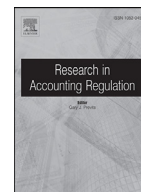




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Developments in accounting regulation: A synthesis and annotated bibliography of evidence and commentary in the 2017 academic literature

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ABSTRACT

In this paper, recent regulation-related findings and commentaries in the academic literature are synthesized in annotated bibliography form. This annotated bibliography is one in a series of bibliographies that summarizes regulation-related academic research. Papers in top accounting outlets such as *The Accounting Review*, *Journal of Accounting Research*, *Journal of Accounting and Economics*, *Contemporary Accounting Research*, *Accounting Horizons*, *The Journal of Accounting, Auditing & Finance*, *Journal of Accounting and Public Policy*, *Journal of Business, Finance & Accounting*, *The Journal of Financial Reporting*, *Auditing: A Journal of Practice and Theory*, *Research in Accounting Regulation* and *Review of Accounting Studies* are included. Threads in the 2017 literature included general regulatory accounting issues, general financial reporting issues, examinations of the impact of specific guidance, and examination of issues surrounding the independent audit.

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Introduction

In this paper, an annotated bibliography of accounting regulation research findings in the 2017 academic literature is developed. Papers from academic outlets such as *The Accounting Review*, *The Journal of Accounting Research*, *The Journal of Accounting and Economics*, *Accounting Horizons*, *The Journal of Accounting, Auditing & Finance*, *The Journal of Accounting and Public Policy*, *The Journal of Business, Finance & Accounting*, *The Journal of Financial Reporting*, *Auditing: A Journal of Practice and Theory*, *Research in Accounting Regulation* and *Review of Accounting Studies* are included. While research in these journals is intended primarily for the academic audience, the findings are relevant to the regulatory debate. To this end, this paper provides a convenient summary and analysis of the literature for practitioners and regulators and a literature overview for students and academics.

Obviously, every paper related to the regulatory debate published in 2017 could not be included. However, those of particular relevance are presented. The 2017 literature is organized as follows:

- Regulation – general
- Financial reporting – general
- Evaluation of specific guidance
- Auditing

Regulation – general

Several 2017 papers assess regulatory activities at the Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) and the results largely support the work of the regulators. Heese et al. provide evidence that the SEC is not a victim of regulator capture by politically connected companies, Edmonds and Leece find that SEC activities tend to relate to companies about which market participants have accounting and reporting concerns, and Bozanic et al. find that the SEC comment letter process leads to improvements in the information environment. Bartov and Konchitchki find that stock prices fall when 10-Q and 10-K releases are delayed, that the price decrease is not always complete, and that the delayed filings are often a signal of deeper operating issues. Wilde finds that whistleblower laws are an effective deterrent to financial misreporting and aggressive tax behaviors. Aobdia and Shroff find evidence that market participants value the PCAOB inspections of auditors and use information in the PCAOB reports. Kim and Klein find a less positive regulatory result. They provide evidence that the 1999 NYSE and NASDAQ rules on

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Table 1
Regulation – general.

Heese, Khan, and Ramanna (2017)	Find no evidence of regulatory capture at the SEC Division of Corporate Finance based on propensity to issue comment letters to politically connected firms.
Edmonds and Leece (2017)	Find that firms that receive comment letters from the SEC tend to be those that investors indeed have concerns regarding accounting quality.
Bozanic, Dietrich, and Johnson (2017)	Find evidence that the SEC comment letter process create improvements in the information environment, which lead to lower information asymmetry, increased analysts following, and decreased litigation risk.
Bartov and Konchitchki (2017)	Find stock price decreases associated with announcement that 10-Q or 10-K filing deadlines will be missed, additional stock price decrease if the grace period filing deadline is missed, additional downward stock price drifts in subsequent periods, and poorer operating performance in current and subsequent quarters for firms that miss SEC filing deadlines.
Aobdia and Shroff (2017)	Find evidence that market participants value the PCAOB inspection of auditors as well as certain of the information in the inspection report.
Wilde (2017)	Provides empirical evidence that whistleblower laws are an effective deterrent for financial misreporting and tax aggressiveness.
Kim and Klein (2017)	Present evidence that the requirement to have a fully independent Board audit committee was not perceived as value-enhancing by stock market participants.

fully independent audit committee membership was not perceived as value-enhancing by market participants (Table 1).

Heese, Khan, and Ramanna

The SEC has regulatory purview over publicly traded companies. The SEC Division of Corporate Finance issues comment letters to registrants when the agency is concerned about some aspect of their accounting. The SEC Division of Enforcement may take enforcement actions related to such issues.

Regulatory agency “capture” is said to exist when a regulatory agency created to protect the public interest instead work in the interest of prominent firms or groups in the industry or sector the agency is charged with regulating. Past research found evidence that the SEC is captured because enforcement actions are found to be less likely for politically connected firms.

Heese et al. (2017) study the relationship between political connectedness (measured as lobby expenditures and political action committee donations) and comment letter receipt from the SEC’s Division of Corporate Finance. The authors control for other factors correlated with propensity to receive a comment letter because of accounting quality and/or accounting complexity (e.g., accounting restatements, internal control weaknesses, financial statement length and complexity, and the number of SEC filings). Using this measure, they find politically connected firms are actually more likely to receive a comment letter from the Division of Corporate Finance.

This result differs from the previous research. The authors examine potential reasons for the different finding. Could it be that both the SEC Division of Corporate Finance and the SEC Division of Enforcement are captured such that the SEC proactively works with politically connected firms in the comment letter state to remediate issues and preempt the need for an enforcement stage? The authors provide theoretical and anecdotal evidence that suggests this is unlikely. Another possibility is that only the Division of Enforcement is captured so that the Division of Corporate Finance that issues the comment letters is unaffected by political pressure. Again, the authors provide reasons this is unlikely.

Another possibility is that the Division of Corporate Finance targets the politically connected firms in the comment letter stage. This could be because political connectedness is viewed by the Division of Corporate Finance staff as an indicator of risk. Under this scenario, the use of this signal would likely lead to less enforcement actions because while relevant – it is not as reliable a measure of likelihood of issues. Hence, enforcement actions are found to not be necessary in more cases. The authors view this as the most likely reason for their finding.

A final possibility is that SEC enforcement action-prone firms are less likely to truthfully report lobbying expenditures and PAC

donations. The authors leave this possibility for future research. Overall, the results suggest that evidence of SEC capture in other studies may be overstated or at least that the relationship between politically connectedness and SEC oversight is more complex than earlier models suggest.

Edmonds and Leece

Edmonds and Leece (2017) point out that the SEC Division of Corporate Finance have a limited budget with which to carry out the oversight function for financial reporting. As a result, to regulate efficiently the Division must invest its time examining firms about which stakeholders have concerns. The authors examine whether the Division appears to do so. The authors identify firms of more concern to stakeholders as those with lower earnings response coefficients. They find that firms with lower earnings response coefficients are more likely to receive a comment letter. The authors interpret this finding as indicating that the SEC is devoting resources to firms that market participants perceive to be of lower accounting quality.

Bozanic, Dietrich, and Johnson

The SEC seeks to ensure that current and potential investors have access to all necessary information about public firms by issuing regulation and then by checking to see if disclosures conform to the regulation. Bozanic et al. examines the extent to which firms modify their disclosures consistent with comments from the SEC and whether any such modifications are significant to market participants. The authors set forth four ways that firms can respond to a comment letter, but not fulfill the requirements. First, they might not respond at all. Second, the firm might promise to revise future filings but fail to do so. Third, the firm might seek to convince SEC staff that revision is actually not necessary. Fourth, the firm might convince SEC staff that disclosure of the information will reveal valuable private information to the competition.

The authors provide evidence that the comment letter process does lead to improvements in firm disclosure. The authors find a positive overall change in their disclosure factor measure following a comment letter suggesting that firms, on average, modify their disclosure following a review. However, firms that make a confidential treatment request on average revise their disclosures less suggesting that confidential treatment requests are frequently honored. Further, firms that negotiated with the SEC about the disclosure (measured as rounds of back and forth) revised the disclosures less. The authors do find that firms requesting confidential disclosure or negotiating heavily with the SEC tend on average to be firms with high proprietary cost concerns such as

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