Read the annexure and answer:

Q1. Critically examine the motivation for International Accounting Research. [500 words]

Q2. Discuss how the suppliers and demanders of information contributed to the field of accounting research. [250 words]

750 words

NOTE: Assignment Format:

1. Introduction
2. Body of assignment
3. Learning derived
4. Bibliography

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Why We Do International Accounting Research

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ABSTRACT: This essay was a keynote address at the Third International Conference of the *Journal of International Accounting Research* in São Paulo, Brazil. It addresses the question of why the volume and quality of international accounting research have grown rapidly in recent years. It begins by asking why we do *accounting* research and moves on to discuss the reasons for conducting *international* accounting research. These include to better understand others (and in the process, to better understand ourselves), to provide more replication options, to exploit differences in national institutional structures when investigating the determinants and effects of institutional variables on accounting, to address some limitations of within-jurisdiction research, and to obtain a wider range of changes to exploit (the paradigm example being the advent of IFRS). I then offer some concluding comments. Despite its somewhat presumptuous title, I do not presume to speak for others; the essay reflects a purely personal viewpoint.

Keywords: international accounting; IFRS; replication; research design.

I. INTRODUCTION

Both the volume and quality of international accounting research have grown rapidly in recent years, to the point where it appears not only in specialist volumes such as the *Journal of International Accounting Research*, but also in the mainstream accounting journals. The essay addresses the question of why this has occurred.

At first blush, the answer would seem obvious: commerce and politics have become increasingly global, and therefore so has accounting. But, as usually is the case, on closer inspection the answer is not that obvious, since globalization would seem to imply that accounting practice and its determinants have become more homogeneous across nations, not less. In other words, globalization makes accounting more similar across nations, reducing the information learned from studying other nations. So, why do we do *international* accounting research?

To establish a background for addressing this question, I begin by asking why we do *accounting* research. I then address several reasons for conducting international accounting research, in approximately the historical order in which I believe they have motivated researchers. These are to better understand others (and in the process, to better understand ourselves), to provide more replication options, to exploit differences in national institutional structures when investigating the determinants and effects of institutional variables on accounting, to address some limitations of within-jurisdiction research, and to obtain a wider range of changes to exploit (the paradigm example being the advent of IFRS). I then offer some concluding comments.

II. WHY WE DO *ACCOUNTING* RESEARCH

Financial reporting is a large and important industry. It is different than (say) telecommunications, healthcare, or consulting, but an industry nevertheless. Consequently, in accounting research, we study and learn about both sides of the market. We study and learn about how these supply and demand effects intersect to generate financial reporting.

On the demand side, we develop our understanding of what users do with accounting information. Important users include shareholders, analysts, borrowers and lenders, rating agencies, suppliers and customers, boards, managers, employees, unions, and the press. Different user groups give rise to different information demands. For example, due to their asymmetric loss function, lenders are more interested in information about downside risk, whereas shareholders also are interested in information about upside risk. Short-term lenders want more information about liquidity.

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On the supply side, we develop our understanding of the institutional structure that evolved over centuries to satisfy user demands, and of the information accountants have comparative advantage in providing. At a fundamental level, accountants specialize in providing verifiable information about financial outcomes. How this inherent trait is manifested in actual financial reporting practice depends upon a complex structure of complementary economic, legal, and political/regulatory institutions. These institutions give rise to the incentives that firms and auditors face when preparing and issuing their financial statements. Influential institutional variables include the size and state of development of debt and equity markets, the legal system, the extent of political interest in how and what firms report, the set of accounting and auditing rules in place, and the degree of independence of financial reporting monitors including audit firms, boards, and the press. These and many other institutional variables are jointly determined complements that work together to satisfy user demand.

Financial reporting research addresses the political and regulatory institutions that overlay financial reporting. Regulation has become so pervasive that in my experience many observers today believe audits exist because they are required by statute, whereas their underlying economic determinants lie in the demand for independent verification of financial information and the evolution of audit institutions (education, standards, professional bodies) to satisfy that demand (Watts and Zimmerman 1986). When I graduated with an accounting degree 50 years ago, I would only have described accounting as a profession. As documented by Zeff (2003a, 2003b), the status of accounting as a profession has declined over time, and it increasingly is referred to as an industry. I personally have come to view it as a heavily regulated industry.[1]

Overall, accounting research provides a rich and complex tapestry to study. As I will now endeavor to demonstrate, *international* accounting research plays a special role in this process.

III. WHY WE DO *INTERNATIONAL* ACCOUNTING RESEARCH

There undoubtedly are many reasons that individual researchers have for conducting international accounting research, so I offer a purely personal perspective. I discuss several reasons, in approximately the historical order in which I believe they have motivated researchers.

To Better Understand Others

This appears to have motivated much of the early international accounting literature, which emerged before the Internet and low-cost communication and travel. There are many reasons to increase our understanding of other countries and their economic, political, legal, social, and other institutional structures. We satisfy our curiosity. For millennia, and well before the term "globalization" was coined, there has been political and economic intercourse among nations, so it is important to develop greater understanding of others. Furthermore, in the process of learning about others, we come to better understand ourselves, much as night helps us understand day.

Much of the early literature seems to have had this objective. Consequently, much of the literature consisted of simply cataloging national differences. Some effects of national differences were described, with largely small-sample correlations. There was little testing of universal theories that could be refuted in multiple contexts. While the literature has moved on to other things, understanding others remains an important reason for conducting *international* accounting research.

To Provide More Replication Options

Replication of results in another country was a feature of early international research. Over time, replicability has become an especially serious dimension of research generally.[2] The potential for spurious results has increased due to several factors: researchers have access to larger sample sizes and hence larger t-statistics, but continue to emphasize t-statistics rather than magnitudes; elaborate databases give greater flexibility in selecting dependent and independent variables based on their "significance"; statistical programs provide multiple model specification options; and cheap computing permits multiple combinations of data handling (e.g., trimming) and model choices. This has given rise to "torturing the data until it confesses," a

[1] Carmichael (2014), the initial Chief Auditor of the Public Company Accounting Oversight Board (PCAOB), attributes the decline in professionalism to increased incentives of auditors to please clients, reduced auditor legal liability, and the AICPA morphing from an ethical professional association into a trade association. He also blames insufficient regulation. My own view is almost the opposite. Regulation of financial reporting has expanded considerably over a long period. Important events in the U.S. were creating the SEC with statutory oversight of financial reporting, stripping the AICPA of its role in setting expectations for financial reporting (moving it from the Institute's Accounting *Principles* Board to the newly created Financial Accounting *Standards* Board), the SEC's increased involvement in standard setting, and stripping the AICPA of its role in setting expectations for auditing (giving the PCAOB almost unfettered authority to legislate and enforce detailed auditing rules). The auditor has gradually shifted from being a member of a professional practice who is charged with behaving ethically when exercising judgement in applying accounting principles, to being an employee of a commercial firm who is charged with behaving legally when applying detailed regulatory rules.

[2] For example, see Renfro (2011). Jasny, Chin, Chong, and Vignieri (2011, 1225) state, "Replication—the confirmation of results and conclusions from one study obtained independently in another—is considered the scientific gold standard."

practice that can only be exposed by published results failing to replicate when using different data or different estimation procedures.

Jasny et al. (2011) summarize a widely publicized attempt to independently replicate 100 studies published in three psychology journals. The mean treatment effect in the replications was half the magnitude of that originally reported. The proportion of significant results (with p-values < 0.05) fell from 97 percent to 36 percent. They recommend that reviewers and editors should not dismiss new tests of old results out of hand, because successful replication attempts increase our confidence in the results and unsuccessful attempts cast doubt on the underlying theory being tested, as well as the methods used to test it, and hence promote innovation.

In economics, "replicable economic research is the exception and not the rule" (Anderson, Greene, McCullough, and Vinod 2008, 100). Several journals have recently adopted rules requiring authors to upload data and coding onto online archives, to help guarantee that their published results are replicable (McCullough 2009, 117). Not surprisingly, these have tended to be the traditional journals with better reputations to protect. The top *accounting* journals now are taking action too, primarily by requiring public disclosure of data and code. Exactly how this will play out remains to be seen.[3] Thorny issues include whether journals will publish replication attempts, how they will do so (in print or online), whether and how to grant authors a grace period for disclosing data they have hand-collected at their own cost, proprietary data, and dealing with potential malcontents (who could, for example, take a perfectly valid study, torture the data themselves, and claim the original study lacks replicability (an inversion of the intended process). Will authors have to respond to all "replications" to protect their reputations? Despite such difficulties, replication seems destined to play a larger role in accounting research.

Replication options include within-jurisdiction replications, from mimicking the research design exactly (same data sources, data selection, models tested, data analysis), to checking sensitivity to sample selection methods (different data sources, time periods, firms, data trimming, including outliers), to checking sensitivity to different model specifications and estimation procedures (clustered standard errors, better identification). International studies provide a completely different set of replication options.

Some results replicate reasonably well across jurisdictions. For example, the basic Ball and Brown (1968) event study graph and the Sloan (1996) accruals anomaly reproduce well, presumably because they are not fundamentally affected by cross-regime variance in institutional factors. Other results replicate with differences that are a function of institutional variables that matter according to the underlying theory, thereby confirming the theory. For example, Ball, Kothari, and Robin (2000) report that the Basu (1997) timely loss recognition asymmetry replicates differently across countries, as a predictable function of their legal and economic systems. Failure to observe the predicted differences would cast doubt on the results.

Despite barriers such as the historical lack of interest by editors and referees in replication studies, replication is attracting increased attention and will be an additional motive for international accounting research.

To Exploit National Differences in Institutions to Better Understand Universal Phenomena

Archival accounting research can be viewed as coarsely mapping theory whose domain is abstract into data whose domain is "institutional." For example, the conceptual economic signal x can provide insights into—but differs from—the complex institutional variable "Income From Continuing Operations" calculated by firms under the rules of GAAP, audited by CPAs, and monitored by boards, short sellers, regulators, litigants, courts, etc. Viewed one way, this is a negative. It makes accounting research especially challenging, because the institutional shape of the data necessitates a poorer fit between data and theory than the researcher might prefer. For example, this necessitates different research design trade-offs than in the basic disciplines, and requires special skills in using the insights of theory to understand data that do not map directly into that theory. Viewed another way, this is a positive. It makes a detailed, subtle knowledge of institutional facts a source of comparative advantage.[4] The additional institutional complexity in international research therefore provides both opportunities and difficulties for accounting research, and is yet another reason why we do it.

To Alleviate Some Limitations of Within-Regime Research

By definition, firms within a given financial reporting regime face a relatively homogeneous accounting environment. For example, they share common economic, legal and political institutions, regulatory and litigation incentives, and accounting rules. One implication is that the major influences on financial reporting are expected to occur at the *regime* level. This makes it

[3] The current data integrity policy for American Accounting Association journals can be found at: http://aaahq.org/About/Governance/Policies-Procedures/. The *Journal of Accounting Research* policy is at: http://onlinelibrary.wiley.com/journal/10.1111/(ISSN)1475-679X/homepage/ForAuthors.html

[4] However, my sense is that this comparative advantage is eroding, due to a combination of intellectual arbitrage from adjacent disciplines and declining knowledge of institutional facts among accounting researchers.

difficult or even impossible to observe the effects of these institutions on financial reporting practice: there is little or no variation to exploit in the independent variables.

To illustrate, suppose the researcher is investigating the effect on accounting quality of a single segment of the demand for financial reporting—its use in debt contracting—and is doing so by exploiting variation in the importance of debt.[5] At the regime level, because financial reporting quality is in costly supply, the quantity of resources we observe being put into it should reflect the size of demand. Regimes that are observed to be high debt, (i.e., with larger, better-developed debt markets) would be expected to have greater demand for high reporting quality. Low-debt regimes would be expected to exhibit lower reporting quality, reflecting lower demand for it. Consequently, cross-regime studies have the potential to discover variation in important influences on accounting characteristics such as reporting quality. In contrast, equivalent variation would be less likely to be observed in a within-regime study. Continuing the example, both low-debt and high-debt *firms* in a high-quality regime are held to a similarly high standard of reporting quality. One reason for international research therefore is that many universal influences on financial reporting practice are better identified in cross-regime studies.

The assumption that financial reporting quality is in costly supply, which underlies the above illustrative example of debt contracting effects, warrants further attention. For example, in cross-regime analyses it is easy to overlook the implications of accounting being a costly economic good. This is a potentially important issue for smaller, less wealthy, or less-developed economies. There are substantial *regime-level* costs of developing and operating an effective reporting infrastructure, including securities laws, accounting rules, an independent and effective judiciary, an independent and effective audit profession, professional education, regulatory functions, and sundry monitoring institutions (analysts, rating agencies, press, etc.). Larger, more-developed, richer economies tend to build a high-quality financial reporting infrastructure. Smaller, less-developed, poorer countries cannot be expected to have made the same level of investment in the infrastructure required to achieve high-quality reporting.

There also are substantial *firm-level* costs, including the resources that go into developing and operating high-quality financial information collection and reporting systems, internal controls, internal audit, external audit, board monitoring, etc. The cost of making accruals, such as taking closing inventory counts and making uncollectible receivables estimates, most likely increases in how comprehensive, accurate, and free of management manipulation the accruals are. Fair value gains and losses, including asset impairment charges, involve longer-run cash projections, and the cost of accruing them can be expected to be particularly sensitive to their desired quality. Even counting and verifying cash flows and balances accurately is costly, as exemplified by the Parmalat scandal (in which there were faked sales, cash collections, and cash balances) and the notorious Enron case (in which there were fabricated transactions that affected the classification of cash flows as operating versus financing).

In cross-regime work, it is easy to forget that financial reporting quality is a costly economic good, so the resources devoted to financial reporting should reflect demand, which likely is an increasing function of variables such as size, wealth, trade, and economic development.

There are several options open to researchers seeking to surmount the limitations of single-regime studies. Exploitable differences in regime include public versus private, and for-profit versus not-for-profit. International studies provide a rich lode of alternative options. A major reason for conducting international research therefore is to exploit cross-regime variation in institutional determinants of important properties of financial reporting, such as timeliness, degree of manipulation, and usefulness in various contexts, in order to learn more about the determinants and effects of financial reporting and its properties.

To Obtain a Wider Range of *Changes* to Exploit

Accounting researchers have become more aware over time of problems in identifying causality in simple cross-sectional and time-series research designs. Consequently, difference-in-differences designs have become more common. These designs assume that a particular change in an explanatory variable (e.g., in accounting rules) is exogenous and hence is akin to an experimental treatment effect. The observations that experience the change are the treatment group; those that do not are the control group. Researchers then estimate the effect of this change (the treatment) on an outcome of interest (e.g., information asymmetry in the share market). They do so by estimating the difference between the treatment and control groups in the change in the outcome variable from the pre-treatment period to the post-treatment period. The challenge is finding interesting changes that plausibly can be assumed to be exogenous with respect to the outcome variables (i.e., that affect them only indirectly, through their effect on the explanatory variables). Because more changes can be identified if the researcher scans a large number of countries, international studies play a useful role in these research designs.

[5] This example is due to Ball, Robin, and Sadka (2008).

The adoption of International Financial Reporting Standards (IFRS) by a swath of nations around 2005 has spawned many difference-in-differences designs. It provides a rare "quasi-experiment" with a very substantial change in financial reporting by many countries involving a large number of firms. Despite its inherent attractiveness, IFRS adoption has its limitations as a research topic. Finding reliable, substantial effects is difficult, for a variety of reasons. At this point in time we have only ten years of post-IFRS data, most of which are affected by the Global Financial Crisis and the extended subsequent malaise. Prior research has shown that preparer incentives have an important influence on financial reporting practice, and that incentives are a function of institutional variables that include enforcement regimes (Ball, Kothari, and Robin 2000; Ball, Robin, and Wu 2000, 2003). Consequently, changes made to many countries' implementation mechanisms around the time of adopting IFRS confound the effects of the new standards *per se* (Daske, Hail, Leuz, and Verdi 2008, 2013; Christensen, Hail, and Leuz, 2013; Cascino and Gassen 2015). Many of the effects of IFRS also might be relatively small and difficult to detect. We do not know whether the long-run elasticities will be larger (due to diffusion and other adjustment costs) or smaller (due to initial reactions cooling off). IFRS adoption is an issue on which some researchers might have strong priors or value judgments, thereby coloring their view of the data. All of these factors constrain what we can learn at this point from widespread IFRS adoption.

Nevertheless, IFRS adoption is a historically large change that lends itself to difference-in-differences designs. It illustrates the expanded set of opportunities that international studies provide for such research on important issues.

IV. CONCLUSIONS

So, why do we do international research? For a variety of reasons. Because accounting is an important industry almost everywhere. To better understand others and, in the process, to better understand ourselves. To replicate results obtained in other contexts (some with predicted changes). To exploit international differences in institutional structure to better understand the determinants and effects of national differences in accounting, and to better understand universal issues in accounting. To address the limitations of within-jurisdiction research. To obtain a wider range of institutional changes to exploit. All of which suggest that we live at a high point in international accounting research.

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