
Introduction to the INTACCT Project

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Training Workshop I
Lancaster University
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Outline

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- Introductions
 - Objectives
 - Training programme
 - Scientific Programme
 - Dissemination

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1. Lancaster (UK)
 2. Tilburg (Netherlands)
 3. Frankfurt (Germany)
 4. HEC (France)
 5. Valencia (Spain)
 6. Cyprus (Cyprus)
 7. Porto (Portugal)
 8. Ljubljana (Slovenia)
 9. Varna (Bulgaria)
 10. Macedonia (Greece)

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- To introduce a pan-European research training programme
 - Early stage financial accounting researchers
 - To implement a scientific research programme centred on International Financial Reporting Standards
 - To produce research useful to and informed by regulators and policy makers
 - To promote empirical study of accounting and financial reporting in a multi-disciplinary context
 - Accounting, finance, economics and law

1. Training workshop 1 (Lancaster)
 - Literature Review, Research Ethics, Project Management, Career Planning, May 2007
2. Training workshop 2 – Summer School (Thessaloniki)
 - Empirical Research Methods, Research Design, Writing-Up Research Proposals, June 2007
3. Training workshop 3 (Tilburg)
 - Data Management and Econometrics, October 2007

4. Colloquium 1 (Frankfurt)
 - Presentation of Research Proposals, January 2008
5. Training workshop 4 (Cyprus)
 - Thesis Write-Up, Research Dissemination, Communication and Presentation Skills, Career Planning, September 2008
6. Colloquium 2 (Paris?)
 - Preliminary Results, January 2009
7. Advanced international workshop 1 (Porto)
 - September 2009
 - EIASM

8. Colloquium 3 (Varna)
 - Presentation of Work-in-Progress, January 2010

9. Advanced international workshop 2 (Ljubljana)
 - EIASM
 - April 2010

10. Colloquium 4 (Valencia)
 - Presentation of Final Research Output, September 2010

1. EAA conferences
 - Rotterdam, 2008
 - Tampere, 2009
 - Istanbul, 2010
 - Symposia and papers

2. Policy conference (London)
 - October, 2010
 - IASB, EFRAG

3. EIASM workshops
 - e.g. Siena, September 2007

Administrative Meetings

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1. EAA conferences
 - Rotterdam, 2008
 - Tampere, 2009
 - Istanbul, 2010
 2. Mid-term review
 - January 2009

Scientific Programme

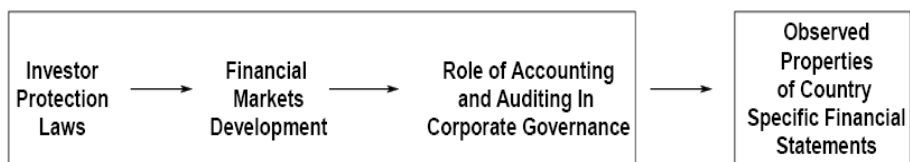
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1. The institutional framework
 2. The IFRS “experiment”
 3. Academic research agenda
 4. Some problems with extant accounting research tools
 5. Concluding remarks

Institutions and Financial Reporting

“First generation” financial reporting and institutions research emphasises accounting as an endogenous outcome depending on law and institutions (e.g. Ball, Kothari and Robin, 2000).

Figure 1

Investor Protection Framework



Source: Francis et al. (2001)

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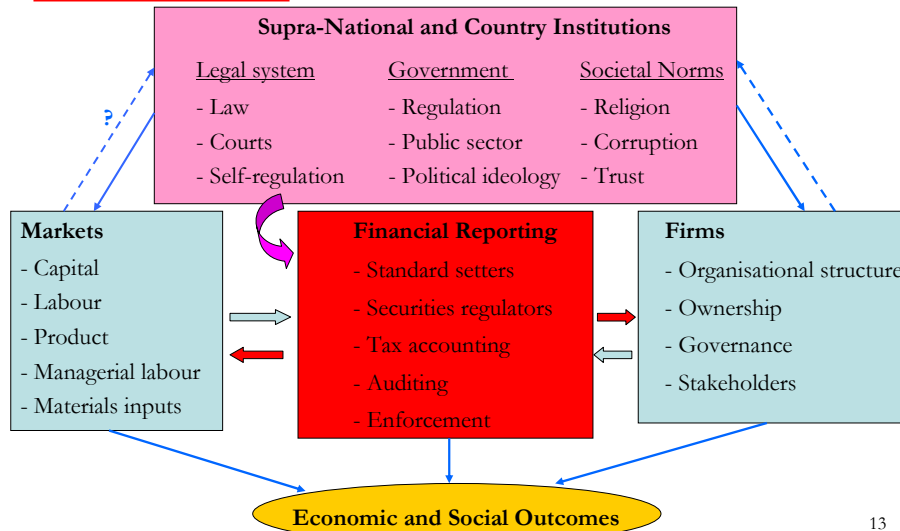
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Institutions and Financial Reporting

- Institutions: constraints shaping human behaviour, formal and informal rules, enforcement (North, 1990).
- But financial reporting regime is not the only endogenous element in the economy.
 - Economic growth
 - Corruption
 - Investor protection
 - Structure of markets, e.g. labour, product, financial
 - Organisational structure
 - Contracting norms
 - Capital structure
 - Private v. public financing
 - Firm performance
 - Accounting choices

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- Many “moving parts” in the system
- What happens if we change just one?
- If accounting rules are endogenous, what is the impact of “forcing” rules to change, holding other institutions constant?
- Will changes in other institutions (e.g. markets) follow as predicted/hoped for by some?
- Given the inter-related moving parts, can we construct unambiguous tests of research questions?

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- Markets in Financial Instruments Directive – MiFID
 - Effective 1 November 2007
 - Part of the EU’s Financial Services Action Plan.
 - Designed to help integrate European financial markets.
 - Sets out detailed requirements governing the organisation and conduct of business of investment firms.
 - Requirements for how regulated markets operate.
 - New pre-trade and post-trade transparency requirements.
 - More extensive transaction reporting.
 - Intended to impact on order flow and liquidity.
 - These are potential objects of interest in accounting studies.

Why is IFRS adoption an “experiment”?

- Economic (and social) consequences are uncertain
- Based on “articles of faith”
 - Transparency and comparability are “good” for capital markets
 - IFRS enhances “transparency” and comparability
 - Cost of capital will fall and investor protection will improve
 - Resource allocation and economic performance will improve
 - “Faith, hope and parity” (Ball, 2006).
- Weak scientific support to underpin some of these claims
 - Ignores institutional economics literature
- Based on strong assumptions
 - Implementation
 - Enforcement
 - User resource allocation decisions
 - Potentially costly consequences can be ignored

Researchers (e.g. INTACCT network) are interested in questions related to the following broad areas:

1. Implementation, compliance and enforcement:

- What is the level of “real” IFRS compliance?
 - How to measure.
 - “Serious” and “Label” compliance (Daske, Hail, Leuz and Verdi, 2007)?
- Does compliance vary?
 - By country, sector, other firm types?
- What determines (non-)compliance?
- Can we detect non-compliance effectively?
 - Disclosures v. recognition rules.
 - Reliance on quality of audit?



Greek woman in empty street in Vienna:

Q. “*We have those signs in Greece – what do they mean?*”

Englishman:

A. “*That’s a European standard symbol meaning no parking*”

Preliminary findings from a personal field study in Greece

“Innovation is important to driving and parking success”.

“If you thought parking is difficult, you should try crossing the road!”

“That [distilling your own liquor] is slightly illegal”.

2. Accounting quality consequences:

- Are earnings more persistent?
- Are analysts' earnings forecast errors lower?
- Is accounting less unconditionally conservative?
- Are earnings more conditionally conservative?
- Is earnings management lower?

Question: Are we agreed on desirable accounting quality attributes?

- e.g. accounting conservatism.
- Representational faithfulness and neutrality.
 - With respect to what economic construct(s)?
- Risk and risk-adjustment.

3. Economic consequences of IFRS adoption:

- Direct capital market impacts, e.g.
 - Market liquidity
 - Cost of equity
 - Cost of debt
- Firm performance, e.g.
 - Investment
 - Operating
 - Innovation
- Stakeholders, e.g.
 - Managers
 - Employees
 - Creditors
 - Government
 - Customers and suppliers
 - Society

4. Emerging Issues in Financial Reporting and Capital Markets:

- Financial reporting and accounting methods evolve dynamically
 - lessons can be learned by identifying “best practice”.
- What approaches are firms voluntarily adopting to resolving current issues of accounting controversy
 - e.g. accounting for financial instruments, reporting financial performance, fair value reporting, financial risk disclosure, hedge accounting?
- How are European SMEs adapting IFRS and does this provide useful insights for the development of IFRS for SMEs?
- To what extent does IFRS adequately reflect non-reciprocal transfers
 - e.g. government/EU grants and subsidies?
- How are EU firms dealing with the two sets of standards (individual vs. consolidated)?

1. Event studies
2. Value-relevance studies
3. Valuation modelling and pricing efficiency studies
4. Accounting choice and earnings management studies
5. Conditional conservatism studies

Application of these “standard” research designs in comparative international analysis involves some potentially important assumptions that might be problematic.

Cost of Equity Effects

- Suppose that greater transparency of IFRS does have cost of equity effects.
- What effects would we expect?

1. Cost of equity lower for all firms?

OR

2. Some winners (R_{\downarrow}) and some losers (R_{\uparrow})?

Conjecture:

Even if cost of equity falls on average, it will rise for some firms.

If true, what are the implications for research design?

Two examples: (i) value-relevance tests; (ii) conditional conservatism tests.

Value-relevance studies

Suppose we consider an experiment along the following lines:

- Regress market value (P) on financial statement variables.
- Before v. after IFRS adoption; or
- Adopters v. non-adopters.

What can we learn from:

1. Valuation coefficients?
2. R-squared/pricing errors?

- Suppose that Ohlson (1995) model is valid.

$$P_t = BV_t + \alpha_1 NI_t^a + \alpha_2 V_t \quad [VAL1]$$

where $\alpha_1 = \frac{\omega}{R - \omega}$, $\alpha_2 = \frac{\omega}{(R - \omega)(R - \gamma)}$ and $R \equiv 1 + r$.

$$P_t = (1 - k)BV_t + k[\phi NI_t - d_t] + \alpha_2 V_t \quad [VAL2]$$

where $k = (R - 1)\alpha_1$, $\phi = \frac{R}{R - 1}$.

- Valuation coefficients depend on three parameters, all of which can (will?) change across GAAP regime.

- Cost of equity is an omitted variable in cross-sectional analysis
 - If variance of cost of equity increases, R-square ↓ and pricing errors ↑.
 - Value-relevance appears to fall.
- Differences in persistence (ω) and timeliness (γ) across firms and GAAP regimes will have unpredictable consequences for valuation coefficients.
- It is going to be very difficult to use market prices to infer anything about usefulness of IFRS.
- These and similar problems apply to direct attempts to infer cost of equity (and changes) from fundamental data (as in Daske et al., 2007).
 - e.g. expected growth, dividend payout parameters.

Asymmetric timeliness of earnings with respect to returns

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S. Basu / *Journal of Accounting and Economics* 24 (1997) 3–37

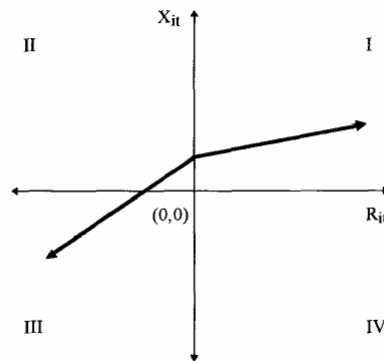


Fig. 2. Hypothesized association between earnings and returns under conservatism.
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- Ball et al. (2000, 2003) assess conditional conservatism as the proportion of total change in market value captured in earnings.
 - Asymmetric timeliness disappears when accounting is mark-to-market.
 - Not clear this is the most obvious benchmark!
- Pope and Walker (1999) assess conditional conservatism as the proportion of change in “permanent earnings”.
 - Estimated slope coefficients and conditional conservatism depend on cost of equity.
 - Differences in estimated conditional conservatism across samples (e.g. countries, GAAP regimes) captures differences in expected returns=cost of equity.
 - If distribution of the cost of equity changes, need to control for cost of equity differences.
- If conditional conservatism is an interesting attribute for study, and if cost of equity changes across regimes, then need to control for cost of equity in order to compare conditional conservatism.

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Concluding Remarks

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- Financial reporting differences are endogenous.
 - Markets respond to accounting differences in sophisticated ways.
 - Complex interactions between many moving institutional parts.
 - Financial reporting harmonization without institutional harmonization could have unintended and undesirable consequences.
 - Reporting incentives and compliance are critical.
 - Testing the effects of IFRS adoption will be tough, but interesting!