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# Are our quantitative research methods able to provide the answers to standard-setters?


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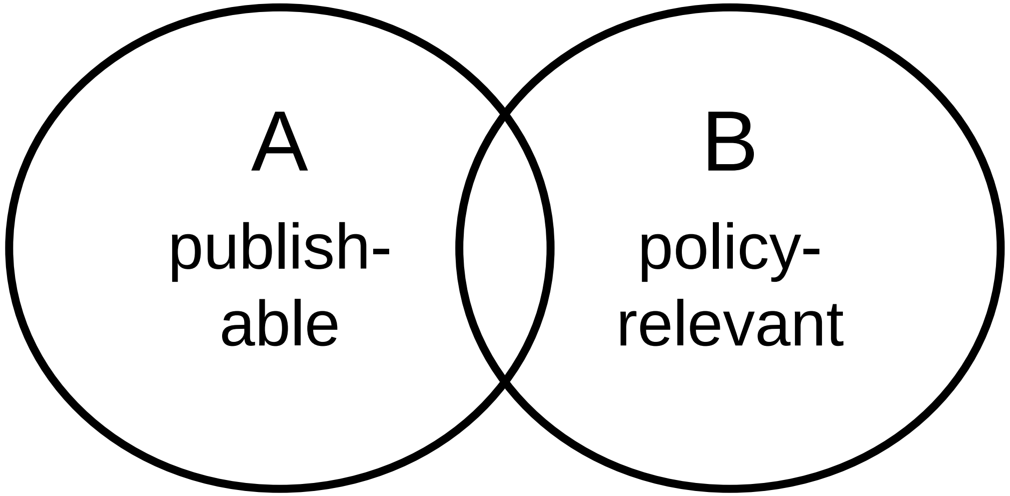
# Two (incompatible?) types of accounting research




**publishable:** subject to the rigorous quality standards of relevant academic outlets

➔ well-understood through PhD classes, Aims & Scope of journals, Editor Panels, conferences, …

**policy-relevant:** increasingly communicated by standard setters (*for example, via events like today's!*)

➔ YET: For some reason,

- academics often perceive publishability and policy relevance as incongruent, or even conflicting; and
- what exactly makes a study policy relevant – and hence potentially impactful – seems *ex-ante* unclear.

# Operationalizing decision usefulness: Ball and Brown (1968)

- **Decision usefulness** *the* key outcome of interest to standard setters.
- Research had concluded "that financial statement information prepared under existing reporting rules is **meaningless**" (Ball and Brown 2014, p. 15)
- "It was as if academics were saying '[W]e have **not collected data** on whether or how consumers use cars as they currently are designed, but we know a priori that these cars are useless and all cars henceforth should be redesigned as 16-wheel trucks'" (Ball and Brown 2014, p. 16).
- **BUT:** "An empirical evaluation of accounting income numbers requires **agreement** as to what real-world outcome constitutes an **appropriate test of usefulness**" (Ball and Brown 1968, p. 160).
- Ball and Brown (1968, p. 160) decided: "Because net income is a number of particular interest to investors, the outcome we use as a predictive criterion is the **investment decision** as it is reflected in security prices."
- An **observed revision of stock prices associated with the release of the income report** would thus provide evidence that the information reflected in income numbers is useful" (Ball and Brown 1968, p. 161).

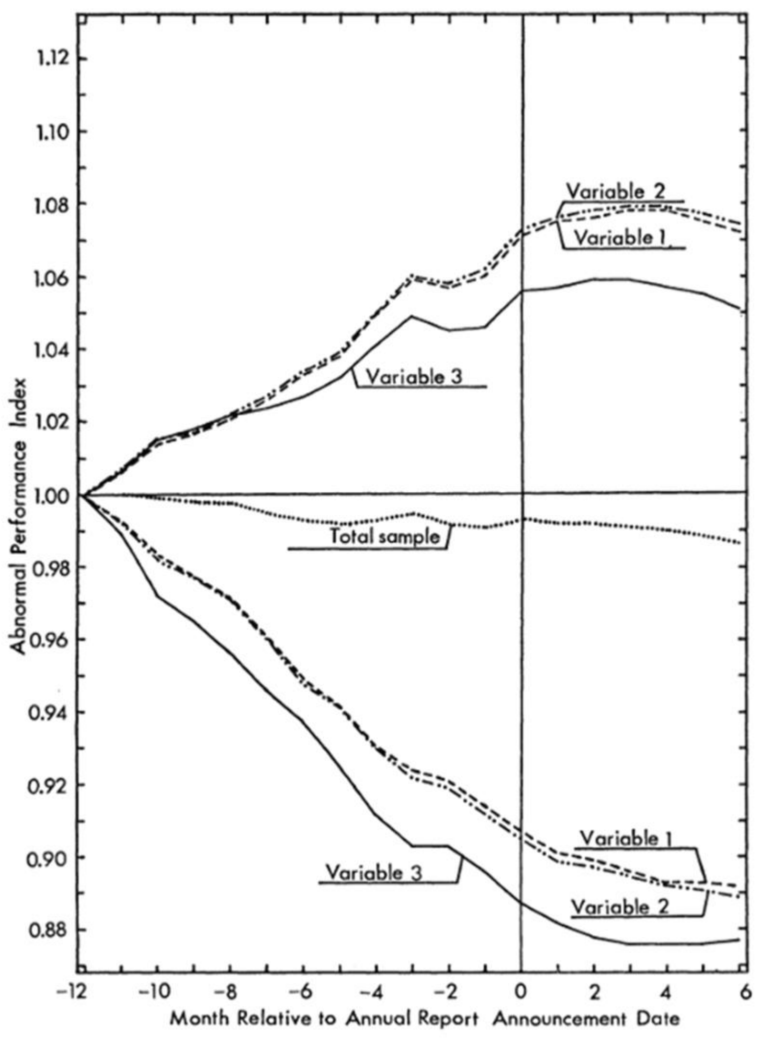



FIG. 1 Abnormal Performance Indexes for Various Portfolios

# Operationalizing decision usefulness: Value relevance

Disagreement over whether **value relevance**—i.e., the statistical association between accounting numbers and stock prices—is, as Ball and Brown (1968) assumed, a valid indicator of decision usefulness

**Heated debate**—e.g., between Barth, Beaver, and Landsman (2001) and Holthausen and Watts (2001)

**Barth et al. (2001): In favor**

- Such associations provide meaningful evidence on the combined relevance and reliability—and hence, decision usefulness—of financial reporting and
- offer a practical way to assess the extent to which accounting standards meet their high-level objectives.

**Holthausen and Watts (2001): Opposed**

- question both the theoretical underpinnings and the interpretability of value-relevance metrics,
- arguing that price associations may reflect investor behavior or market inefficiencies rather than the quality of accounting information itself.

*To this day, academics wonder who is right—and where standard setters stand in this debate.*

# Operationalizing financial statement comparability

De Franco, Kothari, and Verdi (2011): A possible measure of „financial statement comparability" is the **similarity** with which

- different firms' economic outcomes (e.g., **stock prices**) map into
- these firms' accounting amounts (e.g., **earnings**).

**Validation:** „This measure is positively related to analyst following and forecast accuracy, and negatively related to analysts' dispersion in earnings forecasts."

**Conclusion:** „financial statement comparability lowers the cost of acquiring information, and increases the overall quantity and quality of information available to analysts about the firm."

**Application:** Barth, Landsman, Lang, and Williams (2012) adopted this approach to examine „whether application of IFRS by non-US firms results in accounting amounts comparable to those resulting from application of US GAAP by US firms."

*Does this operationalization of comparability resonate with standard setters?*

# An information asymmetry

To my knowledge, there are **no ‚official' positions** by standard setters on the extent to which

- value relevance is a valid empirical measure of **decision usefulness** as per the Conceptual Framework
- financial statement comparability (as defined by De Franco et al. 2011) is a valid empirical measure of **comparability** as per the Conceptual Framework

Absent such statements, **researchers struggle** to

- form expectations about the expected/unexpected and intended/unintended **effects** of accounting standards
- document the **policy relevance and real-world impact** of their quantitative empirical work
- argue that their empirical measures have **construct validity**

➔ **Resulting uncertainty may dampen (junior) researchers' incentives to get involved**

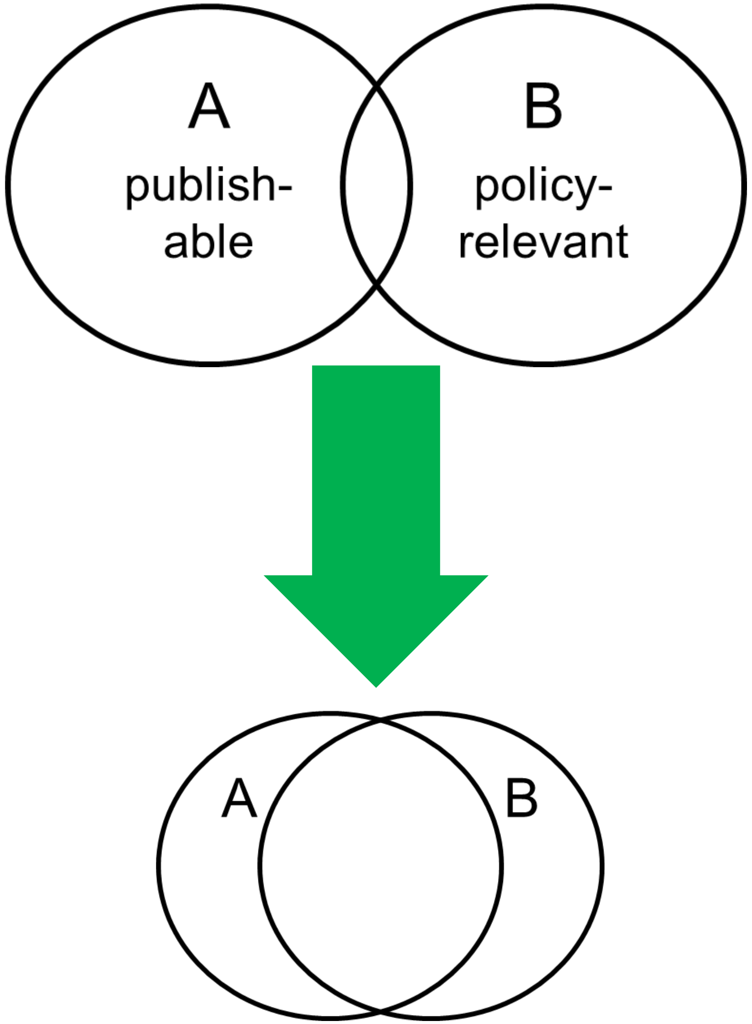
# A proposal: Co-designed pre-registrations

## 1. Groundwork: Joint development of valid constructs and metrics

- Collaborative effort to identify a set of key evaluative concepts and their empirical operationalizations
- ***Standard setters:*** deep understanding of their objectives, legal mandates, and the preferences of their constituents.
- ***Researchers:*** trained to identify valid proxies, work with complex datasets, and design econometrically sound evaluation strategies.
- Structured, transparent and open process – facilitated by EAA FRSC?

## 2. Application: Co-designing impact studies of new standards

- Apply co-developed constructs and metrics to study new IFRSs
- Jointly design empirical studies to be run *after* new IFRS takes effect
- Core element of post-implementation review (PIR) process
- Ex-ante commitment instead of ad-hoc ex-post selection
- Facilitated by Registered Reports publication format (e.g., in *European Accounting Review* or *Journal of Accounting Research*)



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# Thank you.

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