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COMMENTARY

Katherine Schipper

Katherine Schipper is a Professor at the University of Chicago.

Academic Accounting Research and the Standard Setting Process

I. INTRODUCTION

The purpose of this paper is to contribute to the discussion of the potential and actual relevance of academic research to the accounting standard setting process. This paper is a compilation of my own views and those of selected individuals involved in accounting research, accounting standard-setting, and professional practice.¹ I took this approach in order to present a multilateral perspective on two questions of interest: whether, and how, the standard setting process might benefit from the participation of academic accounting researchers; and whether, and how, data access and data availability affect this potential.²

Although my primary focus is the standard setting process, I include an example relating to auditor legal liability to illustrate several practical concerns about the flow of information to academic researchers. Because the focus of the paper is standard setting, I do not consider a number of important accounting research areas that arguably have, or could have, substantial relevance to some aspect of the practice of accounting, including audit judgment research, the acquisition of expertise, distinctions between the investment and stewardship uses of accounting numbers (except as these research areas impinge on standard setting), tax accounting, and the uses of accounting data for certain internal purposes, such as cost allocations. In addition, I do not consider in any detail research approaches

other than those based on empirical-archival methods, although it is certainly my view that research which uses other approaches can substantially benefit the standard-setting process.

This paper proceeds as follows. In the next section, I describe the attributes of policy-rel-

¹I did not attempt to conduct a systematic survey, so there can be no assurance that the views expressed in this paper reflect a consensus among academics, standard-setters and practicing professionals. Also, none of the persons with whom I spoke is in any way responsible for the statements made in this paper.

²By "participation" I mean both direct participation in research projects undertaken by the FASB and other groups interested in the standard setting process and indirect participation by means of conventional academic research.

This paper was prepared at the request of the planning committee for the third Financial Reporting Research Conference, for discussion purposes only. The paper has been revised in light of comments made by participants at that conference. In addition, I have benefited from discussions with Philip Ameen, Rick Antle, J. T. Ball, Mary Barth, Dennis Beresford, Robert Bushman, Fischer Black, Joel Demski, John Fellingham, Daniel Filiberto, Jennifer Francis, Steven Huddart, Todd Johnson, Richard Lambert, David Larcker, James Leisenring, Timothy Lucas, Silvia Madeo, Donald Nicolaisen, Patricia O'Brien, Zoe-Vonna Palmrose, Krishna Palepu, Richard Sansing, Charles Smith, Lenny Soffer, Shyam Sunder, Larry Tomassini, Linda Vincent, Peter Wilson, Amir Ziv, and Mark Zmijewski. The ideas in this paper have been shaped by the presentations and participant comments at the 1993 AAA Corporate Accounting Policy Seminar.

evant research, that is, research that is, or might be, relevant to accounting standard setting. I also discuss characteristics that distinguish academic accounting research efforts, and describe what I see as the consistencies and inconsistencies between these characteristics and the attributes of policy-relevant research. The third section describes where in the standard setting process academic researchers might make a contribution and, by implication, where they most likely cannot contribute. The fourth section uses several examples to illustrate how data access/data availability limitations place constraints on the scope of academic researchers' contributions to the standard setting process.

II. DISTINCTIONS BETWEEN POLICY-RELEVANT RESEARCH AND CONVENTIONAL ACADEMIC ACCOUNTING RESEARCH³

In this section I will first describe and contrast what I see as the underpinnings of policy-relevant research and conventional academic research. The second subsection focuses on specific attributes that, in my view, distinguish the two types of research.

Overview of Distinctions Between Policy-Relevant Research and Academic Research

As a general matter, I take relevance to imply the quality of bringing evidence to bear on specific instances of interest, or, alternatively, the quality of providing evidence that tends to resolve (in the sense of proving or disproving) some matter at issue.⁴ In accounting standard setting, the instances of interest and the matters at issue are proposed accounting rules that specify either recognition practices or disclosure (i.e., reporting) practices or both, along with a set of measurement rules or guidelines. The idea of bringing evidence to bear implies that policy-relevant research will tell the standard setter something about a proposed standard which will shift (or solidify) his beliefs about that proposal.⁵ The question then arises, what might that something be? I believe the answer to this question depends

in turn on the kinds of questions standard setters must answer.

My view is that standard setters ultimately must answer a normative question: should a given item be disclosed; if the answer is yes, then should the item be recognized or placed in the notes. In either case, the standard setter must also specify when in an ongoing economic process disclosure or recognition should occur (a timing issue) and he must provide measurement rules or at least measurement guidelines. Given these specifics, it would appear that policy-relevant research brings evidence to bear on whether, when and how a given item should be disclosed (where "how" includes the system of measurement as well as the reporting versus recognition distinction). Viewed this way, relevant research (from a standard setter's perspective) is also sometimes referred to as *ex ante* research.

Ex ante research can perhaps be most easily described by reference to its opposite, *ex post* research. The former deals with an item the standard setters are considering or will consider; the latter uses results of previously-promulgated standards as an input to the research analysis. In the context of the preceding discussion, policy-relevant *ex ante* research should ideally treat the item being studied in a way that provides the kind of evidence or insights sought by standard setters. Dennis Beresford, Chairman of the FASB, identified three kinds of evidence that might be sought on an *ex ante* basis by standard setters: how would reported results change un-

³The descriptions of "relevance" and "ex ante research" in this section are based on discussions with several persons involved in the standard setting process. Thus, the descriptions are intended to capture the standard setter's perspective.

⁴Leisenring and Johnson (1994) distinguish between relevance and usefulness by pointing out that relevant research won't be used in the standard setting process unless it is understandable (and understood) by standard setters. They point to the use of mathematical and statistical research approaches as impediments to understandability; I discuss this concern in section III.

⁵A standard setter might also use research findings to convince others of the correctness of his position on some matter at issue.

der the proposed standard; how would corporate actions change under the proposed standard; what might be the effects on users' (investors') decisions under the proposed standard.⁶

My discussions with persons involved in the standard setting process elicited several examples of relevant *ex ante* research. A number of these fall into two broad categories: the delineation of possible alternatives generally, and the calculation of (simulated) reported numbers under specific reporting regimes. An example of research in the first category might be an enumeration of the possibilities for reporting various financial instruments; preparing such an enumeration would presumably first require a categorization of the many such instruments into a few groups based on their fundamental economic characteristics. An example of research in the second category is the calculation of employee stock option values under various assumptions about exercise dates and other practical considerations (e.g., vesting) that capture departures from the valuations implied by the Black-Scholes options pricing formula.

How well does conventional academic research conform to these characteristics of *ex ante*, policy-relevant research? Probably not very well, for at least two reasons. First, much empirical academic accounting research is devoted to exploring questions related to the description of an existing situation (what are the relations among things) and explanations of existing situations (why things are as they are). This research by definition requires data which describe an existing situation. Second, the descriptive-explanatory focus of academic accounting research does not necessarily fit with the normative questions faced by standard setters. I refer to the descriptive-explanatory perspective as a social science perspective, as opposed to a social engineering perspective, which would consider how things should be.

The descriptive—explanatory nature of much academic accounting research means that a person wishing to use such research to settle a normative issue must supply a nor-

mative criterion, since the research in general does not. For example, academic research might tell us whether a particular accounting number seems to be statistically associated with share prices or returns, but the research cannot, by design, tell us whether the item should be recognized in the financial statements or disclosed in the notes. It cannot, by design, answer questions about the appropriate measurement rules to be applied. The reason is that the academic research consciously and deliberately lacks a normative criterion on which to base a standard setting decision.⁷

Specific Distinctions Between Policy-Relevant Research and Conventional Academic Research

Given my own understanding of the standard setting process and in light of the views expressed by standard setters both orally and in their published writings, I believe that policy-relevant *ex ante* research would have four qualities. The first is immediacy—the FASB wants research it can connect immediately and directly to the topic at hand while it is considering (or deciding whether to consider) that topic.⁸ The second quality (which could be in conflict with the first) is a comprehensive analysis of the entire issue, all at once. The third quality is a sort of conclusiveness, a freedom from multiple interpretations—

⁶Mr. Beresford distinguished between *ex ante* and *ex post* research in the following way. He identified the former with “what is going to happen if the proposed standard is adopted?” and he identified the latter with “what has happened now that the standard has been adopted?”

⁷I do not mean to imply that social-science based research is entirely free from values or normative criteria (or debates about these). I believe, however, that the values and normative criteria associated with social science research are distinct from and largely irrelevant to the task of selecting a normative criterion for evaluating and choosing among alternative accounting standards.

⁸Given the length of the standard setting process in some cases, the window for immediacy could in principle be as long as several years. It still seems likely, however, that the FASB would prefer to have inputs earlier rather than later in the process, whatever its length.

equivocal discussions and qualified conclusions are less likely to be regarded as useful than are definite statements. The fourth is an emphasis on the answer to the question, as opposed to the specifics of the approach used to arrive at the answer. Taken together, these qualities imply that relevant research would take the form of a timely and unequivocal report on the entire issue at hand, with emphasis on the answer (i.e., the explicit or implicit recommendations). In the remainder of this section, I will discuss how well conventional academic accounting research conforms to the model implied by these attributes.

Immediacy seems to relate to the timeliness of the research findings in the standard setting process. That is, the standard setter wants the information before he has to make a decision (and he wants the information to be tied closely to the issue which will be resolved by the standard).

Initially, the distinction between research which has immediacy and all other research may seem clear. In my view, however, this distinction (which is also a distinction drawn between *ex ante* and *ex post* research) may in fact be idiosyncratic to the person who is reading the research, and not intrinsic to the research itself. An example, provided by both Professor Mary Barth of Harvard University and James Leisenring of the FASB, concerns the relation between *ex post* research on the value-relevance of pension cost measures and the debate over disclosing other post-employment benefits (OPEB). Under the assumption of economic similarity between the two types of obligations, the value-relevance of mandated pension disclosures is used to support arguments for disclosing the other post-employment benefits.⁹

The analogy between pension cost and other post-employment benefits is clear and the relation is direct; it is relatively easy to see the *ex ante* nature of the *ex post* pension research for the OPEB issue. I believe, however, that *ex ante* lessons can also be gained when the link is much less direct, as long as the research has considered questions with substantial economic similarity to the issue at hand.

My argument about the *ex ante* value of accounting research rests on a form of external validity, or generalizability. That is, the implications of a given piece of research are potentially applicable to other accounting issues if the research design captures features common to a number of issues, so that the findings and conclusions are not mostly idiosyncratic to the setting examined. For example, if research about the adoption and use of LIFO inventory accounting provides empirical regularities that apply generally to situations where the financial accounting treatment of a tax-advantaged business activity leads to income statement disadvantages, that research contains at least some information that is on point for other accounting debates over the income statement treatment of tax-advantaged activities. If, however, the findings of LIFO research are confined to the accounting choice effects of the 1974 shift in anticipated inflation, then it is not so clear that the research is *ex ante* relevant to other debates.¹⁰

The comprehensive treatment approach to an accounting issue (which, I have argued, is a key attribute of policy-relevant research) is most likely in conflict with the incrementalist approach taken by social-science based accounting research. That is, academic researchers tend to focus on a segment or aspect of a broad issue, building on, and in some cases questioning, previous work. This focus is due in part to design issues; it is in general not possible to design a single study, whether analytical, empirical-archival or experimental, that investigates more than a slice of a given problem. Given this attribute, it is highly unlikely that a given research project would en-

⁹This example assumes that value-relevance is a consideration in FASB deliberations. This assumption is explored in section III.

¹⁰Regardless of its other attributes, research will not be considered relevant if it addresses issues that are of little concern to standard setters. To understand what makes *ex ante* research relevant for standard setting decisions, it is necessary to have a sense of what matters in the FASB's decisions. That question is addressed in section III.

compass all or even most of the aspects of a standard setting issue.¹¹

To see how the incrementalist approach can create an apparent disconnect between academic research and standard setting, consider the following example. Suppose that in requiring disclosure or recognition, standard setters wish to provide measurement guidance.¹² On the one hand, the standard setters may wish to provide substantial measurement flexibility, so each manager can choose the measurement approach most appropriate for his firm. On the other hand, standard setters may be concerned that providing too much flexibility is an open invitation to earnings management. To give a specific example, if the FASB requires the expensing of employee stock option values, but does not mandate a specific valuation formula, will management take this discretion as an opportunity to manipulate earnings?

Academic accounting researchers have considered, or could consider, how changing the assumptions underlying an option valuation formula affects measurements in various settings. A separate strand of research has considered the conditions giving rise to earnings management, the various ways earnings can be managed and the measurable effects of earnings management. The research on various aspects of earnings management is not generally integrated in any single paper, so it is usually not possible for a standard setter to find a treatment of how discretion over measurements turns up as managed earnings.¹³ Nevertheless, the research exists and it is, I argue, relevant for the standard setting issue at hand, provided the standard setter is sufficiently familiar with the academic literature to take an integrated view of its findings.¹⁴

A third characteristic of research which is considered relevant for standard setting is a substantial degree of conclusiveness, or freedom from qualification, equivocation and multiple interpretations. The nature of social science research, however, means that qualified and partial conclusions are almost inevitable.¹⁵ This lack of conclusiveness is, in my view, due partly to the incremental nature of social science research, in that each piece of research is viewed as a foundation or starting point for a deeper or more extensive inquiry.

There is always more to know and another question that can be posed.

Conclusiveness in research findings should be distinguished from conclusiveness about what standard is to be chosen. Reaching conclusions about standards is the proper responsibility of standard setters, not academic researchers. Researchers can and should provide evidence which can be used as an input to standard setting judgments, but there is no reason for researchers to attempt to substitute their own weighing of the evidence for that of the standard setters. All that said, the standard setters would prefer clear and unambiguous evidence to equivocal and conflicting evidence. To the extent that research findings and interpretations—the evidence—are themselves ambiguous and inconclusive, it will be difficult for standard setters to glean clear signals to use in their deliberations.

In addition, social science research is equipped to ask and answer only certain types of questions. In the empirical area (including both archival and experimental research), accounting research can ask and answer descrip-

¹¹Thoughtful surveys of the literature are intended to bring together the approaches and findings of a body of related research. To some extent, therefore, such surveys integrate over the various increments to knowledge implied by the research to date. In addition, carefully focussed literature reviews at the beginning of research papers can be very helpful in explaining to the reader how the research fits into and adds to the existing literature.

¹²Examples include reserve recognition accounting (disclosure of a natural resource asset), OPEB (disclosure of a long-term liability) and the value of employee stock options.

¹³There are exceptions to this generalization. See, for example, Petroni (1992) for an examination of earnings management via claim loss reserves in the property-casualty insurance industry.

¹⁴Substantial familiarity with academic research on the part of standard setters is an important and difficult condition. I will return to this issue in section III.

¹⁵This point is made, in the context of tax research and tax policy, by Alan Auerbach, in an interview published in the April 5, 1993 issue of *Tax Notes*. He states: "There is the pressure to have very succinct, clear results and policy recommendations, which is not the natural outcome of academic research, and the academic researcher is put in a bind. On the one hand, to be relevant it's necessary to simplify and perhaps overstate slightly the clarity of the results that one has found in the course of research. On the other hand, there is the need to be professionally honest, to qualify one's conclusions ..." (p. 127).

tive questions, sometimes by hypothesis testing and sometimes by identifying empirical regularities. Both the tests of hypotheses and the generalizations about empirical regularities are heavily conditioned by the assumptions (in the case of the hypothesis test) and by the setting generating the data (in the case of the empirical regularities). In the analytical area, accounting research can lay out the conditions under which a certain outcome is expected. Thus research can provide *conditional* facts, theoretical predictions and descriptive evidence which can be used by standard setters in considering solutions to normative questions.¹⁶

The fourth characteristic I believe to be associated with policy-relevant research is related to but distinct from conclusiveness. In my view, standard setters prefer a presentation which places relatively greater emphasis on the answer, not on the process used to arrive at the answer. In contrast, the presentation of conventional academic research is characterized by a relatively heavy emphasis on reporting the research process. That is, much of the research paper is devoted to describing, and explaining the reasons for, the assumptions made in the paper, sample selection criteria and procedures, research design choices, and selection of methods.¹⁷ The specifics of how the methods are applied are also usually explained in some detail.

This attention to the specifics of design, sample selection and method is intended to provide both replicability (i.e., enough information about the procedures to permit another person to replicate the research project) and a basis for judging the technical correctness of the work. There can be no confidence placed in a set of research results—whether these are statements of theorems or empirical findings—unless there is a full description of how those results were obtained. A substantial portion of peer review of academic research is devoted to issues related to how results were obtained, so that others can judge the academic rigor of the work. In general, the greater the academic rigor of the research, the more persuasive are the results obtained.¹⁸

It is impossible to overemphasize the importance placed by academic researchers on replicability and its precondition, a complete description of methods and procedures. Others reading and evaluating the research wish to know precisely how the work was done so that they can, if they wish, evaluate the sensitivity of results and conclusions to choices of research design and methods. One mechanism for such an evaluation is a replication (perhaps accompanied by an extension to illustrate some preferred alternative). It is replicability which provides the basis for confidence in research results.¹⁹ Since

¹⁶For example, Easton et al. (1993) provide descriptive information on the use of discretionary asset write-ups of nonmonetary assets in Australia. Their findings could be an input to a policy discussion of the feasibility and possible consequences of a US standard permitting such write-ups. Similarly, Bernard et al. (forthcoming) describe the Danish mark-to-market regulatory accounting system for banks. Results and conclusions in this paper can provide insights for the debate over extending the use of mark-to-market accounting in U.S. financial institutions.

¹⁷I have been told by nonacademic readers of academic research that they find lengthy discussions of the research process distracting and confusing, and that they interpret the emphasis on discussions of process as an emphasis on the process itself, as opposed to the research product. In contrast, however, a former research project manager of the AICPA wrote—over 20 years ago—that “the tendency of decision-makers to look first at a researcher’s recommendations for action and regard the supporting analysis as secondary is misguided It is no exaggeration to say that the value of good research lies primarily in the analysis and not in the recommendations.” (Gerboth 1973, 478).

¹⁸As discussed at the two previous Financial Reporting Research Conferences, academic rigor can directly conflict with one or more of the characteristics associated with policy-relevant *ex ante* research.

¹⁹Confidence in results, combined with a presumption that the academic researcher is independent, gives academic research credibility. But when results conflict, how is the standard setter to judge who is correct and who is incorrect? This dilemma is described in the context of economic advice by Alan Auerbach in *Tax Notes*, April 5, 1993: “It’s very difficult for policymakers to distinguish good from bad economists and good economic advice from bad economic advice [T]here are some issues where you’ll get crazy arguments along with very sensible arguments, and it’s very difficult for a politician to distinguish It’s very difficult for them [policymakers] to judge who has the pedigree—except by looking at qualifications in terms of affiliations and so forth—who’s making good sense and who is just crazy.”

replicability requires an extensive and detailed description and discussion of the research process, it is in my view inevitable that academic research will appear to place a heavy (disproportionate, in the view of some) emphasis on such matters as assumptions, research design and methods and sample selection.

III. Where Can Accounting Researchers Contribute to the Standard Setting Process?

The preceding discussion and comparison has highlighted the frictions and disconnections between conventional academic accounting research and research which, I argue, would be viewed as relevant for standard setting. Does this mean that the contribution of academic accounting researchers to the standard setting process is, by the very nature of the research process, limited? The answer, I believe, is a qualified yes. That is, there are some aspects of the standard setting process, i.e., those which involve the application of normative criteria, which lie far outside the purview of academic research. There are other stages of the process, however, where I believe academic researchers can have a positive impact.

For purposes of this discussion paper, I will characterize the standard setting process as having three parts. The first part concerns the establishment of basic concepts; in accounting, these include (for example) the concepts of assets, liabilities and revenues. As a practical matter, the FASB's Conceptual Framework may serve as the basic concepts.

The second part of standard setting asks, what considerations affect how those concepts are applied to economic events and transactions? The considerations might include how the resulting accounting information would be used, the costs to produce the information, the acceptability of various alternatives to external constituencies, the degree to which various alternatives yield verifiable information and the impact of various alternatives on the internal consistency and coherence of the accounting system. Presumably, an aggregation of these considerations yields decision crite-

ria to be used in the third stage. These might include, for example, recognition rules and verifiability standards. The third part of standard setting involves choosing the standards themselves. At this stage, each standard setter imposes his own criteria; these need not be uniform across persons or over time.

In my view, academic researchers can have a constructive impact on the standard setting process at the second stage, where facts and theoretical predictions can be marshalled as part of identifying and describing the links (the considerations to be taken into account) between concepts and standards. The extent of that impact will of course vary with the specific standard setting consideration under examination, because the essentially descriptive (and, in the case of analytical research, predictive) nature of social science research means it is better suited for addressing some questions than others.²⁰

Some of the problems facing standard setters are not solvable by research so much as they are addressable from a knowledge of research. Consider, for example, allegations that the Black-Scholes option valuation formula is too complex, too arcane or too inaccurate to be used as a basis for an accounting measurement. Familiarity with research in accounting and finance would perhaps enable a proponent of the use of this valuation formula to answer these allegations in several ways. First, the proponent could explain in intuitive terms how the formula works, and how it is in fact implemented in a variety of settings. The proponent could also explain precisely where the formula requires simplifications relative to the specifics of the accounting measurement problem at hand.²¹ The ability to

²⁰In the case of empirical-archival research, the impact will also vary with the degree to which academic researchers have access to the data necessary to support their inquiries. I will consider this issue in section IV.

²¹For example, a researcher could point to Noreen and Wolfson (1981) for an examination of the accuracy of two valuation formulas (one of which is the Black-Scholes formula) for estimating the value of traded warrants that are in many ways similar to employee stock options. I am grateful to Steven Huddart for bringing this example to my attention.

make these arguments presupposes substantial familiarity with the research based on this valuation formula as well as the practical applications stemming from this research—but there is no particular research paper which contains the essence of the arguments to be used.

To say that a standard-setting problem is addressable from a knowledge of research is, first, to acknowledge the indirect policy-relevance of academic research and second, to raise the question of how such knowledge is to be brought to the standard-setting process, that is, how it is to be used. As pointed out by Leisenring and Johnson (1994), research must be in some sense understandable to the standard setter if he is to use it. While it may seem desirable in principle for standard setters themselves to develop the skills necessary to understand academic research which is or could be policy-relevant, this does not seem practicable, given the many demands on standard-setters' time and the variety of issues they face. Academic researchers, on the other hand, are subject specialists who can be called upon to assist standard setters with their knowledge of research in a given area of immediate interest.²²

Because research provides facts and predictions, it is of limited usefulness (or no usefulness) in the first and third stages of standard setting. There are two reasons for this view, the first of which stems from my understanding of the decision criteria used in standard setting. Based on my discussions with persons involved in the FASB's standard setting process, I believe that the primary criterion used in standard setting is consistency with the FASB's Conceptual Framework.²³

To evaluate consistency, a Board member presumably makes some subjective comparisons and comes to a conclusion about whether the alternative under consideration is sufficiently consistent with the Conceptual Framework. From a social sciences perspective, whether an alternative is or is not sufficiently consistent with something else is an inherently nonresearchable issue. That is, there is no descriptive empirical or analytical question

at issue here; there is instead an internal (to the Board member) exercise of expertise in reaching a subjective judgment. Research can evaluate selected consequences of such a judgment, but absent a metric of comparison, research cannot provide objective evidence on whether a given proposed standard is close to, or far from, consistency with the Conceptual Framework.

The second reason has to do with difficulties of rule making in the absence of a price mechanism to aggregate preferences. This is a familiar social choice problem, one that is well accepted in certain academic circles. Whenever many persons are involved in (that is, affected by) a rule, but there is no agreed-upon metric for aggregating their preferences over the various alternatives for this rule, we cannot say for certain that a given rule is an "improvement" over any other possible rule.²⁴ That is, if a proposed rule change is disadvantageous to one group but advantageous to another group, the standard setting process offers no mechanism for cumulating the groups' preferences to arrive at an unambiguous decision. In addition, accounting standards and

²²A number of academics have made presentations to the FASB on their research, so it seems that this approach has some appeal to the Board. It may be, however, that the approach could be expanded to include both more and broader research presentations. Of course, expanding the scope of these interactions places a new demand on the time of Board members.

²³A secondary and related criterion is consistency with previous standards. A third and unrelated criterion is acceptability of the proposed standard to external constituencies. For discussions of the FASB's decision criteria, including the influence of external constituencies, see Wyatt (1990, 1991).

²⁴This point has been made in the academic literature a number of times. See, for example, Beaver and Demski (1979) on the difficulties of arriving at optimal (or at least preferred) income measures when prices are missing. The point has also been made in discussions of the politics of standard-setting; see, for example, Gerboth (1973, 479). In discussing why accounting research (which contributes to the store of knowledge on which standard setters can draw) has often failed to live up to the hopes and expectations of standard setters, Gerboth notes that accounting rule-making, as an essentially political activity, faces as its chief obstacle not a lack of technical knowledge but rather the conflict among interest groups.

accounting information generally are public goods; nonpurchasers are not excluded from the use of accounting standards (they apply to all covered firms and there is no mechanism for bidding on the standards). In contrast, most observers would probably agree that a new inventory management system is an improvement if it permits the firm to spend less cash with no other adverse consequences. The objective of profit maximization provides a generally agreed-upon metric for evaluating many production and operating alternatives; no such summarizing or aggregating mechanism is available in the case of standard setting.

Conventional academic accounting research can evaluate some of the consequences of various accounting rules to some constituencies. I believe, however, that such consequences are not viewed as especially important in the Board's deliberations. The reason is that consequences are not themselves a mechanism for determining preferability, defined as consistency with the Conceptual Framework.²⁵ Thus, empirical accounting research—which deals in empirical regularities and effects of information disclosures—cannot be used to judge preferability.²⁶

In addition, conventional accounting research can be used to evaluate the value-relevance of some disclosure (where value-relevance is typically assessed by the statistical association between the number disclosed and some measure related to share values). But the existence of such an association does not answer the FASB's normative question of whether the value-relevant item should be placed in the financial statements.²⁷ One reason is that the criterion of the research—a contemporaneous relation between share values and a disclosed number—lies outside the criterion of consistency with the Conceptual Framework. A second reason is that share values cannot be used as a signal about preferences for accounting standards (i.e., since accounting standards are a public good, they are not priced with shares).

Finally, my discussions with persons involved in the standard setting process indi-

cated that preparer implementation issues play a role in the choice of accounting standards. Some mentioned that standard setters would like to have academic guidance on whether the calculations implied by a proposed standard and its accompanying measurement guidelines can be done at reasonable cost. This consideration seems to lie within the scope of the Conceptual Framework (although it does not appear to me to be the primary focus). In particular, a number of alternatives which seem approximately equally consistent with most aspects of the Conceptual Framework could differ in their costs of implementation.

To what extent can academic researchers contribute directly to providing information about measurement and implementation concerns? Certainly, researchers could participate in the design of field tests, as discussed in more detail in section IV. A more important issue, however, concerns whether and when such activities fall into the category of research (as opposed to consulting). While the distinction between research and consulting is sometimes indistinct, and different persons would draw the line differently, in my view research, relative to consulting, is driven by more fundamental and more general questions and issues, and gives rise to something of a public good. Thus, if the result of the activity is a private transmittal of information to a single user, as opposed to broad dissemination, then the activity lacks a characteristic I normally associate with research. More generally, if the activity gives rise to a private

²⁵ For a discussion of economic and social consequences of financial accounting standards and the degree to which such consequences can or should influence the FASB's deliberations, see Brown (1990).

²⁶ One might argue that the FASB seeks to increase the relevance and reliability of accounting information without increasing its cost. This statement might be taken as an implication of the Conceptual Framework. The issue again comes back to agreement on preferability in terms of reliability (or any other attribute) without a mechanism to aggregate preferences.

²⁷ The test of association also does not shed light on the value-relevance of the disclosure given other disclosures (i.e., competing information sources) not considered or controlled for in the test of association.

benefit but no public benefit, in the sense that the output of the activity is owned by the client, then I believe the activity is more like consulting than it is like research.

I do not mean to imply that academic researchers are ill-equipped to provide consulting services, or that they should not do so. If the consulting application requires substantial research-based knowledge and skills, then competent academic researchers would very likely be the ideal consultants. Purely consulting work can also have a positive feedback effect on research efforts by bringing the researcher into contact with problems and issues that he would otherwise not have encountered. In addition, an investigation can be very important for a practical decision-making purpose without giving rise to new knowledge.

To summarize, I have indicated where in the standard setting process I believe academic researchers can have a positive impact. In particular, I have noted that researchers can help familiarize FASB members and staff with research findings. They can also act as consultants on FASB research projects, or possibly undertake research activities that are intended to be directly relevant to the standard setting process. In all these roles, however, access to data is key for those who use empirical-archival methods. In the next section, I discuss how access to data can facilitate or hinder the contributions of academic researchers to the standard setting process.

IV. How Does Data Access/ Availability Affect Academic Researchers' Contributions to the Standard Setting Process?

If empirical researchers are to marshal facts as part of the second stage of the standard setting process outlined in the previous section, they must have access to relevant data. In discussing issues relating to data, it is important to distinguish between access (the data exist, and the issue concerns who may use them) and availability (the data do not exist, and the issue concerns both creating the data and providing access). An example of the former situation is data on share-

holder litigation which alleges audit failures (e.g., information on the audit, the basis for the complaint, the terms of the settlement). An example of the latter is calculations under various measurement alternatives for accounting standards that have not yet been promulgated.

Based on my discussions, I believe that data access and data availability limitations experienced by academic accounting researchers stem from some combination of incentive misalignments, concerns about losses from the disclosure or misuse of proprietary information, and concerns about the outcomes of independent inquiries. I will discuss and illustrate these by means of several examples.

Example 1: Data on Current Disclosure Practices

As part of its inquiry into how financial reporting might be improved, a task force of the AICPA Special Committee on Financial Reporting asked a professor to design and participate in a study of "best disclosure practices." The study involved asking selected firms for complete disclosure information for a given period (including all public disclosures and all private disclosures to stakeholders such as bankers, regulators, leasing companies, and suppliers).

To obtain the information, it was decided that the partner in charge of the audit would approach the CFO of each selected company and make the request. The accounting professor working on the project wrote a letter addressed to each company selected for the study; a Big 6 representative on the task force took the letter to the relevant audit partner (who would in turn speak directly with the CFO). The designers of the project believed that this rather indirect approach would increase the response rate substantially. In fact, the response rate was just under 28 percent (25 of 90 firms) and only a few of these responses included the private disclosures. After repeated samplings of firms and somewhat different approaches, the final sample included 56 firms, but fewer than half included their private disclosures.

This example illustrates incentive difficulties with obtaining data. Specifically, audit partners were asked to make a request of their clients—but the partners must balance this particular request with the many demands for information they must make in the course of the audit. CFO-audit partner relations are complex, in that the auditor must please the client as a customer while making many demands for information and asking potentially difficult questions. What is the audit partner's incentive for making yet another request for information, for a project that is not related to the audit itself? After all, those participating on the task force that designed the disclosure study do not bear the costs of making the request; those making the request were in general not involved on the disclosure task force.

Perhaps the best way to engage the attentions and efforts of audit partners and CFO's would be to demonstrate the existence of direct or indirect benefits to participation. Given, however, that the AICPA committee was considering material changes in the financial reporting system, along with substantially increased disclosure, it may be difficult to demonstrate how a given firm would benefit from participating in a research project whose outcome might support potentially costly reporting and disclosure changes. Gaining constituent participation, for example in FASB field tests, requires a demonstration that the costs of participation are smaller than the benefits (e.g., an opportunity to influence the form of the standard adopted).

Example 2: Data on Auditor Litigation

Auditor litigation is an economically and politically charged issue, and one where both empirical analysis and theory can be used to shed light on a number of questions with policy implications. For example, proposals to cap settlements or to mandate proportional liability imply certain assumptions which could, at least in principle, be addressed in the context of a conventional academic research study.²⁸

While there are some public data on auditor litigation, many data exist (in the files of

defendant firms, insurance companies, plaintiffs attorneys and defendant attorneys, for example) but are not publicly available. In addition, the AICPA maintains some records on auditor litigation, but does not disclose the information. Auditors, a direct source of information, are reluctant, even unwilling, to disclose information on litigation because they fear research based on such information could be inimical to their interests in and of itself, or, even if the research is itself neutral, either the research or the data on which the research is based could nevertheless be turned against their interests in some other way. Thus, if research could arrive at the "wrong" answer, then why would a rational person supply data to be used in such research? And even if the immediate research project itself is neutral or even beneficial, why risk possible adverse consequences from the act of releasing the data (for example, the data could be used to the disadvantage of the auditors in some future legal or regulatory action).

This limitation on data access seems inevitable when research meets economic incentives. If the answer to a question is foregone (i.e., we can guarantee the outcome before we do the analysis) then the exercise is not research. And even if public accountants are convinced of the soundness of their position on litigation, why would they take the chance of supplying data for disinterested inquiries when there is some possibility—however remote—that the conclusions of the research will not support their position?²⁹

There does not seem to be a straightforward solution to this data access problem. Unless the owners of the data conclude that

²⁸For a discussion of the possibilities for academic research on questions related to auditor litigation, see Kinney (1994).

²⁹A pointed statement on this issue, developed in the context of using research in the standard setting process, was made by Watts and Zimmerman (1979). In discussing the use of theory as an input to accounting standard setting, they note that "while individuals want a theory which prescribes procedures conducive to their own interest, they do *not* want a normative theory which has their self-interest as its stated objective" (p. 275, emphasis in original).

the downside risk of an independent inquiry is outweighed by the benefits derivable from scholarly research, they will not be willing to provide data. Interestingly, in some cases the data sought by academic researchers are at least nominally in the public domain (e.g., in court records) but highly fragmented. Thus, a reluctance to provide access to internal firm records does not, at least in principle, keep the data out of academic hands, but it does increase the cost of gathering those data considerably.

Example 3: Stock Option Exercise Data on Individual Employees

A matter of concern to the FASB in its deliberations on employee stock options is the effect of early exercise on the fair value of the option at the date of grant. The basic Black-Scholes formula has several parameters, one of which will be adjusted to deal with this timing issue, under the proposal in the exposure draft. A potentially researchable question is the precision and accuracy of the valuation that arises from this proposed adjustment.

A professor who believes that the exposure draft proposal is conceptually flawed was seeking data to evaluate his analytical reasoning, and to ascertain both where real world data indicate the greatest departures from the Black-Scholes formula and where (and how) the formula might most usefully be adjusted. Knowing that the FASB was conducting field tests on employee stock options, he telephoned the FASB to inquire about data availability. He was told that confidentiality agreements preclude disclosing even the names of firms participating in the field test. Upon inquiry, I learned that extremely tight confidentiality agreements between the FASB and corporate participants in field tests of proposed standards are the rule, not the exception. The demand for these agreements stems from corporate concerns about proprietary costs associated with the dissemination of their private information.³⁰

In light of concerns about the possible misuse of data and costs of disclosure of proprietary information, it is perhaps surprising

that some firms are willing to participate in FASB field tests. Given the free rider problems inherent in this type of research, it seems likely that participating corporations become field test sites because they wish to affect the content of the standard that is adopted.³¹ Thus, participants are not randomly selected. Nevertheless, field tests of proposed accounting standards provide substantial opportunities to design studies that will shed as much light as possible on important features of a proposed standard.

In my view, academic researcher participation could be invaluable in all phases of FASB field tests. Academic researchers with substantive knowledge of the economic phenomenon for which the standard is being proposed (e.g., hedging transactions) as well as research design skills can help work out a design for the field test which produces the best answers possible, given the constraints of the field test approach. In addition, academic researchers can bring extensive theoretical knowledge to bear on the design of tests as well as practical knowledge based on years of experience with research designs. I believe that academic researchers can contribute to the FASB's field test efforts when the question at hand calls for design skills, technical expertise or substantive knowledge that is not available elsewhere. In addition, by virtue of not being part of the standard setting process, the academic can be expected to bring a disinterested perspective to the research question.

³⁰For example, FASB members and staff were given anonymous data on firms that participated in the SFAS 106 field test (firms were identified by letters or numbers and not by name). Only Coopers & Lybrand employees had direct access to the data, unless the participating firms chose to identify themselves to either FASB members or staff, or both. An academic research team that attempted to gain access to the field test data obtained the co-operation of the FASB and Coopers & Lybrand, but was unable to obtain the data from more than a handful of participating companies.

³¹The free rider problem arises because the participating firms bear all the costs, while all firms affected by the standard receive the benefits. The costs can be quite large; for example, the SFAS 106 field test was estimated to cost \$5 million (Ihlanfeldt 1993).

V. CONCLUSIONS

In this discussion paper, I have attempted to lay out some issues affecting the participation of academic researchers in the standard setting process, whether directly—by involvement in field tests, for example—or indirectly, by undertaking research that will be viewed as *ex ante* relevant for the standard setting process. I have argued that fundamental dis-

tinctions between the nature of standard setting and academic accounting research necessarily circumscribe the role of academic researchers, and I have described where and how in the standard setting process I believe that academic researchers and their scholarly inquiries can have a positive impact. In at least some cases, data access and data availability limitations further limit that impact.

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