Due Process and the Adoption of IFRS in New Zealand

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Abstract

This paper reviews the decision to adopt IFRS in New Zealand and the subsequent decisions made on implementation of adoption. The emphasis of the review is on due process. The paper outlines the current regulatory structure for financial reporting in New Zealand, the role of due process and describes the due process requirements that applied in New Zealand prior to implementation of the decision to adopt IFRS. The paper describes how the decision to adopt IFRS was made, how the approach to implementation was determined and reviews the adequacy of the due process followed. We conclude that the limited due process followed for the decision to move to international financial reporting standards and for each individual IAS or IFRS was adequate. However, the actual method of converting international standards to New Zealand standards did not go through sufficient due process.

Keywords: IFRS, standard setting, due process

Due Process and the Adoption of IFRS in New Zealand *

1. Introduction

The Accounting Standards Review Board (ASRB) announced on 19 December 2002 that New Zealand reporting entities should apply International Financial Reporting Standards (IFRS) for periods commencing on or after 1 January 2007 but have the option to apply IFRS from 1 January 2005.[1] The ASRB's announcement was that it would "recommend to Government" the adoption of IFRS. However, subsequent clarification indicates that the intention was to announce a decision to adopt IFRS (Hagen and van Zijl 2003, Hickey and van Zijl 2003a and 2003b). The decision followed the ASRB's earlier announcement, made on 21 October 2002, proposing adoption of IFRS by listed issuers and confirming New Zealand's commitment to a single set of sector neutral standards.

This paper reviews the decision to adopt IFRS in New Zealand. The decision to move to IFRS will have a major impact on financial reporting in New Zealand. It will impact, not only what has to be reported, but has triggered the issue of which entities have to report. While a descriptive coverage of the adoption of IFRS in New Zealand is provided by Hickey et al. (2003) and Bradbury and van Zijl (2005), we specifically emphasize due process and the subsequent decisions on implementation of the adoption. In particular we add to the increasing literature that standard setting is a political activity. Similar to Miller (2002) we view the decision to adopt IFRS as policy making with limited formal due process.

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* Both authors have had extensive involvement in standard setting for financial reporting. Mike Bradbury was a member of the international *Joint Working Group on Financial Instruments and Similar Items*, is currently a member of the FRSB, and was recently appointed to the International Financial Reporting Interpretations Committee. Tony van Zijl is a former Director of Research for ICANZ, a former member of the ASRB, and a former Chair of the FRSB. The authors recognise that the paper reflects just one of the possible ex post rationalisations that could be formed of the complex processes they observed and participated in. Any criticism that a reader might infer from the paper, of the bodies involved in standard setting or individual current or past members of those bodies, is totally unintended by the authors.

[1] The term 'reporting entity' is used here in the conceptual sense but it has yet to be operationally defined - see Section 5.2 below. IFRS is used here to refer to the International Accounting Standards Board (IASB) standards (International Accounting Standards and International Financial Reporting Standards) and all interpretations thereof.

Section two of the paper outlines the current regulatory structure for financial reporting in New Zealand. Section three reviews the due process that applied prior to implementation of the decision to adopt IFRS. Sections four and five describe how the decision to adopt IFRS was made and the implementation issues. Section six reviews the adequacy of the due process followed. Section seven provides the conclusion.

2. Current Regulatory Structure for Financial Reporting

All Western style economies have adopted some form of standards and enforcement regime for financial reporting. However, as Healy and Palepu (2001) observe, surprisingly little is known about why financial reporting is regulated.[2] It remains a matter for debate that financial reporting regulation in the form of standards and enforcement is necessary in order to achieve characteristics such as high quality and comparability in reporting (Watts and Zimmerman 1986, Solomons 1986, and Godfrey et al. 2003).

Financial reporting regulation in New Zealand began in 1946 with the New Zealand Society of Accountants (now Institute of Chartered Accountants of New Zealand (ICANZ)) issuing a series of *Recommendations on Accounting Principles.* These recommendations were a direct reprint of recommendations issued by the Institute of Chartered Accountants of England and Wales (See Zeff 1979, van Zijl 1994 and Bradbury 1998). From these beginnings, ICANZ graduated, in 1974, to issuing *Statements of Standard Accounting Practice* (SSAPs). The standards were produced by the Accounting Research and Standards Board (now Financial Reporting Standards Board (FRSB)) (in combination with various subcommittees and working groups) and approved for issue by the ICANZ Council. By 1993 there were on issue twenty five SSAPs and five *Financial Reporting Standards* (FRSs) (the new term for standards from 1992). The standards were to be applied in preparation of external financial statements and were binding on members of ICANZ. The standards were linked to the state sector by the requirement in the Public Finance Act 1989 for compliance with generally accepted accounting practice and listed companies were required under the listing agreement with the New Zealand Stock Exchange to comply with the standards.[3] However, there was no direct legal backing for the standards in respect of any class of entity.

[2] However, a relation between financial accounting and governance regimes, financial stability, and economic growth has been identified (see Rajan and Zingales 1998 and Bushman and Smith 2001).

From time to time there were claims of poor compliance with the standards and this became more frequent in the period of the 1980s share market boom and subsequent crash (see Tower 1989). These claims were often linked to the lack of legal backing. In the aftermath of the crash, calls for legal backing intensified and, despite the Ministerial Working Party on Securities Law Reform of 1991 recommending that legal backing was not necessary, the Government acceded to this pressure. The new arrangements for standard setting were introduced in the Financial Reporting Act 1993. The Act established the ASRB, a Crown Entity and thus independent of the accounting profession, with the principal role of approving proposed financial reporting standards. Once approved, a standard has the force of law with provision for penalties for non-compliance by issuers and companies other than exempt companies. Approved standards also apply to state entities and local government entities – 'public benefit' entities.

In principle, proposed standards can be submitted to the ASRB by entities other than ICANZ but to date all the proposed standards have been produced by the FRSB. Thus the arrangement essentially reduces to the FRSB being the producer of financial reporting standards but the ASRB, via the approval process, having control over the form and content of the standards.[4] To approve a standard, the ASRB has required justification of the need for the standard and, where appropriate, an impact analysis and assessment of the anticipated effects of the standard on financial statements of New Zealand entities including costs and benefits (ASRB Release 6, paragraph 25).

3. Due Process Prior to the Decision to Adopt IFRS

Standard setting is highly technical in nature and therefore cannot, in any realistic sense, be conducted in the conventional political arena of any government. However, given the impact of financial reporting on allocation and distribution outcomes, delegation of standard setting to a body of technical experts can only be satisfactory in a democratic society if that body engages in appropriate (procedural) due process. Johnson and Solomons (1984) show that procedural due process, adequate authority and substantive due process are together sufficient to establish regulatory defensibility for a regulator and

[4] The new arrangement was modelled on the standard setting arrangement that had been introduced in Australia in 1984. However in contrast to the tensions that quickly arose in Australia between the two corresponding bodies, in New Zealand the ASRB and FRSB have enjoyed a productive working relationship, and the arrangement has thus proved to be durable here.

also sufficient to establish institutional legitimacy under individualistic constitutional calculus. That is, interested parties in the financial reporting constituency must be able to become informed of the activities of the standard setter, make submissions to the standard setter, and be assured that submissions made are considered. Therefore, where appropriate, the final standard should reflect submissions made but this should not lead to standards that are permissive of many optional treatments and descend to the lowest common denominator in order for the standard setter to achieve consensus. In determining the responses to submissions, the standard setter should be guided by considerations of quality and consistency in the standards. However, the standard setter must also be aware that persistent failure to produce standards that are generally acceptable, risks the emergence of forces to challenge the system. In that respect, standard setters in a democratic society can expect to be subject to the same discipline as a government that becomes insensitive to the views of its electorate.

Due process in standard setting comprises many activities. Given notice of a particular proposal, constituents might participate in public forums, present submissions at public hearings, and/or make written submissions. The participation may apply at all stages of the development of a proposed standard – agenda building, initial proposal, and final Exposure Draft (ED) – or be confined to a particular stage of the development. Furthermore, given notice of a proposal, interested parties can seek to influence the form and content of the final standard by operating outside the standard setter's open process. For example, by open or discrete lobbying of bodies with influence over the standard setter or by such lobbying of the individual members of the standard setter. The decision processes of standard setters have been subject to many studies. However, the parties have different (but not well defined) degrees of power and the studies inevitably focus on the public methods of influencing the process. Even the open involvement, for example as submissions on EDs, may reflect strategic or opportunistic action rather than genuine views.

The Financial Reporting Act (section 26) requires the ASRB to withhold approval of a proposed standard unless there has been adequate due process. As a result, the ASRB has required that the FRSB, in developing a new standard or revising an existing standard, should:

1. Prepare and release for public comment an ED, together with a Discussion Paper identifying the major issues on which comment is sought (ASRB Release 6, paragraphs 21-22);
2. Normally allow a period of three months for comment on the ED (ASRB Release 6, paragraph 23);
3. Where appropriate, arrange forums for further discussion and interchange of opinion. (ASRB Release 6, paragraph 23);
4. Consider and debate the comments received, in developing the proposed standard submitted for approval (ASRB Release 6, paragraph 24); and
5. Prepare a report on the consultation process undertaken, giving a summary of all the significant issues raised and how they were resolved (ASRB Release 6, paragraph 25).

If the ASRB is not satisfied that appropriate consultation has taken place it might engage in such consultation itself (ASRB Release 6, paragraph 31).[5]

Given the complexities, due process remains poorly understood. Design of due process should reflect the size and nature of the constituency and be sufficiently flexible to allow appropriate gearing of the process to particular proposals. However, choice of design inevitably involves tradeoffs on dimensions such as cost and timeliness. While the approach taken by the ASRB is less rigorous that the Financial Accounting Standards Board and the Australian Accounting Standards Board, we consider that it has probably been adequate for New Zealand.

4. Adoption of IFRS

The ASRB's decision to adopt IFRS in New Zealand arose from the directive given by the Australian Financial Reporting Council (FRC) to the AASB on 3 July 2002, for adoption of IFRS in Australia from 2005. The directive came as a surprise to the FRSB and ASRB but, as discussed below, it was also a surprise to the AASB.

Adoption of IFRS seemed to present two major implementation problems. Firstly, there was concern that for many 'smaller' entities compliance with IFRS would not meet the cost benefit test for financial reporting, even with the reporting concessions available under the ICANZ *Framework for Differential Reporting*. Secondly, IFRS are developed

[5] Release 6 was revised and issued as Release 8 in August 2004. However, the requirements specified at points 1-5 above were operative during the time period of the key events discussed in this paper.

primarily for application by profit oriented entities and this would inevitably conflict with the established policy of standards in New Zealand (and Australia) being designed for application by all entities – 'sector neutral standards'.

The FRSB debated the course of action to be taken in response to the directive in Australia. It was agreed that New Zealand should follow suit but concerns were held on compliance costs and there was division on the weight to be given to maintenance of sector neutrality in standards. It was decided to monitor reactions and developments in Australia to observe how the AASB planned to comply with the FRC's directive and yet maintain sector neutrality. Discussions were held with both the AASB and the ASRB and eventually it was agreed that the Standing Committee of the FRSB would meet with the ASRB on 21 October 2002 to formally discuss the action to be taken. This meeting resulted in the ASRB's announcement proposing adoption of IFRS for listed issuers but noting concern on compliance costs and confirming continuing commitment to sector neutrality. It was agreed to establish a consultative group comprising the Chair and Deputy Chair of each of the Boards to consult with interested parties on the proposed adoption of IFRS.

The consultations took place over the next two months with nineteen relevant parties including the Securities Commission, the Stock Exchange, the Controller and Auditor General, Treasury, Ministry of Economic Development, Institute of Finance Professionals of New Zealand, small and large accounting firms, and various other private and public sector interests. The list of parties consulted is stated in Appendix I. In addition the group met with the Ministers of Finance and Economic Development.

The members of the consultative group attended the meetings as available and only the Chair of the FRSB attended all twenty meetings. The consultations showed strong support for adoption of IFRSs.[6] For some parties the support reflected interest in adopting an internationally recognised financial reporting model but for others it reflected resignation to being left with no effective option but to follow the decision made in Australia to adopt IFRS. The New Zealand economy is closely tied to that of Australia and many international investors perceive the two economies as a single bloc. To hold back from

[6] The results of the consultations are summarised in Appendix II which is an excerpt from a memo from the Chair of the FRSB to the Chair of the ASRB, dated 12 December 2002, reporting on the results of the consultations after fourteen meetings had taken place.

adoption of IFRSs would therefore risk the credibility of financial reporting by New Zealand entities. This was subsequently corroborated in the PricewaterhouseCoopers (2003) survey, 88% of respondents indicated support for adoption of IFRS, 6% gave no response, and only 7% were negative.

5. Implementation Issues

5.1 Date

The consultations showed that there was a degree of support for 2005 over 2007 as the date for adoption. This was subsequently corroborated in the PricewaterhouseCoopers (2003) survey where 54% of respondents said that the requirement to adopt should be effective from 2005. However, the ASRB opted to make 2007 the date for mandatory adoption as it was concerned over the ability of smaller entities, in particular, to be ready for adoption by 2005.

5.2 Cost Benefit

To meet the concerns over cost benefit, the FRSB established a Working Group to develop a financial reporting structure that would provide full or partial exemption from compliance with IFRSs for those entities for which the test would not be met. The consultations indicated support for the reporting entity approach followed in Australia and the structure developed by the Group was based on that approach. The benefits and costs of financial reporting are of course difficult to identify and measure and therefore the proposed structure applied a number of proxies for benefits and costs to classify entities into three different types of reporting groups – Tiers 1, 2 and 3. The proxies applied were power to levy taxes or rates, responsibility to report, and size. Tiers 1 and 2 entities were designated as "reporting entities" and would both be required to comply with IFRS, although Tier 2 would receive some differential reporting concessions. Tier 3 entities were not "reporting entities" and would not be subject to legal reporting requirements.

The structure covered all entities in both the private and public sectors, irrespective of organisational form, and therefore included partnerships, trusts, and sole traders. The structure thus widened the net in terms of the types of entities potentially subject to legal requirements on financial reporting. However, the structure also had higher thresholds for being subject to these requirements, and therefore the net effect was expected to be that many smaller entities currently subject to such requirements would be relieved of the

requirements. The proposed structure has been described in detail in Hickey and van Zijl (2003a).

The reporting structure was proposed to the ASRB, which in turn proposed the structure to the MED in February 2003 as the basis for a public discussion paper to be issued by the ministry. The MED's discussion paper was to be issued in June 2003 and, following review of comments submitted, the new reporting structure would be given legal footing. However, the discussion paper, *Review of the Financial Reporting Act 1993 Part I: The financial reporting structure*, was not published until March 2004. While *Part I* followed the structure developed by the FRSB and the ASRB, a further MED discussion paper *Review of the Financial Reporting Act 1993 Part II*, published in November 2004, proposed at least a partial shift away from the structure. The latter paper retains the notion of tiered reporting requirements but steps away from entity neutrality. Thus *Part II* proposes that the revised FRA should specify what is to be reported but the separate Acts under which each class of entities of a particular organisational form are registered would specify the degree of compliance with the FRA.

Until the consultation and review process now commenced by the MED is concluded – likely to be early 2006 – there is uncertainty with regard to what entities are caught and in what tier. This is a matter of considerable concern for preparers of financial reports. Across the spectrum of entities that could conceivably become subject to IFRS, those at the extremes can surmise their position with confidence. However, a broad range of entities around the margins between the tiers, face uncertainty as to their eventual reporting requirements, with attendant difficulty in choice and development of appropriate information systems.

5.3 Sector Neutrality

In July 2003, the FRSB, with the support of the ASRB, issued the statement *Process for Adoption of IFRS* that sets out the process it would follow in adapting IFRS for approval by the ASRB as the new approved New Zealand standards – 'NZ IFRS'. The consultations showed support for continuing with sector neutral standards, with public sector parties indicating a strong preference for integrating any additional requirements into IFRSs rather than adding them in an appendix. The ASRB accepted that preferred approach, and therefore any additional requirements in an NZ IFRS are being placed

alongside related requirements (if any) in the IFRS but marked so as to be clearly distinct and separate from the IFRS.

It was initially expected that the disclosure, measurement and recognition requirements of IFRSs could be extended so as to make the standards applicable to both profit oriented and public benefit entities.[7] Sector neutrality would thus be maintained and yet allow both sectors to assert compliance with IFRS. However, further consultation with the IASB showed that such adaptation of IFRSs was acceptable only in respect of additional disclosures. The IASB would also accept narrowing of the set of optional treatments available in any IFRS. The consequence of imposing additional measurement and recognition requirements would be that the entities subject to the requirements could no longer claim to be complying with IFRS. Such requirements will therefore, now be restricted to apply only to public benefit entities. Thus profit oriented entities complying with NZ IFRS simultaneously comply with IFRS but public benefit entities achieve compliance only with NZ IFRS. Although strictly speaking the approach taken spells the end of sector neutral standards in New Zealand, the FRSB aims to hold the two sectors together by keeping additional requirements to the minimum and thus maintain the sectors, at least in substance, closely aligned.

5.4 Due Process for NZ IFRS

As explained in *Process for Adoption of IFRS*, the FRSB issues an ED of the proposed NZ IFRS showing, in marked up form, any proposed additional requirements. The proposed standards are initially prepared by the Conversion Working Group or other working groups of the FRSB. The Conversion Working Group is chaired by a member of the FRSB and the membership, while mainly from outside the FRSB, is widely representative of the reporting constituency. The ED is accompanied by a Discussion Paper, which provides a summary of the main differences between the proposed standard and current NZ requirements. The ED and DP are posted on the ICANZ website, and the period for comments is typically 2 months. Following review of comments received the proposed NZ IFRS is submitted to the ASRB for approval.

[7] Such changes were to be made to an IFRS only if they were clearly consistent with the IFRS and the IASB constraints on choice of accounting policies as now stated in IAS 8 (2003): *Net Profit or Loss for the Period, Fundamental errors and Changes in Accounting Policies*, paragraphs 10-12.

Once approved by the ASRB, the standards were then posted to the ICANZ website as a pending standard to assist early adopters to prepare for 2005. Final "big bang" approval of all NZ IFRS was completed in November 2004.

6. The Adequacy of Due Process

6.1. Adoption

The decision to adopt IFRS was consistent with an expectation of net benefit to New Zealand reporting entities, at least, in aggregate. While the consultations indicated a resignation to following Australia, it was not infeasible for New Zealand to continue with its own standards. Examination of the question of net benefit is not the subject of this paper.[8] There is anecdotal support for the claim that the current set of New Zealand standards is at least equal in quality to the current set of IFRS. However, even if that were true it is unlikely to remain true as additional IFRS are introduced, both on new topics and on topics currently dealt with in IAS. In any case, the substance of the comparison is of less interest than the perception of the comparison and, at least for those not familiar with the current New Zealand standards, the ready judgment would be that the adoption signals a shift to higher quality standards.

An entity can only claim that its financial statements comply with IFRS if they have complied with the requirements of all IFRSs (IAS 1 (2003) *Presentation of Financial Statements*, paragraph 14). Therefore, if New Zealand reporting entities are to benefit from the adoption, then all IFRSs must be adopted. That is, if New Zealand standard setters adopted nearly all IFRS but excluded, say, one or two standards, New Zealand entities could not claim to have complied with IFRS in the preparation of their financial statements. Thus adoption of IFRS effectively removes from the ASRB the discretion to reject or substantively amend any particular IFRS for application in New Zealand irrespective of its own assessment of the net benefits of a standard or constituent's objections to any part of a standard. The ASRB's role in respect of approval will therefore, in substance, reduce to examining the additional requirements introduced. The implication is that interested parties in New Zealand will have influence in standard setting in New Zealand only through influence in the IASB. This situation has been described for

[8] See Collett et al. (1998) and Brown and Tarca (2001) for an assessment of the consequences of adoption of international standards in response to an earlier such proposal in Australia.

the case of Australia as "…allowing Australian financial reporting practices to be determined by a foreign private–sector body" (Howieson and Langfield-Smith 2003).

Currently, New Zealand has an established intellectual capital base in standard setting and therefore, relative to the size of its capital market, it can wield disproportionate influence within the IASB. Indeed this is reflected in New Zealand's special position of being one of the IASB's partner standard setters.[9] Thus New Zealand's financial reporting constituency can participate in the IASB's due process (a more extensive process than has existed in New Zealand) and also be directly represented by the New Zealand standard setter in the IASB's research and standards development processes. However, this advantage is likely to dissipate over time as larger countries increase their capacity in standard setting and funding for standard setters in New Zealand comes under increasing pressure (Bradbury 2003). Furthermore, while influence in standard setting is in part determined by the quality of the intellectual contribution made, the IASB must also aim for a reasonable degree of consensus and therefore New Zealand will be handicapped by its small size, especially given the size of the IASB's constituency. [10]

It can be argued that while adoption of IFRS will result in less control over standard setting, New Zealand was "converging" towards that outcome anyway. While the initial development of standards in New Zealand relied heavily on the UK pronouncements, gradually the standards began to reflect original work as well as draw on the standards of Canada, the US and Australia. However, from the early 1990s, choice of the sources for building the synthesis began to be increasingly constrained by calls for harmonisation and thus, in 1997, the FRSB announced that in future, standards would be based on the standards of the IASC or the AASB. The AASB standards were seen as an alternative to IASC standards as the AASB was itself committed to harmonisation with IASC and therefore the objective of harmonisation could be achieved by either group. The policy was to be implemented by issuing either the relevant IASC or AASB pronouncement as the New Zealand ED (Bradbury 1998).

[9] The other partner standard setters are the standard setters of Australia, Canada, France, Germany, Japan, UK and US. New Zealand was also represented on the G4 + 1 and the Joint Working Group on Financial Instruments.

[10] For example, Japan continues to voice concern over the IASB's alleged lack of responsiveness to its concerns (for example, Nakamura, 2003) and Australia has recently found the IASB responding in the negative to the case made for departure from the requirements of IFRS 1 on intangible assets (IASB, 2003).

With the transformation of the IASC into the IASB, and New Zealand having the status of a partner standard setter, the FRSB recognised the need to review its operations and develop new operating policies. By 2002, a model for a new set of operating policies was readily at hand from the AASB as it had experienced similar change in its operations and had just developed Policy Statement 4 (PS 4) *International Convergence and Harmonisation Policy*, which was issued in April 2002. The FRSB decided to revise the *Explanatory Foreword to General Purpose Financial Reporting* and to include in the exposure draft (ED-92) of the revised Foreword a policy statement on international convergence and harmonization based on PS 4. The intent of the policy was well captured in the following excerpts from paragraph 5.6 of ED-92, issued in June 2002: "… the [ ] objective is to work towards the development of financial reporting standards in New Zealand that harmonise with IFRSs and IPSASs… When applying this policy the Board will act on the basis of a rebuttable presumption that IFRSs and IPSASs reflect best international practice and that the Board will depart from IFRSs and IPSASs only in rare and exceptional circumstances". (IPSAS refers to the International Public Sector Accounting Standards issued by the Public Sector Committee of the International Federation of Accountants). Thus while the FRC directive to the AASB was the catalyst for the adoption of IFRS in New Zealand, standard setting was in fact already well advanced in that direction. There was surprise in New Zealand at the FRC directive. However, there was also surprise at the AASB, as PS 4 had been issued only in April and the FRC had reviewed and approved the statement.

Irrespective of the trend towards loss of control over standard setting, it is appropriate to review the basis for the decision to adopt IFRS. The due process followed was clearly less than that required of the FRSB by the ASRB in respect of approval of particular standards, it contained similar elements: (1) notice of the proposal was given to the constituency, (2) there was consultation on the proposal, and (3) in forming the decision to adopt IFRS the comments made were given due consideration.

Notice was given firstly by way of the public statement made on the 21 October 2002 and secondly as the lead article (Hagen and van Zijl, 2002) in the *Update Forum* section of the November 2002 issue of the Chartered Accountants Journal. The proposed adoption was also referred to in the *FRSB Developments* column in the same issue of the Journal. The public statement appeared to pass without significant comment in the press and the Journal article passed without response to the Editor. The Journal article gave a brief background

to the decision and described the consultation process on the proposal. While there was no general invitation for comment, any interested party not consulted by the consultative group could obviously have made comment to the ASRB, the FRSB, or individual members of the Boards.

Analysis and consideration of the feedback from the meetings with the interested parties was largely confined to the consultative group and the ASRB decision was made by circular resolution of its members rather than in a physical meeting. This reflected difficulties in arranging a meeting at that time of the year (late December), the need to progress the matter, and confident assessment that a full meeting would have produced the same decision.

Given on the one hand, the range of entities consulted, their representativeness, the interactive open ended nature of the consultation meetings, and on the other, the often narrow or limited feedback received in response to an ED, it could be argued that the consultative process engaged in on the question of adoption is likely to have been at least as effective as an ED type process might have been in providing comment.[11] However, beyond the information obtained from the consultations, there was no due process on the actual method of conversion of IFRS to NZ IFRS. The ASRB, after consultation with the FRSB, simply mandated the way forward.

Constituents' participation in due process of setting standards is essential for two reasons. The first is to provide input into the decision process, including identification of problems, identifying alternatives and providing information on the likely impact. Second, participation is necessary to ensure the legitimacy of the standard setting body (see Tandy and Wilburn 1992 and Johnson and Solomons 1984). The consultative process may have achieved the first of these objectives and possibly the substance of the second, but without formal due process on the conversion process the appearance of legitimacy is lacking.

6.2 Implementation

The key implementation issues were cost benefit and sector neutrality.

[11] This conclusion is speculative. However, the normal ED process is not without its problems. Baskerville and Newby (2002) identify a breakdown in the exposure draft process, whereby a public sector constituent failed to make its objections known prior to the release of an accounting standard. The unexpected opposition led to a revision of the particular standard.

6.2.1 Cost Benefit

Development and issue of EDs of NZ IFRS could not be delayed beyond mid 2003 and thus the late publication of the MED discussion paper resulted in EDs of NZ IFRS being issued for comment while a large number of entities are uncertain as to their future reporting obligations. For some entities the question is will they be subject to NZ IFRS and, for other entities whether they might qualify for reporting concessions and, if so, what the concessions might be. It was noted above that this uncertainty is likely to extend well into 2005. The degree of uncertainty has now increased as a result of the IASB's more rapid progress on its project on accounting for Small and Medium Entities (SMEs). The IASB published a discussion paper on accounting by SMEs in June 2004 and obviously the regime introduced in New Zealand should be consistent with the approach finally adopted by the IASB. The entities affected do have two sources of comfort. Firstly, the FRSB working group that developed the structure proposed to the MED was chaired by a member of the FRSB and was well representative of the various interests in the reporting constituency. Secondly, the structure now proposed by the MED was first published in May 2003 (Hickey and van Zijl, 2003a) and has therefore been available for some time for critical examination. On the other hand, the approach likely to be taken by the IASB has received little public attention in New Zealand.

6.2.2 Sector Neutrality

The long time taken to iterate to a position of certainty on the scope for adaptation of IFRS, while retaining for reporting entities the ability to claim compliance with IFRS, ruled out effective opportunity for due process on the issue of sector neutrality. Difficulty in the resolution of uncertainty in part resulted from interpretation of IASB guidance but was complicated by the wish to also harmonise with Australia. By the time certainty was reached, time pressure on progressing the release of EDs of NZ IFRS precluded separate consultation on the scope for adaptation and sector neutrality. This issue produced division within the FRSB on adoption of IFRS, the division continues to exist and is probably mirrored in the reporting constituency. The compromise reached provides ability to profit oriented entities to claim compliance with IFRS. However, with the differences arising from possibly different disclosure requirements and narrowing of the set of optional treatments, the signalling value of the switch to IFRS may be significantly reduced.

The issue is of course apparent in the EDs of NZ IFRS and therefore those parties remaining dissatisfied with the approach taken have had the opportunity to submit comments for initial consideration by the FRSB in its review of the EDs and subsequently by the ASRB when considering approval. However, the final NZ IFRS standards indicate that the approach taken in the EDs has been carried through to the standards. Issue of EDs of NZ IFRS is obviously consistent with due process but the number of EDs required to be issued was such that it is likely that the exercise had greater potential as a means for education in NZ IFRS than in providing substantive due process

7. Conclusion

The decision to adopt IFRS in New Zealand was a significant step in standard setting. This paper has discussed some of the key aspects of both the initial decision and the subsequent implementation issues. In reviewing these aspects, particular emphasis has been placed on due process.

Implementation is still in progress and while many issues have been addressed, a number remain to be considered. The latter include issues already identified such as cost benefit but also other issues that have received little consideration. One example is specification of audit and filing requirements. Another example is the design of a new standard setting arrangement that reflects the loss of effective control over the setting of New Zealand standards but ensures the continuing viability of a New Zealand standard setter to continue the special role with the IASB.[12]

The adoption of international standards will have a significant impact on New Zealand financial reporting. This decision, precipitated by the AASB's decision to adopt, merely accelerates New Zealand's convergence towards international standards and has been welcomed or at least accepted by regulators, preparers and users of financial statements. The decision to adopt IFRS went through a form of due process. A limited due process was applied for conversion of individual international standards. Given the all or nothing nature of the adoption of IFRS , the limited due process was for (1) education purposes and (2) to preserve veto rights over letting an overseas body regulate New Zealand entities.

[12] However, the establishment by the governments of Australia and New Zealand of a Trans-Tasman Accounting Standards Advisory Group to work towards common trans-Tasman accounting standards suggests that the future of standard setting in New Zealand might be as part of an Australasian body - see http://www.treasurer.gov.au/tsr/content/pressreleases/2004/006.asp

However, the actual method of converting international standards to New Zealand standards did not go through sufficient due process.

Appendix I: The Parties Consulted

The entities consulted on the ASRB's October 2002 proposal to adopt IFRS were as follows:

Auckland CFO Group of ICANZ
Capital CFO Group of ICANZ
Deloitte Touche Tohmatsu
Ernst and Young
Finance and Expenditure Committee of Parliament
Institute of Finance Professionals of NZ
Inland Revenue Department
KPMG
Local Government New Zealand
Ministry of Economic Development
National Public Practice Committee of ICANZ
National Public Practice Committee: Sub-Committee
New Zealand Bankers' Association
New Zealand Stock Exchange
Office of the Controller and Auditor-General
PricewaterhouseCoopers
Society of Local Government Managers
Securities Commission
Treasury

Appendix II: Results of the Consultations

Excerpts from a Memo from the then Chair of the FRSB, Professor Tony van Zijl, to the then Chair of the ASRB, Mr John Hagen, dated 12 December 2002:

1. There is general acceptance that in order to maintain credibility for financial reporting in New Zealand we must adopt IFRS. Some concede this with enthusiasm others with reluctance.

2. There is support for continuing with sector neutral standards. Some private sector groups accept the benefits of sector neutral standards but express concern that adding public sector requirements should not be allowed to delay the issue of IFRSs.

3. Public sector groups have expressed a strong preference for interspersing the public sector material throughout an IFRS rather than including the material in an appendix. Making the standards sector neutral would include changing the titles of the financial statements and terms such as 'profit' to 'surplus'.

4. There is strong support for the principle that the benefits of reporting must exceed the associated costs. The reporting entity approach followed in Australia is generally preferred over alternative approaches to achieving this principle. There is general agreement that some differential reporting exemptions should apply above the line but there is a mix of views on the need for any structure in reporting by entities below the line. Some were willing to accept such sa structure only for companies.

5. There is strong support for harmonising with Australia in the solutions adopted for both sector neutrality and the cost benefit constraint.

6. The proposed dates of 2007 for mandatory adoption and 2005 for voluntary opt-in have found general favour although some have expressed a preference for 2006 or 2005, at least, for listed issuers.

7. There is a preference for a gradual introduction of IFRS but it is recognised that with many of the IFRS under review a big bang approach may be the only feasible option.

8. There is recognition that ICANZ and the Big Four firms will have to mount a significant education programme for both preparers and users.

9. There is acceptance that adopting IFRS is a zero/one choice and that adoption effectively hands over to the IASB the final say on financial reporting standards in New Zealand. The current approval role exercised by the ASRB would therefore, in substance, reduce to examining the additional public sector material.

10. There appears to be strong support for a continuing standards developing body to work closely with the IASB and thus ensure that we have some substitute for the loss in effective due process.

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