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Effective controls for research in international accounting

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Abstract

Numerous studies have examined the value relevance and other characteristics of international and country-specific accounting standards. This paper evaluates the experimental designs of selected studies with respect to the controls essential for effective research. Both cross-country and within-country research designs share a common need for controls. Perhaps the most distinctive element of effective design in these studies is the control for institutional, cultural, and structural differences between countries. Previous research shows that the key outputs of various country-specific accounting standards are functions of a variety of factors including accounting-related issues, legal origin, shareholder protection, the information environment, financial markets, and enforcement of these standards. In addition, effective studies of country-specific or international accounting principles require control for firm and industry-specific effects and for self-selection bias, as in conventional within-country examinations. When controls are not sufficient, observed differences in the outputs of alternative accounting standards may result from differences between countries or firms rather than from different accounting principles. We review a sample of recent research with attention to these control considerations.

Keywords: International accounting; Controls and value relevance

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1. Introduction

The continuing evolution toward global economic integration has been paralleled by the growth of world-wide capital markets. These trends, in turn, have influenced the move toward common international accounting standards. Numerous countries have joined this trend and in 2005, the European Union required all member countries to adopt International Financial Reporting Standards (IFRS).

Within the US, both the Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) have cooperated in the trend toward common worldwide standards. The FASB, for example, has issued joint exposure drafts with the International Accounting Standards Board that propose uniform accounting principles for selected accounting and disclosure areas. International accounting standards are generally more principles-based and less detailed than US Generally Accepted Accounting Principles (GAAP). This leads some observers to question the relative informativeness or decision-usefulness of alternative accounting standards. Are US standards more informative? Or is the informativeness of financial reports prepared under international standards comparable to or superior to that of reports prepared under US GAAP? If international standards do appear to be potentially more useful, should the US subscribe to these standards? These questions clearly have important implications for investors, auditors, and regulators.[1] Consequently, a considerable body of research seeks to compare the empirical properties of accounting information produced under "home country", international, and US accounting standards.[2] While these studies typically focus on the value relevance of earnings (e.g., Barth et al., 2005), some also examine other properties, such as the extent of earnings conservatism and asymmetric timeliness (e.g., Ball et al., 2003).

A second set of issues relates to the access of foreign companies to US capital markets and the listing of securities on US exchanges. Foreign firms that wish to trade their securities in the US may file financial statements with the SEC that are prepared under either home country or international GAAP. The SEC requires, however, that these firms also file reconciliations of these home country (or international) financial statements to US GAAP. Such requirements are made to increase the comparability of the foreign financial statements to those of domestic firms and to increase the transparency of such statements (assuming that US GAAP produces more transparent financial

[1] For example, international vs. US GAAP can materially affect the information environment for investors, affect audit risk and litigation risk for auditors, and affect the policing of capital markets for regulators.

[2] Throughout the study, we refer to "home country" GAAP as the GAAP of a non-US company's country. For instance, when referring to the home country GAAP of a UK firm, we mean UK GAAP.