

**The Role of Expectancy Theory and Observed
Constituency Response Levels to Exposure Drafts
in Accounting Standard-Setting in New Zealand**

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Abstract:

A brief history of studies of standard setting and constituency lobbying is summarised, and a description of standard setting in New Zealand is provided. Historically, levels of responses to exposure drafts in New Zealand indicate there is no clear existing body of theory to clarify the factors contributing to the pattern in responses to exposure drafts in the last twenty years. The historic longitudinal data from New Zealand exposure drafts exhibited a pattern which could be described as consistently low with two major fluctuations. An alternative approach (expectancy theory) is explored. It is proposed that the response level in New Zealand was generally low over time because there is not a sufficient belief by stakeholders that the Board will change the resulting standard sufficiently to ensure making a submission is cost-benefit efficient. It is suggested that the fluctuations represent periods when there were changes in expectancy by participants of their potential influence on due process.

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1. INTRODUCTION

Accounting research literature in the last two decades is replete with studies examining the accounting standard setting process in the United States and elsewhere (Gibson, 1980; Brown, 1981, MacArthur, 1988, Mezas & Chung. 1989; Tandy & Wilburn, 1992; Kenny & Larson, 1995). Yet one aspect of this process, the diversity of factors which determine the participation levels of standard-setters constituencies, is not well understood. This aspect is the focus of the present study.

From studies in the United States in particular it is apparent that although the topic generates regular research attention, there remains an absence of consensus on the most useful theoretical approach under which such research should be undertaken. In addition to this diversity of approach, studies tend to focus on the constituency of only one Board, or only one promulgation and responses to it.

In contrast to the existing literature, the following examination of accounting standard setting and due process in New Zealand focuses on changes in the standard-setting structures, examines constituency response over two decades of institutional change, and changing expectations by constituents within accounting standard-setting.

This dynamic of institutional change is important because the degree to which there have been changes in the structures for standard setting varies considerably between jurisdictions. The mechanisms for standard setting which evolved and adapted from the establishment of the FASB in 1973 were not paralleled by a similar equilibrium elsewhere in the United Kingdom, Australia, or New Zealand. Such

institutional changes have repercussions on the effective operation of due process in these different jurisdictions.

A study of these factors in New Zealand in particular is valuable because of the substantive changes in the structure of standard-setting in New Zealand since 1992. A major finding of this research is that the historic changes in standard-setting boards appears to impact on participation in due process. If accounting professionals gain a better understanding of what motivates constituency responses, they may be able to achieve more involvement by diverse members of the constituency, which may in turn lead to greater acceptance and effective application of accounting standards. In New Zealand in particular this would necessitate the two standard setting Boards to be more responsive to the input received in submissions on exposure drafts. In the situation now faced by those wishing to lobby on accounting standards, the move to IFRSs will, undoubtedly, result in even less participation on a one-on-one basis. In a recent review of the decision to adopt IFRS in New Zealand provided by Bradbury and van Zijl (2006), they describe how this decision triggered the issue of which entities have to report, changes in due process and the subsequent decisions on implementation of the adoption. As they note:

“New Zealand’s financial reporting constituency can participate in the IASB’s due process (a more extensive process than has existed in New Zealand) and also be directly represented by the New Zealand standard setter in the IASB’s research and standards development processes. However, this advantage is likely to dissipate over time as larger countries increase their capacity in standard setting and funding for standard setters in New Zealand comes under increasing pressure” Bradbury and van Zijl (2006).

New Zealand preparers and users are now in a position where it is overly optimistic to anticipate more participation in due process than in the past. This means identifying changing expectations by constituents within accounting standard-setting will be more difficult in the future, which is the objective of this study. The structure of the remainder of this paper is as follows:

- A review of major studies of due process and response levels is provided in the next section;
- Section 3 describes the history of standard-setting in New Zealand and factors leading to recent institutional changes;
- In Section 4 Vroom's Expectancy Theory is described, and implications explored;
- The recent historic response levels in New Zealand are described and possible explanations of the varying levels of responses are the topics in Section 5; and
- This paper concludes in Section 6 with a consideration of the implications of expectancy theory, and suggested further directions for study in this area of accounting research.

2. REVIEW OF STUDIES OF DUE PROCESS AND RESPONSE LEVELS

Past research into due process and submissions to standard-setting boards indicates that research in this area has evolved from studies of responses to particular exposure drafts to cross-sectorial or longitudinal studies; partly this occurred as a larger body of

systematic data became available. The variety of approaches in studies of due process can be clustered into three groups:

1. General studies of the levels of responses to exposure drafts by various standard-setting bodies;
2. The responses of a particular sector (e.g. the corporate sector or the academic sector); and
3. Responses to a particular topic addressed in one or more exposure drafts.

Restricting this literature only to studies that examined the levels of responses to exposure drafts, the results are summarised in Table 1 as follows:

[Table 1 in here]

Subsequent to a review of this research, it appears that a detailed examination of the content of submissions and of the subsequent standard does not give many researchers confidence to relate the changes or withdrawal of the exposure draft to submission content. This suggests there still remains considerable scope for further investigation to establish whether or not there are tenable hypotheses concerning the relationship between the level of responses, incentives for responding, the content of submissions, and the outcome of due process, in research on the effectiveness of institutionalised due process.

In addition to studies summarised in Table 1 there have been various reviews of the standard setting boards to examine criticisms of lack of responsiveness by the Boards. In the United States responsiveness by the Board is considered to be an important determinant of constituency satisfaction with the standard setting

institutions, and is repeatedly surveyed in reviews of the FASB. The 1978 FASB survey of attitudes over its first five years of operation found that 43% respondents did not consider there had been any change in the responsiveness of the new Board, although further 43% thought the FASB was more responsive.

In Canada, the 1977 Adams Report (The Report of the Special Committee to Examine the Role of the Auditor) noted that from the review of the regulation of the profession, the typical rate of 50 to 100 responses (to at least 40,000 ED's which had been mailed out) led them to question "whether the benefits of this procedure could be achieved by alternative means at less cost" (1978:60). Douglas Thomas (Director of Research for the Canadian Institute) suggested in 1978 that "if thoughtful people are going to take the time to comment on exposure drafts, they must be assured that the committee is prepared to reconsider its position when new points are raised" (Thomas, 1978: 62). He considered that these comments invariably resulted in changes to the exposure draft, some of which were substantive, before the standard was promulgated; although such comments were not further substantiated with data analysis.

Furthermore, it was clear from this literature review that although some research methodologies have proposed models to enable an accurate prediction of the likelihood of lobbying as a single event activity (based on firm characteristics), few studies have examined the response patterns from any sectors longitudinally over a series of promulgations, nor through periods of institutional or structural change. Early USA studies were contemporaneous with the 1973 establishment of the FASB.

The drivers to the varying levels of responses may be other than firm characteristics, or the content of the exposure draft. The expectation by respondents of

their ability to impact on the development of the proposed standards is only rarely evaluated. The Tandy and Wilburn study was noteworthy in this aspect; participants considered that participation was deterred by low expectations of affecting FASB decisions (1996: 106).

The remainder of this paper will address issues surrounding expectancy theory and the light this may cast on this topic. It will be suggested that when there are changes in the organisational or institutional environment, then there is a parallel change in the expectation of the constituents in their ability to impact of the standard-setting processes. In order to provide evidence of the likelihood of such a dynamic driving variations in the response levels to exposure drafts, data will be presented which documents the levels of responses in New Zealand in the last 22 years. The last two decades in New Zealand provide evidence from a jurisdiction over a period when there have been a series of major institutional changes to the standard-setting body. A summary of the standard setting structures in New Zealand and the changes in them is relevant to this objective.

3. STANDARD SETTING IN NEW ZEALAND

In order to focus on variations in the levels of responses to exposure drafts in New Zealand, the following brief summary indicates the manner in which standard setting in New Zealand is organised. Events in the evolution of standard setting Boards in New Zealand do not easily fit in with the patterns of the establishment of standard setting bodies in Australia, United Kingdom or the United States (Gibson, 1980: 152).

Table 2: STANDARD SETTING AUTHORITIES IN NEW ZEALAND:

Date Established	Board	Reasons for new Board	Promulgations	Refs.
1950	Accounting	To make pronouncements and proved		Zeff, 1976

	Practice and Procedure Committee	guidance, whether based on overseas practice or specific to New Zealand, and to lobby Government committees, especially Companies Act Review		page 17 -19
1960	Board of Research and Publications	Reconstruction of previous committee as a Board to which the different committees contributed; full-time Research Officer appointed in 1973	First Statement of Accounting Practice in 1966	Zeff, 1976 Chapter 3
1980	Accounting Research and Standards Board (ARSB)	10 of the 13 members of the ARSB had to be members of the New Zealand Society of Accountants (NZSA) but had more autonomy from Council; primary function was the development of accounting standards.	Statements of Standard Accounting Practice	Millen, 1986
1992	Financial Reporting Standards Board (FRSB)	The ARSB was dissolved and replaced with two boards: the Professional Practices Board to issue auditing standards, and the FRSB to publish financial reporting standards and interpretations or technical guidance as necessary; still entirely funded by the NZSA	The first Financial Reporting Standards with mandatory status through the Companies Act were approved by the ASRB (see below) in 1994	Simpkins, 1993
1994	Accounting Standards Review Board (ASRB)	A Government-appointed and funded independent board to review and approve financial reporting standards	The ASRB has no mandate to develop standards, but considers those submitted to it	Financial Reporting Act 1993

The mechanisms for due process throughout the 1970's and 1980's under the different Boards largely paralleled processes in the United Kingdom. Initially, the Board of Research and Publications issued Tentative Statements of Accounting Practice; these were issued at least once with requests for comments; and then eventually submitted to the Council of the NZSA for approval, to become final Statements of Accounting Practice. After Tentative Statement of Accounting Practice 9 on inventory valuation, the name of these preliminary documents changed to Exposure Draft, but with no change in due process.

In 1973 the Board of Research and Publications decided that the system for developing standards should be similar to that in the United Kingdom, and ED-10 on current purchasing power proposals was the first issued under the newly reconstituted system in New Zealand.

The change in the structures in 1992 with the division of the functions of the Accounting Research and Standards Board was considered to be justified because of the new demands created from:

- proposals of the new Financial Reporting Act, from which approved standard would be deemed legally binding or mandatory for all issuers; this would necessitate reviewing and revising all existing standards; and
- merging of the standard setting for both the public and private sector prior to this change public sector requirements were promulgated by a separate committee (Simpkins, 1993).

In describing the reasons for the establishment in New Zealand of the FRSB in 1992 it was suggested that “under the previous structure, ability to adapt to changes in the standard-setting environment was limited” and there would have been difficulties in coping with the heavy load expected of the Board with the enactment of the Financial Reporting Act (1993) (Simpkins, 1993: 57). This is because it was not until 1993 that the NZSA could anticipate enforceable or mandatory standards with the passing of the Financial Reporting Act; this occurred considerably later than in the United Kingdom or United States. Prior to this date standards were binding on members only by virtue of the Code of Ethics.

In New Zealand the profession retained control over the FRSB as all members are appointed by the Council of the NZSA (now the Institute of Chartered Accountants of New Zealand). The Financial Reporting Act (1993) established the “higher” board, the Accounting Standards Review Board (ASRB), appointed and funded by the Government. The ASRB has the power to approve standards under the

Financial Reporting Act 1993, and after a 28-day tabling period in the House of Parliament the standard is mandatory. Any body may submit financial reporting standards to the ASRB for approval; however, to date all approved standards have been submitted by the FRSB. As the appointments currently made by Government include five accountants out of the seven-member Board, it is seen as strongly influenced by the profession, albeit indirectly. Generally, New Zealand standard-setting has the hallmark of regulatory capture by the profession.

4. AN APPLICATION OF EXPECTANCY THEORY

As already described, there is a range of methodologies which have been utilised in order to develop research on events and drivers surrounding due process. An alternative method for the study of due process could be derived from expectancy theory. Vromm (1964: 17–19) established two underlying principles of expectancy theory in a series of formulations similar to decision theory. If applied to this body of data concerning response levels to EDs, then the two propositions of expectancy theory suggest that responding to the request for responses to exposure drafts is a function of two factors: firstly, the perceived value of the net benefit which would be gained if a preferred change in the accounting standard occurred; and secondly, the expectation on the part of the respondent that preparing the submission will yield that net benefit. It can be stated thus:

$$X < EV = NB \times P(c) \text{ where}$$

X = benchmark net benefit from responding;

EV = expected value of the response;

NB = net benefit; and

P(c) = probability of being successful

Assuming that the costs of making a response are stable, and that an entity preparing a submission has established the cost:benefit benchmark X ; then an increase in $P(c)$ which may be anticipated at a time of institutional changes will drive up the expected value of the response, and thus the number of responses received by the Board, irrespective of the lack of material change in the net benefit for the entity (NB) either from the proposed changes to the standard, or benefit from inhibiting the proposed changes..

If applied to the New Zealand data, this would suggest that a change in the standard setting structure may alter perceptions of the likely responsiveness of the Board to those making a submission. Thus when an institutional change occurs, there would be an increase in the perceived net benefit of making a submission. This in turn would change the levels of responses to exposure drafts. The response rates in New Zealand were tested on this basis of expectancy theory, as follows.

5. RESPONSE LEVELS IN NEW ZEALAND

There have not been any published studies of the longitudinal analysis of the responses levels in New Zealand to date. Part of unpublished thesis research at Massey University (New Zealand) by Greg Tower was an examination of responses to EDs 19 – 54. This data was updated for this project by including responses to exposure drafts since ED-54. The total number of exposure drafts including conceptual framework documents and re-issued exposure drafts is 86 promulgations. Of these, the number of responses was established for all the EDs after ED-19. The level of responses is indicated in Figure 1. This excludes EDs 59 – 63 (the Conceptual Framework documents) as these were not exposure drafts of accounting standards. This graph indicates there is a consistently low level of responses (under 40 per

document) but there are two major periods of steep fluctuations. These were at the time of the higher levels of responses to exposure drafts 28 and 29 in 1982 – 83, and a cluster higher responses to exposure drafts just prior to 1992.

An examination of the higher responses to exposure drafts after the establishment of the ARSB in 1980 suggests that the expectancy of potential to influence the Board might have resulted in a higher response level for some EDs (25, 28 and 29). If this could be a cause of that increased response level, why did the response level then decline afterwards? One cause could be that the Board was not sufficiently responsive to the submissions to sustain the belief that a new Board would continue to be more responsive to respondents than the previous institution.

The second peak in New Zealand responses occurs in the period 1991 – 1993. This was a period of rapid change in the New Zealand standard setting environment, because the draft contents of the Financial Reporting Act were circulating as the Financial Reporting Bill, and it was anticipated by users that:

- accounting standards would have legal backing;
- the approval for mandatory status would be given by a second-tier body; while
- the “old” ARSB was being replaced by the FRSB in 1992.

The circulation at the end of 1992 of the draft conceptual framework documents also increased interest in the new financial reporting framework. Therefore the second peak at that stage would be consistent with this hypothesis that the fluctuations in responses are not random, but might reflect changing expectations of respondents.

There are two gaps in this analysis: firstly, there was only data from three exposure drafts before the establishment of the Accounting Research and Standards Board in 1980, so the apparent increase in levels of responses after the establishment of the ARSB is not completely balanced by data concerning responses to earlier exposure drafts. Secondly, it may have been expected that there would also be a change in the perceived net benefits of responding after the proposed establishment of the ASRB in 1994. However, the ASRB did not (and still does not) usually invite submissions from the wider constituency, but relies on submissions made to the ASRB from the FRSB in support of the proposed standards. Thus the establishment of the ASRB did not appear to impact on constituent's perception of capacity to influence the standard-setting process.

6. CONCLUSIONS AND IMPLICATIONS

The initial objective of this research was to examine the responses to exposure drafts in New Zealand, to assess whether these response levels indicate an effective operation of due process, and to hypothesise a driver to the fluctuating response levels.

Research in other jurisdictions had not established an effective means of measuring whether exposure draft responses can be proven to affect the final standard, nor had research unequivocally demonstrated that the anticipated impact of the proposals affected the response levels. Thus the incentive to respond to different exposure drafts was not clear from data available if the level of responses was driven solely by distinguishing characteristics in each document.

The two postulates of expectancy theory were described, in order to provide an approach to distinguishing between the importance of the impact of the changes and the importance of the perceived influence. It is possible that Boards attempted to increase the legitimation of their authority by persuading stakeholders that they take their views into account; however, little research by means of content analysis of submissions has lent weight to this tenet.

The longitudinal data from New Zealand exposure drafts exhibited a pattern which could be described as consistently low with two major fluctuations. These fluctuations were attributed to the possible changing expectations of respondents as to the efficacy of submissions and due process. From this examination of structures associated with the establishment of accounting standards in New Zealand, it is apparent that changes in those structures affected incentives to respond to exposure drafts to a sufficient extent to impact on the response levels.

If the real influence in exposure responses and other means of the process is from preparers, i.e. those that are being regulated by the standards, then “a process which is influenced only by those with special interest to promote is unlikely to survive”(Wyatt 1991: 114). In a similar vein Beresford suggested that “maintaining standard setting in the private sector can be accomplished only through the continued participation and support of those interested in financial reporting” (1991: 96). Due process gives an opportunity of continued participation, but when responses to exposure drafts do not have a demonstrable effect on the outcome of the standard setting process, the invitation to participate in an “emasculated” due process may provide insufficient incentive to maintain participation.

The implications of this are that:

1. the standard setting process of soliciting stakeholders input is costly for all parties: costly for the profession in New Zealand because of the costs of sending out many copies of every exposure draft and reviewing every submission; and costly for those who may consider submitting well-argued comments because of the low expectancy of an ability to impact on the subsequent decisions or output of the respective Boards;¹

2. although due process may be enshrined in legislative and judicial procedures, there is danger in the expectations by constituents that is created by the assurance of consideration of responses to draft standards. It has been observed in the past that when the due consideration of views (of those outside of the Board membership) is not seen as influencing the outcome, the structure of standard setting may be seen to be at fault, and alternative structures may be established.

3. the expectation of impact in due process is hypothesised to affect response levels more than the impact of the nature of the changes proposed.

Future research could focus on applying the quantitative methodology of expectancy theory to respondents to determine the extent to which their belief in the ability to impact on the outcome was materially different between individuals in a sample group (for example; academics or corporates). The utilisation of expectancy theory in accounting research has already been illustrated in the study by Geiger *et al* (1998) to assess student motivation.

¹ In New Zealand, standard setting is a material cost for the Institute of Chartered Accountants of New Zealand. There is only very little funding for standard setting to the Institute from other sources in the past. There has been limited specific funding to the Institute for the development of financial reporting standard projects; such as support for the business combinations project from the government supported Accounting Standards Review Board, and support for the development of a standard on financial reporting by Financial Institutions from the Reserve Bank of New Zealand. There is no commitment of financial support on a regular basis for standard setting from the Government, the Corporate Sector or the Stock Exchange.

Another methodological approach would be to use grounded theory to analyse interviews with Board members on the standard setting processes, such as the drivers behind decisions on changes between exposure drafts and final statements outside of submissions on the draft statements. If this was undertaken, it may identify whether or not public policy arguments which indicate the need for due process are supported by effective impact or influence on Board decisions; either through responses by the Board members to narrative in submission to exposure drafts, through lobbying Board members, or through mandated representation on each Board. This is also likely to change the expectancy effect for participants in the submission process. The development of improved mechanism for the solicitation of stakeholders' views and consultation in the standard setting process would be beneficial to all parties.

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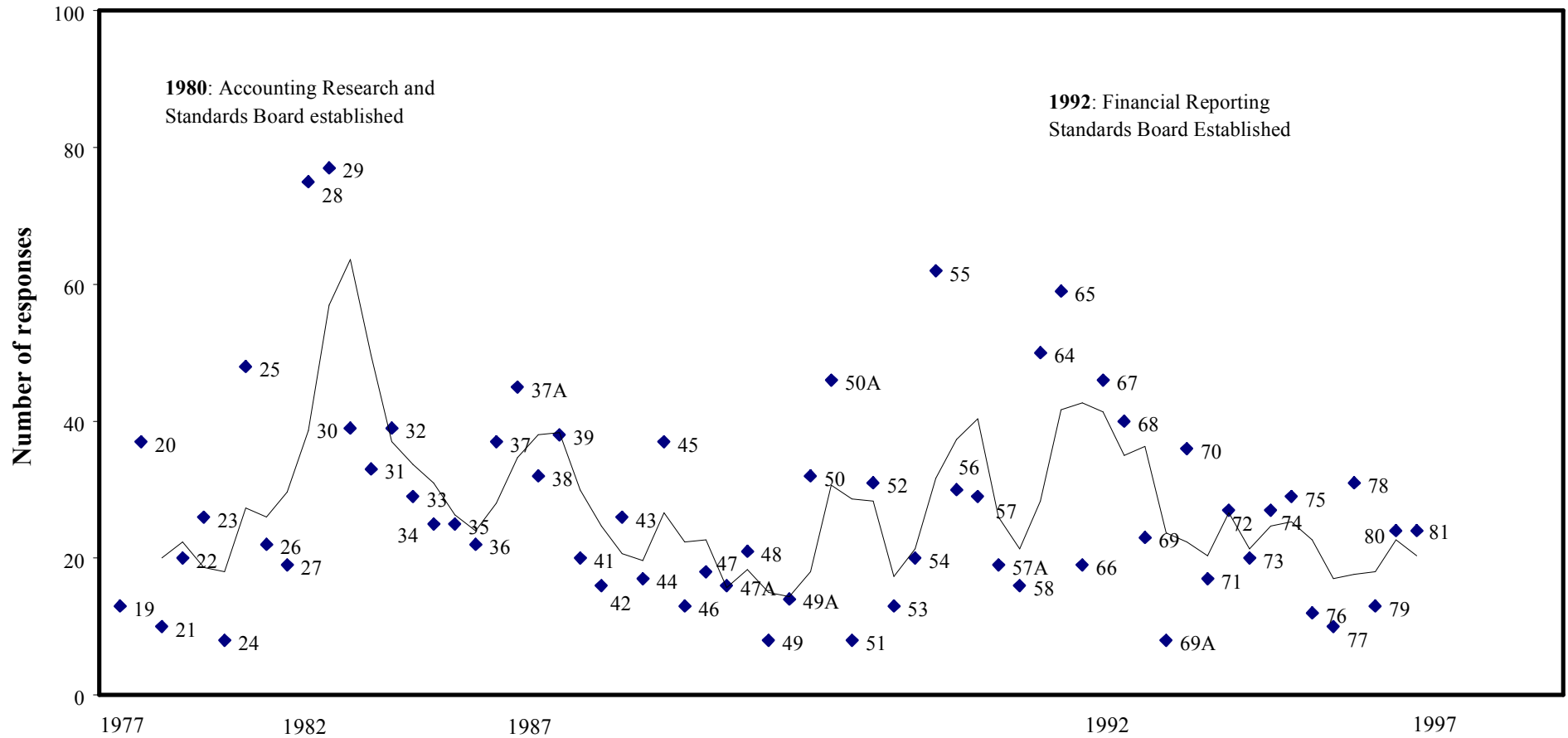
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Responses to Exposure Drafts by submission in New Zealand 1977 - 1997
 (data from 63 promulgations)



Author	Area	Period	Research	Major Finding
General Studies: Gibson, 1980	United Kingdom, USA, Australia	1973 – 1978	Comparative study of response levels in different jurisdictions.	Higher average level of responses in UK (122) and USA (155) compared with other jurisdictions.
Brown, 1981	United States	1973 – 1978	Multi-dimensional scaling analysis of respondents preferences for 51 policy questions in nine EDs to identify FASB alignment with different responder groups.	FASB takes an outlying position on issues compared with respondents; and FASB decision have not mirrored preparer or attestor preferences.
Morris, 1986	Australia	1979 – 1982	Studied submission content and firm characteristics of 54 firms lobbying on 6 EDs compared with 60 non-lobbyists.	Size and debt/asset ratio of lobbyists significantly higher than non-lobbyists. Unclear whether lobbying impacted on final standard.
MacArthur, 1988	United Kingdom	1970 – 1982	Content analysis of submissions on 28 EDs.	Potential impact of ED affected content and volume of response. Disclosure standards had lower levels of comments generally.
Mezias & Chung, 1989	United States	1973 – 1987	Analysis of comment letters on 30 SFAS's by content and sources	All constituency groups tended to oppose, rather than support, alternatives. Impact inconclusive.
Tandy & Wilburn, 1992	United States	1973 – 1988 100 FASB statements	Analysis of levels of response, constituent groups, types of standards.	Type of standard affected response level. Participation increased after EITF

				established.
Kenny & Larson, 1995	IASC	1989 – 1992 on IASC EDs 32 – 47	Categorised 745 comment letters on the basis of diversity and frequency of constituent participation. Excluded content analysis.	No increase in levels of participation over time. 40 respondents provided 60% of comment letters. Few corporation respondents. Constant participation by large CA firms.
<i>Groups Of Respondents</i> Corporate Gavens, Day, Carnegie & Gibson, 1989	Australia	June 1986	Surveyed listed companies; 197 respondents to survey.	Larger companies participate more; those who disagree with proposals more likely comment. Respondents did not anticipate that introduction of mandatory standards would increase lobbying activity.
Academics Tandy & Wilburn, 1996	United States	1973 – 1992 for SFAS 1 – 117	Survey of academics (151 participants and a matched non-participant group).	Identified motivational and cost benefit issues which affected academic participation in due process. Response rate has been stable but low (3.7% of ED comments).

Particular Topics Leasing: Nakayama, Lilien & Benis, 1981	United States	FAS 13 1974	Classified 167 industry respondents including content analysis and effects of proposals. No control group used.	Response rate affected by the perceived interest in or impact of proposals.
Foreign Currency Standards: Griffin, 1982	United States	SFAS 8, May 1978	Studied financial reports of respondents and non-respondents and concerns expressed to FASB.	Forex rules have a minor impact on earnings. Limited evidence that FASB respondents exhibited greater earnings volatility than non-respondents.
Griffin, 1983	United States	FAS 52, December 1981	Further analysis of corporate profiles of FAS 52 respondents	Further development of a model to predict firms likely to make comments on EDs.
Kelly, 1985	United States	SFAS 8, December 1974	Compared firm characteristics of 55 lobbying and 140 non-lobbying corporates	Lobbyists had lower management ownership %; no significant relationship between income effects, leverage and lobbying.
Velayutham, 1990	Australia	1985 – 1988	Responses to 15 EDs analysed, respondents categorised. Content analysis of submissions on 3 proposed foreign currency standards.	Corporate sector appeared to have a greater influence over the ASRB and AARF than other respondents groups. Amendments to the EDs by the ASRB were not supported by public opinion.

Oil & Gas Company Reporting King & O'Keefe, 1986	United States	SFAS 19	Studied submission content and insider trading positions of 17 firms around exposure draft release date; compared with non-lobbyists (29)	Lobbying activities were correlated with wealth impacts; trading activities paralleled lobbying position.
Deakin, 1989	United States	SFAS 19, 1977	Studied characteristics of 27 lobbying Corporates and 67 Non-lobbyists	Developed a predictive model for likelihood of lobbying behaviour based on firm characteristics.
Intangibles: Tutticci, Dunstan & Holmes (1994)	Australia	ED 49 – 1989	Lobbyist and Issue analysis of 113 submissions. ED was subsequently withdrawn.	CA Firms produced longest submission and addressed most issues. Preparers were largest lobbying group. Strategies depend on motivation for lobbying and perceived influence.
Investment Properties: Rahman, Ng & Tower 1990	New Zealand	ED 29 & ED 45 SSAP 17 1983 – 1989	Analysis of evolution of the standard and a Study of submissions and subsequent non-compliance.	Provision of alternative allowable treatment in investment property standard did not reduce opposition.
Research and Development: Hope & Gray 1982	United Kingdom	SSAP 13 1975 – 1978	Analysis of comment letter on ED14 and ED17 using sociological approach to identify relative influence.	Identified that major changes in SSAP 13 were from lobbying from aerospace industry.