"CONTEMPORARY ADVANCEMENTS IN ACCOUNTING AND DIRECTIONS FOR FUTURE RESEARCH"

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ABSTRACT

This study underscores the recent advancements in the domain of accounting and also identifies the opportunities for future research from these advancements. Particularly, this study synthesizes and disuses three contemporary advancements in the accounting area: (i) rising quantum of disclosures in the annual reports; (ii) allowing unobservable inputs in measurement of reported accounting numbers; and (iii) the rise of disclosures accounting numbers which are not based on generally accepted accounting principles (GAAP).

Further, this study proposes various research issues pertaining aforementioned advancements, namely, how disclosure efficiency could be enhance which has been declining with rise in quantity of disclosures in the annual report?, how to audit accounting numbers measurement of which is based on inputs which aren't directly observable?, and how to evaluate authenticity of non-GAAP based accounting numbers?, etc.

Keywords: *Disclosure efficiency, fair-value measurement, conservatism, non-GAAP accounting numbers.*

1. INTRODUCTION

Financial reporting plays an important role in facilitating potential stakeholders atleast investors to decide about whether to provide financial resources to an entity or not. Besides facilitating better decisions, it also enables existing investors in monitoring corporate managers, particularly; about how effectively they are utilizing funds supplied to the entity. It is imperative that financial statements must provide fair view of the economic reality of a business enterprise lack of which could misallocate the financial resources.

In pursuit of discharging the aforesaid two roles, financial accounting has been gradually evolving since many centuries. Accounting domain has experienced significant advancements across a period of time. This study focuses and synthesizes little recent advancement, viz., increasing quantity of disclosures in the annual report, harmonization of accounting standards across the globe through adoption of International Financial Reporting Standards, and the dawn of the disclosure of non-GAAP accounting numbers. But these advancements have

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made financial reports increasingly complex and also provide more potential of managerial opportunism. This paper discusses these advancements and research issues pertaining to it.

This paper contributes to the literature in two ways: First, This paper documents contemporary trends in the domain of financial reporting. Second, it suggests various research issues pertaining to these trends.

The remainder of this paper proceeds as follows: Section 2 exhibit the methodology adopted, Section 3 provides discusses the aforesaid advancements and research issues pertaining these advancements, and Section 4 concludes the study.

2. METHODOLOGY ADOPTED

Critical review of the recent advancements in the accounting domain has been made with an objective of identifying contemporary research issues.

3. THEORETICAL RESULTS

3.1. Efficiency of voluntary disclosure in annual reports

3.1.1. Annual report and importance of voluntary disclosures

Annual Report is a publication issued by the corporation to its stakeholders. It provides useful insights to the stakeholders, regarding the company's performance throughout the preceding year and about its future prospects. Disclosure in annual report may be either quantitative or qualitative; and further it may be of financial or non-financial nature.[1]

Numerous researchers, academicians, and practitioners believe that corporate value is not adequately portrayed through the traditional financial disclosures due to its inability to depict he value generated from the intangible assets. Accounting fails to capture value and importance of the most of the activities related to intangibles of the business like research and development activity, information technology, brands and human resources etc. Author argues that accounting fails to match accurately the cost and benefits of the intangibles and this mismatching has resulted in decrease in the informativeness of the reported earnings (Lev and Zarowin, 1999). This inability has created information asymmetry and this cause impairment to the process of the efficient allocation of the resources on the stock market.

[1] Disclosures in the annual report can be classified into different categories like Regulatory Disclosures (which are compulsory under legal regulations and laws applicable on the disclosing entity; for example disclosure of financial statements is mandatory for corporations) and Voluntary Disclosures (other than the regulatory disclosures i.e. management of an organization make public that information voluntarily); Narrative Disclosures (which are in textual form) and Pictorial Disclosures (involves other than the textual i.e. images, diagrams, charts etc); Operational Disclosure (disclosure related to the operations of the entity) and Non-Operational Disclosures (Disclosures which are not related to the operations of the company like details of Board of Directors of company) (Lee, 1994).

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Voluntary disclosures in the annual report mitigate this problem by capturing some of the value generated by the intangibles. Therefore voluntary disclosures in the annual report supplement the financial information and helps stakeholders in better understanding the organization. In other words, it mitigates the information asymmetry (Wyatt, 2002).

3.1.2. Increasing quantum and declining efficiency of voluntary disclosures

Lee (1994) examined historical changes occurred in the form of corporate annual reporting; between 1965 and 1988 (23 years); of 25 largest British industrial corporations. He analyzed empirical data in three phases 1965, 1978 and 1988 and "page count" technique is used to discover changes in the in the reporting volume devoted to general categories of disclosures (regulatory Vs voluntary disclosures, narrative Vs pictorial disclosures and operational Vs non-operational disclosures). It has been observed that regulatory mean page count increased by 67% (presumably as a result of requirement of mandatory disclosures) whereas voluntary mean count was expanded by 164%; overall change in the mean of pictorial presentation is 233% (compared with the narrative disclosures 138%). This numbers clears that corporations uses of annual report for projecting their image to the stakeholders (with the increase in use of visual techniques) besides to satisfy regulatory requirements for financial disclosures. This evidence suggests that that quantum of voluntary disclosures have been increasing across the period of time.

Whereas, Bloomfield (2012) argued that present disclosures are inefficient. He justified his arguments by stating that regulations are one sided because they encourage corporations to increase the quantum of disclosures, but they fail to discourage corporations to not disclose such information that do not add value to the stakeholders knowledge; and present definition of *materiality* fails to distinguish (disclosures) information which is newsworthy to stakeholder from the information which is already known (prior understanding) to the stakeholders, as a result of which truly newsworthy information is hidden in the haystack of disclosures that provide little value to the stakeholders.

He applied pragmatic theory of philosophy of language in answering solution to the rising disclosure inefficiency. He suggested that such regulations should be enacted which should elevate/promote the newsworthy disclosures that deviates from the prior and thus deserves special emphasis of the stakeholders. This can be done either by creating one separate section in the annual report to depict the most important deviations or by using special formatting within the body of the annual report which would indicate the important deviations (Bloomfield, 2012).

3.1.3. Research issue's in the area of disclosure efficiency

Numerous normative (i.e. what should be) research questions follow from the aforesaid propositions which could be better explored using qualitative research approach vis-à-vis quantitative research approach:

- How the disclosure efficiency can be improved?
- What would be prior understanding level of the diverse stakeholders?

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- What would be the characteristics of a particular piece of information to be called newsworthy information?
- What does a construct "deviations in annual report" means for stakeholders? (i.e. how to operationalize the construct deviation in annual report by considering diverse set of the stakeholders)
- How deviations should be presented in the annual report?
- What would be the characteristics of a particular piece of information to be called newsworthy information?

3.2. Fair value measurements: a new source of accounting-based manipulations

3.2.1. Harmonization of accounting standards

Economies across the world has been deregulating markets and privatizing its public sector. Such initiatives have opened up new opportunities for international investment and international joint ventures/alliances. Accounting plays important role in attaining the objectives of the economic integration.[2] Adoption of International Accounting Reporting Standards (hereafter IFRS) by economies across the globe is a landmark step for reaping the benefits of economic integration.[3] But it is being argued that such benefits are not without cost. Particularly, cost in term of subjectivity being introduced in the financial statements. This is because IFRS are principle-based standard which heavily relies on judgment and estimates.

3.2.2. Fair-value measurements and subjectivity in financial statements

IFRS emphasize "Fair Value Accounting" i.e., showing number of assets and liabilities in financial statements on fair value. Fair Value is amount that would be obtained for an asset in an arm's-length exchange transaction between knowledgeable, willing parties. It means that value will be determined on the basis of transaction between the market participants. This is a measurement attribute upon which IFRS is based. The fair value accounting allows to consider three types of hierarchical inputs (information) to measure fair value of a particular transaction- level 1- quoted prices for identical assets or liabilities in the active markets; level 2- quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets in markets that are not active; Level 3- unobservable inputs for the asset or liability based on the best information available. Studies have pointed out numerous areas in the GAAP which accounting manipulations are higher likely to occur (see Hepworth 1953;[4] Sherman and Young 2001[5]). Another potential evolving area which will

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[2] European community, have emphasized on major program of harmonization. Thus to attain the objectives of economic integration measures were undertaken to coordinate company law, accounting, taxation, capital market and monetary systems in EC.

[3] Common accounting practice across the economies will facilitate comparability of financial results of companies of different economies which will in turn promotes cross-border investments and also saves time and cost which globally operating companies have been incurring in complying with the GAAP of the different economies.

[4] Author points out the accounting techniques which could smoothen the income: First, gross revenue manipulation; Second, deferred charge and intangible asset accounting; Third, inventory accounting; Fourth, property accounting; Fifth, reserve accounting; and Sixth, treatment of non-recurring charges or credits.

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increase the likelihood of accounting-based manipulation is fair-value accounting. The justification of this proposition lies in the potential misuse of the aforesaid hierarchies in deriving fair value measurements; and the brief exposition on the same is provided in the following paragraph.

Measurement become complex when market participant for a particular transaction doesn't exist and firms resort to Level-3 inputs which are not directly observable in the market. Here IFRS emphasize need for "hypothetical transaction assumption" i.e., to assume hypothetical transaction occurred in hypothetical markets. Defining such hypothetical market participants and hypothetical markets is difficult and further this differs due to the different perceptions of different accountants. Thus, it leaves lot of gray area where manager's may rigs this allowed flexibility and could deliberately make accounting numbers in the financial statements more subjective.

Allowing such discretionary inputs for fair value measurement will depart accounting from one of the historically important concept of conservatism, which requires higher degree of verification to recognize gains vis-à-vis loses. Watts (2003) argue that if regulators and standard setter try to eliminate conservatism from the financial reporting without understanding its benefit, the resultant standards are likely to be seriously detrimental to financial reporting. They also argue that allowing unverifiable estimates of accounting numbers will make accounting venerable to manipulation. This concern reinforces in the findings of Joe, Vandervelde, and Wu, (2017) who documented "…significant management bias and opportunism around the discretionary inputs of audited complex estimates, including fair value measurements…" Particularly, they argue that discretionary inputs adversely affects the auditors ability to audit fair value measurements and "…there is the potential for management to manipulate the evidence they provide to auditors to distract auditors from testing the discretionary inputs to complex estimates that are susceptible to management opportunism". Such opportunistic managerial behavior could impose significant costs on investors and economy in general. The other potential areas in IFRS which offers plenty of discretion to the managers to exercise their judgments like-revenue recognition, hedge accounting etc. and are likely to enhance accounting-based manipulations.

3.2.3. Research issues derived from the above perspectives are as follows:

There is need to empirically investigate the impact of IFRS adoption on the earnings conservatism as a dimension of reporting quality. Specifically, the association between discretionary inputs used in fair value measurements and its impact upon conservatism level of reported accounting numbers. Further, this issue could be examined for specific IFRSs like IFRS 15- Revenue from Contracts with Customers; IFRS 9 Financial Instruments etc. Findings on these issues will highlight the standards which exhibit least conservatism and will be useful for standard setters in issuing timely guidance to circumvent the potential manipulations.

What is the impact of IFRS on the quality of accounting earnings reported in the financial statements? What is impact of IFRS adoption or convergence to IFRS on the choice of earnings management strategies adopted to

[5] Author's identifies six areas where accounting manipulations are higher likely to occur: First, revenue measurement and recognition; Second, provisions for uncertain future costs; Third, valuation of assets; Fourth, treatment of derivatives; Fifth; related-party transactions; and Lastly, information used for benchmarking performance.

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smoothen the income? Will IFRS-based accounting earnings predict future corporate performance of the firm? How auditors will respond to the need for the development of the innovative ways to deal with the issue of being unable to express an opinion on future oriented information? How will auditors' requirements around auditability influence internal processes, information gathering and the provision of evidence in support of increasingly future oriented disclosure? These research questions needs to be answered so to extend the frontiers of accounting knowledge and findings will be useful to the standard setters while formulating accounting principles.

3.3. Rise of non-GAAP Disclosures.

Sherman and Young (2016) argue that neither the financial reporting is fulfilling its primary objective "…to make intelligent estimates of the magnitude, timing, and uncertainty of the future cash flows" nor the information content of the accounting numbers are reflected in the current stock prices. One of the important reasons for this failure is that financial reports don't exhibit the intangibles of the enterprise.[6] This issue is more pronounced in tech companies. Gap between their earnings and stock prices is widening. In order to depict the reality, these companies are increasingly disclosing non-financial measures and non-GAAP based accounting numbers in their annual reports so as to convince the users that their business still has a value despite of absence of profits. For example, (i) in 2014, Twitter reported GAAP loss per share $ (ii) in 2015, Amazon reported GAAP earnings per share (EPS) of $0.37 and non-GAAP EPS of $4.14.

3.3.1. Research issues pertaining to the non-GAAP and non-financial disclosure:

Several classic studies examined issue of earnings-price anomaly, particularly, the relationship between reported accounting earnings and stock prices (see Ball 1968; 1992). It is being argued that the importance of this issue is reinforced with the rise of the disclosures of non-GAAP measures. Specifically, research issue is that whether non-GAAP based numbers and other non-financial measures better predicts future abnormal stock returns vis-à-vis GAAP based accounting earnings/ratios. It is important to examine this issue so as to validate the disclosure of non-GAAP measures.

4. CONCLUSION

This study concludes that the pursuit of providing more quantity of disclosures to the stakeholders is leading them to the state wherein it becomes difficult to find decision relevant information among the haystack of disclosures. Further, in pursuit of providing more relevant accounting numbers enhances the potential for managerial opportunism. Lastly, GAAP inhibits the corporations to reveal their true value. Research questions enlisted in the previous section pertaining to these issues are important to examine and their findings could provide useful basis to the standard setters while formulating new accounting principles.

[6] Becker, Brain, Huselid, and Ulrich (2001) argue that upto 85 percent of a corporation's value is based upon the intangible assets. Kaplan and Nortan (2004) argue that intangible assets- those not measured by company's financial systems, account for more than 75% of company's value.

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