Carmen-Alexandra BALTARIU
„Babeş-Bolyai University" of Cluj-Napoca,
Faculty of Economic Sciences and Business Administration

THE CURRENT STATE OF KNOWLEDGE IN THE VALUE RELEVANCE RESEARCH FIELD

Literature Review

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Abstract

The purpose of this paper is to assess the scientific literature referring to the value relevance of reported accounting information over a twelve year period starting from 2002. The approach of the paper is a theoretical (conceptual) one. In order to complete the purpose of the paper we selected as research method the longitudinal qualitative analysis. The qualitative analysis carried out presents a deductive character. Our conclusions regarding the general characteristics of the research field pertaining to the value relevance of reported accounting information are drawn based on the main results and scientific contributions identified in the research field of interest.

1. Introduction

Value relevance represents "a major area of empirical research" according to Beaver (2002: 460). This research domain can be included in a wider area of accounting research, called Market-Based Accounting Research (MBAR). MBAR is considered by Lev and Ohlson (1982: 249) as "the most focused and ambitious research effort in the history of accounting." The purpose of this paper is to assess the scientific literature pertaining to the value relevance research domain over a twelve year period starting from 2002. Following our analysis we point out the main characteristics of the research field of interest between 2002 and 2014. This paper represents a descriptive review of the current state of knowledge in the accounting research field of value relevance of reported information. In the academic literature we can find similar studies, namely Lev and Ohlson (1982), Holthausen and Watts (2000), Barth, Beaver and Landsman (2001). By qualitatively analyzing more than 80 value relevance studies, we make a contribution to the value relevance research field by summarizing the main topics and highlighting its essential characteristics in the period 2002-2014.

In order to carry out our qualitative analysis we conducted a thorough investigation for articles published in journals recognized nationally, or internationally, or for books relevant to the topic being addressed. Our search was conducted in scientific journals published online by the American Accounting Association, the Romanian Chamber of Financial Auditors, the Emerald Group Publishing, Franklin Publishing Company, Heckner, Inderscience, John Wiley & Sons (Wiley-Blackwell), JSTOR, Oxford University Press, Palgrave Mcmillan, Questia, SAGE Publication, Springer, Reed Elsevier, and Taylor & Francis. We performed our search by using expressions and words such as: „value relevance”; „value relevance of accounting information”; „accounting information and value relevance”; „value relevance of financial information”; „value relevance of financial statements”; „value relevance of consolidated financial information”. The qualitative analysis carried out presents a deductive character, our conclusions regarding the general characteristics of the research field pertaining to the value relevance of reported accounting information being based on the main results and scientific contributions identified in the research field of interest.

2. Literature review

Between 2002 and 2014 the academic literature regarding value relevance is very well represented by studies focused on a country level analysis. In country level analysis studies value relevance is very often analyzed in relation to national accounting reporting standards (NGAAPs) (Ragab & Omran, 2006: 279 – Egypt), or in relation to the newly adopted international reporting framework (IASs/ IFRSs) (El Shamy & Kayed, 2005: 68-69). A number of studies address the topic of value relevance considering the influence that moderator factors (covariates) have on value relevance as a reporting quality attribute. One of the moderator factors that we encountered in our research are macroeconomic circumstances, an umbrella term for financial-economic crisis (Davis-Friday & Gordon, 2002: 2; Moraes da Costa, Santana dos Reis & Campagnaro Teixeira, 2012: 128), accounting system reforms (Naceur & Nachi, 2006: 2; Chalmers, Navissi & Qu, 2010: 792), the adoption of a new currency (Dimitropoulos, Asteriou, & Siriopoulos, 2012: 299) or the effect of inflation (Kirkulak & Balsara, 2009: 363). The academic literature on value relevance includes studies addressing value relevance in relation with other type of moderator factors, namely different company characteristics (Ely & Pownall, 2002: 632 – shareholder/ stakeholder orientation; Habib, 2004a: 1 – management practices like company earnings manipulation; Brown Jr., He & Teitel, 2006: 605; Kousenidis, Ladas & Negakis 2009: 219 – accounting conservatism; Habib & Azim, 2008: 167 – corporate governance practices; Chandrapala, 2013: 98 – company size and ownership concentration; Gallizo & Salvador, 2006: 268 – life cycle of the company) or circumstances considered to have a strong influence on the value relevance of reported accounting information.

The academic literature regarding value relevance is mainly focused on two reported accounting elements, namely book value of equity and earnings. The studies presenting a country level analysis regarding these accounting items are numerous (Anandarajan, Hasan, Isik & McCarthy, 2006; Durán Vásquez, Lorenzo Valdés & Valencia Herrera 2007; Abiodun, 2012; Shamki & Rahman, 2012; Dahmash & Qabajeh, 2012). The interest of value relevance researchers was piqued by other reported accounting items as well (Ben Ayed & Abaoub, 2006: 2; Beisland, 2011: 773– earnings components; Kabir & Laswad, 2011: 268 – net income; Negakis, 2006: 7 – residual earnings (= net income minus the cost of borrowed capital); Kwon, 2009: 28 – cash-flows; Cheng, Cheung & Gopalakrishnan, 1993: 195; Dhaliwal, Subramanyam & Trezevant, 1999: 46; Biddle & Choi, 2006: 1; Kanagaretnam, Mathieu & Shehata, 2009: 349; Kabir & Laswad, 2011: 268 – comprehensive income and its components; Habib, 2010: 190 – operating income; Perera & Thrikawala, 2010: 1 – earnings per share, return on equity (ROE), earnings yield; Christian & Jones, 2004: 16; da Silva Macedo, Machado, Dal Ri Murcia & Reis Machado, 2011: 300 – operational cash-flows; Habib, 2004b: 23; Al-Hares, AbuGhazaleh & Haddad, 2012: 221 – dividends; Dorantes Dosamanes, 2013: 5 – fundamental variables employed in forecasting).

From the point of view of its evolution, value relevance is studied through a country level analysis by Thinggard & Damkier, (2008: 375). The authors carry out a longitudinal investigation from 1983 until 2001 on a sample of Danish companies. The comparative approach regarding value relevance is very well represented in the academic literature through a large number of studies. In some of these works (Kang, 2003; Platikanova & Nobes, 2006; Hellström, 2006, Davis-Friday, Eng & Liu, 2006; Iatridis & Dimitras, 2013) the parallel is drawn between two or more countries with respect to the relative or incremental value relevance of reported accounting information on the financial markets. The comparative perspective in the value relevance academic literature is extended from countries to other elements. Some of these elements are represented by consolidated financial information reporting theories, namely the entity theory in contrast with the extended parent company theory. (Müller, 2012: 949) Likewise, the comparative perspective is adopted in papers studying the value relevance of accounting information reported in the consolidated financial statements in comparison with the accounting information reported in the parent company separate financial statements (Dolinar, 2002; Yamaji, 2002; Goncharov, Werner & Zimmermann, 2009; Gould & Rammal, 2009; Safa, Gholami Mehrabadi & Borhani, 2011; Müller, 2011; Srinivasan & Narasimhan, 2012). The research studies mentioned above report various findings, a higher value relevance of the accounting information reported in the consolidated financial statements is suggested in Dolinar (2002: 69), Yamaji (2002: 5), Goncharov et al. (2009: 352), Gould & Rammal (2009: 5) and Müller (2011: 342), while a superior value relevance of the information reported in the parent company's separate financial statements is supported by the findings of Safa et al. (2011: 127) and Srinivasan & Narasimhan (2012: 58).

The research regarding the value relevance of accounting information is enriched through findings stemming from examining associations between stock market price, stock return and goodwill (Duangploy, Shelton & Omer, 2005: 26; Al Jifri & Citron, 2009: 123; Lapointe-Antunes, Cormier & Magnan, 2009: 56; Dahmash, Durand & Watson, 2009: 120; Laghi, Matt & di Marcantonio, 2013: 32) Research studies such as those of Emmanuel & Garrod (2002: 215), Chen & Zhang (2003: 426), Bodnar, Hwang & Weintrop (2003: 171) and Aleksanyan (2004: 4) address the issue of segment reporting information value relevance. Regarding the value relevance of non-financial information, namely the information related to intangible assets, the studies of Kallapur & Kwan (2004: 151), Liang & Yao (2005: 135), Abayadeera (2010: 3) and Chang & Kim (2013: 237) bring evidence in its favour. Extraordinary accounting items such as the company's restructuring expenses, the expenses related to completed research and development activities, merger expenses, impairment expenses, the expenses or revenues resulting from legal lawsuits, the costs arising from the revaluation of assets at fair value after an inventory takes place, the expenses or revenues resulting from calamities, or other items, such as the income resulting from collected insurance premiums are tested for value relevance in the study of Earnes & Sepe (2005: 61). Their findings suggest that only certain extraordinary accounting items, like for example the expenses related to uncompleted research and development activities or merger expenses are value relevant on the financial market. Hassan, Percy & Stewart (2006: 41) document the value relevance of accounting information regarding financial instruments. Graham, King & Morrill (2003) and Soonawalla (2006: 395) focus on testing the value relevance of accounting information reported by joint ventures through different methods of consolidation (the proportionate method of consolidation and the equity method of consolidation). Minority interests' value relevance is examined by So & Smith (2009: 166). The results suggest that the change in the presentation of minority interests, minority interests being reported as an equity component, not a debt component, has value relevance for investors. A new measure of performance, different from the earnings reported in accordance with the enforced GAAPs, is tested in terms of value relevance by Albring, Cabán-García & Reck (2010: 264). The information regarding pensions recognized in the financial statements is analyzed by Werner (2011: 427), while the value relevance of the R&D expenses are addressed in the work of Ali Shah, Liang & Akbar (2013: 159).

A few studies provide the value relevance research field with arguments explaining the decline in the value relevance of accounting information. The works of Dontoh, Radhakrishnan & Ronen (2004: 2) and Dontoh, Radhakrishnan & Ronen (2007: 3) suggest that the decline in value relevance might be the consequence of 'noise' embedded into the stock market price. The "noise" is due to the increase in the volume of non-information based transactions, the ability of the stock price to reflect accounting information being thus reduced. Similar results are reported by Gu (2007: 1073), and Lim & Park (2011: 947). The field of value relevance also presents research studies focused on the financial sector (Danbolt & Rees, 2002; Asthana & Chen, 2007), or the venture capital market (Hand, 2005).

3. Discussion of results and conclusions

First of all, we remark upon the diversity which characterizes the value relevance research field. In the academic literature published between 2002 and 2014 we find studies that cover a large number of value relevance topics, mainly from an empirical perspective. From a methodological point of view, the value relevance empirical research uses for the most part two econometric models, namely the price specification and the return specification econometric models. These models are designed to address both types of value relevance, the relative value relevance, as well as the incremental value relevance of accounting information. (Biddle, Seow, and Siegel, 1995: 1) In a large number of studies the value relevance of accounting information is analyzed in relation with moderator factors, or covariates, with a possible role in determining its level. The covariates that we encountered are mainly macroeconomic circumstances and microeconomic (company level) characteristics. The studies we included in our qualitative examination exhibited a country level perspective, a longitudinal perspective, or a comparative perspective regarding value relevance.

A qualitative summarization of the results in a particular research field entails certain limitations, like subjectivity or lack of transparency concerning a number of factors that remain at the discretion of the researcher. These factors are the criteria used for selecting the studies included in the analysis, the different levels of importance given to the various studies, or the number of papers included in the review. In addition, the usefulness of this type of summarization is limited to the period of time analyzed, because of new papers being published and new results being made available in the following periods of time. (Borenstein, Hedges, Higgins & Rothstein, 2009: XXII) In addition, following a qualitative analysis we cannot specify the manner in which the values of the effects reported are being influenced by moderator factors (covariates). Thus, a qualitative analysis does not allow us to formulate general conclusions concerning the field of interest.

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