

**SOUTH AFRICAN CORPORATE MANAGEMENT'S ATTITUDE TO THE
ACCOUNTING STANDARD-SETTING PROCESS AND INTERNATIONAL
HARMONISATION**

by

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ABSTRACT

The South African Institute of Chartered Accountants recently made a decision to adopt accounting standards issued by the International Accounting Standards Committee rather than continuing to develop standards locally. Reasons used to justify this policy change include: the lack of resources to develop accounting standards from a zero base and, with what has been classified as the sub-standard financial reporting that occurs in South Africa. By adopting International Accounting Standards, amending the standard-setting process and providing legal backing for these standards, the South African Institute of Chartered Accountants aims to improve the standard of financial reporting.

It will be argued that this decision will effect the contribution preparers of financial statements make to the standard-setting process. Corporate management as preparers of financial information participate in this process by reacting to proposed statements of generally accepted accounting practice in a number of ways, including lobbying the standard-setting body. This thesis aims to establish the views of South African corporate managers to the proposed changes to the accounting standard-setting process which incorporates the adoption of international accounting standards.

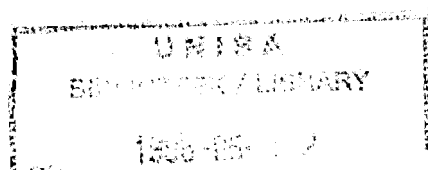
To achieve this objective, the responses of South African corporate managers to the first six exposure drafts issued by the Accounting Practices Committee based on International Accounting Standards are examined to supply evidence that is descriptive in nature and which provides additional support for the findings of the empirical study.

Forty hypotheses were developed and tested in an attempt to establish the views of executives to various issues relating to the accounting standard-setting process, corporate managers as the producers of firm specific financial information, the regulation of accounting, management incentive schemes and the international harmonisation of accounting standards. The tests of the hypotheses together with the findings of the individual case studies, provide evidence to suggest that this new disposition effectively marginalises South African corporate managers from the accounting standard-setting process. Finally, it is concluded that the existence of a management compensation/incentive scheme, is unlikely to influence corporate management's reaction to a proposed accounting standard.

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CHAPTER ONE

INTRODUCTION

- 1.1 THE RESEARCH TOPIC**
- 1.2 SIGNIFICANCE OF THE RESEARCH**
- 1.3 RESEARCH APPROACH**
- 1.4 LIMITATIONS OF THE RESEARCH**
- 1.5 ORGANISATION OF THE STUDY**

1.1 THE RESEARCH TOPIC

This study examines South African corporate management's attitude to the accounting standard-setting process and international harmonisation.

Kelly-Newton (1980:3) explains that three parties are primarily involved in the accounting standard-setting process. In the South African context this would include: The South African Institute of Chartered Accountants as the regulatory policy making body, corporate management who, as financial statement preparers, must comply with statements of generally accepted accounting practice, and financial statement users who employ the output. Kelly-Newton (1980:29) has previously implied that it has been the needs of users of financial information that has traditionally been the focus of accounting research. Users of financial statements, including security regulators and stock exchanges, require comparable standards of financial reporting to assist them in making a variety of economic decisions. It is this focus that has resulted in the development, by standard-setting bodies, of their respective conceptual frameworks such as the International Accounting Standards Committee's *Framework for the preparation and presentation of financial statements* which has been adopted for use in South Africa.

The needs of corporate managers as the primary suppliers of financial information has, however, not been subject to the same level of scrutiny. Kelly-Newton (1980:29) observes that, "The lack of descriptive research into management's role has often been cited as a deficiency in prior accounting research." Corporate management, suggests Kelly (1983:111), plays a pivotal role in the accounting standard-setting process. They are responsible not only for the selection of the particular accounting method from various alternatives, but also for the level of disclosure over and above that required by legislation. In addition to the above function,

corporate management participates in the accounting standard-setting process by reacting to proposed statements of generally accepted accounting practice. This reaction can take one of two forms: either acceptance/rejection, or support/opposition of a proposed standard. Management's stance is, depending on its position, one of the following: lobbying the standard-setting body, making discretionary accounting changes, or changing financing, production or investment activities to overcome the effect of the proposed standard.

Recent events in South African history have made it possible for local companies to once again compete for finance in the international capital markets. This reintroduction into the global community (Blumberg 1995(b):3), together with the reinvestment by foreign investors in local public and private companies, has contributed to the view from some quarters (Whitehead 1996:25 and Buss 1996:3) that South African accounting standards should be consistent with those internationally. This would mean that multinational companies operating from South Africa would make use of identical accounting standards to produce similar financial results irrespective of the country that the multinational corporation originated from.

In South Africa, the international harmonisation of accounting standards and corporate management's attitudes to them is a relatively unexplored concept with limited, if any, research having been conducted on the subject. Evidence of this is represented by the paucity of papers on this subject presented at overseas conferences or appearing in recognised academic journals. This fact, together with the results of research on international harmonisation and corporate management's attitudes to the accounting standard-setting process previously undertaken overseas, means that this is a fertile area for research in a South African context. In particular, this study will examine the desirability of South Africa adopting international accounting standards with particular emphasis being placed on:

- the theoretical background to the accounting standard-setting process,
- the South African position relevant to the accounting standard-setting process and international harmonisation, and
- the opinions of South African corporate management to various aspects of the accounting standard-setting process and international harmonisation.

This study is conducted in two parts. In the first part of the study an attempt is made to enhance the knowledge of, and provide insight into the subjects of accounting standard-setting and international accounting harmonisation, against which South African developments can be evaluated. This discussion is intended to provide input for the research carried out in the second part of the study. To achieve this, the accounting standard-setting process is placed within the correct financial reporting and theoretical frame of reference. Secondly, certain aspects important

to a better comprehension of the subject are highlighted. These include a discussion of the South African accounting standard-setting process, an examination of environmental factors that influence the setting of accounting standards, the process adopted by the International Accounting Standards Committee in the setting of accounting standards, and South Africa's involvement in that process. Prior research relevant to the study is also reviewed to provide the foundation for the research conducted in the second part of the study.

In the second part of the study, South African corporate management's attitude to the accounting standard-setting process and international harmonisation is empirically investigated. This investigation takes the form of six individual case studies and an opinion survey research strategy.

Statistical sampling was not employed in the selection of the target group. Rather, one hundred corporate managers representing the top companies listed on the Johannesburg Stock Exchange ranked by market capitalisation, and who initially expressed their willingness to participate in the survey were selected. These individuals were chosen because it was considered that they would display characteristics which would result in accurate and meaningful responses to the questionnaire.

1.2 SIGNIFICANCE OF THE RESEARCH

In South Africa, corporate management's involvement in the accounting standard-setting process has traditionally been limited to their industry representation on the Accounting Practices Board, and by their lobbying of the Accounting Practices Committee for changes to provisions contained in exposure drafts issued for comment. It would not be unreasonable to argue that the format of the standard-setting process together with corporate management's contribution to it, has resulted in a number of 'flexible' accounting standards having been issued by the Accounting Practices Board. Samkin's (1993) study of the deferred taxation deliberations, together with the number of accounting standards issued by the Accounting Practices Board permitting alternative accounting treatments, provide support for this contention.

In recent years certain academics including Wallace (1990:2) and Wyatt (1991:13.4) have argued that the International Accounting Standards Committee has actively sought to become the dominant supplier of global accounting standards. As such, this body has encouraged and participated in the international harmonisation of accounting standards. It would not be unreasonable to argue that by virtue of its Board member status of this body, the South African Institute of Chartered Accountants has enthusiastically endorsed this process. This resulted in the decision by the South African Institute of Chartered Accountants to adopt International Accounting Standards rather than developing accounting standards locally. In

addition, legal backing for these standards has been sought by the South African Institute of Chartered Accountants in the form of proposed amendments to the *Companies Act, Act 61 of 1973*. The rationale for this decision is two-fold. Firstly, in light of South Africa's now acceptable status as a member of the international community, Dickinson (1994:1) argues that access to the world's capital markets will be facilitated if accounting standards are consistent with those internationally. Secondly, dissatisfaction expressed in both the popular and professional press (Bunting 1993, Crotty 1995 and Singer 1994), with what is perceived to be unacceptable levels of financial disclosure, and with what appears to be South African corporate management's selective compliance with existing statements of generally accepted accounting practice. Although the harmonisation process is now well under-way in South Africa, a review of the relevant literature would suggest that limited, if any, empirical studies have been conducted to establish:

- whether accounting standards that take into account the unique environmental and cultural circumstances that exist in South Africa should continue to be developed and issued for use,
- whether accounting standards set by a body largely unrepresentative of South African preparers and users, such as the International Accounting Standards Committee, are in fact relevant to South African circumstances, and should therefore be issued as exposure drafts for possible adoption in this country as statements of generally accepted accounting practice,
- if international accounting harmonisation can be considered *fait accompli* in South Africa, would it not be preferable for the South African Institute of Chartered Accountants to rather liaise with other selected countries, for example Commonwealth countries with similar environmental factors, such as Australia and New Zealand, and develop accounting standards on a regional basis, and
- whether South African corporate management as the predominant suppliers of financial information, would adhere to International Accounting Standards if the legislative threat facing them for non-compliance under the *Companies Act, Act 61 of 1973* did not exist?

What is significant about this thesis is that it focuses on the South African accounting standard-setting process since the 1993 decision (Blumberg 1995(b) and Mockler 1993:3) of the accounting regulatory body, the South African Institute of Chartered Accountants, to abandon the development of South African specific accounting standards in favour of adopting accounting standards issued by the International Accounting Standards Committee.

Research overseas by academics including, Carlson (1994), Chandler (1992), Nobes (1990), Rivera (1989) and Wolk and Heaston (1992) has highlighted the obstacles and factors impeding progress towards the complete harmonisation of international accounting standards.

This study therefor attempts firstly, to fill a void in the South African literature on the international harmonisation of accounting standards, secondly, to provide guidance to the South African Institute of Chartered Accountants in their harmonise efforts and finally, to provide a South African perspective on the international harmonisation process.

This research is important in that it provides an in depth study of the various aspects necessary for a proper study of the harmonisation of accounting standards. In particular, empirical evidence will be collected on:

- the extent of the involvement of South African corporate management in the accounting standard-setting process,
- factors that influence corporate management's response to proposed statements of generally accepted accounting practice, and
- whether corporate management views the harmonisation of accounting standards as a desirable objective.

Information obtained from this part of the study is intended to enhance knowledge of the international accounting harmonisation project and to establish whether the adoption of international accounting standards in South Africa is justified. It is also intended to serve as a basis for further South African research on international accounting issues. In addition, the research attempts to establish whether the South African Institute of Chartered Accountants correctly anticipated the effect that the harmonisation process would have on the contribution made by South African participants to the accounting standard-setting process.

The aim of this investigation is to provide empirical evidence of South African corporate management's attitude to the accounting standard-setting process and international harmonisation. This study can be considered significant from both a national and international perspective, as an extensive literature review indicates that this topic has not been subject to previous research.

1.3 RESEARCH APPROACH

Three research methods were used to implement the research objective described above, namely: a literature review, the conducting of specific case studies, and survey research. Ryan, Scapens and Theobald (1992:131) explain that a crucial factor in postgraduate academic research is a thorough review of literature relevant to the study being undertaken. This they argue, is necessary to assist in identifying the research problem, converting the research problem into research questions, and the development of the research hypotheses. A literature review was undertaken in chapters two, three, four, and to a lesser extent in chapter five. This review, conducted primarily by means of library research of secondary data, sought to establish an

effective, structured and comprehensive review of the most relevant work undertaken to date. Chapters six and seven of the study resulted from an application of both survey and case study research methodology.

Although the use of case study research methodology can be considered unusual in financial accounting research, this form of inquiry is useful as a means of obtaining descriptive information that provides supplementary evidence to the research project. To obtain maximum benefit, the data to be the subject of the case study should be of a primary source. This presupposes that the information should be derived from original documents, official files or records. Within the context of this study, primary data sources are the responses of interested parties to certain exposure drafts issued by the South African Institute of Chartered Accountants based on International Accounting Standards and kept in the official files of the South African Institute of Chartered Accountants. These are exposure draft 89, *Revenue*; exposure draft 90, *Property, plant and equipment*; exposure draft 91, *Net profit for the period, fundamental errors and changes in accounting policies*; exposure draft 92, *Borrowing costs*; exposure draft 93, *Construction contracts*; and exposure draft 94, *Inventories*.

The survey research methodology included the identification of the research objective, the development of the hypotheses and the selection of the sample for testing. In addition, this included: providing details of the design of the research instrument (the questionnaire), the data collection process, the preparation of the data for processing and analysis, and the statistical presentation and analysis of the data. The interpretation of the research results, the drawing of conclusions and making of recommendations on the basis of the research findings are also provided. The survey research was implemented by means of a postal survey which sought to establish South African corporate management's attitude to the accounting standard-setting process and international harmonisation.

Although the majority of companies surveyed have their headquarters in the Gauteng province, this did not influence sample selection. Companies from throughout South Africa which were listed on the Johannesburg Stock Exchange were eligible for selection, irrespective of where their headquarters were located.

1.4 LIMITATIONS OF THE RESEARCH

It is necessary to recognise that all research results are subject to certain limitations. In the context of this study to establish South African corporate management's attitude to the accounting standard-setting process and international harmonisation, the following limitations were identified. Firstly, the target group tested was not selected by means of a random sample but on the basis of being a member of the top one hundred companies by market capitalisation

listed on the Johannesburg Stock Exchange. As a result, the findings cannot be generalised to the whole population, namely South African corporate managers. However, in view of the characteristics displayed by the target group, it would not be unreasonable to extend the results to the entire population of corporate managers.

The second limitation is that question 1.1 of the research instrument was a branching question. This could have resulted in respondents answering NO to this question in order to complete the survey instrument as quickly as possible. This was however not considered to be a major problem for two reasons. Firstly, the respondents were contacted prior to the research instrument being posted to them, and secondly, they could have at that stage indicated their reluctance to participate in the survey. Furthermore, those respondents who participated by completing the research instrument could be viewed as sophisticated leaders in their fields who would be motivated to complete the questionnaire as accurately as possible.

The third limitation of the study relates to the case studies. In the individual case studies, firm specific financial information was not used in conjunction with corporate management responses to the various exposure drafts made to the Accounting Practices Committee. From the case studies it was only possible to draw general conclusions for corporate management's opposition to a proposed accounting standard based on an exposure draft. It was not possible to establish with any certainty whether their lobbying, either in favour of, or in opposition to, a proposed accounting standard was made in response to costs of regulation or the existence of monitoring and bonding contracts.

The final limitation relates to difficulties that certain respondents may have had in understanding particular questions. The responses to individual questions provided an indication that certain respondents were not always familiar with all of the terminology used. However, this limitation was not considered to have significantly affected the overall outcome of the results.

1.5 ORGANISATION OF THE STUDY

This study comprises seven chapters. A synopsis of each chapter follows:

CHAPTER ONE: INTRODUCTION

In this chapter, the background of the research topic is provided. In addition, the significance of the research including the motivation for, and the purpose of the study is examined. Finally, the organisation of the study is presented.

CHAPTER TWO: CONCEPTUAL UNDERPINNINGS OF ACCOUNTING STANDARD-SETTING

The conceptual underpinnings of accounting standard-setting are discussed in this chapter. Chapter two commences with an overview of the nature and purpose of accounting standards. The development of accounting theory and alternative theories of accounting, namely positive and normative theories, are discussed and their application to accounting standard-setting are reviewed. Thereafter the nature of regulatory theories, interest intermediation and other approaches to accounting standard-setting are then examined. Finally, the eclectic approach to accounting theory is discussed.

CHAPTER THREE: ACCOUNTING STANDARD-SETTING AND INTERNATIONAL HARMONISATION: THE SOUTH AFRICAN POSITION

In this chapter, the process currently used to develop accounting standards in South Africa is described. The historical developments in the international harmonisation process are then reviewed. Environmental difficulties facing those bodies advocating the harmonisation of accounting standards are described. Suggestions that may possibly overcome these difficulties are also provided. Thereafter the role of the International Accounting Standards Committee and the South African Institute of Chartered Accountants in the harmonisation process are described. The recent decision by the South African Institute of Chartered Accountants to adopt International Accounting Standards for use in South Africa requires that accounting standards are provided with legal backing within the framework of the *Companies Act, Act 61 of 1973*. This proposed standard-setting structure together with the roles of participants are described. Finally, the role that South African corporate management is likely to play in the standard-setting and harmonisation process is reviewed.

CHAPTER FOUR: CORPORATE MANAGEMENT AND THE ACCOUNTING STANDARD-SETTING PROCESS

This chapter reviews corporate management's role in the accounting standard-setting process. This includes a discussion of those factors likely to influence management in their response to a proposed standard. In addition, prior research that examines the relationship between accounting standards and the decisions taken by corporate management when they formulate their responses to proposed accounting standards is described. The nature of these studies presupposes that this research is primarily positive in nature. It is argued that this review is necessary as it provides both practical and theoretical insights to the present study.

CHAPTER FIVE: METHODOLOGY USED TO DETERMINE SOUTH AFRICAN CORPORATE MANAGEMENT'S ATTITUDE TO THE ACCOUNTING STANDARD-SETTING PROCESS AND INTERNATIONAL HARMONISATION

In this chapter the methodology employed in the research is described. This is achieved by focusing on the details of the research design. Included in this discussion is an overview of the research objective and the rationale behind the development of each of the hypotheses tested in this study. Finally, details relating to the selection of the target group as well as aspects relevant to the implementation of the survey research method are provided.

CHAPTER SIX: PRESENTATION AND ANALYSIS OF RESEARCH FINDINGS

Chapter six describes the findings of six individual case studies that examine South African corporate managers responses to exposure drafts based on International Accounting Standards issued for comment by the Accounting Practices Committee of the South African Institute of Chartered Accountants. Also presented is a description of the statistical tests used to analyse the research data. The results of the hypotheses tested are presented. The chapter ends by presenting the conclusions drawn from the study.

CHAPTER SEVEN: SUMMARY, RECOMMENDATIONS AND CONCLUSION

The contents of the previous chapters are summarised, conclusions reached and implications arising from the study of South African corporate management's attitude to the accounting standard-setting process and international harmonisation are considered. Areas warranting further research are also presented.

CHAPTER TWO

CONCEPTUAL UNDERPINNINGS OF ACCOUNTING STANDARD-SETTING

- 2.1 INTRODUCTION**
- 2.2 THE NATURE AND PURPOSE OF ACCOUNTING STANDARDS**
- 2.3 THE CONCEPT OF "THEORY" AND ALTERNATIVE THEORIES OF ACCOUNTING**
- 2.4 THE NATURE OF REGULATION**
- 2.5 THEORIES OF REGULATION**
- 2.6 INTEREST INTERMEDIATION**
- 2.7 APPROACHES TO THE STANDARD-SETTING PROCESS**
- 2.8 ECLECTIC APPROACH TO ACCOUNTING THEORY**
- 2.9 CONCLUSION**

2.1 INTRODUCTION

The importance of soundly developed accounting standards, that permit the production of accounting information that can be reliably used for decision-making purposes, is universally accepted. Corporate management makes use of accounting standards in the preparation of financial statements, while auditors make use of these standards in establishing whether financial statements 'fairly present' the financial position of the enterprise and the results of its operations for the year. Other financial statement user groups are also affected by accounting standard choice in a variety of ways. However, the difficulty in establishing accounting standards is that not all users have the same accounting information requirements. Benston (1980:51) illustrates this dilemma as follows: "Some want data that reflect cash flows but others would accept accruals, but not adjustments to the numbers that cannot be verified by reference to actual market transactions, while still others prefer estimates of economic values, but disagree about the basis on which these estimates are made."

From the perspective of corporate management, their involvement in external reporting is in the selection of alternative accounting methods, level of disclosure, and reaction to proposed or enacted standards in the form of lobbying, discretionary accounting changes, and changes in financing, production, or investment activity of the firm (Kelly 1983:111). Corporate management as producers of financial statements have, according to Sutton (1984:89), two goals when lobbying accounting standard-setting bodies. The short-term goal is the attempt to

influence the content of a proposed standard, while the long-term goal is to alter the standard-setting process itself in an attempt to influence both the incidence and form of future accounting standards.

Accounting standards are in fact a form of regulation. As Sutton (1984:81) suggests, they have two functions: they restrict the choice of accounting methods available to management, or alternatively, they force management to disclose financial information in a form they would not voluntarily have chosen.

This chapter commences with a theoretical exposition of the accounting standard-setting process. This includes a review of the nature and purpose of accounting standards. In view of the importance of accounting standards within the context of this study, this is considered necessary to provide an awareness of those parties who require accounting information for decision-making purposes and, as a result, seek to influence the standard-setting process.

Against this review of the accounting standard-setting process, the concept of theory and accounting theory is examined. The relationship between accounting theory and practice is examined. Descriptions of two of the primary competing theories of accounting are distinguished, normative and positive theory. This discussion is included not only to provide a perspective of competing accounting theories, but also because the development and structure of these two theories place significantly different emphases on the accounting standard-setting process, the topic central to this study. This examination will highlight some of the difficulties experienced in formulating a single generally accepted theory of accounting.

In view of the impact that ever increasing regulation has on the accounting profession, the nature of regulation and its application to accounting is examined. Two different forms of regulation are examined. Firstly, three economic theories of regulation and their application to the accounting standard-setting process are discussed. Thereafter, regulation from various political perspectives and their application to the accounting standard-setting process is examined. Finally, the free market approach to accounting standard-setting and arguments surrounding accounting regulation in the public and private sector are reviewed.

2.2 THE NATURE AND PURPOSE OF ACCOUNTING STANDARDS

This section reviews the nature and purpose of accounting standards. In view of the complexity of the modern financial reporting environment, this discussion detailing the nature and purposes of accounting standards, must be considered central to any study that examines corporate management's attitude to the accounting standard-setting process and international harmonisation.

2.2.1 Background to accounting standards

It was the rapid changes in ownership and management structures of corporations after World War I that has been identified by Hendriksen (1982:28) and Chen (1975:540) as one of the major factors leading to changes in accounting information requirements. No longer was the primary objective of accounting to provide financial information to management and creditors but, increasingly, to provide financial information to shareholders and other users. It was this change in ownership and management structure that Paton and Littleton (1940:2) suggest increased the need for accounting standards:

These considerations, together with the ease with which misunderstanding may be magnified by vagueness, omissions, incompleteness, concealment of important details within totals, and the like, make it evident that there is need for developing standards of accounting to secure proper protection for the equities of corporate investors.

In this early work, Paton and Littleton (1940:5) suggest that accounting standards should provide the rules that govern accounting choices when alternatives exist. Paton and Littleton (1940:6) did however also argue for orderly, systematic and coherent accounting standards that "should be in harmony with observable, objective conditions and that [accounting standards] should be impersonal and impartial."

Credence should however not be given to the view that accounting standards are a recent (post World War I) phenomena. Baxter (1982) and Burggraaff (1981) with Percy (1982), concurring, have shown that self developed rules were created by accountants before standards existed. Burggraaff (1981:37) provides the following example of one of these rules: "All accountants would classify moneys (*sic*) in cash on the balance sheet as cash and these will be recognised at face value."

2.2.2 Nature and purpose of accounting standards

The stewardship function played by the modern corporate manager is recognised in the accounting literature. He is appointed by shareholders to act on behalf of and be accountable for the resources of the enterprise and reports to those shareholders not directly involved in the management of the corporation. As a point of departure of this thesis, it must be accepted that the purpose of financial statements prepared for external financial reporting purposes is the communication of relevant economic information to persons who do not have direct access to that information (Burggraaff 1981:37 and Grinyer 1978:50). More recently, both the International Accounting Standards Committee and South African Institute of Chartered Accountants's conceptual frameworks state that the object of financial statements is the provision of information about the financial position, performance and changes in financial position of an enterprise that

is useful to a wide range of users in making economic decisions (International Accounting Standards Committee:1989:12 and AC 000:1990: para 12).

Accounting standards explain Bloom and Naciri (1989:71), can best be described as rules designed to achieve uniformity and comparability in external financial reporting. They detail the procedures used in the accounting treatment and disclosure of specific items contained in the balance sheet, income statement, cash flow statement and accompanying notes, prepared by management for external financial reporting purposes. As such, accounting standards have a dominant influence on the work of accountants. Standards are continually being changed, amended, added to or superseded. One needs only examine Samkin's (1993) recording of the South African Institute of Chartered Accountants's deliberations in regards to deferred taxation for a practical illustration of these changes in a South African context.

Corporate management has the responsibility of selecting and applying appropriate accounting policies so as to ensure that the final results fairly present the financial position and financial result of the corporation. It is the accounting standards from which the policies are derived that, Belkaoui (1992:75) suggests, provide the rules for the conduct of the accountant's work. Therefore, for an accounting standard to be effective, Vieler (1977:158) and Dearing (1990:86) believe that the standard must meet the expectations of the preparers (management), auditors, and users.

In addition to shareholders or investors, *The Corporate Report* (1975), the South African Institute of Chartered Accountants's (1990) and International Accounting Standards Committee's (1989) conceptual frameworks all identify many other and varied user groups that demand accounting information. Although a wide diversity of information is required by these users, as can be established from table 2.1 below, it is suggested that financial statements prepared for shareholders will meet the majority of these users' needs.

Table 2.1: Users of financial statements and their information needs

USER GROUP	INFORMATION NEEDS
· Equity investors	· Require information to assist them in reaching share trading decisions, including likely movements in share prices, levels of future dividend payments and management efficiency.
· Employees	· Information about stability and profitability of employers, including the ability to provide remuneration, retirement benefits and employment opportunities.
· Leaders	· Require information that will enable them to determine whether there is any risk of default on loans, and whether the interest attaching to them will be paid when due.
· Suppliers and other trade creditors	· Information to enable them to establish whether amounts due will be paid. Creditors are interested in estimating cash and near cash assets, net cash flow in the immediate future, the reliable value of assets and the priority of various claims.
· Customers including business contact group	· Are interested in information about the continuance of an enterprise, especially when they have a long-term involvement with or are dependent on, the enterprise. Information is sought as potential investors and to promote their own efficiency by making economic comparisons.
· Governments and their agencies	· Interested in the allocation of resources, the activities of the enterprises, for regulatory purposes and to determine taxation policies.
· Public	· Require information on the role of the entity as employers, cash flows, profitability and efficiency, contributions to political organisations, pressure groups and charities, impact on the balance of trade, transactions with governments, compliance with laws and expenditure affecting society and the environment.
· Analyst-adviser group	· Concerned with promoting the interests of those involved or potentially involved in a direct relationship with the entity. They act in an agency capacity. This group leads to a demand for more elaborate information.

Accepting that the objective of financial statements is to provide information useful to a wide range of users in making economic decisions, and that accounting standards are the rules used for external financial reporting purposes, it is necessary to examine the development and content of accounting standards more closely.

2.2.3 The development and content of accounting standards

Accounting standards have traditionally been developed in response to one or more of the following circumstances:

- failure of the market for information,
- a method of resolving potential conflicts of interest between the various user groups of financial statements, or
- where they will be beneficial to society by improving the allocation of certain resources.

A soundly formulated and correctly implemented accounting standard should result in accounting policies that are consistently applied. However, in South Africa as in other countries, this has not been the case. As the interests of the various users of financial statements identified in table 2.1 differ, the choice of an accounting standard to be applied in a particular scenario from various alternatives may not necessarily be congruent. It would therefore be naive to suggest that a change to an accounting standard, or the adoption of an additional accounting standard to accommodate a particular user group would be free of economic consequences. This is confirmed by Gellein (1978), Hines (1989), Solomons (1978), and Zeff (1978) amongst others, who have argued that accounting standards have the potential to affect income and resource allocation, while Brown (1990:90-91) suggests that standards have both economic benefits and costs. User groups therefore seek the adoption of accounting standards that provide them with the greatest economic benefit. The result of this is that the process of issuing and adopting accounting standards is fraught with difficulty.

To prevent potential conflict among users of financial statements, the accounting standard-setting process should, according to Gaa (1988:13), have two important and enduring features. Firstly, the standard-setting process should serve the public interest and, secondly, the choice of standards should be made logically or rationally on the basis of some set of basic principles. If employed correctly, this process should result in an accounting standard which, when applied, will produce financial statement information useful to users in making economic decisions.

An accounting standard should, according to Baxter (1981:5) and Belkaoui (1992:75), consist of three parts:

- a description of the problem to be tackled,
- a reasoned discussion (possibly exploring fundamental theory) or ways of solving the problem, then,
- in line with decision or theory, the prescribed solution.

An accounting standard should therefore comprise a soundly conceived theoretical base.

2.2.4 Types of accounting standards

Baxter (1981:6), Belkaoui (1992:75) and Benston (1980:52) have all identified the subject matter contained in the different types of accounting standards. These standards have been categorised as follows:

Type 1: requires accountants to disclose what they are doing. This would be in the form of the assumptions and policies adopted in financial statements. Benston (1980:52) suggests that a disclosure standard of this nature implies generally accepted definitions and requires an explicit statement of changes in the methods and assumptions followed.

Type 2: prescribes the uniformity of layout of the financial statements. The purpose of a presentation statement of this nature, according to Benston (1980:52), is to reduce the cost to users of recording and using financial statement data.

Type 3: prescribes disclosure requirements for specific items where users are required to exercise their own judgement.

Type 4: provides an indication of how economic phenomena should be measured.

Belkaoui (1992:75) poses the following two questions relevant to Type 4 standards: firstly, are these standards based on broadly debated principles and on a comparison of the basis of arguments both in favour of and against rival theories? Secondly, is the standard selected on that basis by the standard-setting body? In any event, Belkaoui (1992:75) suggests that all of the above types of standards should continue to be promulgated.

2.2.5 Arguments for and against accounting standards

Although table 2.2 below reflects the persuasive arguments in support of, and in opposition to accounting standards that have been made by academics including Baxter (1981), Belkaoui (1992) and Solomons (1983, 1986(a) and 1989), Solomons (1983:107) cautions against viewing arguments in favour of accounting standards as support for the presently used historical cost model of accounting.

In criticising the accounting profession and its accounting standardisation programme, Jones (1975:274) believes that insufficient thought or research was conducted into what the profession was trying to achieve. A further concern expressed by Jones (1975:275) is that the existence of standards that produce conflicting financial results, seriously undermines the credibility of financial statements.

Table 2.2: Arguments for and against accounting standards

ARGUMENTS FOR ACCOUNTING STANDARDS	ARGUMENTS AGAINST ACCOUNTING STANDARDS
<ul style="list-style-type: none"> · Market cannot be depended upon to promptly discipline corporations that are left to choose what to report and how to report to their investors and creditors · There exists a need for comparability of financial information published by business enterprises · Receiver of information have a limited capacity to interpret and use the information · Leads to credibility of financial reporting. The information is assumed to be clear, consistent, reliable and comparable · Useful to governments for tasks such as price control, regulation of industry, planning and regulation of the economy, taxation purposes and other social issues · Forces weak accountants to improve their work · Provides guidelines to public accountants and rules of action. Accountants feel sheltered against allegations of misconduct when acting in step with other accountants · Argued that accounting standards lead us nearer to the "right" measure of value · Generates interest in principles and theories among those interested in accounting. Promulgation of a standard should generate controversy and debate which is better than apathy 	<ul style="list-style-type: none"> · May be detailed and prescriptive and leave little room for the professional judgement of those close to the situation being reported on · Standard overload caused by mounting number and complexity of standards · Pose a danger of curtailing innovation in financial reporting · Inhibit preparers from applying their expert judgement to all the circumstances of the company and that, on balance, standards hinder rather than help the development of fair financial reporting · The existence of standards breeds more standards and involves the risk of a highly prescriptive system designed to cover every contingency, in which the letter of the standards, rather than the aim of fair financial reporting, predominates · Form may supersede substance if accounting standards are developed in a legalistic way · Standard-setters may have to bow to political pressure · Standard-setting process is costly and bureaucratic · Accounting figures do not lend themselves to standardisation · Wording of standards can result in difficulty of interpretation · The essence of a profession is that each member must be willing to think for themselves

Brown, Collins and Thomson (1993:275) however in providing the following caveat regarding accounting standards, suggest that by the very nature of their structure, only incomplete direction is provided to preparers of financial statements which therefore necessitates the application of

professional judgement. Baxter (1981:10), on the other hand, is concerned that accounting standards represent "a godsend to the feebler type of writer and teacher who finds it easier to recite a creed than to analyse facts and to engage in argument." In educating future accountants, accounting academics in particular must take cognisance of this view.

Having examined the nature and purpose, as well as the advantages and disadvantages of accounting standards, it is instructive to examine the concept of accounting theory and its application to two of the primary competing theories of accounting and to the standard-setting process.

2.3 THE CONCEPT OF "THEORY" AND ALTERNATIVE THEORIES OF ACCOUNTING

This section will examine the concept of theory and the development of accounting theory. In particular, a brief overview of various competing theories of accounting is examined. This is considered necessary in order to provide the theoretical framework against which South African corporate management's attitude to the accounting standard-setting process and international harmonisation is studied.

2.3.1 The concept of theory

It is suggested that there are almost as many alternative views on the concept of "theory" as there are academics engaged in empirical research. Godfrey, Hodgson, Holmes and Kam (1994:1) and Kam (1992:486) have defined theory as a "deductive system of statements of decreasing generality," while Most (1982:55) describes theory as a "systematic statement of rules or principles which underlie or govern a set of phenomena." Glautier and Underdown (1991:24), on the other hand, describe theories as generalisations which serve to organise otherwise meaningless masses of data in order to establish significant relationships in respect of such data. Finally, the committee to prepare a statement of basic accounting theory (American Accounting Association 1966:1) described theory as "a cohesive set of hypothetical, conceptual, and pragmatic principles forming a general frame of reference for a field of study."

Kam (1992:486), in stating that theories must be general, argues that the range of things that is the subject of a statement must have a wide application, while Wolk, Francis and Teamey (1992:29-30) believe theories should be useful to explain relationships or predict phenomena. In addition, Wolk *et al.* (1992:29-30) believe that a theory should contain a set of conclusions that can be determined either by deduction or induction.

It is therefore suggested that theory can be described as a set of interrelated concepts, either verbal or written, containing narrative or mathematical components that can be used to provide a framework within which relationships can be explained, and conclusions drawn

in a logical and systematically sound manner. In addition, a theory should be capable of being subjected to either logical or empirical testing so that its accuracy can be verified.

2.3.1.1 The evolution of accounting theory

As with the concept "theory," attempts to provide a universally accepted definition of accounting theory has been fraught with difficulty and disagreement. As is illustrated in this section, the definition of "accounting theory" must be seen as a continuing evolutionary process.

To date, a single theory that satisfactorily explains accounting phenomena in a logical and sound manner continues to elude accounting academics. It is suggested that the primary reason for this is that definitions of accounting theory have evolved simultaneously with changes in accounting thought. Accounting theories, or definitions that have masqueraded as accounting theories, have developed as a result of business practices existing at a particular point in time, as well as being influenced by the increasing complexities of business related transactions.

Before the 1930's the primary purpose of accounting information, according to Hendriksen and van Breda (1992:98), was to provide information to management and creditors. In supporting this contention, Godfrey *et al.* (1994:2), have argued that until the 1930's, developments in accounting theory was rather *ad hoc* and ill-defined, evolving as needed to justify particular practices.

Attempts to provide a suitable, unambiguous definition of accounting theory continued after the 1930's. In 1941, the Committee on Terminology of the American Institute of Accountants described accounting as "the art of recording, classifying, and summarizing in a significant manner and in terms of money, transactions, and events, which are, in part at least, of a financial character, and interpreting the results thereof" (American Institute of Accountants 1953:9). In 1953, Littleton (1953:30) described the central purpose of accounting as "[making] possible the periodic matching of costs (efforts) and revenues (accomplishments). This concept is the nucleus of accounting theory and a bench mark that affords a fixed point of reference for accounting discussions."

In 1966, the American Accounting Association became the first professional accounting body to use a theoretical basis to underpin their definition of accounting. Accounting was defined as "the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by the users of the information" (American Accounting Association 1966:1). This definition provided the impetus to shift the emphasis of reporting from primarily owners and creditors to a wider range of users. This orientation has continued to dominate the accounting standard-setting process, as has the use of objectives in accounting (Hendriksen & van Breda 1992:106).

The above definitions, or what can more accurately be described as descriptions of accounting, relate to practical situations where little or no distinction between accounting theory and practice could be ascertained. It is submitted that these descriptions, principles or postulates were developed in response to practical requirements as well as assisted in reducing ambiguities in definitions of practical accounting concepts such as 'realisation' and 'objectivity,' or in the determination of items such as 'value' and 'profit'.

This evolutionary development of accounting theory has continued as accounting academics have attempted to inculcate theories from disciplines as diverse as philosophy, economics and finance, in an attempt to formulate a comprehensive theory of accounting. For example, various philosophies of science have been used to justify a particular accounting theory. Work of Popper (1980) has been used by Watts and Zimmerman (1978, 1979 and 1986) to develop positive accounting theory. Kuhn's (1970) paradigmatic approach to philosophy has been used by both the American Accounting Association (1977(a)) and Wells (1976) to develop an approach to accounting theory. Imre Lakatos's (1970) research programme approach to philosophy has been suggested by Mouck (1990) as being more suitable than Popper's (1980) philosophy to develop a positive theory for accounting. More recently, Godfrey *et al.* (1994:32-33), Henderson, Peirson and Brown (1992:23-24), as well as Mathews and Perera (1991:47-50), have suggested that Feyerabend's (1975) philosophy can be made applicable to accounting, while vindication theory has been posited as an alternative approach to developing accounting theory by De Reuck, van Rhyn, Kestel and Holloway (1994). However, these approaches have been criticised by Chua (1986:606), who argues that the debate over philosophical issues demonstrates that any attempt to search for a permanent, neutral framework within which competing theories and paradigms can be evaluated is likely to be futile.

In addition, the discipline of accounting has been influenced by ideologies and methodologies of certain individual accounting academics as authoritative and influential as Stirling and Chambers, as well as 'schools' of accounting such as the 'Rochester School.' It should therefore come as no surprise to realise that, in spite of the numerous attempts to formulate a definition of accounting theory, the futility of the exercise was recognised by the American Accounting Association as early as 1977 when they stated: "In the view of this committee, a single universally accepted basic accounting theory does not exist at this time. Instead, a multiplicity of theories has been and continues to be proposed" (American Accounting Association 1977(a):1).

Additional support for this view is provided by Wolk *et al.* (1992:6) and Underdown and Taylor (1985:1), while Belkaoui (1992:56), in recognising that at present a comprehensive theory of accounting does not exist, suggests that: "Instead, different theories have been and

continue to be proposed in the literature. Many of these theories arise from the use of different approaches to the construction of an accounting theory or from an attempt to develop theories of a **middle range**, rather than one single comprehensive theory."

The difficulty with middle range theories from Belkaoui's (1992:56) perspective is that these theories result from differences in the way researchers perceive both the 'users' of accounting data and the 'environments' in which the users and preparers of accounting data are supposed to behave. A further difficulty faced in an attempt to provide an acceptable definition of accounting theory is the inability of accounting academics to agree on which theoretical approach is most applicable to accounting.

Since the mid 1970's and the advent of the Rochester School of accounting, an ideological debate has ensued focusing on whether accounting theory should be seen as either normative or positive in nature. The differences in these two approaches to accounting theory can be illustrated by the following definitions of accounting theory. Hendriksen (1982:1), in an often cited definition of accounting theory, considers that:

[accounting theory] may be defined as logical reasoning in the form of a set of broad principles that (1) provide a general frame of reference by which accounting practices can be evaluated and (2) guide the development of new practices and procedures. Accounting practice may also be used to explain existing practice to obtain a better understanding of them. But the most important goal of accounting theory should be to provide a coherent set of logical principles that form the general frame of reference for the evaluation and development of sound accounting practice.

Demski (1973:718) argues that "a primary goal of accounting theory is to explain what accounting alternatives should be used (in some particular circumstances)," while Belkaoui (1992:56) considers that the primary objective of accounting theory is to provide a basis for the prediction and explanation of accounting behaviour and events. This definition does not differ markedly from the definition offered by self proclaimed positivists Watts and Zimmerman (1986:2) who argue that the objective of accounting theory is to explain and predict accounting practice. The statements by Demski (1973) and Hendriksen (1982) can be seen as being normative in nature, while the definitions tendered by Belkaoui (1992), and Watts and Zimmerman (1986), are positive in nature.

It is clear that the term accounting theory will continue to evolve with there being little likelihood of a single generally accepted definition of accounting theory being developed. The number of definitions of accounting theory, as well as approaches to accounting theory, will almost certainly increase as accounting academics engaging in empirical research look outside the traditional influences on accounting, such as economics and philosophy, in an attempt to formulate or justify an acceptable theory of accounting.

2.3.1.2 The nature of accounting theory and its application to accounting standard-setting

Before examining the nature of accounting theory and its application to accounting standard-setting, it is necessary to distinguish between accounting theory and accounting policy. As discussed in 2.3.1.1, a plethora of accounting theory definitions exist.

Accounting theory has been described by Most (1982:55) as a systematic statement of accounting principles, distinct from practice, which serves as a framework for the explanation and prediction of accounting phenomena. Belkaoui (1992:56) suggests that accounting theory provides a basis for the explanation of accounting behaviour and events. Ijiri (1975:9-11) argues that accounting theory is a descriptive or predictive model whose validity is independent of the acceptance of any implicit or explicit goal structure, while Hendriksen (1982:1) believes that accounting theory consists of two components: first, to provide a general frame of reference by which accounting practice can be evaluated and, second, to guide the development of new practices and procedures. Belkaoui (1992:57) concludes that accounting theory should be seen as providing a set of logically developed principles that serve as a frame of reference for evaluating and developing accounting practices.

Accounting policy on the other hand is described by Hendriksen and van Breda (1992:235) as a "body of accounting standards, opinions, interpretations, rules and regulations used by companies in their financial reporting," while Ijiri (1975:10) makes it clear that accounting policy requires a commitment to goals to make value judgements. From an accounting point of view, a compelling argument could therefore be made to assert that no material differences exist between accounting theory and accounting policy. Ijiri (1975:10), in providing the rationale for this contention, argues that in accounting, accounting theories always seem to be tied to accounting policies. The reason provided for this is that theories and policies are perhaps more intimately related in accounting than they are in other fields. However, in order to make accounting research more scientific, Ijiri (1975:10) believes a distinction between accounting theory and policy must be made. He argues that:

The distinction between theories and policies is, nevertheless, very important, because the lack of such a distinction is perhaps one of the most serious impediments to making accounting research scientific. The distinction needs to be made because issues of theory must be resolved by scientific means, while policy issues must be resolved by political means (Ijiri 1975:10).

This view has found favour with a number of academics. In formulating their positive theory of accounting, Watts and Zimmerman (1978:112) believed that the development of a positive theory would enable researchers to obtain a more complete understanding of the "source of pressures that drive the accounting standard-setting process, the effects of various accounting standards

on different groups of individuals and the allocation of resources, and why various groups are willing to expend resources trying to affect the standard-setting process.”

In an article published a year later, Watts and Zimmerman (1979:301) argued that an acceptable accounting theory justifying accounting standards does not exist, and is unlikely to ever exist. Watts (1977:54) appears to concur with this view when lamenting that little attention has been given to developing a theory of observed phenomena, in particular, why financial statements take the form they do.

Like the attempt to obtain a single acceptable definition of accounting theory, attempting to apply a single theory, or develop a theory applicable to accounting standard-setting, has to date proved futile. For example, economic theories of regulation have been used by Johnson and Messier (1982), economic theory of democracy has been used by Sutton (1984), while the agency/contracting cost perspective or public choice theories have been used by Kelly (1982 and 1985) and Watts and Zimmerman (1978). Cushing (1977) and Bromwich (1980) have used rational choice theory, Hussein (1981) uses an innovation process to explain the standard-setting process, while Tinker (1980) has argued that marginalism has had a pervasive influence on accounting theory. While this list of approaches may at first glance appear comprehensive, it is important to recognise that this is not an exhaustive listing of attempts to develop a theory that can be considered applicable to accounting standard-setting.

Various academics including Gerboth (1973), Hines (1983), Horngren (1972 and 1973), Moonitz (1974), Stamp (1979), Walker (1987) and Walker and Robinson (1994), have all argued that accounting standard-setting is a 'political' process. Horngren (1973:61) believes that “setting of accounting standards is as much a product of political action as of flawless logic or empirical findings.” Support for this view can also be found in empirical research conducted by Watts and Zimmerman (1978 and 1979). Not only did they seek to develop a scientifically acceptable theory of accounting standard-setting, but also considered political issues. In their 1978 study, Watts and Zimmerman examined written submissions made to the Financial Accounting Standards Board on its discussion memorandum on General Price Level Adjustments. It is submitted that the behaviour of lobbyists when submitting written submissions, can be characterised as 'political.'

It should be clear from the above discussion that any attempt to apply a single theory to accounting standard-setting is unlikely to be successful. For the purposes of this thesis therefore, it is considered instructive to examine three alternative theoretical approaches to accounting theory, namely: the normative or prescriptive approach, the positive or descriptive approach and the eclectic approach. Within the positive or descriptive approach, economic theories of regulation as well as agency/contracting cost perspectives, all provide a satisfactory

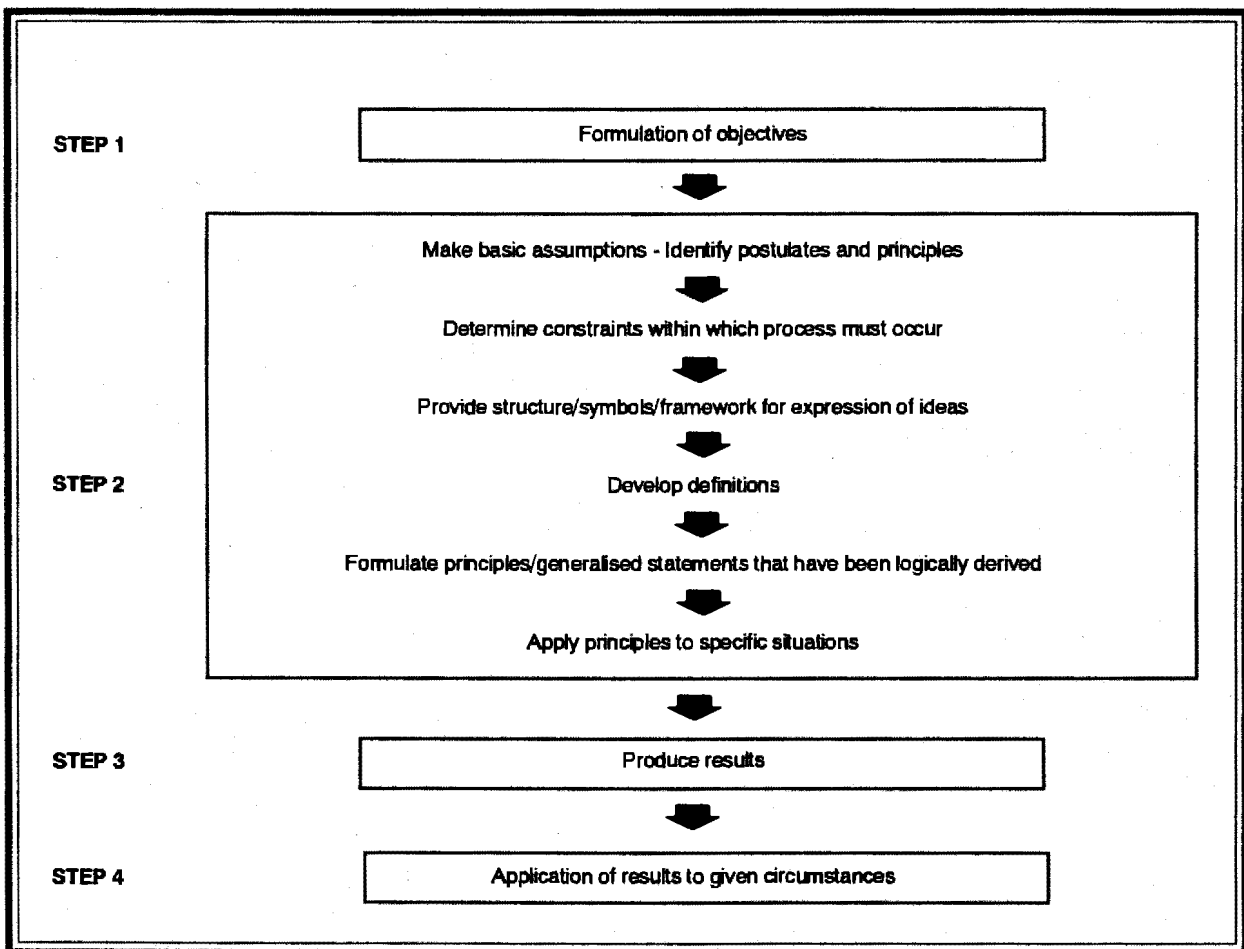
explanatory capacity capable of providing a framework for positive research in accounting standard-setting.

2.3.2 Nature of normative theories

Various authors have described normative or prescriptive theories as those theories that propose or recommend a specific course of action (Henderson *et al.* 1992:11 and Hedriksen 1982:56). A common characteristic of all prescriptive theories, suggest Henderson *et al.* (1992:11), is that they ultimately depend upon an unverifiable 'value judgement.' In addition, normative theories rely heavily on deductive reasoning that only arise after the observation of a particular event has occurred. Thereafter, a few implicit or explicit assumptions are made based on the observations, with the deductive reasoning following. The critical issue under the deductive process is the formulation of objectives. Hendriksen (1982:7) suggests that different objectives require different structures and, as a consequence, different principles may result.

The construction of a theory based on deductive reasoning is illustrated below.

Figure 2.1: Illustration of theory construction based on deductive reasoning



From the above figure it is clear that normative theory consists of four distinct parts. The first part of the theory is concerned with establishing what the objective should be, a general statement, while the second part of the theory provides a framework within which the objective will be solved. All these components are necessary for a normative theory to exist. This process can be illustrated with an example of the following theory taken from Henderson *et al.* (1992:11). "Personal income taxes should be increased to force a decrease in consumption expenditure, in order to reduce inflation." Reduced to an Aristotelian syllogism this process can be illustrated as:

Figure 2.2: Illustration of a normative theory

STEP 1:	Formulation of objective:	Inflation should be reduced.
STEP 2:	Make assumptions:	An increase in personal income tax will reduce consumption expenditure.
	Formulate principles:	A decrease in consumption expenditure will reduce inflationary pressures.
STEP 3:	Produce results:	<i>Personal income taxes should be increased.</i>
STEP 4:	Apply results to given circumstances	Test whether increases in personal income tax reduces inflation

Source: Henderson *et al.* (1992:11)

2.3.2.1 Normative theories of accounting

Having established the criteria for a normative theory, it is necessary to validate the nature of normative accounting theory. The focus of normative accounting theory according to Godfrey *et al.* (1994:56), Henderson *et al.* (1992:39), Hendriksen (1982:10), and Jensen (1983:319-320), is on policy prescriptions that recommend courses of action, rather than the analysis and explanation of accounting practice. Watts and Zimmerman (1986:9), in not disagreeing with these contentions, provide the following practical example: "Normative propositions are concerned with prescriptions. They take the form 'Given the set of conditions C, alternative D should be chosen.' For example, a normative proposition is, 'Since prices are rising, LIFO should be adopted.' This position is not refutable."

The American Accounting Association (1977(a):5) identified three normative accounting theories they described as true income, information economics and decision usefulness. The true income approach is based on the notion of 'value to the owner.' Henderson

et al. (1992:128) and Godfrey *et al.* (1994:56), in reviewing the true income approach to normative accounting theory, suggest that a deficiency of true income is that agreement is not forthcoming on what constitutes measures of value or income.

The information economics approach is, according to Henderson *et al.* (1992:42-43), based on the premise that information is a commodity capable of both supply and demand in the same way as other economic commodities. The production of information involves the consumption of scarce resources which necessitates choices by those who supply and consume the information.

The decision usefulness approach to normative accounting theory is based on the assumption that the objective of financial statements is to provide useful information that will assist users in their decision making process (Henderson *et al.* 1992:129 and Godfrey *et al.* 1994:56). The decision usefulness approach to accounting theory was confirmed by the American Accounting Association (1966:1) when defining accounting as "the process of identifying, measuring and communicating economic information to permit informed judgements and decisions by users of information."

Since the American Accounting Association's 1966 monograph there has been various attempts to develop a comprehensive framework based on decision usefulness. These includes *The Corporate Report* (1975) and *The Sandilands Report* (1975), which according to Peasnell (1978:223) "acknowledge the importance of decision-usefulness and rely on the normative-deductive classical literature without getting very bothered about the agonies of paradigm choice." This normative approach to accounting theory, suggests Glautier and Underdown (1986:35-36), reflects a degree of disillusionment with the problem of relating accounting practice to economic and social realities. Consideration should therefore be given to the development of a comprehensive framework that would provide a theoretical basis on which to judge quality and reliability of published accounting information.

Like its modern conceptual framework counterparts (South African Institute of Chartered Accountant's, 1990 and International Accounting Standards Committee's, 1989, *Framework for the preparation and presentation of financial statements*), the American Accounting Association (1966:7) suggested that to enhance decision usefulness, accounting information should contain characteristics that make it relevant, verifiable, free from bias and quantifiable. Sorter (1969:12-19) also emphasised a decision useful approach in suggesting that the events approach to normative accounting provides information about economic events that could be considered useful in a variety of decision models.

2.3.2.2 Criticisms of normative theories of accounting

Criticisms of normative theories of accounting can be categorised into three main areas: scientific, welfare, and the deficiency of existing accounting practice.

The first criticism levelled at normative accounting theory relates to the scientific testing of the theory. Nelson, [Henderson *et al.* (1992:39-40)] considered normative theories to be '*a priori*' theories. A priori research has been classified as semi research as it concerns how accounting should be done, without empirically testing hypotheses to establish the foundations of the theory (Peasnell 1978:222, Hendriksen 1982:87, Jensen 1983:320, and Godfrey *et al.* 1994:205). A second deficiency of normative accounting theory suggested by Hendriksen (1982:87), is that it focuses on the welfare of the individual investor rather than on the welfare of society. The third criticism is that normative accounting theory focuses on perceived deficiencies in existing accounting practice. Henderson *et al.* (1992:40) state that "In most cases, prescriptive theories of accounting proceed logically from a value judgement about the purpose of accounting or a deficiency of contemporary accounting." A difficulty with normative theories based on value judgements is the inability to obtain agreement on any particular normative accounting theory.

This discussion and review of normative theories of accounting is considered relevant to this study in light of recent attempts by accounting standard-setting bodies including the International Accounting Standards Committee and the South African Institute of Chartered Accountants, to develop a comprehensive theory of accounting on which to base accounting standards. This discussion also provides the foundation upon which the conceptual framework based on the decision usefulness approach to normative accounting theory, is founded.

2.3.3 The conceptual framework

This section examines the role of the conceptual framework of accounting in the private sector standard-setting environment. The possession of a conceptual framework can be viewed as a mechanism whereby private sector standard-setting bodies attempt to enhance their authority in the community. This is discussed further in 2.7.2.1 below.

Prior to the existence of a conceptual framework, Langenderfre (1973:46) suggested that accounting theory evolved from generalisations of actual accounting practice rather than from a framework of objectives and principles that set out measuring and reporting techniques. In reviewing alternative approaches to standard-setting, Solomons (1983:109) cautioned that developing accounting theory primarily on the inductive observation method described above, could lead to: "A principle or a practice would be declared to be 'right' because it was generally accepted; it would not be generally accepted because it was 'right'."

The recognition that attempts to develop a comprehensive theory of accounting on the basis described by Langenderfre (1973) and Solomons (1983) above were likely to fail, galvanised accounting bodies and theorists to undertake the development of a theory of accounting in the form of a conceptual framework. Additional impetus to the development of a conceptual framework that would provide definitive statements as to the nature and purpose of accounting was, as Peasnell (1982:244) argues, dissatisfaction with existing standard-setting programmes. In addition, Hines (1989:74) suggests that the possession of a conceptual framework would provide users of financial statements with reassurance that financial accounting does in fact have a formal knowledge base from which practices and standards are derived. More persuasive however, are the arguments of Bromwich (1992:281) and Solomons (1983:115 and 1986(b):116) who suggest that accounting standards that are developed from a coherent theoretical base provide a modicum of protection from political interference in the accounting standard-setting process. Solomons (1983:115), in summarising this position, hypothesises that although a standard developed without reference to a framework could be considered to have certain quality deficiencies, an explicit theoretical foundation is an indispensable defense against political interference:

If a standard-setting body cannot show that its standards will lead to the production of information having the qualities and characteristics necessary to attain a defined accounting objective, it will have no defence against a sectional interest that sees a standard as injurious to its welfare, for if a standard is not derived from a conceptual system, how can it be shown that one standard is better than any other? And if it is not better why should I accept your standard if I think it is going to harm me?
Solomons (1983:115).

As indicated in 2.3.2.1 above, it was the decision usefulness approach to normative accounting theory that must be considered as the foundation of the conceptual framework. Accounting theorists, although being unable in the past to develop a universally acceptable comprehensive theory of accounting, generally agreed that the purpose of financial statements is to provide financial information useful in making a wide range of economic decisions. This need for the development of sound and consistent accounting framework provides the foundation for the development of sound and consistent accounting standards, as well as the evaluation of the acceptability of alternative accounting methods, resulted in documents such as *The Corporate Report* (1975) and *The Sandilands Report* (1975), and culminated in the drafting of various conceptual frameworks of accounting.

The aim of the conceptual framework is to ensure that accounting standards are developed based on a framework formulated on deductive reasoning rather than on generalisations based on experience. This approach is supported by Miller (1985:62) who considered that the three paramount reasons for establishing a conceptual framework were: to

describe existing practice, prescribe future practice, and to define key items and fundamental issues.

According to Kam (1990:490), a conceptual framework provides criteria for the recognition of relevant economic events as well as providing a basis for judging the acceptability of alternative accounting practices. Bromwich (1992:281) and Hope and Gray (1982:531), in agreeing with Kam (1990), argue that a controversial choice of a particular accounting standard can be defended on the grounds that its development was based on a conceptual framework. Furthermore, the authority of the standard-setting bodies is enhanced if they can show that accounting standards flow from a logically constructed theoretical framework. In spite of agreement on substantive issues such as definitions like asset and liability, Gerboth (1987:1-8) cautions against the blind application of accounting element definitions to situations without the underlying circumstances being reviewed. To do so, suggests Gerboth (1987:4), would be irrational.

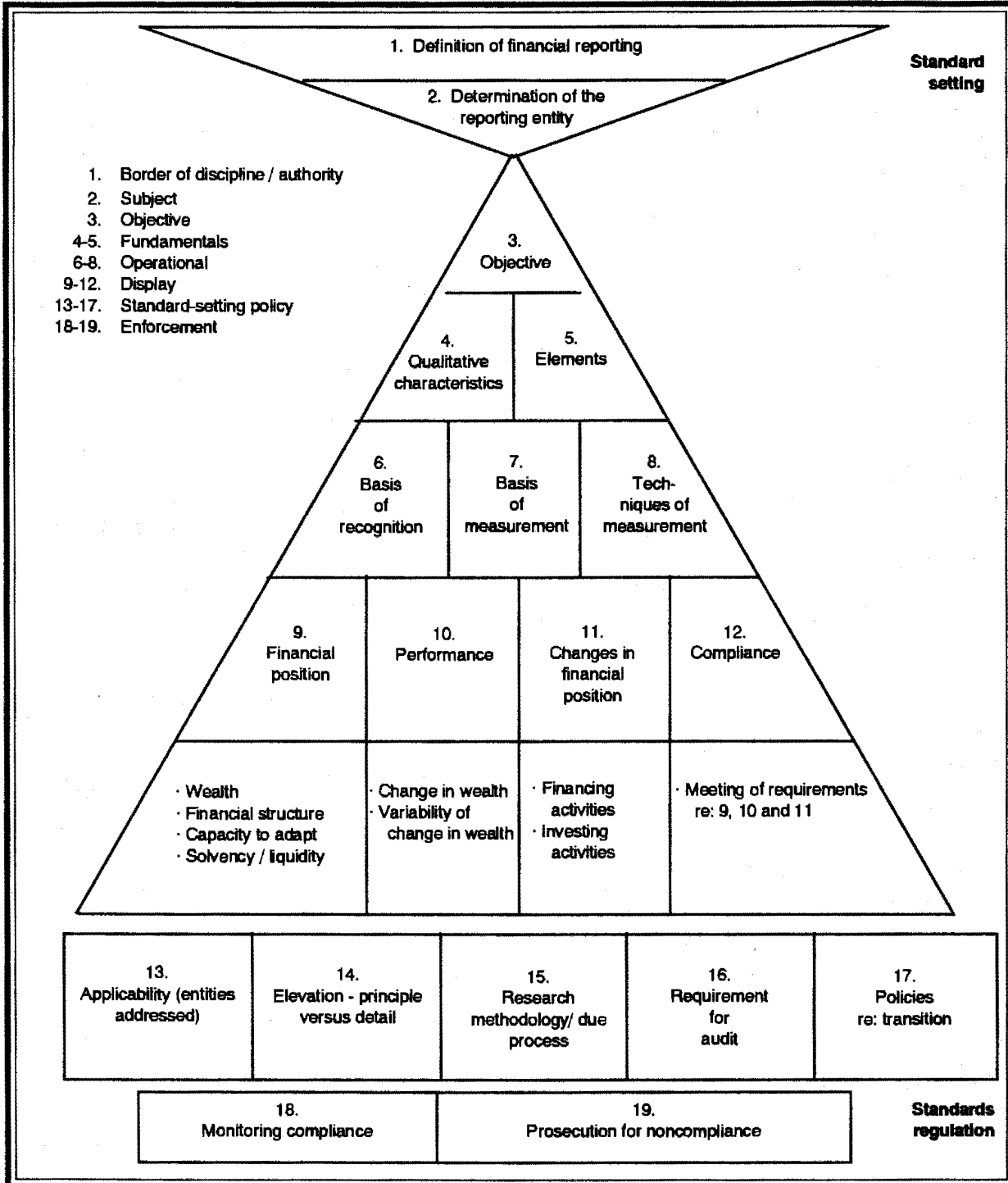
One can conclude that a comprehensive theory based on a conceptual framework provides users with the ability to properly measure items such as income or gains, expenses or losses, as well as defining elements such as assets and equity. Miller (1987:6) submitted what she considered to be a complete and effective framework that would satisfy the requirements of the accounting environment in which it is to apply:

- 1 *It should establish the overall objectives of financial reporting.*
- 2 *It should identify the entities that use economic resources and should report either publicly or to specific groups of users.*
- 3 *It should identify the various groups which have a legitimate claim to information about each entity.*
- 4 *It should identify the type of information that each reporting entity should provide to the various groups.*
- 5 *It should recommend the form of financial reporting needed to provide the information required.*

The objectives of conceptual frameworks described by Miller (1985), Miller (1987) and Solomons (1983), can be classified as being normative in nature in that they call for the evaluation of existing and proposed practices. The conceptual framework would be able to focus attention on those areas that required additional research. In addition, the framework should provide a logical basis from which to continue the development of accounting. Existing accounting statements would be revised to take into account the definitions provided by the conceptual framework, while new accounting statements would be developed on the basis of the conceptual framework.

Diagrammatically, a conceptual framework of accounting and its relationship with accounting standards can be viewed as:

Figure 2.3: Tentative building blocks of the conceptual framework for regulated financial reporting



Source: Australian Accounting Research Foundation.
Guide to Proposed Statements of Accounting Concepts, 1987

However, the creation of a comprehensive set of accounting theories and practices has been criticised and, in some quarters is considered unresolved. Bromwich (1980:288) is of the opinion that "[a] stream of partial standards provides more explicit evidence of activity than do efforts to formulate a comprehensive conceptual accounting framework," while Anthony (1987:75) states that in spite of the conceptual framework project, accounting still lacks a satisfactory conceptual framework. The primary reason for this, argues Anthony (1987:80), is the theoretical nature of the development of a conceptual framework and the inability of the Financial Accounting Standards Board (FASB) in identifying and attracting 'qualified conceptualisers' to its staff. Anthony (1987:81) does, however, concede that an analysis of the existing results suggests that the outline of an acceptable framework does in fact exist.

More recently, detractors of the conceptual framework project have questioned the inclusion of the characteristic 'neutrality' within the framework. Wyatt (1990:86) agrees that the inclusion of the term is appropriate in those rare circumstances where the conceptual framework is an inappropriate mechanism for developing a proposed accounting statement. Where a standard is found to be flawed, the inclusion of the characteristic of neutrality in the framework will provide a defence, should the private standard-setting body be accused of acting as an agent of a special lobby group. Daley and Trauter (1990:15) are convincing in their argument that, because of their very nature, accounting standards cannot be neutral. They justify this by arguing that accounting standards are social policies without *Pareto* optimal solutions. Political processes are therefore necessary to resolve conflicts. Wyatt (1990:87) agrees with this contention by suggesting that the perceived willingness of certain standard-setting bodies to depart from the conceptual framework provides evidence that these bodies are political rather than neutral.

Normative theories are concerned with what should be done, rather than analysing and explaining current or accepted practice. Within the context of this study, it is the normative approach that has been used to develop the conceptual framework that is used as the foundation of developing statements of generally accepted accounting practice.

2.3.4 The nature of positive theories

Watts (1988:5) suggests that the impetus for positive research in accounting arose from dissatisfaction with accounting's prescriptive or normative emphasis and the perceived relationship of accounting with other related disciplines, notably, finance. "Students of both accounting and finance noticed that the assumptions on which the leading academics based their prescriptions for accounting standards were inconsistent with the, by then, voluminous evidence attesting to the sophistication of capital markets" Watts (1988:5).

Through empirical research, positive accounting theory seeks to explain why accountants choose a particular accounting alternative, thereby providing scientific explanations of the relationship between accounting numbers and stock prices. It was these attempts to explain the development and communication of financial information that led to Hankansson (1969:34) suggesting that theories of this nature be called positive or descriptive theories.

2.3.4.1 Positive theory of accounting

Accounting theories which have as conceptual underpinnings one of the philosophies of science are known as scientific or positive theories to distinguish them from prescriptive or normative theories. A theory developed using these methods can be used to explain, to predict, or to both explain and predict accounting practice. This approach results in descriptive or positive theories of accounting which, according to Glautier and Underdown (1991:27), provide explanations and enable predictions to be made about behaviour. For example, the receipt of cash will be entered in the debit side of the cash book. This contention is supported by Watts and Zimmerman (1986:8-9) where they state:

Positive propositions are concerned with how the world works. They take the form 'If A then B' and are refutable. For example, the following is a positive proposition: 'If a firm switches from FIFO to LIFO and the stock market has not anticipated the change, the stock price will rise.' This statement is a prediction that can be refuted by evidence.

The contention that positive theories can be used to explain, to predict, or to both explain and predict, has led to Watts and Zimmerman (1986:2) defining accounting theory as the explanation and prediction of accounting practice. They continue by arguing that the importance of positive theory is that it can provide accounting policy decision makers (including corporate managers) with predictions of, and explanations for, the consequence of their decisions. While the positive approach to accounting theory can be traced to individual research projects conducted during the middle years of the 1960's by researchers including Ball and Brown (1968), Beaver (1966), Benston (1967) and Gordon (1964). This approach was popularised by Watts (1977) and Watts and Zimmerman (1978, 1979, 1986 and 1990). In their seminal work, Watts and Zimmerman (1978:112) sought to develop a positive theory of accounting that would "help us to understand better the source of the pressures driving the accounting standard-setting process, the effects of various accounting standards on different groups of individuals and the allocation of resources, and why various groups are willing to expend resources trying to affect the standard-setting process."

From an accounting standard-setting perspective (the theme central to this study), Belkaoui (1992:156), Felton (1982:60) and Kelly (1983:111), all concur that positive accounting has as its primary emphasis the explanation and prediction of corporate managements' selection

of accounting standards. This is done by analysing the costs and benefits of particular financial disclosure in relation to various individuals and to the allocation of resources in the economy. More specifically, Godfrey *et al.* (1994:207-208) argue that positive accounting seeks to explain whether particular accounting choices are selected for opportunistic reasons, so as to maximise their managers own utility, *ex post*, or selected for efficiency reasons, or to reduce contracting costs between the firm and claimholders, *ex ante*.

Watts and Zimmerman (1986:353-354) have suggested that the positive approach to accounting theory is based on two economic theories: the economic theory of government regulation and, the economic theory of the firm. The economic theory of the firm regards the company as a legal nexus of contracts and accounting information as the medium whereby the contracts are monitored and enforced to reduce agency costs (Belkaoui 1992:157, Godfrey *et al.* 1994:236 and Watts & Zimmerman 1986:354). The economic theory of the firm therefore assumes that the selection of accounting policies is part of the wealth maximising process (Belkaoui 1992:158 and Collins, Rozeff & Dhaliwal 1981).

Saenger (1991:54) argues that the economic theory of government regulation views the political process as the method whereby interested parties compete for wealth transfers. In the United States and elsewhere, accounting numbers (especially earnings) are used in the political process for justifying company regulation. The oil industry, suggests Watts (1988:10), is an example of this. Accounting policies also affect financial results and cash flows. Watts (1988:10) provides the example of management compensation contracts being linked to reported earnings, thereby providing incentives for executives to manipulate financial results, possibly at the expense of real corporate profitability. Watts and Zimmerman (1986:354) indicate that accounting policies and consequently cash flows, also affect the ability of a company's competitors to improve costly regulations.

A cornerstone of modern finance theory, economic theory and therefore, by implication, positive theory, is the assumption that investors behave rationally. This assumption was acknowledged from an accounting perspective by Gordon (1964:261) who suggested that corporate management acts to maximize its own utility or welfare when selecting accounting principles. It is this proposition by Gordon (1964) that enables Watts and Zimmerman (1986:301) to conclude that this was an early attempt to derive a positive theory of accounting.

In viewing the development of accounting standards, Watts (1988:10) takes cognisance of both the economic theory of the firm and government regulation:

To understand the development of accounting standards, we must go beyond the "normative" assumption that the standards reflect disinterested attempts to realize some set of accounting ideals. More illuminating, we think, is an approach which explains our current accounting standards as the result of the interaction of the various interests of government regulators, academic accounting boards, public accounting firms, and private corporations.

Watts (1988:10) believes that positive approach to accounting theory provides a more concise view of the way in which accounting methods can affect corporate cash flows, and ultimately market value. This includes the regulatory process, effects on legislation, and corporate contracts specified in terms of accounting measures.

2.3.4.2 Criticisms of positive theories of accounting

It has been suggested that the advent of positive accounting theory, particularly the 1978 and 1979 articles by Watts and Zimmerman, led to accounting academics scampering for their various ideological trenches. In spite of the numerous accolades and citations of the early works of Watts and Zimmerman and the resultant plethora of work with a positive theoretical bias, there has been persistent criticism of positive accounting theory. Although most of the criticisms of positive accounting theory have been focused on the 1978, 1979 and 1986 work of Watts and Zimmerman, these criticisms can be viewed as applying to positive accounting research generally. Briefly these criticisms relate to:

- procedures used in the original Watts and Zimmerman studies (Ball & Foster 1982, Holthausen & Leftwich 1983, McKee, Bell & Boatsman 1984),
- basic premise used by Watts and Zimmerman in the development of positive accounting theory (Christenson 1983, Hines 1988, Lowe, Puxty & Laughlin 1983, Mouck 1990, Whittington 1987), and
- methodological criticism (Chambers 1993, Stirling 1990, Tinker, Merino & Niemark 1982, Whitley 1988, and Williams 1989).

In spite of the above criticisms, positive accounting research continues to flourish, assisted, to a large extent, by the proliferation of journals prepared to publish work of this nature. As Chambers (1993:21) rather cynically observes:

It has spawned new journals only too willing to publish work of its kind. Its devotees, rising to editorial and referential posts, have shifted publication opportunities in its favour; it is the avowed policy of some journals and the implicit policy of others to disregard submissions not of its genre. Its products have captured the allegiance of whole schools in teaching institutions across the breadth of English-speaking communities, and perhaps elsewhere. As one may judge from journal acknowledgements, it is a most tightly knit and closely inbred brotherhood.

In spite of such criticisms levelled against positive accounting, this approach remains relevant to research that has as its primary focus corporate management's attitudes to the accounting standard-setting and international harmonisation.

The above discussion reviewed the differences between the primary competing theories of accounting, namely the positive and normative theory. The two alternative theoretical approaches place different emphases in their approaches to accounting standard-setting. In the context of this study, the positive theory of accounting attempts to provide explanations for current accounting practice and to predict economic decisions made by individuals in the light of accounting and other associated information available to them. This would include the regulation of accounting, the focus of the next section.

2.4 NATURE OF REGULATION

Two views associated with the development of accounting standards have been forwarded by Walker (1987:269), a regulatory theoretical approach or a change in the overall political process. This section focuses on the nature of regulation. Thereafter the rationale for regulation and the regulation of accounting is discussed.

Regulation is described by Mitnick (1980:2-5) as a form of governed, guided or controlled interference or intervention in an activity subject to regulation. It is, according to Wolk *et al.* (1992:89), essentially a political activity. The key feature to regulation is that the activity is not subject to curtailment. From the perspective of information as a commodity, the rationale for regulation is that information should be viewed as any other form of economic good.

In a seminal article describing the theory of economic regulation, Stigler (1971:3) describes the nature of regulation as follows:

The state—the machinery and power of the state—is a potential resource or threat to every industry in the society. With its power to prohibit or compel, to take or give money, the state can and does selectively help or hurt a vast number of industries... The central task of the theory of economic regulation are to explain who will receive the benefits or burdens of regulation, what form regulation will take, and the effects of regulation upon the allocation of resources.

While Stigler (1971:3-6) argues that the primary purpose of regulation is the protection and benefit of the public, it seldom occurs as interest groups attempt to capture the state's regulatory power in an effort to increase their profitability. This may be in the form of (a) direct subsidies of money, (b) raising barriers to curtail entry of competitors, (c) suppression of substitutes and complementary products and, (d) price fixing.

Regulation of an industry can arise in two ways: it may either be actively sought by the industry, or it may be forced upon it. Stigler (1971:3) with Belkaoui (1992:84) concurring,

argue that the purpose of regulation in any given industry is that it should be designed and operated primarily for its [the industry's] benefit. Wolk *et al.* (1992:81) on the other hand, justify regulation on the grounds that the public interest needs protection.

The aim of this section is to provide an overview for the rationale and to provide an indication of the various forms of regulation that accounting is subjected to. This review is considered necessary to provide a broad-based analysis of the economic, social and political influences involved in the regulatory process and their impact on the accounting standard-setting process.

2.4.1 The rationale for regulation

Ramsay (1985:354) provides two reasons for justifying regulation: the improvement of economic efficiency by remedying market failures, and equity. The rationale for government regulation of business has been the 'public interest.' Public interest can be defined, suggests Watts (1980:153), as *Pareto* optimality or economic efficiency. If a regulation is *Pareto* optimal, it would be in the public interest if it improved at least one person's condition, without worsening any other person's condition. Peirson and Ramsay (1983:293) however take an alternative view of the term 'public interest.' They suggest that in the area of politics, philosophy and law, as in economics, the term is difficult to define as it has been used in the past to 'camouflage the pursuit of self-interest.'

The equity justification for regulation, suggest Peirson and Ramsay (1983:291), is based on the premise that the pursuit of individual self interest is not necessarily congruent with the concept of maximising societies utility. Ramsay (1985:354) believes that under these circumstances, equity includes: distributive and corrective justice considerations, concern for public values, honesty and fair dealing.

2.4.2 Regulation of accounting

Interference or intervention in the accounting process can be easily understood if accounting information is viewed as an economic commodity. Any rules that govern either the form, content, or both form and content that information should take when corporations produce financial information for users, is a form of regulation. Cooper and Keim (1983:190), Daley and Trauter (1990:16), and Kelly-Newton (1980:1) all concur that the rationale for the regulation of corporate financial information is that the private market for this information does not function efficiently and fairly in the absence of government regulation. Both Daley and Trauter (1990:16) and Kelly-Newton (1980:1) suggest that the existence of regulation implies that no *Pareto* optimal solution for the provision of accounting information occurs. (A similar conclusion was arrived at by Demski

(1973:721) using *Arrow's Impossibility Theorem*, who argued that no set of standards exist that will always rank [accounting] alternatives in accordance with individuals' preferences and beliefs.) Furthermore, Daley and Trauter (1990:16) justify regulation on the grounds that private markets for information have failed to resolve issues relating to the quantity and quality of information to be produced as well as having failed to establish who should bear the cost of information production.

Leftwich (1980:194-195), in reviewing the market failure argument for financial disclosure, explains that a market failure occurs when either the quantity or quality of goods produced in an unregulated market differs from what is purported to be the social optimum. Social optimum is that output which maximises aggregate social welfare and occurs only when the prices of inputs and outputs equal their social costs. From an accounting perspective, Leftwich (1980:197-200) describes market failures as occurring when information is overproduced, underproduced, or free riders exist. Under these circumstances, government intervention is seen as the only viable alternative to move the actual output of the private market closer to the social optimum.

Accounting information is subject to a variety of rules that regulate financial reporting. These can broadly be described as legislative, listing and disclosure rules. Legislative rules, suggest Peirson and Ramsay (1983:287), regulate financial reporting and will normally be contained in a Companies Act. Solomons (1989:6) describes accounting standards of this nature as being an extension of the statutory regulation of accounting. These rules prescribe the minimum accounting records to be maintained, the form of reports to be presented to shareholders, items requiring mandatory disclosure, and audit report requirements for financial statements. From a South African perspective, this would also include the requirement that financial statements should 'fairly present' the financial position and financial result of operations for the year.

Listing rules are applicable to companies whose shares are listed on a stock exchange. These prescribe certain disclosure requirements. Peirson and Ramsay (1983:287) explain that like legislative rules, listing rules are not concerned with accounting measurement.

Disclosure rules, explain Peirson and Ramsay (1983:287), are contained in statements of generally accepted accounting practice. These rules, developed by professional associations often acting under the authority of specific acts of legislation, contain both accounting measurement and disclosure standards designed to enhance the quality of financial reporting. Adherence to these rules is necessary to comply with the 'fairly presents' requirement of the legislative rules.

In seeking to provide a rationale for the regulation of accounting, Richardson and McConomy (1992:40) argue firstly, that it is the authority of the state, acting through legislation, court decisions and professional associations that provide the context within which accounting services are exchanged. Secondly, 'input regulations' provide individuals with the right to use specific designations such as "*Chartered Accountant (South Africa)*" and allow the accounting profession to monitor and discipline their members, thereby ensuring that the designation serves as a reliable indicator of quality. Thirdly, 'output regulations' provide assurance that the quality of external auditing meets the public expectations. When an audit failure occurs, injured parties can approach the courts for recourse and to establish the auditor's liability for damages. In addition, access is also available through the profession to ensure that standards are maintained.

Watts and Zimmerman (1978:112) and Godfrey *et al.* (1994:303) have suggest that the existence of many and varied interest and pressure groups provides the rationale for what they term a decision-making, or regulatory body. The form of regulation that accounting takes is likely to affect the content and consequences of accounting policy and practices. Conversely, states Puxty, Willmott, Cooper and Lowe (1987:274), the form that the accounting rules take, will have implications for the mode of their regulation.

Various reasons have been provided for the regulation of accounting. Richardson and McConomy (1992:43) present three reasons why accounting is regulated. Firstly the market for accounting information has failed in some way; the state therefore intervenes to protect the public interest. Secondly, accounting information has economic consequences; those affected use the political process to capture the benefits of regulation to increase their wealth. Finally, accounting is regulated as it is the most efficient way in which the state and private interest groups can be aligned to maintain social order and productivity.

2.5 THEORIES OF REGULATION

Mitnick (1980:119) has suggested that it has been economists including Stigler (1971), Posner (1974) and Jordan (1972) who could be described as the developers of the economic theory of regulation. A synopsis of the following three economic theories of regulation, public interest theory, regulatory capture theory and public choice theory, is given to provide an understanding of the process of regulation and to identify their application to the accounting standard-setting process. Public interest and regulatory capture theory must be seen as being positive in nature as they are designed to explain why regulation occurs and to provide an explanation of how regulators behave.

An understanding of the above three regulatory theories is considered necessary to provide a theoretical foundation to the regulatory activity of the South African accounting

standard-setting process. This framework will serve as a basis of evaluating South African corporate management's attitudes to the accounting standard-setting process and international harmonisation.

2.5.1 Public Interest theory

Public interest theory (Belkaoui 1992:84, Mitnick 1980:91, Posner 1974:335-6, and Wolk *et al.* 1992:81) holds that regulation is a response to public demand that attempts to correct inefficient or inequitable market practices. In other words, a market failure can be said to have occurred which might be remedied by government intervention which is then justified on the basis that the regulation is the public interest. This market failure can occur either as a result of the firm being a monopoly supplier of information about itself, Wolk *et al.* (1992:81), or with what Godfrey *et al.* (1994:307) and Wolk *et al.* (1992:83) call public goods. The public goods issue is discussed further in 2.5.1.1 below.

Although a detailed discussion of the market failure concept can be found in Bator (1958), Posner (1974) and Ramsay (1985), a brief explanation follows. A potential market failure, suggests Ramsay (1985:354), occurs when there is a failure of one of the conditions necessary for the optimal operation of a competitive market. A number of potential failures in consumer markets have been identified by Ramsay (1985:355) as: (a) a lack of competition (monopoly, oligopoly); (b) barriers to entry; (c) problems with product differentiation where there are qualitative differences within a product market (and thus a lack of product homogeneity); (d) information gap between buyer and seller, or certain market signals, e.g., seller reputation may be imperfect and; (e) there may be third party effects which are not costed in the market price. This is the classical problem of 'externalities.' Leftwich (1980:194-195) concurs with Ramsay (1985) when he describes a market failure as occurring when either the quantity or quality of a good produced in an unregulated market differs from what is purported to be the social optimum.

When a market failure occurs, Leftwich (1980:195) with Fels (Godfrey *et al.* 1994:307) concurring, suggest that government intervention in the form of legislation is one method where the actual output of the private market can be moved closer to the supposed intended social optimum. Consumer or public interests are then protected with improved economic performance. This can take the form suggest Richardson and McConomy (1992:40), of restrictions on who should be allowed to practice an occupation, or on how individuals should conduct their practice.

Although Ramsay (1985:354) argues that the failure of one of the conditions necessary for optimal operation of a competitive market is necessary for intervention, it is not a sufficient condition. Ramsay (1985) justifies his stance as follows:

Government intervention is not costless and policy makers must estimate the effect of the failure on the price, quality, and quantity of goods and services provided in a market and in addition identify the financial and economic costs of remedying the failure. These include compliance, rule formulation, and enforcement costs and the potential indirect effects of intervention on market behaviour.

Peirson and Ramsay (1983:291) in concurring with Ramsay (1985), argue that regulation can only be justified when the aggregate benefits of regulation exceed the aggregate costs.

Godfrey *et al.* (1994:308) provide three additional assumptions upon which public interest theory is grounded. Firstly, consumer interests are translated into legislative action through the operation of the internal market place. Within this market, votes are seen as a form of currency and the policies, or at least the images, presented by the competing candidates for the office are the commodities being bought. Secondly, as the state is in no position to act on its own behalf in seeking regulation, Mitnick (1980:91) with Posner (1974:340-341) concurring, argues for the existence of agents (for example entrepreneurial politicians or public interest groups) who seek regulation in the 'public interest.' Finally, government plays no independent role in the development of regulations. Officials can be seen as simply neutral arbitrators who intervene costlessly in markets at the request of 'public interest' agencies.

2.5.1.1 The nature of a public good

If, as Godfrey *et al.* (1994:307) suggest, it is the public good nature of some products that leads to a market failure, it is necessary to consider the nature of a public good. Although detailed discussion of the nature of public goods can be found in Coarse (1974) and Demsetz (1970) a brief description follows. Both Ramsay (1985:357) and Cooper and Keim (1983:190) identify public goods as those commodities from which individuals may benefit without having contributed to its cost. A further characteristic provided by Bowers (1974:46) is that public goods are those goods where the consumption by one person does not reduce the ability of another to consume the same item. Bromwich (1985:61) views public goods as those goods where one person is supplied with the good, its benefits are conferred "simultaneously and generally and indiscriminately on all, or some, others in the community." Examples of public goods are television, national defence and roads, and pest control. Certain public goods are equally available to all; that is, if one person buys and consumes the good everyone else within the region also consumes the good. An example of this is fluorinated water. Although most public goods are jointly consumed, they are not necessarily consumed equally, as an individual has a choice to either consume the good or not. Television and public parks are examples of this type of public good. Coarse (1974:357-376) provides an example of a lighthouse as a public good.

Public goods are underproduced in the free market according to Peirson and Ramsay (1983:290) and Bromwich (1985:62), because of the existence of externalities. Externalities arise where the producer of a good is unable to impose production costs on the user. Wolk *et al.* (1992:83) with Peirson and Ramsay (1983:291) concurring, argue that the existence of externalities has the effect of reducing the production incentive of the public good as the consumer of the good is not charged for it. An externality, according to Beaver (1989:180), will exist "when the actions of one party have effects on other parties who are not charged (or compensated) via the price mechanism." According to Ramsay (1985:354), intervention to remedy a market failure would only occur where the economic benefits of intervention outweigh the economic costs. In Coarse's (1974) example, all ships in the vicinity of the lighthouse would benefit from it whether or not their owners had contributed to its costs. These users are known as free riders.

By being able to make use and benefit from the good without making a financial sacrifice, free riders result in the true market demand for information being understated. The good is therefore underproduced with the result that a market failure occurs. Intervention in the market is necessary to increase production of the public good.

A private good on the other hand possesses what Wolk *et al.* (1992:83) term hard property rights. This means that those parties who have not paid for the good are excluded from benefiting from it.

2.5.1.2 Accounting Information as a public good

A characteristic of a public good is that the consumption by one party does not reduce the supply of the good to any other party. The question to be asked is, does accounting information possess the characteristics of a public good?

Gonedes and Dopuch (1974), Kelly-Newton (1980:2) and May and Sundem (1976), all consider accounting information to be a form of public good. It is able to be passed freely from person to person with each person consuming the content of the information. Bromwich (1985:61) and Schipper (1993:16) both concur that from an accounting perspective, one individual's consumption of accounting information does not diminish the quantity of available for others. In other words, Bromwich (1985:61-62) is arguing that the provision and consumption of published accounting information benefits all decision makers simultaneously. No one consumer is able to benefit from this information at the expense of other consumers which would have been the case had the information flowed from private possession of the information.

From an accounting information context, theories of failure in the market for accounting information are based primarily on the public good problem. According to May and

Sundem (1976:749), demand for accounting information exists because individuals wish to improve their investment decisions. However, accounting information is, according to Gonedes and Dopuch (1974:77-78), underproduced as a result of being unable to exclude non-purchasers from accessing the information. This is the free rider problem described in the discussion of public goods in 2.5.1.1 above. Examples of free riders in accounting standard-setting are financial analysts and potential investors.

In a free market, companies do not have any incentive to produce and sell firm specific financial information. This, argues Wolk *et al.* (1992:84), results in private contracting opportunities for firm-specific information being restricted. In the absence of regulation, underproduction of accounting information may therefore result, specifically external accounting disclosure.

Intervention in the market for accounting information in the form of mandatory reporting requirements is therefore justified, state Cooper and Keim (1983:191), so that equitable and efficient production and distribution of firm-specific information occurs. Peirson and Ramsay (1983:291) however, argue that the potential for a market failure does not necessarily imply that the market for accounting information should be regulated. Foster (1980:525-532) and Cheung (1973) provide an indication of mechanisms other than regulation, that could control the effects of externalities.

2.5.1.3 Application of public interest theory to accounting standard-setting

As discussed in 2.5.1 above, public interest theory of regulation is based on the premise that intervention in an industry is supplied in response to public demands for the correction of inefficient or inequitable market prices. Regulation in the form of legislation is seen as justified if it protects the public's interest by securing improved economic performance.

The rationale for regulating financial information is based on the assumption that the information market has departed from the competitive ideal in the absence of government intervention. Two principal market failure possibilities can be identified. These are the public good problem and information asymmetry in the distribution of financial information. It is the imperfections in the market that, Cooper and Keim (1983:191) suggest, necessitates government intervention by way of mandatory disclosure requirements to ensure equitable and efficient production and dissemination of corporate information.

In a South African context, government intervention in the accounting standard-setting process could be justified under public interest theory in the light of recent corporate collapses that have occurred. These include the spectacular R600 million collapse by Masterbond and the resulting R450 million claim against the auditors Ernst & Young (Woods 1994:3), the collapse

of the Supreme Holdings group of companies as well as the fiasco concerning 101 Victoria Embankment. These collapses occurred even though the auditors of the respective institutions may have considered the financial statements to have fairly presented the financial position and financial result of those institutions prior to their demise. Godfrey *et al.* (1994:308) have suggested that collapses such as these could possibly indicate that violations of competitive conditions occurred. These conditions would have occurred as a result of the public good and information asymmetry nature of financial information identified by Cooper and Keim (1983:190).

The violation of the public good nature of accounting information would according to Godfrey *et al.* (1994:308), occur as a result of "a divergence between the marginal cost and benefits to the users of financial information produced and the marginal costs and benefits to information producers (corporate management)." The violation of the information asymmetry between the suppliers of accounting information (corporate management and accounting professionals) and users of the financial statements (investors) arose, according to Godfrey *et al.* (1994:308), because investors "did not know what accounting information they needed and/or were unable to determine the value of the accounting information they had received."

Cooper and Keim (1983:191) have argued convincingly that the existence of non-mandatory accounting and disclosure requirements is a contributing factor to the situation where the information produced by corporations fails to meet the necessary qualitative characteristics to enable informed investment decisions and resource allocations to be made.

Government intervention in the accounting standard and disclosure requirements must, in terms of public interest theory, be seen as an attempt to rectify failures in the market for accounting information. The public interest is served by a return of investor confidence in the capital market.

Godfrey *et al.* (1994:309) have argued that government intervention to protect consumers ignores studies that have provided evidence of corporate management's incentives to correct market failure perceptions concerning business activity. This is achieved through the voluntary release of disclosure information which in turn protects the users of financial information. (Studies by Morris (1984) and Benston (1969) provide early evidence of this.) Market forces exert pressure on firms to reduce uncertainty about the quality of the firm's product, the future viability of the firm, and the ability of current management to ensure appropriate returns to investors. Failure to reduce this uncertainty has been found to lead to the information being produced by the firm being viewed as what Akerlof (1970) calls, a 'lemon.' This in turn results in additional costs in higher interest charges, increased security requirements for loans and an increased threat of takeover from competitors.

The question that needs to be posed is, can public interest theory be considered more applicable to private rather than public companies who are not subject to the same public scrutiny and where the demand for financial information is not as significant as public companies? It is suggested that a convincing argument could be made for government intervention to protect the public interest in cases such as Masterbond, Supreme Holdings and 101 Victoria Embankment, companies not listed on a stock exchange.

Comprehensive criticism of the application of public interest theory to accounting has been made by Leftwich (1980). In this criticism, Leftwich (1980:199) questions the presumption that accounting information can be treated as a public good. Leftwich (1980:208) suggests that proponents of increased regulation of accounting information base their arguments on the assumption that accounting information produced in unregulated markets is defective and that, because of implicit or explicit market failures, an unregulated market is unable to remedy those defects. Leftwich counters this argument by suggesting that accounting information can more correctly be classified as a private good because its consumption by one investor reduces the quantity available to others. Leftwich (1980:200) justifies his stance as follows:

Suppose that a particular piece of accounting information, e.g., the annual income number, has value to an investor, i.e., prior to the release of the accounting information, the market value of the firm does not incorporate that information. To the extent that the investor's use of the information impounds some or all of it in the prices of the firm's securities, the value of the information to other investors is reduced.

Leftwich (1980:200) argues that implicit market failure arguments are fundamentally flawed. To illustrate this, Leftwich (1980) identifies what have been claimed by academics and the popular press as defects in the private market for accounting information. These are: (1) monopoly control over information by management, (2) naive investors, (3) functional fixation, (4) misleading numbers, (5) diversity of procedures and, (6) lack of objectivity. To overcome these defects, critics of the private market for accounting information recommend increased government regulation to improve both the quality and quantity of accounting information. Leftwich (1980:201) however counters this by arguing that proponents of increased regulation seldom present evidence of the alleged defects in privately produced accounting information, and that the evidence that is presented is at best, anecdotal. In addition he claims that no evidence is presented to support the claim that regulation improves the output of the private market for accounting information. Leftwich (1980:208) concludes as follows:

Market failure theories contain a fundamental flaw. The output identified by these theories as optimal is optimal in name only - it is defined independently of any institutional arrangements that can produce the output. None of these theories identifies a level of output which is optimal given the existing technology of markets, regulation, or any other regimes. Thus, unless market failure theories incorporate attainable institutional arrangements, they can yield on policy implications. 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.

2.5.2 Regulatory capture theory

Capture theory recognises that regulations have economic consequences. Resources are therefore invested to ensure that interests are protected. Capture theory, suggests Belkaoui (1992:84), Posner (1974:335-336) and Wolk *et al.* (1992:91), holds that regulation is supplied in response to the demands of specific interest groups who seek to maximise the incomes of their own members. Walker (1987:281) argues that regulatory capture theory refers to the capture of regulatory agencies by interest groups so as to protect their own interest.

Capture theory is based on the following two premises. Firstly, that members of society are economically rational. As a result these individuals pursue their own self interest by lobbying regulators: "The assumption here is that since regulation has the power to increase wealth, people lobby for regulations that increase their wealth or they lobby for regulations that are ineffective in decreasing their wealth" (Richardson & McConomy 1992:42).

Secondly, government has no role to play in the regulatory process. Interest groups vie for control of the governments coercive powers so as to maximise their wealth distribution. While the purpose of regulation is ostensibly to protect the public interest, Wolk *et al.* (1992:91) argue that this in fact is not achieved. The regulatee takes control of the regulator to protect its own interests. This leads to regulation developing what Hendriksen and van Breda (1992:250) term, its own momentum, a momentum based on past actions: "What emerges is a regulatory body that is 'captured' by the very forces that it was meant to control. The regulator now serves the interests of the regulated by creating a protected cartel." Posner (1974:341-342) describes this position as regulated firms "prevailing in the struggle to influence legislation, and it predicts a regular sequence, in which the original purposes or a regulatory program are later thwarted through the efforts of the interest group." Mitnick (1980:95) with Godfrey *et al.* (1994:310) concurring describe the capture process as follows:

*"Capture" is said to occur if the regulated interest controls the regulation and the regulatory agency; or if the regulated parties succeed in **coordinating** the regulatory body's activities with their activities so that their private interest is satisfied; or if the regulated party somehow manages to neutralise or insure **nonperformance** (or mediocre performance) by the regulating body; or if in a subtle process of interaction with the regulators the regulated party succeeds (perhaps not even deliberately) in **coopting** the regulators into seeing things from their own perspective and thus giving them the regulation they want; or if, quite independently of the formal or conscious desires of either the regulators or the regulated parties the basic structure of the **reward system** leads neither venal nor incompetent regulators inevitably to a community of interests with the regulated party (Mitnick 1980:95).*

In an Australian study, Walker (1987:282) provides an illustration of how a particular regulatory agency, the Australian Accounting Standards Review Board, was captured by the accounting profession. This involved positioning members of the interest group within the regulatory agency, controlling the regulator's budget or agenda, establishing countervailing sources of power (Richardson & McConomy 1992:42), and influencing new appointments.

2.5.2.1 Application of regulatory capture theory to accounting standard-setting

In examining the applicability of capture theory in the United States accounting environment, Wolk *et al.* (1992:91) notes that between 1976 and 1978, the United States Congress investigated the allegation that accounting regulation had been captured by the, then, so called "Big Eight" accounting firms. They argued that these firms would obtain the most benefit from the capture of the regulatory process as these firms were predominately the auditors of listed corporations. Furthermore, prior to the formation of the Financial Accounting Standards Board (FASB), accounting regulation was controlled by American Institute of Certified Public Accountants subcommittees which were influenced by the so called "Big Eight" firms. Wolk *et al.* (1992:91-92) however, suggest that since the formation of the Financial Accounting Standards Board, regulatory capture theory is not applicable to financial reporting in the United States.

The applicability of the regulatory capture hypothesis to accounting has been examined by Walker (1987) in an Australian study and by Willmott (1985) in an English study. Walker (1987) suggested that although the establishment of the Australian Accounting Standards Review Board (ASRB) in 1984 was to ensure the protection of the public interest, the Australian Accounting Standards Review Board was successfully captured by the accounting profession whom Walker saw as the regulated industry. The reasons for this capture suggested Walker (1987 and 1993) is that the accounting profession found it necessary to legitimise accounting standards by providing them with legislative backing. On the other hand, the accounting profession had an economic interest in retaining the standard-setting process rather than

abdicated this power to government control. What resulted was not regulatory intervention in the accounting standard-setting process to protect the public interest, but rather the capture of the standard-setting process by an elite group, the accounting profession, for its own gain.

These findings are consistent with Willmott's (1985) study of the English accounting profession. Willmott (1985:63) concluded that: "The outcome of this investigation has been the revelation of an elite group that in effect is unaccountable to the general public, and which is constrained only by the fear of state intervention." Willmott (1985:64) bases his conclusion on the following facts. Firstly, the conceptual foundation of accounting had been consistently ignored. Secondly, the public and other potential users of financial statements have been disregarded as potential users of financial statements. Thirdly, evidence to suggest that accounting standard-setting has been influenced by pressures from industry. Fourthly, standards are ineffective as there is no mechanism to enforce them and finally, the economic dependence of the auditor on the audited organisation which, Willmott (1985:64-65) suggests,

promotes a situation in which corporate management rather than the users of accounts is regarded as the 'real' client. The main sanction against organizations that breach accounting standards has been a qualified audit report. But this is unaccompanied by any further legal or financial penalty. So, in effect, standards can be ignored (Willmott 1985:64-65).

These findings provide credence to Godfrey *et al's.* (1994:316) conclusion regarding regulatory capture theory. They argue that, because accounting information has the ability to transfer wealth from one interest group to another, these interest groups seek control of the process that has the ability to increase wealth or prestige. In an accounting context, this is illustrated by the accounting profession who wish to keep the benefits of regulation for themselves by capturing the regulatory process at the expense of the public interest. Rahman (1992:5) has however, argued that if the principle of regulatory capture theory in accounting is accepted there could be unfavourable far reaching consequences. Should the accounting standard-setting body be seen to be captured and dominated by a professional body, accounting standards, argue Rahman (1992:5), could lose support from "important allies such as the politicians in power, the law enforcing agencies, and the preparers of [financial] statements."

One of the reasons that these situations occur is that regulatory agencies such as those described above are, as Richardson and McConomy (1992:42) suggest, one step removed from the political process (described in public choice theory in 2.5.3 below). As a result, those persons who have captured the regulatory process are not directly answerable to voters.

2.5.3 Public choice theory

Unlike public interest and regulatory capture theory which is based on the premise that the purpose of intervention by government in the form of regulation is to protect the public interest, public choice theory assumes that a market for regulation exists with similar supply and demand forces as those that operate in the capital market. Public choice theory, according to Posner (1974:344), is based on two simple but important insights: the coercive power of government, and the theory of cartels which provide the location of demand and supply curves. In reviewing the power of government, Stigler (1971:4) argues that the state:

has one basis resource which in principle is not shared by even the mightiest of its citizens: the power to coerce. The state can seize money by the only method which is permitted by the laws of a civilized society, by taxation. The state can ordain the physical movements of movements of resources and the economic decisions of households and firms without their consent. These powers provide the possibilities for the utilization of the state by an industry to increase its profitability.

In other words, Stigler (1971:3) is arguing that the government has the power to selectively help or hurt a large number of industries. In addition, Stigler (1971:10-13) argues that regulatory activity is a reflection of political power between interest groups and their interaction with politicians who are not neutral arbitrators but, as Leftwich (1980:195) and Watts (1980:154) suggest, like other consumers, rationally self-interested, who seek to maximise their chance of future electoral success. These officials, suggest Stigler (1971:12), 'sell' aspects of their right to coerce others in the form of supplying regulatory programmes and legislation which, according to Godfrey *et al.* (1994:312), enhances their ability to win votes and raise money to finance election campaigns.

The commodity being transferred in the political market according to Godfrey *et al.* (1994:312) is wealth, with constituents on the demand side and their political representatives on the supply side. Peltzman (1976:212) views this process as more of the commodity being transferred to those whose effective demand is the highest.

Public choice theory acknowledges that there is a demand for regulation, with supply and demand forces operating. Within the market for regulation, the most successful bidders will be those who make the highest bid for regulation. Stigler (1971:5) sees this as "every industry or occupation that has enough political power to utilise the state will seek to control entry." In Posner's (1974:345) second insight into public choice theory, the theory of cartels, he argues that the fewer prospective beneficiaries of regulation there are, the easier it will be for them to coordinate their efforts to obtain the regulation. Wilson (1980:358), in concurring with Posner (1974:345), argues that a firm is able to use state power to its advantage for two reasons:

First, the firms in any given industry are fewer in number than the persons outside the industry that must bear the cost of any restrictions on entry. Therefore, the firms seeking political protection find it easier to organise to wield political influence: since the per capita gains to them are likely to be high, they have an incentive to combine their efforts to achieve their collective ends.

On the other hand, Godfrey *et al.* (1994:313) suggest that other larger, more diverse interest groups, such as consumer and other public interest groups, are unable to make effective bids for regulation due to the costs of both organisation and information.

Godfrey *et al.* (1994:313) concludes that the fundamental assertion of public choice theory is the law of diminishing returns, found in the relationship between group size and the cost of using the political process. Unlike public interest and regulatory capture theory which both assume that regulation comes into existence as a result of government response to public demands for the rectification of inefficient or inequitable practices, public choice theory posits that regulation is sought by a 'producer' private interest group and is designed and operated primarily for its own benefit. Regulation appears to be merely a device transferring income to well-organised groups in the form of subsidies, price-fixing, control of entry of political competitors and suppression of the production of substitutes if, as Godfrey *et al.* (1994:313) suggest, the beneficiaries of regulation return the favour with votes and contributions to politicians.

Public choice theory is seen by Posner (1974:343-344) as being superior to public interest and capture theories in that (1) it discards the unexplained, and frequently untrue, assumption of pristine legislative purpose, (2) it admits the possibility of 'capture' by interest groups other than the regulated firms, (3) it replaces the 'capture' metaphor, with its inappropriate militaristic flavour, by the more neutral terminology of supply and demand and, (4) it is committed to the strong assumptions of economic theory generally, notably that people seek to advance their self-interest and do so rationally.

2.5.3.1 Application of public choice theory to accounting standard-setting

Support for the public choice theory of regulation is provided by Rahman (1992) in an Australian study. Rahman argued that the supply of government intervention in the accounting standard-setting process, was the result of its 'demand' by corporate managers and directors who wanted to protect themselves from the possibility of over-regulation following corporate collapses. Rahman also considered the accounting profession to be active in the 'supply' side in that the profession sought to strengthen their position by ruling over 'compulsory standards'.

Public choice theory of Peltzman (1976), Posner (1974), and Stigler (1971) has been applied by Rahman (1992) to the accounting standard-setting process. Rahman's (1992) study was based on what he considered to be a number of inadequacies and anomalies with Walker's

(1987) study. While Walker correctly identified that the primary interest of the accounting profession was to secure and enhance the material and symbolic value of their members' labour by negotiations with government, proponents of the public choice theory suggest that the highest bidder in the market for government regulation in the accounting standard-setting process in Australia may well have been the corporate management group. Henderson (1985:52) provides credence for this view in that he suggests that corporate management prefers having the discretion to choose or change accounting procedures in a way that is consistent with corporate interests. This appears to be consistent with Gordon's (1964) income smoothing hypothesis, as well as findings by Smith (1976) and Kamin and Ronen (1978).

It is these findings that lead Rahman (1992:1) to suggest that Walker's (1987) research can be considered flawed. Rather than the accounting profession or the user group capturing the standard-setting process, it was the well organised and politically influential producer group that ultimately controlled Australian standard-setting during the 1980's. These findings are not inconsistent with Hope and Gray's (1982) findings on the development of a Research and Development standard in the United Kingdom, or Samkin's (1993) findings on the development of a deferred taxation standard in South Africa.

In addition to Rahman's (1992) study discussed above, various applications of public choice theories have been used in evaluating the accounting standard-setting process. In using the Stigler-Posner-Peltzman model of public choice theory in studying the determination of accounting standards by the Financial Accounting Standards Board, Johnson and Messier (1982:202-211) argue that an accounting standard is demanded if a need (perceived benefit) exists. On the supply side, supply would be granted when demand was high.

Sutton (1984:118), in using a Downsian voting model of accounting standard-setting bodies, suggests that a rational individual only allocates resources to lobbying if the expected benefits to him [from lobbying] exceed the costs. Sutton's (1984) analysis covers the demand side of the regulatory market. Sutton (1984:93) concludes that (1) producers of financial statements are more likely to lobby (ie find the activity profitable) than consumers of financial statements, (2) large producers are more likely to lobby than small producers and, (3) undiversified producers are more likely to lobby than diversified producers.

Crisis theory has been used by Watts (1977:65-71) to illustrate the rationale behind the existence of regulation. Examples of corporate collapses illustrate how various crises have resulted in specific acts of legislation (for example The South Sea Bubble Act and various Companies Acts) to regulate perceived crises. Watts (1977:66) suggests that political entrepreneurs would have perceived the lack of corporate disclosure as being ultimately responsible for the collapse of the stock market in the United States during 1933. The solution

to this crisis was the establishment of a legislative body (the Securities and Exchange Commission) in an attempt to strengthen their position as law makers and law enforcers.

From an accounting viewpoint, Godfrey *et al.* (1994:315) argue that the supply of government intervention in the accounting standard-setting process:

was the result of its 'demand' by corporate managers and directors who wanted to protect themselves from the possibility of over-regulation following the media and shareholder backlash associated with the spate of corporate crashes outlined earlier. Also active in the 'supply' side were the accounting profession who sought to strengthen their position by 'ruling over' compulsory standards, and the bureaucrats themselves who wished to relieve themselves of the problems of rule enforcement and to satisfy their political ambitions.

An understanding of theories of regulation, argue Richardson and McConomy (1992:43), is necessary to appreciate and evaluate accounting standard-setting from a regulatory perspective. Godfrey *et al.* (1994:316) do however, provide the following caveat regarding regulatory theories: "None of these theories of regulation is really able to tell us if the market for financial information and, in turn, the capital markets, are now performing more efficiently and/or equitably as a result of government intervention in the standard-setting process."

In the next section a framework is sought to establish whether special interest groups (standard-setting bodies) that have been granted government recognition, are responsive to lobbying behaviour, and whether any weight is placed on the submissions of these groups.

2.6 INTEREST INTERMEDIATION

Although accounting standard-setting forms part of the regulatory process, a number of researchers including Armstrong (1977), Gerboth (1973), Hines (1983), Horngren (1972 and 1973), Hussein and Ketz (1980), Moonitz (1974), Tonkin (1981), Walker (1987) and Walker and Robinson (1994), have characterised the accounting standard-setting process as a political process. Gerboth (1973:481) in particular has forcefully argued the case for accounting standards to be formulated in the political arena:

Moreover, in those circumstances, a politicization 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.... Thus, if the current changes in the accounting rule-making process do not make it politically responsive, then more changes should be expected (Gerboth 1973:481).

In today's modern society, accounting cannot, and indeed does not, stand alone as a discipline uninfluenced by other disciplines. In accounting, and in particular the accounting standard-setting process, which functions to regulate the form and content of financial statements, there is a tangible relationship between the state, the accounting profession and users of financial

statements. In South Africa, the state traditionally plays a passive role in the development of accounting standards. The accounting profession is provided with statutory legitimacy through various acts of parliament. Individual professional accountants are also indirectly influenced by the state in that 'licences' to practice accounting are issued by the accounting profession, as well as being influenced by users of financial statements. It is clear that although a relationship exists between the state, the accounting profession and users of financial statements, the interests of these parties in the development of accounting standards is not necessarily congruent.

This section on interest intermediation will examine roles played by those parties that attempt to exercise power and control in the accounting standard-setting process. This understanding is considered necessary to obtain an understanding of how, when, and by whom, power is exercised. Hope and Gray (1982:531) argue that this understanding is a necessary prerequisite to any form of rigorous analysis of the political process. Hope and Gray (1982:533-534) have listed various forms of power that can be exerted on individuals or groups in an attempt to affect behaviour. These power forms can be described as legitimate and competent authority. Competent authority is that exercised by an acknowledged expert or by persuasive arguments, while legitimate authority is that wielded by an individual or group to whom power has been granted. Power can also be exerted by force, manipulation, coercion, and inducement. Hope and Gray (1982:534) suggest that evidence indicates that such influence had been bought to bear on the English standard-setting body, the Accounting Standards Committee (ASC).

For the purposes of this study, the influence that parties attempt to exercise in the accounting standard-setting process will be contextualised by an examination of alternative paradigms of interest politics grounded within the discipline of political science. Two forms of interest intermediation identified by Schmitter (1974:93-98 and 1977:9-10) that are considered appropriate for describing and analysing interest politics in an accounting context namely, pluralism and corporatism, will be examined in an attempt to provide insight into the regulation of accounting.

This examination is necessary to establish whether any forms of interest intermediation can be considered applicable to the accounting standard-setting process in South Africa examined in chapter three.

2.6.1 Pluralism

Schmitter (1974:95) suggests that the term pluralism is generally associated with liberal democracies, a fact Moonitz (1974:56-57) concurs with if one accepts the United States as being a liberal democracy. Pluralism has been defined by Schmitter (1977:9) as:

a system of interest intermediation in which the constituent units are organised into an unspecified number of multiple, voluntary, competitive, nonhierarchically ordered, and self-determined (as to type or scope of interest) categories that are not specifically licensed, recognised, subsidized, created, or otherwise controlled in leadership selection or interest articulation by the state and that do not exercise a monopoly of representational activity within their respective categories.

Nimmo and Ungs [Hussein & Ketz 1980:358], supported by Rahman (1992:4), argue that in a pluralistic or liberal democratic society, special interest groups exist whose function it is to promote influence in rule making. From an accounting standard-setting perspective, evidence of actual behaviour (either first-hand or by reconstructing behaviour from documents/informants) in the form of the lobbying activities of interested parties to discussion papers and exposure drafts, provide an indication of whether this form of behaviour could be considered consistent with pluralistic ideals.

The appropriateness of the concept pluralism in the setting of accounting standards has been reviewed by Hope and Gray (1982), Hussein and Ketz (1980), Johnson and Messier (1982), Rahman, Ng and Tower (1994), Walker (1987), and Walker and Robinson (1994). These studies have however, produced inconclusive results.

Hussein and Ketz (1980:364-366) suggested that the evidence provided by their study, that the Financial Accounting Standards Board was subject to wide influence, findings later confirmed by Brown (1981:246), enabled them to tentatively conclude that accounting standard-setting in the United States was pluralistic in nature. Johnson and Messier (1982) however, argued that Hussein and Ketz's (1980) conclusions were premature. In an 1987 article Walker noted that the membership and first published procedures of the Australian Accounting Standards Review Board appeared to be consistent with the pluralistic ideal. However in a later study, the evidence provided by Walker and Robinson (1994) indicated that the pluralistic notion could not be considered consistent with the accounting standard-setting process in Australia (post 1988, Walker & Robinson 1994:37). In a New Zealand study reported in the same issue of the accounting research journal 'Abacus,' in which Walker and Robinson's (1994) study is reported, Rahman *et al.* (1994) suggests that standard-setting in New Zealand can be considered pluralistic in a limited way.

In concluding about the appropriateness of pluralism (albeit in an Australian context) in accounting standard-setting, Walker and Robinson (1994:36) suggest that "the hypothesis of pluralism may be appropriate when considering the deliberations of a single agency (such as AARF or the ASRB) but it is not clear that it can readily be translated to an environment where regulatory arrangements are more complex and dynamic."

Walker (1987:283) however, expresses scepticism of the conclusions arrived at in a number of North American studies claiming that the standard-setting process is pluralistic in nature. His scepticism is based on the fact that only written submissions were used in the attempts to establish whether standard-setting bodies are responsive to lobbying behaviour. The limited scope of these studies provides the rationale for his conclusion.

2.6.2 Corporatism

Corporatism as a form of regulation has been used by academics including Puxty *et al.* (1987), Richardson (1989), Richardson and McConomy (1992), Walker (1987), Walker and Robinson (1994), and Willmott (1985) in an attempt to obtain an understanding of the process of regulation in the accounting profession, and to identify the purposes and interests served. In recognising the significance of inter-organizational relationships, Schmitter (1977:9) defines corporatism as:

a system of interest intermediation in which the constituent units are organised into a limited number of singular, compulsory, noncompetitive, hierarchically ordered, and functionally differentiated categories, recognized or licensed (if not created) by the state and granted a deliberate representational monopoly within their respective categories in exchange for observing certain controls on their selection of leaders and articulation of demands and supports (Schmitter 1977:9).

Under corporatist arrangements, Richardson and McConomy (1992:43) suggest that private interest groups are provided with an influential role in the creation and implementation of governmental policy. In supporting this contention, Walker and Robinson (1994:36) argue that corporatist arrangements are encouraged by the state as it believes that professional expertise would best be served by having a "singular hierarchically consensually led representatively monopoly." However, under corporatist arrangements the danger exists that this monopoly will make use of their expertise to pursue their own interest.

In an accounting context, Willmott (1985:62) suggests that the accounting standard-setting process can be viewed as a form of societal corporatism. In supporting his contention, he makes reference to Schmitter's (1977:9) definition as well as Schmitter's (1974:95) discussion of corporatism. Willmott (1985:62) argues that the accounting profession is in fact licensed and recognised by the state. As such, it is provided with a representative monopoly to regulate the industry. An example of this is the setting of accounting standards. By examining various forms of interest intermediation and modes of policy formation in Schmitter (1982:263) one can conclude that the accounting standard-setting process is an example of public policy formation characterised by 'concentration' rather than 'pressure' (Willmott 1985:62). As the accounting profession is completely responsible for the formulation of accounting standards, the profession will, according to Schmitter's (1982:263) criteria, take on semi-public or para-state qualities.

Walker and Robinson (1994:37) do however, provide a caveat where attempts are made to describe regulatory arrangements as corporatist. They suggest that, while the state may be content to abdicate responsibilities to the accounting profession for the development of accounting standards, a mechanism still exists for the state to intervene in this process if it perceives the profession's performance to be inadequate.

2.7 APPROACHES TO THE ACCOUNTING STANDARD-SETTING PROCESS

Agreement has not been forthcoming on whether accounting regulatory arrangements should be left to the free market, or whether it would be preferable for accounting regulatory arrangements to be set by either a private or public sector standard-setting body. This section seeks to address these issues.

2.7.1 Unregulated markets for accounting information

The accounting literature has put forward several arguments supporting the argument for an unregulated market for accounting information. These arguments are based on the premise that markets are efficient and therefore there is no necessity for financial disclosure requirements. Using explicit or implicit market models, various explanations can be used to justify unregulated financial markets. In this section certain of these arguments are discussed under the free market approach, competitive capital markets and private contracting agreements. It must be remembered however, that the arguments provided in this section are not a comprehensive summary of all arguments in favour of unregulated markets for accounting information.

2.7.1.1 Free market approach

Both Belkaoui (1992:85) and Kam (1990:549) suggest that the free market approach to accounting standard-setting has as its basis assumption that accounting information is an economic good. As with any other economic good, accounting information in the form of financial statements is subject to supply by interested preparers, and demand forces by interested users. These users include investors, creditors, security regulators and stock exchanges, amongst others, who demand information which is supplied by companies in the form of financial statements. It is this demand for information that has led to certain accounting academics, including Wolk *et al.* (1992:78), to argue that financial reporting possibly needs no regulation. Using as their premise the economic law of supply and demand, the end result will, according to Belkaoui (1992:85), be the disclosure of an optimal amount of information at an optimal price. This is discussed further under the competitive capital markets respectively.

2.7.1.2 Agency theory

As indicated in 2.2.1 above, a significant change in the ownership structure of corporations occurred post World War I. The traditional owner managed undertakings gave way to corporations where significant separation of ownership and control was evident. These corporations required the appointment of professional managers to oversee their operations. These appointments can be viewed as forming the basis of agency theory. From a legal perspective, an agent can be defined as the person employed to represent another's interests.

The economic theory of agency builds on the legal concept of agency in an attempt to predict and explain the behaviour of parties within the firm. Agency theory (Jensen and Meckling 1976:310 and Kelly 1983:115), views the firm as a nexus (intersection) of contracts and seeks to understand organisational behaviour by examining how the various parties to agency relationships within the firm act so as to maximise their own utility.

Jensen and Meckling (1976:308), with Bromwich (1992:316), Morris (1987:47) and Ross (1973:134) concurring, see agency relationships as arising from the separation of ownership and management of firms. They view agency relationships as a contractual position whereby one or more suppliers of capital, the principal, engage an agent to act on their behalf by delegating risk taking, decision making and control functions of the firm. From this relationship, various potential conflicts of interest have been identified by Kelly (1983:116). The potential conflict applicable to this study is the one between shareholder-manager giving rise to the agency cost of equity.

Using Jensen and Meckling (1976:308), and Watts and Zimmerman's (1978:113) neoclassical economic assumption that individuals are utility maximisers, it is not difficult to establish that the goals of managers and owners may not be congruent, with managers not necessarily making decisions that are principal optimal. Owners would be interested in maximising return on investment, while managers would seek to satisfy their wider economic and psychological needs through the employment contract, which would incorporate the maximisation of income. The compensation that would be subject to attempted maximisation by management, suggests Kelly (1983:115), is a function of current and future compensation, which includes components of salary, incentive remuneration in the form of cash bonuses (typically measured using either accounting net income or rate of return on book value of assets as a base), shares, share options, perquisites or other non-pecuniary rewards, and enhancements to the value of managerial human capital.

Because of the potential conflict between managers and owners relating to compensation, Wolk *et al.* (1992:78) suggest that parties contract so as to mitigate conflict. The rationale for this, according to Jensen and Meckling (1976:313), is that as the owner-manager's

proportional ownership falls, they seek to procure a larger amount of the corporate resources in the form of perquisites. Kelly (1983:116) sees the existence of monitoring and bonding agreements as tying the manager's interest to that of shareholders, thereby reducing manager's tendency to appropriate non-pecuniary benefits. These monitoring and bonding agreements include; audits of the accounting records, formal control systems, budget restrictions, explicit bonding against malfeasance and, limits on management's decision making power. Wolk *et al.* (1992:78) argue that the monitoring of agency contracts with management results in incurring costs that ultimately reduce managers' compensation. An incentive therefore exists for management to control these costs by not being in conflict with owners. By doing so, management will maximise their own welfare by minimising various identified agency costs.

This conflict between owners and managers can be mitigated to a certain extent by financial reporting. This view is supported by Thornton (1984:90) (with supplementary evidence provided by Mills 1990 and Watts & Zimmerman 1983) who argues that under agency theory the demand for both auditing and financial reporting is derived from fundamental assumptions concerning human behaviour and capital markets. What is apparent is that owners have an interest in the financial information contained in financial reports provided by managers as this is one method whereby costs associated with employment contracts can be monitored. Should management performance be linked to output, then *ceteris paribus*, their compensation should be similarly linked, otherwise the incentive to achieve is missing. Wolk *et al.* (1992:79) see the level of remuneration as being an incentive to report. As the reputation of management is enhanced by good reporting practices, higher compensation packages result. As a result, monitoring costs are minimised as owners perceive the accounting reports to be reliable. Kelly (1983:116-117) suggests conflict between owners and managers can also be reduced if compensation schemes include share ownership and option schemes which effectively convert managers to shareholders.

As accounting measurements are used to enforce many contracts within the firm, agency theory can be used in an attempt to provide an explanation of contracting parties' reaction to mandatory changes in accounting methods, especially if these changes impact on corporate management's compensation. Both Godfrey *et al.* (1994:317) and Kam (1992:550) argue that, because accounting information is the critical factor, agency theory attempts to provide a theoretical explanation of the accounting profession. It seeks to understand the nature of the demand and the costs of supplying accounting information. One of the implications that relates to this is accounting standard-setting. Holthausen and Leftwich (1983:84) rationalise this as follows:

managers can respond to a mandatory change in accounting methods by altering the firm's investment and financing decisions to reduce any unfavourable impact of the mandatory change on their compensation payments. To the extent that the new set of investment and financing decisions does not maximise the value of the firm, the mandatory accounting change causes a change in the value of the firm. Thus, changes in accounting rules have economic consequences and there are incentives for managers to spend resources to voluntarily switch to different accounting principles, or to lobby for or against proposed mandatory accounting rule changes.

Both Hendriksen and van Breda (1992:207) and Kam (1990:550) argue that, under agency theory, the demand for financial information is categorised as being either for stewardship or decision making purposes. Atkinson and Feltham (1982:260) suggest that agency theory is mainly concerned with stewardship's demand for information. This demand relates to the desire to motivate the agent and distribute risks efficiently, while the demand for information for decision making purposes focuses, according to Kam (1992:550), on the role of information in statistical decision theory.

Atkinson and Feltham (1982:261) argue that the role of standard-setting should be to identify situations where social welfare improvements would result from a common policy on financial reporting. In using *Pareto* comparisons and analysis of the efficiency with which resources and risks are allocated, Atkinson and Feltham (1982:261) argue: "Pareto comparisons consider the expected well-being of individuals on a person-by-person basis. Information policy A is **Pareto preferred** to policy B if, under policy A, every individual is at least as well off as under policy B, and at least one individual is better off."

From an accounting standard-setting perspective, policy A would also be considered preferable to policy B if more efficient allocations of resources and risk resulted. Godfrey *et al.* (1994:318) therefore conclude that accounting standards have significant economic consequences especially in those circumstances where producers are costlessly persuaded to change their output so as to conform with the social optimum.

It is submitted however, that, in the modern context, suggesting that using the agency relationship as an argument in favour of unregulated financial reporting must be considered flawed as management effectively controls the modern corporation. Support for this view is provided by Radebaugh and Gray (1993:50) and especially Chen (1975:538) who explains that:

[the small stockholder] does not have either in law or in fact the capacity to interfere in management. He is no longer an owner of the corporation in the traditional sense. Rather, he is a mere corporate citizen with the sole choice of either retaining or surrendering his citizenship in the corporation concerned. In effect, when an individual invests capital in a large corporation, he grants the management all power to control and use that resource.

For the purpose of this study, agency theory can be considered appropriate when South African corporate management's attitude to the accounting standard-setting process and international harmonisation is examined.

2.7.1.3 Competitive capital markets

In an absolutely free market environment, the law of supply and demand should operate. As a firm is required to report information about itself to suppliers of capital as well as to the capital markets in order to raise capital, it is not inconceivable that by using the law of supply and demand, an equilibrium price can be found for accounting information. Proponents in favour of the deregulation of accounting argue that contracting for accounting information can be used as an alternative to financial reporting. When circumstances arise that lead to new financial information being required, and a supplier is found willing to supply that information, the price for the information will be that price at which the supplier "still finds it advantageous to furnish the information and users believe that cost is equal to or less than the benefits of the information" Kam (1992:549). Free market forces could be employed to determine the type of accounting data to be provided and the necessary accounting standards to underpin the information.

Agency theory used to provide a framework for analysing financial reporting incentives between managers and owners, can also provide the rationale for voluntary reporting by firms. In a competitive capital market, firms compete for scarce risk capital. This potential conflict of interest between the bondholder and shareholder/management, according to Kelly (1983:116), gives rise to the agency cost of debt. In this analysis, it is assumed that management acts to maximise the value of the firm's shares rather than the value of the firm (debt plus shares). This will result in wealth transfers from bondholders to shareholders which, according to Kelly (1983:117), "can arise from discrepancies between the dividend, financing, or investment policies that were expected when the debt was originally issued and those policies that are actually followed....Rational expectations on the part of bondholders should lead them to price the debt lower in order to compensate for these potential wealth transfers."

Voluntary disclosure is one of the means whereby firms can compete in this market. The ability of a firm to raise capital will be improved if the firm has a good reputation for financial reporting. In addition, good reporting in the form of audited financial statements, also lowers a firm's cost of capital because there is less uncertainty about firms that report more extensively and reliably. As a result, there is less investment risk which translates into a lower required rate of return. Jensen and Meckling (1976:338-339) describe this method of reducing agency costs as reducing bonding costs:

Suppose, for example, that the bondholders (or outside equity holders) would find it worthwhile to produce detailed financial statements such as those contained in the usual published accounting reports as a means of monitoring the manager. If the manager himself can produce such information at lower costs than they (perhaps because he is already collecting much of the data they desire for his own internal decision making purposes), it would pay him to agree in advance to incur the cost of providing such reports and to have their accuracy testified to by an independent outside auditor. This is an example of what we refer to as bonding costs (Jensen & Meckling 1976:338-339).

Wolk *et al.* (1992:7) have suggested that incentives existed to voluntarily prepare prospectus prior to raising capital. Furthermore, regular reporting by the entity would maintain investor confidence in the firm. Wolk *et al.* (1992:78) argue that in a competitive capital market that does not require mandatory financial reporting, an incentive does exist for firms to report. A synopsis of this argument provided by Benston (1980:54) and Wolk *et al.* (1992:78) follows: Above average performance companies have a strong incentive to report their operating results to maintain investor confidence. As a result, outside competitive pressure forces other companies, even those with below par performance, to report. Silence (a failure to report) is interpreted as substandard operating results. The argument is that those companies with average performance would report to avoid the suspicion of poor results, while firms with below par performance would have to report in order to maintain credibility in the capital market. Benston (1980:54) suggests that the end result will be that those companies who chose not to disclose the same items disclosed by competitors would eventually do so as they consider that the negative connotations attached to nondisclosure exceed the costs of disclosure.

Further evidence supporting the contention that voluntary disclosure occurs in a competitive capital market is available in accounting literature from Benston (1969), Leftwich, Watts and Zimmerman (1981), Mills (1990) and Morris (1984). In a 1969 study examining accounting and disclosure reporting prior to the implementation of the 1934 Securities Exchange Act, Benston (1969:531) concluded that significant voluntary disclosure occurred prior to the legislation being enacted. Morris (1984), in a study of corporate disclosure rules and practices of certain banks, mining companies and other companies in New South Wales during the second half of the nineteenth century, (a period of substantially unregulated accounting practices,) found that certain companies voluntarily published accounting information and subjected themselves to audit. Aspects of these voluntary disclosure practices identified by Benston (1969) and Morris (1984) were later formally codified in disclosure regulations.

One can conclude that the evidence provided above lends credence to Bromwich's (1992:235-236) argument that supporters of a free market for accounting information would

expect management to be willing to issue sufficient information to allow interested outsiders to monitor behaviour.

2.7.1.4 Private contracting opportunities

Under private contracting, Wolk *et al.* (1992:80) argues that any information not provided voluntarily by the firm, can be obtained through contracting. Parties requiring additional information, suggest Benston (1969:516), would be able to obtain it by entering into a contract between the firm, owners of the firm or information intermediators, and purchase it in the same manner as other goods are purchased. In this way suggests Wolk *et al.* (1992:80), market forces would operate to establish the optimal allocation of resources in the production of information.

Wolk *et al.* (1992:80) provides an example of the stock market to indicate the willingness of individuals to contract for information. They argue that the securities market is as much a market for information as it is a market for securities. Investor newsletters, available only by subscription, are examples of where private information is paid for. Wolk *et al.* (1992:80) also suggest that a less formal purchase of information is the use of brokerage firms for investment advice. The cost of the investment advice is hidden in commission rates, but it is still a real cost.

Wolk *et al.* (1992:80) also argue that the existence of private contracting opportunities makes intervention in the form of mandatory accounting rules both unnecessary and undesirable. Information demand will be met when market forces determine the production (supply) and disclosure of accounting information.

The free market theory approach to accounting standard has been considered unrealistic by certain authors (Godfrey *et al.* 1994: 319 and Kam 1990:551), as they consider it to be unlikely that regulatory bodies will relinquish their control over the accounting standard-setting process. Furthermore, they argue that the free market theory is unworkable in that no market mechanism exists to enable the achievement of a socially optimal equilibrium price for accounting information. Godfrey *et al.* (1994:319) provide the following reasons in support of their argument: firstly, accounting information is a public good. Once information is released, it is available to everyone. Secondly, a firm has a monopoly on the supply of information about itself. The tendency will therefore be for the firm to underproduce and sell at a high price. An argument against the free market approach is also provided by Bromwich (1992:236). He suggests that the existence of market failures, as well as imperfect functioning markets, may result in accounting information manifesting some of the characteristics of public goods which are not dealt with efficiently by the market.

Even if a free market existed for accounting information, Godfrey *et al.* (1994:319) argue that a regulatory board would still be necessary as users would not be able to agree on

what they want, while accountants would not be able to agree on procedures to obtain the information.

2.7.2 Regulation of accounting: private or public sector

That accounting standards should be seen to act in the public interest cannot be disputed. The question that must be answered is how will the public interest best be served? Will this be achieved by having accounting standards be set in either the public or private sector? The following section examines both the private-sector and public-sector approaches to the accounting standard-setting process.

2.7.2.1 Private sector regulation

The private sector approach to the regulation of accounting standards, asserts Belkaoui (1992:87) is based on the assumption that the public interest is best served if the accounting standard-setting process is left to the private sector. In any private standard-setting environment, two unique problems are identified by Bromwich (1992:273) that require resolution before standard-setting commences: (1) the mandate for policy makers to lay down 'quasi laws' affecting a wide range of people and, (2) a method for obtaining consensus on accounting standards.

Belkaoui (1992:87-89) and Kaplan (1980:182-186) provide the following arguments both in favour of and against private sector regulation of accounting standards. Although these arguments relate primarily to the United States situation, it is considered instructive to review them here:

Arguments in favour of private sector regulation of accounting:

- The composition, financial support, and the due process of relying on responses of interested parties ensures that private standard-setting bodies are responsive to their constituents. The due process procedure also generates an active concern about the consequences of its actions on its constituents.
- Private standard-setting bodies are able to attract and retain staff who have the necessary technical knowledge to develop and implement alternative measurement and disclosure systems that are more likely to be accepted by preparers and users.
- Responses from constituency base can be generated and responded to through discussion memoranda and exposure drafts.
- A purely private standard-setting body would be relatively insulated from political pressure from government.
- Because of the costs involved, private sector standard-setting bodies would be more likely to appreciate the inherent weaknesses in accounting standards and that manipulation and extreme use of permissible accounting standards will result.

- Pressure would be exerted on private standard-setting bodies to avoid producing standards that result in expensive subjective data that introduces volatility to financial statements, disclosure and auditing.

Arguments against private sector regulation of accounting

- Private sector bodies lack both statutory authority and enforcement power, and can be overridden by legislation.
- Private standard-setting bodies are vulnerable to the accusation that they have been captured by private interest and are no longer responsive to the public interest. Undue influence from large accounting firms and corporations can result in the impairment of independence, and translate into a lack of responsiveness to the public interest.
- Private standard-setting bodies can be accused of not acting in the public interest as major issues are not resolved timeously due, in part, to the length of time required for due process and deliberations or to the impact that the changes may have on important groups among its constituents.

Over the years, dissatisfaction has been expressed both in the popular press and professional accounting magazines with the level of accounting disclosure in South Africa, as well as the non compliance by certain publicly traded companies with promulgated accounting standards when preparing financial statements. This sorry state of accounting in South African occurs, suggests Singer (1994:7), with the support of preparers and auditors. A contributing factor to this state of affairs is the number of flexible accounting standards that have been issued. This resulted in what Terry (1992:127), in an editorial opinion in the May 1992 issue of *Accountancy SA* describes, as South Africa establishing itself as one of the "cowboys of the accounting world." Bunting (1993:26), in evaluating the 1992 CA Reporting Award, commented that the disclosure content of financial statements of many companies listed in the industrial and development capital sectors of the Johannesburg Stock Exchange was mediocre. More recently Crotty (1995:20) has argued that in the absence of legal backing, a generally accepted accounting practice can be interpreted as any practice pursued by a handful of companies. Continuing criticism of both content and compliance of South African accounting standards could result in pressure being sought to have standards set in the public sector described in 2.7.2.2.

The adoption of the International Accounting Standards Committee's conceptual framework project in South Africa can be seen as a manoeuvre by the private standard-setting body, the South African Institute of Chartered Accountants, which as Hines (1989:89) suggests is, "[an attempt to] provide legitimacy to standard-setting bodies and the accounting profession during periods of competition or threatened government intervention."

2.7.2.2 Public-sector regulation

As early as 1958, Spacek (1966:84) warned that failure by public accountants to improve the quality of their performance would lead public accountants being replaced with government regulators. Like private sector regulation, public sector regulation of accounting standards is based on the premise that the public interest needs protecting. Justification for public-sector regulation would occur if private sector accounting, together with market forces, fails to provide the necessary mechanisms to effect changes in accounting.

Belkaoui (1992:90-91) and Kaplan (1980:187-193) have provided the following arguments both in favour of and against public sector accounting standard-setting. As with private sector regulation, these arguments relate primarily to the United States environment.

Arguments in favour of public sector regulation of accounting:

- A government agency could be viewed as a 'creative irritant,' that would provide the necessary catalyst and leadership from 'safe' or 'conservative' methods of accounting towards more innovative and realistic methods of accounting.
- Public interest would be protected in that a mechanism would exist to offset preparer bias that institutionally exists in the standard-setting process, as well as offsetting the economic limitations of investors seeking adequate information.
- Users needs would be continually determined by surveying analysts and other interested users.
- Experiments in disclosure policy could be conducted as they would be enforceable and could proceed uncontested by all participants in the standard-setting process.
- Private sector interest may sometimes contradict the public interest.

Arguments against public sector regulation of accounting:

- There is a high corporate cost for compliance with government regulation of information.
- Bureaucrats have a tenancy to maximise the total budget of their bureau. This assumes that staff members act so as to maximise their own utility with no consideration for the costs and benefits of additional disclosure.
- Standard-setting may become increasingly politicised. Special interest groups lobbying the government agency could disrupt the creation of 'fair' standards. Armstrong (1977) provides an example of this.
- A government system backed by police power could hinder the conduct of research and experimentation of accounting policy and is not essential to achieve standardisation.
- Accounting standards could become extremely detailed and complex, with standards unlikely to ever be rescinded, new standards could be introduced with no regard to the incremental costs to firms, resulting in an information overload.

- Delays in releasing financial statements could result.

Accounting standards set in the public sector would be essentially normative in nature, in that they would prescribe a course of action. It is also submitted that standards developed in this manner would be unable to keep pace with the rapidly changing and increasingly complex business environment.

Authors including Belkaoui (1992), Benston (1980), Horngren (1972), Kaplan (1980), and Moran and Previts (1984) have debated the issue of whether the accounting standards should be set in either the public or private sector. These authors (including Daley & Trauter 1990) acknowledge that the responsibility for regulating financial reporting is often divided between the public and private sectors. Walker and Robinson (1994:19) suggest that conflicts may occur between government agencies and the profession's rule-making bodies as each seek to establish, maintain or expand their sphere of influence.

2.8 ECLECTIC APPROACH TO ACCOUNTING THEORY

As was discussed above, it is clear that the development of accounting theory has followed a combination of approaches rather than one specific approach. This has lead Belkaoui (1994:65) to suggest that the formulation of accounting theory and the development of accounting principles has followed an eclectic approach. This approach can be viewed as the result of the participation by individuals, the accounting profession as well as government sponsored bodies in establishing accounting concepts and principles. It is this eclectic approach, argues Belkaoui (1994:65), that has lead to the development of new dimensions to accounting. For the purpose of this study these dimensions would include the normative approach of decision usefulness contained within the conceptual framework, as well as various theories including those of a regulatory nature contained within the framework of the positive approach to accounting theory.

2.9 CONCLUSION

In this chapter the theoretical foundation for the formulation of accounting standards, including the nature, purpose and various aspects of regulation of accounting and accounting standard-setting, were considered. This was considered necessary in order to provide the background against which to study South African corporate management's attitudes to the accounting standard-setting process and international harmonisation, and place the study within the appropriate theoretical context.

Firstly, the accounting standard-setting process was reviewed due to the central theme of this topic within the context of this study. This review reflected that convincing arguments exist both for and against accounting standards. Furthermore by their very nature,

accounting standards can only provide incomplete direction which therefore necessitates the exercising of professional judgement.

Secondly, the concept theory and alternative theories of accounting were examined. In particular, two competing theories of accounting were examined, namely normative and positive theories. Within the framework of normative theory, which prescribes how information should be reported in financial statements, the conceptual framework was examined. This framework was seen as the private sector's attempt to enhance its authority within the accounting community as well as providing protection from political interference in the accounting standard-setting process. This would be achieved by ensuring that all standards were developed using a soundly conceived and consistent theoretical framework. Positive theory was examined because of the perceived dissatisfaction with prescriptive or normative theories. This approach to accounting standard-setting attempts to explain and predict management's choice of accounting standards. This was considered necessary as these two conflicting approaches place different emphases on accounting standard-setting.

Three specific economic theories of regulation were examined in an attempt to provide an understanding of the process of regulation and their application to the accounting standard-setting process. Public interest theory was seen as regulation occurring in response to public demand for the correction of ineffective or inequitable market practices occurring as a result of a market failure. Regulatory capture theory recognises that regulations have economic consequences. Members of society, as economically rational individuals, lobby regulators to pursue their own self interest. In doing so they capture the regulatory process. Private interest theory is based on the premise that there is a market for regulation with similar supply and demand forces that operate in the capital market. Within the market for regulation, the most successful bidder will be those who make the highest bid for regulation. An understanding of theories of regulation is necessary to both appreciate and evaluate accounting standard-setting from a regulatory perspective.

In view of the fact that the accounting standards are a form of regulation, the nature and rationale for the regulation of accounting is examined. This examination is essential in providing the background to understanding specific aspects of accounting regulation. The concept of interest intermediation was used to examine the role played by interest politics in the development of accounting standards. Two forms of interest intermediation, namely pluralism and corporatism were studied in an attempt to provide additional insight into the parties that seek to exercise power and influence over the accounting standard-setting process.

Finally alternative approaches to the accounting standard-setting process are examined. In this section, the question of whether the accounting standard-setting process

should be left to free market forces or set by public or private standard-setting bodies is reviewed. The conclusion reached here is that even though accounting standards could be set using free market forces, a regulatory body would be necessary to monitor detail and compliance with standards. On the question of private and public sector standard-setting, the conclusion is reached that responsibility for this function is often shared by these bodies.

The next chapter examines in detail the accounting standard-setting process in South Africa, and the rationale behind the South African Institute of Chartered Accountant's decision to adopt International Accounting Standards Committee statements of generally accepted accounting practice after exposure in South Africa. This examination is necessary to provide the framework from which South African corporate management's attitude to the accounting standard-setting process and international harmonisation can be studied. The concept of harmonised accounting standards is examined. Included in this examination is an explanation of the terms harmonisation, standardisation and uniformity. Arguments in favour of and in opposition to the international harmonisation of accounting are also reviewed. Environmental impediments to the harmonisation process, including an examination of comparative development patterns, classification of accounting practices and cultural and development influences are provided.

CHAPTER THREE

ACCOUNTING STANDARD-SETTING AND INTERNATIONAL HARMONISATION: THE SOUTH AFRICAN POSITION

- 3.1 INTRODUCTION**
- 3.2 THE SOUTH AFRICAN STANDARD-SETTING PROCESS: A HISTORICAL OVERVIEW**
- 3.3 THE HARMONISATION OF ACCOUNTING STANDARDS**
- 3.4 ENVIRONMENTAL IMPEDIMENTS TO INTERNATIONAL HARMONISATION**
- 3.5 OVERCOMING IMPEDIMENTS TO THE HARMONISATION PROJECT**
- 3.6 ROLE OF THE INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE IN THE HARMONISATION PROCESS**
- 3.7 INTERNATIONAL HARMONISATION OF ACCOUNTING STANDARDS: THE SOUTH AFRICAN POSITION**
- 3.8 THE SOUTH AFRICAN ACCOUNTING STANDARD-SETTING PROCESS REVISITED**
- 3.9 THE ROLE OF SOUTH AFRICAN CORPORATE MANAGEMENT IN THE ACCOUNTING STANDARD-SETTING AND HARMONISATION PROCESS**
- 3.10 CONCLUSION**

3.1 INTRODUCTION

In chapter two, the conceptual underpinnings of accounting standard-setting were examined in order to establish a framework within which the South African accounting standard-setting process and international harmonisation could be studied. As is illustrated in chapter two, the accounting standard-setting process can be both controversial and problematic at the national level. Standard-setting at the international level is, in view of the problems associated with this process, more complex and dynamic. In agreeing with this contention, Wallace (1987:15) hypothesises that international accounting research is likely to parallel recent approaches to understanding domestic operations. She does, however, agree that it is likely to be more complicated "due to the diverse environments internationally, particularly with respect to contracting practices, government, ownership, regulation and intervention, and cultural influences on perceptions" (Wallace 1987:15).

As the language of business, accounting is a service activity. As such it should be seen to be both technically and socially useful and dynamic enough to be able to respond to the changing needs of society. At a national level, accounting reflects the cultural, economic, legal, social and political conditions of the society within which it functions. It is these differing environmental considerations that affect the development of accounting systems and standards. For the purposes of this study, the definition of accounting standards provided by Van der Tas (1988:157) suffices: "Standards will be defined as any financial reporting rule published by either government or private standard-setting body. These standards can refer either to the degree of disclosure or to the accounting method to be applied."

Within the international community, countries are also subject to internal and external influences that influence their development. As with the national level, this includes historical, moral, cultural, economic and political factors. National differences that arise as a result of these environmental factors means that accounting information of a multinational company operating in a number of different countries will be subject to the application of different financial accounting standards. Even though financial decisions are becoming increasingly international in nature, Choi (1994:1) explains that most businesses continue to prepare their financial statements in line with local accounting standards which are "rooted in local business culture." As a result, corporate management and other users of financial statements are faced with financial results that differ depending on which accounting standards were applied.

This chapter commences with a historical overview of the South African accounting standard-setting process, including the steps taken from the inception of a standard to its issue. The parties involved in this process, including the roles played by them, are discussed. In view of the importance of accounting standards to this study, this review is considered necessary to provide an understanding of how accounting standards are developed and the roles played by the different parties, including corporate management in their development.

Against this setting, the concept of harmonised accounting standards is examined. This will include explaining the differences between terms often used interchangeably, namely harmonisation, standardisation and uniformity. Arguments used to support and oppose accounting harmonisation will be examined.

Environmental impediments to the harmonisation process are then reviewed. This includes an examination of comparative development patterns, classification of accounting practices, cultural and development influences and problems of developing nations, focusing on those in Africa. What is suggested are feasible alternatives to the harmonisation process, envisaged by the International Accounting Standards Committee, are proposed.

The 1993 decision (Blumberg 1995(b) and Mockler 1993:3) by the South African Institute of Chartered Accountants to adopt International Accounting Standards Committee statements of generally accepted accounting practice makes it necessary to examine the role of this body in the harmonisation process. The roles of all parties involved in the harmonisation process, including the development of International Accounting Standards, are examined together with the attempts made to address the alleged inferiority of these standards. The efforts made towards the harmonisation of accounting standards would imply that accounting techniques, and concepts that exist and are unique to each country, can be made to conform to globally acceptable principles and concepts.

The South African position regarding the harmonisation of accounting standards is also reviewed. A possible reason for the South African Institute of Chartered Accountants' obsession with this process is that they perceive that South African companies which prepare their accounts using international accounting standards will find it easier to compete for funds in the international arena now that comprehensive international sanctions against South Africa have been lifted.

The proposed standard-setting process is also examined. This includes a review of the role it that various parties will play in this proposed process. Finally, the role of South African corporate management in the harmonisation process is reviewed.

3.2 THE SOUTH AFRICAN ACCOUNTING STANDARD-SETTING PROCESS: A HISTORICAL OVERVIEW

In this section a brief historical overview of the South African accounting standard-setting process and its development is provided. This illustrates that the South African accounting standard-setting process had very humble beginnings. In fact, the importance of the role that South African corporate management could play in the accounting standard-setting process was formally recognised only with the establishment of the Accounting Practices Board.

Prior to 1973 financial reporting in South Africa was regulated by the *Companies Act* of 1926. Comprehensive provisions regarding information to be disclosed in financial statements were introduced to South Africa with the incorporation of the Eighth Schedule (which had as its origins the recommendations of the English Institute of Chartered Accountants) into the 1926 *Companies Act* by Act 46 of 1952. During this period the close trading ties between South Africa and England ensured that South African accounting had a strong English bias. The influence of the Institute of Chartered Accountants in England and Wales was particularly significant. As Hinton (1968:11) explains, the South African Companies Act was based on English company legislation and, as a result, South African reporting requirements were almost identical to those of England.

The formal development of South African specific statements of accounting practice is traced to the year 1962 with the appointment by the Joint Council of the Societies of Chartered Accountants of South Africa (Joint Council) of a standing committee for the purposes of preparing statements on auditing and accounting. Statements prepared by this committee were to be issued on approval by Joint Council to members of the four provincial Societies (Shuttleworth & Vieler 1965(a):29). By November 1964 the Accounting and Auditing Standards and Procedures Committee of Joint Council had recognised the need for the South African accounting profession to establish some uniformity of the terms and descriptions used in financial statements. This was to be the third statement issued by Joint Council (the first two being auditing statements on general principles and stock and work in progress) (Shuttleworth & Vieler 1965(c):31-32). The task of preparing the statement on accounting principles was given to the Natal Task committee (Shuttleworth & Vieler 1965(e):35). By 1965 two auditing statements had been issued while a statement on accounting principles and another on terms used in accounts, reports and certificates was still to be prepared (Shuttleworth & Vieler 1965(a):29).

The adoption of the Eighth Schedule did not find universal favour with the South African accounting profession (Shuttleworth & Vieler 1967(a):83 and 1967(b):119). In fact, the detail required by the Eighth Schedule was viewed in some quarters as not contributing to the primary purpose of financial statements, namely the presentation of a true and fair view. This attitude is apparent in the April 1967 editorial by Shuttleworth and Vieler (1967(b):119) appearing in *The South African Chartered Accountant* which, it is suggested, viewed the Eighth Schedule with an element of suspicion when arguing "we believe that there is an inherent danger in laws and regulations which seek to lay down detailed accounting and disclosure requirements; the danger of accounting becoming a form filling technique, with the presentation of the true and fair view being subordinated to the application of the technique" (Shuttleworth & Vieler 1967(d):119).

This apparent disquiet expressed in the Editorial over the Eighth Schedule appears to have unconsciously spilled over into the development of accounting statements. This is evidenced by the fact that by the time the National Council of Chartered Accountants South Africa met on 20/21 October 1969, the technical statements on accounting principles and accounting terminology were still in the pipeline (Woodhouse 1969:369).

During the 1960's the South African accounting profession was kept abreast with overseas developments by articles that appeared in various issues of the *South African Chartered Accountant*. For example, how the American drug company, Richardson-Merrell Inc. disclosed the existence of contingencies that arose as a result of the misuse of the cholesterol-inhibiting drug MER/29 and thalidomide, was illustrated in the July 1965 (Shuttleworth & Vieler 1965(b):16-17) issue of the journal.

It is not unreasonable to suggest that during the decade of the 1960's, there was no consistency in accounting policies used by companies in South Africa to account for similar items. This suggestion is supported by the following comment made by Shuttleworth and Vieler (1965(b):14) that appeared in the February 1965 issue of the *South African Chartered Accountant* "At present time it is not general practice in South Africa to describe, in accounts, the basis of stock valuation" (Shuttleworth & Vieler 1965(b):14).

Failure to disclose the basis of stock valuation was not the only problem facing financial statement users during this period. Other problems included the non-disclosure of items such as turnover (Putland 1968(b):230) and extreme permissiveness in financial reporting (Vieler 1977:156). In a review of the 30 June 1967 financial statements of Hanky-Jardine Holdings Limited, the need for some measure of standardisation in the presentation of financial statements was finally recognised. These financial statements were criticised by Putland (1968(a):150-151) on the grounds that "the recognised sequence of headings has been largely reorganised, even to the extent of disguising the true shareholders' interest by treating preference share capital not as permanent capital employed but as a reduction of the capital invested in assets!"

In March 1971 the Accounting Principles Committee of National Council (Woodhouse 1971(a):91) was set up and entrusted with the development of South African accounting standards. The uncertainty surrounding the forthcoming Companies Act inevitably resulted in a certain amount of wasted effort (Jeffery 1973(b):426). Foreign influence, particularly that of England, was still apparent in the development of South African accounting standards during this period (Jeffery 1973(a):232-234). Before a South African statement was exposed, overseas pronouncements were consulted (Woodhouse 1971(b):219). This consultation resulted in the South African exposure draft on Inventories being held back when the English Institute postponed issuing a statement on the same topic (Woodhouse 1972(a):99). Prior to this postponement, exposure draft 1, dealing with the disclosure of accounting policies, had been re-exposed on the basis of comments received as well as the issue of a statement overseas on the subject (Woodhouse 1972(c):167). April 1971 saw greater uniformity (but not inflexibility), and greater information content (but not obscurity) being called for in financial statements (Jeffery 1971(a):117). Although Smith (1971:319), the then Chairman of the National Council of Chartered Accountants of South Africa, saw the development of accounting standards in South Africa as being necessary to provide a firm foundation for financial reports relevant to South African law and circumstances, he considered it necessary that these standards should also be in line with overseas practices. Smith (1971:319) viewed this harmonisation as being vital in light of South Africa's role in international trade.

Following difficulties and confusion in the interpretation of the word 'principles' (Cox 1965:6-7, Gibbs 1972:237, Jeffery 1972:235 and Stamp 1969:314), National Council made the decision to change the name of the Accounting Principles Committee to the Accounting Standards Committee (Woodhouse 1972(c):167). In October 1972 the name of this body was again changed to the more familiar Accounting Practices Committee (Woodhouse 1972(e):379).

It was the accounting profession, in the form of the Accounting Standards Committee, through the National Council of Chartered Accountants of South Africa, that sought to make compliance with accounting practice mandatory. To achieve this, the Accounting Standards Committee lobbied the Company Law Commission, the body responsible for the redrafting the Companies Act (Woodhouse 1972(b):100) in order to legislate the requirement that financial statements conform to generally accepted accounting practice (Woodhouse 1972(d):380). While recognising that a failure to establish a clear, definite and acceptable set of standards for financial accounting and reporting would lead to this function being usurped by some body, possibly even government (Vieler 1977:156), the accounting profession viewed themselves as the body best able to codify generally accepted accounting practice (Woodhouse 1972(d):167). The result was a decision in September 1972 to form the Accounting Practices Board (Woodhouse 1972(e):379-380) whose function would be to determine generally accepted accounting practice.

To make the Accounting Practices Board representative of all preparers of financial statements, Vieler (1973:239 and 1977:155) and Woodhouse (1972(f):464) indicated that other interested parties, such as the Johannesburg Stock Exchange and the principal associations representing commerce, industry and mining, would be approached to serve on the Board. This change can be seen as progressive, as prior to this, the accounting profession did not view corporate management as being able to make a significant contribution to the development of accounting standards. Although 'relevant' exposure drafts had been exposed to all the bodies representing business in one form or another (Jeffery 1971 (b):321 and Woodhouse 1971(c):328), the views of chartered accountants were the Accounting Principles Committees' main guide as to the worth of the exposure draft.

The year 1973 can be viewed as being the commencement of 'the new age' in South African accounting standard-setting. The promulgation of the *Companies Act*, Act 61 of 1973 as well as the formation of the International Accounting Standards Committee contribute to this view.

3.2.1 Review of the South African accounting standard-setting process

In this section the composition of and roles played by the Accounting Practices Committee and the Accounting Practices Board in the development of an accounting standard are described. In

addition, the process including the individual stages through which a South African accounting standard is developed is explained. This review provides an indication of both the direct and indirect involvement of South African corporate management in the accounting standard-setting process.

3.2.1.1 The Accounting Practices Board

The South African Institute of Chartered Accountants, the body representing chartered accountants, is responsible for the setting of accounting standards or as they are more commonly known, statements of generally accepted accounting practice. The initiative for developing standards and advising on their applicability was taken by the body then known as the National Council of Chartered Accountants (South Africa) (Flynn & Weil 1991:156). To ensure that accounting standards developed commanded the widest possible acceptance, a decision was taken by the National Council of Chartered Accountants to form a body sufficiently representative of the business community to provide the leadership in setting accounting standards. This resulted in the creation of the Accounting Practices Board. Current representatives on the Accounting Practices Board are indicated in table 3.1. By virtue of their industry representation on the Accounting Practices Board, South African corporate management can be viewed as having playing an indirect role in the accounting standard-setting process.

Table 3.1: Current members of the Accounting Practices Board

- | |
|--|
| <ul style="list-style-type: none">• Banking Association Joint APC Committee• Chamber of Mines of South Africa• Die Afrikaanse Handelsinstituut• Institute of Municipal Treasurers and Accountants• Investment Analysts Society of Southern Africa• Public Accountants' and Auditors' Board• Southern African Accounting Association• The Chartered Institute of Management Accountants• The Johannesburg Stock Exchange• The South African Chamber of Business• The South African Institute of Chartered Accountants• The South African Institute of Chartered Secretaries and Administrators |
|--|

The control, development and issue of statements of generally accepted accounting practice in South Africa rests with the Accounting Practices Board. This organisation is charged with establishing and procuring the recognition and acceptance of generally accepted accounting practice. Since its inception in 1973, the Accounting Practices Board has approved and issued 23 statements of generally accepted accounting practice. These are listed in appendix one.

According to Blumberg, (1995(a):1) Accounting Practices Board members are appointed by their constituent bodies as follows: The South African Institute of Chartered Accountants appoints five members, the Johannesburg Stock Exchange appoints two members, while all other bodies appoint a single member. Members are not appointed in their personal capacities but as Blumberg (1995(a):1) explains, "to convey to the meetings of the Board the views of the constituent bodies they represent." Approval of the existing constituent bodies of the Accounting Practices Board must be obtained before any new body or association is appointed to the Board.

The chairman of the Accounting Practices Board is non-voting and does not represent any constituent body. In recent years this individual has been a retired member of the South African Institute of Chartered Accountants. All other members of the Accounting Practices Board are entitled to a single vote.

Secretarial functions of the Accounting Practices Board are provided by the South African Institute of Chartered Accountants who, according to Blumberg (1995(a):2), also provide the bulk of the funding required for the standard-setting process.

3.2.1.2 The Accounting Practices Committee

The Accounting Practices Committee is a committee of the South African Institute of Chartered Accountants responsible for the development of statements of generally accepted accounting practice. Once the statements of generally accepted accounting practice have been developed by the Accounting Practices Committee, they are submitted to the Accounting Practices Board for approval.

The Accounting Practices Committee is responsible for monitoring accounting developments both in South Africa and elsewhere. As Blumberg (1995(a):2) explains, this is to identify whether a need for a new accounting pronouncement exists, or whether existing standards require revision.

The composition of the Accounting Practices Committee is illustrated in table 3.2.

Table 3.2: Participants in the Accounting Practices Committee

- | |
|---|
| <ul style="list-style-type: none">· 1 chairperson· 4 auditors· 3 preparers· 2 users· 1 academic· 2 International Accounting Standards Committee representatives (as observers) |
|---|

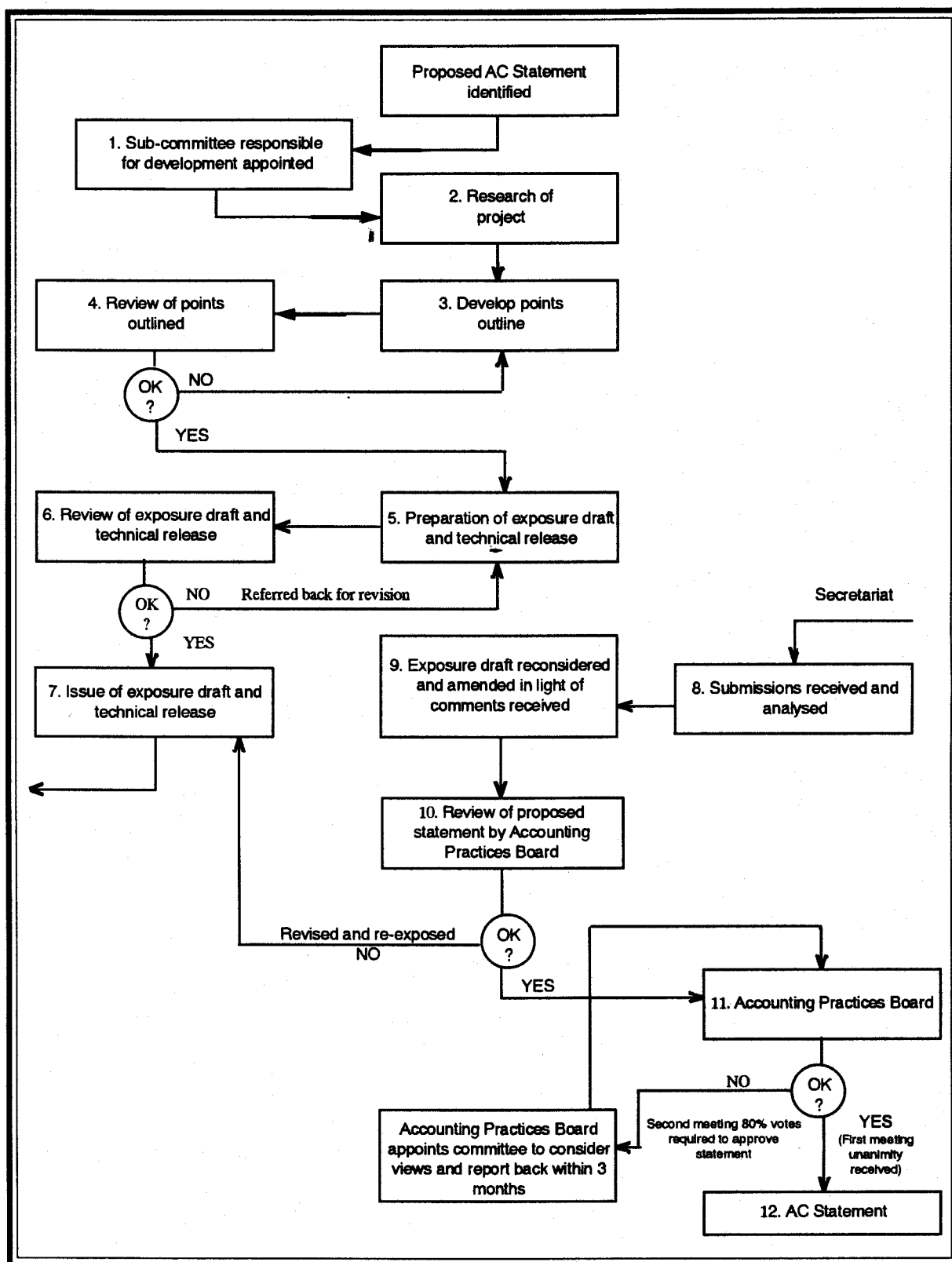
According to Blumberg (1995(a):2), members of the Accounting Practices Committee are appointed by the Council of the South African Institute of Chartered Accountants on the basis of the "best person for the job." They generally serve a three year term as a committee member. During the period of their appointment, they represent their own view and not the view of their firm or company.

3.2.2 The development of a statement of generally accepted accounting practice

Before a statement of generally accepted accounting practice is issued, it passes through a lengthy process of scrutiny and discussion before the Accounting Practices Board approves the statement for issue. The steps described in this process are those through which a statement of generally accepted accounting practice was developed prior to the recent adoption and implementation of the Harmonisation and Improvement Project. This review is necessary as it provides an indication of how South African corporate management can participate in the accounting standard-setting process.

The following flowchart illustrates the sequence of events in the development of a statement of generally accepted accounting practice before changes that will become necessary as a result of the implementation of the Harmonisation and Improvements Project, which will be examined more fully in section 3.8.

Figure 3.1: Flowchart illustrating the development of a statement of generally accepted accounting practice



Stage 1: Need for a statement of generally accepted accounting practice

Prior to the Harmonisation and Improvement Project undertaken by the South African Institute of Chartered Accountants, the need for a new statement of generally accepted accounting practice arose from either dissatisfaction with an existing statement, problems relating to the accounting treatment of a particular item, or the development of an International Accounting Standard.

Once the need for a statement of generally accepted accounting practice on a particular topic has been identified by the Accounting Practices Committee, a sub-committee responsible for the development of the statement is appointed. Generally these sub-committees are made up of members of the Accounting Practices Committee. However, Blumberg (1995(a):2) explains that where individuals possess an extensive knowledge of a particular topic, or where the topic is of a specialised nature, non Accounting Practices Committee members can be appointed. An example of this was the retirement benefit costs sub-committee which included members of the South African Institute of Chartered Accountant's Pension and Provident Fund Interest Group as well as a representative of the Actuarial Society of Southern Africa. Although a number of sub-committees can exist simultaneously, each committee is responsible for a single project at a time.

Stage 2: Research of project

Once a potential statement of generally accepted accounting practice has been identified, the topic is researched by the secretariat or the sub-committee appointed by the Accounting Practices Committee. The following procedure is followed. The need for a statement of generally accepted accounting practice is first established. Although a perception may exist that a particular accounting standard is required, it is unlikely that scarce resources will be utilised in the development of a statement with limited applicability.

Once the specific issues or problems that require addressing in the accounting standard have been identified, an 'issues paper' is prepared by the secretariat for consideration by the responsible sub-committee. The purpose of the paper is to ensure that all issues relevant to the proposed statement are addressed. Further research into these issues is then undertaken by the secretariat or the responsible sub-committee of the Accounting Practices Committee.

Where complex issues exist, additional general research is undertaken to establish whether an accounting standard can and should be developed, and if developed what its scope will be. If considered necessary, the results of this research is issued in the form of a wide-ranging discussion paper.

Stage 3: Development of a 'points outline'

Once the research has been completed, the sub-committee responsible for the proposed standard are able to focus on the issues to be addressed. These are contained in a 'points outline.' This highlights those issues the sub-committee considers appropriate and which should be included in the proposed standard. This would include the applicability of the standard (types of entities it will apply to), terms requiring definition, items to be addressed in the discussion section and finally, accounting treatment and required disclosure.

Stage 4: Review of the 'points outline'

Once the 'points outline' has been prepared, it is again subject to review by the sub-committee responsible for the proposed statement. This review provides both a quality and resource control and helps ensure nothing of importance is likely to be omitted from the proposed statement. Similarly, this review ensures that redundant material and inconsistencies are excluded. In reviewing the 'points outline,' the subcommittee may approve it as is, approve it subject to minor amendments being made, or recommend that major changes be made. In this case, the 'points outline' is referred back to the secretariat for further revision and research.

Stage 5: Preparation of an exposure draft

Once the 'points outline' has been approved by the sub-committee, it forms the basis of an exposure draft of the proposed statement. Once the drafting of the exposure draft is completed it is discussed and amended until the sub-committee is satisfied with it. This process could take a number of meetings.

At this stage a technical release to accompany the exposure draft is also prepared by the sub-committee. This sets out the background to the subject-matter of the exposure draft, explains the purpose of the proposed AC statement, the main accounting and disclosure requirements, and highlights those points that differ from existing practice, either in South Africa or overseas, and which are likely to be controversial.

Where issues are likely to be controversial, such as those contained in exposure draft 61, *Taxation in financial statements* and more recently, exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policies*, the responses of interested parties to individual questions contained in the technical release are obtained. Controversial issues of this nature usually arise either from differences of opinion within the sub-committee, deviations from existing practice, or that break new ground.

Stage 6: Review of exposure draft and technical release

Once the sub-committee is satisfied with the exposure draft and technical release, they are submitted to the Accounting Practices Committee for approval. Here the Accounting Practices Committee may either approve the exposure draft and technical release for issue as they are, approve the documents subject to minor amendments being made to one or both, or require major changes to the exposure in which case it is referred back to the subcommittee for revision. Where only the technical release requires revision, this is usually attended to by the sub-committee. Once amendments have been completed, the exposure draft and technical release are submitted to the Accounting Practices Committee for final approval.

Stage 7: Issue of exposure draft and technical release

Once approved for issue by the Accounting Practices Committee, the exposure draft of the proposed AC statement and its accompanying technical release are sent to interested members of the South African Institute of Chartered Accountants as an enclosure in their monthly magazine, *Accountancy SA*, as well as being supplied to any other party who requests a copy of the document.

The exposure draft calls for submissions to be made by a certain date, usually within three months of the date of the exposure draft. Porter (1990:30) views this as the critical stage in the standard-setting process. It is at this point in the process that members of the South African Institute of Chartered Accountants and other interested parties, including constituent members of the Accounting Practices Board, should participate. South African corporate management's participation at this stage of the standard-setting process is the lobbying of the Accounting Practices Committee in an attempt to influence the form that the accounting standard will finally take.

Stage 8: Submissions received, collated and analysed (secretariat)

The next step in the standard-setting process is the analysis by the secretariat of the comments received to the exposure draft. Where questions requiring specific responses have been asked, these are summarised in tabular form to provide the Accounting Practices Committee sub-committee with an overview of the reaction of commentators to the issues addressed.

For those exposure drafts where responses are in the form of comment letters, the secretariat performs a 'cut-and-paste' operation on the comments received. This enables all observations relating to the various issues contained in the exposure draft to be addressed by the sub-committee.

Stage 9: Exposure draft to AC statement

Once analysed, the submissions to the exposure draft are returned to the relevant sub-committee for review. The comments are analysed and the proposed statement is reconsidered in light of the comments received.

The responses to the issues addressed by the exposure draft and technical release are reviewed and, where appropriate, amendments are made to the exposure draft. General comments made by respondents are also considered and, if appropriate, the exposure draft is amended in line with these comments. The revised document is then submitted to the Accounting Practices Committee for approval. If the changes resulting from the exposure draft are significant, the proposed statement may be re-exposed for comment after further research. This was the position where exposure draft 72, *Taxation in financial statements* was re-issued after the exposure of exposure draft 61, *Taxation in financial statements*.

The exposure draft is then subjected to a line-by-line review to ensure that the amended document is internally consistent and that wording is as clear and concise as possible. Changes of an editorial nature usually result from this review process. The outcome is a proposed AC statement.

Following the sub-committee meeting, the secretariat subjects the proposed AC statement to a comprehensive editorial review so as to ensure that all the required changes are incorporated in the document. Unless the amendments are relatively minor, the proposed AC statement is returned to the Accounting Practices Committee for final review before being submitted to the Accounting Practices Board for consideration. Once the proposed statement is finally approved by the Accounting Practices Committee and should the final product appear to be in substantial agreement with commentators' responses to the exposure draft, it is submitted to the Accounting Practices Board for consideration.

Stage 10: Review of the proposed AC statement

The proposed AC statement is presented to members of the Accounting Practices Board by the Accounting Practices Committee at an informal presentation where fundamental or contentious issues relating to the proposed statement of generally accepted accounting practice are discussed. At this discussion, the Accounting Practices Committee sets out the background to the AC explaining why the standard was developed, the position adopted on the topic by the International Accounting Standards Committee and professional bodies overseas (especially Australia, New Zealand, the United Kingdom, Canada and the United States). Issues which arose during the course of the AC development and, in particular, points made in submissions which resulted in significant changes being made to the exposure draft as it was converted into an AC

statement, together with any issues remaining to be resolved, significant differences between the exposure draft and the proposed AC statement, and a copy of the proposed AC in the form of the original exposure draft with all subsequent amendments clearly marked, are presented to the Accounting Practices Board.

The Accounting Practices Board reviews the material submitted to it and either approves the proposed AC statement (with or without minor amendments), requires major changes to be made and refers the proposed AC back to the Accounting Practices Committee for further revision. If the changes are fundamental (as was the case with deferred taxation), the proposed AC statement may be converted back to a exposure draft for new proposals to be exposed.

Stage 11: To Accounting Practices Board

Assuming that the informal meeting with the Accounting Practices Board progressed smoothly, the proposed AC statement is submitted by the Accounting Practices Committee to a formal meeting of the Accounting Practices Board for final approval. Here the Accounting Practices Board also considers a supporting memorandum that provides details to the background of the AC statement, in particular, an explanation of why it has been developed, an outline of comparative overseas requirements, an outline of the review process (the exposure period and list of respondents to the exposure draft), a summary of the changes made to the exposure draft as it was converted into a proposed AC statement, and an impression of submissions received of the acceptability (or otherwise) of the AC statement.

A copy of the exposure draft and its technical release are also provided. The Accounting Practices Board, like the Accounting Practices Committee, reviews the proposed standard and either approves for issue (with or without minor amendments), requires significant changes to be made, referring it back to the Accounting Practices Committee (and then in turn the relevant sub-committees) for revision.

Unanimity needs to be reached at this meeting for a statement to be approved. In terms of the constitution of the Accounting Practices Board, a statement of generally accepted accounting practice can only be issued if it is approved by a unanimous resolution passed at a meeting of the Board at which all members are present, or approved by a resolution passed unanimously at a meeting of the board by those members present at the meeting and subsequently consented to in writing by members who were absent from the meeting in letters delivered to the secretaries, or it was thereafter approved with or without amendment by a resolution passed with not less than 80 percent of the members of the Board voting in favour of it at a meeting of the Board held not later than three months after the original meeting.

Given a majority in favour, but not unanimity, the Accounting Practices Board will appoint a committee to consider the views of dissenters and report back to a meeting of the Accounting Practices Board to be held in three months. At that meeting a minimum of 80% votes in favour will be sufficient to approve the statement, with or without amendment.

There are no minority reports nor any publication of dissent. Constituent bodies disagreeing with the statement remain free to work towards the subsequent revision of statements already issued (Woodhouse 1972(e):380).

Stage 12: AC statement

Once a statement of generally accepted accounting practice has been approved by the Accounting Practices Board it is translated into Afrikaans. Individual copies are printed and sent out to interested members of the South African Institute of Chartered Accountants who have indicated that they wish to receive copies of AC statements. Copies are also sent to subscribers to the member's handbook and sold through the South African Institute of Chartered Accountants' book shop.

Although South African corporate management should actively participate at stage 7 in the standard-setting process illustrated above, evidence would suggest that their participation is limited to merely lobbying for changes to those statements that are of particular interest to them.

This discussion of the development of South African accounting standards would suggest that, because of the wide influence on the Accounting Practices Board, as well as the participation by interested parties, the South African accounting standard-setting process can be considered pluralistic in nature.

3.3 THE HARMONISATION OF ACCOUNTING STANDARDS

The move towards greater harmonisation of accounting standards can, according to Chandler (1992:221), be traced back to the first international accounting congress held in St. Louis, Missouri, in 1904. More recently, the desirability and feasibility of establishing international accounting standards has been discussed numerous times in the academic literature since the late 1950's when Kraayenhof (1960:37-38) first proposed the establishment of a multinational accounting standard-setting committee. Since then there has been extensive research on harmonisation issues by authors including Aitken and Islam (1984), Choi and Bavishi (1982(a)), Daley and Mueller (1982), Emenyonu and Gray (1992), Fantl (1971), Goeltz (1991), Gray, Shaw and McSweeney (1981), Gray (1980 and 1984), Kanga (1980), McComb (1979), McMoonies (1977), Mueller (1967 and 1968), Rivera (1989), Stamp (1972), Tremblay (1986) and Turner

(1983). This research has focused on the merits, limitations and costs of harmonisation, problems and obstacles facing the harmonisation process, as well as the scope for, and factors that encourage harmonisation.

Prior to the period of international isolation, the merits and benefits of international harmonisation of both accounting and auditing standards from a South Africa perspective had been discussed in the local professional journals by both academics and professional accountants including Benson (1977), Hinton (1968), Layton (1975), Sempier (1979) and Vieler (1976 and 1977). The post isolation period has seen contributions from Terblanche and Buss (1994) and Van Esch and Buss (1994). Possibly the first individual to address this issue in South Africa was Robson (1963:505), who, in an address to the annual meeting of the Transvaal Society of Accountants, opposed accounting harmonisation by arguing that any attempt to make international recommendations, at that point in time, and at that stage of professional development in South Africa, would be wholly inappropriate.

What is important from South African corporate management's perspective is the significant number of differences that exist in accounting internationally. While certain of these differences such as disclosure levels may not materially affect financial decisions, the application of different accounting standards can significantly influence financial results. Examples of these differences are provided by Kale (1995:3) and Walton (1992:44) who illustrate the impact that different countries' accounting standards can have on financial results. The magnitude of these differences are illustrated in table 3.3 below:

Table 3.3: Differences in financial operating results arising from the application of different accounting standards

		UK Result £ m	US Result £ m
Cadbury Schweppes		179,4	134,0
SmithKlein Beechman		130,0	87,0
		German Result DMm	US Result DMm
Daimler Benz	1993	615,0	(1 839,0)
Daimler Benz	1994	1 052,0	895,0
		Norwegian Result NKRm	US Result NKRm
Norsk Hydro		1 763,0	167,0
		Australian Result A\$m	US Result A\$m
News Corporation		502,0	241,0

It is self-evident that without international harmonisation, South African corporate management is faced with the burden of reconciling disparate accounting practices in an attempt to significantly reduce any risk associated with operating and investment decisions. Harmonised accounting standards will reduce this burden on corporate management.

In this section the harmonisation of accounting standards is discussed. Firstly, the differences between harmonisation, standardisation and uniformity in relation to accounting standards are described. Secondly, the arguments used to justify the harmonisation of accounting standards are provided. Thirdly, arguments against and impediments to harmonisation are examined, which includes an overview of the difficulties faced in the harmonisation from a South African perspective. Finally, the role of the International Accounting Standards Committee in the harmonisation process is described.

3.3.1 Harmonisation, standardisation and uniformity

Differences in financial reporting practices of companies in countries around the world inevitably provide preparers, auditors and interpreters with complications. This has resulted, suggest Radebaugh and Gray (1993:142), on pressure by user groups for improvements to be made in the comparability of accounting and information disclosure. To achieve this, various organisations and bodies throughout the world are currently engaged in attempts to harmonise or standardise international accounting practices.

Although Radebaugh and Gray (1993:142) explain that pressure for international harmonisation as a means of achieving comparability is growing, they suggest, with Belkaoui (1992:479) and Tay and Parker (1990:71) concurring, that in the accounting literature, the term 'harmonisation' is often confused and used interchangeably with the term 'standardisation.' Harmonisation of financial reporting, suggest Douplik (1987:47) and Van der Tas (1988:158), is the process by which differences in financial reporting practices among countries are reduced. This process should result in increasing the comparability of financial statements by what Tang (1994:147) and Nobes and Parker (1995(c):117) describe as setting bounds to their degree of variation. Harmonisation according to Radebaugh and Gray (1993:142) implies a more flexible approach, while Nobes (1995(c):117) suggests that standardisation implies the imposition of a more rigid and narrow set of rules which, Radebaugh and Gray (1993:142) argue, would ultimately result in a state of uniformity. The difference between harmonisation and standardisation is explained by Wilson [Belkaoui (1992:480)] as:

The term harmonization as opposed to standardization implies a reconciliation of different points of view. This is a more practical and conciliatory approach than standardization, particularly when standardization means that the procedures of one country should be adopted by all others. Harmonization becomes a matter of better communication of information of information in a form that can be interpreted and understood internationally.

Emenyonu and Gray (1988:50) suggest that an element of caution be exercised in the harmonisation/standardisation/uniformity debate by explaining that although harmonisation implies a movement away from a total diversity of practice, standardisation suggests a movement towards uniformity. The difficulty would be in establishing at what point on the continuum does the accounting regulatory process change from harmonisation to standardisation.

A more complete description of the differences between harmonisation and standardisation is provided by Tay and Parker (1990:73) who argue that:

*Harmonization (a **process**) is a movement away from total diversity of practice. Harmony (a **state**) is therefore indicated by a 'clustering' of companies around one or a few of the available methods. Standardization (a process) is a movement towards uniformity (a state). It includes the clustering associated with harmony, and reduction in the number of available methods.*

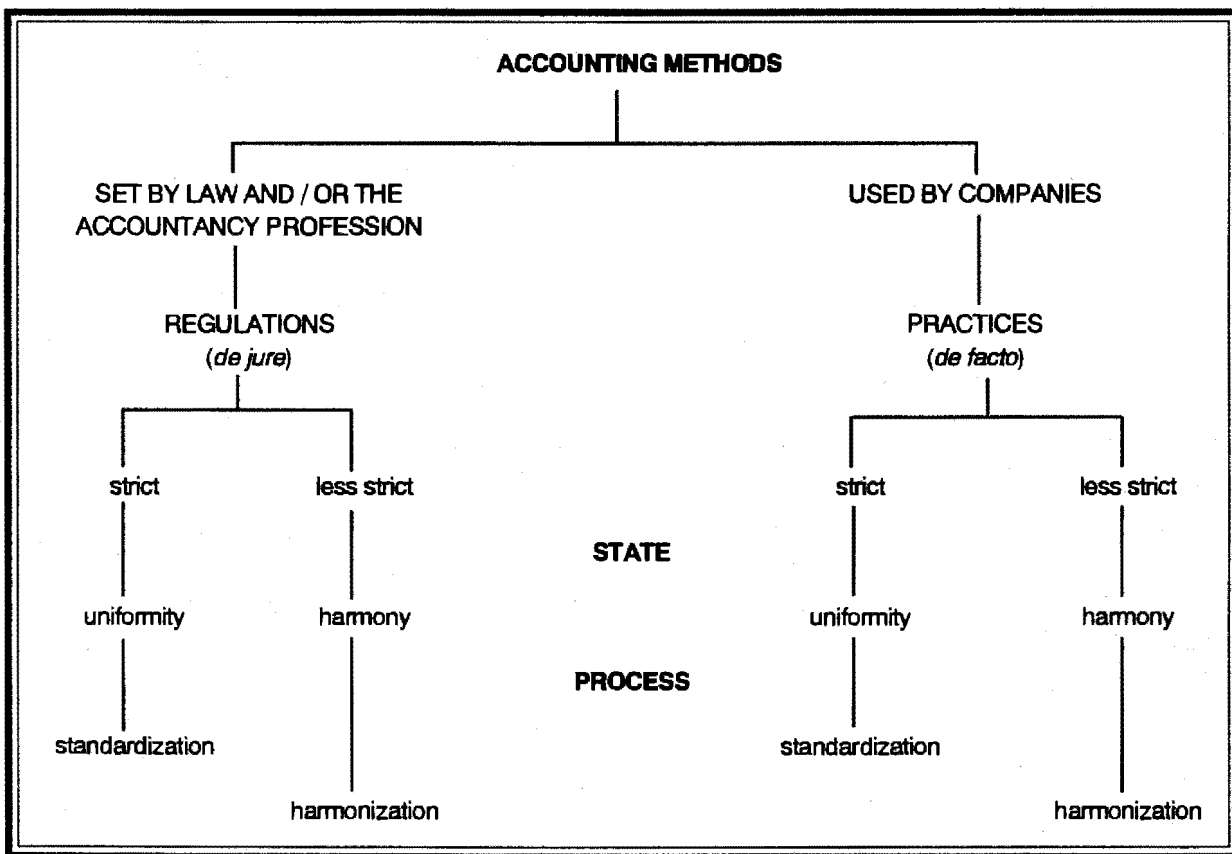
Before the harmonisation of accounting standards can occur, Belkaoui (1992:480) suggests that recognition must be given to the unique environmental characteristics of each individual country, including the rules, objectives and philosophies at the national level aimed at protecting and controlling their national resources. It is these rules and measures that ultimately affect the countries accounting system. Harmonisation, leading to increased comparability and consistency in financial reporting would recognise these idiosyncrasies and, as Belkaoui (1992:480) and Nobes (1994:32) explain, attempt to reconcile them with other countries' objectives by reducing the differences in accounting and company law.

Within the concept of regulation and practice, Tay and Parker (1990:73) with Tang (1994:147) concurring, explain that harmonisation, harmony, standardisation and uniformity exist at the levels of concepts, principles, regulations and practice, with regulation and practice having the most immediate impact on company accounts. Both regulation and practice may be either *de jure* or *de facto*. Tay and Parker (1990:73) explain that accounting regulations may be strict or less strict in three different senses. They describe it as follows:

First, a regulation may apply to all companies (*strict*) or only to some companies (*less strict*). Second, a regulation may be contained in the law (*strict*) or in a professional accounting standard (*less strict*). Compliance with a legal regulation may be expected to be higher than compliance with a standard. Third, a regulation may contain a precise definition (*strict*) or a discretionary one (*less strict*). All three senses of the terms '*strict*' and '*less strict*' imply that the former is associated with uniformity, and the latter with harmony.

These concepts are illustrated in figure 3.2.

Figure 3.2: Terminology of harmonisation and standardisation



Source: Tay and Parker (1990:74)

It is important, argue Tay and Parker (1990:74), that the difference between *de jure* (that of rules and standards) uniformity and *de facto* (corporate financial reporting practices) standardisation is understood. As Nobes (1995(c):120) explains, for any particular topic or set of countries it is possible to have one of these two forms of harmonisation. A practical example of segment reporting, is provided by Tay and Parker (1990:74) to illustrate these differences. Where a regulation (either a Companies Act, national accounting plan or an accounting standard) requires

a company to produce a segment report in which the disclosure of sales by strict geographical area is prescribed, this represents *de jure* uniformity at a point in time. Compliance with this regulation would result in *de facto* standardisation over a period of time.

While acknowledging harmonisation to be primarily concerned with the promotion of similarity among sets of national accounting standards, both Arpan and AlHashim (1984:35) and Wolk, Francis and Tearney (1992:578) have indicated that the issue of uniformity of accounting has also arisen. Three models of uniformity at the international level are proposed. These are the absolute uniformity model, the circumstantial uniformity model, and the purposive uniformity model. The absolute uniformity model provides for one set of standards as well as financial statement format throughout the international economic community. This model disregards different economic circumstances or user needs. Although the absolute uniformity model appeals from the perspective of administrative ease, it is unlikely that this model would ever be adopted. It is clear that a model of this nature would be resisted on the grounds of individual countries' national sovereignty as far as the accounting standard-setting process is concerned.

Under the circumstantial uniformity model, explain Arpan and AlHashim (1984:35), different accounting methods and reports would be permitted on a transnational basis that would take into account varying economic facts and conditions exist. This model allows for flexibility under different circumstances.

The purposive uniformity model on the other hand, considers both circumstances as well as user needs and purposes in establishing the appropriate accounting methods, standards, and reports (Arpan & AlHashim 1984:35 and Wolk *et al.* 1992:578). This model provides for flexibility for both different circumstances and different purposes. As a result, it is unlikely that the purposive uniformity model would be successful where both different circumstances and different user needs underlie accounting standards. In reviewing these models, Wolk *et al.* (1992:578) argue that "At this point in time, international accounting standard-setting has not yet reached the point where any of these models have been successfully selected." Rivera (1989:322) on the other hand, suggests that standardisation of accounting principles internationally is more of a harmonisation process than a uniformity process.

3.3.2 Justifying the harmonisation of accounting standards

The revolutionary developments in transportation and communication over the last two decades has resulted what has been called 'the global village.' This internationalisation of economies has resulted in an increasing interdependence of nations in terms of trade and investment flows. This globalisation of business, investment and capital markets, together with advances in technology and pressure from users, preparers, security regulators and stock exchanges has, explains

Sharpe (1994:4), created pressure for comparable, high quality standards of financial reporting. As is illustrated, this has provided a number of grounds for the justifying the international harmonisation of accounting standards.

The rise of the multinational firm has been tendered by Buggraaff (1982:104), Walton (1992), Wolk *et al.* (1992:577) and Wyatt (1991(a):13.8) as a reason for harmonising accounting standards. Belkaoui (1992:480) believes that internationalisation in the form of harmonisation of accounting standards will facilitate international transactions, pricing and resource allocation decisions and, in addition, may render the international financial markets more efficient.

Choi (1994:1) with Rivera (1989:322), Tang (1994:146-147) and Turner (1983:58) concurring, explain that it has been recognised that the harmonisation of accounting standards facilitates the internationalisation of capital markets and multinational businesses because it can provide comparable financial information for international users. Investors and financial analysts require assurances that the financial statements produced by companies in which they are interested are reliable and comparable, or at least be clear about the nature and magnitude of the differences. In addition, Nobes (1995(c):118) argues that investors and analysts would also require confidence in the auditing function. A failure to maintain the current impetus in the development of international accounting standards will, suggest Meek and Saudagaran (1990:167), deter international investment and act as an impediment to the optimal worldwide allocation of resources.

Belkaoui (1992:480) has identified the recent trend of companies raising foreign capital to finance projects as a further reason for accounting harmonisation. In relying on financial statements to make the most effective investment and loan decisions, Belkaoui (1992:480) argues that suppliers of capital would show preference to those companies who provided comparable reporting.

The harmonisation process, suggest Meek and Saudagaran (1990:168) and Wyatt (1991(a):13.9), is also justified on the basis that countries with inadequate codified accounting and auditing standards who adopt International Accounting Standards will derive tangible benefits. Sharpe (1994:3) explains that many small countries do not have the infrastructure to develop their own accounting standards. In these countries, International Accounting Standards form the basis of national standards. Belkaoui (1992:480) suggests that these countries will benefit from adopting International Accounting Standards in that set-up costs will be eliminated.

Nobes (1995(c):118-119) argues that revenue authorities, especially those in developing countries, would be able to understand and control the operations of multinational corporations operating in their territories if financial reporting was harmonised. Other potential

beneficiaries of the harmonisation process could include labour unions, and international credit grantors such as the World Bank.

3.3.3 Arguments against harmonisation

A number of recent studies question whether the complete international harmonisation of accounting standards will ever be achieved. These include studies by Fantl (1971), Goeltz (1991) and Rivera (1989). Fantl (1971:13) in particular, argues that the international harmonisation of accounting standards is too simple a solution for a complex process. Both practical and theoretical considerations are identified by Rivera (1989:322) as reasons, why the standardisation of accounting principles internationally may not occur.

Fantl (1971:15) lists what he considers are three formidable barriers to internationally uniform accounting systems. These include differences in background and tradition among nations, differences in needs of economic environments, and, the challenge of uniformity to state sovereignty. In questioning the need for international accounting standards, Goeltz (1991:85-88) articulately argues that fully harmonised international accounting standards are neither practical nor truly valuable. He bases his arguments around the following points:

- no authoritative body exists that has the ability to mandate the adoption of global generally accepted accounting practice,
- many national groups have vested interests in maintaining their own accounting standards and practices which have been developed from widely different perspectives and histories,
- a well developed capital market has evolved without uniform accounting standards,
- the lack of accounting harmonisation has not hampered the growth of new international debt and equity instruments such as interest rate and currency swaps,
- investors and issuers of securities have been able to make investment decisions without the convenience of international accounting standards. The market rather than accounting standard setters or regulators will determine the amount of information required,
- investors are rational and will expend the necessary time and money to analyse investment opportunities correctly. By the effective use of data they are able to use accounting and other information to predict future cash flows which are the ultimate source of investment value rather than relying on accounting uniformity.

Other arguments against harmonisation follow.

Nobes (1994:10) with Rivera (1989:322) and Walton (1992) in agreement, question whether those companies whose ownership is not spread among investors who do not participate in the management of the business, should be subjected to the extensive disclosure required by

international accounting standards. In these companies, the need for disclosure and the emphasis on agency theory is relatively insignificant.

A further argument against the harmonisation of accounting standards must be based on governmental influence. First is the question of revenue collection. A significant demand for accounting services worldwide results from taxation and related legislation. As the method and basis of revenue collection varies between countries, it is not unreasonable to expect diversified accounting practices that comply with individual legislative requirements. Secondly, Belkaoui (1992:480-481) argues that in certain countries, politicians have used accounting policies to achieve certain political or economic goals. As there is little likelihood of there ever being a single global political or economic system, differences in political and economic systems will continue to act as a barrier to international accounting harmonisation.

In addition to direct governmental influences in accounting practice, underlying economic, legal, social and other environmental factors that occur in each country, further influence accounting development. Nobes (1994:10) explains that in different countries, accounting has evolved to accommodate user requirements. As a result, significant differences in international financial reporting are likely to occur, including the interpretation of fundamental terms such as 'fairness,' and 'valuation bases.' As Nobes (1995(a):57) illustrates, the major differences in inter-country comparisons of financial statements arise from asset valuation and profit measurement issues. This would suggest therefore, that the accounting and reporting system in existence in a particular country is suitable for that particular environment and should not be changed merely to simplify the work of multi-national companies or auditors.

A further obstacle to international harmonisation is, suggests Kanaga (1980:56) with Belkaoui (1992:480-481) in substantial agreement, the strict national licensing requirements of accounting bodies internationally. These licensing requirements, argues Kanaga (1980:57), can appear to discriminate on the basis of nationality in that they are often not pertinent, equitable or consistently administered. Meek and Saudagaran (1990:171) argue that although the need for international harmonisation and, more specifically, the case for international standards has been asserted, this proposition is yet untested. In addition, they argue that proponents of international harmonisation have been unable to establish, in an international setting, whether comparable financial information is preferable to relevant, reliable and timely information.

Finally, in his most recent study, Choi (1994) questions whether international accounting diversity does in fact represent a serious barrier to the globalisation of financial markets. More specifically, the variability may have a detrimental effect on investment funding and regulatory decisions. Choi (1994:20) concluded that empirical evidence provided by him contradicts the traditional arguments in support of harmonisation, namely:

- active public policy initiatives are desirable to set standards regarding international accounting principles and financial disclosure, and
- harmonisation of international accounting principles and financial disclosure is a necessary part of developing a large, well-functioning international market.

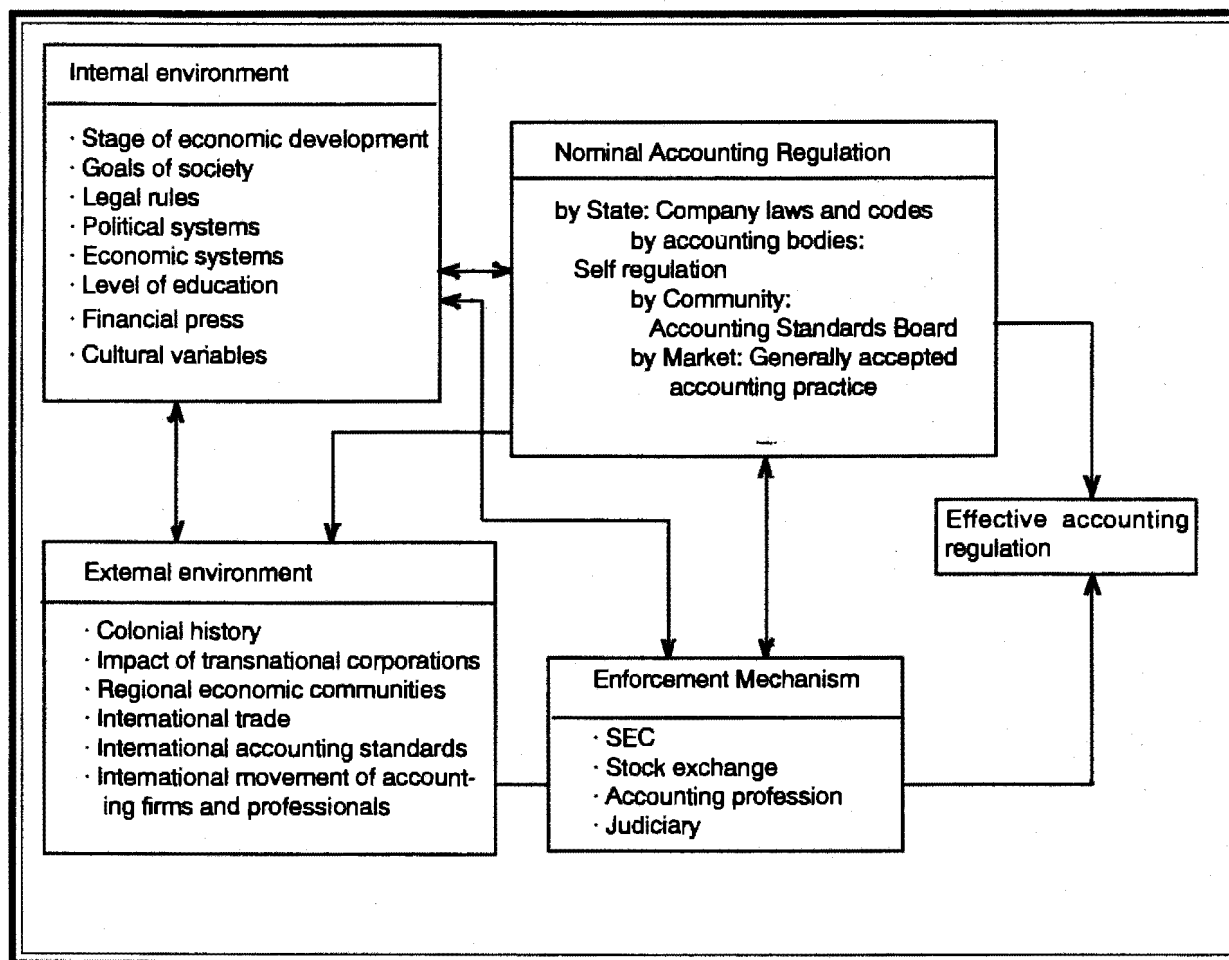
In addition to the arguments against harmonisation discussed above, there are numerous impediments facing those who advocate the international harmonisation of accounting standards. The following section describes certain of the environmental difficulties faced in the harmonisation process.

3.4 ENVIRONMENTAL IMPEDIMENTS TO INTERNATIONAL HARMONISATION

The relationship between accounting and various environmental aspects has been hypothesised and empirically examined by the American Accounting Association (1977(b)), Belkaoui (1983), Belkaoui and Masky (1985), Choi (1994), Choi and Mueller (1992), Da Costa, Bourgeois and Lawson (1978), Frank (1979), Gray (1980), Mueller (1967 and 1968), Nair and Frank (1980), Radebaugh (1975), Radebaugh and Gray (1993), Seidler (1967) and Tondkar, Adhikari and Coffman (1990) among others. In acknowledging the complex role played by environmental factors in the accounting process, Cooke and Wallace (1990:82) identify historical, political, economic and social factors at both the national and international level as influencing accounting. It is these factors in various combinations that influence accounting and accounting regulation in different countries. These environmental influences are illustrated in figure 3.3.

Included in internal variables, explain Cooke and Wallace (1990:82), are: (1) the stage of economic development, (2) implicit and explicit goals of society, for example, should accounting serve a macro or micro purpose, (3) whether the legal system is code based or common law based and, (4) culture. External factors are those variables likely to influence accounting regulators. Examples of these include colonial ties, the effect of multinational corporations, regional economic cooperation and internationalisation of world trade, and stock markets.

Not only do the environmental factors interact with each other, but the individual elements identified within each grouping also interact. An awareness of environmental factors is necessary to appreciate the factors influencing the accounting standard-setting process.

Figure 3.3: Environmental influences on accounting regulation

Source: Cooke and Wallace (1990:83)

As the primary supplier of financial information in South Africa, corporate management should be aware of the environmental factors that lead to differences in financial statements. If the harmonisation process is successful, South African corporate management should be aware of the potential impact this will have on their decision making. For example what will be the effect on those smaller businesses who prepare financial statements merely to comply with financial reporting and taxation requirements? In addition Choi (1994:18) questions: "If managers base their financing, investing or operational decisions on tax-based or some internal information set rather than 'harmonised accounting numbers,' will the provision of the latter be more useful to external statement readers? Or, will it simply be a case of making unlike things appear alike, thus confusing or misleading readers?"

This section illustrates certain of the impediments to international harmonisation that arise as a result of environmental factors. So as to provide additional structure to the section that

follows, these have been further categorised as: (1) comparative development patterns, (2) classification of accounting practices, (3) cultural influences on accounting, (4) developmental influences and, (5) developing countries. While these impediments may not reduce the overall need for harmonisation, it is submitted that these factors will need to be addressed if the harmonisation process is to be successful.

3.4.1 Comparative development patterns

Mueller (1967) was one of the first academics to classify financial accounting and reporting practices using a judgemental basis. Since this initial work, numerous researchers including Choi and Mueller (1992:28), Gray (1988:2) and Wolk *et al.* (1992:581) have described four economic/professional approaches to accounting development that exist in Western nations with market-oriented economic systems. These are: (1) the macroeconomic pattern, (2) the microeconomic pattern, (3) the independent discipline approach and, (4) the uniform accounting approach, all of which have close links to economic or business factors.

A brief description of each of these economic/professional approaches follows, because, as Nobes (1995(b):63) explains, an examination of financial reporting system's classifications, casts doubts on the possibility and usefulness of international harmonisation.

3.4.1.1 The macroeconomic pattern

Choi and Mueller (1992:44) suggest that two of the central propositions in business and economic writings are: (1) individual firms establish formal and informal goals and then gear their operations towards optimising these goals and, (2) nations establish formal and informal national policies and then adopt administrative procedures towards the optimal implementation of these policies. This view is supported by Gray (1988:2) and Wolk *et al.* (1992:581), who view private sector accounting as being closely linked to national economic policies under the macroeconomic approach pattern. Nobes (1995(b):63) suggests that under a macroeconomic pattern, accounting emphasises value-added statements, encourages income smoothing, equating financial and taxation accounting, and encourages responsibility accounting. Although these goals and policies are not always easily identifiable, Choi and Mueller (1992:44) argue that this does not invalidate this assertion, and these become guides to overall organisational actions.

Under a macroeconomic pattern, business goals will, of necessity, be narrower than national policy. As a result, firm goals normally follow national economic policies, although Choi and Mueller (1992:44) explain that this an absolute condition.

In light of the above description, Choi and Mueller (1992:44) provide the following three propositions applicable to a developed economic environment:

1. *The business enterprise is the essential unit in the economic fabric of a nation.*
2. *The business enterprise accomplishes its goals through close coordination of its activities with the national economic policies of its environment.*
3. *Public interest is served best if business enterprise accounting interrelates closely with national economic policies (Choi & Mueller 1992:44).*

Swedish capital investment accounting procedures have been identified, by Choi and Mueller (1992:44) and Nobes (1991(b):63), as following the macroeconomic development pattern of accounting. Seidler's (1967:776) observations would tend to confirm this.

3.4.1.2 The microeconomic pattern

Market-orientated economies, including those with an element of central government intervention, entrust, according to Choi and Mueller (1992:45), much of their economic well-being to the business activities of both individuals and businesses. It is in these economies, Choi and Mueller (1992:45) explain, that a fundamental orientation exists to the individual cells of economic activity.

Choi and Mueller (1992:45) explain that as private and business activities form the core of the economic affairs of a market-oriented economy, with accounting as a service function, it follows that accounting would seek to orient itself to the same micro considerations represented in the economy. Under the microeconomic environment, Nobes (199(b):63-64) suggests that accounting must reflect economic reality in both measurement and valuation. Although accounting rules must be sophisticated, they should also be flexible.

The following propositions are postulated by Choi and Mueller (1992:45) using a microeconomic framework of accounting:

1. *Individual firms provide focal points for business activities.*
2. *The main policy of the business firm is to ensure its continued existence.*
3. *Accounting, as a branch of business economics, derives its concepts and applications from economic analysis.*

In the microeconomic pattern, Gray (1988:2) with Wolk *et al.* (1992:581) concurring, view accounting as an aspect of managerial economics with decision-making overtones. Here, the accounting process must ensure that the capital investment in the firm remains constant in real terms so that: (1) the continued survival of the firm is ensured, (2) the invested capital remains the economic foundation of the firm and, (3) the firm's business activities can be evaluated and controlled. This is achieved by an effective separation of capital and income.

The Netherlands are identified by Choi and Mueller (1992:46) with Nobes (1995(b):64) concurring, as the most comprehensive example of microeconomic pattern of accounting development.

3.4.1.3 The independent discipline approach

Choi and Mueller (1992:46) explain that the business environment incorporates complex human emotions and reactions, and uncertainty. Therefore, factors such as sound judgement and estimate play an integral part in the decision-making process in successful businesses. As Nobes (1995(b):64) indicates, under the independent discipline approach, accounting systems develop independently of government or economic theories. Choi and Mueller (1992:46) argue that if business is the primary interest served by accounting, and if accounting provides an efficient and effective service, should accounting and business practices not have the same basis and follow the same development pattern. This is confirmed by Gray (1988:2) and Wolk *et al.* (1992:581) who suggest that within the independent discipline orientation, accounting must be viewed as a service-type function that is derived from business practice. Theory, according to Nobes (1995(b):64), is held in little regard and is used only in emergencies or *ex post* in an attempt to justify practical conclusions.

Choi and Mueller (1992:46) further postulate that if accounting is viewed as a service function, one could logically conclude that a suitable framework applicable to accounting could be derived from the business environment. Accounting could be established as an independent discipline without underlying conceptual support from disciplines such as economics.

The development in financial statements of full and fair disclosure is, according to Choi and Mueller (1992:46), one of the more important standards of accounting within the independent discipline pattern. Choi and Mueller (1992:46) suggest that the tenet of full and fair disclosure could possibly be seen as a substitute for a comprehensive conceptual framework under the independent discipline approach.

Countries which include the United Kingdom and the United States have been identified by Choi and Mueller (1992:47) as comprehensive examples of those where accounting has developed as an independent discipline. South Africa also falls into this category.

3.4.1.4 The uniform accounting approach

Gray (1988:2) describes the uniform accounting approach as both a control and administrative tool. Nobes (1995(b):64) explains that under such an approach, accounting has been used by governments as a means of enforcing administrative control of business. Nobes (1995(b):64) explains that under the uniform accounting approach: "Accounting can be used to measure

performance, allocate funds, assess the size of industries and resources, control process, collect taxation, manipulate sectors of business, and so on. It involves standardization of definitions, measurements and presentation" Nobes (1995(b):64).

Three practical approaches to this development pattern have been identified and are described below.

(a) *Business approach*

The business approach to accounting uniformity has been described by both Mueller (1967:95) and Choi and Mueller (1992:47) as being orientated specifically to particular users of accounting data. Full account is taken of both business characteristics and the environment under which information is collected, processed and communicated. Choi and Mueller (1992:47) describe this approach as both pragmatic and relying on convention. The Swedish 'M-Chart' and railways or utility accounting in the United States provides, according to Mueller (1967:95), examples of this form of accounting.

(b) *Economic approach*

This approach to accounting uniformity has been described by both Mueller (1967:97) and Choi and Mueller (1992:47) as essentially a macro approach, where accounting is linked to public policy. Under this approach, public laws and regulatory agencies are used to enforce the established system. National economic policy considerations are uppermost, while technical accounting considerations are of secondary importance.

(c) *Technical approach*

Mueller (1967:98) and Choi and Mueller (1992:47) describe this approach to uniformity development as being largely the work of academics. Three approaches to uniformity development are described: (1) the analytical, (2) the general and, (3) the theoretical approach.

The analytical approach attempts to derive uniformity schemes from double-entry bookkeeping. Under the general approach, Choi and Mueller (1992:47) direct attention to specific business characteristics of accounting transactions or accounting processes. The theoretical approach attempts to establish links between accounting of the same type so that consistent treatment may occur. Choi and Mueller (1992:48) and Nobes (1995(b):64) identify France as the country most identifiable with the uniformity pattern of accounting development, while Seidler (1967:781) indicates that as a civil law country, accountants and businessmen in France are accustomed to a substantial degree of legal control over their activities.

As Nobes (1995(b):64) explains, these classifications are not based on the differences of accounting practice, but on the influence of economic, governmental and business factors in the development of the particular system. Gray (1988:2) indicates that the perception is that all the above approaches are closely linked to economic and business factors. While a wider set of influences such as legal systems, political systems and social climate were recognised as being relevant, there is no precise specification to accounting.

3.4.2 Classification of accounting practices

Accounting systems around the world have, in the past, been influenced or indeed dominated by certain countries. In the eighteenth, nineteenth and early twentieth centuries these influences could be identified as trade, occupation or colonialism. Since World War II however, it would not be unreasonable to argue that countries have used economic considerations to obtain influence, which has in turn, indirectly influenced accounting systems. Research by Choi and Mueller (1992), Cooke and Wallace (1990), Mueller (1967), and Nobes and Parker (1995) and Radebaugh and Gray (1993) has reinforced the realisation that, as a result of various environmental factors, fundamental differences exist in accounting patterns across countries. An understanding of the nature of these differences is considered essential in any study that examines South African corporate management's attitude to the accounting standard-setting process and international harmonisation.

International classification of accounting practices can be categorised as: traditional studies addressing the output from accounting systems (ie. actual accounting practices) and, more recently, research focusing on the input side of accounting, or the accounting standard-setting process. Research into the output side of international classification has been approached from two directions. Choi and Mueller (1992:32) have described these as: (1) supposed classifications and, (2) empirically tested classifications. Supposed classifications which are deductive in nature, are generally subjective and non-hierarchical. Relevant environmental factors are identified and by linking them to national accounting practices, international classifications of development patterns are proposed. Researchers who have followed this approach have included Mueller (1967 and 1968) Seidler (1967) and Nobes (1983 and 1992). Empirically tested classifications which are inductive in nature, analyse accounting practices, development patterns are identified and explanations provided that relate to economic, social, political and cultural factors. Researchers following this approach include Da Costa *et al.* (1978), Doupnik (1987), Frank (1979) and Nair and Frank (1980 and 1981).

3.4.2.1 Classification based on accounting systems output

A discussion of the different classifications of accounting practices follows.

(a) Supposed or deductive classifications

Classification of accounting practices appears to have first been undertaken by Seidler (1967) and Mueller (1968). Seidler (1967:775) developed the concept of 'spheres-of-influence.' These are described as countries who, through associations either colonial, traditional or political, reflect the influence that 'mother' countries have on their accounting practices. Examples provided by Seidler (1967:775-776) include the British, American and French models. In a more comprehensive classification, Mueller (1968) identifies ten different accounting practices based on the business environments in which they operate. These are indicated in table 3.4 below.

Table 3.4: Mueller's classification of accounting practices

<p>United States / Canada / The Netherlands British Commonwealth (excluding Canada)* Germany / Japan Continental Europe (excluding Germany, the Netherlands, and Scandinavia) Scandinavia Israel / Mexico South America Developing nations of the Near and Far East Africa (excluding South Africa)* Communist nations</p> <p>* From a historical perspective, South Africa would be included with the British Commonwealth model.</p>

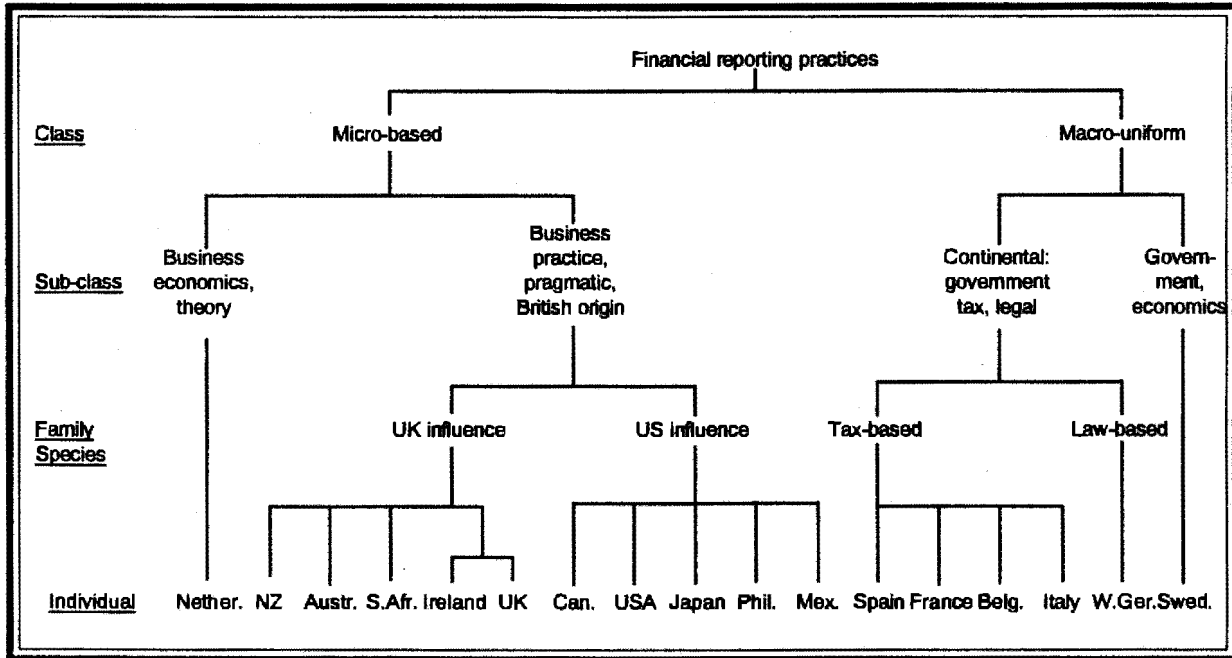
Source: Mueller (1968:91-103)

A later study by the American Accounting Association (1977(b)), suggested that global accounting patterns could be classified according to zones of influence. In a subjective assessment the American Accounting Association (1977:105) identified five zones of influence as: (1) British, (2) Franco-Spanish-Portuguese, (3) Germanic/Dutch, (4) United States and, (5) Communistic.

Expanding Mueller's (1968) analysis, Nobes (1983:6) attempted to identify measurement practices in fourteen developed nations that are considered 'vital' for the purposes of international harmonisation. A hierarchical classification was used to provide subtlety and discrimination to the assessment of country differences. After a basis distinction between micro

and macro economic systems was made, certain discriminating classification features were incorporated based on the financial reporting practices of these countries. Nobes' (1983) classification is illustrated in figure 3.4 below.

Figure 3.4: Nobes' classification of accounting systems in fourteen developed western countries



Source: Nobes (1983:7)

(b) Empirically or empirically tested classifications

Various empirical classifications of accounting practices have been conducted. These include Ainajjar (1986), Da Costa *et al.* (1978), Doupnik (1987), Frank (1979), and Nair and Frank (1980 and 1981). The majority of these, Da Costa *et al.* (1978), Doupnik (1987), Frank (1979), and Nair and Frank (1980 and 1981) have used as a survey data base the accounting principles and reporting practices prepared by the international accounting firm of Price Waterhouse International in 1973, 1975 and 1979.

In the Da Costa *et al.* (1978) study, the two hundred and thirty three accounting principles and reporting practices contained in the Price Waterhouse International 1973 survey were screened so that uniform practices across the thirty eight countries were eliminated. The remaining one hundred practices were ordinally scaled and a principal component factor analysis was performed. The scaling was as follows:

(a) is not permitted or found in practice (1);

- (b) is followed by a minority of reporting companies (2);
 (c) is followed by about half of the reporting companies (3);
 (d) is followed by a majority of reporting companies (4); or
 (e) is required of, or conventionally followed by, all reporting companies (5).

Da Costa *et al.* (1978:76-83) were able to discern that the sample countries fitted into two clusters "exhibiting a homogeneity of financial reporting practices." These clusters are illustrated in table 3.5.

Table 3.5: Da Costa, Bourgeois and Lawson's classification of international accounting practices

<u>Group 1</u>	<u>Group 2</u>	<u>Unclassifiable</u>
Japan	United Kingdom	Netherlands
Philippines	Eire	Canada
Mexico	Rhodesia	
Argentina	Singapore	
Germany	South Africa	
Chile	Australia	
Bolivia	Jamaica	
Panama	Kenya	
Italy	New Zealand	
Peru	Fiji	
Venezuela		
Colombia		
Paraguay		
United States		
Pakistan		
Spain		
Switzerland		
Brazil		
France		
Uruguay		
Sweden		
India		
Ethiopia		
Belgium		
Trinidad		
Bahamas		

Source: Da Costa *et al.* (1978:79)

Although using the same data and statistical technique (factor analysis) as Da Costa *et al.* (1978), Frank (1979) provided additional structure to his analysis. This enabled him to distinguish four groupings for the thirty eight countries surveyed. These groupings formed four distinct models of accounting: British, American, Continental Europe and Latin America. Frank's (1979) groupings are illustrated in table 3.6.

Table 3.6: Frank's classification of accounting groups

<u>Group 1</u>	<u>Group 2</u>	<u>Group 3</u>	<u>Group 4</u>
Australia	Argentina	Belgium	Canada
Bahamas	Bolivia	Colombia	Germany
Ethiopia	Brazil	France	Japan
Eire	Chile	Italy	Mexico
Fiji	India	Spain	Netherlands
Jamaica	Pakistan	Sweden	Panama
Kenya	Paraguay	Switzerland	Philippines
New Zealand	Peru	Venezuela	United States
Rhodesia	Uruguay		
Singapore			
South Africa			
Trinidad & Tobago			
United Kingdom			

Source: Frank (1979:596)

Using the statistical technique, factor analysis, Nair and Frank (1980) extended the study of the 1973 data base by dichotomizing the 1975 Price Waterhouse International data of accounting practices relating to forty four countries into accounting practices reflecting measurement procedures and disclosure practices. Distinctions illustrated in tables 3.6 and 3.7 are based on different development patterns observed between the measurement and disclosure practices. Both Frank (1979) and Nair and Frank (1980) found underlying environmental variables to be closely associated with country groupings based on accounting practices.

Table 3.7: Nair and Frank's classification of accounting groups by measurement practices

<u>Group 1</u>	<u>Group 2</u>	<u>Group 3</u>	<u>Group 4</u>	<u>Group 5</u>
Australia	Argentina	Belgium	Bermuda	Chile
Bahamas	Bolivia	Denmark	Canada	
Fiji	Brazil	France	Japan	
Iran	Colombia	Germany	Mexico	
Jamaica	Ethiopia	Norway	Philippines	
Malaysia	Greece	Sweden	United States	
Netherlands	India	Switzerland	Venezuela	
New Zealand	Italy	Zaire		
Nigeria	Pakistan			
Republic of Ireland	Panama			
Rhodesia	Paraguay			
Singapore	Peru			
South Africa	Spain			
Trinidad & Tobago	Uruguay			
United Kingdom				

Source: Nair and Frank (1980:433)

Using measurement practices, five broad groupings of countries were identified in Nair and Frank's (1980) classification. Following Seidler's (1967) 'spheres-of-influence' classification, the groupings can be broadly classified as British Commonwealth, Latin America/South European, Northern and Central European, and United States model.

Table 3.8: Nair and Frank's classification of accounting groups by disclosure practices

<u>Group 1</u>	<u>Group 2</u>	<u>Group 3</u>	<u>Group 4</u>	<u>Group 5</u>	<u>Group 6</u>	<u>Group 7</u>
Belgium	Australia	Bahamas	Bermuda	Argentina	Denmark	Italy
Bolivia	Ethiopia	Germany	Canada	India	Norway	Switzerland
Brazil	Fiji	Japan	Jamaica	Iran	Sweden	
Chile	Kenya	Mexico	Netherlands	Pakistan		
Colombia	Malaysia	Panama	Rep of Ireland	Peru		
France	New Zealand	Philippines	Rhodesia			
Greece	Nigeria	United States	United Kingdom			
Paraguay	Singapore	Venezuela				
Spain	South Africa					
Uruguay	Trinidad & Tobago					
Zaire						

Source: Nair and Frank (1980:436)

When disclosure patterns are considered, the number of groupings increases to seven. These groupings cannot be described satisfactorily on a similar 'spheres-of-influence' classification because of their diversity.

A later study by Nair and Frank (1981) incorporated the thirty seven countries common to the 1973, 1975 and 1979 Price Waterhouse International surveys. The accounting practices of these countries were categorised as follows: (1) required, (2) predominant practice, (3) minority practice, (4) not applicable and, (5) not permitted.

Results obtained by cluster analysis enabled Nair and Frank (1981:74) to conclude that during the period of the Price Waterhouse International survey, there was a movement towards the harmonisation of accounting practices. The number of practices agreed upon by a majority of countries increased from eight in 1973 to forty nine in 1979. Most of this movement, according to Nair and Frank (1981:77), was as a result of changes made by the British Commonwealth, Central Europe and Latin America. Where differences existed between positions taken by the United States and the International accounting Standards Committee, no degree of harmonisation was evident.

In an attempt to assess the extent of international harmonisation, Douplik (1987) used the data generated by the 1975 Price Waterhouse International survey and updated it to 1983.

As a result, Douppnik (1987:52) was able to compare the data for two periods. Using factor analysis, Douppnik (1987:64) was able to conclude that with the exception of West Germany and Switzerland, differences in financial reporting on an international level measured by compliance with International Accounting Standards Committee standards had improved. Douppnik (1987:64) did however caution that although evidence of harmonisation did exist, substantial differences occurred among countries within a group and among countries in different groups. Douppnik's (1987) classification of accounting practices by country are illustrated in table 3.9

Table 3.9: Douppnik's classification of accounting practice

<u>Group 1</u>	<u>Group 2</u>	<u>Group 3</u>	<u>Group 4</u>	<u>Group 5</u>	<u>Group 6</u>
Australia	Argentina	Japan	Bermuda	Denmark	Germany
Chile	Belgium	Panama	Canada	Jamaica	Switzerland
France	Bolivia	United States	Mexico	Sweden	
Ireland	Colombia				
Kenya	Greece				
Malaysia	India				
Netherlands	Italy				
Singapore	Norway				
South Africa	Paraguay				
United Kingdom	Peru				
Zimbabwe	Zaire				

Source: Douppnik (1987:62)

Doubts have been expressed by Nobes (1981:268, 1983:2 and 1987) on the reliability of the data contained in the 1973 Price Waterhouse International survey for classification purposes. Nobes (1983:2) identifies the following four types of problems with the 1973 data: (1) straightforward mistakes (Nobes 1981:268), (2) misleading answers, (3) swamping of important questions by trivial ones and, (4) exaggeration of the differences between the United States and the United Kingdom because of the familiarity of these countries (and thus their differences) to the compilers of the survey questions. Other errors were noted by Nobes (1983:2) with the 1979 Price Waterhouse International survey.

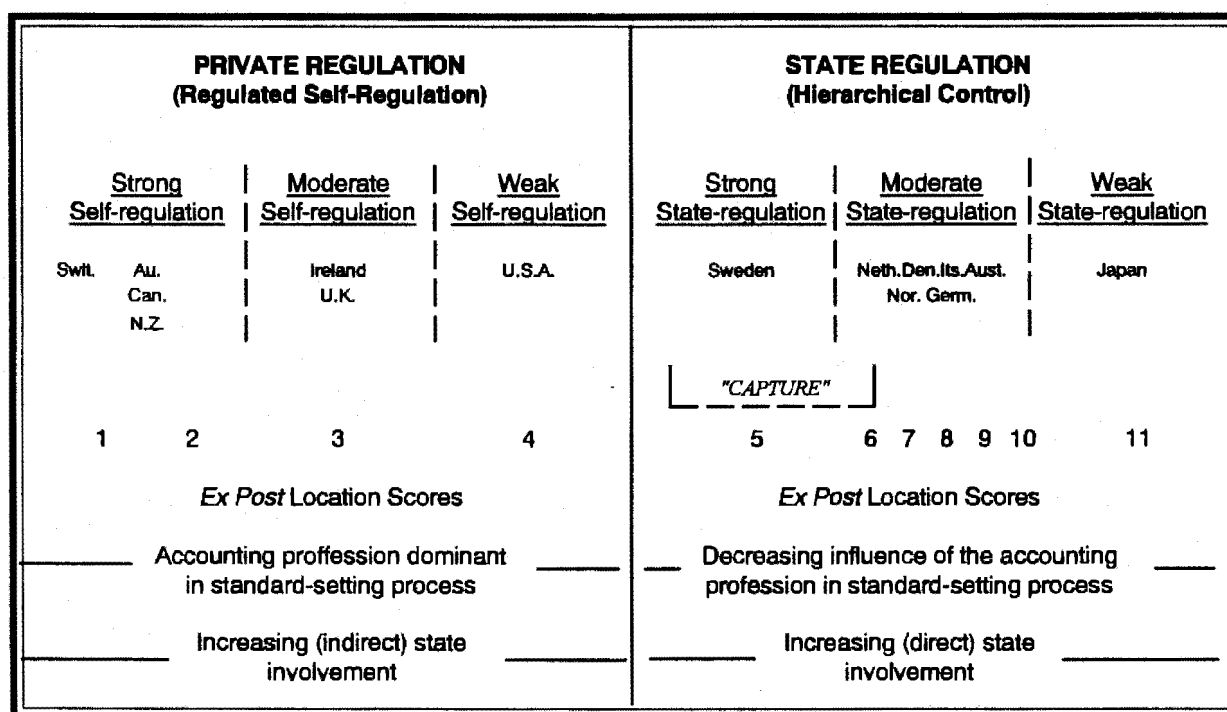
From the above discussion the following conclusions are apparent: (1) the Price Waterhouse International data appears to be unsuitable as a base for classifying accounting practices and, (2) researchers using a common (albeit possibly flawed) data base, are unable to obtain agreement on the classification of accounting practices from a relative small group of countries. It would not be unreasonable to expect that these problems will be compounded as researchers attempt to classify accounting influences on more countries.

3.4.2.2 Classification based on input to accounting

In addressing the input side of accounting classification, factors influencing the accounting standard process, including those factors underlying financial reporting, warrant consideration. These include the division between private and state regulation, the standard-setting process, and the participation of the accounting profession in the setting of accounting standards.

Rebmann-Huber [Choi & Mueller 1992:38-39] used the political science paradigm of neo-corporatism in classifying influences on financial accounting standard setters in sixteen (highly industrialised) member countries of the Organization for Economic Cooperation and Development. This study found governmental influence or legitimisation of the financial accounting standard-setting process to be a useful tool in the classification accounting practices. Rebmann-Huber's findings are illustrated in figure 3.5 below.

Figure 3.5: Assignment of countries in the private-state regulation continuum.



Source: Choi and Mueller (1992:40)

3.4.3 Cultural Influences

Although comparative development patterns discussed in 3.4.1 and development issues described in 3.4.4 are acknowledged as being relevant to accounting development, a number of academics (Arwidi 1993, Bloom & Naciri 1989, Bromwich & Hopwood 1983, Gray 1988 and 1989, Jaggi 1975, Macharzina 1988, Mathews & Perera 1991, McComb 1979, Nobes 1995(a),

Perera 1989(a), Perera & Mathews 1990 and Violet 1983) have all recognised the importance of cultural issues in the development of accounting. The cultural dimension to accounting can be viewed as representing an advance on the economic and professional approaches described elsewhere. This section will address the influence of culture on accounting.

National culture has been described by Perera and Mathews (1990:221) as the sum of shared values of members of a nation, while Perera (1989(a):43) suggests that culture can be regarded as an expression of norms, values and customs which reflect typical behavioural characteristics. Clearly, culture cannot be viewed as every individual behaviour pattern, but should rather be seen as average behaviour patterns of individual members of a nation. Within this national culture, various subcultures, organizational, occupational, generation and class cultures can be determined. It is these cultural differences that manifest themselves in behaviour. Perera and Mathews (1990:221) explain that since the early nineteen eighties, the concept of culture has been viewed as playing an influential role in accounting. In suggesting that although the technical aspects of accounting are less culture-dependent than the human aspect, Violet (1983:8-12) argues that the two interact. Consequently, accounting cannot be considered free from cultural influences. This is consistent with the thoughts of Perera and Mathews (1990:221) who further posit that because accounting is a sociotechnical activity, it involves dealing with both human and nonhuman resources or techniques as well as the interaction between the two.

Gray (1988:1) explains that prior research, such as that by Frank (1979), Mueller (1967), Nair and Frank (1980), Nobes (1983) and Radebaugh (1975), has illustrated different patterns of accounting internationally. Although the development of national systems appears to be a function of environmental factors, these have yet to be identified. Gray (1988:2) explains that these earlier research efforts approached international accounting classification of accounting from two directions; the inductive and deductive approaches.

For example, the deductive approach was used by Mueller (1967 and 1968) and Nobes (1983 and 1992). These researchers identified what they considered to be relevant environmental factors and linked them to national accounting practices. International classification or development patterns were then proposed. Using the inductive approach, Frank (1979) and Nair and Frank (1980) analysed accounting practices. Development patterns were identified and explanations proposed based on a variety of economic, social, political and cultural factors. Countries' language was used as a proxy for culture in the study by Frank (1979:601) and Nair and Frank (1980). Although these studies by Frank (1979) and Nair and Frank (1980) suggest a statistical relationship between culture and accounting, Harrison and McKinnon (1986:234) argue that Frank (1979) and Nair and Frank (1980) were unable to explain the nature of the relationship.

In recent years, a more commonly used approach to national accounting differentiation has, according to Wolk *et al.* (1992:582), focused on the cultural dimension developed by Hofstede (1980 and 1984). An extensive study by Hofstede (1980) revealed four underlying societal value dimensions into which countries could be classified. He labelled these Individualism, Power Distance, Uncertainty Avoidance and Masculinity (Gray 1988:5 and Perera 1989(a):44-46). Later studies by Hofstede (1983 and 1984) provided additional explanations to these value dimensions, which were reduced as follows:

- 1 Individualism versus Collectivism,
- 2 Large versus Small Power Distance,
- 3 Strong versus Weak Uncertainty Avoidance,
- 4 Masculinity versus Femininity.

Hofstede (1984:83-84) provides the following description of these value dimensions. Collectivism indicates a tightly knit social grouping, whereas individualism implies a looser and freer social framework and resulting modes of action by members of the society. In large power-distance societies, the place of individuals within the society is accepted by the participants; whereas much more unrest and turmoil relative to the power vested in institutions and organizations is present in small power-distance cultures. In weak uncertainty-avoidance cultures, people feel relatively secure; whereas in strong uncertainty-avoidance societies, people have a stronger desire to manage the future and hedge or avoid risks than in weak uncertainty-avoidance culture. In masculine societies, qualities such as heroism, assertiveness, and financial and other forms of success are strongly desired; whereas in feminine orientated cultures, altruism and similar forms of behaviour prevail. Gray (1988), Perera (1989(a)), Perera and Mathews (1990) and Radebaugh and Gray (1993) are in substantial agreement with these dimensions. It is these dimensions suggest Radebaugh and Gray (1993:67), that Hofstede (1980) perceived represented elements of a common structure in cultural systems. Hofstede (1980:335-336) illustrated that countries could be grouped into cultural areas on the basis of their scores on the four value dimensions, using cluster analysis and taking into account geographical and historical factors.

On the basis that should cultural values significantly influence a nation's social system, it would not be unreasonable to hypothesise that international accounting patterns should track cultural patterns. Gray (1988:8), Mathews and Perera (1991:326-327), Perera (1989(a):48) and Perera and Mathews (1990:225-228), have used Hofstede's (1980) model in an attempt to identify significant accounting values at the level of accounting subculture. In the first, and what can be argued is the most successful of these treatise, Gray (1988:8) proposes the following accounting values at the level of the accounting subculture. These values are illustrated in table 3.10.

Table 3.10: Gray's (1988) accounting values

Professionalism versus Statutory Control - a preference for the exercise of individual professional judgement and the maintenance of professional self-regulation as opposed to compliance with prescriptive legal requirements and statutory control.

Uniformity versus Flexibility - a preference for the enforcement of uniform accounting practices between companies and for the consistent use of such practices over time as opposed to flexibility in accordance with the perceived circumstances of individual companies.

Conservatism versus Optimism - a preference for a cautious approach to measurement so as to cope with the uncertainty of future events as opposed to a more optimistic, laissez-faire, risk-taking approach.

Secrecy versus Transparency - a preference for confidentiality and the restriction of disclosure of information about the business only to those who are closely involved with its management and financing as opposed to a more transparent, open and publically accountable approach.

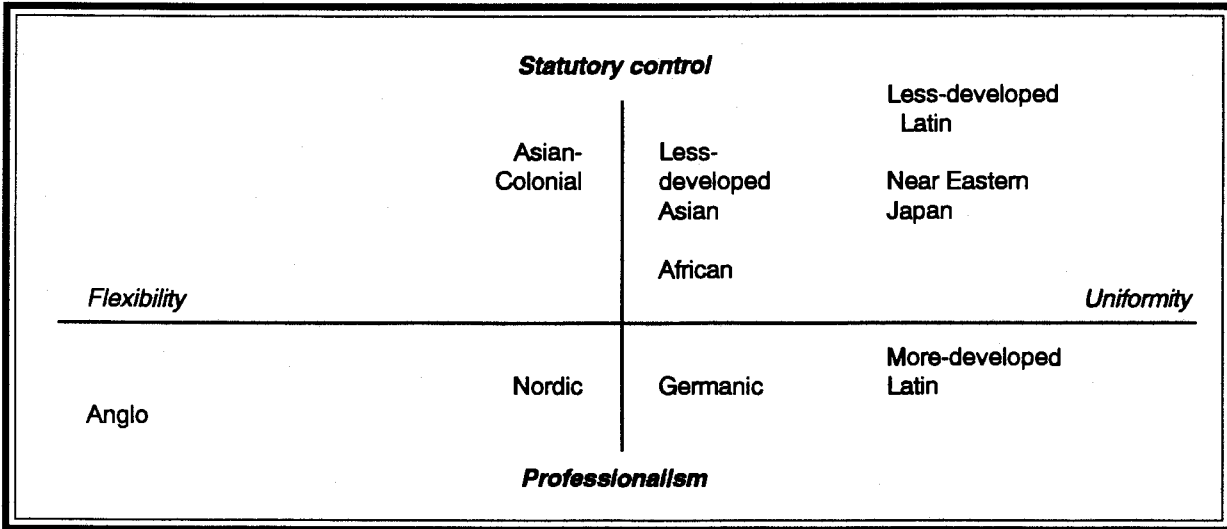
Source: Gray (1988:8)

Having related societal values to accounting values, Gray (1988:11) argued that the most important societal values at the level of the accounting subculture was uncertainty avoidance and individualism. While power distance and masculinity were significant to a lesser extent, masculinity was relatively unimportant. Gray (1988), Perera (1989(a)), Perera and Mathews (1990) and Radebaugh and Gray (1993) illustrate how accounting value dimensions relate to societal values and their likely impact on the development of national accounting systems.

Where a significant level of professionalism is evident in a society with professional self-regulation being the norm, the less likely it is that government will intervene in the regulation of accounting. The higher the degree of uniformity in a society the more likely it is that accounting rules will be strictly applied with little or no professional judgement being employed. Conservatism by its very nature, influences accounting measurement practices. More conservative societies lean towards well-specified measurement practices such as historical cost, while those less conservative would acknowledge alternative measures such as current values. It would appear self evident that the degree of secrecy in a culture would influence the extent of financial disclosure in that environment.

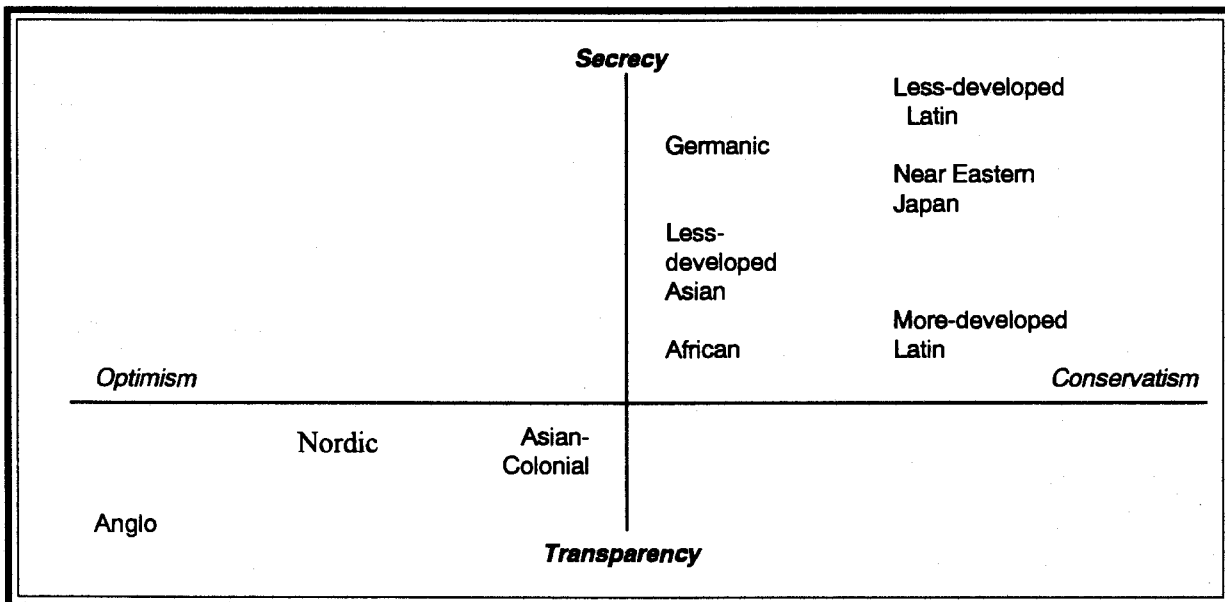
Gray (1988:12-13) proposed a judgemental grouping of countries based on dimensions developed from Hofstede's model and his societal values at the level of the accounting subculture. The relationship between accounting value dimensions relate to societal values and their impact on different national accounting systems is clearly illustrated in figures 3.6 and 3.7.

Figure 3.6: Accounting systems: authority and enforcement



Source: Gray (1988:12)

Figure 3.7: Accounting systems: measurement and disclosure



Source: Gray (1988:13)

Perera (1989) restated Hofstede's cultural dimension and Gray's accounting subculture into a number of hypotheses that he argued shed light on these relationships. For example, Perera (1989(a):49) hypothesised that the greater the uncertainty avoidance and the less the individualism, the greater the conservatism exhibited by the accounting subculture.

Although Wolk *et al.* (1992:583) indicate that these approaches to deducing national characteristics have the potential to provide interesting future research findings, this avenue of

research is still in its infancy. A possible reason for this is that the research to date on the relationship between accounting and culture has not focused on particular accounting practices within a nation, much less provide specifics about whether harmonization can occur and how it would best be accomplished. As illustrated in figures 3.6 and 3.7 above, Gray (1988:11-13) argues that this research appears to be leading to the coalescing of countries into various groupings based on the cultural dimensions combined with the values of the accounting subculture. In spite of potential difficulties, an appreciation and understanding of cultural groupings can nevertheless be useful in terms of guiding the harmonization process as well as establishing its limits. As Perera (1989(a):54) explains, the standard-setting process of the International Accounting Standards Committee is strongly influenced by the Anglo-American accounting model. This is likely to result in problems of relevance being experienced in those countries whose culture does not mirror Anglo-American culture.

3.4.4 Developmental Influences

The cultural dimension discussed above is not the only area that may impede the harmonisation of accounting standards (Evans & Taylor 1982 and Taylor, Evans & Joy 1986:1). As Taylor *et al.* (1986:1) explain: "Each nation's unique accounting rules and regulations mirror its culture and its economic, political, and legal systems. These national variations have led to a worldwide diversity in accounting standards."

Puxty, Willmott, Cooper and Lowe (1987:282) provide further evidence of this when arguing that the mode of accounting regulation (market, state or accounting profession) in a country is a function of the social environment of that country. For example, where market forces exist in a country, a liberal regulatory environment will generally be found where the market will be allowed to determine disclosure practices. Morris (1984) and Watts (1977) provide further evidence of this.

A further criticism of international harmonisation is based on the question of whether standards set on an international basis and applicable to all countries, can in fact be considered relevant in view of the widely divergent national circumstances that occur. These include differing legal systems and stages of economic development. This section seeks to identify the various development issues that may impact on the harmonisation process. Choi and Mueller (1992:39) recognise the influence of environmental factors when they argue that:

Many observers have long proclaimed that accounting is influenced by its environment and, in turn, reciprocates that influence. In essence, this thesis holds that accounting innovation and development are triggered by nonaccounting factors. Auditing standards surfaced after major lawsuits against accountants, LIFO was spawned by inflationary conditions, and broad financial disclosures appear to be a consequence of broad public securities markets Choi and Mueller (1992:39).

Choi and Mueller (1992:39) further suggest that recent advances in conceptual matters is derived from different evaluations of various systems, conditions, or other factors that are thought to impinge on international accounting.

To obtain support for this hypothesis, Choi (1974) formulated and tested what he termed the competitive disclosure hypothesis. This study sought to establish whether a relationship existed between entry to non-regulated public securities markets and the amount and quality of financial disclosure. Choi (1974:19) found that financial disclosure increased up to the point of the initial issue of corporate equity or bond security in the securities market and thereafter stabilised. Choi and Mueller (1992:39) believe that analyses such as that by Choi (1974) facilitate disclosure predictions, strategies regarding corporate earnings announcements at home and abroad, and possible new issue pricing.

A list of environmental factors that influence the development of accounting was initially proposed by Seidler (1967:775-776). These included colonial, traditional, or political associations, capital flows, dominance of civil or common law, taxation objectives, and inflation. In addition to the quantitative issues addressed above, Choi and Mueller (1992:40-43) and Mathews and Perera (1991:287) identified other environmental factors that they suggest influencing accounting. These are briefly addressed below.

3.4.4.1 Legal system

Arpan and AlHashim (1984:7) with Mueller, Geron and Meek (1991:130), Radebaugh and Gray (1993:43-45) and Wolk *et al.* (1992:583) concurring, argue that legal systems have a cultural basis. Choi and Mueller (1992:40) indicate that in Roman or code law countries, the codification of accounting practices appears appropriate, while in common law countries, the non-legalistic approach to accounting standard-setting is more appropriate. Choi and Mueller (1992:40) explain that other regimes such as martial law may require the accounting function to be regulated by central government or agency, such as that under the Nazi government in Germany prior to World War II.

3.4.4.2 Political system

Samuels and Piper (1985:102) with Mueller *et al.* (1991:12), Radebaugh and Gray (1993:43-44) and Arpan and AlHashim (1984:7) concurring, explain that colonists such as the British, Dutch and French exported their individual political systems to their various colonies during the nineteenth and twentieth centuries. This included their accounting systems. In addition, the German use of political sympathy to influence accounting in Japan and Sweden as well as these countries modern political systems have been identified by Choi and Mueller (1992:40-41) as factors that have influenced accounting development.

3.4.4.3 Nature of business ownership

Business ownership patterns, suggest Mueller *et al.* (1991:11) and Radebaugh and Gray (1993:43-44), also influences accounting development. More detailed and extensive financial reporting and disclosure requirements are required where corporate ownership is widespread compared to closely held or family controlled companies. Additional examples provided by Choi and Mueller (1992:41) are the virtual absence of public participation in corporate equities ownership in France which effectively limits financial information to insiders, and the extensive ownership of corporations in Germany by banks which requires their own unique accounting requirements. Perera and Mathews (1990:234) explain that French companies place less reliance on active new issue market as a source of long-term funds than either the companies operating in the United States and United Kingdom.

3.4.4.4 Differences in size and complexity of business firms

Accounting development, argue Mueller *et al.* (1991:14-15) and Radebaugh and Gray (1993:43-44), is also influenced by accounting requirements that relate directly to both the size and complexity of business undertakings. It should be self evident that while the deferral of a portion of a large advertising expense or the capitalisation of a portion of research and development expenditure may be appropriate for a multinational corporation, the same techniques may not be appropriate for smaller firms. Furthermore, a company producing a wide range of products will require more complex accounting systems than one producing a single product line.

3.4.4.5 Social climate

Choi and Mueller (1992:41) and Radebaugh and Gray (1993:43) submit that the level of social climate existing in a country will also influence accounting development. The French attempts to discharge corporate social responsibility by individual companies is compared to the conservative social climate in Switzerland where the level of financial disclosure Swiss

companies is less onerous. Other examples provided by Choi and Mueller (1992:41) are the Italian view on items relating to taxation, and the disdain with which accounting is viewed in certain European and South American countries.

3.4.4.6 *Level of sophistication of business management and the financial community*

The level of sophistication of business management and financial community, suggest Mueller *et al.* (1991:14) and Radebaugh and Gray (1993:43-46), also influences accounting development. For example, sophisticated accounting standards, disclosure requirements and techniques such as the capitalisation of leases, deferred taxation, consolidation of subsidiaries, equity accounting, financial forecasts and capital budgeting are only appropriate in those environments where they are understood and not subject to misuse.

The nature of international financial markets will also influence the development of financial reporting. Differences, according to Rebmann-Huber (Wolk *et al.* 1992:583), occur between capital-based financial markets where long-term investment is dominated by individual investors, and credit based financial markets where the bulk of long-term funds are provided by government or financial institutions. In individual dominated capital markets, the focus of financial reporting is the provision of information useful to current and prospective investors.

3.4.4.7 *Degree of legislative business Interference*

The existence of specific legislation aimed at either mandating or prohibiting certain accounting principles for taxation purposes, for example disallowing inventory valuation on the last-in-first-out (LIFO) basis in South Africa for taxation purposes, which influences accounting development. Additional examples provided by Choi and Mueller (1992:42) include the existence of social security laws that influence accounting standards, the disclosure of severance payment requirements in certain South American countries and pension fund accounting in the United States. It is evident that legislation of this nature will influence accounting development.

3.4.4.8 *Presence of specific accounting legislation*

Most and Slater [Belkaoui 1992:583] argue that financial reporting is grounded in the legal system of nations. The presence of legislation aimed specifically at accounting information disclosure and the process through which it is incorporated into legislation, suggest Arpan and AlHashim (1984:7), can also influence accounting development. In the United States for example, the Securities and Exchange Commission prescribes accounting and disclosure rules for large publically held companies, although as Choi and Mueller (1992:42) explain that it does so by relying on "the authoritative and private sector Financial Accounting Standards Board."

In other western countries particularly those with ties to the United Kingdom, such as Australia, New Zealand and South Africa amongst others, regulations governing accounting information are contained in companies' acts. (Classification of accounting practices in the study by Da Costa *et al.* (1978:78) would tend to confirm the influence of company law on accounting practices.) In the South African context, the South African *Companies Act*, Act 61 of 1973, the dominate legislative statute relevant to companies, requires audited financial statements to be approved by shareholders at an annual general meeting, and that these auditors be appointed by shareholders. Changes to accounting provisions such as those currently contemplated in South Africa and described in 3.7 below are predominately private sector driven. This can be contrasted to the position existing in Germany. Here, Choi and Mueller (1992:42) explain that, changes to company legislation is a political process and determined largely in the political arena. Wolk *et al.* (1992:583), in providing an additional example of legislative influence, explain that in continental Europe, conformity with taxation legislation dominates accounting. This is forwarded as the possible reason why leases are not capitalised in France and are seldom, if ever, disclosed.

3.4.4.9 *Speed of business innovations*

Innovations in financing and other transactions occur readily in the business environment. This should not be seen as a recent trend. As Choi and Mueller (1992:42) explain, business combinations only become popular in Europe a few years ago. Prior to that, there was little need for accounting standards and practices relating to mergers and acquisitions of going concerns. Other examples provided by Choi and Mueller (1992:42) include the recent innovation in the United States of small stock distributions or stock dividends. More recent innovations include junk bonds, derivatives, interest rate and currency swaps.

3.4.4.10 *Stage of economic development*

It is self evident that a highly developed industrialised country such as the United States will require different accounting principles to those of a third world, predominately agricultural economy such as Burundi. While sophisticated accrual accounting may be appropriate for industrialised countries suggest Arpan and AlHashim (1984:8), basic cash accounting may be more appropriate for predominately agricultural economies.

3.4.4.11 *Growth pattern of an economy*

The growth pattern that exists in an economy is likely to influence accounting development. Choi and Mueller (1992:43) explain that in an expanding economy the capitalisation of deferred

charges is feasible. Where stable conditions result in intensive competition for a static market share, more restrictive credit and inventory methods may be appropriate. In declining economic conditions, write-offs and adjustments not warranted in other circumstances may be appropriate. In addition, factors such as protracted civil war or hyper-inflation may influence accounting development.

3.4.4.12 Status of professional education and organisation

In those countries where the accounting profession is either not professionally organised or does not exist, International Accounting Standards or standards from those countries that significantly influence economic life are likely to be adopted. Choi and Mueller (1992:43) explain that until the end of World War II, the United Kingdom significantly influenced accounting development. Since that event, the influence has been predominately the United States.

Wolk *et al.* (1992:583) argue that many of the analyses of why accounting systems differ, overlap. They provide the example of legal institutions which they believe have a cultural basis. It is clear that as environmental factors interact with each other, they cannot be viewed in isolation. It is self evident that an environmental factor such as a political system will impact on the legal system, which in turn impacts on the degree of legislative business interference and pressure of specific accounting legislation.

A further argument could be made that accounting standards set on an international basis cannot cater for the widely differing national circumstances that arise as a result of development influences. Aitken and Islam (1983) in rejecting this argument, explain that the nature of economic transactions and their accounting do not differ significantly.

In addition to the environmental factors discussed above, there are also political costs attributable to the harmonisation process. As Choi (1994:17) explains, countries could lose part of their national sovereignty if their fiscal tax base is based on externally-imposed harmonised accounting numbers.

From the above discussion it is clear that the role of environmental factors in financial reporting is a complex one. As Cooke and Wallace (1990:82) explain:

Many historical, political, economic, and social factors—at both national and international levels—affect the level and extent by which various national societies regulate corporate financial disclosure (CFD). Two societies may exist side by side for many years, each with the same contextual characteristics, yet one society may choose to regulate CFD extensively and the other may not. One may respond to internal factors and the other to external factors.

3.4.5 Developing countries including those in Africa

Accounting in developing countries has enjoyed the attention of Belkaoui (1992 and 1994), Briston (1978), Choi and Mueller (1992), Ghartey (1985), Hove (1982 and 1986), Mirghani (1982), Mueller (1968), Nobes and Parker (1995), Perera (1989(b)), Samuels and Oliga (1982), and Wallace (1988) amongst others. The benefit and contribution that accounting can make to developing countries, according to Seidler (1967:780), is that it provides a positive mechanism contributing to the formation of capital markets, national planning, price control, and tax administration. However, in line with other countries, accounting in developing countries has the potential to take on a unique form. As Perera (1989(b):141) observes: "Accounting is a product of its environment, and a particular environment is unique to its time and locality."

Developing nations have certain characteristics that have been described by Ghartey (1985:146) and Enthoven (1991:259), who explain that [in developing nations]

domestic savings for long-term investment are generally in short supply. Inadequate savings may be caused by low income and inequitable income distribution, poor investment opportunities and conditions, and other institutional factors. Changes which are institutional, legal, socio-cultural or ecotechnical in nature may be necessary to improve capital market mechanisms and to mobilize domestic and foreign funds into productive activities.

Barkay, quoted in Mirghani (1982:62), describes developing countries as representing "a heterogeneous group and, as such, vary widely in terms of the stages of social and economic development achieved, endowment with regard to natural and human resources, economic and social structures, attitudes, and planning policies." These countries suggest Perera (1989(b):141), are those in the third world not belonging either to the Western world centred on the United States, or the Eastern world with the Union of Soviet Socialist Republics as the centre.

Of the ten different business environments identified by Mueller (1968:93) the one relevant to this study as a group of developing nations is Africa. Here Mueller (1968:95) is less than complementary when describing Africa (excluding South Africa) as follows: "Most of the African continent is still in the early stages of independent civilization and thus little or no native business environment presently exists. There are significant natural and human resources. Business is likely to assume a major role and responsibility in the development of African nations."

What is disappointing in view of the international reputation of academics such as Belkaoui (1992 and 1994) Choi and Mueller (1992) and Nobes and Parker (1995) is the almost total lack of attention paid by them to the question of accounting in Africa in general and Africa as a group of developing nations within a particular economic sphere in particular. In fact, it could be argued that Belkaoui (1992:479 and 1994:42) fails to conceptualise the reality of accounting in Africa. This apparent lack of understanding is evident in that he has failed to update the above

quote from Mueller (1968:95) in his books published in 1992 and 1994 containing descriptions of the African business environment.

This study of South African corporate management's attitude to the accounting standard-setting process and international harmonisation would, in view of the economic role South Africa is likely to play on the African continent in general and Southern Africa in particular, be incomplete if it did not include a discussion of the international harmonisation of accounting from an African including a developing countries perspective. What makes this discussion relevant is the South African Institute of Chartered Accountant's decision to adopt International Accounting Standards rather than developing South African specific accounting standards. This decision by the South African Institute of Chartered Accountants is in line with the thoughts of Belkaoui (1994:75) who argues that one of the strategies developing countries can use in developing accounting standards is the wholesale adoption of International Accounting Standards Committee pronouncements. The benefits of this approach suggests Belkaoui (1994:75-76) are:

- the reduction of setup and production costs of accounting standards,
- joining the international harmonisation drive,
- facilitating the growth of foreign investment,
- enabling the profession to emulate well-established professional standards of behaviour and conduct,
- to legitimise the status of the country as a full-fledged member of the international community.

Accounting practices in a substantial number of developing nations have, according to Hove (1982:44 and 1986:82), been imposed upon them through colonialism, the operations of transnational corporations, professional accounting institutes as well as special conditions contained in economic aid agreements. This is confirmed by Perera (1989(b):141-142), Mirghani (1982:61), Samuels and Oliga (1982:71) and Briston (1978:107-108) who suggests that: "In a number of countries, of course, the British influence is very long standing, and almost all of the colonial territories in which any substantial degree of industrial development took place under British rule will have had imposed upon them a British Companies Act with the usual reporting and auditing requirements."

The question is then: What form should an accounting system take for it to be considered appropriate for developing countries? An examination of this question has been made by Briston (1978), Nair and Frank (1981), Mirghani (1982), Samuels and Oliga (1982), Hove (1982 and 1986) Perera (1989(b)). In forcefully rejecting prescriptions from outside parties such as the International Accounting Standards Committee, the American Accounting Association and the

United Nations, Hove (1986:99), with Perera (1989(b):142) concurring, argues that these groups fail to take any consideration of the needs of these countries. In fact Hove (1982:44), with Francalanza (1988:176-177) in substantial agreement, argues convincingly that accounting practices imposed in unmodified form by developed countries are wholly inappropriate for developing countries. Accounting technology transfers of this nature have been described by Choi and Mueller (1992:54) as a form of colonialism similar to that of yesteryear. As Hove (1986:98-99) argues:

the accounting objectives of each developing nation, and not those of all developing nations, should be determined. In addition, these objectives should not be determined by the International Accounting Standards Committee, the American Accounting Association, or the United Nations, for example; they should be determined by the natives of those developing countries on the basis of the legal, economic, and social conditions there in accordance with the understanding within each country of the basic economic facts underlying business transactions.

In what appears to be a misinterpretation of Nair and Frank (1981:75-76), Perera (1989(b):142) suggests that multinational corporations also be excluded from the development of accounting standards in developing countries as the elimination of local accounting practice is seen by these companies as a method of facilitating the accounting practices of the multinational. Support for this view is provided by Samuels and Oliga (1982:71) who argue that:

Individuals and certain interest groups, including those in developing countries, have perhaps supported the international harmonization efforts for reasons not excluding enhancement of personal or group interests and status. However, whatever the real motives underlying support for harmonization, such support is usually rationalized in terms of greater international understanding and better economic efficiency in the allocation of scarce resources, including avoidance of duplication in the cost of producing accounting reports.

The accounting requirements of developing nations should, according to Mirghani (1982:61), be developed through basic research that will result in an indigenous model rather than one which is 'imported' into the country.

Perera (1989(b):142) has argued that the most influential body, in terms of the development of accounting standards in these countries has, since its formation in 1973, been the International Accounting Standards Committee. One could be excused for questioning whether the adoption of International Accounting Standards appropriate for those countries with a large private sector and a well developed capital market is relevant to developing countries such as those in Africa where the only significant capital market is limited to South Africa with other minor capital markets existing in Nigeria and Zimbabwe. As Mirghani (1982:67) explains "it will be a mistake if a developing country blindly adopts an accounting system of a certain developed country rather than focusing on assessing their own information needs in order to provide a sound basis for the creation of an indigenous accountancy (sic) function."

It is apparent from the above discussion that imposing International Accounting Standards on developing countries could be viewed by these countries as another form of colonialism. Hove (1986:100) with Mirghani (1982:68) in substantial agreement provides the final word: "Those who advocate the standardization of accounting practice internationally will not solve the problem; only the nationals of LDCs [less developed countries] themselves can and should find ways to correct the situation." Consulting and financial assistance for research projects can however be provided by developed countries to assist developing countries adapt existing accounting practices to suit their needs.

The challenge facing parties wishing to implement any form of accounting system, indigenous or otherwise, in Africa has been identified by Ghartey (1985). In a hard-hitting article, Ghartey (1985:143-144) describes the factors that contribute to economic malaise as: inappropriate policies, abuse of power, fraud, corruption, oppression and violence, inefficiency, embezzlement, incompetence, misappropriation of public funds, and economic and financial mismanagement. Evidence is provided by Ghartey (1985:157) of all these factors existing in Africa, making the domestic environment in certain countries in the continent extremely volatile and susceptible to turmoil. A lack of stewardship and accountability are identified as the factors that result in misery, poverty and underdevelopment in Africa. Ghartey (1985:157) explains it as follows:

These environmental factors that exacerbate inadequate accountability and stewardship and hence misery and underdevelopment include deficiencies in accounting systems, conceptual and operational difficulties of accountability, government monopoly of power, bureaucratic secrecy, conflicts in perspectives and inadequate institutional linkages, technological obsolescence and inadequate surveillance systems, poverty and lack of motivation, cultural factors, and crisis management.

Possible reasons for the problems highlighted by Ghartey (1985) are those identified by Radebaugh and Gray (1993:562) as facing countries in Africa. These include the relatively few indigenous fully qualified accountants, poor public sector accounting, inadequate education, poor quality accounting technicians, accounting standards and their enforcement warrant low priority, overdependence on accounting systems and standards developed in France and the United Kingdom. Former French colonies place excessive reliance upon taxation laws and use an older version of the *Plan Comptable* rather than adopting the new *Plan Simplifié*. Former British colonies tend to use outdated legislation. In addition, smaller countries are not in a position to develop and support a national accounting profession.

From the above discussion it is questionable whether the adoption of International Accounting Standards will find favour, or make a significant contribution to the development of accounting in developing countries, especially those in Africa. These countries require the

development of an accounting system that is unique to each individual country taking into account economic, political and social systems. In addition, these accounting systems must improve stewardship, accountability and well as contributing to economic growth and well being. The South African accounting profession through its expertise and position on the continent, is well placed to make a significant contribution to this development.

3.5 OVERCOMING IMPEDIMENTS TO THE HARMONISATION PROJECT

From the above discussion, it is clear that the harmonisation process internationally is likely to be fraught with difficulties. In particular, should South African corporate management be dissatisfied with the manner in which accounting harmonisation is being imposed upon them, a convincing argument for non-compliance with International Accounting Standards could be the development patterns, differences in accounting practices, cultural influences and development influences described above. In order to overcome any opposition to international harmonisation, Burggraaff (1982:108) believes that the accounting profession is in the best position to persuade the business community and corporate management that it would be in their best interest to comply with International Accounting Standards.

It is clear that a number of impediments stand in the way of comprehensive accounting harmonisation. It is not unreasonable to suggest therefore, that the internationalisation of accounting standards is unlikely to occur. This section will discuss the submission of suitable alternatives to the harmonisation process as envisaged by the International Accounting Standards Committee. It would not be unreasonable to expect that these alternatives could be considered by both the International Accounting Standards Committee and the South African Institute of Chartered Accountants as a means of reducing possible opposition to this process.

3.5.1 Multinational corporations as a means of promoting accounting harmonisation

In view of the potential economic and political influence that multinational companies may exert on developing nations, it is not unreasonable to expect these countries to support the development of accounting standards that would assist in controlling the influence of these corporations. It is important however, not to confuse accounting standards aimed at controlling the operations of multinationals operating in developing nations, and accounting standards for developing nations. Accounting standards for developing nations should be based on what Hove (1986:98) considers are the individual nation's objectives. This would include improving stewardship, accountability and contributing to economic growth and well being.

However, because of difficulties facing the development of comprehensive international harmonised accounting standards, agreement on these is unlikely to be achieved in the short

term. A possible alternative is that because of the accounting problems unique to multinationals, consideration could be given to the development of accounting standards applicable only to these companies. Responsibility for the development of these accounting standards could therefore be left to the multinational corporations. This possibility has been discussed by Choi and Mueller (1992:52-54), Gray *et al.* (1981:127) and Mueller and Walker (1976:74). This would overcome the problem identified by Gray *et al.* (1981:127) who argue that multinational corporations seldom provide information that is useful to users of financial statements in those countries in which they operate. Choi and Mueller (1982:53) do not believe that this role would be alien to multinationals.

They argue that:

If, indeed, a body of financial accounting standards were to evolve for specific MNC purposes, these enterprises would be thrust into an accounting innovative role of major proportions. Since their very existence depends on organizational, economic, political, and other innovation, such a role would be familiar territory to them. Put differently, we see no reason why MNC's as a group might not prove to be successful accounting innovators.

Following ideas of Mueller and Walker (1976:74) multinational corporations could be required to produce primary financial statements in terms of the individual country requirements, and simultaneously prepare secondary financial statements based on these purposively developed international standards. In addition, this approach would overcome the International Accounting Standards Committee's global village perspective philosophy for all accounting.

Should this approach to the development of accounting standards be adopted, the participation by South African corporate management in accounting standard-setting would be encouraged. External factors such as previous international disinvestment or the restrictive exchange control regulations currently in operation would not affect their participation.

3.5.2 The cluster approach to the harmonisation of accounting standards

As was illustrated in section 3.4.4 and confirmed by Mueller *et al.* (1991:15), the variables that shape the development of financial accounting overlap. Accepting therefore that accounting is influenced by its environment, then, logically, it is reasonable to assume that accounting similarities will exist in those countries whose business environments are similar.

A number of studies including those by Ainajjar (1986), Da Costa *et al.* (1978), Douppnik (1987), Frank (1979), Nair and Frank (1980 and 1981) and others, have illustrated that it is possible to group or cluster countries according to accounting similarities. Although the classification systems provide an indication of individual countries' characteristics, the groupings tend to be too wide for useful classification purposes. This would require further subdivision to provide more realistic environmental similarities so that countries could be accurately clustered. However, because of each country's unique blend of environmental factors, Mueller *et al.*

(1991:15) caution that no two countries have identical accounting practices. Evidence would therefore suggest that the unique environment of individual countries precludes the imposition of an international body of accounting standards. Even taking Mueller *et al*'s. (1991) caution into account, it appears reasonable to assume that the harmonisation of accounting standards using a number of common environmental factors as a point of commencement to international harmonisation would be preferable to comprehensive harmonisation with all its identified problems.

Since the harmonisation of accounting standards on a cluster basis was first considered by Choi (1981), a number of recent studies based on accounting in Australia and New Zealand (Hill 1993, Rahman, Perera & Ganeshanandam 1994, Sharpe 1993, and Tower, Perera & Rahman 1991), would suggest that this form of harmonisation is both relevant and feasible. On a regional basis this could be achieved by the merger of the accounting standard-setting bodies. This is not either a unique or original suggestion. Examples of mergers of this nature are the accounting bodies of the United Kingdom and Ireland, and Scotland and Wales. Clearly at this stage this form of harmonisation is not feasible from an international perspective, but could be considered as the first step in the harmonisation process.

From evidence provided by the studies of Da Costa *et al.* (1978), Doupnik (1987), Frank (1979) and Nair and Frank (1980), it is possible to classify South African accounting as an accounting subgroup within the British model. If Australia and New Zealand can be similarly classified as suggested by Tower *et al.* (1991:5), then it would be reasonable to expect that the harmonisation of accounting standards between these three countries would be easier to achieve and possibly more acceptable to corporate management and other users than the unilateral imposition of international accounting standards that has occurred in South Africa. In addition it could further be argued that harmonisation on this basis is also preferable to that undertaken by European Economic Community with its diverse environmental characteristics, where in spite of directives and individual country legislation, acceptable levels of harmonisation has yet to be achieved.

3.6 ROLE OF THE INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE IN THE HARMONISATION PROCESS

As the stated objective of the South African Institute of Chartered Accountants is to adopt International Accounting Statements for issue after exposure in South Africa of all bodies involved in the harmonisation process, the International Accounting Standards Committee is the most relevant body from a South Africa perspective. In terms of the *Companies Act, Act 61 of 1973* (South Africa 1973, sec 286(3)), corporate management are required to prepare financial statements so as to comply with statements of generally accepted accounting practice issued by

the South African Institute of Chartered Accountants. Any proposed changes to the accounting standard-setting process must of necessity, be of interest to them. This therefore provides the justification for focusing on various aspects of the International Accounting Standards Committee.

The first step in the development of international accounting standards was taken in 1966 with the formation of the Accountants International Study Group, Benson (1976:34 and 1977:340), Chandler (1992:223), Mueller and Walker (1976:69), Jeffery (1975:48), Vieler (1977:157) and Wyatt (1991(a):13.2). Agreement was reached between the then president of the Institute of Chartered Accountants in England and Wales, Sir Harry Benson, and the accounting bodies of the United States and Canada on the formation of a study group to make and publish comparative studies of the accounting problems in these three nations. In addition, the Accountants International Study Group undertook comparative studies in accounting, auditing and financial reporting in an attempt to promote greater international harmonisation. Although Jeffery (1975:48) in the February 1975 issue of *The South African Chartered Accountant* considered this group to have been successful, it must be recognised that this was the first of modern attempts to harmonise accounting standards on an international basis.

The formation of the International Accounting Standards Committee in 1973 (Choi & Mueller 1992:263) can, argue Tower *et al.* (1991:2) and Wyatt (1991(a):13.5), be viewed as a private sector response to the demand for an international standard-setting process. As Taylor (1987:158) explains, the need for the international harmonisation of financial reporting practices and the growth of multinational businesses are two of the more popular explanations used to justify the existence and operation of the International Accounting Standards Committee.

Although one of the primary objectives of the International Accounting Standards Committee is the "improvement and harmonisation of financial reporting, primarily through the development and publication of International Accounting Standards" (International Accounting Standards Committee 1995:7), other objectives contained in the International Accounting Standards Committee constitution explains Kirkpatrick (1986:87) and Wyatt (1991(a):13.5) include:

- (a) *to formulate and publish in the public interest accounting standards to be observed in the presentation of financial statements and to promote their world-wide acceptance and observance;*
- (b) *to work generally for the improvement and harmonisation of regulations, accounting standards and procedures relating to the presentation of financial statements.*

It is clear that although the implicit goal of the International Accounting Standards Committee is accounting harmonisation, its official goal is the formulation and publication of accounting standards that can be used in the preparation and presentation of financial statements.

The International Accounting Standards Committee has wide representation. At January 1995, membership was made up of 110 member bodies in 82 countries representing over one million accountants in commerce and industry, government, public practice and academic institutions. Funding is provided by the professional accounting bodies "other organisations on its Board, and International Federation of Accountants (IFAC), and by contributions from multinational companies, financial institutions, accounting firms and other organisations" (International Accounting Standards Committee 1995:7).

A Board comprising the representatives of accounting bodies of thirteen countries and up to four other organisations with an interest in financial reporting, conduct the business of the International Accounting Standards Committee. The composition of this Board is illustrated in table 3.11.

Table 3.11: Board members of the International Accounting Standards Committee for the two and a half years ending 30 June 1995

· Australia	· Jordan
· Canada	· Netherlands
· France	· Nordic Federation of Public Accountants
· Germany	· South Africa
· India	· United Kingdom
· Italy	· United States of America
· Japan	· Representatives of the International Coordinating Committees of Financial Analysts' Associations

Source: International Accounting Standards Committee (1995:8)

As alluded to earlier, the International Accounting Standards Committee was not the only party involved in the harmonisation process. As early as 1982 (Daley & Mueller 1982:40), at least twenty different parties were involved in this endeavour. More recently, Belkaoui (1994:64-69) has attempted to provide a comprehensive list of all participants, both globally and regionally. A schedule of participants are provide in table 3.12.

Table 3.12: Participants in the harmonisation process

- International Accounting Standards Committee (IASC)
- The United Nations (UN)
- The Organization for Economic Cooperation and Development (OECD)
- The European Community (EC)
- ASEAN Federation of Accountants (AFA)
- African Accounting Council (AAC)
- Union Européenne des Experts Comptables Économiques et Financiers (UEC)
- Association Interamericana de Contabilidad (AIC)
- Confederation of Asian and Pacific Accountants (CAPA)
- Nordic Federation of Accountants (NFA)
- Association of Accountancy Bodies in West Africa (ABWA)
- American Accounting Association (AAA)
- Canadian Association of Academic Accountants (CAAA)
- European Accounting Association (EPA)
- Japan Accounting Association (JAA)
- Association of University Instructors in Accounting (AUIA)
- Financial Analysts Federation (FAF)
- Financial Executives Institute (FEI)
- Arab Society of Certified Accountants (ASCA)

Source: Belkaoui (1992:64-69)

It is clear that in the market for the supply of global accounting standards, the International Accounting Standards Committee is not the sole participant. They are however, a dominant and the most respected supplier (Wallace 1990:2 and Wyatt 1991(a):13.4). Solomons (1986(a):59-60) also explains that because not all governments have been willing to leave the accounting standard-setting process to private sector bodies, this has not been the exclusive preserve of any one organisation. The International Accounting Standards Committee (1995:7) however, disagrees with this contention by arguing that they are now established as the sole international due process for the development of International Accounting Standards.

The suitability of the International Accounting Standards Committee to conduct the harmonisation process has also been questioned. Wallace (1990:5-4) suggests that the meagre budget under which the body operates, the lack of qualified staff employed by the body, and source of funding of the International Accounting Standards Committee makes this body unsuitable to undertake this task. What is of particular concern is the source of funding which is shared equally between International Accounting Standards Board members and the International Federation of Accountants on behalf of its entire membership. This method of funding could result in the International Accounting Standards Committee being accused of failing to represent their constituencies in that "the IASC is more likely to conform to the wishes of the funding population [its Board members] than the wishes of the beneficiary population [TNEs, stock exchanges, national accounting regulatory bodies of the Third World]" (Wallace 1990:5).

In spite of this criticism, it is likely that the International Accounting Standards Committee will remain a permanent fixture in the accounting standard-setting process. As Wallace (1990:21) concludes:

Despite its lack of de Jure institutional legitimacy, the IASC has managed to generate a global constituency of broad public support. Its survival is being sustained by (a) the increasing internationalization of business and finance which make global harmonization of accounting and disclosure practices desirable, (b) the composite nature of its standards and its preoccupation with topics of a general nature, (c) its evolutionary strategy and (d) the absence of a rival organization with keen and prolonged interest in the development and marketing of global accounting standards.

3.6.1 The development of International Accounting Standards

Suggestions for new topics to be dealt with in International Accounting Standards are suggested by Board representatives, member bodies, members of the consultative Group, other organisations and individuals and the staff of the International Accounting Standards Committee. Project proposals are prepared by staff which set out reasons why particular topics should be added to the work programme. These proposals are considered by the Board.

Once a topic has been added to the Board's work programme, a Steering Committee is set up to develop a statement of Principles, an exposure draft, and ultimately, an International Accounting Standard. A Board representative chairs each Steering Committee which usually includes representatives of the accounting bodies in at least three other countries. Representatives of other organisations may also be included on the Steering Committee or the Consultative Group or which are expert in the particular topic.

The International Accounting Standards Committee (1995:9) argues that this process helps ensure that International Accounting Standards are of a high quality, and are appropriate in particular economic circumstances. In addition, this process ensures that International Accounting Standards are acceptable to users and preparers of financial statements.

The development of every International Accounting Standard according to International Accounting Standards Committee (1995:9-10) includes:

- (a) the identification and review of all the accounting issues associated with the topic;*
- (b) the consideration of the application of IASC's Framework for the Preparation and Presentation of Financial Statements to those issues;*
- (c) the study of national and regional accounting requirements and practice, including the different accounting treatments that may be appropriate in different circumstances;*
- (d) a detailed review by the staff and the project Steering Committee of the issues, national and regional accounting requirements and practice, and other relevant material;*

- (e) *a detailed review by the Board of the Steering Committee's recommendations;*
- (f) *consultation with the Consultative Group, Member Bodies, standard setting bodies and other interested groups and individuals on a worldwide basis;*
- (g) *public exposure of the Steering Committee's initial proposals in a Draft Statement of Principles;*
- (h) *public exposure of an Exposure Draft of the proposed International Accounting Standard; and*
- (i) *evaluation of the comments received on the Draft Statement of Principles and Exposure Draft.*

Evans and Taylor (1982), Kirkpatrick (1986:88-89) and The International Accounting Standards Committee (1995:10) explain that the procedure for the development of an International Accounting Standard is as follows:

- (a) *the Steering Committee considers the issues involved and develops a Point Outline;*
- (b) *after receiving comments from the Board on the Point Outline, the Steering Committee prepares a Draft Statement of Principles. The purpose of this Statement is to set out the underlying accounting principles that will form the basis for the preparation of the Exposure Draft. It also describes the alternative solutions considered and the reasons for recommending their acceptance or rejection;*
- (c) *the Draft Statement of Principles is issued by the Steering Committee for comment. The exposure period is usually four months;*
- (d) *the Steering Committee reviews the comments on the Draft Statement of Principles and agrees a final Statement of Principles, which is submitted to the Board for approval and used as the basis for preparing an Exposure Draft of a proposed International Accounting Standard;*
- (e) *the Steering Committee prepares a draft Exposure Draft for approval by the Board. After revision and with the approval of at least two-thirds of the Board, the Exposure Draft is published. Comments are invited from all interested parties during the exposure period, usually six months;*
- (f) *the Steering Committee reviews the comments and prepares a draft International Accounting Standard; and*
- (g) *the Board reviews the draft International Accounting Standard. After revision and with the approval of at least three-quarters of the Board the Standard is published.*

The Board can during this process, decide that the subject of the proposed International Accounting Standard warrants further consultation and issue a discussion paper for comment. It may also be necessary to issue more than one exposure draft. In addition, the Board may also decide that a Steering Committee needs to be set up to consider whether a revision to an existing International Accounting Standard is warranted in light of developments since the standard was first approved.

At January 1995, twenty nine International Accounting Standards had been issued. International Accounting Standards Committee (1995:11) believes that these standards deal with

the majority of topics affecting financial statements of business enterprises. A list of the current International Accounting Standards is provided in appendix two.

3.6.2 The comparability/improvement project

Various authors including Chandler (1992), Rivera (1989) and Wolk and Heaston (1992) have suggested that the slow progress towards international harmonisation can be attributed to differences in environmental, cultural and sovereignty issues. Carlson (1994) argues that perceptions of the poor quality of International Accounting Standards have contributed the slow progress towards harmonisation, while Choi and Bavishi (1982(b):160) believe that the International Accounting Standards Committee has a credibility problem in spite of its impressive publication record. Despite accusations that International Accounting Standards are inferior to those developed on a national basis, Douplik and Taylor (1985:27) have argued that, although standards issued by the International Accounting Standards Committee have as yet failed to address controversial topics, they can, if viewed as a whole, constitute a basic core of accounting practice necessary for providing useful information. Further credibility is given to the Douplik and Taylor (1985) view now that the conceptual framework, *Framework for the preparation and presentation of financial statements*, has been adopted and issued by the International Accounting Standards Committee.

As a point of departure, it is necessary to examine whether a need existed for the International Accounting Standards Committee to undertake its comparability/improvement project (Grove & Bazley 1993:16). A number of studies (Douplik & Taylor 1985, Evans & Taylor 1982, Purvis, Gernon & Diamond 1991 and Taylor *et al.* 1986) have been completed aimed at determining whether individual countries complied with International Accounting Standards. These studies however provide contradictory results. The Douplik and Taylor (1985), Evans and Taylor (1982) and Purvis *et al.* (1991) studies illustrate what can be considered to be lack of conformity with International Accounting Standards by certain countries, including countries that are International Accounting Standards Committee Board members. The Taylor *et al.* (1986) study however, indicates that the International Accounting Standards Committee is achieving a measure of success in requiring compliance with its standards. A brief review of the studies follow.

3.6.2.1 The Evans and Taylor (1982) study

The purpose of the Evans and Taylor (1982) study was to determine the impact of International Accounting Standards Committee standards on financial reporting using a sample of large corporations operating in member nations. To achieve this, five of the early International

Accounting Standards were selected and used to establish whether the major provisions of the standards selected were complied with. From the results of the study, Evans and Taylor (1982) were able to conclude that the International Accounting Standards Committee were unable to exert significant influence on the accounting practices of the countries surveyed.

3.6.2.2 The Douplik and Taylor (1985) study

The objective of Douplik and Taylor's (1985) study was to ascertain the extent to which Western European countries conformed to a basic core of accounting practices based on the first eight International Accounting Standards Committee standards, and whether this conformity improved over time. Douplik and Taylor (1985:29) found that while Europe as a geographical area showed the least compliance with International Accounting Standards in 1979 when compared to other geographical areas, the level of compliance had increased by 1983. Africa as a geographical area however, showed decreased compliance with International Accounting Standards between 1979 and 1983.

3.6.3.3 The Taylor, Evans and Joy (1986) study

The Taylor *et al.* (1986) study aimed at evaluating the extent to which International Accounting Standards Committee standards were successful in improving the comparability and consistency of international accounting reporting practices. To achieve this, public accountants in forty countries were selected and surveyed. Respondents were required to evaluate the effects of five International Accounting Standards Committee standards on the comparability and consistency of national and international accounting reporting practices (Taylor *et al.* 1985:3). Unlike the Evans and Taylor (1982) study which concluded that the International Accounting Standards Committee had little impact on the accounting practices of the countries surveyed, Taylor *et al.* (1985:5-9) found that the International Accounting Standards Committee, through its international accounting standards was successful in improving the comparability and consistency of international accounting reporting practices.

3.6.3.4 The Purvis, Gernon and Diamond (1991) study

In a more extensive study to those discussed above, Purvis *et al.* (1991) reviewed the results of an International Accounting Standards Committee 1988 survey on the extent to which national standards or practices of fifty four member countries complied with the twenty five International Accounting Standards that existed in 1988. On a standard by standard basis, Purvis *et al.* (1991:26-27) found that there was generally a high level of conformity with early International Accounting Standards, which decreased for the more recent standards.

An examination of Purvis *et al.*'s (1991:29) study indicates, for example, that South Africa complied with only 36 percent of International Accounting Standards. In explaining why a country may or may not adopt an accounting treatment conforming with International Accounting Standards, Purvis *et al.* (1991:28) argue that: "One contributing factor is the strength of the national accounting institutions, which affects the way in which standards are developed. Countries with weak or newly established accounting professions may lack a formalized system for developing, issuing and enforcing accounting and reporting standards."

Deep differences existing between countries' attitudes to International Accounting Standards and standard-setting were also confirmed by Purvis *et al.* (1991:31) which they argue, are compounded by the existence of a major stock exchange. In order to obtain country compliance with International Accounting Standards, Purvis *et al.* (1991:33) suggest the International Accounting Standards Committee must win not only the support the national standard setters in different countries, but also that of regulators in those countries where the world's major stock exchanges are situated, including Japan, the United States and the United Kingdom. Resistance to change could be the difficulty facing the International Accounting Standards Committee in these circumstances. As Choi (1973:166) explains, the capital markets in the United Kingdom and the United States already have sophisticated disclosure requirements as well as highly developed accounting professions that play influential roles in the development of financial disclosure requirements. Furthermore, Purvis *et al.* (1991:37) consider the possibility of national standard-setters and regulators in those countries with strong national policy-setting groups, such as the United States, Japan, the United Kingdom, Canada, France and Germany, revising national accounting standards so as to conform with International Accounting Standards Committee standards, to be remote.

In order for the comparability project to be successful, Purvis *et al.* (1991:39) identify three obstacles that must be overcome. Firstly, International Accounting Standards Committee member countries must cooperate with the International Accounting Standards Committee rather than concentrating on promoting their own interests. Second, regional efforts at harmonisation must be restrained or otherwise subordinated to the International Accounting Standard Committee's endeavours. Third, the International Accounting Standards Committee must vigorously pursue its aims, and must be sufficiently funded to enable it to achieve them.

In concluding the review of the above studies, an element of caution must be introduced. Studies such as those of Doupnik and Taylor (1985) and Purvis *et al.* (1991), that provide an indication of the level of individual country compliance with International Accounting Standards, must of necessity be viewed with a healthy measure of scepticism. This is primarily because prior to the comparability and improvement project embarked upon by the International

Accounting Standards Committee in 1987, a wide range of alternative accounting treatments were permitted by International Accounting Standards. Individual countries were therefore able to indicate compliance with at least one of the accounting alternatives.

3.6.3.5 Comparability/Improvement

In an attempt to address both the alleged inferiority of accounting standards as well as improving standards, the International Accounting Standards Committee decided in 1987 that the reduction or elimination of alternative accounting treatments should be given priority. One of the problems with these original statements was that they were relatively general in nature. This arose as a result of the International Accounting Standards Committee having to make compromises (Walker 1978) and accept two alternatives for the standard to receive the required 75 percent support from members for approval. In addition, national policies of member nations resulted in limited cooperation to reduce alternative accounting practices (Wyatt 1991(a):13.6). It is not surprising therefore that International Accounting Standards were often considered inferior.

This action would, according to Purvis *et al.* (1991:25-26), consolidate the International Accounting Standards Committee's claim as the preeminent private standard sector provider of international financial accounting and reporting standards. To achieve this, the International Accounting Standards Committee with the encouragement of the International Organisation of Securities Commissions (Choi & Mueller 1992:266, Nobes 1994:16 and Purvis *et al.* 1991:25) published in 1989, E32, *Comparability of Financial Statements*. This dealt with 29 issues where existing International Accounting Standards had allowed a free choice of accounting treatment for similar transactions and events which were initially agreed upon during the setting of the original standards. Once each issue had been considered in the light of the comment letters received by the International Accounting Standards Committee on E32, the Board approved a *Statement of Intent on Comparability of Financial Statements* in June 1990 (International Accounting Standards Committee 1995:12).

Recognising that many accounting standards required revision in light of developments since they were first issued, the implementation of the revisions in the *Statement of Intent on Comparability of Financial Statements* provided the opportunity to revise standards. The purpose of the improvements project according to the International Accounting Standards Committee (1995:12) was:

- (a) *to revise the Standards for the changes set out in the Statement of Intent on the Comparability of Financial Statements;*
- (b) *to ensure that the Standards are sufficiently detailed and complete, that their explanations are adequate and that they are consistent with other Standards;*
- (c) *to review each Standard in the context of the Framework for the Preparation and Presentation of Financial Statements;*
- (d) *to review the disclosure requirements; and*
- (e) *to revise the format of each Standard.*

Exposure drafts of all the revised International Accounting Standards were issued to the International Accounting Standards Committee's constituents to enable them to provide comment letters on the implementation of the Statement of Intent changes as well as other revisions. Ten revised International Accounting Standards approved by the Board in November 1993 (Nobes 1994:16) completed the present phase of the Comparability and Improvements project. Other changes will be made when further International Accounting Standards are revised.

Meeting the goal of comparability and improvement of accounting standards on an international basis is recognised by Purvis *et al.* (1991) as being no easy task. Purvis *et al.* (1991:43) provide the following reasons for the expected difficulties:

If global comparability of accounting standards is ever to be achieved, significant effort will have to be expended to alter the direction of accounting evolution, to emphasize international, rather than national interests. It is important to recognize that whatever scenarios evolve, progress toward international comparability of accounting standards is likely to be slow and will not proceed in the same direction nor at the same pace in the various IASC-member countries. Changing domestic standards is a slow process; the economic, legal and professional differences among countries provide additional complexity in the international arena.

3.6.3 The use and application of International Accounting Standards

The International Accounting Standards Committee (1995:14) sees International Accounting standards as having made a significant contribution to the improvement and harmonisation of financial reporting internationally. International Accounting standards are, according to the International Accounting Standards Committee (1995:14), used:

- (a) *as national requirements, often after a national due process;*
- (b) *as the basis for all or some national requirements;*
- (c) *as an international benchmark for those countries which develop their own requirements;*
- (d) *by regulatory authorities for domestic and foreign companies; and*
- (e) *by companies themselves.*

In addition the International Accounting Standards Committee (1995:14) explains that the International Organisation of Securities Commissions (IOSCO) looks to the International Accounting Standards Committee to provide International Accounting Standards acceptable for

multinational securities and other international offerings. International Accounting Standards Committee (1995:14) indicates that certain stock exchanges either require or allow foreign issuers to present financial statements in accordance with International Accounting Standards. As a result, a growing number of companies disclose the fact that their financial statements comply with International Accounting Standards. This statement does not however seem to be supported by empirical evidence. Studies by Evans and Taylor (1982), McKinnon and Jannell (1984), Nair and Frank (1981) and Nobes (1990) would suggest that the statement by the International Accounting Standards Committee is possibly without foundation.

3.7 INTERNATIONAL HARMONISATION OF ACCOUNTING STANDARDS: THE SOUTH AFRICAN POSITION

This section examines the harmonisation of accounting standards from a South African perspective. This will include detailing the rationale of the South African Institute of Chartered Accountants for adopting International Accounting Standards Committee statements of generally accepted accounting practice.

As was illustrated in the Purvis *et al.* (1991) study, South African compliance with International Accounting Standards was very low at 36 percent. Two possible reasons exist which must be taken into account when evaluating this level of compliance. The first was the comprehensive international sanctions against South Africa during this period with the resultant lack of international exposure received by companies, the accounting profession and accounting academics. The second relates to the functioning of the accounting profession. While South Africa did not lack a system for developing and issuing accounting standards, the accounting profession lacked both the ability and mechanism to force companies to comply with accounting standards. For countries such as South Africa with low level compliance with International Accounting Standards and who wish to improve compliance levels, Purvis *et al.* (1991:36) explain that two possible choices exist. These countries can either move closer to the International Accounting Standards Committee position by adopting International Accounting Standards, or follow a country that develops accounting standards independently from the International Accounting Standards Committee within an sphere of economic influence. From a South African perspective, countries complying with the requirements of setting national standards independently of the International Accounting Standards Committee would, in terms of Purvis *et al.*'s. (1991:29) study, include the United Kingdom, Australia and New Zealand. As an International Accounting Standards Committee Board member, it is understandable that the South African accounting profession chose the option of adopting International Accounting Standards.

This decision was formally taken in 1993 when the Council of the South African Institute of Chartered Accountants approved a proposal by its Secretariat that statements of generally accepted accounting practice be based on the International Accounting Standards Committee standards (Blumberg 1995(b):3). Approval for this proposal was also obtained from the Accounting Practices Board. In a letter to members of the South African Institute of Chartered Accountants, Mockler (1993:3) provided the following details of Council's decision:

Council formally resolved to adopt a policy of adapting international standards for use in South Africa rather than setting our own standards from scratch. This applies initially in the fields of accounting, auditing and ethics. It is envisaged that the international standards will be amended only to accommodate the requirements of South African law and tax.

From a South African perspective, this decision makes sense, especially as, at that point in time, international trade and investment sanctions, previously enforced against South Africa, were being lifted. As Dickinson (1994:1) explains, an essential ingredient in attracting foreign investment and a necessary condition for the free flow of capital at its lowest cost to its most efficient users, is the international comparability of financial information produced by South African companies. For this to be achieved, locally produced accounting standards should be as consistent as possible with accounting standards around the world.

As a result of this decision, the Accounting Practices Committee embarked on its Harmonisation and Improvements Project. The primary object of this project would be to amend all South African statements of generally accepted accounting practice so as to bring them into line with International Accounting Standards Committee standards. This would be achieved by the identification and elimination of alternative accounting bases, where appropriate to identify and eliminate inconsistencies between standards, and finally to incorporate in existing standards guidance on additional issues which have arisen since the original standard was released. The only relevant difficulty in this operation identified by Terblanche and Buss (1994:27), would be to ensure that the International Accounting Standards adopted adequately addresses specific South African issues.

The adoption of accounting standards on this basis is, however, not without risks. What must not be forgotten is that international harmonisation of accounting standards will have economic consequences for various user groups. The benefits of harmonisation must exceed the costs. The costs of harmonisation must be fairly distributed among affected user groups. As Tang (1994:147) explains: "The harmonization of accounting standards usually means a change of local standards in favour of international standards. The change not only affects foreign users, but local groups as well. The change may seriously affect the interests of particular user groups."

It appears that as a International Accounting Standards Committee Board member, South Africa sought to be seen as an active and enthusiastic participant in the comparability and

improvement project, as well as playing a leading role in the adoption of International Accounting Standards. However, standard-setting on this basis could result in the South African Institute of Chartered Accountants being criticised for its lack of long term vision and for failing to take into account the requirements of financial statement preparers and users. For example: should the International Accounting Standards Committee become the primary originator of financial and reporting standards, the South African Institute of Chartered Accountants could, following the logic provided by Daley and Mueller (1982:48), become obsolete or relegated to merely dealing with issues left by the International Accounting Standards Committee, or merely being reduced to a lobbying body on behalf of the South African financial community.

Furthermore, the South African Institute of Chartered Accountants could face the criticism of embarking on the harmonisation process so as to benefit the large audit firms. In discussing the relationship between international accounting standards and the audit process, Taylor (1987:167) explains that the adoption of International Accounting Standards requires additional verification and attest functions being performed. This results in increases in costs to preparers of financial statements. Taylor (1987:167) further argues that although international accounting standards would not appear to increase either the complexity or responsibility of the attest function, their existence does provide the auditing profession with the opportunity to justify the additional verification requirements to their clients. In addition, the existence of alternative accounting practices embodied in International Accounting Standards provides auditors of failed or troubled firms with a defence when the legal action against the auditor is based on the clients accounting policies. Taylor (1987:167) concludes therefore that:

Hence, there is an implication that the strongest supporters of IASC standards should be professional accounting organizations whose members' livelihoods stem from the Anglo-American type of audit, rather than those accounting bodies whose audit activities are closely regulated by government agencies. The behaviour of the accounting profession in the U.S., U.K., Australia, New Zealand and Canada is consistent with this implication.

There is no evidence to suggest that this is not the position in South Africa.

The decision to adopt International Accounting Standards Committee statements of generally accepted accounting practice in South Africa as well as the proposed legal backing for accounting standards has made it necessary for the South African Institute of Chartered Accountants to revise the South African accounting standard-setting process. The accounting standard-setting process proposed by the South African Institute of Chartered Accountants is described in section 3.8 below.

3.8 THE SOUTH AFRICAN ACCOUNTING STANDARD-SETTING PROCESS REVISITED

In an attempt to address the deficiencies that exist in South African financial reporting, as well as ensuring that financially credible information is produced, the South African Institute of Chartered Accountants considered that it would be appropriate to establish legal backing for accounting standards, as well as implementing a system to guarantee compliance. After consultation with the Accounting Practices Board, the South African Institute of Chartered Accountants proposed to the Standing Advisory Committee on Company Law, that the accounting standard-setting process be revised. In July 1994 the Chief Executive of the South African Institute of Chartered Accountants advised the accounting procession of the proposed changes to the *Companies Act*, Act 61 of 1973 making compliance with accounting standards mandatory:

The proposed final wording of the legislation to give legal backing to standards was approved. This wording will now be submitted to the Standing Advisory Committee on Company Law (SAC).

Proposals regarding the new standard setting process were also approved.

It was agreed that when submitting proposals to the SAC, it should be indicated that Council was still in favour of non-compliance with standards giving rise to civil liability rather than making it a criminal offence. However, if it was decided to make it a criminal offence, then this should only apply if the non-compliance was both material and misleading (Mockler 1994:1).

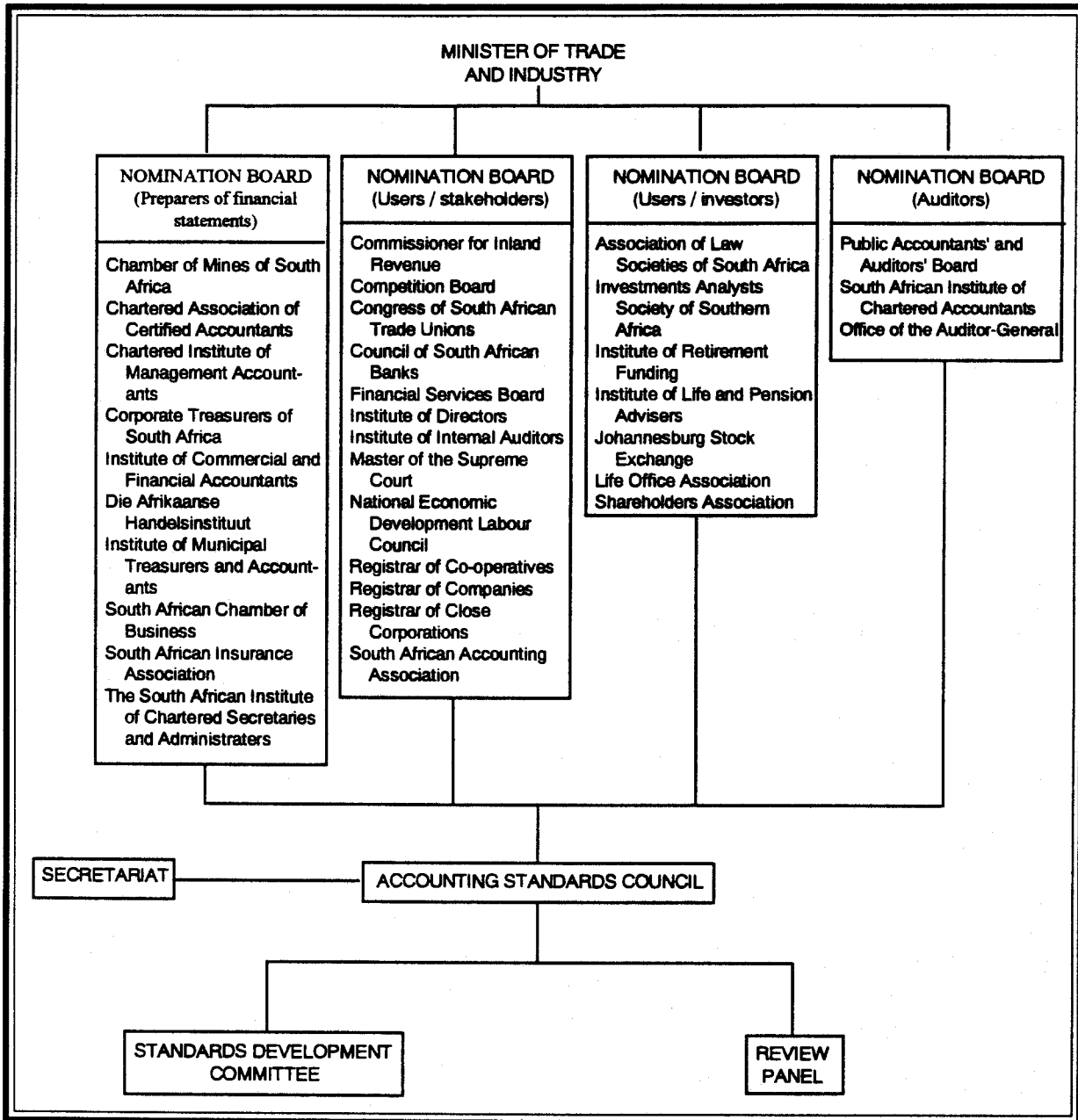
According to the South African Institute of Chartered Accountants (1995:26-26) the rules of the new standard-setting body will be drafted outside of the *Companies Act* as it was done for the Securities Regulation Panel. Because of the very nature of the proposed revised accounting standard-setting process, this section does, of necessity, follow closely the proposals contained in the document *Proposed Amendments to the Companies Act, 1973 on legal backing to accounting standards* prepared by the South African Institute of Chartered Accountants in August 1995.

A new body the Accounting Standards Council will replace the Accounting Practices Board (South African Institute of Chartered Accountants 1995:26 and Dickinson 1995:1). In terms of the *Companies Act*, Act 61 of 1973, the Accounting Standards Council will have the power to set and monitor compliance with accounting standards. So that the Accounting Standards Council's responsibilities are streamlined in terms of the *Companies Act*, Act 61 of 1973, Dickinson (1995:1) and South African Institute of Chartered Accountants (1995:26) explain that two sub-committees will be formed by the Accounting Standards Council. One sub-committee called the Standards Development Committee will be responsible for the development of accounting standards, while the other sub-committee, the Review Panel, will be responsible for monitoring whether companies comply with accounting standards.

It has been proposed by Dickinson (1995:1) and the South African Institute of Chartered Accountants (1995:26) that because of the existing Secretariat of the South African Institute of Chartered Accountants long involvement in the South African accounting standard-setting process, the South African Institute of Chartered Accountants continues to perform the duties of the Secretariat reporting directly to the Accounting Standards Council. This would ensure that contacts with other standard-setting bodies, research methodology, extensive library and communications networks and skills would be retained.

The South African Institute of Chartered Accountants (1995:28) explains that four Nominations Boards made up of four groups of bodies, associations, and institutions with an interest and who would like to participate in the accounting standard-setting process, will be formed to nominate the members of Accounting Standards Council. An additional member, the chairperson of the Accounting Standards Council, will be elected by the members of the Accounting Standards Council. Once the Minister of Trade and Industries has appointed all the members of the Accounting Standards Council, the Nomination Boards would only meet when vacancies occur.

Figure 3.8: Parties involved in the accounting standard-setting process



3.8.1 The role and responsibilities of the Accounting Standards Council

The Accounting Standards Council will comprise sixteen members representing equally. These are indicated in table 3.13.

Table 3.13: Composition of Accounting Standards Council

- | |
|---|
| <ul style="list-style-type: none">• users - investors,• users - other stakeholders,• auditors, and• preparers. |
|---|

Source: South African Institute of Chartered Accountants (1995:28)

In addition, a non-voting chairperson will be appointed by the members of the Accounting Standards Council.

The role of the Accounting Standards Council will be to approve accounting standards once the Standards Development Committee has expressed satisfaction with the document. The South African Institute of Chartered Accountants (1995:28) expects the Accounting Standards Council to have legislative power to make Court applications requiring company directors to prepare revised financial statements should the Review Panel find that the company did not comply with statements of generally accepted accounting practice. In addition South African Institute of Chartered Accountants (1995:28) explains that the Accounting Standards Council should also:

- approve accounting standards for issue once agreed by at least 75% majority of Accounting Standards Council members present at meetings,
- give guidance to the Standards Development Committee on priorities and work programmes,
- advise the Standards Development Committee, in broad terms, on accounting issues of public concern or controversy,
- act as an instrument for promoting good accounting practice, in particular compliance with accounting standards, and for encouraging those bodies represented on the Accounting Standards Council to take an active interest in the development of standards,
- be responsible for monitoring the finances of the standard-setting process,
- act as an appellant to the decisions taken by the Review Panel,
- amend, alter or add to the Constitution by a resolution passed by not less than 80% of its members, and
- not be liable in damages for its actions unless it was found that the action was in bad faith.

3.8.2 The Standards Development Committee

South African Institute of Chartered Accountants (1995:28) argue that accounting standard-setting in the private sector will only survive if the standard setters are highly competent, independent and whose integrity is unquestionable. In addition, the process must be seen as being open and free from bias or favouritism from any constituency.

The Standards Development Committee, the body which will replace the Accounting Practices Committee, will have the same functions as the Accounting Practices Committee. Thirteen members appointed by the Accounting Standards Council, will make up the Standards Development Committee as indicated in table 3.14.

Table 3.14: Composition of the Standards Development Committee

- | |
|--|
| <ul style="list-style-type: none">· 3 auditors,· 3 preparers,· 3 users - investors,· 3 users - stakeholders, and· 1 chairperson. |
|--|

Source: South African Institute of Chartered Accountants (1995:28-29)

The South African Institute of Chartered Accountants (1995:29) justifies the composition of the Standards Development Committee by stating that "A review of overseas practice indicates that the members of the standard setting bodies in the USA, UK, Canada and Australia represent the views of preparers, users and the practising arm of the profession and the number of members in these bodies is not less than 7, not more than 15."

The South African Institute of Chartered Accountants (1995:29) expects that the chairperson of the Standards Development Committee (SDC) would be a member of the Accounting Standards Council (Council) and have voting power "on the SDC and as a Council member." Dickinson (1995:1) and South African Institute of Chartered Accountants (1995:29) explain that the members of the Standards Development Committee should be appointed for at least three years but not more than five years. Continuity of membership will be achieved by ensuring that the terms of office of all members, including replacements, do not expire simultaneously. The South African Institute of Chartered Accountants (1995:29) argues that Standards Development Committee appointments need not be made on a full-time basis. However, it would be expected that members be proficient in advanced accounting issues, commit themselves as to the time they are prepared to spend on the standard-setting process, in addition to being prepared to move the standard-setting process when circumstances dictate.

Furthermore, Standards Development Committee members should not feel obliged to support any individual constituencies' perspective.

3.8.3 The Review Panel

The purpose of the proposed Review Panel would be to monitor compliance by companies with accounting standards. Dickinson (1995:1) and the South African Institute of Chartered Accountants (1995:30) suggest that the South African Securities Regulation Panel provides an appropriate model for the Review Panel. Dickinson (1995:1) and the South African Institute of Chartered Accountants (1995:30) argue that the attributes of the Securities Regulation Panel that are particularly attractive are:

the breadth of its representation, the fact that it includes people with experience of the problems it is discussing, and the fact that those who come before it can identify with the panel and thus feel that their cases are fully understood. It would be preferable that the majority of members of the panel should comprise preparers as in the United Kingdom's Review Panel.

Membership of each sub-committee of the Review Panel that would consider departures from accounting standards would vary depending on the experience required in individual circumstances. Members of the sub-committee would be drawn from a pool of members by the chairperson of the Review Panel.

The South African Institute of Chartered Accountants (1995:31) explains that the purpose of the Review Panel is not to undertake a regular review of financial statements, but merely to investigate complaints from interested parties (Mathews 1995:16). The South African Institute of Chartered Accountants (1995:31) believes that the [Review Panel] "will encourage all bodies, institutions and associations, identified in the Companies Act and in the rules of the Council as the 'nominating bodies', to inform the panel when they become aware of cases of non compliance with standards." The South African Institute of Chartered Accountants (1995:31) identifies the role of the Review Panel as examining, as it judged appropriate, any identified or alleged material departures from accounting standards that, in its view, (whether or not it had received representations from outside sources, including the accountancy bodies) involved an issue of principle, or which it felt might result in financial statements not achieving fair presentation. This examination could also reveal gaps or inadequacies in existing accounting standards, which would be brought to the attention of the Accounting Standards Council and the Standards Development Committee.

In those situations where it is found that financial statements contain misleading and material items of disclosure, both Dickinson (1995:2) and the South African Institute of Chartered Accountants (1995:31) indicate that the Review Panel would be able to disclose this:

to the press and any Attorney-General or the Registrar of Banks or any officer in the public service or any member or creditor of the company concerned or any juristic person of whom the directors or auditors are members or which has the power to take disciplinary steps against the directors or auditors, or to the committee of the JSE. The members of the panel should be indemnified from possible court action brought upon them by an aggrieved party.

Dickinson (1995:2) indicates that the Standing Advisory Committee on Company Law has, in line with the King Report on Corporate Governance, agreed to provide the Review Panel with statutory power. An application could be made to the Supreme Court of South Africa by the Review Panel to have financial statements changed in those circumstances where the Review Panel disagreed with the directors' departure from compliance with an accounting standard. In those circumstances where the court application succeeds, the directors personally, jointly and severally will be liable for all expenses and legal costs incurred in the investigation by the Review Panel and the court application.

The South African Institute of Chartered Accountants (1995:31) expects that full-time support staff within the Secretariat of the South African Institute of Chartered Accountants will be needed to co-ordinate investigations and conduct the necessary administrative tasks. Like the United Kingdom, the names of members appointed to the members of the Review Panel would not be kept confidential. Specific projects would be allocated to them when identified and when the need arises.

3.8.4 Basis and development of accounting standards

The South African Institute of Chartered Accountants (1995:32) explains that under the new dispensation described above, accounting standards would still be based on those issued by the International Accounting Standards Committee and on the concepts set out in AC 000, *Framework for the preparation and presentation of financial statements*. It is envisaged that this situation would continue for as long as International Accounting Standards Committee standards remain relevant to the business needs and circumstances in South Africa. This explains that the South African Institute of Chartered Accountants (1995:32) "would ensure that there is consistency in the principles being followed, that the needs of users that do not have access to detailed information are catered for and that the needs of users that do not have access to detailed information are catered for and that the financial information is presented in an unbiased manner."

Accounting standards developed on this basis should establish principles but not detailed accounting rules or guidance on implementation. This would ensure that ultimately accounting standards would require professional judgement in their application. The South

African Institute of Chartered Accountants (1995:32) justifies their position as follows: "Writing standards that are too detailed may even encourage bad practice by increasing the number of loopholes and the need for even more rules. Accounting standards should thus establish principles but not detailed accounting rules or implementation guidance, as does the FASB."

The Standards Development Committee should issue proposed accounting standards in the form of exposure drafts for comment, for at least three months. An announcement in the Government Gazette that the exposure draft has been issued for comment should also be made. When comments have been received and studied, the Standards Development Committee would make a decision on whether the exposure draft requires amendment. Once the revised document is approved by the Standards Development Committee, it should be forwarded to the Accounting Standards Council for final approval.

In those circumstances where exposure of the proposed standard has resulted in significant changes, the exposure draft should be re-exposed for comment. The Accounting Standards Council should decide on what constitutes 'significant changes' in each particular case. The Standards Development Committee should provide a detailed report-back to the Accounting Standards Council on the comments received on exposure and on what action was taken by the Standards Development Committee regarding the comments received.

Once the Accounting Standards Council has been formed and the standard-setting process is in operation, the South African Institute of Chartered Accountants (1995:33) recommends that the Accounting Standards Council should consider adopting all standards previously issued by the Accounting Practices Board and should only revise them if needed.

3.8.5 Approval of accounting standard

The South African Institute of Chartered Accountants (1995:32) proposes that for an accounting standard to be approved by the Standards Development Committee, at least a 75% majority must agree to the proposed standard. When the accounting standard is submitted to the Accounting Standards Council, at least 75% of members present at the meeting (after ensuring that there was a quorum where there is representation from at least 75% of all members present personally) must approve the statement. A simple majority could make the acceptance of the standard more difficult, while unanimous approval is not practical or reasonable.

In South Africa, the state has traditionally played a passive role in the setting of accounting standards. At face value it would appear that the South African standard-setting process is more consistent with the corporatist rather than the pluralist arrangement. The justification for this view is that the accounting profession is recognised and licensed by the state,

and is provided with a representative monopoly in the setting of accounting standards. In spite of the proposed changes to the standard-setting process this view remains constant.

3.8.6 Financing

Both the South African Institute of Chartered Accountants (1995:29) and Mathews (1995:16) suggest that for the standard-setting process to be independent, its funding should come from a levy to be imposed on the approximately 150 000 companies registered as such with the Registrar of Companies. This levy should be weighted in relation to the company's ability to pay - possibly on net worth or on some other scale to be determined. It is thought that income collected from this levy would be sufficient to fund the standard-setting process. The South African Institute of Chartered Accountants (1995:3) justifies this view as follows:

The standard-setting process should be independent of any particular constituent body. As the Council would be formed in terms of the Companies Act for the benefit of companies and their stakeholders therefore, companies should pay its costs. The estimated costs in a year for the setting and monitoring of compliance with standards by all companies in present terms would not exceed two million rand.

The proposed section, establishing the new standard-setting process to be incorporated into the Companies Act 1973, is included as appendix three. However, Mathews (1995:16) cautions that these changes aimed at improving South African financial reporting could be overturned by the lack of funding.

The South African Institute of Chartered Accountants (1995:33) states that accounting standards will only serve their purpose successfully if they are of an acceptable quality and command support from preparers and users. To achieve this a full consultative process must occur before a standard is issued so as to ensure the commitment of preparers and users. This is a laudable objective. However the previous attempt to issue statements of generally accepted accounting practice that would command the support of preparers, users and auditors was a spectacular failure. If these attempts had been successful, then there would have been no need for the comprehensive overhaul of the accounting standard-setting process. Judgement must therefore be reserved on whether this attempt is likely to be successful.

3.9 THE ROLE OF SOUTH AFRICAN CORPORATE MANAGEMENT IN THE ACCOUNTING STANDARD-SETTING AND HARMONISATION PROCESS

As discussed in chapter two, accounting standards should ensure that financial statements prepared by corporate management meet the information needs of those user groups with a right to financial information. In addition, this information should be produced in the most cost efficient manner possible. As the purpose of this thesis is to establish South African corporate

management's attitude to the accounting standard-setting process and international harmonisation, it is necessary to establish the nature of role played by these individuals in this process. An extensive literature survey would suggest that this issue has yet to be adequately addressed.

Kelly-Newton (1980:90) explains that the acceptance or rejection of a proposed accounting standard by corporate management is a complex decision that is affected by a number of interactive factors. These include (1) resistance to change inherent within the individual and social system, (2) aspects specific to the proposed standard, (3) the communication channels used to diffuse the proposed changes and, (4) social system effects. Kelly-Newton (1980:120) has indicated that corporate management has two choices when faced with a particular accounting standard. From a South African perspective the choices facing corporate management are (1) to decide to either accept or reject a standard issued by the Accounting Practices Board, or (2) to either support or oppose a proposed statement of generally accepted accounting practice.

Traditionally, South African corporate management has been able to participate in the accounting standards setting process in two ways. Firstly, their participation can be viewed as being indirect in nature. This arises as a result of their applicable industry representation on the Accounting Practices Board. The second form of involvement is more direct, and involves making written submissions indicating either support or opposition to an exposure draft issued by the Accounting Practices Committee within the relevant time period. It is self evident that the representatives of the relevant sub-committee of the Accounting Practices Committee responsible for the exposure draft, cannot by virtue of their participation on this committee, hope to represent the interests of all parties likely to be affected by the exposure draft. Participation at this stage of the standard-setting process by corporate management must therefore be considered critical. As Porter (1990:30) explains: "It is only with such active participation that the Society can produce good workable standards which are acceptable to preparers, auditors and users of financial statements alike."

Corporate management must bring to the attention of the relevant Accounting Practices Committee sub-committee, details of any likely impact that the new proposed statement is likely to have. In addition, any perceived flaws and difficulties in the application of accounting standard needing attention before the standard can be supported, should be highlighted by corporate management or other interested parties at this stage.

As is indicated in section 3.7 above, the South African Institute of Chartered Accountants has made the decision to adopt International Accounting Standards Committee standards for use in South Africa. This decision raises the question of what the future roles of

South African corporate management and the South African Institute of Chartered Accountants in the accounting standard-setting process is likely to be. On the face of it, the future role of South African corporate management is likely to be reduced to merely lobbying the South African Institute of Chartered Accountants who, in turn, also face the very real danger of being relegated to a mere lobbying role on behalf of South African financial statement users and preparers.

Now that the South African Institute of Chartered Accountants has made the decision to adopt accounting standards developed using the professional approach of the International Accounting Standards Committee, the following issues need addressing. How will the South African accounting profession react should corporate management fail to comply with an International Accounting Standard on the basis that it is inferior to an accounting standard developed in South Africa? Will the proposed amendments to the *Companies Act*, Act 61 of 1973 be sufficient to cover this eventuality? In addition it would not be unreasonable for South African corporate management to question the adoption of accounting standards formulated by a body possibly perceived to be unrepresentative of the majority of the members, when the standard-setting process has not been agreed upon. The approach adopted here suffers from the following weakness identified Gray *et al.* (1981:129) who argue that professional accounting bodies such as the South African Institute of Chartered Accountants and the International Accounting Standards Committee cannot "legitimately claim to identify exclusively the effort of accounting reports on the decision-making behaviour of users nor the sole right to choose between reporting alternatives which may influence actions by some users to the detriment of others."

3.10 CONCLUSION

In this chapter the South African accounting standard-setting process is examined within the context of the international harmonisation of accounting. By reviewing selected aspects of international accounting, this chapter seeks to provide the necessary framework within which the accounting setting process and South African corporate management's attitude to accounting standard-setting and the international harmonisation process could be studied.

This chapter commenced with a historical overview of the South African accounting standard-setting process. In view of the importance of accounting standard-setting to the overall research topic, this review is considered to be the correct point to commence the study. Evidence is provided that prior to the formal accounting standard-setting process commencing with the introduction of the *Companies Act*, Act 61 of 1973, it is likely that excessive variations in the selection of accounting methodology occurred in South Africa. In addition, numerous other disclosure related problems were experienced by financial statement users during this period. The existing South African accounting standard-setting process was also examined including the

composition of the Accounting Practices Board, the Accounting Practices Committee, and the roles played by them. This review illustrated the sophisticated and well developed accounting standard-setting process which, it has been argued, could be considered pluralistic in nature.

Secondly, the harmonisation of accounting standards was examined. This included a review of the terms associated with this process including, harmonisation, standardisation and uniformity. Arguments both justifying and opposing harmonisation were provided. It was emphasised that the term 'comparability of financial statements' should not be confused with 'uniformity of accounting practice.' This review emphasised that a result of the harmonisation process should be the disclosure of sufficient information so as to enable comparisons between financial statements prepared using different accounting treatments to be made, rather than a global imposition of uniform accounting practices.

In view of the importance of the international harmonisation of accounting standards to this thesis, the environmental factors that impede this process were then discussed. These included comparative development patterns, classification of accounting practices, cultural influences, development influences and the existence of developing countries. As a result of this discussion, a convincing argument can be made to the effect that global harmonisation in the way envisaged by the International Accounting Standards Committee using a top-down rather than encouraging a bottom up approach, is ill-conceived. They failed to take into consideration both natural groupings that exist between countries and environmental factors that exist in these countries. The feasibility of developing comprehensive accounting and measurement rules applicable to all countries under all economic circumstances must therefore be questioned. Countries that place a great emphasis on social justice, social welfare, corporate responsibility with wide public participation in the accounting standard-setting process should be encouraged to continue developing their own standards rather than having accounting standards imposed on them. A better understanding of a country's national characteristics would be obtained.

The relatively low level of success in the harmonisation project to date can be attributed in part to the differences in environmental factors that exist between countries. In light of impediments of an environmental nature of the harmonisation process, methods to overcome these were posited. This included making use of multinational corporations as development agents and the cluster approach to harmonising accounting standards. In the light of the discussion on developing countries including those in Africa, a convincing argument can be made for encouraging those countries to develop their own accounting standards taking into account their own unique environmental characteristics rather than having unsuitable International Accounting Standards imposed upon them as a prerequisite for any form of assistance. It could also be argued that with the expertise that South Africa had developed in the formation of their

own statements, South Africa is in a strong position to be a significant player in an African environment.

The role of the International Accounting Standards Committee in the harmonisation process was then examined. It was concluded that despite its lack of de jure institutional legitimacy, the International Accounting Standards Committee has managed to develop broad public support on a global basis. The development of International Accounting Standards was examined including steps undertaken by the International Accounting Standards Committee to address the alleged inferiority of its accounting standards. In spite of the activity to date in that harmonisation process it must be questionable whether the advantages of harmonisation are worth the effort. Harmonisation of accounting standards can be attained by means other than the development of International Accounting Standards.

The South African position towards the international harmonisation of accounting standards was reviewed. This included a review of the proposed accounting standard-setting process to be adopted in light of the South African Institute of Chartered Accountants decision to adopt International Accounting Standards. The role and responsibilities of the new bodies to be set up to replace the Accounting Practices Board and the Accounting Practices Committee were examined. With the adoption of International Accounting Standards committee statements of generally accepted accounting practice by the South African Institute of Chartered Accountants, the continued existence of this institution as a standard-setting body must be questioned. Finally, the role of South African corporate management in the harmonisation process was examined.

The next chapter examines the role played by corporate management in the accounting standard-setting process.

CHAPTER FOUR

CORPORATE MANAGEMENT AND THE ACCOUNTING STANDARD-SETTING PROCESS

4.1 INTRODUCTION

4.2 THE ROLE PLAYED BY CORPORATE MANAGEMENT IN THE ACCOUNTING STANDARD-SETTING PROCESS

4.3 PRIOR RESEARCH FOCUSING ON CORPORATE MANAGEMENT'S ROLE IN THE ACCOUNTING STANDARD-SETTING PROCESS

4.4 CONCLUSION

4.1 INTRODUCTION

In chapter two, the theoretical foundation for the formulation of accounting standards is reviewed. This includes an examination of the nature and purpose of accounting standards, together with various aspects of accounting regulation. Chapter three describes the South African accounting standard-setting process within the context of the international harmonisation of accounting standards. The reviews conducted in chapters two and three are considered necessary to provide the theoretical background to the study of South African corporate management's attitude to the accounting standard-setting process and international harmonisation. In chapter four, an attempt is made to focus on the central theme of this study, namely corporate management's attitude to the accounting standard-setting process. The international harmonisation of accounting standards must, for the purpose of this chapter, be viewed as an integral part of the accounting standard-setting process rather than an innovation distinct from the standard-setting process.

As investors are able to adjust accounting earnings to take into account changes in accounting policies that occurred in the preparation of financial statements (Ball & Brown 1968, Choi 1994 and Kelly 1983), relatively little new information is provided to them. The question to be posited therefore is: Why does corporate management expend resources in an attempt to influence the accounting standard-setting process? A number of academics, including Bowen, Lacey and Noreen (1981), Dhaliwal (1980), Hagerman and Zmijewski (1979), and Zmijewski and Hagerman (1981), have investigated what motivates corporate management to select a particular accounting policy from the available choices. These studies have incorporated the use of agency theory and other economic factors to identify the reasons why corporate management selects a particular accounting treatment from the available alternatives (for example capitalisation versus expensing) for similar events and transactions.

There is no disputing that corporate management is an active participant in the accounting standard-setting process, a fact with which both Watts and Zimmerman (1978:113) and Moonitz (1974:64) concur. As is illustrated in chapter three, the reason the South African Institute of Chartered Accountants requests comments to an exposure draft, is to obtain reactions and attitudes of various parties, including corporate management, to a proposed accounting change. South African corporate management and other interested parties respond to these exposure drafts by submitting comment letters to the Accounting Practice Committee in an attempt to influence the outcome of the proposed accounting policy. However, Kelly (1982:154) rather cynically observes that interest by bodies such as the Accounting Practices Committee with the opinions of interested parties is merely, "to at least appear concerned with undesirable consequences from enactment." Unfortunately, as is illustrated in chapter six, South African corporate management, with a few individual exceptions, appears to be an unenthusiastic participant in this process.

In this chapter corporate management's role in the setting of accounting standards is examined. The identification of factors that influence corporate management to respond, either positively or negatively, to a proposed change in accounting standards are reviewed. Included is a review of the sociological role played by corporate management in the accounting standard-setting process. In addition, certain prior research highlighting corporate management's reaction to accounting standard changes likely to negatively impact on their wealth is described. As South African corporate management's responses to exposure draft 89, *Revenue*; exposure draft 90, *Property, plant and equipment*; exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policies*; exposure draft 92, *Borrowing costs*; exposure draft 93, *Construction contracts*; and exposure draft 94, *Inventories*; are reviewed as individual case studies in chapter six, it is instructive to review prior research focusing on management's reaction to accounting standard changes.

It is important to realise that this section does not purport to be a comprehensive review of all research that has as its focus corporate management and their reaction to accounting changes, but rather a selective overview of research to date. As prior research is primarily positive in nature, it is reasonable to expect that the criticisms of positive accounting research highlighted in chapter two could be considered applicable to these studies. This chapter however, aims at merely describing the research and its outcomes, rather than being a methodological critique of the studies reviewed.

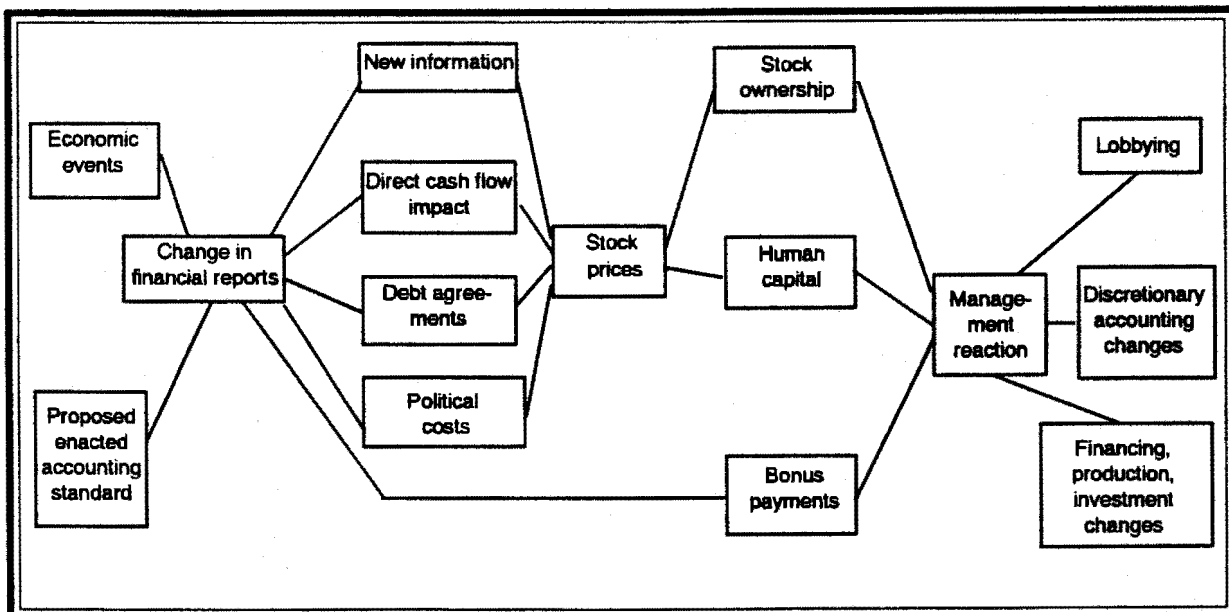
4.2 THE ROLE PLAYED BY CORPORATE MANAGEMENT IN THE ACCOUNTING STANDARD-SETTING PROCESS

As is explained in chapter two under agency theory, corporate management acts as the agent for the principal, the supplier of equity capital (Jensen & Meckling 1976 and Watts & Zimmerman 1978 and 1986). One of the ways in which the principal monitors the potential conflict that arises as a direct consequence of the agents' and principals' goals not being congruent, is financial reporting. As accounting measures are used to enforce many of the contracts existing within a firm, agency theory can be used to explain the reaction of the contracting parties (agent and principal) to proposed or mandatory changes to accounting standards. This is especially relevant where these changes are likely to impact on corporate management's wealth.

Corporate management's reactions to proposed or enacted changes in accounting policies can best be understood by recognising that as part of its stewardship function, management is responsible for reporting the organisation's financial position and results of operations. This is achieved by management selecting those accounting policies and disclosure levels necessary to ostensibly maximise the wealth of the company, after taking into account existing economic conditions.

To understand why corporate management reacts to a proposed or enacted accounting standard, it is necessary for the costs and benefits of the alternative accounting procedures to be assessed in terms of their cash flow implications. As Kelly (1983:112) explains, "this involves identifying the points at which the selection of accounting methods and reactions to policy prescriptions occur." Figure 4.1 illustrates how changes in economic events or accounting policies impact on financial reports, which in turn have cash flow implications.

Figure 4.1: Wealth effects and reaction to accounting changes



Source: Kelly (1983:113)

Figure 4.1 illustrates that either a change in economic events, or a proposed or enacted change in accounting standards impact on financial reports by: (1) providing new/better financial information, (2) having a direct cash flow impact, (3) effecting debt agreements or, (4) resulting in political costs. Each of these changes has the potential to influence share prices, and as a result, corporate management's wealth. Kelly (1983:112), argues that corporate management can react to a proposed change in accounting standards in one of three ways. Firstly, by lobbying policy makers to initiate a change in allowable procedures, or to express support or opposition to a proposed or enacted accounting standard. Secondly, by making discretionary changes to mitigate the financial statement effect of the economic event or accounting standard. Finally, financing, production, or investment activities can be changed in an attempt to assuage the financial statement effect of the change in accounting standard.

To overcome the effect of economic events or proposed or mandatory changes to accounting standards, Kelly (1983:112-114) suggests that corporate management make a number of decisions. Where mandatory accounting changes have occurred, for example, the expensing of research and development costs has been made mandatory, corporate management may make discretionary accounting changes. Examples of these includes extending the period used to amortise pension costs to reduce the negative impact that expensing research and development costs would have on earnings. Examples of economic events necessitating changes in financing, production or investment activities, include disinvesting in politically unstable countries, and the increased use of hedging transactions for foreign currency translations (Kelly 1983:114).

Alternatively, where corporate management opposes a particular accounting standard they can attempt to either circumvent the reporting requirements, subvert the standard, and/or discredit the policy maker (Kelly 1985:615). It would not be unreasonable to argue that for certain accounting standards (for example deferred taxation), corporate management in South Africa embarked on a process of circumventing the reporting requirements required by the accounting standard which effectively discredited the accounting standard-setting body. The only retaliation available to the South African Institute of Chartered Accountants was to propose to the Standing Advisory Committee on Company Law, that the *Companies Act, Act 61 of 1973*, be revised, making compliance with statements of generally accepted accounting practice mandatory. The low level of compliance in South Africa with accounting standards highlighted in chapters two and three, as well as certain identified responses to the various deferred taxation exposure drafts (Samkin 1993), provides adequate justification for this stance.

Academics including Bowen *et al.* (1981), Dhaliwal (1980), Hagerman and Zmijewski (1979), Watts and Zimmerman (1978 and 1986), Zmijewski and Hagerman (1981) and Zimmer

(1986), have investigated the reasons why corporate management select a particular accounting alternative. In their seminal work, Watts and Zimmerman (1978:113-116) identified factors which, they argue, influence corporate management's attitude towards accounting standards. Based on the Watts and Zimmerman's (1978:114) assumption that management's utility is a positive function of the expected compensation in future periods (or wealth) and a negative function of the dispersion of future compensation (or wealth), management would select wealth increasing accounting standards. The reason for this is that corporate management is typically compensated for performing their stewardship function by direct remuneration and incentive plans linked to both accounting earnings and share prices (Healy 1985, Murphy 1985, Ronen & Aharoni 1989, Smith & Watts 1982, and Watts & Zimmerman 1978).

Managerial compensation, explains Smith and Watts (1982:140-144), is a function of both current and future compensation. This includes salary, incentive remuneration such as cash bonuses, share or share option schemes, perquisites or non-pecuniary rewards, and enhancements to the value of managerial human capital. Corporate management is therefore motivated to select that permutation of accounting policies likely to maximise their income through increasing share prices and cash incentive bonuses. As Watts and Zimmerman (1978:114) explain, factors influencing corporate management's attitude towards choice of accounting standard are those that affect both:

forms of compensation indirectly through i) taxes, ii) regulatory procedures if the firm is regulated, iii) political costs, iv) information production costs, and directly via v) management compensation plans. The first four factors increase managerial wealth by increasing the cash flows and, hence, share price. The last factor can increase managerial wealth by altering the terms of the incentive compensation.

The obvious implication of corporate management's wealth maximising function is that, based on their own self-interest, they will participate in the standard-setting process by lobbying the standard-setting body, provided the costs of lobbying does not exceed that which would be incurred by changing financing, production or investment activities. Obviously, it is less costly for a firm to lobby the accounting standard-setting body to amend a proposed standard, than for the firm to change its financing, production or investment activities. Kelly (1983:114) explains the rationale behind this as follows:

Offsetting these costs, and providing the incentives for management's choices and reactions, are benefits in terms of the effect of alternative accounting policies on management's wealth. These benefits are influenced by the probability of success of the various reactions. Thus lobbying, while less costly, may be less effective in mitigating the impact of an accounting change on a financial statement.

4.2.1 Factors Influencing corporate management's attitude towards accounting standards

Changes in accounting policies not only influence the cash flows of a firm, but also impact on future taxation policies, regulatory action, political, and bookkeeping costs. In reacting to a proposed change in accounting standards, corporate management must not only take into account the immediate impact on the firm's cash flow, but also any potential cash flow effects that will occur as a result of the change.

Factors identified as influencing corporate management's attitude towards accounting standards have been developed into a number of hypotheses. These are described as: (1) taxation hypothesis, (2) costs of regulation hypothesis, (3) political costs hypothesis, (4) information production costs hypothesis and, (5) management compensation hypothesis. In addition, academics including Dhaliwal (1980 and 1982), Holthausen and Leftwich (1983), and Kelly (1983), identify the existence of monitoring contracts as an additional factor that influences corporate managers attitude towards accounting standards.

4.2.1.1 Taxation hypothesis

Although financial statements prepared for taxation purposes and those prepared for other external users differ, an indirect relationship exists between these two sources of financial information. Both Watts and Zimmerman (1978:114-115) and Kelly (1983:124) argue that the use of a particular accounting procedure makes it more likely that revenue authorities will adopt that practice than had it not been used. Watts and Zimmerman (1978:115) explain this as follows: "To the extent that management expects a proposed financial accounting procedure to influence future tax laws, their lobbying behaviour is affected by the future tax law effects."

Measuring this aspect of political costs explains Kelly (1983:124), requires the firm's exposure to the taxation effects of a particular policy to be specified. For example, the taxation impact of expensing research and development costs would be greater for companies with significant research and development activities.

4.2.1.2 Costs of regulation hypothesis

Certain public utilities (Watts & Zimmerman 1978:115 and Kelly 1983:125), base their rate-setting formulas on accounting determined costs. A proposed accounting standard that reduces reported income would find support on the grounds that management of the utility could lobby for rates increases. Whether a rates increase is granted, depends on consumer and other groups opposed to the increase, being able to exert the necessary political pressure to prevent it.

4.2.1.3 Political costs hypothesis

Kelly (1982:156 and 1983:118), in concurring with Watts and Zimmerman (1978 and 1986), explains that costs to the firm from political events have several sources. Accounting disclosure is often used by third parties in their dealings with the firm. These include union contracts, government regulations in the form of price controls, taxation policy, and public surveillance which includes antitrust activities. Political costs occurring as a direct result from reactions of various parties to the firm's accounting disclosures have potential cash flow implications. Higher profits increase the likelihood of incurring political costs from antitrust action, union demands, price controls, and increased taxes. Where these circumstances exist, corporate management is likely to oppose any accounting standard increasing income. These situations can be avoided however by the use of appropriate income decreasing accounting procedures.

Watts and Zimmerman (1978:115) explain that governments are able to mandate wealth transfers between various groups, with the corporate sector especially vulnerable to redistributions of this nature. They provide the following explanation for this position:

Certain groups of voters have an incentive to lobby for the nationalization, expropriation, break-up or regulation of an industry or corporation. This in turn provides an incentive for elected officials to propose such actions. To counter these potential government intrusions, corporations employ a number of devices, such as social responsibility campaigns in the media, government lobbying and selection of accounting procedures to minimise reported earnings (Watts & Zimmerman 1978:115).

Four economic variables that can be used as proxies for political costs are identified by Hagerman and Zmijewski (1979:142-145), Holthausen and Leftwich (1983:95), and Watts and Zimmerman (1986:251-252). These include size, risk, capital intensity and concentration.

(a) Size

In an attempt to reduce attention that may be focused upon them, large corporations have an incentive to select accounting standards that either reduce or postpone net income. Empirical studies by Bowen *et al.* (1981), Daley and Vigeland (1983), Dhaliwal, Salamon and Smith (1982), Hagerman and Zmijewski (1979), Watts and Zimmerman (1978), and Zmijewski and Hagerman (1981), focus on the hypothesised relationship between firm size and the income effect of accounting policies.

(b) Risk

Hagerman and Zmijewski (1979:143) with Kelly (1983) concurring, hypothesise that in an equilibrium situation, the expected return a firm can expect on capital invested is positively related to systematic risk. Firms with higher systematic risk can expect higher accounting returns.

Unless adjustments are made for risk, these firms will appear to make excessive profits and face the threat of negative wealth transfers. Furthermore, high risk firms also have a high variability of accounting earnings which, under certain circumstances, appear abnormal. In order to reduce the potential of incurring political costs, these firms select income reducing accounting procedures. Hagerman and Zmijewski (1979:143) explain this as follows: "The beta of accounting earnings should serve as a reasonable proxy for variability of accounting earnings, since systematic risk is a large component of total risk, so we expect higher risk firms to choose income deflating alternatives."

(c) *Capital intensity*

Capital intensive firms, argue Hagerman and Zmijewski (1979:143), do not use the opportunity cost of capital in the calculation of net income. This results in capital intensive firms appearing more profitable than a labour intensive firms. Capital intensive firms subject to political costs, have an incentive to select accounting techniques that reduce reported income.

(d) *Concentration*

Concentration refers to the degree of competition within a particular industry. Hagerman and Zmijewski (1979:144) provide two reasons why excessive accounting profits increase the competition faced by a firm. The first is antitrust or other legislative action aimed at increasing competition. The second is the entry of new firms into the market reducing excessive profits which results in a portion of corporate management's explicit or implicit earnings being forfeited.

Hagerman and Zmijewski (1979:145) with Watts and Zimmerman (1978:115-116 and 1986:252) concurring, argue that because of the greater probability of incurring political costs, firms that are large, risky, capital intensive or have monopoly rents, have an incentive to select income reducing accounting techniques. Costs incurred in avoiding political events lead to share price movements which impact on the value of management's shareholding and human capital. The political costs that arise through regulation or taxation occur, suggests Kelly (1983:124-125), because politicians and other regulators are unaware of the impact of accounting changes when making decisions. One of the reasons why politicians and regulators fail to make these adjustments is their perception that no benefits will accrue to them. However, a more likely scenario is the lack of ability on the part of politicians and regulators to make the adjustments.

It is submitted that the potential threat associated with the political cost hypothesis has been recognised by South African corporate management. The pre and post 1994 unbundling of a number of South African corporations provides testimony to this. By unbundling these corporations, corporate management has sought to avoid both political regulation and

negative wealth transfers associated with what has been perceived in some quarters as excessive profits. In addition, potential costs in the form of increased wage demands are also avoided. In South Africa, the mining, banking and insurance industries are especially susceptible to pressure attributable to the political cost hypothesis.

4.2.1.4 Information production costs hypothesis

Changes in accounting procedures argues Watts and Zimmerman (1978:116), are not costless to firms. Information production or bookkeeping costs are incurred when changes in accounting standards are promulgated, or additional disclosure is mandated. However Bowen *et al.* (1981:156) have argued that for certain accounting changes, the resultant increased information production costs are relatively inconsequential.

4.2.1.5 Management compensation hypothesis

It is corporate management's principal/agent relationship with owners, explains Hagerman and Zmijewski (1979:145-146) with Holthausen and Leftwich (1983:84), Kelly (1982:155 and 1983:116), and Watts and Zimmerman (1986:204-210) concurring, that gives rise to compensation agreements linking compensation schemes and bonus plans to accounting earnings and share prices. Recognising that management, acting in their own self interest may not necessarily make decisions that are principal optimal, these compensation agreements represent bonding and monitoring arrangements aimed at reducing corporate management's tendency to appropriate non-pecuniary benefits. This potential conflict of interest between managers and shareholders is reduced by offering management various incentive compensation schemes, including bonus plans dependent upon accounting earnings, and stock option plans, which have the effect of making managers shareholders.

Proposed changes to accounting standards effect either the financial position, financial result or cash flow of a firm. Where a proposed accounting standard is likely to have a direct cash flow effect, for example by increasing taxation or bookkeeping costs, the value of the firm changes which results in the revision of return distributions. As share prices are a function of the cash flow distributions expected to be generated by a firm, these proposed changes may affect a firm's equity markets (Kelly-Newton 1980:29). Where a portion of corporate management's wealth is derived as a direct result of its ownership of the firm's shares, the existence of share options schemes, or share appreciation rights, management will be understandably concerned about the effect that changes in the firm's disclosure policies may have on share prices, especially as Murphy (1985:40) explains, "firm performance as measured by the shareholder's realised return, is strongly and positively related to managerial

remuneration." As stated earlier, it is this potential loss of wealth that provides corporate management with the incentive to react to policy issues. Furthermore as is illustrated in figure 4.1, changes to the firm's share price also affect the value of management's human capital in the managerial market. This factor is, however, of more concern to professional managers rather than owner managers.

4.2.1.6 Monitoring and bonding contracts

In the context of the firm, monitoring and bonding agreements exist to ensure that managers act in the best interest of the principal and reduce the manager's tendency to appropriate non-pecuniary benefits. These agreements include formal audits of the accounting records, control systems, budget restrictions, explicit bonding against malfeasance, and limits on the decision-making power of the manager.

Where a firm has extensive borrowings, these are often matched with various restrictions in the form of debt covenants on the firm's activities. These debt covenants often contain certain limitations. These include, limiting dividend payments, restricting redemptions, requiring the firm to maintain a minimum amount of working capital, or maintaining a particular current ratio. Daley and Vigeland (1983:196) provide illustrations of typical leverage and dividend distribution restrictions. These include, limits on long-term debt/total assets and limits on interest cover ratios, while restricting to a maximum available pool from which they may be paid. Restrictions of this nature all affect the operating decisions of corporate management.

Financial statements used to monitor debt covenants are usually based on statements of generally accepted accounting practice. The existence of a debt covenant which, if violated, places the firm in technical default of the loan thereby resulting in the debt's maturity or renegotiation, influences management's attitude to a proposed standard. Where a firm is in default of a debt covenant, this represents a cost to the firm which will impact on its share price. Where a proposed standard results in negative consequences to a firm's financial statements by either (1) reducing net income, (2) decreasing the book value of equity, (3) increasing the debt/equity ratio, (4) causing a deterioration in the relationship between interest expense and capital, (5) causing a deterioration in the relationship between interest expense and income or, (6) reducing retained earnings available for dividends, management will oppose the proposal (Bowen *et al.* 1981, Daley & Vigeland 1983, Dhaliwal 1980, and Zmijewski & Hagerman 1981) as it will have an adverse impact on the value of management's shareholding, and human capital.

4.2.2 The sociological role played by corporate management in the accounting standard-setting process

The sociological role played by corporate management in the accounting standard-setting process has been examined by Kelly-Newton (1980). The acceptance or rejection of a proposed accounting change is a complex decision affected by numerous interacting factors. These are described as: (1) resistance to change inherent within the individual and social system, (2) aspects specific to the innovation, (3) communication channels used to diffuse the proposed change and, (4) social system effects. These factors are more fully described below.

4.2.2.1 Resistance to changes

Watson [Kelly-Newton, 1980:90] describes the various factors existing in both individuals and the social system that influences resistance to change. As far as individuals are concerned, these include established attitudes, dependence on others, and insecurity which, as Kelly-Newton (1980:90) explains, gives rise to "forces such as homeostasis, habit, primacy, selective perception, and retention which act to inhibit movement toward change." The corresponding forces that exist within social systems include "conformity to norms, cultural coherence and interrelationships, vested interests and distrust of those outside the social unit" (Kelly-Newton 1980:90).

Sterling (1973:51-52) has suggested that the resistance to change by corporate management is partially responsible for the lack of innovation in accounting. This can be attributed in part to the fact that only those accounting methods currently in use are taught by accounting educators. In their future roles as corporate managers and practising accountants, students utilise the methods taught to them and oppose new practices as being modifications to the existing *status quo*. It is this resistance explains Kelly-Newton (1980:90), that impedes progress in the form of new modifications, innovations not being implemented, and deficient practices not being corrected. Changes will only occur if corporate resistance is low, or some form of coercion is used.

As is illustrated in chapter three, the coercion used to overcome any potential resistance to change in South Africa can be described as two-fold. First is the proposed amendments to the *Companies Act*, Act 61 of 1973, making adherence to statements of generally accepted accounting practice, mandatory. Second, is the proposed creation of the Review Panel whose brief it will be to identify material departures from accounting standards involving issues of principle, or which the Panel feels may result in financial statements not achieving fair presentation.

4.2.2.2 Aspects specific to the innovation

Three elements that influence corporate management's innovation decision are described by Kelly-Newton (1980:91) as being the innovation's form, function and meaning. From these elements, five characteristics which influence the acceptability or otherwise of an innovation by management are identified.

The meaning or perception of the innovation is a critical factor in whether it is accepted. Perceptions are described by Kelly-Newton (1980:92) as being both individualistic and subjective. Corporate management may ascribe a different meaning to a proposed accounting change than that envisaged by the policy maker. Kelly-Newton (1980:92) therefore argues that "Anticipation of the perceptions should be part of the *ex-ante* consideration of potential consequences, and successful assessment of the business community's existing norms and values will yield more accurate anticipation of the meaning which the innovation will have to management."

The five characteristics of an innovation which influence management's acceptance of rejection of a proposed accounting standard are described below.

(a) Relative advantage

For a change in accounting policy to be supported by corporate management, management must believe that an economic advantage will accrue from adopting the changes. Examples of these advantages would include an expectation of increased economic profitability, low implementation costs and attendant risks, and improved time savings. Kelly-Newton (1980:93) however cautions that since biases exist on the part of those assessing the relative advantages of the innovation, costs are easily understated.

(b) Comparability with norms

The second factor influencing the adoption of an innovation by management, is the perceived consistency of the innovation with existing norms, values, past experiences, attitudes and needs. Kelly-Newton (1980:98) explains that these variables are closely associated with sociological and cultural attributes existing within a particular business community. The more congruent the proposed change is with existing norms, the less likely it is that management will reject the innovation.

(c) Complexity in use

Complexity represents the difficulty in understanding and implementing the proposed change. Kelly-Newton (1980:100) illustrates the importance of the dual dimension. Comprehension and

calculation influence the perception of complexity. Existing technical skills, knowledge, education, prior experiences, availability of outside consultants and the expected learning curve, must all be taken into account when establishing whether management is able to implement the changes required by the innovation.

(d) Trialiability of the change

Trialiability or divisibility is defined by Kelly-Newton (1980:102) as, the extent to which an innovation can be implemented on a partial basis. This can be achieved by each firm adopting the proposed change in a limited manner. Alternatively, the complete change can be implemented by a number of firms only. Corporate management may see this form of implementation as advantageous if the risks associated with the innovation are reduced. In introducing an element of caution, Kelly-Newton (1980:102) argues that should the proposed innovation not be suitable for trialiability as envisaged above, dysfunctional consequences may be obtained.

(e) Observability of perceived benefits

The degree to which the benefits from adopting the proposed change to accounting standards are visible and are communicated to management, is a characteristic of the innovation. The benefits associated with adopting the innovation must be emphasised. Kelly-Newton (1980:104) explains that social system effects are involved in this process. This would include the communication of the expected benefits among members of the business community.

4.2.2.3 Communication

The channels used to communicate a change in accounting policy can influence its acceptance. In South Africa this includes the role played in the development of accounting standards by The South African Institute of Chartered Accountants, the Accounting Practices Board and the Accounting Practices Committee. Should deviations from the established communication system described in chapter three occur, it would not be unreasonable to expect that uncertainty among both corporate management and practising accountants would result.

In addition to the communication channels, the clarity of communication is essential. Where the proposed policy is couched in confusing and ambiguous language, the change will be resisted irrespective of the potential benefits. In addition, poor language usage in the communication process can increase the perception that the proposed standard is unnecessarily complex. To overcome this, a proposed statement of generally accepted accounting practice could make use of an appendix to illustrate the accounting application.

It is clear therefore, that uncertainty arising from communication can impede the implementation of accounting changes.

4.2.2.4 Social system effects

Kelly-Newton (1980:106) explains that any innovation plan should include a study of the power structure of the social system. This factor encompasses the power elite and opinion leaders who are influential in gaining acceptance of the standard by the corporate community. A power elite makes innovate decisions, while opinion leaders are those individuals to whom social system members look to for advice and approval. In viewing these two groups as crucial to achieving adoption, Kelly-Newton (1980:106) argues that "the policy maker should focus on compatibility of the innovation with the value scheme of the power elite or opinion leaders."

Kelly-Newton (1980:106) describes two groups of opinion leaders as being important to accounting policy makers. These includes the management of firms considered to be industry leaders, and the public accounting profession. The reactions and opinions of corporate managers are highly influential in the business community and within their respective industries. From a South African perspective, it can be argued that the companies which responded to the various exposure drafts examined as individual case studies in chapter six be considered industry leaders. Corporate management often turn to their professional accountants for assistance in interpreting a proposed standard, assessing the impact of the standard on the firm and framing the appropriate response. Examples of this form of social system effect is illustrated by the responses of interested parties to exposure draft 61, *Taxation in financial statements*, discussed by Samkin (1993).

4.3 PRIOR RESEARCH FOCUSING ON CORPORATE MANAGEMENT'S ROLE IN THE ACCOUNTING STANDARD-SETTING PROCESS

Although broad agreement has been reached by academics in the categorisation of these studies, this is not always consistent. Previous studies have been categorised by Holthausen and Leftwich (1983) as those that predict corporate management's choice of accounting techniques (Bowen *et al.* 1981, Dhaliwal 1980, Dhaliwal *et al.* 1982, Hagerman & Zmijewski 1979, Leftwich 1983, and Zmijewski & Hagerman 1981), those dealing with voting and lobbying behaviour including Watts and Zimmerman (1978), and those examining the impact of accounting choice and their impact on share prices (Collins, Rozeff & Dhaliwal 1981, Holthausen 1981, and Leftwich 1981).

Using a different classification to that employed by Holthausen and Leftwich (1983), Kelly (1983) categorised fourteen studies into those that related to corporate management's voluntary choice of accounting policies to establish the optimal accounting policy mix, and those

concerning corporate management's reaction to mandated accounting changes. These studies are reflected in table 4.1 below.

Table 4.1: Categorisation of prior research on corporate management's choice

Discretionary accounting choices	Mandated accounting changes
Accounting procedure selection <ul style="list-style-type: none"> · Dhaliwal (1980) · Hagerman and Zmijewski (1979) · Zmijewski and Hagerman (1981) · Bowen, Lacey and Noreen (1981) · Dhaliwal, Salamon & Smith (1982) 	Lobbying and financing, production or investment changes <ul style="list-style-type: none"> · Watts and Zimmerman (1978) · Dhaliwal (1982) · Kelly (1982)
Voluntary disclosure and auditing <ul style="list-style-type: none"> · Salamon and Dhaliwal (1980) · Leftwich, Watts & Zimmerman (1981) · Chow (1982) 	Stock market reaction <ul style="list-style-type: none"> · Collins, Rozeff & Dhaliwal (1981) · Leftwich (1983)
Stock market reaction <ul style="list-style-type: none"> · Holthausen (1981) 	

Source: Kelly (1983)

In addition to those listed above, numerous other studies have focused on the discretionary accounting changes made by corporate management when responding to accounting standard changes likely to impact on their wealth. These include Daley and Vigeland (1983), Healy, Kang and Palepu (1987), Kelly (1985), Liberty and Zimmerman (1986), Ronen and Aharoni (1989) and Zimmer (1986).

As responses of South African corporate management to exposure draft 89, *Revenue*; exposure draft 90, *Property, plant and equipment*; exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policies*; exposure draft 92, *Borrowing costs*; exposure draft 93, *Construction contracts*; and exposure draft 94, *Inventories*, are examined in chapter six, a review of certain studies is considered necessary to illustrate the relationship between corporate management and accounting standards. A comprehensive search did not identify any South African studies focusing on the relationship between accounting standards and corporate management's remuneration. The possible reason for this is the poor level of financial disclosure of South African companies which includes the non-disclosure of the total remuneration received by corporate managers from all sources. In addition, it would not be unreasonable to argue that, because of the comprehensive sanctions previously enforced against South Africa, a number of companies are concerned with the nature and extent of information they disclose.

As a comprehensive review of all previous research is considered inappropriate and unnecessary for the purposes of this study, six studies are selected for review in this section.

4.3.1 The 1978 Watts and Zimmerman study

Probably the most important empirical work reviewed in this section is the seminal work of Watts and Zimmerman (1978). Watts and Zimmerman (1978:112) sought to develop a positive theory for the determination of accounting standards which would assist in understanding "the source of the pressures driving the accounting standard-setting process, the effects of various accounting standards on different groups of individuals and the allocation of resources, and why various groups are willing to expend resources trying to affect the standard-setting process."

Based on the assumption that individuals act to maximise their own utility, Watts and Zimmerman (1978:113) explained that the obvious implication is that corporate management would lobby either in favour of or in opposition to a particular standard based on their own self-interest.

A number of factors were identified as affecting corporate management wealth. These include: (1) taxes, (2) regulatory procedures, (3) political costs, (4) information production costs and, (5) management compensation plans. In accordance with these five criteria, management's wealth can be expected to increase when: (1) taxes decrease, (2) utility rates increase, (3) political costs decrease, (4) information production costs decrease and, (5) incentive compensation payments increase.

For any proposed accounting standard, Watts and Zimmerman (1978:118) argue that the position taken by corporate management is dependent on the firm's size (which affects the magnitude of the political costs) and whether an increase or decrease in reported earnings is likely to result. Managers of those firms subject to either regulation or political pressure would have incentives to select accounting policies that reduce reported earnings. Small unregulated firms would be expected to select accounting policies that increase reported earnings, provided that the expected increase in managers' incentive compensation more than offsets the expected increase in the firms' expected taxation and information production costs.

The fifty-three corporate responses to the Financial Accounting Standards Board discussion paper *Reporting the Effects of General Price Level Changes in Financial Statements*, were used by Watts and Zimmerman (1978) in the formulation of their theory. Using asset size as the surrogate for firm size, Watts and Zimmerman (1978:124) were able to make predictions about the relationship between asset size and firm submissions. Using the direction of earnings change, Watts and Zimmerman (1978) predicted that irrespective of size, firms whose earnings would be increased by the General Price Level Adjustment standard will oppose the standard.

Firms whose earnings are decreased by the General Price Level Adjustment standard would either support the standard, or make no submission.

From the results of a Mann-Whitney U test, Watts and Zimmerman (1978:127) were able to confirm the relationship between firm size and management attitudes on General Price Level Adjustments. Political costs and taxation effects were identified as being most likely to influence corporate management's attitudes to accounting standards.

In the second part of the study, Watts and Zimmerman (1978:127) used a discriminant analysis model incorporating management compensation, depreciation, net monetary assets and changes in price-adjusted income. The discriminant function suggested that the political cost factor be more important than taxation in affecting corporate management's attitude towards accounting standards.

As the Watts and Zimmerman (1978) study was the first attempt to formally develop a positive theory of accounting standards, the following factors need to be taken into account when evaluating their results. Firstly, Watts and Zimmerman (1978) did not establish the nature of the compensation plan. For example; was it based on generally accepted accounting practice at the date the compensation plan was initiated, or was it based on generally accepted accounting practice during the compensation period? Secondly, the existence of bond covenants was not taken into account. Finally, the study focused on General Price Level Adjustments, supplemental information, and not reported income.

4.3.2 Hagerman and Zmijewski 1979

In this paper, Hagerman and Zmijewski (1979) sought to establish whether economic motives are determinants in the choice of alternative accounting principles. Economic variables that could possibly influence the choice of accounting methods include: (1) size, (2) risk, (3) capital intensity, (4) competition and, (5) incentive plans. Hagerman and Zmijewski (1979:145) argue that firms which are large, risky, capital intensive, or have monopoly rents, have an incentive to select accounting alternatives which reduce reported income. The rationale for this assumption is that a greater likelihood exists of political forces intervening to reduce their wealth. Similar incentives exist for firms with significant market power. By the same token, the existence of a management compensation plan should increase the probability of income increasing accounting alternatives being selected.

To test whether firms base their choice of accounting policies on the economic variables identified above, Hagerman and Zmijewski (1979) examined four frequently used income reducing and increasing accounting procedures. These particular accounting policies differ from other policy choices which are timing choices because they re-allocate accounting

revenues and expenses between periods without the total revenues and expenses over those periods being altered.

Table 4.2: Income increasing and reducing accounting alternatives

Income increasing alternatives	Income reducing alternatives
<ul style="list-style-type: none"> • First-in-first-out method of inventory valuation. • Straight line depreciation method. • Flow-through method of accounting for investment tax credit. • Longer time period to amortise past service pension costs. 	<ul style="list-style-type: none"> • Last-in-first-out method of inventory valuation. • Accelerated depreciation methods such as declining-balance and sum-of-years digits. • Deferral method of accounting for investment tax credit. • Shorter time period for amortising past service pension costs.

Source: Hagerman and Zmijewski (1979:146-148)

A random sample of 300 non-regulated industrial firms that disclosed their accounting policies were selected for testing. A multivariate test in the form of a probit analysis model was used to establish the effect of various independent variables on the choice of accounting principle. The form of the model is:

$$Y_i = a + b_1CR + b_2MP + b_3Beta + b_4CI + b_5Size_j + b_6Eff.Tax_k$$

where

Y_i	=	1 if income inflating policy, 0 if income deflating policy; $i = 1,2,3,4$ (policy);
CR	=	8 firm concentration ratio;
MP	=	1 if a management profit-sharing plan, 0 if no profit-sharing plan
Beta	=	beta coefficient computed from the CRSP tape;
CI	=	Capital intensity = Gross fixed assets/Sales;
Size _j	=	either total assets or total sales, $j = 1,2$
Eff.Tax	=	effective tax rate, $i = z$ inventory policy.

Hagerman and Zmijewski (1979:157) found the results of their model to be consistent with their hypotheses. The explanatory variables tended to be different for each accounting principle tested.

Although the findings of Hagerman and Zmijewski (1979) suggest that the existence of an earnings based compensation plan makes managers more likely to prefer income increasing accounting alternatives, Watts and Zimmerman (1986:270) argue that Hagerman and

Zmijewski's (1979) study is flawed in that they failed to include variables representing debt contracts. Watts and Zimmerman (1986:270) provide the rationale behind their criticism as follows: "The existence of bonus plans and the existence of debt contracts are highly correlated cross sectionally. Hence, the compensation dummy could be capturing debt contract effects and representing the manager's incentive to increase earnings for debt contract reasons" (Watts & Zimmerman 1986:270).

4.3.3 Dhaliwal 1980 and 1982

In these 1980 and 1982 studies, Dhaliwal sought to establish whether the existence of debt covenants influence corporate management's attitude to a proposed accounting standard change.

4.3.3.1 The 1980 study

Dhaliwal (1980:79) hypothesises that because of the existence of restrictive covenants in credit agreements and indentures, corporate management's attitude towards accounting standards is related to the capital structure of the firm. As Dhaliwal (1980:79) explains, these arrangements are designed to prevent the debtor from unilaterally altering the creditor's risk. For highly leveraged firms, a proposed accounting standard that will reduce reported earnings or net worth, and which if enacted, is likely to place the firm in default of their credit agreements which will result in them having to enter into costly debt renegotiations, will oppose the accounting standard.

The basis of this study was Financial Accounting Standards Board Statement of Financial Accounting Standard (SFAS) No. 19, *Financial accounting and reporting by oil and gas producing companies* (Dhaliwal 1980:81). Prior to the issue of Statement of Financial Accounting Standard No. 19, two methods of accounting for exploration expenses were used, the full cost method, and the successful efforts method. Under the successful efforts method, only those prediscovery costs directly identifiable with a commercial reserve could be capitalised. All other costs were treated as an operating expense. Under the full cost method, all prediscovery costs were capitalised irrespective of the final result. Statement of Financial Accounting Standard No. 19 required all oil and gas producing companies previously using the full cost method to switch to the successful efforts method. The result of this switch was that companies previously using the full cost method experienced reduced earnings and equity, while the variability of their reported earnings increased.

Using two samples of oil and gas producing firms that had previously used the full cost method and the successful efforts method prior to the issue of Statement of Financial Accounting Standard No. 19, Dhaliwal (1980:81-83) tested the following two specific hypotheses.

- *There is no difference in the average debt-to-equity ratios of firms using the full cost method and firms of similar size using the successful efforts method.*
- *There is no difference in the average total long-term debt between firms which use the full costing method and those firms which use the successful efforts method.*

The test of the first hypothesis enabled Dhaliwal (1980:82) to conclude that firms with a higher debt/equity ratio were more likely to oppose an accounting standard which reduces reported earnings or equity and/or increased fluctuations in reported earnings, than firms with a low debt/equity ratio. The results of the test of the second hypothesis enabled Dhaliwal (1980:83) to confirm that firms with a relatively large amount of long term debt relative to equity, were also likely to oppose an accounting standard that reduced the reported earnings or equity, and/or increased the variability of reported earnings.

From these results, Dhaliwal (1980:84) concluded that corporate management's attitude to an accounting standard can be directly related to the capital structure of the firm. A proposed accounting standard likely to place a company in technical default of its loan agreement would be opposed.

4.3.3.2 The 1982 study

Dhaliwal's 1982 study examined whether variables other than taxation, regulation, political costs, bookkeeping costs and management compensation plans, impact on the lobbying behaviour of corporate management. Dhaliwal (1982:255-256) argued that because of the protective covenants typical in loan agreements, highly leveraged firms oppose accounting standards that decreased reported income or equity, or increase the volatility of reported earnings.

Both Dhaliwal (1982) and Smith and Warner (1978:131-135) explain that bond covenants often set an upper limit on the amount that a firm can pay in dividends or use for share repurchase. The maximum amount a firm can use to pay dividends in a given period is:

$$D_t = K \left(\sum_{i=0}^t E_i \right) + \left(\sum_{i=0}^t S_i \right) + F - \left(\sum_{i=0}^{t-1} D_i \right)$$

where

- D_t = the maximum amount allowed for dividend payments in period t ;
- D_t = the dividend payments in period t ;
- E_t = the accounting (reported) earnings of period t ;
- S_t = the net proceeds from the sale of ordinary shares in period t ;
- F = a positive constant; and
- K = a positive constant less than 1.

Dhaliwal (1982:257) explains that:

the inventory of funds available for the payment of dividends in a given period, D_t , is a positive function of the accounting earnings accumulated since the bonds were issued. For those firms with debt subject to such a covenant, an accounting change which reduces reported equity, by causing a reduction in the firm's earnings accumulated since the bonds were issued, will have the effect of reducing the inventory of funds available for the payment of dividends.

Any proposed accounting standard that results in lower reported earnings, reduces the pool of funds available for the payment of dividends. The firm is left with the costly option of either lowering dividends or renegotiating the loan agreements.

Prior to the issue of Statement of Financial Accounting Standard No. 34, *Capitalization of interest costs*, three alternative methods of accounting for interest costs were utilised: (1) accounting only for interest on borrowed funds and treating it as a current expense; (2) capitalising interest on borrowed funds as part of the cost of the assets not yet producing revenues (e.g., construction work in progress); and (3) capitalising as part of the cost of certain non-earning assets imputed interest on funds allocated to shareholders' equity in addition to interest on borrowed funds (Dhaliwal 1982:258). Although Dhaliwal (1982:258) explains that these three accounting alternatives do not differ in their effects on reported income generated by a qualifying asset over its entire life, the timing of the income differs. Firms that are required to change their accounting policy from capitalising to expensing the interest expense will experience reduced earnings and increased interest expenses.

Using the one hundred and twenty position papers submitted in response to the Financial Accounting Standards Board discussion memorandum on accounting for interest costs, Dhaliwal (1982:259) formulated the following three hypotheses:

- *Firms supporting the adoption of capitalisation of interest costs had higher debt/equity ratios than firms opposing capitalisation of interest costs.*
- *Firms opposing the adoption of capitalisation of interest costs were larger in terms of assets than firms supporting capitalisation of interest costs.*
- *Proportionately more firms supporting capitalisation of interest costs had management compensation plans tied to accounting data than firms opposing capitalisation of interest costs.*

After obtaining a homogeneous set of firms, each of the above hypotheses were tested independently using univariate techniques. A multivariate approach using discriminant analysis was used to test the effect of the entire range of variables (asset size, debt/equity ratio and management compensation plan) taken as a whole, on the firm's position, and to test the relative effect of each of the variables.

The test results enabled Dhaliwal (1982:259) to conclude that the debt/equity ratios of firms opposed to the expensing of interest costs, was significantly higher than that of the firms opposed to capitalisation, findings consistent with his 1980 study. Although the test of the second hypothesis suggested that firms opposed to capitalising interest costs were larger than firms opposed to expensing interest costs, the level of significance was low. These results were however consistent with the findings of both Watts and Zimmerman (1978) and Hagerman and Zmijewski (1979). No support was however found for the hypothesis linking management compensation schemes to accounting numbers.

4.3.4 Kelly 1982 and 1985

In these 1982 and 1985 studies, Kelly examined the relationship between the lobbying activities of corporate management and changes that occurred in firm financing and operating activities in response to Financial Accounting Standard No. 8.

4.3.4.1 The 1982 study

Kelly (1982) examined the relationship between corporate lobbying activities and changes in financing and operating activities in response to Financial Accounting Standard No. 8. As Kelly (1982:157) explains, Financial Accounting Standard No. 8 required the temporal method of translating foreign currencies to be used, thereby eliminating the use of deferral accounts. This introduced a measure of uniformity to accounting for the translation of foreign currency transactions and foreign subsidiaries. However as Kelly (1982:157) observed, corporate profits became more sensitive to changes in foreign exchange rates.

The sample for Kelly's (1982) analysis consisted of those firms responding to a 1977 *Peat, Marwick, Mitchell & Co.* survey that requested details of the economic impact of compliance with Financial Accounting Standard No. 8. Two specific hypotheses were tested. The first examined the relationship between corporate lobbying and subsequent financing or operating changes in reaction to a mandated accounting change, while the second studied the economic factors that motivate corporate management to react to an accounting policy. This included the proportion of management's remuneration received as incentive compensation, the existence of incentive compensation contracts dependent upon accounting earnings, the extent of the firm's leverage, political costs, and proportion of management's ownership of the firm. For any given incentive plan, Kelly (1982:160) hypothesised that management's reaction to a particular standard could be explained by the wealth expected from bonus payments.

Kelly (1982:168) was unable to identify a statistically significant relationship between firms that lobbied and those that made financing or operating changes. A possible explanation,

suggests Kelly (1982:168), was that prior to the issue of Financial Accounting Standard No. 8, corporate management were unable to provide an indication of how they would react.

Economic factors were however found to be important to lobbying positions. Kelly (1982:170) explains that:

The empirical results indicate that the anticipated effects of an accounting standard arising from bond covenants, political costs, and management's stock ownership explain lobbying actions and, of the firms that lobby, financing or operating changes. This implies that policy makers should expect several economic factors to motivate management's lobbying position. However, it appears that political costs are the dominant factor behind decisions to change financing or operating activities.

More specifically, firms that lobbied were characterised by a larger proportional management ownership. Those firms that lobbied and subsequently made financing or operating changes generally had greater leverage, were larger in size (asset value), and had lower management ownership.

4.3.4.2 The 1985 study

In an extension of the 1982 study, Kelly (1985) focused on those factors that influenced corporate management to lobby the accounting standard setting body rather than focusing on responses in favour or opposition to a particular standard. The sample used for this study was the 195 firms identified in the *Accounting Trends and Techniques (1976-1977)*, as being forced to change their method of accounting for foreign operations to comply with Financial Accounting Standard No. 8 (Kelly, 1985:621). Using agency theory, Kelly (1985:620) sought to establish whether corporate management's ownership of companies and their firm's leverage would explain the decision to lobby on Financial Accounting Standard No. 8. Four variables hypothesised as influencing lobbying activities were identified: (1) foreign sales as a percentage of total consolidated sales, (2) firm size, (3) leverage and, (4) management's ownership percentage.

Kelly (1985:629) found that firms opposing Financial Accounting Standard No. 8 citing implementation difficulties as the grounds, were generally larger with a higher percentage of foreign sales. Neither the level of leverage or management ownership were significant factors in opposing the standard. Firms opposing Financial Accounting Standard No. 8 because of the possible income effect, were larger, had a higher percentage of foreign sales, and higher leverage.

4.3.5 Healy, Kang and Palepu 1987

Based on the joint assumptions that (1) it is costly for the bonus and salary awards of chief executive officers to be amended in line with changes in accounting procedures and, (2)

managers have rational expectations, Healy *et al.* (1987:31-32) suggest that, based on this "compensation hypothesis," remuneration contracts entered into by corporate management will recognise their incentives to opportunistically select those accounting rules with the potential to increase remuneration. As a result, it would not be unreasonable, suggest Healy *et al.* (1987:32), that following accounting rule changes adopted by a company, no adjustments to corporate management's compensation will be observed.

In this study, Healy *et al.* (1987) investigate whether a statistically significant relationship exists between the cash salary and bonus elements of remuneration paid to chief executive officers, and corporate earnings. The relationship is again tested subsequent to an accounting procedure change. The form of change envisaged in the Healy *et al.* (1987) study are those that: (1) transform reported earnings under the new accounting method to earnings under the original method and, (2) adjustments to the parameters of the relationship that offset the effect of the accounting change. Also examined was the effect of an accounting change on the salary and bonus awards of chief executive officers if either the reported earnings, or parameters between executive compensation and corporate earnings, were not adjusted to nullify the earnings effect of the accounting change.

Two specific accounting method changes were used to investigate this relationship. An accounting change that typically increases earnings, and the other that typically results in a decrease in earnings. The change from the first-in-first-out (FIFO) to the last-in-first-out (LIFO) method of inventory valuation was selected as the income decreasing accounting change, while the change from accelerated to straight-line depreciation was selected as the accounting change that increased income. The rationale for selecting these particular accounting changes was that they both significantly impact on reported earnings.

One hundred and sixty one companies that changed from first-in-first-out (FIFO) to last-in-first-out (LIFO) method of inventory valuation during the period of the study were identified from *Accounting Trends and Techniques (1970-1976)* (Healy *et al.*, 1987:10). The depreciation sample was selected from Holthausen's (1981) data base. The total inventory sample comprised 52 test firms that changed from the first-in-first-out (FIFO) to the last-in-first-out (LIFO) method of inventory valuation, and 50 control firms that did not change either their inventory or depreciation accounting policies. The depreciation sample comprised 38 test firms that changed from accelerated to straight-line depreciation, and 37 control firms. Bonus, salary data, and management changes were collected for the chief executive officers' of the sample companies for the year of the accounting change and the ten years before and after that event from corporate proxy statements, and *Business Weeks* annual compensation survey.

Earnings before extraordinary items were obtained from COMPUSTAT for the test and control samples for each of the years that compensation data was available.

Using the following firm-specific compensation model:

$$\ln(\text{COMP}_i) = \sum_{i=1}^n \alpha_i D_{it} + B \ln(\text{EARN}_i) + \epsilon_i$$

where

- COMP_i = salary and cash bonus paid to chief executive officer during year t in 1967 constant dollars,
- EARN_i = accounting earnings before extraordinary items for the firm during year t in 1967 constant dollars,
- D_{it} = 1 if individual i was chief executive officer of the firm during year t , 0 otherwise,
- n = number of individuals who held the position of chief executive officer of the firm during the sample period,
- B, α_i = firm-specific parameters, to be estimated using time-series data on compensation and earnings ($i = 1, \dots, n$).

Healy *et al.* (1987) sought to establish whether, subsequent to an accounting change, the relationship between chief executive officers' salary and bonus awards and reported earnings was adjusted to fully offset the earnings effect of the accounting change. The following features of the compensation model are considered significant. First, the model is in logarithmic form. Evidence suggest Healy *et al.* (1987:15), that power transformations perform better than linear regressions in estimating relationships between compensation and measures of performance. In addition, other studies have made use of this model which makes the final results comparable. Second, the intercept term (or fixed component of compensation), α , can vary across executives. Differences in manager-specific factors such as age, ability and education can therefore be accounted for. The elasticity of compensation to earnings, B , is assumed to be firm specific. Finally, the compensation variable is represented by the salary and bonus payments to the chief executive officer. Components of compensation, such as performance awards contingent on earnings, and stock option compensation are excluded as financial statement disclosure of these elements of compensation is frequently incomplete.

The compensation model described above assumes that management compensation is in part determined by contemporaneous earnings. A change in the rules used to compute accounting earnings therefore affects executive's earnings-based compensation unless

adjustment are made to negate the effect of the change. The salary and bonus compensation can however be insulated from the effects of an accounting rule change in three ways. Firstly, earnings computed under the pre-change accounting rules can continued to be used. Secondly, reported earnings can be used without any adjustment for the accounting change, but the parameters α and B can be modified so that compensation is unaffected by the accounting change. Finally, the effect of accounting changes on chief executive officer's remuneration can be offset by adjustments to stock-based compensation.

Healy *et al.* (1987:32) found the potential effect of inventory and depreciation accounting changes on chief executive officers bonus and salary remuneration to be generally small when compared to economy-wide changes in compensation over time. Testing the earnings definition used as a basis for compensation indicates that chief executive officers bonus and salary awards were based on reported earnings both before and after the accounting changes. Healy *et al.* (1987:32) found no evidence that, subsequent to either the inventory or depreciation change, reported earnings were translated to earnings under the original accounting method used in calculating the compensation awards. The relationship between compensation and earnings would suggest that changes do occur in these elements of the test firms subsequent to an accounting change. However, these changes can in part be attributed to economic and industry-wide changes unrelated to accounting changes.

Tests of changes in compensation model parameters to the effects of accounting changes proved inconclusive. Healy *et al.* (1987:33) were unable to reject the hypothesis that compensation contracts nullify the effects that changes in accounting policy have on salary and bonus elements of executive compensation by modifying the parameters of the compensation-earnings relationship.

4.3.6 Ronen and Aharoni 1989

In this abstract study, Ronen and Aharoni (1989) examined the influence that changes in corporate taxation rates would have on management's accounting choices. Ronen and Aharoni (1989:70) recognised that the existence of a management compensation scheme would not be the sole factor affecting management's choice of accounting standards. Other factors include the threat to owners and other parties of legal liability that arise should misleading information be issued, as well as the resulting reputation affects.

Using a stylised model, Ronen and Aharoni (1989) sought to establish the impact that a change in the taxation rate would have on financial accounting choices featuring a manager who wished to maximise the present value of his earnings, and owners who wished to maximise the present value of their wealth over a two-period horizon.

The accounting choices featured by Ronen and Aharoni (1989) were those they found easy to identify and evaluate. They included inventory valuation methods (first-in-first-out (FIFO) versus last-in-first-out (LIFO)), depreciation methods (accelerated versus straight line), investment tax credit (flow-through versus deferral), the amortisation of past service pension costs (long versus short-term period of amortisation) and the treatment of interest (capitalisation versus non-capitalisation). Information on the accounting treatment of these items together with details of firm specific compensation schemes was solicited from the *Fortune* 1 000 largest companies (Ronen & Aharoni 1989:79).

From their study, Ronen and Aharoni (1989:83) were able to conclude that increases in corporate income taxation rates are associated with an income-increasing accounting mix. The structure of the management compensation scheme was also found to be significant. The income-increasing accounting mix was found to be optimally adjusted following increases in income taxation rates for those managers receiving both performance based bonuses and stock options.

4.4 CONCLUSION

In this chapter, both the factors influencing, as well as the role played by corporate management in the accounting standard-setting process are considered. This review is considered necessary to provide the necessary background to the research reported on in chapter six.

Firstly, the role played by corporate management in the accounting standard-setting process is reviewed. This suggests that corporate management's reaction to a proposed or enacted change to an accounting standard can best be understood by recognising management's stewardship function. To understand why corporate management reacts to a proposed or enacted standard in a particular way, it is necessary for the costs and benefits of the alternative accounting procedures to be assessed in terms of their cash flow implications.

This chapter illustrates that corporate management can overcome the effect of a proposed or enacted change to accounting standard by either lobbying the accounting standard-setting body either in support or opposition to a proposed standard, altering financing, production or investing activities, circumventing the reporting requirements, subvert the standard, and/or discredit the policy makers.

Based on the neoclassical assumption that individuals are wealth maximisers, it was illustrated that corporate management is motivated to select that permutation of accounting policies most likely to maximise their income through increasing share prices and cash incentive bonuses. Factors identified as influencing corporate management's attitude towards accounting

standards include, taxation costs, costs of regulation, political costs, information production costs, the existence of management compensation plans, and monitoring and bonding contracts.

The sociological role played by corporate management in the accounting standard-setting process is also reviewed. The acceptance or rejection of a proposed accounting standard is shown to be a complex decision affected by numerous interacting factors. These include resistance to change inherent within the individual and social system, aspects specific to the innovation, the channels used to communicate the proposed change, and social system effects.

Secondly, as South African corporate management's responses to exposure draft 89, *Revenue*; exposure draft 90, *Property, plant and equipment*; exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policies*; exposure draft 92, *Borrowing costs*; exposure draft 93, *Construction contracts*; and exposure draft 94, *Inventories*; are examined as individual case studies in chapter six, a review of certain prior research illustrating those factors associated with corporate management and their attitude towards accounting standards is necessary. This research provides an overview of those factors corporate management takes into account when deciding whether to lobby in favour of, or in opposition to a particular accounting standard. Although certain of the evidence from this research provides contradictory results, it does in the main suggest that corporate management's attitude to the accounting standard-setting process is a function of taxation, political costs, regulatory action, bookkeeping costs, managerial compensation, capital structure, and monitoring and bonding contracts.

The next chapter examines the methodology used to determine South African corporate management's attitude to the accounting standard-setting process and international harmonisation. This includes the development of the hypotheses used in the study.

CHAPTER FIVE

METHODOLOGY USED TO DETERMINE SOUTH AFRICAN CORPORATE MANAGEMENT'S ATTITUDE TO THE ACCOUNTING STANDARD-SETTING PROCESS AND INTERNATIONAL HARMONISATION

- 5.1 INTRODUCTION**
- 5.2 RESEARCH METHODOLOGY EMPLOYED**
- 5.3 DEVELOPMENT OF THE HYPOTHESES**
- 5.4 SURVEY DESIGNS AND TECHNIQUES USED**
- 5.5 DEVELOPMENT OF THE QUESTIONNAIRE: GENERAL CONSIDERATIONS**
- 5.6 DEVELOPMENT OF THE QUESTIONNAIRE: PRACTICAL CONSIDERATIONS**
- 5.7 CONCLUSION**

5.1 INTRODUCTION

In the previous chapter, corporate management's attitude and the role played by them in the setting of accounting standards are reviewed. This study seeks to establish by empirical means, South African corporate management's attitude to the accounting standard-setting process and international harmonisation. It is suggested that no empirical study, either nationally or internationally, of the accounting standard-setting process, or corporate management's attitude to this process and international harmonisation, has been conducted during a period of transformation such as the one currently embarked upon by the South African Institute of Chartered Accountants.

In this chapter the features of the study design and methodology used to determine the South African corporate management's attitudes to the accounting standard-setting process and international harmonisation are described. Included is an overview of the empirical research methodologies employed in the research process. Both survey research and case study/document research were employed to investigate these issues. According to Oppenheim (1992:7-8), the following steps in survey research can be distinguished:

- 1 Identification of the objectives and hypotheses to be studied.**
- 2 Review of the relevant literature.**
- 3 Preliminary conceptualization of the study.**
- 4 Decisions on design and feasibility of the study within various constraints such as time and costs.**

- 5 Decisions on specific hypotheses to be investigated and making them specific to the research topic.
- 6 Designing the necessary research instrument.
- 7 Completing the necessary pilot work to test the research instrument, and modify the research instrument if necessary.
- 8 Designing the samples.
- 9 Drawing the sample.
- 10 Completion of the field work.
- 11 Processing the data, including coding the responses, preparing the data for analysis and entering in the computer.
- 12 Completing the statistical analysis.
- 13 Collating the results and testing the hypotheses.
- 14 Describing the results, drawing conclusions and making recommendations.

The steps described as 1 to 4 above by Oppenheim (1992:7-8) were covered in the research proposal assessing the feasibility of the project. However in a thesis of this nature, the identification of the objectives are described in chapter one. Chapters two, three and four review the relevant literature. This chapter deals with steps 5 to 10 above. Chapter six describes the processing of the data, the completion of the statistical analysis, the tabulation of the results of the survey and the testing of the hypotheses, described as steps 11 to 13 above. In chapter seven the results obtained, conclusions drawn, and recommendations for possible future research are suggested.

5.2 RESEARCH METHODOLOGY EMPLOYED

According to Leedy (1989:89), it is the data that dictates the research methodology. In other words, it is the nature of the available data that determines the research methodology utilised in the research process.

In this study, the available data enabled three research methods to be used, namely archival research, case study/document research and survey research. Archival research was utilised in chapters two, three, four and to a certain extent in chapter five. This research, explains Henderson, Pierson and Brown (1992:39), uses existing literature as its data source and is sometimes called archival research. If archival research involves observation and the analysis of existing data, that research can be termed a field study. Studies that use existing documentation such as published financial statements, historical share prices, or responses to exposure drafts can be termed *ex post facto* research. In this research, real world phenomena are observed and conclusions drawn from the observations.

As is discussed in chapter three, the South African accounting standard-setting process requires interested parties (including corporate management and those with vested interests) to comment on discussion papers, exposure drafts, and, in the case of deferred

taxation, an unpublished memorandum. The availability of the comments of interested parties to these documents supplies information that is historical in nature, and which provides an opportunity to conduct various independent case studies. Findings of this case study or document research conducted during this study are described in chapter six.

The survey research, more fully described in 5.4 below, was conducted to establish, using empirical means, South African corporate management's attitude to the accounting standard-setting process and international harmonisation. Perceptions of the target group highlighted by this survey are expected to further enhance the understanding of, provide insights into, and provide justification for conclusions drawn in this study.

5.2.1 Case study/document research or content analysis

Responses by interested parties to certain exposure drafts based on International Accounting Standards Committee statements of generally accepted accounting practice were made available for research purposes by the Technical Director, Accounting, of the South African Institute of Chartered Accountants. These were the responses to exposure draft 89, *Revenue*; exposure draft 90, *Property, plant and equipment*; exposure draft 91, *Net profit for the period, fundamental errors and changes in accounting policies*; exposure draft 92, *Borrowing costs*; exposure draft 93, *Construction contracts*; and exposure draft 94, *Inventory*. As the responses were in the form of comment letters, a decision first had to be taken on whether these comment letters should be subjected to either case study/document research, or content analysis. The differences between these research methods are considered below.

5.2.1.1 Case study/document research

A major source of neglected research data according to Bailey (1987:290), is the analysis of documents containing information on the research topic. Although Bailey (1987:291-294) provides a comprehensive list of the advantages and disadvantages of document research, these are not reviewed in detail here. Two advantages do however merit comment. They are the relatively low cost of accessing the documents compared to the cost of large scale surveys, and the quality of the documents. Often the content and written quality of documents is superior to the responses obtained from questionnaires.

Three disadvantages of this form of research warrant comment. Firstly, the document may be biased towards a particular point of view. Secondly, documents lack a standard format thereby making the comparison of responses difficult. Finally, coding the responses provides certain difficulties. As documents are written in words rather than numbers, responses are difficult to quantify. Bailey (1987:313-315) further explains that documents subject to document research

must also pass validity and reliability checks. As the documents subject to the study are the responses by individuals to particular exposure drafts, the document must, by implication, comply with the necessary face validity requirement. Reliability, according to Bailey (1987:314-315), may be obtained by comparing similar documents at two or more points in time (instrument reliability), or by comparing the results of two or more researchers at the same point in time (analyst reliability). As responses to exposure drafts are of a "one-off" nature, and responses are generally not subject to frequent research, Bailey's (1987) criteria for reliability are difficult to meet. However, due to the recent nature of the responses, reliability of the documents could be verified, if necessary, by direct contact with the author. This was, however, not considered necessary.

The use of case studies as an acceptable research technique in accounting is discussed by Ryan, Scapens and Theobald (1992). They note that this form of research is beginning to obtain wide acceptance, and starting to find favour in prominent academic journals. Although providing an indication of the alternative forms of case study available to researchers, Ryan *et al.* (1992:115-116) state that the intention of the researcher determines the appropriate form of case study. They explain it as follows: "The particular use made of case study research methods will depend on the nature of the research and the methodology of the researcher. It should be recognized that case studies are a research method, and not a methodology" (Ryan *et al.* 1992:115-116).

Neale and Liebert (1986:25) however, caution that the case study approach to research is usually aimed at emphasising the uniqueness of the individual. As a result, Neale and Liebert (1986:25) argue that case studies are generally not appropriate to the nomothetic approach to research. While a case study is considered by them to be limited in its ability to provide positive support for a theory, a case study in the form of document research envisaged above, can provide a useful source of descriptive information which can be used as supplementary evidence in confirming a theory.

5.2.1.2 Content analysis

According to Kerlinger (1986:477) content analysis is a method of studying and analysing communications in a systematic, objective, and quantitative manner to measure variables. This permits an impression of the range of an opinion on a particular topic to be obtained as well as facilitating the development of hypotheses about differences in the data being analysed.

The following exposition of content analysis methodology has been provided by Abbott and Monsen (1979:504):

Content analysis is a technique for gathering data that consists of codifying qualitative information in anecdotal and literature form into categories in order to derive quantitative scales of varying levels of complexity. The simplest of content analyses consists of nothing more than the attribution of the incidence of an event under question in the literary document that consists of the raw data. In this simple analysis, therefore, the dichotomy is the only level of measure that may be achieved for each category. However, if more than one category is subjected to a content analysis, a more complex level of measurement may be achieved through the summing of the result for each category. Thus, if each is assigned a score of zero or one, indicating the absence of presence of the attribute under analysis, the resulting scale varies between zero and the number of attributes being investigated.

Both Krippendorff (1980:21) and Kerlinger (1986:477) explain that content analysis allows for making replaceable and valid inferences from data and their context while meeting the needs of the research to be objective, systematic and quantitative. The criterion of objectivity is met when similar results are obtained from tests carried out by different researchers using the same data at different points in time (Krippendorff 1980:21).

5.2.1.3 Selection of method

In his criticism of positive accounting research methodology, Williams (1989:467) argued that:

relying so heavily on COMPUSTAT tapes may not be the best way to subject PAT [positive accounting theory] to rigorous testing. Perhaps case studies of procedure choice or lobbying behaviour are in order to begin building a meaningful data base with which to test such theories of accounting practice.

Three factors therefore influenced the selection of case study/document research as being the most appropriate research method. Firstly, the intense criticism positive accounting theory has been subject to highlighted in chapter two, and William's (1989) comments above. Secondly the difficulties and uncertainties associated with content analysis. Thirdly, Ryan *et al.* (1992:116) argue that: "case studies are particularly appropriate in those areas where theory is not well developed. Such studies represent an exploratory device which can be used as a precursor to 'scientific' research. Case studies suggest the hypotheses to be scientifically tested at a later stage." As a comprehensive theory dealing with the South African accounting standard-setting process, corporate management's attitude to this process and international harmonisation is not yet available, it can be argued that under these circumstances, case studies are the most appropriate research technique.

Ryan *et al.* (1992:113) indicate that a case study implies a single unit of analysis. An explanatory case study according to Ryan *et al.* (1992:115), provides explanations for observed practices. The specific case forms the research focus. The responses to each individual exposure

draft must therefore be seen as a distinct case study. As responses to six exposure drafts are available, six different case studies are performed.

The documents subject to the case study are the responses solicited by the Accounting Practices Committee to exposure drafts developed from International Accounting Standards Committee accounting standards. As the documents subject to case study research are responses to exposure drafts, it is likely that they will be biased to a particular point of view. The responses of corporate management to exposure drafts can be compared to the responses obtained from the questionnaire sent to corporate management. This comparison will take care of the criterion validity. Although case study or document research is subject to the limitations described above, the evidence provided by the responses to the exposure drafts issued by the Accounting Practices Committee will provide additional confirmation for any findings resulting from the descriptive survey.

5.2.2 The descriptive survey method

The descriptive survey is the appropriate research methodology where a clearly defined population exists, and where the data is to be obtained from observation. As Christensen (1988:39) explains, it represents an attempt to provide an accurate description of a particular phenomenon. A questionnaire is an acceptable method of obtaining information by observation. The development of the questionnaire is considered in section 5.5 below.

The rationale behind the development of the individual hypotheses subject to the empirical investigation are examined below.

5.3 THE DEVELOPMENT OF THE HYPOTHESES

Before research on a problem can commence, the research problem must be narrowed into clearly defined, researchable terms. This process involves the formulation of testable hypotheses that flow logically from the problem statement and, as Christensen (1988:98) explains, are capable of being either refuted or confirmed. Bailey (1987:41) defines a hypothesis as a proposition stated in testable form that describes expected or predicted relationships between two (or more) variables. An important characteristic of hypotheses as far as scientific research is concerned, is that they must be couched as factual statements, capable of either confirmation or rejection through empirical testing. By implication, this definition therefore excludes all statements that are merely opinions, value judgements, or normative in nature.

Christensen (1988:98) provides an indication of where hypotheses for testing can be derived. They can either be a function of the literature review, formulated from theory, or from

reasoning based on a casual observations of events. All the hypotheses developed to achieve the objectives of this study have been derived from one or more of the above functions.

Hypotheses in this study have been expressed in the null form. This form of hypothesis represents a statement of no relationship between the variables being tested. In scientific research, Christensen (1988:388) explains that any statistical test represents a test of the null-hypothesis. The null-hypothesis must be rejected in order to obtain evidence for the scientific hypothesis. In other words, rejection of the null-hypothesis provides an indication that a relationship does in fact exist between the variables being tested.

In view of the dearth of knowledge on South African corporate management's attitude to the accounting standard-setting process and international harmonisation, it was decided that authoritative views on these topics would be appropriate. To provide empirical evidence of corporate management's attitude to the accounting standard-setting process and international harmonisation, certain null-hypotheses relating to the topic are identified. The rationale for the development of each individual null-hypotheses is provided below.

5.3.1 The individual hypotheses

To test South African corporate management's attitude to the accounting standard-setting process, the following null-hypothesis was formulated. This question was viewed as important as it is considered central to the research topic.

Hypothesis 1: *There is no significant difference in the frequency of responses in the respective categories on whether South African corporate management should play an active role in the accounting standard-setting process such that $f_1 = f_2$.*

As is illustrated in chapter three, the South African accounting standard-setting process requires interested parties including corporate management to respond to alternative accounting treatments of a topic contained in either discussion papers, unpublished memorandum, or exposure drafts in the form of a comment letter, prior to a formal statement of generally accepted accounting practice being approved for issue by the Accounting Practice Board. Prior South African research by Samkin (1993) would suggest that corporate executives are not active in the accounting standard-setting process. The responses by companies (and by implication, corporate executives) to the deferred taxation considerations, the subject of Samkin's (1993) study, were as follows:

Table 5.1: Corporate responses to various deferred taxation deliberations

	Title	No. of responses by companies
DP 5	Taxation in the financial statements of companies	6
	Unpublished memorandum	16 *
ED 61	Taxation in financial statements	24 **
ED 72	Taxation in financial statements	12
*	This document was sent to the then top 100 companies.	
**	One executive made responses on behalf of two companies in the group.	

Source: Samkin (1993:103-137)

In view of the number of companies listed on the Johannesburg Stock Exchange, corporate financial executive's direct involvement in the accounting standard-setting process appears to be insignificant. A possible exception occurs when the proposed statement of generally accepted accounting practice is likely to be controversial, as was the case with exposure draft 61, *Taxation in financial statements*.

Hypothesis 2: *There is no significant difference in the frequency of responses in the respective categories on whether the existing method employed for setting accounting standards is the most appropriate for the South African business environment such that $f_1 = f_2 = f_3 = f_4$.*

Hypothesis 3: *There is no significant difference in the frequency of responses in the respective categories on whether the Accounting Practices Board through the Accounting Practices Committee should remain responsible for developing and issuing South African specific exposure drafts and statements of generally accepted accounting practice such that $f_1 = f_2 = f_3 = f_4$.*

Two factors influenced the development of hypotheses 2 and 3. The first was a June 1992 letter to members of the South African Institute of Chartered Accountants by Mockler the Chief Executive Officer. In this letter, Mockler solicited responses from members as to whether the current standard-setting body remained the best possible method of setting accounting standards. In addition, members were asked whether the Accounting Practices Board continued to be the most appropriate body to issue statements of generally accepted accounting practice, or whether improvements to the standard-setting process could be made. The second factor influencing the development of the hypotheses 2 and 3 was the Harmonisation and Improvement Project which advocates adopting International Accounting Standards Committee accounting standards in South Africa. As the purpose of this thesis is to establish South African corporate management's attitude to the accounting standard-setting process and international

harmonisation, the views of corporate executives to the questions forming these hypotheses is considered central to the study.

Hypothesis 4: *There is no significant difference in the frequency of responses in the respective categories on whether non-accounting groups (such as the South African Law Society and the trade union movement), should participate in the accounting standard-setting process such that $f_1 = f_2 = f_3 = f_r$.*

AC 000, *Framework for the preparation and presentation of financial statements*, identifies users of financial statements as being investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies, and the public. When reviewing the accounting standard-setting process, the South African Institute of Chartered Accountants, recommended that the Standards Development Committee (the committee proposed to assume responsibility for the development of accounting standards) would be appointed by the Minister "from names and motivated credentials submitted by all existing constituent bodies of the Accounting Practices Board and any recognised institution, association or body which would like to participate in the standard-setting process" (Dickinson 1995:2). The purpose of hypothesis 4 is to determine whether corporate management agrees that parties traditionally excluded from the development of accounting standards, participate in this process.

Hypothesis 5: *There is no significant difference in the frequency of responses in the respective categories on whether the standard of South African developed statements of generally accepted accounting practice are acceptable for financial reporting purposes in South Africa such that $f_1 = f_2 = f_3 = f_r$.*

Hypothesis 6: *There is no significant difference in the frequency of responses in the respective categories on whether existing accounting standards provide a sufficiently wide choice of accounting alternatives so as to enable corporate executives to prepare financial statements that fairly present the financial position and financial result of the company such that $f_1 = f_2 = f_3 = f_r$.*

As was illustrated in chapter two, dissatisfaction has been expressed, by Bunting (1993), Crotty (1995) and Singer (1994) in both the popular and professional press, with South African adherence to statements of generally accepted accounting practice. These views, in addition to the comments expressed by Terry (1992:127) in the May 1992 editorial of *Accountancy SA* which lamented that [South African accounting standards] "are far more flexible and permit many more options than those of other countries. As South Africa emerges from isolation and begins to participate in world markets our standards will be found wanting" (Terry 1992:127), must concern

the accounting profession. As corporate management is responsible for the preparation of financial statements, the development of hypothesis 5 and hypothesis 6 was considered necessary to establish whether these individuals held views consistent with those of the commentators above.

Hypothesis 7: There is no significant difference in the frequency of responses in the respective categories on whether the resources spent on the development of South African statements of generally accepted accounting practice have contributed to the maintenance of a high level of local accounting expertise such that $f_1 = f_2 = f_3 = f_r$

The accounting profession in South Africa enjoys a well deserved reputation of technical excellence. A significant number of professionally qualified accountants have risen to responsible positions in commerce and industry. As it was expected that the majority of respondents to the questionnaire would be Chartered Accountants (SA), hypothesis 7 sought their views on whether resources spent in developing South African statements of generally accepted accounting practice, contributed to the high level of accounting expertise in this country.

Hypothesis 8: There is no significant difference in the frequency of responses in the respective categories on whether additional resources should be made available to the South African Institute of Chartered Accountants to enable them to continue the development of South African specific statements of generally accepted accounting practice.

Hypothesis 8 was developed in specific response to Blumberg's (1995(b):3) justification of the South African Institute of Chartered Accountant's Council decision to adopt International Accounting Standards in South Africa. The reason provided by Blumberg (1995(b)) for this decision was that resources necessary for the development of accounting standards from a zero base are not available in South Africa. The provision of additional financial and technical resources would, it is suggested, enable the South African Institute of Chartered Accountants to continue developing South African specific statements of generally accepted accounting practice and, in so doing, maintain a high level of local accounting expertise. The view of corporate management was sought in an attempt to establish whether the provision of additional resources to the South African Institute of Chartered Accountants on these grounds is justified.

Hypothesis 9: There is no significant difference in the frequency of responses in the respective categories on whether corporate executives of private companies are less likely to respond to proposed statements of generally accepted accounting practice than corporate executives of public companies such that $f_1 = f_2 = f_3 = f_r$.

This hypothesis was extended from the concept of management utility contained in the 1978 study by Watts and Zimmerman and the 1982 study by Dhaliwal, Salamon and Smith. In the latter study, Dhaliwal *et al.* (1982) examined the relationship between owner controlled status of the firm and the adoption of choice of accounting policies. Hypothesis 9 assumes that in a South African environment public companies can, by virtue of their diverse shareholding, be classified as management controlled (MC), while private companies can be classified as owner controlled (OC) companies.

Based on the premise that management utility is positively related both to the amount and timing of compensation, Dhaliwal *et al.* (1982:44) hypothesise that management controlled firms are more likely than owner controlled firms to select accounting methods that results either in higher or earlier reported income:

*In OC firms, the owners can motivate and monitor the behaviour of managers directly so the need for incentive compensation schemes based on reported income is not great. On the other hand, the outside owners of MC firms must devise mechanisms to motivate the firm managers to act in a manner which does not ignore the interests of the outside owners. One common mechanism used for this purpose is the adoption of incentive compensation schemes (of either the cash bonus or stock option type) which depend upon reported income. Consequently, it is likely that MC firms are more likely than OC firms to have incentive compensation schemes based on reported income. This means that the managers in MC firms are more likely to benefit than are the managers in OC firms from the selection of accounting methods which result in high and/or early reported income (Dhaliwal *et al.* 1982:44).*

It is hypothesised that the existence of executive compensation and share option schemes linking remuneration to financial performance, makes it more likely that corporate management of public companies will lobby for changes to statements of generally accepted accounting practice than will management of private companies. Their motivation for this action is the maximisation of their remuneration and to maximise the value of their portfolios.

In South Africa, owner controlled firms usually prepare financial statements to comply with the requirements of the *Companies Act*, Act 61 of 1973, and the *Income Tax Act*, Act 58 of 1962. As the owners of these firms are the beneficiaries of all profits, no motivation exists for them to lobby for changes to accounting standards. This would be confirmed by Watts and Zimmerman's (1978:119) graphic model of firm submissions to the Financial Accounting Standards Board. In this figure, Watts and Zimmerman (1978:119) maintain that owner controlled companies do not

lobby for accounting standards that increase reported income, because the submission costs exceed the expected value of the net benefits.

Hypothesis 10: There is no significant difference in the frequency of responses in the respective categories on whether amendments to the Companies Act making adherence to statements of generally accepted accounting practice mandatory, have been made expeditiously such that $f_1 = f_2 = f_3 = f_4$.

As early as 1977, the Accounting Practices Board recognised that difficulties existed with the interpretation of the phrase contained in Section 286(3) of the *Companies Act, Act 61 of 1973*, requiring companies to prepare their financial statements in conformity with 'generally accepted accounting practice' and which fairly present the state of affairs of the company. In 1987 (Singer 1992:5 and 1994:7) the Accounting Practices Board questioned whether a proposed amendment to Section 286(3) would have the necessary effect of requiring companies to comply with statements of generally accepted accounting practice approved by the Accounting Practices Board. A 1991 submission to the Standing Advisory Committee on Company Law to amend the *Companies Act, Act 61 of 1973*, was subsequently withdrawn. More than 18 years after first recognising the difficulties existing with section 286(3) of the *Companies Act, Act 61 of 1973*, the South African Institute of Chartered Accountants (1995), has issued their *Proposed Amendments to the Companies Act, 1973 on legal backing to accounting standards*. Legal backing to accounting standards in South Africa is still therefore not *fait accompli*. Hypothesis 10 seeks corporate management's view on whether this delay in making appropriate amendments to the *Companies Act, Act 61 of 1973* is acceptable.

Hypothesis 11: There is no significant difference in the frequency of responses in the respective categories on whether significant penalties should accrue to both preparers and auditors of financial statements for not complying with statements of generally accepted accounting practice such that $f_1 = f_2 = f_3 = f_4$.

In reviewing the perceived need for legal backing to accounting standards in South Africa, Singer (1994:7) states that legal opinion confirmed that practices other than those codified and issued by the Accounting Practices Board could constitute generally accepted accounting practices. It is self evident that uncertainty in this respect results in unsound accounting practices being sanctioned, especially if adopted by a significant group of companies such as Barlows or Anglo America. A lack of policing, together with South Africa's own brand of accounting morality (or lack thereof) "often supported by preparers and auditors alike" (emphasis added) (Singer, 1994:7), has contributed to this position.

If, as Singer (1994) suggests, auditors provide tacit support for companies not complying with statements of generally accepted accounting practice by failing to qualify their audit reports, then surely they should face the same penalties under the *Companies Act, Act 61 of 1973* as preparers of the financial statements. Hypothesis 11 seeks to establish whether corporate management supports the view that auditor's face penalties under the *Companies Act, Act 61 of 1973*, should preparers fail to comply with codified statements of generally accepted accounting practice.

Hypothesis 12: There is no significant difference in the frequency of responses in the respective categories on whether the South African Institute of Chartered Accountant's conceptual framework will provide a measure of legitimacy to the accounting profession threatened by government intervention in the accounting standard-setting process such that $f_1 = f_2 = f_3 = f_4$.

Academics such as Bromwich (1992:281), Solomons (1983:115 and 1986:115) and Hines (1989:89), have argued persuasively that a defence against political interference in the accounting standard-setting process is the possession of a framework that provides a sound theoretical base from which accounting standards are developed. Cameron (1995:24) has however suggested that since the demise of Masterbond in South Africa, the profession is coming under increased threat of statutory regulation. In addition, questions are being raised about the relevance of the information provided to investors and other users of financial statements. Any threat of political interference can be countered, suggests Hines (1989:85), by arguing that the existence of a conceptual framework provides a coherent differentiated knowledge base from which accounting standards are developed. This would result in the legitimisation of these standards as well contributing the required power to the accounting profession whose authority to engage in self regulation is threatened. Hypothesis 12 seeks corporate management's view on whether the existence of a conceptual framework in South Africa protects the accounting profession from the threat of government intervention in the accounting standard-setting process.

Hypothesis 13: There is no significant difference in the frequency of responses in the respective categories on whether proposed statements of generally accepted accounting practice issued for comment and response, should include a presentation of the theory and arguments underlying the standard such that $f_1 = f_2 = f_3 = f_4$.

Grinyer (1978:52) suggests that a method of increasing financial statement credibility among all users would be to provide a presentation of the arguments and theory underlying each statement

at the exposure draft stage. This, he argues, would be useful in enabling respondents to establish the principles on which they are based, thereby resulting in more effective implementation. Hypothesis 13 seeks to establish whether corporate management supports the issue of exposure drafts on this basis.

Hypothesis 14: There is no significant difference in the frequency of responses in the respective categories on whether companies should bear the financial cost of the accounting standard-setting process such that $f_1 = f_2 = f_3 = f_4$.

The new method proposed of financing the standard-setting process first appeared in an article in the February 1995 issue of *TechTalk*, the monthly technical newsletter of the South African Institute of Chartered Accountants. In justifying the proposed financing method Dickinson (1995:2) states that:

Currently SAICA is the main provider of funds towards the standard-setting process. As the existing influence that SAICA exerts over this process will be handed over to a fully representational transparent process, it has been agreed that the funding of the process should come from companies. The funding of the standard-setting process will therefore be derived from a levy to be charged to all companies. The Registrar of Companies will have the responsibility of collecting and administering the levy.

Hypothesis 14 was developed in response to this article. It is clear that a possibility exists that inadequate consultation occurred between the South African Institute of Chartered Accountants and corporate management when the funding proposal was formulated. Alternatively, the possibility of a unilateral funding decision was taken by the South African Institute of Chartered Accountants. Corporate management's response to this method of funding the standard-setting process is therefore sought.

Hypothesis 15: There is no significant difference in the frequency of responses in the respective categories on whether corporate management plays a central role in the determination of accounting standards such that $f_1 = f_2 = f_3 = f_4$.

Hypothesis 15 is based on the arguments of Watts and Zimmerman (1978 and 1986); Kelly (1983) and Moonitz (1974) who argue that [corporate] management plays a central role in the determination of accounting standards. The view of South African financial executives are sought to establish whether they view themselves as playing a central role in the determination of accounting standards. Empirical evidence of how South African corporate executives view this matter is not readily available.

Hypothesis 16: There is no significant difference in the frequency of responses in the respective categories on whether corporate executives are concerned with either the potential earnings or cash flow consequences that may result from the adoption of a particular accounting standard.

The empirical studies of Bowen, Lacey and Noreen (1981), Daley and Vigeland (1983), Dhaliwal (1982), Dhaliwal *et al.* (1982), Hagerman and Zmijewski (1979), Kelly (1982, 1983 and 1985), Kelly-Newton (1980), Liberty and Zimmerman (1986), Watts and Zimmerman (1978 and 1986) and Zmijewski and Hagerman (1981), support the proposition that corporate management selects accounting policies in a systematic manner. Based on this evidence, it would not be unreasonable to expect South African corporate management to select accounting methods on the same basis, after taking into account all available information. As empirical evidence of South African corporate management's view on this matter is not readily available, Hypothesis 16 seeks to establish whether corporate management would select accounting standards on a systematic basis so as to maximise income.

Hypothesis 17: There is no significant difference in the frequency of responses in the respective categories on whether corporate executives are entitled to disregard compliance with a statement of generally accepted accounting practice, if compliance results in the company not meeting its financial performance objectives such that $f_1 = f_2 = f_3 = f_4$.

The rationale for the development of hypothesis 17 is what Crotty (1995:20) terms "appalling levels of [financial] disclosure." Crotty (1995) can be excused her cynicism in viewing generally accepted accounting practice as being any practice pursued by a handful of companies, such as the Rembrandt group (Remgro), South African Breweries (SAB) or W & A Investment Corporation (W&A) who are in a position to devise their own accounting practice. This attitude is unfortunately not only the preserve of the popular press. Singer (1994:7), in reviewing the 1992 Chartered Accountant reporting awards, stated that out of more than 400 companies screened, only about 70 qualified for the first round of marking. Even among the top 10 companies many instances of non-compliance with statements of generally accepted accounting practice were evident. Prominent among areas of non-compliance according to Bunting (1993:26-27) occurred in the treatment of deferred taxation, equity accounting, inflation accounting, investment properties, subsidiaries and joint ventures, retirement benefits, goodwill, and extraordinary items.

In light of the extensive non-compliance with existing statements of generally accepted accounting practice highlighted by Bunting (1993), Crotty (1995) and Singer (1994), hypothesis 17 aims at establishing whether corporate management supports the view that disregarding

accounting standards is justified if compliance would result in the company not meeting its financial performance objectives.

Hypothesis 18: There is no significant difference in the frequency of responses in the respective categories on whether corporate executives will lobby for changes to accounting standards.

A direct result of corporate management's wealth maximising function based on their own self interest is reflected in their lobbying of the standard-setting body in an attempt to influence the outcome of a proposed accounting standard. As is illustrated in chapter four, this lobbying can take a number of forms.

In South Africa, an examination of comment letters to exposure draft 61, *Taxation in financial statements*, and exposure draft 72, *Taxation in financial statements*, by Samkin (1993), illustrates that corporate management is prepared to lobby for changes to accounting standards. As this has been the only South African study providing details of corporate management's lobbying, it was decided that it would be useful to establish whether corporate management's view is consistent with the evidence provided by Samkin (1993).

Hypothesis 19: There is no significant difference in the frequency of responses in the respective categories on whether an audit firm is unlikely to qualify the audit report of a company falling to comply with statements of generally accepted accounting practice because of the potential economic consequences to the audit firm such that $f_1 = f_2 = f_3 = f_4$.

Hypothesis 19 was developed in response to Singer's (1994:7) belief that the lack of accounting morality among South Africa corporations occurs with the support of their auditors. If this assumption is correct, it would not be unreasonable to expect that this is due in part to the economic benefits that accrue to the audit firms in the form of substantial fees.

Hypothesis 20: There is no significant difference in the frequency of responses in the respective categories on whether individuals act so as to maximise their own utility and are resourceful and innovative in doing so such that $f_1 = f_2$.

Hypothesis 21: There is no significant difference in the frequency of responses in the respective categories on whether, irrespective of mandatory changes to statements of generally accepted accounting practice, corporate managers are able to 'manage' accounting earnings so as to maximise their own utility such that $f_1 = f_2 = f_3 = f_4$.

Hypothesis 22: There is no significant difference in the frequency of responses in the respective categories on whether corporate executives will lobby for amendments to those accounting policies that negatively impact earnings and consequently on their remuneration derived from incentive schemes such that $f_1 = f_2 = f_3 = f_4$.

The neoclassical assumption that individuals act so as to maximise their own utility, is integral to positive accounting research, and is therefore by implication, central to any research whose objective is to establish the attitudes of corporate management to the accounting standard-setting process. Watts (1977:54), in an attempt to outlining a theory of financial statements, based his approach on price theory, a methodology supported in later research by Watts and Zimmerman (1978:113). This approach assumes that all individuals act so as to maximise their own utility and that they are innovative and creative in doing so. A study by Hagerman and Zmijewski (1979:145) confirms that the existence of management incentive compensation plans influences managements's choice of accounting standard. "If management incentive schemes are related to accounting earnings we expect that management has an incentive to use accounting principles that increase accounting earnings if part of their income is derived from incentive plans" (Hagerman & Zmijewski 1979:145).

Hagerman and Zmijewski (1979:157-158) conclude that a positive theory of accounting is a prerequisite to understanding how firms react to changes in accounting standards. Hagerman and Zmijewski (1979:157-158) suggest that the evidence provided in their study indicates that corporate management is influenced by economic factors when selecting from among alternative accounting standards. A later study by Murphy (1985:40) supports this contention and concludes that "firm performance as measured by the shareholder's realised return, is strongly and positively related to managerial remuneration." The rejection of hypotheses 20 to 22 would indicate that corporate management is influenced by economic motives when selecting a particular accounting policy from a choice of alternative accounting methods. Research in this area has been neglected in South Africa.

Hypothesis 23: There is no significant difference in the frequency of responses in the respective categories on whether accounting standards should be set in the private sector such that $f_1 = f_2 = f_3 = f_4$.

As is illustrated in chapter two, Belkaoui (1992:87) asserts that the public interest can best be served by having accounting standards set in the private sector. Convincing arguments in favour of this method of setting accounting standards are provided by both Belkaoui (1992:87-88) and Kaplan (1980:182-186).

Bromwich (1992:273) however identifies two problems he considers require resolution before private sector standard-setting can occur. These are, firstly, the standard setters have the necessary mandate to enable them to prescribe accounting requirements affecting a large number of users, and secondly, the method used to obtain consensus on accounting standards be universally accepted. As South African accounting standards are currently set in the private sector, it must be acknowledged that the problems identified by Bromwich (1992:273) have been overcome.

The objective of hypothesis 23 is to determine whether corporate management believes that the private sector continues to be appropriate to set future accounting standards.

Hypothesis 24: There is no significant difference in the frequency of responses in the respective categories on whether, in the light of recent corporate collapses, the public interest would best be served by having accounting standards set in the public sector such that $f_1 = f_2 = f_3 = f_r$

Chapter two cautioned that the failure by public accountants to improve the quality of their performance could see them becoming highly regulated, a view shared by Singer (1992:7). As is illustrated in chapter two, arguments in favour of setting accounting standards in the public sector have been reviewed by Belkaoui (1992:90-91) and Kaplan (1980:187-193). In light of recent corporate collapses, it was considered necessary to establish whether corporate management considered that the public interest would best be served by having accounting standards set in the public sector.

In addition to the reasons provided for the development of hypothesis 23 and 24, the hypotheses were phrased in this manner to obtain reassurance that respondents understood the distinction between public and private sector forms of accounting standard-setting.

Hypothesis 25: There is no significant difference in the frequency of responses in the respective categories on whether the accounting standard-setting process is in need of further regulation such that $f_1 = f_2 = f_3 = f_r$

Hypothesis 25 sought the view of corporate management on whether they believe further regulation of accounting is required in South Africa. The rationale for the development of this hypothesis is two-fold. Firstly, recent corporate collapses, for example Masterbond referred to by Woods (1994:3), and secondly, the conviction by certain users of financial statements (Cameron 1995:24) that the accounting profession is unable to meet their expectations.

Hypothesis 26: There is no significant difference in the frequency of responses in the respective categories on whether accounting regulation is essential to ensure that financial statements contain adequate disclosure so as to enable them to compete effectively in the capital market.

Benston (1969), Mills (1990), Morris (1984), Watts (1977), and Watts and Zimmerman (1983) amongst others, suggest that the existence of competitive capital markets is sufficient to ensure that sufficient and adequate financial disclosure will occur. This disclosure would be sufficient to allow interested outsiders or suppliers of capital to monitor corporate management's behaviour. Hypothesis 26 aims at establishing whether South African corporate management holds views consistent with those above.

Hypothesis 27: There is no significant difference in the frequency of responses in the respective categories on whether statements of generally accepted accounting practice developed by the International Accounting Standards Committee are of an inferior quality to those developed in South Africa such that $f_1 = f_2 = f_3 = f_4$.

This hypothesis was generated in response to the apparent dissatisfaction with the quality of International Accounting Standards expressed by Briston (1978), Carlson (1994), Schroeder and Clark (1995) and Taylor (1987). For example, Briston (1978:116) views International Accounting Standards as representing the lowest common denominator of Western accounting standards, views supported by Taylor (1987:160) and Schroeder and Clark (1995:779). Carlson (1994:9) explains that while the development of quality accounting standards is an expensive time-consuming activity, the International Accounting Standards Committee has insufficient resources to sustain high quality research for any extended period. The development of hypothesis 27 sought to establish whether South African corporate management view International Accounting Standards as inferior to South African developed accounting standards.

Hypothesis 28: There is no significant difference in the frequency of responses in the respective categories on whether the South African Institute of Chartered Accountants should collaborate with specific countries (such as Australia and New Zealand) when developing statements of generally accepted accounting practice such that $f_1 = f_2 = f_3 = f_4$.

Chapter three illustrated that the international harmonisation of accounting standards on a global basis is likely to be fraught with difficulties. The South African Institute of Chartered Accountant's Council decision to adopt International Accounting Standards Committee accounting standards rather than continuing with the development of South African specific statements of generally

accepted accounting was not empirically tested. Hypothesis 28 aims to obtain corporate management's opinion whether, it would be preferable for the South African Institute of Chartered Accountants forge links, and share resources with countries possessing similar environmental backgrounds. This would include countries whose first Companies Acts were originally based on early English Companies Acts, have an industrial base with significant agriculture and mining sectors, possess an active stock market and experience growing consumer markets, all characteristics that currently exist in South Africa. The use of this avenue to develop accounting standards cannot be discounted. Discussions with Blumberg (September 1995(c)), the Technical Director, Accounting, of the South African Institute of Chartered Accountants revealed that from August 1995, the South African Institute of Chartered Accountants had been invited to sit on the Commonwealth accounting standards committee. The harmonisation of accounting standards on a regional or cluster basis also appears to be supported by both the Australian and New Zealand governments. As Perera and Rahman (1994:17) report:

At the governmental level there is a commitment on both sides of the Tasman to harmonise accounting standards between the two countries. Under the Australian Corporations Law, the AASB is required to consult with its New Zealand counterpart in developing and issuing accounting standards relevant to Australian corporations. In turn, the Financial Reporting Act requires the ASRB to liaise with the AASB with a view to harmonising New Zealand and Australian accounting standards.

Hypothesis 29: There is no significant difference in the frequency of responses in the respective categories on whether, within an African context, impediments exist that impede the harmonisation of accounting standards.

This hypothesis follows logically from hypothesis 28. Should it be accepted that the international harmonisation of accounting standards on a global basis is not feasible, the question to be posed is: can accounting standards be harmonised in an African context? In addition to the problems facing developing countries in general, and Africa in particular, Ngindu (1986), identifies the individual countries that have influenced the development of accounting in Africa. These include the French, Belgian, British, German, Spanish and Portuguese colonial influences, and the Soviet and United States business influences. In addition, Ngindu (1986:106) explains that a number of African states already have an elaborate form of standardised general accounting structure that has evolved from two main philosophies derived from two of the three major schools of accounting standardisation, the British, the Franco-German and the Soviet school. It would appear therefore, that the problems facing the harmonisation of accounting standards on a global basis would be the same as those facing the harmonisation of accounting standards in an African context. The aim of hypothesis 29 is to establish whether South African corporate

management sees the harmonisation of accounting standards in an African context as a feasible objective.

Hypothesis 30: There is no significant difference in the frequency of responses in the respective categories on whether the adoption of International Accounting Standards by the Accounting Practices Board will result in a saving of resources of those multinational companies that operate from South Africa such that $f_1 = f_2 = f_3 = f_r$

Purvis, Gernon and Diamond (1991:37) argue convincingly for requiring all listed public companies to use International Accounting Standards. They justify this stance by explaining that no company can be considered purely as domestic if individuals or institutions from a number of countries are able to invest in its shares. In addition, Purvis *et al.* (1991:38) believe that where companies' shares are listed on more than one stock exchange, the preparation of a single set of financial statements using International Accounting Standards provides the potential for considerable cost savings. Hypothesis 30 seeks to establish whether South African corporate management believe that the adoption of International Accounting Standards will result in cost savings to preparers of financial statements.

Hypothesis 31: There is no significant difference in the frequency of responses in the respective categories on whether the harmonisation of accounting standards will result in more meaningful information being provided to users of financial statements such that $f_1 = f_2 = f_3 = f_r$

A complete set of financial statements includes an income statement, a balance sheet, a statement of changes in financial position (such as a cash flow statement) and relevant notes providing explanatory material to figures included in the above statements. Conceptual frameworks such as those issued by the South African Institute of Chartered Accountants and the International Accounting Standard Committee, indicate that the primary purpose of financial statements is to provide meaningful information about the financial position, performance and changes in financial position of an enterprise useful to a wide range of users in making economic decisions (AC 000 1992: para .12). Additional information provided with financial statement aimed at assisting users in making these economic decisions, will to a large extent, depend on the environmental factors existing in a particular country. Hypothesis 31 seeks to establish whether South African corporate management believes that the international harmonisation of accounting standards will contribute to more meaningful information being provided to users of financial statements.

Hypothesis 32: There is no significant difference in the frequency of responses in the respective categories on whether the harmonisation process should include stock exchange listing requirements such that $f_1 = f_2 = f_3 = f_r$

One of the consequences of the comprehensive international sanctions that have recently been lifted against South Africa was the shortage of external capital available to South African corporations. One of the methods now available to South African corporations seeking additional capital is a listing on a foreign exchange, subject to exchange control regulations.

Hypothesis 32 was developed in response to research by Meek and Gray (1989) and Biddle and Saudagaran (1991). Meek and Gray (1978:315-316) identify the perceived advantages of internationally coordinated stock exchange disclosure requirements as cost minimisation that will result in the removal of barriers to foreign listings as well as the free flow of information. In addition, companies will be able to compete more effectively for capital in international financial markets. Marketing, political and employee advantages are other advantages identified by Biddle and Saudagaran (1991:69-70) as accruing to firms seeking foreign stock exchange listings.

As this issue has not yet been addressed in South African research, hypothesis 32 was developed to seek corporate management's view on this matter.

Hypothesis 33: There is no significant difference in the frequency of responses in the respective categories on whether corporate management will become more accountable to users of financial statements as a result of the harmonisation process such that $f_1 = f_2 = f_3 = f_r$

It would not be unreasonable to conclude that as far as a large number of financial statement users are concerned, the perception exists that corporate management remains unaccountable to users of financial statements. A financial reporting expectation gap therefore exists. This is evidenced by reports from Crotty (1995), Mathews (1995) and Cameron (1995) that have appeared in the financial press. These reports, for example Crotty (1995:20), suggest that a number of large corporations (for example W&A) do not consider themselves accountable to users, in particular minority investors. Hypothesis 33 aims at establishing whether South African corporate management believes that the harmonisation of financial statements is likely to make corporate management more accountable to financial statement users.

Hypothesis 34: There is no significant difference in the frequency of responses in the respective categories on whether the adoption of International Accounting Standards Committee statements of generally accepted accounting practice is likely to result in the modifications to corporate management incentive schemes such that $f_1 = f_2 = f_3 = f_4$.

Healy, Kang and Palepu (1987) investigated two accounting method changes on the cash salary component and bonus payments contingent on company earnings. These were changes from the first-in-first-out (FIFO) to last-in-first-out (LIFO) method of inventory valuation, and from accelerated to straight-line depreciation methods. The research indicated that in spite of these changes no modifications were made to corporate management compensation schemes. Hypothesis 34 seeks to establish whether the position in South Africa is consistent with that described by Healy *et al.* (1987).

Hypothesis 35: There is no significant difference between the responses of South African male and female corporate managers on various issues relating to corporate management as the producers of firm specific financial information.

Hypothesis 36: There is no significant difference between the responses of South African male and female corporate managers on various issues relating to the regulation of accounting.

Hypothesis 37: There is no significant difference between the responses of South African male and female corporate managers on various issues relating to the international harmonisation of accounting standards.

Hypothesis 38: There is no significant difference between the responses of South African corporate managers of different ages on various issues relating to corporate management as the producers of firm specific financial information.

Hypothesis 39: There is no significant difference between the responses of South African corporate managers of different ages on various issues relating to the regulation of accounting.

Hypothesis 40: There is no significant difference between the responses of South African corporate managers of different ages on various issues relating to the international harmonisation of accounting standards.

Hypotheses 35 to 40 were developed to examine whether differences exist in the way South African male and female corporate managers, and corporate managers of different ages view various issues relating to corporate managers as producers of firm specific financial information, the regulation, and international harmonisation of accounting. The training and education of these

individuals would suggest that there be no significant differences in how these individuals view these issues. The results of these hypotheses should provide support for this view.

5.4 SURVEY DESIGN AND TECHNIQUES USED

In this section, the survey design used in surveying the opinions of corporate management to the accounting standard-setting process and international harmonisation is examined.

5.4.1 The use of surveys

The purpose of a survey is, according to Neale and Liebert (1986:49), to determine the frequency of some characteristics in a population. On the basis of the results of the survey, generalisations can be made about the population as a whole. Neale and Liebert (1986:49) however, caution against the use of generalisations: "They involve an inference and can only be made according to a series of assumptions and rules that tend to assure their legitimacy within certain bounds" (Neale & Liebert 1986:49). Two types of surveys can be identified. These are described by Oppenheim (1992:12) as "the descriptive, enumerative, census-type of survey; and the analytic, relational type of survey"

A descriptive survey can be considered a fact finding survey. Researchers are provided with information about what proportion of a population reflect a certain characteristic, or how often certain events occur together. A descriptive survey does not reflect casual relationships between one variable and another. The sample being surveyed must be fully representative of the population as a whole before meaningful conclusions can be drawn. On the other hand, an actuarial survey examines group differences from which relationships between variables can be inferred.

A descriptive survey was considered appropriate to canvass the opinions of South African corporate management to the accounting standard-setting process and international harmonisation.

5.4.2 The population

A population has been described by Neale and Liebert (1986:31) as a well-defined collection of objects, and by Christensen (1988:48) as all events, things or individuals to be represented.

As the primary objective of this thesis is to obtain an understanding of South African corporate management's attitude to the accounting standard-setting process and international harmonisation, the population for this study comprises those South African corporate managers employed by companies listed on the Johannesburg Stock Exchange, and who were considered responsible for accounting or financial policy decisions.

5.4.3 The sample

The sample subjected to study was selected as follows. Of companies whose shares are traded on the Johannesburg Stock Exchange those companies falling under the mining sector and financial sector were excluded from the sample. The rationale for excluding mining companies was two-fold. Firstly, although mining companies have substantial investment in total assets and employ a significant number of people, Konar (1989:205) explains that special financial reporting exemptions are extended to these companies. Secondly, a study of those International Accounting Standards extant at 1 January 1995 indicates that no statement dealing with extractive industries had yet been promulgated.

Financial sector companies were excluded as they are also subject to unique financial reporting and disclosure requirements. Furthermore, this exclusion is consistent with Dhaliwal's (1982) exclusion of banks and financial service companies in his study of accounting for interest costs, Meek and Gray's (1989) study of voluntary disclosures by foreign companies on the London Stock Exchange, and Choi's (1973) research on financial disclosure and entry into the European capital market. In addition the only accounting standard relevant to banks is AC 120 *Disclosure in the financial statements of banks*, effective for all periods commencing on or after 1 January 1996, a date after which this survey was conducted. From the Industrial sector, cash companies, development capital and venture capital companies were excluded from the sample because of their relatively small size. However a review of the market capitalisation of these companies indicated that none of these companies would have made the top 100 companies by market capitalisation.

Barrett (1976:11) identifies three reasons for using market capitalisation as the basis for sample selection. Firstly, it is an easily obtainable figure which is available for all public companies. Secondly, it represents a unbiased measure of a firm's importance as perceived by the investing public. Finally, a sample of companies would result in which current or potential investors are likely to be interested.

The actual sample was selected as follows: all the shares from the Industrial sector were ranked in descending order by market capitalisation. From this list where any shares were duplicated, for example where companies trade both ordinary and cumulative preference shares, the duplicates were eliminated. In addition, where shares are traded on the industrial sector but which are not South African based, for example Richemont whose headquarters are in Switzerland, these were also eliminated from the sample. From the companies that remained, the top 100 companies ranked by market capitalisation were selected. This method of sample selection is consistent with that used by Barrett (1976) in his study. By making continual reference to *McGregor's Stock Exchange investor's handbook* (McGregor 1994), care was taken

to ensure that in group situations where a number of listed companies had the same postal address, only one questionnaire was sent to that group. This ensured that the sample comprised of only the top individual 100 companies by market capitalisation and that only one questionnaire was sent to group companies. The financial magazine, *Finance Week*, for the week September 28 - October 4, 1995, was used as the source for the completion of this exercise.

In any sample, according to Christensen (1988:400), there must be population validity. Population validity allows generalisations to be made about the total population based on the sample on which the study was conducted. As the sample comprised corporate managers of those companies listed in the Industrial section of the Johannesburg Stock Exchange, it would not be unreasonable to conclude that population validity exists.

5.5 DEVELOPMENT OF THE QUESTIONNAIRE: GENERAL CONSIDERATIONS

This section reviews the development of the questionnaire and the collection of the relevant data.

5.5.1 Collection of data

5.5.1.1 Method of data collection

There are three accepted techniques of data collection when descriptive surveys are undertaken. These are classified by Neale and Liebert (1986:52) as being: the distributed questionnaire, the phone survey and the systematic interview. The choice of the survey depends, according to Crimp (1990:38), on the following: the subject of the survey, the nature of the survey population and the research budget. Each of the three descriptive methods are discussed below.

A descriptive survey requires respondents to complete a questionnaire that is mailed to them, while a phone survey requires respondents to respond in a telephone interview to specific questions put to them. In a systematic survey, data is collected by either direct observation or personal interview with the respondent.

As the opinions of South African corporate management was being sought, it was not possible to obtain the required information by observation. This factor dictated that a distributed survey be undertaken.

Once the decision was taken to undertake a distributed survey, two additional factors warranted consideration: the degree of structure of the questions; whether the questions were open or closed and the degree of disguise of the question.

(a) Degree of structure

The degree of structure refers to the nature of the questions asked in a questionnaire. A questionnaire that is highly structured provides the respondent with a predetermined question and range of responses.

The nature of the research topic dictated that the questionnaire should be highly structured with respondents being given a number of fixed alternatives from which to select. In addition to the fixed responses given, respondents were given the opportunity of clarifying their responses or providing additional information to certain questions. This is considered further in 5.5.1.2 below.

Although the respondents were not required to answer any open ended questions in the questionnaire, certain questions allowed respondents to clarify their positions.

(b) Degree of disguise

The degree of disguise refers to the extent to which the objectives of the survey are obvious from the questions asked. Disguise may be necessary because answers may be influenced by predetermined opinions the respondent may have on the topic.

In order to make respondents aware of the topic being researched, a covering letter was sent to each person in the sample. As the questionnaire contained no terminology that could be considered ambiguous, it was not considered necessary to provide any definitions. The questionnaire was considered to be totally undisguised.

As the terminology was considered to be unambiguous, no definitions were provided for any of the terms used.

(c) Method of administration

As discussed above, questionnaires can be administered by mail, personnel or telephonic interview. As the sample included respondents from all parts of South Africa, the use of personnel and telephonic interviews was considered inappropriate.

The questionnaire was posted to all respondents together with an appeal for cooperation from Professor JH Martins from the Bureau of Market Research at the University of South Africa. A postage paid reply envelope was enclosed to facilitate the return of the completed questionnaires.

As mail questionnaires provide little control in securing a reply from the respondent, it is necessary to appeal for cooperation in the completion of the questionnaire. Oppenheim (1992:105), in considering response rates to questionnaires, states that it is the topic and the degree of interest the respondents have in the topic that will determine the response rate

"questionnaires will often be completed successfully if the topic is of interest to respondents (for example, if it is about their children), or if they believe that their response will have a direct influence on policy" (Oppenheim 1992:105).

Administering questionnaires by mail has certain advantages. Firstly, it provided respondents with the opportunity to answer the questionnaire in their own time and at their own pace. Other advantages identified by Oppenheim (1992:102) include the low cost of data collection and processing, the avoidance of interview bias, and the ability to reach respondents at widely dispersed locations. In addition, a mail questionnaire allows the respondent to be more frank on what can be considered sensitive issues. The questions covering management compensation schemes were considered sensitive, and allowance had to be made for different opinions.

Disadvantages experienced with mail questionnaires include the general low response rate and consequent bias associated with this. A second problem associated with mail questionnaires is sequence bias. It is not possible for the researcher to control the order in which the questions are answered. Respondents will be able to study the entire questionnaire and make responses based on the entire questionnaire. Furthermore, the researcher is unable to monitor incomplete questionnaires or prevent the passing on of the questionnaire to others. Mail questionnaires do not normally provide the researcher with any opportunity to clarify any questions that are not fully understood. To overcome this problem, the researcher's work telephone number was included in the covering letter inviting respondents to contact him should they experience any difficulties with the questionnaire. It was considered that the respondents should not experience any difficulty with the standard of language used in the questionnaire.

5.5.1.2 Description of questionnaire

The questionnaire can, in the light of the above discussions, be described as structured and undisguised. The advantages and disadvantages of using this type of questionnaire are considered below.

(a) Simplicity

The advantage of a structured, undisguised question is the simplicity of analysis and administration. Respondents should have little difficulty on answering the questionnaire. They are required to select the response they consider the most appropriate from the alternatives provided. This method relieves the respondent of having to convert their own thoughts to writing.

(b) Reliability

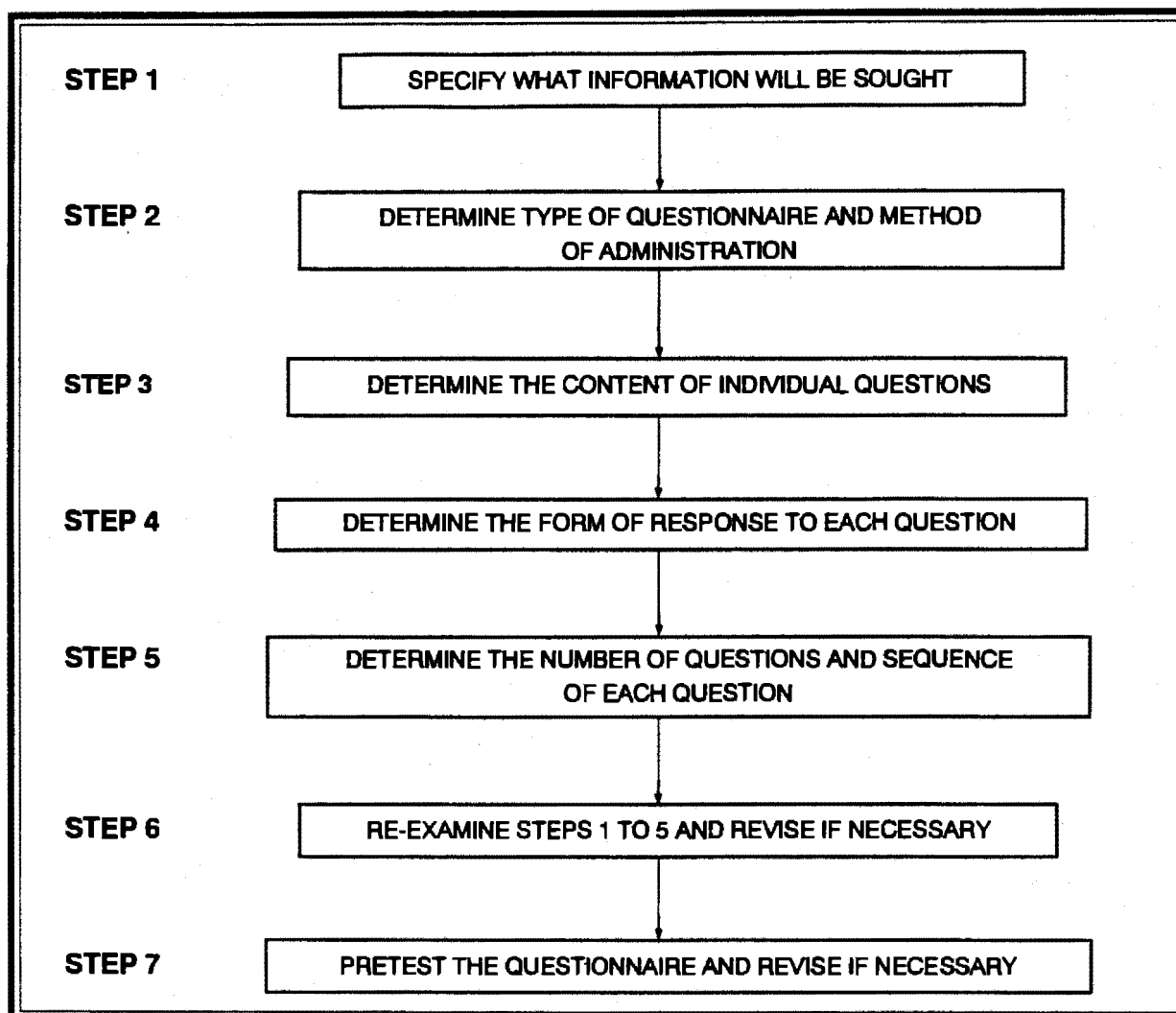
The reliability of the questionnaire needs to be established. This includes the following factors:

- Should the respondent not have altered his opinion, the response, if the respondent is asked the same question again, should remain unchanged.
- Reliability is increased because the frame of reference is obvious from the stated alternatives. By providing the respondent with a specific range of replies from which to choose, the question itself may become clearer to the respondent. For example, when answering the question *"The existing method for setting accounting standards is the most appropriate for the South African business environment,"* the respondent has no choice but to use one of the following alternatives, strongly agree, agree, disagree, or strongly disagree. Interpretations would be impossible if each respondent was able to answer the question in their own words.
- The reliability of fixed alternative questions is sometimes associated with a loss of validity. This is because answers may not necessarily reflect the respondent's opinion. This potential disadvantage was overcome by providing respondents with the facility to make comments on certain questions. Respondents were not provided with the opportunity to make a 'no opinion' or 'neutral' form of response. This alternative was excluded as it was considered that as the respondents are corporate management responsible for the preparation of financial statements, they would have specific views on the subject.
- Stated alternative responses may also lower validity where the response categories themselves introduce bias. This would be particularly appropriate where a response was omitted. To overcome this, care was taken to ensure that the full range of responses was provided for.

5.6 DEVELOPMENT OF THE QUESTIONNAIRE: PRACTICAL CONSIDERATIONS

The process used for developing the questionnaire is illustrated below.

Figure 5.1: Outline of the procedure followed in the development of the questionnaire



5.6.1 Specification of information sought

The information required from the respondents related to five specific subject areas. These were broken down into six distinct questions each containing a number of subquestions. The questionnaire was designed to ascertain respondent's opinions to various aspects in the subject areas of corporate management's participation in the accounting standard-setting process, the South African accounting standard-setting process, corporate management and their incentive schemes, accounting regulation and the international harmonisation of accounting standards.

5.6.2 Determination of type of questionnaire and method of administration

As is indicated in section 5.5.1.2, the questionnaire to be completed by corporate management, was described as structured and undisguised. The questionnaire was distributed as a mail survey.

5.6.3 Determination of the content of individual questions

The content of a questionnaire is determined by the nature of the research to be undertaken. The information required to be obtained from the respondent, the degree of disguise of the questions, and the administration of the questionnaire influenced the content of the individual questions. Crimp (1990:93) recommended that as each question is formulated, the following questions need to be asked:

- do the respondents have the information?
- will the respondents understand the question?
- are the respondents likely to give a true answer?

Each of these factors is considered below.

5.6.3.1 Do the respondents have the necessary information?

In the research process where questionnaires are used, it is necessary that the researcher be confident that the respondents have the necessary information at their disposal to answer the questions posed. Furthermore, the researcher must be satisfied that the answers the respondents provide will be reliable.

As all the respondents are senior management within their corporations, it is assumed that they have the necessary information and expertise to enable them to answer the questionnaire and provide reliable answers.

5.6.3.2 Will the respondents understand the questions?

There was no terminology that would provide the respondents with any difficulty.

5.6.3.3 Are the respondents likely to give a true answer?

If the respondent has the required information and understands the question, the question of whether a true answer will be elicited must be raised. Crimp (1990:95) considers that the following factors will prevent a true response from being provided:

- the respondent may find it difficult to verbalise,
- the respondent's memory may be defective,
- the respondent may be reluctant, or unwilling, to answer the question.

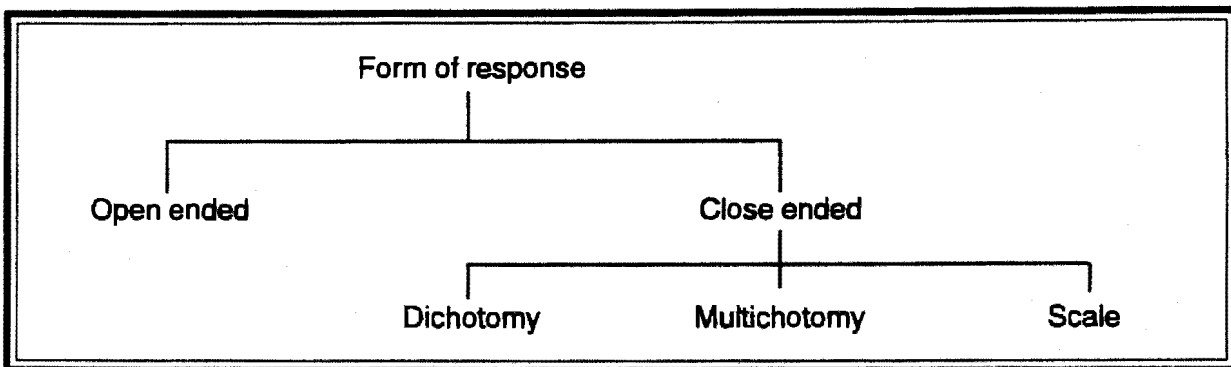
Given the population of respondents, it was considered that none of the above factors would prove to be an impediment that would prevent true responses from being obtained.

5.6.4 Determination of the form of response to each question

The wording of a question is not the only consideration when drafting a descriptive survey questionnaire. A decision must be made on what response categories to use. The two usual forms of response are either the open ended or closed ended questions or a combination of the two.

The alternative forms of response to a question are illustrated in figure 5.2 below.

Figure 5.2: Forms of responses to a questionnaire



As the questionnaire contained a mix of both open ended and closed ended questions, these types of questions are discussed further below.

5.6.4.1 Open ended questions

An open ended question is a question in which response categories are not given. As Bailey (1987:121) explains, open ended questions are usually used for complex questions that cannot be answered in a few simple categories. Normally questions of this sort are used to elicit the views, philosophy or goals of a respondent, and are used when accuracy, detail and exhaustiveness are important. Bailey (1987:120) with Oppenheim (1992:115) in agreement, has described the advantages and disadvantages of open ended questions as follows:

Advantages

- 1 They can be used when all the possible answer categories are not known, or when the investigator wishes to see what the respondent views as appropriate answer categories.
- 2 They allow the respondent to answer adequately, in all the detail he or she likes, and to clarify and qualify the answer.
- 3 They can be used when there are too many potential answer categories to list on the questionnaire.

- 4 They are preferable for complex issues that cannot be condensed into a few small categories.
- 5 They allow more opportunity for creativity or self-expression by the respondent.

Disadvantages

- 1 They lead to the collection of worthless and irrelevant information
- 2 Data is often not standardised from person to person, making comparison or statistical analysis difficult.
- 3 Coding is difficult and subjective.
- 4 Require superior writing skills, better ability to express one's feelings verbally, and generally a higher educational level than do closed ended questions.
- 5 They may be too general for the respondent to understand what is meant.
- 6 May require more of the respondents time and effort.
- 7 Require more paper and make the questionnaire look longer, possibly discouraging certain respondents.

5.6.4.2 Closed ended questions

Closed ended questions, explains Bailey (1987:120), should be used when the answer categories are discrete, distinct and relatively few in number. Closed ended questions are generally self contained, can be answered quickly, and require few instructions. They are appropriate for survey questionnaires. Like open ended questions, fixed alternative questions also have advantages and disadvantages. These are described by Bailey (1987:118-119) with Oppenheim (1992:115) in substantial agreement, as follows:

Advantages

- 1 The answers are standard and can be compared from person to person.
- 2 The answers are easier to code directly from the questionnaire.
- 3 The respondent is often clearer about the meaning of the question.
- 4 The answers are relatively complete.
- 5 Respondents will often respond to sensitive topics more readily than with an open ended question.
- 6 Closed ended questions are more easily answered as the respondent merely has to choose an alternative rather than formulate a response.

Disadvantages

- 1 A respondent who does not know the answer or has no opinion may try to guess the appropriate answer or answer randomly.
- 2 The respondent may feel frustrated because the appropriate category for his answer is not provided.

- 3 Too many answer categories may be provided.
- 4 Differences in interpretation of what was meant by the question may go undetected.
- 5 Variations in answers among the different respondents may be eliminated artificially by forced-choice responses.
- 6 There is the likelihood of clerical errors where the respondent selects a choice that differs from their thoughts.

The various responses to closed ended questions are discussed below.

(a) Dichotomous questions

A dichotomous question is one that allows for only two alternatives. Certain of the questions in the questionnaire limited the respondents choice to YES and NO. *Question 1.1 "Should corporate executives play an active part in the accounting standard-setting process?"* taken from the questionnaire provides an example of this form of question.

(b) Multichotomous questions

A multichotomous question is one that has a fixed number of alternatives. The respondent is required to select alternatives that most closely corresponds with his opinion on the subject. This type of multiple choice question does not usually permit the respondent to elaborate on his position although it does allow for more alternatives and finer distinction between viewpoints than the dichotomous question.

All the questions in the questionnaire contained dichotomous and multichotomous questions as the information sought related to opinions on management compensation schemes, the accounting standard-setting process and international harmonisation.

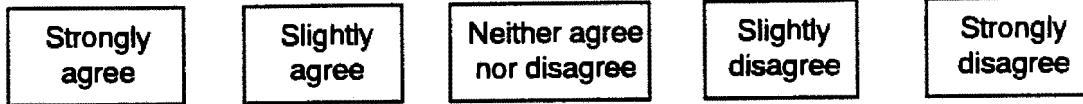
(c) Scale

The use of a scale requires the respondent to choose an answer that best suites his opinion. In this form the question is multichotomous within the framework of a fixed alternative scale.

The nature of the questions asked suited the adoption of a Likert scale as the intention was to test respondents opinion and strength of opinion on various issues surrounding accounting theory, the accounting standard-setting process and various aspects of management compensation schemes.

(d) Likert scale

The Likert scaling method allows the respondent to express their feelings in response to a particular statement made in the questionnaire. The diagrammatic rating scale of based on the Likert approach is as follows:



A Likert scale was considered suitable for certain of the questions posed in the questionnaire. These questions related to opinions regarding various aspects of accounting theory, accounting standard-setting, management compensation schemes and harmonisation of accounting standards.

A modified Likert scale was considered to be appropriate for the questionnaire as respondents would be able to select an alternative that best corresponded with their opinion.

5.6.5 Determination of the number, sequence and content of questions

In any study, the number of questions comprising the questionnaire should be sufficient so as to ensure that all issues are adequately covered. However, the questionnaire should not be so long so as to alienate the respondent. The questionnaire comprising this study was divided into seven sections with a number of questions in each section. In one of these sections, respondents were required to provide a limited amount of background detail.

In attempt to obtain as high response rate as possible the following suggestions from Bailey (1987:131-132) were taken into account. An easy to answer question was placed first in the questionnaire. This question was non-threatening, clear, and contain distinct answer categories. In addition, Bailey (1987:132) suggests that the opening question should be interesting and should stimulate the completion of the questionnaire. The section requiring personal information was placed last, while the open ended questions were left until late in the questionnaire.

The individual questions and their relationship to the specific hypotheses formulated in section 5.3 above, are described below.

5.6.5.1 Questions dealing with whether corporate management should participate in the accounting standard-setting process

As the overall purpose of the research was to determine South African corporate management's attitude to the accounting standard-setting process and international harmonisation, a decision was taken to establish whether the respondents were familiar with the South African accounting standard-setting process. To achieve this, the following dichotomous question, where the respondents choice was limited to either YES or NO was used:

- 1.1 *Are you familiar with the South African accounting standard-setting process.*

This question was followed by a branching instruction. Those respondents who were not familiar with the South African accounting standard-setting process were required to proceed to question 3. Those who answered YES to question 1.1 were required to complete the remainder of the questionnaire.

The question whether South African corporate management should play an active part in the accounting standard-setting process was dealt with in the hypothesis 1.

This hypothesis was tested by Question 1.2 using a dichotomous question structured as follows:

1.2 *Should corporate management play an active role in the accounting standard-setting process?*

To provide additional information why respondents made the particular choice in Question 1.2, Questions 1.2(a) and 1.2(b) were developed to provide an indication of the reasons why corporate management should or should not play an active role in the accounting standard-setting process. Questions 1.2(a) and 1.2(b) were framed as follows:

1.2(a) *Why should corporate management play an active role in this process?*

- (i) Management is in the best position to make decisions on the format and content of financial statements*
- (ii) Standards should permit earnings and cash flows to be maintained rather than fluctuating every time a new standard is issued*
- (iii) Standard-setting bodies and academics are unaware of practical realities*
- (iv) Management is not adequately represented on the standard-setting body*
- (v) Other (please specify)*

1.2(b) *Why should corporate management not play an active role in this process?*

- (i) It lacks the practical expertise and knowledge to make a meaningful contribution*
- (ii) Theoretical considerations means the process is best left to standard-setting bodies and academics*
- (iii) Participation and personal opinion may be contrary to corporate policy*
- (iv) Standard-setting body has in the past disregarded the opinions of contributors*
- (v) Other (please specify)*

These alternatives provided respondents with a number of reasons why they should or should not play an active role in the accounting standard-setting process. A respondent would select as many alternatives they wished. Provision was also made for other reasons which the respondent considered relevant and would like to highlight.

5.6.5.2 Questions relating to the South African accounting standard-setting process

This section of the questionnaire was only answered by those respondents who were familiar with the South African accounting standard-setting process. Questions 2.1 through 2.14 were required to be answered on the Likert scale.

The purpose of hypothesis 2 was to test whether there was any significant differences in the frequency of responses in the respective categories on whether the existing method employed for setting accounting standards is the most appropriate for the South African business environment. This hypothesis was tested with the aid of question 2.1:

2.1 The existing method for setting accounting standards is the most appropriate for the South African business environment.

The view of respondents on the credibility of the Accounting Practices Committee and the Accounting Practices Board as the bodies responsible for exposing and ultimately for promulgating accounting standards in South Africa was tested by hypothesis 3. Hypothesis 3 was tested with the aid of question 2.2 phrased as follows:

2.2 The Accounting Practices Board (APB) through the Accounting Practices Committee (APC) should continue to develop South African specific exposure drafts and statements of generally accepted accounting practice (GAAP).

The aim of hypothesis 4 was to test the opinion of respondents on whether bodies traditionally excluded from the accounting standard-setting process, should actively participate in the process. Question 2.3 phrased as follows, was used to test this hypothesis.

2.3 Non-accounting groups (such as lawyers and unions) have a right to participate in the accounting standard-setting process because they have a legitimate interest in the content of financial statements.

The purpose of hypothesis 5 was to test the opinion of respondents on whether the standard of South African developed statements of generally accepted accounting practice was acceptable for financial reporting purposes. Hypothesis 5 was tested with the aid of question 2.4 of the questionnaire.

2.4 The standard of South African developed statements of generally accepted accounting practice are acceptable for financial reporting in the South African environment.

Respondents' views on whether existing accounting standards provide corporate executives with a sufficiently wide choice of accounting alternatives to as enable them to produce financial statements that fairly present the financial position and financial result of the company were tested in hypothesis 6. This hypothesis was tested using question 2.5

2.5 Existing accounting standards provide management with a sufficiently wide choice of accounting alternatives so as to enable them to prepare financial statements that fairly present the financial position and financial results of the company.

Hypothesis 7 focused on whether respondents believed that the resources spent in the development of South African statements of generally accepted accounting practice have contributed to the high level of local accounting expertise. Question 2.6 was used to test this hypothesis.

2.6 Resources spent on the development of South African statements of generally accepted accounting practice have contributed to maintaining a high local level of accounting expertise.

Hypothesis 8 sought to test respondents' views on whether additional resources or staff should be made available to the South African Institute of Chartered Accountants to enable them to continue the development of statements of generally accepted accounting practice. Questions 2.7 and 2.8 of the questionnaire were used to test this hypothesis.

2.7 Additional resources should be made available to the South African Institute of Chartered Accountants to enable them to attract and keep suitably qualified staff to ensure relevant ongoing research into accounting issues.

2.8 Suitable qualified staff from South African universities should be co-opted by the South African Institute of Chartered Accountants to contribute to the development of local accounting standards.

The purpose of hypothesis 9 was to establish whether respondents to the questionnaire believed that corporate executives of public companies were more likely to respond proposed statements of generally accepted accounting practice than executives of private companies. The question relating to this hypothesis was framed as follows.

2.9 Corporate executives of private companies are less likely to respond to proposed statements of generally accepted accounting practice than corporate executives of public companies.

Hypothesis 10 sought respondents' views on whether amendments to the Companies Act making adherence to statements of generally accepted accounting practice mandatory had been made expeditiously by the South African Institute of Chartered Accountants. This hypothesis was tested with the aid of questions 2.10

2.10 The accounting profession has made sufficient effort to expedite legal backing for statements of generally accepted accounting practice.

The aim of hypothesis 11 was to test the views of respondents on whether significant penalties should accrue to both preparers and auditors of financial statements where a company failed to comply with statements of generally accepted accounting practice. The question did however not seek the views of respondents on what they thought the penalties should be. Question 2.11, framed as follows, was used to test the responses.

2.11 Legal backing to accounting standards should contain a provision for significant penalties to both preparers and auditors of financial statements for non-compliance with statements of generally accepted accounting practice.

To test hypothesis 12, views of respondents were sought on whether the conceptual framework adopted by the South African Institute of Chartered Accountants to provide a theoretical basis on which to formulate statements of generally accepted accounting practice does in fact provide a measure of legitimacy to the accounting profession threatened by government intervention in the standard-setting process. This hypothesis was tested by question 2.12.

2.12 The conceptual framework recently adopted by the South African Institute of Chartered Accountants provides legitimacy to the accounting profession threatened by government intervention in the accounting standard-setting process.

The penultimate hypothesis in this section sought the views of respondents on whether proposed statements of generally accepted accounting practice should contain a presentation of theory and arguments underlying the standard when it is issued. Question 2.13 was used for this purpose.

2.13 Proposed statements of generally accepted accounting practice should include a presentation of the theory and arguments underlying the standard.

The final hypothesis in this section sought the views of respondents on whether companies should bear the financial cost of the accounting standard-setting process. Question 2.14 was framed to test this hypothesis.

2.14 Companies should bear the financial cost of the accounting standard-setting process.

As discussed in chapter three, the South African Institute of Chartered Accountants is in the process of amending the accounting standard-setting process. It was therefore considered instructive to obtain an indication of whether corporate management is aware of these proposed changes. Question 2.15 framed in the dichotomous form was used for this purpose.

2.15 Are you aware of the proposed changes to the South African accounting standard-setting process.

5.6.5.3 Questions dealing with corporate management

The third section of the questionnaire focused on various aspects relating to corporate executives and their role in financial statements preparation. A Likert scale was used to answer Questions 3.1 to 3.9.

The purpose of hypothesis 15 was to establish whether corporate management view themselves as being central in determining accounting standards. This hypothesis is tested using question 3.1.

3.1 Management plays a central role in the determination of accounting standards.

Hypothesis 16, sought to test the view of corporate management on whether the potential earnings or cash flow consequences of adopting a particular accounting standard would concern them. Questions 3.2; 3.3 and 3.4 were framed to test the response.

3.2 Accounting standards should be developed that have as their focus the measurement of earnings rather than the measurement of assets/liabilities.

- 3.3 *Management will select an accounting alternative that maintains or increases earnings over one that, if adopted, will reduce earnings.*
- 3.4 *An accounting standard that has as its effect the reduction of income will be countered by management making discretionary changes to accounting policies so as to minimise the potential reduction in income.*

As discussed in the formulation of hypothesis 17, a culture of non compliance with statements of generally accepted accounting practice exists in South Africa. In an attempt to establish a possible reason for this, the views of corporate executives were sought on whether they believed non compliance with statements with generally accepted accounting practice to be warranted if compliance would result in the company not meeting its financial performance objectives. This hypothesis was tested by question 3.5.

- 3.5 *Management is entitled to disregard a statement of generally accepted accounting practice if, in the opinion of management, compliance with that statement would result in the company not meeting its financial performance objectives.*

Hypothesis 18 sought the views of respondents on whether they would engage in lobbying activities if they were dissatisfied with a statement of generally accepted accounting practice.

Questions 3.6; 3.7; and 3.8 were used to test this hypothesis.

- 3.6 *Policy makers within the standard-setting process are lobbied by management either in an attempt to initiate changes in allowable accounting procedures, or to express support or opposition to a proposed or enacted accounting standard.*
- 3.7 *Partners in audit firms responsible for the audit engagement are encouraged by corporate management to lobby for changes in accounting standards that are perceived to be detrimental to the company.*
- 3.8 *Proposed changes to statements of generally accepted accounting practice which, if implemented, would adversely effect company earnings, influences management to respond to the change.*

The purpose of hypothesis 19 was to test the views of management on whether they perceived themselves as being able to influence the content of an audit report by virtue of their having an economic hold over an audit firm. Question 3.9 framed as follows was used to test this hypothesis.

- 3.9 *An audit firm is unlikely to qualify the audit report of a company who fails to comply with statements of generally accepted accounting practice because of the potential economic consequences to the audit firm.*

5.6.5.4 Questions dealing with corporate management incentive schemes

The fourth section of the questionnaire was aimed specifically at attempting to establish the extent that the existence of corporate incentive schemes influences management's responses to statements of generally accepted accounting standards. This section contained a mix of dichotomous, multichotomous and open ended questions.

Hypothesis 20 was framed with reference to accounting theory. As discussed in the development of the hypotheses in 5.4 above, the neoclassical assumption that individuals act so as to maximise their own utility is central to positive accounting research. By using question 4.1, an attempt is made to test whether this view is held by corporate executives.

4.1 *Individuals act so as to maximise their own utility and are resourceful and innovative in doing so.*

Questions 4.2; 4.3 and 4.4 sought information about the existence of corporate incentive schemes and whether contractual obligations existed between the company and participants to the scheme. Respondents merely had to answer a dichotomous question where the choice was limited to either YES or NO. Question 4.2; 4.3 and 4.4 were structured as follows:

4.2 *Is a management incentive/compensation scheme in operation in the company you are employed by*

4.3(a) *Does the scheme require a level of accounting earnings to be achieved*
(b) *and/or share price performance*
(c) *and/or a particular return on assets to be maintained before participation*

4.4 *Are there any other contractual obligations between the participants of the compensation scheme and the company*

4.5 *Have any changes to the management compensation scheme been made in response to changes in statements of generally accepted accounting practice*

In question 4.5 information was sought on whether any changes had been made to compensation schemes in response to changes in statements of generally accepted accounting practice. As with questions 4.2; 4.3 and 4.4 above, respondents merely had to answer a dichotomous question where the choice was limited to either YES or NO. Question 4.5(a) was structured as follows:

Question 4.5(a) was an open ended question requiring participants who answered YES to question 4.6 to provide certain details of the amendments to the compensation scheme. The question was phrased as follows:

4.5(a) *If YES, briefly state what changes were made to the management compensation scheme:*

The purpose of hypothesis 21 was to test the opinion of management on whether, irrespective of changes to statements of generally accepted accounting practice, they perceive themselves as being able to manage accounting earnings so as to maximise their own utility. Question 4.6 was used for this purpose.

4.6 *Management of companies, although complying with statements of generally accepted accounting practice, are able to 'manage' accounting earnings so as to maximise their own utilities.*

The purpose of the final hypothesis in this section, hypothesis 22, was to test the views of management on whether they would lobby against amendments to statements of generally

accepted accounting practice that would have an adverse effect on earnings and remuneration derived from incentive schemes. This hypothesis was tested using question 4.7

- 4.7 *Lobbying will occur for amendments to those statements of generally accepted accounting practice that negatively impact earnings and therefore on remuneration derived from incentive schemes.*

5.6.5.5 Questions dealing with the regulation of accounting

In this section of the questionnaire the attitudes of corporate management on various aspects of the regulation of accounting was sought. All the questions in this section were to be answered by means of the Likert scale described previously.

Hypothesis 23 tested the opinion of respondents on whether accounting standards should continue to be set in the private sector. Question 5.1 was used for this purpose.

- 5.1 *South African accounting standards should be set in the private sector.*

Following on from hypothesis 23, hypothesis 24 sought the opinion of respondents on whether in view of recent corporate collapses, it would be preferable to set accounting standards in the public sector. This hypothesis was tested using question 5.2

- 5.2 *In the light of recent corporate collapses (Masterbond, Supreme Holdings, IGI), the public interest can best be served by having accounting standards set in the public sector.*

The attitude of respondents as to whether the accounting standard-setting process required further regulation was tested with hypothesis 25. Question 5.3 was used for this purpose.

- 5.3 *The accounting standard-setting process as it is currently set up is in need of further regulation.*

Hypothesis 26 was framed to test whether respondents viewed accounting regulation as being necessary to ensure that adequate financial disclosure occurred for companies to compete effectively in the capital markets. Questions 5.4 and 5.5 were developed to test this hypothesis.

- 5.4 *Regulation of accounting is necessary to ensure that financial statements contain adequate disclosure so as to enable companies to compete effectively in the capital market.*

- 5.5 *In the absence of regulation, companies would still disclose sufficient information in financial statements so as to enable them to compete effectively in the market for capital resources.*

5.6.5.6 Questions dealing with the international harmonisation of accounting standards

The penultimate section of the questionnaire dealt with corporate management's attitude to the harmonisation of accounting standards. Question 6.1 sought respondent's views on the harmonisation process. The remainder of the questionnaire required respondents to respond in the form of a Likert scale.

- 6.1 *The harmonisation process would lead to:*
- a. *An improvement in the quality of financial statements in South Africa*
 - b. *The provision of comparable financial information for international use*
 - c. *The elimination of misleading accounting practices*
 - d. *The range of acceptable practices being narrowed*
 - e. *Assisting in the regulation of accounting across national boundaries*
 - f. *Other (please specify)*
- 6.2 *The harmonisation process should not continue because:*
- a. *International accounting standards cannot be amended promptly to take into account changing circumstances in individual countries*
 - b. *The underlying economic, legal, social and other environmental factors in different countries does not justify it*
 - c. *Continued rapid growth of global markets proves harmonisation of accounting standards is not necessary*
 - d. *International accounting bodies are unable to deal with the increasing sophistication of debt/equity markets including items such as interest rate and currency swaps on a timeous basis*
 - e. *Other (please specify)*

Hypothesis 27 was framed to establish whether corporate management viewed International Accounting Standards Committee statements of generally accepted accounting practice inferior to South African developed standards. The hypothesis was tested using question 6.3.

- 6.3 *Statements of generally accepted accounting practice developed by the International Accounting Standards Committee are of an inferior quality to those produced by the South African Institute of Chartered Accountants.*

In the light of the potential difficulties of harmonising international accounting standards, hypothesis 28 was aimed at testing whether respondents believed that collaboration with specific countries would be preferable to attempted global harmonisation. This hypothesis was tested using question 6.4.

- 6.4 *The South African Institute of Chartered Accountants should collaborate with specific countries (such as Australia and New Zealand) when developing statements of generally accepted accounting practice.*

Hypothesis 29 sought to test whether respondents believed that within an African context, any impediments exist that would impede the harmonisation of accounting standards. Questions 6.5 and 6.6 framed as follows were used to test this hypothesis.

- 6.5 *Too much diversity of culture exists in Africa as a result of the colonial past for the adoption of International Accounting Standards to be successful.*
- 6.6 *In an African context, governments of former colonies and other developing nations may view the harmonisation of accounting standards as an infringement of their national sovereignty and, as a result, will not support the harmonisation process.*

The aim of hypothesis 30 was to test the opinion of respondents on whether the adoption of International Standards by the Accounting Practices Board would save resources of those

multinational companies that operate from South Africa. Question 6.7 was used to test this hypothesis.

6.7 The adoption of International Accounting Standards by the Accounting Practices Board will result in a significant saving of resources of multinational companies that operate from South Africa.

The purpose of hypothesis 31 was to establish whether the harmonisation of accounting standards would result in more meaningful and useful information to financial statement users. Question 6.8 was used to test this hypothesis.

6.8 Harmonisation of accounting standards will result in more meaningful information being provided to users of financial statements.

Hypothesis 32 sought respondents views on whether the harmonisation process should include stock exchange listing requirements. Question 6.9 framed as follows was used to test this hypothesis.

6.9 The harmonisation process should include stock exchange listing requirements

The penultimate hypothesis, hypothesis 33 sought the views of respondents on whether corporate management was likely to become more accountable to users of financial statements as a result of the harmonisation process. This hypothesis was tested by question 6.10.

6.10 Corporate management will become more accountable to users of financial statements as a result of the harmonisation process.

The final hypothesis sought to test whether respondents thought the adoption of International Accounting Standards Committee statements of generally accepted accounting practice in South Africa would be likely to result in any modifications to corporate incentive schemes. Question 6.11 was framed to test this hypothesis.

6.11 The adoption of International Accounting Standards is likely to result in modifications to corporate management incentive schemes.

The final question in this section sought respondents views on whether South Africa should continue with the harmonisation programme. In question 6.12 respondents merely had to answer a dichotomous question where the choice was limited to either YES or NO. The question was framed as follows:

6.12 South Africa should continue with the process of harmonising international accounting standards.

5.6.5.7 Background questions

The final section of the questionnaire sought certain background information from the respondents. This related to the qualifications and experience of the respondents. It is suggested that those respondents with higher qualifications and experience would be able to provide insight into the issues covered in the questionnaire.

- 7.1 *What qualifications do you hold?*
a. *Bachelor's degree/diploma*
b. *Honours Bachelor's degree*
c. *Other advanced degree (please specify)*
d. *Professional qualification eg CA (SA) (please specify)*
e. *No post-matric qualification*
- 7.2 *How many years has it been since you obtained your latest qualification?*
a. *1 - 10 years*
b. *11 - 20 years*
c. *More than 20 years*
d. *Not applicable - no qualifications held*

7.3 Gender Male Female

7.4 Age Under 30 31-40 41-50 51-60 61+

A note of thanks to respondents for completing the questionnaire was attached together with a request that should queries arise could the respondent be contacted. Space was provided for the respondents' name and telephone number.

5.6.6 Re-examination of steps 5.6.1 to 5.6.5

Steps 1 to 5 were thoroughly re-examined. This was to ensure that none of the questions posed were confusing, ambiguous or were likely to introduce bias. The re-examination also included the sequence of questions and the suitability of the response categories selected for each question.

5.6.7 Pretesting and revision of the questionnaire

The final stage of the questionnaire construction was the pretesting of the questionnaire. Pretesting is aimed at detecting weaknesses in the questionnaire. Cooper and Emory (1995:317) explain that this procedure "relies on colleagues, surrogates, or actual respondents to evaluate or refine a measuring instrument." Colleagues in the Department of Accountancy, together with a senior colleague in the Department of Business Administration at the University of Durban-Westville were requested to assist in the pretesting of the questionnaire. With the exception of one colleague in the Department of Accountancy and the colleague in the Department of Business Administration, all the remaining pretest subjects were Chartered Accountants with both practical and academic experience in company financial reporting. The remaining colleague in the Department of Accountancy who was not a Chartered Accountant had practical experience

and possessed a postgraduate qualification. The colleague in the Department of Business Administration in addition to possessing an advanced qualification and business experience, has conducted and published extensively in both academic and professional journals on the functioning of the Johannesburg Stock Exchange. The rationale for selecting colleagues to pretest the questionnaire was that they possessed both the academic and professional qualifications it was expected that corporate managers would possess.

The questionnaire to be pretested contained the same wording, format and, with one exception, sequence of the final questionnaire. During the pretest, colleagues were required to:

- identify whether any of the questions were ambiguous,
- ensure that all the questions were understandable,
- indicate whether the questionnaire was too long,
- indicate whether all possible aspects of the research topic were covered, and
- indicate whether the instructions to respondents were clearly understood,

before the questionnaire was distributed to the selected target group.

5.6.7.1 Results of the pretest

All colleagues who pretested the questionnaire completed it in under 15 minutes. As a result of the pretest, one additional question was included in the questionnaire. No other modifications other than those of a grammatical nature were deemed necessary.

5.6.8 Distribution of the questionnaire

The Bureau of Market Research at the University of South Africa distributed the questionnaire to the selected sample. Prior to the posting of the questionnaire, the financial directors were contacted telephonically and requested to participate in the survey. As Oppenheim (1992:104) explains, advance warning of the arrival of the questionnaire has been found to increase the response rate. Postal addresses of the selected companies were obtained from *McGregor's Stock Exchange Investor's Handbook* for the period June 1994 - December 1994, and confirmed with the company when they were initially contacted.

The first batch of questionnaires was posted during November 1995 followed by a reminder on 11 January 1996. Although the process of initially contacting the respondents and the posting of follow-up requests boosts response rates, Bailey (1987:162) believes that a response rate of at least twenty percent less will be achieved by a failure to send follow-up letters.

5.6.8.1 Covering letter

Each questionnaire was accompanied by an appropriate covering letter from Professor JH Martins from the Bureau of Market Research at the University of South Africa. In this letter emphasis was placed on:

- the nature of the research being undertaken,
- the exclusivity of the target group,
- the expected time in which the questionnaire should be completed,
- the confidentiality of the answers,
- the contact telephone number and the name of the person to whom enquiries about the questionnaire could be directed, and
- a promise that a copy of an article based on the research findings would be sent to them as a token of appreciation for their participation.

Although confidentiality was promised, anonymity was not. Had anonymity been promised, the follow-up of non responses would not have been possible. The covering letters were enclosed with the questionnaire. A prepaid reply envelope was also included with the questionnaire.

5.7 CONCLUSION

Chapter five considered aspects of the research methodology and questionnaire design used to determine South African corporate management's attitude to the accounting standard-setting process and international harmonisation. In view of the recent emphasis placed on the international harmonisation of accounting standards, this study seeks to contribute to the overall body of knowledge on the subject, and to establish whether South African corporate management, as preparers of financial information, consider this process to be feasible.

Also dealt with in this chapter was the selection of the target group, the development of the individual hypotheses, the design and administration, and methods used to boost the response rate of the questionnaire. It was considered that the design and methodology used in the administration of the questionnaire was adequate to provide meaningful results.

In the next chapter the preparation and collection of the data for processing and analysis will be discussed. In addition, a description of the statistics used in the presentation and analysis of the data will be provided. Finally, the research findings will be discussed and evaluated.

CHAPTER SIX
PRESENTATION AND ANALYSIS OF RESEARCH FINDINGS

- 6.1 INTRODUCTION**
- 6.2 INDIVIDUAL CASE STUDIES**
- 6.3 RESPONSES TO SURVEY QUESTIONNAIRE**
- 6.4 STATISTICAL ANALYSIS**
- 6.5 TESTING THE HYPOTHESES**
- 6.6 FACTOR ANALYSIS: DISCUSSION AND INTERPRETATION OF RESULTS**
- 6.7 CLUSTER ANALYSIS: DISCUSSION AND INTERPRETATION OF RESULTS**
- 6.8 CRONBACH'S ALPHA COEFFICIENT: DISCUSSION AND INTERPRETATION OF RESULTS**
- 6.9 SUMMARY**

6.1 INTRODUCTION

The preceding chapters outlined the nature and purpose of the study, together with the conceptual and research literature relating to it. Chapter five crystallised the research methodology employed to establish South African corporate management's attitudes to the accounting standard-setting process and international harmonisation.

This chapter presents and analyses the research findings. It commences with six individual case studies that analyse and evaluate the responses of South African corporate managers to the first exposure drafts issued by South African Institute of Chartered Accountants based on International Accounting Standards. These are exposure draft 89, *Revenue*; exposure draft 90, *Property, plant and equipment*; exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policy*; exposure draft 92, *Borrowing costs*; exposure draft 93, *Construction contracts*; and exposure draft 94, *Inventories*.

These case studies are important for two reasons. Firstly, as indicated in chapter three, as part of its Harmonisation and Improvement Project, the South African Institute of Chartered Accountants has commenced with the process of adopting International Accounting Standards Committee accounting statements for exposure in South Africa. Secondly, the responses of corporate management to the exposure drafts will provide an indication of South

African corporate management's attitude to the accounting standard-setting process and international harmonisation, the focus of this thesis.

Thereafter, the number of responses to the survey instrument is evaluated. The preparation and processing of the data is then described. The various statistical techniques together with the reasons for employing these techniques to analyse the data is provided. Finally, forty individual tests of hypotheses are discussed and interpreted.

6.2 INDIVIDUAL CASE STUDIES

Various factors have been identified by Bowen, Lacey and Noreen (1981), Hagerman and Zmijewski (1979) and Watts and Zimmerman (1978) as influencing corporate management's decision to respond to a proposed statement of generally accepted accounting practice. As is illustrated in chapter four, these include: the link between corporate management's remuneration and reported earnings, the costs of regulation, taxation considerations, political costs, information production costs and the existence of monitoring and bonding contracts. If the assumptions made by Bowen *et al.* (1981), Dhaliwal (1980 and 1982), Hagerman and Zmijewski (1979) and Watts and Zimmerman (1978) are correct, it would not be unreasonable to expect that South African corporate managers who oppose the proposed accounting standards based on statements issued by the International Accounting Standards Committee, would ground their opposition on one or more of the above factors.

To examine the validity of this argument, the responses to exposure draft 89, *Revenue*; exposure draft 90, *Property, plant and equipment*; exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policy*; exposure draft 92, *Borrowing costs*; exposure draft 93, *Construction contracts*; and exposure draft 94, *Inventories*; are examined in this section. This examination is aimed at contributing to the creation of an appropriate data base against which theories of accounting choice can be studied.

As the focus of this thesis is South African corporate management's attitude to the accounting standard-setting process and international harmonisation, corporate manager's responses to the above exposure drafts are summarised in the tables that follow. Other responses, including those from audit firms, regional associations, universities and individuals are provided in appendix five.

In the discussion that follows, the following overriding assumption has been made. Where responses are primarily concerned with editorial issues, or make suggestions on items of detail that the respondents consider require clarification, in the absence of any indication to the contrary, it has been assumed that the respondents accept the principles embodied in the proposed statement.

6.2.1 Exposure draft 89, Revenue

As part of the Accounting Practices Committee's Harmonisation and Improvement Project, exposure draft 89 was based on IAS 18 (revised) issued by the International Accounting Standards Committee. The exposure draft differed from its predecessor AC 111, *Revenue*, in a number of ways. Firstly, the definition of income was brought into line with the definition contained in AC 000, *Framework for the preparation and presentation of financial statements*. Secondly, the criteria for the recognition of revenue was changed. Finally, the appendix to the exposure draft provided more comprehensive guidance on specific revenue recognition problems than the appendix to AC 111. Exposure draft 89 did not contain any differences in matters of principle to IAS 18 (revised).

Like most accounting standards, exposure draft 89 is a measurement and disclosure standard. It can also be classified as a statement that impacts on the timing of revenue as it provides guidance to the accounting period in which revenue should be recognised.

The responses to exposure draft 89 are summarised as follows:

Table 6.1: Summary of responses to exposure draft 89, *Revenue*

	Responses	Support statement	Oppose statement
Major companies	11	11	-
Audit firms*	6	5	-
Regional associations of Chartered Accountants	2	2	-
Universities	1	1	-
Individuals	2	2	-
	<u>22</u>	<u>21</u>	<u>-</u>

* The numbering would suggest that one response is missing.

From the responses received to this exposure draft, it is clear that overwhelming support for the proposed statement was obtained from corporate management, audit firms, regional associations, universities and individuals. This exposure draft cannot be considered controversial in any way.

6.2.2.1 Corporate management responses to exposure draft 89, Revenue

This section reviews the responses of South African corporate managers to exposure draft 89, *Revenue*. While there was no opposition to exposure draft 89, a certain degree of lobbying from individual companies is apparent from an examination of the responses. Although this does not have as its primary objective the obtaining of amendments to the proposed statement, it does highlight the peculiarities of individual respondent companies. The companies that responded to

this exposure draft required clarification of certain issues, or suggested amendments to the statement that would maintain their *status quo* as far as financial disclosure and other accounting issues are concerned. It would not be unreasonable to argue that the rationale for lobbying the Accounting Practices Committee to obtain amendments to the proposed statement was to avoid additional information production costs. These costs are those that are incurred when changes in accounting standards occur, or additional disclosure is mandated.

Table 6.2: Responses to exposure draft 89, Revenue

	Support issue of ED 89	Oppose issue of ED 89	Editorial issues	Specific comments
Major Companies				
Anglo-Alpha Limited	Yes		Yes	
Anglovaal Industries Ltd	Yes			Suggests clarification on certain issues
COSAB ¹	Yes			No problems arose from the exposure draft.
Edgars Stores Limited	Yes		Yes	See text
Eskom (Finance Group)	Yes			Suggests clarification on certain issues. Raised questions about revenue recognition under specific circumstances that are expanded on in text.
Gencor Limited	Yes			Questions suggested treatment of dividends and sale of shares. Statement fails to give guidelines as to what should be disclosed as Turnover.
Johannesburg Stock Exchange ²	Yes			No comments on this draft.
Saambou Bank	Yes			No comments on this draft.
Sanlam	Yes		Yes	
South African Breweries Limited	Yes			Suggests clarification on certain practical issues.
Wooltru Limited	Yes		Yes	See text
Yskor Beperk	Yes			
¹ Council of Southern African Bankers				
² Member of the Accounting Practices Board				

An indication of the lobbying that occurred on this exposure draft is illustrated by the response by Bower and Wharton-Hood (1994:letter), on behalf of Edgars Stores Limited.

Paragraph 12 is of fundamental concern and importance to the Edgars Group. Whilst we accept in principle that where an enterprise provides interest free credit to a buyer this may constitute a financing transaction, it is of paramount significance to stress that this will only be applicable in circumstances where the cash price is lower than the interest free credit price. In the Edgars Group, where these two prices are equivalent, the imputed rate of interest is accordingly zero and the arrangement is therefore marketing oriented and not a financing transaction. For those entities where it will be possible to impute a financing element into such transactions, certain practical implementation considerations need to be considered. Such issues focus on the treatment to be applied to revolving credit accounts, subjectively involved in determining the imputed rate and

the difficulty in ascertaining the pure financing element of the difference between the cash price offered and the interest free credit price. It would be naive to assume that all of the difference is a financing element since there are also bad debt collection, maintenance and administrative costs involved in making such facilities available (sic). Whilst it would be correct to recognise the financing element on a time basis in proportion to the balance outstanding, that portion of the revenue which recovers the other incidental costs should be correctly matched with the underlying costs. The need to base such recognition criteria on broad assumptions may well undermine the usefulness of the information so reported.

In examining the criteria for revenue recognition Kok, responding on behalf of Eskom (1994:letter), identifies what he perceives to be a problem with one of the criteria namely "It is probable that economic benefits associated with the transaction will flow to the enterprise." This criteria becomes problematic explains Kok (1994), when a portion of an enterprise's revenue is derived from the supply of goods or services to those customers who are perceived to be an unacceptable credit risk. While under normal circumstances goods and services would not be supplied to such customers, services (such as the provision of electricity) are often supplied as part of a social responsibility programme, even though the possibility exists that amounts involved will not be collected. Kok (1994:letter) expands on the concern of Eskom as follows:

Should such transactions be recognised as revenue? This will depend on the definition of 'economic benefits'. Economic benefit can be interpreted on a micro or macro level and could be more than the cash of cash equivalent received by the enterprise. Does possible future business generated by the decision to supply goods or services to high risk customers qualify as 'economic benefits'?

What if, the goods or services were supplied to a community to maintain their goodwill and by doing so ensuring that the entities assets in the community's jurisdiction are not maliciously damaged? Would the future use of the assets qualify as 'economic benefit' in return for free services and/or goods?

Support for the international harmonisation of accounting standards is provided by both The South African Breweries Limited and Wooltru Limited. Eksteen responding on behalf of The South African Breweries Limited (1994:letter) explains that: "The need to upgrade the statement on Revenue is recognised and The South African Breweries Group supports the development in order to align the existing statement with the international standard." Lavies, responding on behalf of Wooltru Limited (1994: letter) does however, provide the following caveat:

I approve, in principle, our attempt to conform to International Accounting Standards. However, I doubt that all these standards are the most appropriate and wonder what we will do if there is significant local opinion for a different treatment of some standards. Aside from general interest in this question, it will also help me to decide whether there is any value in commenting on exposure drafts if the commentary is merely going to be discarded.

The relatively small number of responses to exposure draft 89 indicates that no significant lobbying of the Accounting Practices Committee occurred.

In spite of the comments and suggestions made by Edgars Stores Limited, Eskom (Finance Group), Gencor Limited and Wooltru Limited, no changes other than those of a minor editorial nature, were made to the exposure draft when statement AC 111 (revised) was issued by the Accounting Practices Board.

6.2.2 Exposure draft 90, Property, plant and equipment

Exposure draft 90, *Property, plant and equipment* was based on the IAS 16 (revised) issued by the International Accounting Standards Committee. This exposure draft differed from its predecessors AC 106, *Depreciation accounting*, and AC 202, *Accounting for fixed asset revaluations*, in two ways. Firstly, a change in the method of depreciation resulting from a change in economic benefits, would be accounted for as a change in accounting estimate. Previously all changes in method were treated as changes in accounting policies. Secondly, the proposed statement contains comprehensive disclosure requirements. Exposure draft 90 differs from IAS 16 (revised) in that the proposed South African statement prescribes the accounting treatment for realised revaluation surpluses, while IAS 16 (revised) provides guidance in this area. Revaluation surpluses in equity are required to be transferred directly to retained earnings when realised, while IAS 16 (revised) merely states that this transfer may take place.

From an accounting perspective, the exposure draft can be viewed as both a measurement and disclosure statement. Under certain circumstances the application of the statement may result in income being deferred from one accounting period to another.

The responses to exposure draft 90 are summarised as follows:

Table 6.3: Summary of responses to exposure draft 90, *Property, plant and equipment*

	Responses	Support statement	Oppose statement
Major companies	13	11	2
Audit firms	8	8	-
Regional associations of Chartered Accountants	2	2	-
Universities	2	2	-
Individuals	1	1	-
	<u>26</u>	<u>24</u>	<u>2</u>

From the responses received by the Accounting Practices Committee, South African corporate management did, in the main, favour the issue of a statement of generally accepted accounting

practice based on the exposure draft. However as is illustrated, concern was expressed with the extensive disclosure requirements.

6.2.2.1 Corporate management responses to exposure draft 90, Property, plant and equipment

This section reviews the responses of South African corporate management to exposure draft 90, *Property, plant and equipment*. It would not be unreasonable to argue in the absence of any indication to the contrary, that the basis for lobbying against the extensive disclosure requirements contained in this exposure draft, is the increase in information production costs that will be incurred in complying with the requirements to the proposed statement, which increases the potential for additional political costs. A summary of these responses are contained in table 6.4 below.

In lobbying against the increased disclosure requirements of the proposed statement, Taylor (1994:letter) on behalf of Anglovaal Industries Limited, questions the need for such comprehensive disclosure as follows: "We obviously have no desire (sic) not to follow international requirements in this connection, but must question the benefit to shareholders of disclosing full details of movements on fixed assets, and detailing the depreciation rates adopted by a substantial group with diverse interests (e.g. stating "plant and machinery - 10% - 33½" is probably not that meaningful?)."

While supporting the proposed statement, Bower and Wharton-Hood (1994:letter) on behalf of Edgars Stores Limited, express two main concerns. The first relates to what they call "the continued reference to the dichotomy between non distributable reserves and distributable reserves" which they argue, should be restricted. Bower and Wharton-Hood (1994:letter) explain that it is time accounting standards incorporated an enlightened approach towards the distributions made from reserves "since accounting conventions are not consistent with the underlying legal principles, and ultimately distributability (sic) is dependent on the availability of cash resources together with shareholder sanction." The second concern was the disclosure requirements contained in paragraphs 63 and 64. While these were considered by Bower and Wharton-Hood (1994:letter) to be desirable, they argue that the requirements cannot be applied on a group basis where a significant number of diverse operations exist. They further argue that "In addition the reconciliation required is superfluous as the detail required for such a reconciliation can already be ascertained from the income statement, balance sheet and cash flow information provided."

Table 6.4: Responses of major companies to exposure draft 90, *Property, plant and equipment*

	Support issue of ED 90	Oppose issue of ED 90	Editorial issues	Specific comments
Major Companies				
Anglo-Alpha Limited	Yes		Yes	Agree with the decision to allow property, plant and equipment to be valued at either cost or at a revalued amount. In addition suggests clarification of certain issues.
Anglovaal Industries Ltd	Yes			Suggests clarification of certain issues.
Consol	Yes			Clarification of certain issues suggested. In particular, suggests that requirements regarding the frequency and method of valuation are not definitive and leaves too much discretion to allow for consistency.
COSAB ¹	Yes			The committee did not have any problems or comments on exposure draft 90.
Edgars Stores Limited	Yes			Support statement subject to suggestions and recommendations outlined in letter being incorporated into standard. Problems of investment properties can be dealt with in this statement. See text.
Eskom (Finance Group)	Yes			The Accounting Practices Committee's Harmonisation and Improvement Project is supported. In general the definitions in exposure draft 90 are more comprehensive than in AC 106. This will improve financial statement understandability. The comprehensive disclosure requirements are supported.
Gencor Limited	Yes			Suggests clarification on certain issues.
Johannesburg Stock Exchange ²	Yes			No comments on this draft.
Saambou Bank	Yes		Yes	Suggests clarification of certain issues. Die gevoel is dat die vereiste vir beoordeling van die verbetering van toekomstige ekonomiese voordele as maatstaf vir kapitalisering al dan nie weer net tot gevolg sal he dat die beleid gemanipuleer sal word soos wat verkies word.
Sanlam	Yes			Suggests clarification on certain issues.
SA Breweries Ltd	Yes			The proposed statement is well structured and that enhances the effectiveness of imposing accounting practice. Expresses concern on the clarity of the scope of the statement. Explains that South Africa is not comparable to first world countries like the European countries. The level of education, in general, is much lower and statements therefore, need to be explicitly clear and understandable especially as the intention exists of giving legal backing to accounting standards. Overall exposure draft is a noticeable improvement on the previous statement.
Wooltru Limited		Yes	Yes	Details on specific issues provided. See text.
Yskor Beperk		Yes		Initially responded in favour of draft. See text.

¹ Council of Southern African Bankers
² Member of the Accounting Practices Board

Saayman (1994:letter) responding on behalf of Sanlam, also expressed concern on the disclosure requirement. "n Rekonsiliasie tussen die drabedrag aan die begin en die eiende word deur .63 vereis. Behalwe dat dit hier per tipe bate gegee moet word, word die meeste van hierdie

inligting reeds in die finansiële jaarstate, of in die inkomstestaat of in die kontantvloeiastaat, verskaf. Is dit werklik nodig dat hierdie verdere detailinligting verskaf word?"

Eksten (1994:letter) on behalf of The South African Breweries Limited notes the comprehensive disclosure requirements. In explaining that while The South African Breweries Group generally does not consider this to be a problem, reason must prevail. Eksteen (1994:letter) explains this as follows:

In the case of reporting the consolidated results of a large diversified group, the requirement that depreciation methods and depreciation rates or useful lives be given for each class of asset would be completely impractical. There is every likelihood that numerous permutations may apply for such a group and we strongly reject the requirement for this disclosure as being impractical to prepare and, quite frankly, meaningless to an understanding of the results of such a group. In circumstances like this the statement must allow for the exclusion of such impractical disclosure.

In a comprehensive response, Lavies on behalf of Wooltru Limited (1994:letter), commences with the belief that fundamental shortcomings exist with [South African] accounting standards. He argues that the historical cost basis as the basic platform for all accounting standards is seriously flawed. This is occasionally acknowledged by allowing (and, for trading investments, requiring) revaluations. While acknowledging that "up-to-date information about assets and liabilities must (by definition) be better than historical information," Lavies (1994:letter) queries why accounting standards discourage the disclosure and impact on company performance of "up-to-date" information except when this information represents bad news.

It is for these reasons, argues Lavies (1994:letter), that a fundamental paradigm shift is required by the accounting profession. This could be achieved by debating the following issues:

- What is the purpose of financial statements?
- Who are financial statement prepared for?
- What is good information to interest groups?
- How should this information be disclosed?
- What safeguards are needed to ensure the integrity of the information disclosed in financial statement?

A possible reason for the accounting profession's reluctance to change, surmises Lavies (1994:letter), is their concern with the integrity of information contained in financial statements. For example, the cost of an item is factual and cannot be questioned. In explaining why the accounting profession's narrow focus is insufficient and in urgent need of what he terms a fundamental paradigm shift, Lavies (1994:letter) explains that "at a time when the image of the

accounting profession is at risk (questionable audit competence and dubious accounting treatments being largely to blame) it is important that we make creative efforts to re-establish our professional stature. Breaking new ground and producing more relevant information must surely be a help." This could be achieved, states Lavies (1994:letter), by introducing value accounting as opposed to historical cost accounting and a complete review of the structure and content of the income statement.

Although not specifically indicating that Wooltru Limited disagrees with the issue of a statement of generally accepted accounting practice based on exposure draft 90, the following comments by Lavies (1994:letter) provide an indication why the proposed standard could not be supported:

Where such a one sided picture is painted, one must question the value of the income statement towards understanding both the current performance of the company, and the predictability of that performance into the future.

Despite the benefits of the information, companies will be reluctant to revalue assets, except where these assets are not depreciated. And even where the depreciation is not significant, as with land and buildings, companies will not want to revalue now that 'capital' profits must be shown 'above the line' rather than extraordinary.

What companies will tend to do instead is to note the value of assets, without formally revaluing them. This will considerably dilute the revaluation information in that the balance sheet will not reflect the revaluation and the income statement will not show the ongoing cost of trading activities. Alternatively companies may choose not to revalue at all as the cost of revaluation may no longer be justified.

Again we have selective treatment of the bad news but no ability to offset this with on the good news (sic) (Lavies 1994:letter).

Lavies (1994:letter) also expressed concern with the extensive disclosure requirements. While acknowledging information that enables a user of financial statements to appreciate the basis upon which assets are being depreciated is an advance, much of the additional information appears to be of doubtful value:

Why is it necessary to show the carrying amounts and accumulated depreciation at the beginning of the period? There is now a compulsion to reconcile the figures (by each class of asset). Comments on the suggested components of the reconciliation are as follows:

- *additions and disposals are contained in the cash flow statement.*
- *why should assets acquired generally be distinguished from those acquired with a business (or does a business combination have some other special meaning).*
- *revaluation adjustments are generally shown in movements to the reserves.*
- *adjustments arising from paragraphs .54 and .57, can be shown separately in the income statement (or notes thereto) if material.*

- *depreciation is shown in the income statement (or notes thereto).*
- *exchange differences are not unique to fixed assets. Overall translation differences are shown in the income statement or separately elsewhere.*

While initially commenting favourably on this exposure draft, the preparation of Yskor's annual financial statements on the basis of the proposed statement provided Geyer (1994:letter) with an illustration of the practical difficulties that would be experienced, particularly in complying with the disclosure requirements. The requirements to comply with the reduction in the carrying amount and the amounts written back subsequent to a write-down or write-off in the reconciliation was one of the disclosure requirements that caused problems. Geyer (1994:letter) expanded on the problem as follows: "we have difficulty in complying with the disclosure which requires whether or not, in determining the recoverable amount of items of property, plant and equipment, expected future cash flows have been discounted to their present value."

An examination of the responses to exposure draft 90 suggests that while corporate management were in the main satisfied with the issue of a statement of generally accepted accounting practice based on the exposure draft, they opposed the extensive disclosure requirements. It would not be unreasonable to assume that compliance with the proposed accounting standard will result in the firm incurring increased information production costs. In addition, this increased disclosure may also result in an increase in political costs. As is stated in chapter four, political costs occur as a direct result of the reactions of various parties, including unions, government regulators, revenue authorities, and the public, to companies accounting disclosure. From a South African perspective, one of the political costs listed companies seek to avoid is the increasing wage demands from unions that are becoming more sophisticated in the interpretation of information contained in financial statements.

Concern expressed by Lavies (1994:letter) and Bower and Wharton-Hood (1994:letter), as well as a number of the international auditing firms (appendix five), with the lack of guidance in the exposure draft with accounting for investment properties, encouraged the Accounting Practices Committee to issue AC 123 with an appendix dealing with this topic. However, in spite of opposition to the disclosure requirements referred to above, no changes other than those of a minor editorial nature, were made to the exposure draft when AC 123 was finalised.

6.2.3 Exposure draft 91, Net profit or loss for the period, fundamental errors and changes in accounting policy

Exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policies*, was based on IAS 8 (revised) issued by the International Accounting Standards Committee. This exposure draft differed from its predecessor AC 103 in a number of ways. The

majority of items previously classified as extraordinary would be classified as normal operating income or expense items. Discontinuation profits or losses would be classified as normal operating items, the treatment of abnormal items was improved, and improved disclosure was required. Changes in the disclosure of prior year adjustments was also made. The alternative treatments for the correction of a fundamental error and the effects of a change in accounting policy permitted under IAS 8 (revised) were not incorporated into exposure draft 91.

From an accounting perspective, the effect of implementing exposure draft 91 effectively eliminates the subjective classification companies could make when disclosing 'extraordinary' and 'abnormal' items. The majority of items previously classified as extraordinary would now be classified as normal operating items, with the result that both earnings and earnings per share figures, would be affected.

The responses to exposure draft 91 are summarised as follows:

Table 6.5: Summary of responses to exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policy*

	Responses	Support statement	Oppose statement
Major companies	14	8	6
Audit firms	8	8	-
Regional associations of Chartered Accountants	2	2	-
Universities	3	3	-
Individuals	2	1	1
	<u>29</u>	<u>22</u>	<u>7</u>

6.2.3.1 Corporate management responses to exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policy*

This section reviews the responses of South African corporate management to exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policy*. As is apparent from table 6.5, exposure draft 91 did not obtain universal support from South African corporate managers. Although their comments are reviewed in detail below, corporate managers expressed concern that the introduction of an accounting standard based on exposure draft 91, would impact negatively on reported earnings and the earnings per share statistic. As is illustrated in appendix five, auditors supported the proposed statement, presumably as it narrowed the definition of extraordinary items which, it is argued, would limit their exposure to charges that they were subject to undue influence from corporate management if an item that should have been classified as abnormal was treated as extraordinary in the financial statements.

Table 6.6: Responses of major companies to exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policy*

	Support issue of ED 91	Oppose issue of ED 91	Editorial issues	Specific comments
Major Companies				
Alusaf Limited	Yes			Main concern is exposure draft 91 cannot be looked at in isolation. Statement on earnings per share also needs revision. Support the reporting of maintainable earnings per share. However what is to stop companies manipulating the figure it is based on.
Anglo-Alpha Limited	Yes			Discussed further in text.
Anglovaal Industries Ltd	Yes			Agree with the objective of the statement. Discussed further in text.
CG Smith Limited		Yes		Discussed in text.
Chamber of Mines of SA ¹	Yes			The concept of disclosing all items of income and expense through the income statement is supported.
COSAB ²	Yes			The treatment of many items classified as extraordinary in AC 103 as normal operating income and expense is welcomed.
Consol Limited		Yes		This exposure draft is of concern as it appears to move away from the premise that the earnings as disclosed should be that for the period under review, a fundamental requirement for analysts. If this definition is clear and unambiguous the responsibility and discretion is placed on management to correctly account for earnings. Discussed further in text.
Edgars Stores Limited		Yes		The Accounting Practices Committee's Harmonisation and Improvement Project is supported. The narrowing of the definition of an extraordinary item to ensure that extraordinary items can no longer be used to manipulate earnings per share is welcomed.
Eskom (Finance Group)	Yes			The definition of extraordinary items and the treatment of transactions "not ordinary" in the business of the company will continue to be a grey area unless more specifically defined. The draft goes a long way to achieve this.
Gencor Limited	Yes			We are opposed to the proposed disclosure of items presently regarded as extraordinary, as part of a company's earnings. We firmly believe this will result in distorted comparisons between different accounting periods and companies.
ICS Holdings Limited		Yes		In general we are in agreement with the above exposure draft.
Iskor Limited	Yes			The Exchange's Accepted Accounting sub-committee has no further comment to make on this draft.
Johannesburg Stock Exchange ²	Yes			Discussed in text.
Tiger Oats Limited		Yes		Discussed in text.
Wooltru Limited		Yes		Discussed in text.

¹ Member of the Accounting Practices Board
² Council of Southern African Bankers

While supporting the narrowing of the definition of an extraordinary item, Soma (1994:letter) responding on behalf of Anglo-Alpha Limited, considered the proposed definition to be too restrictive. He rationalises his view as follows:

Inclusion of profits and losses arising from transactions which are not typical of the ordinary activities, will have a major impact in the 'earnings per share' calculation which is widely used to assess a company's current performance, and to compare it with its performance with prior periods. This disclosure will add to further complications in that the user will now have to analyse disclosures to carefully ascertain what portion of earnings relate to 'ordinary' trading activities. The earnings per share calculation is commonly used in share valuations and using an earnings per share calculation which is not sustainable will distort share valuations.

Soma (1994:letter) believes that the misuse of the extraordinary items definition contained in AC 103 could be monitored and controlled by providing Accounting Practices Board accounting pronouncements with legal backing and the implementation of the proposed Review Panel to monitor compliance with accounting standards.

While generally agreeing with the objective of the proposed statement, Taylor (1994:letter), responding on behalf of Anglovaal Industries Limited, expressed concern that extraordinary items in the proposed statement were restricted only to the expropriation of assets and natural disasters. Other items which could be considered outside the control of management and thus qualify as an extraordinary item suggests Taylor (1994:letter), would be punitive settlements imposed by central government and, in a local context, losses as a result of riots or unrest.

Vaux (1994:letter) responding on behalf of CG Smith Limited, explains that the primary purpose of preparing financial statements is to enable users of these statements to make informed decisions. Exposure draft 91, argues Vaux (1994:letter), seeks to achieve this "by limiting the items that may be treated as extraordinary, and written off below the line, to natural disasters and the expropriation of assets." A statement of generally accepted accounting practice based on exposure draft 91 would not only "fail to achieve its stated objective but, more importantly, it would prejudice financial statements by rendering meaningless one of the primary financial indicators, namely earnings per share."

Vaux (1994:letter) explains that for consistency to be achieved in the calculation of earnings, the accounting profession should seek to limit the alternative methods currently used in the accounting treatment of contentious items such as:

- trademarks and brand names,
- goodwill,
- disposals of businesses,
- discontinued operations,
- disposals of major fixed assets,
- taxation (e.g. STC, deferred taxation), and
- restructuring costs.

As earnings per share is one of the primary financial indicators used with regard to listed companies and is often used as a surrogate for maintainable earnings, eliminating extraordinary items may result in "gross distortions" in earnings per share making this important financial indicator incomparable and inconsistent. Vaux provides the following support for his views:

For example, an expanding group making acquisitions which writes off goodwill in full in the year of acquisition may appear substantially less attractive than a static one merely by virtue of this goodwill write off. On the other side of the coin a contracting group which is being forced into selling off businesses may report superior trading profits through the inclusion of large capital gains on these disposals. Clearly neither of these practices is desirable (Vaux 1994:letter).

Vaux (1994:letter) concludes by arguing that: "Whilst the objectives of the exposure draft are laudable, we cannot support the recommendation which effectively eliminates the use of extraordinary items. Furthermore we do not believe that this process will achieve the objective of consistency in financial reporting" (Vaux 1994:letter).

Wharton-Hood and Bower (1994:letter) on behalf of Edgars Stores Limited, welcomed exposure draft 91 as a return to what they call "the ongoing attempt to reconcile the debate between the all inclusive and current operating approaches to the presentation of an enterprise's net profit and loss statement." They argue that the importance of the reported profit or loss per share statistic make it essential that "the inter-temporal consistency of reported information is preserved together with the elimination of opportunities for manipulation achieved by the exploitation of ambiguities or abuse of sanctioned alternatives to conceptually acceptable benchmark treatments" (Wharton-Hood & Bower 1994:letter). However Wharton-Hood and Bower (1994:letter) expressed the following major concerns with the statement. Firstly, the disclosure of certain items as abnormal in terms of the exposure draft that would have previously been classified as extraordinary under AC 103. They argue that:

Whilst we support the consequent inclusion and separate disclosure of more items in the reported profit or loss for the period, the severely restrictive definition will lead to a distortion in the performance trends and compromise the inter-temporal comparability of the reported profit or loss per share statistic. Some leeway to allow for the reporting of consistently comparable information will have to be provided.

Secondly, the inclusion of discontinued operations as part of ordinary activities of the business which, they argue, is extraordinary. Wharton-Hood and Bower (1994:letter) conclude their response by expressing the following concerns:

It would seem that accounting for extraordinary items has now turned a complete circle. Previous standards have been criticised for their latitude both in definition and applicability which led to widespread abuse through the manipulation of the reported profit or loss per share statistic. ED 91 has now been criticised for its restrictive definition of extraordinary items that almost precludes any business transaction from being reported as

such. The ultimate solution would appear to be the redirection of attention away from the abused and misused profit or loss per share statistic and towards the presentation of recurring and non-recurring earnings and cash flow statistics. This would harmonise external reporting with the focus applied by financial management and enhance the quality of reported information.

Pritchard (1994:letter) on behalf of ICS Holdings Limited, firmly opposed exposure draft 91 for the following reasons:

- The review of previous years' results will entail lengthy explanations for each year in order to make a meaningful comparison of year by year earnings.
- Profits or losses on the sales of properties to be included in earnings will result in manipulation of earnings as a result of the timing of the sale of properties.
- Premiums paid or discounts received on the acquisition of a business should not be included in the result of normal trading operations. Incidental costs written off on the acquisition of a business is not a result of trading activities as the company's business is not the buying and selling of businesses.
- Costs in respect of discontinued operations should also be excluded from normal trading activities. These losses are normally highly incidental and by distorting normal trading profit with such losses, the true trading capabilities of a company will not be reflected in the financial statements.

Pritchard (1994:letter) further argues that exposure draft 91 will result in less comparability and reliance on earnings per share figures due to the inclusion of items in the calculation which are not typical of normal trading activities. In providing an example of the extent of the differences that the introduction of exposure draft 91 will have on a set of published financial statements,

Pritchard (1994:letter) uses the following illustration:

If the 1993 Annual Financial Statements of ICS Holdings Ltd are taken as an example, none of the items disclosed as extraordinary will, according to ED91, be classified as extraordinary. This would result in a loss per share of 4.7 cents (actual 1993 EPS = 164.c). This would give an incorrect reflection of the trading activities for the year. Given the present JSE quoted price of 2300 cents/share, the price earnings ratio would become a meaningless figure. Any comparison of the ICS results with previous years, or with other companies, would require major adjustments to the disclosed EPS, which is contrary to the statements (sic) objective of having a standardised basis of comparison.

Holmes (1994:letter) on behalf of Tiger Oats Limited (a member of the CG Smith Group), explains that the treatment of goodwill and trademarks and discontinued operations impact on the calculation of earnings per share. Using the policy of Tiger Oats Limited as an example, Holmes (1994:letter) explains that the accounting policy, as it is with many leading groups, is to write-off goodwill and trademarks in the year of acquisition for the purposes of consolidation as extraordinary:

The amounts of goodwill that have been written-off from year to year have varied considerably but in our case from R3 million to R83 million over the last ten years. The size of acquisitions has varied greatly and the calculations of EPS based on ED 91 classification of extraordinary items would of necessity include these write-offs causing large fluctuations in EPS figures, which would obviously be misleading and contrary to AC 100 (fair presentation) (Holmes 1994:letter).

While acknowledging that many companies stretch the interpretation of 'a significant identifiable part of an enterprise' in determining the level of discontinued operations, in accordance with AC 117, Holmes (1994:letter) argues that the discontinuance of a significant part of a business other than by expropriation or natural disaster as permitted by exposure draft 91, would significantly impact on the calculation of earnings per share.

In Holmes's opinion (1994:letter), the proposed statement would prejudice users of financial statement by rendering meaningless one of the primary financial statement indicators; earnings per share. "Price earnings ratios and earnings yields are derived directly from EPS which is often used as a surrogate for maintainable earnings." The CG Smith Group influence can be clearly identified when comparing the response by Vaux (1994:letter) who in a similar vein states "Price earnings ratios and earnings yields are further indicators derived directly therefrom [earnings per share]. It should also be borne in mind that earnings per share (EPS) is often used as a surrogate for maintainable earnings" (Vaux 1994:letter).

Holmes (1994:letter) concludes as follows: "In conclusion we cannot support a recommendation which effectively eliminates the use of extraordinary items. It is our view that the proposed statement is unlikely to achieve the objective of consistency in financial reporting."

In once again calling for a complete review of the structure and content of the income statement, Lavies (1994:letter) on behalf of Wooltru Limited, advocates that this statement should reconcile opening and closing shareholder funds. This would be achieved by the income statement containing a number of layers including:

- normal trading (with separate information being provided for acquisitions and disposals).
- exceptional (previously known as "abnormal").
- extraordinary (what we used to call "extraordinary").
- other gains and losses (including property revaluation, goodwill write-offs, exchange gains and losses etc.).
- other (which would even include the effect of new share issues).

Other concerns expressed by Lavies (1994:letter) include the level [in the income statement] at which earnings per share is required to be calculated. The alternative proposed by Lavies (1994:letter) is that earnings per share "be calculated at each layer in each statement which contributes to the final reconciliation of opening and closing shareholders funds."

While approving in principle of [the Accounting Practices Committee's] attempt to conform to International Accounting Standards, Lavies (1994:letter) expressed concern that many international accounting standards fail to present the most meaningful information to the companies' various stockholders. Lavies (1994:letter) also questioned what the role of the Accounting Practices Committee will be should it decide that International Accounting Standards are not appropriate for South African circumstances. In addition, Lavies (1994:letter) asks what steps are being taken to influence the International Accounting Standards Committee to amend their statements, and what the prospect of success is likely to be.

Lavies (1994:letter) concluded by stating that he would only be able to support the change in the definition of an extraordinary item if, as previously mentioned, the income statement was layered and items previously treated as extraordinary are located in an appropriate layer, and the earnings per share calculation was performed only after reporting those items previously treated as extraordinary.

From an examination of corporate management responses to exposure draft 91, it is clear that significant opposition to the proposed standard existed. As with exposure draft 90, it would not be unreasonable to assume that compliance with the proposed accounting standard will result in the firm incurring increased information production costs. In addition, this increased disclosure may also result in an increase in political costs. Political costs occur as a direct result of the reactions of various parties, including unions, government regulators, revenue authorities, and the public, to companies' accounting disclosure.

In spite of the concerns expressed by Anglo-Alpha Limited, Anglovaal Industries Limited, Consol Limited, Edgars Stores Limited, ICS Holdings Limited, Tiger Oats Limited and Wooltru Limited, no changes, other than those of a minor editorial nature, were made to the exposure draft when AC 103 was finalised.

6.2.4 Exposure draft 92, Borrowing costs

An accounting standard that requires either the expensing or capitalisation of borrowing costs, effects the timing of accounting profits. Should borrowing costs on the construction of a depreciable asset be capitalised, the effect of this is that accounting profits can, under certain circumstances, be deferred over the life of the asset.

Exposure draft 92 differed from its predecessor AC 114, *Borrowing costs*, in two material respects. Firstly, the exposure draft is silent on the period of time that must elapse before capitalisation of borrowing costs can occur. AC 114 prescribed one year as a substantial period of time before capitalisation can occur. Secondly, AC 114 required interest received on monies borrowed specifically for a project temporarily invested, pending use, to be deducted from

interest paid only for the purposes of arriving at the limit to be capitalised. The exposure draft requires this interest received to be deducted when calculating the amount of interest to be capitalised.

The issue of exposure draft 92, *Borrowing costs*, by the Accounting Practices Committee requiring the mandatory capitalisation of borrowing costs (exposure draft 92 para. .01), must, in the light of the requirements of E32, *Comparability of financial statements*, and IAS 23 (revised), issued by the International Accounting Standards Committee, be considered anomalous. As part of the International Accounting Standards Committee's policy on harmonisation, the preferred treatment of borrowing costs was that they "be recognised as an expense in the income statement in the period in which they are incurred" (E32 para. 188).

Exposure draft 92 differed from IAS 23 (revised) in that while IAS 23 (revised) required borrowing costs to be expensed in the period they were incurred and permitted as an alternative treatment the capitalisation of borrowing costs, exposure draft 92 proposed the mandatory capitalisation of borrowing costs. No alternative treatment was permitted.

From an accounting perspective, the effect of capitalising borrowing costs would, in the short term, increase assets, and increase profits. Although this would have the effect of increasing the return on equity and return on assets, the effect on the return on assets ratio is likely to be negligible.

The responses to exposure draft 92 are summarised as follows:

Table 6.7: Summary of responses to exposure draft 92, *Borrowing costs*

	Responses	Support statement	Oppose statement
Major companies	9	2	7
Audit firms	8	5	3
Regional associations of Chartered Accountants	1	1	-
Universities	3	3	-
Individuals	1	1	-
	<u>22</u>	<u>12</u>	<u>10</u>

6.2.4.1 Corporate management responses to exposure draft 92, *Borrowing costs*

In this section, the responses of South African corporate managers to exposure draft 92, *Borrowing costs*, is examined. From table 6.7, it is apparent that exposure draft 92 did not find universal favour with South African corporate management. With the exception of The Chamber of Mines of South African and the Johannesburg Stock Exchange (both members of the

Accounting Practices Board) other respondents were unanimous in rejecting the issue of an accounting standard based on the exposure draft.

As is discussed in chapter four, findings by Hagerman and Zmijewski (1979), Dhaliwal (1980 and 1982), Kelly (1982 and 1985), and Healy, Kang and Palepu (1987), would suggest that corporate management would lobby in favour of, or support accounting standards that increased income or improve return on asset and return on equity ratios. The comments of South African corporate management to the responses of exposure draft 92, do not support this contention.

Individual responses by South African corporate managers and their lobbying against the accounting treatment of borrowing costs contained in exposure draft 92 is provided in table 6.8 below.

Table 6.8: Responses of major companies to exposure draft 92, *Borrowing costs*

	Support issue of ED 92	Oppose issue of ED 92	Editorial issues	Specific comments
Major Companies				
Anglovaal Industries Limited		Yes		Whilst acknowledging the obvious desire to ensure the comparability of the financial statements of enterprises, we still have some considerable difficulty in understanding why in this instance the South African Institute chooses to differ from the IAS 23 (revised). Discussed further in text.
Chamber of Mines of SA ¹	Yes			The Chamber supports the automatic capitalisation of borrowing costs provided the specific requirements are met. In addition, the definition of buying costs should be extended to include hedging costs, including premiums on forward exchange contracts and interest rate and currency options.
Consol Limited		Yes		We are concerned that the determination of borrowing costs to be capitalised are extremely difficult unless they are obvious, and under these circumstances would question the consistency of the approach.
Edgars Stores Limited		Yes		The alternative route followed in IAS23 is more logical and supportable and accordingly exposure draft 92 should provide the alternative provided in IAS23.
Eskom (Finance Group)	Yes			Discussed further in text.
Johannesburg Stock Exchange ¹	Yes			The sub-committee has no comment to make on this draft.
Rainbow Farms (Pty) Ltd	Yes			Requires further clarification on a particular issue.
Standard Merchant Bank		Yes		It is recommended that no amendment be requested to the Act, as such an amendment would prejudice taxpayers purely to achieve tax and accounting harmonisation. Discussed further in text.
Wooltru Limited		Yes		The purpose of exposure draft 92 is not clear. Discussed further in text.

¹ Member of the Accounting Practices Board

While acknowledging the desire to ensure direct comparability of financial statements of different enterprises, Taylor (1994:letter), on behalf of Anglovaal Industries Limited, expressed surprise that exposure draft 92 differed from IAS 23. No circumstances unique to the South African commercial environment exist that preclude the adoption of IAS 23. Taylor (1994:letter) argued that the only prudent approach to the accounting treatment of interest is to expense all costs when incurred. It is this alternative that should be the one permitted in the revised statement.

In addition to the accounting treatment of interest costs, Taylor (1994:letter) questioned whether an accounting treatment exists for the loss of interest income in those circumstances where an entity having available cash resources embarks on an asset investment. Taylor (1994:letter) rationalised this request as follows: "entities that borrow and capitalise interest in accordance with the ED could 'benefit', whilst entities that utilise their own funds for such an acquisition could 'suffer'". Taylor (1994:letter) did, however, recognise the difficulties inherent in such an accounting issue.

In responding on behalf of Consol Limited, Forgan (1994:letter) expressed concern that the proposed standard made the determination of those borrowing costs to be capitalised difficult, unless they were obvious. As a result, the consistency of the exposure draft 92 approach is questioned. In addition, Forgan (1994:letter) expressed surprise that the proposed South African standard did not conform to the international standard IAS 23 (revised), and strongly urged a similar approach to be adopted in South Africa.

Wharton-Hood and Bower (1994:letter), in responding on behalf of Edgars Stores Limited, expressed three major concerns with the proposed statement. Firstly, they argued that the requirement for the capitalisation of borrowing costs and the expensing alternative when the capitalisation criteria were not met, to be too prescriptive. They argued that:

Whilst compulsory capitalisation can be rationalised in terms of the matching concept, it may not necessarily be prudent in all circumstances and leeway should therefore be allowed. An overriding factor in determining the propriety of capitalisation should be the specific circumstances of the entity and the policy adopted. The alternative route followed in IAS23 is more logical and supportable and accordingly ED92 should provide the alternative provided in IAS23. Once a policy to capitalise, or not, has been adopted it should then be applied consistently (Wharton-Hood & Bower 1994:letter).

The second difficulty that Wharton-Hood and Bower (1994:letter) found was the paragraph .05 (e) requirement that borrowing costs include "exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs." They argue that because South African specific circumstances are different to other international markets, latitude should be given in determining the extent to which exchange differences could be regarded as an adjustment to interest costs. Wharton-Hood and Bower (1994:letter) support this

contention by arguing: "With significant shifts in basis and political risk, which arise frequently, this point should be carefully explained to only allow the capitalisation of exchange differences to the extent that they equal the equivalent cost of forward cover on the affected foreign currency borrowings for the specific period."

The final difficulty that Wharton-Hood and Bower (1994:letter) experienced with the proposed accounting standard related to the impact of equity funding on qualifying projects or those assets where the associated cannot be capitalised and "the sensitivity of interest deductibility on capitalised borrowing costs from a fiscal point of view." They argued that this taxation issue, which is particularly important when considering capitalisation as the prescriptive treatment to be followed in exposure draft 92 with the expensing of interest as an allowed secondary alternative, may jeopardise the future deductibility for taxation purposes of the interest.

While supporting the Accounting Practices Committee's Harmonisation and Improvement Project, Hobbs (1994:letter), responding on behalf of Eskom, suggests that exposure draft 92 was compiled with little cognisance being taken of this project. Hobbs (1994:letter) provides two points to substantiate his argument. Firstly, the benchmark treatment in IAS23 is the expensing of borrowing costs while the alternative treatment is capitalisation. Exposure draft 92 requires the capitalisation of borrowing costs. Secondly, while the capitalisation of borrowing costs is in accordance with the matching concept, the adoption of exposure draft 92 in its present format, would contradict AC 000 *Framework for the preparation and presentation of financial statements*. In supporting his second argument Hobbs (1994:letter) explains that:

[according to AC 000] financial statements are compiled making use of the 'asset and liability' view. This means that assets and liabilities are treated as independent terms (and all others such as revenue and expenses are treated as dependent terms) and that matching is no longer a qualitative characteristic of financial statements. The income statement is the primary account in terms of the 'revenue and expense' view and the balance sheet consists of deferred income and expenses as a result of matching, however this view is not advocated by AC 000.

In responding on behalf of Rainbow Farms (Pty) Ltd, Brocklebank (1994:letter) queries why the proposed standard is silent on the allocation of interest received, if the organisation is in a cash positive position. He questions whether interest received should, under these circumstances, be credited to qualifying assets. In addition, Brocklebank (1994:letter) queried how the situation, when an entity moved from a cash positive to cash negative position during the creation of a capital asset, be dealt with.

Cramer (1994:letter) responding on behalf of Wooltru Finance (Pty) Limited, suggests that the purpose of exposure draft 92 is unclear. A particular difficulty is the failure of the statement to deal with the reduction in interest earnings which may result from the investment process. There is a conceptual weakness, explains Cramer (1994:letter), in "capitalising interest

paid that has increased as a consequence of the investment, but not capitalising interest lost (i.e. the reduction in interest earnings)." This inconsistency could result in different costs for the investment and a different profit for the periods concerned depending on whether the company was a borrower or a lender at the time the investment was made. In addition, Cramer (1994:letter) argues that this accounting treatment could lend itself to manipulation:

- A company which wished to capitalise interest (to show higher earnings) could borrow money specifically for the investment, even though it had substantial cash resources in the bank. Alternatively it could arrange for the contractor to deliver on a turnkey basis which would include a component of capitalised interest.
- Another company which wished not to capitalise these costs (to get an earlier tax deduction for interest) might make the investment from cash at bank or on call even though it was a substantial long term borrower.
- Manipulation might even be easier within groups of companies by virtue of the ease with which capital structures can be changed and intercompany loans arranged (whether interest bearing or not).

Cramer (1994:letter) argues that in its present form, exposure draft 92 leads to inconsistent profits and asset values between companies that borrow when developing assets and those that are able to develop assets from new equity, interest free loans, or own cash resources. Economically unsound differentiation between the two situations results.

In addition, Cramer (1994:letter) questions the reason for the fundamental differences between IAS23 (revised) and exposure draft 92 as follows:

If our objective is to internationalise our accounting standards through the APC's Harmonisation and Improvements Project, why do we suggest a divergence in ED92....If the real purpose for requiring the capitalisation of borrowing costs on qualifying assets is to introduce certainty by limiting choice (i.e. alternate treatments), then we would suggest that we opt for the IAS23 (Revised) preferred treatment rather than the alternative treatment.

In concluding, Cramer (1994:letter) argues that the purpose of exposure draft 92 is unclear. In particular, the exposure draft fails to provide the reason for capitalising borrowing costs on qualifying assets, which in turn provides difficulty in understanding the requirements [of the exposure draft]. Cramer (1994:letter) argues that the Accounting Practices Board fails to present a convincing argument for the proposed accounting standard.

The concerns expressed by Wharton-Hood and Bower (1994:letter) and Van As (1994:letter) on behalf of Standard Merchant Bank, with the taxation implications of the proposed accounting standard, is based on what Watts and Zimmerman (1978:114-115) call the 'taxation hypothesis.' Under this hypothesis, the use of a particular method for accounting purposes makes it more likely that revenue authorities will adopt that policy than had it not been used. Under the

taxation hypothesis, corporate manager's lobbying behaviour is affected by how they believe the revenue authorities will react.

The lobbying of the Accounting Practices Committee by South African corporate managers in opposition to the accounting treatment proposed in exposure draft 92, must be considered successful. The responses contained sufficient conceptual justification for the Accounting Practices Committee to amend the statement in line with IAS 23 (revised) when AC 114 (revised) was issued. It would not be unreasonable to argue that because significant opposition was experienced with exposure draft 92, the Accounting Practices Committee should have re-issued the proposed standard. As the Accounting Practices Committee has in the past disregarded the responses made by corporate management to previous exposure drafts, it can be argued that this body saw no reason to incur additional costs in re-issuing the exposure draft.

The responses by Anglovaal Industries Limited, Consol Limited, Edgars Stores Limited, Eskom (Finance Group), Rainbow Farms (Pty) Limited, Standard Merchant Bank and Wooltru Finance (Pty) Limited persuaded the Accounting Practices to base the revised AC 114 *Borrowing costs*, on statement IAS 23 (revised). AC 114 (revised) does not contain any differences in principle to IAS 23 (revised).

6.2.5 Exposure draft 93, Construction contracts

As part of its Harmonisation and Improvement Project, the Accounting Practices Committee based exposure draft 93, *Construction contracts*, on IAS 11 (revised) issued by the International Accounting Standards Committee. This exposure draft differed from its predecessor AC 109, *Construction contracts*, in a number of ways. Firstly, the exposure draft brought the criteria for the recognition of revenue into line with AC 000, *Framework for the preparation and presentation of financial statements*. Secondly, only the percentage of completion method for accounting for construction contracts was permitted. Finally, comprehensive guidance on the treatment to be followed when the outcome of a contract cannot be reliably estimated was given, as well as comprehensive disclosure requirements being prescribed. Exposure draft 93 did not contain any differences in matters of principle to IAS 11 (revised).

From an accounting perspective, while being a measurement and disclosure statement, the implementation of exposure draft 93 requiring companies to account using the percentage of completion method influences the timing of accounting earnings. Although the total amount of revenue and net income recognised over the life of the contract is the same using the completed contract and percentage of completed contract method, the pattern of income and net income differs.

The responses to exposure draft 93 are summarised as follows:

Table 6.9: Summary of responses to exposure draft 93, *Construction contracts*

	Responses	Support statement	Oppose statement
Major companies	8	6	2
Audit firms	5	5	-
Regional associations of Chartered Accountants	1	1	-
Universities	3	3	-
Individuals	1	1	-
	<u>18</u>	<u>16</u>	<u>2</u>

6.2.5.1 *Corporate management responses to exposure draft 93, Construction contracts*

In this section, the responses of South African corporate managers to exposure draft 93, *Construction contracts*, is examined. Although the responses to the exposure draft can in the main be considered favourable, those from certain construction companies sought to reduce their information production costs. Increased accounting disclosure does have the potential to result in an increase in political costs.

Grinaker Holdings Limited and LTA Limited were the only companies that expressed serious reservations with the proposed statement. Mitchell (1994:letter) responding on behalf of Grinaker Holdings Limited, argued that in many instances, the use of the percentage of completion method of accounting for contracts is inappropriate. This is particularly the case where a contract has a duration of less than twelve months. Under these circumstances, the contract should be accounted for under the completed contracts method.

In addition, Mitchell (1994:letter) believed that requiring contract revenue and costs to be recognised as revenue and expenses respectively by reference to the stage of completion of the contract activity at the balance sheet date is misleading. Mitchell (1994:letter) explains his rationale as follows:

This is misleading and is compounded by the determination of contract revenue and expenses in the appendix. The determination of profits has as one of its fundamental concepts the matching concept whereby the incidence of income and expenditure is matched. Certification of revenue is not merely a formality of recognising the stage of completion of the contract. The client's representative visits the contract site, inspects and measures the work performed and only when he has satisfied himself as to the accuracy of these measurements will he approve a certificate for payment. Once this is accomplished, the contractor must match revenue and expenses adjusting for over and under measurements which can arise from various causes eg unbalanced rates at tender stage.

Finally, Mitchell (1994:letter) believed that a number of the disclosure requirements were impractical and made recommendations to improve them. The individual responses by South

African corporate managers to exposure draft 93, *Construction contracts*, are provided in table 6.10 below:

Table 6.10: Responses of major companies to exposure draft 93, *Construction contracts*.

	Support issue of ED 93	Oppose issue of ED 93	Editorial issues	Specific comments
Major Companies				
Chamber of Mines of SA ¹	Yes			The Chamber has no comment to make as it believes that it is an industry specific matter.
Concor Holdings (Pty) Ltd	Yes			As a large contractor we are happy with exposure draft 93 but are not sure how smaller enterprises would comply as fairly detailed records, contract by contract, would have to be kept.
Consol Limited		Yes		The necessity of the disclosure for contracts in progress is queried as this could show competitive information which could lead to commercial advantages which would particularly effect smaller construction companies.
Dorbyl Marine (Pty) Ltd	Yes			Although agreeing in principle with the exposure draft, disagree that a group of contracts be treated as a single construction contract where the group of contracts has been negotiated as a single package.
Eskom (Finance Group)	Yes			In general we agree with the financial accounting treatment suggested in the exposure draft. The Accounting Practices Committee's Harmonisation and Improvement Project is supported, especially in so far as the local statements are brought into line with the international standards and with AC 000.
Grinaker Holdings Limited		Yes		Completed contract method should be permitted for contracts that are of 12 months or less duration. See text.
LTA Limited		Yes		Discussed in text.
S A Breweries Ltd	Yes			Proposed statement is not of the utmost relevance to The South African Breweries Group so an official response is not submitted. The intention of exposure draft 93 is to deal with construction contracts and all related issues only. In the attempt to harmonise the statements, this should be specifically scoped out in the statement on Revenue.
¹ Member of the Accounting Practices Board				

In a comprehensive response, Mather (1994:letter), on behalf of LTA Limited, suggests that the exposure draft attempts to classify all contracts into one of two conditions namely; those contracts where:

- The final revenue and costs attributable to the contract cannot be reliably measured. If this condition exists, no profit is recognised on the contract until it can be reliably measured.
- The final revenue and costs applicable to the contract can be reliably measured. In this instance, the percentage profit recognised at any particular stage is the same as the percentage costs incurred at that stage.

By focusing only on final revenue and costs, every contract would be forced into one of these absolute conditions. By using 'an over simplified arithmetic calculation' a profit would then be determined. Matcher (1994:letter) argues that these requirements fail to take cognisance of the realities of contracting.

Numerous practical difficulties with the content of the exposure draft, together with the disclosure requirements, enabled Matcher (1994:letter) to argue that: "In view of the major changes proposed above any attempt to alter the appendix would be of little benefit."

The small number of responses to exposure draft 93 indicates that no significant lobbying of the Accounting Practices Committee occurred. From an examination of the responses it is apparent that what lobbying did occur was in opposition to the exclusion of the completed contract method of accounting from the exposure draft as well as opposing the increased disclosure requirements. Compliance with this standard would increase the information production costs of companies, as well as increasing the potential for increasing political costs.

In spite of the comments and suggestions made by Concor Holdings (Pty) Limited, Dorbyl Marine (Pty) Ltd, Grinaker Holdings Limited and LTA Limited, no changes other than those of a minor editorial nature, were made to the exposure draft when statement AC 109 (revised) was finalised.

6.2.6 Exposure draft 94, Inventories

Exposure draft 94, *Inventories*, was based on IAS 2 (revised) issued by the International Accounting Standards Committee. Exposure draft 94 differed from its predecessor AC 108, *Valuation and presentation of stock in the context of historical cost system*, in a number of ways. From a terminology perspective, the exposure draft uses the term 'inventories' rather than the more common 'stock.' Extensive disclosure requirements are contained in the exposure draft. These include the disclosure of:

- the carrying amount of inventories carried at net realisable value,
- the amount of any reversal of write-down that is recognised as income in the period, and the circumstances or events that led to the reversal, and
- the cost of inventories recognised as an expense during the period.

Unlike AC 108, exposure draft 94 did not permit the exclusion of fixed production overheads from the cost of inventories, while it also required the rate for recovering fixed overheads to be reduced in periods of abnormally high production.

Exposure draft 94 differed from IAS 2 (revised) in that the exposure draft prohibits the use of the last-in-first-out (LIFO) method of inventory valuation. Only the first-in-first-out or

weighted average cost formulas for determining the cost of inventories is permitted by exposure draft 94.

From an accounting perspective, the exposure draft is a measurement and disclosure statement. Under certain circumstances, the application of the statement may result in income being deferred from one accounting period to another.

The responses to exposure draft 94 are summarised as follows:

Table 6.11: Summary of responses to exposure draft 94, *Inventories*

	Responses	Support statement	Oppose statement
Major companies	12	7	5
Audit firms	8	8	-
Regional associations of Chartered Accountants	1	-	1
Universities	2	2	-
Individuals	2	2	-
	<u>25</u>	<u>19</u>	<u>6</u>

From the responses received by the Accounting Practices Committee to exposure draft 94, it is clear that South African corporate management did not overwhelmingly support this proposed statement.

6.2.6.1 Corporate management responses to exposure draft 94, *Inventories*

In this section, the responses of South African corporate managers to exposure draft 94, *Inventories*, is examined. Individual responses by South African corporate managers and their lobbying against the proposed standard on inventories is provided in table 6.12 below. The lobbying against this by companies including Anglovaal Industries Limited, Consol Limited, Edgars Stores Limited, Yskor Beperk, and Wooltru Finance (Pty) Limited is based on the additional information production costs that would be incurred by complying with the standard. Where additional accounting disclosure is mandated, the potential exists for an increase in political costs. Illustrations of this lobbying by corporate management follows:

Table 6.12: Responses of major companies to exposure draft 94, *Inventories*

	Support issue of ED 94	Oppose issue of ED 94	Editorial issues	Specific comments
Major Companies				
Anglovaal Industries Ltd Chamber of Mines of SA ¹	Yes	Yes		Required clarification on certain issues. See text. Suggests amendments to writing down and expensing of inventory. Suggests amendments to disclosure paragraph .31
Consol Limited		Yes		Suggests clarification of certain issues. Concern expressed with disclosure requirements. See text.
Edgars Stores Limited		Yes		We are extremely concerned with the impact that this proposed statement will have on the application of the retail method for the determining the cost of inventories in the Edgars Group. See text.
Eskom (Finance Group)	Yes			In general we agree with the financial accounting treatment suggested in the exposure draft. Require clarification on certain issues. The exposure draft is silent on inventory items that have no value of its own until it is used in the production process, e.g. water. Should a value be placed in natural resources like water, if it forms a material part of the cost of sales as a part of the primary energy cost, e.g. in the context of a power station?
Highveld Steel	Yes			Concern expressed with the appropriateness of disclosure required by paragraph .31 (d) (e) and (g). See text.
Yskor Beperk		Yes		While initially commenting favourable on the exposure draft, are now finding difficulty in complying with certain items. See text.
Johannesburg Stock Ex ¹	Yes			
Morkels Limited	Yes			Provides suggestion relating to the valuation of inventory.
South African Breweries	Yes			See text.
Transnet	Yes			Expresses concern over definition of one item.
Wooltru Finance (Pty) Ltd		Yes		See text.

¹ Member of the Accounting Practices Board

While opposing the proposed accounting standard, Taylor (1994:letter), responding on behalf of Anglovaal Industries Limited, expressed reservation over the level of disclosure required by paragraph .31(g).

We express extremely strong reservations in connection with this requirement. Apart from the disclosure of such sensitive information to both competitors and suppliers of individual reporting entities, we contend very strongly that the disclosure of such a number in a diverse group of companies dealing with many different products and margins relating thereto will be meaningless. We suggest that this requirement be removed.

If not, we foresee a very distinct possibility of many companies not complying with this requirement.

Taylor (1994:letter) further indicates that while not motivating an entire re-exposure of the exposure draft, the offending paragraph should be fully debated with, in particular, preparers of

financial statements in commerce and industry before a statement of generally accepted accounting practice is issued.

Winson (1994:letter) on behalf of the Chamber of Mines, suggests that the paragraph .31, disclosure requirements, be amended so that sub-paragraphs (c); (d) and (e) only apply where the amounts concerned were abnormal. In addition, sub-paragraph (g) should be amended so that the cost of inventories recognised as an expense during the period be included with the cost of goods sold.

Forgan (1994:letter) on behalf of Consol Limited, expressed three main concerns with the proposed statement. Firstly, the absence of a clause allowing the arbitrary write down of inventories such as consumable stores and machine spares. Secondly, the lack of the last-in-first-out (LIFO) inventory valuation option. Finally, the superfluous disclosure requirements envisaged by paragraph .31.

In a comprehensive submission, Wharton-Hood and Bower (1994:letter), responding on behalf of Edgars Stores Limited, state that in spite of the exposure draft forming part of the Accounting Practice Committee's Harmonisation and Improvements Project, "We are, nevertheless, extremely concerned with the impact that this proposed statement will have on the application of the retail method for the determination of the cost of inventories in the Edgars Group." The response by Edgars Stores Limited is based on a number of factors; firstly, what they perceive to be incorrect definitions and treatment of the retail method of inventory valuation. As Wharton-Hood and Bower (1994:letter) explain: "The application of the retail method is not only the fundamentally sound basis for determining the cost of inventories within the retail environment, but also the most practical and cost-effective method of application." Secondly, the exclusion of the last-in-first-out (LIFO) formula in the preparation of the statement, and finally, the disclosure requirements envisaged in the statement. In particular, Wharton-Hood and Bower (1994:letter) argue:

The disclosure requirements included in paragraph 31 are particularly onerous and the usefulness of the information to be provided, is questionable. In particular, sub-paragraphs (c), (d), (e) and (g) are unacceptable. Furthermore, sub-paragraph (g) would necessitate the disclosure of the gross margin information and we consider this to be a compromise of the confidentiality of retail competitor information.

While Dingle (1994:letter) on behalf of Highveld Steel and Vanadium Corporation Limited did not envisage a problem with sub-paragraphs (a), (b) and (c) of the paragraph .31, disclosure requirements, sub-paragraphs (d), (e) and (g) were unacceptable. The primary reason for Dingle's opinion is that disclosure of this information from a business perspective would provide customers and competitors with accurate information on profitability and margins.

Although Yskor Beperk initially responded in favour of exposure draft 94, Geyer (1994(b):letter) explains that in the course of the preparation of the financial statements based on the proposed standard the following disclosure was found to be impractical and/or sensitive:

- the carrying amount of inventories carried at net realisable value,
- the amount of any reversal of any write-down which is recognised as income in the period,
- the circumstances of events that led to the reversal of a write-down of inventories, and
- the cost of inventories recognised as an expense during the period.

While generally agreeing with the accounting treatment prescribed in exposure draft 94, Prins (1994:letter) on behalf of The South African Breweries Limited expressed the following concerns. Firstly, the retail method is dealt with in insufficient detail; secondly, the elimination of last-in-first-out (LIFO) as method of inventory valuation, and finally, the disclosure requirement detailing the cost of inventories recognised as an expense during the period.

Finally, Lavies (1994:letter) on behalf of Wooltru Finance (Pty) Limited, also expressed concern with the paragraph .31 disclosure requirements, in particular the disclosure of sensitive information to competitors.

An examination of the responses to exposure draft 94 indicates that corporate management opposed the proposed statement for two reasons. Firstly, the comprehensive disclosure requirements; and secondly, the exclusion of the last-in-first-out (LIFO) method of inventory valuation in the proposed statement. It would not be unreasonable to assume that compliance with the proposed accounting standard will result in the firm incurring increased information production costs. In addition, this increased disclosure may also result in an increase in political costs. As stated in chapter four, political costs occur as a direct result of the reactions of various parties, including unions, government regulators, revenue authorities, and the public, to companies' accounting disclosure.

In spite of opposition by Anglovaal Industries Limited, Consol Limited, Edgars Stores Limited, Yskor Beperk, and Wooltru Finance (Pty) Limited, no changes other than those of a minor editorial nature were made to the exposure draft when statement AC 108 (revised) was finalised.

6.3 RESPONSES TO SURVEY QUESTIONNAIRE

An overall response rate of 77 percent was obtained for the questionnaire. This response rate must be considered very favourable as, in mail surveys, a low response rate is usually obtained.

For example, in recent studies Samkin (1993:137) obtained a response rate of 28,8 percent, while Ford (1993:22) obtained a response rate of 15 percent.

The high response rate can be attributed primarily to the research being conducted under the auspices of the Bureau of Market Research at the University of South Africa, contacting potential respondents prior to posting the survey, the follow-up process, and the topical nature of the survey.

6.3.1 Data preparation

The data for processing and analysis was first edited then coded. Editing, according to Cooper and Emory (1995:379), detects errors and omissions, corrects them when possible, and ensures that minimum data quality standards are achieved. This ensures that the data is (1) accurate, (2) consistent with other information, (3) uniformly entered, (4) complete and, (5) arranged to simplify coding and tabulation (Cooper & Emory 1995:379). Proper editing, explains Sekaran (1992:276), ensures that the validity and replicability of the study is not impaired.

The editing of the data resulted in two questionnaires being discarded. One questionnaire was largely incomplete, while one respondent had returned two identical questionnaires.

According to Cooper and Emory (1995:381), coding involves assigning numbers or other symbols to answers so that the responses can be grouped into classes or categories. As the questionnaires had been pre-coded during the compilation process, there was no need for them to be re-coded. Computer codes for respondents' answers were built into the layout of the questionnaire. These codes were considered unlikely to confuse the respondents.

6.3.2 Data processing

Information contained in each questionnaire was captured using the spreadsheet programme Lotus 123 before being processed by the Computer Services Division of the University of Durban-Westville.

The SPSS statistical programme developed for use in the social sciences (Sekaran 1992:282) was used to analyse the data. This software was chosen for its ability to:

- 1 Convert data into a format that it can use and then bring into the system.
- 2 Optionally, modify the data (for example, change data measured in centimetres to data measured in inches).
- 3 Analyse the data by counting them, plotting them, or running various statistical procedures (Norusis 1990(a):1).

In addition, Sekaran (1992:302) explains that SPSS/PC+ is a package that can be used:

to generate frequencies, descriptive statistics such as the mean and standard deviation, correlations, t-test, the ANOVA, multiple regression, and other analyses. It can also produce tables and graphs. An advanced supplementary programme is also available for more sophisticated multivariate analyses such as factor analysis, cluster analysis, discriminant analysis, and multivariate analysis of variance.

6.4 STATISTICAL ANALYSIS

The following eight statistical procedures were employed to analyse the data provided by the respondents to the survey questionnaire to determine South African corporate management's attitude to the accounting standard-setting process and international harmonisation.

- **One sample chi-squared test:** This test is based on how good a fit exists between the data frequency observed and the expected frequency obtained from the hypothesised distribution.
- **Chi-square test of Independence:** This test permits decisions to be made about whether a relationship exists between two variables, using frequency data.
- **Binomial test:** This test is appropriate when the population is viewed as only two classes. Each population element falls into one of the two classes.
- **t-Test:** This test may be used to establish whether two groups differ from each other on a particular issue. A t-Test may be used to establish whether significant differences exist in the mean responses of two groups on a particular issue.
- **Analysis of variance (ANOVA):** An analysis of variance (ANOVA) is used to examine whether significant mean differences exist between multiple groups.
- **Factor analysis:** Factor analysis examines the data for patterns among variables to establish if an underlying combination of the original variables (a factor) can summarise the original set.
- **Cluster analysis:** Cluster analysis is used to identify homogeneous subgroups or clusters.
- **Cronbach's alpha coefficient:** This procedure measures the internal reliability of the questionnaire.

These techniques can be classified as parametric where underlying distributional assumptions are made, and non-parametric tests of significance, multivariate analysis, and a reliability coefficient.

6.4.1 Nonparametric statistics

Where nominal data is available, only nonparametric tests can be used. Nonparametric tests according to Cooper and Emory (1995:444) have fewer and less stringent assumptions. No

distributional assumptions are made about the underlying population which is thus not required to be normally distributed, or have homogeneity of variance.

6.4.1.1 *One sample chi-square test*

Cooper and Emory (1995:447) describe the chi-square test as probably the most widely used nonparametric test of significance. This test is used to establish whether significant differences exist between the observed distributions of data among categories and the expected distribution based on the null-hypothesis, or how well the observed data fits the expected data. The chi-square test was considered appropriate as all the observed frequencies are independent of each other. The completion of the questionnaire by a respondent would not have been influenced by any other respondent.

When calculating a one-sample chi-square statistic the data must be classified into mutually exclusive categories, for example, strongly agree, agree, disagree and strongly disagree. In one sample chi-square tests, the null-hypothesis is based on the expected frequencies of objects in each categories. The data is expressed in terms of frequencies (actual counts), and the empirically observed frequencies are compared to frequencies expected on the basis of some hypothesis. Once the expected frequencies are obtained, the chi-square statistic (X^2) is calculated using the formula:

$$X^2 = \sum_{i=1}^k (O_i - E_i)^2/E_i$$

where

- O_i = the observed frequency for the i th category,
- E_i = the expected frequency for the i th category, and
- k = the number of categories.

If the differences between the observed frequencies and the expected frequencies are small, X^2 will be small. The greater the difference between the observed frequencies and those expected under the null-hypothesis, the larger X^2 will be. If the differences between observed and expected values are so large collectively so as to occur by chance only 0,05 or less of the time when the null-hypothesis is true, the null-hypothesis is rejected.

6.4.1.2 *Chi-square test of independence*

A chi-squared test of independence is used to test the significance of a relationship between two variables when the data is expressed in terms of frequency or joint occurrence. No *a priori*

expected frequencies are involved; instead, the relationship between two variables, each of which has a number of categories, and the null-hypothesis is that the two variables are independent.

A chi-squared (X^2) test of independence allows decisions to be made about whether a relationship exists between two variables using frequency data. If the null-hypothesis is rejected, there is a statistically significant relationship between the two variables.

The chi-square test of independence can be calculated using the formula:

$$X^2 = \sum_i \sum_j \frac{(O_{ij} - E_{ij})^2}{E_{ij}}$$

where

O_i = the observed frequency for the i th category,

E_i = the expected frequency for the i th category.

Although the chi-square test of independence enables a decision to be made on the acceptance of rejection of a hypothesis, the X^2 value does not provide an indication of the strength of the relationship. Various measures of association are used to establish the strength of the relationship.

In this thesis, two measures of association will be used. The phi coefficient is used for 2×2 X^2 tables (Welkowitz, Ewen & Cohen 1982:285 and Cooper and Emory 1995:501). Here X^2 is converted to a correlation coefficient using the formula:

$$\phi = \sqrt{\frac{X^2}{N}}$$

This phi coefficient is interpreted as a Pearson r (Welkowitz *et al.* 1982:286).

For tables larger than 2×2 , a contingency coefficient can, according to both Welkowitz *et al.* (1982:287) and Cooper and Emory (1995:502), be used. This contingency coefficient is calculated by using the formula:

$$C = \sqrt{\frac{X^2}{N + X^2}}$$

Unlike ϕ , C is not a Pearson r coefficient. The value of C can never be greater than 1.0. The maximum value of C is equal to:

$$C_{\max} = \sqrt{\frac{k-1}{k}}$$

where

k = the smaller of r (number of rows) or c (number of columns), and either one of r or c . Thus for a 2×3 table, $C_{\max} = 0,71$.

6.4.1.3 Binomial test

The binomial test is appropriate when the population is viewed as splitting into two distinct (non-overlapping) classes. All observations will fall into one or other of the categories. This test was used when respondents were required to answer a dichotomous question either YES or NO. The binomial test can be calculated using the formula:

$$p(x) = {}_n C_x p^x (1 - p)^{n - x}$$

where

${}_n C_x$ = is a combination $\frac{n!}{x!(n - x)!}$

p = probability of the response being YES,

n = number of responses, and

x = number of responses being YES out of the n

6.4.2 Parametric tests

Parametric tests are generally more efficient than nonparametric tests. Parametric tests usually make assumptions about the distribution of the population. They are, as Cooper and Emory (1995:442) explain, more powerful because their data is derived from interval and ratio measurements.

6.4.2.1 *t*-Test

A *t*-Test is useful in establishing whether differences exist between two groups on a particular variable. The *t*-Test is appropriate, according to Cooper and Emory (1995:454), where persons, objects, or events are closely matched or the phenomena are measured twice.

In the context of this study, the *t*-Test was used to establish whether a significant mean difference in variables exist between South African male and female corporate managers in their responses to various questions relating to corporate managers as the producers of financial information, the regulation of accounting, and various issues relating to the international harmonisation of accounting standards.

The *t*-Test can be calculated using the formula:

$$t = \frac{\sum D_i}{\sqrt{\frac{n \sum D_i^2 - (\sum D_i)^2}{n-1}}} - t_{n-1}$$

where

D_i = the difference in mean responses of South African male and female corporate managers to question i

$i \in \{1, 2, \dots, n\}$

n = number of questions

6.4.2.2 Analysis of variance (ANOVA)

An analysis of variance (ANOVA) can be used to establish whether significant mean differences exist among more than two groups. The analysis of variance (ANOVA), according to Cooper and Emory (1995:457), breaks down or partitions total variability into component parts.

In the context of this study the ANOVA was used to establish whether significant mean differences in variables existed between South African corporate managers of different ages in their responses to various questions relating to corporate managers as the producers of financial information, the regulation of accounting, and various issues relating to the international harmonisation of accounting standards.

The test statistic for the ANOVA is the F ratio. The variance is calculated using the formula:

$$F = \frac{\text{Between-group variance}}{\text{Within-group variance}} = \frac{\text{Mean square}_{\text{between}}}{\text{Mean square}_{\text{within}}}$$

where

$$\text{Mean square}_{\text{between}} = \frac{\text{Sum of squares}_{\text{between}}}{\text{Degrees of freedom}_{\text{between}}}$$

$$\text{Mean square}_{\text{within}} = \frac{\text{Sum of squares}_{\text{within}}}{\text{Degrees of freedom}_{\text{within}}}$$

6.4.3 Multivariate analysis

Multivariate statistics are used to provide answers to complex problems. As Tabachnick and Fidell (1989:1) explain, "they provide analysis where there are many independent variables (IVs) and/or many dependent variables (DVs) all correlated with one another to varying degrees." The

growth of multivariate statistics, believe Tabachnick and Fidell (1989:1-2), is a direct result of the increased complexity of research.

6.4.3.1 *Factor analysis*

Factor analysis is a statistical technique applied to a single set of variables, the questionnaire, to establish which of the variables in the set form coherent subsets that are relatively independent of one another. Factor analysis can, according to Tabachnick and Fidell (1989:28), be used where hypotheses exist about the underlying structure, and assess the fit between the data and the hypothetical structure.

Factor analysis has been described by Oppenheim (1992:166) as an "analytical statistical tool which may enable us to find out what (if any) are the chief underlying dimensions of a set of variables, attributes, responses or observations." Neale and Liebert (1986:80) consider that the primary aim of a factor analysis is to "find a smaller set of dimensions, factors, that can account for the entire array of intercorrelations." These factors are then used to analyse and explain the interrelationship between the variables of the questionnaire in terms of their common underlying factors. In other words, a factor analysis can be used to identify those factors that have common loadings without imposing any preconceived structure on the outcome.

The factor analysis was extracted using the principal component factor analytic approach. This, according to Cooper and Emory (1995:538), "transforms a set of variables into a new set of composite variables of principal components that are not correlated with each other. These linear combinations of variables, called factors, account for the variance in the data as a whole." Where the relationship among variables is not enlightening, this can be overcome by rotation (Cooper & Emory 1995:539). Rotation usually clarifies the relationship between factors and variables.

In establishing which factors should be considered significant in a factor analysis and used for interpretation, Child (1970:43) states that only those factors "having latent roots (eigenvalue values) greater than one are considered as common factors."

6.4.3.2 *Cluster analysis*

Cluster analysis has been described by Cooper and Emory (1995:543) as a set of techniques for grouping similar objects or people. By starting with an undifferentiated group of people, events or objects, cluster analysis attempts to reorganise them into homogeneous subgroups. Cooper and Emory (1995:543-544) identify five basic steps in the application of cluster studies.

- 1 Selection of the sample to be clustered.
- 2 Definition of the variables on which to measure the objects, events or people.

- 3 Computation of similarities among the entities through correlation, Euclidean distances, and other techniques.
- 4 Selection of mutually exclusive clusters or hierarchically arranged clusters.
- 5 Cluster comparison and validation.

6.4.4 Reliability estimate

According to Sekaran (1992:284), the reliability of a measure is established by testing both consistency and stability. The consistency of the data provides an indication of how the individual items correlate with each other.

6.4.4.1 Cronbach's alpha coefficient

One of the most commonly used reliability coefficients to establish the internal consistency of a test is Cronbach's alpha (or α) coefficient (Cooper & Emory 1995:154-155). Cronbach's alpha can be calculated using the following formula:

$$\alpha = \frac{(k)\text{cov/var}}{1 + (k - 1)\text{cov/var}}$$

where

k = the number of items in the scale,

cov = the average covariance between items, and

var = the average variance of the items (Norusis, 1990:B191).

From a research perspective, reliability is, according to Cooper and Emory (1995:153), concerned with estimates of the degree to which a measurement is free of random or unstable error. Oppenheim (1992:159) argues that the importance of reliability is not only a precondition for validity, it also ensures "that the measuring instrument will behave in a fashion which is consistent within itself; that a very high proportion of the score on every occasion is due to the underlying scale variable, with a minimum of error."

In establishing what an acceptable correlation level is for interpretation, Sekaran (1992:287) explains that reliabilities less than 0,60 are generally considered to be poor, those in the 0,70 range are acceptable while those over 0,80 are good. The closer the reliability coefficient gets to 1,0, the better. Oppenheim (1992:159-160) considers that a reliability measure of below 0,80 means that repeated administrations will cover less than 64 percent of the same ground. Under these circumstances the error component is more than one-third. A measure lower than this could result in the instrument being subject to serious criticism.

6.5 TESTING THE HYPOTHESES

The analysis and interpretation of the results is divided into sub-sections that correspond with the hypotheses developed in chapter five. Each hypothesis is discussed within the following structure:

- results of the statistical tests of hypothesis, and
- discussion and interpretation of results.

Where a respondent failed to respond to a particular question, either because they did not understand the question or did not wish to express an opinion on the question, the non-responses were scored '0.' This was necessary so that when the questionnaire results were processed, error messages would not be generated.

6.5.1 Hypotheses 1 to 14: the accounting standard-setting process

Hypotheses 1 to 14 deal with various aspects of the South African accounting standard-setting process.

6.5.1.1 Hypothesis 1: discussion and interpretation of results

The data used to test this hypothesis was gathered from question 1.2 of the questionnaire. This question required respondents to answer a dichotomous question, either YES or NO.

Hypothesis 1: *There is no significant difference in the frequency of responses in the respective categories on whether South African corporate management should play an active role in the accounting standard-setting process such that $f_1 = f_2$*

The application of the binomial test at a 5 percent level of significance, $Z = 7,375$ with $p \approx 0,000$. As $p < 0,05$, the null-hypothesis is rejected. Since the sample size > 30 , the binomial test was approximated by the normal distribution.

The majority of respondents (sixty-two, or 96,875 percent) agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, they should play an active role in the accounting standard-setting process. Respondents were required to 'tick' as many of the options illustrated as to the reasons why they should play an active role in the accounting standard-setting process. The reasons given by the respondents for this view are provided in table 6.13.

Table 6.13: Reasons why corporate management should play an active role in the accounting standard-setting process

Reason	Percentage of responses
Management is in the best position to make decisions on the format and content of financial statements	48,44
Standards should permit earnings and cash flows to be maintained rather than fluctuating every time a new statement is issued	28,13
Standard-setting bodies and academics are unaware of practical realities	64,06
Management is not adequately represented on the standard-setting body	48,44
Other	3,13

The other reasons provided by respondents included: *"Management can make a meaningful contribution to the process"* and *"The accounts belong to the company and it is its means of communication to all its stakeholders."*

Of the respondents who believed that corporate management should not play an active role in the standard-setting process, there was one response for the option that management lacks the necessary practical expertise and knowledge to make a meaningful contribution, while other responses included: *"Corporate management (ie non-financial) must focus on business"* and the *"Propensity to set standards which facilitate the manipulation of earnings."*

The number of responses by corporate managers to the various exposure drafts issued by the Accounting Practices Committee and examined as individual case studies must, in light of the responses by South African corporate managers to question 2.1, be considered disappointing. Although corporate management believes that they should actively participate in the accounting standard-setting process, their direct involvement based on the number of companies listed on the Johannesburg Stock Exchange is negligible. There are a number of possible reasons for this situation. The first is that in a South African context, generally accepted accounting practice has often been that practice developed or pursued by a significant group of companies. Corporate management sees no reason therefore to change their approach to the subject or to participate in the process. Secondly, apathy on the part of corporate managers. Thirdly, acceptance of the standard-setting process, and finally, perception by corporate managers that they will derive no tangible benefit from participation.

6.5.1.2 *Hypothesis 2 and hypothesis 3: discussion and interpretation of results*

The data used to test null-hypothesis 2 was gathered from question 2.1, while the information to test null-hypothesis 3 was gathered from question 2.2 of the questionnaire.

Hypothesis 2: *There is no significant difference in the frequency of responses in the respective categories on whether the existing method employed for setting accounting standards is the most appropriate for the South African business environment such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 26,000$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 2 is rejected.

The majority of respondents (forty-one, or 65 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the existing method employed for setting accounting standards is the most appropriate for the South African business environment.

Hypothesis 3: *There is no significant difference in the frequency of responses in the respective categories on whether the Accounting Practices Board through the Accounting Practices Committee should remain responsible for developing and issuing South African specific exposure drafts and statements of generally accepted accounting practice such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 68,375$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 3 is rejected.

The majority of respondents (fifty-three, or 82,8 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the Accounting Practices Board through the Accounting Practices Committee, should remain responsible for developing and issuing exposure drafts and statements of generally accepted accounting practice.

The results of the tests on hypothesis 2 are consistent with earlier findings by Samkin (1993:153) where 69,23 percent of respondents to a questionnaire agreed that the existing method of setting accounting standards in South Africa was the best available. From the results of the tests performed on hypothesis 2 and 3, it can be concluded that South African corporate managers are, in the main, satisfied with the existing method of setting accounting standards. They believe that the Accounting Practices Board remains the most appropriate body to issue statements of generally accepted accounting practice in South Africa. However, the exposure given by the South African Institute of Chartered Accountants to its Harmonisation and Improvement Project (Blumberg 1995(b):3, Dickinson 1995:1-2, Mockler 1992:letter and

Terblanche & Bus 1994:25-27), it would not have been unreasonable to expect that respondents to the questionnaire would have believed the proposed method of setting accounting standards to be superior to the one which currently operates.

The results of hypothesis two and three would suggest that the South African Institute of Chartered Accountants needs to continue advertising the benefits of the proposed change to the accounting standard-setting process to all interested constituencies.

6.5.1.3 Hypothesis 4: discussion and interpretation of results

The data used to test null-hypothesis 4 was obtained from question 2.3 of the questionnaire.

Hypothesis 4: *There is no significant difference in the frequency of responses in the respective categories on whether non-accounting groups (such as the South African Law Society and the trade union movement), should participate in the accounting standard-setting process such that $f_1 = f_2 = f_3 = f_r$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 33,500$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 4 is rejected.

The majority of respondents (thirty-six, or 56,25 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, non-accounting groups (such as the South African Law Society and the trade union movement), should participate in the accounting standard-setting process.

These findings would support the recommendations made by the South African Institute of Chartered Accountants that the Standards Development Committee (the committee proposed to assume responsibility for the development of accounting standards) be made up of the existing constituent bodies of the Accounting Practices Board as well as any other recognised institution, association or body prepared to participate in the standard-setting process.

6.5.1.4 Hypothesis 5 and hypothesis 6: discussion and interpretation of results

The data used to test null-hypothesis 5 was obtained from question 2.4, while the data used to test null-hypothesis 6 was obtained from question 2.5 of the questionnaire.

Hypothesis 5: *There is no significant difference in the frequency of responses in the respective categories on whether the standard of South African developed statements of generally accepted accounting practice are acceptable for financial reporting purposes in South Africa such that $f_1 = f_2 = f_3 = f_r$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 52,666$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 5 is rejected.

The majority of respondents (fifty-three, or 84,12 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the standard of South African developed statements of generally accepted accounting practice are acceptable for financial reporting purposes.

Hypothesis 6: *There is no significant difference in the frequency of responses in the respective categories on whether existing accounting standards provide a sufficiently wide choice of accounting alternatives so as to enable corporate executives to prepare financial statements that fairly present the financial position and financial result of the company such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 66,500$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 6 is rejected.

The majority of respondents (fifty-six, or 87,5 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, existing accounting standards provide management with a sufficiently wide choice of accounting alternatives so as to enable them to prepare financial statements that fairly present the financial position and financial result of the company.

The results of the statistical tests of hypotheses 5 and 6 suggest that South African corporate management believe that South African accounting standards are of a sufficiently high standard for financial reporting purposes. The obvious question then is: why has dissatisfaction been expressed both in the popular and professional press (Bunting 1993, Crotty 1995 and Singer 1994) with the adherence by South African companies to these standards? A possible explanation is that a financial reporting expectation gap exists between corporate managers as suppliers of financial information, and certain categories of users.

While existing accounting standards have provided a sufficiently wide choice of accounting alternatives to enable corporate managers to prepare financial statements that, in their and their auditors' opinion, fairly present the financial position and financial results of the company, it is uncertain how they will react when the alternatives currently available to them are eliminated as the Harmonisation and Improvement Project progresses. Research will need to be undertaken to establish whether South African corporate managers alter financing, production or investing activities in an effort to negate the effect that will arise as a direct consequence of being unable to select a particular accounting method from the various alternatives.

6.5.1.5 Hypothesis 7: discussion and interpretation of results

The data used to test null-hypothesis 7 was obtained from question 2.6 of the questionnaire.

Hypothesis 7: There is no significant difference in the frequency of responses in the respective categories on whether the resources spent on the development of South African statements of generally accepted accounting practice have contributed to the maintenance of a high level of local accounting expertise such that $f_1 = f_2 = f_3 = f_4$.

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 80,301$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 7 is rejected.

The majority of respondents (fifty, or 79,37 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the resources spent on the development of South African statements of generally accepted accounting practice have contributed to the maintenance of a high level of local accounting expertise.

The results of this hypothesis should not be unexpected as sixty-three, or 81,82 percent of the respondents were Chartered Accountants, while the remainder were all graduates. Of the remaining graduates, four held bachelors degrees, while the remaining ten held honours bachelors degrees of other advanced qualifications. It was assumed that because of their position in industry and by virtue of their qualifications, the respondents were in an ideal position to comment on this hypothesis.

6.5.1.6 Hypothesis 8: discussion and interpretation of results

The data used to test null-hypothesis 8 was obtained from questions 2.7 and 2.8 of the questionnaire.

Hypothesis 8: There is no significant difference in the frequency of responses in the respective categories on whether additional resources should be made available to the South African Institute of Chartered Accountants to enable them to continue the development of South African specific statements of generally accepted accounting practice.

The results of chi-square test of independence indicate that at a 5 percent level of significance, X^2 value of 4,187 with one degree of freedom $p \approx 0.04075$. As $p < 0.05$, a significant relationship exists between questions 2.7 and 2.8. Null-hypothesis 8 is therefore rejected.

Forty-one, or 64,06 percent, of the respondents to question 2.7 strongly agreed, or agreed that: *Additional resources should be made available to the South African Institute of*

Chartered Accountants to enable them to attract and keep suitably qualified staff to ensure relevant ongoing research into accounting issues. Forty-six, or 71,88 percent of respondents strongly agreed, or agreed that: Suitably qualified staff from South African universities should be co-opted by the South African Institute of Chartered Accountants to contribute to the development of local accounting standards.

By substitution X^2 of 4,187 and $N = 64$ into the phi coefficient formula, $\phi = 0,256$ is obtained. Although a relationship does exist between the responses to questions 2.7 and 2.8, this relationship is weak.

As there is a relationship in the responses to the questions, it is concluded therefore, that in the opinion of South African corporate managers, additional resources should be made available to the South African Institute of Chartered Accountants to enable them to continue the development of South African specific statements of generally accepted accounting practice.

6.5.1.7 Hypothesis 9: discussion and interpretation of results

The data used to test null-hypothesis 9 was obtained from question 2.9 of the questionnaire.

Hypothesis 9: *There is no significant difference in the frequency of responses in the respective categories on whether corporate executives of private companies are less likely to respond to proposed statements of generally accepted accounting practice than corporate executives of public companies such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 43,875$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 9 is rejected.

The majority of respondents (fifty-four, or 84,38 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, corporate executives of public companies are more likely to respond to proposed statements of generally accepted accounting practice than corporate executives of private companies.

The results of the test of hypothesis 9 would support the contention that as managers of private companies are usually the owners, and therefore the beneficiaries of all firm profits; no motivation exists for them to lobby either in favour of, or in opposition to, a particular accounting standard. In addition, it would not be unreasonable to assume that corporate managers of private companies do not have the necessary expertise to make a meaningful contribution to the accounting standard-setting process.

6.5.1.8 *Hypothesis 10: discussion and interpretation of results*

The data used to test null-hypothesis 10 was obtained from question 2.10 of the questionnaire.

Hypothesis 10: *There is no significant difference in the frequency of responses in the respective categories on whether amendments to the Companies Act making adherence to statements of generally accepted accounting practice mandatory, have been made expeditiously such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 60,666$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 10 is rejected.

The majority of respondents (forty, or 66.67 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, amendments to the *Companies Act*, Act 61 of 1973, making adherence to statements of generally accepted accounting mandatory, have been made expeditiously.

Although the Accounting Practices Board recognised as early as 1977 that difficulties existed with the interpretation of section 286(3) of the *Companies Act*, Act 61 of 1973, and made various attempts to amend this section, this has still not occurred. The results of the test of hypothesis 10 would suggest that corporate managers believe that the accounting profession has made a reasonable attempt to expedite legal backing to accounting standards. The responses to question 2.10 would, however, suggest that either corporate managers are largely unaware of the steps taken by the Accounting Practices Board to obtain legal backing for accounting standards, or they have been satisfied with section 286(3) of the *Companies Act*, Act 61 of 1973, remaining unamended.

6.5.1.9 *Hypothesis 11: discussion and interpretation of results*

The data used to test null-hypothesis 11 was obtained from question 2.11 of the questionnaire.

Hypothesis 11: *There is no significant difference in the frequency of responses in the respective categories on whether significant penalties should accrue to both preparers and auditors of financial statements for not complying with statements of generally accepted accounting practice such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 40,875$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 11 is rejected.

The majority of respondents (forty-three, or 67,19) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers,

significantly penalties should accrue to both preparers and auditors of financial statements where statements of generally accepted accounting practice are not complied with.

What is interesting about South African corporate managers response to question 2.11 is the extent of support for this hypothesis. It would appear that corporate managers are aware that a lack of accounting morality has existed in South Africa which requires rectification. The implication is that auditors who tacitly support companies who fail to comply with statements of generally accepted accounting practice by not qualifying their audit reports, should, together with their client, face severe penalties under the *Companies Act, Act 61 of 1973*.

6.5.1.10 Hypothesis 12: discussion and interpretation of results

The data used to test null-hypothesis 12 was obtained from question 2.12 of the questionnaire.

Hypothesis 12: *There is no significant difference in the frequency of responses in the respective categories on whether the South African Institute of Chartered Accountant's conceptual framework will provide a measure of legitimacy to the accounting profession threatened by government intervention in the accounting standard-setting process such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 48,100$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 12 is rejected.

The majority of respondents (forty-nine, or 81,67 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the South African Chartered Accountant's conceptual framework will provide a measure of legitimacy to the accounting profession threatened by government intervention in the accounting standard-setting process.

As is indicated in chapter five, a conceptual framework provides a sound theoretical base from which accounting standards can be developed. The responses by South African corporate managers to question 2.12 would indicate that they believe the adoption of the conceptual framework, *Framework for the preparation and presentation of financial statements*, by the South African Institute of Chartered Accountants will provide a means of defence against political interference in the accounting standard-setting process. The results of this test support the opinions of Bromwich (1992), Solomons (1983 and 1986) and Hines (1989) who have argued that the possession of a framework providing a sound theoretical base from which accounting standards are developed will provide a defence against political interference in the accounting standard-setting process.

6.5.1.11 Hypothesis 13: discussion and interpretation of results

The data used to test null-hypothesis 13 was obtained from question 2.13 of the questionnaire.

Hypothesis 13: *There is no significant difference in the frequency of responses in the respective categories on whether proposed statements of generally accepted accounting practice issued for comment and response, should include a presentation of the theory and arguments underlying the standard such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 46,156$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 13 is rejected.

The majority of respondents (sixty-three, or 98,44 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, proposed statements of generally accepted accounting practice issued for comment and response should include a presentation of the theory and arguments underlying the standard.

From the responses to question 2.13, it is clear that an overwhelming majority of South African corporate managers believe that by providing a presentation of theory and arguments underlying a proposed standard they would be in a better position to formulate a meaningful response to the exposure draft. Further support for this hypothesis can be found in corporate management's responses to exposure drafts submitted to the Accounting Practices Committee. Frequently, these responses contain illustrations or worked examples so that management is able to obtain clarification on points raised.

6.5.1.12 Hypothesis 14: discussion and interpretation of results

The data used to test null-hypothesis 14 was obtained from question 2.14 of the questionnaire.

Hypothesis 14: *There is no significant difference in the frequency of responses in the respective categories on whether companies should bear the financial cost of the accounting standard-setting process such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 35,156$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 14 is rejected.

The majority of respondents (forty-three, or 68,25 percent) either disagreed, or strongly disagreed with the statement, thereby indicating that, in the opinion of South African corporate managers, companies should not bear the financial cost of the accounting standard-setting process.

It is clear from the responses to question 2.14 that South African corporate managers are opposed to the proposal that the funding of the proposed accounting standard-setting process be obtained by charging a levy on all companies. It would appear that inadequate consultation occurred between the South African Institute of Chartered Accountants and corporate managers when this funding proposal was formulated. What appears to be a unilateral decision on the source of funding for the accounting standard-setting process by the South African Institute of Chartered Accountants is not supported by corporate managers.

In response to question 2.15: *Are you aware of the proposed changes to the South African accounting standard-setting process?*, forty-one or sixty-four percent of the respondents indicated YES. This would suggest that the South African Institute of Chartered Accountants has not been totally successful in communicating the proposed changes to the accounting standard-setting process to all parties. The number of respondents who are unaware of the proposed changes to the accounting standard-setting process may provide an explanation as to why a relatively large number of respondents to hypothesis 2 agreed that the existing method employed for setting accounting standards is the most appropriate for the South African business environment.

6.5.2 Hypotheses 15 to 19: corporate management

Hypotheses 15 to 19 deal with various aspects relating to corporate management.

6.5.2.1 Hypothesis 15: discussion and interpretation of results

The data used to test null-hypothesis 15 was obtained from question 3.1 of the questionnaire.

Hypothesis 15: *There is no significant difference in the frequency of responses in the respective categories on whether corporate management plays a central role in the determination of accounting standards such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 49,746$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 15 is rejected.

The majority of respondents (thirty-eight, or 50,67 percent) either disagreed, or strongly disagreed with the statement, thereby indicating that, in the opinion of South African corporate managers, that management plays a central role in the determination of accounting standards.

As thirty-seven respondents either strongly agreed, or agreed to the question, thirty-eight strongly disagreed or disagreed, the null-hypothesis was therefore again tested after collapsing the data.

The results of a one sample chi-square indicates that at a 5 percent level of significance and one degree of freedom, $X^2 = 0,0133$ with $p \approx 0,9963$. As $p > 0,05$, null-hypothesis 15 is accepted.

Null-hypothesis 15 provides contradictory results. A number of possible explanations can be given for this. Firstly, as the training of South African chartered accountants is technical, rather than theoretically based, corporate management may possibly be unaware of the role they play in the accounting standard-setting process. Secondly, corporate management is of the opinion that, irrespective of their responses to an exposure draft, no cognisance will be taken by the Accounting Practices Committee of their submissions. Finally, South African corporate managers have in the past been guilty of developing their own version of generally accepted accounting practice.

It is concluded therefore, that South African corporate managers are uncertain of the role they should, or are able to play in the accounting standard-setting process.

6.5.2.2 Hypothesis 16: discussion and interpretation of results

The data used to test null-hypothesis 16 was obtained from questions 3.2; 3.3 and 3.4 of the questionnaire.

Hypothesis 16: *There is no significant difference in the frequency of responses in the respective categories on whether corporate executives are concerned with either the potential earnings or cash flow consequences that may result from the adoption of a particular accounting standard.*

The results of chi-square test of independence indicate that at a 5 percent level of significance, X^2 value of 10,9035 with two degrees of freedom, $p \approx 0,043$. As $p < 0,05$, a significant relationship exists between questions 3.2, 3.3 and 3.4. Null-hypothesis 16 is therefore rejected.

Forty-one, or 54,67 percent, of the respondents to question 3.2 either strongly disagreed, or disagreed that: *Accounting standards should be developed that have as their focus the measurement of earnings rather than the measurement of assets or liabilities.* Fifty-five, or 71,43 percent of the respondents to question 3.3 either strongly agreed, or agreed that: *Management will select an accounting alternative that maintains or increases income over one that, if adopted, will reduce earnings.* Forty-two, or 54,55 percent, of the respondents to question 3.4 either strongly agree, or agree that: *An accounting standard that has as its effect the reduction of income will be countered by management making discretionary changes to accounting policies so as to minimise the potential reduction in income.*

By substituting the calculated X^2 of 10,9035 and $N = 229$ into the contingency coefficient formula, a value of $C = 0,2132$ is obtained. As C_{max} for a $2 \times 3 X^2$ table is 0,71, this is statistically significant because $X^2 = 10,9035$ is significant.

The majority of the respondents agreed, or strongly agreed with the statements, thereby indicating that, in the opinion of South African corporate managers, they are concerned with the potential earnings or cash flow consequences that may result from the adoption of a particular accounting standard. They would select accounting standards on a systematic basis in their attempt to maximise the income reflected by the company.

Evidence provided in this hypothesis supports the position taken by Bowen, Lacey and Noreen (1981), Daley and Vigeland (1983), Dhaliwal (1982), Dhaliwal, Salamon and Smith (1982), Hagerman and Zmijewski (1979), Kelly (1982, 1983 and 1985), Kelly-Newton (1980), Liberty and Zimmerman (1986), Watts and Zimmerman (1978 and 1986) and Zmijewski and Hagerman (1981), that corporate management selects accounting policies in a systematic manner.

6.5.2.3 Hypothesis 17: discussion and interpretation of results

The data used to test null-hypothesis 17 was obtained from question 3.5 of the questionnaire.

Hypothesis 17: There is no significant difference in the frequency of responses in the respective categories on whether corporate executives are entitled to disregard compliance with a statement of generally accepted accounting practice, if compliance results in the company not meeting its financial performance objectives such that $f_1 = f_2 = f_3 = f_4$.

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 58,636$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 17 is rejected.

The majority of respondents (sixty-nine, or 89,61 percent) either disagreed, or strongly disagreed with the statement, thereby indicating that, in the opinion of South African corporate managers, corporate executives are not entitled to disregard compliance with a statement of generally accepted accounting practice, even if compliance would result in the company not meeting its financial performance objectives.

Significant non-compliance with statements of generally accepted accounting practice has been reported by Bunting (1993), Crotty (1995) and Singer (1994), among listed companies including so called 'top 10' companies. It is therefore paradoxical that, in responding to question 3.5, South African corporate managers believe that companies are not entitled to disregard a statement of generally accepted accounting practice even if compliance with that standard may

result in the company not meeting its financial performance objectives. A rational explanation for this change of attitude since the appearance of the articles referred to above, could be that the lifting of economic trade sanctions against South Africa together with the ability of South African companies to compete for finance in the international market, has contributed to this more enlightened perspective.

6.5.2.4 Hypothesis 18: discussion and interpretation of results

The data used to test null-hypothesis 18 was obtained from questions 3.6; 3.7 and 3.8 of the questionnaire.

Hypothesis 18: *There is no significant difference in the frequency of responses in the respective categories on whether corporate executives will lobby for changes to accounting standards.*

The results of chi-square test of independence indicate that at a 5 percent level of significance, X^2 value of 13,8332 with two degrees of freedom, $p \approx 0.001$. As $p < 0.05$, a significant relationship exists between questions 3.6, 3.7 and 3.8. Null-hypothesis 18 is therefore rejected.

Thirty-nine, or 53,42 percent, of respondents to question 3.6 either strongly agree, or agree that: *Policy makers within the standard-setting process are lobbied by management either in an attempt to initiate changes in allowable accounting procedures, or to express support or opposition to a proposed or enacted accounting standard.* Forty-two, or 56,76 percent, of respondents to question 3.7 either strongly disagreed, or disagreed that: *Partners in audit firms responsible for the audit engagement are encouraged by corporate managers to lobby for changes in accounting standards that are perceived to be detrimental to the company.* Fifty-six, or 72,73 percent, of respondents to question 3.8 either strongly agree, or agree that: *Proposed changes to statements of generally accepted accounting practice which if implemented, would adversely affect company earnings, influences management to respond to the change.*

By substituting the calculated $X^2 = 13,8332$ and $N = 224$ into the contingency coefficient formula, a value of $C = 0,2412$ is obtained. As C_{\max} for a $2 \times 3 X^2$ table is 0,71, this is statistically significant. The relationship between questions 3.6, 3.7 and 3.8 is considered significant.

The majority of the respondents agreed, or strongly agreed with the statements thereby indicating that, in the opinion of South African corporate managers, corporate executives will lobby for changes to accounting standards.

The evidence provided by this hypothesis supports the position that corporate management will lobby for changes to accounting standards. However, as is illustrated by the

responses to question 3.7, they are unlikely to encourage partners of audit firms responsible for their audit engagement to lobby the accounting standard-setting body on their behalf.

6.5.2.5 Hypothesis 19: discussion and interpretation of results

The data used to test null-hypothesis 19 was obtained from question 3.9 of the questionnaire.

Hypothesis 19: There is no significant difference in the frequency of responses in the respective categories on whether an audit firm is unlikely to qualify the audit report of a company failing to comply with statements of generally accepted accounting practice because of the potential economic consequences to the audit firm such that $f_1 = f_2 = f_3 = f_4$.

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 41,263$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 19 is rejected.

The majority of respondents (fifty, or 65,79 percent) either disagreed, or strongly disagreed with the statement, thereby indicating that, in the opinion of South African corporate managers, audit firms are likely to qualify the audit report of a company failing to comply with statements of generally accepted accounting practice irrespective of the potential economic consequences to the audit firm.

The results of this hypothesis appear inconsistent with Singer's (1994:7) view that one of the possible reasons for the lack of accounting morality among South African corporations is the apparent unwillingness of large company auditors to issue qualified audit reports.

6.5.3 Hypotheses 20 to 22: corporate management incentive schemes

Hypotheses 20 to 22 deal with various aspects of corporate management incentive schemes.

6.5.3.1 Hypothesis 20, hypothesis 21 and hypothesis 22: discussion and interpretation of results

The data used to test null-hypothesis 20 was obtained from question 4.1 of the questionnaire. This question required respondents to answer a dichotomous question either YES or NO. The data used to test null-hypothesis 21 was obtained from question 4.6 while the data used to test null-hypothesis 22 was obtained from question 4.7 of the questionnaire.

Hypothesis 20: There is no significant difference in the frequency of responses in the respective categories on whether individuals act so as to maximise their own utility and are resourceful and innovative in doing so such that $f_1 = f_2$.

An application of the binomial test indicates that at a 5 percent level of significance $Z = 6,0861$, with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 20 is rejected. Since the sample size > 30 , the binomial test was approximated by the normal distribution.

The majority of respondents (sixty-three, or 86,30 percent) agree with the statement, thereby indicating that in the opinion of South African corporate managers, individuals act so as to maximise their own utility and are resourceful and innovative in doing so. These findings are consistent with the neoclassical assumption that individuals are utility maximisers.

Questions 4.2 to 4.5 inclusive were not subject to hypothesis testing. Respondents were required to answer a number of dichotomous questions relating to the management incentive/compensation schemes that operate in the companies they are employed by. The results are summarised in table 6.14.

Table 6.14: Summary of responses to questions 4.2 to 4.5

	YES	NO	No response	Total %
4.2 Is a management incentive/compensation scheme in operation in the company you are employed by?	80,5	19,5	0	100
4.3(a) Does the scheme require a level of accounting earnings to be achieved?	64,9	27,3	7,8	100
4.3(b) and/or share price performance?	28,6	59,7	11,7	100
4.3(c) and/or particular return on assets to be maintained before participation?	36,4	55,8	7,8	100
4.4 Are there any other contractual obligations between the participants of the compensation scheme and the company?	28,6	63,6	7,8	100
4.5 Have any changes to the management compensation scheme been made in response to changes in statements of generally accepted accounting practice?	1,3	93,5	5,2	100

Of those corporate managers who responded to questions 4.2 through to 4.5 inclusive, management incentive/compensation schemes operated in 80,52 percent of the companies. While the majority of the schemes (70,42 percent) required a level of accounting to be achieved, 67,65 percent of the schemes were not linked to share price performance, while 60,56 percent did not require a particular return on assets to be maintained before participation. There were no contractual obligations between participants of the compensation schemes and the company in 69,01 percent of the responses. What is significant in the context of this study, is that of the seventy-three corporate managers responding to question 4.5, only one company had made

changes to its management compensation scheme in response to changes in statements of generally accepted accounting practice.

Hypothesis 21: *There is no significant difference in the frequency of responses in the respective categories on whether, irrespective of mandatory changes to statements of generally accepted accounting practice, corporate managers are able to 'manage' earnings so as to maximise their own utility such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 77,243$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 21 is rejected.

The majority of respondents (forty-nine, or 66,22 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, although complying with statements of generally accepted accounting practice, corporate managers are able to 'manage' accounting earnings so as to maximise their own utility.

Hypothesis 22: *There is no significant difference in the frequency of responses in the respective categories on whether corporate executives will lobby for amendments to those accounting policies that negatively impact earnings and consequently on their remuneration derived from incentive schemes such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 52,162$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 22 is rejected.

The majority of respondents (forty-four, or 59,46 percent) either disagreed, or strongly disagreed with the statement, thereby indicating that, in the opinion of South African corporate managers, lobbying for amendments to those statements of generally accepted accounting practice that negatively impact on earnings and therefore on remuneration derived from incentive schemes will not occur.

In responding to question 4.6, South African corporate managers provide evidence that they are able to 'manage' accounting earnings so as to maximise their own utility. In light of these findings, it is reasonable to assume that there is no need for corporate managers to lobby against a statement of generally accepted accounting practice that, if implemented, would negatively impact on accounting earnings and consequently, on management remuneration derived from incentive schemes. The 'management' of earnings would occur through the creative use of accounting provisions and other techniques. The rejection of hypotheses 20 to 22 would indicate that although corporate management is influenced by economic motives when lobbying either in favour of or in opposition to a particular accounting policy, the impact that the proposed

policy is likely to have on management compensation/incentive schemes is not taken into consideration when the decision to lobby the standard-setting body is made.

6.5.4 Hypotheses 23 to 26: the regulation of accounting

Hypotheses 23 to 26 deal with various aspects of accounting regulation.

6.5.4.1 Hypothesis 23: discussion and interpretation of results

The data used to test null-hypothesis 23 was obtained from question 5.1 of the questionnaire.

Hypothesis 23: There is no significant difference in the frequency of responses in the respective categories on whether accounting standards should be set in the private sector such that $f_1 = f_2 = f_3 = f_r$.

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 37,896$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 23 is rejected.

The majority of respondents (fifty-seven, or 74,03 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, accounting standards should be set in the private sector.

These findings would support Belkaoui's (1992:87) assertion that the public interest is best served if the accounting standard-setting process is left to the private sector.

6.5.4.2 Hypothesis 24: discussion and interpretation of results

The data used to test null-hypothesis 24 was obtained from question 5.2 of the questionnaire.

Hypothesis 24: There is no significant difference in the frequency of responses in the respective categories on whether in the light of recent corporate collapses, the public interest would best be served by having accounting standards set in the public sector such that $f_1 = f_2 = f_3 = f_r$.

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 33,320$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 24 is rejected.

The majority of respondents (forty-six, or 61,33 percent) either disagreed, or strongly disagreed with the statement, thereby indicating that, in the opinion of South African corporate managers, in spite of recent corporate collapses (Masterbond, Supreme Holdings, IGI), the public interest would not best be served by having accounting standards set in the public sector. From the results of hypotheses 23 and 24, it can be concluded that South African corporate managers

believe that the public interest would best be served by having accounting standards set in the private sector.

6.5.4.3 Hypothesis 25: discussion and interpretation of results

The data used to test null-hypothesis 25 was obtained from question 5.3 of the questionnaire.

Hypothesis 25: There is no significant difference in the frequency of responses in the respective categories on whether the accounting standard-setting process is in need of further regulation such that $f_1 = f_2 = f_3 = f_4$.

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 23,702$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 25 is rejected.

The majority of respondents (forty-one, or 55,41 percent) either disagreed, or strongly disagreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the accounting standard-setting process as it is currently set up, needs no further regulation.

The findings of this hypothesis suggest that in spite of recent corporate collapses and the dissatisfaction expressed by certain users of financial statements with the information supplied in these documents, the existing accounting standard-setting process suffices. Lavies (1994:letter), in his response to exposure draft 90, does however provide the following caveat when he argues: "at a time when the image of the accounting profession is at risk (questionable audit competence and dubious accounting treatment being largely to blame) it is important that creative efforts are made to re-establish professional stature. Breaking new ground and producing more relevant information must surely be a help."

6.5.4.4 Hypothesis 26: discussion and interpretation of results

The data used to test null-hypothesis 26 was obtained from questions 5.4 and 5.5 of the questionnaire.

Hypothesis 26: There is no significant difference in the frequency of responses in the respective categories on whether accounting regulation is essential to ensure that financial statements contain adequate disclosure so as to enable them to compete effectively in the capital market.

The results of a chi-square test of independence indicates that at a 5 percent level of significance and one degree of freedom, $X^2 = 0.85375$ with $p \approx 0.35549$. As $p > 0,05$, no significant relationship exists between questions 5.4 and 5.5. Null-hypothesis 26 is accepted.

Sixty-nine, or 89,61 percent, of respondents to question 5.4 either strongly agree, or agree that: *Regulation of accounting is necessary to ensure that financial statements contain adequate disclosure so as to enable companies to compete effectively in the capital market.* Forty-five, or 59,21 percent, of respondents to question 5.5 either strongly agree, or agree that: *In the absence of regulation, companies would still disclose sufficient information in financial statements so as to enable them to compete effectively in the market for capital resources.*

The majority of the respondents agreed, or strongly with the statements thereby indicating that, in the opinion of South African corporate managers, accounting regulation is not essential to ensure that financial statements contain adequate disclosure to enable companies to compete effectively in the capital market.

The evidence provided by this hypothesis supports the position taken by Benston (1969), Mills (1990), Morris (1984), Watts (1977) and Watts and Zimmerman (1983) who argue that the existence of capital markets is sufficient to ensure that sufficient and adequate financial disclosure will occur in the preparation of financial statements.

6.5.5 Hypotheses 27 to 34: the international harmonisation of accounting standards

The first part of the section of the questionnaire dealing with the international harmonisation of accounting standards sought to establish from South African corporate managers whether or not they believed that the international harmonisation process should continue. The responses are summarised in table 6.15 and table 6.16.

Table 6.15: Individual responses to the benefits of harmonisation

		Strongly Agree	Agree	Disagree	Strongly Disagree	No Response	% Total
6.1	The harmonisation process would lead to						
(a)	An improvement in the quality of financial statements in South Africa	20,8	62,3	16,9	0	0	100
(b)	The provision of comparable financial information for international use	28,6	70,1	1,3	0	0	100
(c)	The culmination of misleading accounting practices	9,1	57,1	33,8	0	0	100
(d)	The range of acceptable practices being narrowed	15,6	62,2	16,9	0	1,3	100
(e)	Assisting in the regulation of accounting across national boundaries	16,9	77,9	5,2	0	0	100
(f)	Other	0	0	0	0	0	0

It is clear from table 6.15, that of those South African corporate managers who responded to the questionnaire, the majority of them believed that tangible benefits would accrue from the harmonisation process. However, in responding to exposure draft 89, Lavies (1994:letter) expressed doubt that all International Accounting Standards would be appropriate for adoption in South Africa. He wondered what the position would be if significant local opinion existed for an alternative treatment in certain circumstances.

Strong feelings were also expressed against the reasons provided for why the harmonisation process not to continue.

Table 6.16: Individual responses to reasons why the harmonisation process should not continue

	Strongly Agree	Agree	Disagree	Strongly Disagree	No Response	% Total
6.1 The harmonisation process should not continue because:						
(a) International accounting standards cannot be amended promptly to take into account changing circumstances in individual countries	2,6	15,6	70,1	7,8	3,9	100
(b) The underlying economic, legal, social and other environmental factors in different countries does not justify it	2,6	10,4	76,6	9,1	1,3	100
(c) Continued rapid growth of global markets proves harmonisation of accounting standards is not necessary	1,3	3,9	74,0	18,2	2,6	100
(d) International accounting bodies are unable to deal with the increasing sophistication of debt/equity markets including items such as interest rate and currency swaps on a timeous basis	3,9	27,3	55,8	9,1	3,9	100
(e) Other	0	0	0	0	0	0

Hypotheses 27 to 34 deal with various aspects of international harmonisation of accounting standards.

6.5.5.1 Hypothesis 27: discussion and interpretation of results

The data used to test null-hypothesis 27 was obtained from question 6.3 of the questionnaire.

Hypothesis 27: *There is no significant difference in the frequency of responses in the respective categories on whether statements of generally accepted accounting practice developed by the International Accounting Standards Committee are of an inferior quality to those developed in South Africa such that $f_1 = f_2 = f_3 = f_4$*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 67,648$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 27 is rejected.

The majority of respondents (sixty-five, or 87,84 percent) either disagreed, or strongly disagreed with the statement, thereby indicating that, in the opinion of South African corporate managers, statements of generally accepted accounting practice developed by the International Accounting Standards Committee are not of an inferior quality to those developed in South Africa.

The response by corporate managers to question 6.3 contradict the findings of Briston (1978), Schroeder and Clark (1995) and Taylor (1987) who have suggested that International Accounting Standards are inferior to those developed by bodies such as the South African Institute of Chartered Accountants.

6.5.5.2 Hypothesis 28: discussion and interpretation of results

The data used to test null-hypothesis 28 was obtained from question 6.4 of the questionnaire.

Hypothesis 28: There is no significant difference in the frequency of responses in the respective categories on whether the South African Institute of Chartered Accountants should collaborate with specific countries (such as Australia and New Zealand) when developing statements of generally accepted accounting practice such that $f_1 = f_2 = f_3 = f_r$.

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 67,133$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 28 is rejected.

The majority of respondents (fifty, or 66,67 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the South African Institute of Chartered Accountants should collaborate with specific countries (such as Australia and New Zealand) when developing statements of generally accepted accounting practice.

The rejection of hypothesis 28 would suggest that South African corporate managers recognise the difficulties inherent in attempting to harmonise accounting standards on a global basis. The rejection of hypothesis 27 would suggest that while corporate managers do not believe International Accounting Standards to be inferior, the harmonisation of accounting standards on a regional or cluster basis may be appropriate.

6.5.5.3 Hypothesis 29: discussion and interpretation of results

The data used to test null-hypothesis 29 was obtained from questions 6.5 and 6.6 of the questionnaire.

Hypothesis 29: *There is no significant difference in the frequency of responses in the respective categories on whether, within an African context, impediments exist that impede the harmonisation of accounting standards.*

The results of a chi-square test of independence indicate that at a 5 percent level of significance and one degree of freedom, $X^2 = 6,94507$ with $p \approx 0,0084$. As $p < 0,05$, a significant relationship exists between questions 6.5 and 6.6. Null-hypothesis 29 is therefore rejected.

Seventy-one, or 93,42 percent, of respondents to question 6.5 either strongly disagree or disagree that: *Too much diversity of culture exists in Africa as a result of the colonial past for the adoption of International Accounting Standards to be successful.* Sixty-three, or 82,89 percent, of respondents to question 6.6 either strongly disagree, or disagree that: *In an African context, governments of former colonies and other developing nations may view the harmonisation of accounting standards as an infringement of their national sovereignty and, as a result, will not support the harmonisation process.*

By substituting $X^2 = 6,94507$ and $N = 76$ into the phi coefficient formula, $\phi = 0,3053$ is obtained. Although a relationship does exist between the responses to questions 6.5 and 6.6, the relationship is a moderate one.

As there is a relationship in the responses, it is concluded therefore, that in the opinion of South African corporate managers, within an African context, no impediments exist that should impede the harmonisation of accounting standards.

The evidence provided by this hypothesis suggest that from an African perspective, the harmonisation of accounting standards is feasible.

6.5.5.4 Hypothesis 30: discussion and interpretation of results

The data used to test null-hypothesis 30 was obtained from question 6.7 of the questionnaire.

Hypothesis 30: *There is no significant difference in the frequency of responses in the respective categories on whether the adoption of International Accounting Standards by the Accounting Practices Board will result in a saving of resources of those multinational companies that operate from South Africa such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 34,876$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 30 is rejected.

The majority of respondents (forty-one, or 56,16 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the adoption of International Accounting Standards by the Accounting Practices Board

will result in a saving of resources of those multinational companies that operate from South Africa.

The responses by corporate managers to question 6.7 and the results of the test on hypothesis 30 supports the view of Purvis, Gernon and Diamond (1991:37) that the preparation of a single set of financial statements using International Accounting Standards provides the potential for considerable cost savings for multinational companies.

6.5.5.5 Hypothesis 31: discussion and interpretation of results

The data used to test null-hypothesis 31 was obtained from question 6.8 of the questionnaire.

Hypothesis 31: *There is no significant difference in the frequency of responses in the respective categories on whether the harmonisation of accounting standards will result in more meaningful information being provided to users of financial statements such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 37,520$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 31 is rejected.

The majority of respondents (sixty-three, or 84,00 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the harmonisation of accounting standards will result in more meaningful information being provided to users of financial statements.

The evidence provided by this hypothesis would suggest that South African corporate managers believe that International Accounting Standards developed and adopted using the International Accounting Standards Committee's conceptual framework will result in more meaningful information being provided to users.

6.5.5.6 Hypothesis 32: discussion and interpretation of results

The data used to test null-hypothesis 32 was obtained from question 6.9 of the questionnaire.

Hypothesis 32: *There is no significant difference in the frequency of responses in the respective categories on whether the harmonisation process should include stock exchange listing requirements such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 102,330$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 32 is rejected.

The majority of respondents (sixty, or 80,00 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the harmonisation process should include stock exchange listing requirements.

As one of the methods of raising additional capital available to South African corporations is a listing on a foreign exchange, it is clear that benefits in the form of cost savings will accrue to these firms should stock exchange listing requirements be harmonised.

6.5.5.7 Hypothesis 33: discussion and interpretation of results

The data used to test null-hypothesis 33 was obtained from question 6.10 of the questionnaire.

Hypothesis 33: There is no significant difference in the frequency of responses in the respective categories on whether corporate management will become more accountable to users of financial statements as a result of the harmonisation process such that $f_1 = f_2 = f_3 = f_4$

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 53,520$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 33 is rejected.

The majority of respondents (fifty-five, or 73,33 percent) either agreed, or strongly agreed with the statement, thereby indicating that, in the opinion of South African corporate managers, they will become more accountable to users of financial statements as a result of the harmonisation process.

The response by corporate managers to question 6.10 would provide an element of comfort to writers such as Crotty (1995), Mathews (1995) and Cameron (1995) who believe that a large number of corporations do not consider themselves accountable to users. Corporate managers believe that they will become more accountable to users as a result of the harmonisation process. What is more likely however, is that the impending amendments to the *Companies Act, Act 61 of 1973*, requiring mandatory adherence to statements of generally accepted accounting practice, together with the Harmonisation and Improvements Project, influenced corporate managers' response to this question.

6.5.5.8 Hypothesis 34: discussion and interpretation of results

The data used to test null-hypothesis 34 was obtained from question 6.11 of the questionnaire.

Hypothesis 34: *There is no significant difference in the frequency of responses in the respective categories on whether the adoption of International Accounting Standards Committee statement of generally accepted accounting practice is likely to result in modifications to corporate management incentive schemes such that $f_1 = f_2 = f_3 = f_4$.*

The results of a one sample chi-square test indicates that at a 5 percent level of significance, $X^2 = 23,702$ with $p \approx 0,000$. As $p < 0,05$, null-hypothesis 34 is rejected.

The majority of respondents (fifty-one, or 71,83 percent) either disagreed, or strongly disagreed with the statement, thereby indicating that, in the opinion of South African corporate managers, the adoption of International Accounting Standards Committee statements of generally accepted accounting practice is not likely to result in modifications to corporate management incentive schemes.

The responses by corporate managers to question 6.11 of the questionnaire support the findings of Healy, Kang and Palepu (1987) whose research indicated that, in spite of accounting changes, no modifications would be made to corporate management incentive schemes. The rejection of hypothesis 21 would also support these findings. These responses by corporate management are consistent with the responses made to question 4.5, where seventy-two, or 98,63 percent, of the respondents to that question stated that no changes had been made to management compensation schemes in response to changes in statements of generally accepted accounting practice.

In responding to question 6.12: *South Africa should continue with the process of harmonising international accounting standards*, seventy out of seventy-three (95,89 percent) answered YES. These responses are consistent to the responses to section 6.1 of the questionnaire illustrated in table 6.15. There is, however, no indication whether the respondents supported the harmonisation of accounting standards based on International Accounting Standards Committee statements of generally accepted accounting practice which they consider inferior to South African developed accounting standards, or whether they support the regional or cluster approach to accounting standard harmonisation envisaged in question 6.4.

6.5.6 Hypotheses 35 to 40: the relationship between age and gender

Hypotheses 35 to 40 examine the relationship between age and gender within corporate management, the regulation of accounting and various aspects of international harmonisation of accounting standards.

Of the respondents to the questionnaire, 70 were male and 7 were female.

Table 6.17: Ages of respondents

	<30	31 - 40	41 - 50	51 - 60	61+	Total
Number of respondents	10	25	19	23	0	77

6.5.6.1 Hypothesis 35: discussion and interpretation of results

The data used to test null-hypothesis 35 was obtained from section 7.3, gender; and section 3 dealing with various aspects of corporate management.

Hypothesis 35: *There is no significant difference between the responses of South African male and female corporate managers on various issues relating to corporate management as the producers of firm specific financial information.*

Table 6.18: Relationship between gender and questions dealing with corporate management

Gender	Number of cases	Mean	Standard Deviation	Standard Error	F	P
Male	70	22,729	2,604	0,311	1,696	0,197*
Female	$\frac{7}{77}$	22,286	3,200	1,209		
* p > 0,05						

The results of a t-Test indicate that, at a 5 percent level of significance, F = 1,696 with p = 0,197. As p > 0,05, null-hypothesis 35 is accepted. It is concluded, therefore, that there is no significant difference between South African male and female corporate managers on whether corporate managers are the producers of firm specific financial information.

6.5.6.2 Hypothesis 36: discussion and interpretation of results

The data used to test null-hypothesis 36 was obtained from section 7.3, gender; and section 5 dealing with accounting regulation.

Hypothesis 36: *There is no significant difference between the responses of South African male and female corporate managers on various issues relating to the regulation of accounting.*

Table 6.19: Relationship between gender and questions dealing with the regulation of accounting

Gender	Number of cases	Mean	Standard Deviation	Standard Error	F	P
Male	70	11,671	1,700	0,203	0,639	0,427*
Female	<u>7</u>	11,286	1,254	0,474		
* p > 0,05						

The results of a *t*-Test indicate that, at a 5 percent level of significance, $F = 0,639$ with $p = 0,427$. As $p > 0,05$, null-hypothesis 36 is accepted. It is concluded, therefore, that there is no significant difference between South African male and female corporate managers on whether they believe that accounting standards are a form of regulation.

6.5.6.3 Hypothesis 37: discussion and interpretation of results

The data used to test null-hypothesis 37 was obtained from section 7.3, gender; and section 6 dealing with the international harmonisation of accounting standards.

Hypothesis 37: *There is no significant difference between the responses of South African male and female corporate managers on various issues relating to the international harmonisation of accounting standards.*

Table 6.20: Relationship between gender and questions dealing with the international harmonisation of accounting

Gender	Number of cases	Mean	Standard Deviation	Standard Error	F	P
Male	70	44,229	4,508	0,539	0,479	0,491*
Female	<u>7</u>	44,714	2,563	0,969		
* p > 0,05						

The results of a *t*-Test indicate that, at a 5 percent level of significance, $F = 0,479$ with $p = 0,491$. As $p > 0,05$, null-hypothesis 37 is accepted. It is concluded, therefore, that there is no significant difference between South African male and female corporate managers on whether the South African Institute of Chartered Accountants should adopt International Accounting Standards for use in South Africa rather than developing South African specific standards.

6.5.6.4 Hypothesis 38: discussion and interpretation of results

The data used to test null-hypothesis 38 was obtained from section 7.4, age; and section 3 dealing with various aspects corporate management.

Hypothesis 38: There is no significant difference between the responses of South African corporate managers of different ages on various issues relating to corporate management as the producers of firm specific financial information.

Table 6.21: Relationship between age and questions dealing with corporate management

Source	DF	Sum of squares	Mean Squares	F	P
Between groups	3	37,32	12,44	0,317	0,813*
Within groups	<u>73</u>	<u>493,20</u>	6,76		
	<u>76</u>	<u>530,32</u>			
* p > 0,05					

The results of an ANOVA indicate that, at a 5 percent level of significance, $F = 0,317$ with $p = 0,813$. As $p > 0,05$, null-hypothesis 38 is accepted. It is concluded, therefore, that there is no significant difference between South African corporate managers of different ages on whether corporate managers are the producers of firm specific financial information.

6.5.6.5 Hypothesis 39: discussion and interpretation of results

The data used to test null-hypothesis 39 was obtained from section 7.4, age; and section 5 dealing with accounting regulation.

Hypothesis 39: There is no significant difference between the responses of South African corporate managers of different ages on various issues relating to the regulation of accounting.

Table 6.22: Relationship between age and questions dealing with the regulation of accounting

Source	DF	Sum of squares	Mean Squares	F	P
Between groups	3	11,79	3,93	0,136	0,938*
Within groups	<u>73</u>	<u>198,03</u>	2,71		
	<u>76</u>	<u>209,82</u>			
* p > 0,05					

The results of an ANOVA indicate that, at a 5 percent level of significance, $F = 0,136$ with $p = 0,938$. As $p > 0,05$, null-hypothesis 39 is accepted. It is concluded, therefore, that there is no significant difference between South African corporate managers of different ages on whether they believe that accounting standards are a form of regulation.

6.5.6.6 Hypothesis 40: discussion and interpretation of results

The data used to test null-hypothesis 40 was obtained from section 7.4, age; and section 6 dealing with the international harmonisation of accounting standards.

Hypothesis 40: There is no significant difference between the responses of South African corporate managers of different ages on various issues relating to the International harmonisation of accounting standards.

Table 6.23: Relationship between age and questions dealing with the international harmonisation of accounting standards

Source	DF	Sum of squares	Mean Squares	F	P
Between groups	3	52,26	17,42	1,232	0,304*
Within groups	<u>73</u>	<u>1 391,01</u>	19,05		
	<u>76</u>	<u>1 443,27</u>			
* $p > 0,05$					

The results of an ANOVA indicate that, at a 5 percent level of significance, $F = 1,232$ with $p = 0,304$. As $p > 0,05$, null-hypothesis 40 is accepted. It is concluded, therefore, that there is no significant difference between South African corporate managers of different ages on whether the South African Institute of Chartered Accountants should adopt International Accounting Standards for use in South Africa rather than developing South African specific standards.

In the context of this study, the acceptance of hypotheses 35 to 40 is important as it indicates that, irrespective of age of gender, South African corporate managers hold consistent views with regard to corporate management, the regulation of accounting and various aspects of the international harmonisation of accounting standards.

6.6 FACTOR ANALYSIS: DISCUSSION AND INTERPRETATION OF RESULTS

The factors identified by the factor analysis represent the hypothetical groupings of statements which are perceived to represent the factors under investigation. In establishing the guidelines

to interpret factors, Child (1970:45) explains that items with loadings greater than $\pm 0,30$ should be used for interpretation purposes. In discussing the loading of the item, the amount of the variation explained by the factor will be explained in terms of its eigenvalue after rotation. The factors extracted by the factor analysis are illustrated in table 6.24.

Fourteen items represented by questions 2.1 through 2.14 inclusive, have high loadings in factor one. Together these represent 13,94 percent of the total variance, or 95,6 percent of the variance accounted for by factor one. Factor one accounts for 29,50 percent of the total variance. This factor represents South African corporate management's views on various aspects relating to the accounting standard-setting process.

Factor two represents 8,90 percent of the total variance. Items represented by questions 6.2, 6.5, 6.6 and 6.11 have high loadings on factor two. Together these represent 55,21 percent of the variance accounted for by factor two, and 2,44 percent of the total variance. This factor represents corporate management's views on those aspects that they perceive may hinder the international harmonisation of accounting standards.

Four questions have high loadings on factor three which account for 6,10 percent of the total variance. The questions with high loadings are 5.2, 5.3, 6.7, and 6.8. This factor accounts for 66,89 percent of the variance accounted for by factor three and 2,02 percent of the total variance. This factor deals with the regulation of accounting and the production of more meaningful information being provided to users of financial statements.

Factor four represents 5,5 percent of the total variance. High loading factors are represented by questions 3.6 and 3.7. Together these represent 66,34 percent of the variance accounted for by factor four, and 1,79 percent of the total variance. These factors are concerned with whether corporate management will lobby for changes to accounting standards.

Two questions; 4.6 and 4.7, have high loadings on factor five. This factor accounts for 5,10 percent of the total variance. These items account for 55,39 percent of the variance accounted for by factor five, and 1,39 percent of the total variance. Factor five appears to be concerned with incentive schemes for corporate management.

Table 6.24: Factors extracted by factor analysis (varimax rotated factor matrix)

QUESTION n = 40	Factor 1	Factor 2	Factor 3	Factor 4	Factor 5	Factor 6	Factor 7	Factor 8	Factor 9	Factor 10	Factor 11	Factor 12	Factor 13	h ²
2.13	.97806	.00770	.03432	.03690	-.04660	.01540	.01828	-.00995	.00275	-.02205	-.02123	.00922	.02104	.96351
2.9	.93410	-.01890	.09521	-.07388	-.07888	.06882	.01022	-.09436	-.00560	-.03728	.00664	-.00459	-.06749	.91343
2.5	.92909	.00491	.08100	.05331	-.01111	.02807	-.01173	-.03747	-.03866	.07207	-.13354	.03223	-.01111	.90077
2.2	.92536	.02254	.00744	.06789	-.11420	-.02803	.05281	-.02804	-.01810	.00731	.08464	.02338	.02756	.88771
2.8	.92279	-.04710	-.06781	-.07750	-.07070	-.06876	.05617	.06761	.01208	.03999	.01189	-.05166	.02112	.88683
2.7	.90843	-.02472	.00256	-.03703	-.08182	-.07518	-.05526	.06314	.15562	-.01757	-.09629	-.03978	-.04513	.88404
2.14	.90622	.01804	.10894	.02194	.15354	-.09652	-.01946	.04116	.08292	.07040	-.06677	-.05083	-.00133	.88775
2.4	.90081	.00996	.20341	-.03629	.15334	-.04114	.01201	-.09476	-.04628	.04822	-.05898	.03265	-.04706	.89980
2.11	.89475	-.06531	.08444	.09282	-.12149	-.01945	.01515	.15451	.05101	.03919	-.00180	-.06648	.09492	.87918
2.6	.89367	.04556	-.02870	-.04887	-.01486	.04410	.02577	-.00956	-.05699	.15738	.01843	.01897	.10063	.84570
2.3	.89124	-.08316	-.00694	.01557	-.10446	-.07847	.08928	-.01958	.07614	-.04235	-.11016	.03791	.08854	.85594
2.1	.88425	.05918	-.01764	.03235	-.03033	.00501	-.06497	.08721	-.06772	.13615	.10706	.07430	.03346	.84075
2.12	.79285	-.10067	.09296	.22250	.26500	-.08703	.02348	-.18907	-.15335	-.06195	.10735	.01344	-.01577	.85030
2.10	.78406	.22017	.14185	.11237	.11986	-.03215	-.07503	-.20186	-.04674	-.04230	-.05546	.15084	-.03870	.78905
6.5	-.03092	.84105	.03690	-.07105	-.14585	-.00786	-.05154	-.08042	-.07164	-.00962	.00370	-.03744	.06160	.75563
6.6	-.06002	.78479	.04426	.04349	-.06076	-.17343	-.15869	.06958	-.20093	.00848	.01637	-.01369	.17186	.72658
6.3	.03791	.66391	.21691	-.04051	.04018	.07881	.23012	-.17436	.07916	.02824	-.10461	.02750	-.26974	.67361
6.11	.12483	.49113	.05232	-.18571	.40338	-.21389	.13396	-.00068	.23841	-.34139	-.21465	-.10758	.04908	.75388
5.3	.13177	.18396	.72856	-.04910	.16858	-.05594	.10825	.30741	.10780	.14145	.04250	-.07027	-.00302	.76056
5.2	.23425	-.00875	.72615	.19994	-.20362	-.01547	-.00530	.09305	-.22703	-.08716	-.01176	.00929	.01527	.73221
6.7	.14240	.30676	.59018	-.06031	.25603	.06790	-.12074	-.20614	.35945	-.00093	-.16671	.08024	-.06855	.76169
6.8	.02347	.32740	.47903	-.22376	.29967	.00295	-.43348	.03646	.11478	-.19431	.00407	.09559	.06846	.73110
3.7	.03426	-.02559	-.05777	.89179	.09618	.15718	.00492	-.13366	.12281	.00167	-.02807	-.00493	.04578	.87029
3.6	.12879	-.10878	.12039	.80815	-.08991	-.18331	-.05918	.13646	-.04651	-.04814	-.04224	.02809	.20268	.80796
4.6	-.11359	-.16358	.04468	.04859	.86750	.11907	.01239	-.02737	-.02845	.02793	.22989	-.01514	.04236	.86812
4.7	-.07338	-.03192	.05381	.03707	.60668	-.04118	-.02751	.52123	.29084	.06666	-.25330	-.05308	.06887	.81371
3.3	-.08196	-.04899	.02093	.04684	.02868	.87356	-.07142	-.06673	.03968	.03010	.00424	-.07883	.06418	.79806
3.4	-.13048	-.18819	-.02069	-.14515	.02163	.66064	-.02902	.30217	-.04761	-.29784	.10624	-.07370	.15789	.73562
3.8	-.00688	.20090	-.35921	.37341	.17323	.47235	.09703	.11384	-.09348	.16748	-.09300	.22670	-.16342	.70790
6.4	.09614	.07197	.04633	-.08845	.07372	-.04709	.82451	-.00545	.21216	-.14751	.06684	-.00321	.05993	.78673
6.10	.04880	.46508	.04792	.01655	.03212	.10171	-.59666	.16713	.20269	-.18191	.25002	-.20630	.11107	.80814
3.5	-.03018	-.08886	.15398	-.01084	.01258	.09689	-.07118	.81041	-.02836	.00519	.04652	.07904	-.10391	.72404
3.9	-.04499	-.11947	-.01634	.09046	.05637	-.01095	.12718	.03887	.85570	-.00194	.18592	.02742	-.04876	.81565
3.1	.24282	-.08257	-.05389	-.01184	.06789	-.13409	-.04218	.00833	.00702	.78116	.01704	-.21519	-.03923	.72081
6.9	-.02488	.35223	.17347	-.11169	-.14588	.30268	-.08938	.16429	.01919	.46931	.09235	.25055	.39999	.76704
5.4	.12839	-.24700	.29574	-.19916	-.02677	.06903	-.29403	-.27725	.34065	.34162	-.30570	.13038	.13937	.73604
4.1	-.08143	-.05706	-.02303	-.07701	.09432	.04292	-.03091	.00569	.15894	.03297	.90125	.04441	-.00598	.86806
5.5	.06334	-.10684	-.08233	.13262	-.12554	-.08756	.16183	.01389	.03991	-.21948	.04959	.80394	.08723	.79576
3.2	-.05321	-.05295	-.15803	.20172	-.18011	.02351	.40665	-.09930	-.01231	-.11480	-.22360	-.58974	.12440	.70612
5.1	-.10934	-.07083	.00325	-.21909	-.09280	-.11357	-.04063	.12135	.04119	.01744	.03023	-.00468	-.85582	.83824
$\Sigma a^2, \Sigma h^2$	11.79650	3.57599	2.44557	2.18344	2.02325	1.66204	1.48109	1.38947	1.36152	1.20680	1.16798	1.04612	1.00853	32.3483
% common variance	36.47	11.05	7.56	6.75	6.25	5.14	4.58	4.30	4.21	3.73	3.61	3.23	3.12	100.00
% total variance	29.50	8.90	6.10	5.50	5.10	4.20	3.70	3.50	3.40	3.00	2.90	2.60	2.50	80.90

Factor six accounts for 4,2 percent of the total variance. Three questions; 3.3, 3.4 and 3.8, account for 85,60 percent of the variance accounted for by factor six, and 1,76 percent of the total variance. Factor six is concerned with whether corporate management is concerned with the potential earnings or cash flow consequences that may result from the adoption of a particular accounting standard.

Two questions; 6.4 and 6.10, account for 85,60 percent of the variance accounted for by factor seven, and 1,76 percent of the total variance. Factor seven represents 3,70 percent of the total variance. Factor seven is concerned with a particular dimension of the international harmonisation of accounting standards.

Factor eight represents 3,50 percent of the total variance. One item represented by question 3.5 accounts for 47,27 percent of this variance and 0,82 percent of the total variance. This factor is concerned with whether corporate management is entitled to disregard a particular accounting standard if compliance with that standard would result in the company not meeting its financial performance objectives.

Factor nine represents 3,40 percent of the total variance. The high loading factor is represented by question 3.9. This represents 53,78 percent of the variance accounted for by factor nine, or 0,91 percent of the total variance. This factor is concerned with whether an audit firm will qualify the audit report of a client who fails to comply with statements of generally accepted accounting practice because of the potential economic consequences to the audit firm.

Three items; question 3.1, 5.4 and 6.9, have high loadings on factor ten which accounts for 3,00 percent of the total variance. These factors account for 73,93 percent of the variance accounted for by factor ten, and 1,13 percent of the total variance. Factor ten appears to be concerned with corporate management's role in the determination of accounting standards.

Factor eleven accounts for 2,90 percent of the total variance. One item represented by question 4.1, accounts for 69,54 percent of the variance accounted for by factor eleven and 1,00 percent of the total variance. Factor eleven relates to the neoclassical assumption that individuals maximise their own utility and are resourceful and innovate in doing so.

Two items represented by questions 5.5 and 3.2 account for 95,03 percent of the variance represented by factor twelve, and 1,23 percent of the total variance. Factor twelve represents 2,60 percent of the total variance explained by this factor. Factor twelve is concerned with the disclosure of accounting information by companies and the development of accounting standards.

Factor thirteen represents 2,50 percent of the total variance. One item representing question 5.1 accounts for 72,62 percent of this variance and 0,91 percent of the total variance.

This factor is concerned with the regulation of accounting, in particular the setting of accounting standards in the private sector.

The results of the factor analysis suggest that the underlying concepts in the hypotheses are supported.

6.7 CLUSTER ANALYSIS: DISCUSSION AND INTERPRETATION OF RESULTS

The objective of the cluster analysis was to attempt to establish whether any subgroups could be established among South African corporate managers who responded to the questionnaire.

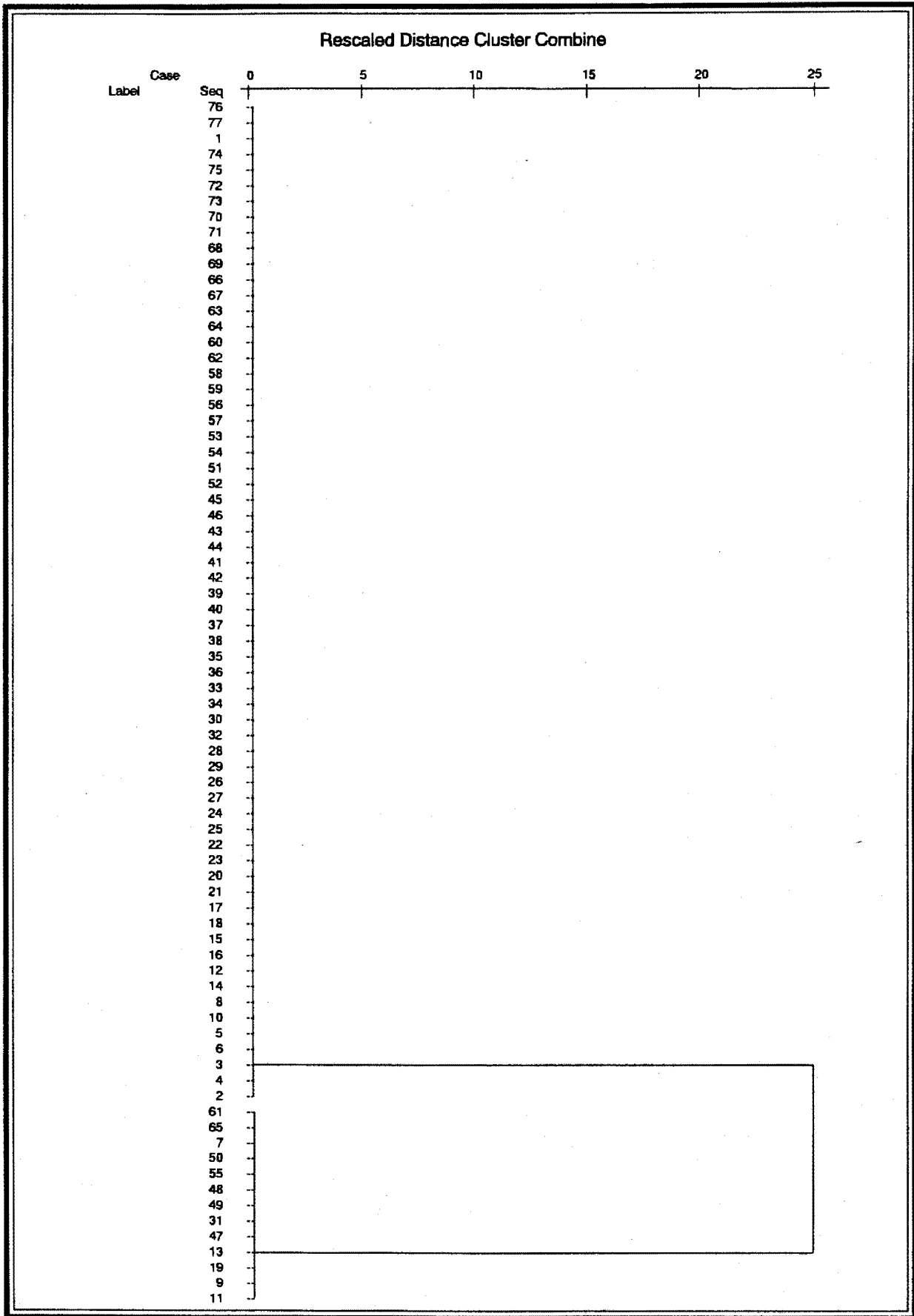
The sample to be clustered was the responses to the questionnaire used to determine South African corporate management's attitude to the accounting standard-setting process and international harmonisation. It was assumed that if numerous clusters were obtained, numerous subgroups of South African corporate managers would exist. These subgroups may all have different attitudes to the accounting standard-setting process and international harmonisation. Three variables were used to measure the differences in corporate management. These were questions 1.1: *Are you familiar with the South African accounting standard-setting process?*, 2.15: *Are you aware of the proposed changes to the South African accounting standard-setting process?* and 4.2: *Is a management incentive/compensation scheme in operation in the company you are employed by?*

When one variable, question 4.2, was used to measure the differences in corporate management, only one cluster was obtained. The conclusion to be drawn under these circumstances is that the population of South African corporate managers is relatively homogeneous. When question 1.1 was used as the variable, two clusters were obtained. The same conclusion can be drawn. When all three variables were used two clusters were obtained. These clusters were made up of the identical cases to the clusters obtained when question 1.1 was used as the variable. From these results it is not unreasonable to assume that South African corporate managers form a relatively homogeneous population.

The two clusters explaining the cluster set is reassuring. These findings would tend to suggest that the findings for hypotheses 35 to 40, where no significant differences between South African male and female corporate managers or between corporate managers of different ages, are correct.

The development of the clusters and their relative distances is reflected in the dendrogram shown as figure 6.1.

Figure 6.1: Dendrogram using average linkage (between groups)



6.8 CRONBACH'S ALPHA COEFFICIENT: DISCUSSION AND INTERPRETATION OF RESULTS

The reliability of the questionnaire used to determine South African corporate management's attitude to the accounting standard-setting process and international harmonisation, was established by using Cronbach's alpha. Evaluating the statistical data, and using the reliability guideline of 0,80 suggested by Oppenheim (1992:159), it can be concluded that, with an overall value of 0,8925, the internal consistency and reliability of the questionnaire has been established.

6.9 SUMMARY

This chapter describes the findings and results of the six independent case studies of responses by South African corporate managers to exposure draft 89, *Revenue*; exposure draft 90, *Property, plant and equipment*; exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policy*; exposure draft 92, *Borrowing costs*; exposure draft 93, *Construction contracts*; and exposure draft 94, *Inventories*.

From an analysis of the responses to the exposure drafts made in the individual case studies, the following tentative conclusions can be drawn:

- South African corporate managers have accepted the issue of exposure drafts based on International Accounting Standards Committee statements of generally accepted accounting practice.
- South African corporate managers do, in the main, support the South African Institute of Chartered Accountant's Harmonisation and Improvement Project.
- The Accounting Practices Committee appear to disregard the comments made by those corporate managers who respond to a proposed statement of generally accepted accounting practice when the statement is finalised. This is not surprising as the arguments used by corporate managers, when opposing a proposed statement of generally accepted accounting practice, lack sound conceptual foundations.
- Changes will only be made to an exposure draft if the Accounting Practices Committee believe they erred in the issue of the initial document. Exposure draft 92, *Borrowing costs*, provides an example of a situation where changes were made.
- South African corporate managers are concerned with the increased disclosure requirements contained in the proposed statements. Although not specified by corporate managers, it would not be unreasonable to assume that this concern is based two issues: firstly, an increase in information production costs that will be incurred; secondly, the potential for increased political costs that may be incurred as a result of the increased disclosure requirements.
- The existence of a corporate management compensation/incentive scheme is unlikely to influence South African corporate manager's decision to lobbying either in favour of, or in opposition to a proposed accounting standard.

- South African corporate managers consider taxation effects (taxation hypothesis) when responding to a proposed accounting standard.

The statistical methods employed to analyse the responses to the survey questionnaire were described. The one sample chi-square test, chi-square test of independence and the binomial test were the nonparametric tests employed. Parametric tests used included the *t*-Test and the analysis of variance (ANOVA).

The results of the forty hypotheses tested were described, each of which provides information about South African corporate managers' attitudes to the accounting standard-setting process and international harmonisation. The results of the statistical tests reveal that South African corporate managers believe that:

- They should play an active role in the accounting standard-setting process.
- The existing method employed for setting accounting standards is the most appropriate for the South African business environment.
- The Accounting Practices Board, through the Accounting Practices Committee, should remain responsible for developing and issuing South African specific exposure drafts and statements of generally accepted accounting practice.
- Non-accounting groups (such as the South African Law Society and the trade union movement) should participate in the accounting standard-setting process.
- The standard of South African developed statements of generally accepted accounting practice are acceptable for financial reporting purposes.
- Existing accounting standards provide management with a sufficiently wide choice of accounting alternatives to enable them to prepare financial statements that fairly present the financial position and financial result of the company.
- The resources spent on the development of South African statements of generally accepted accounting practice have contributed to the maintenance of a high level of local accounting expertise.
- Additional resources should be made available to the South African Institute of Chartered Accountants to enable them to continue the development of South African specific statements of generally accepted accounting practice.
- Corporate executives of public companies are more likely to respond to proposed statements of generally accepted accounting practice than corporate executives of private companies.
- Amendments to the *Companies Act, Act 61 of 1973*, making adherence to statements of generally accepted accounting practice mandatory, have been made expeditiously.
- Significant penalties should accrue to both preparers and auditors of financial statements where statements of generally accepted accounting practice are not complied with.

- The conceptual framework: *Framework for the preparation and presentation of financial statements*, will provide a means of defence against political interference in the accounting standard-setting process.
- Proposed statements of generally accepted accounting practice issued for comment and response should include a presentation of the theory and arguments underlying the standard.
- Companies should not bear the financial cost of the accounting standard-setting process.
- They are unaware of the role they play in the accounting standard-setting process.
- They select accounting policies in a systematic manner.
- They must comply with a statement of generally accepted accounting practice even if compliance would result in the company not meeting its financial performance objectives.
- They will lobby for changes to accounting standards.
- Audit firms are likely to qualify the audit report of a company failing to comply with statements of generally accepted accounting practice irrespective of the potential economic consequences to the audit firm.
- Individuals act so as to maximise their own utility and are innovative and resourceful in doing so.
- Irrespective of mandatory changes to statements of generally accepted accounting practice, corporate managers are able to 'manage' accounting earnings so as to maximise their own utility.
- The existence of management compensation/incentive schemes will not influence corporate management to lobby for amendments to those statements of generally accepted accounting practice that negatively impact on earnings, and therefore on remuneration derived from incentive schemes.
- Accounting standards should be set in the private sector.
- The accounting standard-setting process requires no further regulation.
- Accounting regulation is not essential to ensure that financial statements contain adequate disclosure to enable companies to compete effectively in the capital market.
- Statements of generally accepted accounting practice developed by the International Accounting Standards Committee are not of an inferior quality to those developed in South Africa.
- The South African Institute of Chartered Accountants should collaborate with specific countries (such as Australia and New Zealand) when developing statements of generally accepted accounting practice.

- Within an African context, impediments do not exist to impede the harmonisation of accounting standards.
- The adoption of International Accounting Standards by the Accounting Practices Board will result in a saving of resources of those multinational companies that operate from South Africa.
- The harmonisation of accounting standards will result in more meaningful information being provided to users of financial statements.
- The harmonisation process should include stock exchange listing requirements.
- They will become more accountable to users of financial statements as a result of the harmonisation process.
- The adoption of International Accounting Standards Committee statements of generally accepted accounting practice is not likely to result in modifications to corporate management incentive schemes.
- There is no difference between South African male and female corporate managers on whether corporate managers are the producers of firm specific financial information.
- There is no difference between South African male and female corporate managers on whether they believe that accounting standards are a form of regulation.
- There is no difference between South African male and female corporate managers on whether the South African Institute of Chartered Accountants should adopt International Accounting Standards for use in South Africa rather than developing South African specific standards.
- There is no difference between South African corporate managers of different ages on whether corporate managers are the producers of firm specific financial information.
- There is no difference between South African corporate managers of different ages on whether they believe that accounting standards are a form of regulation.
- There is no difference between South African corporate managers of different ages on whether the South African Institute of Chartered Accountants should adopt International Accounting Standards for use in South Africa rather than developing South African specific standards.

Multivariate techniques in the form of a factor and cluster analysis were employed. The factor analysis summarised the data contained in the questionnaire and thirteen factors were extracted. These factors were compared to the hypotheses tested and were found to support the underlying concepts in the hypotheses. From the cluster analysis, two clusters were obtained. The results of the cluster analysis support the findings of hypotheses 35 to 40.

Cronbach's alpha coefficient was used as the reliability estimate to establish the validity of the research instrument. The result of this test established the internal consistency and reliability of the questionnaire.

These findings, together with the results of the case studies, provide the necessary platform on which various conclusions and recommendations can be made.

CHAPTER 7

SUMMARY, RECOMMENDATIONS AND CONCLUSION

- 7.1 INTRODUCTION**
- 7.2 LITERATURE REVIEW**
- 7.3 SOUTH AFRICAN CORPORATE MANAGEMENT'S ATTITUDE TO THE ACCOUNTING STANDARD SETTING PROCESS AND INTERNATIONAL HARMONISATION**
- 7.4 IMPLICATIONS OF THIS STUDY AS APPLIED TO THE FIELD OF ACCOUNTING**
- 7.5 CONCLUSION**

7.1 INTRODUCTION

This chapter summarises, analyses and evaluates the overall research findings of South African corporate management's attitude to the accounting standard-setting process and international harmonisation. The chapter commences with a review of literature studies. Thereafter, the findings of the case studies are reviewed and some of the more significant empirical findings are highlighted. Areas for future research that have emerged from this study are identified. Finally, a conclusion is drawn.

7.2 LITERATURE REVIEW

The importance of soundly developed accounting standards that permit the production of accounting information that can be reliably used for decision making purposes is emphasised. Accounting standards are used by corporate managers when they prepare financial information for external consumption. Corporate management's involvement in external reporting is in the selection of the appropriate accounting method, level of disclosure, and reaction to a proposed or enacted accounting standard.

The nature and purpose of accounting standards

The nature and purpose of accounting standards form the underlying theme of this study. Accounting standards are described as those rules designed to achieve uniformity and comparability in external financial reporting. As is indicated, corporate management is responsible for selecting and applying accounting policies, that in their opinion are appropriate to ensure that the financial results fairly present the financial position and results of the company for the year.

It is illustrated that the application of a particular accounting standard in the preparation of financial statements may result in economic benefits accruing to a particular user. As there are many and varied users of financial statements, each user group seeks to adopt that accounting standard that provides them with the greatest economic benefit. This results in conflict among user groups in the development and adoption of accounting standards.

To avoid this conflict of interests, the accounting standard-setting process should ideally serve the public interest. This would be achieved if accounting standards were formulated using a soundly conceived theoretical base. In addition, the selection of a particular accounting standard on a basis that is both logical and rational will assist in reducing conflict among users.

The concept of theory and alternative theories of accounting are examined to provide the theoretical framework against which South African corporate management's attitude to the accounting standard-setting process and international harmonisation is examined. For the purposes of this study, a theory is described as a set of interrelated concepts, either verbal or written, containing narrative or mathematical components that can be used to provide a framework within which relationships can be explained and conclusions drawn in a logical and systematically sound manner. From the above description, it is evident that a theory should be capable of being subjected to either logical or empirical testing so that its accuracy can be verified.

It is illustrated that a single theory to satisfactorily explain accounting phenomena in a logical and sound manner does not exist. The reason for this is that definitions of accounting theory have evolved simultaneously with changes in accounting thought, the evolutionary nature of business practices, as well as the increasing complexities of these practices. As the term accounting theory is likely to continue evolving, it is unlikely that an universally agreed upon theory of accounting will be developed. What is more likely however, is that the number of definitions of accounting theory will increase as academics look outside the traditional influences of accounting such as economics and philosophy in an attempt to formulate or justify an acceptable theory of accounting.

The attempt to apply a single theory or develop a theory applicable to accounting standard-setting has also proved unsuccessful. In this study, three alternative approaches to accounting theory are examined, the normative or prescriptive approach, the positive or descriptive approach and the eclectic approach.

Normative theory focuses on policy prescriptions and recommends courses of action rather than the analysis and explanation of accounting practice. Three normative accounting theories, the true income, information economics and the decision usefulness approach are reviewed. The discussion of normative theories is considered relevant in view of the attempts by

various accounting standard setting bodies to develop a comprehensive theory of accounting on which to base accounting standards.

A motivating factor for the development of a conceptual framework was dissatisfaction with the then existing methods of setting accounting standards. It is further argued that the possession of a conceptual framework provides users of financial statements with reassurance that financial accounting has a formal knowledge base from which practices and standards are derived. Furthermore, a coherent theoretical base from which accounting standards are developed provides protection from political interference in the accounting standard setting process. However in criticising the conceptual framework, it can be argued that in attempting to formulate a comprehensive framework to govern the accounting standard-setting process, the architects of this framework failed to appreciate that the accounting information is an economic good capable of being traded. Corporate management and other preparers of financial information will continue to manipulate financial information in an effort to maximise their welfare.

Accounting theories which have as their conceptual underpinnings one of the philosophies of science are known as positive theories. Through empirical research, these theories attempt to provide scientific explanations why accountants choose a particular accounting alternative. The positive approach to accounting theory is based on two economic theories: the economic theory of government regulation and the economic theory of the firm. The economic theory of government regulation views the political process as the method whereby interested parties compete for wealth transfers. Accounting numbers and especially earnings are used in the political process to justify company regulation. The economic theory of the firm regards the company as a legal nexus of contracts and accounting information as the medium where contracts are enforced to reduce agency costs. Economic theory of the firm assumes that the selection of accounting policies is part of the wealth maximising process. Under positive accounting theory, investors are assumed to behave rationally. This approach to accounting theory provides a more concise view of the way in which accounting methods can affect corporate cash flows, and ultimately the market value of securities. This includes the regulatory process, effects on legislation and corporate contracts specified in terms of accounting measures.

The nature of regulation is examined. Regulation is described as a form of governed, guided or controlled interference or intervention in an activity subject to regulation. From the perspective of information, and particularly accounting information as a commodity, the rationale for regulation is that accounting information should be viewed as any other form of economic good. The primary purpose of regulation is the protection and benefit of the public. Regulation of accounting can be justified if it improves economic efficiencies by remedying market failures,

and equity. Equity includes: distributive and corrective justice considerations, concern for public values, honesty and fair dealing.

Interference or intervention in the accounting standard-setting process can be easily understood if accounting information is viewed as an economic commodity. Any rules that govern either the form, content, or both form and content that information should take when corporations produce financial information for users is a form of regulation. As accounting standards govern the form and content of financial statements, they are a means of regulation.

A number of reasons have been used to justify the regulation of accounting. These include the failure of the market for information, potential economic consequences of accounting information, and regulation being the most efficient way in which the state and private interest groups can be aligned to maintain social order and productivity. When the market for information fails, the state intervenes to protect the public interest. Those parties affected make use of the political process to capture the benefits of regulation in an attempt to increase their wealth.

Three theories of regulation are examined; public interest and regulatory capture and public choice theories. Public interest theory holds that regulation is a response to a public demand that attempts to correct inefficient or inequitable market practices. In other words, a market failure has occurred which may be remedied by government intervention which is then justified on the grounds that it is in the public interest. Included in public interest theory is a discussion of the nature of a public good. It is the public good nature of some products including accounting information, which can lead to a market failure.

It is illustrated that, in a South African context, government intervention in the accounting standard-setting process can be justified under public interest theory in light of the recent corporate collapses including Masterbond, Supreme Holdings, IGI and 101 Victoria Embankment. These collapses occurred even though the auditors of the respective institutions may have considered that the financial statements fairly presented the financial position and financial results of these institutions prior to their demise. Government intervention under these circumstances must be viewed as an attempt to rectify failures in the market for accounting information.

Regulatory capture theory recognises that regulations have economic consequences. Capture theory holds that regulation is supplied in response to the demands of specific interest groups who seek to maximise the income of their members. Regulatory capture theory refers to the capture of regulatory agencies by interest groups so as to protect their own interest. From an accounting perspective it can be argued that the establishment of the Accounting Practices Board was formed to ensure the protection of the public interest. However, based on the Australian experience, it can be argued that the Accounting Practices Board was captured by the

South African accounting profession which is the regulated industry. A plausible reason to justify this hypothesis is that recently the accounting profession has found it necessary to legitimise accounting standards by providing them with legislative backing. The accounting profession has an economic interest in retaining the accounting standard-setting process rather than abdicating this power to government control. The result was not regulatory intervention in the accounting standard-setting process to protect the public interest, but was rather the capture of the standard-setting process by an elite group, the accounting profession, for its own gain.

Public choice theory assumes that a market for regulation exists with similar supply and demand forces as those that operate in the capital market. Public choice theory is based on the following two insights: the coercive power of government, and the theory of cartels which provide the location of demand and supply curves. Public choice theory holds that regulation is sought by a producer private interest group and is designed and operated primarily for its own benefit. From an accounting perspective, the intervention by government in the standard-setting process was as a result of the demand by corporate managers and directors who wished to protect themselves from the possibility of over-regulation following corporate collapses.

Although the accounting-standard setting process forms part of the regulatory process, it can also be viewed as a political process. In the accounting standard-setting process which regulates the form and content of financial statements, there is a relationship between the state, the accounting profession and users of financial statements. In South Africa, the state traditionally plays a passive role in the development of accounting standards. The accounting profession is provided with legitimacy through various acts of parliament. Individual accountants are indirectly influenced by the state in that 'licences' to practice are issued by the accounting profession. Interest intermediation examines the roles played by those parties who attempt to exercise power and control of the accounting standard-setting process. Two forms of interest intermediation are considered appropriate for describing and analysing interest politics in an accounting context: pluralism and corporatism.

The term pluralism is generally associated with liberal democracies. In a pluralistic or liberal democratic society, special interest groups whose function it is to promote influence in rule making exist. From a South African accounting standard-setting perspective, evidence of lobbying activities by corporate management, the accounting profession and other interested parties to exposure drafts, provides an indication that this form of behaviour is consistent with pluralistic ideals.

Corporatism attempts to identify the purposes and interests served by the process of regulation. Private interest groups are provided with an influential role in the creation and implementation of governmental policy. The state encourages corporatist arrangements as it

believes that professional expertise is best served by having a single representative monopoly such as the South African Institute of Chartered Accountants.

Alternative approaches to the accounting standard-setting process are examined. This section reviews whether accounting regulation should be left to the free market or whether it would be preferable for accounting regulation to be set by either a private or public sector standard-setting body. Several arguments supporting an unregulated market for accounting information were examined. These included: the free market approach, agency theory, competitive capital markets and private contracting opportunities. Finally, the private-sector and public-sector approach to the accounting standard-setting process is examined.

The South African accounting standard-setting and international harmonisation

The South African accounting standard-setting process is then reviewed. This includes the composition of and the roles played by the Accounting Practices Board and the Accounting Practices Committee. The Accounting Practices Board is the body responsible for the control, development, and issue of statements of generally accepted accounting practice in South Africa. The Accounting Practices Committee is a committee responsible for the development of statements of generally accepted accounting practice. Before a statement of generally accepted accounting practice is issued, it passes through a lengthy process of scrutiny and discussion before the Accounting Practices Board approves it for issue. The sequence of steps in the development of a statement of generally accepted accounting practice are described in detail. By virtue of industry representation on the Accounting Practices Board, South African corporate managers can be viewed as playing an indirect role in the accounting standard-setting process. By lobbying the Accounting Practices Committee either in favour of or in opposition to a proposed accounting standard, South African corporate managers can play a direct role in the accounting standard-setting process.

The desirability and feasibility of harmonising of accounting standards has been discussed numerous times in the accounting literature since first proposed in the late 1950's. It is illustrated that the application of different accounting standards can materially effect the financial results of companies. In addition, these differences in financial reporting practices of various countries provide preparers, auditors and users with difficulties. As a result, pressure has been exerted on accounting bodies from user groups to improve the comparability of accounting and information disclosure. Without harmonisation, corporate management is faced with a burden of reconciling disparate accounting practices in an attempt to significantly reduce any risks associated with operating and investment decisions.

The differences in the terms harmonisation, standardisation and uniformity in relation to accounting standards are described. The term harmonisation refers to the process by which differences in financial reporting practices among countries are reduced. The result is that increasingly comparable financial statements should result. Standardisation implies a more rigid and narrow approach which would ultimately result in uniformity. Within the concept of regulation and practice, harmonisation, harmony, standardisation, and uniformity exist at the levels of concepts, principles, regulations and practice, with regulation and practice having the most immediate impact of financial statements.

While harmonisation is primarily concerned with the promotion of similarity among sets of national accounting standards, the issue of uniformity has also arisen. Three models of uniformity are described. These are firstly, the absolute uniformity model which proposes a single set of accounting standards and financial statement format throughout the international economic community. Secondly, the circumstantial uniformity model which would permit different accounting methods and reports on a transnational basis that would take into account varying economic factors and conditions, and thirdly, the purposive uniformity model which would consider both circumstances as well as user needs and purposes in establishing appropriate accounting methods, standards and reports.

The primary justification for harmonised accounting standards is the increasing interdependence of nations in terms of trade and investment flows. The globalisation of business, investment and capital markets, together with advances in technology together with pressure from users, preparers, security regulators and stock exchanges has created the need for comparable high quality financial reporting. It is argued that the harmonisation of accounting standards will facilitate the internationalisation of capital markets and multinational businesses because comparable financial information will be provided to international users. Accounting harmonisation is also justified on the grounds that it can assist in raising foreign capital. Providers of capital rely on financial statements to make the most effective investment and loan decisions. It is illustrated that tangible benefits accrue to countries with inadequate accounting and auditing standards who adopt International Accounting Standards which is also provided as an argument supporting harmonisation. The beneficiaries in these countries include revenue authorities who would be able to understand and control the operations of multinational corporations, labour unions, and international credit grantors such as the World Bank.

In spite of the arguments in favour of harmonisation, convincing arguments against the harmonisation process exist. These include differences in background and tradition among nations, differences in needs of economic environments and the challenge of uniformity to state sovereignty. Additional arguments against harmonisation include the number of companies whose

ownership is not spread among investors and the strict licensing requirements of accounting bodies internationally. Empirical evidence contradicting the traditional arguments in support of harmonisation is also provided.

An illustration of the complex role environmental factors play in the accounting process are provided. These include: historical, political, economic and social factors at both the national and international level. Internal and external variables also influence accounting. The internal variables include: the stage of economic development, implicit and explicit goals of society, the nature of the legal system and culture. External factors are described as those variables likely to influence accounting regulators. These include colonial ties, the effect of multinational corporations, regional economic cooperation, internationalisation of world trade and stock markets.

Impediments to international harmonisation that occur as a direct result of environmental factors are described in detail. These include: comparative development patterns, classification of accounting practices, cultural influences on accounting, development influences and developing countries. It is illustrated that while these impediments do not reduce the overall need for harmonisation, they need to be addressed in order for the harmonisation process to be successful.

A convincing argument for non-compliance with International Accounting Standards is the existing differences in accounting practices, cultural influences and development influences described above, which suggest that the harmonisation process is likely to be fraught with difficulties. Suitable alternatives to the harmonisation process envisaged by the International Accounting Standards Committee are provided. In view of the potential economic and political influence that multinational corporations may exert on developing nations, it would not be unreasonable to expect that these countries would support the development of accounting standards that would assist them in controlling these corporations. The cluster approach to the harmonisation of accounting standards is based on the premise that, because accounting is influenced by its environment, it is reasonable to assume that accounting similarities will exist in countries whose business environments are similar. This form of harmonisation is both relevant and feasible. On a regional basis this could be achieved by merging national accounting standard-setting bodies.

The role of the International Accounting Standards Committee in the harmonisation process is then examined. The role played by this body is viewed as a private sector response to the demand for an international accounting standard-setting process. The existence of the International Accounting Standards Committee is justified on the grounds of the need for the international harmonisation of financial reporting practices and the growth of multinational

businesses. Although the implicit goal of the International Accounting Standards Committee is accounting harmonisation, its official goal is the formulation and publication of accounting standards that can be used in the preparation and presentation of financial statements.

It has been the perception by preparers of financial statements that International Accounting Standards are of a poor quality, that has been a contributing factor to the slow progress towards harmonisation. The belief that their standards are inferior to those developed on a national basis, as well as the perception that the organisation failed to address any controversial topics, has resulted in the International Accounting Standards Committee developing a credibility problem. To overcome these criticisms, International Accounting Standards Committee embarked on an improvement project aimed at improving the accounting standards and eliminating alternative accounting treatments permitted by the standards.

The international harmonisation of accounting from a South African perspective is then examined. It is illustrated that South African compliance with International Accounting Standards has in the past been low. Two reasons are provided for this low level of compliance. First, the comprehensive sanctions previously in force against South Africa and the lack of international exposure received by companies, the accounting profession and accounting academics. Second, the inability of the South African accounting profession to force companies to comply with either local or International Accounting Standards.

The decision to adopt international Accounting Standards for use in South Africa and the proposed accounting standard-setting process was reviewed. This included the proposal to provide legal backing for accounting standards, the introduction of a body known as the Accounting Standards Council to replace the Accounting Practices Board, the formation the Standards Development committee, and the introduction of a Review Panel to rule on departures from accounting standards.

It is appropriate to question whether the South African Institute of Chartered Accountants, when taking the decision to adopt International Accounting Standards for issue in South Africa were influenced by the political uncertainty that existed in the early 1990's. Did the South African Institute of Chartered Accountants embrace the International Harmonisation Project in an effort to protect the accounting profession from the threat of political interference in the accounting standard-setting process? A further factor to consider is: would the harmonisation of accounting standards which should contribute to the free flow of funds into South Africa, be one of the prerequisites to the possible lifting of exchange control regulations?

By adopting International Accounting Standards it is argued that the South African Institute of Chartered Accountants has failed to take the long term requirements of South African preparers and users into account. This view is justified on the grounds that should the

International Accounting Standards Committee become the primary originator of financial and reporting standards, the South African Institute of Chartered Accountants will, as a standard-setting body, face an uncertain future. Its standard-setting function may either become obsolete, be relegated to dealing with issues left by the International Accounting Standards Committee, or be reduced to a lobbying body on behalf of the South African financial community.

Finally, the role that South African corporate management plays in the accounting standard-setting process is examined. Their participation in the standard-setting process is described as both direct and indirect. Indirect participation arises as a result of industry representation on the Accounting Practices Board. Direct participation involves making written submissions indicating either support or opposition to an exposure draft issued by the Accounting Practices Committee. In view of the South African Institute of Chartered Accountants' decision to adopt International Accounting Standards Committee accounting standards for use in South Africa, no significant role appears to exist for corporate management's participation in the accounting standard-setting process. At best their role is likely to be relegated to merely lobbying the South African Institute of Chartered Accountants in a vain attempt to influence the standard setting process, who in turn face the very real danger of being regulated to a mere lobbying role on behalf of South African financial statement users and preparers.

Corporate management's reaction to accounting standards

The central theme of this study namely, corporate management's attitude to the accounting standard-setting process is then reviewed. For the purposes of this study, the international harmonisation of accounting standards can be viewed as merely part of the accounting-standard setting process rather than a new innovation.

As corporate managers are an active participant in the accounting standard-setting process, the factors that influence them to respond either positively or negatively to a proposed change in accounting standards are reviewed. Corporate management's reaction to a proposed accounting standard can be understood by appreciating that as part of its stewardship function, management is responsible for reporting the financial position and financial results of operations. In order to achieve this, management selects those accounting policies and disclosure levels necessary to maximise the wealth of the company.

To understand why corporate management reacts to a proposed or enacted standard in a particular way, it is necessary for the costs and benefits of the alternative accounting procedures to be assessed in terms of their cash flow implications. This reaction can take a number of forms. These include lobbying the accounting standard-setting body, making discretionary accounting changes to mitigate the financial statement effect of the change in

policy, changing financing, production or investment activities of the firm, subverting the standard or discrediting the standard-setting body.

The reason corporate management reacts to a proposed accounting standard in a particular way is that management is compensated for performing its stewardship function by both direct remuneration and incentive plans linked to accounting earnings and share prices. Based on the neoclassical assumption that individuals are wealth maximisers, it is illustrated that corporate management selects that permutation of accounting policies most likely to maximise their income through increasing share prices and cash incentive bonuses. Management is therefore motivated to select that permutation of accounting policies likely to maximise their income. Based on their own self interest, management will therefore participate in the standard-setting process by lobbying the accounting standard-setting body, provided the costs of lobbying do not exceed that which would be incurred by changing financing, production or investment activities of the firm. Factors identified as influencing corporate management's attitude towards accounting standards include: taxation costs, costs of regulation, political costs, information production costs and management compensation, and monitoring and bonding contracts.

The sociological role played by corporate management in the accounting standard-setting process viewed the acceptance or rejection of a proposed accounting standard as being effected by numerous interacting factors. These included resistance to change inherent within the individual and social system, aspects specific to the innovation, communication channels used to diffuse the proposed change, and social system effects.

A number of studies focusing on discretionary accounting changes made by corporate management when responding to proposed changes in accounting standards likely to impact on their wealth were examined. These studies provide an illustration of those factors corporate management takes into account when making the decision to lobby either in favour of or in opposition to a proposed accounting standard. The results of these studies suggest that corporate management's attitude to the accounting standard setting process is a function of taxation costs, costs of regulation, political costs, information production costs and management compensation, monitoring and bonding contracts and capital structure.

7.3 SOUTH AFRICAN CORPORATE MANAGEMENT'S ATTITUDE TO THE ACCOUNTING STANDARD SETTING PROCESS AND INTERNATIONAL HARMONISATION

In this section, the results of the six individual case studies and the research instrument provide evidence of South African corporate management's attitude to the accounting standard-setting process and international harmonisation.

7.3.1 The case studies

Various factors influence corporate management's decision to respond to a proposed statements of generally accepted accounting practice. These include the link between remuneration and reported earnings, the costs of regulation, taxation considerations, political costs, information production costs, and the existence of monitoring and bonding contracts. Individual case studies covering the first six exposure drafts based on International Accounting Standards issued by the Accounting Practices Committee of the South African Institute of Chartered Accountants are examined in an attempt to establish whether any of the above factors influence South African corporate managers response to a proposed accounting standard.

From the comments received from South African corporate managers to the six independent case studies, the following tentative conclusions are drawn.

- South African corporate managers have accepted the issue of exposure drafts based on International Accounting Standards Committee statements of generally accepted accounting practice. This would suggest that the South African Institute of Chartered Accountants Harmonisation and Improvement Project is supported by corporate management.
- Responses made by corporate management to an exposure draft are generally ignored by the Accounting Practices Committee when finalising the statement of generally accepted accounting practice.
- The Accounting Practices Committee will only consider corporate management responses to a proposed accounting standard if the Accounting Practices Committee erred in drafting the initial exposure draft.
- South African corporate managers are concerned with the increased disclosure requirements contained in the proposed statements. Although not specified by corporate managers, it would not be unreasonable to conclude that this concern is based on an increase in information production costs that will be incurred by companies. In addition, the increased disclosure may result in an increase in political costs accruing to companies.
- Possible taxation effects are taken into account by corporate management when responding to a proposed statement of generally accepted accounting practice.

Although accounting standards affect resource allocation through corporate managements reaction to proposed accounting standards, no mechanism exists for standard-setting bodies to establish how corporate managers feel about a proposed standard or to measure the effect that the imposition of the standard will have on resources. Comment letters may not necessarily be the most effective method of achieving this.

7.3.2 The empirical investigation

The results of the forty hypotheses tested provide evidence of an empirical nature of South African corporate management's attitude to the accounting standard-setting process and international harmonisation. The following are the more important conclusions that have been drawn from the application of the research instrument.

7.3.2.1 Accounting standard-setting process

It is clear from the results of the study that South African corporate managers believe that they should play an active role in the accounting standard-setting process. In addition, they believe that existing method of setting accounting standards continue to be appropriate for South African circumstances. Although resources spent on the development of South African statements of generally accepted accounting practice have contributed to the high level of accounting expertise in South Africa, additional resources should be made available to the South African Institute of Chartered Accountants to enable them to continue the development of South African specific statements of generally accepted accounting practice.

South African corporate managers also believe that significant penalties should accrue to both preparers and auditors of financial statements where statements of generally accepted accounting practice have not been complied with. Provisions for these penalties could be contained within amendments to the *Companies Act*, Act 61 of 1973 providing legal backing for accounting standards. Finally, companies should not bear the financial costs of the accounting standard-setting process.

7.3.2.2 Corporate management

South African corporate managers appear uncertain of the role that they play in the accounting standard-setting process they do believe that they select accounting policies in a systematic manner. Although they will lobby for a change to an accounting standard, corporate managers do not believe that they are entitled to disregard a statement of generally accepted accounting practice even though compliance with that standard would result in the company not meeting its financial performance objectives.

7.3.2.3 Corporate management compensation/incentive schemes

Corporate managers act to as to maximise their own utility and are innovate and resourceful in doing so. The existence of management compensation/incentive schemes, suggest corporate managers, is unlikely to influence their decision to lobby for amendments to statements of generally accepted accounting practice that negatively impact on earnings, and by implication

on remuneration derived from incentive schemes. The reason for this is that irrespective of mandatory changes to statements of generally accepted accounting practice, South African corporate managers believe that they are able to 'manage' accounting earnings so as to maximise their own utility. In addition, evidence from the research instrument suggests that the harmonisation process is also unlikely to result in modifications being made to incentive schemes.

7.3.2.4 Regulation of accounting

In spite of recent corporate collapses, management believe that accounting standards should continue to be set in the private sector. Furthermore, the South African accounting standard-setting process requires no further regulation.

7.3.2.5 International harmonisation of accounting standards

Although South African corporate managers do not view accounting standards issued by the International Accounting Standards Committee as inferior to those issued by bodies such as the South African Institute of Chartered Accountants, they do believe that collaboration with specific countries could be beneficial when developing accounting standards. The international harmonisation process was viewed as a method whereby more meaningful information would be provided to users of financial statements.

7.3.2.6 Effect of age and gender on corporate management attitudes

There is no difference between how South African male and female corporate managers view issues relating to corporate management, accounting standards as a form of regulation, and the international harmonisation of accounting standards. In addition, there is no difference as to how South African corporate managers of different ages view issues relating to corporate management, accounting standards as a form of regulation, and the international harmonisation of accounting standards.

7.4 IMPLICATION OF THIS STUDY AS APPLIED TO THE FIELD OF ACCOUNTING

Research in all fields of accounting and in particular research that has as its focus the behaviour of corporate management, and the international harmonisation of accounting standards is a neglected area of study in South Africa. This is primarily due to a lack of a research ethic in many departments of Accountancy at South African Universities. Evidence of this is the lack of research papers on this subject that appear in local recognised academic journals. A contributing factor to this is that the focus of teaching at South African universities at undergraduate and

honours level is on technical aspects of accounting when preparing students for a career in the accounting profession.

However in spite of these shortcomings, a number of areas where further research is warranted are provided.

7.4.1 A need to establish whether the International harmonisation process has been captured by the international accounting firms

Evidence in this study recognises that regulations have economic consequences. Regulation is supplied in response to the demands of specific interest groups who seek to maximise the incomes of their members. This is achieved by the regulatory agency being captured by the interest group to protect their own interest.

For these reasons the composition of the International Accounting Standards Committee Board warrants further research. The cover of a recent publication (Nobes 1994) sponsored by Coopers & Lybrand indicates that four partners of that firm were International Accounting Standards Committee Board representatives. Evidence of this nature would suggest that the International Accounting Standards Committee Board has been captured by the international accounting firms. This capture would in all likelihood result in an increase in revenues of these firms. Evidence either supporting or refuting allegations of this nature is only likely to be obtained through further research.

7.4.2 A need to establish whether financing and operating changes occurred in companies as a result of changes in accounting standards

To overcome the effect of a proposed or mandatory statement of generally accepted accounting practice, corporate management has a number of options available to them. They can, depending on their position, lobby the accounting standard-setting body, make discretionary accounting changes or change financing, production or investing activities to overcome the effect of the standard.

Evidence from the individual case studies examined in this study would suggest that corporate management's lobbying of the accounting standard-setting body is unlikely to be successful. In addition, the reduction in the number of accounting alternatives permitted in accounting standards suggests that corporate management will experience difficulties in making discretionary accounting changes to overcome the effect of a proposed accounting standard. The only consistently feasible option available to corporate management will be to make financing and operating changes.

Research to establish how corporate management changes financing and operating activities to counter a proposed statement of generally accepted accounting practice will provide insight into the behavioural aspects of accounting.

7.4.3 A need to establish the effect that the Harmonisation and Improvement Project has on South African financial reporting practices

This study has illustrated that the adoption of a particular accounting standard has economic consequences. Taken one step further, the Harmonisation and Improvement Project is also likely to have economic consequences for various user groups. As South African accounting standards are being constantly amended to take into account international requirements, it is important that the accounting profession not lose sight of the fact that the benefits of harmonisation should not exceed the costs.

Once completed, the Harmonisation and Improvement Project will have resulted in a completely new accounting standard-setting process. This process will include legal backing for accounting standards as well as a method of guaranteeing compliance with the standards.

Research to establish whether the Harmonisation and Improvement Project has been effective in achieving its objectives is warranted.

7.4.4 A need to contribute to the development of accounting theory

The fact that a comprehensive theory cannot be said to exist, and it is suggested that it will not exist in the future, should not deter academics from utilising philosophies of science, various paradigms of political science or theories of economics in an attempt to formulate a comprehensive theory of accounting. In this regard, the following are suggested as potential avenues of fruitful research in accounting theory from a South African perspective. The work of Feyerband could be extended further in an attempt to develop an anarchistic theory of accounting, while the application of critical theory to accounting should not be neglected.

The adoption of International Accounting Standards Committee statements of generally accepted accounting practice, together with the reduction in the accounting alternatives available in a standard, will result in corporate management no longer having a choice between different accounting alternatives. In addition, the influence that corporate management was able to exert on the standard setting process through lobbying will be significantly reduced. The study explains that positive accounting theory attempts to establish why accountants select a particular accounting method from those available, and in so doing, provides explanations of the relationship between accounting numbers and stock prices. It is evident that corporate managements' inability to influence the accounting standard-setting process, together with the elimination of accounting choices is likely to impact on future accounting research that is positive

in nature. Research to determine the effect of these changes on positive accounting research will be enlightening.

7.5 CONCLUSION

The comments made by South African corporate managers to six of the proposed statements of generally accepted accounting practice and the Accounting Practices Committee's final response to them, supports an earlier conclusion that by adopting International Accounting Standards, South African corporate managers have effectively been marginalised from the accounting standard-setting process. With few exceptions, corporate managers appear to be unaware of their now diminished influence on the accounting standard-setting process.

Unlike United States studies that support the contention that the existence of a corporate management/incentive scheme influences how managers will respond to a proposed accounting standard, preliminary evidence provided in this study suggests that this is not the position in South Africa. Evidence from the case studies and the research instrument suggest that the existence of a compensation/incentive scheme is unlikely to influence the decision to lobby either in favour of or in opposition to a proposed accounting standard. The reason for this is that corporate managers believe that they have the ability to 'manage' accounting earnings. This would be achieved through the judicious use of provisions and other techniques.

On-going research is essential for any academic discipline to flourish and survive. Accounting as a philosophy, is no exception. Research into accounting issues in South Africa is in its infancy and requires nurturing in the form of additional resources being made available for this purpose. With the encouragement of the accounting profession and business, research into accounting and related disciplines is likely to be advanced.

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APPENDIX ONE

**STATEMENTS OF GENERALLY ACCEPTED ACCOUNTING PRACTICE,
ACCOUNTING GUIDELINES AND ACCOUNTING OPINIONS ISSUED BY THE
ACCOUNTING PRACTICES BOARD**

APPENDIX ONE

ACCOUNTING FRAMEWORK

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AC 112 Accounting for the effects of changes in foreign currency exchange rates

AC 113 Lessor accounting

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AC 120 Disclosure in the financial statements of banks

- AC 121 Disclosure in the financial statements of long term insurers
- AC 122 Research and development costs
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ACCOUNTING GUIDELINES

- AC 201 Disclosure of effects of changing prices on financial results
- AC 202 Accounting for fixed assets revaluations (withdrawn)
- AC 203 Valuation of real estate assets
- AC 204 Accounting and reporting practices of long term insurance institutions (withdrawn)
- AC 205 Valuation of livestock in the financial statements of farming enterprises
- AC 206 Accounting by co-operatives
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ACCOUNTING OPINIONS

- AC 301 Preface to opinions issued by the Accounting Issues Task Force
- AC 302 Accounting for the tax effects arising from the change in tax legislation concerning LIFO reserves, consumable stock and work in progress
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- AC 305 Accounting for postretirement benefits other than pensions
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- AC 307 Separately disclosable items of income or expenditure within profit or loss from ordinary activities

APPENDIX TWO

**STATEMENTS OF GENERALLY ACCEPTED ACCOUNTING PRACTICE
APPROVED FOR ISSUE BY THE INTERNATIONAL ACCOUNTING
STANDARDS COMMITTEE**

APPENDIX TWO

STATEMENTS OF GENERALLY ACCEPTED ACCOUNTING PRACTICE APPROVED FOR ISSUE BY THE INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE

IAS 1	Disclosure of accounting policies
IAS 2	Inventories
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PROPOSED NEW INTERNATIONAL ACCOUNTING STANDARD

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FRAMEWORK FOR THE PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS

APPENDIX THREE

**SECTION ESTABLISHING THE NEW STANDARD-SETTING PROCESS TO BE
INCORPORATED INTO THE COMPANIES ACT 1973**

APPENDIX THREE

SECTION ESTABLISHING THE NEW STANDARD-SETTING PROCESS TO BE INCORPORATED INTO THE COMPANIES ACT 1973

A. DEFINITIONS - (1) In this Chapter, unless the context otherwise indicates -

"Council" means the Accounting Standards Council;

"Minister" means the Minister of Trade and Industry;

"Chairperson" means the Chairperson of the Council designated in terms of section B (4);

"rules" means the rules made or amended from time to time by the council and approved by the Minister and published by him by notice in the Gazette.

- (2) When the Council makes or amends rules, it shall, not less than 1 (one) month before submitting the rules to the Minister for his approval, publish the text of the proposed rules in the Gazette, together with a statement of its intention to so submit such rules.

B. ESTABLISHMENT OF COUNCIL - (1) There is hereby established a body corporate to be known as the Accounting Standards Council.

- (2) The members of the Council shall be appointed by the Minister and shall consist of-

(a) the Chairperson; and

(b) 16 persons nominated in accordance with the provisions of subsection (3).

- (3) Each of the following groups shall be entitled to nominate 4 (four) persons to serve on the Council, namely -

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(a) **GROUP 1 : PREPARERS OF FINANCIAL STATEMENTS**

Chamber of Mines of South Africa;
Chartered Association of Certified Accountants;
Chartered Institute of Management Accountants;
Corporate Treasurers of South Africa;
Institute of Commercial and Financial Accountants;
Die Afrikaanse Handelsinstituut;
Institute of Municipal Treasurers and & Accountants;
South African Chamber of Business;
South African Insurance Association;
The South African Institute of Chartered Secretaries and Administrators.

(b) **GROUP 2 : USERS / STAKEHOLDERS**

Commissioner for Inland Revenue;
Competition Board;
Congress of South African Trade Unions;
Council of South African Banks;
Financial Services Board;
Institute of Directors;
Institute of Internal Auditors;
Master of the Supreme Court;
National Economic Development Labour Council;
Registrar of Co-operatives;
Registrar of Companies;
Registrar of Close Corporations;
South African Accounting Association.

(c) **GROUP 3 : USERS / INVESTORS**

Association of Law Societies of South Africa.
Investment Analysts Society of Southern Africa;
Institute of Retirement Funding;
Institute of Life and Pension Advisers.
Johannesburg Stock Exchange;

APPENDIX THREE continued

Life Office Association;
Shareholders Association;

(d) **GROUP 4 : AUDITORS**

Public Accountants and Auditors Board;
South African Institute of Chartered Accountants;
Office of Auditor-General.

- (4) The Chairperson, who need not be one of the nominated members, shall be designated by the members of the Council nominated in terms of sub-section 3.
- (5) The Council may designate a member of the Council as acting Chairperson to exercise and perform the powers and duties of the Chairperson whenever the Chairperson is unable to do so or while the office of Chairperson is vacant.
- (6) Every member of the Council (including the Chairperson) shall hold office for a period of three years: Provided that any group referred to in sub-section 3 may apply to the Minister to have any person nominated by it and appointed by the Minister, replaced by any other nominee before the expiry of his term of office.
- (7) If, during such three-year period:-
- (a) a member of the Council nominated pursuant to the provisions of subsection (3), dies, becomes incapacitated, resigns, or becomes disqualified from being appointed or acting as a director of a company in terms of section 218, or ceases for any other reason to be a member of Council, the vacancy arising in this manner may be filled for the unexpired period of such member's term of office by a person nominated by the group of which the member who ceases to be on the Council was a nominee;
- (b) the Chairperson dies, becomes incapacitated, resigns, or becomes disqualified from being appointed or acting as a director of a company in terms of section 218, or ceases for any other reason to be a member of Council, the vacancy may be filled for the unexpired period of such Chairperson's term of office by a person nominated by the Council, and

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(who need not be a member of the Council) and approved by the Minister.

- (8) A member of Council shall, on expiry of his term of office, be eligible for reappointment.
- (9)
 - (a) The meetings of the Council shall be held at such times and places as the Chairperson may determine.
 - (b) The person presiding at a meeting of the Council shall determine the procedure at such meeting.
 - (c) The Chairperson shall not be entitled to vote at Council meetings.
 - (d) The decision of three quarters of the members of the Council present at any meeting thereof at which there is a quorum (as determined in accordance with the rules of the Council) shall constitute the decision of the Council.
- (10) The Council may appoint such officers and employees as are required for the proper performance of its functions.
- (11) The Council may delegate any of its powers to any subcommittee of the Council which may be established by the Council.

C. FUNCTIONS OF COUNCIL - (1) The functions of the Council shall be to -

- (a) set accounting standards with which companies shall comply, in causing to be made out annual financial statements in accordance with the provisions of section 286 and group financial statements in accordance with the provisions of section 288;
- (b) monitor compliance with the accounting standards so set from time to time;
- (c) determine whether or not non-compliance with sections 286(3)(a) and 288(2)(a) is both misleading and material when such matters are brought to its attention;

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- (d) take such action as may be appropriate to enforce and maintain the accounting standards set from time to time;
 - (e) prepare and publish, from time to time, directives and guidelines on standards to be used in financial reporting as required by the Act; and
 - (f) generally do whatever the Council deems necessary to enable it to carry out its functions in terms of this enabling legislation.
- (2) Without derogating from the provisions of subsection (1), the functions of the Council shall include the making of rules in respect of matters falling within the provisions of this Chapter.
- (3) Subject to the provisions of this Chapter, the rules shall make provision for:-
- (a) the administration and financing of the Council;
 - (b) the remuneration and allowances of members and officers and employees of the Council, and the conditions upon which such members, officers and employees are appointed;
 - (c) appeals from the decisions of any sub-committee of the Council to the Council;
 - (d) the effective monitoring of compliance with, and enforcement of, the rules;
 - (e) the dissolution of the Council.
- (5) Rules made or amended by the Council and approved by the Minister shall be published by notice in the Gazette.

D. INVESTIGATIONS BY COUNCIL - (1) For the purposes of performing its functions in terms of this Chapter, the Council or any committee thereof may -

- (a) summon any person who is believed to be able to furnish any information on the subject of any investigation or to have in his possession or under his control any book, document or other object which has any bearing upon that subject, to appear before the Council or

APPENDIX THREE continued

committee at any time and place specified in the summons, to be interrogated or to produce such book, document or other object; and

- (b) interrogate any such person under oath or affirmation administered by the Chairperson or a person appointed by him, and examine or retain for examination any such book, document or other object: Provided that any person from whom any book, document or other object has been taken and retained under this subsection shall, so long as such book, document or object is in the possession of the Council or a committee thereof, at his request be allowed, at his own expense and under the supervision of the investigating officer, to make copies thereof or to take extracts therefrom at any reasonable time;

Provided that the Council shall, before acting in terms of this section, give formal notice to the company of the institution by the Council of an investigation as herein contemplated.

- (2) A summons for the attendance of any person before the Council or a committee thereof or for the production to the Council or a committee thereof any book, documentation or other object shall be in the form prescribed by the Council, shall be signed by the Chairperson of the Council or the committee and shall be served in the manner so prescribed.
- (3) Any person who has been summoned to attend before, or to produce any book, document or other object to the Council or a committee thereof and who, without sufficient cause (the onus of proof which shall rest upon him), fails to attend at the time and place specified in the summons or to remain in attendance until he is excused by the Chairperson thereof from further attendance or, having attended, refuses to be sworn or to make an affirmation after he has been asked by the Chairperson (or a person appointed by the Chairperson) to do so or, having been sworn or having made affirmation, fails to answer fully and satisfactorily any question lawfully put to him, or fails to produce any book, document or other object in his possession or under his control which he has been summoned to produce, shall be guilty of an offence.
- (4) Any person who, after having been sworn or having made affirmation, gives false evidence before the Council or a committee thereof on any matter, knowing such evidence to be false or not believing it to be true, shall be guilty of an offence.

APPENDIX THREE continued

- (5) The law relating to privilege as applicable to a witness giving evidence before, or summoned to produce a book, document or other object to, a provincial division of the Supreme Court of South Africa shall apply in relation to any person summoned under this section.
- (6) Nothing contained in this Chapter shall be deemed to compel the production by a legal adviser of a letter, report or other document containing a privileged communication made by or to him as legal adviser, or to authorise the seizure or retention thereof.
- E. FINANCING OF COUNCIL** - (1) All fees payable under the rules contemplated in section C(3) shall be paid to the Council and shall constitute its funds, and the Council shall utilise its funds for defraying expenses incurred in connection with the performance of its functions.
- (2) The Council may invest any unexpended portion of its moneys and may establish reserve funds and pay into them such amounts as it may deem necessary or expedient.
- F. PRESERVATION OF SECRECY** - (1) No person shall, except for the purposes of carrying out his functions or performing his duties in terms of this Act or for the purpose of legal proceedings under this Act or when required to do so by any court or under any law, disclose to any other person any information acquired by him in the carrying out of his functions or the performance of this duties in terms of this Chapter and relating to the business or affairs of any other person.
- (2) Any person who contravenes the provisions of subsection (1) shall be guilty of an offence.
- G. LIMITATION OF LIABILITY** - The Council, any committee or member thereof or any officer or employee thereof, shall not be liable in respect of anything done in good faith in the exercise or performance of a power or duty conferred or imposed by or under this Chapter.
- H. ENFORCEMENT OF STANDARDS** - (1) Where copies of a company's annual financial statements have been sent out in terms of section 302 or a copy of a company's annual financial statements have been laid before the company in general meeting and it appears to the Council that there is, or may be, doubt as to whether or not the financial statements comply with the requirements of this Act, or any accounting standards set by the Council, the Council may give notice to the directors of the company indicating the respects in which it appears that such a doubt

APPENDIX THREE continued

arises, or may arise, and calling upon the directors to furnish such explanation in respect thereof as the Council may require. Such notice shall specify a period of not less than one month for the directors to give such explanation.

- (2) If at the end of the period specified in such notice, or such longer period as the Council may allow, the Council forms the opinion that no satisfactory explanation of the financial statements has been given and that the financial statements have not been revised so as to comply with the requirements of this Act or any accounting standards set by the Council, the Council, or any person authorised by the Council to do so, may apply to the Court for a declaratory order that the annual financial statements of the company do not comply with the requirements of this Act or any accounting standards set by the Council and for an order requiring the directors of the company to prepare revised financial statements which do so comply.
- (3) If, upon such application, the Court orders the preparation of revised financial statements, it may also give directions with respect to -
 - (a) the auditing of the financial statements;
 - (b) the steps to be taken by the directors to bring the order of the Court to the notice of persons likely to rely or to have relied on the previous financial statements;
 - (c) such other matters as the Court thinks fit.
- (4) If the Court finds that the financial statements did not comply with the requirements of this Act or any accounting standards set by the Council, it may order that all or part of -
 - (a) the costs of and incidental to the application, and
 - (b) any reasonable expenses incurred by the company in connection with or in consequence of the preparation of revised financial statements

shall be borne by such of the directors as were party to the approval of the defective financial statements. For this purpose every director of the company at the time the defective financial

APPENDIX THREE continued

statements were approved shall be taken to have been a party to their approval unless he shows that he took all reasonable steps to prevent their being approved.

- (5) Where the Court makes an order under subsection (3) it shall have regard to whether the directors who were party to the approval of the defective financial statements knew or ought to have known that the financial statements did not comply with the requirements of this Act or any accounting standards set by the Council, and the Court may exclude one or more directors from the order, or order the payment of different amounts by different directors.
- (6) The Council, any committee or member thereof, shall not be liable in damages for anything done or purporting to be done for the purposes of or in connection with -
- (a) the taking of steps to discover whether there are grounds for an application to the Court,
 - (b) the determination whether or not to make such an application;
 - (c) the bringing of any application to the Court;
 - (d) the publication of its reasons for bringing any such application

unless the conduct of the Council, any committee or member thereof shall have been shown to be in bad faith.

PREPARED BY : THE SOUTH AFRICAN INSTITUTE OF CHARTERED ACCOUNTANTS
FINAL DRAFT : AUGUST 1995

APPENDIX FOUR

QUESTIONNAIRE COMPRISING THIS STUDY

QUESTIONNAIRE TO DETERMINE SOUTH AFRICAN CORPORATE MANAGEMENT'S ATTITUDE TO THE ACCOUNTING STANDARD SETTING PROCESS AND INTERNATIONAL HARMONISATION

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1 2

Please indicate your answer by ticking (✓) the relevant square.

1. CORPORATE MANAGEMENT'S INVOLVEMENT IN THE ACCOUNTING STANDARD SETTING PROCESS

1.1 Are you familiar with the South African accounting standard setting process

YES	NO	
1	2	4

- (a) If YES, please complete the remainder of the questionnaire.
- (b) If NO, please go to question 3.

1.2 Should corporate management play an active role in the accounting standard setting process

YES	NO	
1	2	5

1.2(a) If YES, why should corporate management play an active role in this process

- (i) Management is in the best position to make decisions on the format and content of financial statements
- (ii) Standards should permit earnings and cash flows to be maintained rather than fluctuating every time a new standard is issued
- (iii) Standard setting bodies and academics are unaware of practical realities
- (iv) Management is not adequately represented on the standard setting body
- (v) Other (please specify) _____

Tick one or more boxes (✓)

1	6
1	7
1	8
1	9
	10

1.2(b) If NO, why should corporate management not play an active role in this process

- (i) It lacks the necessary practical expertise and knowledge to make a meaningful contribution
- (ii) Theoretical considerations means the process is best left to standard setting bodies and academics
- (iii) Participation and opinion may be contrary to corporate policy
- (iv) The standard setting body has in the past disregarded the opinions of contributors
- (v) Other (please specify) _____

Tick one or more boxes (✓)

1	11
1	12
1	13
1	14
	15

2. THE ACCOUNTING STANDARD SETTING PROCESS

Accounting standards permit the production of financial information that can be reliably used for decision making.

2.1 The existing method of setting accounting standards is the most appropriate for the South African business environment

2.2 The Accounting Practices Board (APB) through the Accounting Practices Committee (APC) should continue to develop South African specific exposure drafts and statements of generally accepted accounting practice (GAAP)

2.3 Non-accounting groups (such as lawyers and unions) have a right to participate in the accounting standard setting process because they have a legitimate interest in the content of financial statements

2.4 The standard of South African developed statements of generally accepted accounting practice are acceptable for financial reporting in the South African environment

2.5 Existing accounting standards provide management with a sufficiently wide choice of accounting alternatives so as to enable them to prepare financial statements that fairly present the financial position and financial results of the company

Strongly agree	Agree	Dis-agree	Strongly Disagree	
1	2	3	4	16
1	2	3	4	17
1	2	3	4	18
1	2	3	4	19
1	2	3	4	20

- 2.6 Resources spent on the development of South African statements of generally accepted accounting practice have contributed to maintaining a high local level of accounting expertise
- 2.7 Additional resources should be made available to the South African Institute of Chartered Accountants to enable them to attract and keep suitably qualified staff to ensure relevant ongoing research into accounting issues
- 2.8 Suitable qualified staff from South African universities should be co-opted by the South African Institute of Chartered Accountants to contribute to the development of local accounting standards
- 2.9 Corporate executives of private companies are less likely to respond to proposed statements of generally accepted accounting practice than corporate executives of public companies
- 2.10 The accounting profession has made sufficient effort to expedite legal backing for statements of generally accepted accounting practice
- 2.11 Legal backing to accounting standards should contain a provision for significant penalties to both preparers and auditors of financial statements for non-compliance with statements of generally accepted accounting practice
- 2.12 The conceptual framework recently adopted by the South African Institute of Chartered Accountants provides legitimacy to the accounting profession threatened by government intervention in the accounting standard setting process
- 2.13 Proposed statements of generally accepted accounting practice should include a presentation of the theory and arguments underlying the standard
- 2.14 Companies should bear the financial cost of the accounting standard setting process
- 2.15 Are you aware of the proposed changes to the South African accounting standard setting process

1	2	3	4	21
1	2	3	4	22
1	2	3	4	23
1	2	3	4	24
1	2	3	4	25
1	2	3	4	26
1	2	3	4	27
1	2	3	4	28
1	2	3	4	29

YES	NO
1	2

30

3. CORPORATE MANAGEMENT

Corporate managers are the producers of firm specific financial information.

- 3.1 Management plays a central role in the determination of accounting standards
- 3.2 Accounting standards should be developed that have as their focus the measurement of earnings rather than the measurement of assets/liabilities
- 3.3 Management will select an accounting alternative that maintains or increases earnings over one that, if adopted, will reduce earnings
- 3.4 An accounting standard that has as its effect the reduction of income will be countered by management making discretionary changes to accounting policies so as to minimise the potential reduction in income
- 3.5 Management is entitled to disregard a statement of generally accepted accounting practice if, in the opinion of management, compliance with that statement would result in the company not meeting its financial performance objectives

Strongly agree	Agree	Dis-agree	Strongly Disagree	
1	2	3	4	31
1	2	3	4	32
1	2	3	4	33
1	2	3	4	34
1	2	3	4	35

- 3.6 Policy makers within the standard setting process are lobbied by management either in an attempt to initiate changes in allowable accounting procedures, or to express support or opposition to a proposed or enacted accounting standard
- 3.7 Partners in audit firms responsible for the audit engagement are encouraged by corporate management to lobby for changes in accounting standards that are perceived to be detrimental to the company
- 3.8 Proposed changes to statements of generally accepted accounting practice which, if implemented, would adversely effect company earnings, influences management to respond to the change
- 3.9 An audit firm is unlikely to qualify the audit report of a client who fails to comply with statements of generally accepted accounting practice because of the potential economic consequences to the audit firm

	Strongly agree	Agree	Dis-agree	Strongly Disagree	
	1	2	3	4	36
	1	2	3	4	37
	1	2	3	4	38
	1	2	3	4	39

4. CORPORATE MANAGEMENT INCENTIVE SCHEMES

Changes in accounting policies mandated by changes in accounting standards can influence both earnings and cash flows.

- 4.1 Individuals act so as to maximise their own utility and are resourceful and innovative in doing so
- 4.2 Is a management incentive/compensation scheme in operation in the company you are employed by
- 4.3(a) Does the scheme require a level of accounting earnings to be achieved
- (b) and/or share price performance
- (c) and/or a particular return on assets to be maintained before participation
- 4.4 Are there any other contractual obligations between the participants of the compensation scheme and the company
- 4.5 Have any changes to the management compensation scheme been made in response to changes in statements of generally accepted accounting practice
- 4.5(a) If YES, briefly state what changes were made to the management compensation scheme:

	YES	NO	
	1	2	40
	1	2	41
	1	2	42
	1	2	43
	1	2	44
	1	2	45
	1	2	46
			47
			48

- 4.6 Management of companies, although complying with statements of generally accepted accounting practice, are able to 'manage' accounting earnings so as to maximise their own utilities
- 4.7 Lobbying will occur for amendments to those statements of generally accepted accounting practice that negatively impact on earnings and therefore on remuneration derived from incentive schemes

	Strongly agree	Agree	Dis-agree	Strongly disagree	
	1	2	3	4	49
	1	2	3	4	50

5. REGULATION OF ACCOUNTING

Accounting standards are a form of regulation

	Strongly agree	Agree	Dis-agree	Strongly disagree	
5.1	1	2	3	4	51
5.2	1	2	3	4	52
5.3	1	2	3	4	53
5.4	1	2	3	4	54
5.5	1	2	3	4	55

6. INTERNATIONAL HARMONISATION OF ACCOUNTING STANDARDS

The South African Institute of Chartered Accountants has recently begun adopting International Accounting Standards for use in South Africa rather than developing South African specific standards.

6.1 The harmonisation process would lead to

	Strongly agree	Agree	Dis-agree	Strongly Disagree	
a.	1	2	3	4	56
b.	1	2	3	4	57
c.	1	2	3	4	58
d.	1	2	3	4	59
e.	1	2	3	4	60
f.					

61 62

6.2 The harmonisation process should not continue because:

	Strongly agree	Agree	Dis-agree	Strongly disagree	
a.	1	2	3	4	63

- b. The underlying economic, legal, social and other environmental factors in different countries does not justify it
- c. Continued rapid growth of global markets proves harmonisation of accounting standards is not necessary
- d. International accounting bodies are unable to deal with the increasing sophistication of debt/equity markets including items such as interest rate and currency swaps on a timeous basis
- e. Other (please specify)

Strongly agree	Agree	Dis-agree	Strongly disagree	
1	2	3	4	64
1	2	3	4	65
1	2	3	4	66

67	68
----	----

- 6.3 Statements of generally accepted accounting practice developed by the International Accounting Standards Committee are of an inferior quality to those produced by the South African Institute of Chartered Accountants
- 6.4 The South African Institute of Chartered Accountants should collaborate with specific countries (such as Australia and New Zealand) when developing statements of generally accepted accounting practice
- 6.5 Too much diversity of culture exists in Africa as a result of the colonial past for the adoption of International Accounting Standards to be successful
- 6.6 In an African context, governments of former colonies and other developing nations may view the harmonisation of accounting standards as an infringement of their national sovereignty and, as a result, will not support the harmonisation process
- 6.7 The adoption of International Accounting Standards by the Accounting Practices Board will result in a significant savings of resources of multinational companies operating from South Africa
- 6.8 Harmonisation of accounting standards will result in more meaningful information being provided to users of financial statements
- 6.9 The harmonisation process should include stock exchange listing requirements
- 6.10 Corporate management will become more accountable to users of financial statements as a result of the harmonisation process
- 6.11 The adoption of International Accounting Standards is likely to result in modifications to corporate management incentive schemes

Strongly agree	Agree	Dis-agree	Strongly disagree	
1	2	3	4	69
1	2	3	4	70
1	2	3	4	71
1	2	3	4	72
1	2	3	4	73
1	2	3	4	74
1	2	3	4	75
1	2	3	4	76
1	2	3	4	77

- 6.12 South Africa should continue with the process of harmonising international accounting standards

YES	NO	
1	2	78

7. PERSONAL INFORMATION

7.1 What qualifications do you hold

- a. Bachelor's degree/diploma
- b. Honours Bachelor's degree
- c. Other advanced degree (please specify)

- d. Professional qualification eg CA (SA) (please specify)

- e. No post-matric qualification

1	79
1	80
	81
	82
	83
1	83

7.2 How many years has it been since you obtained your latest qualification

- a. 1 - 10 years
- b. 11 - 20 years
- c. More than 20 years
- d. Not applicable - no qualifications held

1	84
1	85
1	86
1	87

7.3 Gender

Male	Female
1	2

88

7.4 Age

Under 30	31 - 40	41 - 50	51 - 60	61+
1	2	3	4	5

89

Thank you for completing the questionnaire.

If we have any queries, may we contact you?

YES	NO
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If YES, please state your name and telephone number

APPENDIX FIVE

**RESPONSES OF AUDIT FIRMS, REGIONAL ASSOCIATIONS UNIVERSITIES
AND OTHER INTERESTED PARTIES TO EXPOSURE DRAFTS 89 TO 94**

Appendix 5.1: Responses of audit firms, regional associations, universities and individuals to exposure draft 89, *Revenue*

	Support issue of ED 89	Oppose issue of ED 89	Editorial issues	Specific comments
Audit firms				
Ernst & Young	Yes			APC efforts to harmonise South African statements of generally accepted accounting practice and to improve existing statements are strongly supported. Clarification required on certain issues. Suggests allowing dividends received from subsidiaries to be recognised in the income statement of holding company although the dividends were declared after the year end.
Fisher Hoffman Stride	Yes		Yes	Suggests clarification on certain issues.
Kessel Feinstein	Yes			Turnover should equate revenue as defined in the statement. Should fair value of cash or cash equivalents received or receivables be discounted?
Missing				
Price Waterhouse Meyernal	Yes			Suggests clarification on certain issues.
Unknown	Yes			Proposed statement is an improvement on AC 111. Supports statement being brought into line with international generally accepted accounting practice as well as local conceptual framework. May be resistance from some companies to disclose level of detail.
Regional Associations				
Midlands	Yes			Clarification of certain issues
Pretoria	Yes			Clarification of certain issues.
Universities				
Oranje-Vrystaat	Yes		Yes	
Individuals				
Kruger, L.	Yes		Yes	
van der Walt, K.	Yes		Yes	

Appendix 5.2: Responses of audit firms, regional associations, universities and individuals to exposure draft 90, *Property, plant and equipment*

	Support issue of ED 90	Oppose issue of ED 90	Editorial issues	Specific comments
Audit Firms				
BDO Spenser Steward	Yes			Suggests clarification of certain issues. Accept the need to bring South African statements of generally accepted accounting practice in line with those issued by the International Accounting Standards Committee (IASC) where possible. Support the enhanced disclosure requirements proposed. Suggests clarification of certain issues including the distribution of unrealised revaluation surpluses. Investment properties not dealt with adequately.
Coopers & Lybrand	Yes		Yes	
Ernst & Young	Yes			Efforts to harmonise South African statements of generally accepted accounting practice with international statements and to improve existing statements is supported. Suggests clarification of certain issues. Investment properties issue requires clarification.
Fisher Hoffman Stride	Yes			Requires clarification of certain issues.
KPMG Aiken & Peat	Yes			Suggests clarification of certain issues, including investment properties.
Price Waterhouse Meyernel	Yes			Suggests clarification of certain issues. In addition expresses regret that the APC followed the IASC in recommending historic cost as the benchmark treatment. In South Africa the majority of quoted companies revalue land and buildings and many revalue other tangible fixed assets. The benchmark treatment should be to revalue, with historic cost as an allowed alternative. Investment properties not dealt with.
Riceman	Yes			Certain of the disclosure requirements appear onerous.
Unknown	Yes			Expresses concern with the vague treatment of investment properties. As a result existing ED90 may need re-exposure. Disclosure requirements are more comprehensive than those previously required and may result in resistance. Proposed treatment of realised revaluation surplus is conceptually sound in prescribing the release of realised revaluation surpluses to retained earnings.
Regional Associations				
Midlands	Yes		Yes	
Pretoria	Yes		Yes	
Universities				
Cape Town	Yes			Consistency of the proposed document with AC000's asset definition and recognition criteria is an improvement. Requires clarification of certain issues.
Orange-Vrystaat	Yes		Yes	
Individuals				
van der Walt, K.	Yes			Suggests issues needing clarification.

Appendix 5.3: Responses of audit firms, regional associations, universities and individuals to exposure draft 91, *Net profit or loss for the period, fundamental errors and changes in accounting policy*

	Support Issue of ED 91	Oppose Issue of ED 91	Editorial Issues	Specific comments
Audit Firms				
Arthur Anderson	Yes			We are in broad agreement with the comments [of the exposure draft]. We suggest that future explanatory Technical Releases deal not only with comparison to the IAS publications and our own AC's but also indicate the consideration given to the requirements of the UK and US statements where appropriate.
Deloitte & Touche	Yes			We feel that the omission of the alternative treatment is acceptable, as greater standardisation will result from just having one recommended treatment.
Fisher Hoffman Stride	Yes			In general, we are in agreement with the proposed statement as the revisions are essentially to ensure consistency with international Statement IAS8 (revised). Suggests clarification of certain issues.
Fisher Hoffman Stride (Wainer)	Yes			Suggests clarification of certain issues.
Kessel Feinstein	Yes			We support the issue of a statement based on the ED. The present application of a wide interpretation of an extraordinary item, does not facilitate comparability of reported earnings. Accordingly we support the revised definition of ED91.
KPMG Aiken & Peat	Yes			Extraordinary items should be limited to those events which arise and are beyond the control of management. The figure upon which EPS should be calculated should be the net result of management's decision and actions during the year.
Price Waterhouse Meyernel	Yes			Suggests clarification of certain issues.
Regional Associations				
Midlands	Yes			No alterations necessary.
Pretoria	Yes			Suggested definition of extraordinary item be amended to include transactions that "cannot be controlled by management." Suggested clarification of certain items.
Universities				
Cape Town	Yes		Yes	Suggests improvements to the definition of extraordinary item.
Oranje-Vrystaat	Yes		Yes	Suggests clarification of certain issues.
Potchefstroom	Yes			As vertrekpunt meld ons graag one eenstemmige ondersteuning van die geopenbaarde konsep in die geheel. Ons sal baie teleurgestel wees indien die GK nie 'n standpunt word nie.
Individuals				
van der Walt, K. Wolpert, J.	Yes		Yes	Required clarification of particular definition. I do not support the proposed change to narrow the definition of extraordinary items. The volatility in EPS which would result from the application of the proposed ED 91, would compromise the usefulness, integrity and understandability of the EPS statistic.

Appendix 5.4: Responses of audit firms to exposure draft 92, *Borrowing costs*

Audit Firms	Support issue of ED 92	Oppose issue of ED 92	Editorial issues	Specific comments
Coopers & Lybrand	Yes			The comparison between the international statement and the proposed new South African statement given in the Technical Release does not explain why the draft local statement proposes capitalisation of borrowing costs as the preferred alternative. Whilst we support the treatment preferred, the justification for the treatment should be explained.
Coopers & Lybrand (van Maaren)		Yes		ED92 should not differ from IAS23.
Deloitte & Touche	Yes			We support this exposure draft other than for the elimination of the effective free choice between capitalisation of borrowing costs and the expensing thereof. The temptation of amending these standards should be avoided unless the IASC documents are fundamentally flawed or cannot be applied in South Africa. Amending the IASC statements could cause significant difficulties with enforcement. The proposed statement should be brought into line with IAS23 and re-exposed.
Ernst & Young			Yes	The efforts of the APC to harmonise the South African generally accepted accounting standards with international statements and to improve existing statements is supported. The issue of this exposure draft in its current format cannot be supported. By making the capitalisation of borrowing costs mandatory for all qualifying assets, we are differing from the approach adopted by the International Accounting Standards Committee.
Fisher Hoffman Stride	Yes			The proposed statement and revisions are essential to ensure consistency with the provisions of IAS23 (Revised).
Kessel Feinstein	Yes			The issue of a statement based on the exposure draft is supported. The capitalisation of borrowing costs where the criteria for capitalisation are met, and the deduction from interest to be capitalised of any interest earned on funds temporarily invested pending use, is supported.
KPMG Aiken & Peat			Yes	Interest is a financing decision and does not directly relate to the acquisition, construction or production of assets. Financing should be dealt with separately from the acquisition. Interest is an expense and should be charged to income over the period during which the financing facilities were available. South Africa should follow the international approach of IAS23 (revised) ie borrowing costs should be expensed in the period incurred (preferred treatment) but permits the alternative treatment of the capitalisation of borrowing costs, where the criteria for capitalisation are met.
Price Waterhouse Meyernel	Yes			The removal of the allowed alternative appearing in IAS 23 is supported. The technical release should have clarified the reason for the removal of the alternatives permitted in IAS 23.

Appendix 5.5: Responses of regional associations, universities and others to exposure draft 92, *Borrowing costs*

	Support issue of ED 92	Oppose issue of ED 92	Editorial issues	Specific comments
Regional Associations				
Pretoria	Yes			An Appendix containing an example of the disclosure requirements would be of great help.
Universities				
Cape Town		Yes		We feel that companies should not be required to capitalise borrowing costs as they may feel that it is not appropriate in terms of the framework. If the desire is to achieve comparability by eliminating options in accounting treatments, this should be done by disallowing the capitalisation of any borrowing costs.
Oranje-Vrystaat	Yes			Dit is 'n verbetering op die ou standpunt aangesien daar nie meer 'n keuse vir kapitalisering bestaan nie en aangesien die 1 jaar periode/riglyn nie meer geld nie.
Witwatersrand	Yes			Requires clarification on certain issues.
Other				
Office of the Auditor-General	Yes			Supports the exposure drafts as such changes to the relevant accounting standards will lead to harmonisation with the international accounting standards as well as making the financial statements of different companies more comparable.

Appendix 5.6: Responses of audit firms, regional associations, universities and others to exposure draft 93, *Construction contracts*

	Support Issue of ED 93	Oppose Issue of ED 93	Editorial Issues	Specific comments
Audit Firms				
Coopers & Lybrand	Yes			We confirm our agreement in broad terms with the exposure draft. However, we believe that there are many small contracting business whose record keeping will not be sufficient to facilitate use of this method. We recommend that, to cater for this situation, circumstances be set out in which the completed contracts basis may still be used.
Deloitte & Touche	Yes			Support the extended disclosure requirements.
Fisher Hoffman Stride	Yes			We are in agreement with the proposed statement.
Kessel Feinstein	Yes			We are pleased to support the issue of a statement based on the ED. In particular, we concur with requiring the percentage of completion method only, and the more comprehensive disclosure.
Price Waterhouse Meyernel	Yes			No comments on this document.
Regional Associations				
Pretoria	Yes			Suggests clarification of certain disclosure requirements.
Universities				
Cape Town	Yes			No mention is made as to the basis used to calculate turnover. The effective deletion of the completed contract method of accounting for construction contracts is supported.
Oranje-Vrystaat	Yes		Yes	Editorial issues only.
Rhodes	Yes			More comprehensive disclosure requirements commended.
Witwatersrand	Yes		Yes	
Other				
Office of the Auditor-General	Yes			Supports the exposure drafts as such changes to the relevant accounting standards will lead to harmonisation with the international accounting standards as well as making the financial statements of different companies more comparable.

Appendix 5.7: Responses of audit firms to exposure draft 94, *Inventories*

Audit Firms	Support Issue of ED 94	Oppose Issue of ED 94	Editorial Issues	Specific comments
Arthur Anderson	Yes		Yes	Suggests clarification on certain issues. If the intention is to base our South African standards substantially on International Accounting Standards, it may be more meaningful to members to receive the exposure draft in a form which includes the standard on which it is based marked up with the proposed revisions for South Africa.
BDO Spencer Stewart	Yes			Requires clarification of a particular issue.
Coopers & Lybrand	Yes			Suggests clarification of certain issues.
Deloitte & Touche	Yes			Support the exposure draft other than for the elimination of the effective free choice between the FIFO/weighted average and LIFO formulas. Although the LIFO formula may not be widely used in South Africa, foreign holding companies may require their South African subsidiaries to use the LIFO formula. As a decision has been made to adopt the IAS statements, we should avoid the temptation of amending these standards unless there are very good reasons for doing so, i.e. where the IASC documents are fundamentally flawed or cannot be applied to the South African situation.
Ernst & Young	Yes			The efforts of the APC to harmonise the South African statements of generally accepted accounting standards (sic) with international statements and to improve existing statements is strongly supported.
Fisher Hoffman Stride	Yes			We are in agreement with the proposed statement as the revisions are essentially to ensure consistency with the international statement.
Kessel Feinstein	Yes			We support the issue of a statement based on the ED. The additional disclosure requirements supported.
Price Waterhouse Meyernel	Yes			The ED goes far to remove alternatives in accounting for inventories and improving the disclosures required. Suggests clarification of certain items.

Appendix 5.8: Responses of regional associations, universities and others to exposure draft 94, *Inventories*

	Support issue of ED 94	Oppose issue of ED 94	Editorial issues	Specific comments
Regional Associations				
Pretoria			Yes	The disclosure required by par.31(g), with regard to the cost of inventories which should be disclosed, should be scrapped. We feel it is inappropriate to compel any enterprise to disclose information that enables the user to calculate the gross margin with ease.
Universities				
Cape Town	Yes			We concur with the new terminology and the abolition of LIFO.
Witwatersrand	Yes			Is use of retail method and standard costs precluded by new statement?
Other				
Office of the Auditor-General	Yes			Supports the exposure drafts as such changes to the relevant accounting standards will lead to harmonisation with the international accounting standards as well as making the financial statements of different companies more comparable.
Cooper, F.	Yes			Suggests changes to bring proposed statement in line with Income Tax Act requirements.

APPENDIX SIX

RESPONDENTS TO EXPOSURE DRAFTS 89 TO 94

RESPONDENTS TO EXPOSURE DRAFT 89 - REVENUE

Bernhard, D.E. 3 March 1994. *Discussion of Exposure Drafts*. Letter. **The Midlands Regional Association of the Natal Society of Chartered Accountants** to The Technical Director, The South African Institute of Chartered Accountants. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Bower, M.R. & Wharton-Hood, P.G. Group Financial director and Group Accounting Manager. 10 March 1994. *Exposure Draft 89 - Revenue ("ED89") and Exposure Draft 90 - Property, Plant and Equipment ("ED90")*. Letter. **Edgars Stores Limited** to The Technical Director. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Cilliers, A. 2 March 1994. *ED89 - Proposed statement on auditing (sic) standards - Revenue*. Letter. **Fisher Hoffman Stride** to The Technical Director, The South African Institute of Chartered Accountants. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Coppin, G. 22 February 1994. *File reference APC - ED89*. Letter. **Ernst & Young** to The Technical Director, The SA Institute of Chartered Accountants. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Dadd, A.A. National Technical Manager. 7 March 1994. *ED 89 - Revenue*. Letter. **Price Waterhouse Meyernel** to The Technical Director. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

De Meulenaere, A.J. 28 February 1994. *Comments on ED 89 and ED 90*. Letter. **The Pretoria Regional Association of the Transvaal Society of Chartered Accountants** to The Technical Director, The South African Institute of Chartered Accountants. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Eksteen, T. Manager: Technical Accounting. 3 March 1994. *ED 89 - Revenue*. Letter. **The South African Breweries Limited** to The Technical Director, South African Institute of Chartered Accountants. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Geyer, W.P. Group Financial Manager. 14 February 1994. *ED89 - Revenue, ED90 - Property, Plant and Equipment*. Letter. **Yskor Beperk** to The Technical Director. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Kok, W.J. Executive Director (Finance). 3 February 1994. *File reference APC - ED 89 - Revenue*. Letter. **Eskom** to The Technical Director. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Kruger, L. 26 Februarie 1994. *Geopenbaarde Konsep 89 - Inkomste*. Letter. **Louw Kruger** to Die Tegnieuse Direkteur. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Lavies, P.J. Financial Director. 9 March 1994. *ED 89 - Revenue*. Letter. **Wooltru Limited** to Technical Director. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Möller, J.P. Financial Manager. 24 February 1994. *Comments on ED 89 - Revenue*. Letter. **Gencor Limited** to The Technical Director. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Pelser, H.A.J. Assistent Hoofbestuurder: Groepfinansies. 26 Januarie 1994. *Kommentaar op GK 90 (Eiendom, aanleg en toerusting)*. Letter. **Saambou Bank** to Die Tegniëse Direkteur. Files: The South African Institute of Chartered Accountants, file reference APC - ED90. Johannesburg

Saayman, M.P. Senior Finansiële Rekenmeester. 25 Februarie 1994. *Kommentaar op geopenbaarde Konsepte*. Letter. **Sanlam** to Die Tegniëse Direkteur. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Soma, A.K. Group Financial Accountant. 7 March 1994. *ED 89 - Revenue; ED 90 - Property, Plant and Equipment*. Letter. **Anglo-Alpha Limited** to The Technical Director, The S.A. Institute of Chartered Accountants. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Taylor, J.R. Financial Manager. 3 March 1994. *Exposure Draft 89 - Revenue*. Letter. **Anglovaal Industries Limited** to The Technical Director, The South African Institute of Chartered Accountants. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

Timmins, F. 10 March 1994. *Revenue - File reference APC-ED89*. Letter. **Kessel Feinstein** to The Technical Director, The South African Institute of Chartered Accountants. Files: The South African Institute of Chartered Accountants, file reference APC -ED89. Johannesburg

Unknown. undated. *Commentary on recent exposure drafts*. Extract of Letter. Files: The South African Institute of Chartered Accountants, file reference APC - ED89. Johannesburg

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APPENDIX SEVEN

RESPONSES TO INDIVIDUAL QUESTIONS IN QUESTIONNAIRE

QUESTIONNAIRE TO DETERMINE SOUTH AFRICAN CORPORATE MANAGEMENT'S ATTITUDE TO THE ACCOUNTING STANDARD SETTING PROCESS AND INTERNATIONAL HARMONISATION

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1 2

Please indicate your answer by ticking (✓) the relevant square.

1. CORPORATE MANAGEMENT'S INVOLVEMENT IN THE ACCOUNTING STANDARD SETTING PROCESS

	YES	NO	
1.1 Are you familiar with the South African accounting standard setting process	64	13	4
(a) If YES, please complete the remainder of the questionnaire.			
(b) If NO, please go to question 3.			

	YES	NO	
1.2 Should corporate management play an active role in the accounting standard setting process	62	2	5

1.2(a) If YES, why should corporate management play an active role in this process

	Tick one or more boxes (✓)	
(i) Management is in the best position to make decisions on the format and content of financial statements	31	6
(ii) Standards should permit earnings and cash flows to be maintained rather than fluctuating every time a new standard is issued	18	7
(iii) Standard setting bodies and academics are unaware of practical realities	41	8
(iv) Management is not adequately represented on the standard setting body	31	9
(v) Other (please specify) _____	2	10

1.2(b) If NO, why should corporate management not play an active role in this process

	Tick one or more boxes (✓)	
(i) It lacks the necessary practical expertise and knowledge to make a meaningful contribution	1	11
(ii) Theoretical considerations means the process is best left to standard setting bodies and academics		12
(iii) Participation and opinion may be contrary to corporate policy		13
(iv) The standard setting body has in the past disregarded the opinions of contributors		14
(v) Other (please specify) _____	2	15

2. THE ACCOUNTING STANDARD SETTING PROCESS

Accounting standards permit the production of financial information that can be reliably used for decision making.

	Strongly agree	Agree	Dis-agree	Strongly Disagree	
2.1 The existing method of setting accounting standards is the most appropriate for the South African business environment	4	37	22	14	16
2.2 The Accounting Practices Board (APB) through the Accounting Practices Committee (APC) should continue to develop South African specific exposure drafts and statements of generally accepted accounting practice (GAAP)	9	44	10	1	17
2.3 Non-accounting groups (such as lawyers and unions) have a right to participate in the accounting standard setting process because they have a legitimate interest in the content of financial statements	4	32	22	6	18
2.4 The standard of South African developed statements of generally accepted accounting practice are acceptable for financial reporting in the South African environment	5	48	10	14	19
2.5 Existing accounting standards provide management with a sufficiently wide choice of accounting alternatives so as to enable them to prepare financial statements that fairly present the financial position and financial results of the company	4	52	8	13	20

- 2.6 Resources spent on the development of South African statements of generally accepted accounting practice have contributed to maintaining a high local level of accounting expertise
- 2.7 Additional resources should be made available to the South African Institute of Chartered Accountants to enable them to attract and keep suitably qualified staff to ensure relevant ongoing research into accounting issues
- 2.8 Suitable qualified staff from South African universities should be co-opted by the South African Institute of Chartered Accountants to contribute to the development of local accounting standards
- 2.9 Corporate executives of private companies are less likely to respond to proposed statements of generally accepted accounting practice than corporate executives of public companies
- 2.10 The accounting profession has made sufficient effort to expedite legal backing for statements of generally accepted accounting practice
- 2.11 Legal backing to accounting standards should contain a provision for significant penalties to both preparers and auditors of financial statements for non-compliance with statements of generally accepted accounting practice
- 2.12 The conceptual framework recently adopted by the South African Institute of Chartered Accountants provides legitimacy to the accounting profession threatened by government intervention in the accounting standard setting process
- 2.13 Proposed statements of generally accepted accounting practice should include a presentation of the theory and arguments underlying the standard
- 2.14 Companies should bear the financial cost of the accounting standard setting process

4	46	11	2
12	29	23	13
7	39	15	3
17	37	8	2
2	38	19	1
7	36	18	3
4	45	11	0
18	45	1	0
1	19	33	10

- 2.15 Are you aware of the proposed changes to the South African accounting standard setting process

YES	NO
41	23

3. CORPORATE MANAGEMENT

Corporate managers are the producers of firm specific financial information.

- 3.1 Management plays a central role in the determination of accounting standards
- 3.2 Accounting standards should be developed that have as their focus the measurement of earnings rather than the measurement of assets/liabilities
- 3.3 Management will select an accounting alternative that maintains or increases earnings over one that, if adopted, will reduce earnings
- 3.4 An accounting standard that has as its effect the reduction of income will be countered by management making discretionary changes to accounting policies so as to minimise the potential reduction in income
- 3.5 Management is entitled to disregard a statement of generally accepted accounting practice if, in the opinion of management, compliance with that statement would result in the company not meeting its financial performance objectives

Strongly agree	Agree	Dis-agree	Strongly Disagree
4	33	35	3
3	31	39	2
6	49	18	4
2	40	32	3
1	7	44	25

- 3.6 Policy makers within the standard setting process are lobbied by management either in an attempt to initiate changes in allowable accounting procedures, or to express support or opposition to a proposed or enacted accounting standard
- 3.7 Partners in audit firms responsible for the audit engagement are encouraged by corporate management to lobby for changes in accounting standards that are perceived to be detrimental to the company
- 3.8 Proposed changes to statements of generally accepted accounting practice which, if implemented, would adversely effect company earnings, influences management to respond to the change
- 3.9 An audit firm is unlikely to qualify the audit report of a client who fails to comply with statements of generally accepted accounting practice because of the potential economic consequences to the audit firm

	Strongly agree	Agree	Dis-agree	Strongly Disagree	
	1	38	31	3	36
	1	31	35	7	37
	2	54	19	2	38
	5	21	41	9	39

4. CORPORATE MANAGEMENT INCENTIVE SCHEMES

Changes in accounting policies mandated by changes in accounting standards can influence both earnings and cash flows.

- 4.1 Individuals act so as to maximise their own utility and are resourceful and innovative in doing so
- 4.2 Is a management incentive/compensation scheme in operation in the company you are employed by
- 4.3(a) Does the scheme require a level of accounting earnings to be achieved
- (b) and/or share price performance
- (c) and/or a particular return on assets to be maintained before participation
- 4.4 Are there any other contractual obligations between the participants of the compensation scheme and the company
- 4.5 Have any changes to the management compensation scheme been made in response to changes in statements of generally accepted accounting practice
- 4.5(a) If YES, briefly state what changes were made to the management compensation scheme:

	YES	NO	
	63	10	40
	62	15	41
	50	21	42
	22	46	43
	28	43	44
	22	49	45
	1	72	46

- 4.6 Management of companies, although complying with statements of generally accepted accounting practice, are able to 'manage' accounting earnings so as to maximise their own utilities
- 4.7 Lobbying will occur for amendments to those statements of generally accepted accounting practice that negatively impact on earnings and therefore on remuneration derived from incentive schemes

	Strongly agree	Agree	Dis-agree	Strongly disagree	
	1	48	22	3	49
	2	28	39	5	50

5. REGULATION OF ACCOUNTING

Accounting standards are a form of regulation

- 5.1 South African accounting standards should be set in the private sector
- 5.2 In the light of recent corporate collapses (Masterbond, Supreme Holdings, IGI) the public interest can best be served by having accounting standards set in the public sector
- 5.3 The accounting standard setting process as it is currently set up is in need of further regulation
- 5.4 Regulation of accounting is necessary to ensure that financial statements contain adequate disclosure so as to enable companies to compete effectively in the capital market
- 5.5 In the absence of regulation, companies would still disclose sufficient information in financial statements so as to enable them to compete effectively in the market for capital resources

	Strongly agree	Agree	Dis-agree	Strongly disagree	
5.1	7	50	20	0	51
5.2	3	26	35	11	52
5.3	0	33	36	5	53
5.4	16	53	7	1	54
5.5	3	42	27	4	55

6. INTERNATIONAL HARMONISATION OF ACCOUNTING STANDARDS

The South African Institute of Chartered Accountants has recently begun adopting International Accounting Standards for use in South Africa rather than developing South African specific standards.

6.1 The harmonisation process would lead to

- a. An improvement in the quality of financial statements in South Africa
- b. The provision of comparable financial information for international use
- c. The elimination of misleading accounting practices
- d. The range of acceptable practices being narrowed
- e. Assisting in the regulation of accounting across national boundaries
- f. Other (please specify)

	Strongly agree	Agree	Dis-agree	Strongly Disagree	
a.	16	48	13	0	56
b.	22	54	1	0	57
c.	7	44	26	0	58
d.	12	51	13	0	59
e.	13	60	4	0	60

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6.2 The harmonisation process should not continue because:

- a. International accounting standards cannot be amended promptly to take into account changing circumstances in individual countries

	Strongly agree	Agree	Dis-agree	Strongly disagree	
a.	2	12	54	6	63

- b. The underlying economic, legal, social and other environmental factors in different countries does not justify it
- c. Continued rapid growth of global markets proves harmonisation of accounting standards is not necessary
- d. International accounting bodies are unable to deal with the increasing sophistication of debt/equity markets including items such as interest rate and currency swaps on a timeous basis
- e. Other (please specify)

	Strongly agree	Agree	Dis-agree	Strongly disagree	
b.	2	8	59	7	64
c.	1	3	57	14	65
d.	3	21	43	7	66

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- 6.3 Statements of generally accepted accounting practice developed by the International Accounting Standards Committee are of an inferior quality to those produced by the South African Institute of Chartered Accountants
- 6.4 The South African Institute of Chartered Accountants should collaborate with specific countries (such as Australia and New Zealand) when developing statements of generally accepted accounting practice
- 6.5 Too much diversity of culture exists in Africa as a result of the colonial past for the adoption of International Accounting Standards to be successful
- 6.6 In an African context, governments of former colonies and other developing nations may view the harmonisation of accounting standards as an infringement of their national sovereignty and, as a result, will not support the harmonisation process
- 6.7 The adoption of International Accounting Standards by the Accounting Practices Board will result in a significant savings of resources of multinational companies operating from South Africa
- 6.8 Harmonisation of accounting standards will result in more meaningful information being provided to users of financial statements
- 6.9 The harmonisation process should include stock exchange listing requirements
- 6.10 Corporate management will become more accountable to users of financial statements as a result of the harmonisation process
- 6.11 The adoption of International Accounting Standards is likely to result in modifications to corporate management incentive schemes

	Strongly agree	Agree	Dis-agree	Strongly disagree	
6.3	0	9	58	7	69
6.4	4	46	23	2	70
6.5	1	4	54	17	71
6.6	0	13	54	9	72
6.7	1	40	32	0	73
6.8	13	50	12	0	74
6.9	4	56	13	2	75
6.10	2	53	20	0	76
6.11	1	19	49	2	77

- 6.12 South Africa should continue with the process of harmonising international accounting standards

YES	NO	
70	3	78

7. PERSONAL INFORMATION

7.1 What qualifications do you hold

- a. Bachelor's degree/diploma
- b. Honours Bachelor's degree
- c. Other advanced degree (please specify)

- d. Professional qualification eg CA (SA) (please specify)

- e. No post-matric qualification

4	79
4	80
6	81
63	82
	83

7.2 How many years has it been since you obtained your latest qualification

- a. 1 - 10 years
- b. 11 - 20 years
- c. More than 20 years
- d. Not applicable - no qualifications held

28	84
28	85
21	86
0	87

7.3 Gender

Male	Female
70	7

88

7.4 Age

Under 30	31 - 40	41 - 50	51 - 60	61+
10	25	19	23	0

89

Thank you for completing the questionnaire.

If we have any queries, may we contact you?

YES	NO
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If YES, please state your name and telephone number

