CORPORATE LAW ECONOMIC REFORM PROGRAM

ORR Submission to The Treasury

THE REGULATORY IMPACT OF THE AUSTRALIAN ACCOUNTING STANDARDS BOARD

May 1997

OFFICE OF REGULATION REVIEW

CONTENTS

FIGURES

BOXES

EXECUTIVE SUMMARY

Accounting standards create a framework within which business entities prepare financial reports for public dissemination. They facilitate information flows and informed decision-making by firms, consumers, investors and governments. However, such standards must balance the benefits of improving the quality of financial reporting with their associated preparation, compliance and flow-on costs.

The impacts of accounting standards on stakeholders are considerable, and are part of the regulatory burden imposed by governments on businesses. Accordingly, the Office of Regulation Review (ORR) — which is part of the Industry Commission — has an interest in these issues.

This ORR submission to the Corporate Law Economic Reform Program qualitatively examines the incidence and impact of accounting standards, made under the *Corporations Act 1989*. It finds that the accounting standards and associated guidelines of the Australian Accounting Standards Board (AASB) have an impact beyond those entities upon which they are imposed. Other stakeholders who are affected by accounting standards — either directly or indirectly — include shareholders, potential shareholders, creditors and government. While an accurate quantitative assessment of the costs and benefits of accounting standards is difficult, this paper assesses in qualitative terms the likely impacts of such standards on different parts of the community.

This submission concludes that the overall benefits of accounting standards can be expected to exceed their costs. They improve information flows, facilitating the movement of capital within the economy. While market requirements will result in some disclosure anyway, the quality and quantity of such information is likely to be less in the absence of a system of centrally created accounting requirements.

Despite the benefits of such a system, individual accounting standards are not required to undergo the sort of rigorous government mandated processes to ensure their efficiency and cost effectiveness that many other regulations must face. Though the AASB engages in a process of consultation with prospective stakeholders, there are no formal legislative or policy mechanisms to demonstrate that the benefits associated with prospective accounting standards outweigh the costs. Nor do existing mechanisms show whether the proposed standard is the most effective way to improve information flows.

The *Legislative Instruments Bill 1996* will help overcome these shortcomings by requiring future legislative instruments which impact on business — including accounting standards — to be subject to a “legislative instrument proposal”. This will entail an examination of the costs and benefits of proposed accounting standards, along with an assessment of the efficacy of alternatives to such regulation.

These formal guidelines will assist the AASB in formulating high quality standards necessary to improve information flows within the economy, but at the lowest possible regulatory cost to business, and to other stakeholders.

The ORR will assist in the preparation of legislative instrument proposals, consistent with its role of promoting best practice in regulation review and reform.

1 Introduction

Markets can be characterised as providing an arena where buyers and sellers engage in transactions to their mutual advantage. But for the right decisions to be made in the market place, parties need to be provided with good quality information. In some cases, failure may occur in the provision of such information. For example, the separation of ownership and control in many organisations means that stakeholders — such as shareholders and the government — are reliant on information provided by managers, yet this may be insufficient or of poor quality.

To assist decision making by stakeholders, information flows need to be improved within the economy. However, governments should only regulate such flows until the costs of providing additional information outweigh the expected benefits from doing so.

Methods available to governments to influence the creation and dissemination of information can include:

- *implementing financial reporting requirements* to mandate information disclosure;
- *promoting enhanced information strategies* to assist stakeholders in making more informed decisions about a firm’s performance;
- *listing or certification schemes* requiring firms to inform a central authority like the Australian Securities Commission (ASC) or the Australian Stock Exchange (ASX) about matters — such as name, address, board of directors and profit — which may influence investor decision making; and
- *negative licensing* methods whereby firms are free to disclose any information they wish, but if it is false or misleading they may forfeit their right to engage in a particular activity, or alternatively are then required to comply with minimum licence standards when engaging in such activity.

Financial reporting obligations imposed on entities by government can require entities to detail their performance, position, and associated compliance with government regulations.

The Australian Accounting Standards Board (AASB) makes standards and guidelines for financial reporting. By promoting consistency in information disclosure by organisations, it allows:

- investors to make informed judgements about the relative profitability of the organisation;
- governments to assess compliance with regulatory requirements;
- managers to assess their own performance;
- creditors — including lending institutions — to make decisions concerning the provision of goods, services and funding; and

- other stakeholders — including consumers — to make informed decisions regarding the organisation.

Accounting standards can improve resource allocation throughout the economy, and enhance the welfare of Australians. However, while AASB standards are made after consultation with stakeholders, there are currently few external mechanisms to ensure that their benefits outweigh their costs.[1]

This paper examines some of the regulatory issues that arise from the AASB seeking to address information failures in the marketplace. Section 2 outlines the role and impact of the board upon decision making throughout the economy. Section 3 investigates the benefits and costs of accounting standards and alternative ways of informing markets and regulators. Section 4 then examines how the *Legislative Instruments Bill 1996* will modify the process of creating accounting standards. Finally, Section 5 provides concluding comments.

2 Role and impact of the AASB

The objective of the AASB is to improve the quality of financial reporting by entities required to prepare financial statements under Part 3.6 of the *Corporations Law*. To this end, it develops accounting standards known as AASB standards, as well as statements of accounting concepts (see Appendix 1).[2]

The AASB also works with the Public Sector Accounting Standards Board (PSASB) to develop Australian Accounting Standards (AASs). While many AAS standards mirror AASB standards, they are outside the AASB/*Corporations Law* regime. Rather, AASs provide an accounting framework for the reporting requirements for government, and non-corporate private entities. Both boards seek to increase the transparency of an entity's performance, by improving the quality and comparability of financial reporting. This allows stakeholders to make more informed resource allocation decisions (see Section 3).

Private and public sector entities that have to prepare financial statements under Part 3.6 of the *Corporations Law* are bound by AASB standards.

Previously, most "exempt proprietary companies"[3] were not reporting entities and did not have to prepare general purpose financial reports in accordance with the *Corporations Law*. However, the *First Corporate Law Simplification Act 1995* abolished the distinction between exempt and non-exempt companies.

[1] It is acknowledged that an accounting standard is a disallowable instrument and may be disallowed by either House of Parliament if (*inter alia*) inadequate analysis has occurred of its costs and benefits (s 48 *Acts Interpretation Act 1901*).

[2] The concept statements are not approved accounting standards and do not have the force of law.

[3] According to s 69 (1) of the *Corporations Law*, an exempt proprietary company is a proprietary company no member of which is, and no share in which is owned by, a non-exempt person. Subsection (2) defines a "non-exempt person" to include (*inter alia*) public companies.

Proprietary companies are now classified as either large or small and this determines whether they will have to lodge general purpose financial reports in accordance with AASB standards.[4]

The purpose of this provision was to make it easier for small companies to be managed. According to Senator Gibson (1995, p. 695):

> ...[i]t allows small private companies to operate with a single director and a single member and allows them to avoid having to put in financial reports and having annual general meetings.

Large companies will have to comply with AASB standards which have the force of law.[5]

This has significant implications for the application of AASB standards. In December 1995, there were 880 583 proprietary companies registered with the ASC. Of these, 850 736 were exempt proprietary companies, which did not have to produce general purpose financial reports in accordance with AASB standards, while 19 595 were non-exempt proprietary companies who had to lodge annual financial accounts in accordance with AASB requirements.

It is uncertain how many (previously) exempt proprietary companies will now come under AASB auspices, having been described as "large" companies. Many companies will only be able to determine whether they are large or small near the end of the financial year, and this will determine whether they will have to lodge financial statements with the ASC.

Certain organisations are outside the scope of the *Corporations Law* and are normally exempt from preparing general purpose financial reports in accordance with accounting standards. These include:

- family trusts;
- partnerships; and
- sole traders (Australian Securities Commission 1996, p. 3). [6]

---

4 According to s 9.1 of the *First Corporate Law Simplification Act 1995*, a "large" company is one which fails to meet any 2 of the following criteria:

- gross operating revenue of less than $10 million for the year;
- gross assets of less than $5 million at the end of the year; and/or
- fewer than 50 employees at the end of the year.

5 The relevant sections of the *Corporations Law* are:

- s 298(1): which requires that a company's directors shall ensure that the company's financial statements for an accounting period are made out in accordance with applicable accounting standards; and
- s 299(1): if a company's financial statements, when prepared in accordance with applicable accounting standards would not otherwise give a true and fair view of the matters, the directors are required to add such information as will give a true and fair view of those matters.

6 In addition, certain small foreign controlled proprietary companies are exempt by the ASC from certain accounts and audit requirements of the Law under Class Order 96/82.

However, even these organisations may have to produce general purpose financial reports where users of information would rely upon such reports to base their investment decisions. In such a case, the organisations would be “reporting entities”, having to produce general purpose financial reports in accordance with the relevant accounting standards.[7]

While the management of reporting entities may have to prepare financial reports in accordance with accounting standards, there are other stakeholders who are also directly affected by this process. They include (Australian Society of Certified Practising Accountants 1996, M2. 24):

- users such as shareholders, debt holders and creditors who rely on accounting standards to provide quality assurance;
- financial reporting regulators such as the ASC and the ASX who have to enforce and monitor compliance with accounting requirements; and
- any other groups that rely on general purpose financial reports to ascertain an entity’s true financial position.

Compliance with AASB standards also can have flow-on effects, indirectly impacting on:

- shareholders whose returns on equity may be affected by a change in the firm’s investment behaviour in light of particular accounting standards (see Section 3.2.2); and
- consumers who may have the cost of compliance with accounting standards passed onto them in the form of higher prices.

3 Benefits, costs and alternatives to accounting standards

This section provides a broad overview of the costs and benefits of accounting standards, by examining their impact upon particular stakeholders. It then assesses alternative methods of achieving their objectives.[8]

[7] Where users exist, small foreign controlled companies are bound by AASB standards. In contrast, family trusts, partnerships and sole traders which are reporting entities are bound by AASs, as they are outside the *Corporations Law*.

[8] Refer to Australian Society of Certified Practising Accountants (1996, pp. M2.21-M2.28).

Box 1: Summary of the costs and benefits of accounting standards

The main benefits of accounting standards include:

- increased confidence in capital markets because of more accurate and consistent financial information;
- reduced borrowing costs arising from this increased confidence;
- reduced monitoring and bonding costs between owners and management; and
- improved equity in information between small and large investors.

The main costs of accounting standards include:

- costs of administration and compliance with the standards;
- possible distortions in business decision making; and
- risk of regulatory capture.

3.1 Benefits of accounting standards

Underpinning the regulation of financial reporting is a question of market failure. Accounting standards and associated regulations improve information flows within markets, assisting the efficient allocation of resources throughout the whole economy.

3.1.1 Direct benefits of accounting standards

Accounting standards and associated concept statements help to reduce information asymmetries between managers and those who depend upon general purpose financial reports in making their resource allocation decisions.

This view was echoed by Masel, the first chairman of the National Companies and Securities Commission, as he noted the importance of financial reporting in improving information flows:

> As ownership in the shares of a corporation has increasingly become divorced from management, the flow of investor funds to corporations...has been assisted to a large extent upon financial and other reports being available...to shareholders...[I]f securities markets are to function efficiently, investors must have confidence in the periodic report issued by directors (Masel 1983, p. 541).

Due to the dichotomy between ownership and management in many large companies, accounting reports help those outside the firm to monitor the performance of the firm. Accounting standards provide guidelines for the production of such reports, thereby providing quality assurance in financial reporting.

In effect, disclosure regulations and accounting standards reduce the potential for insiders to gain monopoly rents from their inside information. This increases confidence in the capital markets by enabling users of financial information to gain a “better picture” of the financial state of an organisation.

Improved efficiency in the capital markets can also lead to net gains for society by:

- increasing the liquidity of securities; and

- increasing the investor base (Lev 1988, p. 17).

This improves the efficient allocation of resources within the economy, benefiting the community as a whole.

A related benefit of accounting standards is based on the “stewardship concept”, which was popular earlier this century as an explanation for the need for accounting.

> The origins of accounting and indeed of written records are probably to be found in the need of an “accounting” officer to render a statement of money and other assets received in his charge...There was a need for a check on the honesty and reliability of subordinates (Yamey 1962, p. 15).

Accounting measures are often used in the employment contracts of management — for example management salaries may be tied into profits of the company. As accounting standards promulgate a set of enforceable guidelines for financial reporting, they provide rules within which indications of company position and profit can be calculated. Therefore, when investors negotiate with managers as to the frequency and content of financial reports, such standards provide a minimum standard of information disclosure, with additional disclosure governed by the relationship between investors and managers. As a result, accounting standards can reduce monitoring and bonding costs between owners and management.

While the benefits of accounting standards are clear, assessing their magnitude is difficult. Bonding and monitoring costs, while clearly a cost to contracting parties, are not easy to assess.

Furthermore, general purpose financial reports may be regarded as a quasi public good. Additional users of such information can not be excluded from this information although they may not have paid for it. Also, the benefits to them of uniform accounting guidelines are difficult to quantify.

3.1.2 Indirect benefits of accounting standards

Financial reporting requirements and accounting standards help reduce the information assymetries that may occur between well informed investors, who have the capacity to acquire better information, and investors with lower information gathering capacities.[9]

> An objective of financial statements is to serve primarily those users who have limited authority, ability, or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise’s economic activities (AICPA 1973, p. 17).

Improvements in the equity of information dissemination reduces the advantage to those who have a better ability to collect information, by increasing information flows within the economy. This can then lead to net gains to society in the manner described in Section 3.1.1.

---

9 For example, Feldstein and Yitzhaki (1982) found that shares owned by high income investors appreciated substantially faster than stocks owned by lower-income investors.

Further, as better information reduces the risk inherent in a user's fund allocation decisions, the risk component of interest rates will be less, leading to significant interest savings for the corporate sector as a whole.

According to Lonergan, a partner in Coopers and Lybrand (1991, p. 2), by the end of the 1980s, there was widespread international scepticism about the levels of corporate morality in the Australian commercial sector, which led to disclosed losses equivalent to about $1000 for every person in Australia. This was compounded by overseas uncertainty over the quality of Australian standards of financial reporting.

Lonergan (1991) notes that an interest premium associated with this lack of confidence of between 0.5 and 1 per cent would reflect a national interest bill of between $820 million and $1.64 billion per annum. These figures may be too high as they appear to have been calculated on the basis of gross foreign debt. Much overseas borrowing also occurs by government, and it is unlikely that the level of corporate morality would significantly affect such borrowing costs.

However, even if one considers gross private sector foreign borrowings, using Lonergan's assumption of the interest premium, the reduced overseas investor confidence would have resulted in an interest bill of between $450 million and $900 million in 1991. Had poor financial reporting and disclosure requirements continued, the same interest premium would have led to a bill of between $740 million and $1.48 billion in 1996.[10]

Rigorous accounting standards[11] are helping to ensure that financial reporting by Australian companies is of a high standard, thereby reducing the costs of investment capital. This has, and will, continue to lower costs to Australian businesses, improving their competitiveness.[12]

Such benefits to society are enhanced when there is greater international compatibility between the standards of each country. To this end, the AASB has released a policy statement on this issue:

> ...[t]he globalisation of capital markets has resulted in an increased demand for high quality, internationally comparable financial information. The Boards [the AASB and the PSASB] believe that they should facilitate the provision of this information by pursuing a policy of international harmonisation of Australian accounting standards (AARF 1996, p. 5).

The main benefits of harmonisation are that it:

- assists in the comparability of domestic and foreign financial reports, allowing participants in the international capital markets to make more

[10] The interest bill is based on foreign borrowings (gross debt) figures for the private sector in December 1991 (ABS 1991, p. 14), and September 1996 (ABS 1996, p. 15).

[11] The AASB is attempting to achieve international best practice in accounting standard-setting (AARF 1995d, p. 4).

[12] However, increased transparency in financial reporting may lead to higher interest rates for those firms whose poor performance is now more evident.

informed credit and investment decisions. This improves the ability of capital providers to price capital according to the relative risk, and will enhance the ability of more productive organisations to get access to capital;

- improves the ability of foreign investors to understand Australian financial reports, thereby removing barriers to international capital flows as information asymmetry between preparers of financial reports and foreign users are reduced; and
- lowers the financial reporting costs for Australian multinational companies reporting abroad, and foreign multinational companies reporting in Australia, as the additional cost of an overseas company having to comply with a peculiar domestic reporting requirement will be less (Australian Accounting Research Foundation 1996a, pp. 6-7).[13]

These benefits assist in improving the competitiveness of Australian enterprises, while promoting the efficient allocation of resources between companies. For further information on the AASB's project on international harmonisation, refer to Appendix 3.

3.2 Costs of accounting standards

The costs of accounting standards extend beyond the administrative costs of the AASB. A full assessment of costs must include an analysis of compliance costs, the costs of possible distortions in business decision-making as a result of standards, and the flow-on costs throughout the economy.

3.2.1 Direct cost of accounting standards

Considerable resources are consumed by the AASB in monitoring and progressing accounting standards.

Operating expenses of the AASB in 1995-96 were over $1 million (Australian Accounting Standards Board 1996, p. 18). While some operating costs are met through cost recovery — such as publications revenue — funding for the board also comes from the Commonwealth Government. But as the national corporate regulation scheme is now self funding, the Commonwealth's contribution to the costs of the AASB is covered by fees collected (by the ASC) from companies and other securities market participants and not by the taxpayer in general.[14]

In addition to fees, many preparers and users of financial reports also contribute to the development of accounting standards. Firms often will prepare

---

[13] As smaller companies generally only comply with Australian reporting requirements, the move towards international harmonisation may benefit them to a lesser extent than it will multinational companies.

[14] Further, the ASX is providing $1 million (over two years) in assistance to the AASB in its international harmonisation project.

submissions to the AASB on accounting standards, the drain on resources adding to their internal costs.

To the extent that the information produced by accounting standards is not generated anyway through market forces (see Section 3.4), the compliance costs of accounting standards can also be considerable, especially if the paper burden associated with meeting new accounting standards requires more staff. A firm's external costs could also rise if greater consultations are required with external specialists — such as accountants and lawyers — in order to meet accounting standards.[15]

Additional direct costs to firms of complying with corporate regulation, (including accounting standards) can include:

- collection;
- storage;
- retrieval;
- presentation;
- analysis and interpretation of the information;
- the purchase of publications to assist in compliance with such regulations, and
- possible loss or diminution of competitive position due to increases in cost structures (Australian Accounting Research Foundation 1990b, p. 13).[16]

For further details about the compliance costs of accounting standards, refer to Appendix 4.

3.2.2 Indirect costs of accounting standards

While the indirect costs of accounting standards are not as transparent as direct costs, they may be more significant.

Accounting standards do not directly affect the underlying economics of a particular transaction or event, for example the cash flow expected from a particular transaction. However, some accounting standards may lead to the disclosure of accounting information which is viewed negatively by investors. In particular, managers may be discouraged from engaging in profitable longer term activities, if they would be reported as adversely affecting short term (profit or debt) figures. This could create investment distortions in some circumstances,

[15] However, it is acknowledged that compliance with standards can lead to management efficiencies, as managers are forced to assess accurately the performance of their organisation.

[16] These costs are only an additional burden on firms if they only arise due to regulation, and would not have occurred anyway through market forces.

with companies not necessarily investing in those areas which yield the greatest profit (see Box 2).[17]

Box 2: Examples of possible investment distortions arising from accounting standards

1 AAS 20 (AASB 1012): Foreign Currency Translation

This standard states that any costs or gains arising at the time of entering into hedge transactions shall be amortised in the profit and loss account over the lives of the hedge transactions.

In addition, losses incurred on foreign exchange loans which are re-financed before maturity must be reported.

However, companies which obtain loans in foreign currencies may try to avoid re-financing at a lower rate because the loss from the first loan must then be recorded, with concomitant investor confidence being affected. This particularly impacts upon large mining companies, which must borrow in foreign currencies in order to hedge against fluctuations in the foreign currencies in which their sales contracts are negotiated (Hutchingson 1986, p. 74).[18]

While many of the hedging practices of mining companies are due to prudent commercial practices, some costly hedging may also be motivated by the desire to reduce the effects of AAS 20 on the variance of the reported earnings of companies. In the U.S., some banks have even developed and marketed models that demonstrate to firms how to manage their foreign assets and reduce their exposure to the U.S. equivalent of AAS 20.

As firms have always had the option of hedging, if they only chose to hedge to avoid the impact of AAS 20, then such hedging behaviour represents a cost to the firm, which then leads to a loss to shareholders, as the company is not strictly profit maximising.

2 AAS 25: Financial Reporting by Superannuation Plans

This standard allows the calculation of the surplus or benefit of superannuation plans by comparing assets (which are measured at net market values) with accrued benefit liabilities that are not realisable. Therefore, potential investors will be able to compare the value of unit holder funds against the current price of investments bought with those funds. While this improves the information available to investors, assisting their allocation of resources, it can also have some unintended consequences. In particular, this could discourage investment in areas where market prices are likely to fluctuate more. For instance, even if superannuation funds believe that investment in the share market will yield high returns, as an investment in this area could be more volatile, affecting figures required to be disclosed under this standard, they may choose not to invest in shares. In such a case, AAS 25 may lead to funds not being invested in areas which would maximise returns. Such action is likely to flow onto fund members in the form of lower dividends (see Boyd 1990, p. 6).[19]

---

[17] Shareholders may still be better off if the benefits of the additional information to them outweighs the lower returns which they may receive.

[18] Comments by Hutchingson (1986, p. 74) were made in relation to an exposure draft of the standard. The standard applies to financial years ending on or after 1 January 1988.

[19] According to the Australian Accounting Standards Board (1997), there has been no evidence to date that accounting standards such as AAS 25 have distorted investment policies.

3.3 Issues of "regulatory capture"[20]

The effectiveness of accounting standards stems from the interaction between 3 stakeholder groups: the AASB, business, and the accounting profession.

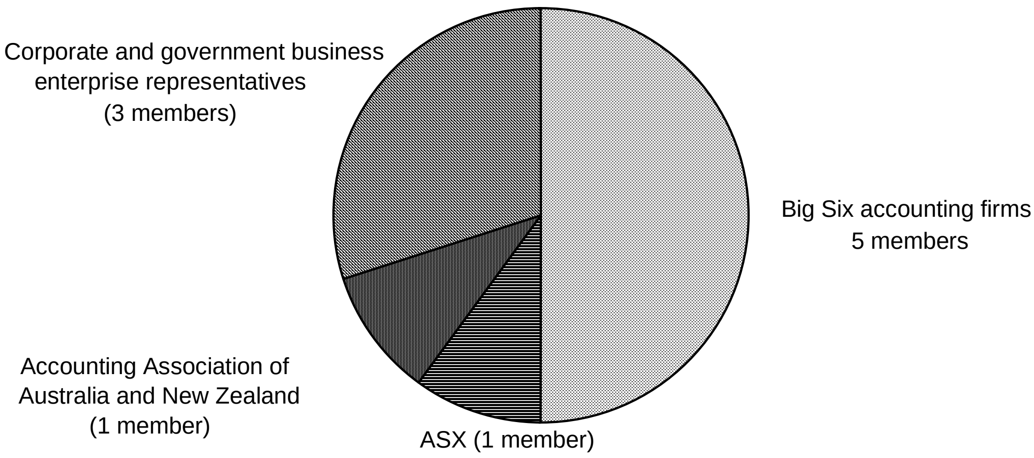
Ultimately, it is the financial reporting obligations of businesses subject to the *Corporations Law* which are regulated by accounting requirements. Consequently, it may be argued that the AASB — which is an independent body of technical experts — introduces neutrality into the accounting standard setting process. This prevents those subject to disclosure requirements (ie. business) from unduly influencing the creation of standards within which reports are prepared.

However, though it is the financial reports of companies which are regulated, it is the role of the accounting profession to ensure that they are prepared in accordance with accounting requirements. It has been contended that the promulgation of accounting standards by the AASB could result in the accounting profession "capturing the process" of creating requirements for financial reporting. This could generate benefits for the profession through the creation of accounting regulations beyond that which are necessary for the effective and efficient operation of markets and businesses.

While the AASB canvasses public opinion through exposure drafts and public consultation, technical and secretariat support comes from the Australian Accounting Research Foundation (AARF), which is constituted by the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia. Furthermore, of the 10 member board of the AASB, 5 are from the "Big Six" accounting firms. Of these, 4 represent the accounting professional bodies (see Figure 1).

[20] Regulatory capture occurs when an organisation affected by regulations is able to exert undue influence over the development and application of those regulations.

Figure 1: Composition of the Board of the AASB



Source: Treasury 1997a.

In addition, the two major accounting professional bodies contributed $820 000 each to the cost of running the AARF in 1995, of which nearly $400 000 was directed towards providing support to the AASB (Australian Accounting Research Foundation 1995d, p. 23).

Increased government funding for the AASB's work program in 1996 has led to a reduction in contributions from the accounting bodies. However, their continuing managerial, intellectual and financial influence in the activities of the AASB, has led to some perceptions that the accounting organisations may have captured the regulatory process for the making of accounting standards.

For example, Walker (1987) contends that such a capture has occurred of the AASB. He argues that, prior to the creation of the ASRB (the precursor to the AASB), the accounting profession successfully lobbied to ensure that the ASRB did not have an independent research capability. In addition, Walker provides examples of the ASRB refusing to consider proposed standards by non accounting bodies, yet announcing reviews of standards not yet submitted by the AARF.

However, the move towards international harmonisation of accounting standards and the public scrutiny to which proposed accounting standards are subject, reduce the possibility of regulatory capture at a domestic level.

In addition, such influence by the accounting profession is limited by the fact that all standards have effect pursuant to parliamentary approval, and the ASC is responsible for ensuring compliance with accounting requirements. However, as the AASB formulates standards without direct government involvement, it still has many of the generic characteristics of self regulation (see Box 3).

Box 3: The costs and benefits of self regulation

Advantages of self regulation arrangements include:

- they are more likely to be observed because they are made by those to whom they apply;
- they utilise the insiders expertise and experience in the formulation of codes, standards, and agreements;
- they can often be more responsive and flexible than regulation with changes and updating occurring more often;
- they can allow for innovative behaviour by industry participants;
- they have the agreement of major industry participants and therefore awareness and compliance is likely to be higher;
- they are cheaper for governments to develop and monitor, as those being regulated bear the cost of regulating; and
- they may provide a dispute resolution mechanism, via independent arbitrators, the ombudsman, or industry councils.

Disadvantages of self regulation arrangements are:

- there are no legal remedies for breaches of the code or agreement;
- they could be used to promote anti-competitive behaviour;
- they impose monitoring costs which are incurred by the industry or professional association;
- compliance may be low if there is no sense of commonality amongst those affected; and
- they may create barriers to trade, by being too rigorous in nature, or alternatively, they may lack rigour in order to accommodate the interests of all groups who seek to come within the self regulation framework.

Source: Office of Regulation Reform 1996, pp. 27-28.

The AASB is a board appointed by, and accountable to, the government, but much of its research and standards preparation activities occur through the AARF. While the AARF itself is a quasi-autonomous organisation, its resources come from the accounting bodies. Consequently, there is a possibility that by influencing the preparation of accounting standards, the professional bodies have largely insulated themselves from government involvement in the standard setting process. Allen (1991) contends that this could have increased the professional prestige and financial rewards to accountants. This type of regulatory capture may impose some potential costs on society. For instance, it may result in financial disclosure requirements being created without adequate regard being given to the compliance costs it imposes on business.

However, despite this, clear advantages can also accrue from such self regulation. Firstly, the AASB through the assistance of the major accounting organisations is more expert than a government regulator in developing accounting standards. This is reinforced by the fact that the quality of the Australian accounting standard setting function is internationally acknowledged as one of the top three accounting standard setting jurisdictions. Secondly, self regulation by the accounting profession can allow for the enforcing of ethical standards beyond which any law could establish. As a former Chairman of the United States Securities Exchange Commission stated:

> By and large government can only operate satisfactorily by proscription. That leaves untouched large areas of conduct...in the realms of ethics and morality. Into these large areas self government and self government alone can effectively reach (Douglas 1938).

The importance of high ethical and moral standards is essential in accounting, as investor confidence depends on it. Consequently, even if the accounting profession has partially captured accounting standard setting, it may be that the benefits of self regulation in engendering confidence in information disclosure outweighs any costs associated with regulatory capture.

3.4 Market alternatives[21]

An accounting market failure will exist where the information in accounting reports in the absence of regulation is non-optimal — in terms of quality or comparability — or where there is an inequitable distribution of accounting information (Watts and Zimmerman 1986, p. 163).

Several theories argue that no such failure exists, as forces in the funds market coupled with contractual incentives compel organisations to disclose high quality financial information, irrespective of the existence of accounting standards.

3.4.1 Competition in capital markets

This theory argues that investors will decide whether or not to allocate their limited capital on the basis of a firm’s projected earnings performance. Critics of accounting regulation contend that investors make such decisions on the basis of the current information available and its perceived reliability. Firms therefore have a powerful incentive to disclose timely and accurate information, even in the absence of accounting guidelines. Ross (1979) goes even further, claiming that it is advantageous to disclose even negative information in order to preserve the firm’s long-term credibility.

Such arguments are based on investors questioning the veracity of financial reports in the future, because they realise that a particular firm has a tendency to withhold relevant information. However, the incentive for a firm to provide such information will become ameliorated to the extent that it can successfully conceal bad information (Lev 1988).

Even if market discipline led to the disclosure of relevant information, such disclosure may still be non optimal if the information was of varying quality, preventing users of financial reports from comparing the relative efficiency of firms.

---

[21] For further details on alternative market mechanisms to accounting standards and mandatory reporting, refer to Australian Society of Certified Practising Accountants (1996, pp. M2.11-M2.20).

3.4.2 Signalling

Whereas Ross' contentions are based on disclosure of information to preserve credibility, signalling theory focuses on signalling by firms in order to alleviate information asymmetry. It contends that as corporate managers have more information about the value of a firm's shares than outsiders, they will either disseminate or withhold information, depending on whether the information will increase the value of the firm.

Firms which are undervalued will spend additional resources on financial disclosure, in order to promote the firm's financial strength. In contrast, overvalued firms will seek to minimise the promulgation of financial information, and *ipso facto*, will have signalled that they are overvalued. The value of all such firms will then drop to the average value of overvalued firms, resulting in some previously overvalued firms now being relatively undervalued. These firms then have an incentive to provide additional information to distinguish themselves. The end result will be that only the worst firms will not signal.

While signalling improves the allocation of resources within the economy, as the more efficient firms will receive more capital, part of the expenditure on signalling will be devoted towards past performance. Unless past performance is likely to reflect future performance, signalling could actually cause an overproduction of irrelevant information in financial reports (Watts and Zimmerman 1986).

Moreover, even if the information is timely, there is no guarantee of its quality. While firms engaging in creative accounting would become penalised in the long run, such a reputation would only accrue *ex post*. Investment decisions may then have been taken on the basis of an entity's reports before it became known that the firm had engaged in dubious accounting practices.

Further, Watts and Zimmerman (1986) argue that centralised accounting standard setting is necessary as the accounting information in public reports is a public good, and not a private good. Investors who do not hold securities in a company can examine its financial statements without contributing towards the cost of the production of the information. If prospective investors cannot adequately signal the use which they make of such information, corporate managers may underestimate the quantity of useful information that should be produced.

Consequently, if the market was left to determine the level and quality of accounting disclosure, there would be a paucity of relevant information disclosed. As a result, disclosure regulation and accounting standards are necessary to ensure that firms provide a sufficient amount of useful information for the markets to function effectively.

3.4.3 Contractual incentives

This theory argues that regulation of accounting standards is unnecessary because contractual forces will necessitate the divulging of relevant accounting information. According to Jensen and Meckling (1976, p. 308):

> The principal can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs designed to limit the aberrant activities of the agent.

Relating this to the management of a company, managers are under a contractual obligation to administer the company to the satisfaction of investors. The latter will seek to prevent management from acting in its own self interest by insisting that there is adequate disclosure in financial reports.

However, investors do not have any guarantee of quality assurance when they receive financial reports. They can only build up an idea of the quality of financial reporting after the fact, and this may be too late.

Even if information which is provided is presumed to be accurate, it will only be available to those in a contractual relationship, ie the existing investors (shareholders) and managers. It does not take into account the information needs of potential investors in the capital market who may want financial information on which to base future resource allocation decisions.

In addition, the costs of agency may outweigh the costs of promulgating and enforcing accounting standards through centralised bodies. According to Jensen and Meckling (1976, p. 308), agency costs are the sum of:

1. the monitoring expenditures by the principal;
2. the bonding expenditures by the agent; and
3. the residual loss.

A centralised accounting standard setting process may impose less costs on society than aggregated agency costs.

3.4.4 Market discipline theories appear inadequate

While the competition in capital markets, signalling and contractual incentives theories provide reasons for allowing markets to freely determine information flows, they have been insufficient in ensuring that only high quality financial information was disseminated in Australia and overseas.

Effective disclosure requirements and relevant accounting standards inspire confidence in the markets. Furthermore, they reduce the possibility of misleading and deceptive financial reporting which can occur despite the propositions of the market disclosure theories.

In light of this, a centralised system of accounting standards is preferable to market alternatives. Rather, the real issue is whether particular accounting requirements are fully costed to ensure that their beneficial impact on information flows outweighs their direct and indirect costs.

4 The impact of the *Legislative Instruments Bill 1996* upon accounting standards

The AASB presently engages in comprehensive consultation with stakeholders before making accounting standards. The *Legislative Instruments Bill 1996* will strengthen this process through specific requirements, assisting in the development of high quality accounting standards.

4.1 Existing mechanisms for the development of accounting standards

The AASB is mandated with national standard setting through the *Corporations Act 1989*, a Commonwealth Act, to which the states have devolved power. As a result, AASB standards are disallowable instruments under the *Acts Interpretation Act 1901*.[22] Therefore, while the AASB undergoes a vetting and consultation process before a standard is promulgated, there is no formal legislative or policy mechanism to ensure that new accounting standards are the most cost effective method of meeting a financial reporting need (see Figure 2).

[22] This is enshrined in s 32(2) *Corporations Act 1989.*

Figure 2: Current process for AASB standard promulgation

Event	Time Frame	Outcome
AASB makes a draft standard.	No specific legislative process is required	
Notice of making a standard is published in the Commonwealth Government Gazette.[23]	It is unclear how quickly a standard must be Gazetted.	
Standard is tabled in each House of the Commonwealth Parliament.	Within 15 sitting days of their making.	If a standard is not tabled, it ceases to have effect.
A member in either House can give notice of motion of disallowance.	Within 15 sitting days of being tabled.	If no notice is given, the standard has continuing effect.
Where notice of motion for disallowance is given, it may be:	Within 30 sitting days of being tabled.	
• put to the House and succeed.		The Standard ceases to have effect.
• put to the House and fail.		The Standard has continuing effect.
• put to the House and not withdrawn.		The Standard ceases to have effect.
• called on, moved and seconded, not withdrawn or otherwise disposed of.		The Standard ceases to have effect.

Source: Australian Accounting Research Foundation (1996b)

4.2 *Legislative Instruments Bill 1996* and the promulgation of accounting standards

While the standards of the AASB are of a high quality, it does not appear that the process of creating them entails an economy-wide analysis of the proposed standard's impact and associated costs and benefits. The method of developing accounting standards will need to be revamped when the *Legislative Instruments Bill 1996*[24] is passed, applying to the promulgation of all legislative instruments.

Part 3 of the bill requires that all organisations — which are empowered under Acts to make regulations affecting businesses decision-making — follow particular processes aimed at quality assurance in regulations. Specifically, this Part will require disallowable instruments (including accounting standards) to be

[23] s 48 *Acts Interpretation Act 1901*.

[24] A legislative instrument under s 5 (1) of the *Legislative Instruments Bill* is an instrument in writing "...that is of legislative character, and that is or was made in the exercise of a power delegated by the Parliament..." The power is delegated by s 32 of the *Corporations Act*. Under s 18 (b) of the *Legislative Instruments Bill*, a legislative instrument made under enabling legislation in Schedule 2 is subject to consultation as part of a legislative instruments proposal. As the *Corporations Act* which empowers the AASB to make accounting standards is in this Schedule, it is clear that AASB standards will be subject to a LIP under the new regime.

subject to a Legislative Instruments Proposal (LIP) entailing the following elements.

4.2.1 A summary of the proposal for the legislative instrument

This requirement is unlikely to result in any procedural changes as the AASB already provides summaries of proposed accounting standards in exposure drafts which are publicly disseminated for comment by interested parties.

However, under s 21 (2) (a) of the bill, these exposure drafts will be formally required to contain:

> ...a full statement of the issues giving rise to the need for the proposed legislative instrument and of the objectives of the instrument.

Consequently, greater analysis may be required of the specific market failure which the standard seeks to address (the need), along with an explanation of how the proposed accounting proposal will rectify this failure (the objective).

4.2.2 An analysis of other means of achieving the objective

At present, it appears that alternatives to nationally promulgated AASB accounting standards are not considered. Rather, the test to determine a standard's creation is embodied in s 226 of the *Australian Securities Commission Act 1989*, which requires that the information generated by the application of the proposed standard is relevant to "informed decision-making and management accountability" (Australian Accounting Research Foundation 1994b, p. 4).[25]

However, under s 21 (2) (b) of the proposed legislation:

> ...a statement of the various options...that may constitute viable means for achieving the objective [must be contained in the LIP].

Consequently, the feasibility of some accounting standards being made by other national bodies may warrant closer inspection. Such bodies may include the Insurance and Superannuation Commission (ISC), Reserve Bank of Australia, ASC and the Australian Shareholders Association.[26] In addition, the viability of promulgating accounting standards and requirements through schedules in primary legislation may have to be considered.[27]

This requirement will help to ensure that promulgated standards are carefully considered and are the most effective means of achieving the desired regulatory objective.

[25] For further information about the requirements which need to be satisfied before a draft standard is created, refer to Appendix 1.

[26] The advantages of bodies with a specific regulatory function preparing accounting standards would have to be balanced against the possibility that these bodies, in developing reporting requirements tailored to their specific regulatory objectives, may result in inconsistent reporting between entities.

[27] However, it is noted that the *Corporations Law Simplification Program* is removing accounting requirements from the legislation (see Appendix 3).

Alternatively, accounting standards could be promulgated through state legislation (see Box 4).

Box 4: An alternative to accounting standards coming under *the Legislative Instruments Bill 1996*

Under s 5 of the *Corporations Act 1989*, the *Corporations Law* applies as the law for a state. Therefore, while it is a national scheme, it is the Commonwealth, not the states which implements the law. However, national corporate legislation is under-pinned by a Heads of Agreement between the States and the Commonwealth. In theory, at least, the States could largely circumvent the *Legislative Instruments Bill 1996* by amending their Application Acts either to re-establish the AASB under state law, or to give responsibility for making such standards to the accounting profession.

However, if the AASB was established under state law, it is likely that its standards would then be subject to the state equivalents of the bill, in the absence of a statutory exemption. For example, in Tasmania, the *Subordinate Legislation Act 1993* requires that:

> ...[t]he responsible Minister must ensure that before subordinate legislation is made, a regulatory impact statement...is prepared in connection with those parts of the proposed legislation which would impose a burden, cost or disadvantage on any sector of the public.

As accounting standards are part of the regulatory burden faced by business, analysis of costs and benefits would still be required in accordance with such provisions.

4.2.3 A broad indication of the relative costs and benefits of the proposal

Currently the AASB only has to consider the “commercial and economic consequences which might flow from its [the standard’s] implementation” (Australian Accounting Research Foundation 1994b, p. 4).

While *SAC 3 Qualitative Characteristics of Financial Information* does discuss the importance of fully costing a proposed accounting standard, it does not provide any methodology to do so. Rather, it merely states (1990b, p. 14):

> ...measuring costs and benefits of financial information...is a matter for professional judgment by those who have to prepare, or influence the preparation of, financial information.

It is acknowledged that the measurement of costs and benefits of financial information is a difficult task as accounting standards affect a broad cross section of the business community. According to the (United States) Financial Accounting Standards Board (1991, foreword):

> In debates over proposed accounting standards, [the board] is frequently challenged to measure the expected benefits to the large and diverse community of users of financial information versus the costs of that information. In most cases, the best that can be done is conscientious judgemental assessment of costs and benefits.

In Australia, the AASB uses its discretion to make a judgement as to what costs and benefits to consider in its evaluation of the efficacy of a proposed standard (Accounting Standards Review Board 1990, Clause 38).

The proposed legislation will supplement the AASB's discretion in determining what costs and benefits to consider. In addition to assessing the costs and benefits of standards upon the stakeholders upon whom they directly impact, analysis will also have to occur of likely community-wide and feedback consequences of the proposed standard. While a quantitative assessments of impacts is ideal, it is recognised that due to the difficulty of precisely determining how stakeholders will react to the standard, a qualitative assessment may suffice in some circumstances.

This will entail consideration (inter alia) of the indirect effects of the standard on consumers and taxpayers (see Section 2) and will be analogous to a Regulation Impact Statement (RIS). The Commonwealth's RIS guidelines are located in Appendix 5.

As the AASB moves towards increasing international harmonisation of its standards, an examination of the overseas experience regarding particular accounting standards may provide an insight into the likely impact of such standards within Australia.

4.2.4 An evaluation of whether the option restricts competition, whether the restriction is necessary to achieve the objective, and if other options achieve the objective without restricting competition

The present process for standard formulation does not include this requirement. Rather the criteria for promulgation focuses on the need and usefulness of the proposed standard (ss 297-299 of the *Corporations Law Act 1990* and s 226 of the *Australian Securities Commission Act 1989*).

Many proposed standards will not restrict competition as they will apply universally across all companies. However, where a proposed standard imposes a discriminatory burden upon particular sectors of the community, it may restrict competition, and a consideration will be required of whether the restriction is necessary to achieve the stated objective and if there are alternatives to the standard which can achieve the objective without restricting competition.

A restriction on competition could occur in the following circumstances:

- where a particular standard is developed for a specific sector of business, such as AASB 1023 Financial Reporting of General Insurance Activities — which only impacts upon the reporting obligations of general insurance companies. Had such a standard been developed after the bill commenced operation, it might have been necessary to evaluate the extent to which (if any) the standard restricted the competitiveness of that particular sector, by imposing disclosure requirements which were more onerous than (for example) in other parts of the insurance industry; and
- where different accounting standards in the public and private sectors provide one sector with an advantage in the competitive tendering and contracting process when formulating bids (see Box 5).

Box 5: Consistency between public and private sector accounting methodologies

The AASB and the PSASB have been developing accrual accounting principles for use in the public sector, which are similar to those used in the private sector. The efficiency gains arising from the adoption of accrual principles are considerable, with increased compatibility between private and public sector accounting methodologies improving the transparency of resource allocation between the public and private sectors.

This will also allow comparisons to be made of the relative efficiencies of public and private sector organisations, increasing competitiveness in the competitive tendering and contracting process for public sector contracts. For example, when external suppliers are competing for a contract which would otherwise remain in-house, they will only place a bid if they feel the resulting contract would be profitable. By implication, they would have fully costed the proposal, and this would be reflected in the bid price. If this bid is competing with an in-house bid from a department which has not adopted accrual accounting, there is a risk that the in-house bid will not include costs which may arise in the future, but whose impact has not yet been felt. This may allow an in-house bid to succeed, though it is in effect more costly in the long term, resulting in an inefficient allocation of resources.

Source: Industry Commission 1995, pp. 289-290.

Even if a standard is applied uniformly across all reporting entities, it may still restrict competition if the costs of compliance with it are disproportionately high for particular sectors of the community — such as small business (see Appendix 4).[28]

According to Pope (1994), the compliance costs of company income tax are higher for small firms than for large firms.

> Compliance costs as a percentage of tax paid are extremely regressive, falling from nearly ten times greater than the tax paid for the smallest (taxable) companies to 0.5 per cent for the largest companies. The regressive pattern is also confirmed when internal costs are expressed as a percentage of annual turnover, with costs falling from 3.0 per cent to 0.01 per cent (Pope 1994, p. 90).

AASB standards are a part of the disclosure regime within which the amount of company tax payable is assessed. If there are substantial differences in compliance costs for firms — of different sizes — to meet such standards, and this affects competition, alternatives which meet the objective without restricting competition will have to be considered. A list of some of the compliance costs of accounting standards are in Section 3.2.1.

[28] While accounting standards are based on the principle of “differential reporting”, with large companies subject to a greater accounting burden, the compliance costs to small businesses of accounting standards may still be high (see Appendix 4).

Although an accounting standard may restrict competition, it can still be made if "the option should be pursued despite the restriction". This would occur where the community-wide benefits of the standard outweigh the costs.

In addressing this issue, some guidance may be sought from the "public interest" test in the Competition Principles Agreement (CPA), which provides for an examination of the relationship between the overall interest of the community, competition and desirable economic and social outcomes (National Competition Council 1996, p. 4) (see Appendix 6).

4.2.5 A statement of the reasons for the preferred approach

The form of the proposed accounting standard, its overall impact and its method of promulgation will have to be justified in light of alternatives. The present process of AASB promulgation under the *Acts Interpretation Act 1901* requires no specific external processes to be complied with.

4.2.6 Consultation

The AASB currently engages in a wide ranging consultation process by inviting public comment on its policies (see Appendix 2). These procedures assist in assessing the community wide implications of a standard. However, under the proposed legislation, these consultation processes would be supplemented by a formal two-tiered system of consultation as specified in Part 3 of the *Legislative Instruments Bill*.

S 19 will require the rule maker (the AASB) to identify whether a particular organisation exists which would sufficiently represent the interests of most parties to be affected by the accounting standard, and invite them to make submissions before the due date (s 20 (b)).

While this procedure is similar to the process of inviting submissions in response to an exposure draft, the Office of Regulation Review (ORR) would have to certify under s 21 (5) (a) that notification was adequate, as well as whether the LIP contains sufficient analytical rigour (as required by s 21 (2) and (3)). This is consistent with the role of the ORR in assisting agencies improve regulatory design and achieve minimum effective regulation (see Box 6).

Box 6: Role of the ORR in regulation reform

The ORR — located within the Industry Commission — provides advice on the Commonwealth Government's regulation review policy. It reviews new regulations, and monitors the progress and participates in programs for the reform of existing regulations. The ORR also advises Cabinet on regulatory proposals affecting business, liaises with departments and agencies in the development of regulations, and comments publicly on regulatory issues.

The *Legislative Instruments Bill 1996* seeks to improve the quality of subordinate instruments, and the ORR will have an obligation advising on their regulatory design. This is part of the broader regulation review and reform programs that utilise RISs which assess the objective of the regulation, its costs and benefits, and alternative ways of meeting the objective for which the regulation was designed. RISs are already required in the following circumstances:

- a RIS must be prepared by Ministerial Councils and National Standard Setting bodies when creating new standards;
- a RIS must be attached to all submissions to Ministers or Cabinet, as well as letters to the Prime Minister, dealing with issues that impact upon business; and
- the Legislative Review Program (under the Competition Principles Agreement) requires all Australian governments to review legislation that restricts competition, incorporating the basic elements of a RIS.

Once the ORR has certified that notification has occurred and that the LIP complies with the provisions of the Act, the AASB must then invite written submissions relating to the proposed standard or invite participation in a public hearing under s 22. This should occur through an advertisement in each state.

> The advertising must be included in one or more newspapers circulating in the relevant States and Territories or broadcast on the electronic media received in the relevant States and Territories (s 24).

The aim of the extensive consultation processes is to ensure that wide ranging public comment is possible on a proposed legislative instrument prior to its promulgation.

However, there may be occasions where the AASB has engaged in what they believe to be a sufficiently consultative process, during the formulation of the accounting standard. A particular case where this could occur is where exposure drafts have been issued and submissions are currently being considered, such as with ED 71 Equity Accounting and ED 65 Financial Instruments. If Part 3 of the bill becomes operational before the finalisation of such standards, the AASB will not necessarily have to go back and comply with ss 22-25 of the bill. Instead, the "regulatory review body" (currently the ORR), may grant a waiver from post LIP consultation. That would be in accordance with s 31:

> ...[i]f the regulatory review body has certified, under s 21 that a Legislative Instruments Proposal meets the requirements of this Part; and in the particular circumstances of the case, the costs of undertaking consultation in accordance with sections 22, 23, 24 and 25 in relation to the legislative instrument would outweigh any benefits from the consultation; and the consultation required to be undertaken by the rule-maker in relation to the making of the instrument under the enabling legislation...constitutes a sufficient level of consultation in the circumstances; the rule maker is not required to comply with sections 22, 23, 24 and 25 in relation to that instrument.

Clearly, if the AASB has engaged in wide ranging consultation in preparing an exposure draft and has accepted comments on its contents, extensive consultation may have already occurred, and it may not be cost effective to comply with ss 22-25. Whether the ORR would grant a waiver from compliance with ss 22-25 would depend upon the circumstances of the case, and would be influenced in part by the magnitude of the impact of the proposed standard upon stakeholders.

However, a waiver can only be granted for *post*-LIP consultation. If the consultation and analysis embodied in the LIP itself are inadequate, the ORR will be unable to certify it as complying with Part 3 of the bill, and therefore could not grant a waiver from the subsequent need to comply with ss 22-25.

A summary of the consultation procedures under the *Legislative Instruments Bill 1996* is found in Figure 3.

Figure 3: Application of Part 3 consultation requirements to accounting standards

Event	Time Frame	Outcome
AASB makes a draft standard.	No specific due process is required.	
Minister to decide whether or not there is a particular body that sufficiently represents interests of those parties to be affected by the accounting standard (s 19).		The AASB to notify relevant parties (s 20). These bodies are likely to be organisations which represent business.
The AASB is to invite written comments (s 20 (b)).	Before a date specified in the notification. (s 20 (b)).	Comments are received on the need for the standard, and its objective.
After considering the comments, if the AASB continues to decide that the proposed accounting standard is the preferable way of achieving the objective under s 20, a LIP must be prepared.	The AASB must “soon as it is practicable”, submit the LIP to the ORR for certification (s 21 (4)).	If the ORR agrees that notification was adequate and that the LIP meets the requirements under s 21 (2) and (3), it will certify the LIP as meeting the requirements of Part 3 (s 21 (5)).
The AASB must then invite submissions relating to the proposed standard, or invite participation in a public hearing (s 22 (1)).	Written submission must be allowed at least 21 days after the day the invitation is advertised (s 23 (3)).	Invitation must declare: • the intention to make the accounting standard; and • describe how to obtain copies of either the LIP or the standard.
Alternatively, the ORR may grant a waiver from post-LIP consultation.		The AASB is not required to comply with ss 22-25.
The AASB must prepare a written consultation statement in respect of the instrument (s 27 (1)).		Statement is tabled in parliament.

Source: ORR and Legislative Instruments Bill 1996.

While the quality of the AASB's standard setting procedures are already of a high standard, when compared internationally, these processes may be further improved through the introduction of the *Legislative Instruments Bill 1996*. In particular, through consultation requirements which are more onerous than those currently employed by the AASB, there is likely to be even greater community confidence that robust procedures are being followed, reducing the ability of any one stakeholder group to exert control over accounting standard setting.

Alternatives to draft standards researched and developed by the AARF may have to be considered, including proposals for standards from government organisations, industry bodies or even consumer groups. Admittedly, the final decision of what draft standards to adopt will rest with the AASB. However, as the bulk of research into standards development is still likely to come from the AARF, the accounting profession will continue to exert considerable control over standard setting.

The accounting standards which were tabled in the Senate in 1995 as disallowable instruments are listed in Box 7.

Box 7: Accounting standards tabled in the Senate in 1995

AASB 1001	Establishes accounting standards for disclosures in respect of accounting policies.
AASB 1018	Establishes accounting standards for profit and loss accounts.
AASB 1029	Prescribes reporting requirements for half year accounts and consolidated accounts of disclosing entities.
AASB 1030	Requires disclosing entities other than companies to comply with accounting standards in preparing financial accounts.
AASB 1031	Defines materiality and the role of materiality in making judgements in the presentation and presentation of financial reports.

Source: Senate Standing Committee on Regulations and Ordinances 1995.

4.3 Sunsetting arrangements for all legislative instruments including accounting standards

While the *Legislative Instruments Bill 1996* is designed to improve the process of creating accounting standards, it is likely to impose a significant additional burden on the AASB.

Part 3 of the pending Act requires all accounting standards made more than 6 months after the commencement of the bill to have a LIP attached in the manner described above (s 18).

In addition, Part 4 of the bill requires that all existing accounting standards be placed on a register of legislative instruments within a certain time after the commencement of the Act (s 49). If an accounting standard fails to be registered by the required time, s 56 deems that:

> ...the instrument [such as an accounting standard] ceases to be enforceable by or against the Commonwealth, or by or against any other person or body; and is taken to have been repealed by this Act.

Once both new and existing accounting standards are on the register, they are valid for a period of up to 5 years, when they cease to be in effect (s 66). If such a standard is to be remade, it will have to have a LIP attached in accordance with Part 3 of the bill. Appendix 7 lists current accounting standards and when they would sunset under the bill.

Of the 33 existing AASB standards, 20 are due to sunset within 5 years and 9 months from the commencement of the Act, while another 13 will sunset 6 months later (see Appendix 7). When considering that only 5 standards were tabled in the Senate in 1995 (see Box 7), this suggests that the AASB could face considerable resource pressures in complying with Part 3, when remaking its standards.

However, if there is widespread support for the remaking of an accounting standard, “representative groups” who are notified under s 20 of the bill are less likely to provide substantial comments which need to be incorporated into the LIP. Further, the costs and benefits are likely to be easier to assess for a standard which is already in operation and of clear net benefit. The ORR may also grant a waiver from post-LIP consultation in accordance with s 31 (2) if the costs of post-LIP consultation of the remaking of an accounting standard would outweigh the benefits.

5 Conclusion

It is clear that accounting standards have an important role in ensuring the effective functioning of the economy. While market forces may compel organisations to disclose information, there is no guarantee that this information will be timely, easily comparable between entities, or of adequate quality.

This paper has attempted to provide a qualitative assessment of the costs and benefits of accounting standards. However, for accounting standards to result in optimal information provision, a quantitative assessment — where possible — of the benefits, costs, and impact of proposed accounting standards is required.

This is not feasible for now because the *First Corporate Law Simplification Act 1995* results in companies being no longer classed as exempt or non exempt. Companies will have to lodge financial reports in accordance with AASB standards only if they are deemed “large”, and the number of companies in this category may change significantly each year.

The compliance costs of accounting standards upon individual organisations is also difficult to assess. Market discipline theories suggest that many entities prepare detailed financial reports anyway, due to their contractual obligations to shareholders or because of their need to attract funds in the capital markets. In such cases, accounting standards may merely mandate what was already occurring, thereby having a minimal effect on compliance costs.

While reliable quantitative indicators of the benefits and the costs of accounting standards are not available, the qualitative assessment in this paper points to some general conclusions.

Firstly, accounting standards do impose considerable costs upon governments, management, shareholders and other stakeholders. Nevertheless, they provide the basis for general purpose financial reporting and are an integral aspect of the accounting procedures of many companies.

Secondly, while the *First Corporate Law Simplification Act* removed the need for most small proprietary companies to prepare financial statements, the costs of accounting regulations are still likely to fall disproportionately upon smaller companies, which are deemed “large” under the Act.

The recognition of these factors means that the preparation of accounting standards must take into account the vicissitudes of different entities, the extent to which accounting standards will impact upon them, and the manner in which it does so.

The AASB has already sought to recognise this, engaging in a consultative process before preparing standards. However, if it is explicitly recognised that the benefits of proposed standards should exceed their associated costs, then the design and incidence of such standards would be improved.

Thirdly, the *Legislative Instruments Bill 1996* will provide such a mechanism, allowing a methodological appraisal of proposed standards in terms of whether they constitute a net benefit to the community. This will allow the AASB to continue its important role, but within a framework which will improve the ability to create timely and effective standards, benefiting all stakeholders.

Appendix 1: Powers of the AASB

The AASB was established by s 224 of the *Australian Securities Commission Act 1989*. Under s 226, the AASB has such powers as are conferred on it by a national scheme law. S 32 of the *Corporations Act 1989* (a national scheme law) provides that the AASB may make accounting standards for the purposes of Part 3.6 and Part 3.7 of the *Corporations Law* (Australian Accounting Standards Board 1996, p. 2). In addition, s 226 requires the AASB to:

1. develop statements of accounting concepts (SACs)[29] that ought to be a source of guidance in the absence of an appropriate accounting standard (Australian Accounting Research Foundation 1993b, p. B9);
2. consider existing and proposed accounting standards. Through its own processes, that are not regulated, the AASB determines:

- whether the information generated by application of the proposed accounting standard would be likely to satisfy the objective of general purpose financial reporting[30];
- whether the information is relevant and passes the test of materiality;
- whether the accounting standard is well formulated;
- whether the standard is consistent with existing accounting standards and concepts; and
- whether the proposed accounting standard has been developed with sufficient regard for its costs and benefits.[31]

3. consider proposed accounting standards emanating from other sources;
4. make such standards as it sees fit following consideration of whether:

- the information generated by the application of a proposed standard is relevant to informed decision-making and discharges directors' accountability in a manner consistent with community requirements and expectations;[32]
- the proposed standard is well formulated and logically derived;
- the proposed standard is consistent with presently existing accounting laws; and

[29] The SACs were intended to:

- make reporting requirements more consistent and logical;
- create all embracing provisions which are more difficult to avoid; and
- reduce the risk of over regulation by reducing the need for specific accounting standards to those cases where the application of concept statements is not clear cut.

[30] According to the Australian Accounting Research Foundation (1990a), the information must be useful in assessing performance, financial position and compliance of reporting entities.

[31] Refer to Australian Accounting Research Foundation (1990b) for the role of costs and benefits in standards formulation.

[32] Refer to ss 297-299 of the *Corporations Law Act 1990*.

- the proposed standard is practicable having regard to its commercial and economic consequences;

5. engage in public consultation as may be necessary to decide whether or not it should make a proposed accounting standard; and
6. make such changes to the form and content of a proposed accounting standard as it considers necessary (Australian Accounting Research Foundation 1994b, p. 4).

Appendix 2: Activities of the AASB

The activities of the AASB are directed towards the promulgation of accounting standards and principles. The specific activities which contribute to this process are detailed below.

2.1. Development and issue of pronouncements

The AASB encourages the preparers and users of financial reports to participate in the standard setting process through:

- communicating its views via discussion papers, accounting theory monographs, invitations to comment and exposure drafts;
- inviting representatives of a number of organisations to meet with board members; and
- issuing media releases about its activities.

2.2 Monitoring and maintenance of existing standards

This role is enshrined in s 226 of the *Australian Securities Commission Act* (see Appendix 1).

2.3 Applications to the Australian Securities Commission for relief

The ASC, and not the AASB, enforces accounting prescriptions. However, the ASC can consult with the AASB when deciding whether to exercise its discretion to provide relief from particular accounting requirements under s 313 of the *Australian Securities Commission Act*.

2.4 Seminars

The AASB presents papers on its work program at seminars and conferences throughout Australia.

2.5 Liaisons with constituents

The AASB regularly consults with a variety of parties to discuss matters of both general and specific interest. For example, it has met with life insurance representatives in developing specific standards for the life insurance industry.

2.6 Involvement with other accounting standard setting bodies.

The AASB communicates closely with its national accounting standard-setting counterparts and the International Accounting Standards Committee (IASC). This helps achieve accounting consistency between countries.

Appendix 3: Mooted reforms

The activities of the AASB are constantly evolving. The *Corporations Law Simplification Program* has provided much of the impetus for this change, as is evident below.

3.1 Expediting procedures for tackling non-compliance.

Under s 332A of the *Corporations Law*:

> Where an auditor of a company is not satisfied that the company's financial statements for an accounting period have been drawn up in accordance with particular accounting standards...the auditor must...send by post to the Board a copy of the report.

However as the AASB has no enforcement powers under the *Corporations Law*, the reports must then be passed onto the ASC.

The AASB argues that it ought to deal with non-compliance directly and the Corporations Law Simplification Task Force is currently considering changes to the Act in this regard.

3.2 Proposal to merge the AASB with the PSASB[33]

The complementary nature of the AASB's and the PSASB's work has led to a submission being made to the Commonwealth Attorney-General's Working Party to merge these bodies (Australian Accounting Research Foundation 1994a, p. 4).

The PSASB is also working in concert with the AASB to produce a Conceptual Framework comprising a single set of SACs that are applicable to reporting entities in both the public and private sectors.

3.3 Specific standards for life insurers

Life insurance business can only be carried out by companies incorporated under the *Corporations Law* who are also registered under the *Life Insurance Act 1995*. They are therefore bound by the financial reporting requirements of Parts 3.6 and 3.7 of the *Corporations Law*, the *Life Insurance Act* and circulars issued by the ISC. However, to alleviate the burden on life insurance companies of having to prepare two sets of accounts, one for the ASC and one for the ISC, Part 4.5 of the *Corporations Law* gives life companies an exemption from complying with Parts 3.6 and 3.7 of the *Corporations Law* (by deeming them to have complied with it), if they produce accounts in compliance with another Commonwealth law ie. the *Life Insurance Act.*

The *Corporations Law* requires the preparation of financial statements and therefore necessitates compliance with the accounting standards issued by the

[33] Refer to *Commonwealth Attorney General (1993)* for further details about the proposed merger.

Australian Accounting Standards Board. The Part 4.5 exemption given by the *Corporations Law* does not lift the requirements of life companies to comply with AASB standards in their financial statements.

Rather the same requirement is enforced through the "Life Insurance" accounting standard issued by the ISC, giving life companies the flexibility to depart from accounting standards that are incompatible with life insurance concepts and accounting principles.[34]

A development presently in progress to eliminate the dual reporting regime for life insurers is the AARF's project to develop a life insurance accounting standard suitable for general purpose financial reporting (Insurance and Superannuation Commission 1995, p. 43). An exposure draft of the standard has already been released for comment.

3.4 Exemptions applicable to banks and life insurers will operate through ASC class orders

The exemption from the financial reporting requirements of the *Corporations Law*, currently given to banks and life insurance companies by Part 4.5 of the *Corporations Law* is proposed to be transferred to Class Orders issued by the ASC. For life insurance companies for example, many AASB standards will still apply, but through Commissioner's Rules, issued under the authority of the *Life Insurance Act 1995*.

3.5 Removal of accounting requirements from the Corporations Law

Under s 297(1) of the *Corporations Law*, the directors of a company must ensure that the company's financial statements for an accounting period comply with any relevant prescribed requirements. These disclosure requirements were previously imposed by Schedule 5 in the *Corporations Regulations*. However, due to the expansion of accounting standards, many accounting standards now contain disclosure requirements, as well as detailing how companies should prepare financial information.

These disclosure requirements have now been simplified and transferred out of the Corporations Law, with the making in December 1996 of AASB 1034: Information to be disclosed in financial reports.

In reviewing which Schedule 5 disclosure requirements would be kept or deleted, under AASB 1034, the AASB adopted the following principles of:

[34] According to s 408A(1) a prescribed corporation is an Australian bank or a body corporate registered under the *Life Insurance Act* 1995. These organisations are **deemed** to have complied with s 298 and s 299 if they have complied with the specific accounting laws relating to banking or commerce respectively (s 409).

- *essential information only* — which required that disclosure requirements were only to be imposed when the benefits to the users outweighed the costs incurred by those providing the information;
- *international harmonisation* — when transferring the disclosure requirements to accounting standards, significant departures from overseas practices were only to be made where the benefits exceeded the costs;
- *no duplication* — Schedule 5 requirements which were already duplicated in accounting standards, were removed when transferring requirements to AASB 1034; and
- *clarity* — disclosure requirements were to be clearly and simply expressed (Australian Accounting Standards Board 1993).

The promulgation of AASB 1034 has assisted in simplifying the requirements for the preparation of financial reports by companies under Part 3 of the *Corporations Law*. However, it has also significantly increased the impact of accounting standards upon business as basic company disclosure requirements are now located in the form of accounting standards.

3.6 International harmonisation

The AASB (and the AARF) make a significant contribution to the work of the International Accounting Standards Committee (IASC), and the G4 + 1 (an affiliation of Board members of the standard setting bodies of Australia, Canada, New Zealand, UK, and US.

This has assisted the AASB (and the PSASB) in developing their International Harmonisation Policy. The objective of this policy is to assist in the achievement of an internationally accepted set of accounting standards which can be adopted in Australia (Australian Accounting Research Foundation 1996, p. 6).

In particular, research is occurring into:

- the use of use existing International Accounting Standards (IAS) as the basis for AASB standards;
- existing standards that detract from the quality of general purpose financial reporting in Australia, when viewed in an international perspective;
- identifying methods of removing incompatibilities between IAS standards and the corresponding Australian accounting standard, where it has been necessary to modify the international standard for Australian financial reporting; and
- foreign national accounting standards such as those issued by New Zealand (Australian Accounting Research Foundation 1996a, pp. 8–9).

Appendix 4: Compliance costs of accounting standards

When attempting to assess the need for a proposed accounting standard, the costs of promulgation must be outweighed by the benefits likely to accrue from such a standard.

The compliance costs of regulations has been a major issue with small business. They argue that often the costs of complying with a regulatory burden outweighs any benefits from such regulation.[35]

Accounting standards are part of this burden, as businesses need to follow particular standards in order to determine profit figures for taxation purposes. The extent of the compliance costs of accounting standards are indicated by Greenwood (1996, p. 2):

> Some accounting standards are expensive to adopt, eg., the leasing standard [AASB 1008] costs an average [sic] about $2,000 per company in accounting fees just to record the leases (as opposed to merely expiring lease payment).

Under the previous reporting regime, 19 595 non-exempt proprietary companies existed in Australia.[36] If each had to comply with AASB 1008, this would have translated into an economy-wide compliance cost of AASB 1008 to private companies of some $40 million per annum. Such a figure must be regarded however as the minimal aggregate compliance cost of this standard.

There are currently 1189 listed companies Australia[37], who would incur far greater compliance costs for such a standard, and who have not been included in the calculation of the estimate.

Furthermore, due to the *First Corporate Law Simplification Act 1995*, many previously exempt proprietary companies[38] will now be subject to AASB financial reporting requirements, including the leasing standard. However, the total compliance costs of standards such as the leasing standard is uncertain, as some previously non-exempt companies would now be classified as small, thereby not subject to reporting requirements.

Yet these compliance costs are attributable to only one particular accounting standard — the leasing standard. In fact, according to the SBP State Council[39], the main compliance cost of accounting standards lies in the need to look back over the financial year in order to calculate particular accounting figures. An

---

35 Refer to the Small Business Deregulation Task Force Report (1996) for further information about the regulatory compliance burdens faced by business.

36 These figures relating to the previous reporting regime were supplied by the ASC and valid as at 8 December 1995.

37 Figure supplied by the Australian Stock Exchange and valid as at 11 June 1996.

38 According to the ASC, 850 736 exempt proprietary companies existed as at 8 December 1995.

39 SBP is a small business organisation which is a member of the Council of Small Business Organisations of Australia Ltd (COSBOA).

example is AASB 1020 “Accounting for Income Tax”, which requires a retrospective analysis of business activities over the financial year which affect taxable income. SBP estimated the cost of this standard at between $1500 to $2500 per organisation.[40]

Extrapolating this to an Australia-wide figure, if it can be assumed that each previously non-exempt proprietary company incurs the compliance cost associated with AASB 1020, the aggregate cost of this standard to firms could be in the range of $29 million to $49 million per annum.

Further, the calculation may regarded as a lower end estimate of the cost of AASB 1020 as it excludes the costs of accounting for income tax for public companies.

However, as with the previous example, it is difficult to assess the true magnitude of this standard as the number of “large” companies who were required to lodge accounts with the ASC at the end of the 1995-96 financial year is not publicly available. Further, the classification of many companies — as either large or small — may change on a yearly basis.

Estimates of total compliance costs for company tax have been analysed by Rimmer and Wilson (1996, p. 11). Referring to Pope (1994), they note that total compliance costs of company income tax in 1990-91 was estimated to be as high as $3246 million or 22.9 per cent of total company income tax revenue. While these estimates could be too high, a significant part of the compliance burden may be attributable to accounting standards and associated guidelines, as this provides the disclosure basis within which taxable income can be calculated by the application of taxation law.

[40] Discussions over the phone.

Appendix 5: Commonwealth Government RIS Guidelines

The following guidelines set out the information requirements for a Commonwealth Regulation Impact Statement (RIS). They have applied in this form since August 1995, but will be updated to reflect decisions announced by the Government in March 1997.

A Problem identification and specification of regulatory objectives

This section should specify the social, environmental, financial, distributional or other economic problem the initiative is intended to address. Information should be provided on the nature and magnitude of the problem. Where one exists, an underlying market failure (such as imperfect competition, lack of consumer information or non-market 'external' costs) causing the problem should also be identified.

Next, the objective of the regulatory initiative should be specified. The objective should not be specified so as to align with (and thus pre-justify) the particular effects of the proposed regulation. Rather, it should be specified in relation to the underlying problem.

This section should also identify the pre-existing policy authority (if any) for the regulatory initiative: for example, a relevant Cabinet Decision or governmental policy announcement.

B Identification of alternatives

This section should set out the alternative mechanisms (including the proposed mechanism) which could wholly or partly achieve the objective(s) specified in (A).

Alternative regulatory mechanisms (only some of which will be relevant for a particular type of regulatory initiative) include:

- no specific action (ie, rely on the market in conjunction with existing law);
- general liability laws (strict, negligence or no fault);
- information strategies (including product labelling or media campaigns);
- market-based instruments (including taxes, subsidies, tradeable permits, performance bonds);
- standards (which may be principles standards, performance-based or prescriptive);
- pre-market assessment schemes (such as listing, certification and licensing);

- post-market exclusion measures (such as bans, recalls, licence revocation provisions, and ‘negative’ licensing);
- other mechanisms: community right to know requirements, mandatory audits, quality assurance schemes, self-regulation and co-regulation.

In identifying relevant alternatives, it may also be necessary to examine different levels of a particular type of regulation at different levels of stringency. For example, if considering a tax on a polluting substance, it may be appropriate to consider a high, an intermediate and a low tax rate.

As well as regulatory alternatives, in some cases alternative enforcement strategies should be identified. Relevant options/issues may include:

- administrative versus civil versus criminal sanctions;
- corporate versus director liability;
- the desirability of risk-based enforcement strategies;
- the desirability of enforcement pyramids (ie, warnings for initial or low-level breaches, fines for subsequent and/or high level breaches, leading to licence suspension or revocation as ultimate sanctions).

C IMPACT ANALYSIS

This section should analyse the benefits and costs of the options identified in (B), both for different groups within the community and for the community as a whole. Benefits and costs should not be restricted to tangible or monetary items — possible changes in environmental amenity, health and safety outcomes, and other non-monetary outcomes should also be included. The implications for government revenue should also be identified.

Impact group identification

The groups likely to be significantly affected by the regulatory initiative should be separately identified. These groups should be broken down into sub-groups where the initiative will have different effects on those sub-groups. Group and sub-group distinctions may include:

- government, business and consumers;
- within the government category, Commonwealth, State/Territory, or local governments;
- within the business category, big and small businesses; and importers, exporters and/or firms supplying the local market;
- within the consumer category, groups with different levels of information and/or abilities to process information;

- groups in different geographical areas (eg, urban/rural) or different States; and
- groups with different age, language, physical, cultural, gender, family or income/wealth characteristics.

Assessment of costs and benefits

Estimates of the cost to government of introducing the new regulatory process or amendment, and the other alternatives, should be given, including where relevant:

- numbers and levels of staffing;
- salary costs;
- costs of other relevant items such as any special advertising, accommodation, travel; and
- enforcement costs.

The sources of revenue against which the costs will be charged should be included: for example, general appropriation or fees. Estimates of revenue from any licences, fees or related charges in the regulation process should be given. Where possible, a net cost to government should be indicated.

Estimates of costs to businesses affected by the regulatory initiative should also be given. These costs might derive from:

- 'paper burden' or administrative costs to businesses associated with complying with and/or reporting on particular regulatory requirements;
- license fees or other charges levied by government;
- changes likely to be required in production, transportation and marketing procedures;
- shifts to alternative sources of supply;
- delays in the introduction of goods to the marketplace and/or restrictions in product availability.

Estimates of costs to consumers are also required. These may derive from:

- higher prices for goods and services;
- reduced utility of goods and services; and
- delays in the introduction of goods to the marketplace and/or restrictions in product availability.

Where possible, a cost estimate for the community as a whole should be provided. When assessing aggregate costs, it is important to avoid double-counting. For example, if a regulation is likely to increase business costs and it is expected that businesses will pass these costs on to consumers in the form of higher prices, this cost item should be counted only once in an assessment of aggregate costs.

Information on the benefits of the alternatives to affected groups and/or to the community at large should be identified. Such benefits, some of which may not be quantifiable, could derive from:

- firms being able to take greater advantage of economies of scale;
- reductions in excess costs or prices emanating from monopoly;
- reductions workplace accidents and improvements in public health (and Medicare cost savings consequent upon them);
- improvements in environmental amenity; and
- improvements in the information available to business, the work force, consumers or the government.

D Other requirements (if not elsewhere covered in the RIS)

Consultation

This section should contain a statement of the consultation processes undertaken and the views elicited from the main interested parties. Relevant individuals and groups may include:

- Commonwealth Ministers, departments and agencies;
- State, Territory and local governments, particularly where the regulatory process arises from negotiations between different levels of government and /or involves overlapping responsibilities; and
- business, consumers, unions, environmental groups and other interest groups which will be affected by the regulatory process, and
- other groups or sub-groups identified in (C).

Where consultation of relevant groups is not undertaken, this should be indicated and reasons (if any) specified.

Administrative simplicity, economy and flexibility

This section should discuss the administrative simplicity of the proposal, including:

- whether any administrative burdens on business can be reduced;
- the feasibility of ‘one stop’ facilities for the regulation. This may in some cases involve consideration of the practicability of joint facilities or offices with

another Commonwealth agency, with an appropriate State or local government agency, or even with a private agency related to the field or operation;

- the feasibility of the administrative procedure being carried out by existing teams of staff in other departments or agencies; and
- whether it is appropriate to have an in-built authority to waive or modify the regulation in certain circumstances, and provide for an adequate appeal process.

Explanatory material

This section discusses whether, and to whom, explanatory material will be provided.

E Review

This section should state how the regulatory process will be monitored for amendment or removal when or if the circumstances which led to its introduction change. The information should include the result of considerations as to the feasibility of:

- a ‘sunset’ clause:
- on-going arrangements for consulting with the interest groups affected;
- provision for regular review; and
- provision for regular reporting to the public such as in an agency’s annual report.

Appendix 6: Public interest test and restrictions on competition

In accordance with the Hilmer report (Hilmer 1993) recommending the need for National Competition Policy to promote competitive reform in the public interest, the CPA was signed by the Council of Australian Governments in April 1995. This provides the basis for competition reforms in a range of government and non government activities where they are in the public interest.

While this agreement does not apply to the *Legislative Instruments Bill 1996*, it may provide guidance in the process to be followed where a proposed legislative instrument restricts competition.

Ascertaining whether a proposed reform is in the public interest requires an analysis of the community costs and benefits of the proposal. Clause 1 (3) of the CPA states that:

Without limiting the matters that may be taken into account, where this agreement calls:

(a) for the benefits of a particular policy or course of action to be balanced against the costs of the policy or course of action; or

(b) for the merits or appropriateness of a particular policy or course of action to be determined; or

(c) for an assessment of the most effective means of achieving a policy objective;

the following matters shall, where relevant, be taken into account:

- government legislation and policies relating to ecologically sustainable development;
- social welfare and equity considerations, including community service obligations;
- government legislation and policies relating to matters such as occupational health and safety, industrial relations and access and equity;
- economic and regional development, including employment and investment growth;
- the interests of consumers generally or of a class of consumers;
- the competitiveness of Australian business; and
- the efficient allocation of resources.

The purpose of the public interest test is not to exhaustively provide a range of issues to consider, but rather to assist in a systematic and comprehensive consideration of community costs and benefits.

While some of the issues listed above may not be relevant to any (or all) proposed accounting standards, the public interest test does provide an indication of the breadth of analysis that may be necessary under the bill, before formulation of an accounting standard which restricts competition.

Appendix 7: Sunsetting of existing accounting standards under *the Legislative Instruments Bill 1996*

Under s 49 of the bill, existing accounting standards will have to be gradually entered onto the Register of Legislative Instruments. Standards made between 1 January 1990 to the day before the commencing day of the Act will have to be placed on the register before the first day of the ninth month after the commencing day. Standards made between 1 January 1980 and 31 December 1989 will have to be lodged before the first day of the 15 month after the commencing day. All other existing accounting standards will have to be lodged before the first day of the 27 month after the commencing day.

Once on the register, all accounting standards will be subject to a 5 year sunset, after which they will have to be re-made, if they are necessary. Figure 4 lists those accounting standard which will sunset within 5 years and 9 months from the commencement of the proposed legislation, while Figure 5 lists those due to sunset within a further 6 months.

Figure 4: Standards which sunset within 5 years and 9 months from the commencement of the Act

	Date created
AASB 1014 Set-off and extinguishment of debt	June 1990
AASB 1025 Application of the reporting entity concept and other amendments	July 1991
AASB 1026 Statement of cash flows	December 1991
AASB 1024 Consolidated accounts	May 1992
AASB 1027 Earnings per share	November 1992
AASB 1017 Related party disclosures	May 1993
AASB 1028 Accounting for employee entitlements	March 1994
AASB 1029 Half-year accounts and consolidated accounts	December 1994
AASB 1030 Application of accounting standards to financial year accounts and consolidated accounts of disclosing entities other than companies	December 1994
AASB 1001 Accounting policies	September 1995
AASB 1031 Materiality	September 1995
AASB 1018 Profit and loss accounts	October 1995
AASB 1010 Accounting for the revaluation of non-current assets	June 1996
AASB 1013 Accounting for goodwill	June 1996
AASB 1021 Depreciation of non-current assets	June 1996
AASB 1023 Financial reporting of general insurance activities	November 1996
AASB 1014 Set-off and extinguishment of debt	December 1996
AASB 1032 Specific disclosures by financial institutions	December 1996
AASB 1033 Presentation and disclosure of financial instruments	December 1996
AASB 1034 Information to be disclosed in financial reports	December 1996

Source: Treasury 1997b

Figure 5: Standards which sunset within 5 years and 15 months from the commencement of the Act

	Date created
AASB 1004 Disclosure of Operating Revenue	March 1986
AASB 1005 Financial Reporting by segments	April 1986
AASB 1006 Accounting for interests in joint ventures	April 1986
AASB 1002 Events occurring after balance date	July 1986
AASB 1009 Accounting for construction contracts	November 1986
AASB 1011 Accounting for research and development costs	May 1987
AASB 1008 Accounting for leases	November 1987
AASB 1012 Foreign currency translation	July 1988
AASB 1015 Accounting for the acquisition of assets	September 1988
AASB 1016 Disclosure of information about investments in associated companies	June 1989
AASB 1019 Measurement and presentation of inventories in the context of the historical cost system	October 1989
AASB 1020 Accounting for income tax (Tax-effect accounting)	October 1989
AASB 1022 Accounting for extractive industries	October 1989

Source: Treasury 1997b

Bibliography

ABS 1991, *Foreign Investment in Australia*, Catalogue No. 5306.0, Commonwealth Government Printer, Canberra.

ABS 1996, *International Investment Position - Australia*, Catalogue No. 5306.0, AGPS, Canberra.

Allen, K. 1991, “In Pursuit of Professional Dominance: The Australian Accounting Experience 1953–1985”, 4 (1) *Accounting Auditing and Accountability Journal*, pp. 51-67.

AICPA (American Institute of Certified Public Accountants) 1973, “Objectives of Financial Statements”.

Attorney-General’s Department 1996, *Budget Statements* 1995-96, AGPS, Canberra.

Australian Accounting Research Foundation 1990a, *SAC 2: Objective of General Purpose Financial Reporting*, August.

——1990b, *SAC 3: Qualitative Characteristics of Financial Information*, August.

——1991, *AAS 27: Financial Reporting by Local Government*, July

——1993a, *The Development of Statements of Accounting Concepts and Accounting Standards*, July.

——1993b, *APS 1: Conformity with Accounting Standards and UIG Consensus View*.

——1993c, *AAS 29: Financial Reporting by Government Departments*, December.

——1994a, *AARF Annual Report*.

——1994b, *AASB Review and Financial Report 1994*.

——1995a, *PSASB Progress Report.*

——1995b, *ED 67: Information to be Disclosed in Financial Reports,* December.

——1995c, *ED 62: Financial Reporting by Governments*, March.

——1995d, *Australian Accounting Research Foundation Annual Report 1995*

——1996a, *International Harmonisation Policy,* Policy Statement 6, April.

——1996b, *Correspondence Regarding Statutory Powers and Responsibilities of the AASB.*

Australian Accounting Standards Board 1993, *Proposals to revise Schedule 5 to the Corporations Regulations and Consider Replacement by an Accounting Standard*, Invitation to comment, AGPS, Melbourne.

——1993b, *AASB Annual Report 1994-95*, AGPS, Melbourne.

——1996, *AASB Annual Report 1995-96*, AGPS, Melbourne.

Australian Accounting Standards Board 1997, *Correspondence*, 29 April.

Australian National Audit Office 1995, Submission to the Joint Committee of Public Accounts report titled *Accrual Accounting - A Cultural Change*, Report 338, Parliament of the Commonwealth of Australia, August 1995, AGPS, Canberra.

Accounting Standards Review Board 1990, *Nature of Approved Accounting Standards and Statements of Accounting Concepts and Criteria for the Evaluation of Proposed Approved Accounting Standards*, ASRB.

Australian Securities Commission 1996, *In Focus*, January/February.

Australian Society of Certified Practising Accountants 1996, *Module 2 Accounting Standard-Setting: Rationale, Processes and Institutions*.

Boreham, T. 1991 "Insurer Ready to Defy New Standard", *Business Review Weekly*, 5 April.

Boyd, A. 1990, "New Super Rule May Make Fund Trustees Wary", *Australian Financial Review*, 14 September.

Commonwealth Attorney General 1993, *Proposed Merger of the Australian Accounting Standards Board and the Public Sector Accounting Standards Board*, Working Party.

Commonwealth Joint Parliamentary Committee of Public Accounts 1982, *The Form and Standard of Financial Statements for Commonwealth Undertakings-A Discussion Paper, C Report 199*, Australian Government Publishing Service, Canberra.

Deloitte Touche Tohmatsu 1994, *Summary of Australian Accounting Requirements*, May.

Douglas, W. 1938, Address by the Securities Exchange Commission Chairman before the Bond Club of Hartford, Connecticut, January 7 as quoted in Masel, L. 1983, "The Future of Accounting and Auditing Standards", *The Australian Accountant*, September, pp. 541-544.

Ernst and Young 1995, *Accrual Accounting in the Public Sector: A National Survey*, Ernst and Young, Canberra.

Feldstein, M. and Yitzhaki, S. 1982, "Are High Income Individuals Better Stock Market Investors?", *Working Paper*, National Bureau of Economic Research, No. 948 , July.

Financial Accounting Standards Board 1991, *Benefits, Costs and Consequences of Financial Accounting Standards*, Connecticut.

Gibson, B. 1995, *Senate Hansard*, AGPS, Canberra.

Greenall, D., Paul, J. and Sutcliffe, P. 1988, *Financial Reporting by Local Governments*, Discussion Paper No. 12, Australian Accounting Research Foundation.

Greenwood, P. 1996, *Correspondence*, Vice President, SBP State Council.

Hilmer, F., Raynor, M. and Taperell, G. (The Independent Committee of Inquiry) 1993, *National Competition Policy*, AGPS, Canberra.

Hutchingson, J. 1986, “Miners Want to Spread Their Forex Losses”, *Business Review Weekly*, 24 January.

Industry Commission 1995, Draft Report: *Competitive Tendering and Contracting by Public Sector Agencies*, 24 October, AGPS, Canberra.

Insurance and Superannuation Commission 1995, *Insurance and Superannuation Commission Annual Report 1994-95*.

Jensen, M. and Meckling, W. 1976 “Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure”, 3 *Journal of Financial Economics*, October, pp. 305-360.

Joint Committee of Public Accounts 1995, *Accrual Accounting - A Cultural Change*, Parliament of the Commonwealth of Australia, Report 338, August, AGPS, Canberra.

Lev, B. 1988, “Towards a Theory of Equitable and Efficient Accounting Policy”, 63(1) *The Accounting Review*, January, pp. 1-22.

Lonergan, W. 1991 “The Role of Regulation in the Securities Market”, *Coopers and Lybrand 10th Accounting Education and Research Fund Conference*, Melbourne, May.

Mackintosh, I. 1992, *Accrual Accounting — For Departments and the Whole of Government: Costs, Benefits and Opportunities*, Australian Society of Certified Practising Accountants, November, Canberra.

Management Advisory Board 1991, *Improving Asset Management in the Public Sector*, No. 1, May, AGPS, Canberra.

Masel, L. 1983, “The Future of Accounting and Auditing Standards”, 53(8) *The Australian Accountant*, September, pp. 541-544.

Mitnick, B. 1980, *The Political Economy of Regulation*, Columbia University Press.

National Commission of Audit 1996, *Report to the Commonwealth Government*, June, AGPS, Canberra.

National Competition Council 1996, *Considering the Public Interest Under National Competition Policy*, Fineline Printing Pty Ltd, November.

Nelson, B. 1995, Acting Auditor-General, Transcript of evidence to Joint Committee of Public Accounts 1995, *Accrual Accounting - A Cultural Change*, Parliament of the Commonwealth of Australia, Report 338, August, AGPS, Canberra, 13 February.

Office of Regulation Reform 1996, *Regulatory Alternatives*, State Government of Victoria.

Pope, J. 1994, *Compliance Costs of Taxation: Policy Implications*, Australian Tax Forum, Volume 11, pp. 85-121.

Ranby, P. 1996, "Introducing Accrual Accounting: Reaping the Benefits While Avoiding the Pitfalls", in *Readings in Accounting Developments in the Public Sector 1994-95*, Public Sector Accounting Centre of Excellence, Australian Society of Certified Practising Accountants, Melbourne.

Rimmer, S. and Wilson, S. 1996, *Compliance Costs of Taxation in Australia*, Staff Information Paper, Office of Regulation Review, July 1996.

Robinson, M. 1996, "Accounting for the Latest Fad", *Australian Financial Review*, 2 June.

Ross, A. 1979, "Disclosure Regulation in Financial Markets", in Edwards (ed) *Issues in Financial Regulation*, McGraw-Hill, New York.

Senate Standing Committee on Regulations and Ordinances 1995, *Delegated Legislation Monitor: Disallowable Instruments of Delegated Legislation Tabled in the Senate*, Secretariat of the Senate Standing Committee on Regulations and Ordinances, Senate Procedure Office.

Small Business Deregulation Task Force 1996, *Time for Business*, November.

Treasury 1997a, *Correspondence*, 4 February.

Treasury 1997b, *Correspondence on the List of Accounting Standards*, 26 February.

Tullock, G. 1980, "Rent Seeking as a Negative Sum Game" in Buchanan, J. and Tullock, G. (eds), *Towards a Theory of the Rent Seeking Society*, Texas, A & M University Press, College Station, TX.

Walker, R. 1987, "Australia's ASRB: A Case Study of Political Activity and Regulatory Capture", 17 *Accounting and Business Research*, No. 67, pp. 269-286.

Watts, R. and Zimmerman, J. 1986, *Positive Accounting Theory*, Prentice-Hall, Englewood Cliffs, N.J.

Yamey, B. 1962, "Some Topics in the History of Financial Accounting in England 1500-1900", in Baxter, W. and Davidson, S. eds, *Studies in Accounting Theory*, London, Sweet and Maxwell.