p.75).

America has established several important elements in their accounting regulatory mechanisms. The SEC's legal backing has been effectively delegated to the FASB. The FASB is an organisation seeking to be independent of any special interest group. The American standard setting process is designed to encourage broad participation with the FASB first issuing a discussion memorandum, then an exposure draft and at times holding public hearings (Bloom & Naciri, 1989, p.72). The votes of the Board members are published along with dissenting opinions. FASB's approach to standard setting is thus seen to be relatively open and participatory in nature.

2.3.2 Canada

Many of the Canadian accounting rules are similar to the American promulgations (Buchanan, 1988, p.40). The Canadians have twice considered their perception of the objectives of financial statements. The evolution of financial reporting has developed within the framework of both the British and American influence (Murphy, 1986, p.31). In 1980, the Canadian Institute of Chartered Accountants (CICA), following

6. The stock market crash of 1929 directly resulted in the Securities Acts of the early thirties (Gellein, 1986, p.5).

7. An example of this hierarchy would be the acrimonious debate over accounting for natural resources which pitted the Congress against the SEC and FASB (Zeff, 1988, p.21).

the British approach, suggested a practical evolutionary approach to setting objectives (see also Stamp, 1980, p.30). In 1987, the Accounting Standards Authority of Canada (ASAC) offered their own conceptual framework project which was more in line with the American model. In general, the Canadians closely follow the International Accounting Standards Committee's (IASC) standards except when they oppose domestic or American rules (Most, 1984, chap.3).

The Accounting Standards Committee (AcSC) of the CICA prepares Canadian rules (Simyar & La Rochelle, 1989, p.32). Whilst there are Board appointees from the other major accounting bodies (the Society of Management Accountants (SMA) and Canadian Certified General Accountants' (CCGA)) onto the AcSC there has been some dissatisfaction by the CCGA and SMA of the strong role played by the CICA (Blazouske, 1983, p.15). There is a provision for non-accountants to become members of the AcSC, with up to six members potentially nominated from accountee and preparer groups (Peirson, 1990b, p.19).

Bloom & Naciri (1989, p.77) note the lack of due process with no public meeting, open hearings or published votes. Denham (1985, p.38) describes the Canadian system as a close knit family type of standard setting process in contrast with the more open participative process in the United States. Bryant & Thornton (1984, p.155) predict there would be fewer surprises in the Canadian process given the homogeneous nature of the regulatory group.

The accounting profession is given great latitude in Canada (Bloom & Naciri, 1989, p.73). Both the selection and monitoring of the choice of any particular accounting treatment is left in the hands of the accounting profession (Bryant, 1987, p.4). The Ontario Securities Commission (OSC) has SEC-style powers but unlike the American experience has generally not interfered in the accounting standard setting arena (Murphy, 1986, p.47). Canada's Business Corporation Act and many provincial company and securities acts specify that the recommendations promulgated by the CICA standard setting committee are to govern the preparation of financial statements (Zeff, 1988, p.21). This delegation of enforcement powers to the profession is in response to a series of bankruptcies and company failures in the 1960s (Murphy, 1986, p.47). In effect these rules are given force-of-law status (Gray, 1988, p.3).

2.3.3 Britain

Regulation in Britain⁸ has two main elements, a general legal framework and private sector regulation by the accounting profession and the securities industry (Taylor & Turley, 1986, p.18). Company law fails to specify the form and type of financial information to be disclosed, with an emphasis on stewardship⁹ and a well defined role for the independent auditor (Evans, Taylor & Holzmann, 1985, p.29). In response to criticisms of the ad hoc nature of accounting standards (see for example Hope & Briggs, 1982, p.87) and lack of direction (Whittington, 1989, p.195) the British advanced a second attempt at a conceptual framework (written by Solomons (1989)) after apparently not obtaining acceptance for The Corporate Report (ASSC, 1975).

A landmark event in Britain was the establishment of the Accounting Standards Steering Committee (ASSC)¹⁰ in 1969 (Gibson, 1976/1977, p.24; McDougall, 1988, p.1). The ASC was created during a period of frequent company failures (Singleton-Green, 1990, p.84), when the accounting profession was in crisis (Bromwich, 1981, p.38; Taylor & Turley, 1986, p.19). The implementation of this institution was a movement away from the reliance upon professional judgement towards more mandatory rules (Whittington, 1989, p.195). However, no legislated mandate to strengthen accounting standards was granted at that time (Taylor & Turley, 1986, chap.3). The selection and monitoring of accounting rules were maintained within the profession (Bryant, 1987, p.4) and all the six founding bodies had veto power over the issuance of accounting standards (Bromwich, 1981, p.36; Taylor & Turley, 1986, pp. 49-50).

The degree of independence of the Accounting Standards Committee can be questioned. The ASC, like their Canadian counterpart, was staffed by part-time volunteers who were not required to sever professional associations (Mathews & Perera, 1991, p.113). Sikka, Willmott & Lowe (1989, p.56) highlight the closed-shop mentality of the British body with most of the decisions and disputes transpiring within the profession.

The debacle of the British attempt to accounting for inflation is cited as an highly-visible failure which severely damaged the reputation of the ASC (Singleton-Green,

8. For simplicity in writing style this thesis uses the term 'Britain' to denote the British Isles therein including the UK and Irish accounting regulatory bodies.

9. Gray (1980, pp.73-74) notes the historical emphasis on the equity investor in Britain.

10. Which later became the Accounting Standards Committee (ASC).

1990, p.85). The ASC was unable to command compliance with their accounting standard. This crucial setback along with the ASC's lack of enforcement powers inspired calls to change the process (Whittington, 1989, pp.196-197).

Two significant changes occurred in 1990. The first is the issuance of the Companies Act 1990's important remedies clause which contains the power to force companies to reissue financial statements which are considered defective. The second change is a structural modification largely based on the proposals of the Dearing Committee (Consultative Committee of Accountancy Bodies, 1988). The ASC is replaced by the Accounting Standards Board (ASB). The new body continues to have a strong professional representation. An Emerging Issues Task Force is now established, the Chairperson and Technical Director are paid full-time members and are asked to sever professional relationships. Furthermore, the founding bodies no longer have veto power over the promulgation of standards (Peirson, 1990b, p.23).

2.3.4 Australia

The accounting profession in Australia is organised into two principal bodies, the Institute of Chartered Accountants in Australia (ICAA) and the Australian Society of Certified Practising Accountants¹¹ (ASCPA). The Australian standard setting process appears to have evolved through several distinct phases of development. During the 1960s criticism arose from a series of much publicised company failures (Birkett & Walker, 1971, p.98). As a response the Australian Accounting Research Foundation (AARF) was formed in 1964, jointly funded by the ICAA and ASA (Zeff, 1973, p.43). Up until 1984, the AARF was the sole promulgator of accounting standards with board member appointment powers resting solely with the professional bodies (Craig, 1985, p.81).

Public and governmental pressures grew in the late 1970s and early 1980s concerning: a greater desire by the general public to participate in the process, a wave of company failures, the lack of enforcement of accounting standards, and a perceived lack of quality and quantity of these standards (Coombe, 1983, p.524; Coombes & Stokes, 1985, p.33; Craig, 1986, p.11; Walker, 1987, p.270). These forces lead to the creation of the government-backed Accounting Standards Review Board (ASRB) in 1984 (Rahman, 1988, chaps 8-9). The stated mandate of the Board was to review current and future accounting standards and to approve standards. When approved by the ASRB, the AARF-promulgated standards were given legal authority (Craig, 1986, p.14).

11. Before 1990 they were known as the Australian Society of Accountants (ASA).

The original composition of the seven member 1984 Board as appointed by the Ministerial Council¹² was also at issue. Hines (1983) argued for a representative wide-based selection for the board members. Using the analogy of the FASB she stated,

A major reason that the FASB unlike its predecessors, has so far survived political pressures is that it is, and it is seen to be representative, and therefore responsive to the third parties affected by the standards which it promulgates (p.25).

However, McKeon (1984, p.6) felt the initial appointment of board members was a major victory for the profession in that it was dominated by accountants. Walker (1987, p.271) noted that the Australian accounting profession strongly resisted the creation of the ASRB. He argued that when the implementation of the ASRB became inevitable, the profession changed strategies, sought and achieved control of the Board (p.282).

Prosser (1988, p.4), Rennie (1988, p.6) and many others within the Australian accountancy bodies wanted the ASRB and the private sector standard setting board¹³ of the AARF merged. It was argued that such an alliance would eliminate the conflict of standards, cease the duplication of effort in standard setting, rationalise scarce human resources, reduce costs and clarify priorities (Rennie, 1988, p.6). In 1988/1989, the two boards merged and the new standard setting entity assumed the ASRB label (McGregor, 1990, p.69). The new-style ASRB was controlled by a nine member board appointed by the government with four of the seats reserved for the accountancy bodies (Mathews & Perera, 1991, p.119). Unlike the previous AARF structure, the two accountancy bodies did not have veto power over accounting standards (Peirson, 1990b, p.9).

Australia is in the midst of important changes to their standard setting structure. The Corporations Act 1989 along with Acts of State Parliaments have once again modified the regulatory system. Responsibility for accounting standard setting in the corporate sector is now with the Australian Accounting Standards Board (AASB) which replaces the ASRB (Porter, 1991b, p.78). Members of the new AASB are

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12. This group was composed of the Attorneys General of the Commonwealth and the states.
 13. The AARF's public sector board has not yet merged with its private sector equivalent although this has recently been advocated by the profession (AARF, 1991).

appointed by the Federal Attorney General¹⁴ who has announced that the administration of the AASB would rest with the AARF through 1991 and would then be reviewed (M.N. Nugent, Assistant Director-Auditing, AARF, personal communication, May 13, 1991).

The Australian accounting profession proposes a movement (Maher, 1990, p.74; Peirson, 1990b) towards a combination of an American and Canadian style systems (Tower, Perera & Rahman, in press). The Peirson Report, commissioned by the AARF, calls for the creation of a consultative group. Other key points of this report include proposals for the establishment of an independent foundation, and the merger of the private and public sector boards (Peirson, 1990a, p.14). This has been followed up by a similar professional initiative (see Proposed Reforms of the Institutional Arrangements for Accounting Standard Setting in Australia (AARF, 1991)).

There have been moves towards clarifying the objectives of financial statements. In 1990, Australia issued an innovative conceptual framework programme encompassing both the public and private sector. As part of that programme the AARF (1990b) released Statement of Accounting Concepts-2 (SAC 2), Objective of General Purpose Financial Reporting which provides direction for determining the function of corporate reports.

2.4 CRITIQUE OF CURRENT REGULATORY MECHANISMS

Important flaws in Anglo-American accounting regulatory structures can be gleaned from the Section 2.3 discussion. Special concerns are noted with regard to how accounting mechanisms are structured, the success of regulation to improve corporate reporting and the tendency of rules to arise in response to crises.

First, specific problems in the structure of accounting regulation are discerned in the examination of the Anglo-American bodies. The level of the accounting profession's independence from interest groups is called into question as are the due process procedures. Further, important problems are discussed below on the efficacy of regulation enforcement. Second, the inadequacies of the current level of guidance for the objectives of corporate report are examined with the quality of current corporate reporting communication considered dubious. Analysis is then conducted as to the

14. Before 1991, appointment and legal powers were actually given to the Ministerial Council. Legal (but not appointment) power was then delegated down to the ASRB (Rahman, 1988, p.14).

clarity and ability of accounting regulation to improve the nature of this communication. Finally, these features are identified as symptoms of a crisis that *exerts* pressure on the accounting standard setting process.

2.4.1 Accounting regulatory arrangements

Zeff (1987, 1988) highlights the importance of due process in the accounting regulatory process. In scrutinising the Anglo-American accounting regulatory systems, important issues arise including the degree of independence, due process procedures and the enforcement mechanisms.

2.4.1.1 Independence

In America, the Financial Accounting Foundation (FAF), the parent body of the FASB, selects the FASB members. The FAF is composed of both accountants and non-accountants. The Australian Accounting Standards Board (AASB) members are now chosen by the government through the Federal Attorney General. In contrast the professional bodies choose the board members in Canada and New Zealand. As a result, the members selected in all these bodies are almost always members of the accounting profession.

Membership on standard setting boards is generally part-time, except for the FASB and two positions on the new British ASB. New Zealand and Canadian board members do not receive any significant monetary compensation, whereas the FASB members receive substantial remuneration.

There are notable national differences in the funding for the accounting standard setting process. The possible range of contributors would include the accounting profession, corporations, accountee groups, and the government. Arrangements at present range from broadly based (America) to professional only (Canada and New Zealand) with the Australian, British and New Zealand systems in the process of widening their funding base.

The American and British accounting standard setters assert their independence from the profession with the former body maintaining the stronger claim. The Australian system appears an interesting mix of professional and government influence. The Canadian system allows great professional autonomy combined with a significant level of government delegation. New Zealand has the highest level of professional self-regulation.

2.4.1.2 Due process

Due process procedures require the regulatory body to allow adequate participation by the various interest groups (Zeff, 1987, p.27). This entails compromises between various viewpoints--a political process (Solomons, 1978, p.65). Thus, politics has a logical place within the accounting standard setting process (Sutton, 1984, p.81; Wyatt, 1990, p.87). Yet with the possible exception of the FASB, none of the Anglo-American standard setting bodies has a transparent rule-making process in which the interactions and compromises that take place in the process can be viewed. Furthermore, non-accountants play only a minor role in the entire process.

American, British and Canadian accounting standard setting bodies have formal arrangements for consultative groups with the former two having relatively higher power sharing arrangements in that they help appoint the Board members. In contrast there is no current formal consultative arrangement in Australia, however the profession is considering a major overhaul of the standard setting structure (AARF, 1991; Maher, 1990, p.74; Peirson, 1990a, p.14). Part of the proposed change would incorporate some form of consultative group (Leo, 1990, p.21). This component of the Peirson Report has been recently criticised as empty rhetoric with Starr (1990, p.26) and Prentice (1990, p.24) expressing concerns about the lack of provision in the proposals for true outside representation.

There are also different levels of openness within the Anglo-American structures. Only the FASB has an active discussion memorandum and public hearing stage. None of the other accounting standard setters are as open in nature. One important concern is that much of the interaction with most of these Anglo-American accounting standard setting bodies goes on behind closed-doors (see for example Sikka et al., 1989, p.56). Typically most decisions within many of these standard setting bodies, such as the agenda-setting and formation of options in regard to specific issues, are made internally until one late exposure draft phase. Horngren (1973, pp.63-64) emphasises the ramifications of this approach. He uses the development of an American standard on marketable securities as a case study of the procedures of the now defunct Accounting Principles Board (APB). He shows how several important changes occurred to the proposed rule before it ever reached the exposure draft phase. Horngren concludes that the options shown to the general public at the exposure draft phase are but a small subset of the original possibilities (p.65). This example is especially relevant because of the structural similarities between the APB to the British ASC, Canadian AcSC and the New Zealand accounting standard setting body.

2.4.1.3 Enforcement

A lack of due process in an accounting rule-making system may result in the preparers, as a group, not having their views properly aired or taken seriously. One implication of this non-involvement may be an unwillingness to follow the standard's dictates. Non-compliance of accounting rules puts more pressure and onus upon the regulatory enforcement function. Boymal (1986, p.39) argues that consensus is more important than enforcement. Without enforcement, however, "The production of accounting rules will be nothing more than symbolic behaviour unless it is accompanied by some programme for monitoring compliance with those standards, and for imposing sanctions for non-compliance" (Walker, 1985, p.12).

The structure of the accounting standard setting body plays a crucial part in the enforcement mechanism. Canada has the most straightforward enforcement design, with the professional standards granted force-of-law status. In America, the FASB's rules are given added weight through the disciplinary powers of the SEC. Britain recently began a new rule-making system with the new Companies Act 1990 containing the power to amend defective accounts. Under this Act, court remedies for revision of inadequate¹⁵ accounts and reports can be sought by regulatory authorities. The Australian standards approved by the ASRB (and new AASB) also have legislative support. In New Zealand the profession has maintained its dominant role, with no legal backing for NZSA's accounting standards (Mathews & Perera, 1991, p.103).

The inability of the British ASC to ensure compliance with their inflation accounting rule was an important factor leading to their downfall (Singleton-Green, 1990, p.84). Gray (1988, p.3) points out there are many instances of New Zealand companies and their directors ignoring standards and manipulating profit to increase their profitability and share price. In New Zealand, both the current cost and investment property standards were withdrawn because of a lack of compliance (Cameron & Heazlewood, 1985, p.11; NZSA, 1988a, p.2) and Tower, Rahman, Tan & Cuthbertson (1990, p.13) found high levels of non-compliance with accounting rules on depreciation and subsequent events by New Zealand listed companies in the time period: 1987-1989.

15. As Walker (1985, p.2) points out, registration procedures wherein the regulatory institution had the ability to remedy defective accounts clearly give the regulatory agencies much greater authority over companies than do disclosure requirements which are currently in use in New Zealand.

The NZSA, having no legal backing of standards, can only expel its own members (Gray, 1988, p.3). This was also true of the pre-1990 British rules ("Enforcing the", 1987, p.24). As Masel (1983) states "A serious weakness encountered by any private standard-setting agency may be the lack of true authority to enforce accounting standards... simply because something more than acceptance by individual members of the accounting profession is required" (p.543). Walker (1990) argues,

From the perspective of shareholders, and other major users of financial reports, the case for continuing government involvement in accounting regulation is compelling. The history of standard setting in several countries shows that profession-sponsored standard-setting activities have tended to peak in times of crisis and to deteriorate when the threat of government intervention has passed. Moreover, governments often play a productive role in filling gaps in the profession's rules, and in gingering up standard-setting bodies when they get bogged down (p.16).

Enforcement of accounting rules can be enhanced by legal intervention¹⁶. Masel (1983, p.543) feels that government authority is usually the only acceptable form of coercion and thus argues for the need of a transfer of some part of the standard setting process from the profession to a government authority. Craig (1986, p.11) points out that countries such as Australia and Canada with similar cultural, political and judicial heritage with that of New Zealand have involved the government directly into the accounting standard setting process.

2.4.2 Regulatory effectiveness

Accounting regulation is a mandatory call for information that the preparer may have not voluntarily provided (Taylor & Turley, 1986, p.7). To meet the goals of the accounting standard setter the objectives of corporate reporting needs to be clear and explicit. The customary method for Anglo-American countries to provide overview guidance is through the development of conceptual framework projects. However, the quality of communication contained within corporate reports is questioned as is the clarity of the accounting standards.

2.4.2.1 Objectives of corporate reporting

One of the hallmarks of a profession is the overall theory in which it works (Hines, 1989a, p.79). The accounting professional is widely criticised for the lack of a

16. Not everyone agrees with this position, alternative viewpoints to regulation will be discussed in Chapter Four.

comprehensive accounting theory. There is also a concern over the gap¹⁷ between the deemed needs of practitioners and academics' interests and outputs (see for example Baxter, 1988, p.1; Bricker & Previts, 1990, p.11).

In financial accounting, attention has turned to the development of an overall conceptual framework¹⁸ to provide guidance¹⁹ for rule-making. The American (FASB, 1978, 1980a, 1980b, 1984), International Accounting Standards Committee (IASC) (1989), Australian (AARF, 1990a, 1990b, 1990c), Canadian (CICA, 1980; ASAC, 1987) and British (ASSC, 1975; Solomons, 1989) standard setting bodies have all issued conceptual framework pronouncements. Only in New Zealand, amongst all the other Anglo-American countries discussed above has the accounting standard setting body failed to elucidate explicit financial accounting objectives (Naran, 1984, p.15; Tower, 1990a, p.14).

2.4.2.2 Quality of communication of the corporate report

Accounting is thought of as the language²⁰ of business and can be perceived primarily as providing a communication service (Bruyne, 1980, p.30; McMonnies, 1985, p.34). Language is crucially important to the communication process because it constrains both what is thought and how it is thought (Stephens, Dillard & Dennis, 1985, p.146). As such, the language employed needs to be clear and concise to fulfil the communication role (Stonier, 1984, p.193). However, Lee and Tweedie (1975,

17. As an extreme, Watts & Zimmerman (1979, pp.300-301) argue that academics produce research to maximise their self-interest. Convincing rebuttals to this argument can be found in the works of Christenson (1983, pp.19-20); Lowe, Puxty & Laughlin (1983, p.40); Ng (1985, p.4); Peasnell & Williams (1986, p.126); Tinker, Merino & Neimark (1982, p.187); and Tower & Kelly (1989, pp.11-13).

18. Hines (1989a, p.74) offers an alternative explanation for conceptual framework projects, she argues that these projects are initiated by accounting standard setting bodies so that they can be seen as active and vigorous. This type of highly visible action may well reduce the likelihood of government intervention. Seen in this light, the conceptual framework projects of the American, British, Canadian bodies as well as the IASC have been highly successful.

19. These conceptual framework projects have been widely criticised. For instance, Stamp (1982, p.123) refers to the FASB's conceptual framework as a "costly white elephant" and Joyce, Libby & Sunder (1982, p.670) examined FASB Concepts 2 and found it was unable to facilitate accounting policy making. However, the desire for the establishment of overall financial accounting objectives is strong. Without a comprehensive theory, standard setting may well degenerate into crisis fire-fighting (Hopwood, 1990, p.84; McGregor, 1990, p.69).

20. Stephens et al. (1985, p.140) applies modern language theories to accounting and concludes that accounting cannot be considered a formal language. They believe that many areas of accounting require additional specification such as relationships of signs to objects or events.

1977, 1981, 1990) find that certain British accountee groups do not appear to understand the information provided in financial statements.

General purpose financial statements are designed as a vehicle for communication. The fundamental question is how well do general purpose financial statements communicate? Communication models are usually composed of six elements: 1) the meaning of the sender's intended message, 2) the encoding of the message into a signal, 3) dispatch of the signal, 4) receipt of the signal, 5) decoding of the signal, 6) meaning of the received message (Houghton, 1989, p.2; Sligo, 1988, p.28).

The ability to communicate is defined as "to express oneself in such a way that one is readily and clearly understood" (The American Heritage Dictionary of the English Language (AHDEL), 1979, p.269). Smith & Smith (1971, p.552) argue that communication occurs in financial reporting only if the intended meanings are assigned to the financial statement messages by the recipient. They feel that the preparer should transmit the selected messages such that the recipient is capable of assigning the intended meanings (p.552).

Parker (1982, pp.279-280) states that the annual report is a mass communication medium involving public documents produced by large organisations, which is distributed to a large heterogeneous number of readers engaged in a wide range of activities. Through this form of communication the performance of companies is classified, quantified and communicated. Readability formulas have emerged in the literature to provide evidence about this communication process (see for example Lewis, Parker, Pound & Sutcliffe, 1986, p.200; Schroeder & Gibson, 1990, p.79).

The ability of the annual report to communicate clearly to accountee groups is often difficult to assess, however, readability studies are used as surrogates to evaluate the effectiveness of this form of communication. Readability formulas seek to examine the extent to which the message can be read²¹. They typically measure word length and number of syllables and compare these findings to the educational make-up of the populace.

21. There are limitations in the use of readability formulas. The presentation format of the material cannot be quantified (Smith & Smith, 1971, p.554); reader characteristics, i.e., interest level, motivation, experience and maturity cannot be measured (Guidry & Knight, 1976, p.552) nor can "accounting and finance knowledge, business experience and inquisitiveness" (Hawkins & Hawkins, 1986, p.66).

Several Anglo-American readability studies of annual reports highlight important communication deficiencies. For instance, Soper & Dolphin (1964) concluded that corporate annual report readability did not improve over the time period 1948-1961. Smith & Smith (1971, p.557) applied the Flesch readability formula (and Dale-Chall) to fifty American industrial companies and found them, in aggregate, very difficult to read. Still (1972, p.38) observed a similar result with British firms, although the overall readability was higher than in the Smith & Smith study. Courtis (1986, pp.289-290) studied Canadian companies and stated that based on readability formulas the chairman's address and footnotes were difficult-very difficult to read. Parker (1982, p.284) applied the Fog/Gunning Index and Kwolek Readability Index to Australian employee reports and concluded that the notes and directors' reports were able to be read by only a limited audience. Healy (1977, p.220) and Tower & Bauer (1991, p.172) examined New Zealand listed companies' annual reports via the use of the Flesch formula and observed that only a small subset of the general population could read this important communication instrument.

The thrust of these Anglo-American studies is the concern over the nature of data communicated to accountee groups. Whether corporate reports are perceived by management as a marketing tool or as the primary method of disseminating enterprise data (or both), the conclusions by the above-cited commentators show a serious problem of communication.

2.4.2.3 Clarity of accounting rules

One of the determinants of the qualitative characteristics of information provided in corporate reports is the clarity of accounting regulatory requirements upon corporate reports by mandating how much and what kind of information must be made public. However, the ability of current regulatory arrangements to supply such protection is questioned. For example, Chambers, Ramanathan & Rappaport (1978, chap.1) felt that current accounting rules in Australia were the result of several decades of conflicting methodology, uncoordinated development and lacked any general framework. Walker (1986, p.11) examines American, British and Australian standards and concludes that the wording/style of the promulgations is inadequate. He cites ambiguous phrasing such as **should** or **the general rule is**. He also argues that "The rules continue to be permissive, and to incorporate loopholes through lack of definitions, vagueness and ambiguity" (1986, p.11). Hopwood (1990, p.79) states that accounting terminology is subject to poor usage and lacks clarity. In Australia, one of the first issues the ASRB faced, in 1984, was the need to change the wording of standards to give them more legal precision (Walker, 1987, p.278).

It may be that permissiveness is considered to be a necessary characteristic by the accounting standard setters. For example, Thornton (1979) argues that this enigmatic phraseology may not be accidental. He hypothesises that Canadian accounting standards may be deliberately worded in a vague manner to ensure acceptance. Tower & Bauer (1991, p.173) find evidence of a similar problem in New Zealand accounting standards.

2.4.3 Regulatory initiatives

Hines (1988, p.256) correctly cites company failures and bankruptcies^{ies} one of the most important problems facing the accounting profession in regard to public perceptions. These collapses, often not forewarned by annual reports, create great concern and trauma within the society. It is observed that large numbers of company failures frequently generate strong pressures for change upon the accounting regulatory mechanisms.

As discussed in Section 2.3, corporate failures and the resultant fall-out helped lead to the demise of the American APB and the creation of the British ASC. The FASB was evolved in part to serve as a stronger, more independent body. In Canada, corporate failures in the 1960s lead to the accounting profession being granted force-of-law status for accounting standards. However, in Australia, similar problems in the 1960s and 1970s foreshadowed direct governmental involvement. To date, New Zealand has avoided major radical changes to their accounting standard process. However, the analysis in Section 9.3 highlights the likelihood that the status quo position will soon alter due to the current atmosphere of crisis in the accounting profession with many important changes recommended.

2.5 SUMMARY

The New Zealand accounting environment is influenced by many forces. Numerous accounting classification systems cluster New Zealand with America, Australia, Britain and Canada. An analysis of these countries' accounting regulatory processes reveals several important inadequacies, such as the closed nature of the standard setting process, ineffective nature of rule enforcement, the importance of clear explicit objectives for a standard setting body, and the need for qualitative criteria in corporate reports. Changes to the accounting regulatory systems are found to be often generated as a response to external crises.

CHAPTER THREE: AN ANALYSIS OF FINANCIAL ACCOUNTING PARADIGMS

3.1 INTRODUCTION

As discussed in Chapter Two, one of the major weaknesses of New Zealand accounting practice is the lack of clearly enunciated objectives for corporate reporting. This inarticulation, according to the American Accounting Association, stems partially from the inability of various groups to agree upon the underlying theory and purpose for external reporting (AAA, 1977a). The failure to elucidate clear objectives may result in a tendency to issue rules on an ad hoc basis without any overall unifying theory (Solomons, 1989, chap.1). The haphazard nature of this approach seriously affects the quality and quantity of information communicated to the public (Hopwood, 1990, p.84; MacLennan, 1989, p.30).

3.2 ENVIRONMENT OF REPORTING

This thesis takes a broad societal viewpoint (Section 1.4.2) of accounting regulation and corporate reporting. This perspective is in keeping with broad accountability tenets as espoused by ASSC (1975), Birkett (1988), Bird (1973), Gray, Owen & Maunders (1987), Harris & Spannier (1976) and Rosenfield (1973). Therefore, an examination of the overall effect on societal welfare is needed when studying the impact and relevance of corporate reports. Most societies seek to improve the welfare of the community at large, but the most effective method of achieving this noteworthy goal is not always clear. How does one improve the welfare of society? What role can accounting play? How can information from corporate reports assist societal-oriented goals? The relationship of accounting, especially external corporate reporting, to social welfare is investigated below.

3.2.1 Accounting as a social choice function

The application of the concept of social welfare to accounting is well documented (see Mathews & Perera (1991, chap.18) for an overview). SyCip (1981) notes that "Accounting's social utility is recognized in the manner it responds to the unceasing and changing demands of the particular society and environment it serves..." (p.85).

Accounting is viewed in this thesis as a social construct in that it serves as an important communication medium between corporations and the society.

These views have been explored from various perspectives in the accounting, economics and business literature. In a Paretian vein, Arrow (1963) evolved his well known Impossibility Theorem for social welfare functions. Arrow concludes that it is impossible to construct a collective choice rule that satisfies even a minimal set of general conditions (also see May & Sundem, 1976, pp.750-751). Arrow's axioms and logic are offered in Appendix A. Mueller (1976, p.421) establishes that one way out of the Impossibility Theorem is to introduce value judgements. As described in Section 3.2.4, an equity criterion could serve as such.

Demski (1973) applies Arrow's proof to the accounting realm and described his own Impossibility Theorem. Demski uses this to argue that there is no feasible method of selecting financial accounting standards that is capable of ensuring the consent of the affected parties in the accounting standard setting process to the satisfaction of Arrow's conditions. Demski (1974) believes that people use published accounting information to address a multitude of problems, thus, he feels there is no one acceptable model. Aivazian & Callen (1983, p.231) and Bromwich (1981, p.51) deploy the work of Arrow and Demski to question the role of the accounting standard setter.

The above arguments are overstated. As Schreuder & Ramanathan (1984, p.414) note, the failure to provide a perfect solution should not thwart activity. Johnson & Solomons (1984) correctly assert that "...due to the inherent inability of any real world accounting standard-setting process to meet Arrow's conditions, Demski's Impossibility Theorem is largely irrelevant to the assessment of the legitimacy of a process like the FASB" (p.166). This thesis considers the standard setting process crucial in helping equity and efficiency goals. Hence, arguments that would eliminate regulation because of a possible failure to obtain certain over-idealised optimum conditions are rejected.

An alternative viewpoint is offered, important societal goals are pursued with the aim towards net positive benefits. This decision process involves choice selection amongst various possibilities and is thus seen to be ultimately political in nature. Beaver (1981, p.52) notes that a selection amongst financial reporting systems inevitably involves a choice of the most desirable set of consequences which involves value judgements. Boritz (1982, p.36) feels the arguments of Arrow and Demski claim that there is no basis for using the market mechanism to demonstrate desirable or optimal accounting policies. Consequently, the choice can be only made by a political process which is perfectly acceptable as long as standard setters are

recognised as a social choice mechanism and regulatory institutions are answerable to their constituents (see also Harris & Spannier, 1976).

3.2.2 Social welfare goals

Merino & Coe (1979) describe the sought after state, "The ultimate goal, everyone seems to agree, is 'truth', 'fairness', 'justice' or perhaps, more simply, that financial statements not be misleading" (p.68). The utopian state is, however, a very long-term goal, beyond most peoples' expectations. Moreover, everyone does not agree on either its definition or the means required to attain it. May & Sundem (1976, p.748) recommend that the maximisation of social welfare should be a necessary goal of financial accounting, but again the question of how to maximise societal welfare remains.

Mitnick (1980, p.286), in attempting to describe preferred options, evaluates intermediate goals. He discusses the application of a set of rules which can be rationalised for a consensual 'public interest' to implicitly describe fundamental societal organisations. He classifies these public interest rules as intermediate goals as they represent a set of values or goals that a given society considers important at a given point in time. Accounting as a social construct is subject to societal expectations (Mathews & Perera, 1991, p.345) and is influenced by these intermediate goals.

Efficiency and equity are arguably the two most important intermediate goals that can enhance societal welfare as affected by accounting information (see Lev, 1988, p.3; Pallot, 1991, p.203). Efficiency can be construed to be performing a function in the least wasteful manner (The Random House Dictionary, 1980, p.287). The concept of efficiency examines the relationship between inputs and outputs (Rutherford, 1983, p.19). The efficiency goal has many parameters: the Pareto-optimal concept of social welfare (Bell, 1988, p.5), cost-benefit trade-offs (Benston, 1982a, p.14; Coopers & Keim, 1983, p.192), the communication process (Parker, 1982, p.279), the extent to which information is fully reflected in market prices (Beaver, 1981, p.38), and measurement and disclosure issues (Beaver, 1981, chap.6).

The second important intermediate goal is equity. There are two possible perceptions of equity: informational equity and wealth (distributional) equity. The first perception advances the notion that people should have access to the same information whereas the second perspective considers that wealth distributions should be equal. The former view is adopted in this thesis. Equity¹, as used here, is defined

by Merino & Neimark (1982) as, "the right of all market participants to equal access to information" (p.40).

Ronen (1979, p.432) agrees that accounting information should ultimately serve to enhance social welfare but he argues that the most important goal is the efficient allocation of resources. This latter view is shared by many writers, especially those in concurrence with the information economics and decision usefulness paradigms (discussed in Section 3.3). For instance, the agency theorists believe that societal-welfare can be enhanced by a reduction of the agency costs within the agent-principal relationship (Jensen & Meckling, 1976, p.345). They think agency cost can be reduced in an unregulated market by using audited financial statements (Watts, 1977, p.59; Watts & Zimmerman, 1978, p.118).

Other scholars, however, deem the current market structure inadequate and perceive regulation as a means to improve efficiency and social utility (e.g. Bell, 1988, p.17). It is argued in this thesis that theories which focus exclusively on the economic nature of information are too narrow in scope. The much neglected goal of equity is considered worthy of greater attention than is now tendered in the accounting literature.

There can be divergence between the intermediate goals of efficiency and equity. For instance, movement towards the goal of efficiency could be at times at the expense of the equity criterion (Feldman, 1980, p.154; Rawls, 1971, p.14). This thesis considers that both criteria are necessary and they should be given equal priority. The impact and interactions of efficiency and equity goals upon the accounting environment and social welfare is discussed below.

3.2.3 Efficiency criterion

In the area of societal welfare, economic theory has been heavily influenced by Vilfredo Pareto's seminal work Manual of Political Economy (Pareto, 1971, chap.6; Whittington, 1987, p.331). The Pareto-criterion is an efficiency² notion (Bell, 1988, p.4; Pallot, 1991, p.202). A condition is Pareto-optimal if an alternative cannot be

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1. The term equity, unless specifically excepted, will be considered to refer to informational equity for the remainder of this thesis.
 2. Modern welfare economics is based on the Pareto criterion (Sen, 1970, p.21). The first theorem of welfare economics states that (barring externalities) a competitive economy guarantees a Pareto optimal economic outcome (Feldman, 1980, p.3). However, externalities do exist in accounting (as discussed in Chapter Four), thus over-reliance on the Pareto-criterion is problematic.

chosen that: 1) everyone will regard to be at least as good and 2) which at least one person considers themselves better off (Cirillo, 1979, p.23; Sen, 1970, p.21). Bell (1988) defines this optimal condition as "a state wherein no one individual or firm can be made better off by reallocating resources in an economy without making some other individual or firm worse off" (p.5).

So how can accounting affect the achievement of social goals? Beaver & Demski (1974, p.174) feel the provision of Pareto-optimal information may not be practicable in the realm of accounting in that the conflict between interests of producers of corporate reports and the information needs of accountees heightens the possibility of a loser always arising in the provision of accounting information. The existence of losers (people who incur decreases in utility) preclude Pareto-optimal solutions. In regard to the goal of efficiency, an acceptable lesser standard could be the notion of Pareto improvements wherein "any change is potentially good so long as the improvement in the welfare of those who gain from a change is more than sufficient to compensate those who lose" (Culyer, 1975, p.7).

There are several areas of concern with the Pareto view³, for instance, the Pareto criterion offers no insights on equity issues (Peirson & Ramsay, 1983, p.291; Sen, 1970, chap.2). The Pareto view is an utilitarian approach (Shirley & Wilkes, 1984, p.281) in that it assumes that people seek to maximise their own personal wealth (Culyer, 1975, pp.13-19). Perhaps the most serious criticism is that Pareto analysis avoids variables such as power, class, personality and culture (Sen, 1970, p.26; Shirley & Wilkes, 1984, p.281; Tinker, 1984, pp.61-63). It is also important to note that a policy/social choice function, outside the Pareto scheme, is necessary when choosing between the gains and losses of various individuals (Culyer, 1975, p.23). The equity criterion is offered, in this thesis, as such a balancing force. For example, Rawls (1970, p.302) and Lev (1988, p.13) advocate the need to focus on the less advantaged members of society. They persuasively argue the importance of giving explicit consideration to equity goals.

3.2.4 Equity criterion

Equity considerations have frequently been advocated from a social and moral viewpoint (see for example Rawls (1971)). The importance for an explicit equity perspective can also be championed from an economic perspective. The crucial point is that market forces cannot be relied upon to achieve social equity. For instance,

3. See Aron (1965, p.117, 1967) and Winch (1958, p.109) for further critiques.

Tinker et al., (1982, p.171) expresses concern about the manipulation of accounting data and the related damage to investor confidence. Lev (1988, p.3) notes that if investors perceive the market to be inequitable they will not willingly participate, the results⁴ will be thinner markets, lower liquidity and higher transaction costs. It is asserted that the equity orientation provides a justification for the regulation of information disclosure through the systematic decrease of information asymmetries as well as on moral grounds.

Informational equity is thus considered an essential intermediate goal of society. Rawls (1971) champions this philosophy. He (1971, p.70) considers the utilitarian Pareto-based efficiency criterion too narrow and advances an alternative 'Theory of Justice' (see Appendix B for more details). Rawls' principles of justice satisfy the principles of fairness (Sen, 1970, p.135) and therefore are congruent to the idea of informational equity. This type of equity⁵ in the realm of financial accounting refers to equal access to information for all accountee groups deemed to have a right of access, and is accurately defined by Lev (1988) as "equality of opportunity" (p.3).

Rawls (1971, p.87) argues that fair institutions should be established to satisfy demands for fair equality of opportunity (also see Pallot, 1991, p.203). Rawls (1971, p.195) believes that constitutional democracy is the best method to establish just institutions and states,

Justice as fairness begins with the idea that where common principles are necessary and to everyone's advantage, they are to be worked out from the viewpoint of a suitably defined initial situation of equality in which each person is fairly represented (p.221)

It is concluded that the search for the best method of financial reporting is a social choice issue with ramifications upon equally weighted equity and efficiency goals. Due process and democratic institutions⁶ are considered essential features for obtaining accountability of corporations.

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4. The continuing depressed state of the stock market from October 1987 to the present time offers a good example of Lev's conclusion in the New Zealand context (see Section 9.2.5.2).
 5. Rawls' perspective appears to encompass both types of equity. The analysis in this thesis relates solely to the informational equity version.
 6. Tinker (1984, pp.60-62, 1980, p.153) considers the flaws to neo-classical economics (i.e. Pareto-criterion) so vast that the introduction of sociopolitical ideals (such as democratic institutions) would be cosmetic in nature. In particular, he felt that social inequalities are so great (i.e. slavery, feudalism etc.) that the concept of political voluntarism is invalid. Tinker's concerns, however, would seem to be less applicable in Anglo-American countries with their long-standing democratic traditions which have lead to a reduction of such inequalities.

3.3 PARADIGMS OF FINANCIAL ACCOUNTING

The impact accounting has on social welfare can be illustrated by an analysis of the objectives of corporate reports through a classification of different theories into paradigms. Ritzer (1957) defines a paradigm as,

...a fundamental image of the subject matter within a science. It serves to define what should be studied, what questions should be asked, how they should be asked, and what rules should be followed in interpreting the answer obtained. The paradigm is the broadest unit of consensus within a science and serves to differentiate one scientific community (or subcommunity) from another (p.157).

A paradigm forms an image or perception of how one views the world (AAA, 1988, p.16). Though broad in nature and not clearly delineated⁷ (Wells, 1976, p.476), these paradigms represent different ways of perceiving the primary function of external corporate reporting. There is no one dominant paradigm in financial accounting theory at present, but as shown below several studies have offered views on the main paradigms⁸.

3.3.1 Prior seminal works

Five major pronouncements issued by the American Accounting Association (AAA) before 1977, failed to provide a cohesive theory of accounting (Rahman, 1989, p.1). In 1977, the AAA issued the Statement of Accounting Theory and Theory Acceptance (SOATTA). This document's classification scheme lists three financial accounting paradigms: classical, decision usefulness and information economics (see Table 3.1). The classical paradigm is further categorised, by SOATTA, into the normative-deductive school which formulated an implicit accounting model for accountants and the positivist-inductive school which is composed of those who were interested in rationalising or justifying the elements of extant practice. The decision-usefulness paradigm is bifurcated into decision model approaches and studies of decision makers at either the individual or aggregate market level.

Belkaoui (1981, chap.9) offers a different classification of financial accounting paradigms (see Table 3.1). He expands the classical paradigm into the anthropological-inductive bracket and true income-deductive category. The decision usefulness classification is broken into three subparts: decision model, aggregate

7. Kuhn (1970, p.182) advocated usage of the term 'disciplinary matrix' in lieu of 'paradigm', feeling that the former phrase is clearer (see also Wells, 1976, p.473).

8. See Rahman (1989) for a good summary review.

market behaviour and individual user paradigm. Information economics, in each study, is kept as a separate paradigm.

TABLE 3.1 VARIOUS CLASSIFICATIONS OF FINANCIAL ACCOUNTING PARADIGMS

<u>Source</u>	<u>Year</u>	<u>Paradigms</u>
AAA	1977a	Classical Normative-deductive Positive-inductive Decision Usefulness Decision models Decision makers Information Economics
Belkaoui	1981	Anthropological-inductive True Income-deductive Decision Usefulness Decision model Individual user Aggregate market behaviour Information Economics
Tower	1990a	Critical thought Accountability Decision Usefulness Information Economics

AAA (1977a) and Belkaoui (1981) classify financial accounting paradigms by their methodological approach. However, an alternate perspective needs to be considered; the purpose of corporate reporting. In contrast to prior studies, the position taken in this thesis is that financial accounting theories should be evaluated from a purposive viewpoint (see Tower, 1990a). This classification approach can enhance the understanding of linkages between financial accounting theory and corporate reporting practices.

3.3.2 A purposive scheme of classification

It is concluded that the above studies are incomplete in that they do not list accountability as a separate paradigm despite the uniqueness of this viewpoint. The accountability framework would appear to fall within the anthropological-deductive paradigm under Belkaoui (1981, p.290)⁹ and within the classical paradigm of the AAA (1977a) review. These previously cited classification systems also fail to include the critical thought¹⁰ paradigm which offers profound criticisms of contemporary accounting practice.

Using the purposive approach, an alternative framework (see Table 3.1) is offered with a classification of four major paradigms. The paradigms selected are information economics, decision usefulness, accountability and critical thought. These paradigms are classified¹¹ based on their assumption/premise about what is the corporate reports' primary function. It is argued that the purposive classification scheme provides a more significant perspective when examining corporate reporting issues.

Financial data is perceived in the narrowest sense in the information economics paradigm in that non-economic rationales are downplayed. From an information economics perspective, the demand for and supply of accounting information is explained in terms of the choice behaviour of individuals (Walker, 1988, p.170). It is assumed that people make full use of all information available. This paradigm takes a limited view of the interactions with data. Information is treated as an economic good. Social, political and cultural variables are downplayed. Further, equity issues are unacceptably disregarded. The narrow approach to information is not in keeping with the broad societal viewpoint adopted in this thesis.

The second paradigm encompasses the broad concept of decision usefulness. The primary function of corporate reports is deemed to be the provision of useful information, mainly for economic decision-making purposes (Belkaoui, 1981, p.295). One premise of the decision usefulness paradigm is that past data on financial status

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9. Belkaoui (1981, p.9) narrowly discusses accountability (using Ijiri (1975) as an example) as a reason to justify historical cost accounting.
 10. This is also known as the radical or historical materialism paradigm, see for example Merino & Neimark (1982).
 11. The debate of normative versus positive research as espoused by Watts & Zimmerman (1986, pp.7-9) is considered irrelevant. This thesis adopts the view of Tinker et al., (1982, p.191) that all theories have an underlying normative viewpoint.

provides important information to predict future earnings/cash flows¹² (Staubus, 1986, p.117). However, the present level of information via corporate reports fails to deliver a preponderance of data for decision usefulness purposes (see Section 8.3.1). For instance, the strong reluctance of companies and regulators to provide forecasting information (see for example Watt & Johnston, 1989, p.32) cannot be explained by this paradigm.

The third paradigm is that offered by the critical thinkers. Many disparate views can be observed with this paradigm (see Chua (1986) for an overview). For example, accounting could be seen as a type of ideology (Tinker, 1985, p.106), legitimising institution (Hines, 1989b, p.53; Richardson, 1987, p.341), tool of the capitalists (Tinker, 1985, p.177), reality-creation device (Hines, 1988, p.261, 1899a, p.73) or ritual (Gambling, 1977, p.145, 1987, pp.322-323). The critical thinkers offer perceptive critiques of current practice. Whilst advancing some alternatives (for instance Tinker's (1980, p.156) political economy of accounting), an important deficiency of this group is their overall failure to elucidate clear solutions to the multitude of problems they cite (see the Solomons (1991a,1991b) versus Tinker (1991) debate)

A fourth perception of the function of corporate reports is given through the accountability paradigm. This view is an outgrowth of the stewardship function (Bird, 1973, p.143) which focussed narrowly on the shareholder/manager relationship (Beaver, 1981, p.2). Broader views incorporate the need to report to accountee groups (such as bondholders, shareholders, customers) or even the entire society (Porter, 1989, p.51). Under the accountability perspective, data within corporate reports serves as a feedback mechanism.

The purpose of corporate reports is seen in a holistic fashion in this thesis. It is considered that society's intermediate goal set, such as equity and efficiency criteria, need to be pursued. The accountability paradigm best fits this viewpoint. Under an accountability model, corporate reports would provide more and better information to society. Walker (1988, p.178) lists the social benefits which could be gleaned from

12. Financial statements are one tool used in the attempt to measure the value or wealth of the firm (for instance the calculation of discounted cash flows). Net income has been seen by many as the primary surrogate of wealth, hence the pursuit of profit has been deemed to be the principal goal of managers. Some would argue that the profit figure reflects both the effectiveness and efficiency of an enterprises' operations. This argument is rejected in this thesis. Profit is viewed here as a crude and potentially inaccurate measure of the wealth of a firm, indeed it may have little relevance in the determination of the enterprises' impact upon the society.

public information: improved risk sharing, enhanced real production/investment decisions, lessened private information production cost, better management decision-making and reduced insider-trading cost. Other improvements, based on equity considerations, should also be included in the list of accountability-driven benefits.

3.4 NATION-SPECIFIC EXAMPLES

Chandler (1982, p.208) notes the movement in the New Zealand corporate sector towards more accountability. However, the New Zealand Society of Accountants has not explicitly advocated this or any other paradigm within which they view corporate reporting. Guidance can be garnered from overseas reports which have been influential upon the New Zealand accounting environment. Table 3.2 offers such an examination. The analysis is conducted using a purposive classification scheme using the four financial accounting paradigms as described by Tower (1990a, p.10).

National seminal works, as demonstrated by Table 3.2, are seen to have a variety of views about the end-purpose of corporate reports. For example, the British Corporate Report (ASSC, 1975) offers the broadest perspective based on accountability whilst the American FASB (1978) Concepts 1 advances the narrowest view based on decision usefulness. Critical excerpts highlighting each reports' view of information are presented in Appendix C. Five reports (67.5%) mainly focus on the decision usefulness aspect of corporate reports, two (25%) give primary emphasis upon accountability and one (12.5%) appears to give equal weighting to both. It can thus be seen that decision usefulness is the dominant paradigm in most of these studies, but the accountability perspective is often championed.

3.5 EXPANDED VERSION OF THE ACCOUNTABILITY PARADIGM

The Corporate Report (ASSC, 1975, section 2) supports the idea that communication is required regarding the custodial care of the scarce resources and endorses the idea of reporting to a broad recipient group (see also Van Peurse, 1990, p.5). The accountability paradigm is in congruence to the broad societal viewpoint incorporated in this thesis (see Section 1.4.2) Moreover, it appears in agreement with the two most important intermediate goals: equity and efficiency as discussed earlier (see also Williams, 1987).

**TABLE 3.2 PURPOSIVE CLASSIFICATION OF NATIONAL REPORTS
BY PARADIGMS**

<u>Author</u>	<u>National Report</u>	<u>Year</u>	<u>Country</u>	<u>Paradigm</u>
ASSC	Corporate Report	1975	Britain	Primarily Accountability*
FASB	Concepts 1	1978	America	Decision Usefulness
CICA ¹³	Corporate Reporting: Its Future Evolution	1980	Canada	Primarily Accountability*
ASAC	Conceptual Framework for Financial Reporting	1987	Canada	Primarily Decision Usefulness**
ICAS	Making Corporate Reports Valuable	1988	Scotland	Both Accountability & Decision Usefulness
IASC	Framework for the Preparation and Presentation of Financial Statements	1989	IASC	Primarily Decision Usefulness**
Solomons	Guidelines for Financial Reporting Standards	1989	Britain	Primarily Decision Usefulness**
AARF	SAC 2	1990b	Australia	Primarily Decision Usefulness**

* These reports presented the decision usefulness paradigm as a secondary view.

** These reports presented the accountability paradigm as a secondary view.

Reports primarily possessing accountability viewpoints	25%
Reports primarily possessing decision usefulness viewpoints	62.5%
Reports possessing both viewpoints equally	12.5%

Source: Adapted from Tower (1990a, fig.5).

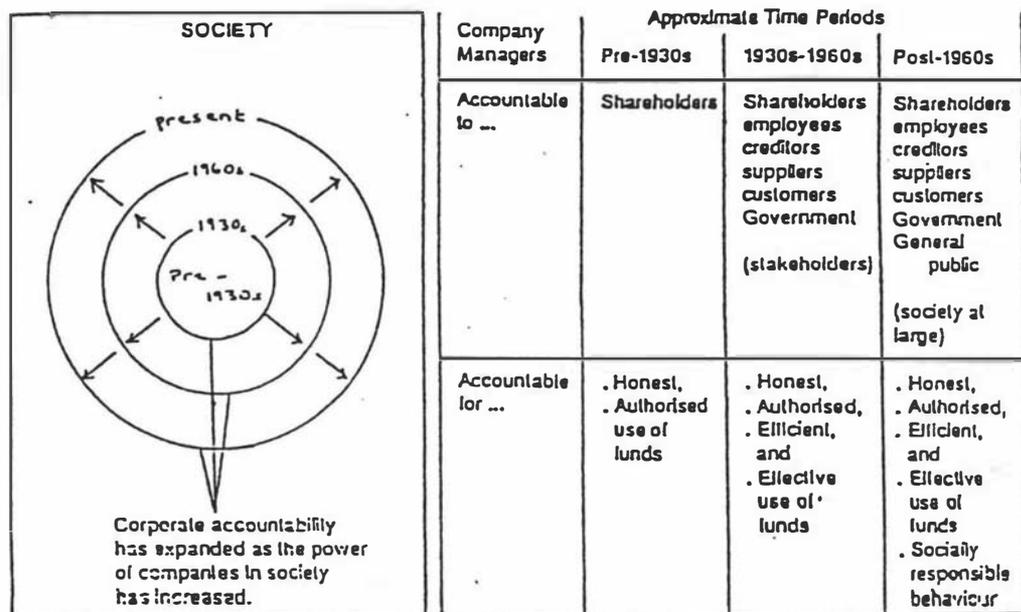
As mentioned in Section 3.3.2, the historical precedent to accountability was the much vaunted stewardship concept of financial statements. The concept of stewardship was traditionally viewed as the primary role of corporate reports (Frese

13. The strong accountability theme in the British (ASSC, 1975) and Canadian (CICA, 1980) studies can at least partially be attributed to the influence of Stamp who actively participated in both of these reports (see for example Stamp, 1985).

& Mautz, 1972, p.8; May, 1943, p.19; Ronen, 1979, p.417; Wixon, Kell & Bedford, 1970, section 1-3). This view slowly began to change in the 1950s and 1960s as new paradigms such as decision usefulness¹⁴ gained popularity¹⁵.

The stewardship perspective typically viewed reporting as detailing guardianship of company resources, in that managers protected the company assets for their absentee owners (shareholders). Over a period of time the meaning of the term 'stewardship' became increasingly more ambiguous (Rosenfield, 1974, p.124), the resulting confusion led to a new term 'accountability' gaining favour in academic circles. The new term, however, is used in a broader manner (see Figure 3.1).

FIGURE 3.1 GROWTH IN CORPORATE ACCOUNTABILITY



Source: Porter (1989, p.50).

The term accountability is described by Gray et al. (1987) as the, "onus, requirement, or responsibility to provide an account (by no means necessarily a *financial* account) or reckoning of the actions for which one is held responsible" (p.2). This definition considers that the controller of resources has a greater responsibility to report. The (British) Royal Commission of Financial Management and Accountability defines

14. It is interesting to note that Ronen (1979, p.415) feels that the modern term of agency costs is the new label for the stewardship concept.
15. See Wells (1976) for some interesting thoughts on why paradigms (which he calls disciplinary matrix) evolve and change.

accountability as "the fundamental prerequisite for preventing the abuse of delegated power and for ensuring ... instead, that power is directed toward the achievement of broadly accepted national goals..." (Kelly & Hanson, 1981, p.1). Gray et al. (1987) suggests that,

The term 'accountability' is used in at least two separate but related senses. Individuals and organisations are accountable in a broad sense if they are answerable for their conduct and responsibilities. ...In another sense, individuals and organisations are accountable if they are liable to render an account of their activities (p.14).

Similarly, with the changing definition of the stewardship term in earlier decades, the 1970s and the 1980s witnessed the evolution of different meanings for accountability. This concept is now applied in vastly different ways. To avoid confusion the reporting obligations for the term accountability as discussed in this thesis focuses on a particular category known as 'public accountability' as described in Section 3.5.4.

One important criticism of the accountability framework is the failure of the paradigm to explain certain issues such as: to whom should one report, what should be reported, and who should decide what is to be reported? Consequently, further examination is needed to explore these issues in order to evolve a workable definition of the reporting obligation for public accountability.

3.5.1 Accountability to whom

For whom should corporate reports be intended? What groups have a legitimate right to enterprise information? The traditional view is the narrow relationship between owner and manager, but many authors think it should apply to a wider range of groups (see for example AAA, 1966, p.5; Bevis, 1965, pp.7-19; CICA, 1980, chap.5).

Several countries have evolved different nation-specific models for accountee groups. The United States standard setters focus their attention on the sophisticated investor and creditor (FASB, Concepts 1, 1978, para. 34). While the Australian accounting profession expands their conceptual framework to encompass both the public and private sector and perceive their accountee groups as being resource providers (i.e. investors, creditors and employees), recipients of goods and services (i.e. customers) and oversight parties (i.e. regulators, unions, and the media) (AARF, SAC 2, 1990b, p.10).

This thesis envisions a broader application of information contained in corporate reports with the emphasis shifting towards societal welfare which can meet efficiency and equity goals. However, reporting is not a costless exercise and cost-benefit constraints need to be acknowledged. The issue remains as to whom the preparers should report. Who has the right to corporate information?

Gray et al. (1987, p.85) argue for an expanded¹⁶ focus of reporting to include not only shareholders and creditors but also other groups with a legitimate interest in the enterprise. Benston (1982a, p.8) describes three views of accountability: to the shareholders, to the stakeholders and to society. Rubenstein (1986, p.36) recognises three categories of stakeholders: 1) Input stakeholders (i.e. employees, owners, suppliers and creditors); 2) Output stakeholders (i.e. consumers), and 3) Environmental stakeholders (i.e. the community and government who influence or are influenced by the company's performance). Finally, an important perspective is offered in The Corporate Report (ASSC, 1975) who lists the following seven groups as having a reasonable right to financial accounting information,

- a) equity investor group
- b) loan creditor group
- c) employee group
- d) analyst-adviser group
- e) business contact group (i.e. customers, competitors)
- f) government agencies
- g) the public (p.17).

A pragmatic evolutionary approach to reporting is advocated in this thesis with an emphasis on accountee groups that have a right to reporting. Harris & Spannier (1976, p.253) offer an important insight when they differentiate between two types of accountee groups. They consider a 'bond of accountability' exists where the accountee can hold the provider of information directly to account. A weaker 'link of accountability' is present when accountee groups relations are in accordance to custom or indirect influence. Accountee groups that have a bond of accountability are thought to have a greater right to corporate information (Gray et al., 1987, p.89). They feel that consumers, employees and the local community all qualify as recipients of this higher standard. Their differentiation is consistent with the views in this thesis; requirements for corporate reporting should encompass more than mere

16. Not all scholars agree with the broad view of accountability, Benston (1982b, p.92) stated that in practice corporate managers have very little discretion to act other than in the interest of the shareholders. Chen (1975, p.541), however, proposed that management of modern corporations have two stewardship responsibilities: a primary stewardship responsibility to society and a secondary responsibility to shareholders.

shareholders and creditors but need not enter the impractical ranks of the entire society. The term 'stakeholder' will be used in the remainder in this thesis to describe the accountee groups considered to have a right¹⁷ to corporate data.

Public accountability is thus discussed in terms of stakeholders possessing a legitimate interest (i.e. a bond of accountability) with the business enterprise.

3.5.2 Accountability for what

The next important question on accountability relates to the targeted data. Under accountability tenets it is not clear what should be accounted for (Kelly & Pratt, 1990, p.20). What information should be disseminated to the stakeholders identified above? The annual corporate report is considered the primary communication vehicle of business enterprises (ASSC, 1975, p.16). Yet, the question remains, what data should be incorporated in such a report?

One viewpoint is that historical cost-based reporting fulfils the accountability obligation. Concepts such as stewardship and accountability take on historical implications since they are an examination of prior performance (Gray, 1983, p.5; Rosenfield, 1974, p.127). As such they are used to justify the use of the historical cost system (Chambers, 1966, p.253; Ijiri, 1983, p.79; May, 1943, p.24). It is considered that this view is inadequate in that it ignores the current significance of data relating to corporate performance and the resulting societal impact.

Friedman (1962) is the best known protagonist for the traditional corporation viewpoint advocating the need for business enterprises to pursue profit maximisation (Porter, 1990a, p.97). In a similar vein, Sherwin (1983, p.185) believes that social action falls outside the economic sphere that public policy has assigned to the business system. In contrast the Corporate Report considered that profit "can no longer be regarded as the sole or premier indicator of performance" (ASSC, 1975, p.38). The latter perspective is adopted in the thesis, in that it appears much more in line with the ideals of communicating an enterprise's dynamic activities.

The nature and elements of the corporate report may well be different under an accountability philosophy. New accountabilities have evolved in harmony with

17. Accountants and preparers are also deemed to have the right to corporate data. For clarity in writing, they will be specifically identified rather than lumped within the 'stakeholder' label. Consequently, in the remainder of this thesis the term 'stakeholder' will be generally refer to non-accountant, non-preparer groups with a bond of accountability.

societal changes (Kelly & Pratt, 1990, p.21), for instance, the sudden interest in green accounting for the environment (Pearce, Markandya & Barbier, 1989; Gray, 1991) is a good example of evolving societal priorities. Harris & Spannier (1976, p.259) observe that accountability is dynamic and is determined by a particular political environment/norms of the community. This links with the views of Wells (1978, pp.15-18) and Rahman (1988, p.99) who argue that accounting regulation is often a result of a perceived crisis.

It is considered that business managers are responsible for both achieving economic goals and for behaving in a socially responsible manner (Chen, 1975, p.541). The accounting literature has demonstrated an increasing demand for corporations to provide more financial and non-financial information on corporate activities (Porter, 1990a, p.106). The equilibrium level of mandated information at any point in time should be established jointly by the stakeholders, producers, and regulators. Democratic institutions, with appropriate mechanisms installed for evolutionary development, would seem to be the most appropriate vehicle for this decision process (Section 3.2.4). Within accounting this can be operationalised via the use of regulatory bodies with wide representation of the above listed groups. Using this approach, representative democracy would evolve the kinds of corporate information deemed important.

3.5.3 Auditing and accountability

Accounting regulation is viewed as an instrument of accountability in that it can affect the nature of corporate information reported. Professional self-regulation is often the primary choice in Anglo-American countries (Section 2.4.1). Bird (1973, p.2) and Flint (1988, pp.22-23) note the large emphasis placed on the auditor to fulfil such responsibilities. However, Section 2.4.2 shows that the audit function is not capable, by itself, of achieving accountability tenets.

Sanctions are needed to monitor business activities. As Schulusberg (1969, p.66) states, business enterprises have significant economic, social and political power and The Corporate Report summarises,

The public's right to information arises... from the general role played in our society by economic entities. Such organisations, which exist with the general consent of the community, are afforded special legal and operational privileges, they compete for resources of manpower, materials and energy...(ASSC, 1975, p.25).

Birkett (1988, pp.7-8) discusses the obligations related to these powers. He elaborates the notion of communal accountability as an acceptance of an obligation to act in accord with the norms of a community. Accountability is demanded of company managers as a check on possible abuse of the power accorded them by society via the provision of resources (Porter, 1990a, p.96; Tricker, 1982, p.58). Public accountability would encapsulate a larger component of communal accountability than is traditionally held.

Harris & Spannier (1976, pp.254-255) conclude that accountability attaches liabilities to people's obligation in the sense that they are open to sanction if their accounts are unsatisfactory. This concept embodies notions of blameworthiness and liability to punishment (Blatz, 1972, pp.102-103). The implication of this view is that if the companies do not satisfy their obligations by failing to give a satisfactory account of their actions they will be liable to sanction (Porter, 1990a, p.89).

The audit function is thus considered a necessary condition (Gray et al., 1987, p.201) towards the advancement of accountability, It is not, however, a sufficient condition. The weaknesses of the Anglo-American accounting regulatory systems, as discussed in Chapter Two, exist despite the presence of auditing requirements. It is considered that dynamic, comprehensive and effective regulation is needed for accountability goals. The audit role is viewed as only one of the parts, albeit an important one, in the accounting regulatory framework for corporate reporting.

3.5.4 Essential ingredients of public accountability

Cyert & Ijiri (1974, p.32) believe that one of the fundamental objectives of financial statements is to communicate information for the discharge of accountability of an entity to parties to whom the entity is accountable. Some regard company managers¹⁸ as being accountable to society as a whole, this is seen to arise from the power and influence which business enterprises exert over the lives and welfare of members of society. A broad perspective is offered in the philosophy underpinning the recommendations of The Corporate Report (ASSC, 1975), one of 'public accountability'. It is considered that to report publicly is an implicit responsibility incumbent upon every economic entity regarded as significant in terms of the scale of its command over human and material resources being such that the results of its

18. The accountability criterion also applies to the producers of financial data. Whilst they are expected to operate the business successfully, they are also held responsible for the resources under their control (Ijiri, 1983, p.76). Rosenfield (1974, p.127) properly conclude that they should have a voice in the evolution of these objectives.

activities have significant economic implications for the community as a whole (Gray et al. 1987, p.43).

Public accountability incorporates the concepts of communication of a wide range of information to stakeholder groups with regulation seen as a tool of enhancement. The fulfilment of the reporting obligation for public accountability is thus seen to be,

The responsibility of an entity to communicate data to its stakeholder groups in recognition of the bond of accountability which exists with such groups. This involves the rendering of an account of both financial and non-financial nature. The data to be communicated will be dependent upon the changing needs and expectations of society. The dynamic nature of this communication needs to be safeguarded through institutional democratic processes. Since market forces cannot be relied upon to discharge this social responsibility, regulation is considered an important instrument in obtaining these means.

3.6 SUMMARY

Accounting as a social choice function has an important impact on societal welfare. The significance of two important societal intermediate goals, efficiency and equity, is highlighted. It is argued that corporate reporting must give explicit consideration to both these criteria.

Financial accounting theories are classified into four paradigms to enhance an evaluation of the end-purpose objective for corporate reporting. These paradigms are information economics, decision usefulness, accountability and critical thought. All these views are analysed with the accountability framework selected as the most appropriate societal viewpoint because of its broader perspective. The principle of public accountability is advocated and the need to report financial and non-financial information to stakeholders with a legitimate interest in the enterprise is advanced. Regulation is offered as an important instrument to promote such accountability.

CHAPTER FOUR: AN EVALUATION OF REGULATION THEORIES

4.1 INTRODUCTION

Several important accounting regulatory issues are discussed in Chapter Two such as the need for clear regulatory arrangements and constituent support. A range of possible objectives for corporate reporting is analysed in Chapter Three with the accountability paradigm advocated as being most closely aligned with a broad societal viewpoint. This chapter focuses on classification and evaluation of regulation theories. Regulatory theories and practices are evaluated and linked to financial accounting objectives. It is argued that under the public accountability perspective (Section 3.5.4), regulation is used as an instrument to pursue equity and efficiency goals. This view has important regulatory design implications such as the need for a clear and accepted system of due process.

4.2 REGULATION DEFINED

A broad definition of regulation is offered by Mitnick (1980) as "the intentional restriction of a subject's choice of activity, by an entity not directly party to or involved in the activity" (p.5). A narrower definition of regulation within the realm of accounting is tendered as "...the imposition of constraints upon the preparation, content and form of external financial reports by bodies other than the preparers of the reports, or the organizations and individuals for which the reports are prepared" (Taylor & Turley, 1986, p.1).

Regulation is expected to facilitate the production of information deemed important which the marketplace cannot or will not provide (Mitnick, 1980, p.290). Regulation is thus deemed to have two main characteristics: 1) intent to enhance societal welfare and 2) enforcement capabilities. In this thesis regulation is advocated as an instrument to pursue societal goals, in particular public accountability, in that it lessens preparers' freedom of choice (to some degree) to aid stakeholder groups.

4.3 RELATIONSHIP OF REGULATION AND INTERMEDIATE GOALS

How well does regulation assist in the pursuit of societal intermediate goals such as equity and efficiency? Specifically, does regulation enhance public accountability

goals? There are two major difficulties researchers face in this area. First, determining how to measure the total set of benefits which may be derived from the imposition of regulation and second, quantifying the costs of mandated rules (Watts & Zimmerman, 1986, p.172). In the accounting literature many diverse opinions are offered. These viewpoints can be broadly classified as pro-regulation and anti-regulation in nature.

4.3.1 Arguments favouring accounting regulation

Beaver (1981, pp.187-196) gives three arguments justifying market regulation as: the existence of inadequate incentives to disclose information, unequal possession of information and motivation to suppress unfavorable information in an unregulated environment. Regulation is deemed important to correct malfunctioning or undesirable activity, and to help control externalities. An overview of important rationales for regulation is summarised in Table 4.1.

Table 4.1 shows several scenarios where regulation may be appropriate, most of the concerns stem from market failure perceptions. Inefficiency of the capital market is referred to as market failure¹, with its existence and magnitude important issues of contention. This term is defined by Scott (1981) as "the failure of freely functioning markets to provide Pareto Optimal Output " (Footnote 2, p.2). However, his definition focuses exclusively on an efficiency criterion and improperly ignores information equity issues. As Cooper & Keim (1983) state, "The fundamental economic rationale for the regulation of corporate financial disclosure is that information markets will not function efficiently and fairly in the absence of government regulation" (p.190).

Peirson & Ramsay (1983, p.290) summarise market failure concerns when they discuss two main arguments² for regulation of financial reporting based on inefficiencies and inequities arising from the public good-nature and information asymmetry respectively. Improvements in these intermediate goals, it is argued, will enhance public accountability.

-
1. This term is also applied to issues of equity--i.e. information asymmetry, (Cooper & Keim, 1983, p.190).
 2. These arguments are derived from market economics. Peirson & Ramsay (1983, pp.290-295) discuss three views concerning regulation of financial reporting: market economics approach, legal, and public choice theory. These views are categorised (albeit slightly differently) in Section 4.4.

TABLE 4.1 RATIONALES FOR REGULATION**I To correct intentional activity that:**

- a) is judged desirable in ideal situations but malfunctions in practice;
- b) is judged undesirable with respect to the public interest.

Under I:

Intermediate goal sets are considered important.

Therefore, regulate where:

- 1) competition can't survive;
- 2) competition exists but, because of imperfections, does not get competitive results.

Possible defects:

- a) buyer ignorance;
- b) excessive risk;
- c) discriminatory competition;
- d) hurtful competition.

- 3) competition exists, but other policies oppose reliance on it.

II To control unintentional by-products of activities (such as externalities³)

Source: Adapted from Mitnick, (1980, p.290).

The first market failure scenario is the public-good nature of accounting information. Samuelson (1954, pp.387-390) describes a public good as any resource in which the consumption by any individual does not diminish the quantity available for others. Accounting information is generally thought of as having the characteristics of a public good (Aivazian & Callen, 1983, p.227). Accordingly, it is considered to foster an underproduction of information in the marketplace because of the presence of 'free riders' (Solomons, 1983, p.107). The public-good nature of accounting means usual market mechanisms cannot easily function. Those who bear the costs of providing information will have little incentive to supply the amount of accounting data desired by the community, hence the supply of accounting information is unlikely to be socially optimal (Bromwich, 1981, p.48).

3. The presence of externalities in the marketplace is advanced as a possible cause of market failure (Dahlman, 1979, p.143). Beaver (1981) defines an externality as "the actions of one party have effects on other parties who are not charged (or compensated) via the price mechanism" (p.189).

The mechanism now adopted in America, Australia, Britain, Canada, and New Zealand to ensure the supply of accounting information in the presence of free riders, is through a dual system of legally enforced disclosure rules and the use of rule-making bodies (Bromwich, 1981, p.48; Carrington, 1986, chap.6). Governments may intervene if the true preferences for accounting information are found to be unsatisfied (Bromwich, 1981, p.49).

The other market failure problem relates to information asymmetry. Information under this concept is thought to be disseminated unevenly with some individuals in the marketplace, such as corporate managers, having far greater access to news than others (Peirson & Ramsay, 1983, p.291). Akerlof (1970, p.489) likens information asymmetry to buying lemons (i.e. deadbeat cars) from a second hand car dealer, in that the lack of quality data can result in less-optimal resource decisions. Further accentuating this problem is the realisation that actions that maximise managers expected utilities may not maximise the utilities of other stakeholder groups (Watts, 1977, p.55), resulting in inequities.

The equity criterion can be defended from a broad sociopolitical perception as well as an economics perspective. A broad view, advanced by authors such as Gray (1991), argues that for democracy to operate efficiently and equitable the actions of major organisations such as companies need to be transparent and open to scrutiny (see also Pallot, 1991, p.203; Williams, 1987, p.172).

From an economics viewpoint, the social consequences of ignoring equity concerns are higher transaction costs, lower liquidity and thinner markets (Lev, 1988, p.3). These adverse social effects are the result of defensive measures taken by uninformed investors because of perceived inequities in the market (Lev, 1988, p.7). Ronen (1979, p.416) concludes the formulation of accounting standards, the audit institution and the push for uniformity of accounting and auditing standards have all evolved in an attempt to deal with the information asymmetry problem.

Efficiency criterion, in the absence of equity, has been found to be unsatisfactory (Pierson & Ramsay, 1983, p.290). This thesis advocates that both equity and efficiency considerations be given equal weighting. Regulation in financial reporting is called for in situations where accounting information is not distributed evenly (Section 3.2.4). The feeling prevails that a more level playing field can be established if insider-only information is publicised and made available to the general public (Lev, 1988, p.1). Ronen (1979, p.441) considers the role of accounting information is

to convey openly what otherwise constitutes inside information. Regular and timely disclosure regulation can mitigate these effects (Lev, 1988, p.9).

Regulation can thus be seen to assist the achievement of intermediate goals such as equity and efficiency and therein enhance public accountability. As Bromwich & Hopwood (1983, p.xi) argue, accounting regulation is required because in its absence management would only provide information which would further their interests without concerning themselves with the desires of the stakeholders.

4.3.2 Explanations against regulation in accounting

The two main arguments against accounting regulation are that socially optimum conditions are unobtainable and that the costs of regulation exceeds any benefit derived. The concept of market failure is disputed by some researchers, primarily the agency theorists. Leftwich (1980, p.195) asserts the social optimum desired by pro-regulators is unobtainable and relates this thought to a 'grass is always greener fallacy' and Baxter (1981, p.7) wonders if accounting standards are overly idealised as curing the world's ills. Leftwich (1980) feels "It is illogical to condemn the actual output of an existing market (or government agency) merely because the quantity or quality of that output differs from an unattainable norm that is falsely described as optimal" (p.208).

This line of argument is flawed in that social improvements (versus optimum solutions) are ignored. Lev (1988, p.11) contends that private incentives (in the absence of regulation) leaves disclosure at a sub-optimal level. As Bell (1988) observes, "Private markets have in fact not developed over the years a lot of information" (p.14). Watts & Zimmerman (1986) admits that "Market failures suggest that social welfare can be improved in a Pareto sense by government regulation moving the private output closer to the social optimum" (p.163). It is considered that market forces do not supply the nature and level of information sought by stakeholders (Section 4.3.1). Improvements to social welfare can thus result from regulation.

Another argument against regulation is that the costs exceed any benefit derived (Stigler, 1964, p.133). Ronen (1979, p.441) summarises efficient market research studies which state accounting reports are only one of the sources of information for capital market agents and they should only report information which is more costly to obtain elsewhere and whose social benefits exceed the social costs. Watts & Zimmerman (1986, p.157) assert that the Efficient Market Hypothesis reduces

arguments for traditional disclosure regulations to unsubstantiated claims about relative costs and benefits. For instance, Phillips & Zecher (1981, p.44) conclude that the American SEC regulatory system fails the cost/benefit test. Benston (1980, 1981, 1982a, 1982b) lists specific costs of regulation as: increased audit fees, higher administrative costs, and the possibility of giving away market sensitive information to competitors and he thus considers that there were few valid arguments for additional regulation in the public interest.

These arguments ignore the benefits that regulation can create. Cooper & Keim (1983, p.191) observe that regulation reduces the cost of capital for all firms by enhancing the perceived integrity and credibility of the investment process. Moreover, regulation can offer cost savings; Davis & Menon (1987, p.201) discuss how the absence of an American Cost Accounting Standards Boards led to increased costs which eventually lead to their reimplementation (Hubbard, 1990, p.56). Cooper & Keim (1983, p.191) argue that the equity perspective should be considered rather than devoting total reliance upon efficiency and cost/benefit analysis. Both societal intermediate goals: efficiency and equity, can be enhanced by regulation. This thesis adopts the view of Mitnick's (1980) statement that "defects in competition can be related to the intermediate goal set and thus be sufficient reasons for considering regulation" (p.310).

4.3.3 Professional self-regulation

Regulation of financial reporting by companies can take many forms (Rahman, 1991, p.29). For example, self regulation by the accounting profession is utilised in Anglo-American countries, especially Britain and New Zealand. As discussed below, it is considered that this form of regulation is inadequate in achieving the goals of public accountability.

Professional self regulation, if successful, could be seen to achieve the goals of public accountability without the need for external action. Hines (1989a, p.73) details the history of accountants obtaining professional status as a group of people that display specialist skills and exhibit a willingness to impose a higher degree of regulation and ethics upon themselves. In an attempt to achieve this status the accounting

professional bodies use two main control techniques: codes of ethics and mandated⁴ member support (Peirson & Ramsay, 1984, p.32).

Peirson & Ramsay (1983, p.296) summarise four important concerns of the self-regulation approach. The first problem with self-regulation is that there is no mechanism for enforcing compliance against non-members. Directors, although having the legal responsibility for corporate reports, are not usually members of the professional accounting body (p.296) and thus do not come under the purview of the accounting profession. Second, the typical enforcement mechanism is not mandatory compliance, but mandatory disclosure of non-compliance (p.296). Thus compliance with accounting rules is not required, rather the specification is simply to disclose the failure to comply. This approach is too weak in that it fails to provide the sought after information. Third, is the lack of effective disciplinary action against members. Zeff (1988, p.20) notes that no accountancy body in the world has expelled a member for failure to comply with accounting standards. This remarkable predilection greatly tarnishes the concept of self-regulation for accounting. Finally, the question arises about the appropriateness of accountants dominating the standard-setting process (Hope & Briggs, 1982, p.87). For example, Willmott (1986, p.559) describes the primary purpose of professional associations is to define, organise, secure and advance the interests of their own members. These actions may not necessarily be in the public interest and as Hopwood (1990, p.83) notes the accounting profession is increasingly being asked to be accountable for its own actions. These forceful criticisms show the weaknesses of professional self-regulation. Better devised mechanisms are needed.

Regulation provides benefits as it assists in the pursuit of intermediate goals and public accountability. The benefits include the mandated provision of a greater level of financial and non-financial data. Further, regulation provides a more equitable atmosphere and can greatly help the communication process between preparers and stakeholders.

4. Financial accounting standards are a form of regulation because they restrict management choices and force a reporting format (Sutton, 1984, p.81). A professional accounting standard can be described as a declaration, with the official support of the accounting profession, of what should be done (Gibson, 1976/1977, p.19).

4.4 REGULATION THEORIES AND FINANCIAL ACCOUNTING PARADIGMS

Part of the problem in evaluating the success of regulation in meeting stated objectives is attempting to determine the original purpose for the promulgation of these rules. Different underlying motives for regulation are, therefore, examined in the following section and linked with the financial accounting paradigms discussed in Chapter Three.

4.4.1 Theories of regulation

Regulation theories are based mainly on public and private interest arguments. Public interest theories perceive regulation as a method of improving societal welfare. In contrast, private interest theories are oriented toward the wealth maximisation of certain individual interest groups (Mitnick, 1980, p.111). Public interest theories are normative (i.e. what should be), whereas private interest theories strive to describe and explain (i.e. a more positive perspective).

Under public interest theories the purpose of regulation is expressed in the need for public protection or interest (Peirson & Ramsay, 1983, p.293). Regulation is seen as correcting market imperfections such as monopoly situations. These theories "assumed that regulation is established largely in response to public-interest related objectives" (Mitnick, 1980, p.91). There are two main versions, the original theory and a reformulation (Posner, 1974, pp.336-337). The original version of public interest "holds that regulation is supplied in response to the demand of the public for the correction of inefficient or inequitable market practices" (Posner, 1974, p.335).

Posner (1974, p.337) describes the reformulated version as the perception that regulatory agencies are created for bona fide reasons but are then mismanaged. Mitnick (1980, p.94) distinguishes three possible explanations for deviations from public interest effects. The first view is that the regulators are or become venal (evil). The second is that the regulators are or become incompetent. The final sentiment is that regulation becomes captured by the regulated interest groups.

The accountability paradigm's social welfare focus, as discussed in Chapter Three, would seem to encompass both the original and reformulated versions of public interest theories. The original perspective could be viewed as the successful application of regulation whilst the reformulated version ^{could be} contrasted as the failure of accountability tenets to be instituted.

Members of the governing elites within accounting frequently publicise the commitment of the profession towards the development of accounting rules (regulation) in the public interest (Buckley, 1980, p.58) and Mitnick (1980) observes that "... public interest rhetoric invariably accompanies legislative and judicial decision-making in the regulatory area" (p.275). Numerous scholars are cynical about the idea of pure public interest theories. They feel that private interest theories offer a better explanatory⁵ tool for regulation.

Under private interest theories regulation is recognised as a mechanism designed to confer benefits on politically effective groups (Peirson & Ramsay, 1983, p.293). Regulation is viewed as the product of coalitions between regulated industry and related interest groups, the former obtaining some monopoly profits from regulation, the latter obtaining higher prices. All these parties gain at the expense of unorganised groups such as the consumers and the public at large (Posner, 1974, p.351). For instance, Bailey (1976, p.82) argues that politicians will institute regulation in times of crisis to appear active and effective (see also Downs (1957, p.137)).

These private interest theories have been applied to accountants. Buckley (1980, p.60) feels the accounting profession employs a rule-making apparatus to enhance the price of its products through the process of restricting entry, restraining supply therein increasing the price charged. There are several versions of private interest theories to explain regulation, each of which focuses on one major group in society (see Table 4.2).

TABLE 4.2 THEORIES OF REGULATION

TWO MAIN CONFLICTING THEORIES	
<u>Public interest theories</u>	<u>Private interest theories</u>
Original version Reformulation	Consumer protection Industry protection Marxist/muckraker view Political scientist view Economic theory of regulation

5. It is noted that the private interest school of regulation also has its normative basis. For instance, agency theorists perceive regulation from a contractual viewpoint (Jensen & Meckling (1976), Watts & Zimmerman (1978, 1986, 1990). This perspective stems from neo-classical economics which has its own neo-conservative biases (see Tinker et al. (1982, p.172; Tower & Kelly (1989, p.14))

Within private interest theories three main viewpoints are offered to explain the regulation phenomenon: consumer protection, industry protection and the economic theory of regulation (Table 4.2). The consumer protection theory is the traditional view of regulatory origin wherein rules/laws are begun at the behest of adversely affected groups to correct abuses (Mitnick, 1980, p.176). Under this viewpoint, consumers are seen as the recipient of protection from either a product or an activity. This protection could take various forms such as quality controls or maximum price restrictions which could conceivably result in lower industry profits. The decision usefulness paradigm of financial accounting objectives (discussed in Section 3.3.2) would seem to be especially applicable to this theory. Useful information is seen to be provided to control price and quality decisions for the consumer's benefit.

Under industry protection theories it is reasoned that regulation is not necessarily bad for a profession. This perception claims that the true purpose of regulation is to provide producer (i.e. preparer) protection. For instance, Stigler (1971, p.5) views price protection and barriers to entry as two important advantages that the regulated industry may garner from regulation. Under this viewpoint, the regulatory agency is seen to be captured, therein controlling policy and enforcement matters. Some industries rather than discouraging regulation may actively seek such restrictions, feeling that life within a regulatory industry reduces competition and inhibits supply, thereby increasing the price one can charge.

Posner (1974, p.341) distinguishes two types of capture theories; the Marxist/muckrakers view and the political scientist perspective. The Marxists/muckrakers version states that one of the tools that capitalists use to control the wealth in society is regulation. Various individuals within the critical thought financial accounting paradigm might agree with this viewpoint. For example, Merino & Neimark (1982) describes the promulgation of the Securities Acts in America in the following manner, "sociohistorical analysis suggests the securities acts were designed to maintain the ideological, social, and economic status quo..." (p.49). Many of these (critical thought) scholars argue that regulation maintains the existing positions in society which effectively freezes out certain less powerful groups such as employees, consumers and the local community (see for example Tinker (1985)).

The political scientist viewpoint states that over time regulatory agencies are dominated by the industries regulated. This theory predicts a regular sequence, in which the original purposes of a regulatory program are later thwarted through the

efforts of the interest group. For instance, Walker (1987, p.282) vehemently argued that the Australian standard setting body was captured by the accounting profession.⁶ The decision usefulness financial accounting paradigm could be seen to apply to this narrow producer class in that useful information is employed as part of this capture process.

The economic theory of regulation as expounded by Stigler (1971) disregards the assumption of pristine legislation promoted for the public interest. The theory admits the possibility of capture by interest groups other than the regulated firms and replaces the capture metaphor by the more neutral terminology of supply and demand (Rahman, 1988, p.95). Stigler (1971, p.3) agrees with the political scientists that economic regulation served the private interests of politically effective groups. The economic theory of regulation is committed to the assumptions of general economic theory, notably that people seek to advance their self-interest and do so rationally (Mitnick, 1980, p.343). This theory utilises the views of the information economic financial accounting paradigm. Regulation is viewed as a product whose allocation is governed by laws of supply and demand (Posner, 1974, p.344).

Is accounting regulation then a system to diminish market imperfections or is it a tool for the profession to maximise returns? The answer is probably a mixture of the two, as Davis & Menon (1987) state, "It seems reasonable to presume ... that both public and private interest considerations are present in any decision to institute regulation. The issue would seem to be one of relative proportion" (p.191). Properly designed regulation, taking into account different interest groups' motives, is considered an important instrument for public accountability.

4.4.2 Linkages between regulation theories and financial accounting paradigms

A constructive overview can be observed when public and private regulation theories are compared with financial accounting paradigms (see Table 4.3). Whilst the financial accounting paradigm classification scheme may not unfailingly link with regulation theories, it does appear to offer useful insights.

Table 4.3 categorises the accountability paradigm as encompassing public interest theories because regulation is perceived holistically as a way to protect and improve societal welfare. In contrast, the other three financial accounting paradigms appear to incorporate different parts of private interest theories of regulation.

6. See Rahman (1988) for an in-depth refutation of this claim.

TABLE 4.3 LINKAGES OF REGULATION THEORIES WITH FINANCIAL ACCOUNTING PARADIGMS

<u>Regulation theory</u>	<u>Financial accounting paradigm</u>
PUBLIC INTEREST:	
Original version	Accountability
Reformulation	Accountability
PRIVATE INTEREST:	
Consumer protection	Decision Usefulness
Industry protection	
Marxist/muckraker view	Critical Thought
Political scientist view	Decision Usefulness
Economic theory of regulation	Information Economics

The deemed required level of regulation amongst these financial accounting paradigms appears varied. The quest for accountability, amongst all the paradigms discussed, necessitates the most significant role for regulation. Under the accountability perspective, it is thought that extensive, authoritative accounting standards will provide a higher quality and quantity of corporate information both financial and non-financial in nature.

4.5 CHOICE OF PUBLIC ACCOUNTABILITY AND PUBLIC INTEREST THEORIES

Accounting standards, as a form of regulation, restrict choice in how and in what manner corporate information is presented. These minimum requirements can be seen to enhance comparability between statements and therein aid the public (ASAC, 1987, para. 260).

This thesis takes the view that the reformulated version of public interest theory and the accountability paradigm provide a sound theoretical basis to pursue the intermediate goals of equity and efficiency. Several impediments to accounting regulation are highlighted in Section 2.4. Especially problematic are qualitative issues such as constituent support, due process and regulatory arrangements. Regulatory arrangements which are effective, open and participatory would appear to be an appropriate path to pursue accountability.

4.6 ACCOUNTING STANDARD SETTING ISSUES

Constituent support and preparer compliance are important features of public accountability (Section 3.5). The level of compliance with professional accounting rules and standards is influenced by two important aspects: the enforceability of those standards and their acceptability to preparers and stakeholder groups (Masel 1983, p.542; Stamp 1979, p.21). Accounting rules and standards which are not generally accepted and do not have strong enforcement capabilities are unlikely to generate the nature of information sought by their makers because of low levels of compliance. Failure to understand the powers and reactions of various interest groups may lead to non-acceptance of the accounting standard (Mathews & Perera, 1991, p.105). The degree that an accounting promulgation acquires and maintains political support can thus be crucial (Horngren, 1973, p.65).

4.6.1 Politics of standard setting

It is considered that as part of the due process procedures the political nature of standard setting should be acknowledged and accepted (Section 2.4.1.2). Support will be higher when constituents feel that their views are heard by the standard setting body (Tower & Perera, 1989, p.21).

It was originally thought that accounting rules were nonpolitical (Solomons, 1978, p.65). Hope & Gray (1982, p.531) believe, however, that the lack of clear guidelines and a conceptual framework, and the potential economic consequences of these rules virtually guarantee all accounting standards have some element of controversy. Zeff (1978, p.56) discusses the increasing trend of outside forces participating in the accounting rule-making process. He reasons this was because of economic consequences⁷ which he defines as the "impact of accounting reports on the decision-making behavior of business, government, unions, investors and creditors" (1978, p.56). Lev (1988, p.16) criticises much of the economic consequence research for focusing on the economic interests and behaviour of the average investor, whilst ignoring the welfare of the individual.

7. Since Zeff's (1978) seminal work there have been numerous empirical studies on the economic consequences of financial accounting standards. For example, research has been conducted on: leases (Imhoff & Thomas, 1988, p.278; Taylor & Turley, 1985, p.60); foreign currency (Griffin, 1982, p.56); extractive industries (Collins, Rozeff, & Dhaliwal, 1981, p.63; Deakin, 1989, p.150; Jain, 1983, p.637; Larcker & Revsine, 1983, p.717); and various other accounting issues (Chow, 1983, p.499; Ingram & Chowning, 1983, p.562; Meek, 1983, p.401; Pownall, 1986, p.314). These studies tend to accept the neo-classical assumptions of the individual as the welfare maximiser (see for example Hakansson, 1981, p.4; Sunder & Haribhakti, 1984, p.166).

The political nature of the standard setting process is now widely acknowledged (Hope & Briggs, 1982, p.83; Horngren, 1973, p.61; O'Leary, 1985, pp.96-98). Hussein & Ketz (1980) consider the term, political, as referring, "to situations involving conflict and an institutional means of resolving the conflict" (p.357). They state that accounting standard setting bodies attempt to regulate the conflict. Gerboth (1973) feels the chief obstacle for a standard setter is dealing with the conflict between interest groups and argues, "Accountants' value judgements...will prevail only if the financial community has confidence in the fairness of accounting's rule-making tribunal and the procedures it follows in making its rules" (p.479). Thus, it is asserted that acceptance of the standard setting process by the relevant parties is a necessary condition for the success of the accounting standards.

Walker (1987, p.283) believes that regulation of accounting has become more closely aligned to a type of interest group politics called neo-corporatism where efforts to secure consensus are achieved through government recognition of interest groups and the granting to those groups of privileged access to the policy making process. Daley & Tranter (1990, p.15) acknowledge the political element when they state that decisions should be based on a hierarchy of desirable social effects. As Gerboth (1973) argues,

...a politicalization of accounting rule-making was not only inevitable, but just. In a society committed to democratic legitimization of authority, only politically responsive institutions have the right to command others to obey their rules. To remove that kind of power from politics is to remove it from the public scrutiny and accountability that are essential to democracy (p.481).

4.6.2 Lobbying activities

Political considerations are regarded as a legitimate component of public accountability, in the accounting standard setting arena these views are usually expressed through lobbying efforts. Lobbying is described by Sutton (1984) as the "actions which 'interested parties' take to influence the rule-making body" (p.81). Studies examining lobbying influence implicitly accept the political nature of accounting (Gerboth, 1973, p.480).

Because of its political nature accounting issues can be decided by voting rule (May & Sundem, 1976, p.750). Sutton (1984, p. 83) observes that Down's voting model is readily transposed to a lobbying⁸ context. Downs (1957, p.138) argues that the

8. Sutton (1984, pp. 84-85) lists the major differences between lobbying and voting as fewer rules and higher stakes.

rational individual will vote only if the perceived benefits from voting exceed the costs in that the voter will take account of the likelihood that his/her decision to vote will sway the outcome. As Downs (1957, p.141) points out, it is the size of the potential gain from shaping government policy that turns voters into influencers (also see Sutton, 1984, p.83). Consequently, an important explanation for the lack of stakeholder input within the accounting standard setting process is offered. Stakeholders, given very limited access and power, do not usually participate because they judge the likelihood of changing the standard setters perceptions very small. A rearrangement of regulatory structures is needed to ensure greater stakeholder participation.

Morris (1986, p.46) states that lobbying of accounting standards may take different forms: financial, media interest, oral or written submissions. It is, however, very difficult to detect all forms of evidence in this area since there is a strong probability that written submissions are only a part of the process of influence (Hope & Gray, 1982, p.553). Currie, Robinson & Walker (1987, p.1) note the likelihood of informal and oral submissions influencing the process.

Feroz (1987, pp.8-9) observes that lobbying efforts are expensive involving both time and effort outputs. He draws three implications from this: 1) costs will limit the number of lobbyists, 2) only those who expect large benefits will lobby and 3) a group is more likely to lobby on provisions specific to the industry in which it operates (p.9). Sutton (1984, p.86) believes that preparers of financial statements have a greater incentive to lobby than stakeholders since their homogeneous interests makes it easier for them to form temporary lobbying organisations. Currie et al. (1987, p.21) maintains that non-participation is (at least in part) explained by ignorance⁹ either of the proposals, or of their implications. Another reason for stakeholder non-participation is the small expectation of having a consequential impact upon the process.

9. Thus the importance of educating the public, as to the impact of accounting standards and modes of expressing their opinions, is highlighted.

Morris (1986, p.48) emphasises an important implication of research critiques in this area: lobbyists seem to differ systematically from non-lobbyists, therefore, standard setters¹⁰ are receiving a biased sample of opinion. Yet, conventional Anglo-American accounting standard setting procedures place great emphasis on lobbying activity through the exposure draft process indicating a flaw in their contemporary due process procedures.

4.6.3 Dynamic nature of regulation

Rules and rule-making bodies evolve and change over time (Mitnick, 1980, p.31). Nevertheless, a frequent criticism is that many researchers treat the regulatory body as a neutral, static, black box (p.120). Hopwood (1990, p.84) observes that accounting institutions are concerned with both the immediate problems of regulation of accounting and the longer-term issue of who regulates accounting.

The regulatory changes and adjustments are highlighted in Bernstein's classical 1955 work in describing the life cycle of a regulatory commission. This life cycle is in effect a theory of decay. Bernstein's regulatory bodies, as detailed in Figure 4.1, has four phases: gestation, youth, maturity and old age.

The dynamic nature of regulation is highlighted in Figure 4.1. Regulatory forms, in conformity with a public accountability perspective, exist in the wider environment and are subject to changes and adjustments from time to time in response to changing conditions and circumstances.

Davis & Menon's (1987, p.196) case study of the American Cost Accounting Standards Board (CASB) provides evidence for the Bernstein model. They believe

10. There have been numerous lobbying studies on the issue of interest group domination in the accounting standard setting process (see for example Coombes, 1983, chaps 5-6; Coombes & Stokes, 1985, p.41; Haring, 1979, pp.514-515; Hussein & Ketz, 1980, p.363; Hussein & Ketz, 1991, p.70; Newman, 1981a, p.261; Newman, 1981b, p.140; Puro, 1984, p.645; Rockness & Nikolai, 1977, p.167; Selto & Grove, 1982, p.680; Selto & Grove, 1983, p.622). Currie et al. (1987, pp.8-10) and Hope (1985, p.5) offer important critiques of research in this area when they state that the research conclusions are drawn from a limited component of the process (i.e. submissions to exposure drafts) and note the tendency to overly generalise conclusions. Studies have also examined the variables that could predict lobbying efforts (Francis, 1987, p.52; Kelly, 1985, pp.629-630). However, Griffin (1983, pp.136-137) found that many variables such as size, return and leverage were only marginally better at predicting lobbying activity than a random model. Amershi, Demski & Wolfson (1982, p.20), in a general critique, considers that much of the research in these areas focuses on single-item or single-period therein missing possible important gaming strategies.

that the absence of a strong constituent group for the CASB was a major feature of the demise of this regulatory body and argue that,

Changes in the sociopolitical environment in the late 1970s altered the incentives of elected officials, encouraging them to dismantle agencies or reduce their regulatory ambit....In the new regulatory environment, an agency that lacks a strong supportive constituency is likely to have to fight hard to retain its funding and survive (1987, p.197).

FIGURE 4.1 BERNSTEIN'S (1955) LIFE CYCLE OF REGULATORY BODIES

Gestation

The conception of a regulatory body is often sparked by a crisis. The struggle to establish the regulatory institution usually leads to a compromise solution about the eventual make-up. Short-term simplistic solutions are sought.

Youth

Vigorous, crusading attitude is exhibited. The body encounters well organized resistance from the regulated industry. The regulated industry begins to influence the regulatory body.

Maturity

The regulatory body is less active as it now relies on precedence and routine. It loses support from the legislature and becomes captive to the regulated industry.

Old Age

Staff and management declines. Maintenance of the status quo is a high priority and the regulatory body is unwilling to adapt to changing needs. It now protects the regulated industry. The legislature is now unwilling to maintain funding.

Scandal, crisis or emergency can once again trigger a drive for a strong regulatory mechanism and hence the cycle may repeat itself.

Source: Adapted from Mitnick (1980, p.46).

As emphasised by Bernstein (1955), changes in regulatory mechanisms are usually caused by a perceived crisis. This crisis theme is applicable to accounting (see for example Rahman, 1988, p.99; Wells, 1978, p.16). Kirk, the past FASB Chairman, describes this element,

The extent of standard setting will depend on the economic environment-turbulent times will demand more standards than stable times. Without economic stability, government intervention is likely to increase. Instability encourages regulation of economic behavior (quoted in Hepp & McRae, 1982, p.62).

Hope & Briggs (1982) argue that "...the survival of the policy making body must rest ultimately on *public confidence* in its standard-setting procedures, a process is needed which is seen to be open and fair by interest groups" (p.95). The importance of constituent support is consequently deemed crucial to the survival of the regulatory institution, without it new institutions may be instituted¹¹.

4.7 REGULATORY ARRANGEMENTS

As emphasised above, broad representation of the stakeholder and preparer groups on the standard setting body would provide a strong constituent group base for its activities. This would help enhance the level of acceptability accorded to the standards by those groups, and therein improve public accountability. As Horngren (1973) states when describing the FASB arrangement, "The key to a successful enterprise is to generate a product that is *acceptable* to customers" (p.62). A crucial element in this acceptance is how the rule-making body is viewed by its constituents i.e. how equitable and efficient is the process? The accounting regulatory (standard setting) process can be examined in three phases: the design phase, the approval phase and the enforcement phase (Morley, 1985).

4.7.1 Design phase

The design phase of developing accounting standards is important because it effectively sets the agenda for selection and can thus establish priorities. Hope & Gray (1982, p.551) note the importance of a crucially placed person (i.e. chairperson) in the process. Cobb & Elder (1972) discuss three stages in the agenda building process: 1) issue creation often arises with regulation via a crisis situation, 2) issue expansion is the stage where support is mobilised to gain access to the decision makers' formal agenda, and 3) agenda entrance which entails dealing with the 'gatekeepers', normally considered the politicians and key bureaucrats. Plott & Sunder (1981, p. 237) believe that agendas are used to determine (within limits) the choice of a voting group.

Another aspect of accounting standard setting that needs to be considered is adequate funding. For example, both the Wheat Committee in America and the Dearing Committee in Britain sought to ensure that adequate funding was available for the standard setting body when they made their recommendations to establish the FASB and ASB respectively. As Zeff (1988) states, without adequate resources, "the

11. As discussed in Section 9.3, the accounting regulatory arrangements in New Zealand lack constituent support and are being altered.

quality of the drafting will be made to depend on the uncertain support services likely to be provided by the members' companies or firms" (p.20).

The accounting function through corporate reporting is deemed a social construct with an obligation to stakeholders acknowledged within the public accountability perspective. As such, accounting regulation needs to be designed in line with societal expectations. The achievement of this aspiration seems improbable in the current Anglo-American systems which have very little stakeholder input (Section 2.4.1.2). Accounting professional input is valuable, but is too narrow to monopolise this process. Overall, it is considered in this thesis that the design phase is most appropriately handled by those most technically competent, albeit with a pluralistic approach garnering input from various interest groups. Adequate funding is also reasoned to be essential.

4.7.2 Approval phase

Plott & Sunder (1981) point out an important paradox: the importance of having knowledgeable people participate in the standard setting process versus the issue of professional self interest and the potential for interest group capture within the regulatory institution. The dilemma is seen in the need to approve standards which are both technically defensible and politically acceptable (Wyatt, 1990, p.87), but the choice of the appropriate body and structure for the approval phase is complex (Parker et al., 1987, p.234). Public accountability, encompassing a societal perspective, requires the airing of a wide range of opinions. To ensure the consideration of a myriad of views, the approval body needs to rest outside the accounting profession, possessing significant non-accountant representation.

As discussed in Chapter Two the membership of Anglo-American accounting standard setters resides almost exclusively with accountants. Hope & Briggs (1982, p.95) argue that the range of expertise should be widened at the approval stage. They feel this could lead to a higher level of public confidence. As Gerboth (1973) states,

It is because our shortcomings are invariably political that accounting rule-making should not be completely turned over to technicians. Nothing in their training necessarily gives accountants particular competence in political matters, and because of that, they too often ignore politics in favor of those lesser aspects of a problem that are amenable to technical solutions (p.480).

There are several tasks the approval body could be asked to perform. First, it could implement an effective conceptual framework to provide clearer guidance (Parker et al., 1987, p.240). Second, this phase could seek to establish more definitively worded

standards for better understandability, enforceability and comparability (Walker, 1986). Third, the decision to allow an approval body the power to amend standards which are submitted for approval rather than have the mere power to *accept/reject*. As Parker et al., (1987, p.241) discuss, the right to amend is similar to the right to design, yet the failure to possess this authority inordinately shifts power to the designers.

Based on the above discussion, it is asserted that important elements be incorporated within the approval function for accounting standards. These elements would include the need for: wide non-accountant representation, explicit guidance on ways of fulfilling corporate reporting obligations via a conceptual framework and clearer financial accounting standards, and possessing sufficient structural power (i.e. the ability to amend and revoke as well as approve accounting standards).

4.7.3 Enforcement phase

As detailed in Section 2.4.1.3, the current procedures for enforcement in Anglo-American countries are inadequate. Zeff (1987, p.26), in a historical review, notes the increase in mandatory standards without a consideration of the continuous lack of enforcement. Professional self-regulation is considered a very weak type of enforcement (Craig, 1984, p.5). Typically in Anglo-American countries (excluding Canada) the accounting profession does not have the authority to ensure that the regulation is complied with since they usually only have disciplinary powers over their own members (Parker et al., 1987, p.233). Two suggestions are offered below to improve this facet of regulation: use of the registration method and more direct government intercession.

New Zealand has adopted a disclosure rule philosophy in the capital markets wherein the government only establishes the broad perimeters. Compliance is enforced via the courts which can often be a slow, cumbersome and expensive procedure (Walker, 1985, p.2). Convictions in a court are made much more difficult by vague and ambiguous language (Parker et al., 1987, p.239). In contrast, registration procedures where the regulatory agency has the power to unilaterally enforce the rules by refusing registration to the capital markets clearly give the regulatory agencies much greater authority over companies than do disclosure requirements (p.235).

Enthoven (1985, chap.4) believes that government regulations, because of their coercive nature, are more significant than private sector accounting standards. Craig (1986, p.12) notes a crucial dichotomy: the technical knowledge to set accounting

standards rests with the profession, yet the ultimate power to ensure compliance exists only with the state. As Parker (1986, p.4) suggests, the enforcement stage should be given to the entity equipped with the power to enforce, that is the government. Zeff (1988) also supports this view when he observes "a government agency is in a much better position to enforce compliance with accounting standards than is the council of a professional accounting body" (p.20).

In summary, an accounting standard setting body should have several important regulatory arrangement features in order to pursue public accountability goals such as equity and efficiency. The design phase should utilise the professions' technical expertise supplemented with input from a broad range of interest groups. The approval phase should be lead by an independent body with a large non-accountant component. The enforcement stage needs the coercive power of the state.

4.8 SUMMARY

The public accountability viewpoint, as advocated in Section 3.5.4, calls for the provision of a greater amount of qualitative and quantitative information, both financial and non-financial in nature. Regulation can be seen as the mandatory distribution of corporate data deemed important for purposes of equity and efficiency. Regulation, as an instrument of public accountability, can promote this public interest by increasing the supply of *society*-desired information.

An effective regulatory mechanism is crucial to the successful achievements of these goals. The important features include the utilisation of the technical expertise of the profession in the design phase, the introduction of a large non-accountant component in the approval phase, and the use of the state's coercive power in the enforcement stage. Furthermore, important structural features such as explicit due process procedures and consultation can greatly enhance constituent support and makes the survivability of the regulatory body more likely.

The issues raised in these last few chapters point to the need for an integrated model of regulation. A Public Accountability Model of Accounting Regulation is advanced in the following chapter. This Model incorporates the need for the dissemination of a wide range of information to fulfil public accountability tenets in tandem with the use of well-designed and supported regulation.

CHAPTER FIVE: PUBLIC ACCOUNTABILITY MODEL OF ACCOUNTING REGULATION

5.1 INTRODUCTION

This chapter presents a Public Accountability Model of Accounting Regulation based on the analysis in the last three chapters. The Model encompasses the public accountability viewpoint of financial accounting and public interest theories of regulation. The need for better communication, both financial and non-financial information, within corporate reports is emphasised. Regulation is considered an important instrument to supply the means of attaining this higher level of communication.

5.2 THE MODEL

Anglo-American accounting standard setting institutions are critiqued in Chapter Two. The review highlights important deficiencies such as the lack of independence, weak regulatory arrangements, the necessity for clearer objectives by the standard setters, and the requirement for better communication in the corporate report. The need for clear objectives, effective regulatory arrangements and the importance of constituent support is emphasised in Chapters Three and Four. Many of these elements are absent from present models of accounting regulation.

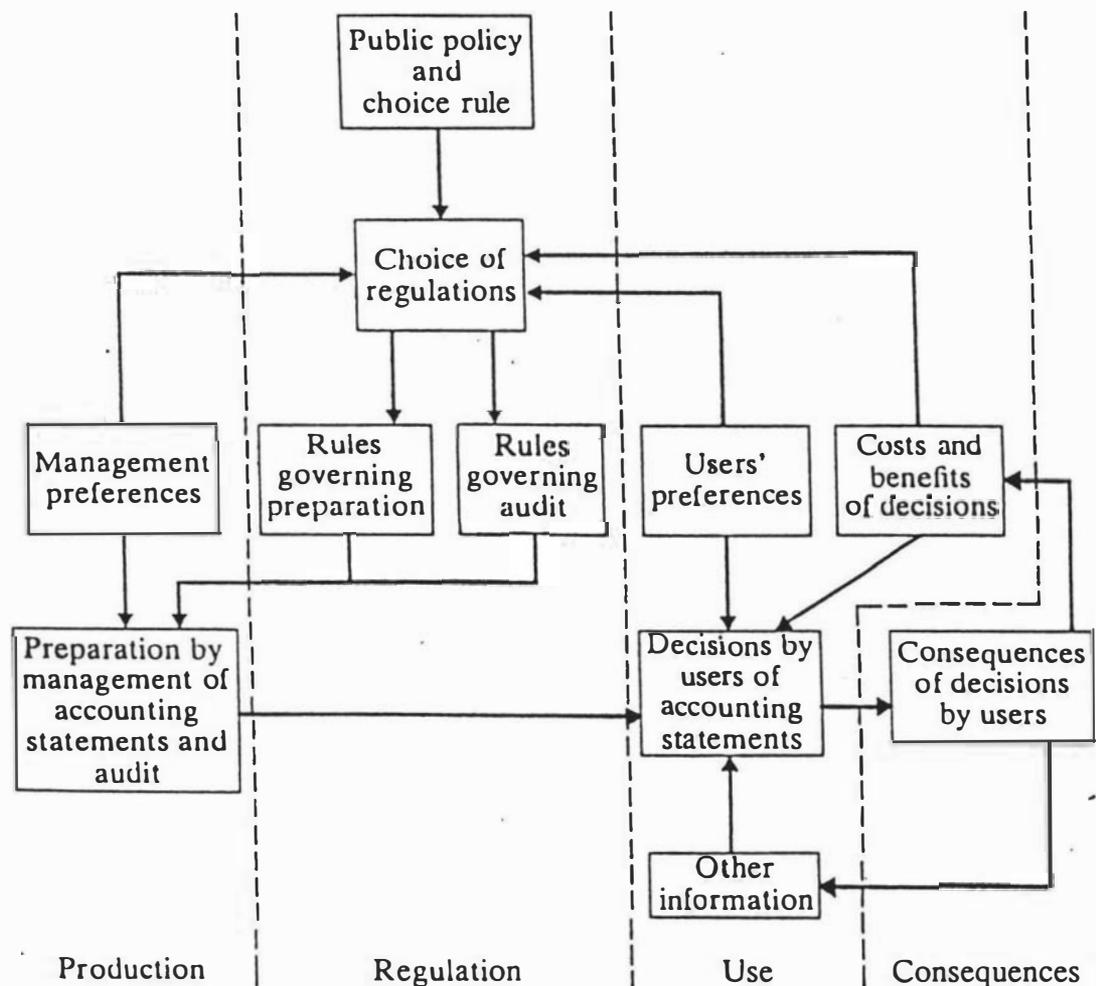
The word model is defined as "A miniature representation of some existing object...A tentative ideational structure used as a testing device" (The American Heritage Dictionary of the English Language, 1981, p.454). It is used in this thesis as a description of a structure to blend accountability precepts and the regulation mechanism. In essence the model seeks to answer both *descriptive and functional* questions. What would be in a public accountability model? What information would be required? How would it operate? How can constituent support be maintained? How can compliance be achieved? How would the requirements be enforced?

An utilitarian model of accounting regulation is found in the writings of May & Sundem (1976, p.752) as adapted by Taylor & Turley (1986, p.2). Under this model the environment of financial reporting¹ is seen to comprise four inter-related parts:

1. Gibbins, Richardson & Waterhouse (1990, p.128) argue that the current level of disclosure is determined by a combination of ritualism, opportunism and regulation.

production, regulation, use and consequences (see Figure 5.1). The basis of their model is the supply of corporate reports from preparers to users (Taylor & Turley, 1986, p.2). They argue these reports are influenced by accounting regulation, preparer predilections and stakeholder preferences (p.2). As highlighted in Figure 5.1, the responsibility for the production of annual reports rests with the preparers.

FIGURE 5.1 FINANCIAL ACCOUNTING ENVIRONMENT



Source: Taylor & Turley (1986, p.2) which was adapted from May & Sundem (1976, p.752).

The Taylor & Turley model operates primarily from a decision usefulness paradigm as it concentrates on the consequences of decisions to users. In contrast a public accountability framework, as advanced in this thesis, perceives corporate reporting as a feedback mechanism to stakeholders.

Regulation in the Taylor & Turley model is determined by public policy and choice rules which supposedly take into account both preparer and stakeholder preferences. The analysis in Chapter Two, however, underscores the closed nature of Anglo-American regulatory structures and brings into question the very low level of preparers and non-accountants.

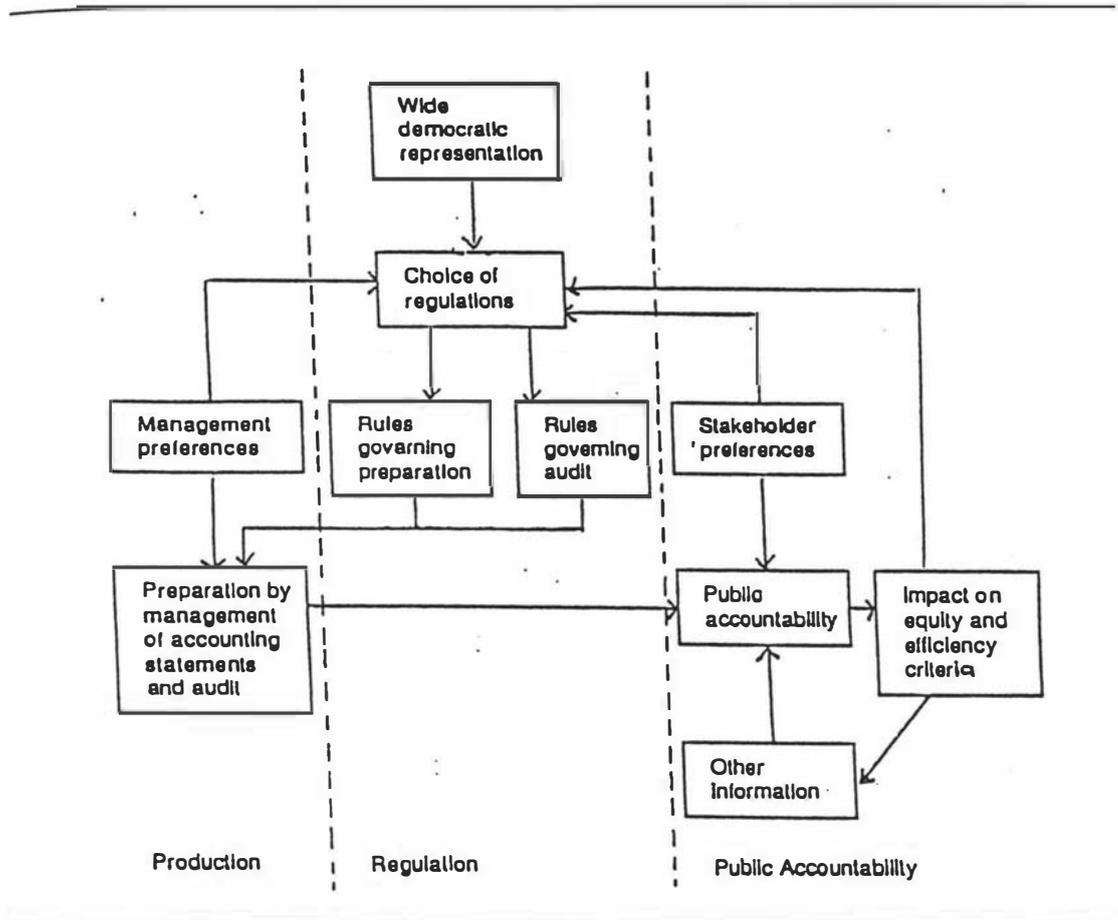
The distributional effect of accounting information generated by standards will affect the entire society. Indeed accounting itself is socially constructed (Mathews & Perera, 1991, p.99). As such, society has the right to participate in the promulgation of accounting rules. More stakeholder and preparer participation in the process is likely to increase the level of acceptance and constituent support. Stronger, more effective regulation enhances the equity criterion by making public a higher level of corporate data and greater efficiencies would result from a greater use of cost-benefit analysis along with a higher level of comparability in corporate reporting.

5.3 TOWARDS A NEW MODEL

The Public Accountability Model of Accounting Regulation deduced below focuses on three themes: the fiduciary duty to report, public accountability criteria, and the implementation of structures to safeguard stakeholder interests. First, preparers have a duty to report the activities of the enterprise in a timely and understandable manner. Second, public accountability objectives promote a theme of a broad range of stakeholders requiring adequate communication of enterprise data. Third, regulatory arrangements are offered as a method of furthering equity and efficiency goals.

A new Model of accounting regulation is given in Figure 5.2. It incorporates the wider view of corporate reporting information, provided by preparers, based on public accountability objectives. Specific, well-backed, effective regulation is a cornerstone.

FIGURE 5.2 PUBLIC ACCOUNTABILITY MODEL OF ACCOUNTING REGULATION



So how can the Public Accountability Model of Accounting Regulation be operationalised? Preparer preferences and concerns need to be examined via cost-benefit analysis. Yet, the disparity between preparer's willingness to disclose and stakeholder needs must be overcome. To ensure public accountability, the Model would possess: independence, wide representation, an open standard setting process, and adequate continued funding with an explicit focus on intermediate goals. To achieve this, regulation would be administered with wide enforcement powers such as implementation of the registration method, more powerful remedies and vigorous monitoring. The government will need to play a more direct role in the design and enforcement of accounting standards to ensure a more optimal movement towards equity and efficiency goals. Regulation can help overcome the public-good nature of accounting (which causes an underproduction of corporate data) and can provide a more level playing field to surmount information asymmetry.

This Model views accounting standards in the broader context, as a social choice function, with board representation of the key stakeholder groups as an essential

component. Strong, enforceable regulation is deemed crucial. Three main components are emphasised: production, regulation and public accountability.

Under this Model corporate reports are generated by preparers. Management's communication outputs are then modified by regulation. Regulation incorporates professional expertise, vetting by stakeholder groups and sufficient enforcement techniques. Auditors exert an important influence in their attestation of the report. Effective remedies are introduced to moot non-compliance. Public accountability precepts are explicitly heeded. Efficiency criterion is introduced via mandatory disclosures, clearer objectives and cost-benefit considerations. Equity criterion is emphasised by adequate board representation and mandated disclosure.

Important issues arise on an examination of the production element. How can preparer concerns about disclosure of costly and commercially sensitive information be reconciled with stakeholder needs? Some type of cost-benefit consideration may well be appropriate. Most commentators agree that reports should clearly communicate the state of affairs of the enterprise in an accurate and timely fashion. How well does this happen now? How can the status quo reporting techniques be improved?

5.3.1 Production component

The production component, in the proposed Model, is the purview of the corporate entity. Preparer's have the responsibility to report, at least annually, the state of affairs of the enterprise. It is considered that this responsibility is heightened for entities offering securities to the public due to their large economic impact (Section 1.4.2).

Preparers have a fiduciary duty to report (Section 3.5). Superior communication can be seen to provide a benefit to society. This responsibility includes more than just divulging conservative, financial activities which can be easily quantified. Non-financial activities, future prospects, corporate objectives are all important considerations which should be communicated. Cost-benefit concerns arise at two levels. First, is the questionable usefulness of old out-of-date information. Second, is the preparer's concern at generating costly data which may have very little benefit to society.

Under the Model the duty of preparers to communicate information to stakeholders has three main elements: timeliness, quality of communication, and cost-benefits constraints. Table 5.1 amplifies these elements.

TABLE 5.1 PRODUCTION ELEMENTS OF THE MODEL

<u>Element</u>	<u>Issue</u>	<u>Resolution</u>
Timeliness	Frequency	Bi-annual reports mandated.
		Consideration of quarterly reports for large entities.
	Movement towards on-line retrieval.	
Quality of communication	Issuance	Requirement to issue within 75 days of year-end.
		Public access.
		Further research into ability of stakeholders to understand reports.
	Understandability	Institution of education programme.
		Greater usage of summary reports.
		Statement of Objectives.
Comparability	Disclose effects of all material changes.	
	Disclosure of financial effect of changes in accounting policies.	
	Adequate disclosure.	
Cost-benefit constraints	Disclosure	Implementation of special purpose reports.
		Consideration of regulatory exemptions based on cost-benefit constraints.
	Competitive-advantage	Bifurcation of regulation based on impact to public.
		Acceptance of tax-based reporting in certain cases.
Differential reporting	Differential standards.	

Table 5.1 emphasises several important elements which need to be examined in the production segment of the Model. First, the timeliness of reports can be enhanced by specific time limitations. Second, the quality of communication can be improved by greater disclosure and recognition of stakeholder needs. Third, cost-benefit

constraints should be examined by the introduction of differential reporting requirements.

It is considered that public issuers should publish reports at least a ^{6/12} six-monthly basis, with a maximum time-lag of 75 days permitted from the year end. With improving information technology the feasibility of quarterly or even on-line reporting should be examined.

Greater emphasis on the quality of communication is given in the Model. Further research is recommended in studying the ability of stakeholders to understand reports and possible educational remedies. Moreover, it is considered that the comparability of reports can be enhanced by greater use of disclosure and special purpose reports.

Cost-benefit constraints should be explicitly explored during the promulgation of accounting regulation. Greater usage of differential reporting is advocated especially for non-public issuers. This cost-benefit examination along with a greater emphasis on timeliness and the quality of communication would greatly enhance public accountability criterion explored below.

5.3.2 Public accountability component

Social welfare goals are evaluated in Chapter Three with the concept of public accountability advanced as the preferred view in the Model. This perception emphasised the need for reporting a wide range of information to stakeholders with a bond of accountability.

The reporting obligation for public accountability encompasses several elements including the: 1) responsibility of producers of corporate reports to communicate data to stakeholders, 2) rendering of an account of both financial and non-financial data, 3) dynamic communication process to meet the changing needs and expectations of society, and 4) necessity for an overseer function to monitor the reporting. Table 5.2 shows that these elements can be analysed under the efficiency and equity categories.

The Model calls for the distribution of both financial and non-financial information to stakeholders (i.e. shareholders, creditors, employees, consumer groups and the local community) with a bond of accountability. Both efficiency and equity issues are addressed.

TABLE 5.2 PUBLIC ACCOUNTABILITY ELEMENTS OF THE MODEL

<u>Elements</u>	<u>Issue</u>	<u>Resolution</u>
Efficiency	Under-production	Mandated minimum disclosure.
	Cost-benefit	Differential reporting.
	Funding	Adequate and broad-based.
	Clear objectives	Evolutionary conceptual framework development.
		Mandated Statement of Objectives.
Non-financial activities	Mandated minimum disclosure.	
Equity	Stakeholder needs	Board representation.
		Educational campaign.
	Independence	Independent vetting agency.
		Review of audit role.
Information asymmetry	Insider trading rules.	

From an efficiency viewpoint, regulation should be instituted to prevent an under-production of information. To ensure clear objectives, a conceptual framework should be developed on an evolutionary basis.

Stakeholder views need to be considered. Improvements could be achieved through extended board representation wherein the regulatory institutions be structured to ensure adequate participation of stakeholder groups. Moreover, an educational campaign should be carried out to help lift non-accountant's understanding of accounting rules and their impact.

The occurrence of information asymmetry creates an equity problem whilst the public-good nature of accounting causes an inefficient underproduction of information in an unregulated environment. Both of these issues are viewed as

detrimental to the reporting mechanism needed for public accountability. Regulation can ameliorate these problems.

5.3.3 Regulation component

The different elements of both public and private theories of regulation are investigated in Chapter Four. Public interest theories of regulation are considered to be most closely-aligned with the accountability paradigm. Regulation is found to help in overcoming both the underproduction and the uneven distribution of corporate information. Accounting standard setting is viewed as a dynamic political activity, thus the importance of constituent support is crucial. Regulatory arrangement features suggested include: use of the profession's expertise, admittance of a wide range of non-accountant representation and use of the coercive power of the state.

Regulation, in this Model, seeks to correct equity and efficiency imbalances by mandating the distribution of information consistent with a public accountability theme. Professional self-regulation is found to be inadequate to serve these aims (Section 4.3.3). More rigorous regulatory arrangements are recommended. Table 5.3 lists many of the regulatory arrangement elements that are considered necessary to pursue this aim.

The importance of regulatory arrangements is highlighted in Table 5.3. Elements advocated at the design phase are: 1) an open agenda setting process, 2) use of the technical expertise of the profession, and 3) reasonable funding levels. To fulfil public accountability themes at the approval phase the political nature of accounting would appear to demand broad representation from the various stakeholders. At the enforcement phase, the recommendations are the implementation of registration procedures wherein the regulatory bodies hold the power to refuse registration, the implementation of a stronger monitoring function, and increased use of force-of-law status for accounting rules.

TABLE 5.3 REGULATION ELEMENTS OF THE MODEL

<u>Phase</u>	<u>Issue</u>	<u>Resolution</u>
Design	Need for technical expertise	Use profession's knowledge.
	Funding	Redirect company fees. Greater government support.
	Need for clear objectives	Evolutionary conceptual framework development.
	Lobbying	Open agenda setting. Solicit wide range of views. Implement educational campaign.
	Dynamic guidance	Emerging Issues Task Force. Active consultative committee with wide representation.
Approval	Independence	Separate from design phase, removed from profession.
	Sufficient powers	Right to amend as well as approve standards.
	Quality control	Evaluation of the writing style of standards. Monitor the quality of corporate reports.
	Constituent support	Wide representation.
Enforcement	Constituent support	Wide representation.
	Enforceable regulation	Approved accounting standards given force of law status. Use of registration method.
	Compliance	Professional ethics. Monitoring mechanisms. Adequate funding.
	Remedies	Statutory remedy of defective accounts. Refusal to register. Mandatory disclosure of compliance with standards.

5.4 SUMMARY

The Model offered in this chapter is derived from theories of accountability and regulation. The accountability paradigm views corporate reports as essential to provide feedback to stakeholder groups. The Model calls for the provision of a greater amount of data than is now provided in corporate reports.

Deficiencies in Anglo-American accounting regulatory structures are detailed in Chapter Two. They include the lack of non-accountant representation, weak regulatory arrangements, questionable regulatory effectiveness and a low level of corporate reporting communication. As advocated in the proposed Model, wider board representation by stakeholders (including preparers) is likely to increase the acceptability of accounting rules. This structural change along with legal backing of accounting standards in all probability would increase the level of compliance. The combination of these elements will create a more equitable and efficient environment for the reporting of corporate information congruent with the precepts of public accountability.

CHAPTER SIX: A HISTORICAL ANALYSIS OF THE NEW ZEALAND SOCIETY OF ACCOUNTANTS

6.1 INTRODUCTION

The Public Accountability Model of Accounting Regulation is described in Chapter Five. The Model advocates the broad dissemination of corporate data to stakeholders with a legitimate interest in the enterprise. Regulation is portrayed as an important instrument in fulfilling the public accountability criterion and meeting equity and efficiency goals on an equal footing (Table 5.3).

It is documented in this chapter that in relation to the Model, the NZSA's regulatory mechanisms, has deficiencies in each major component: production, regulation and public accountability. There is a notable lack of preparer input in the production stage, hence, consensus is more difficult to achieve. This results in a high level of non-compliance. The regulation stage does not exhibit democratic representation and domestic enforcement is weak. The audit function and threat of qualified audit opinions seems largely ineffective. At the public accountability phase, stakeholder preferences are not being taken into account and the dual criteria of equity and efficiency are downplayed.

These next five chapters provide empirical evidence about accounting regulatory mechanisms using New Zealand as a case study. Important domestic and overseas influences on accounting standards in New Zealand are considered in Chapters Eight-Ten. Chapters Six and Seven focus on the New Zealand Society of Accountants through a multiple-approach analysis of their function as the primary rule-making body.

The multiple-approach utilises three research methods¹ to provide evidence regarding the NZSA standard setting process. The investigation comprises institutional/environmental and historical analysis to develop a research design suitable for the regulatory study. The regulatory events examined are the various

1. This critique of the NZSA's standard setting process has its limitations, mostly related to the unavailability of public data on issues and their policy of not publicly disclosing minutes of meetings or voting patterns. The investigation compares the Model with political and environmental variables, respondent's submissions, and archival information such as news media reports and NZSA documents (for an expanded defence of this approach, see Rahman, Ng & Tower (1991, p.159)). Some oral and informal interactions between important groups and the NZSA may not be visible. The results in this study, however, are strengthened by institutional and historical analysis.

political and environmental variables relating to the promulgation of and compliance with domestic accounting standards. Merino, Koch & MacRitchie (1987, p.749) emphasise the importance of historical analysis to enhance the construct validity of the research design of events studies.

The multiple analytical approach can supplement traditional weaknesses in studies on accounting regulatory bodies. For instance, Currie et al., (1987) discuss the problem that political behaviour is not fully traceable from written submissions of exposure drafts. This study garners evidence from submissions which is then supplemented with archival and other public forms of data.

The examination of the NZSA bridges two chapters. Chapter Seven focuses on the standard setting process for each regulatory phase: design, approval and enforcement. This chapter analyses historical trends and pressures whilst scrutinising the regulatory impact of promulgated rules.

6.2 HISTORICAL ANALYSIS OF THE NZSA

Accounting regulation in New Zealand has three main sources. First, the legal mandate arises from core company law which is considered old and out-of-date (Hickey, 1989, p.36). The Companies Act 1955 requires that companies provide a "true and fair view" of their activities on an annual basis (Section 153). Second, the government has delegated power over the accounting profession to the NZSA. In carrying out this responsibility the NZSA promulgates rules, standards and guidelines which cover disclosure and measurement issues (Tower, 1989, p.19). Third, the New Zealand Stock Exchange (NZSE) provides additional disclosure rules for listed companies and the Securities Commission also requires certain disclosures from public issuers (Porter & Simpkins, 1990, p.17). The historical evolution of the NZSA's rule-making position, with an emphasis on crises within the business environment, is given below.

6.2.1 History of the NZSA's standard setting role

Starting from the Incorporated Institute of Accountants of New Zealand, founded in 1894, there were four accountancy bodies of national importance in New Zealand. The others were, the New Zealand Accountants' and Auditors' Association, which began in 1898; the New Zealand Society of Accountants, founded in 1908; and the New Zealand Institute of Cost Accountants, formed in 1944 (Zeff, 1979, p.1). The

other three accounting organisations merged with the NZSA. Since 1972, the NZSA is the only national organisation, catering for all the varying interests of the profession.

Accounting rules in New Zealand slowly developed over time in response to external pressures generally following the British pattern (Carrington, 1986, p.273). Historical trends of the accounting standard setting process in New Zealand can be divided into four² stages (see Table 6.1).

TABLE 6.1 HISTORICAL STAGES OF THE NZSA STANDARD SETTING PROCESS

<u>DATE</u>	<u>REGULATORY MECHANISM</u>
Pre-1946	Reliance on professional judgement Strong British influence <u>Companies Act 1933</u>
1946-1965	Followed English Recommendations Recommendations on Accounting Principles issued <u>Companies Act 1955</u> <u>New Zealand Society of Accountants Act of 1958</u>
1966-1973	Generation of non-mandatory standards Statements on Accounting Practice initiated
1974-Present	Mandatory standards Associate member of IASC Price-level accounting debate Accounting implications of the sharemarket crash Investment property standard controversy 27 standards issued to date

No accounting recommendations or standards were issued before 1946. Reliance rested on the use of professional judgement and the broad perception of presenting a true and fair view which was thought best determined by company managers (Graham, 1960, chap. 5). The time period from 1946 to 1965 witnessed the almost verbatim adoption of the English Institutes' Recommendations for Accounting Practice. These recommendations were used as guidelines for practitioners (Zeff, 1979, p.12). In the third phase (1966-1973) New Zealand-based standards were issued although the contents largely mirrored overseas developments in Britain and

2. A fifth stage will begin if the recent legislative initiatives for accounting regulation, as discussed in Section 9.3, are instituted. This new phase will see the introduction of government-backed accounting standards and the creation of an independent accounting review board.

America. These standards were given more weight than mere guidelines, however, they still were not a mandatory requirement. The philosophy of allowing preparers great discretion in choosing accounting methods continued (pp.43-45). In 1974, the first mandatory standards were promulgated (McNally, Eng & Hasseldine, 1982, p.12). This new initiative places the responsibility on the NZSA's members to observe the accounting standards. Auditors are now required to qualify the opinion if the effect on any departure is to impair a true and fair view and to disclose any significant deviations from the standards (NZSA, 1974, para. 1.2).

Never in any of these evolutionary stages is there shown a clear understanding of the purpose of corporate reports or the best type of regulation (if any) that is needed. Instead the NZSA appears to have primarily responded to external influences, mainly the British lead (Naran, 1984, p.15). As Zeff (1979) concluded "... the evidence strongly suggests that the Society *instinctively* inclines to the English Institute's view of things" (p.78).

In Britain, rules are developed in response to external crises (Section 2.3.3). Carrington (1986, pp.275-276) described three features which lead to the evolution of British-style accounting standards. The first was a series of responses to external criticisms (i.e. public outcry following financial collapses). The second factor was court judgements against auditors (Ashton, 1986, p.3; see for example *R v Kylsant (1932)*), and the final aspect was the institution of more stringent stock exchange requirements. These pressures forced the British profession and their New Zealand counterpart to adopt rules for accounting practices.

British initiatives can thus be seen to have played an important part in the shaping of the New Zealand accounting regulatory scheme. Equally important to the NZSA was the occurrence of three important domestic crises. They were: 1) the threat of an interloper creating accounting rules, 2) publicised failure to enforce the professional mandates, and 3) pressures emanating from the accounting component of alleged misleading information relating to the 1987 stockmarket crash. The first two issues are discussed below whilst the third is detailed in Chapter Nine.

6.2.2 Domestic impetus for change

The first impetus for change came from novel accounting treatments by New Zealand companies and the related pressure emanating from the stock exchange. In 1972, three large New Zealand companies issued financial reports using the equity method of accounting³. In August of that year the Registrar of Companies concluded that

equity accounting was not incompatible with the Companies Act. The Stock Exchange Association of New Zealand then approached the NZSA to discuss the possibility of issuing a joint statement on equity accounting. The Society declined, wishing to preserve their sole right to issue accounting standards (Zeff, 1979, p.56), however, this did provide the Society with an impetus to promulgate a standard on this topic. Zeff (1979, p.57) concluded that an important influence for the NZSA to make accounting standards mandatory was the fears of possible independent action by the stock exchange and concerns that companies would not uniformly comply with issued rules under the previous system.

The second major crisis to emerge concerned publicised failures of the NZSA to enforce their accounting standards. The two best examples are the contentious topic of price-level accounting and debates over the rule for investment properties (see for example Cameron & Heazlewood, 1985, p.10; Myers, 1988, p.11; Peterson, Gan & Lim 1984, p.89; Rahman, Ng & Tower, 1990, p.22).

Consistently high inflation rates and an increased level of international attention raised the prominence of the first matter in New Zealand. The New Zealand government appointed the Richardson Committee to look into this issue, they subsequently published the Report of the Committee of Inquiry into Inflation Accounting (1976). This report was hailed at the time as the most comprehensive report in the world in examining current cost accounting (CCA) (World Accounting Report, 1984, p.11). The Richardson report recommended the adoption of current cost accounting for taxation and price control purposes as well as for financial reporting (Emanuel, 1979, p.218). The World Accounting Report ("Survey: Inflation", 1984, p.11) noted that the government reaction to the Richardson Committee's findings was low key and the report was quietly pigeon-holed. Carrington (1986) concluded, "The committee's formation and findings represented effective governmental action to circumvent the issue and to block unilateral action by the accounting profession to replace historical cost accounting with current cost accounting." (p.286).

Despite the government's apparent wish to downplay the issue, the NZSA pressed ahead with accounting rules on price-level accounting. In explaining the motivation

3. Fletcher Holding Limited, Wattie Industries Limited, and Brierley Investments Limited were the three companies. At that time there were no rules whatsoever governing this type of accounting treatment in New Zealand although there were overseas precedents.

for such action, Zeff (1979) argued that, "The Society's leaders were concerned by the prospect of a Government committee becoming involved in the setting of accounting standards" (p.65). In 1982, CCA-1: Information Reflecting the Effects of Changing Prices was promulgated by the NZSA. This standard required supplementary current cost accounts for all companies listed on the stock exchange (Pendrill, 1985, p.140). However, by the time CCA-1 was issued inflation rates had started to come down. As a result, the need for such a standard was becoming less important.

It should be noted that the controversial CCA-1 was rejected by many interest groups especially the preparers⁴. Corporate compliance of the CCA standard was only 8-9% (Cameron & Heazlewood, 1985, p.6; Peterson, Gan & Lim, 1984, p.96). Because of this lack of acceptance the standard was (effectively) withdrawn in February 1986. This backdown, of what was considered the most important issue of the decade, is seen as a major setback since this well publicized dispute generated questions about the ability of the NZSA to uphold the duties of the profession.

In the late 1980s, SSAP-17a Accounting for Investment Properties by Property Investment Companies (1985) and its replacement, SSAP-17b Accounting for Investment Properties and Properties Intended for Sale (1989b) became another controversial accounting standard. These promulgations dealt with the accounting treatment for investment properties. SSAP-17a was originally considered a world leader (Tweedie, 1985, p.21), but soon bogged down into discord. Companies were seemingly only using the standard on an intermittent basis, therefore, the original 1985 standard was withdrawn in June 1988 because of a disappointing level of compliance (NZSA, 1988a, p.1). The standard was modified and reissued in February 1989 despite considerable opposition (Myers, 1988, p.11; Tower & Perera, 1989, p.18). This on-going fierce debate was heavily publicised and did nothing to help the perception of the NZSA's standing within the greater community.

4. This standard was unpopular among many groups. Current cost accounting in times of inflation causes the reporting of lower profit figures for companies. The taxation authority, if CCA was accepted as recommended by the Richardson committee, would have had lower revenues; unions feared lower wage raises (Emanuel, 1979, p.225). Company managers were concerned that lower profits would be viewed as a failure to perform successfully. Wong (1988a, p.166) found the companies that offered voluntary supplementary current cost information tended to have higher effective tax rates, lower leverage ratios, larger market concentration ratios and were more capital-intensive.

The accounting linkage to the 1987 sharemarket crash is the third major domestic impetus for change. The crisis generated from this event (and subsequent failures of a large number of companies) led to several Ministerial Reviews (see Section 9.2.5.2). As detailed in Section 9.3 these reviews have advocated major changes to the present accounting regulatory system.

The historical changes to the NZSA's standard setting process can thus be seen to be a combination of overseas (primarily British) initiatives and domestic crises. Bernstein's (1955) model of regulatory bodies predicts an evolution of the structures over time as regulators lose their crusading spirit and legislative support fades (see Figure 4.1). A central theme in his model is the importance of crises to shake-up and change the status quo level of regulation. The analysis above reveals the appropriateness of the Bernstein model to a study of the NZSA accounting standard setting process. For instance, the threat of government intervention has served as an important catalyst for NZSA structural and attitudinal changes (Eglinton, 1988, p.5). The Society is buffeted by these crises in accordance with the Bernstein (1955) model.

6.3 STRUCTURE OF THE NEW ZEALAND SOCIETY OF ACCOUNTANTS

As of June 30, 1990 there were 17,401 members in the Society, the two biggest groups were company accountants (31%) and public accountants (27%) (NZSA, 1990a, pp.26-28). The NZSA is organized into branches governed by a Council. The Council ultimately approves all major policy matters but the bulk of the work of the Society is performed by the Secretariat and various boards and committees. The Accounting Research and Standards Board (ARSB), a committee of the NZSA, is responsible for developing the accounting standards for the private sector. Accounting standards are generated by the ARSB and given final approval by the NZSA Council.

The government granted sweeping powers to the Society in the New Zealand Society of Accountants Act of 1958. Under Section 3(4)(a) the Society is authorised "To control and regulate the practice of the profession of accountancy in New Zealand." The issuance of this piece of legislation championed the NZSA as the principal regulatory body responsible for the design, approval and enforcement of accounting rules.

The NZSA's level of activity in the accounting standard arena is documented in Table 6.2. Only authoritative pronouncements are analysed, i.e. those that need the Council's approval. Therefore, Technical Practice Aids and Research Bulletins are not included. The historical activity shown in Table 6.2 demonstrates the increasing level of activity as regards the promulgation, amendment and withdrawal of accounting standards.

TABLE 6.2 NZSA AUTHORITATIVE PRONOUNCEMENTS: ISSUANCES, AMENDMENT AND WITHDRAWALS

<u>Year</u>	<u>Issued</u>	<u>Amended</u>	<u>Withdrawn</u>	<u>Total</u>	<u>SSAP</u>
1970				0	
1971				0	
1972				0	
1973				0	
1974	3			3	EF ¹ , 1, 2
1975	2			2	3, 4
1976	1			1	5
1977	2			2	6, 7
1978	2			2	8, 9
1979	2	1		3	EFA ⁵ , 10, 11
1980	1			1	12
1981	1			1	13
1982	3			3	14, 15, CCA1 ²
1983	0	1		1	1A ³
1984	1	2		3	16, 3A, 8A
1985	2	2		4	17, 18, 5A, 6A
1986	2	2	1	5	19, 20, 4A, 7A, CCA1W
1987	1	3	1	5	21, 2W ⁴ , 8A, 10A, 17A
1988	1	1	1	3	22, 21A, 17W
1989	2	1		3	23, 24, 17A
1990	<u>3</u>	<u>2</u>	<u>—</u>	<u>5</u>	25, 18A, 26, 27, 8A
Total	29	15	3	47	

Note: ¹EF stands for the Explanatory Forward.
²CCA refers to the Current Cost Accounting standard.
³A denotes amended.
⁴W depicts withdrawn standards.
⁵EFA identifies the amended Explanatory Forward

Source: NZSA archives, analysis of standards is through 31 December, 1990.

Forty seven changes (issuances, amendments and withdrawals) have occurred over the last seventeen years exhibiting a modest increasing trend of activity. Furthermore, seven Technical Practice Aids have been issued and numerous research projects undertaken (see Robb, Neal, Leo & Hoggett, 1990, p.529 for a complete list).

Part of the NZSA's increased action is attributed to their policy of reviewing each standard every five years (p.526), as more standards are promulgated the back-log of reviews builds up.

This increase in activity can be interpreted in at least two ways. The action could be seen as the Society's sincere attempt to control and regulate the profession as required in the 1958 act. Alternatively, their actions could be seen as a response to external criticisms and crises (Section 6.2.2).

So how seriously does the NZSA take its professional duty? The importance the Society places on professional ethics and regulatory issues is observed in Table 6.3. To generate this evidence the first five issues discussed in each years' NZSA Annual Report-Presidential Report is analysed for the time period: 1970-1990. A ranking of '5' was given to the first item mentioned down to '1' for the fifth item. The priority of topics discussed is used as a surrogate measure for the items thought most important by the NZSA on an annual basis.

TABLE 6.3 **IMPORTANT ISSUES MENTIONED IN PRESIDENTIAL REPORTS**

	Ave.	1990	1989	1988	1987	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973	1972	1971	1970
Regulation & acct. stds.	3.33	4	1	x	2	4	x	1	1	5	5	5	4	5	5	5	5	5	2	4	2	4
Professional & ethical issues	3.21	5	5	4	1	3	2	2	5	1	x	3	3	3	4	3	4	4	3	3	4	5
Membership issues	1.81		4	3	5		x	4		4	3	1	x	x	x	x	x	1	5	5	5	
Education	1.67	2		x	x	5	5		3	x		4	2	2	3	2	1	x	1		1	2
Public relations	1.38		x	5	4	2	1	5		3	4	x					x	x	x	1	x	1
Company law reform	1.29	1	2	1					4			x	5	4	x	x	3	2	x			3
International linkages	0.93		x								2	2		x	2	4	x	3	4		x	x
Tax law reform	0.83	3	3	2		1	4	x			1				x	x	2					
Internal (i.e. finances, branches)	0.81	x	x	x	x	x			2	x	x	x	1	1	1	1	x	x	x	2	3	x
Other	0.60		x		3		3	3	x	2		x										

Note: An ordinal scale is used with a ranking of '5' given to the first issue mentioned, a '4' for the second and so forth., an 'x' was given for an issue mentioned sixth or later (note the 'x' scores are given a value of .5 for averaging purposes).

Source: New Zealand Society of Accountants' annual reports-Presidential reports (1970-1990).

Table 6.3 provides evidence about the importance the NZSA places on both regulation/accounting standard matters and on professionalism/ethical issues. They are the two highest rated items in the Table, with average scores of 3.33 and 3.21 respectively. They are also the only topics discussed in all the reports over both decades. This form of evidence gives some confirmation of the priority the Society places on their fiduciary responsibility to fulfil their professional responsibilities in an ethical manner and the importance of enforcement mechanisms.

To regulate the profession the NZSA has initiated a system of mandatory accounting standards covering most topics, applying to almost all business entities. The NZSA's primary method used to regulate corporate reports has been the issuance of Statements of Standard Accounting Practice (SSAPs). A complete list of the current SSAPs (as of 31 March, 1991) is given in Appendix D. This list reveals that many of the prominent accounting issues have corresponding standards. However, a few important issues such as pension accounting and intangibles have no mandatory guidance.

The NZSE and Securities Commission have more detailed rules for listed companies and public issuers respectively. Their rules apply to less than a 1000 companies, albeit those with a very large economic impact. The NZSA promulgations are much broader in scope as they are the only body to regulate accounting practices for the large number (at least 140,000) of business entities which do not solicit securities from the public. Table 6.4 highlights the wide range of business entities who, the NZSA consider should comply with SSAPs.

Table 6.4 reveals that the vast majority of the NZSA promulgations are deemed to apply to all external financial statements of all business entities. Only one standard, SSAP-20 Accounting for Shares Issued Under a Dividend Election Plan (1986b), is restricted solely to companies. Consequently, the coverage of these rules can be seen to be very broad affecting listed companies, public issuers, private companies, partnerships and small proprietorships.

It should also be noted that the NZSA is in the process of developing differential reporting guidelines wherein modifications may be made to the scope of the standards (see Porter, 1991b, pp.87-91). From an efficiency viewpoint this may be a timely exercise in that Table 6.4 shows the wide scope of entities at present captured under the SSAPs. This wide scope, presently applied, may not be easily defended from a cost-benefit perspective.

TABLE 6.4 NZSA ACCOUNTING STANDARDS: BREADTH OF COVERAGE

<u>Breadth of coverage</u>	Number of standards in this category	<u>Applicable SSAP</u>
All external financial statements	18	EF,3-7, 11, 13-19, 21-22, 26-27
All external financial statements with certain exclusions	1	25
All external interim financial statements where they include components of financial statements	1	24
All external final statements	1	1
External financial statements of all groups of entities excluding the Crown	1	8
All audited external financial statements other than wholly owned entities	2	10, 23
All external financial statements of companies and other incorporated bodies for which income tax is an expense of operation	1	12
All external financial statements of companies	1	20
Enterprises subject to the conditions of the <u>Companies Act 1955</u>	<u>1</u>	9
Total	27	

Note: SSAP 2 was withdrawn in 1987. EF stands for the Explanatory Forward, all other numbers in the far right column refer to the specific SSAP. The categorisation is based on the stated applicable coverage contained within each standard.

Source: Analysis on NZSA standards outstanding as of 31 March, 1991.

As can be observed in Tables 6.3 and 6.4, the NZSA has shown an increasing level of activity in the standard setting arena, maintaining a continuing long-term focus on professional and regulatory issues. However, important questions remain about the efficacy and effectiveness of the current regulatory arrangements.

6.4 REGULATORY EFFECTIVENESS

It is postulated that current New Zealand accounting regulation does not fulfil societal-based public accountability criterion. Questions arise about the ability of domestic regulation to meet stated goals? How effective is it? To answer these questions several aspects of regulatory effectiveness are studied. First, an examination is conducted of the overall objective(s) of financial statements and the perceived purpose of accounting regulation. Second, the timeliness of accounting rules is studied. Third, the level of clarity within the NZSA promulgations is investigated. Fourth, an evaluation of the impact of audit qualifications is presented. The conclusion is reached that the present system does not have clear goals or rules and is not, on the whole, effective.

6.4.1 Financial accounting objectives in New Zealand

In offering a coherent structure to accounting regulation there is a need for clear objectives on the ultimate purpose that corporate reports serve. As discussed in Chapter Two, New Zealand, as distinct from all the other Anglo-American countries has singularly failed to offer explicit financial accounting objectives (Section 2.4.2.1).

The only formal statement on accounting objectives in New Zealand was contained in the government-sponsored Richardson Committee report. They felt that the "objective of accounting is to meet relevant information needs of the users of the financial statements in a realistic way" (Report of the Committee of Inquiry into Inflation Accounting, 1976, para. 2.01).

The primary rule-making body, the NZSA, has never explicitly offered an overview for the purpose of corporate reports and, unlike the other Anglo-American regulatory bodies, a conceptual framework has never been issued (Naran, 1984, p.15; Tower, 1990a, p.1). At present⁵ there is no general guidance. The failure to clearly delineate the purpose of corporate reports can be seen to have serious consequences. This lack of direction can result in: the promulgation of ad hoc standards, underfunded regulatory bodies and outdated regulation (Section 2.4). The result is a confused climate for the generation and regulation of accounting information.

An assessment of contemporary accounting rules, using content analysis, is conducted in an attempt to determine the existence of any implicit conceptual

5. This may change in the near future. See Section 9.3.4.2 for a discussion of the not-yet-published concepts statement currently being drawn up by the NZSA.

framework within the NZSA accounting standards. The criterion for classification is based on the end-purpose of the promulgation as explicitly stated in each individual standard. Berelson (1952, p.181) describes content analysis as a research technique for the systematic and quantitative description of the manifest content of communication. Three purposes⁶ of this approach are: 1) to describe communication characteristics, 2) make inferences on the antecedents and 3) make inferences about the effects of communication (Holsti, 1969). Content analysis is conducted on the entire set of accounting standards listed in Appendix D. The detailed workings of the analysis are contained within Appendix E.

This study of the NZSA accounting standards reveals no dominant paradigm, however, two viewpoints (accountability and decision usefulness) are implicit in many standards. Table 6.5 recounts the stipulated paradigm for each of the current SSAPs.

The classification in Table 6.5 is based on the stated objective contained in each standard (i.e. what the NZSA said was the overall purpose). The clarity and end-product of these standards, as discussed in many parts of this thesis, is far from optimal. In other words, there does not appear to be a clear matching of stated versus achieved objectives.

This inquiry reveals two preferred paradigms, with the accountability viewpoint taking precedence eight times, decision usefulness four times, and a combination of both of these three times. Thus, 56% (15/27) of the standards have a discernible purpose. The decision usefulness concept is notable in the Explanatory Forward and Materiality (SSAP-6) standards (both of which apply to all the other standards). The accountability viewpoint with a call for the provision of the need to report is specifically observed in 40.7% of the promulgations. These observed objectives are consistent with the movement in the New Zealand public sector rules towards an accountability and decision usefulness outcome (NZSA, 1987c, para. 4.1).

6. There are limitations to this approach. Judgement is required in the classification of the SSAPs into purposive-based paradigm clusters. Whilst the conclusions should not be overly-generalised, the method is supplemented with many other forms of evidence, as regards the NZSA, forming a more complete composite picture.

TABLE 6.5 HISTORICAL PARADIGM ANALYSIS OF THE NZSA ACCOUNTING STANDARDS

<u>Date</u>	<u>SSAP</u>	<u>Issue</u>	<u>Paradigm</u>
1978	9	Disclosure	Decision Usefulness
1979	EF	Explanatory Forward	Decision Usefulness
1979	11	Contingencies	Indeterminable
1980	12	Deferred Tax	Unstated
1981	13	R & D	Accountability
1982	14	Construction	Unstated
1982	15	Contingencies	Unstated
1983	1	Accounting Policies	Decision Usefulness
1984	16	Govt. Grants	Accountability
1984	3	Depreciation	Accountability
1985	5	Subsequent Events	Accountability and Decision usefulness
1985	6	Materiality	Decision Usefulness
1985	18	Leases	Indeterminable
1986	4	Inventories	Accountability
1986	7	Extraordinary	Accountability
1986	19	GST	Unstated
1986	20	Dividend Plans	Unstated
1987	10	Cash Flow	Accountability
1988	21	Foreign Currency	Unstated
1988	22	Related Party	Accountability and Decision usefulness
1989	17	Investment Prop.	Accountability and Decision usefulness
1989	23	Segments	Accountability
1989	24	Interim Reports	Accountability
1990	25	Joint Ventures	Unstated
1990	26	Defeasance	Indeterminable
1990	27	Right of Set-off	Indeterminable
1990	8	Consolidations	Indeterminable
Standards possessing accountability viewpoints			40.7%
Standards possessing decision usefulness viewpoints			25.9%
Standards with no decipherable objective			44%

Note: Percentages do not add to 100% because of the double counting of standards containing multiple paradigms.

Source: NZSA standards outstanding as of 31 March, 1991.

The historical analysis reveals a partial trend for the decision usefulness paradigm for the early years and the accountability paradigm in more recent times, however, it was impossible to categorise the last four standards promulgated. Furthermore, a large minority (44%) of the standards have no discernible stated objective. Overall there appears to be a lack of consistency in the structural logic for the New Zealand SSAPs. The absence of a concepts statement appears to inhibit the communication of the overall objective for the promulgation of accounting rules.

6.4.2 Timeliness of accounting standards

Timeliness is another important aspect of regulatory effectiveness. In an ever changing business environment, the accounting rules must be issued in a prompt manner.

It takes many months for an issue to be identified, drafted and tentatively approved by the Accounting Research and Standards Board (ARSB) for publication as an exposure draft (Porter, 1991a, p.5). From that point, Table 6.6 shows that the average time span for a standard to be released after the issuance of an exposure draft is just over 24 months.

As regards developing issues, it is likely that companies will provide sub-optimal information in the absence of accounting standards (Section 4.3.1). The long lead time of the generation of an accounting rule exhibited in Table 6.6 can be seen to be detrimental in that the lack of guidance detracts from the communication of comparable corporate information.

A trend analysis is conducted to view the time lag between the exposure draft and the standard in five year increments. The observations in Table 6.6 show a notable reduction of the time lag over time, ^(↑time) providing evidence that the NZSA has greatly streamlined the process. The fastest time lag (1986-1990 period), however, still takes almost a year. It thus takes at least two to three years on the average (from initial investigation to promulgation) for an accounting promulgation to be published on a particular accounting topic. The need for a more expeditious form of guidance, such as an Emerging Issues Task Force, is discussed in Section 7.2.2.4.

TABLE 6.6 TIME LAG FROM ISSUANCE OF EXPOSURE DRAFT TO RELEASE OF STANDARD (1966-1990)

SSAP	ED	Title	ED Issued	Std. Issued	Time Lag (mon.)
*	1	Hire Purchase	69	*	*
12	2	Income Tax	Oct 66	Apr 80	162
4	3	Inventories	Feb 67	Nov 75	104
3	4	Depreciation	Feb 68	Aug 75	66
*	5	Prospectus Reports	Mar 68	*	*
3	6	Depreciation	Nov 72	Aug 75	34
2	7	Equity Accounting	Jul 73	Dec 74	17
1	8	Accounting Policy	Mar 74	Nov 74	8
4	9	Inventories	Jul 73	Nov 75	28
CCA	10	Purchasing Power	Mar 75	Mar 82	84
12	11	Income Tax	Jun 75	Apr 80	58
7	12	EI + PPA	Nov 75	Dec 77	25
5	13	Subsequent Events	Dec 75	Dec 76	12
CCA	14	Current Cost I	Aug 76	Mar 82	67
6	15	Materiality	Oct 76	Aug 77	10
8	16	Consolidated Fin. Stmts.	Feb 77	Aug 78	18
9	17	Disclosure	Feb 77	Aug 78	18
10	18	Funds Statement	Apr 77	Jul 79	25
11	19	Expenditure c/f	Sep 77	Dec 79	27
12	20	Income Tax	Jun 78	Apr 80	22
13	21	Research + Development	Jun 79	Aug 81	26
14	22	Construction	Sep 80	Mar 82	18
1	23	Accounting Policy	Dec 80	Dec 83	36
15	24	Contingencies	Feb 81	Dec 82	22
CCA	25	Current Cost II	Aug 81	Mar 82	7
TPA	26	Earnings per share	Mar 82	May 83	14
16	27	Government Grants	Dec 82	Oct 84	22
4	28	Depreciation	Jul 83	Oct 84	15
17	29	Reval. Investment Properties	Jul 83	Mar 85	20
18	30	Leases	Mar 84	Jul 85	16
5	31	Subsequent Events	Aug 84	Jul 85	11
6	32	Materiality	Aug 84	Jul 85	11
4	33	Inventory	Feb 85	Apr 86	14
7	34	Extraordinary Items	Dec 85	Oct 86	10
19	35	GST	Mar 86	Jun 86	3
20	36	Share Dividend	Mar 86	Jun 86	3
21	37	Foreign Exchange	May 86	Jun 87	13
21	37A	Foreign Exchange	May 87	Apr 88	11
8	38	Business Combinations	Oct 86	Oct 87	12
10	39	Cash Flows	Feb 87	Oct 87	8
**	40		**	**	**
22	41	Related Party Disclosures	Feb 88	Nov 88	9
17	42	Development Margin	Mar 88	Feb 89	11
*	43	Intangibles	Jul 88	*	*
23	44	Segment Reporting	Jul 88	Jul 89	12
17	45	Reval. Investment Properties	Aug 88	6	
24	46	Interim Reporting	Nov 88	Aug 89	9
26	47	Debt Defeasance	Feb 89	Nov 90	21
26	47A	Debt Defeasance	Feb 90	Nov 90	9
25	48	Joint Venture	Mar 89	Aug 90	17
8	49	Business Combinations	Feb 90	Dec 90	10
*	50	Fixed Assets	May 89	*	*
*	50A	Fixed Assets	Jun 90	*	*
18	51	Lease Amendment	Oct 89	Jul 90	9
*	52	Deferred Tax	Mar 90	*	*
27	53	Right of Set-off	Feb 90	Nov 90	9
*	54	Research + Development	Jun 90	*	*

Average time lag: 1966-1990 is 24.4 months.
 Average time lag: 1966-1970 is 110.7 months.
 Average time lag: 1971-1975 is 33.3 months.
 Average time lag: 1976-1980 is 26.7 months.
 Average time lag: 1981-1985 is 14.7 months.
 Average time lag: 1986-1990 is 10.1 months.

Note: * No standard issued as of March 1991.
 ** Exposure draft #40 never issued.

Source: NZSA archives, analysis of standards outstanding as of 31 March, 1991.

6.4.3 Clarity of the NZSA accounting standards

Regulation enhances comparability of financial statements (ASAC, 1987, para. 260). It is argued that this improved comparability will only blossom in an accounting environment where the standards limits the number of reporting options on any particular topic. Table 6.7 gives a rating of the magnitude of strength expressed in the NZSA SSAPs. The assessment rates each standard by its strength (i.e. obligatory nature).

TABLE 6.7 CLASSIFICATION OF NEW ZEALAND ACCOUNTING STANDARDS

<u>Type</u>	<u>Total number</u>	<u>Relevant SSAP</u>
Mandatory, strongly worded	0	
Mandatory, flexible wording	15	EF, 1, 5, 6, 7, 9, 10, 11, 13, 14, 15, 18, 20, 21, 25
One preferred method, alternatives are reconciled	2	12, 19
Alternative methods allowed	9	3, 4, 8, 16, 17, 23, 24, 26, 27
Do anything	1	22
Total standards examined	27	

Note: This was a judgmental rating modifying a four-point ordinal scale used by Mason (1978, chap. 9).

Source: NZSA standards outstanding as of 31 March, 1991.

Table 6.7 highlights the flexibility contained within most New Zealand accounting standards. The classification reveals that whilst 56% (15/27) of standards are considered mandatory, none of these are worded strongly, instead flexible phraseology is the norm. It is argued that the primary explanation for this malleability is the perceived need by the NZSA to generate politically acceptable accounting standards (see for example Myers, 1988, p.11; Rahman, Ng & Tower, 1991, p.161; Sutton, 1984, p.94).

This flexibility allows many reporting options and would seem to abrogate one of the most important justifications for regulation (i.e. the need for comparability). Hence, a critical dilemma can be observed between the need for politically acceptable rules versus the need for comparability (Wyatt, 1990, p.85). Table 6.7 shows a large minority of NZSA rules (44%) allow alternative methods, usually without reconciliation. This latitude does not help the ability of stakeholders to compare corporate reports.

Tower & Bauer (1991, p.173), using content analysis, evolved an Ambiguity Index. The purpose of the Index is to generate an objective measurement of the permissiveness and preciseness of the NZSA's Statements of Standard Accounting Practices (SSAP). The Ambiguity Index⁷ incorporates the level of defined versus undefined concepts along with permissive versus mandatory phraseology, it is calculated as follows:

$$\text{Ambiguity Index} = \frac{[U/(U + D)] + [P/(P + O)]}{2}$$

Where:

- U = Number of undefined words in a standard.
- D = Number of defined words in a standard.
- P = Number of permissive words in a standard.
- O = Number of obligatory words in a standard.

Table 6.8 presents the results in regard to the outstanding SSAPs whilst Table 6.9 offers a historical analysis of revisions to standards.

The Government has given the NZSA a fiduciary duty to control and regulate the profession⁸. As such the NZSA has an important responsibility to issue unambiguous regulation. This need for obligatory and defined phrases can be defended if clear communication is considered an important goal.

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7. The Ambiguity Index is derived from an equal weighting of the percentage of undefined words and the percentage of permissive words. Undefined words are considered to be crucial concepts mentioned in the standard where the meaning was unclear. Examples were terms such as: true and fair view, significant, appropriate, etc. Examples of permissive phrases were: should, may, however, an exception, unless, and so forth. See Appendix F for more detail.
 8. See for example the New Zealand Society of Accountants Act of 1958.

TABLE 6.8 AMBIGUITY INDEX: ANALYSIS OF SSAPs

SSAP	Year	Defined Words	Undefined Words	Not Defined	Obligatory Words	Permissive Words	Permissive	Ambiguity Index	Trend
9	1978	9	3	0.250	10	33	0.767	0.509	0.509
*EF	1979	0	4	1.000	9	7	0.438	0.719	0.614
11	1979	0	1	1.000	10	8	0.444	0.722	0.650
12	1980	9	4	0.308	20	33	0.623	0.465	0.604
13	1981	2	4	0.667	9	28	0.757	0.712	0.625
14	1982	3	1	0.250	11	41	0.788	0.519	0.608
15	1982	2	5	0.714	5	25	0.833	0.774	0.631
1	1983	2	2	0.500	9	26	0.743	0.621	0.630
3	1984	6	2	0.250	4	21	0.840	0.545	0.621
16	1984	3	4	0.571	12	31	0.721	0.646	0.623
5	1985	3	4	0.571	3	9	0.750	0.661	0.627
6	1985	1	0	0.000	5	10	0.667	0.333	0.602
4	1986	5	4	0.444	7	42	0.857	0.651	0.606
7	1986	5	7	0.583	12	50	0.806	0.695	0.612
19	1986	6	1	0.143	6	11	0.647	0.395	0.598
20	1986	2	1	0.333	6	13	0.684	0.509	0.592
10	1987	5	0	0.000	22	27	0.551	0.276	0.574
21	1988	17	2	0.105	15	57	0.792	0.448	0.567
22	1988	5	1	0.167	9	17	0.654	0.410	0.558
17	1989	8	1	0.111	10	66	0.868	0.490	0.555
23	1989	12	6	0.333	39	36	0.480	0.407	0.548
24	1989	2	3	0.600	6	21	0.778	0.689	0.554
18	1990	18	6	0.250	35	85	0.708	0.479	0.551
25	1990	4	1	0.200	8	20	0.714	0.457	0.547
26	1990	8	3	0.273	31	23	0.426	0.349	0.539
27	1990	5	0	0.000	22	12	0.353	0.176	0.525
8	1990	23	12	0.343	46	142	0.755	0.549	0.526
Averages				0.369			0.683	0.526	
									Pre-crash standards
									0.574
									Post-crash standards
									0.446

Note: * EF is the Explanatory Forward. SSAP 2 was withdrawn in 1987.

Source: Content analysis of standards outstanding as of 31 March, 1991.

Table 6.8 discloses the high level of ambiguity within the standards, with the overall pattern shown in the far right hand column. It reveals no real change over time although there is a minor improvement in the clarity of the accounting standards in the post-crash period (after October 1987). The overall Ambiguity Index rating for the SSAPs is 53%. The New Zealand SSAPs are judged ambiguous with 56% (15/27) above a 50% rating.

If one agrees that accounting regulation should seek to improve the level of clarity within corporate reports, then the results of the above study are discouraging. The evidence generated in Table 6.8 points to a consistently high degree of ambiguity contained within these rules. This finding is consistent with earlier criticisms of other Anglo-American regulatory bodies, offered by Walker (1986) and Thornton (1979).

Paradoxically, the results in Table 6.8 run counter to the overall (49%) non-compliance rating of SSAPs (as highlighted in Table 7.5). It appears that the preparers seem unwilling to comply with the rules as promulgated, even given ambiguous standards. One explanation for this is the communication failure between the NZSA rule-making structure and the preparer groups. Greater preparer involvement is a likely remedy to this conflict. Corporate accountability also is hampered by the lack of preparer compliance and the issuance of ambiguous regulation. To enhance efficiency and equity criteria it is considered that properly vetted accounting standards need to be clearly written and well-enforced.

Several New Zealand accounting standards have been re-issued and reworded. Re-issuances are caused by preparer unrest, overseas initiatives and the policy of five year reviews (Porter, 1991b, p.48). Table 6.9 details the changes in the Ambiguity Index score upon the revision of an accounting standard. It is shown that, historically, standards tend to become more ambiguous upon re-issuance.

TABLE 6.9 HISTORICAL ANALYSIS OF THE CHANGES IN THE AMBIGUITY INDEX DUE TO THE REVISION OF SSAPs

SSAP	Year	Defined Words	Undefined Words	Not Defined	Obligatory Words	Permissive Words	Permissive	Older Ambiguity	Newer Ambiguity Index	Numeric Change Index	Change in Index in Index
1	1974	2	3	0.600	14	10	0.417	0.508	0.621	0.113	0.22
3	1975	8	5	0.385	7	33	0.825	0.605	0.545	-0.060	-0.10
4	1975	8	2	0.200	13	27	0.675	0.438	0.651	0.214	0.49
5	1976	2	2	0.500	12	7	0.368	0.434	0.661	0.227	0.52
6	1977	1	0	0.000	8	12	0.600	0.300	0.333	0.033	0.11
7	1977	2	4	0.667	14	18	0.563	0.615	0.695	0.080	0.13
8	1978	10	6	0.375	32	74	0.698	0.537	0.586	0.049	0.09
10	1979	3	5	0.625	8	24	0.750	0.688	0.276	-0.412	-0.60
17	1985	4	2	0.333	12	19	0.613	0.473	0.490	0.017	0.04
18	1987	18	6	0.250	35	85	0.708	0.479	0.479	0.000	0.00
21	1987	8	0	0.000	4	1	0.200	0.100	0.448	0.348	3.48
8	1987	14	11	0.440	64	175	0.732	0.586	0.549	-0.037	-0.06
Average								0.480	0.528	0.048	

Note: SSAP-8 has been revised twice (1987 and 1990).

Source: NZSA changes in accounting standards as of 31 March, 1991.

As demonstrated in Table 6.9, of the twelve changes in rules over the period (1979-1990), three standards (25%) became less ambiguous, one (8.3%) remained the same whilst eight (66.7%) became more ambiguous.

It is thus shown from the evidence that the procedure of five-year reviews of current standards and subsequent re-issuance of rules does not, from an ambiguity viewpoint, enhance the communication process. Instead, political considerations probably cause the re-issuance of unclear standards (Section 4.6.1). Whilst New Zealand accounting standards may have been (at times) revised to gain more political acceptability, they are also likely to be easier to avoid and do not seem to give clear guidance.

6.4.4 Effectiveness of the audit qualification

Enforcement vehicles available to the Society are from two primary sources: NZSA censure and a qualified/adverse audit opinion. Neither occurs to any great degree. The NZSA has not publicly censured companies or members for questionable reporting practices. There appears to be three possible reasons for the failure to follow accounting rules: the variations from accounting rules are not considered material, the true and fair criterion conflicts with specific standards and is thus overridden or the auditors/directors are not doing their jobs properly. The current minimal disclosure level of domestic financial statements makes it impossible to accurately judge which of the above scenarios is the most prominent.

It is acknowledged that the presence of the auditor and threat of a qualified report probably serves as a useful constraint against overly-creative accounting techniques. Yet, despite high levels of preparer non-compliance (documented in Table 7.5), the number of qualified or adverse audit opinions is quite low. Fairfield (1990, p.272) examined the top 100 New Zealand companies for the periods 1987-1989 and found an average of only 8% qualifications of which approximately three-fourths related to departures from accounting standards.

The role of the auditor as an independent watchdog within the business environment is extremely valuable. Accountants have a professional duty to act independently in performing this monitoring role. In AS 1 Integrity, Objectivity and Independence the NZSA (1986) states,

Independence is the quality which permits the auditor to apply unbiased judgement and objective consideration in arriving at an opinion... To preserve independence the auditor should maintain freedom from any conflicting interests or improper influence and should avoid situations which may lead others to conclude that there is a conflict of interest and that objectivity is impaired (paras 1.2-1.3).

There are three potential conflicts which could be seen to hinder auditor independence: the audit fee, related accounting work and other links with the company (i.e. management consultancy, share ownership) (Cameron, 1990, chap. 5).

One possible remedy to minimise the perception of a lack of independence would be the greater use of audit committees. Typically, the audit committee is composed of outside directors whose function is to serve as the client company's voice in audit issues (Porter & Cameron, 1987, p.38). The audit committee could serve as valuable intermediary between the auditor and company directors and managers. The introduction of such an institution for non-public issuers may fail cost-benefit considerations, however, for public issuers the implementation of mandated use of audit committees appears to be a viable proposition. It is interesting to note that the Securities Commission (1990, p.54) mentions several advantages of such of system for New Zealand. However, for some undisclosed reason they fail to recommend legislation.

6.5 SUMMARY

The New Zealand Society of Accountants has evolved from relying wholly on professional judgement, to a gradual move over time to recommend and then mandate accounting rules. The standards evolved from domestic crises and British influence. These rules help to maintain the NZSA's role as a profession. They are promoted as mandatory rules which companies are to follow with the implication that the corporate reporting environment is improved due to the Society's activities.

The evidence provided in this chapter highlights deficiencies in the regulatory effectiveness of the New Zealand accounting standards. These rules are hampered by their own ad hoc nature with no clear objective or purpose offered for their existence. Although an improving trend of the issuance of timely standards is noted, it still takes at least two or three years for the generation of accounting rules. This long timeframe inhibits the comparability of corporate reports. Further, many of the promulgated rules are found to be ambiguous, with extensive levels of undefined and permissive phrases observed. Finally, the low level of audit qualifications or NZSA censure is noted. In aggregate, these failures can be seen to weaken the NZSA's claim of professional stature, making the Society more politically vulnerable.

CHAPTER SEVEN: AN EXAMINATION OF THE NEW ZEALAND SOCIETY OF ACCOUNTANTS' STANDARD SETTING PROCESS

7.1 INTRODUCTION

This chapter completes the critique of the NZSA. In Chapter Six the internal workings of the NZSA are explained. The historical analysis of the standard setting role shows that external crises provided major incentives to change. The effectiveness of present regulatory arrangements is questioned. The evidence suggests significant problems with: the lack of explicit overall objectives, the issuance of untimely and ambiguous accounting standards, and the low level of audit qualifications and NZSA censure.

To further the study, the features of this accounting standard setting process are examined in this chapter. A useful classification for analysis of regulatory arrangements, as offered in Section 4.7., is the breakdown of the design, approval and enforcement phases.

7.2 DESIGN FEATURES

It is considered that within the accounting standard setting process, the design phase is most appropriately handled by those most technically competent (Section 5.3.3). Within New Zealand this proficiency rests with the NZSA.

Three important issues arise when discussing the NZSA design phase of accounting standard setting: the proper use of the profession's expertise, the narrowness of funding arrangements, and the lack of non-accountant participation into the process.

The research below reveals that the strengths of the status quo include the Society's contribution of substantial energies into the standard setting process, offering both technical expertise and a large financial outlay. Weaknesses of the current design phase include its domination by the NZSA members and the lack of mechanism for dealing with emerging issues.

7.2.1 Funding standard setting costs

In regard to the funding issue, the NZSA's rising financial outlay to the standard setting process during the time period (1970-1990) is documented in Table 7.1.

TABLE 7.1 NEW ZEALAND SOCIETY OF ACCOUNTANTS FINANCIAL DATA (1970-1990)

Year	Members	Revenue	Fees from members	Standard setting cost	Cost per member	Cost/revenue	Cost/fees	% Change in costs
1990	17401	4051000	3301000	437000	25.11	.11	.13	17
1989	16485	3475000	3041000	372000	22.57	.11	.12	-12
1988	15777	2985000	2715000	423000	26.81	.14	.16	33
1987	15189	1947000	1802000	319000	21.00	.16	.18	33
1986	14615	1896000	1480000	239000	16.35	.13	.16	57
1985	14102	1508000	1340000	152000	10.78	.10	.11	153
1984	13685	1454000	1238000	60000	4.38	.04	.05	00
1983	12594	1360599	1209390	59893	4.76	.04	.05	148
1982	12155	1274203	1178470	24155	1.99	.02	.02	-43
1981	11724	852048	832330	42305	3.61	.05	.05	44
1980	11411	721021	706801	29350	2.57	.04	.04	20
1979	11106	501529	487896	24461	2.20	.05	.05	92
1978	10782	488344	485824	12711	1.18	.03	.03	-04
1977	10407	490623	481361	13240	1.27	.03	.03	148
1976	10163	320517	314696	5338	.53	.02	.02	23
1975	9946	190736	184290	4355	.44	.02	.02	25
1974	9641	186652	172363	3494	.36	.02	.02	139
1973	9376	180887	166980	1464	.16	.01	.01	06
1972	9158	147842	135983	1380	.15	.01	.01	135
1971	9019	149540	134342	588	.07	.00	.00	-59
1970	8767	143298	131749	1430	.16	.01	.01	---

Note: All amounts expressed in historical cost figures (\$). The costs referred to in the four right-hand columns refer to the accounting standard setting process.

Source: New Zealand Society of Accountants' annual reports (1970-1990).

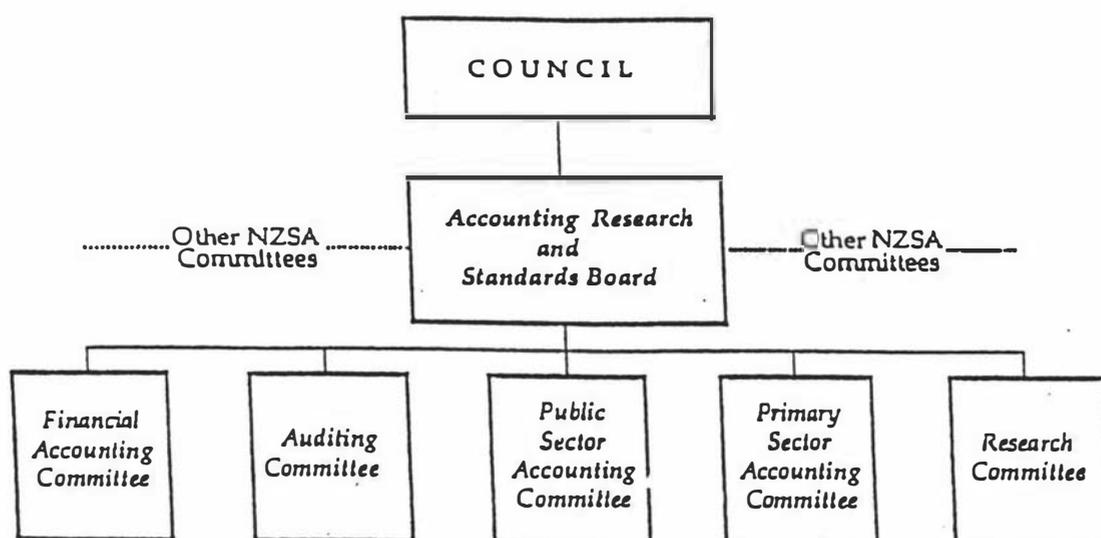
Historically, the Society has shouldered the funding burden in generating accounting standards, Table 7.1 displays the large degree of support which the NZSA has offered with \$437,000 spent in 1990. Funding for standard setting has swelled from less than a dollar per member in the early 1970s to over \$25 per member in 1990, rising as a proportion of both fees from members and total revenue. A noticeable increase in the financial commitment for standard setting activities is observed in the late 1980s in comparison with the token expenditures in the early 1970s. The NZSA is seen to have radically changed their priorities (as measured from a funding viewpoint) over the last two decades. It is also noted that this Table does not reflect the opportunity cost of committee members' time.

However, there appears to be no good reason the accounting profession should bear the entire brunt of standard setting costs. Many groups in the country receive the benefits from the promulgation of these rules, especially if a public accountability viewpoint is accepted. It is appropriate to expect contributions from preparer, stakeholder groups and the government towards this cause.

7.2.2 Due process procedures

The NZSA's standard setting structure is depicted in Figure 7.1. The Accounting Research and Standards Board (ARSB) is the originator of the standards, they have the responsibility to create the standards. The ARSB is composed of twelve members of the Society appointed by the Council. There are five functional sub-committees of the Board: Accounting Research, Auditing, Public Sector, Primary Sector and Financial Accounting. At times the drafting of standards is delegated from the ARSB to the Financial Accounting Committee (FAC) or the Audit Committee (AC) (Porter, 1991b, p.45). The NZSA Council gives ultimate approval.

FIGURE 7.1 NZSA STANDARD SETTING STRUCTURE



Source: Porter (1991b, p.44).

None of the meetings of any of these Board Committees are open to the public nor are any votes or minutes released (Bloom & Naciri, 1990, p.75). The entire process is conducted entirely by NZSA members. Great concerns about the lack of public accountability of such a structure (as shown in Figure 7.1) can be raised.

There are three ways the NZSA could ensure an adequate due process system. The first is through an open standard setting process which obtains sufficient outside input to gain an understanding of stakeholder needs. Second, usage of a widely-representative consultative group which meets frequently and is given due weight. Third, is the implementation of a standard setting board structure whose membership composition more closely reflects the greater community. These potential proposals can be evaluated within the present system.

7.2.2.1 The degree of openness of the standard setting process

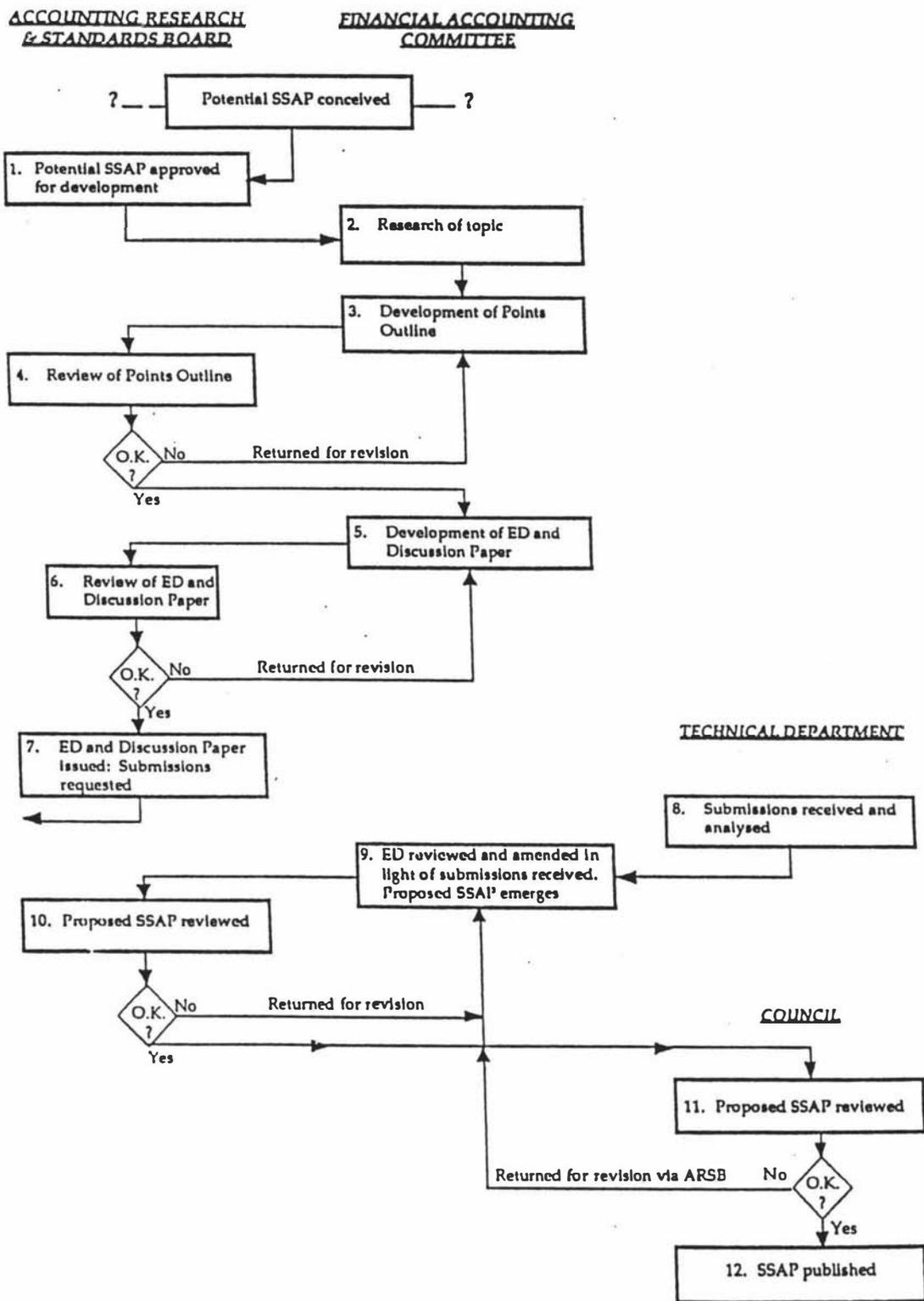
The present due process procedures for the creation of accounting standards began in 1974. First, the need for a standard is established, then (supposedly) comes a consultative stage with interested parties, this is followed by the issuance of an exposure draft, then public submissions are received and analysed, next comes the promulgation of a final standard and lastly a policy of five yearly review of these standards for possible revisions is instigated. An overview of the current NZSA due process procedures for accounting standard setting is given in Figure 7.2.

The process is supposedly designed to ensure adequate discussion and obtain outside input in the making of accounting rules. The views of stakeholders and preparers, however, are noticeably lacking. Figure 7.2 shows that there is negligible outside consultation in the present NZSA system until step seven of a twelve step process. Moreover, as noted in Section 4.6.2, the few parties that do submit responses to the exposure drafts are not a representative sample of the community's attitudes.

As of the beginning of 1991, there were a total of 53 exposure drafts issued. Table 7.2 examines the respondents¹ to these exposure drafts to determine: 1) how many groups respond, 2) who tends to respond, and 3) what standards garner the most attention.

1. The difficulties of generalising respondents submissions are well documented (Currie et al., 1987; Rahman, Ng & Tower, 1991). The focus in this study is on the choice to respond (see for example Kelly, 1985) using the Down's (1957) voting model approach to examine lobbying efforts.

FIGURE 7.2 NZSA'S DUE PROCESS PROCEDURES FOR ACCOUNTING STANDARDS



Source: Porter (1990c, p.27).

TABLE 7.2

BREAKDOWN OF SUBMISSIONS TO EXPOSURE DRAFTS
(SEPTEMBER 1977-DECEMBER 1990)

SSAP	ED	Title	Date Issued	Total	Public Accts	Comp-anies	Branch	Acad-emics	Govt.	Other
11	19	Expenditure c/f	Sep 77	13	5	1	6	1	0	0
12	20	Income Tax	Jun 78	37	9	12	10	1	0	4
13	21	Research & Devel.	Jun 79	10	0	4	0	1	1	4
14	22	Construction	Sep 80	20	5	6	5	0	0	4
1	23	Accounting Policy	Dec 80	26	7	6	8	2	2	1
15	24	Contingencies	Feb 81	8	4	2	2	0	0	0
CCA	25	Current Cost	Aug 81	48						
TPA	26	Earnings per share	Mar 82	22	3	5	0	3	0	11
16	27	Government Grants	Dec 82	19	4	3	6	3	0	3
4	28	Depreciation	Jul 83	75	9	44	3	8	6	5
17	29	Investment properties	Jul 83	77	12	35	6	3	3	18
18	30	Leases	Mar 84	39	6	14	3	4	4	8
5	31	Subsequent Events	Aug 84	33						
6	32	Materiality	Aug 84	39	11	14	1	2	4	7
4	33	Inventory	Feb 85	29	6	16	0	2	2	3
7	34	Extraordinary Items	Dec 85	25	8	9	2	4	2	0
19	35	G.S.T.	Mar 86	25	3	7	4	3	4	4
20	36	Share Dividend	Mar 86	22	5	10	1	2	0	4
21	37	Foreign Exchange	May 86	37	7	17	2	4	1	6
21	37A	Foreign Exchange	May 87	45	7	22	3	1	2	10
8	38	Business Combinations	Oct 86	32	8	10	2	1	1	10
10	39	Cash Flows	Feb 87	38	9	6	4	5	5	9
**	40		**							
22	41	Related Party Disclosures	Feb 88	20	7	8	1	1	1	2
17	42	Development Margin	Mar 88	16	8	5	1	0	2	0
*	43	Intangibles	Jul 88	26	12	5	2	2	5	0
23	44	Segment Reporting	Jul 88	17	6	8	0	0	1	2
17	45	Investment properties	Aug 88	37	12	12	1	4	2	6
24	46	Interim Reporting	Nov 88	13	6	2	0	1	2	2
26	47	Debt Defeasance	Feb 89	18	11	2	2	1	2	0
26	47A	Debt Defeasance	Feb 90	16	5	2	2	1	3	3
25	48	Joint Ventures	Mar 89	21	10	1	2	3	3	2
8	49	Business Combinations	Feb 90	8	3	3	0	1	1	0
8	49A	Business Combinations	Jun 90	14	4	4	0	2	4	0
*	50	Fixed Assets	May 89	32	9	8	1	4	4	6
*	50A	Fixed Assets	Jun 90	46	9	12	2	8	8	7
18	51	Lease Amendment	Oct 89	8	3	1	2	0	2	0
*	52	Deferred Tax	Mar 90	31	9	7	2	4	6	3
27	53	Right of Set-off	Feb 90	13	5	2	1	1	3	1
*	54	Research & Devel.	Jun 90	20	7	3	2	3	4	1
Sum				974	247	325	87	84	86	145
Average				26.32	6.86	9.03	2.42	2.33	2.39	4.03

Profession/preparer average= 17.8 responses per exposure draft (67% of total).

Stakeholder average= 8.5 responses per exposure draft (33% of total). This assumes governmental responses were as stakeholders.

Note: These averages (and sums) exclude the data from ED 25 and 31 which did not have detailed information available in the NZSA archives. ED 26 was issued as a Technical Practice Aid (TPA). A detailed breakdown of respondents was not available on pre-September 1977 exposure drafts.

Note: * No standard issued as of March 1991.

** Exposure draft #40 was never issued.

Source: NZSA archives.

The low number of response to NZSA's promulgations is reflected in Table 7.2, the average number of respondents to exposure drafts is 26.32. This represents only .0176% of companies and .00082% of the general population. It is considered axiomatic that the responses by this tiny minority should not be generalised to the total population.

Differing explanations for this low level of response can be offered: dearth of interest, lack of awareness, or a feeling of powerlessness (Wilson, 1974, p.143). The huge societal impact of corporate entities leads to the conclusion that a lack of interest is not the problem, an educational campaign might generate more general public awareness of the accounting rule-making body. However, an educational campaign is insufficient. As Downs (1957, p.138) observes, groups will only vote (i.e. offer submissions) when they consider their opinions are given a fair weighting and there is a likelihood that their views may prevail. The present narrowly-based NZSA system appears to largely preclude outside interest groups, this fact may explain the historically low level of respondents.

The conclusion is reached that an extraordinarily low level of individuals respond to the present set-up. Furthermore, the responses appear distorted with 67% coming from preparer/professional groups and only 33% coming from potential stakeholders.² The current due process system, used by the NZSA, does not generate a sufficient spectrum of opinions to properly assess societal needs.

7.2.2.2 Consultative Group

One procedure to help obtain outsider viewpoints is by using a consultative group which periodically meets with the NZSA's board members for exchanges of views (Prentice, 1990, p.24; Starr, 1990, p.26). The lack of such a system was discussed in Horizon 2000 (NZSA, 1984, p.41) and a year later such a group was formed. The NZSA met with this consultative group twice a year. The stated purpose of this procedure is to garner feedback from interested parties.

It is argued, however, that these meetings are available only to certain powerful interest groups. For instance, the NZSA Consultative Group consists of members from the Institute of Directors, Financial Executive Institute, Society of Investment

2. In the examination of responses to the exposure drafts it was often difficult to categorise those in the 'other' category. Some respondents so classified may actually be preparers, consequently this category may actually be overstated. This possibility would result in even less input from the various stakeholder groups therein further strengthening the above research conclusions.

Analysts, Listed Companies Association, Securities Commission and the New Zealand Stock Exchange (Robb et al., 1990, p.526). Other stakeholders such as employees of business firms, consumer groups, environmental groups and local community interest groups had no representation and appeared to have very little impact upon the accounting standard setting process. Furthermore, this Consultative Group has not met³ since June 1988. The Consultative Group's narrow representation and failure to meet is in conflict with public accountability tenets.

7.2.2.3 Board membership composition

The third problem relates to the inadequate outside stakeholder representation upon the NZSA's rule-making boards. In New Zealand, these boards in the 1970s were perceived to possess an over-representation of academics (Zeff, 1979, p.83) and in the 1980s witnessed an over-domination of public accountants (NZSA, 1984, pp.37-38).

An institutional analysis of the relevant NZSA's board composition is conducted. Table 7.3A-E documents the parochial pattern of board selection over the period: 1970-1990. The background data is given in Appendix G.

Table 7.3A-E shows that most of the stakeholder groups have no representation upon the standard setting structure. There has been no non-accountant representation⁴ on the NZSA's Council, ARSB, Financial Accounting Committee (FAC) or Auditing Committee (AC) in at least the last twenty years. The analysis also indicates that preparer groups are historically under-represented whilst public accountants consistently have over-representation.

-
3. This fact was obtained in a 1991 interview with K. Simpkins, Technical Director of the NZSA.
 4. This can be linked backed to institutional barriers of NZSA membership criteria, created by the government, in the New Zealand Society of Accountant's Act of 1958.

TABLE 7.3A PROPORTIONAL OCCUPATIONAL BREAKDOWN (%) OF NZSA MEMBERSHIP (1970-1991)

Year	1991	1990	1989	1988	1987	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973	1972	1971	1970
Academics	01	01	01	02	02																	
Public Acct.	27	27	27	27	27	19	18	19	20	20	21	22	22	23	23	24	25	24	25	25	25	25
Company Acct.	30	31	31	32	32																	
Government Acct.	07	07	07	07	07																	
Other Acct.	35	34	34	32	32																	
Total	100	100	100	100	100																	

Note: Before 1987, the NZSA only provided specific information on public accountants. The 'Other Accountant' category is mostly comprised of retired and overseas members. The 1991 figures are estimates based on prior period trends.

Source: Adapted from Tower, Perera & Rahman (in press).

TABLE 7.3B BREAKDOWN OF OCCUPATIONAL REPRESENTATION (%) ON NZSA STANDARD SETTING BOARDS (1970-1990)

Year	1991	1990	1989	1988	1987	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973	1972	1971	1970
Public Accountants																						
PA ¹ on Council	63	71	75	65	67	78	82	76	73	80	80	80	80	80	80	81	80	80	80	75	75	77
PA on ARSB ³	50	50	50	67	73	67	58	58	50	58	58	50										
PA on FAC ⁴	38	38	38	25	33	50	33	67	57	57	71	67										
PA on AC ⁵	67	63	63	71	67	67	83	50	86	86	83	83										
PA on BOR ⁶													42	42	33	33	42	42	50	45	36	30
Year	1991	1990	1989	1988	1987	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973	1972	1971	1970
Company Accountants																						
CA ² on Council	21	17	08	17	21	13	09	14	18	15	15	15	15	15	15	14	15	15	15	20	20	18
CA on ARSB	17	17	17	08	09	17	17	17	25	25	25	25										
CA on FAC	38	38	38	50	22	33	00	00	14	14	00	00										
CA on AC	00	00	00	00	00	00	00	00	00	00	00	00										
CA on BOR													17	08	17	17	17	17	08	09	18	20

- Note:
- ¹ PA refers to public accountants.
 - ² CA denotes company accountants.
 - ³ ARSB is the Accounting Research and Standards Board.
 - ⁴ FAC is the Financial Accounting Committee.
 - ⁵ AC is the Auditing Committee.
 - ⁶ BOR is the Board of Research.

Source: Adapted from Tower, Perera & Rahman (in press).

TABLE 7.3C AVERAGE REPRESENTATION (%) ON NZSA STANDARD SETTING BOARDS: PUBLIC AND COMPANY ACCOUNTANTS

<u>Occupation</u>	<u>NZSA membership</u>	<u>Aggregate board Representation</u>	<u>Detailed average Board representation</u>				
			<u>Council</u>	<u>ARSB</u>	<u>FAC</u>	<u>AC</u>	<u>BOR</u>
Public Acct.	23.33	60.99	75.96	57.34	46.51	71.95	39.66
Company Acct.	31.20	14.96	15.74	18.18	22.09	00.00	14.66

Note: Figures are annual percentage averages (1970-1991).

Source: New Zealand Society of Accountants' annual reports (1970-1990).

TABLE 7.3D COMPARISON OF (%) NZSA MEMBERSHIP PROFILE TO BOARD REPRESENTATION (1970-1991)

Year	1991	1990	1989	1988	1987	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973	1972	1971	1970
PA ¹ on Council	63	71	75	65	67	78	82	76	73	80	80	80	80	80	80	81	80	80	80	75	75	77
PA in NZSA	27	27	27	27	27	27	19	18	19	20	20	21	22	22	23	23	24	25	24	25	25	25
Proportion	233	263	278	241	248	289	432	422	384	400	400	381	364	364	348	352	333	320	333	300	300	308
CA ² on Council	21	17	08	17	21																	
CA in NZSA	30	31	31	32	32																	
Proportion	-30	-45	-74	-47	-34																	

Note: ¹PA refers to public accountants.
²CA denotes company accountants

Note: 1991 occupational breakdown percentages are estimates. Detailed breakdown of Company Accountants before 1987 is not available.

Source: New Zealand Society of Accountants' annual reports (1970-1990).

TABLE 7.3E NZSA (%) BREAKDOWN OF CHAIRPERSON POSITIONS BY OCCUPATIONS (1970-1991)

	Time Period	Public Accountant	Company Accountant	Government Accountant	Academic	Total	Non- Acct.
President-Council	1970-1991	77	14	09	0	100	0
Chairperson-ARSB ¹	1980-1991	100	0	0	0	100	0
Chairperson-FAC ²	1980-1991	100	0	0	0	100	0
Chairperson-AC ³	1980-1991	100	0	0	0	100	0
Chairperson-BOR ⁴	1970-1979	100	0	0	0	100	0

Note: ¹ ARSB is the Accounting Research and Standards Board.
² FAC is the Financial Accounting Committee.
³ AC is the Auditing Committee.
⁴ BOR is the Board of Research.

Source: Adapted from Tower, Perera & Rahman (in press).

Three important points about the NZSA standard setting process are documented in Table 7.3A-E: the over-representation of public accountants, the under-representation of company accountants (i.e. preparers), and the non-representation of other stakeholders.

Table 7.3C indicates that whilst public accountants historically comprise 23.33% of the NZSA membership they have 60.99% aggregate board membership. Preparers, on the other hand, are largely under-represented with a historical 31.20% NZSA membership, yet having only 14.96% of the board seats (Table 7.3C). Based on NZSA membership composition, the trend of public accountants over-representation runs from 233%-432% (Table 7.3D), in direct contrast the company accountants are under-represented by 30%-74% (Table 7.3D).

Numerical dominance of one group within the standard setting process does not necessarily mean that this group will always vote together nor does it always ensure that public accountant's views will prevail. For instance, Rahman, Ng & Tower (1991, p.165) examines the submissions to both exposure drafts relating to investment properties (SSAP-17a & 17b) and concludes that the end product was a compromise between many groups and find no evidence of public accounting domination. It should be noted, however, that their study relates only to one standard and studies only one aspect of the process (submissions to exposure drafts). It is thus unclear how broadly these conclusion can be generalised.

Hope & Gray (1982, p.555) spotlight the powerful role played by the Chairperson of the standard setting boards in influencing outcomes and determining the agenda items. As viewed in Table 7.3E, public accountants have garnered 100% of the ARSB (1980-1991), Financial Accounting Committee (1980-1991), Auditing Committee (1980-1991), and Board of Research (1970-1979) chair positions. Public accountants also serve as the vast majority (77%) of the Council presidents (1970-1991). These numbers are far more than the membership composition would indicate is appropriate.

Table 7.3A-E potently proves the numerical dominance and the under-representation of preparers and non-representation of other stakeholders upon the NZSA's standard setting process. The NZSA's agenda setting process regarding accounting standard issues is thus considered closed in nature. Other stakeholders are not allowed in this power sharing arrangement and their views remain largely unsolicited.

7.2.2.3 Emerging Issues Task Force

The long time lag between the perception of the need for regulation and the issuance of the accounting standard is highlighted in Section 6.4.2. This lag illuminates another deficiency of the NZSA standard setting process: the lack of an Emerging Issues Task Force. Such a body, usually a sub-committee of the standard setting board issues tentative guidance on important emerging issues (Leo, 1990, p.21). As discussed in Chapter Two, the accounting regulatory bodies of America, Britain and Canada have such a system and the Australian ASRB (now known as the AASB) has been criticised for its absence (Walker, 1990, p.18).

Under the production component of the Model, timely guidance is considered a necessity (Section 5.3.3). The introduction of an Emerging Issues Task Force within the New Zealand accounting regulatory environment would provide influential interim guidance on dynamic issues.

A properly functioning design phase is critical in that it determines the agenda, the product and the funding mechanism. Overall, several flaws are highlighted in the current NZSA system of designing accounting standards. Problems are observed with the narrow funding base, due process procedures and timeliness of promulgating regulation.

7.3 APPROVAL MECHANISMS

In contrast to the design phase's technical component, the approval phase is perceived as the point in the accounting standard setting process where outside viewpoints judge the proposals based on societal criteria (Parker et al., 1987, p.234). The approval phase under the Model notes the importance of four elements: independence, sufficient powers, quality control, and constituent support.

To maintain independence, it is considered that this phase needs to be completely removed from the profession (Section 4.7.2). Presently, the NZSA accounting standard setting system does not have an independent approval phase. As shown in Figure 7.1, the NZSA Council has the sole power for approval, with no mechanism for outside review.

Table 7.3 reveals the membership composition of the NZSA Council is dominated by the public accountants (63-82% average representation over the last two decades) with some preparer representation (8-21%). There is no outside stakeholder presence.

Most (77%) of the NZSA Presidents have been public accountants with (14%) company accountants and (9%) government accountants (Table 7.3E). Non-accountants have no official leadership role. Hence, under the present system there is no mechanism for the greater community to vet the NZSA's accounting standards. Further, it is very unusual for the Council to reject or modify the ARSB's recommendation⁵.

Under the Model, the approval mechanism introduces quality control at a societal level upon a profession which has been delegated great powers. One important aspect of quality control would be the monitoring of all qualified reports with corresponding follow-up procedures (Section 4.7.2). However, the low level of audit qualifications documented in Section 6.4.4, highlights the importance of additional safeguards. The Model advances the notion that extensive, on-going research on corporate reporting practices, and consideration of the quality of communication of the accounting regulation would enhance quality control procedures.

Another important issue is the degree of power possessed by the approval body. Under the Model the approval body would have the power to amend and revoke as well as approve accounting standards. This additional power is considered important to ensure the preferences of the community are incorporated (Section 4.7.2). Whilst there is no such system currently, a Tripartite Agreement by the NZSA, NZSE and Securities Commission correctly advocates the need for the possession of amendment and revocation powers for an approval body (Business Law Reform: Financial Reporting in New Zealand, 1991, p.2; see Section 9.3.4.1 for an expanded analysis of this Agreement).

The approval phase is the logical place where community interests are weighted. Technical accounting standards, largely drafted by accountants, are vetted at this stage by stakeholders for acceptance and appropriateness. However, an independent, separate approval body with a substantial non-accountant representation, although considered vital, is now absent.

7.4 ENFORCEMENT CAPABILITIES

There is currently no statutory enforcement of accounting standards, instead the Society requires its members to disclose deviations from the standards (NZSA,

5. This trend was discussed in a 1991 interview with B. Porter, former Director of Research, NZSA.

1979a, para. 2.2). Their enforcement techniques consist of persuasion (McMonnies, 1985, p.27) and threatening disciplinary action against members. The NZSA has no active programme for reviewing compliance with accounting standards (Craig, 1986, p.12). As discussed in Chapter Six, the rise and fall of standards such as CCA-1 (NZSA, 1982) and SSAP-17 (NZSA, 1985) raises important questions about the method of preparation or enforcement of domestic accounting standards.

In the Model, regulation is offered as an important tool in the pursuit of public accountability offering the potential for an environment with more equity and efficiency (Section 5.3.2). Regulation enhances equity by mandating certain minimum disclosures and creates efficiencies by improving comparability (Section 5.3.3). The promulgation of accounting standards, however, without adequate enforcement can be seen to be a sham (Walker, 1986, p.12). The NZSA has been given the responsibility for governing their members but, has not been given the congruent power to enforce their own rules.

The present status of the NZSA's enforcement mechanism is evaluated via compliance studies. The results reveal a large amount of non-compliance with seemingly little enforcement pressures. The historical debate of the proper role of the government is detailed with evidence offered that the threat of intervention has changed NZSA's behaviour. Recent events (notably the 1987 sharemarket crash) are leading to more fundamental changes in this enforcement mechanism such as: the introduction of an independent accounting board and government-backed standards (see Porter & Simpkins, (1990, pp.18-20) and Tower (1990b, p.15) for reviews of the various New Zealand proposals).

7.4.1 Enforcement studies

Accountants want the NZSA to take a stronger line in enforcement ("Call for", 1988, p.16). A poll, conducted in 1983 (see Table 7.4) demonstrates that the Society's performance in enforcing standards is not as highly regarded as its performance in setting them (McLean, 1984, p.82).

The low level of support for enforcement by all the polled groups in Table 7.4 raises questions about the efficacy of NZSA standards. How useful are they? Do they change corporate reporting practices?

TABLE 7.4 APPROVAL RATING OF THE NZSA STANDARD SETTING PROCESS

	Members	Non-NZSA acct.*	Accounting students	Business leaders
Setting standards	74%	60%	52%	73%
Enforcement of standards	30%	29%	29%	56%

* Accountants who are not members of the NZSA.

Source: NZSA (1984, p.25).

In an attempt to gain answers to these questions a recent study was completed by Tower & Dowds (1991). The impact of accounting regulation upon New Zealand reporting practices is examined over time. The H Index of industrial concentration is used (see Thiel, 1972; Van der Tas 1988, p.159 for an expanded discussion of the formula) to measure the degree of harmony of reporting practices. The formula for the H index is:

$$H = \frac{1}{\sum_{i=1}^n P_i^2}$$

where:

H = Hirschman-Herfindahl index.

n = number of alternative reporting methods available to the reporting entity.

p = the relative frequency of the reporting method, i.

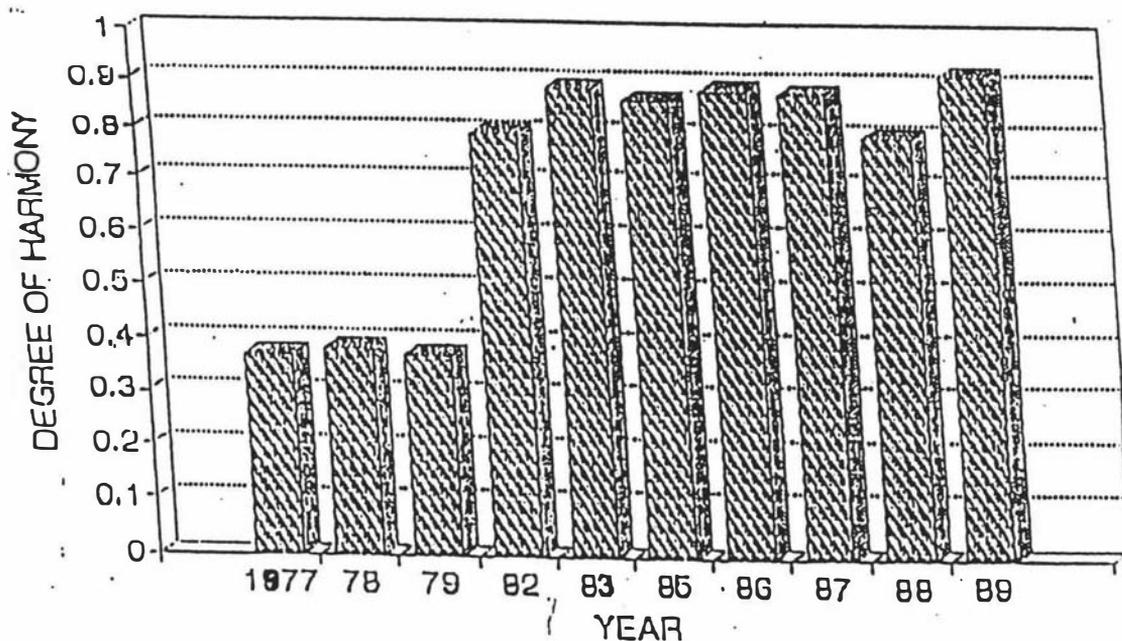
The formula⁶ is applied to the top 100 New Zealand companies 1978-1989 as surveyed in Ryan, Heazlewood, Andrew & Perkinson (1982); Ryan, Heazlewood, Wong & Chye (1984); and Ryan (1987, 1990a). Two accounting issues are examined: the reporting of funds/cash flow statement (SSAP-10a (NZSA, 1979c) and SSAP-10b (NZSA, 1987b)) to demonstrate the methodology via a disclosure issue and accounting for investment properties (SSAP-17a (NZSA, 1985) and SSAP-17b

6. There are limitations with this study and methodology. First, the Ryan surveys have three missing years (1980,1981,1984), however, a clear picture can be garnered from the other periods. Second, the SSAP-10 analysis focuses on the title of the statement, an item which is arguably not as crucial as other possible issues, although it is perceived to aid comparability. Third, the H index is unable to deal with multiple reporting (Van der Tas, 1988, p.163).

(NZSA, 1989b)) to investigate a measurement issue. These two accounting standards are chosen because of: 1) the importance of the funds/cash requirement for a third major financial statement and the public controversy surrounding the investment property rule, 2) availability of sufficient suitable data to apply the methodology, and 3) lengthy time frame for analysis.

Company reporting of funds/cash flow issues is measured via an examination of the title of statement, and the reporting for investment property focuses on the location of unrealised changes in the value of investment property within the financial statements. Figures 7.3A-B shows the impact accounting regulation has upon New Zealand reporting practices.

FIGURE 7.3A MEASURE OF HARMONISATION: SSAP-10

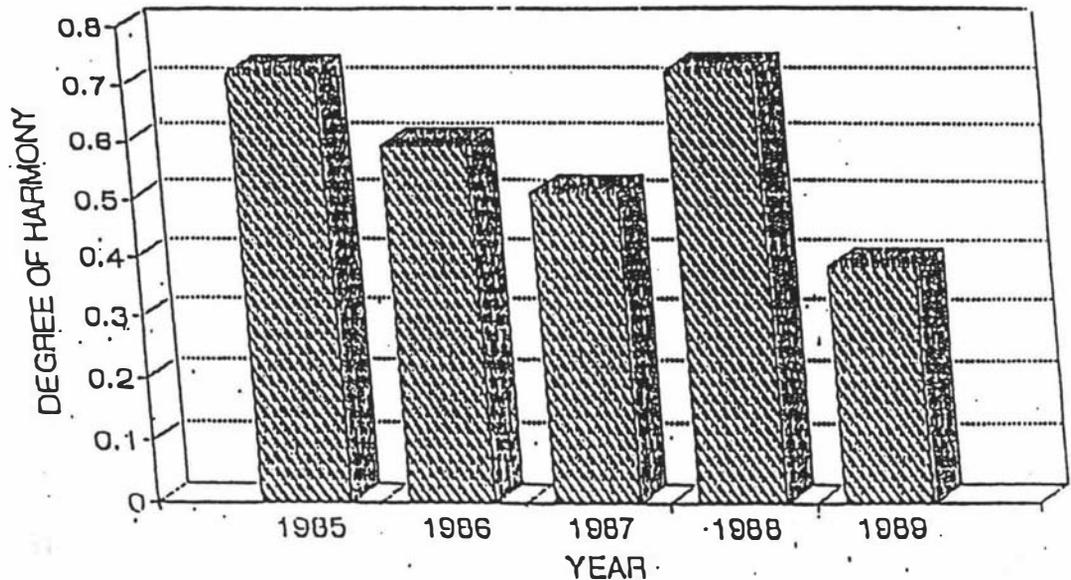


Source: Tower & Dowds (1991, p.91).

As shown in Figure 7.3A, the implementation of the original SSAP-10a in late 1979, requiring a Statement of Changes in Financial Position, resulted in a large increase in harmony of reporting practices in the early 1980s. The evolution of SSAP-10b in October 1987, mandating a Statement of Cash Flow, continues the trend. Whilst this

pattern might be seen to be stating the obvious, it is important to prove that accounting regulation can increase the harmony of company reporting practices, therein assisting comparability.

FIGURE 7.3B MEASURE OF HARMONISATION: SSAP-17



Source: Tower & Dowds (1991, p.95).

Figure 7.3B demonstrates (from a comparability viewpoint) the hazards of promulgating accounting standards with too much flexibility. SSAP-17a, issued in 1985, required investment property companies to take unrealised gains and losses of investment properties through the income statement. This standard was controversial and as shown in Figure 7.3B had a downward⁷ trend of harmony (1985-1987). SSAP-17a was withdrawn in June 1988.

Revised SSAP-17b, issued in February 1989, allows multiple options for the reporting of unrealised gains and losses of investment properties (Rahman, Ng & Tower, 1990, p.23). These items under SSAP-17b can be reported either in the income statement or through the balance sheet (via a reserve). Usage of the Van der Tas (1988) methodology to SSAP-17 reporting practices highlights the potential

7. It is interesting to note the upward 1988 trend of harmony in SSAP-17 reporting practices leading Tower & Dowds (1991, p.96) to speculate that the NZSA may have prematurely withdrawn the original SSAP 17.

negative impact that regulation has to the comparability of corporate reports when multiple options are allowed (see Figure 7.3B). This analysis provides evidence that the mere promulgation of a rule does not necessarily improve comparability.

Although Figure 7.3A shows the potential positive impact that accounting regulation may have on reporting practices, in aggregate, the current regulatory structure in New Zealand does not appear to have resulted in a high level of compliance with accounting standards by preparers of financial statements. For instance, various studies contained in Ryan (1990a) have documented a historical trend of non-compliance at a high level.

A listing of all available New Zealand-based studies highlights this problem, encompassing eight separate studies which examines nine New Zealand accounting standards over many years. Table 7.5 details an average rate of 49.2% non-compliance with New Zealand accounting standards.

TABLE 7.5 COMPLIANCE STUDIES: NEW ZEALAND COMPANY FINANCIAL REPORTING PRACTICES (1975-1989)

Authors	Year Published	Study Period	SSAP Studied	Topic	Degree of Compliance	Overall Averages**	Breakdown Time Period		
							75-84	85-89	
Sattler	1978	1975	1	Accounting Policies	40				
Grant et al.	1976	1976	1	Accounting Policies	100				
Sattler	1978	1976	1	Accounting Policies	100				
Sattler	1978	1977	1	Accounting Policies	100				
Ryan	1990b	1987	1	Accounting Policies	63				
Ryan	1990b	1988	1	Accounting Policies	70				
Ryan	1990b	1989	1	Accounting Policies	62	SSAP 1 Average	76.4	85.0	65.0
Grant et al.	1976	1976	3	Depreciation	61				
Tower et al.	1990	1987	3	Depreciation	69				
Tower et al.	1990	1988	3	Depreciation	64				
Tower et al.	1990	1989	3	Depreciation	59	SSAP 3 Average	63.2	61.0	64.0
Grant et al.	1976	1976	4	Inventories	59	SSAP 4 Average	59.0	59.0	
Tower et al.	1990	1987	5	Subsequent Events	52				
Tower et al.	1990	1988	5	Subsequent Events	59				
Tower et al.	1990	1989	5	Subsequent Events	61	SSAP 5 Average	57.3		57.3
Carshaw & Neale	1990	1989	8	Business Combinations	62	SSAP 8 Average	62.0		62.0
Cliffe et al.	1984a	1981	12	Income Tax	36				
Cliffe et al.	1984a	1982	12	Income Tax	48				
Cliffe et al.	1984a	1983	12	Income Tax	52	SSAP 12 Average	45.3	45.3	
Emery	1990	1987	13	Research & Development	73				
Emery	1990	1988	13	Research & Development	64				
Emery	1990	1989	13	Research & Development	71	SSAP 13 Average	69.3		69.3
Cliffe	1990	1987	18	Leases	11				
Cliffe	1990	1988	18	Leases	12				
Cliffe	1990	1989	18	Leases	26	SSAP 18 Average	16.3		16.3
Peterson et al.	1984	1983	CCA1*	Inflation Accounting	8				
Cameron & Heazlewood	1985	1984	CCA1	Inflation Accounting	9	CCA 1 Average	8.5	8.5	
						Overall Compliance	50.8	51.8	55.6

Note: * CCA1 denotes the Current Cost Accounting standard.

** All studies were equally weighted in the calculation of the specific SSAP average. The SSAP averages were equally weighted in determining the overall average.

Source: Adapted from Tower, Perera & Rahman (in press).

Table 7.5 draws attention to the marked inability of the NZSA to enforce⁸ their promulgations. Average compliance over the study period (1975-1989) is only 50.8%. Compliance has slightly increased over time with an initial rating of 51.8% (1975-1984) as compared with a later compliance score of 55.6% (1985-1989). The slight increase in the compliance rating may be explained by the issuance of the most controversial standard (price level accounting (CCA-1)) in the former period.

The general trend of continuing non-compliance is observed in an analysis of a subset (1987-1989 time period only) of the Table 7.5 data. The Ryan (1990a) survey provides compliance scores on five standards (SSAPs' 1,3,5,13,18). Four of these five standards are rated mandatory-flexible wording in the Table 6.7 classification. Because of the flexibility of these rules a high level of compliance could be expected. However, very little improvement is observed, with compliance scores of 53.6% (1987), 53.8% (1988) and 55.8% (1989). The conclusion is reached that there is an unacceptably high degree of non-compliance with the New Zealand Society of Accountant's promulgations.

The current NZSA system of self-regulation does not appear to be sufficient in preventing the historical trend of preparer-disregard for accounting rules. Hill (1991, p.26), the Chairperson of the Accounting Research and Standards Board, rates the current NZSA enforcement mechanism a one on a ten point scale. These concerns have generated a call for more governmental involvement (see for example, New Zealand Press Association, 1991, p.15).

7.4.2 Role of the Government in enforcement

The debate between the merits of private versus public sector enforcement and promulgation of accounting standards has raged for some time, both domestically and internationally (Kerkin, 1984, p.54; Rebmann-Huber, 1990, p.7). Although the NZSA, in *Horizon 2000* (1984, p.33), acknowledges that public regulation is superior to internal regulation, they maintain that the power to promulgate accounting standards should stay with the private sector, when they conclude,

8. There are limitations to aggregating the results of these individual studies. Some of the investigations used random sampling whilst others used the top 40, 50 or 100 companies in given year(s). Moreover, many of the studies failed to disclose their rating rationale. It was, thus, unclear how stringent each research team was in their evaluation (i.e. was greater than 50% compliance considered adequate or was 100% compliance deemed necessary). Despite these limitations, the aggregate result reveals a high level of non-compliance with the NZSA's promulgations.

External pressures could come from two sources: Government intervention, and public scrutiny. We are opposed to an increase in Government intervention, because we believe that statutory regulation would be slow, cumbersome, rigid, unresponsive to change-the very antithesis of the qualities which are needed for meeting the challenges of the future (NZSA, 1984, p.120).

The authors and participants of Horizon 2000 express fears of civil service intervention stating the most likely government intervention scenario would be caused by pressure from dissatisfied parties (1984, p.114). To counteract this potential scenario they recommend an expanded private standard setting process with more user-participation (p.116).

Tower & Perera (1989, p.22) conclude that enforcement of standards is made easier when a wide range of constituent support is available. Craig (1986, p.12) and McLean (1984, p.82) feel that to be successful the regulatory mechanism must attain a consensus of all affected parties, however, McManamy (1984, p.241) describes how difficult this objective is to reach. Table 7.3A-E provides confirmation that within the New Zealand standard setting process there is very limited participation of non-accountant stakeholder groups and no board representation. The important strategy of opening the system, as recommended by the Horizon 2000 authors and endorsed by the NZSA, is apparently unsuccessful.

The NZSA has been criticised for not taking a more aggressive stance in the area of standard setting and in particular the need for expansion of research in support of development of standards for New Zealand (Jensen, 1981, p.88; Zeff, 1979, pp.78-79). Craig (1986, p.11) notes the widespread dissatisfaction with the effectiveness of self regulation whilst McMonnies (1985, p.15) correctly observes that neither the accountancy societies, auditors, nor fellow directors in a private standard setter system can procure compliance with standards from the non-accountant directors and concludes that the capability to require compliance did not exist with any non-governmental body (p.17).

One useful power to raise corporate acquiescence, within New Zealand, could be the implementation of a British-style remedy clause which provides the government the authority to demand the correction of defective accounts (see Tweedie & Whittington, 1990, p.97).

From the above discussion, it is concluded that a government body is in a much better position to enforce accounting standard compliance than professional accountancy

bodies. For instance, with government legislative backing, qualified audit reports would potentially have much more influence upon preparer's compliance with accounting rules. This more stringent enforcement mechanism coupled with greater stakeholder/preparer participation would facilitate a greater level of compliance with issued accounting rules.

7.5 AN EVALUATION OF PROFESSIONAL SELF-REGULATION

The history of the NZSA as a professional body may be seen in two different ways. On the one hand, many examples can be found over the decades of selfless volunteer work serving as technical consultants on such issues as taxation reform and company legislation. The Society served as a technical consultant in the major tax changes made by the Labour government in the last half of the 1980s (NZSA, 1989a, p.16). In addition, the accounting profession is now deeply involved in the reviews of the sharemarket, companies act and financial reporting (Simpkins, 1991, p.20). As regards accounting standards, minor improvements were noted in these last two chapters concerning the pace of change and the time lag for producing rules. A notable improvement is observed in the NZSA's funding commitment.

On the other hand, the Society could also be seen as a group which protects its own interest. For example, Wilson (1983, p.226) argues that accounting standards are the New Zealand profession's security blanket in providing protection against legal action. In 1933, the Society was accused by some members of Parliament of running a "closed shop" (Graham, 1960, p.70). In the formulation of the Companies Act 1955, the NZSA fought the English Society's desire to allow Commonwealth (i.e. non-New Zealand) accountants to perform audits in New Zealand (Graham, 1960, p.123). Authority over professional status is reinforced in the 1958 legislation which gives the NZSA control and regulation over accountants.

The above incidents could be seen as partial evidence for an industry seeking to maximise wealth by restricting entry. This is in essence an industry protection theory as discussed by Stigler (1971), Posner (1974), Peltzman (1976), and Walker (1987) among others. Arguments about entry requirements into the accounting profession led the Society to create Horizon 2000 to formulate long-term objectives and policies on education (NZSA, 1984, chap.6).

The lack of enforcement of accounting standards in New Zealand (see Table 7.5) emphasises the weaknesses of professional self-regulation. Further, there is a gap

between the high level of non-compliance (49%) and low level of related audit qualifications (8%). The NZSA does have a Professional Standards Committee to oversee enforcement issues, but they have openly decided that the Committee's role is educational rather than disciplinarian (see for example Butler, 1982, p.268; Edwards, 1989, p.11; "The Professional", 1980, p.258). Furthermore, many ongoing problems remain with the current regulatory process, they include: lack of explicit guidelines for accounting rules, the high level of overall ambiguity in accounting standards especially upon re-issuance, and the low number of audit qualifications. The conclusion is reached that professional self-regulation, in the New Zealand accounting environment, is inadequate.

7.6 SUMMARY

Many of the weaknesses of the Anglo-American countries accounting rule-making bodies are noticeable in New Zealand accounting regulatory arrangements. Institutional/environmental evaluation, historical assessment and various empirical event studies provides evidence of critical problems within the NZSA accounting standard setting process. The research shows deficiencies in several important areas: due process, stakeholder representation, regulatory effectiveness, the design phase, the approval phase and the enforcement phase.

The study results indicate that the accounting standard setting in New Zealand is not open and lacks adequate representation from groups such as preparers and stakeholders. Moreover, the enforcement mechanism for standards is ineffective. The low level of compliance results from problems associated with enforcement and acceptance.

CHAPTER EIGHT: A REVIEW OF THE DOMESTIC INFLUENCES UPON THE ACCOUNTING REGULATORY MECHANISMS

8.1 INTRODUCTION

The massive changes in the New Zealand business environment in the last few years has lead to a re-examination of the impact of corporate accounting. Evidence in this chapter demonstrates that the accounting structures, which may have been adequate in the past, more static business environment, are now seen as inappropriate. The accounting profession's freedom to operate is at issue.

The view that accounting matters are too important to be left for the accountants alone to decide has figured prominently in recent domestic discussions. The maintenance of standards of performance is a central responsibility of any profession (McLean, 1984, p.82), yet the Current Cost Accounting (CCA) debacle proves the danger of promulgating rules that are not acceptable to the parties affected by them. Further, the threat of de-regulation seems to have encouraged the New Zealand Society of Accountants to at least appear to be more open to the public. Eglinton (1988), the then President of the NZSA, expresses his concern about possible government interference:

There is a need for us to demonstrate to the legislators and the general public that as a professional body we are capable of operating our own system of quality control. This is the age of consumerism and we must act to put our house in order before someone else tries to do it for us (p.5).

There is a general trend of governments becoming more active concerning the assessment of the accounting standard setting process (Craig, 1986; Flint, 1982). A likely scenario for increased New Zealand government involvement would follow a series of major company failures accompanied by public awareness of white collar crime, growing public disquiet over the accounting regulatory arrangements, press sensationalism and a clamour for politicians to do something. All these features, as shown later, are already present in the New Zealand environment.

The changes which affect accounting regulation are dynamic and diverse. As discussed in these next two chapters, the nine institutions in New Zealand which generate the largest impact upon the process of regulation of accounting rules (especially the NZSA) are the: preparers, stakeholder groups, auditors, public sector,

Registrar of Companies, Companies Act, judiciary, Securities Commission and New Zealand Stock Exchange. The interactions of these groups and a growing perception of crises in accounting regulation have led, via several Ministerial Reviews, to calls for substantial changes to the process.

8.2 AN OVERVIEW OF THE NEW ZEALAND BUSINESS ENVIRONMENT

Bloom & Naciri (1989, p.71) argue that the standard setting system within any given country is largely derived from its environmental influences and cultural traits. Historically, in New Zealand, great reliance was placed on selling basic agricultural goods to 'Mother' England. This trend was largely unchanged from the early 1800s until Britain's admittance into the European Community (EC) in 1973. The static nature of demand provided little incentive to change. Accounting rules reflected this inertia, regulation seemed to only evolve in response to British (and to a lesser extent other Anglo-American) accounting bodies' initiatives (Section 6.2.1).

Recent events have radically changed the business environment. Several crises have occurred in New Zealand during the last two decades: the British entry into the Common Market, the energy shocks of 1973 and 1978, and the stockmarket crash in 1987. In addition, major reforms brought in by the Labour government (1984-1990), moving more towards a free market economy, greatly affected business entities.

8.2.1 Historical economic trends

Since the European settlements in the early 1800s, most of the history of New Zealand has been in the context of the British cultural and economic dominance on the colonial society (James, 1982, p.12). New Zealand's temperate climate and fertile soil together has led to the economy's historical reliance on agriculture. Favourable climatic conditions are offset by lack of mineral and energy wealth as well as the problem of great distance from traditional markets. The agricultural dominance continued through both world wars and in the 1950s New Zealand had the eighth highest Gross Domestic Product per capita in the world, although this ranking fell dramatically to 23rd by 1987 (Bailey, 1991, p.74).

In the decade of the seventies and early eighties, low unemployment and a rigid business environment is observed. New Zealand had evolved a formidable welfare state with very high farm subsidies and many restricted union/labour practices (OECD, 1989, p.11). The National government (1975-1984) instituted price controls,

maintained foreign exchange controls, and acquired a large overseas debt. New Zealand had the highest level of direct taxation of all the OECD countries in the mid 1980s (OECD, 1988, p.25). The Economist accurately portrayed this insular business environment when they stated, "In 1984 New Zealand had the most regulated, protected and distorted economy of any OECD country. Price controls, high import tariffs and subsidies diverted resources into the wrong industries. High taxes blunted incentives to work hard and take risks" ("The Kiwi", 1989, p.17). Bailey (1991, p.74) notes that New Zealand, from the mid 1960s to the mid 1980s had one of the lowest growth rates in the developed world. This stagnancy can be directly contrasted to the dynamic changes soon to come.

8.2.2 Winds of change

The Labour party campaigned on a platform of reform and was ushered into power in 1984. The changes that followed have had vast effects on the New Zealand business environment and upon the accounting institution (see Table 8.1).

In a stated effort to reduce the national debt and provide a more efficient business environment the Labour Government (1984-1990) implemented many strategies. For instance, the maximum corporate and individual tax rate was lowered in steps from 66% in 1982 (pre-Labour) to 33% in 1989. This was partially negated by a new 10% comprehensive value added-tax, called Goods and Services Tax (GST), introduced in 1986 and since raised to 12.5% in July 1989 (Coopers & Lybrand, 1991, pp.7,13,32). Exchange controls were lifted and new financial instruments gained popularity (Stock, 1987, p.123). In addition, greater emphasis was placed on output and accountability in the state and local governmental sectors (see for instance the Public Finance Act of 1989).

As observed in Table 8.1, extensive changes took place within the New Zealand environment. The stated purpose for many of these modifications is to be more efficient in dealing with the international business community (OECD, 1989, p.15). The new era is causing much uncertainty and concern in exposing domestic businesses to international competition.

TABLE 8.1 THE REORIENTATION OF ECONOMIC POLICIES SINCE 1984: A SYNOPSIS

Wage and price controls:

- abolished in 1984;
- No government involvement in private wage negotiations;
- Rents and energy prices deregulated between 1985 and 1988.

Labour market regulations:

- Labour Relations Act 1987 to encourage decentralised bargaining and union amalgamation;
- Compulsory unionism is restricted and national award agreements made more flexible under the Employment Contract Bill of 1991;
- State Sector Act 1988 puts public sector employment on a comparable basis to private sector.

International trade:

- Export subsidies for agriculture and industry rapidly phased-out from 1985;
- Import quotas and licensing phased out in mid-1988 for industries outside industry plans;
- Phasing out of quotas for trade-sensitive industries by the early 1990s;
- Rapid bilateral removal of tariffs with Australia through Closer Economic Relations (CER);
- Phased unilateral tariff reductions with third countries;
- Effective rate of industry assistance fell from 37% in 1985/6 to 26% in 1987/8.

Financial markets:

- Removal of controls on international capital flows and domestic credit in 1984;
- Removal of barriers to entry into banking in 1987.

Other private services:

- Deregulation of road-haulage in 1983 and partial deregulation of airlines in 1987;
- Deregulation of telecommunications in 1987 and 1989.

Public sector reforms:

- Tax and transfer reform establishing the least distortive tax system among OECD countries;
- Corporatisation of government departments providing commercial services;
- Reform of the government sector with emphasis on outputs;
- Opening government procurement to private competition;
- Introduction of greater local autonomy and accountability for hospital, education boards and for local authorities;
- Adoption of full cost recovery pricing and users cost principles for government services.

Source: Adapted from OECD (1989, p.16).

The short-term results of the Labour Government's *laissez faire* governmental stance was discouraging. Unlike many other Western countries, the New Zealand economy did not appreciably grow in the late 1980s, instead New Zealand remains in the

midst of a recessionary trough. In addition, chronic balance of payment problems continue to plague New Zealand (OECD, 1989, p.17). The rapid pace of change in the business environment has disconcerted many individuals (Gawenda, 1989, p.12). Whilst, inflation has fallen from 16% in 1985 to 2% in 1991; unemployment has risen to unprecedented post World War II domestic levels, jumping from 4.0% in 1985 to 10.1% in 1991 (Munro, 1991, p.1; OECD, 1989, pp.67-68; Weir, 1991, p.1). Perhaps due to these problems the National Party won the October 1990 general election. However, despite the election rhetoric, the National Government's economic policies appear very similar to that of the previous Labour Government (Hall, 1991, p.20).

The economy appears unusually vulnerable because of the lack of diversification as compared with other OECD economies. The New Zealand share market fell 36% in October 1987 (NZSE, 1988, p.1). While prices in other markets gradually recovered, New Zealand prices continued to decline. For instance, the share price of Brierley Investments, the then largest New Zealand company, fell from \$5.20 in 1987 to a 1991 figure of little over \$1. Considering Brierley's total issue of over one billion shares, this amounts to the removal of over \$4 billion from the market concerning that company. The New Zealand Barclays' Index has fallen from over 3600 in October 1987 to under 1500 in August 1991.

The New Zealand business community is witnessing extensive changes in the early 1990s. Rapid deregulation has resulted in efficiency gains, more competitive industries and opening of markets; yet these changes have also generated hardship in the agricultural sector, large employee redundancies and an unfamiliar user-pay philosophy. The effects of all these dynamic changes coupled with the 1987 sharemarket crash and resultant spate of company failures have generated an increased call for social legislation and regulation, and concern for the large disparities being created in a traditionally egalitarian society (see for example Gold & Webster, 1990, chaps 1,7; Hooper, 1989, p.20).

8.3 NATIONAL INFLUENCES

Within the domain of accounting there are different means of regulation: government legislation, the official listing requirements of the New Zealand Stock Exchange (NZSE) and the NZSA's professional accounting standards (Farrar & Russell, 1985, p.306). Rebmman-Huber (1990) conducted an in-depth empirical study analysing the financial accounting reporting systems of 16 OECD countries. Using questionnaires

she determined the institutions that affect the New Zealand structure and ranked them by order of influence (see Table 8.2).

TABLE 8.2 MEDIAN RANK INFLUENCE OF VARIOUS INSTITUTIONS ON NEW ZEALAND ACCOUNTING STANDARD SETTING

<u>Top Tier</u>	<u>Middle Tier</u>	<u>Bottom Tier</u>
1) Accounting profession		
2) Corporations		
3) Other countries		
4) International organisations		
	5) Stock exchange	
	6) Government bodies	
		7) Banks
		8) Other creditors
		9) Shareholders
		10) Employees

Source: Adapted from Rebmman-Huber (1990, p.7).

Table 8.2 exhibits three diminishing levels of influence in New Zealand. First, is the accounting profession, preparers and overseas institutions. The middle tier is composed of government bodies and the stock exchange. At the bottom in the ranking scheme rests the non-accountant stakeholders. This low ranking for these 'other' stakeholders is of particular significance in a public accountability framework, suggesting the need for major structural changes to the current domestic standard setting process.

One weakness of the Rebmman-Huber study is her failure to consider other domestic institutions which may exert influence. For instance, an assessment of the accounting and business literature also reveals the importance of the public sector and the judiciary in the standard setting process (see for example Dixon, 1991; Ross, 1991b; Hays, 1991a). There are thus considered to be nine institutions, on the national level, which may generate a large impact upon the regulation of accounting rules.

Four institutions (preparers, stakeholder groups, auditors and the public sector) are analysed below whilst the remaining five are examined in the following chapter. This

study is conducted to gain a better understanding of the interrelationships of these groups with the New Zealand Society of Accountants' standard setting process.

8.3.1 Preparers

The conflict between preparer objectives and stakeholder needs is one of the primary justifications for the implementation of accounting regulation (Tweedie & Whittington, 1990, p.97). Corporate accounts are generated by company accountants, managers and directors. Minimum requirements on the information contained within these reports are mandated by the Companies Act 1955 and accounting standards issued by the NZSA. This minimum reporting requirement, however, often seems to become the maximum level disclosed. Two important problems are discussed below: the timeliness and the low level of communication of the corporate reports.

8.3.1.1 Timeliness of corporate reports

There exists the predicament of old, out-of-date information. Berryman (1989, p.6) feels that New Zealand corporate reports arrive too late to do anything constructive with them. The Companies Act 1955 states that companies must lodge their financial statements with the Registrar within 30 days of the annual general meeting and the New Zealand Stock Exchange requires an audited annual report within ninety days of the firm's balance sheet date.

Lont & Duncan (1989, p.7) examined the total time lag (i.e. time period between balance sheet date and issuance of audited financial statements) for a large majority of New Zealand listed companies over the time period: 1982-1985. They concluded that listed companies in New Zealand are slower at reporting their earnings announcements compared with American counterparts. Lont & Duncan (1989, p.8) found an average total lag time of 103 days in New Zealand. They observed that six companies annual reports were issued more than six months after the company year end and 36 companies had late preliminary announcements, but noted the lack of disciplinary actions against these late-filers. In terms of the proposed Model, these long time frames are considered detrimental to stakeholders (Section 5.3.1). The lack of corrective action leads to calls for more stringent, better enforced regulation (Section 5.3.3).

The business community has a different perception. Business leaders, in a 1983 poll, recommend the development of standards oriented towards practical solutions, as opposed to 'ivory tower' proposals (Hayward, 1984, p.10), and argue that the NZSA should not be the sole body for setting financial reporting standards (NZSA, 1984,

pp.23-26). In the 1983 poll, the business leaders when asked who should create accounting standards in New Zealand offered the following alternatives to the NZSA:

Business community/listed companies	44%,
Stock exchange/sharebrokers	23%
Government	16%

(Horizon 2000, NZSA, 1984, pp.24-26).

The low level of preparer representation upon the NZSA standard setting boards (see Table 7.3D) may be one important factor for the apparent tension between the professional accountants and the business community. Better relationships and a higher level of compliance with accounting rules (see Table 7.5) may be mitigated by greater preparer representation.

8.3.1.2 Communication traits of New Zealand corporate reports

The consequences of corporate reporting stem from the reactions to and perceptions of society towards operating entities based in part on the generation of financial and non-financial information (Hines, 1988, p.253; Tinker, 1991, p.298). There are two main characteristics of corporate reporting: the quantitative levels of communication and the qualitative features.

8.3.1.2.1 Quantitative characteristics

How much information is produced in New Zealand corporate reports? Is the disclosure adequate? Can the reader solicit enough information to obtain an overall understanding of the enterprise's activities? To answer these questions Tower, Grosh, Rahman, Tan & Cuthbertson (1990) and Tower, Grosh, Tan, Rahman & Cuthbertson (1990) conducted an empirical examination of New Zealand corporate reports.

For the period 1987-1989, corporate reports of the top 100 New Zealand companies are examined (see Table 8.3) based on market capitalisation. Companies which merged, de-listed, entered bankruptcy or closed down are excluded. The depreciation (SSAP-3) and subsequent events (SSAP-5) financial reporting practices are analysed. Since there was no fixed asset standard existing during this study period, other related issues such as asset revaluation, treatment of asset revaluation reserve, and accumulated depreciation are also examined under the depreciation heading.

Subsequent event disclosures are selected due to its potential for important change to the financial statement. Depreciation issues are examined due to its historically large

financial impact and the relatively settled nature of generally accepted accounting rules in this area.

TABLE 8.3 AN ANALYSIS OF REPORTING PRACTICES BY NEW ZEALAND LISTED COMPANIES (1987-1989)

Accounting for Depreciation and Fixed Assets

All years (1987-1989)

	<u>1987</u>	<u>1988</u>	<u>1989</u>
Treatment of asset revaluation unknown	24%	36%	42%
Asset revaluation only disclosed in notes	13%	12%	16%
Depreciation disclosed by asset class	4%	3%	2%

For 1989 only

Asset valuations more than two years old			<u>1989</u> 14%
Cost and valuation category:			
Identity of valuer not disclosed			20%
Qualifications of valuer not disclosed			39%
Valuation only category:			
Identity of valuer not disclosed			28%
Qualifications of valuer not disclosed			47%

Accounting for Subsequent Events

All years (1987-1989)

	<u>1987</u>	<u>1988</u>	<u>1989</u>
Financial impact of subsequent event:			
Disclosed	29%	23%	22%
Effect on financial statements:			
Financial statements adjusted	5%	5%	11%
Disclosure of subsequent event:			
Notes to financial statements	57%	67%	45%
Director's report	43%	29%	50%
Attached letter	--	4%	5%

Source: Adapted from Tower, Grosh, Rahman, Tan & Cuthbertson (1990, pp.49-59) and Tower, Grosh, Tan, Rahman & Cuthbertson (1990, p.82).

Table 8.3 highlights the relatively low level of quantitative information shown in relation to depreciation/fixed asset and subsequent event disclosure. Several

important trends are noted. First, depreciation amounts tend to be shown only in broad aggregate figures. Second, information in regards to asset revaluation is scanty and reflects a relatively high level of non-disclosure of the identity and qualifications of the valuer. This latter point is of special significance given the high concern for reliability of data in this subjective area. Third, in relation to subsequent event disclosure only 5-11% of the financial statements are adjusted and only 22-29% of the potential financial impact of the subsequent event is given.

The overall lack of disclosure of present and future events would appear to be in violation of the accountability doctrine. Further, there was a small but noticeable trend towards increasing non-disclosure over the study period. Based on the Table 8.3 initial study, it can, therefore, be tentatively concluded that in New Zealand the public outcry, following the 1987 sharemarket crash, demanding more information about the activities of companies does not appear to have resulted in increased disclosure in corporate reports.

8.3.1.2.2 Qualitative characteristics

The qualitative characteristics of corporate reporting are often difficult to measure. One important feature is the ability of such documents to communicate to stakeholders (see Section 2.4.2.2). Superior communication can be seen as providing a benefit to society. An integral component of the fulfilment of an accountability requirement is the need for the reporting of data in a form that can be read and understood by the general populace (Table 5.1). As such corporate reports should be readable to the vast majority of New Zealanders. Stonier (1984) feels that,

...the accountant should be concerned as much with communication as with perception. That is what the principle of materiality and the concept of true and fair are about: effectively the preparation of clear unequivocal statements that can readily be understood by readers (p.193).

A study by Tower & Bauer (1991) focused on the ability of a large segment of the New Zealand populace to read corporate reports. Within the context of this project certain terms are defined. To understand is "to comprehend ("to take in") the language, sounds, form, or symbols of (any kind of expression)" (The American Heritage Dictionary of the English Language (AHDEL), 1979, pp.274, 1397), i.e. the ability to read the written word. Interpret refers "to the translation of a..." language, eg. accounting, "...or, by extension, to translation of complexities into..." simpler, known "...terms. It also implies the disclosure of underlying meaning by the

application of special knowledge or insight" (AHDEL, 1979, p.462), i.e. having read the written passage has the receiver/target audience assigned the intended meaning?

Prior accounting research has treated the terms understandability and readability as synonymous (Jones, 1988, p.298; Schroeder & Gibson, 1990, p.79). Readability is, thus, used as a surrogate measurement for understandability in that qualitative characteristics of corporate reports can be analysed (Section 2.4.2.2). Readability, as measured by various formulas, is defined as the "ease of understanding... due to the style of writing" (Healy, 1977, p.219).

Before the communication process can be achieved, i.e. assignment of the intended meaning, the message must be decoded (Sligo, 1988, p.28). If the message is encoded such that the signal at a cursory level requires a reading/education level greater than that of the end recipient, it follows that the message cannot be decoded and the intended meaning cannot be assigned. Therein readability indices¹ find their usefulness: they provide an indication of the level to which material is written. The Flesch Formula² was chosen because it provides comparability with previous studies (Smith and Smith, 1971; Healy, 1977) and it adequately measures readability and permits comparison between educational attainment and reading ease scores.

The Flesch Index is calculated by examining the relationship of syllables to words and words to sentences in the following manner:

The Flesch formula: Reading Ease= $206.835 - 0.846wl - 1.015sl$

where:

wl = number of syllables per 100 words
sl = average sentence length in words

An updated replication of Healy's (1977) examination of New Zealand listed companies' reports, using the Flesch formula, is given below. The formula is applied to samples from both the management review and the accounting policies of the 1990

1. "...some may dismiss many of the readability research methodologies as being irrelevant to annual reports. This would be a mistake. If the research methodology limitations are recognised and extravagant claims avoided, the findings can raise valid questions, provide benchmarks to measure progress, and help focus...attention on readership in a constructive manner" (Hawkins and Hawkins, 1986, p.100).
2. There are several readability indices in the literature such as Dale-Chall, Fog, Kwolek and Lix. Each formula measures components in word structure. All of these readability formulas tend to generate similar results. See Lewis et al. (1986) for a useful comparison.

annual reports of forty randomly selected New Zealand listed companies (possessing 31 March, 31 May and 30 June year ends). The Grammatik IV software package is used to compute³ the readability scores.

The Flesch index generates a reading ease score from 0 (most difficult) to 100 (least difficult). A score of 100 would correspond to a passage which could be read by the barely literate (Still, 1972, p.37). The 7-point ordinal scale represents various levels of educational attainment (see Tables 8.4 and 8.5).

Table 8.4 indicates that for the listed companies examined, the Flesch Formula had a mean of 28 (very difficult to read) for the management review section and a mean of 24 (very difficult to read) for the accounting policy footnote. Table 8.5 shows that 90% of the management reviews and 100% of the accounting policy footnotes are difficult or very difficult to read. The comparative figure for Healy's (1977) New Zealand study on accounting policy footnotes was 94%, therein suggesting no improvement in readability has taken place.

Table 8.5 establishes that a much higher reading level is required for most corporate reports with 90-100% considered difficult or very difficult to read. Educational attainment statistics derived from the 1986 Census shows that 50% of the New Zealand population have no school qualification and 32% of the population 20 years of age or older have, after leaving school gained some qualifications (New Zealand Department of Statistics, 1988, p.50). Consequently, most New Zealanders would find the financial reports arduous to read. High levels of difficulty in reading New Zealand corporate reports would seem to be in conflict with the accountability viewpoint and prevent clear communication of an enterprise's activities (Sections 2.4.2.2 and 5.3.1).

3. It should be noted that the Flesch Formula scores are slightly different than reported in the original Tower & Bauer (1991) study due to an error discovered in application of the computer software. The corrected results show even lower levels of readability in New Zealand therein strengthening the analysis.

TABLE 8.4 READABILITY OF NEW ZEALAND PRIVATE SECTOR CORPORATE REPORTS (1989)

Organisation	<u>Flesch formula scores</u>		<u>Company characteristics</u>		
	Management Review	Accounting Policy	Net Income Before Taxes in \$000's	Total Assets in \$000's	Debt-to-Equity ratio
Air New Zealand	28	28	90,681	2,189,247	1.91
Amuri Corporation	35	24	2,543	64,334	.11
Bank of New Zealand	31	18	99,774	17,956,832	15.05
BNZ Finance	35	13	24,075	1,066,505	6.42
Bridgecorp Holdings	33	17	(494)	14,454	.83
Brierley Investments	31	14	642,895	9,722,787	1.53
Carborundum Abrasives	10	28	(997)	15,406	2.72
Carter Holt Harvey	39	22	152,311	3,028,212	1.13
Cavalier Corporation	29	19	11,337	107,029	.79
Ceramco Corporation	4	11	13,526	169,572	.66
Corporate Investments	14	15	30,501	529,480	1.44
Countrywide Banking	41	24	20,711	1,651,047	11.65
Donaghys	13	20	6,494	106,036	.78
Elders Resources NZFP	17	43	98,372	4,230,331	2.01
Fisher and Paykel	13	10	30,208	386,478	.77
Fletcher Challenge	33	13	900,629	17,600,025	2.35
Frenz Corporation	42	15	33,693	335,599	1.52
Helicopter Line	5	21	3,828	51,799	1.39
Independent Newspapers	37	17	30,580	460,523	.58
Jarden Morgan	13	24	(80,645)	425,137	1.74
Kiwi Gold	34	42	(472)	3,083	.01
Lasercorp Holdings	19	44	3,335	98,310	.88
Magnum Corporation	15	25	69,702	1,012,052	.46
Mineral Resources (NZ)	54	45	4,207	49,042	.47
Mount Cook Group	27	1	8,634	84,728	.70
New Zealand Oil and Gas	2	0	(1,868)	91,175	.01
Nuplex Industries	33	31	5,005	44,846	.70
Otago Cheese	37	36	651	6,662	.94
Owens Group	23	31	2,895	122,779	2.30
Perry Dines Corporation	27	17	766	60,867	.12
Reid Farmers	28	37	4,658	45,541	1.36
Renco (NZ Rennett)	59	32	1,347	19,911	1.60
Renouf Corporation	14	24	249	368,826	2.85
Robert Jones Investments	54	17	43,769	1,768,636	.84
Salmond Smith Biolab	25	31	4,328	64,336	.65
Steel and Tubing Holdings	43	32	6,098	236,487	.82
Transmark Corporation	21	18	5,634	45,879	1.66
U-Bix Business Machines	53	38	368	24,994	.88
United Resources	15	18	4,309	26,933	.16
<u>Wilson Neill</u>	<u>46</u>	<u>33</u>	<u>28,205</u>	<u>461,389</u>	<u>1.34</u>
Mean	28	24	57,546	1,618,683	1.85

Source: 1990 New Zealand listed companies' annual reports.

TABLE 8.5 READABILITY OF NEW ZEALAND PRIVATE SECTOR CORPORATE REPORTS (1989): A SUMMARY

Flesch Formula Score	<u>Management Review</u>		<u>Accounting Policy</u>		Educational Level	Difficulty Level
	Number of Companies	%	Number of Companies	%		
Below 30	21	52.5	27	67.5	Univ. Graduate	Very difficult
30 - 50	15	37.5	13	32.5	Univ. Undergrd.	Difficult
50 - 60	4	10	0	0	Forms 5-7	Fairly difficult
60 - 70	0	0	0	0	Forms 3-4	Standard
70 - 80	0	0	0	0	Form 2	Fairly easy
80 - 90	0	0	0	0	Form 1	Easy
90 - 100	0	0	0	0	Standard 4	Very easy
	40	100	40	100		

Source: 1990 New Zealand listed companies' annual reports.

The ability of contemporary accounting regulation to improve corporate readability can thus be questioned. The Ambiguity Index (see Table 6.8) reveals the high level of undefined and permissive phrases within the NZSA's accounting promulgations. Table 8.4 shows that the accounting policy footnote, which is subject to SSAP-1 (NZSA, 1983) and audit verification, has a lower Flesch score than does the management review (not regulated or audited). This can partially be explained by the nature of the two samples. The management review is designed to give a clear overview of the results of the company's operation in contrast to the more technical nature of footnotes. However, the accounting policy footnote is a crucial element in the financial statements in that it explains the policies and procedures upon which the entire financial statements rest.

The low level of readability of accounting footnotes considerably hinders the pursuit of overall quality communication for the annual report. Future accounting regulations which are easier to read and clearer are necessary to improve the readability (i.e. the understandability) of corporate reports (Section 5.3.3).

In a world of scarce resources, individuals need to decide what entities will be given funds, approval, backing and acceptance. One of the primary purposes of accounting standards is to promote comparability (ASAC, 1987, para.260) between different firms and for the same firm over time. Success of the corporate report is viewed as the transmission of the desired message to the intended stakeholder in an accurate and understandable way (Smith & Smith, 1971, p.553). A low level of communication between the preparer of corporate reports and stakeholder groups can create

unrealistic expectations and sub-optimal resource allocation decisions (Burton & Sack, 1990, p.118). Whether annual reports are perceived by management as a marketing tool or as the primary method of communicating enterprise data (or both), the conclusions of this study reveal the listed companies' failure to communicate readable information to the vast majority of New Zealanders.

8.3.2 Stakeholder groups

For the New Zealand environment, an additional question is posed: corporate reports are directed at what groups? Who are the stakeholder groups and what information do they seek? The Canadian Institute of Chartered Accountants (CICA)⁴ in a 1980 study (chap.6), offers a wide lists of potential stakeholder groups (see Section 3.5.1 for a summary of other seminal studies' lists of stakeholder groups). Besides shareholders the CICA lists present and potential suppliers, trade creditors, customers, employees, consumer and environmental groups, the income tax department and other government interests.

No such in-depth study has been initiated in New Zealand, although the Richardson Committee (Report of the Committee of Inquiry into Inflation Accounting, 1976) did list six groups of stakeholders: equity investors, creditors, management, employees, the government and the public. New Zealand stakeholder groups exhibit a strong belief in the importance of corporate reports (Chang & Most, 1981, pp.55-56). Yet, the target audience for corporate reports is not clearly identified by the NZSA. Without specific identification, the needs of the stakeholder groups, other than investors and creditors, may well be downplayed or ignored in the accounting standard setting process and corporate reporting.

Without a clear understanding of the target audience it would seem difficult, if not impossible, to provide the level and type of information sought by these groups. In Section 3.5.4, it is concluded that those with a bond of accountability (such as investors, creditors, employees, the financial press, employees, the local community and environmental groups) are considered to have a reasonable right to information. To obtain quality corporate reporting and provide adequate regulatory safeguards, these groups (and their needs) must be explicitly heeded.

4. This study was written by Stamp, but his name was not credited on the final version because of internal CICA politics (see Stamp, 1985). This tale highlights the highly-charged political nature of the accounting standard setting process (see also Section 4.6.1).

From an efficiency perspective, regulation may not be needed or appropriate for this wider group if sufficient information is disclosed voluntarily. Table 8.6 examines all the available studies in New Zealand which examine corporate reporting issues where there are no mandatory requirements.

TABLE 8.6 VOLUNTARY DISCLOSURE: NEW ZEALAND CORPORATE REPORTING (1979-1989)

Authors	Year Published	Study Period	Topic	Degree (%) of Reporting	Overall Averages	
					Stakeholder Data	Shareholder Data
McNally et al.	1982	1979	Employee reporting	35		
Chua & Mathews	1990	1987	Employee reporting	61		
Chua & Mathews	1990	1988	Employee reporting	65		
Chua & Mathews	1990	1989	Employee reporting	63	56.00	
McNally et al.	1982	1979	Social responsibility	9		
Chua & Mathews	1990	1987	Social responsibility	3		
Chua & Mathews	1990	1988	Social responsibility	4		
Chua & Mathews	1990	1989	Social responsibility	5	5.25	
Chua & Mathews	1990	1987	Natural environment	1		
Chua & Mathews	1990	1988	Natural environment	2		
Chua & Mathews	1990	1989	Natural environment	4	2.33	
McNally et al.	1982	1979	Shareholder profiles	10		
Young	1990	1987	Shareholder profiles	21		
Young	1990	1988	Shareholder profiles	23		
Young	1990	1989	Shareholder profiles	10		16.00
McNally et al.	1982	1979	Shareholder dispersion	40		
Young	1990	1987	Shareholder dispersion	60		
Young	1990	1988	Shareholder dispersion	66		
Young	1990	1989	Shareholder dispersion	57		55.75
Young	1990	1987	S/H geographical profiles	31		
Young	1990	1988	S/H geographical profiles	31		
Young	1990	1989	S/H geographical profiles	22		28.00
			Average-Social Reporting		21.19	
			Average-Shareholder Information			33.25
			Overall Average			27.22

Note: These ratings reflect the percentage of companies which disclosed the specific topic examined. The above figures do not reflect data about compliance because many of these variables are not required by any form of regulation. These studies reveal the percentage of companies that have disclosed some information voluntarily in line with accountability tenets.

Table 8.6 reveals a low level of voluntary disclosure from New Zealand corporate reports. The average amount of social reporting is shown to be 21.19% and only 33.25% shareholder data is provided in the absence of regulation. McNally et al.

(1982, pp.16-17) noted that large companies⁵ in New Zealand tend to disclose more voluntary information than small companies. They thought this higher level of disclosure may be attributable to greater resources available, more public exposure or stronger public pressures. Table 8.6 establishes, however, that only a limited amount of information is disclosed voluntarily. The needs and rights of the stakeholder groups which are deemed to have a right to corporate information (Section 3.5.1) are examined below.

8.3.2.1 Investors

One of the original motivations for corporate reports was the need to inform the absentee owners about the activities of their managers (Kelly & Pratt, 1990). However, in New Zealand shareholder information is disclosed voluntarily by only one third of the companies in the Table 8.6 study. A majority of companies are willing to disclose shareholder dispersion, but few are eager to show geographic or shareholder profiles.

Chang & Most (1981, p.50) surveyed the comparable information needs of investors in three countries (see Table 8.7). They found that New Zealand investors have similar perceptions to British investors (see also Chang, Most & Brain, 1983, p.63).

Table 8.7 shows the high priority that each of the different investor classes give to the corporate report. Within New Zealand, Chang et al. (1983, pp.65,73) establishes that individual, institutional and financial analysts seem to have somewhat varied information priorities, this is consistent with overseas studies (see FERF, 1987, chaps 3-4). Young (1987, p.45) points out that the perception of the average shareholder being an individual is not true. He found that in New Zealand, 76.18% of firms surveyed are owned by other companies, hence rule-makers should be cognizant of the increasing influence of the institutional investor (see also Naran, 1984, p.23). Institutional investors in New Zealand, however, have shown a tendency to vote with management and in conflict situations usually sell their shares rather than confront management (Farrar & Russell, 1985, p.216). Financial analysts have benefited from the implementation of accounting standards especially the rules on segment reporting and leases (Cliffe, Devenport & Robb, 1984b, p.442; Lees, 1980, p.20; McIntosh, 1989, p.27).

5. Wong (1988b, p.50) felt that New Zealand company accounting choice decisions were related to political (size was used as a surrogate) and leverage variables.

TABLE 8.7 INVESTOR'S RANKING OF INFORMATION SOURCES IN ORDER OF RELATIVE IMPORTANCE

	United States			United Kingdom			New Zealand		
	A	B	C	A	B	C	A	B	C
Corporate annual reports	1	1	1	3	1	2	3	2	1
Newspapers and magazines	2	3	8	1	2	5	1	5	7
Advisory services	3	2	5	5	5	8	5	3	8
Stockbroker's advice	4	4	-	2	3	-	2	1	-
Proxy statements	5	5	7	4	4	7	4	4	6
Advice of friends	6	6	-	6	6	-	6	6	-
Tips and rumors	7	7	-	7	7	-	7	7	-
Prospectuses	-	-	2	-	-	3	-	-	5
Communications with management	-	-	3	-	-	1	-	-	3
Interim reports	-	-	4	-	-	4	-	-	2
Press releases	-	-	6	-	-	6	-	-	4

Note: A=Individual investors, B=Institutional investors, C=Financial analysts.

Note: Ranking ranged from 1-Highest ranked source of information to 8-Lowest rank.

Source: Chang & Most (1981, p.50).

The investor group is heterogeneous in nature (and needs) with individual investors placing more emphasis on the management report, whilst institutional investors focus on more technical issues (Chang et al., 1983, p.73). The investor classes, in New Zealand, place heavy emphasis on corporate report information. As these shareholders are deemed to have first priority in the Companies Act 1955, a large responsibility exists to communicate relevant and timely information. Yet, Section 8.3.1 provides evidence severely questioning the communication properties of New Zealand corporate reports.

8.3.2.2 Creditors

Eyes & Tabb (1978, p.85) found that New Zealand bank managers consider timely financial statements important to their decision to lend. However, lending decisions of larger companies now seem more oriented towards future earnings and cash flow rather than the net tangible asset position (Stock, 1987, p.126). Negative pledge agreements and debt defeasance are on the rise, with accounting standards having an important effect on these instruments (Farrar, 1987b, p.157).

The accounting standard process is important to creditors because they use these rules as an objective measure of performance. For instance, creditors have traditionally required debenture trust deeds before advancing financing (Stock, 1987, p.125). These trust deeds provide support for the standard setting process by commonly including provisions defining accounting practice in terms of the accounting standards promulgated by the NZSA (Zeff, 1979, p.75). Creditors, thus place reliance and give support to accounting standards and actively utilise corporate data.

8.3.2.3 News media

The news media can also have an important impact upon accounting regulation. Berryman (1989, pp.6-7), the former editor of the National Business Review argues that information is the free market's regulator. He expresses great concern at the Report of Ministerial Committee of Inquiry into the Sharemarket (1989, p.58) recommendation that the press be controlled by a supervisory authority which in turn would be controlled by the Minister of Justice.

The media can emphasise or even create crises in the eyes of the public (Rahman, 1988; Wells, 1978). However, the financial press in New Zealand has been generally non-critical (Craig, 1986, p.12; Zeff, 1979, p.68). Berryman (1989) argues that the New Zealand financial press is "gutless, lazy, incompetent-and at times corrupt." (p.6). As a partial solution he feels that the libel laws need to be reformed because they make financial reporting a legal minefield where, he states, very few act boldly.

The National Business Review, NZ Financial Review and daily papers all have occasional articles on accounting matters. The largest accounting influence is probably the NZSA's publication, the Accountants' Journal which periodically presents comments on corporate reporting and accounting standard setting issues.

The news media historically appears to have only a small impact upon the accounting regulatory process in New Zealand. However, since the 1987 sharemarket crash there have been numerous articles, radio discussions and television pieces detailing accounting and corporate reporting flaws in relation to company failures. The media has detailed the suffering of many stakeholders from the sharemarket crash through unemployment and investment losses. Public opinion pressures have increased with part of the focus on accounting inadequacies and failure of corporate reporting to correctly report the true status of business enterprises. This upthrust of publicity seems to have amplified the momentum for change to the accounting regulatory system.

8.3.2.4 Other stakeholder groups

Employees, the local community and environmental groups also have the right to corporate information under the Model (Section 5.3.2). In New Zealand, little data is provided about social reporting issues. Table 8.6 reveals that social responsibility and natural environmental reporting disclosure ranges from 1-9%. The exceedingly low level of disclosure concerning information on the natural environment may soon change with the greening of the economy and the growing concern to account for environmental damage (see for instance Pearce et al., (1989); Ross (1990c); St. George (1990); and Wallace (1991)).

Hays, the current President of the NZSA, notes that economic theory and accounting practices have contributed to environmental problems (1991a, p.5) by failing to account for environmental damage an incomplete picture of the company emerges (Gray, 1990, p.67). To improve external reporting, Hays (1991a, p.5) advocates: more publicity, an expanded definition of contingent liabilities, and the setting of specific environmental standards. He also cites the importance of compliance, ethical, waste and energy audits (p.5).

Bebbinton & Gray (1990, p.17) observed the lack of input by New Zealand accountants concerning natural environmental reporting. They recommended much greater disclosure, compliance-with-standard reports and specifying renewable and non-renewable assets. Gray (1990, p.66) also discusses natural environmental response strategies which could be carried out by accountants. For instance, he explains that the compliance audit is the "systematic monitoring of levels of performance/activity against legal and quasi-legal standards by site, by company and by group" (p.66). A combination of internal regulation (ethics and broader-based audits) and external regulation (compliance audits and effective statutory safeguards) would go a long ways towards fulfilling the Model's perspective on environmental issues.

Gray et al. (1987, chaps 8-9) calls for much greater disclosure of employee matters. In New Zealand, as indicated in Table 8.6, employee reporting appears adequate with a 1989 disclosure rating of 63%. However, this statistic may be misleading. In the Chua & Mathews (1990, pp.14-16) study, their disclosure percentages include the provision of any employee information. On one hand, they find a trend of more reporting of: share purchase plans, comparative numbers, segmental facts and corporate structure. On the other hand, they note considerably less information disclosed about: the number of employees, their remuneration, and the employee

contribution to the value of the business. The Corporate Report (ASSC, 1975, para. 6.21) and Gray et al. (1987, p.159) advocate a separate employee report as a way of enhancing corporate accountability. Yet, of the 300 New Zealand reports examined by Chua & Mathews (1990, p.15), only four such reports were observed.

In an in-depth poll of New Zealanders, Gold and Webster (1990, chaps 1-3) found a desire for social change and more accountability in the political and economic arenas. Their survey results show that individuals seek more government spending in environmental and employee related concerns.

In New Zealand, however, voluntary information, as shown in Table 8.6, is low. McNally et al. (1982, p.15), in an important New Zealand study, noted that the level of actual disclosure by companies was lower than what stockbrokers and financial analysts desired. They further found that four of the top twenty items which these stakeholders thought were most important (profit forecast, customer dependence, rate of return and description of major products) were not disclosed by any company surveyed (p.19).

Disclosure of social responsibility information and natural-environment data is shown to be almost non-existent in New Zealand. It is thus considered that within the New Zealand business environment, the disclosure of corporate information on a purely voluntary basis is inadequate. Accounting regulation, as an instrument of public accountability, is required to increase the level and nature of information to these stakeholder groups.

8.3.3 Auditors

Auditors are considered by Stamp (1980, p.40) to be the professional arbitrators. The Companies Act 1955 requires auditors to make a report at the annual shareholder meeting (Section 161). Auditors of companies must be members of the NZSA and be independent of their client companies' (Carrington, 1986, p.284). The audit report is required to provide an opinion on whether financial statements give a true and fair view. The NZSA (1988b) feel "the audit function provides the only independent objective appraisal of the financial information disclosed by a company and is a necessary safeguard against management in this area" (p.26).

Audit qualifications may provide investors with information (Benston, 1985, pp.35-37). In a study by Lees (1980, pp. 22-23), American analysts stated the most important function of the independent auditor was to insure compliance with

accounting standards. The analysts felt that the auditor had a significant influence on the adequacy of reporting. It is considered that New Zealand auditors and audit reports should also serve these functions.

Problems, however, exist with current New Zealand audit practices. For instance, New Zealand audit reports take longer to issue than their American counterparts (Gilling, 1977, p.180, 1984, p.173). Further, McMonnies (1985, p.18) and Zeff (1979, p.73) express doubts that purely technical audit qualifications have any inhibiting effect on corporate reporting behaviour. The number of qualified or adverse audit opinions in New Zealand is also quite low (Fairfield, 1990, p.272; Gilling, 1977, p.177; Ryan et al., 1984, pp.301-302), yet, Table 7.5 documents a high degree of preparer non-compliance with accounting standards. As a result, it is uncertain how influential the qualification (or threat of a qualification) of an audit report is upon New Zealand corporate reporting practices. It is considered that a strengthening of the audit role and report will improve the quality of corporate reports (Section 5.3.3).

Auditors are in somewhat of a dilemma: they wish to maintain their audit client base whilst preserving lucrative management and tax advisory services (Wallace, 1980), avoid litigation (Heian, Knutson, Fogarty & Morreale, 1990, p.1) and still maintain their high ethical position (Wyatt, 1989, p.96). Ross (1990b, p.14) feels that auditors are most likely to bend to the preparers' view on issues not covered by an accounting standard. Wyatt (1989, p.99) expresses concern that auditors are exhibiting a trend of looking for loopholes in accounting standards rather than compliance.

Legal liability, relating to negligent audit practices, is a particularly vexing problem to auditors (see Potter & Hays, 1991, p.16). In the advent of a business failure, auditors are one of the few involved entities still solvent and are thus ripe for litigation (known as the deep-pocket syndrome, see Pratt, 1991a, p.19). Auditors do bear, however, an important responsibility to act professionally and are subject to public scrutiny⁶ and financial damages if this duty is abrogated.

In America, malpractice claims have increased dramatically in the last two decades with \$250 million worth of settlement claims since 1980 (Heian et al., 1990, p.1). Although the New Zealand business environment is generally thought to be much less litigious in nature, several recent cases have given the profession great concern. In

6. See Porter (1990a) for an in-depth examination of the auditor expectation gap in the New Zealand context.

1990, Deloitte Haskins & Sells paid \$2.4 million in relation to the failed AIC group of companies and Arthur Young currently has a \$104 million action against them for alleged negligence in relation to the Registered Securities Ltd. audit (Ross, 1991b, p.9).

The New Zealand Society of Accountants argues it is unfair that auditors should not be allowed the protection of limited liability which is available to most other interest groups (Hays, 1990, p.2; Potter & Hays, 1991, p.16). Pratt (1991b), offers an alternate viewpoint, when he states that limitation of liability would "cause major damage to the credibility of the auditing profession in New Zealand" (p.42). He feels that the arguments in favour of statutory limitation appear to be based on the profession's self interest which he considers violates the tenets of accountability and calls instead for greater quality control and practice reviews (1991a, p.20).

The recent British court decision *Caparo Industries plc v Dickman* gives some comfort to auditors. The House of Lords held the view that an auditor's duty of care to the company itself and not to individual shareholders or outside raiders (Wild, 1990, p.24). Ross (1991b, p.9) thinks this decision could profoundly limit claims in Britain. *Caparo* is at odds with the New Zealand case *Scott Group Ltd v McFarlane* (1978) which sought a broader duty of care (Wild, 1990, p.25). McKenzie (1990, p.3) argues that the New Zealand courts may not accept the *Caparo*-narrow view of auditor duties. It is unclear what position will be taken by the New Zealand judiciary in future decisions as British case law, though persuasive, is not binding (Ross, 1991b, p.9).

Pratt (1991b, p.42) argues the reputation of auditing firms in New Zealand became tarnished with the fallout of the unexpected company failures since the 1987 sharemarket crash. Wallace (1980) feels one method to enhance auditor's reputation is through stronger self-regulation via the promulgation of audit standards. In New Zealand, 22 audit guidelines have been issued (as of 31 March 1991) and ten auditing standards (see Appendix H).

New Zealand auditors appear to be striving to improve their performance and maintain a high ethical code (Hays, 1991b, p.4). Although hard to detect, it is thought that behind the scenes they instigate many improvements to preparer's corporate reports. However, the evidence indicates that in the New Zealand business environment, there is a large number of audit reports where preparer non-compliance goes apparently unmentioned. Court cases such as *Caparo* and the NZSA's desire to

limit their liability appear to run counter to accountability tenets and concepts of professional self-regulation.

Stronger, more vigorously enforced audits are an important facet of the ability of regulation to serve as an instrument of accountability (Section 5.3.3). Greater importance needs to be placed on the audit function (Section 3.5.3). Braddell (1991a, p.7, 1991b, p.2) notes the advancement of one useful proposal wherein all New Zealand company annual reports with qualified audit opinions would be specifically examined and remedies instituted when deemed necessary.

8.3.4 Public sector initiatives

An important impetus for change in the New Zealand regulatory arena is found in recent public sector initiatives. Recent legislation and the NZSA (1987c) Statement of Public Sector Accounting Concepts explicitly advocate the pursuit of the accountability theme. Annual reports provide the means for government departments and agencies to fully account for the activities and stewardship of the public resources under their control.

To achieve these purposes, the reports need to contain complete financial, non-financial and narrative information that allows a comparison to be made between what was achieved and what had been promised. This should be supported by a detailed assessment (in qualitative and quantitative terms) of performance in achieving those results (Controller and Auditor-General, 1987, p.75).

There is growing pressure for greater accountability for actions taken and performance. Among the changes advocated are broader comprehensive annual financial reports disclosing more information about results and costs (Scott & Gorringer, 1989, pp. 82-83). The Audit Office is by statute the external auditor of most of the public sector (Gilling, 1985, p.26) and is proactive in its support of the NZSA pronouncements as the above quotation suggests. The central government including key ministers such as David Lange (Prime Minister 1984-89), Sir Roger Douglas (Minister of Finance 1984-88), David Caygill (Minister of Finance 1988-90), the Treasury, and the legislature were all actively involved in a series of new enactments governing reporting by various public sector organisation types broadly in line with the NZSA pronouncements (Hay, 1991, p.31).

The dynamic changes in accounting in the New Zealand public sector have widespread ramifications upon reporting in the private sector. The two major public sector components of influence which directly affect the private sector are the advancement of explicit accountability themes and broader reporting practices.

8.3.4.1 Accountability themes

Conventional accounting thought seems to believe that the communication of accounting statements is fundamental to the discharge by an organisation of its responsibility for accountability to its stakeholders (Walker, 1988, p.178). It is considered that to report publicly is a responsibility incumbent upon every economic entity regarded as significant in terms of the scale of its command over human and material resources being such that the results of its activities have significant economic implications for the community as a whole (Gray et al., 1987, p.43). This would appear especially relevant to the public sector with its reliance upon communal funds.

The New Zealand public sector was the subject of major reforms during the period of Labour Government from 1984-90 (Scott & Gorringer, 1989, p. 82). Financial accountability was a main plank in these reforms (Hay, 1991, p.31). One consequence of the legislation set in place by the reforms is that financial reports are now relied on to play a significant part in this accountability as is discussed by Huggins (1989, p.55) and Dixon (1990, p.18), who identify linkages between the reforms and accounting.

Accountability was first written into New Zealand legislation in the State-Owned Enterprise Act of 1986. Part of the Act requires each state-owned enterprise to publish annually a statement of corporate intent for the following three year period, an annual report and audited consolidated accounts, half-yearly reports, and other information requested by specified ministers. Significant improvements in reporting standards have been witnessed by the Audit Office in the last few years ("Improved accountability", 1991, p.7).

The broad spectrum of information based on a public accountability framework, as discussed in Section 3.5.2, is not necessarily incorporated into NZSA (1987c) Public Sector Concepts Statement. For instance, issues such as detailed employee information, environmental effects and safety data are not covered by this NZSA pronouncement. Despite this, the more limited view of accountability contained within NZSA (1987c) is still an important advancement of financial accounting objectives for the public sector and provides a role model for the private sector.

8.3.4.2 Reporting practices

Tower, Coy & Dixon (1991) and Tower & Bauer (1991) derived preliminary evidence about the relationship between corporate reporting and accountability

themes by examining one component of the public sector (universities). Universities can be considered a subset of the public sector entities, therefore, tentative conclusions can be drawn as to public sector reporting. However, a limitation of the study is that universities may not be totally representative of the entire public sector.

Tower et al. (1991, p.15), in a quantitative study, find improving university reporting practices over the time period 1985-1989. In a qualitative study, Tower & Bauer (1991, p.174), rates university corporate reports slightly more readable than a sample of listed companies using the Flesch Reading Formula. Both the above studies link the public sector reporting improvements to the promulgation of the PSAC-1 concepts statement (NZSA, 1987c).

8.3.4.2.1 Rising trend of accountability in university reports

To provide evidence on the impact of a concepts statement upon reporting practices, the contents and disclosures of all seven New Zealand university annual reports are analysed to determine whether certain items appeared each year, and how each item which did appear was treated. Selection of items is based on the requirements of various NZSA accounting promulgations (1987a, 1987b, 1987c) and from the items included in the study of British universities for the period 1982/3 to 1986/7 by Gray and Haslam (1990). The items are categorised according to the eight statements identified in NZSA (1987c, paras 3.3-3.9) as being necessary for reporting about public sector service oriented entities. A total of 52 items are selected in all. The frequencies range from a minimum value of 0 (zero), to a maximum of 7 (seven). Each factor is given an equal weighting in the tables.

The general trend of reporting quality over the study period is shown in Table 8.8 which highlights the degree of compliance in percentage terms in each category, and gives an overall picture of accounting practices and trends.

TABLE 8.8 NEW ZEALAND UNIVERSITIES' COMPLIANCE TREND (1985-1989)

<u>PSAC-1 categories</u>	<u>Time period</u>				
	1985	1986	1987	1988	1989
Objectives	0%	14%	29%	29%	29%
Service Performance	0%	5%	12%	12%	18%
Cost of Services	27%	30%	32%	34%	38%
Funds/Cash Statement	71%	100%	100%	71%	86%
Financial Position	38%	50%	50%	50%	50%
Resources	39%	50%	50%	50%	50%
Commitments	14%	29%	29%	29%	57%
Accounting Policies	62%	95%	95%	95%	95%
Total for all Items	19%	29%	32%	32%	37%

Source: Tower et al. (1991, p.15).

A twofold increase in the compliance of universities reporting is observed in Table 8.8. Quantitative reporting practices show an increase by the seven universities from 19% items disclosed in 1985, to 37% items in all in 1989 (see Appendix I for a full breakdown). The NZSA (1987c) public sector concepts statement appears to have had a positive effect. The 1989 data, however, still represents a low level of communication to the various stakeholder groups. Further, other important pieces of information advocated in the accountability literature, (see for instance Gray et al. (1987)) such as detailed employee information, safety data and environmental impact statements are missing from these statements. Such information is not currently required in New Zealand by statute or professional pronouncements.

8.3.4.2.2 An examination of communication traits for one public sector component

All seven New Zealand universities are examined to determine the degree of readability of the 1989 annual reports by applying the Flesch Readability Formula⁷ (Section 2.4.2.2). The study seeks to measure qualitative reporting characteristics (see Tables 8.9A and 8.9B).

7. It should be noted that the scores for the university sector are slightly different than reported in the original Tower & Bauer (1991) study, due to a error discovered in application of the computer software. The corrected results show even lower levels of readability in New Zealand, therein strengthening the analysis.

TABLE 8.9A READABILITY OF NEW ZEALAND UNIVERSITY ANNUAL REPORTS (1989)

University	Flesch formula scores		Company characteristics		
	Management Text	Accounting Policy	Surplus in \$000's	Total Assets in \$000's	Debt-to-Equity ratio
Auckland	35	43	2,160	533,334	.04
Canterbury	*	16	7,374	245,079	.04
Lincoln	*	42	(144)	62,165	.40
Massey	9	46	3,677	344,273	.04
Otago	*	40	38	178,377	.48
Victoria	*	42	90	105,827	.16
<u>Waikato</u>	<u>41</u>	<u>15</u>	<u>2,040</u>	<u>159,316</u>	<u>.05</u>
Mean	28	39	2,176	232,624	.17

* Vice Chancellor's Report not provided.

Source: 1989 New Zealand universities' annual reports.

TABLE 8.9B READABILITY OF NEW ZEALAND UNIVERSITY ANNUAL REPORTS (1989): A SUMMARY

Flesch Formula Score	Management Text		Accounting Policy		Educational Level	Difficulty Level
	Number of Universities	%	Number of Universities	%		
Below 30	1	33	2	29	Univ. Graduate	Very difficult
30 - 50	2	67	5	71	Univ. Undergrd.	Difficult
50 - 60	0	0	0	0	Forms 5-7	Fairly difficult
60 - 70	0	0	0	0	Forms 3-4	Standard
70 - 80	0	0	0	0	Form 2	Fairly easy
80 - 90	0	0	0	0	Form 1	Easy
<u>90 - 100</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>0</u>	<u>Standard 4</u>	Very easy
Total	3	100	7	100		

Source: 1989 New Zealand universities' annual reports.

The results in Table 8.9A reveal an average Flesch rating of 28 (very difficult) for the vice-chancellor's report and 39 (difficult) for the accounting policy footnote. There was a range of scores in the management text ranging from four of the universities neglecting to provide a vice-chancellor's report to Waikato University's score of 41 which is still considered difficult. The accounting policy footnote also shows diversity with Massey University's effort the most readable (see Table 8.9A). Overall 100% of the vice-chancellor's reports and 100% of the accounting policy messages are judged difficult or very difficult to read (Table 8.9B).

8.3.4.3 Timeliness of information

As discussed in Section 8.3.1, the quality of a report depends on its timeliness and its comprehensiveness. The timeliness of various university reports is measured by examining the date at which the audit report was signed. Over the study period (1985-1989) the shortest lapse of time between balance date and audit report date is three months, and the longest is two and a half years (1986 and 1987 by the same university). Such a long time lapse effectively compromises the quality of the information and its contribution to accountability (Section 5.3.1). Potential explanatory aspects are examined in an attempt to determine the cause of the delay. Regression analysis is utilised, using timeliness as the independent variable and the number of compliances as the dependent variable. The regressions for 1988 and 1989 are shown in Table 8.10.

TABLE 8.10 COMPARISON OF UNIVERSITY SIZE, REPORTING PRACTICES AND PUBLICATION TIME LAG

	Number of Compliances		Time (months)		Size (\$m) (expenditure)	
	1988	1989	1988	1989	1988	1989
Auckland	12	20	20	* 11	\$95.9	\$104.7
Canterbury	10	10	10	11	\$59.7	\$62.3
Lincoln	8	8	15	* 11	\$19.1	\$19.8
Massey	21	25	8	7	\$64.9	\$67.7
Otago	13	13	13	* 11	\$82.2	\$88.4
Victoria	9	10	21	9	\$57.5	\$64.9
Waikato	28	29	3	3	\$32.2	\$31.5
Total	101	115			\$411.5	\$439.3

Note: The maximum timeframe used in 1989 is 11 months which was the date when four of the reports were received even though only one of these four is signed by the auditor at that date.

Source: Tower et al. (1991, p.17).

The inverse relationship between comprehensiveness and time taken to publish reports is revealed in the regression of compliances against time. For 1988, $y = 26.1$ and $x = -0.91$ with an R squared of 0.64. For 1989, $y = 36.0$ and $x = -2.18$ with an R

squared of 0.65. The regression statistic⁸ with a negative for the x coefficient corroborates the paradox observed in the relationships; the more compliances made by a university, the more quickly the report is published. This suggests that timeliness is a reflection of factors within the reporting entities. Even though intuitively a more comprehensive report involves more preparation work, it seems that this effect is offset by an overall dedication (or lack of it) by the reporting organisation to quality; that is, to publishing a report which is both timely and comprehensive.

A regression test is also made on the number of compliances in relation to the size of the establishment as represented by the annual operating expenditure. The R squared is 0.03 for 1988, and 0.01 for 1989. This suggests that there is no relationship between size of the institution measured by expenditure and the number of compliances.

8.3.4.4 Audit qualifications by the Audit Office

Many lapses in compliance with NZSA pronouncements are noted in Table 8.8, despite this, only one audit qualification was issued during the study period. The qualification was on an unrelated issue; one university breached regulations with respect to trust investments. Tower et al. (1991, p.18) reason that the Audit Office may change its policy on issuing qualifications concerning compliance and timeliness in the wake of the Education Amendment Act of 1990. Gilling (1985, pp.25-26) and Ross (1991a, p.14) note the Audit Office's virtual monopoly on public sector audits and recommend increased delegation to private sector firms.

Within the last few years there have been vast changes in the structure and accounting requirements of the New Zealand public sector. There is an increasing call for more accountability in enterprise reports beginning with the State-Owned Enterprise Act of 1986 and encouraged by the NZSA's (1987c) Statement of Public Sector Accounting Concepts. The evidence offered above, although focused on one public sector component (universities) and therefore should not be over-generalised, reveals an

8. The seven points used represents the entire populace of the New Zealand university community for the study period (1985-1989). A plotting of all of these points in the regression analysis, however, reveals the likely existence of an outlier (University of Waikato). The statistic is recomputed based on the remaining six data points. The recomputed 1988 results demonstrate a much weaker R squared value of 0.34 with $y = 19.8$ and $x = -0.5$: the 1989 R squared is 0.37 with $y = 38.6$ and $x = -2.4$. This recalculation demonstrates the danger of statistics using a small number of data points (even when the entire population is involved).

increasing pattern of improvement in reports⁹. The public sector in New Zealand is providing an important impetus for change in enterprise reporting. The NZSA's promulgation of a concepts statement, in this area, appears to have assisted accountability tenets. However, both the Tower et al. (1991) and Tower & Bauer (1991) studies conclude that the university sector still has a long way to go if it is to comply with new legislation, let alone be accountable at a more altruistic or pluralistic level.

8.4 SUMMARY

Vast changes in New Zealand's business environment have occurred in the last few years with the floating of the dollar, cessation of farm subsidies and a more open attitude towards the international markets. The accounting profession is not immune to these changes. Companies' primary communication device to society is the external corporate report which purports to convey the state of the affairs of the company. Rebman-Huber (1990, p.7) concludes that within New Zealand the profession and preparers exert the most influence on accounting matters. The evidence generated in this chapter largely confirms her argument, albeit ignoring important public sector initiatives.

Each of these institutional forces provides some level of information and/or regulation, yet in total the provision of accounting data in New Zealand appears to sink down to the lowest common denominator¹⁰. Through neglect or disinterest bare minimal disclosures seem to have become the norm. Preparers issue non-timely reports that do not clearly communicate to the vast majority of New Zealanders. Stakeholders' impact is low, even investors (a group given priority in the current and proposed acts) have expressed dissatisfaction, and the burgeoning community interest in the natural environment is ignored. Auditors may exert positive action behind the scenes, but the threat of audit qualifications does not seem to have greatly inhibited corporations. Of the domestic influences examined in this chapter, only the public sector initiatives seem to be truly enhancing the pursuit of accountability.

9. See Huggins (1989, p.56) for similar preliminary views on other parts of the public sector.

10. Similarly, McMonnies (1985, p.12) concluded that some of the SSAPs in the United Kingdom represented the lowest rather than the highest common denominator.

CHAPTER NINE: CONFLICTS WITH LAW AND THE BUSINESS ENVIRONMENT

9.1 INTRODUCTION

In Section 8.3, it is postulated that nine institutions in New Zealand have significant influence upon the accounting standard setting process. Four of these groups are examined in Chapter Eight: the preparers, stakeholder groups, the auditors, and public sector initiatives. In this chapter the impact of the remaining five institutions upon the process of regulation of accounting rules (especially the NZSA) is assessed. These are the: Registrar of Companies, Companies Act, judiciary, Securities Commission, and New Zealand Stock Exchange.

9.2 INFLUENCES OF OTHER REGULATORY INSTITUTIONS

The Public Accountability Model of Accounting Regulation advocates the importance of an accounting standard setting process with definitive procedures for due process. These guidelines offer two advantages: community's interests can be incorporated and acceptance of the end-product (i.e. issuance of an accounting standard) will be enhanced (Section 5.3.3). It is accepted that the accounting standard setting process is a political process (Section 4.6.1).

The politicisation of accounting standard setting is perfectly legitimate given one important caveat: all the interest groups should have equal access and influence upon the process (Section 3.2.4). In the current system, interest group views are advanced via a lobbying process, usually through submissions to exposure drafts (Section 4.6.2). However, other forms of influence such as external crises (see Section 6.2.2) are observed in New Zealand.

Various governmental influences are analysed below. In the Rebmman-Huber (1990, p.7) study, the institutions discussed in this chapter are categorised within the middle tier of influence (see Table 8.2). The evidence provided below largely confirms her preliminary findings. The interactions of these institutions and a growing perception of crises in accounting regulation has led, via several Ministerial Reviews, for the call of substantial changes to the process.

9.2.1 Registrar of Companies

In theory, the Registrar of Companies (a governmental body) enforces the Companies Act 1955. The Registrar is given the duty to register companies' annual returns and thus have a determination on whether these documents meet the requirements of true and fair doctrine. The Registrar has the power to inspect companies under both the Companies Act 1955 and the Securities Act 1978 (Farrar & Russell, 1985, p.315). S/he has the authority to refuse registration to companies whose accounts are inadequate, however, in practice the primary focus of the Registrar's activities appears to be on de-registering companies who have ceased operations such as bankruptcies, mergers, and so forth (New Zealand Law Commission, 1989, p.74; Zeff, 1979, p.74).

Two important problems appear to exist with this institution: underfunding, and lack of ability and willingness to enforce the Companies Act's accounting provisions. McLay (1977), the then Assistant Secretary for Justice (Commercial Affairs), described the original legislative mandate as "a disjointed, potentially conflicting series of special arrangements, no one of which conferred the ability of decision and action..." (p.129).

A special committee to review the Companies Act (known as the MacArthur Committee) noted "considerable dissatisfaction with the present provisions" (Final Report of the Special Committee to Review the Companies Act, 1973, para.174) and recommended a larger, better financed and more vigorous department. In 1972, the Registrar became part of the newly formed Commercial Affairs Division of the Department of Justice (Report of the Department of Justice, 1973, p.21). Hall (1987, p.122), in an in-depth study of the Registrar, concludes that this regulatory mechanism remains chronically underfunded. Gray (1988, p.3), a former NZSA President, comments on the lack of enforcement by Justice Department (and NZSE) because of problems with outdated legislation and underfunding. This funding problem is confirmed in Table 9.1.

TABLE 9.1 HISTORICAL FUNDING PATTERNS OF THE COMMERCIAL AFFAIRS DIVISION, DEPARTMENT OF JUSTICE (1980-1990)

<u>Year</u>	<u># of Companies</u>	<u>Payments</u>	<u>Receipts</u>	<u>Shortfall</u>	<u>%</u>
1990	157,372	17,256,000	34,170,000	16,914,000	50%
1989	160,988	17,746,000	36,980,000	19,234,000	52%
1988	158,032	11,887,000	32,208,000	20,321,000	63%
1987	147,158	8,378,000	23,544,000	15,166,000	64%
1986	136,533	5,552,000	11,559,000	6,007,000	52%
1985	128,638	4,446,000	10,311,000	5,865,000	57%
1984	123,427	4,310,000	8,703,700	4,393,700	50%
1983	119,322	3,948,200	7,467,265	3,201,475	43%
1982	118,555	3,614,500	7,252,240	3,637,740	50%
1981	115,894	3,158,100	5,523,147	2,365,047	43%
1980	112,752	2,466,800	4,267,500	1,800,700	42%

Note: Percentage deficit shown in the far right-hand column is calculated by dividing the shortfall into the total receipts. All figures are actual rather than budget, 1988-1990 figures are exclusive of Goods and Services Tax.

Source: Adapted from the Report of the Department of Justice annual reports (1980-1990).

A perusal of the Reports of the Department of Justice-Commercial Affairs Divisions (1980-1990) reveals several recurring themes: late company filings, underfunding, untrained staff, inability to attract suitable qualified staff, and lack of success in meeting the objectives set out in the MacArthur Committee report. Table 9.1 shows that by 1987 the shortfall of revenues to expenses of the Commercial Affairs Division had reached an eight digit deficit. Over this period there is a rising trend of monies flowing out of, rather than being applied towards, Divisional activities (such as company regulation). The shortfall has decreased since the sharemarket crash, suggesting some attempt by the government to remedy the funding problem.

In 1985/6, the Commercial Affairs Division generated 15.4% of the Department of Justice's earnings (mostly through corporate registration fees) yet only received 2.8% of their budget (Hall, 1987, pp.122,206). Correction of this imbalance would be a major step in strengthening the Registrar.

The New Zealand Law Commission (1987) concludes that the state of the Registrar is little improved by the reforms introduced as a result of the MacArthur Committee and that,

...there is considerable doubt whether the Registrar is best placed to police documents submitted for accuracy and whether the effort and resources required to enable him to perform the task might not be better used elsewhere. In particular, if financial disclosure by registration is retained, it is questionable whether the Registrar can sensibly be asked to ensure that the accounts submitted present a "true and fair" picture of the company (p.36).

In 1988, the author wrote to the Registrar's office requesting a categorical breakdown¹ of the number of companies in New Zealand. It is revealing to note that this agency, entrusted with administering the Companies Act, did not know the answer. Deputy Registrar of Companies J.A. Arnott (personal communication, 16 December, 1988, p.1) admits that "There are no up-to-date figures categorized in the way you require¹, and the only way these could be ascertained would be through running the database programme to produce these figures- at horrendous costs." The Registrar's ignorance of their target regulatory group does not bode well for effective monitoring of the Companies Act.

Furthermore, many commentators (e.g. Hall, 1987, p.199; New Zealand Law Commission, 1987, p.36, 1989, p.74) question the Registrars' ability and desire to enforce accounting standards. Within New Zealand there has never been a prosecution² by the Registrar of Companies over accounting standards. In discussing the role of the Registrar with K. McCormack, the Deputy Justice Minister in charge of the Commercial Affairs Division of the Department of Justice, in an 1988 interview, the view conveyed was one of underfunding, lack of interest and lack of organisation. The same attitude is exhibited in a 1991 interview with the Registrar. Accounting standards violations are seen as an audit issue. The Registrar and the Commercial Affairs Division simply do not view themselves as the protectors of the public. The NZSA (1988c) states "The Registrar has informed us of his reluctance to reject financial statements presented to him for filing where the audit opinion has been qualified in a material respect" (p.26). It is unclear what useful regulatory role the Registrar serves. The New Zealand Law Commission (1987, p.36; 1989, p.74) recommends the Registrar not be involved in enforcing the new proposed Companies Act.

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1. Yet, the breakdown requested was directly based on the Companies Act 1955 categories: total number of companies, public companies, non-exempt private companies and exempt private companies.
 2. The Registrar has been active in the area of insolvency. 119 investigations were completed resulting in 84 prosecutions (Report of the Department of Justice, 1990, p.70). Unfortunately this high level of activity is not replicated within the accounting standard realm.

However, the Companies Bill (1990), as modified by the Justice Department, maintains the Registrar's role (McManus, 1990b, p.5). This bureaucratic decision to maintain the status quo could be seen as an interest group (the Department of Justice) protecting their own interests, in line with private interest theories (Stigler, 1971; Posner 1974; Peltzman, 1976).

The first sentence of the Commercial Affairs Division Mission Statement reads "To facilitate corporate commercial activity and to monitor and regulate incorporations" (Report of the Department of Justice, 1990, p.69). In the area of accounting standards and reporting this monitoring is not occurring, it is considered that the present and likely future level of regulation provided by the Registrar is suspect.

9.2.2 Companies Act

The Companies Act 1860 was the initial core company legislation in New Zealand, this was followed by the Acts of 1882, 1903, 1908 and 1933 (NZLC, 1987, p.1). The current legislation is the Companies Act 1955. Companies, under the present Act, are classified as public, non-exempt private (subsidiaries) and exempt private (exempted from filing audited financial reports). For public companies, an audited balance sheet and profit and loss account is required, as is an annual report to be sent to the Registrar of Companies (Robb et al., 1990, pp. 508-509). Other important requirements of the Act are that full, true and complete accounts are to be kept of the transactions of the company, the auditors' and directors' reports are annexed and the balance sheet is to be signed by two directors (Carrington, 1986, p.284). The Eighth Schedule details mandatory disclosure rules with which companies have to comply (Farrands, 1970, p.297). The Act has been amended numerous times usually in response to particularly pressing concerns (Elias, 1987, p.4; Watts, 1987, p.30).

Whilst compliance with accounting standards is deemed mandatory, the overriding requirement is the provision of a "true and fair" view of the state of affairs of the company (Section 153). This largely undefined phrase is considered very vague (Farrar & Russell, 1985, p.308) with two possible interpretations: the public and the technical view (Popoff, 1983, p.44; Securities Commission, 1990, paras 4.7-4.10). The public view, that corporate reports are essentially truthful, has not prevailed (Farrar & Russell, 1985, p.309). The technical view is adopted in the NZSA (1979a) Explanatory Forward which states, "A true and fair view implies disclosure and appropriate classification and grouping of all material items, and consistent application of acceptable accounting principles." (para.1.2).

A narrow stewardship approach towards corporate reporting is espoused in the Companies Act 1955. These views are maintained in the draft Companies Act (NZLC, 1989, 1990) and Companies Bill (1990). The current system's main regulatory remedy is shareholder suit, but the high cost of litigation acts as a major deterrent to pursue claims (NZSA, 1990b, p.26). Farrar & Russell (1985, chap. 23) note the procedural difficulties associated with derivative actions and the absence of contingency fees in New Zealand and conclude that these two factors hinder shareholder litigation³. The possibility of shareholder actions will be enhanced under the Companies Bill (1990, clauses 139-142). Under this proposal the courts could make provisions for allocating court costs and derivative actions would be allowed. These recommendations are, however, considered insufficient, placing too much onus on shareholder suits and neglecting stronger regulatory remedies.

The Companies Act 1955 is out-of-date (NZLC, 1987, p.4; Shapira, 1985, p.34). Managh (1984, p.377) and McNally et al. (1982, p.11) describe the disclosure requirements of the Act as limited and substantially unchanged over the last decades. Dugan (1987) considers this act,

...not only wholly inappropriate for the then pastoral economy but largely ignored the competing social interest in the society...[this] benign neglect...has left New Zealand with a company law regime so rudimentary by contemporary standards that it cannot ...accommodate the diverse economic and social interests implicated by those transactions (p.119).

The average time span to update New Zealand company law over the last century and a half is 22 years (assuming the enactment of a Companies Act in 1991). The current act is 36 years old. This time span is far too long to adjust to dynamic business practices and provide safeguards for equity and efficiency. The focus, degree of regulation, and level of guidance provided by current statute is considered inadequate.

9.2.3 Judiciary (Common Law)

In the area of corporate law, New Zealand has inherited a common heritage with the British legal tradition (Carrington, 1986, p.273), still recognising the Privy Council, in London, as the highest judicial authority (Wild, 1990, p.25). Part of this tradition is that broad legislation is supplemented by common law (Jones, 1990, p.20).

3. Pratt (1991b, p.39) argues that class actions and contingent legal fees can encourage unrealistic litigation. These remedies could, however, be seen to assist public accountability.

New Zealand common law falls into two categories: interpretation of legislation and items not covered by statute (Elias, 1987, p.4). In the latter category are important issues such as rules relating to dividend distribution (see *Hilton International Ltd (in liquidation) v Hilton*, 1988), self-purchase of shares (*Trevor v Whitworth*, 1887) and directors duties (*Coleman v Myers*, 1977).

Both equity and efficiency themes can be seen in the common law judicial decisions. Beck (1987, p.89) observes that New Zealand courts have considered the equity criterion when making judgments. It is noted that for efficiency purposes certain important accepted common law practices are later codified. For instance the term 'promoter' is now defined in the Securities Act 1978 (Section 2). However, the New Zealand Law Commission feels that it would be unfeasible, undesirable, difficult and costly to "attempt comprehensive codification of the common law" (1987, paras 18-19).

The judiciary has had an impact upon accounting practice. Within the New Zealand accounting realm, common law provides a definition of accounting records *Maloc Construction Limited (in liq) v Chadwick* (1986). Judgments have clarified insolvency practice, made rulings on investor rights *Re Registered Securities Ltd (in liq)*, *Tuck v National Australia Bank (NZ) Ltd* (1991) and audit liability *National Mutual Life Nominees Ltd v Worn and Ors* (1990).

Probably the most important judiciary position in relation to accounting standards is the general acceptance of the technical perception of what constitutes a true and fair view (Commerce Clearing House, 1981, p.143). This acceptance of the accountants perspective gives added weight to the SSAPs.

In summary, the New Zealand courts have generally interpreted corporate law rather than created it. In the area of accounting rules and regulation the judiciary has supported the status quo: a position which is increasingly being questioned.

9.2.4 Securities Commission

The Securities Commission, a quasi-governmental body, is another important institution which affects the New Zealand accounting regulatory environment. This agency was established under the auspices of the Securities Act 1978 to regulate all soliciting of funds from the public. The creation of the Securities Commission was in direct response to perceived emergencies in the capital markets especially the well published failures of Securitibank Group, Cornish, Circuit, Perpetual Trustees,

Gemco and Mark Craig (Report of the Department of Justice, 1977, p.21). This is consistent with the trend of generating accounting regulation upon the arrival of a crisis (Section 6.2.2).

Unlike the other Anglo-American structures the Securities Commission does not oversee the stock exchange (Report of Ministerial Committee of Inquiry into the Sharemarket, 1989, p.8). Instead the Commission has a narrow mandate with two main functions: law reform and dealing with specific problems relating to a company or individual who came within the jurisdiction of the Securities Act (Hall, 1987, p.39).

The Securities Commission admits that the quality of financial reporting in New Zealand is unsatisfactory ("Financial reporting", 1990, p.5). Further, a recent report by Mak (1990, p.3) concludes that New Zealand company prospectus profit forecasts are less accurate than other Anglo-American experience. He finds a general lack of accountability (p.7) and specifically notes: that management is generally unwilling to disclose bad news (p.4), the lack of an audit requirement to comment on the reasonableness of forecast assumptions (p.5), and failure of the companies to disclose all significant accounting policies (p.6). Overall, Mak (1990, p.31) notes actual profit deviated from forecast profit by an average of almost 70%. He also observes that only 20% of these companies later referred to forecast deviations in the subsequent annual reports (p.33). His study raises considerable doubts at the ability of the Securities Commission to monitor financial disclosure, although it is acknowledged by soliciting Mak's report, action is now forthcoming in the overview of prospectuses (see Securities Commission, 1991).

A budgetary trend analysis is given in Table 9.2. These funding patterns are used as a surrogate for the level of importance given to it by the government over time. Table 9.2 reveals that the Securities Commission's funding levels have increased five-fold in the last decade.

TABLE 9.2 SECURITIES COMMISSION ANNUAL BUDGET (1980-1990)

<u>Year</u>	<u>Annual Grant (\$)</u>	<u>Annual Change</u>
1990	1944081	39.7%
1989	1391307	83.5%
1988	758000	20.9%
1987	627000	17.2%
1986	535000	16.9%
1985	457750	2.6%
1984	446000	4.4%
1983	427000	27.2%
1982	335622	11.2%
1981	301810	-7.7%
1980	327000	-----

Source: Securities Commission annual reports (1980-1990).

Several interesting features are discerned in Table 9.2. First, are the relatively low funding levels that the Securities Commission originally began with. Second, are the minor increases in funding amounts ^(ALLEGED) until the 1987 sharemarket crash. Third, are the very high annual increases ^(SHOWN) in the last few years, reflecting increased interest and deemed importance by government. Despite the increased budgets since the sharemarket crash, the funding levels still appear inadequate, especially if the Securities Commission is asked to expand its mission and take on more of an enforcement role. For instance, the Russell Committee recommends the Securities Commission's budget be more than doubled, up to \$3.9 million (Report of the Sharemarket Inquiry Establishment Unit, 1989, p.154).

The Securities Commission has influenced the NZSA on various occasions in regard to accounting issues (see for example Myers, 1988, p.11). The extent of this influence is difficult to quantify given the Securities Commission policy of making confidential submissions. From an accountability perspective, this is considered an unacceptable policy for a quasi-governmental body. Nevertheless, they do appear to have exerted influence over the NZSA, albeit in a behind-the-doors fashion.

The Securities Commission has stated publicly on occasions that they are not a law enforcement body (see for example "The Securities", 1979, p.132). It would seem, therefore, that any investigations initiated by the Commission would be followed through by the Commercial Affairs Division (i.e. Registrar of Companies), police (Hall, 1987, pp.39-40) or Serious Fraud Office. Doubts are expressed about the

effectiveness of all these institutions (for example see Hall, 1987, p.39; Martin, 1991, p.7). Many commentators perceive a stronger, more robust Securities Commission as the preferred route toward accounting regulation in New Zealand (for example see the Report of Ministerial Committee of Inquiry into the Sharemarket, 1989, p.34).

Other governmental influences

There are other important governmental influences affecting the provision of accounting information. The most prominent is the Inland Revenue Department (IRD). The IRD, through the tax system can have an important impact on financial reporting practices (Purcell & Scott, 1986, p.110). An alternative is offered by MacLennan (1988, p.3, 1990, p.4) and Christiansen (1988, p.41) who cite the Fair Trading Act as a possible new mechanism for enforcing accounting standards (see also "Fair Trade", 1988, p.18). Under this Act both a company and its officers can be liable for misleading and deceptive conduct (Section 9). The Commerce Act of 1986 is another source of regulatory protection providing public oversight of mergers and takeovers.

Insider trading practices have also come under attack. An important conflict can be seen with this activity between efficiency and equity criteria (Farrar & Russell, 1985, pp.251-252). Some argue that insider trading is efficient by providing up-to-date information into the share price (see Ng (1988, p.11) for a review). Other individuals such as Patterson (1987b), the then Chairman of the Securities Commission, considered it to be "unconscionable and unacceptable in any honourable society" (p.174). Because of the perceived inequities the Anglo-American countries have introduced legislated safeguards (see Mathews & Perera, 1991, pp.249-253, for an overview). The MacArthur Committee recommended the prohibition of insider trading of price sensitive information (Final Report of the Special Committee to Review the Companies Act, 1973, paras 312-315). In New Zealand, insider trading legislation was finally introduced for publicly listed companies via the Securities Amendment Act 1988 (Mathews & Perera, 1991, p.247). This Act creates liabilities for insiders who trade or convey non-public price sensitive information and allows aggrieved shareholders to sue for compensation (Report of the Ministerial Working Group on Securities Law Reform, 1991, p.38).

9.2.5 New Zealand Stock Exchange

The origins of the New Zealand Stock Exchange began with the discovery of gold in the last half of the nineteenth century (Hunt, 1986, p.3). The Stock Exchange

Association in New Zealand⁴, founded in 1908, has three regional stock exchanges located in Auckland, Wellington and Christchurch⁵ with the Executive Office in Wellington (NZSE, Undated). The stated objectives of the NZSE are: protection of the interests of the investing public and securing the adoption of uniform regulations governing the cooperation and practices of member exchanges. These goals of protection are aided by disclosure regulations--expressed in terms of listing requirements.

The New Zealand Stock Exchange activities of the capital markets have two important influences upon accounting regulation. First, it strengthens accounting standards via its listing requirements. Second, far-reaching pressures to change domestic regulatory structures have been generated as a result of the inability of the capital market to recover from the 1987 sharemarket crash.

9.2.5.1 Linkage with the NZSA SSAPs

The NZSE displayed an early historical influence on the upgrading of the NZSA's accounting rules (Section 6.2.2). The pressure exerted by the NZSE in the early 1970s over the disparate treatment of associate companies (equity accounting) in corporate reports, provided an important impetus for the NZSA to issue mandatory standards (Zeff, 1979, p.56).

The stock exchange has over time mandated listed companies' disclosure of certain financial information. In 1971, the NZSE required listed companies to issue a preliminary announcement of annual results (in each case pretax profit, taxation, extraordinary items, minority interest and group turnover must be disclosed). In 1973, half-year reports became a requirement. Stock exchange regulations specifically stipulate listed companies should prepare their financial statements in accordance with the standards promulgated by the New Zealand Society of Accountants with explanation of any departures is mandated (Carrington, 1986, p.287). This latter rule significantly strengthens the NZSA promulgations.

The NZSE, a non-profit stockbrokers organisation, has a vested interest in attracting and maintaining as many companies on the exchange as possible. Vigorous rules could well drive companies to overseas exchanges, such as the Australian or the Hong Kong exchange (see Brierley Investments (1988) annual report for an example of the then biggest company in New Zealand making such comments). It is noted

4. This institution was renamed the New Zealand Stock Exchange (NZSE) in the Sharebrokers Amendment Act of 1981.

5. A fourth regional exchange, located in Dunedin, ceased operations in 1986.

that there has never been a de-listing by the New Zealand Stock Exchange⁶ over accounting standards.

9.2.5.2 The 1987 sharemarket crash and its aftermath

The 1987 sharemarket crash and resultant company failures^{the} are now exerting important ramifications, with both efficiency and equity concerns expressed. Inefficiencies with the stock market procedures in the late 1980s are well documented. For instance, especially troublesome was the inordinate long settlement delays with investors waiting up to eight or nine months for transactions to be terminated and payments received (Borrowdale, 1987, p.231). A growing feeling emerged that the stock exchange is not sufficiently monitoring itself (Report of the Sharemarket Inquiry Unit, 1989, p.4). Presently, there is no overseer for the capital markets to correct such inefficiencies (p.5).

Lev (1988, p.3) advocates the need for more equitable distribution of corporate data to stakeholders. He bases his argument on solid business reasons. Given the failure of the provision of equitable information he predicts thinner markets, lower liquidity and higher transaction costs (p.3). These factors are strikingly present in the New Zealand capital markets (See Tables 9.3, 9.4, and 9.5).

Together, these tables provide evidence of the crisis in the business environment. Table 9.3 documents the dramatic fall in the number of companies on the stock exchange. As of August 1991, the NZSE has approximately 120 listed companies, this is down 57% from the historical norm of 286. The impact of this large drop can be seen to have created great unease and distrust. The drop-off in investor confidence is shown in Table 9.4. The New Zealand capital market has yet to recover from the 1987 crash. Table 9.5 shows the poor performance of listed companies and rising number of bankruptcies. These factors, in aggregate, generate pressures for change.

6. This information was obtained in a 1988 and 1991 personal interviews with R. Gill, the then Executive Director, New Zealand Stock Exchange. He argues that self-regulation through the NZSE's newly instituted Surveillance Panel will be sufficient.

TABLE 9.3 NUMBER OF LISTED COMPANIES ON THE NEW ZEALAND STOCK EXCHANGE (1970-1991)

<u>Year</u>	<u>Number of companies</u>
1991*	122
1990	172
1989	248
1988	295
1987	361
1986	339
1985	316
1984	300
1983	281
1982	268
1981	278
1980	275
1979	284
1978	296
1977	300
1976	305
1975	305
1974	305
1973	305
1972	296
1971	298
<u>1970</u>	<u>300</u>
 Average	 286

* Number of listed companies as of 1 August 1991.

Source: New Zealand Stock Exchange archives and private communication with the Administration Manager of the New Zealand Stock Exchange (E. Mowat, 13 August, 1991).

TABLE 9.4 EFFECT OF 1987 SHAREMARKET CRASH IN NEW ZEALAND

<u>Quote</u>	<u>Source</u>
"Substantial loss of investor confidence"	(NZSE, 1988, p.1).
"Value of shares traded fell from \$4.46 billion to \$1.7 billion"	(NZSE, 1988, p.1).
"Equity funds raised fell from \$2,900 million to \$715 million "	(NZSE, 1988, p.1).
"the extent of the falls... represents not just difficult economic conditions but also a major loss of confidence by market participants in the rule making structure, in the observance of ethical standards and in the general integrity of the sharemarket"	(Report of Ministerial Committee of Inquiry into the Sharemarket, 1988, p.17).
"...the stock-market crash in New Zealand was particularly severe. Share prices fell by almost 40 per cent and in contrast to most other OECD countries, they continued to fall..."	(OECD, 1989, p.65)

TABLE 9.5 RECENT NEW ZEALAND ECONOMIC INDICATORS

Calendar Years	Unemployment (average for year) (000s)	Bank-ruptcies	Suicides	% of listed companies reporting losses (end-year)	Growth in GDP %
1980	40	808	337	NA	1.2
1981	45	557	320	NA	3.3
1982	50	569	364	NA	1.9
1983	75	889	352	7.0	1.6
1984	65	814	389	8.5	8.7
1985	61	869	338	8.9	1.6
1986	65	965	414	12.0	1.9
1987	88	1229	463	17.5	0.9
1988	118	1874	NA	35.9	0.7
1989	151	1921	NA	47.6	NA

Source: Catt (1990, p.25).

A clear majority of New Zealanders favour more government regulation and control of the economy especially concerning the activities of large companies (Gold & Webster, 1990, pp.15-16). Certainly the lack of a government-overseer in the New Zealand capital markets is not only at odds with other Anglo-American practices, but

appears to be an important structural weakness in the current accounting regulatory procedures. It is considered that institutional changes, such as the implementation of an effective regulatory overseer, are necessary (Section 5.3.3).

There is a general trend of governments becoming more actively concerned with examining the accounting standard setting process (Flint, 1982, p.19). A likely scenario for increased New Zealand government involvement would follow a series of major company crashes accompanied by growing public disquiet, public awareness of white collar crime, press sensationalism and a clamour for politicians to do something. All these features are already present in the New Zealand environment (see Tables 9.3-9.5).

Tables 9.3-9.5 underscore the growing concern caused by the 1987 stock market crash, the seemingly endless list of major companies which are going into receivership or liquidation coupled with collapses such as the Development Finance Corporation (DFC), and huge writeoffs by the Bank of New Zealand. Questionable accounting practices have been blamed for aiding the crash (Outdershorn, 1989, p.21). These problems can be linked to a failure to provide accountability-based information (Section 5.3.2). As discussed below, the government responded to these pressures by instigating several Ministerial Reviews charged with the responsibility for investigating various aspects of corporate behaviour, including external financial reporting.

9.3 THE FUTURE OF ACCOUNTING REGULATION IN NEW ZEALAND

The future direction of accounting regulation in New Zealand is a widely discussed issue at the present time amongst various parties interested in accounting and financial reporting practices of business enterprises. In the area of New Zealand law reform⁷, Farrar (1987a) perceptively argues,

Important to any serious attempt at reform of company law must be a balancing of efficiency and fairness. The former is predicated by the fact that companies are firms, the creatures of markets... and the latter is predicated by the fact that a company is a social institution built upon the idea of voluntary association (p.xii).

Three completed Ministerial Reviews examined different aspects of the reporting of financial accounting information. In 1989, the Russell Committee (RC) studied

7. See also Patterson (1987a, p.259).

causes and solutions to the sharemarket crash, the New Zealand Law Commission (NZLC) (1987,1989,1990) offered updates to company law and the Securities Commission (SC) (1990) prepared a brief on financial reporting. Officially, these reviews are designed, in part, to uplift investor confidence and improve financial reporting practices. A more cynical view would describe the proliferation of reviews as a method of the government being seen to be doing something in that politicians could be seen to be undertaking positive action undertaken to promote the public interest based on Downs (1957, p.141) voting model.

Both The fall of the value of shares in the share market by two-thirds during (Table 9.4) and the huge drop in the number of listed companies (Table 9.3) provides evidence that the public seemed to have lost a great deal of confidence in the capital market. The quality and reliability of accounting information is also being questioned ("Accounting methods", 1988, p.25). For instance, R. MacDonald, the Executive Director of the NZSA, admits there was an accountant's role in the sharemarket crash (Oudtshoorn, 1989, p.21).

The New Zealand Barclays' Index has not rebounded, it has fallen by 250% from October 1987 to August 1991. It is the post crash decline which most notably distinguishes New Zealand from the rest of the world (Tripp, 1989, p.2). This failure to recover and the continuing procession of company failures and problems led to the Report of Ministerial Committee of Inquiry into the Sharemarket (1989).

9.3.1 Russell Committee proposals

The Russell Committee was established in October 1988 as a response to the sharemarket crash. Their original term of reference was to,

To review the law and practices of, and relating to, the operations of the New Zealand sharemarket and to make recommendations to ensure the maintenance of a fair and efficient market for the investment in and trading of securities of listed companies, having regard to the importance of a capital market to New Zealand's economic system.

The review is to include a consideration of appropriate supervisory structures (Report of Ministerial Committee of Inquiry into the Sharemarket, 1989, p.1).

Patterson (1987b, p.174) observes that insider trading practices have damaged the capital market by diminishing the confidence of investors. The New Zealand public expresses strong disapproval of insider trading and other recurring practices in the

information markets (see Table 9.6). This Table highlights the responses to the Ministerial Committee of Inquiry into the Sharemarket (1988) call for submissions on the capital markets (see Appendix J). Many of the 104 respondents of the Review indicate great frustration with the level of efficiency and equity in the marketplace.

Of those specifically commenting on the issues listed in Table 9.6, an overwhelming majority express dissatisfaction with the status quo structure of the capital markets. The respondents call for more efficiency (95%), equity (100%), change in the present structure (97%), wider representation (78%) and more regulation (96%). The above Table is a strong indictment on the current low level of regulation of the capital market. The New Zealand experience provides proof for Lev's (1988) argument which highlights the importance of the equity criterion and argues that investors will cease to invest in a capital market they feel inequitable.

James (1991) observes the unwillingness of individuals to invest in the New Zealand markets because of perceived inequities and appropriately calls for better regulation against "highway robbers" (p.10). The charge given to the Russell Committee is to examine the problems within the capital markets and venture possible solutions. The first report resulted from the Ministerial Review, whilst the second report Report of the Sharemarket Inquiry Establishment Unit (1989) outlines ways to implement the initial recommendations.

The latter report proposes that a revamped Securities Commission which they called the New Zealand Securities Commission (NZSC), be installed as overseer of the equity markets. This is important in view of the absence of such an overseer at the present time. The Russell Committee advises that the listing requirements be given the force-of-law status and funding increased. The reports advocate sanctions for non-compliance with standards. This is especially critical given the documented high level of non-compliance (Section 7.4.1). Under the Russell Committee's second report proposals certain regulatory agencies or any security holder or creditor of an issuer could appeal to a statutory authority for correction of a qualified set of financial statements (p.140)⁸.

8. It is noted that these recommendations are similar to the Financial Services Act 1986 (UK).

TABLE 9.6 SUMMARY OF RESPONSES TO MINISTERIAL COMMITTEE OF INQUIRY INTO THE SHAREMARKET (1988)

Occupational Breakdown:

Barristers/Solicitors	3	3%
Business	8	8%
Accountants	9	9%
Academics	3	3%
Investors	46	44%
Major Investor	4	4%
Government	2	2%
Sharebrokers	10	10%
Unstated/Other	19	18%

Number of Respondents: 104

Issue 1: Need for more efficiency in the market?

	<u>% of Total</u>		<u>% per Respondents</u>	
Yes	37%	(39)	95%	(39)
No	2%	(2)	5%	(2)
No Response	61%	(63)	-	-

Issue 2: Need for more equity in the market?

	<u>% of Total</u>		<u>% per Respondents</u>	
Yes	49%	(51)	100%	(51)
No	-	-	-	-
No Response	51%	(53)	-	-

Issue 2A: Need wider representation in the stockmarket?

	<u>% of Total</u>		<u>% per Respondents</u>	
Yes	7%	(7)	78%	(7)
No	2%	(2)	22%	(2)
No Response	91%	(95)	-	-

Issue 3: Need more regulation?

	<u>% of Total</u>		<u>% per Respondents</u>	
Yes	44%	(46)	96%	(46)
No	2%	(2)	4%	(2)
No Response	54%	(56)	-	-

Issue 4: Need to change structure of stock market?

	<u>% of Total</u>		<u>% per Respondents</u>	
Yes	50%	(52)	97%	(52)
No	2%	(2)	3%	(2)
No Response	48%	(50)	-	-

Note: The figures in () reflect the actual number of respondents aligned with a position.

Note: The low number of respondents to Chapter 14, and concerns with generalising such responses (see for example Currie et al., 1987) makes statistical analysis of interest groups inappropriate.

Source: Tribunals Division, Department of Justice archives.

In recommending these proposals the Russell Committee considered four possible alternatives: self-regulation, market regulation, merger with Australian Stock Exchange⁹ and market supervision. In their first report the Committee chose self-regulation with statutory enforcement stating that unfettered reliance on market forces would not generate the required improvement in overall market performance (Report of Ministerial Committee of Inquiry into the Sharemarket, 1989, p.4). However, given the past poor track record, a market regulation regime appears more appropriate for New Zealand.

The Russell Committee criticises the quality of corporate reporting in New Zealand,

One of the major disclosure deficiencies identified by the Committee was the level of non-compliance with New Zealand Society of Accountants SSAPs. Despite a requirement in the listing requirements for companies to comply with SSAPs, it is apparent to the Committee that these standards are not adhered to by all listed companies (Report of Ministerial Committee of Inquiry into the Sharemarket, 1989, p.57).

Two important accounting changes are proposed. First, the Eighth Schedule to the Companies Act be updated, and second, legal force be given to accounting standards which are 'approved' by an Accounting Standards Board (ASB)¹⁰. Under their proposals, this new Board would resemble the AASB in Australia by acting as a reviewer of standards and the NZSA would retain the primary role of researching and drafting standards.

9.3.2 A New Companies Act

A new Companies Bill (1990) is currently being considered by the New Zealand Parliament. This is largely based on the earlier efforts of the NZLC (1987, 1989, 1990). In 1986, the New Zealand Law Commission was asked by the Minister of Justice to "To examine and review the law relating to bodies incorporated under the Companies Act 1955, and to report on the form and content of a new Companies Act" (Elias, 1987, p.3). The goal of this law reform is supposedly fairness and efficiency (Clifton, 1990, p.2).

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9. The possibility of an amalgamated sharemarket between Australia and New Zealand was also discussed by Segelov (1988, p.34).
 10. The Securities Commission titled the proposed board the Accounting Standards Review Board (ASRB) while the Russell Committee proposed an Accounting Standards Board (ASB). To avoid excessive use of acronyms the latter title will be used in this thesis to represent a government-backed, stakeholder-approved Board structure.

In 1987, the NZLC disseminated a discussion paper which outlined tentative positions and called for public input. Chapter 14 of that document was devoted to accounting issues (see Table 9.7).

It is interesting to note that 65% of those that responded consider the true and fair view an adequate principle. A large majority of respondents feel the NZSA should set the form of accounting and create the accounting standards. However, they are far less sanguine regarding enforcement mechanisms. Table 9.7 shows that only 18% express their approval of shareholder suit as a primary regulatory force, and only 14% feel the NZSA was the appropriate body for enforcement. It is noted that the Registrar (9%) and the Securities Commission (14%) also gain little support.

In 1989, the NZLC offered a draft companies act with important changes to the current structure (see Table 9.8). The new draft Act would provide core legislation applying to all companies (McManus, 1990a, p.18). It is submitted that these changes are not adequate to fulfil accountability criteria.

TABLE 9.7 SUMMARY OF RESPONSES TO NEW ZEALAND LAW COMMISSION (1987) DISCUSSION PAPER

Occupational Breakdown:Proportion (%)	Respondents
Barristers/Solicitors	24% (15)
Business	21% (13)
Accountants	13% (8)
Academics	10% (6)
Government	6% (4)
Other/Not identified	26% (16)
Total	100% 62

It is interesting to note that even though accountants represented only 13% of the respondents a crude measure of their interest in this topic is revealed by noting that the New Zealand Society of Accountants alone had a 183 page response (out of total response of 1110 pages).

Question 1: Is "true and fair" an adequate standard?

	<u>% of Total</u>	<u>% per Respondents</u>
No Response	73% (45)	- -
Yes	18% (11)	65% (11)
No	5% (3)	18% (3)
Mixed Response	5% (3)	18% (3)

Question 2: Should the form of company accounts be prescribed by statute or by a regulatory body?

	<u>% of Total</u>	<u>% per Respondents</u>
No Response	77% (48)	- -
By Statute	- (0)	- -
By Regulatory Body	23% (14)	100% (14)

What Body?

	<u>% of Total</u>	<u>% per Respondents</u>
No Response	77% (48)	- -
Professional Body	15% (9)	64% (9)
Independent Body	- (0)	- -
Both	8% (5)	36% (5)

Question 4: Should accounting standards be set by a professional body or by an independent statutory authority?

	<u>% of Total</u>	<u>% per Respondents</u>
No Response	71% (44)	- -
Professional Body	23% (14)	78% (14)
Independent Body	6% (4)	22% (4)

Note: The respondents (14) who think that standards should be set by a professional body feel the NZSA should perform this task. Of the respondents (4) who state standards should be set by an independent body, one mentions the Securities Commission, the other three do not specify any entity preference.

TABLE 9.7 SUMMARY OF RESPONSES TO NEW ZEALAND LAW COMMISSION (1987) DISCUSSION PAPER (cont)

Question 5: Should compliance with accounting standards be enforced by a regulatory agency or left to shareholder or creditor suit?

	<u>% of Total</u>		<u>% per Respondents</u>	
No Response	65%	(40)	-	-
By Regulatory Agency	24%	(15)	68%	(15)
By Suit	6%	(4)	18%	(4)
Both	5%	(3)	14%	(3)

What entity should perform the regulatory function?

No Response	65%	(40)	-	-
Independent Body	11%	(7)	32%	(7)
NZSA	5%	(3)	14%	(3)
Securities Commission	5%	(3)	14%	(3)
Registrar of Companies	3%	(2)	9%	(2)
Other/Not Specified	11%	(7)	32%	(7)

Note: The figures in () reflect the actual number of respondents aligned with a position.

Note: Percentage totals do not always equal 100% because of rounding.

Note: Questions 3, 6, 7 and 8 of Chapter 14, NZLC (1987) do not pertain to this analysis and therefore are omitted.

Note: The low number of respondents to Chapter 14, and concerns with generalising such responses (see for example Currie et al., 1987) makes statistical analysis of interest groups inappropriate.

Source: NZLC archives.

TABLE 9.8 PRINCIPAL RECOMMENDATIONS OF THE NEW ZEALAND LAW COMMISSION (1989) COMPANY LAW: REFORM AND RESTATEMENT

-
- * No social objective advocated within core company law.
 - * Abolish classification of companies (i.e. public versus private).
 - * Permit one-person companies.
 - * A company constitution to replace the memorandum and articles of association.
 - * The concept of par value to be abandoned.
 - * The Eighth Schedule to be abolished.
 - * The primary reporting obligation of directors is to provide a true and fair view.
 - * Financial statements will be required to comply with any desirable¹¹ accounting standards which are legally adopted.
 - * A balance sheet, income statement and statement of cash flow will be required.
 - * Audited financial statements will be mandated for companies which offer securities under the Securities Act 1978.

Source: Adapted from NZLC (1989, pp.17-29).

The draft Act does simplify and clarify an out-of-date piece of legislation (Jones, 1989, p.35; Ross, 1991a, p.14). However, this proposal pursues a free market approach which is in conflict with consumer protection and the proposed Model (Chapter Five). For instance, the Companies Bill (1990) is silent on specific accounting rules therein implicitly maintaining the profession's monopoly control. Nowhere does the current or proposed¹² Act prescribe the accounting practices to be used in arriving at the figures that appear in the published financial statements (NZSA, 1991b, p.24). The overriding provision of true and fair view would still prevail, with its ambiguity continuing to cause confusion on the role and function of accounting standards. In addition, the Companies Bill (1990) essentially leaves enforcement in the hands of shareholder suits, an idea ill suited to consumer protection and despite the opinions of respondents to the NZLC (1987) report.

9.3.3 Securities Commission Recommendations

The Securities Commission's (1990) report recommends three main changes to the status quo: new capital requirements, establishment of an Accounting Review Board, and greater usage of in-house rules (1990, pp. 13,42).

-
11. This term is not defined or explained. It could mean what is seen as best in a technical sense or alternatively what is politically acceptable.
 12. Presently, the Companies Bill (1990) is at Parliament's Justice and Law Reform Select Committee stage. The remaining controversial issues are the solvency test for dividend distribution and directors duties (MacLean, 1991, p.10; Ross, 1990a, p.14). It appears that both major parties support the major thrust of the bill (see for example Jeffries, 1990, p.2)

The second recommendation will probably have the most important effect on accountability and the quality of New Zealand corporate reports. The Russell Committee and Securities Commission envisage such a Board would: approve accounting standards, have the power to amend standards, be located outside of the accounting profession's domain, limit the NZSA's representation to a large minority, use accountant's technical expertise, and receive submissions from both the NZSA and others (Porter, 1990b, p.13). Graham, the Minister of Justice, recently confirms the intention to implement such a board for public-issuers with non-compliance fines up to \$50,000 for directors.

In direct contrast, the Companies Bill (1990) does not include¹³ a provision for vetting accounting standards. It thus appears that New Zealand will adopt a bifurcated accounting regulatory system in that there is no clear provision for non-public issuers (i.e. the vast majority of New Zealand companies) compliance with legally enforceable accounting rules (NZSA, 1991b, p.24; Porter, 1990b, p.14).

The Securities Commission also properly contends that the ASB monitor qualified audit reports (see Porter & Simpkins (1990, pp.18-19) for a useful summary). This is a provision that could effectively strengthen the role of the auditor as an independent watchdog.

The Ministerial reviews discussed above are initiated because of perceived crises in the accounting profession and continuing company failures along with the present lack of confidence in the equity markets. The issued reports suggest important changes be made to the regulatory design of the New Zealand accounting standard setting process.

9.3.4 Important recent initiatives

Three recent important initiatives may also have widespread impact upon the accounting standard setting process in New Zealand. The first activity is a joint proposal by several of the influential regulatory agencies, the second is NZSA's

13. Clause 177 of the Companies Bill (1990) does provide a linkage to future promulgated regulation. However, in a 1990 interview, the impression is gained from J. Hodder, the then New Zealand Law Commissioner in charge of company law reform, that this provision is included for political acceptability in that proponents of regulation could look favourably to this clause and opponents to regulation would be comforted by its ambiguity. Nevertheless, such a clause, if enacted, could provide a direct linkage to the much stronger proposed regulation for public issuers.

development of a concepts statement, and the third is a recent Ministerial Working Group report on securities law reform.

9.3.4.1 Tripartite Agreement

In May 1991, a Tripartite Agreement entitled Business Law Reform: Financial Reporting in New Zealand was issued by the NZSA, NZSE and Securities Commission (see Braddell, 1991a, p.7; "Business law", 1991, pp.23-24). The advancement of agreed upon goals by these three influential business interest groups is crucial in that the Government is likely to place great weight on the suggestions. This Agreement offers a definition of the term 'public issuers' and then presents a proposed accounting regulatory scheme for this group. They define a public issuer as,

any entity, whether a company or otherwise, which

- (a) is currently offering securities to the public, or
- (b) while not currently offering securities to the public, has under administration funds which were derived from public subscription and in respect of which members of the public retain an interest (Business Law Reform: Financial Reporting in New Zealand, 1991, unpaginated).

This is a broad definition of public issuers in that it includes non-corporate entities participating in securities activities. The second clause potentially captures other unusually designed activities which may possess large public interest ramifications.

Table 9.9 lists the important suggestions offered by the Tripartite Agreement.

Table 9.9 reveals numerous important issues. As discussed below, several of these recommendations are applauded whilst others are questioned.

The positive steps to the proposal include the call for an independent accounting standards board with reasonable powers. Moreover, the proposed remedies clause and wider funding sought would help to correct current imbalances. Movement towards the issuance of explicit guidance via a conceptual framework is also long overdue. Oratory towards greater public consultation is welcomed.

TABLE 9.9 MAJOR RECOMMENDATIONS OF THE 1991 TRIPARTITE AGREEMENT OF THE NZSA, NZSE AND SECURITIES COMMISSION

-
- 1.1 The establishment of an independent Accounting Standards Review Board by an act of Parliament.
- 1.2 Board members appointed by the Governor-General, on advice of the Minister of Justice with 40% of members nominated by NZSA.
- 1.3 Functions to include:
 development of a conceptual framework,
 sponsor or develop of accounting standards for all entities,
 engage in public consultation,
 approval of accounting standards,
 review accounting standards,
 power to amend and revoke accounting standards,
 review qualified audit reports and related financial statements,
 request the SC undertake appropriate inquiries,
 recommend law reform proposals to the SC.
- 1.4 Wider funding from:
 NZSA,
 Listed Companies Association,
 New Zealand Bankers' Association,
 Financial Services Federation,
 Life Offices' Association of New Zealand,
 Registrar of Companies,
 Audit Office,
 Securities Commission.
- 1.5 Board to report annually to the Minister of Justice.
- 1.6 NZSA will inaugurate the Board and supply research services.
- 2.1 Public issuers will be required to:
 keep accounting records,
 give a true and fair view,
 be audited,
 obtain an audit report,
 prepare an annual report,
 deliver report to Registrar.
- 2.2 Registrar of Companies to refuse non-complying reports.
- 3.1 Penalties for non-compliance be prescribed by regulation.
- 3.2 Power to Securities Commission for the correction of accounts which do not give a true and fair view or do not comply with approved accounting standards:
 Directors to bear costs of revision,
 Letter of Comfort from SC may be obtained.
- 3.3 Courts maintain common law jurisdiction.
- 3.4 Government-General empowered to make regulations prescribing:
 annual report information,
 group accounting,
 accounting for substance versus form issues,
 frequency and recipient group for reports,
 the function of auditors,
 content of audit reports,
 offences and penalties for non-compliance.

Source: Adapted from Business Law Reform: Financial Reporting in New Zealand (1991).

However, several concerns remain. The Securities Commission seems determined to maintain their law reform function, a feature which seems to have served as a distraction in the past (Section 9.2.4). Further, their preference for 'regulation' is not appropriate¹⁴. The Tripartite Agreement proposes the NZSA initiate the accounting standard board. Walker (1987), based on Australian experience, argues that this type of initiative enables the profession to capture the regulator. The above proposals bear many resemblances to recent Australian proposals (see for example Peirson (1990b). Consequently, the criticisms of the Australian proposals on due process and consultation recently aired by Leo (1990), Prentice (1990), Starr (1990) and Walker (1990) should be noted. Especially worrying is the absence of any concrete proposals for public consultation, in their absence community input may only be rhetoric.

9.3.4.2 NZSA concepts statement

The second important initiative¹⁵ stems from the NZSA. It is understood that a secret concepts statement¹⁶ has almost been completed by the ARSB which will be issued as an exposure draft in the beginning of 1992. Whilst work started on such a project would normally be applauded, great concern is raised on the approach and lack of consultation.

There is no public information of this undertaking, however, it is insinuated¹⁶ that the project will closely resemble the Australian conceptual framework project (AARF, 1990a, 1990b, 1990c). If this is the case, the deemed recipient group will be wide (see Section 3.5.1), but the preference towards decision usefulness (Table 3.2) is not in agreement with the proposed Model. The Australian preference towards treating the public and private sector in tandem, is applauded especially given the innovative New Zealand public sector initiatives (Section 8.3.4). Due to the lack of publicly available information about the NZSA's concept statement, further analysis is impossible.

-
14. The Securities Commission uses this term in an unusual way. To them, 'regulation' is a method of generating rules internally, albeit with some outside consultation. This method does not appear to be in accordance with due process procedures discussed in Sections 2.4.1.2 and 7.2.2.
 15. A related project is the development of a structure to support the SSAPs. SSAP-9 (NZSA, 1979b), the primary disclosure accounting standard, may be reissued to provide an outline of the content and information to be disclosed in corporate reports (Porter, 1991b, p.93). In direct contrast to the secret project described above, this proposal has been given at least some public exposure.
 16. This information was obtained from B. Porter, former Director of Research, NZSA, in a 1991 interview.

Due process procedures are disturbingly infringed by the generation of this secret concepts statement. As discussed in Sections 2.4.1.2 and Section 7.2.2, consultation needs to occur during the initial design of a proposal. Submissions at the exposure draft phase do not accurately represent the greater community (Section 4.6.2) and agenda selection and control remains with the ruling elite (Section 7.2). This secrecy is at odds with public accountability criterion (Section 5.3.2).

One possible explanation for the unexpected development of a concepts statement may be the aspiration of the New Zealand Society of Accountants to commandeer the creation of such an overview statement before an approval board (not controlled by the NZSA) has the chance to consider such a project.

9.3.4.3 Ministerial Working Group on securities law reform

In March 1991, a Ministerial Working Group is established to suggest reforms as to securities reform (Martin, 1991, p.7). This group is composed of representatives of four governmental departments (Prime Minister and Cabinet, Commerce, Justice and Treasury) and four from the non-government sectors (Hodder, 1991, p.1). In August 1991 their report is released. The 63 page Report of the Ministerial Working Group on Securities Law Reform critiques the present system using an agency theory perspective and advocates less public regulation (MacAlister, 1991a, p.18). The main tenets of the report are summarised in Table 9.10.

As described in Table 9.10, the report brings up several important points such as the urgent need for reform of enforcement mechanisms, and need for a linkage between the true and fair view criterion and accounting principles. Several important deficiencies, however, exists with the report. An analysis of this document reveals major problems such as: narrow user focus, priority given to efficiency arguments, and lack of empirical evidential support. The most important criticism is reserved for the report's lack of effective regulatory mechanisms with its emphasis on private versus public regulation.

The first problem is the Working Group's almost exclusive focus on investors (Report of the Ministerial Working Group on Securities Law Reform, 1991, p.5). They place their emphasis on contractual relations between absentee owners and managers (pp.6-7). Whilst creditors are mentioned in passing other stakeholders such as employees, environmental groups and the local community are totally ignored. Consequently, the report dismisses the potential benefits of regulation to these relatively powerless groups (MacAlister, 1991b, p.12).

TABLE 9.10 MINISTERIAL WORKING GROUP ON SECURITIES LAW REFORM: A SUMMARY OF VIEWS

Stated objective of the Working Group is to review securities market regulation (p.1).

The report restates the primary importance of presenting a true and fair view (p.37).

The Working Group did not feel there were serious deficiencies in the regulatory framework. They also did not agree that deficiencies contributed to the severity to the sharemarket crash or continuing poor performance of the market (p.9).

They consider that the major problem in New Zealand securities markets has been in the area of enforcement (p.12). They note that the Russell Committee, Securities Commission and NZSA are advocating more public regulation. The Working Group disagrees with this approach and instead recommends more private regulation (p.15). There is acknowledgement that court proceedings are cumbersome (p.13) but advocates shareholder suit as the primary regulatory tool (p.46). To enhance this possibility they recommend costs be awarded to reduce shareholder-related suits (p.14).

The report specifically recommends that the Securities Commission should not be the primary monitoring and supervision institution in the market (p.22). Consequently, they do not support the Tripartite Agreement view that the Securities Commission have the power to order the revision of financial statements (p.34). The Working Group also does not agree with the concept of compulsory compliance with GAAP nor does it endorse accounting standards being granted force-of-law status (p.33). Instead the Group argues that the Companies Bill (1990) should deem compliance with GAAP to be prima facie evidence the financial statements present a true and fair view with departures from GAAP disclosed (p.46). The Group further recommends removal of Clause 177 in the Companies Bill (1991) which gives the power to make regulations (p.46).

Source: Adapted from Report of the Ministerial Working Group on Securities Law Reform, (1991).

The second matter is their ranking of societal goals especially efficiency and equity criteria. The Working Group initially offered some rhetoric as to the dual importance of efficiency and informational equity (Report of the Ministerial Working Group on Securities Law Reform, 1991, p.2). However, their entire paper focuses almost exclusively on the efficiency criterion. For instance, rather than incorporating improved mechanisms for enhancing informational equity, they instead express concern about the lack of efficiency with the current insider trading rules (p.39). The report clearly does not seriously consider informational equity criterion important.

The third problem is the lack of evidence gathered by the Working Group. They incorrectly criticise the Russell Committee, Securities Commission and New Zealand Society of Accountants for advocating positions (i.e. the need for more public regulation) without providing evidence (p.15). Moreover, the Working Group's report is rife with unsubstantiated opinions put forth as facts. For instance, the Working Group critiques regulation and concludes that the costs of regulation exceed the benefits (MacAlister, 1991a, p.18; Report of the Ministerial Working Group on Securities Law Reform, 1991, pp. 7-8). No empirical evidence is offered to validate this assertion. The Working Group admits that due to the limited timeframe of the project that little outside consultation is conducted. Further, no public hearings are held, nor is there any attempt to solicit community opinion.

The fourth concern is the Working Group's insistence that shareholder suit is a better regulatory mechanism than governmental intervention (MacAlister, 1991b, p.12). The report seems to basically recommend a slightly improved maintenance of the status quo. Whilst they correctly advocate the need for linkage of the true and fair view criterion to the SSAPs, they ignore the improvements needed in the enforcement procedures (Martin, 1991, p.7). For instance, they argue the Registrar and Securities Commission maintain their current approach. The Working Group's dislike for public regulation appears to be more an ideological bias than a viewpoint supported by empirical research and is at odds with the evidence presented in this chapter. The perception that regulation can enhance the accountability of corporations is completely ignored.

A fifth consideration is the fact that the Working Group's views are diametrically opposite to the latest developments in Australia in the area of accounting regulation (Section 2.3.4). This is important particularly in the context of Closer Economic Relations (CER) and moves towards Trans-Tasman business harmonisation.

A (unnamed) member of the Working Group expresses strong reservations with the majority viewpoint. Section 16 of the report contains the minority position which appropriately states,

Financial markets should be operating not only efficiently but also equitably. Equity demands the redress of legitimate grievances. But the redress the Group has in mind for individual investors is through the courts by reliance on the general law. That path has been irrelevant for individual investors (of all kinds) in the past...By relegating the enforcement roles of the Securities Commission and of the Registrar of Companies to a 'reserve power only' the report's proposals would lessen the ability of individual investors to have their complaints taken seriously (Report of the Ministerial Working Group on Securities Law Reform, 1991, p.49).

The conclusion is reached that the majority view contained in the Working Group's report is biased and inappropriate for the New Zealand accounting regulatory environment in that they ignore most stakeholder groups, the benefits of regulation and informational equity considerations.

9.4 SUMMARY

It is shown in this chapter that the provision and enforcement of corporate information is influenced by several domestic institutions. The government impact has been provided directly by the Registrar of Companies. This entity is perceived by most commentators as unwilling and unable to provide a reasonable level of regulation. The Companies Act 1955 is out-of-date and unclear on many key terms, making prosecution difficult and judicial decisions have generally maintained status quo positions. The Securities Commission although seen to play the devils advocate to the NZSA behind the scenes, appears to prefer the role of adviser than of enforcer. The New Zealand Stock Exchange has provided important backing to the SSAPs via the listing requirements, but also appears unwilling to stringently enforce their own rules.

The lack of enforcement by the government, Securities Commission, NZSE and the NZSA renders regulation in a state which is little more than voluntary in nature. Weakly enforced regulation coupled with corporate manager's tendency to provide a minimal level of information creates a 'market failure' scenario wherein the public is provided with a sub-optimal level of information.

External pressures are currently being brought to bear on the government and NZSA to modify the current provisions of information and regulation. Publicised non-compliance of accounting standards, the 1987 sharemarket crash and ongoing company failures have all increased the likelihood of change. The Ministerial Reviews and three more recent initiatives discussed above each deal with part of the problem. However, the solutions offered to date appear inadequate. The proposed new Companies Act, although welcomed for its clarity and updated nature, provides

inadequate protection for the populace. This draft Act places the burden of enforcement on the stakeholder groups and maintains the powerful, largely unfettered position of the companies. The Securities Commission offers many useful suggestions but places an undue emphasis on internally generated rules. Both Russell Committee reports offer a better alternative by providing for supervision of the sharemarket and more emphasis on compliance. The Tripartite Agreement has flaws in the proposed regulatory arrangements, the secret NZSA concepts statement conflicts with due process procedures, and the Working Group's report ignores most stakeholders and lacks effective enforcement procedures.

CHAPTER TEN: OVERSEAS INFLUENCES ON NEW ZEALAND ACCOUNTING

10.1 INTRODUCTION

This chapter considers important overseas influences on the New Zealand standard setting process, in addition to the British linkage discussed in earlier chapters. The impact of multinationals (both domestic and overseas) on New Zealand business and accounting environment is explored. A critique is presented of the international harmonisation movement at the global level and through governmental and private initiatives. Finally, the potential impact of the rising trend of regional economic clusters is examined by focusing on the CER agreement between New Zealand and Australia.

The important linkage of Anglo-American bodies with the NZSA is highlighted in Table 2.1. This association is consistent with Graham's (1960, p.96) and Zeff's (1979, p.76) conclusion that the greatest single impact on New Zealand accounting was British practice. Beside Britain, other Anglo-American accounting standard setting bodies, United Nations (UN), Organisation of Economic Co-operation and Development (OECD), International Federation of Accountants (IFAC) and the International Accounting Standards Committee (IASC) all appear to be potential overseas influencers (Bloom & Nacri, 1989, p.86; Carrington, 1986, p.284; Porter, 1991a, pp.5,11; Zeff, 1979, chap. 7).

10.2 IMPACT OF MULTINATIONALS

Two types of multinational companies (MNCs) have the potential to impact the New Zealand external reporting environment. The first influence is the overseas MNCs via their contemporary reporting practices. The second impact is the pressures emanating from large New Zealand-based MNCs for changes in accounting regulation.

From early in New Zealand's colonial beginnings the impact of overseas companies could be felt. For instance, in the late 1800s and early 1900s British companies operating in New Zealand exerted immense influence upon New Zealand accounting systems (Zeff, 1979, p.78). As business transactions became more complex and nations generated their own accounting rules, conflicts arose. Multinationals are caught between the host-country's desire for more information and home-government

reporting requirements (Lees, 1980, p.17). Gray (1981, p.24) notes the perception of some users and governmental organisations such as the UN, OECD and EC that market forces cannot be relied upon to ensure sufficient comparable information about multinationals. Accounting regulation is offered as a remedy (Cooper & Keim, 1983, p.191). Belkaoui (1985, p.19) observes three accounting regulatory options for multinationals: self regulation, political/governmental rules and professional regulation. As discussed below, the first option is found inadequate whilst interesting proposals are emerging with the other two possibilities.

So how well have the multinationals coped with these disparate pressures? Gray, Shaw & McSweeney (1981, p.131) opine that there is an arguable case for accounting standards directed at multinationals imposed at the supranational level, in the situations where MNCs are unwilling to meet the demands of the host country. Stilling, Norton & Hopkins (1984, p.19) survey a sample of international companies and conclude that only 12.6% comply with all the international accounting standards. Tonkin (1989, p.11) finds improvements between 1980 and 1988 in MNCs reporting on issues such as: the use of consolidated accounts, disclosure of accounting policies and use of a cash/funds flow statement while deterioration of reporting practices are observed in timeliness, price-level revelations and pension accounting disclosure. Tonkin (1989, p.49) ranks New Zealand accounting 11th¹ out of 28 countries surveyed, behind all the other Anglo-American countries.

Conflicts seem to remain between preparer's amenability to disclose information and the desire by governments and stakeholders for corporate data (Section 4.3.1). An important concern is the unwillingness of companies to divulge social accounting information (Gray et al., 1987, p.200). For example, Roberts (1988a, p.403, 1988c, p.422) detects very little improvement in MNCs reporting for employees and future prospects from 1980 to 1988 and minimal disclosure of environmental issues (1988b, p.475).

New Zealand companies also face the problem of the lack of internationally harmonised accounting standards (Porter, 1991a, p.4). With its small domestic population, New Zealand historically maintains a large export orientation. For instance in 1987, total exports represented 20.1% of Gross Domestic Product (OECD, 1989, p.140). In 1960, Britain received 60% of New Zealand's exports (Burt, 1979, p.5), but Australia, America and Japan all have now surpassed Britain as a trading

1. It should be noted that their study only includes two New Zealand companies, hence the results should not be overly-generalised.

partner (see Appendix K). Large New Zealand companies with a traditionally large export orientation are faced with at least two sets of accounting standards. One relates to domestic reporting issues and the other is the reporting of accounting information of business activities outside the domestic environment (Samuel & Piper, 1985, p.121). Frustrations can arise with conflicting requirements. For example, the 1988 annual reports of Chase Corporation and Brierley Investments express discontentment with New Zealand accounting standards in relation to equivalent overseas promulgations.

Two primary pressures are providing important credence and impetus towards local support of international harmonisation of accounting standards. First, is the potential conflict of differing accounting rules faced by New Zealand-based MNCs in overseas jurisdictions and by overseas MNCs operating in New Zealand (Edgar, 1976, p.346; Porter, 1991a, p.11).. Second, is the desire of the NZSA to be a part of the international accounting community (see for example NZSA, 1979a, para. 5.1).

10.3 INTERNATIONAL HARMONISATION

For nearly two decades, harmonisation has been the 'buzz word' in international accounting, particularly in discussions focussing on the accounting practices and standards of different countries. The establishment of the IASC is a private sector response to the clamour for an international standard setting process. The IASC works closely with IFAC. In addition, other organisations such as the UN and the OECD are also involved in harmonising the accounting standards between countries (Choi & Mueller, 1984, chap. 11).

10.3.1 Advantages of harmonisation

The pro-harmonisation movement began in modern times with a speech in 1959 by Kraayenhof to the American Institute of Certified Public Accountants (AICPA) in San Francisco. In his speech he spoke of the need for global accounting standards and the need to eliminate diversity (1960, p.34). With the rapid growth of global economic activities during the 1970s, differences in accounting practices between countries was regarded as an impediment to international trade and business expansion (Turner, 1983, p.59). Dissimilarities in national accounting standards have the potential to distort financial information and reduce the level of communication (Choi & Bavishi, 1982, p.45) As a result, increased attention is drawn to the need to eliminate or minimise such differences and it is argued that formal action should be taken to achieve that objective (Evans et al., 1985, pp.85-86). Accordingly,

accounting guidelines from several international bodies have emerged in the last two decades (McMonnies, 1977, p.162). For many countries implementing the IASC's rules is politically more acceptable than adopting British or American standards (Baker, 1986, p.11; Jayson, 1986, p.23).

10.3.2 Impediments to harmonisation

Doost & Ligon (1986, p.41) state four obstacles to the international harmonisation movement: 1) politics, 2) nationalism, 3) differing levels of sophistication, and 4) the lack of a worldwide enforcement agency. The attempt to create a set of global accounting standards is fraught with other problems. Some writers (Fantl, 1971, p.14) feel international standards are a useless, costly repetition of national standards and questioned the need for promulgation of standards which are impossible to enforce. Others consider the issuance of international standards by a separate body yet another foolish component of the problem of standards overload (Kelley, 1982, p.13). Tower & Perera (1989, p.2) note that other authors argue that the need for the IASC may be muted in the future because of the efficiency of the financial markets; arguing that the market place will demand and receive the amount of financial information they desire, therein lessening the necessity of an international accounting entity. Perera (1985, chap. 3) points out that the uniqueness of each country's business and social environment provides an obstacle for the imposition of an international body of standards.

It is thus unclear how successful or useful supranational rules will become. They can enhance comparability and lower preparation and enforcement cost, yet they may not always be appropriate for local usage. Be that as it may, the pressure for applying such rules in the New Zealand context appears to be growing. The impetus is emanating from two main sources: governmental initiatives and supranational professional bodies.

10.4 GLOBAL INSTITUTIONS

Two types of supranational bodies have exerted influence upon the New Zealand standard setting process. The first set of institutions are organisations which are formed by governments and the second relates to groupings of various private national bodies into global entities. It is important to note that both types are essentially voluntary in nature, although governments or respective professional

bodies may commit themselves to certain actions there is generally no compulsory² enforcement.

10.4.1 Governmental approaches: UN and OECD

The United Nations (UN) and the Organisation for Economic Cooperation and Development (OECD) are examples of governmental approaches with each of these entities becoming involved in the accounting standard setting process (Mueller et al., 1987, p.49). Belkaoui (1985, p.69) notes that the New Zealand government is a member of both of these organisations. However, there does not appear to offer any true backing to the accounting disclosure guidelines issued by these two entities.

In 1977, the United Nations set up the Group of Experts on International Standards of Accounting and Reporting (GEISAR) to suggest methods of improving the level of business information now made public (Evans et al., 1985, p.103). The Committee lead by the developing³ countries issued a suggested disclosure list that they felt multinationals should be required to divulge (Fitzgerald, 1981, p.23). This programme includes items such as transfer price information, production and employment statistics, and environmental impact data (Choi, 1981, p.29). Ruffing (1989, pp.71-72) and Moore (1991, p.55) state that the Group Experts continues to critique financial reporting and is beginning to examine non-financial issues such as reporting for employees and the environment. However, no enforcement mechanism has ever been utilised and in New Zealand no action has been taken to promote the UN guidelines.

The United Nations' activity in this area is indicative of an apparent frustration with the current level of corporate reporting and these disclosure requirements are seen as an attempt to garner more information regarding MNCs activity in the host countries (Mason, 1981, p.166). Daley & Mueller (1982, p.48) note that multinationals are under scrutiny for assorted disproportionate effects on the local political economy. They argue that the developed countries, where most of the multinationals are based, have resisted UN's measures citing cost-benefit constraints and unwillingness to reveal information to competitors (p.48).

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2. As discussed in Section 10.5.1, the European Community Directives are an important exception to this general rule.
 3. The author uses this common literature label for countries that have a relatively low level of economic output at the present time. This label does not imply a low level of cultural development, indeed many of the so called developing countries were the home to the early rise of civilisation (McNeil, 1979, chap. 2).

The UN tends to be dominated by developing country initiatives (Ruffing, 1989, p.71), whereas the OECD represents the world's most industrialised countries (Choi & Mueller, 1984, p.482; Moore, 1986, p.63). Perhaps as a response to the UN Committee's proposals, the OECD also issued a set of disclosure guidelines (Geiger, 1989, p.73). These information requirements are generally less expansive in nature and possibly more palatable to the multinationals (Denham, 1980, p.56). As the OECD has no enforcement powers (McDougall, 1985, p.1), they can only propose voluntary disclosure guidelines (Denham, 1980, p.56; Lanz & Rogers, 1979, p.166). No New Zealand accounting regulator appears to be advocating the OECD disclosure requirements.

Neither set of guidelines is mandatory and there appears to be no real pressure on the multinationals to disclose the sought-after information. For instance, Stilling et al. (1984, p.122) and Tonkin (1989, p.56), in surveys of international companies, note that respondents when ranking the importance of various regulatory bodies, give the lowest scores to these UN and OECD recommendations.

At this point in time, there is no evidence to suggest that the UN or OECD disclosure guidelines exert any significant influence upon the New Zealand accounting environment. The failure of the New Zealand accounting regulatory bodies to back these initiatives can be seen to be detrimental from a public accountability viewpoint. The recommended additional disclosure considerably exceeds the average corporate information revealed in New Zealand annual reports (Section 8.3.1.2). The UN's natural environment accounting requirements would seem to be especially relevant to New Zealand stakeholders' needs (see Bebbington & Gray, 1990, p.20 for an useful overview).

10.4.2 Private sector approaches: IASC and IFAC

The International Accounting Standards Committee (IASC) was formed in 1973 by the professional accountancy bodies of nine countries: America, Canada, Mexico, Britain, France, West Germany, The Netherlands, Japan and Australia (Fox & Rueschhoff, 1986, section 3-19). There are now approximately 100 member bodies. The New Zealand Society of Accountants became an associate member of the IASC in 1974.

By joining the IASC, the NZSA pledges their best endeavours (IASC, 1974) to ensure national compliance of the standards both by the companies and the auditors. This

domestic obligation to ensure compliance with international standards is undertaken in the NZSA (1979a) Explanatory Forward which states,

To discharge its obligations as a member of the International Accounting Standards Committee, the Society will implement its support of International Accounting Standards by incorporating them within the body of Statements of Standard Accounting Practice (para. 5.1).

Furthermore, explicit reference to the relevant IASC accounting standards are found in many of the New Zealand SSAPs.

A comparison of the rules from these two standard setting bodies reveals several interesting points. In general, the NZSA seems to have fulfilled their obligation with the IASC. When New Zealand has issued a new standard the tendency is that it will be very similar in form and coverage to its international equivalent. One good example is SSAP-4 (1975) Accounting for Inventories which was adopted in whole in November 1975, from IAS-2 Valuation and Presentation of Inventories in the Context of the Historical Cost System. The international version was considered a better expression of an inventory standard than was the Society's own 1967 Tentative Statement of Inventories (Zeff, 1979, p.59). Moreover, SSAP-9 (1979b) Information to be Disclosed in Company Balance Sheets and Profit and Loss Accounts draws heavily upon the IASC equivalent. Disclosure issues are especially comparable, while measurement issues exhibit more disparity, the New Zealand standards are generally tighter, allowing less flexibility in accounting options⁴. As observed above, the NZSA, as the primary domestic accounting standard setter, appears to have actively and effectively incorporated many of these international accounting positions within the SSAPs.

However, New Zealand is behind overseas bodies on several important financial accounting issues. International standards have been accused of failing to lead and serving merely to codify existing practice (Gray, 1984, p.1). This appears untrue in the New Zealand context. New Zealand standards lag significantly behind the IASC in the promulgation of standards on many important accounting topics such as: capitalisation of interest, investments, changing prices, revenue recognition, pensions accounting and pension plans. The NZSA has taken the lead only in the topics of expenditure carried forwards and investment properties. Certain other IASC rules were given a unique domestic flavour. One example was SSAP-13 (NZSA, 1981)

4. The IASC, through Exposure Draft 32, is making an attempt to reduce the number of alternatives available under its standards (for an analysis see Diamond, Gernon & Purvis, 1989, p.15).

which originally did not require the separate disclosure of costs related to research and development activities which have been expensed in the period in which they have been incurred (Robb et al., 1990, p.532). This is recently reversed and now the 1991 version of SSAP-13 conforms with the IASC standard. The stated reason for the change was the importance of domestic compliance with IASC and Anglo-American standards (Porter, 1991a, pp.26-27).

Unlike the other two supranational bodies discussed above, the IASC has played a large part in the development of New Zealand accounting standards. The present trend appears to be a movement towards conformity with IASC's promulgations. For example, two recent New Zealand proposals have been withdrawn (ED-43, Accounting for Intangibles (1988) and ED-50, Accounting for Fixed Assets (1990)), the stated reason was nonconformity with IASC rules (see Porter, 1991a, p.27),

The IASC works closely with the International Federation of Accountants (IFAC) which was established in 1977 with the broad objective of developing and enhancing a co-ordinated worldwide accounting profession with harmonised criteria (Mueller et al., 1987, p.47). These two organisations entered into a mutual commitment agreement in January 1983 (Evans et al., 1985, p.96). The IFAC appears to have influenced the NZSA on such issues as ethics, accounting education requirements and probably most importantly, the issuance of audit standards.

Another potential monitoring device is more extensive disclosure through member stock exchanges (Saudararan & Blak, 1990, p.4). The International Organization of Securities Commissions (IOSCO) is involved in an effort to reduce differences in accounting and auditing standards between countries (p.4). IOSCO urges their members to include reference to international accounting standards for their listing requirements (Ruyter, 1989, p.67). In the near future, this may well become a very important international accounting regulatory mechanism. However, this provision has not been implemented by New Zealand regulatory authorities.

10.5 REGIONAL INITIATIVES

The basic tenet of the argument for regional initiatives is that a country evolves a unique culture, and accounting is part of that unique social fabric, therefore, accounting standards which are based on different social circumstances and environmental conditions from those found in a particular country are likely to be

dysfunctional in that country (Perera, 1985, chap. 3). In view of the problems involved, Choi (1981) spoke of the paradox of global accounting standards, "Of course, the thesis of environmentally stimulated and justified differences in accounting runs directly counter to efforts at worldwide harmonization of accounting. Hence, the dilemma." (p.29).

With the recent failure of the Uruguay round of General Agreement on Tariffs and Trade (GATT) talks to achieve meaningful breakthroughs in lessening barriers to economic trade in the world, there is a marked movement towards regional and bilateral agreements (Saudargaran & Blak, 1990, p.1). Copeland & Butcher (1979, chap. 2) and Choi (1979, p.64) argue that regional groups have a greater political viability possessing a greater chance at lessening trade barriers. The usual incentive to join in a regional basis has either been for defence or trade purposes (Holmes, Harvey, Mason & Garcia, 1986, pp.23-25).

A potential regional cluster exists in the South Pacific between New Zealand and Australia. Tower & Perera (1989, p.16) examines the cultural and economic variables of both countries and concludes that the environmental conditions affecting accounting are so similar that they could be classified as an accounting sub-group or a cluster within the British model. As Choi (1981) states, "A direct implication of this clustering thesis is that harmonization efforts within clusters may be a more fruitful and feasible development strategy than attempts to harmonize accounting standards on a worldwide basis" (p.29).

Many regional groups have been formed, some of these groups are embryonic or inactive while others such as the European Community (EC) and the newly-formed Canadian-American Free Trade Agreement (FTA) are gaining world attention and prominence.

10.5.1 The European Community (EC)

As a pioneer regional organisation the EC was established by the Treaty of Rome in 1957, to promote full freedom in the movement of goods and labour between member countries (Fox & Rueschhoff, 1986, section 3-30). The EC is an association of governments grouping together with the hope of strengthening trade links. The EC currently consists of Belgium, Denmark, France, Greece, Ireland, Italy, Luxembourg, The Netherlands, Portugal, Spain, Britain and Germany. Copeland & Butcher (1979, pp.29-32) discuss the similar traits possessed by the EC member countries: all are

industrially based, wealthy with comparable standards of living, high trade links and good transport links, with similar political goals though they may have quite different domestic policy objectives.

One of the objectives of the EC has been the creation of a unified business environment, involving the harmonisation of company laws and taxation, and the creation of a community capital market (Hulle, 1986, p.122). The EC cooperation has had major accounting implications for its member countries. External accounting in Europe was originally thought so heterogeneous that harmonisation was considered necessary (Lefebvre, 1981, p.103). This was initiated via the promulgation of Directives by the member states (Most & Salter, 1990, p.1).

The major difference between the EC and the other trade agreements such as the CER and FTA is that the EC Directives possess the force of law (Choi and Mueller, 1984, p.477) in that the member countries are obligated to incorporate the directives into their own national laws (Mueller, et al., 1987, p.49). This is the only example to date, where a form of international accounting standards is broadly applicable and legally enforceable (Choi & Mueller, 1984, p.473). The willingness and future success of the EC member nations to continue to cede part of their national accounting standard authority (and abide by the final decisions) to such a supranational body may well prove crucial to eventual international harmonisation of accounting rules. At this point in time, it appears that regional initiatives offer more hope for international harmonisation of accounting standards and more comparable MNC corporate reporting data.

10.5.2 The Canada-U.S. Free Trade Agreement (FTA)

The recently ratified Free Trade Agreement (FTA) signed in 1988 between Canada and America is another important regional initiative. Saudararan & Blak (1990, p.2) feel the Agreement will greatly enhance cross border investment in that it allows a (mostly) free flow of services and trade between the two countries (see also MacCharles, 1988, p.19).

Saudararan & Blak (1990, p.2) predict important changes to Canada's accounting and auditing standards. They argue the passage of the FTA is likely to accelerate the urgency of reducing differences between the two countries accounting standards (p.3).

In some respects the implications involved here seem to be very much similar to those related to the CER agreement between Australia and New Zealand. For example, the 'smaller' partners, Canada and New Zealand, are quite understandably concerned about the implications of the respective agreements for their countries. Canada and America have cultural differences such as social welfare philosophy and nationalism (Curnew & Simyar, 1989, p.97), but they also share many similarities⁵ especially with their business environments (Buchanan, 1988, p.37; Carsberg & Eastergard, 1981, chap. 2). However, unlike the Antipodean agreement discussed below, the North American pact specifically includes services, therein allowing licensed accounting practitioners the ability to work in either country (MacCharles, 1988, p.19).

10.5.3 New Zealand/Australian relations

In the discussion above the EC member states were thought to have many similarities, likewise Canada and America seem culturally close. The environments of New Zealand and Australia also share many traits (see Appendix K). From an efficiency viewpoint, these similarities may enable a potential merger of accounting standard setting, therein reducing costs.

The historical links between New Zealand and Australia are closely intertwined mainly because of their comparable cultural backgrounds and similar geographical location. Located in the South Pacific, more than 10000 kilometres away from the rest of the comparable world community, they have both experienced geographical isolation as a key factor in their development. Each country witnessed the immigration of British settlers, Australia in 1788 and New Zealand about fifty years later. Both countries use the English language and possess similar economies based on primary industries.

New Zealand was originally a dependency of New South Wales until 1841. In the mid-nineteenth century, Australia was by far New Zealand's most important trading partner, but from the 1860s onward, trans-Tasman⁶ trade rapidly declined as both countries dealt much more directly with Britain. James (1982, p.12) observed that both countries had large efficient agricultural sectors that were competitive instead of complementary.

5. Whereas recent talks to include Mexico within this trade block may encounter problems due to the disparities between Anglo-based and Latin-based cultures.

6. The Tasman Sea is the waterway between Australia and New Zealand.

By the 1960s both New Zealand and Australia erected high trade barriers through high tariffs and import licensing restrictions (Bollard, 1987, p.38). Burt (1979, p.vii) observed that this protection inspired companies to set up in both countries when they might have otherwise manufactured in one country for both. The result was widespread duplication of production, rather than specialisation, and low levels of trade between the two countries. In August 1965, the two countries signed the New Zealand Australia Free Trade Agreement (NAFTA) (Thompson, 1987, p.1). The stated purpose of NAFTA was to liberalise trans-Tasman trade. As a result, trade relations between the two countries moved to a more formalised stage in 1965. However, NAFTA was only a restricted free trade agreement wherein tariffs on specific goods were reduced.

Huge economic shocks in the 1970s encouraged both New Zealand and Australia to reconsider their trade links. A prominent problem was the energy crisis which dramatically increased transportation costs. The inclusion of Britain into the EC in 1973 is also a major matter as it created market access problems for both countries into their historically largest agricultural export market (Burt, 1979, p.12). Each country finds discrimination against their agricultural exports, in which production they are efficient. Australia and New Zealand historically grew products desired by the British consumer. The agricultural sectors were protected by high farm subsidies and were given little incentive to innovate or look for other markets. Therefore, the huge Asian market which was growing more prosperous was largely ignored.

There was increasing recognition on both sides of the Tasman that a totally new approach to trade was needed (Holmes et al., 1986, p.3). As a result, the two countries decided to sign a new agreement, the Australia New Zealand Closer Economic Relation Trade Agreement (more popularly known as CER) in 1983. Previously trade agreements only provided for the elimination of duties on certain goods; CER provides for the phased removal of duty rates and the liberalisation of all remaining quantitative restrictions on trans-Tasman trade by 1992. An important feature has been the inclusion of a greater element of compulsion than was used in the past by the inclusion of automatic steps.

Trade figures indicate that exports from both New Zealand and Australia across the Tasman have increased at an annual average rate of around 15% since the CER agreement commenced, compared with approximately 5% during the preceding four years (Vautier, Farmer, & Baxt, 1990, p.iv). The agreement also provides for the establishment of a programme to examine areas of business law that will need

harmonisation (see Vautier, Farmer, & Baxt (1990) for a good overview). Holmes et al. (1986, p.23) describes the goal of CER as an opportunity to draw the Australian and New Zealand economies closer together.

CER is a concept of economic regionalism, and it is premised on expanded trade and investment flows. These flows, in turn, necessitate that the products of the accounting process cross national boundaries. Joint ventures between the two countries are expedited if financial statements prepared in one country are understandable in the context of accounting principles and standards in the other country. However, the accounting principles and standards now adopted in Australia and New Zealand are by no means uniform. For example, there is some concern in Australia about New Zealand's accounting standards because New Zealand lacks Australia's independent overseer. The establishment of a sound basis of financial communication appears crucial to provide the financial infrastructure necessary to achieve the ultimate objectives of CER. This trade agreement has provided an important impetus to harmonise business law and accounting practices (see Saudagaran & Blak (1990) for a similar viewpoint on the North American initiative).

Not only are there important similarities between the two economies (see Appendix K) but there appears to be a remarkable resemblance between the cultural orientations of Australia and New Zealand. Hofstede (1983) carried out a research study to identify a set of work-related societal value dimensions which determine the value orientation of a country. He finds Australia and New Zealand are very similar in almost all dimensions: Strong versus Weak Uncertainty Avoidance, Individualism versus Collectivism and Masculinity versus Femininity. However, in terms of Large versus Small Power Distance, Australia is ranked relatively higher than New Zealand. It is demonstrated that these factors are likely to influence various aspects of accounting practice in a particular country (Perera & Mathews, 1989). Therefore, the cultural factors which are most likely to influence accounting appear to be in favour of harmonisation of accounting between the two countries. At least, they are not likely to pose any major obstacle in this regard. This is important because the cultural differences between countries seem to be a major problem facing the IASC in its efforts aimed at global harmonisation of accounting standards.

To promote CER, there is a need for compatible business laws of which accounting provisions are a significant component ("Trans-Tasman talks", 1991, p.51). The historical evolution of accounting standards both in New Zealand and Australia stem from 'Mother' England (Zeff, 1979, p.28). The main difference between the

accountancy professions of the two countries lies within the structure of the standard setting process. The new Australian Accounting Standards Board (AASB) (and old Accounting Standards Review Board (ASRB)) has force-of-law status for approved standards whilst New Zealand still relies primarily upon self-regulation. However, the approaches of the two countries to standard setting appear to be more compatible with the recent New Zealand initiatives for an Accounting Review Board and some type of governmental backing (see for example, Report of the Sharemarket Inquiry Unit, 1989, p.17; Securities Commission, 1990, p.50, Business Law Reform: Financial Reporting in New Zealand, 1991, p.1). Both countries have pledged support for international harmonisation initiatives. It is considered that Australia offers much greater enforcement opportunities, as presently structured, through their stronger enforcement mechanisms.

Rahman, Perera & Tower (1991, p.21) noting the similarities between accounting environments of the two countries, argue that from an efficiency viewpoint, the two standard setting bodies should consider merging. They also offer a mechanism through which such a merger can take place. Efficiencies could be seen in: a reduction of funding costs, increased compliance, time and energy savings, and greater comparability of financial statements (p.22). From a public accountability viewpoint there does seem to be some merit in this argument. As regional clusters gain momentum, there are large efficiency gains to be made from removing trade impediments between the two countries. However, as discussed in Chapter Two, neither standard setting system has an active consultative group and accountants still tend to dominate the process on both sides of the Tasman. In other words both regulatory systems are deemed inadequate from an equity perspective indicating an important area for improvement in the event of a merger of the two accounting standard setting mechanisms.

10.6 SUMMARY

Overseas institutions have traditionally played an important role in the New Zealand accounting standard setting process. This global influence is derived from two sources: governmental and private sector initiatives through professional accounting institutions. The evidence shows that the latter group, especially the British profession and the International Accounting Standards Committee has a prominent impact upon New Zealand accounting. The trend towards economic regional clusters is highlighted with emphasis on the CER Agreement between New Zealand and Australia. This trade agreement is providing an important impetus towards harmonisation of accounting standards between the two countries.

CHAPTER ELEVEN: APPLICATION OF THE PROPOSED MODEL

11.1 INTRODUCTION

In this chapter, the current and anticipated status of New Zealand accounting regulatory mechanisms is contrasted with the proposed Public Accountability Model of Accounting Regulation. It is proposed to evaluate how well the New Zealand standard setting process meets public accountability criterion. The discussion leads to the conclusion that the current New Zealand system is largely deficient from a public accountability perspective, although recent Ministerial Review initiatives are moving towards a more equitable and efficient system.

11.2 SUMMARY OF IMPORTANT INFLUENCES UPON NEW ZEALAND ACCOUNTING REGULATION

Accounting regulation in New Zealand has evolved through several historical stages. There have been a series of companies acts which provide a base level of regulation, weakly monitored by the Registrar of Companies (Sections 9.2.1 and 9.2.2). A low level of securities prescription was put in place in the late 1970s, but again enforcement is shown to be inadequate (Section 9.2.4).

The primary form of accounting regulation in New Zealand is generated by the NZSA through the issuance of SSAPs. Several phases are witnessed in this accounting standard setting system. First, reliance was placed upon professional judgement, this policy evolved into a guidance stage, and finally to the present system of (supposedly) mandatory standards.

In examining the evidence as to the development of New Zealand accounting regulatory mechanisms the prominent role of the NZSA, preparers and overseas bodies is highlighted with the government and stock exchange shown to exert some influence, but domestic stakeholder groups are found to have little clout (Chapters Six-Ten). It is argued that the accounting standard setting process is an amalgamation of dynamic interchanges between global, regional, domestic and internal influences (see Figure 11.1).

FIGURE 11.1 AN OVERVIEW OF IMPORTANT INFLUENCES UPON NEW ZEALAND ACCOUNTING REGULATION

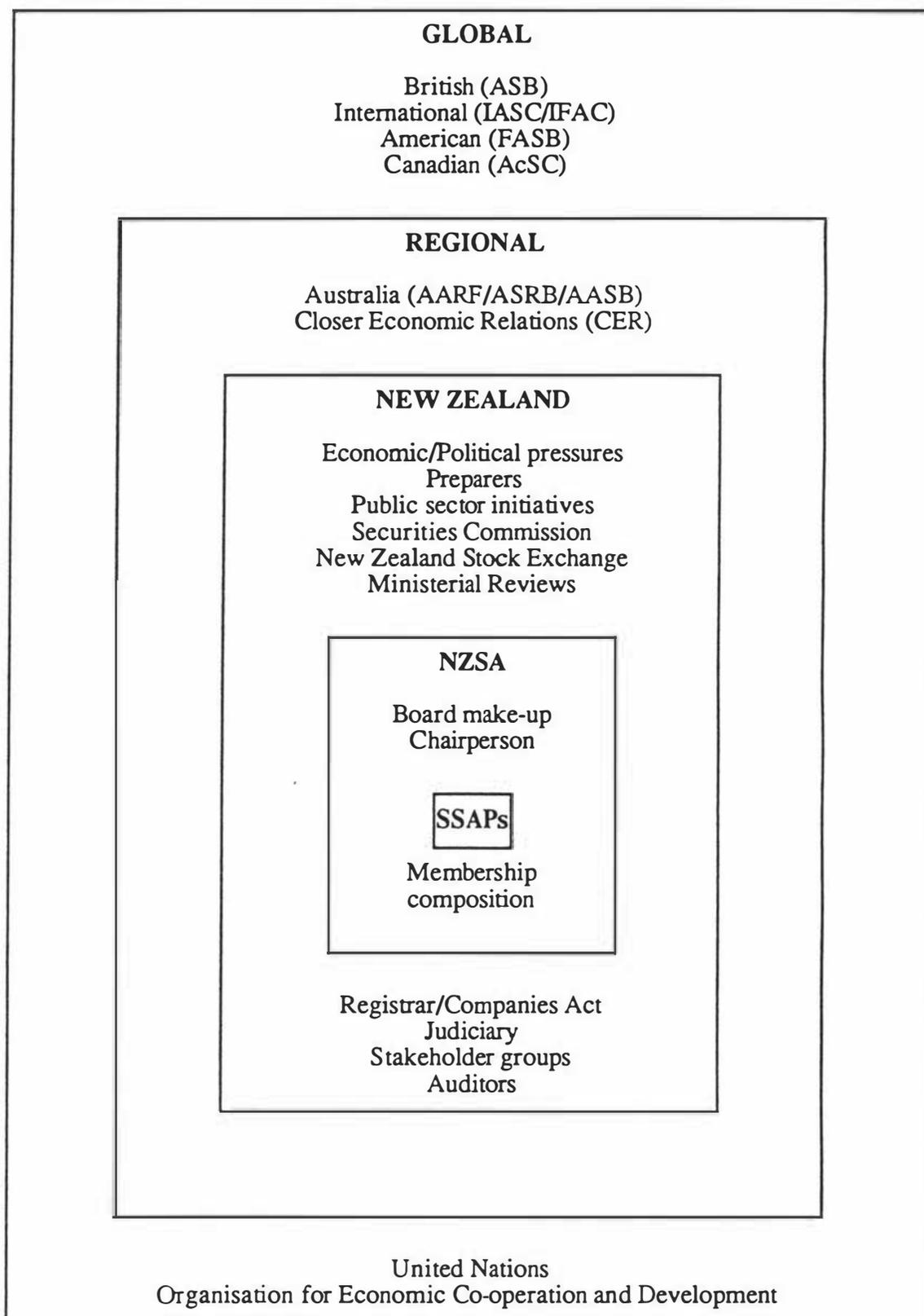


Figure 11.1 outlines the institutions showing important influences upon the New Zealand standard setting process. The analysis leads to the conclusion that the single most important source of power within the New Zealand accounting standard setting process is the NZSA. They create, approve and enforce accounting rules (Chapter Seven). Preparers also have an important influence because of their role as primary communicator via the corporate report and their apparent unwillingness to voluntarily disclose information necessary from a public accountability perspective (Section 8.3.1). Overseas bodies play an important part, especially the IASC and the Anglo-American bodies (Section 10.6). Initiatives by these entities are often mimicked in New Zealand.

Domestic government segments such as the Registrar of Companies and company law could potentially serve as important instruments of accountability. However, the analysis reveals important impediments such as: out-dated structures, low funding levels, and lack of enforcement (Section 9.2). The Securities Commission influences the NZSA on many issues, but as currently structured, does not serve as an enforcement vehicle (Section 9.2.4). The NZSE, through its listing requirements, has increased the status of the NZSA's SSAPs. However, a monitoring body for the capital markets is missing (Section 9.2.5). Other stakeholder groups appear to have little influence upon the New Zealand accounting standard setting process (Section 8.3.2).

11.3 PUBLIC ACCOUNTABILITY MODEL OF ACCOUNTING REGULATION

A Public Accountability Model of Accounting Regulation is offered in Chapter Five. The Model emphasises three main points. First, the preparer's fiduciary responsibility to render a report concerning the activities of the enterprise (Section 5.3.1). Second, the importance of striving to achieve public accountability objectives which seek the provision of sufficient quantitative and qualitative information to meet stakeholder needs (Section 5.3.2). Third, the role of accounting regulation as an instrument to pursue public accountability tenets (Section 5.3.3). Each of these components are analysed and contrasted to the current system of accounting standard setting in New Zealand.

11.4 THE NEW ZEALAND ACCOUNTING STANDARD SETTING ENVIRONMENT AND THE PROPOSED PUBLIC ACCOUNTABILITY MODEL OF ACCOUNTING REGULATION

The current and anticipated accounting standard setting systems are evaluated against the proposed Model with corporate public issuers being the primary focus of the study because of their economic and societal impact (Section 1.4.2). The focus of the examination rests with the communication of adequate corporate report information from a public accountability viewpoint. Critical conclusions are drawn about the ability of current and anticipated accounting regulatory mechanisms to serve as instruments to promote such goals.

11.4.1 Production component

Under the proposed Model, public issuers have an increased responsibility to report the activities of the enterprise to stakeholders (Section 5.3.1). As shown in Table 11.1, the primary elements in the production component are timeliness, the quality of communication and cost-benefit constraints. However, as discussed in Chapters Eight and Nine, New Zealand corporate reports are not timely and do not provide an adequate level of communication. Moreover, the NZSA has not implemented the concept of differential reporting (Table 6.4).

**TABLE 11.1
OF PRODUCTION COMPONENTS OF THE MODEL**

<u>Element</u>	<u>MODEL</u>		<u>ACCOUNTING REGULATORY MECHANISMS</u>	
	<u>Issue</u>	<u>Resolution</u>	<u>Present</u>	<u>Anticipated</u>
Timeliness	Frequency	Bi-annual reports mandated. Consideration of quarterly reports for large entities. Movement towards on-line retrieval.	Interim reports not required. No. No.	Interim reports not required. No. No.
	Issuance	Requirement to issue within 75 days of year-end. Public access.	90 day deadline. Difficult to obtain.	90 day deadline. Under consideration.
Quality of communication	Understandability	Further research into ability of stakeholders to understand reports. Institution of education programme. Greater usage of summary reports.	Largely ignored. Largely ignored. Largely ignored.	Largely ignored. Largely ignored. Largely ignored.
	Comparability	Statement of Objectives. Disclose effects of all material changes of operations. Disclosure of financial effect of changes in accounting policies.	Only for public sector bodies. Inadequate disclosure despite SSAP-1. Inadequate disclosure despite SSAP-1.	Only for public sector bodies. No change. No change.
	Disclosure	Adequate disclosure. Implementation of special purpose reports.	Minimal disclosure. Largely ignored.	Minimal disclosure. Largely ignored.
Cost-benefit constraints	Competitive-advantage	Consideration of regulatory exemptions based on cost-benefit constraints.	Minimal consideration.	Minimal consideration.
	Differential reporting	Bifurcation of regulation based on impact to public. Acceptance of tax-based reporting in certain cases. Differential standards.	Less regulation for non-public issuers. Largely ignored. Very few exemptions.	Significantly less regulation for non-public issuers. Under consideration. More exemptions.

11.4.1.1 Timeliness

The proposed Model endorses stiffer rules on the timely distribution of corporate reports. As a minimum requirement, bi-annual reports should be publicised with future consideration of quarterly or on-line reporting. It is suggested that reports should be issued within 75 days of year end, with ready public access (Table 5.1).

Regulation, albeit inadequate, exists for many of these issues. The NZSE has a half-year (un-audited) requirement to disclose summary aggregate financial data. NZSA (1989c), in SSAP-24, Interim Financial Reporting covers interim reports but contains no mandatory requirements. Further, SSAP-24 fails to state any specific time period for interim reports and requires only aggregate financial sub-totals. Very little non-financial data is sought either in the SSAPs or the NZSE listing requirements. These requirements, from an efficiency perspective, may be plausible for non-public issuers but appear inadequate for public issuers. They are also often violated. Lont & Duncan (1989, p.7) calculated an average total lag period of over 100 days for the publication of the corporate report, with no apparent penalty. Reports are at present filed with the Registrar of Companies, but are located only in the district of origination and the government does not maintain a national data-base. Thus, under the present system, corporate reports are untimely and difficult to obtain (Section 8.3.1.1). Much more expediency and availability is demanded under the Model.

11.4.1.2 Quality of communication

Quality of communication is considered an essential part of public accountability. Understandability, comparability and disclosure are the main elements of this part of the Model. Regulation is required when preparers fail to provide adequate corporate report information (Section 4.3.1).

The extent to which stakeholders are able to understand corporate reports is not well known, hence further research into this important area is necessary. Greater use of summary reports and educational programmes should be explored. More use of special purpose reports could provide better information for specific stakeholder classes (Section 8.3.2.4).

Comparability is enhanced with proper disclosure of material changes of accounting policies as well as communication of the monetary and societal impact of any adjustments. A mandated Statement of Objectives would greatly bolster the ability of stakeholders to understand corporate goals and evaluate actions in relation to those goals (Section 8.3.4).

In New Zealand, the present level of disclosure, understandability, and comparability is found to be less than satisfactory (Section 8.3.1.2). The Tower & Bauer (1991) and Healy studies (1977) note the low level of readability of corporate reports. Mak (1990) discusses the large disparity between prospectus forecasted profit and actual profit. Chang et al. (1983) and McNally et al. (1982) highlight the disparity between preparer presentation and domestic stakeholder needs.

The Model also emphasises the need for an extensive educational campaign. Some educational programmes do exist, for instance the NZSA Continuing Education Series has over the last few decades published 354 papers as of May 1991 (see for example Porter, 1991a). An educational campaign for investors and potential investors in the stock exchange is suggested by the Report of the Sharemarket Inquiry Establishment Unit (1989, pp.30-31). There is, however, no proposals for broad educational programmes for other stakeholder groups (Section 8.3.2).

In New Zealand, it is mandatory for public sector entities to prepare a mandated Statement of Objectives (NZSA, 1987c, para. 3.3), but no such rule exists in the private sector. In the private sector a similar requirement for a Statement of Objective would provide useful information for stakeholders, enable judgements to be made about the achievement and validity of corporate goals, and would enhance the stakeholders ability to evaluate corporate activities (Section 8.3.4).

The present level of communication is shown to be inadequate (Section 8.3.1.2). Quantitative disclosure of corporate data is required by SSAP-1 (1983) Statement of Accounting Policies and the Companies Act 1955's Eighth Schedule. However, the former is hampered by corporate unwillingness to disclose the financial effect of changes and the latter is absent in the Companies Bill (1990). The qualitative communication level would be enhanced by periodic quality assessment of reports and accounting standards. Much greater disclosure is foreseen in the proposed Model through use of accounting regulation as an instrument of enforcement (Section 5.3.3).

11.4.1.3 Cost-benefit constraints

The Model views explicit cost-benefit analysis essential as determined by a broader societal perspective. Efficiency gains can be made by granting regulatory exemptions. Regulation can be reduced via differential reporting where the cost of compliance is seen to exceed any potential benefit (Section 5.3.3).

It is observed in Table 6.4 that two-thirds of all the NZSA SSAPs are deemed applicable to all external financial statements and most of the remaining standards also have wide coverage. This breadth of coverage is being examined by the NZSA as part of a differential reporting overview (Porter, 1991a, p.87). The current Ministerial Reviews starkly propose differential reporting with a higher level of regulation for public issuers and very little regulation for non-public issuers. They recommend that accounting standards for this former group be granted government backing when vetted by an independent body (Section 9.3). These views are somewhat consistent with the Model. However, non-public issuers may have too little regulation under the blueprint offered in the Ministerial Reviews. The Eighth Schedule will be abolished under the Companies Bill (1990) and only the ambiguous true and fair view reporting requirements will apply for these smaller entities. This path can be seen to be cost-efficient to the extent that non-public issuers only impact their owners. To the degree that these smaller entities impact stakeholders, the lack of regulation may be insufficient (Section 5.3.3). No New Zealand-based research has been performed to evaluate the impact of the latter, numerically large group. Further research is also needed to better evaluate the possibilities of disclosure exemptions based on commercial sensitivity arguments.

11.4.2 Public accountability component

Public accountability tenets are enhanced by an explicit examination of efficiency and equity criteria as discussed in Chapter Three. The analysis in Chapters Six-Nine reveals both an under-production of information and information asymmetry in the New Zealand environment. These flaws have led to inefficiencies and a populace with little confidence in the capital markets (Section 9.4). It is considered that the introduction of more due process elements and democratic institutions within the accounting standard arena would aid public accountability (see Table 11.2).

11.4.2.1 Efficiency criterion

Efficiency is a crucial element in the proposed Model. The successful implementation of the efficiency criterion will help ensure the dissemination of an adequate amount and type of data in a cost effective manner (Section 3.2.3).

TABLE 11.2 AN EVALUATION OF CURRENT AND ANTICIPATED ACCOUNTING REGULATORY MECHANISMS IN TERMS OF PUBLIC ACCOUNTABILITY COMPONENTS OF THE MODEL

<u>Elements</u>	<u>MODEL</u>		<u>ACCOUNTING REGULATORY MECHANISMS</u>	
	<u>Issue</u>	<u>Resolution</u>	<u>Present</u>	<u>Anticipated</u>
Efficiency	Under-production	Mandated minimum disclosure.	Minimal under Eighth Schedule.	Removal of Eighth Schedule.
	Cost-benefit	Differential reporting.	Less regulation for public issuers.	Significantly less regulation for non-public issuers.
	Funding	Adequate and broad-based.	Inadequate and narrow.	Broader based.
	Clear objectives	Evolutionary conceptual framework development.	Beginning.	Advocated.
		Mandated Statement of Objectives.	None for private sector.	None for private sector.
	Non-financial activities	Mandated minimum disclosure.	Minuscule.	Minuscule.
Equity	Stakholder needs	Board representation.	No representation.	Wider representation.
		Educational campaign.	Some activity.	More activity proposed for shareholders.
	Independence	Independent vetting agency.	None.	Proposed independent ARB.
		Review of audit role.	No, although more peer review.	No.
	Information asymmetry	Insider trading rules.	Existing.	Existing.

The current nature of corporate reporting data is considered inadequate. The unsatisfactory quality of communication makes societal judgements very difficult and is thus considered inefficient (Section 5.3.2). The public-good nature of accounting results in an under-production of information (Bell, 1988, p.10). More non-financial data is needed for an accountability framework (Gray et al., 1987, p.200). Mandated minimum disclosure of both financial and non-financial information, as advocated in the Model, can alleviate these problems. The proposed removal of the Eighth Schedule would provide a crude differential reporting basis. Greater use of differential reporting could remove burdensome regulation from small enterprises which have only minimal societal impact (Section 9.2). However, as mentioned in Section 11.4.1.3, the virtually elimination of regulation for these entities needs further study.

The public sector concepts statement (NZSA, 1987c) has no private sector equivalent, hence accounting standards seem to arise in response to specific crises (Section 6.2.2). Great reliance is still placed on the provision of a "true and fair view." It appears, however, that this concept is narrowly interpreted (Section 9.2.2). Of special concern is the unwillingness of preparers to provide non-financial information (Section 8.3.2). In Chapter Six, two implicit paradigms are detected in the SSAPs (Table 6.5), yet no constant theme or trend could be detected in these private sector rules (Section 6.4.1). It is recommended that explicitly stated objectives should be disclosed for both the standard setters (as regards objectives for reporting and the role of accounting regulation) and preparers (in regard to corporate objectives). It is suggested that an evolutionary conceptual framework programme be adopted so that the standard setters can generate regulation in a coherent and systematic manner (Section 2.4.2.1). An explicit Statement of Objectives, written by the directors, should also be contained within each corporate report, audited and evaluated in the following year.

Chang & Most (1981, p.50) finds that the New Zealand investment community placed a great deal of faith in corporate reports, yet McNally et al. (1982, p.15) reveals that many issues that were considered important by stakeholders, were not provided in corporate reports. A long-term trend of minimal voluntary disclosure is shown especially in environmental and social reporting (Section 8.3.2.4). Public awareness of resource issues is hampered by the inability and unwillingness of preparers and accountants to show such activity. Inefficiencies and costs to society can be seen to increase in the absence of such data (Section 3.2). Regulation could close such a gap (Section 4.3.1).

The Model suggests the need for adequate and broad-based funding of regulation. The Ministerial proposals do not include clear views for providing adequate and broad-based funding although the Russell Committee did recommend the Securities Commission budget be more than doubled (Section 9.2.4). To date, no such initiatives have been implemented.

11.4.2.2 Equity criterion

The equity criterion is considered a vital component of public accountability (Section 5.3.2). The Model called for explicit notice of stakeholder needs through board representation and an educational campaign. An independent vetting process is advocated as is a review of the audit role. Information asymmetry can also be reduced through the implementation of effective insider trading rules (Section 9.2.4).

The current reality is far from this ideal. Surveys by Gold & Webster (1990) and Rebmann-Huber (1990) show that stakeholder needs are generally not being considered in New Zealand. The Companies Act 1955 and Companies Bill (1990) focus almost exclusively on investors and creditors, other stakeholders (and their needs) are ignored (Section 9.2.2). There is no independent vetting agency, although important proposals for public issuers seem almost unanimous in their recommendation for such an institution (Section 9.3).

On the other hand, some notice has been taken of the equity issue. Chapter Nine shows that stakeholders perceive that New Zealand has inequitable capital markets. Information asymmetry was a influence in the massive withdrawal from the capital markets (Section 9.2.5.2). This monumental slump and poor recent corporate performance has resulted in pressures for change (Section 9.3). For instance, following the 1987 sharemarket crash, insider trading rules were implemented in 1989.

11.4.3 Regulation component

Regulation can assist in overcoming both the underproduction and uneven distribution of corporate information (Section 4.3.1). However, as shown in Chapter Two, current Anglo-American structures are inadequate. The major problems are: lack of openness in the process of creating accounting standards, absence of an independent approval body and ineffective enforcement (Section 2.4).

Using public interest theories, this thesis views accounting regulation as an instrument of public accountability (Section 4.5). Regulation can assist comparability

between financial statements and mandate sufficient information for stakeholders to make judgements about the actions of corporations (Section 4.4). To enhance public accountability the design, approval and enforcement phases of regulation must be effective (see Table 11.3).

11.4.3.1 Design phase

Accounting standards, as a form of regulation, are drawn up for a specific purpose i.e. to correct some imbalance (Section 4.2). To be effective they must be well designed (Section 4.7.1). Public accountability is enhanced in this phase by using technical expertise, adequate funding, clear explicit goals, an open lobbying process, prompt guidance on emerging issues, and careful drafting (Section 5.3.3).

As shown in Table 11.3, important recommendations are offered in the design phase. First, for an efficient use of resources the profession's expertise must be maintained in the design phase. Tapping their technical knowledge will speed up the process and add breadth since they deal with many of these issues on a daily basis. Second, greater assistance needs to be given to the NZSA to cover the cost of designing accounting standards. These costs can come from preparers, stakeholders and the government. Third, the evolutionary development of a conceptual framework would increase the likelihood of clear goals. Fourth, the agenda setting for standards needs to be opened-up, with a wide range of views solicited. This foreshadows the need to educate stakeholders on technical accounting matters and how they can express their concerns in the most constructive method. Fifth, an Emerging Issues Task Force, with wide representation, is recommended to give initial guidance for evolving transactions. This would help generate a greater level of comparability of corporate reports. Finally, the need for a clear, definitive drafting style is considered essential.

The New Zealand Society of Accountants has sought to meet its statutory duty in the realm of accounting regulation. The evidence shows a rising level of activities as their policy of re-examining standards after a five year period encompasses more and more rules (Table 6.2). Table 6.3 offers evidence of the ongoing importance the NZSA places on professional, ethical and regulatory issues. This interest has been strong and constant over the last two decades. In addition, the large amount of funding by NZSA members is documented with costs exceeding \$400,000 a year and rising on a per capita basis (Table 7.1). However, the rules created by the NZSA are ambiguous in terms of the degree of clarity of the terms used and the resulting level of permissiveness (Section 6.4.3).

<u>Phase</u>	<u>MODEL Issue</u>	<u>Resolution</u>	<u>ACCOUNTING REGULATORY MECHANISMS</u>	
			<u>Present</u>	<u>Anticipated</u>
Design	Need for technical expertise	Use profession's knowledge.	Professional expertise.	Broader range sought.
	Funding	Redirect company fees. Greater government support.	Not currently. Inadequate.	Advocated. Wider funding base.
	Need for clear objectives	Evolutionary conceptual framework development.	Beginning.	Advocated.
	Lobbying	Open agenda setting. Solicit wide range of views. Implement educational campaign.	Dominated by accountants. Not currently. Largely ignored.	Wider representation. Discussed. Largely ignored.
	Dynamic guidance	Emerging Issues Task Force. Active consultative committee with wide representation.	Currently lacking. Currently lacking.	Not pursued. Rhetoric.
Approval	Independence	Separate from design phase, removed from profession.	Not currently separated.	Advocated.
	Sufficient powers	Right to amend and revoke as well as approve standards.	No.	Advocated.
	Quality control	Evaluation of the writing style of standards. Monitor the quality of corporate reports.	Not pursued. Inadequate.	Not pursued. More controls proposed.
	Constituent support	Wide representation.	Low levels.	Greater participation.
Enforcement	Constituent support	Wide representation.	Low levels.	Greater participation.
	Enforceable regulation	Approved accounting standards given force of law status. Use of registration method.	Not legally binding. No.	Force-of-law status for approved standards. No.
	Compliance	Professional ethics. Monitoring mechanisms. Adequate funding.	Insufficient. Low level of compliance. Not currently.	Insufficient. Stronger compliance controls. Advocated.
	Remedies	Statutory remedy of defective accounts. Refusal to register. Mandatory disclosure of compliance with standards.	No effective remedies. Inadequate. Not currently.	Stronger remedies. Inadequate. Discussed.

The institutional structure for setting standards in New Zealand is flawed with the narrow due process procedures highlighted (Section 7.2.2). Outsider input is only sought late in the process with very low levels of stakeholder participation. The lack of due process is aptly demonstrated by ARSB's secretive method of developing a concepts statement (Section 9.3.4.2). Moreover, non-accountants are not on any of the NZSA standard setting boards (Table 7.3).

The Ministerial Reviews offer important changes to the design phase. Both the Russell Committee and the Securities Commission feel that outsiders should also have the right to create standards, albeit the greatest expectations remaining with the NZSA (Section 9.3). However, unlike most of the other Anglo-American standard setting systems, the NZSA does not have an Emerging Issues Task Force (Section 7.2.2.4). Although Table 6.6 documents a shrinking time lag (from exposure draft to final standard), there is still a two to three year gap from when a need is identified until the promulgation of an accounting standard (Section 6.4.2).

11.4.3.2 Approval phase

The approval phase is thought to be the time when technical accounting rules are examined by outside parties (Section 4.7.2). This vetting function acts as a check against the promulgation of rules which are not sought by society or are not properly designed in tune with community expectations (Section 3.5.2). As shown in Table 11.3, important elements of the approval phase are independence, sufficient authority, and constituent support. To promote public accountability, in an accounting regulatory system, the approval phase should be independent from the design phase (Section 5.3.3). This step in the process is the chance for the wider community to vet accounting rules (Section 4.7.2).

Under the current system, accounting standards are approved by the NZSA Council (see Figure 7.1). There is no separate monitoring body (Section 7.3). Under the Ministerial Reviews, however, an Accounting Standards Board is recommended with outside representation (Section 9.3). It is envisaged that the NZSA would maintain a large minority presence on such a board. For instance, the Tripartite Agreement advocates 40% NZSA representation (Business Law Reform: Financial Reporting in New Zealand, 1991, p.1).

It is argued that the approval phase should be removed from the profession's auspices because of the need for independence and due process (Section 4.7.2). To ensure effective use of regulation the approval board needs to have the right to amend and

revoke as well as approve standards (Section 4.7.2). Special focus should be placed on the communication content of both the accounting standards and the corporate reports. Given wider representation, constituent support will be enhanced (Section 4.7.2).

11.4.3.3 Enforcement phase

Unenforced regulations are considered a sham (Section 2.4.2). There are three main elements in the enforcement stage of the proposed Model. First, the importance of constituent support is emphasised. This may well be achieved via wider participation in the standard setting process (Section 2.4.1.2). Second, is the need for enforceable regulation (Section 4.7.3). This stage calls for accounting standards with force-of-law status, use of the registration method (i.e. delist non-complying companies), strong monitoring mechanisms, application of professional ethics and adequate regulatory funding (Section 5.3.3). Third, the need for effective remedies. This would go beyond mere disclosure of non-compliance, to include statutory remedies for defective accounts and mandatory disclosure of compliance with standards (Section 4.7.3).

The current level of enforcement of accounting regulation is deficient (Sections 7.4). Professional self-regulation provided by the NZSA is deemed inadequate (Section 7.5). Stakeholders have expressed their disapproval of the current method of enforcement (Section 8.3.2). It is noted that governmental bodies such as the Registrar of Companies (Section 9.2.1) and Securities Commission (Section 9.2.4) perform very few accounting regulatory functions. Company law is also deemed ineffective (Section 9.2.2). The Companies Act 1955 is antiquated and largely superseded by modern business practices and the judiciary has not become actively involved in accounting matters (Sections 9.2.2 and 9.2.3). The New Zealand Stock Exchange has never used its power to delist a company for failure to comply with accounting standards (Section 9.2.5.1). All these factors have contributed the low level of compliance with accounting standards (see Table 7.5).

There are at least four possible explanations for the weaknesses in the current accounting regulation. First, is the low level of preparer representation in the accounting standard setting process. Second, is the inadequate funding amounts spent on accounting regulation. Third, are the institutional barriers to effective regulation, such as lack of effective remedies, absence of a strong regulatory securities body, and the use of the disclosure versus the registration method. Fourth, is the closed-nature of the accounting standard setting process (Section 7.2.2.1).

Current proposals do go some way towards ameliorating these problems. For example, the 1991 Tripartite Agreement by the NZSA, Securities Commission and NZSE call for the power to reject financial statements not in compliance with approved accounting promulgations and the introduction of an independent Accounting Standards Board (Section 9.3.4.1). The audit function would be strengthened by having qualified reports come under immediate scrutiny (Braddell, 1991a, p.7). The Companies Bill (1990) has no effective remedies clause for companies, but stronger reforms are envisaged for public issuers (Section 9.3).

11.5 SUMMARY

In New Zealand, the current accounting regulatory system is shown to be ineffectual. The NZSA, as the primary rule-making body, has a problematic rule-making process. The standard setting process is found to be for the most part a 'closed-shop' operation with the agenda set by accountants, the rules created by accountants, the rules approved by accountants, applied by accountants and audited by accountants. Professional self-regulation alone, without legal backing and greater community acceptance, is not working. Expanded stakeholder representation along with legal backing of accounting standards would probably increase the present low level of compliance and communication.

The Model is strengthened by recent Ministerial proposals. The suggestions offered by the Russell Committee, Securities Commission and Tripartite Agreement are important steps in the right direction. Key elements in these initiatives are the explicit call for an approval mechanism outside of the NZSA, with legally backed standards and supported by increased funding (Section 9.3).

There are some remaining problem areas in carrying out a Public Accountability Model of Accounting Regulation in New Zealand. The Companies Bill (1990) emphasis on shareholder suits as the primary enforcement vehicle is ill-chosen. The removal of minimum disclosure provisions via the Eight Schedule may not be warranted. Non-financial information is still downplayed too much by all the proposals. Greater emphasis needs to be placed on the quality of communication rather than mere rote compliance.

CHAPTER TWELVE: ACCOUNTING REGULATION AS AN INSTRUMENT OF PUBLIC ACCOUNTABILITY

12.1 INTRODUCTION

In the introduction to this thesis several references are made to inadequacies in the New Zealand accounting regulatory environment (Section 1.1). Issues are raised concerning the proper role of the accounting profession in guiding company directors towards quality corporate reporting.

The aim of this research project is to suggest ways and means to improve the current state of accounting regulation and corporate reporting in New Zealand. The main objectives employed to achieve this aim are the development of a Model for accounting regulation based on accountability precepts and critique of the present accounting regulatory regime in New Zealand through a case study approach. The New Zealand Society of Accountants (NZSA), as the primary domestic accounting regulatory, is the primary focus of the project.

12.2 ISSUES IN THE NEW ZEALAND ACCOUNTING REGULATORY ENVIRONMENT

This thesis highlights the importance and privileges of corporations with the obligation to provide information about their activities to society. The primary reporting vehicle is seen to be the annual report with accounting regulation viewed as a significant quality control device. It is postulated that New Zealand accounting self-regulation fails to deliver the latter protection (Chapter One).

By way of providing a background to the discussion the Anglo-American accounting regulatory systems are critiqued and found inadequate. Special concerns are noted with the accounting standard setting due process procedures and enforcement mechanisms. Linkage of the New Zealand accounting system to the Anglo-American cluster is shown through various international classification studies (Chapter Two).

Financial accounting paradigms are analysed with a view to determining the end-purpose of corporate reporting. It is concluded that the accountability paradigm is most closely aligned with a broad societal view of accounting. The responsibility of preparers to communicate sufficient quantitative and qualitative data (both financial and non-financial in nature) to stakeholders is seen as an essential ingredient of public

accountability (Chapter Three). Regulation is offered as an instrument of public accountability as it is seen to ameliorate the under-production of accounting information and information asymmetry (Chapter Four).

A Public Accountability Model of Regulation is proposed. The Model is based on efficiency and equity criteria and the public accountability view with its emphasis on the dissemination of a broad range of information to stakeholders. The regulatory mechanism under the Model incorporates the profession's expertise, stakeholder representation, and the coercive power of the state (Chapter Five).

The New Zealand accounting regulatory structure is empirically examined as a case study, with overseas, domestic and NZSA structures analysed. It is shown that the NZSA, overseas bodies (especially the British and International Accounting Standards Committee), and preparers exert the most influence, with non-accountant stakeholders shown to have the least impact. New Zealand corporate reports are difficult to read, lack sufficient disclosure data and impart very little non-financial information. It is shown that these inadequacies are due mainly to the absence of a capital market overseer, critical lack of stakeholder input, unstated objectives and ineffective enforcement mechanisms. External crises such as the 1987 sharemarket crash, company failures and publicised lack of compliance/enforcement have generated abundant public pressure leading to several governmental reviews. These reviews offer useful suggestions but are deemed incomplete and unlikely to meet societal expectations (Chapters Six-Eleven).

The research provides insights into accounting regulation and its relationship with corporate reporting in New Zealand. It is recommended that more effective regulation be introduced to ensure greater disclosure, recognition of stakeholder needs and a higher level of non-financial data.

12.3 CONTRIBUTION OF THE RESEARCH PROJECT

It is asserted that New Zealand corporate reports contain inadequate information and do not effectively communicate (Section 8.3.1). This major problem leads to criticisms about the type and quality of accounting regulation now in place in New Zealand. However, no comprehensive study exists in the New Zealand context to analyse this matter. The evidence presented in this thesis attempts to fill this gap.

The aim of this research project is to offer suggestions for improvement with the New Zealand accounting regulatory mechanisms and corporate reporting.

In achieving this aim the research has substantially advanced the work of previous studies. The examination of Anglo-American regulatory structures goes beyond mere listing of general trends and offered a critique of the underlying structures and flaws (Section 2.4). A review of the financial accounting literature reveals several disparate paradigms on the objectives of corporate reporting. These theories are categorised and analysed based on their end-utility i.e. how each views the purpose of corporate reporting (Section 3.3). This approach seems more useful and practical than alternate classification approaches.

There exists a great deal of literature on regulation (Chapter Four). However, comprehensive studies examining the legal and accounting profession's impact upon society are rare. This study has offered such an overview. In Chapter Five, a Public Accountability Model of Accounting Regulation is evolved. Public interest theories of regulation are linked with accountability tenets to form a powerful model for the determination of corporate reporting criterion.

The Model is presented as a betterment over the current accounting regulatory arrangements in New Zealand. It blends accountability precepts and the regulation mechanism. This Model emphasises three themes: the preparer's fiduciary duty to report, public accountability criterion and the implementation of regulatory structures to safeguard stakeholder interests (Section 5.3). The public accountability perspective is an important improvement over existing models in that it is broader and more closely linked to stakeholder needs.

The Model offers suggestions in regard to the production component (Section 5.3.1). First, the timeliness of reports could be enhanced by specified time limitations. Second, the quality of corporate report communication could be improved by greater disclosure and recognition of stakeholder needs. Third, cost-benefit constraints should be examined by the introduction of differential reporting requirements (Table 5.1).

Another important contribution is the emphasis on the need for the distribution of both financial and non-financial information to stakeholders (i.e. shareholders, creditors, employees, consumer groups and the local community) with a bond of accountability. Moreover, the Model specifically encompasses the equity criterion,

an element often ignored in previous studies. In this Model, efficiency and equity goals are specifically highlighted under public accountability tenets. It is shown that stakeholders desire equitable treatment and will react poorly in its absence with a resulting loss of confidence in the capital market (Section 9.2.5.2).

Critical analysis is offered based on the three phases of accounting regulation: design, approval, and enforcement. Professional self-regulation is found inadequate to serve public accountability goals (Section 7.5). An enhanced regulatory scheme is presented consisting of the use of professional expertise, stakeholder participation to increase acceptance and provide balance, and the coercive power of the state. The proposed Model imparts efficiencies and would provide more confidence to stakeholders. Current problems of the under-production of accounting information and information asymmetry would be lessened.

In addition, an important empirical research approach is offered. This study faced the problem of generating evidence on a regulatory system which had very little public information. A combination of institutional/environmental examination, historical analysis and events studies is implemented to provide data on domestic phenomena. The analysis is more complete and detailed than previous studies. This multiple analytical approach could be useful in other studies where primary evidence sources are absent.

12.4 IDENTIFICATION OF AREAS FOR FUTURE RESEARCH

Although many issues are covered in this study there remains several important issues worthy of further research. For example, more work could be conducted into the communication process, non-financial reporting issues, cost-benefit constraints such as competitive advantage arguments and differential reporting issues, the impact of non-public issuer entities upon society, and the cross-cultural economic linkages between Australia and New Zealand and how this may impact future accounting regulation.

Traditionally, the main emphasis of company communication has been the annual report. This emphasis is well accepted and forms the primary focus for this study. Future research could explore alternative forms of communication such as employee reports, environmental impact statements, health and safety data, audit reports, prospectuses, and so forth. Moreover, the net positive advantages of accounting regulation is assumed in this thesis (Section 1.4.2). This viewpoint could be explored

in a separate research project incorporating preparer arguments such as the commercial sensitivity of certain corporate data and the need for differential reporting.

The Model advocates the need for more non-financial information. This fits in well with the broad societal perspective taken in this thesis. The Model suggests the implementation of democratic safeguards and stakeholder representation on the approval mechanism will generate a greater demand for such information. The type and extent of non-financial data to be communicated is another potentially rich area of research.

In the New Zealand business environment there is a strong likelihood that a crude regulatory bifurcation will be implemented wherein public issuers are subject to a higher level of regulation whilst non-public issuers are only held to a true and fair view criterion. These policy decisions may be defended from an efficiency viewpoint. However, this movement is based on an assumption of the minuscule impact of the 140,000 non-public issuer companies in New Zealand. No research has been conducted in New Zealand to justify such a premise. The societal impact of non-public issuer companies is worthy of further scrutiny.

Finally, more research is called for to assess the applicability of the proffered Model to Australia. It seems ever more possible that the two countries will rapidly increase their close economic ties leading potentially to some type of loose federation or political union. Consequently, the impact of CER upon accounting regulation should be further scrutinised.

12.5 CONCLUSION

The literature often discussing the importance of regulation and the need to be accountable, but seldom joins the two concepts. This important merger of these themes is accomplished in this thesis.

The viewpoint that New Zealand accounting standard setting process and regulatory structures are flawed is postulated and proven. All the Anglo-American accounting regulatory systems are critiqued and found inadequate. The problems cited include ad hoc rule-making procedures and weak regulatory arrangements. A Public Accountability Model of Accounting Regulation is evolved. The Model gives consideration of preparer's needs, efficiency and equity criteria, and effective accounting regulatory arrangements.

The Model is then applied to the New Zealand accounting regulatory environment. The failure of New Zealand companies to adequately communicate to stakeholders is demonstrated. The evidence shows that the accounting standard setting is influenced by the NZSA's narrow rule-making system, preparers, a few domestic institutions such as the Securities Commission and New Zealand Stock Exchange, regional initiatives such as CER, and global bodies such as the International Accounting Standards Committee. Other stakeholder groups have little influence. It is concluded that self-regulation is inadequate towards meeting public accountability criterion.

This study offers an important contribution to the literature in that it shows the utility of multiple research methodologies in areas where little visible evidence exists. Moreover, accountability themes and regulation theories are merged. Further, equity considerations are explicitly embraced. Finally, the advancement of the Model and related recommendations are timely given the dynamic accounting regulatory proposals at present existing in New Zealand. It is felt that the views expressed in this thesis, if incorporated, could greatly enhance corporate reporting communication and provide an efficient and equitable accounting regulatory regime.

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APPENDIX A ARROW'S (1963) IMPOSSIBILITY THEOREM

The five Arrow (1963) axioms are:

1. Unlimited Domain
2. The Pareto Postulate
3. Transitivity (consistent ordering)
4. Nondictatorship
5. Independence of Irrelevant Alternatives (the social choice between any two alternatives shall not be affected by preferences over any other alternatives).

The logic of the proof runs as follows. The unlimited domain assumption allows any possible constellation of ordinal preferences. When a unanimously-preferred alternative does not emerge, some method for choosing among the Pareto-preferred alternatives must be found. The independence assumption restricts attention to the preferences of individuals for any two issues when deciding those issues. It is difficult to yield choices between three successive choices. The transitivity postulate, however, forces a choice among the three. The social choice process is not to be left indecisive, but with the information at hand there is no method that is not imposed or dictatorial (Mueller, 1976, pp.419-420).

In other words, only collective choice which is consistent with the requirements of transitivity, universality, Pareto, and independence makes one person a dictator, therefore there is no rule which satisfies all five requirements (Feldman, 1980, p.187).

Mueller (1976, p.422), in an analysis of Arrow's theorem, concluded that from a public choice perspective, relaxation of the independence or unrestricted domain axioms appears to be the most appealing ways out of the paradox. The Arrow-type theorems imply further that to choose from among these allocations using a consistent, nondictatorial social choice rule, either restrictions must be placed on the preference domain or postulates introduced that directly allow interpersonal utility comparisons i.e. value judgements must be introduced. The equity and efficiency criteria, as advocated in this thesis, are two such value judgement.

Sources: Arrow (1963), Feldman (1980) and Mueller (1976).

APPENDIX B RAWLS' (1971) THEORY OF JUSTICE

First Principle

Each person is to have an equal right to the most extensive total system of equal basic liberties compatible with a similar system of liberty for all.

Second Principle

Social and economic inequalities are to be arranged so that they are both:

- (a) to the greatest benefit of the least advantaged, consistent with the just savings principle; and
- (b) attached to offices and positions open to all under conditions of fair equality of opportunity.

First Priority Rule (The Priority of Liberty)

The principles of justice are to be ranked in lexical order and therefore liberty can be restricted only for the sake of liberty. There are two cases:

- (a) a less extensive liberty must strengthen the total system of liberty shared by all; and
- (b) a less than equal liberty must be acceptable to those with lesser liberty.

Second Priority Rule (The Priority of Justice over Efficiency and Welfare)

The second principle of justice is lexically prior to the principle of efficiency and to that of maximizing the sum of advantages and fair opportunity is prior to the difference principle. There are two cases:

- (a) an inequality of opportunity must enhance the opportunities of those with the lesser opportunity; and
- (b) an excessive rate of saving must on balance mitigate the burden of those bearing this hardship.

General Conception

All social primary goods - liberty and opportunity, income and wealth, and the bases of self-respect - are to be distributed equally unless an unequal distribution of any or all of these goods is to the advantage of the least favoured.

Source: Rawls (1971, pp.302-303).

APPENDIX C SEMINAL ANGLO-AMERICAN STUDIES VIEWS CONCERNING THE OBJECTIVES OF CORPORATE REPORTS

The Corporate Report (ASSC, 1975) (Primary Emphasis on Accountability)

We consider the responsibility to report publicly... is separate from and broader than the legal obligation to report and arises from the custodial role played in the community by economic entities p.15).

SFAC 1 Objectives of Financial Reporting by Business Enterprises (FASB, 1978) (Decision Usefulness)

Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence" (para. 34).

Corporate Reporting: Its Future Evolution (CICA, 1980) (Primary emphasis on Accountability)

One of the primary objectives of published corporate financial reports is to provide an accounting...(p.31)

...it is in the general economic interest of the nation that public companies should recognise the broad nature of their accountability to outsiders who include many groups other than the present shareholders and holders of long-term debt instruments (p.32).

...an important objective of financial reporting is the provision of useful information to all of the potential users...(p.32).

Conceptual Framework for Financial Reporting (ASAC, 1987) (Primary emphasis on Decision Usefulness)

At the most general level, the objective of financial reporting is to provide information which is useful in making management, investment, credit and similar decisions with regard to an entity (para. 121).

The objectives of financial reporting are realized to the extent that user needs are satisfied... in evaluating how well management has discharged its stewardship responsibilities. Accountability for stewardship is broader when the entity's debt instruments or shares are traded by the public (para. 125).

Making Corporate Reports Valuable (The Institute of Chartered Accountants in Scotland, 1988) (Both Accountability and Decision Usefulness)

We start from the premise that they must provide understandable information on the stewardship of those charged with the duties of managing business entities and on the performance and standing of those entities that will enable readers to form valid judgements (para. 0.4).

**APPENDIX C SEMINAL ANGLO-AMERICAN STUDIES VIEWS
CONCERNING THE OBJECTIVES OF CORPORATE
REPORTS (cont)**

**Framework for the Preparation and Presentation of Financial Statements
(IASC, 1989) (Primary emphasis on Decision Usefulness)**

The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wider range of potential users in making economic decisions (para. 9).

Financial statements may also show the results of the stewardship of management, or the accountability of management for, the resources entrusted to it. Moreover, those users who wish to assess the stewardship of accountability of management do so in order that they may make economic decisions...(para. 11).

Guidelines for Financial Reporting Standards (Solomons, 1989) (Primary emphasis on Decision Usefulness)

The function of general purpose external financial reporting by a profit-seeking enterprise is to provide information that will be useful to a variety of users who have as interest in:

- (1) assessing the financial performance and the position of the enterprise
- (2) assessing the performance of those responsible for its management
- (3) making decision about investing in, lending or extending credit to, doing business with or being employed by the enterprise (p.9).

**SAC 2 Objective of General Purpose Financial Reporting (AARF, 1990)
(Primary emphasis on Decision Usefulness)**

General purpose financial reporting is not an end in itself, but is a means of communicating relevant and reliable information about a reporting entity to users. The objective specified in this Statement derives from the information needs of those identified as the users of general purpose financial reports (para. 11).

...efficient allocation of scarce resources will be enhanced if those who make resource allocation decisions... have the appropriate financial information on which to base their decisions. General purpose financial reporting aims to provide this information.

General purpose financial reporting also provides a mechanism to enable managements and governing bodies to discharge their accountability.... General purpose financial reporting provides a means by which this responsibility can be discharged" (para. 13-14).

APPENDIX D NEW ZEALAND STATEMENTS OF STANDARD ACCOUNTING PRACTICE (SSAPs)

- SSAP 1 Determination and disclosure of accounting policies (reissued 12/83, effective 4/84)
- SSAP 2 Replaced in 1987 by SSAP 8
- SSAP 3 Accounting for depreciation (reissued 10/84, effective 4/85)
- SSAP 4 Accounting for inventories (reissued 4/86, effective 4/86)
- SSAP 5 Accounting for events subsequent to balance date (reissued 7/85, effective 4/85)
- SSAP 6 Materiality in financial statements (reissued 7/85, effective 4/85)
- SSAP 7 Extraordinary items and prior period adjustments (reissued 10/86, effective 1/87)
- SSAP 8 Accounting for business combinations (reissued 11/90, effective 1/91)
- SSAP 9 Information to be disclosed in company balance sheets and profit and loss accounts (issued 8/78, effective 4/79)
- SSAP 10 Statement of cash flows (issued 10/87, effective 1/88)
- SSAP 11 Expenditure carried forward to future accounting periods (issued 12/79, effective 10/80)
- SSAP 12 Accounting for inter-period allocation of income tax (issued 4/80, effective 4/81)
- SSAP 13 Accounting for research and development activities (issued 8/81, effective 10/81)
- SSAP 14 Accounting for profit on construction contracts (issued 3/82, effective 4/82)
- SSAP 15 Accounting for contingencies (issued 12/82, effective 4/83)
- SSAP 16 Accounting for government grants (issued 10/84, effective 4/86)
- SSAP 17 Accounting for investment properties and properties intended for sale (issued 3/85, withdrawn 6/88, reissued 2/89, effective 4/89)
- SSAP 18 Accounting for leases and hire purchase contracts (issued 7/85, effective 4/86)
- SSAP 19 Accounting for goods and services tax (issued 6/86, effective periods ending after issue)
- SSAP 20 Accounting for shares issued under a dividend election plan (issued 6/86, effective periods after 12/85)
- SSAP 21 Accounting for the effects of changes in foreign currency exchange rates (issued 4/88, effective periods after 6/88)
- SSAP 22 Related party transactions (issued 11/88, effective 1/89)
- SSAP 23 Financial reporting for segments (issued 7/89, effective 4/90)
- SSAP 24 Interim reporting (issued 8/89, effective 10/89)
- SSAP 25 Joint ventures and partnerships (issued 6/90, 1/91)
- SSAP 26 Debt defeasance (issued 10/90, effective 4/91)
- SSAP 27 Right of set-off (issued 10/90, effective 4/91)

Source: NZSA accounting standards outstanding as of 31 March, 1991.

APPENDIX E CONTENT ANALYSIS OF NEW ZEALAND SSAPs

SSAP EF*	End-purpose objective advanced by standard
	"...influence users of the statements when making evaluations or decisions." (para. 2.2).
1	"users are assisted in making reliable evaluations or judgements ..." (para. 4.4). "Financial statements should provide users with information which may assist in making evaluations or decisions" (para. 4.8b). "The objective of disclosure in respect of accounting policies is to provide users ...to ensure...informative, reliable...not misleading ...comparability..." (para. 4.15).
2	Was withdrawn in 1987.
3	"Depreciation can ...have a significant effect in determining and presenting the financial position and results of operations of ...enterprises" (para. 4.1).
4	"Inventories ...have a significant effect in determining and presenting the financial position and results of operations of ...enterprises" (para. 4.1).
5	"...evaluation of the future prospects of that entity..." (para. 4.4). ...ability of the users to make proper assessments" (para. 5.2).
6	"A statement...is material if...it is...likely to influence the making of decisions by the users of the financial statements" (para. 3.1). "The information presented in financial statements may be used by various and often quite different classes of persons, each class having its own particular interest in the reporting entity" (para. 4.3).
7	"In order to present fairly the results from the ordinary activities of the entity..." (para. 4.6).
8	"The purpose of this statement is to define a standard method of accounting for...consolidated financial statements..." (para. 1.3).
9	"Users cannot make reliable judgements unless the information in the balance sheets and profit and loss accounts is relevant, clear and understandable" (para. 1.2). "Disclosure of additional items...is encouraged where such disclosure is considered relevant to the judgement decision to be made by users of the financial statements" (para. 1.3).
10	"The objective of a Statement of Cash Flows is to provide information ...help investors, creditors and others..." (para. 4.1). "Provision of cash flow information...ensures that users of financial statements are better informed as to liquidity and financial flexibility" (para. 4.2).
11	"This statement details the special circumstances under which expenditures incurred in one period may properly be charged in future periods" (para. 1.1).
12	No discussion as to the objective of the standard.
13	"...a programme of creative work to...contribute to the maintenance of its business and its competitive position...are therefore important for users... (para. 4.1). "...to achieve a reasonable degree of comparability..." (para. 4.2).
14	No discussion as to the objective of the standard.
15	No discussion as to the objective of the standard.
16	"The receipt of government grants by an enterprise may be significant ...for two reasons. Firstly, ...an appropriate method of accounting for the transfer must be found. Secondly ...to give an indication of the extent to which the enterprise has benefited from such assistance..." (para. 4.1).

* denotes the Explanatory Forward.

Source: Analysis of the NZSA standards outstanding as of 31 March 1991.

APPENDIX E CONTENT ANALYSIS OF NEW ZEALAND SSAPs (cont)

<u>SSAP</u>	<u>End-purpose objective advanced by standard</u>
17	"The purpose of this Statement is to provide guidance on accounting for..." (para. 4.2). "This Statement adopts the general view that in order to ensure that the information presented is relevant to users..." (para. 4.4). "Application of this accounting policy should, however, be restricted to those circumstances in which the margins can reliably be estimated" (para. 4.4).
18	"Transactions and other events ought to be accounted for and presented in accordance with their substance and financial reality and not merely with legal form" (para. 4.5). "If such lease transactions are not reflected in the lessee's balance sheet, both the available economic resources and the level of obligations are understated. It is therefore appropriate that a finance lease incurred be recorded...both as an asset and as an obligation..." (para. 4.6).
19	No discussion as to the objective of the standard.
20	No discussion as to the objective of the standard.
21	No discussion as to the objective of the standard.
22	"The purpose of this Statement is to establish criteria for the disclosure of relationships between a reporting entity and its related parties..." (para. 1.1). "The existence of the relationship may be sufficient to affect the transactions of the reporting entity with other parties" (para. 4.4).
23	"The purpose of this Statement is to set standards requiring reporting...information on...segments whenever it is significant to an understanding of those statements" (para. 1.2). "...users of financial statements need segment information to assess the prospects and risks..." (para. 4.3). "The objective of presenting information by segments is to provide users with information ...to make more informed judgements about the entity as a whole" (para. 4.3). "The information required to be reported is intended primarily to permit users of financial statements to make better assessments of the past performance and future prospects..." (para. 4.5).
24	"The principal objectives of this Statement are to provide guidance on the appropriate accounting practices for interim financial reporting and to set forth minimum disclosure requirements..." (para. 4.1). "Interim financial statements are essential to provide investors and others with relevant information as to the progress of the reporting entity" (para. 4.1).
25	No discussion as to the objective of the standard.
26	"The purpose of this Statement is to specify the circumstances in which a debt ... is to be considered extinguished ..." (para. 1.1).
27	"The purpose of this Statement is to establish the conditions under which assets and liabilities may be set-off ..." (para. 1.1).

Source: Analysis of the NZSA standards outstanding as of 31 March, 1991.

APPENDIX F.1 AMBIGUITY INDEX COMPONENTS: DETAILED LISTING: EXAMPLES OF DEFINED AND UNDEFINED TERMS

EXAMPLES OF DEFINED TERMS (relevant SSAPs in parenthesis):

Accounting policies (1), depreciation (3), inventories (4), material (6), extraordinary items (7), business combination (8), current assets (9), cash flow (10), deferred tax (12), research (13), contingency (14), government grants (16), investment property (17), lease (18), dividend election plan (20), foreign currency (21), related party (22), reportable segment (23), interim financial reports (24), joint venture (25), defeasance (26), right of set-off (27).

EXAMPLES OF UNDEFINED TERMS (relevant SSAPs in parenthesis)

True and fair (M), significant (M), rare circumstances (S), reasonable steps (S), systematic basis (S), reasonable expectation (4), systematic allocation (4), going concern (5), particular circumstances (S), appropriate (M), exceptional circumstances (S), adequate description (7), practicable (S), independent (S), substantially (8), similar (8), undistributable (S), equivalent consideration (8), reasonable certainty (M), reasonable probability (12), reasonable evidence (12), reasonable doubt (12), judgement (S), appropriate (S), special circumstances (15), probable (S), certain circumstances (16), reasonably predictable (18), reasonably certain (18), fair measurement (21), significance (21), impracticable (23), temporary aberration (23), interim period (24), nature and circumstances (24), proper understanding (25).

Note: M = many instances, S = several instances.

Source: Content analysis of NZSA accounting standards outstanding as of 31 March, 1991.

APPENDIX F.2 AMBIGUITY INDEX COMPONENTS: DETAILED LISTING: EXAMPLES OF CLEAR AND PERMISSIVE STATEMENTS

CLEAR STATEMENTS (examples):

- SSAP-1: "...it is necessary to disclose..." (para. 4.13).
- SSAP-4: "...the concept prudence requires losses to be recognised as they occur" (para. 4.3).
- SSAP-5: "...disclosure of such events is necessary..." (para. 4.4).
- SSAP-6: "Requirements...in statutes...must be considered to override considerations of materiality" (para. 4.5).
- SSAP-7: "...extraordinary items are required to be disclosed" (para. 4.6).
- SSAP-8: "... it is essential that ...statements contain up to date information..." (para. 4.9). "In no circumstances should the..." (para. 4.43). "...the consolidation process necessitates ..." (para. 4.62).
- SSAP-10: "This Statement...requires this [direct] method" (para. 4.7).
- SSAP-13: "Costs incurred to... are excluded' (para. 4.4).
- SSAP-20: "Adjusting entries will be necessary..." (para. 4.5).
- SSAP-22: "Interchanges of goods or services between related parties are considered to be related party transactions..." (para. 4.10).
- SSAP-25: "Any loss on transfer is recognised immediately" (para. 4.17).

Source: Content analysis of NZSA accounting standards outstanding as of 31 March, 1991.

APPENDIX F.2 AMBIGUITY INDEX COMPONENTS: DETAILED LISTING: EXAMPLES OF CLEAR AND PERMISSIVE STATEMENTS (cont)

PERMISSIVE STATEMENTS (examples)

- SSAP-1: "An entity should..." (para. 4.6).
- SSAP-3: "The depreciable amount should be allocated on a systematic basis..." (para. 5.1).
- SSAP-4: "A range of methods may be applied in arriving at costs ...(para. 4.17)
- SSAP-5: "Events...should be disclosed when their non-disclosure could affect ...users..." (para. 5.2).
- SSAP-7: "In exceptional circumstances...errors which are of such significance as to destroy the true and fair view...should be accounted for" (para. 4.19).
- SSAP-8: "...particulars...should be disclosed by...alternatively be reported via..." (para. 4.13).
"General guidelines...are as follows..." (para. 4.48).
- SSAP-9: "A true and fair views implies..." (para. 4.1 (a)).
- SSAP-10: "In some circumstances...it may be acceptable..." (para. 4.21).
- SSAP-11: "Expenditures which are expected with reasonable certainty...may be allocated..." (para. 4.1).
- SSAP-12: "A debit balance...should be retained...only to the extent that there is reasonable certainty of recovery..." (para. 5.4).
- SSAP-13: "...it may be appropriate to defer the cost..." (para. 4.7).
- SSAP-14: "Conversely, it may be appropriate..." (para. 3.7).
- SSAP-16: "... this method is not generally preferred..." (para. 4.10).
- SSAP-19: "...where the impact of GST is not significant to the users of the financial statements, reporting on a gross basis is permissible..." (para. 5.1).
- SSAP-20: "Where the company can estimate with reasonable certainty...then the company should..." (para. 5.2).
- SSAP-22: "...the following parties... are not necessarily regarded as related parties..." (para. 4.7).
"This Statement allows but does not requirement (sic) remeasurement" (para. 4.9).
- SSAP-23: "In some circumstances it may be appropriate..." (para. 4.35).
- SSAP-24: "The level of disclosures in interim financial statements will depend on the nature and circumstances of the reporting entity" (para. 5.2).
- SSAP-25: "...the minority interest may be aggregated with other minority interests unless separate disclosure is necessary for a proper understanding of the financial statements" (para. 5.5).
- Source: Content analysis of NZSA accounting standards outstanding as of 31 March, 1991.
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APPENDIX G NZSA ACCOUNTING STANDARD SETTING COMMITTEES' MEMBERSHIP BREAKDOWN (1970-1991)

	1991	1990	1989	1988	1987	1986	1985	1984	1983	1982	1981	1980	1979	1978	1977	1976	1975	1974	1973	1972	1971	1970
Council																						
Academics	2	1	2	2	2	1	1	1	1	1	1	1	1	1	1	0	0	0	0	0	0	0
Public Acct.	15	17	15	15	16	18	18	16	16	16	16	16	16	16	16	17	16	16	16	15	15	17
Company Acct.	4	4	2	4	5	3	2	3	4	3	3	3	3	3	3	3	3	3	3	4	4	4
Government Acct.	1	1	1	1	1	1	1	1	1	0	0	0	0	0	0	1	1	1	1	1	1	1
Other Acct.	1	1	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	24	24	24	23	24	23	22	21	22	20	20	20	20	20	20	21	20	20	20	20	20	22
Accounting Research and Standards Board (1980-1991) (ARSB)																						
Academics	1	1	1	1	1	1	2	2	2	2	2	3	5	6	6	6	5	5	5	5	5	5
Public Acct.	6	6	6	8	8	8	7	7	6	7	7	6	5	5	4	4	5	5	6	5	4	3
Company Acct.	2	2	2	1	1	2	2	2	3	3	3	3	2	1	2	2	2	2	1	1	2	2
Government Acct.	2	2	1	0	1	1	1	1	1	0	0	0	0	0	0	0	0	0	0	0	0	0
Other Acct.	1	1	2	2	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total	12	12	12	12	11	12	12	12	12	12	12	12	12	12	12	12	12	12	12	11	11	10
Financial Accounting Committee (FAC)																						
Academics	2	2	2	2	2	1	2	2	2	2	2	2										
Public Acct.	3	3	3	2	3	3	2	4	4	4	5	4										
Company Acct.	3	3	3	4	2	2	0	0	1	1	0	0										
Government Acct.	0	0	0	0	0	0	0	0	0	0	0	0										
Other Acct.	0	0	0	0	2	0	2	0	0	0	0	0										
Total	8	8	8	8	9	6	6	6	7	7	7	6										
Auditing Committee (AC)																						
Academics	2	2	2	1	1	1	1	1	0	0	0	0										
Public Acct.	6	5	5	5	4	4	5	3	6	6	5	5										
Company Acct.	0	0	0	0	0	0	0	0	0	0	0	0										
Government Acct.	1	1	1	1	1	1	0	0	1	1	1	1										
Other Acct.	0	0	0	0	0	0	0	2	0	0	0	0										
Total	9	8	8	7	6	6	6	6	7	7	6	6										
Chairperson																						
Council	P ¹	G ²	P	P	P	C ³	P	P	P	P	P	P	C	P	P	P	G	P	P	P	C	P
ARSB	P	P	P	P	P	P	P	P	P	P	P	P										
Fin Acct Comm.	P	P	P	P	P	P	P	P	P	P	P	P										
Audit Comm.	P	P	P	P	P	P	P	P	P	P	P	P										
Board of Research													P	P	P	P	P	P	P	P	P	P

Note: ¹Public Accountant, ²Government Accountant, ³Company Accountant. The Board of Research was replaced by the ARSB and committees in 1980.

Source: New Zealand Society of Accountants' annual reports (1970-1990).

APPENDIX H NEW ZEALAND SOCIETY OF ACCOUNTANTS' AUDIT STANDARDS AND GUIDELINES

Auditing Standards

<u>#</u>	<u>Topic</u>
AS 1	Integrity, Objectivity and Independence
AS 2	Confidentiality
AS 3	Skills and Competence
AS 4	Work Performed by Assistants
AS 5	Work Performed by Other Auditors and Experts
AS 6	Planning
AS 7	Accounting Systems and Internal Control
AS 8	Audit Evidence
AS 9	Documentation
AS 10	Audit Reporting

Auditing Guidelines

<u>#</u>	<u>Topic</u>
AG 1	Audit Engagement Letters
AG 2	The Audit Report
AG 3	Reporting on Increased Costs
AG 4	Quality Control Procedures
AG 5	Audit Implications of Events Occurring After Balance Date
AG 6	Using the Work of an Internal Auditor
AG 7	Analytical Review
AG 8	Other Information in Documents Containing Audited Financial Statements
AG 9	Fraud and Error
AG 10	Auditing in an EDP Environment
AG 11	Audit Sampling
AG 12	Representations by Management
AG 13	Going Concern
AG 14	Materiality and Audit Risk
AG 15	Audit of Accounting Estimates
AG 16	Special Purpose Audit Reports
AG 17	Audit Implications of Prudential Supervision
AG 18	Audit of Related Party Disclosures
AG 19	Particular Considerations in the Audit of Small Businesses
AG 20	The Examination of Prospective Financial Information
AG 21	Inherent and Control Risk Assessments and their Impact on Substantive Procedures
AG 22	First Year Audit Engagements - Opening Balances

Source: NZSA (1991a): Auditing standards and guidelines outstanding as of 31 March, 1991.

APPENDIX I NEW ZEALAND UNIVERSITIES' ACCOUNTING AND REPORTING PRACTICES (1985-1989)

NZ UNIVERSITIES ACCOUNTING & REPORTING PRACTICES 1985-89					
	1985	1986	1987	1988	1989
- STATEMENT OF OBJECTIVES					
• Statement of Objectives	0	1	2	2	2
STATEMENT OF SERVICE PERFORMANCE					
• Targets - part financial/non-financial	0	0	0	0	0
• Simplified financial statements	0	0	0	0	0
• Student numbers (total enrolments)	0	1	2	2	3
• Student numbers (total EFTS)	0	1	2	2	3
• Student numbers (by Faculty)	0	1	2	2	2
• Student:staff ratio (total)	0	0	1	1	1
• Student:staff ratios (by Faculty)	0	0	0	0	0
• Graduates (total)	0	1	2	2	3
• Graduates (by Faculty)	0	1	1	1	2
• Description of Graduates	0	0	0	1	2
• Research grants (total)	0	0	0	0	0
• Research grants (by Faculty)	0	0	0	0	0
• Publications (total)	0	0	0	0	0
• Publications (by Faculty)	0	0	0	0	0
• Other Honours received	0	0	0	0	1
• Summary of Courses offered	0	0	1	1	1
• Vice-Chancellor's Report	0	1	2	2	3
• General Review of the University	0	1	2	2	3
• General Review by Faculty	0	1	1	1	2
• Summary Facts & Figures	0	0	1	1	1
• Report of Treasurer	0	0	0	0	0
Service Performance (sub-total)	0	8	17	18	27
STATEMENT OF COST OF SERVICES					
• Operating Statement by subjective heading	7	7	7	7	7
• Accrual basis	6	7	7	7	7
• Depreciation charged	2	2	2	3	3
• Operating Statement by functional heading	0	0	0	0	2
• Operating Statement by programme heading	0	1	1	1	1
• Unit cost per student (total)	0	0	0	0	0
• Unit cost per student (by Faculty)	0	0	0	0	0
• Budget included in accounts	0	0	1	1	1
Cost of Services (sub-total)	15	17	18	19	21
STATEMENT OF CASH FLOWS					
• Funds Flow Statement (85 - 87)	8	7	7		
• Statement of Cash Flows (88 - 89)				5	6
STATEMENT OF FINANCIAL POSITION					
• Balance Sheet	7	7	7	7	7
• Separate Long term/ Crown Assets	0	0	0	0	0
• Community Assets excluded	0	0	0	0	0
• Investments	4	5	5	6	6
• Inventories (Policy disclosure)	3	5	5	5	5
• Contingencies	2	4	4	3	3
Financial Position (sub-total)	16	21	21	21	21
STATEMENT OF RESOURCES					
• Academic staff (total)	0	1	2	2	2
• Academic staff (by Faculty)	0	0	0	0	0
• Library stock (total)	6	7	7	7	7
• Endowment/gifts/prizes	5	6	5	5	5
Resources (sub-total)	11	14	14	14	14
STATEMENT OF COMMITMENTS					
• Statement of Commitments (capital proj's)	1	2	2	2	4
DISCLOSURE OF ACCOUNTING POLICIES					
• general accounting policies	6	7	7	7	7
• particular accounting policies	5	7	7	7	7
• changes in accounting policies	2	6	6	6	6
Accounting policies (sub-total)	13	20	20	20	20
Total for all items	61	90	101	101	115

APPENDIX I NZ UNIVERSITIES ACCOUNTING & REPORTING PRACTICES: 1985-1989 (cont)

NZ UNIVERSITIES ACCOUNTING & REPORTING PRACTICES 1985-89					
OTHER ITEMS -					
Bilingual	0	0	0	1	1
Words in Accounting Policies Statement					
Minimum	30	200	230	200	220
Median	300	500	450	560	530
Maximum	480	700	820	850	700
# Timeliness (months)					
Minimum	6	5	4	3	3
Median	10	10	8	13	11
Maximum	17	30	30	21	11
# Pages of non-accounting information					
Minimum	0%	0%	0%	0%	0%
Median	0%	0%	0%	0%	0%
Maximum	0%	38%	50%	58%	47%
# Total expenditure (\$m) - all universities	274	318	357	412	440
# Total largest single item (\$m)	164	176	201	223	201
# Total largest single item (%)	56%	55%	56%	54%	46%
# % of Total Expenditure in largest unanalysed item					
Minimum	40%	43%	43%	40%	13%
Median	51%	51%	52%	52%	48%
Maximum	72%	73%	73%	73%	73%
<p>* Source from the Gray & Haslam (1980) study</p> <p># Source from NZSA (1985, 1987b, 1987c)</p>					
New Zealand Universities:					
Lincoln University, Massey University, University of Auckland, University of Canterbury.			University of Otago, University of Waikato, Victoria University.		

Source: Tower et al. (1991, p.8).

APPENDIX J MINISTERIAL COMMITTEE OF INQUIRY INTO THE SHAREMARKET: CALL FOR SUBMISSIONS

On Friday, 28 October 1988, the Minister of Justice announced the establishment of a Ministerial Committee of Inquiry into the Sharemarket.

The Committee's terms of reference are:

"To review the law and practices of, and relating to, the operations of the New Zealand sharemarket and to make recommendations to ensure the maintenance of a fair and efficient market for the investment in and trading of securities of listed companies, having regard to the importance of a capital market to New Zealand's economic system.

The review is to include a consideration of appropriate supervisory structures."

The Committee's inquiry will not include current legislative proposals that relate to the sharemarket, namely the Securities Law Reform Bill (insider trading, futures trading, and disclosure of nominee shareholdings) and the Securities Commission's recent recommendations relating to the reform of company takeover law.

The Committee's inquiry will include the following areas:

1. Efficient functioning of the market - what measures ought to be implemented to ensure that sharemarket dealings are completed more efficiently.
2. Fair and open market - what measures can be taken to ensure that the market is more informed, equitable and orderly.
3. Market discipline and surveillance - what supervisory model is appropriate and what role ought there to be for the New Zealand Stock Exchange and/or a statutory body.
4. The constitution, management and membership of the market - what developments might enhance the substance, competence, liquidity and development of the market.

Submissions are encouraged to provide instances of practices and transactions that have impacted on the sharemarket's fairness and efficiency. It is stressed that the Committee's inquiry will not include criticism of individuals, companies or institutions for past events.

Submissions (7 copies) to the Committee should be sent by Tuesday, 20 December 1988 to:

The Secretary (Mrs M Thorn), Committee of Inquiry into the Sharemarket, Tribunals Division, Private Bag, Postal Centre, WELLINGTON

The Committee is to make its report to the Minister of Justice by 31 March 1989. While it is not proposed to conduct public hearings, the committee may wish to enter into meetings and discussions in particular instances.

Source: Ministerial Committee of Inquiry (1988) Call for submissions.

APPENDIX K STATISTICAL COMPARISON BETWEEN NEW ZEALAND AND AUSTRALIA

a. Basic facts

	UNITS	AUSTRALIA	NEW ZEALAND
Size	(1000 Sq. miles)	2,968	104
Climate		Varied	Temperate
Population	1987	16.2M	3.2M
Urban %	1980	86.3%	83.3%
GDP per capita	1987 (US \$)	11,919	10,620
Annual Growth	1983-1987	3.7%	2.1%
Employment			
Agriculture	1988	5.5%	10.3%
Industry	1988	24.3%	25.6%
Service	1988	70.2%	64.1%
Unemployment	1991	9.3%	10.1%
Consumer Price Index	1991	3.4%	2.8%
Export % of GDP	1987	13.6%	20.1%
Import % of GDP	1987	13.9%	20.2%
Government			
Type		2 House Parliament	1 House Parliament
Party in Power	1991	Labour	National

APPENDIX K STATISTICAL COMPARISON BETWEEN NEW ZEALAND AND AUSTRALIA (cont)

b. Trade statistics

Australia as a trading partner for NZ

	1966	1976	1986
IMPORTS	18.5%	19.0%	16.5%
EXPORTS	4.7%	12.2%	17.1%

NZ as a trading partner for Australia

	1966	1976	1986
IMPORTS	1.6%	3.0%	4.2%
EXPORTS	6.3%	4.7%	4.6%

Major destinations of New Zealand exports

	1966	1976	1986
Britain	44.6%	20.1%	8.9%
America	14.1%	12.1%	15.6%
Japan	7.5%	13.9%	14.5%
France	5.3%	3.0%	n.a.
Australia	4.3%	12.1%	17.3%

Major destinations of Australia exports and imports

	EXPORTS		IMPORTS	
	1977	1987	1977	1987
Japan	33.2%	25.4%	19.5%	19.8%
Far East	16.9%	23.6%	12.5%	17.4%
N. America	11.5%	13.0%	23.4%	23.9%
New Zealand	5.0%	5.6%	3.2%	4.1%
Britain	4.1%	4.4%	11.5%	7.2%

Note: n.a. denotes not available.

Source: Adapted from Tower & Perera (1989, Appendix D).