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Advances and opportunities in international accounting research

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1. INTRODUCTION

In this guest editorial, I share my views of advances in international accounting, emerging issues, and areas in need of further investigation. My comments are grounded in my perspective as an empirical researcher, primarily in the area of financial accounting and reporting with an expertise in international accounting. This commentary is based in part on my 2017 Keynote Presentation on Financial Accounting at the 17th USP Controllershship and Accounting Congress, held by the Department of Accountancy and Actuarial Science, College of Economics, Business, and Accounting, University of São Paulo (FEA USP), Brazil.

Having this opportunity to share my views comes at an interesting time in my academic career, as I earned my Ph.D. 20 years ago. So, this editorial provides me an opportunity to look forward and reflect (a bit) on the past. When I was a Ph.D. student, accounting standards were set within each country. The domestic standards reflected the country's economic and social characteristics, such as source of financing, taxation, and culture.

My research exploited these differences in accounting standards across countries to further our understanding of financial accounting and reporting. For example, my Ph.D. dissertation examined accounting for changing prices in Mexico, finding that adjustments for inflation and asset revaluations were value relevant (Gordon, 2001). The United States Generally Accepted Accounting Principles (U.S. GAAP), then and still now, does not use inflation accounting or asset revaluation accounting. Another paper investigated differences between the United States of America (USA) and the United Kingdom (UK) accounting for deferred taxation (Gordon & Joos, 2004). The widespread mandatory International Financial Reporting Standards (IFRS) adoption, starting in 2005, brought this type of research to a halt.

Of course, many countries mandating IFRS adoption *en masse* became a historical, transformational, innovative time in international business that evidenced an unprecedented

world-wide co-operation at many levels – standard-setters, regulators, accountants, auditors, and others. Accounting, accounting standards, and financial reporting were recognized as part of the economic infrastructure to support and enhance global business. Mandatory IFRS adoption provided new and potentially greater opportunities for researchers. Countries have mandated the use of IFRS seeking benefits such as greater access to and lower cost of capital, improving earnings quality and comparability, as well as increasing transparency, facilitating business transactions, and increasing the attractiveness of investment in domestic firms. Indeed, a number of studies exploit IFRS adoption as a natural experiment and examine issues such as changes in accounting quality, effect on debt market, or changes in foreign private investment (Burnett, Gordon, Jorgensen, & Linthicum, 2015; Lima, Lima, & Gotti, 2018; Shima & Gordon, 2011).

Yet, over 10 years have passed. We are now in a world with 2 high-quality globally accepted accounting standards: IFRS and U.S. GAAP. As before and after adoption studies are numerous, there is limited opportunity to contribute. The contributions of adoption studies may potentially be greater in countries that adopted IFRS more recently and those with greater differences in institutional characteristics or market features.

As research moves beyond IFRS adoption studies, there are other emerging areas and areas that need further research. In this commentary, I briefly discuss 4 of the areas where I believe there is an opportunity to make a contribution: 1) research to inform standard-setters and the role of IFRS in a local and international context, including the effects of institutions and regulations; 2) research on the 'principles-based' nature of IFRS and resulting estimates, assumptions, and judgments made; 3) research on differences between IFRS and U.S. GAAP; and 4) research on the role of accountants and accountancy in economic development.

2. RESEARCH TO INFORM STANDARD-SETTERS

Policy-oriented research, in general, is designed to *inform* or *understand* one or more aspects of the public and social policy process, including decision making and policy formulation, implementation, and evaluation. In the case of financial reporting policies, the implication is that standard-setters should pay attention to this research. According to Schipper (2017), results could or should inform standard setting decisions or practical implementation questions. Therefore, looking at the agenda of the International Accounting Standards Board (IASB) to identify topics of current or upcoming interest may be fruitful for research opportunities. For example, the IASB is currently discussing topics that include primary financial statements, financial instruments with characteristics of equity, the IASB's Conceptual Framework for Financial Reporting, goodwill and impairment, and post-implementation review (PIR) of fair value measurement (available at <<https://www.ifrs.org/news-and-events/2018/01/iasb-agenda-papers-and-agenda-available/>>). Being aware of the standard-setter's agenda, a researcher can identify relevant areas of interest, develop research questions, and contribute to the development of accounting standards – see Gordon and Street (2013) for further discussion of research relevant to standard-setters.

PIRs are conducted after a standard is issued and they seek to assess whether this standard achieves the IASB's expectations, better meets the needs of investors and other users by providing more useful information, and resolves issues that were contentious at the time of finalizing the IFRS concerned. As such, issues addressed and steps involved will vary with each PIR. In general, as the issues addressed and the process involved in the PIR are specific to the standard and standard-setter's needs, the PIR's aim differs from that of academic research. Nonetheless, assessing the consequences of recently issued standards is another area where researchers can contribute.

Further, the IASB has expressed interest in increasing the understanding of the IFRS role in a local and an international context (available at <<http://www.ifrs.org/academics/>>). This motivation provides researchers with the opportunity to use their knowledge of country characteristics and institutional features, such as a country's laws and regulations, changes in law regulations, corporate governance characteristics, or ownership structures. Exploring country-specific institutional differences or institutional differences across countries may provide insights into policy-relevant issues. Other recent international accounting research studies have examined the effects of State ownership of Chinese companies on earnings management (Cheng, Jing, & Wei, 2015), reverse merger firms (Kun-Chih, Qiang, Ying Chou, Yu-Chen, & Xing, 2016) or economic freedom and investment flexibility (Chih-Ying, Chen, & Qinglu, 2015). See Gordon, Greiner, Kohlbeck, Lin and Skaife (2013) for a discussion of research design issues in cross-country studies.

In 2014, the *China Accounting and Finance Review* (CAFR) devoted a special issue to replications of classic accounting and capital market studies, which had been conducted in the USA using U.S. data, to the Chinese market using Chinese data. The journal issue included studies on the information content of annual earnings announcements regarding the quality of analysts' cash flow forecasts, the Fama-French three-factor model, and the effects of big auditors. Replication studies of U.S. research in a different country are generally not viewed as a contribution to the literature. Yet, the CAFR recognized that institutional characteristics and regulatory features in the Chinese market differed significantly from those in the USA. So, findings from U.S. studies may not apply to the Chinese market, and findings from U.S. studies may not serve as appropriate benchmarks to interpret findings in other markets. Research that identifies and exploits a country's unique institutional characteristics has the potential to make a contribution.

3. PRINCIPLES-BASED STANDARDS AND JUDGMENT

The 'principles-based' nature of IFRS offers opportunities for researchers interested in estimation uncertainty, as well as estimates and assumptions made in financial reporting. Principles in accounting standards are developed using

a conceptual framework and provide few exceptions. 'Principles-based' standards require more judgment and discretion in need of management to make estimates and assumptions when applying financial accounting standards.

A common view is that more judgment leads to higher accounting quality, as managers are able to report activity in a way that reflects the underlying economics. A concern, though, is that more judgment also allows more leeway for incentive-driven behavior, as managers have incentives to meet earnings targets, get their bonuses, and retain their jobs, among others. For example, Gordon, Henry, Jorgensen, and Linthicum (2017) investigate the flexibility IFRS allows in classifying items such as interest paid in operating cash flows (OCF) on the statement of cash flows, finding that the main determinants of OCF-enhancing classification choices are capital market incentive, including capital structure and accessing equity markets more frequently.

The disclosure of accounting policies, estimates, and sources of uncertainty under the International Accounting Standard (IAS) No. 1 is a source to examine to better understand management's significant choices of accounting policies and areas of significant judgment. For example, Marton and Runesson (2015) develop a

disclosure index of keywords related to estimation in the IAS No. 1 disclosures in the financial statements. Using sample companies from 25 European Union countries, they identify accounting topics with greater disclosures of estimates, including asset impairment, revaluation of long-lived assets, capitalization of research, and development, contingencies, last in, first out cost flow assumption (LIFO), pensions and other post-employment benefits, and consolidation and group reporting. Then, the authors ask whether earnings quality varies in high and low judgment firms, finding that higher earnings quality is associated with firms subject to a low level of judgment. There is no or weak association for firms with a high level of judgment. One implication of their results is that it may be innately difficult to measure those areas where judgment is needed.

Yet, more research is needed to grasp the underlying nature of these disclosures and whether they are providing relevant information to financial statement users.

4. OVERLAP OF JUDGEMENT AREAS AND SIGNIFICANT MEASUREMENT

DIFFERENCES

While IFRS and U.S. GAAP are 2 globally-accepted high-quality sets of accounting standards, major differences exist between them, such as accounting for asset impairments, revaluation of long-lived assets, and capitalization of research and development. So, although IFRS and U.S. GAAP share the same objective – i.e. “provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit” (from the Concepts Statement No. 8 of the Financial Accounting Standards Board (FASB), paragraph OB2, and The Conceptual Framework for Financial Reporting of the IASB, paragraph OB2) –, the 2 standard-setters have made different decisions in accounting in these and other areas.

Interestingly, the areas with differences between IFRS and U.S. GAAP overlap with the areas that Marton and Runesson (2015) identify as requiring significant judgment. The observation of differences in accounting standards, combined with these differences constituting areas of

significant judgment, provides research opportunities to grasp the implications of these differences.

For example, Gordon and Hsu (2018) examine tangible long-lived asset impairments and future operating cash flows under U.S. GAAP and IFRS. They ask whether long-lived asset impairments reported under U.S. GAAP and IFRS are similarly predictive of changes in operating cash flows. The IFRS and U.S. GAAP long-lived asset impairment standards differ in both the timing of loss recognition and loss measurement. Differences imply impairments under U.S. GAAP and they are less timely due to the two-step impairment test, larger because of the delay, and larger because they do not reflect entity-specific information on the asset's use. Keeping the differences in mind, IFRS impairments are expected to have incremental predictive value beyond those under U.S. GAAP.

Gordon and Hsu (2018) find that impairments reported under IFRS are negatively associated with changes in future operating cash flows, whereas those under U.S. GAAP, on average, are not. Additional tests suggest that impairment recognition under U.S. GAAP is delayed. Further, exploiting differences in institutional

setting for IFRS firms, they show that impairment losses under IFRS are more predictive in high enforcement countries. This type of research into the implications of differences between U.S. GAAP and IFRS is similar to studies I have conducted early in my career, addressing differences in accounting standards in place at the time.

While the overall informativeness and properties of aggregate measures of earnings, book values, and cash flows are a matter of interest (Barth, Landsman, Lang, & Williams, 2012; Ball, Kothari, & Robin, 2000),

research on major differences in accounting standards should be relevant to standard-setters, regulators, and financial statement users. This type of research has the potential to inform standard-setters about the effects of specific accounting standards on financial reporting outcomes. The IFRS Foundation (2017) has stated the belief that “academics are important partners in our work to develop and promote the adoption and consistent application of IFRS. The relationship brings benefits to both parties.”

5. THE ROLE OF ACCOUNTING AND THE ACCOUNTANCY PROFESSION IN ECONOMIC DEVELOPMENT

An underexplored research area is the role of accounting and the accountancy practice in economic development. A widely-held view is that accounting and the accountancy practice play a key role in economic development. In 2013, 12 world organizations, including the World Bank, the U.S. Agency for International Development, and the U.K. Department for International Development, signed the Professional Accountancy Organization (PAO) Global Development Report, also referred to as the Memorandum of Understanding to Strengthen Accounting and Improve Collaboration (MOSAIC).

The African Development Bank, Asian Development Bank, Inter-American Development Bank, World Bank Group and International Federation of Accountants (2013) assert that a strong accountancy practice and effective professional accountancy organizations improve the quality of financial management and reporting, which in turn provides the benefits of

attracting foreign direct investment, promoting growth and development of the small- and medium-enterprise sector, increasing transparency and accountability in the use of resources in the public sector, improving the design and delivery of vital public services, and enhancing the effectiveness and efficiency of official development assistance. However, limited academic research evidence exists concerning the relation between accounting and the accountancy practice, as well as economic development.

Just as noticed by Venter, Gordon and Street (2018), this research may help donors in evaluating the outcomes of interventions aimed at building the capacity of professional accountancy organizations in emerging and developing economies and inform future interventions. Instead of repeating the discussion, I refer the reader to the recent commentary provided by Venter, Gordon and Street (2018).

6. CONCLUSIONS

In short, research in international accounting keeps having the potential to expand our knowledge and contribute to the development of accounting and accounting practice. I have identified and briefly discussed 4 of the areas that I see as having the ability to make contributions: 1) research to inform standard-setters; 2) research on the ‘principles-based’ nature of IFRS; 3) research on differences between IFRS and U.S. GAAP; and 4) research on the role of accountants and accountancy in economic development.

The opportunities extend beyond these areas, as well. Importantly, in order to make a contribution, the researcher must identify and communicate what is learned from the study and why the study should be of interest to the audience of an international accounting journal.

I thank the *Accounting and Finance Review*, especially Ph.D. Prof. Fábio Frezatti (Editor-in-Chief), for this opportunity to discuss advances and opportunities in international accounting research.

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