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Developments in accounting regulation: A synthesis and annotated bibliography of evidence and commentary in the 2016 academic literature

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In this paper key regulation-related findings and commentaries in the 2016 academic literature are synthesized in annotated form. This paper is one in a series of previously published annotated bibliographies published in this journal. Papers published in academic outlets including *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*, and *Research in Accounting Regulation* were reviewed for potential inclusion. The 2016 literature featured strong regulation-related threads as follows: financial accounting regulation, analysis of individual pronouncements, SEC regulatory activity and its impact, international financial reporting standards, income tax reporting, and auditing.

Introduction

In this paper an annotated bibliography of accounting regulation research findings in the 2016 academic literature is presented. Key academic outlets including *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,* and *Research in Accounting Regulation* are reviewed. While research in these journals is intended primarily for the academic audience, the findings are relevant to the regulatory debate. To this end, the paper provides a convenient summary and analysis of the literature for practitioners and regulators and a literature overview for academics.

The annotations are organized according to key themes in the 2016 literature:

- Financial accounting regulation – general
- Analysis of individual pronouncements
- SEC regulatory activity
- International Financial Reporting standards
- Income Tax Reporting
- Auditing

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Financial accounting regulation – general

Several 2016 papers addressed financial accounting regulation in general. Seven relevant thought pieces were published. Sunder examines the issue of creating "better" financial reporting. He defines "better" in terms of attribute-, goals-, and social acceptance-driven measurement. Watts and Zou emphasize that conservatism has been eliminated from the Conceptual Framework of the Financial Accounting Standards Board and International Accounting Standards Board and provide historical perspectives to argue that conservatism is a critical information and governance mechanism. Easton provides a perspective on fundamental analysis research and makes the case for entity level measurement as opposed to measurement at the debt or equity holder level.

Hales et al. synthesize the proposed measurement and performance reporting commentaries from Linsmeier, Marshall and Lennard, and Nishikawa et al. Linsmeier's commentary proposes a revised financial performance reporting model. Marshall and Lennard address recent work by the IASB regarding performance reporting and the selection of measurement bases. Marshall and Lennard distinguish between value added businesses and price change businesses. Nishikawa et al. argue that the IASB Conceptual Framework lacks definitions for net income and other comprehensive income and as a result, they propose definitions for both. Drake et al. find evidence that 10-Ks and 10-Qs from earlier years are sought out and provide information to investors. Cazier and Pfeiffer find evidence to explain the increase in the length of

Table 1
Financial accounting regulation: general.

Sunder (2016)	Examines the meaning of and avenues to "better" financial reporting. Since "better" is contextual Sunder explores the impact of regulation, social norms and market competition in improving financial reporting.
Watts and Zuo (2016)	Highlight the importance of accounting and financial reporting to stewardship and echo a call for standard setters to reintroduce an explicit reference to conservatism into the Conceptual Framework for financial reporting.
Easton (2016)	Argues for accounting measurement and valuation at the enterprise/operating/firm level.
Hales, Rees, and Wilks (2016)	Summarize the perspectives of the perspectives of Linsmeier, Marshall and Lennard, and Nishikawa et al. regarding the issues of measurement and performance reporting.
Linsmeier (2016)	Proposes a revised financial performance reporting model.
Marshall and Lennard (2016)	Provide input to Conceptual Framework debates regarding performance reporting and the selection of measurement bases.
Nishikawa et al. (2016)	Propose definitions of net income and comprehensive income and an approach their measurement.
Drake, Roulstone, and Thornock (2016)	Provide evidence that earlier year 10-Ks and 10-Qs remain useful to investors.
Cazier and Pfeiffer (2016)	They find that operating complexity, disclosure redundancy, and residual disclosure attributed to managerial discretion explain most of the increase in 10-K length and that disclosure redundancy is associated with firm size, leverage, and R&D intensity.
Heflin, Kross, and Suk (2016)	The authors examine the effect of Regulation Fair Disclosure (Reg FD) on earnings forecasts and find managers use MFs as a downward guidance mechanism to meet or beat earnings expectations.

10-Ks in recent years. Heflin et al. find evidence that Regulation Fair Disclosure increased managers' use of management forecasts as downward guidance (Table 1).

Sunder

Sunder examines the issue of creating “better” financial reporting. Policy makers focus on qualitative attributes (e.g. truth and fairness) and statistical attributes. Sunder sees difficulties with each of these elements. First, communicating the monetary amount associated with an asset can be difficult. To make this point he discusses market value and historical cost as measurement methods. Second, in discussing the qualitative attributes he explains that while there are lists of attributes that financial reports should adhere to, there is no list of trade-offs between attributes to assist policy makers. Sunder also offers that disclosures and the statistical attributes of their contents is another approach to defining the meaning of better financial reports. Perhaps the best known of such proposals is a larger correlation—positive or negative—between accounting income and stock market returns to be a measure of better financial reporting under the catchy but misleading label of “value relevant” reporting. Value relevance implies a causal direction, and it may generate statistical correlation, but not necessarily causality.

Sunder calls for a process that begins with goals for financial reporting. Examples of goals include creation of wealth and livelihood, promotion of social cohesion and justice, and creation of markets for certain types of physical, financial and human capital that promote economic efficiency. However, like other such aspirational propositions, a broad agreement on which financial reporting regimes better attain such goals is unlikely.

He also recognizes that financial reporting must serve the goals of individuals. Addressing the interests of various classes of participants in an organization is another approach to better financial reporting. In this decision-making perspective, it is assumed that the participants have their preferences and objectives and they combine these with information from financial reports and other sources to make decisions and solve problems.

Finally, Sunder states that financial reporting can be seen as a social practice or ritual where ritual is defined as: an invariant sequence of actions performed in religious, social, organizational, and individual contexts either without a stated purpose or without an empirically verifiable link to its purported purpose.

The author states that “better” in financial reporting could be defined by various kinds of attributes, social or individual goals, or simply as a social acceptance. It is difficult, even at a conceptual level, to obtain agreement on what kind of financial reports meet the criteria of “better.” Obviously, “better” in financial reporting remains unclear: better in what sense and for who are unresolved issues.

Watts and Zuo

Conservatism has been eliminated from the Conceptual Frameworks of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (FASB, 2010). Watts and Zuo explain how and why conservatism as an information control device existed for centuries, and why conservatism remains a critical information and governance mechanism.

The evolution of Anglo-American accounting and auditing practice reflects the influence of governments and markets. The authors summarize the development of accounting and auditing practices beginning with the corporate governance mechanisms introduced into England by the Norman conquerors in 1066, continuing through eras of economic development, and concluding with U.S. financial accounting in the 1920s before the 1929 stock market crash and the consequent increase in government regulation.

The authors explain that over the centuries, accounting, auditing, and corporate governance were heavily shaped by market forces. In the 19th-century the financial accounting practices of U.K. and U.S. firms featured a higher level of verifiability to recognize economic gains versus economic losses. In other words, accounting was conservative. With the SEC in place, U.S. accounting practice entered the political arena and political lobbying resulted. Financial reporting with a few exceptions became even more conservative primarily due to class action lawsuits (Holthausen & Watts, 2001). The net effect of regulation for decades after the creation of the SEC was to understate corporate earnings and assets.

The authors conclude that the current state of accounting, auditing, and corporate governance is not encouraging. The subprime crisis revealed that the corporate governance of many U.S. banks is poor. Many accountants and auditors seem not to understand that accounting and auditing is to assist in corporate governance. The authors end with a reminder to the IASB that stewardship, prudence and reliability are fundamental to financial reporting. Investors rely on financial reporting in order to hold management to account. Providing information for stewardship must be regarded as a central objective. They urge the IASB to reintroduce conservatism (prudence) into the Conceptual Framework for financial reporting.

Easton

Fundamental analysis studies focus on: (1) accounting for changes in equity values; (2) equity valuation; (3) estimation of the cost of equity capital; and (4) prediction of equity earnings. Easton provides his perspective on the state of fundamental analysis research “because fundamental analysis research is a foundation in accounting yet fundamental analysis studies—related to the measurement of accounting numbers— are a smaller part of the literature than they used to be."