

## ABO Doctoral Consortium

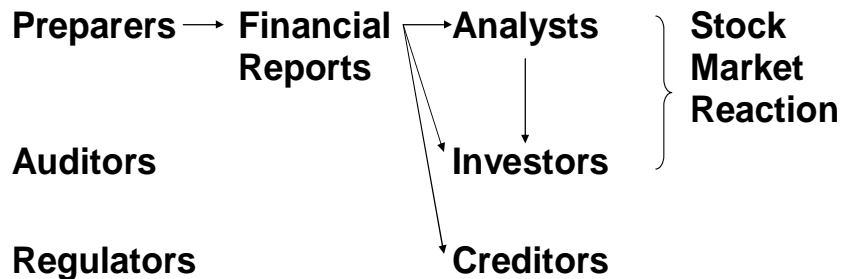
Experimental Research in Financial Accounting  
October 19, 2007

## Objectives

- Provide a brief overview of recent financial experimental research
- Discuss relative strengths of experimental research for financial reporting
- Highlight issues in conducting research
- Provide insights on future research

## Financial Reporting

Standard  
Setters



## Recent Experimental Financial Research - Person and Task Focus

- Majority of research focuses on users
  - Investors
  - Analysts
- Task – Use financial statements to make:
  - Buy/sell decisions (individual or market)
  - Earnings/sales forecasts
  - Stock valuation/price appreciation judgments

## Recent Experimental Financial Research – Research Questions

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- **Task (information) characteristics**
  - Standard setting (format)
  - Other task characteristics (forecast form)
- **Markets**
  - Market characteristics (number of traders)
  - Information characteristics
- Other environmental factors (incentives)
- Insights into archival research results (PEAD)
- Person characteristics (knowledge)

## Experimental Strengths/Weaknesses

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	Archival	Experiments
Data Source - external validity	Naturally occurring	Lab created
Data fineness	Often continuous	Levels
Data timing	Wait until occurs	Create when needed

## Experimental Strengths/Weaknesses

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	Archival	Experiments
Relationship – internal validity	Association	Causal
Independent Variables – internal validity	Confounded	Manipulate (Moderating)
Level of Analysis	Aggregate Outcome	Outcome and Process (Mediating)

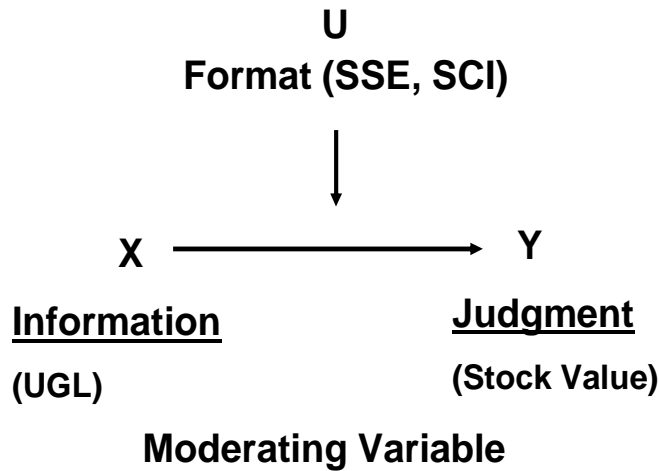
## Example – Comprehensive Income Format

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- Question: What is effect of different formats for comprehensive income on stock prices?
- Archival data
  - Wait until data available
  - Self-selection (causality) problems
- Experiments
  - Hirst and Hopkins (1998)
  - Maines and McDaniel (2000)
  - Hirst, Hopkins, Wahlen (2004)

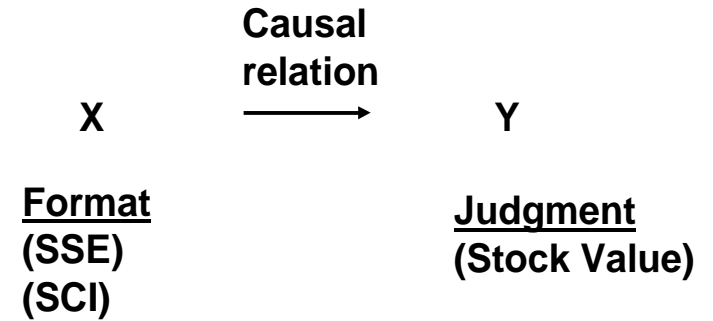
## Experiments - Comprehensive Income

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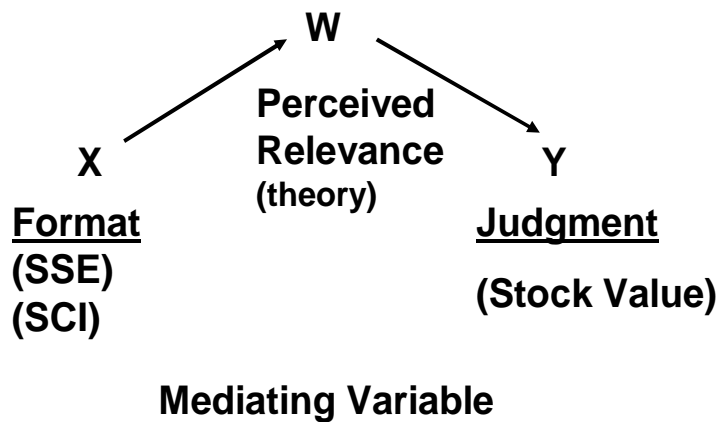
## CI Experiment - A Simpler Model

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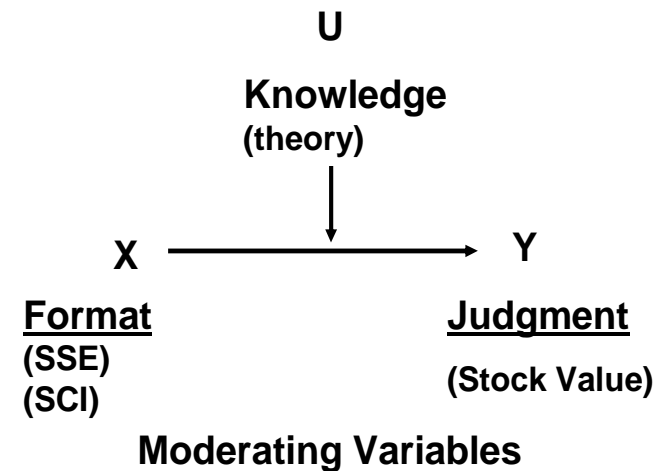
## How or Why Does Relation Occur?

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## When Does Relation Occur?

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## Issues in Performing Experimental Research

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- **Participants?**
- **Monetary incentives?**
- **Level of analysis, individual or market?**

## Participants, Incentives, Markets

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- **All moderating variables**
  - **Will inferences change as a results of using different levels of these variables?**
  - **Process level – what specifically will change in processing**
- **Research question, theory, task should dictate choice**

## Choice of participants?

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- **Negative externalities of using professionals when not needed: limited resource (Libby, Bloomfield & Nelson 2002)**
- **Selection and non-response bias may be stronger with professionals than with students (Peecher & Solomon 2001)**
- **Focus on nature of task (Elliott et al. 2007)**

## Monetary incentives?

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- **Want participants to take the task seriously**
- **Dictated by theory (effort sensitive task?)**
- **Incentives do not necessarily mitigate judgment bias– depends on type of bias (Arkes 1991)**

**Reduce variance but mean unchanged**

## Individuals or Markets?

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- Markets are expensive
- Markets can have less observations, therefore less power (unless repeated measures)
- Research shows that biases are not driven out by markets (may be reduced)

## Suggestions for Future Research - Person

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- Preparers' judgments and decisions
- What factors affect JDM of preparers
  - Incentives (been there, done that)
  - Complexity of transactions
  - Uncertainty
- Difficulties
  - Understanding task
  - Obtaining access to preparers

## Suggestions for Future Research – Task and Environment

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- Task and environmental factors (e.g., Format and Incentives)
  - Need to go beyond “these matter”
  - Moderating/Mediating variables
- Uncertainty / Complexity
  - Complex Transactions
  - Uncertainty – Fair value

## Research Suggestions – Source of Topics

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- Financial Reporting Issues (fasb.org)
- Archival research
- Popular press
- Interact with practitioners (auditors, preparers, standard setters)
- Interact with researchers outside your area (psychology, finance, management)
- Listen to people who make you think

# References



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