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## Reply

# Issues in Cross-Country Value Relevance Studies: Reply to Wilkins<sup>☆</sup>



Stefan Veith<sup>a,1</sup>, Jörg R. Werner<sup>b,\*,1</sup>

<sup>a</sup> Federal Financial Supervisory Authority of Germany (*Bundesanstalt für Finanzdienstleistungsaufsicht - BaFin*),  
Marie-Curie-Straße 24-28, 60439 Frankfurt am Main, Germany

<sup>b</sup> Frankfurt School of Finance & Management, Accounting Department,  
Sonnemannstr. 9–11, 60314 Frankfurt am Main, Germany

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## 1. Introduction

In Veith & Werner (2014-in this issue), we inquire into the sensitivity of findings in comparative international value relevance studies that follow association study designs. Comparative value relevance studies draw conclusions about accounting quality differences across countries. They often also aim to shed light on explanatory factors for accounting quality differences. However, the methodological underpinnings and the validity of inferences drawn from such studies have occasionally been questioned in the previous literature (e.g., Holthausen & Watts, 2001). A fundamental issue is that value relevance is a proxy for decision usefulness, which is regarded as an important objective of

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\* Corresponding author. Tel.: +49 69 154008 838.

E-mail addresses: [stefan.veith@bafin.de](mailto:stefan.veith@bafin.de) (S. Veith), [j.werner@fs.de](mailto:j.werner@fs.de) (J.R. Werner).

<sup>1</sup> Tel.: +49 228 4108 7939.

financial reporting by standard setters (Barth, Beaver, & Landsman, 2001). But this must not hold from an economic perspective since annual reports are not a timely source of information and may have limited information content.

The social value of accounting may thus rather stem from roles such as confirming more timely disclosures of insiders (Ball, 2013). Besides such fundamental criticism, value relevance has also been blamed to be a crude measure for decision usefulness. A compelling argument is that value relevance would be maximal if financial accounting simply reported annual changes in market value. Also, the theoretical foundations of value relevance models are vague, and they are likely not adequate for testing causality. Notwithstanding these concerns, and despite calls for paying more attention to identification of causal relationships in empirical accounting research (Gassen, 2013), value relevance research so far seems to persist as an accepted research design.

Veith & Werner (2014-in this issue) add to the “critical” value relevance literature by analyzing the impact of methodological choices that are deemed to be relevant, particularly in value relevance studies using international samples. We argue that these methodological choices are not just technical in nature, but rather crucial issues for a measure intended to proxy for accounting quality. In the following, we respond to the issues raised in Wilkins (2014-in this issue), particularly by clarifying which design choices we address, how IFRS introduction may interfere with our findings, and by discussing the theoretical underpinnings of testing for an impact of model specification and return window choice.

## **2. Design issues in value relevance studies: do they matter?**

As in any other research design, there are a number of methodological choices that have to be made when estimating value relevance. The literature offers guidance for some of them. Appropriate scaling, for instance, has been discussed intensively (Barth & Clinch, 2009; Barth & Kallapur, 1996; Easton & Sommers, 2003; Gu, 2005). Other issues have been widely disregarded or assumed to be irrelevant. In comparative settings, the number of choices is amplified; also some general ones may become more influential (as findings in Veith & Werner, 2014-in this issue, suggest).

Without claiming to be complete, Table 1 summarizes important choices in cross-country value relevance studies, also highlighting some of the potential issues. Researchers have the choice between event or association study designs; the latter usually do not test causality and are either exerted using the regression approach (by means of price or returns models) or the hedge portfolio returns approach (Panel A). Regarding inputs to these models (Panel B), there is again some discretion: First, one may use normal, weighted, or abnormal returns, either including or excluding dividend payments. Second, the trading days have to be defined for which price information is collected (for models using returns, we would term this the return window choice). Also, scaling of regression variables is an issue — depending on the use of the (regression) return or price specifications. Panel C regards the sample and data used. Particularly the choice of sample countries seems important. Early studies tended to use a relatively small number of countries, and hence potentially over- or understated the total variation across the universe. Also, the observation period may matter, because there are many potential changes over time not only with respect to the accounting rules, but also to the institutional settings in the cross section. To alleviate identification of country-level effects,

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