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“Enhancing the Interface between Standard-setters and Academic Research”

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Abstract

This article points to gaps between academic accounting research and the knowledge and needs of accounting standard-setters. In part it attributes those gaps to the academic literature seeming to be inaccessible and oriented to ideas apparently unrelated to the policy making issues facing standard-setters.

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As a means of partially reducing that perceived inaccessibility, the paper provides a way for standard-setters to identify and classify the various forms of academic accounting research and academic literature they may encounter so that they can evaluate their usefulness. Two prominent strands of research (agency theory/costly contracting and value relevance) are, as illustrations, analysed so that standard-setters can see how they might approach those strands and any received (due process) views based on them.

Rather than concentrating on how research might be better presented by academics, always a laudable objective, the paper identifies a lack of understanding of academic research as a due process failing of standard-setting - which the authors think should be systematically addressed by standard-setters, with the expert assistance of academic researchers. In other words, it suggests a users' needs/demand driven approach to improving understanding, rather than a supply (by academics) driven approach.

Finally, the paper explains how the performance metrics faced by academics can be inconsistent with the readiness expressed by standard-setters to have academics assist them. The paper provides a suggestion as to how there could be some alignment of academic performance metrics and standard-setters' needs.

1.0 Introduction

The authors are of the view that standard-setters (and, through them, other users involved in financial reporting) can benefit significantly from academic research. We wish to explore ways in which such benefit can be better realised.

Happily, standard-setters are looking for assistance from the academe and are frequently calling for more research input when setting and reviewing standards (e.g., IFRS February 2021 monthly news: 'Focus on academics' at <https://www.ifrs.org/news-and-events/2021/02/february-2021-monthly-news-summary/>). And yet, in the authors' views, there is a gulf between advanced academic research being conducted into accounting and the needs being expressed by standard-setters. Why is this so? We think standard-setters do not give exploration of the advanced academic literature a high priority and so are not well placed to evaluate it, or responses in their due processes that might be influenced by it. This lack of attention might in part be put down to the foci of such research not seeming to be relevant and to the research seeming to be inaccessible. It might

also be observed that the type of research sought by standard-setters (essentially descriptive research) is not rewarding under the metrics for performance used within the academe (i.e., publication in leading academic accounting journals). Essentially, the supply and demand for information needed for standard-setting is mismatched.

We are not suggesting that academic research in accounting should exist for the benefit of standard-setters, but we do think it is a pity that common ground is not found more often between the respective parties. The academe has the research and analytical skills, and the standard-setters need high quality information and analysis with which to make policy.

To hopefully contribute to the finding of more common ground, this article:

- (a) provides academics with information about standard-setters (obtained by surveying many standard-setters);
- (b) provides a way for standard-setters and other users to approach the academic literature, by identifying and classifying the various types of academic research being undertaken. It then explains, as examples, the history and significance of the two main streams of research (agency theory/costly contracting and value relevance) to which standard-setters do see reference or allusion during due process, so that standard-setters can understand the context of those inputs;
- (c) expresses the authors' views about the general usefulness, and limitations, of academic research in the context of the due processes of standard-setters;
- (d) suggests some changes to the due processes and publishing of standard-setters to elevate the importance and understanding of academic research and to improve the chances of academic research useful to standard-setters getting the recognition it should.

In relation to (a), the article reports on a survey of many standard-setters aimed at showing how aware standard-setters are of academic research and academic journals, their views about the impact of that research on their work and their openness to research findings. It also provides some demographics of standard-setters and insights on what standard-setters are thinking about on selected issues; for example, in relation to the role and use of the Conceptual Framework and their motivations for being standard-setters. Hopefully, this will promote more research into the nature of standard-setting – an area somewhat neglected in the literature – thus providing a better basis for understanding the objectives for which standard-setters need research.

Our analysis under (b) may well require development, but it responds to the confusion facing standard-setters when they detect aspects (edges) of certain research without having the benefit of the context of that research and any relationship it has to other forms of research. Like academics, standard-setters need to know what new research is said to be contributing to a known body of knowledge. The trouble is that they do not understand the base knowledge. Therefore, in (b), we cover the history and nature of the two selected forms of research and venture views to illustrate the type of context that we believe standard-setters need when considering academic research in those forms. We would be delighted to see debate about our analysis and about the other types of research identified. We think such debate would provide valuable context for standard-setters use of academic research.

In expressing our views in relation to (c), we try to be realistic about the role that academic research can play. As stated, in our view such research does have an important role to play in the due processes of standard-setting - but it also faces challenges and has limitations. We are of the view that expectations of that role should be tempered and should also be cognisant of the differences in support over time for the various types of research within the academe and between the academe and standard-setters. Mostly, the matters covered under (c) are simply not discussed in the academic or professional literature.

In (d), we make some suggestions to improve standard-setting due process by including direct documentation and evaluation of the types of academic research. This is intended to help build the base knowledge of the various forms of research against which to evaluate new research and to elevate the prominence of academic researchers who assist standard-setters.

The paper is set out as follows: section 2 provides the approach/methodology adopted for establishing the views and needs of standard-setters; section 3 reports on aspects of a large-scale survey of standard-setters and their use of the academic literature; section 4 discusses the main foundations that underpin the two selected major and competing strands of academic accounting research (agency theory/costly contracting and value relevance); section 5 discusses the significance of those strands, and of academic research generally, for standard-setters; and, section 6 provides some suggestions for aligning academic performance metrics and the needs of standard-setters.

2.0 Approach/Methodology

As background to the recommendations in this paper, it has been important to faithfully describe the needs and views of standard-setters. Knowledge of those needs and views has come from three sources. Firstly, the authors are experienced in financial reporting, including having had considerable exposure to practice and standard-setting nationally and internationally. Where an expressed view is based on that experience, we make clear that the views are our opinions. Secondly, the paper also uses selected data from the survey of standard-setters referred to above and outlined below. Thirdly, views come from the academic literature itself and we hope that our referencing of it assists readers, particularly standard-setters, to find pathways to better understand that literature.

3.0 Survey of Standard-setters

3.1 Demographics of Survey Respondents

The survey was administered online and sent to 289 current and past standard-setters from 27 countries and from well-known international accounting standard-setting boards. We received 131 usable responses, a 45.3% return. The survey's coverage of the academic literature was only one of several sections, with the others not being relevant to this article.

We sent our survey to as many standard-setters as we could access from an estimated population of 400 to 600 standard-setters who have served, or are serving, on standard-setting structures over the last 20 to 30 years. Due to the recycling of members, and the periods over which standard-setters could serve, the global population of current or relatively recent standard-setters is not large. Our sample is, therefore, quite large by any standards. We are not aware of any other survey that has reached so many standard-setters.

Table 1 reports the career demographic characteristics of responding standard-setters. The most common background was in auditing (especially with the Big 4). A number indicated they had prior experience as technical staff for a standard-setter. Academic backgrounds explained 10% of cited fields of experience. The three most significant career backgrounds of standard-setters, other than in

standard-setting, are as an auditor (48 percent); as a technical accounting specialist (29 percent) and as an academic (24 percent).

(Insert Table 1 about here)

Seemingly under-represented backgrounds among respondents were those as analysts and as preparers. In the authors' experience, this finding is consistent with the concerns of those charged with finding standard-setting board members when trying to ensure balanced board membership. In other words, our sample is not inconsistent with the population mix to be found on accounting standard-setting boards.

The respondents were typically very experienced in standard-setting and, from our personal knowledge, many were, or are, very well-known figures nationally and internationally. As Table 2 shows, 64% of standard-setters responding to the survey had 5 or more years of service in standard-setting.

(Insert Table 2 Years of Service of Standard-setters about here.)

The survey also revealed that the standard-setters surveyed were well educated, with 42 percent of qualifications held being a master's degree with an accounting major and 61 percent being professional qualifications. 24% of respondents held doctorates. It is to be noted that in some countries, people aspiring to be accountants in practice will tend do so by choosing to qualify through professional body accreditation programmes, while those aspiring to join the academe will tend to pursue academic qualifications. In other countries, an academic qualification is required before undertaking a professional accreditation programme. However qualified, there is no evidence that standard-setters lack the aptitude necessary to appreciate research findings.

3.2 Survey Findings

Table 3 shows the main results from our survey of several questions on the use of academic research by standard-setters on a scale from (1) Strongly Agree to (5) Strongly Disagree. Our first question was: Do you agree that the findings of the main streams of academic research are well known to standard-setters? The most frequent response was *Disagree* (41% of respondents). We also

asked: *Has Academic research had a marked effect on standard-setting?* The most frequent response was, and probably contrary to expectations among some practitioners, also *Disagree* (40% of respondents). Overall, the evidence is consistent with standard-setters not currently using academic research extensively. However, the survey results show standard-setters do have a strong interest in evidence to assist in their decision making. We asked, “*Are Standard-setters increasingly searching for empirical evidence for their decision making?*” The most frequent response to the question was *Agree* (62%).

40% of respondents do not find the academic literature to be accessibly written and understandable. Nearly 34% disagree that the geographic source of data commonly used by academics is relevant to their jurisdiction. Only 27% of respondents agreed that certain US journals, that are often regarded in the academe as the most prestigious journals in which to be published, are well known to standard-setters.

(Insert table 3 about here)

There was little in the survey responses to support the contention that academic research is being as impactful as it might be with standard-setters. This conclusion is supported by the results from the responses to the request “*Please indicate the importance of academic research on the impact on the development of financial reporting on a scale from (1) Very Important to (4) Unimportant.*” The results reported in Table 4 are consistent with academic research being of moderate or limited importance (*Very Important* 8.13%, *Important*, 27%, *Somewhat important* (61%) and *Unimportant* (4%)). In contrast, the due processes of standard-setting, legal precedent and the experiences of auditors are all highly ranked in terms of importance to standard-setting.

(Insert table 4 about here)

Standard-setters have spent long periods developing a (normative) Conceptual Framework for financial reporting. That developmental work has often been very controversial and not heavily impacted by academic research - but has, in our experience, become the lexicon of practice (and teaching).

To provide some insight into the current importance of the normative Conceptual Framework to standard-setters, our survey asked the question: Is having a well-developed Framework the most important pre-requisite for setting good quality standards? The responses reported in Table 5 clearly show support for the importance of the Conceptual Framework with 41% of respondents agreeing and 33% strongly agreeing with this statement. The number disagreeing or strongly disagreeing is small but both notable and somewhat surprising. Nevertheless, for academics to understand the needs of standard-setters they do need to understand the Framework and how it is developing over time.

(Insert Table 5 about here)

More findings about academic research are set out later in this article. They relate to aspects of the two selected forms of research discussed below.

3.3 Conclusions about the Impact of Accounting Research upon Standard-setting.

We believe that our survey supports two of the three reasons we postulated in section 1 for there being a gap between academic research and the needs of standard-setters, namely,

(a) academic accounting research is not generally seen to be oriented to ideas that obviously resonate with standard-setters' needs and can seem impenetrable to those outside the academe; and,

(b) standard-setters do not give exploration of the academic literature a high priority and so are not well placed to evaluate it or responses in their due processes that might be influenced by it.

We will come back to the third reason later in this paper.

Standard-setters call frequently for evidence to facilitate their decision-making, often sponsoring research forums (e.g., those of the International Accounting Standards Board (IASB) and those of the Australian Accounting Standards Board (AASB)) at which academics are encouraged to report on

their research, and through forming academic advisory boards. The Financial Accounting Standards Board (FASB) has an academic paper submission portal to encourage the sharing of views. In our view, there probably has been no more receptive a time for the academe to engage with standard-setters, at least since the end of the price level debate in standard-setting in the late 1970's (which, in our view, marked the end of the era in which the standard-setters looked heavily to leading academics for guidance). From that time, our experience is that topical development within standard-setting (e.g., on financial instruments, business combinations, share-based payments, revenue and leasing) has outpaced academic writing in the areas of interest to the standard-setters.

Despite the expressed need of standard-setters, our research shows that standard-setters are not well-read in the academic literature, are not particularly knowledgeable of those aspects of academic research that could be argued to have led to, or supported, some of their accepted principles or required practices, and are probably not well placed to discern the drivers behind the views of various researchers or due process respondents using the work of researchers. They are, arguably, in this respect, naïve in discerning bias when reading the literature or reviewing submissions based in that literature, or in evaluating merit between competing research views. This could not be said of their ability to detect biases generally – a practised skill set for standard-setters.

In our opinion, the overcoming of that naivety is primarily a responsibility of standard-setters. They need to better understand academic research, just as they customarily do with any other matters (events, transactions or activities) affecting financial reporting and standards. The responsibility to appreciate the environment of standard-setting cannot be passed off to stakeholders (including the academe). This is why due process is extensively used by standard-setters. There will always be a gap between exactly what standard-setters need and the appreciation of stakeholders of that need. As we return to in section 6, we believe that due process is needed to enable standard-setters to directly improve their knowledge and appreciation of the academic literature. In this regard, we are not simply referring to research related to a particular topic on the standard-setting agendas or being considered for inclusion thereon.

4.0 Foundations of Selected Academic Accounting Research – Opening Some Pathways

For those outside the academe, a common view of the academic accounting literature would simply distinguish between that which is normative/a priori and that which is empirical. The former would be associated with standard-setting and professional journals, the latter with academic research (at least since the pre-1980 eras of the famous normative academics). But, of course, academic research comprises numerous strands, each with an important history. One of the objectives of this article is to identify and classify the main strands so that standard-setters can start to understand their context and standing. Standard-setters do see the edges of academic thought in due process responses and discussions. For example, they see commentary about the efficiency of capital markets, sometimes holding it out as a fundamental and at other times indicating it is a flawed notion. They see the importance attached to earnings in capital markets and yet do not favour a single line income statement focus. They have seen calls for asymmetry as a legitimate way to validate choosing between recognition criteria and measurement bases. We will return to these issues later, but the point here is that standard-setters are not, in our opinion, seeing those commentaries in the full context of the underlying theory and research.

Further, when standard-setters and others see the academic literature they are usually seeing articles that are marginal to the body of research to which they are intended to contribute. They also see claims and counterclaims, changing over time, about methodology and findings. Accordingly, to us, it seems important that standard-setters should have a good grasp on the types of research and progress therein.

In our literature survey, we identified the following types of research and attached brief descriptors for each of them:

- (a) descriptive research (documenting incidences, practices, and effects);
- (b) market-based research (investigating how markets operate and absorb information);

- (c) contracting research (investigating the use of accounting information for writing contracts with management, by lenders, and for monitoring management);
- (d) research into the lobbying of standard-setters and the possibility of regulatory capture;
- (e) value-relevance research (investigating the association between accounting information and prices of equities);
- (f) fundamental analysis research (to discern analytics applicable to financial statements information when determining equity prices or assessing performance);
- (g) earnings quality research (studying the management of earnings and the roles of incentives and controls for managers' performance);
- (h) asset-pricing research (understanding the building blocks for the pricing of equities, assets and liabilities);
- (i) behavioural research (studying the interface between human nature and the logic of orderly marketplaces and sometimes looking at the "real effects" of regulation when it changes practices); and,
- (j) what has been termed 'critical perspectives research' that looks for alternatives to conventional theory and practice to consider broad implications of accounting (e.g., the implications of accounting for stock market stability and its role in the management of third world debt).

Others may seek to refine our listing. We hope so. But the above listing by itself does not, in our opinion, provide the context that standard-setters will need to understand the importance of the research involved. But it is a first step in gaining an overview of the academic literature in accounting. Standard-setters need the "story" behind each form of research; its history, its standing and where it is going. They need to know what they can depend upon (even if with reservations).

This paper now focuses on (c) and (e), even though each of the above has a story to tell that could be relevant to standard-setters. The chosen types of research are, in our experience, the ones whose "edges" are most commonly detected during due process by standard-setters.

4.1 Underpinning Academic Accounting Research: Positive Economics and Positive Research

Accounting research can be classified as **positive** or **normative** in nature. The simple explanation of “positive research” is that it involves formulating hypotheses about “what is” and then engaging in empirical testing to see whether the facts support the hypotheses (via the refuting of the null form of the hypotheses). The findings of the research might then be used to further understanding, help predict the future or aid in the development of theory. At this level of description, one can see that “positive research” has a justifiable place across many different disciplines, not just in economics and accounting.

Normative research is concerned with developing theories about how thought and practice should be ordered and developed. This was the stuff of the academic literature for many decades but no longer characterises the current literature.

Standard-setting is a hybrid of normative thinking and empirical due process. But it does not normally engage in positive research in the manner undertaken in the academe. In general, we would consider standard-setting to be normative.

In our view, it should be uncontroversial that the determination of accounting policy or standards could be informed by positive research, if research is well directed and robust. Indeed, Ball and Brown (2014: 34) speak of the ‘misconception that there is little or no overlap between ‘positive’ empirical research and ‘normative’ á priori research’. For example, Ball and Brown (1968) helped reveal the importance of financial reporting data in the market’s determination of equity prices.

Positive accounting research has been conducted for considerable periods of time (since the late 1960’s or early 1970’s). Indeed, it seems that today for an academic to have financial reporting research published in a top (A*) journal, it would be unwise to pursue descriptive research or normative ideas.

A heavy orientation towards US authors, US publications (especially the leading few, between 3 and 6 depending on the preferences of accounting schools) and US data are also characteristics of

academic papers (Merigo and Yang (2017) (Lohmann and Eulerich 2017)). Publishing in the leading US journals is often considered the pinnacle achievement for academic researchers, even if they are not US researchers. Whilst US GAAP and international accounting standards have come much closer together in the period since the formation of the IASB in 2001, in our view, exclusive use of US publications and data can limit its perceived usefulness for the standard-setters around the world and by the IASB, either because of differences in the requirements, because of the way standards are applied or enforced outside of the United States or simply because of limited replication in other environments to corroborate the US oriented findings. In any case, the IASB and other standard-setters need to demonstrate the unbiased application of due process to data relevant to their respective roles. It is unlikely that data from one country would be adequate to conclude on the content of standards globally or in another country.

4.2 Background to Positive Accounting Research – Positive Economics

As stated, two of the most prominent streams of positive accounting research are (i) agency (or costly contracting) research and (ii) value-relevance research. We are of the opinion that users of the literature need to understand the economic origins of the assumptions and viewpoints that underpin these forms of research. Having learned our accounting in Australia from normative researchers like Ken Wright, Alan Barton, Reg Gynther, Bill Stewart and Ray Chambers, we have witnessed first-hand how basic beliefs/ideologies can subtly affect arguments in seemingly unrelated areas. Users of the literature need to know from where views are coming.

This opinion is consistent with the need generally for standard-setters to understand the history and motivations of authors commenting on standard-setting and financial reporting topics. In essence, it is the same need as is reflected when standard-setters seek to master any type of transaction, event or industry activity when devising standards.

4.2.1 The Chicago School

In the academic literature, 'positive accounting' is sometimes loosely attributed to the seminal work of Watts and Zimmerman (1978) on agency/costly contracting theory. The Watts and Zimmerman research is one form of positive accounting, but one which seems to have been very influential in the

academic literature. In this part of the paper, we trace the origins of the Watts and Zimmerman work to provide context for non-academic readers.

The Watts and Zimmerman work referenced, among others, the works of economists Stigler (1971), Posner (1974), Peltzman (1975), Jensen and Meckling (1976). The research of those economists addressed theories of economic regulation (rather than accounting).

Stigler was a key figure in the Chicago School of Economics (the Chicago School), along with Friedman. Stigler, in 1982, was awarded a Nobel prize for his “seminal studies of industrial structures, functioning of markets and causes and effects of public regulation”. Friedman was awarded a Nobel prize in 1976 for “his achievements in the fields of consumption analysis, monetary history and theory, and for his demonstration of the complexity of stabilisation policy”.

Stigler, like Friedman, helped characterise the Chicago School as free marketeers, through the development of price theory and transaction cost economics. Stigler (1971: 3) established the ground for a field of research that saw regulation as operating in a marketplace. He came to the somewhat startling conclusion (at least for standard-setters) that “as a rule, regulation is acquired by ... industry and is designed and operated primarily for its benefit”. He used anecdotal evidence of failures in regulation in certain industries in the US in prior decades to support his case. Stigler’s theory has been given the title of “capture theory” (e.g., Levine and Forrence 1990: 169), alluding to the regulated gaining control, for their own benefit, over the regulator and regulations.

Stigler (1971) argued against what he saw as unnecessary and counter-productive public intervention in markets - which markets, if largely left alone, would solve their own problems, and return to price equilibrium between supply and demand. They saw emergency intervention by Governments as being needed only as rare exceptions to “private orderings” and contended that the operations of the courts could solve most problems.

Of relevance to standard-setters, Stigler rejected the conventional explanation of regulation as being a (justified) public interest response to market failures such as inefficiency or inequity (Posner 1974: 2-3, 14). The notion of serving the “public interest”, as a motivation for regulation, had been a prevailing view until Stigler turned the debate to a consideration of self-interested parties trading costs and benefits in a market. Several economists have also since dismissed the public interest reasoning for regulation (e.g., Peltzman 1975, 677-726).

Despite this attack on public interest, our contemporary research shows that the most common reason for **becoming** a standard-setter is to serve in the public interest **and, with the benefit of hindsight from being or having been a standard-setter**, this rationale only grows in importance. Our survey included the question: *When you first become a standard-setter how important was public interest on a 4-point scale from Very Important to Unimportant?* The results are clearly consistent with public interest being one of the primary reasons for becoming a standard-setter (Very Important (62%); Important (30%); Somewhat Important (9%) and Unimportant (0%)).

Simons (2015: 31) argues that economists have been ‘fixated with the roles and rights of senior executives and shareholders – all working from the presumption of self-interest, opportunism, and effort aversion’. In his view, economists had been ‘captured in one way or another by the concept of self-interest’, an ironical twist to Stigler’s view.

The short story then is that the thinking of the Chicago School has been questioned over time and that standard-setters, if they accepted that regulation through standards should be viewed in the way Stigler suggested, would probably be unneeded. The extreme interpretation of Stigler would be that the free-market participants would solve whether they should choose to report, and if so, how best, when and where, to report on their financial position and performance. Users would, if unsatisfied, have recourse to courts who presumably would each have their own idea about how to resolve the matters before them, until legal precedents emerged that, narrowed the choices.

Courts and regulators have in fact depended on accounting standards, over many years, with litigation often focussing on whether standards have been followed (e.g., when analysing allegations about Enron’s use of off-balance-sheet vehicles and other activities (Enron failed in 2001), WorldCom’s capitalisation of expenses and inflated revenue (WorldCom failed in 2002), Lehman Brothers accounting for financial instruments (Lehman Bros failed in 2008), and Freddie Mac’s misstatement of accounting earnings (leading to significant settlements in 2006-2007)).

4.2.2 Migration of Chicago Economic Thinking to Accounting

The Chicago School economic thinking seeped into accounting research as result of the influence of Stigler (1971), Posner (1974), Peltzman (1975) and others active around the early 1970's (Sterling 1990).

Watts, an esteemed Australian researching and publishing prominently in the US, obtained an MBA in 1968 and a PhD in 1971 from Chicago. He then joined University of Rochester where Jensen and Meckling (1976) were developing their views on the theory of the Firm. Their seminal work is referenced (1978: 133) by Watts and Zimmerman (also from Rochester).

Jensen's alma mater was Chicago where he obtained his PhD in 1968. Meckling worked at Chicago from 1949 to 1952.

The Chicago School and its Rochester émigrés had a common, economic history and orientation. That orientation was carried through from economic regulation into accounting by Watts and Zimmerman (1978). This was somewhat cuttingly described by Sterling (1990: 99) as a 'réchauffé' (rehash), in accounting, of the economics-based empirical literature.

4.2.3 Watts and Zimmerman: Their Core Premises of "Positive Accounting"

Watts and Zimmerman (1978, 1979, 1986) subscribed to the idea that accounting theory is about explaining accounting practice ("what is, is") and, based on knowledge of "what is", developing hypotheses about causal relationships that can be researched. They did not agree with accounting theory being normative – being concerned with what accounting "should be". Indeed, Watts and Zimmerman (as shown in the title of their 1979 work 'The Demand for and Supply of Accounting Theories: The Market for Excuses') disparaged the setting of accounting standards as being a part of a "market for excuses", unscientific and state 'Not only is there no generally accepted accounting theory to justify accounting standards, there never will be one' (Watts and Zimmermann 1979: 301). Watts and Zimmerman saw their theory as being "economics-based accounting theory that evolved from the use of scientific concepts of theory".

Standard-setters need to be aware of how positive research was described earlier in this paper. Sometimes the literature seems to equate “positive accounting” with the Watts and Zimmerman version thereof. In the rest of this article, we add “WZ” when addressing their work or the work of like-minded authors. It is but one form of positive accounting.

The main findings from the WZ research are summarised in a paper by Kothari, Ramanna and Skinner (KRS) (2010: 99-107) in their review of the literature and research on positive accounting (WZ), they conclude that:

- (a) financial reporting is shaped by economic forces that affect the demand for and supply of performance measurement and stewardship;
- (b) conservatism in performance measurement is economically efficient because of the control role of the income statement;
- (c) assets should be under the control of an entity and be both separable and saleable;
- (d) fair values should only be used where there are observable prices in liquid secondary markets;
- (e) standard-setters should not expand fair value measurement into areas such as intangibles;
- (f) the principal role of the income statement is to measure performance for contracting, particularly with management;
- (g) convergence between the IASB and FASB should not be pursued;
- (h) managers, accountants and auditors should determine best accounting practices, rather than regulators (presumably they mean standard-setters are regulators); and,
- (i) the market efficiency assumption used in standard-setting should be abandoned (which seems to be code for opposition to the value relevance school).

4.2.4 Chicago’s Relevance to Accounting Standard-setting?

The question for standard-setters to ponder is whether the very basics of the Chicago School thinking could have been relevant to standard-setting, especially considering the questioning since,

in the economics world, of that School's work.

The WZ positive accounting school depended very heavily on a presumption of self-interest motivating managerial choices in accounting. In turn, it argued this motivates conservative choices for reporting to guard against self-interested behaviour. Watts (2002: 2) states the case that conservative accounting is 'a means of addressing problems due to parties to the firm having asymmetric information, asymmetric payoffs and limited liability'. He concludes that 'conservatism is beneficial from the investor information perspective ... (and) is usually adopted by accounting standard-setters and academics'. Watts expanded on his views in 2003 in two lengthy articles in *Accounting Horizons*. The phrase "usually adopted" comes from Watts' (2002: 2) analysis of certain requirements of accounting standards that could be said to follow conservatism. He states that conservatism is 'the asymmetry in the verification requirements for gains and losses'.

It should not surprise that our research indicates that accounting standard-setters do not accept the view that bias should prevail – which is what conservatism, as defined, would mean. They do not support conservatism as a qualitative characteristic. Our survey included the question: *Are standard-setters committed to freedom from bias in financial reporting on a 4-point scale from Strongly Agree to Strongly Disagree?* In the standard-setters' lexicon, freedom from bias is a qualitative characteristic of financial information if such information is to be included in financial statements. The results, reported in Table 6, are clearly consistent with a commitment to unbiased reporting with 67% agreeing or strongly agreeing with this statement. The number disagreeing is also interesting and probably needs to be explored in future research (along with the variance in views noted earlier about the importance of the Conceptual Framework).

(Insert Table 6 about here)

A significant stream of contracting research examines the role of conservatism underpinned by the hypotheses set out by KRS list in 4.2.3 above. For example, Watts and Zimmerman (1978: 113) argue that conservatism in accounting is due to the needs of owners to control the opportunism of managers. They see benefits in asymmetric recognition of gains and losses, in the conservative

criteria for revenue recognition and in disconnection of the income statement and the balance sheet. They do not generally favour recognition of intangibles, though some have seen the recognition of intangibles in business combinations as some form of consequence of principal and agent dealings.

This conservative view about intangibles stands in contrast to the criticisms of some commentators who think that financial reporting needs to catch up with growing importance of intangibles. For example, the Institute of Cost and Management Accountant's chief executive, Professor Janek Ratnatunga, argued (Banking Day 20 May 2020: <https://www.bankingday.com/cma-chief-calls-for-intangible-assets-fix>) that the relevance of financial statements 'could be enhanced if accounting standards permitted companies to recognise internally generated intangible assets'.

Interestingly, KRS (2009: 106) state that 'conditional conservatism' (i.e., in requirements of standards) 'seems to have a long-run survival value as a feature of financial reporting'. However, they say they have little specific evidence on the costs and benefits of imposing accounting principles in general purpose financial statements versus allowing contracting parties to include these features in private contracts.

Whilst the idea that conservatism in performance measurement is economically efficient because of the control role of the income statement is presented as if scientifically derived, it is not a view that standard-setters would be likely to accept, even if some of those standard-setters would like to see separation of some income and expense items from operating income (into other comprehensive income) because of potential volatility, nature or some other criterion.

From the above, it can be deduced that the Chicago School traditional views about regulation, and especially those of Stigler, are alive and well and that the recommendations of Watts and Zimmerman, and their school's proponents, are largely unamicable with the directions traditionally espoused by domestic and international standard-setters.

Watts and Zimmerman have been criticised for trying to create an image of unquestionable grounding in scientific theory and for inferring that normative theory was 'bad' with no place in science (Christenson 1983: 2) (Whittington 1987: 327). The term 'positive' in positive WZ had been

criticised as being loosely purloined from older and outdated scientific literature that favoured what some would call pure inductive reasoning.

It is interesting that the calling for abandonment of the market efficiency hypothesis appears in the above KRS (2010) list in 4.2.3. Assumptions about the role of market efficiency do exist in standard-setting – as justification for setting standards for informed users and not for ‘mums and dads’. Those assumptions could possibly be traced back to (non-WZ) positive accounting research.

The argument against convergence of IFRS and US GAAP, in the KRS list, seems a step too far from the theory. They may see merit in the arguments for pluralism in standard-setting (Dye and Sunder, 2001. Sunder 2009). Promoting pluralism in standard-setting seems to be at odds with the expectations, of markets and of domestic regulators, which expectations drove the formation of the IASB and were the basis for formulating domestic legal backing for IASB standards generated by a private sector board, aiming at global comparability (Tarca 2020), orphaned at birth and having no legal mandate of its own.

Rather than the existence of contracting being the motivation of standard-setters, in our experience, they generally aim to create an economics-based GAAP in which arcane accounting methods give way to a more fulsome recognition of the economic elements that exist (“what is” should be reported, not under-reported or otherwise misreported). In our view, the more that financial statements reveal the economics of the reporting entity the better as far as most standard-setters are concerned. The recent IASB standards on *Revenue from Contracts with Customers* (IFRS 15), *Leases* (IFRS 16) and *Insurance Activities* (IFRS 17) are the latest pieces of evidence of that thrust.

Holthausen and Watts (2001) think that standard-setters have failed if the above motivation applies and catalogue the situations in which standard-setters have not met their objective. However, as those situations are rectified (e.g., with more comprehensive accounting for financial instruments, revenue or leasing), the positive school (WZ) needs to find a reason for an exception or reinterpretation of their theory. Inevitably “what is” shifts and has shifted enormously since the early 1970’s when the WZ positive school first determined its theory. Why then are standards not regarded as an inevitable part of the market for financial information?

Further, we think it would be very difficult in this era of international standards to make the case that standard-setting had been captured by any industry or stakeholder group. Indeed, there are

many examples of hard decisions having been taken in areas such as stock options, business combinations, leasing, financial instruments and insurance, despite strenuous and well-funded lobbying against what the standard-setters were introducing.

Through the decades of developing accounting standards, we believe that standard-setters have become acutely aware of the problems they cause for themselves when recognition criteria and measurement are approached piecemeal or with arbitrary exceptions. What might be conservative, for example, in liability recognition, may well turn out to be “liberal” when it comes to revenue recognition, when the latter is recognised on a liability release basis. Exceptions, as in lease accounting and consolidations, have led to entities looking for arbitrage opportunities. Historical costing of derivatives or provisions is hardly conservative compared to using current values.

Asymmetry is, in our experience, seen by most standard-setters in their work on qualitative characteristics as the biasing of information and a recipe for unintended consequences.

You can see the dilemma facing standard-setters in trying to understand and make use of positive accounting theory (WZ). At its heart positive accounting:

- (a) questions the very need for standards;
- (b) ignores the role of standard-setters (effectively dismissing them as parts in the captured regulatory process that Stigler predicted);
- (c) ignores standard-setting as a force for improving financial reporting despite the radically improved, standards-induced quality of financial reporting since the 1970’s;
- (d) places enormous reliance on free market forces to improve financial reporting (without evidence that discretion has played a significant role in the development of financial reporting thought in the last four decades); and,
- (e) does not mention the more straightforward possibility that standard-setters are managing change and that they are employing an interactive learning process that manages natural tendencies to resist change - rather than facing up to some theoretical equilibrium reached between owners and managers for contracting reasons.

Standard-setters have seen some people (unconcerned with contracting theory but heavily resistant to change) like the answers from positive accounting and so subscribe to the story. However, it is difficult to understand how standard-setters would pursue conservatism if it were to be the ideal. Should they reinforce the stickiness of recognised liabilities so that revenue recognition is delayed materially? Should they, as KRS suggest, only value derivatives when there is a deep secondary market? Should they return to recognising large amounts for goodwill when the alternative involves valuing intangibles for which there are limited or no secondary markets? Should they require consolidation based only on legal ownership as being the basis for control?

We cannot see standard-setters being attracted to such accounting. And indeed, we doubt that the capital markets or regulators would welcome returning to off-balance-sheet accounting. In our experience, standard-setters do not share what might be described as the cynicism of the WZ positive school and that school's acceptance of the role of self-interest, denial of the role of professionalism, their questioning of the legitimacy of working in the public interest, or their faith in the marketplace and private orderings to achieve improvement locally and globally in the quality of financial reporting. Indeed, in our opinion, standard-setters would think that accounting developments, including the proliferation of IFRS, point to markets operating in quite a different way than the costly contracting model focuses upon. They would not, in our opinion, accept that the trading of costs and benefits between owners and agents, to the extent it exists, should motivate accounting standards aimed at informing users, or that it explains accounting or accounting standards or the trends therein.

Some may see some comfort for conservatism in the relatively recent resurrection of prudence in the qualitative characteristics of both the IASB and FASB. We would argue that two arguments were conflated in the arguments for the change. One line of argument was that accounting choices should be exercised with due care ('cautious prudence') (Wagonhofer 2013: 1). That is really another way of appealing to relevance and representational faithfulness. Standard-setters could accept that view, albeit leading to some redundancy among the definitions of the qualitative characteristics. The other line of argument was that asymmetric recognition and measurement ('asymmetric prudence' Wagonhofer 2013: 1) was desirable (often around the question of fair valuing some financial instruments). We believe that a political choice was made by both boards to reinstate the term

prudence to escape the rhetoric and so that the work on the frameworks could go forward. We have seen no evidence that the second line of argument has been accepted, much less acted upon, when invoking relevance and faithful representation.

Shliefer (2005: 441-442) concluded that the economists in the Chicago School's had "confidence in private orderings and in courts (that was) excessive" and that they "failed to come to grips with the basic facts ... that we live a much richer, more benign, but also more regulated society, and that as consumers we are generally happy with most of the regulations that protect us". We believe that the conclusion applies equally to accounting standards and financial reporting. Standard-setting "is" and "what is" has a reason for being – using the WZ positivist's own language.

In short, we see little that standard-setters can gain from WZ agency/costly contracting research other than perhaps to inform them of tensions that may underpin views expressed to them in due process. But they should be aware that such research is prominent in academic research. We make no comment about the roles such research might play in relation to matters such as internal governance or management of performance. Those areas are beyond the scope of financial reporting per se.

4.2.5 Value-Relevance Research and Standard-setting

We turn now to the second selected strand of academic research – value-relevance.

Research into how capital markets operate dates back several decades. Finance theories emerged in the 1960's and 1970's. A broad term for research relating to accounting's role is market-based accounting research. Value relevance research is one form of such research. Fundamental analysis (listed above, but not pursued, in this paper) is another. Using our generic description of positive research, value relevance research is positive in nature.

Value relevance research rests on two premises:

- (a) efficient markets quickly impound available data; and,
- (b) there is a relationship between the fundamental value of a company and accounting variables.

Among the most important of the academics analysing stock pricing was another Chicago School Professor of Economics, Eugene Fama, beginning with his contribution to an understanding of the efficiency with which stock prices adjust to new information (Fama et al. 1969). Fama has been variously described as the “father of modern finance” (e.g., @chicagobooth.edu) and the “father of the efficient markets hypothesis” (EMH) (e.g., @medium.com/the-capital/efficient-markets-hypothesis). Like Friedman and Stigler, Fama won a Nobel Prize for Economics; in his case, in 2013, for his analysis of stock prices.

The work of Fama et al. (1969) and Fama (1991) suggested that if capital markets were efficient that changes in prices could be traceable to changes in information available to the market. It was a short step from there to questions about which types of information were treated as relevant by markets. Researchers then wanted to see the extent to which that the information came from financial statements and how much of that came because of changes in accounting standards.

4.2.6.1 Ball and Brown

The paper of Ball and Brown (1968) on the impact of accounting numbers was recognised as seminal (1986 inaugural Award for Seminal Contributions to the Accounting Literature, American Accounting Association). As young Australian researchers at Chicago, they were excited by the rapid developments of thought at that school in the 1960s and wanted to engage in research that was positive in nature. They were very conscious of the normative criticisms of financial reporting from leading Australian academics like Chambers, Stewart, Gynther and others, to the point that they summarised the literature of the day as having concluded that “Financial information prepared under the existing reporting rules is meaningless” and that “Radical changes in the nature of financial statement information are required.” (Ball and Brown 2014: 7).

However, they puzzled over the observance that financial reporting had survived for a long period despite the harsh criticisms of (mainly) leading academics (Ball and Brown (2014: 10) They questioned what had enabled this. And they were not convinced of the type of “evidence” cited by academics such as Chambers (2006). So, they set out to find out “what is” – whether financial information was impactful and whether it was timely.

As WZ state themselves, Ball and Brown (1968), provoked “an extensive literature investigating the empirical association between earnings and stock prices and whether earnings have information

content” (Watts and Zimmerman 1986: 38). They labelled this type of research by Ball and Brown as being positive in terms of its investigations into “*why* accounting earnings and stock prices are related and *why* earnings convey information to the marketplace”. But they pointed out that the literature of this type did “not explore why accounting earnings are calculated in their current fashion”. WZ would say that it is their form of positive research and theory that filled this gap.

Ball and Brown (1968) based their work around earnings announcements. Starting with the conventional null hypothesis that accounting earnings did not convey information relevant to stock prices, Ball and Brown rejected that hypothesis because they did find a correlation between news in earnings numbers and price reactions. They were less sanguine on the timeliness issue (Ball and Brown 1968: 176).

After Ball and Brown (1968), there have been many replications and extensions of their research. Ball and Brown acknowledge that statistical approaches and data availability, not to mention computing power, have changed very significantly since their original work. But they see the basics of their research as still being valid.

4.2.7 Appeal of Value relevance research to Standard-setters

Our survey of standard-setters questioned their familiarity with and use of value relevance research. The results reported in Table 7 suggest that while they do not frequently use this type of research, they do have an interest in this evidence. The survey asked: *Have you regularly used this type of research?* The most common response was: *Have not Used* (34%). The survey asked the question, “Do you Consider that it addresses the types of issues relevant to you.” The most common response was: *Agree* (34%).

(Insert Table 7 about here.)

Standard-setters have probably watched from afar as the various value relevance models have been applied, found to be anomalous in some regard and then refined for future research. Indeed, Barth, Li and McClure (2019: 1)) pointed to the role of more accounting variables and which essentially said

that other accounting information was taking up the slack as the explanatory power of earnings' relationship to stock prices fell from about 90% in early years of research to less than 50% today.

Davern, Gyles, Hanlon and Pinnuck (2019: 238, 239) examined the relevance of Australian financial reporting to Australian stock prices and found there was no significant drift away from their explanatory power. In particular they looked at net income and shareholders' equity. They did find GAAP and Non-GAAP measures were complementary (correlational not causal).

In a sense, the methodological refinements to improve value relevance research have been a blocking factor for standard-setters as they have not been able to assess when foundation points have been reached that could be relied upon for developing standards.

The general conclusion to be drawn from value relevance research seems to have remained that earnings announcements affect the stochastic properties of stock prices (mean, variance and serial correlation). There seems to be no evidence in the academic literature to support another basis having a more important role than earnings, which is not to say other information is not value relevant.

It seems that all the models developed in the broader positive school have needed to depend on the efficiency of markets to find a basis from which to detect unexpected returns and so judge the informational content of new data. New data is being assessed relatively to the impact of existing knowledge.

The efficient markets presumption, and the limitations of modelling techniques to reveal causes of price changes over time, have been criticised by various authors. It is not uncommon to see authors questioning the efficiency of markets (e.g., due to observed over and under reactions). The rise in behavioural finance is one source of criticism (Shiller 2003: 102).

Barth, Beaver and Landsman (2001: 82-86) list examples of topics for which value relevance research has been conducted, including:

- (a) the measurement of pension assets and liabilities;
- (b) fair values of debt and equity instruments;
- (c) fair values of bank loans;

- (d) fair values of derivative instruments;
- (e) accounting for intangible assets, such as goodwill, R&D and advertising;
- (f) asset revaluations; and,
- (g) fair values of tangible long lived assets;

This list can be contrasted with that of KRS in 4.2.3 above. The most immediate difference, from the perspective of the standard-setter, is that the Barth et al. (2001) examples are all issues with which standard-setters have wrestled or are wrestling. To the extent new information on these topics suggests evidence of a recalibration, or confirmation, of prices, or irrelevancy for prices, one would expect that the research would naturally be of interest to standard-setters as further information to absorb.

4.2.8 Criticism of Value-relevance

Holthausen and Watts (HW) (2001: 11-20) heavily criticised value-relevance research. HW contend that there are two underlying theories behind value relevance literature; the first to do with how to directly value equity and the second with how to draw out the inputs to equity valuation. They then point out that the FASB's objectives do not include the valuation of equity. Next, they turn to practices and find that they do not support standard-setting and accounting theories in the manner supported by WZ. They proceed to criticise the methodologies of the value relevance school as being applicable only in very restrictive circumstances, that they treat information as being costless and that they allow for no information asymmetry (again harking back to the WZ model). They conclude that 'the theories of standard-setting and accounting underlying the value relevance literature are not descriptive. Even if those theories were descriptive, the literature would fail to meet its objectives due to deficiencies in the valuation models used'.

Barth et al. (2001) responded to the above by listing the various examples cited previously in this paper and:

- (a) asserted that value relevance research, using well-accepted valuation models, does attempt to operationalise key dimensions of the FASB's theory of accounting in the assessment of relevance and reliability (representational faithfulness in the contemporary version);

- (b) stated that the equity valuation of primary focus of standard-setters is equity investment;
- (c) suggested that the possible contracting uses of financial statement do not diminish the significance of value relevance research;
- (d) dismissed the significance for value relevance assessment of the simplifying assumptions used in the valuation models;
- (e) pointed out that value relevance literature can be used to assess the very conservatism that HW espouse;
- (f) stated that value relevance research is designed to show what information is included in valuations and not whether it is useful in the sense raised by HW; and,
- (g) expressed confidence in the ability of researchers to deal with limiting issues that may arise in econometric technique.

The contrast in these two sets of views is stark.

Stepping back from the detail, what would the consequences be for standard-setting of accepting either? Our analysis suggests that value relevance research could have a part to play, because of the relevance to standard-setting of the topics that it addresses, but we struggle to see how WZ positive accounting could be operationalised. Whether or not our conclusion is supportable, again we believe that standard-setters need to understand the academic literature for the two forms of research, and, indeed, for the other forms of research identified in this article.

5.0 Reflections on Usefulness of Accounting Research Generally to Standard-setters

As indicated, our research shows that standard-setters would like to know more about accounting research and how it could be useful in helping them to understand how their decision-making affects the provision of new information – to make financial statements more informative about the economics of entities.

When new or significantly changed standards are being developed, past research may be of assistance (as it was, in the experience of one of the authors of this paper, when the approach to segment reporting was changed to a ‘through the eyes of management model’) (IASB, IFRS 8,

Operating Segments, 2006). However, the standard-setter is often concerned with estimated future costs and assessed benefits that may come. Descriptive research can assist them in sizing application costs, as can the intensive multi-layered due processes used to surface information on those costs and other implications. The missing link is whether the anticipated benefits are likely to be realised. Will the proposed new requirements lead to more informed decision-making by users?

New accounting standards do have (real) effects over time on the views of stakeholders. Standard-setters have experienced, over many years, the ways in which such views change. What might be an area of raging dispute when first tackled can become quite accepted over time. For example, the much-criticised bases of standards proposed by the IASC pre-2001 sometimes became the very bases for some arguing against changes mooted by the IASB post-2001. In recent times, some parties have criticised the move to a property rights approach to accounting by lessees for leases. They have defended the finance/operating lease dichotomy. In the experience of one of the authors of this paper, when the latter approach was originally adopted by the IASC it was highly controversial. Opponents did not want to see lease assets and liabilities recorded even for finance/capital leases.

In Australia, the introduction of the accounting standard for general insurance was highly controversial in the insurance industry – because of it requiring the use of current values. And yet, again in the presence of one of the authors of this paper, a company that prominently led the criticisms when the standard was being introduced, even taking the standard-setter to court, more recently apologised to an IASB board member and supported the work to have the IASB adopt a standard that was not incompatible with the Australian insurance standard.

The IASB faced intensive opposition to the introduction of what were seen as subjective fair value measurements for derivatives. Post the global financial crisis, that criticism seems to have largely evaporated. It is hard to see how historical cost accounting for derivatives could serve any purpose.

The standard-setter is always trying to extend and improve the recognition and measurement of the elements of financial statements, and in more recent times to come to better disclosures (IASB Work programme 2020: *Disclosure Initiative – Targeted Standards-level Review of Disclosures*). They try to do this in the context of the Conceptual Framework. These overall efforts sit behind any one new proposal forming part of a direction. Standard-setters, in our experience, see standard-setting as a change management/educational process and understand that “best solutions” cannot be imposed

overnight. Iterative efforts are needed both for the standard-setter, and users of standards, to learn, change views and to discern a way forward. We have not seen this change management role of standard-setting being explored in the academic literature.

Occasionally, the view is expressed that standard-setters should simply ask users what they want in terms of new information. Research of that type is usually simplistic given the change management context described above for standard-setting and the changing expectations of users as new standards are applied.

It seems to us that accounting research offers standard-setters broad lessons (for example, in the areas cited by Barth et al. (2001) cited earlier in this paper), and perhaps on certain building blocks for a new standard, but will face limitations in contributing, on a timely basis, to the overall development of a nuanced, major new standard.

We would expect that post implementation due process will improve over time and that it will have regard to practical experiences of those applying standards (often focussed on costs), the views of users of the information produced by those standards (those intended to benefit), and on the interrelationship of any new standard with the Conceptual Framework and other standards. Each standard is part of a mosaic. To the extent that accounting research can contribute, Standard-setters have indicated they will be paying attention to it as one source of information and have included literature reviews in post implementation reviews.

The ultimate test for standard-setters would be what to decide if value relevance research findings were to be quite contrary to other post implementation inputs. Of course, inputs are rarely polarised in such a manner. However, our cautionary note is that there appears to an interest in accounting research on the part of standard-setters, but not necessarily a deep conviction.

Changing Drivers for Accounting Standards Not coming from the Capital Markets

Beyond the possible questions about whether the research can generate dependable findings on a timely basis, there are increasing questions about the scope and purposes of financial reporting. Already, the Conceptual Framework identifies a range of users of financial information that extends beyond parties holding equities. Some may argue that information relevant to the pricing of equities may not be as relevant for those users who are not owners.

Then there are many reporting entities that do not participate in the public or private markets for equities. There is a paucity of literature in relation to **public sector** accounting and **not-for-profit accounting in the private sector**, but it is interesting that when there is a relationship between management (governments/fund raisers) and shareholders (taxpayers/donors), with an absence of marketplace, that public sector and private sector not-for-profit accounting standards have also developed in ways like those in the private sector, aiming for improved decision-making and accountability. We are of the view that economic elements are the same irrespective of sector and it is that commonality which is drawing the reporting in various sectors together, albeit with additional requirements where a sector faces a situation not faced in other sectors (e.g., periodic appropriations in the public sector, donations in the not-for-profit private sector, extractive industry activity largely in the private sector and different factors influencing the selection of reporting entities in the public and private sectors). Also, the differences between public sector accounting and government financial statistics (a tool of economists) have narrowed dramatically in recent decades, with the notable remaining area of such statistics using current values comprehensively for measurement. This is further evidence of economic focus bringing the reporting together over time. The IASB (from 2003 re IFRS for SMEs) and FASB (from 2006 for private company financial reporting) have turned their attention to entities without public accountability, often looking to scale down the requirements of accounting standards for such entities. Sometimes this scaling back is being justified on the grounds that smaller entities have different information needs than larger ones, even where they hold assets or liabilities equivalent to those of publicly accountable entities. This might imply that values from capital markets are not the most important drivers of interest.

Currently, we are seeing suggestions that periodic reporting beyond financial reporting should be the subject of standard-setting and that there should be some harmonisation of financial and sustainability reporting (IFRS Trustees of the IFRS Foundation. News and Events. February 2021). Some have argued that reporting should be oriented to multiple concepts of capital (IIRC) that go beyond financial capital. Will accounting research provide guidance for such scope issues in financial reporting?

However, shares, other assets and liabilities do need to be valued in circumstances of considerable uncertainty and for the conducting of transactions with which accounting needs to deal (business

combinations, issuance of stock options etc.). Refinements of methodology in valuing equities, which could stem from value relevance research, may contain useful knowledge for standard-setters.

So, there are many key policy decisions looming for standard-setters. Can academic researchers come to understand the circumstances of standard-setters and provide relevant research findings?

5.1 Other Streams of Research

We have concentrated in this paper on the development of aspects of two of the most prominent streams of academic research in accounting – value relevance and research relating to agency theory/costly contracting. Our survey also looked at the familiarity of standard-setters with work on market efficiency, fundamental analysis, earnings quality and pricing. The responses of the standard-setters showed a lack of familiarity, a lack of awareness of how such research has impacted financial reporting and, it must be said, a lukewarm interest in the research.

We hope further papers might be forthcoming to help standard-setters understand the history of these streams of research and their significance for standard-setters.

But what can standard-setters do themselves to directly tackle limitations in their knowledge whilst sending a message to researchers? We suggest that, over time, each of the main forms of research be made the subject of deliberate due process, involving monographs or discussion papers, exposure processes, public fora, board member forays and board deliberations. As standard-setters approach industry activities (e.g., rate regulation, extractive and insurance activities) they do not depend on their own knowledge, but rather the knowledge to be gained by due process, to which they apply standard-setting knowledge and expertise. We believe the academic literature deserves the same attention. This paper is only a limited analysis of the two selected forms of research. We argue for thorough monographs or discussion papers to be prepared for those forms as well as the others identified.

Our suggestion above is that each strand of research be the subject of due process to generate a maintained, documented history and evaluation for standard-setting purposes, documentation that can be challenged and improved over time.

Accounting researchers can contribute significantly to those efforts as authors and reviewers. But primarily standard-setters need to rectify the level of their knowledge of academic research.

6.0 Performance Metrics

The third postulate in section 1 was that:

“the type of research sought by standard-setters (essentially descriptive research) is not rewarding under the metrics for performance used within the academe (or well regarded by the publishers of leading academic accounting journals)”.

In our view, standard-setters can seem to be ill-informed about the nature of research undertaken and this apparent naivety could be off-putting when an industrious researcher is choosing topics to research. Such a researcher might be uneasy about spending a lot of time and effort if the user (standard-setter) seems not to understand what they are asking, or of the likely limitations of the work requested, or worse, only to be interested in obtaining “supporting” evidence. Moreover, researchers may be loath to produce a detailed research report or monograph that might not help them get published in a recognised journal, especially if the research is classified as being “merely descriptive”.

These questions constitute real and well-known conundrums for academic researchers around the world.

We believe that the standard-setters can provide partial answers to these questions. They can help create performance metrics that will be valued by researchers and the universities that employ them. We have recommended above that visible public policy determinations of standard-setters be explicitly inclusive of ongoing academic literature documentation and evaluation. That inclusivity can be a means of providing prominence for academic researchers, their work and their institutions.

Further, standard-setters can, as they have in the past (e.g., the APB Accounting Research Studies and the AASB Discussion papers and Accounting Theory Monographs), create prestigious commissioned publication series that are widely-read and which are explicitly attributed to the authors concerned. If standard-setters do this whilst also demonstrating their ability to understand the various strands of academic research, perhaps they can dispel the image of being naïve or limited users and become well patronised publishers of academic research.

Authors who show a serious command over the descriptive aspects of transactions, events or industry activities, and who are recognised prominently and supported by the IASB, FASB, IPSASB,

AASB or any other prominent standard-setter, may well be able to gain access to data that may not flow as easily to the academe alone. This should put them in a position to author works that go beyond the descriptive aspects. Academics are well used to protecting the privacy of the data they use.

There are widespread calls by the governments calling for impactful research, including in Australia (e.g., 'Getting More for Australia from our University Research', 26 February 2021 media release, The Hon Alan Tudge, MP, Minister for Education and Youth). The need of standard-setters is to have access to research that helps them to assess past decisions and to make decisions about the future. We believe that authors who can show contributions to policy-making (witness the famous Chicago economists cited earlier and the very well-known authors of standard-setting discussion papers and monographs of the past (e.g., Moonitz, Sprouse and Wyatt for the APB and Kerr, Barton and Bell for the AASB)) will find their research very interesting and quite rewarding.

In turn, we would hope that the diversification in the publication alternatives provided by standard-setters could lead to new journals and revised content for existing journals.

The ideal outcome we would like to see is for standard-setters and practitioners to better understand the motivations for relevant academic accounting research, what is being explored, what is being found and what it means for policy making purposes.

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TABLE 1 Career Demographic Characteristics of Standard Setters

Career	Percent
Full time accounting standard-setter	0.69
Public practitioner - auditor	0.48
Public practitioner - technical accounting specialist	0.29
Public practitioner - other	0.05
General management	0.11
Preparer of financial reports	0.21
User of financial reports - investor	0.07
User of financial reports - analyst	0.06
User of financial reports - lender	0.02
Academic	0.24

Securities regulator	0.10
Other.	0.08

The table reports the percent of sampled standard setters that have the tabulated career. As standard setters could have had more than one career the sum of the percent is greater than 1. N= 131.

TABLE 2
Years of Service of Standard Setters

The table reports the percent of standard setters by years of service on the Board. N= 131.

	<i>1 to 2yr</i>	<i>3 to 5yr</i>	<i>6 to 7yr</i>	<i>8 to 9yr</i>	<i>10 or more</i>
Years of service on Board	0.17	0.20	0.21	0.17	0.25

TABLE 3
Use of Academic Research by Standard Setters

The table reports the descriptive statistics for the response to the question: Indicate the degree to which you agree with each of the following overall statements on a scale from (1) Strongly Agree to (5) Strongly Disagree. The statements are reported at the bottom of the Table. The table tabulates the percentage of respondents in each scale category and the mean response on a scale from 1 to 5. N= 131 for all questions.

	Percentage of Respondents in Each Category					
	Me an	Stro ngly Agre e	Agr ee	Neu tral	Disa gree	Stro ngly Disa gree
The findings of the main streams of academic research are well known to standard-setters?	3.28	2%	24%	26%	41%	7%

Academic research has had a marked effect on standard-setting?	3.2	4%	17	34%	40%	6%
	6		%			
Standard-setters are increasingly searching for empirical evidence for their decision making?	2.4	4%	62	20%	11%	2%
	6		%			
Academic research is accessibly written and understandable?	3.4	1%	14	33%	40%	12%
	9		%			
The data commonly used by academic researchers is usually relevant to financial reporting in my jurisdiction?	3.2		20	42%	34%	4%
	2	0%	%			
The most prestigious journals in which academics seek to publish are well known to standard-setters?	3.2		27	31%	33%	8%
	2	0%	%			
Articles that summarize the research literature on topics are valuable to standard-setters?	2.3	11%	54	25%	8%	1%
	3		%			

TABLE 4

Influences on Standard Setting

The table reports the descriptive statistics for the response to the question: Please indicate the importance of the following in terms of the impact they have had on the development of financial reporting on a scale from (1) Very important to (4) Unimportant. The percentage respondents in each category and the mean response on a scale from 1 to 4. N = 131 for all questions.

	Mean	Percentage Respondents to Each Category			
		Very Important	Important	Limited Importance	Unimportant
Standard-setting	1.36	66%	31%	2%	0%
Auditing	1.86	30%	55%	14%	1%
Legal requirements	1.88	29%	56%	14%	2%
Analysts views	2.35	8%	52%	36%	3%

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Academic research	2.61	8%	27%	61%	4%
Lobbyists	2.68	7%	29%	52%	11%
The text book	2.81	2%	29%	54%	15%

TABLE 5

Importance of Conceptual Framework

Having a well-developed conceptual framework is the most important pre-requisite for setting good quality standards

Percentage Response to Each Category

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
33%	41%	13%	5%	8%

TABLE 6

Standard Setters are committed to freedom from bias in financial reporting

Percentage Response to Each Category

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree
18%	48%	18%	13%	2%

TABLE 7

Usefulness of Value-relevance research

Percentage Response to Each Category

Strongly Agree	Agree	Neutral	Disagree	Strongly Disagree	Have not Used

Q1	2%	25%	20%	16%	2%	34%
Q2	5%	34%	27%	10%	3%	22%
Q3	8%	33%	26%	12%	2%	20%
Q4	5%	35%	33%	10%	2%	15%

- Q1 ■ Have regularly used this type of research
- Q2 Consider that it addresses the types of issues relevant to you
- Q3 Think it is of growing importance
- Q4 Want to become more familiar with this type of research

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