

## Research on Critical Issues in Contemporary Accounting

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**Abstract** This paper is a result of survey of contemporary accounting research topics and proposes critical issues in accounting research. This study summarizes the extant accounting research into six major areas and is among the few to recapitulate most important current accounting research topics with a synthetic framework as well as some critiques on missed pieces of the current research. As research indicated, academia closely serves the purpose of accounting practices, which prominently shows in accounting research.

**Key words** Accounting research; Internal control; Accounting quality; Auditing; Accounting internationalization

### 1 Introduction

After the Sarbanes-Oxley Act was passed in 2002 that intended to revolutionize accounting reporting and auditing in response to accounting reporting debacles like Enron, Global Crossing, and WorldCom, top-rated accounting academic journals have published most articles on corporate governance, internal control, accounting irregularities and restatements or aggressive accounting, earning management, accounting transparency, auditing quality and audit independence, and auditor conservatism, among others. All these topics not only bear practical weights and signify implication for regulations and policy settings, but also have much academic indications and propositions. The present research could be classified into the following six critical topics, offer some critiques, and discuss missed pieces. The issues are in the matter of fact interlinked, and thus studies are seen likely to cross the classifications. To elaborate the inter-linkage of the classification, eventually outline a framework that delineates the relationship of the components among themselves and with the outside world.

### 2 Six Critical Issues in Accounting Research

The first critical issue is the corporate governance, and related organizational environment and structure that must be established and maintained to function properly to assure the accounting system operating well and reporting in a timely and regulations-abiding manner. Regulatory authorities' rules and monitoring can also enforce the general business environments (Ball, 2009; Mahoney, 2009; Ashbaugh-Skaife, et al, 2009; and, Stulz, 2009; Holthausen, 2009). As one of the major functions in an organization, accounting must operate in unison with the surrounding environment, and institute well in the organizational environment to maintain high quality of accounting functioning. A number of articles published in recent years investigate the effects of corporate governance and organizational environments on accounting system and accounting reporting functioning and quality. The general findings are that an independent corporate governance structure and healthy organizational environments can significantly improve and maintain accounting system and reporting quality (Givoly, et al, 2010; Campbell, et al, 2009; Magilke, et al, 2009; Katz, 2009; Kho, et al, 2009). Public ownership, institutional ownership (transient or otherwise), and even managerial ownership can influence accounting conservatism and reporting quality. (Lafond and Roychowdhury, 2008; Dikolli, et al, 2009; Givoly, et al, 2010). The eventual effects of healthy environments can transfer into smooth internal controls, the corporate transparency, and efficient company resource allocations. (Francis, et al, 2009; Hoitash, et al, 2009). For instance, one such corporate governance is incentive compensations for management. (Janse, et al, 2009), (Armstrong, et al, 2010), (Laux and Laux 2009) have shown that executives' incentives and compensations are linked to accounting irregularities and internal control effectiveness, and such a result is obvious not only in the US, but also in other countries. Another example is the audit committee of the board of directors. Why is independence and technicality of the committee members so important, and can they be objectively and independently enough to help to maintain internal control systems, and deter violations to internal control functioning? (Naiker, et al 2009), and (Magilke, et al 2009) are among the first to examine the correlation. Dev (2008) is a master

piece on the corporate governance and agency conflict. In short, the environmental factors can contribute significantly to the effectiveness of accounting functioning, and the quality of accounting reporting. The irregularities and aggressive accounting are likely to incur if the environments are weakened, and deteriorate in the aspect of supports and monitoring. These issues will be picked up in a later section.

The second issue is accounting system and internal control systems. Except organizational guarantee, the typical divisions and segregations of accounting functions supply accounting internal checks and balances, which is the first and foremost important front-line of prevention against potential violations and frauds, though collusions and management overrides can easily break down the frontline. According to the current research, professional training, including accounting ethics and professional moral and independence education, can help to but cannot prevent frauds (Prawitt, et al, 2009; Earley, et al, 2008). The implementation of accounting functions is not as evident until the accounting reports are produced and rendered to the public. If we bring in more restrictive requirements of the Sarbanes-Oxley Act, and functioning of internal and external auditing, we would see dramatically more new research topics on their effects on accounting in recent years (Earley, et al, 2008; Badertscher, et al, 2009). However, many studies touching upon the corporate governance and business environments have more or less investigate on the accounting internal system functions. The one main reason is that effectiveness of accounting functioning can be derived from its outcome of financial reports and quality accounting information (Lee and Masulis, 2009). Thus, it is easier to study the outcome of the process, which is often not directly observable or viewable to outsiders, than to investigate the process itself. In general, this area is not yet as much studied as other topics, especially as those discussed below.

The third critical issue emphasizes the accounting measurement and estimations, and the outcome of accounting works: financial reports and their quality. This is the core of accounting research. It is in fact a group of research topics that are composed most of advanced and pioneer studies in modern accounting research. Financial Accounting Standard Board (FASB), accounting academia, and accounting professions have been spending years on testing various possible techniques and ways to improve accuracy of accounting measurements and functionality, and accounting information quality. Accounting publications have been mainly on the various slices of accounting problems that may be raised and warrant answers. Detail splits of this topic can note three typical areas or layers of accounting research: Accounting estimations and measurements, accounting reporting quality, and accounting irregularity and related restatements. Researches on this area were, have been, and will be the main themes of accounting.

Accounting estimations and measurements. Accounting regulations and pronouncements, like those issued by FASB, allow for various methods and estimations for accounting for a type of transactions, say inventories and marketable securities. Many judgmental calls must be made to apply one method over another. (Gigler, et al 2009), (Clor-Proell 2009), and (Gao 2009) found that accounting judgment and method choices can significantly affect accounting information quality. One major issue is the disclosure, either mandatory or voluntary. Recent years have seen more voluntary disclosure, because significant benefits can be resulted from more rather than less of the voluntary disclosures (Bagnoli and Watts, 2007; Kang and Zhao, 2010; Gao, 2008 and 2010).

Accounting quality. How to measure accounting quality and how to improve accounting quality is always an issue in accounting research. (Dichev and Tang 2008) examine the properties of accounting earnings throughout 40 year history for quality related issues. Their findings show that accounting quality has been changing, but the fundamentals are more dependent on the regulations. Consistence of accounting quality can be kept if appropriate policies are implemented in a consistent way. A number of researches have shown that sufficient disclosures can systematically enhance accounting quality. Though accounting conservatism is arguably the important character of accounting quality, research has found that more conservatism in accounting measurements and estimations do reduce low quality accounting reporting. More voluntary disclosures can increase content of quality accounting information. Choices of appropriate accounting methods can also increase accounting quality (Clor-Proell, 2009). Voluntary disclosures and its effects on accounting reporting quality have become one of the recent hot topics. Studies have found the linkage between the improved disclosure and enhanced quality (Francis, et al, 2008, and (Einhorn and Ziv 2008).

Accounting irregularity and related restatements. Accounting irregularity has become one of the most studied topics in the years since the debacles of series of company failures and bankruptcy shortly after the turn of this century. Most of these companies played accounting irregularities, like speeding up revenue recognitions, delaying expense matching or recognition, or intentional misclassifications.

Among the topics of accounting irregularity, the most studied is the earnings management. Earnings management probably has been a few of major accounting as well as non-accounting academic research topics for so many years. Earnings management fundamentally is deviation from Generally Accepted Accounting Principles (GAAP), and violates the principal-agency responsibilities (Kalyta, 2009; Stubben, 2010; Gao, 2010). Studies on the irregularity not only investigate why the irregularity occurred, like management incentives for personal gains, but also probe what techniques were used and how effective these techniques might be (Hribar and Craig, 2007; Kalyta, 2009; Gao, 2010; Leone and Liu, 2010; McInnis, 2010). (Dichev and Tang 2008) provide a good summary for accounting earnings and related issues. (Gu and Li 2007), and Doyle and (Magilke 2009), among others, studied effects of timing of earning announcements on management's disclosure strategies, and credibility of voluntary disclosures. Various techniques applied by companies to maintain information asymmetry. Files, et al, (2009) relate disclosure of accounting restatements caused by irregularities. Jackson and Liu (2010), (Zechman 2010), and (Nikolaev 2010) apply analyses on specific accounts to examine effects of earnings management.

In addition, recent years, managers' forecasts have become more important as the views and knowledge of the management are considered asymmetric information that is not available to outsiders otherwise. (Suijs (008) provides a good study of value relevance of asymmetric financial reporting effects. Beyer (2009), and (Bamber, et al 2010) present important studies on managers' forecasts, and their relationship with accounting quality and earnings management. (Li and Ramesh 2009) examine the event effects of filings with SEC reports. All these studies have shown that the more management forecasts are revealed, the less asymmetric the accounting information may become, and the better quality the accounting report is exposed.

The fourth topic targets internal and external auditing, and related mechanics of monitoring on accounting function. This is another large research area, and it is closely linked to the accounting systems and control examinations. Sarbanes-Oxley Act has special and restrict requirements on internal and external auditing. One of them is that the auditor must maintain independence from material decision-making and operations of the company, and be shed from influences by management. The Audit Committee should be the one to control and supervise the internal auditors and hire and monitor external auditors. Research has found that management can influence or mislead auditors' judgments on internal controls (Wolfe, et al, 2009). Auditors' professional proficiency and conservatism can also act as major factors in audit effectiveness and efficiency (Tong and Sapra, 2009). Research has found that a company must maintain effective supporting systems of audit and other monitoring means to help to provide high quality of accounting information (Dowling, 2009). A number of studies have examined the functionality and effectiveness of internal auditing and external auditing, and their influences on accounting quality improvements (for example, Tong and Sapra, 2009). Most studies can be made as auditing is one of the last preventive screens that can help to prevent accounting from functional failure and providing low quality of reports.

The fifth topic is the relationship between accounting and other disciplines, and uses of accounting reports. The value of accounting all depends on the usefulness of its products to the users, especially by investors, financial professionals, tax authorities, and unions. Throughout many years of accounting history, principles and techniques of accounting have evolved into more adaptive to societal development and economic growth. For instance, historical costs are considered non-economic valuation, and they are likely to distort reporting on fair value of assets and liabilities of a company. However, as historical costs are more reliable and less subjective, they are probably still the best valuation method accounting professions can provide and report on. These past years have witnessed that accounting professions have been trying to balance reliability, which is more acceptable to accounting practitioners, and relevance, which is more tended by other disciplines, like finance and economics. The recent pronouncements of the current Financial Accounting Standard Board have been struggling between the two pillars, and trying to serve the best interest of users of accounting information while keeping up with the accounting theoretical framework, established in its FASC no. 1-6. The current accounting academia follow closely, sometimes even anticipatively study the topics that are or may be interested to accounting regulatory bodies. The interactions between of academia and professionals have demonstrated the best in various topics of this area. (Gao 2010) examines the effects of disclosure quality on cost of capital and investor welfare. (Callen, et al 2009) inspects the impact of earnings on pricing of credit defaults swaps. (Kothari, et al 2009) examines the effects of management disclosure and analysis on cost of capital and return volatility. (Bradshaw 2009), and (Langberg and Sivaramakrishnan 2010) examine the relationship between disclosure, financial regulations and financial

analyses. While (Keung, et al 2010) investigates the effects of changes in earnings on stock market, (Ball and Shivakumar 2008) and (Ball, et al 2009) examine the general effects of earnings on asset prices, and specific usefulness of earnings. (Nekrasove and Shroff 2009) look into the fundamentals to examine the risk measurement in valuation. (Piotroski and Srinivasan 2008) probe the effects of Sarbanes-Oxley Act on cross-listings. All these studies have investigated the usefulness of accounting information, or effects of quality accounting information on the users' decision making. It can be easily observed that as the most likely users of accounting information, financial professions make various adjustments to accounting data before applying them to analyses. Whether accounting formats and presentations need to be adjusted accordingly is a research topic (Ball, et al, 2009).

The sixth critical topic is the accounting internationalization and convergence of accounting standards. In the past, harmonization of accounting was widely applied, and considered a trend of accounting development. The perception is that accounting must be harmonized or converged to make it more useful and widely acceptable to users of different markets or nationals. With internationalization of businesses and investment, internationalization and convergence of accounting has become an unavoidable aftermath of joint efforts of international and national accounting regulatory and authoritarian organizations. The International Accounting Standards Board (IASB), joined with various international and national accounting bodies, has issued a number of standards, interpretations, and framework, in the name of International Financial Reporting Standard (IFRS). At the same time, accounting regulatory bodies of different nations have issued new regulations more intended to converge to the international standards, or simply adopted the standards, while many others have allowed companies from overseas and even domestics to report on the IFRS regulations. For instance, the Securities Exchange Commission (SEC) of U.S. once required to reconcile financial statements compiled with non-US GAAP rules to US GAAP, but now accepted IFRS based financial statements of foreign companies for US stock exchanges listing. Research on effects of convergence on financial statement and accounting report quality has been the most popular issue in this area. Many unanswered topics still exist as countries and different accounting regulatory bodies have taken different attitudes and picked up with various paces for convergences. That having been said, the topics in this area will become more acceptable and published, especially in emerging markets and developing countries. For countries with more advanced and developed in accounting theories and applications, topics in this area may be less intensively studied, as their convergence may not be as extensive and widespread. (Christensen, et al 2009) investigates effects of reconciliations based upon IFRS on quality of accounting information. (Li 2010) has studied the effects of adoption of IFRS on cost of capital. Armstrong (2010) investigates market reactions to the adoption of IFRS in Europe. Their findings are that the results are more apparent for stricter rules and applications. (Daske, et al 2008), (Wu and Zhang 2009), and (Li 2010) observe that both mandatory IFRS reporting and voluntary IFRS reporting have positive effects on accounting quality, especially for those countries that have low or lax national accounting regulations. (Barth, et al 2008) is a master piece on international accounting standards and accounting quality. Their findings have been confirmed by the aforementioned research.

### 3 Conclusion

The critical contemporary accounting research topics that are identified in this observation cover from the fundamental macro and micro environments, to accounting systems, to accounting quality and the related issue irregularity, internal and external auditing that monitoring accounting, and then to the accounting relationship or use of accounting information by other disciplines, especially finance. The last topic identified is accounting internationalization or convergence, which may be a timed topic in the current globalized economic environment. Rather than going genetically, this survey uncovers those areas that have been recognized by acute and securitizing eyes of well-known scholars and academic journal editors. The evidences show that these areas are the most important for current practical purposes, while they also have theoretical implications. The literature search shows that among these topics some have been attended to with more research and more frequent publications, and thus come with more findings. One major such area is accounting internationalization and convergences. Witness is found in more articles that are devoted to inquiries into this area have been more seen in top-rated accounting journals in recent years. Traditional topics like accounting quality and irregularities have been resurrected as the aftermath of accounting frauds and the responding to Sarbanes-Oxley Act. It can be anticipated that these areas will be seen more research and findings in the years to come. A few research topics are, on the other hand, less focused on, like the fundamental environments and its

relationship with accounting functions and accounting reporting quality. One possible reason is that less data are available or they are too proprietary. Only special survey inside an organization can peek into the core of such fundamentals. Another possible reason may be that these characters are hard to be quantified. As modern accounting studies have become more quantified, and quantitative techniques and methods become a benchmark and criteria for publications, normative research has less been seen in topic accounting academic journals. However, lack of such researches and needs for more sufficient understanding of these areas should call for more research. Some other normative oriented accounting or non-accounting journals may see more research findings in these areas.

In short, all the six critical research topics identified in this paper have urgent demand for more research and investigations. More studies on the cross areas and cross topics, even the classifications here, will be easily noted in accounting academic publications in the years to come.

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