Application of positive accounting theory in capital market research & market response to accounting disclosures

Aplicação da teoria positiva da contabilidade na pesquisa de mercado de capitais e resposta do mercado às divulgações contábeis

DOI:10.34117/bjdv9n12-084

Recebimento dos originais: 17/11/2023
Aceitação para publicação: 22/12/2023

Yolanda Agustina Ananta
Master in Accounting
Institution: Universitas Sumatera Utara
Address: Jl. Prof. TM Hanafiah 12, USU - campus Medan
E-mail: yolandaagustina94@gmail.com

Alfanita Gratia Telaumbanua
Master in Accounting
Institution: Universitas Sumatera Utara
Address: Jl. Prof. TM Hanafiah 12, USU - campus Medan
E-mail: alfanita@student.usu.ac.id

Maulana Siregar
Master in Accounting
Institution: Universitas Sumatera Utara
Address: Jl. Prof. TM Hanafiah 12, USU - campus Medan
E-mail: maulana@student.usu.ac.id

Iskandar Muda
Doctors in Accounting
Institution: Universitas Sumatera Utara
Address: Jl. Prof. TM Hanafiah 12, USU - campus Medan
E-mail: iskandarl@usu.ac.id

ABSTRACT
This research examines Positive Accounting Theory and its relationship with the capital market. This theory is based on three hypotheses that underlie managerial accounting theory. Using a qualitative descriptive approach, this research presents an overview of the application of Positive Accounting Theory and capital market research methods. Markets are explained through economic models that include decision trees, supply and demand, and game theory, with external factors such as competitors, consumer behavior, and political and monetary policy influencing the market. In the corporate context, the application of Positive Accounting Theory varies according to the characteristics and internal conditions of the company. However, the use of positive accounting can have a significant positive impact on company sustainability as revealed in the results of previous research. Positive Accounting Theory describes social phenomena as the result of individual decision making based on rational behavior to maximize utility, especially in the context of capital markets.
Keywords: positive accounting theory, capital market research, efficiency, markets.

RESUMO
Esta pesquisa examina a Teoria Positiva da Contabilidade e sua relação com o mercado de capitais. Essa teoria se baseia em três hipóteses que fundamentam a teoria da contabilidade gerencial. Usando uma abordagem descritiva qualitativa, esta pesquisa apresenta uma visão geral da aplicação da Teoria Positiva da Contabilidade e dos métodos de pesquisa do mercado de capitais. Os mercados são explicados por meio de modelos econômicos que incluem árvores de decisão, oferta e demanda e teoria dos jogos, com fatores externos como concorrentes, comportamento do consumidor e políticas políticas monetárias e políticas que influenciam o mercado. No contexto corporativo, a aplicação da Teoria Positiva da Contabilidade varia de acordo com as características e as condições internas da empresa. Entretanto, o uso da contabilidade positiva pode ter um impacto positivo significativo na sustentabilidade da empresa, conforme revelado nos resultados de pesquisas anteriores. A Teoria Positiva da Contabilidade descreve os fenômenos sociais como o resultado da tomada de decisões individuais com base no comportamento racional para maximizar a utilidade, especialmente no contexto dos mercados de capitais.

Palavras-chave: teoria positiva da contabilidade, pesquisa de mercado de capitais, eficiência, mercados.

1 INTRODUCTION
Accounting theory functions as a basis for solving accounting problems using ethical and scientific logic and reasoning so that they can be accounted for. With accounting, society can see a problem as a whole and use it as an internal basis for accounting practice. The development of accounting theory began with the emergence of normative theory, which is defined as a theory that requires and uses value judgments. This normative theory does not yet use a formal investigative approach; only in subsequent developments did a deductive approach or positive accounting theory emerge. This theory attempts to explain observed accounting phenomena by looking for the reasons why events occur. This is different from descriptive theories, which only focus on describing events, and normative theories, which regulate what must happen.

Friedman (1953) stated regarding positive accounting theory in economics: “The goal of positive science is the development of valid 'theories' or 'hypotheses' and meaningful predictions about phenomena that have not yet been observed.” Positive accounting theory describes social phenomena as a consequence of individual decision-making. Positive accounting theory research can be seen in the use of accounting numbers that have relevance to price changes, which also affect the capital market. According to one interpretation of the predictive approach, observations of capital market reactions can
be used as a guide for evaluating and determining choices between several accounting measures. Observation of market reactions to the acceptance of accounting output should guide the evaluation of the actual information content of accounting figures produced through alternative procedures. Other market approaches focus on society's wealth rather than individual wealth, even though the combination of individual decisions determines a market's behavior, but we assume that optimal market behavior can be achieved by focusing on individual behavior.

Therefore, market reactions to accounting information emerge that are very good in positive-normative theory by emphasizing the decision-making process of individual investors. This active accounting theory focuses on predicting management behavior in choosing accounting methods and their reactions to new accounting standards. And positive accounting theory assumes that management rationally chooses accounting principles that they believe are good. Positive accounting theory is based on three hypotheses that underlie managerial accounting theory. Common economic models include decision trees, supply and demand calculations, or game theory calculations. Each market describes a specific opportunity or goal that a company can focus on and assigns a probability of success to each opportunity. External factors such as competitors, consumer behavior, and current political and monetary policies can influence economic markets. This market is very complex, depending on the size of the company's business and the economic market it contains (Budiskj, 2023).

Positive accounting theory has an economic focus that can be used to find out how stock prices change due to information. Most empirical research states that accounting earnings information contains information content so that it can be used to predict stock prices. The information contained in these events can be seen as positive signals of good quality (good news) and bad news signals. The capital market reaction to the announcement can be shown by changes in share prices and share volume (Sari et al., 2017).

In capital market activities, both sellers and buyers of shares certainly expect profits. Therefore, investors need information as an important element in making investment decisions. This information includes events that can cause the market to react after receiving information about these events. This analysis provides important information for companies to make business decisions regarding expansion and acceptance of new business growth opportunities. Common economic models include decision trees, supply and demand calculations, or game theory calculations. Each market
describes a specific opportunity or goal that the company should focus on and establishes a probability of success for each opportunity.

2 LITERATURE REVIEW

2.1 REVIEW OF PREVIOUS RESEARCH

(Badriatin et al., 2020) "Introducing Investment Culture Through the Capital Market": This activity has not achieved optimal results in increasing investor awareness in the capital market. Therefore, continuous learning and training are required, as indicated by limited participation (only 5 participants) in opening securities accounts. However, participants showed increased knowledge, as evidenced by good and correct answers regarding the introduction of capital markets.

(Azwar et al., 2021) "Indonesia's Capital Market Reaction During the COVID-19 Pandemic at Manufacturing Companies Listed on the Indonesia Stock Exchange": Research Results This has implications for investors and potential investors as a source of information in making investment decisions. Research also becomes a guide for analyzing capital market performance as a basis for determining whether a potential company will provide big returns, especially when an incident is significant like the COVID-19 pandemic.

(Fong et al., 2015) "Scale Problem in Capital Market Research": The results of field investigation evaluations show that deflating all elements of the regression model with appropriate deflators is the preferred approach to overcome scale problems in research.

(Situmorang et al., 2023) "Philosophy of Positive Accounting Theory and Market Model in Chemical Sector Companies": This research concludes that the application of positive accounting can have a positive impact on company continuity, especially in presenting objective financial information. Positive accounting can also be used as material for company evaluation, increasing transparency and accountability and providing a basis for evaluation.

(Fitriyah & Barokah, 2021) "Analysis of Factors Affecting Public Interest in Investing in the Capital Market": Research results show that variable knowledge, income, and motivation are influential and significant in encouraging the public to invest in the capital market. However, the risk variable does not have a significant influence on interest in investing in the capital market.
"The Capital Market Response To The Announcement Of The 2019-2024 Indonesia Onward Cabinet System (Empirical Study on Companies Listed on Kompas Index 100)"

Research results This supports the theory signaling that states that the announcement System: The Advanced Indonesia Cabinet 2019-2024 provides a positive impact on the capital market.

CMA Dr. Meena Bhatia (2018), "Capital Markets and Financial Reports": The purpose of financial reporting is to provide useful information for investors and creditors in making investment, credit, and similar resource allocation decisions. Information must have certain qualitative characteristics to be useful and not have a negative impact on decisions.

(Hodnett & Hsieh, 2012) "Capital Market Theories: Market Efficiency Versus Investor Prospects" Prospect theory and behavioral finance explain investment decisions in imperfect capital markets. This provides a different understanding than the assumption of perfect market efficiency.

(Maninder & Pavani, 2020) "A Study Of The Capital Market": Investment brand plays an important role. They believe that the company is known to them, or people. The distribution channels of investment funds are very important. Recommended for donation purposes to financial advisors, funds are important. They contribute to the awareness of dependence on the success of market risk capital.

(Preston & Collins, 2012) "The Analysis of the Capital Market Efficiency": Capital market efficiency, according to the ‘60s theory, can be measured by the extent to which financial asset prices reflect all available information. Market efficiency is a prerequisite for efficient capital allocation and is the basis for classical financial asset evaluation methods.

2.2 PHILOSOPHY OF ACCOUNTING THEORY POSITIVE

Positive accounting theory understands accounting phenomena through empirical observations of events and uses these observations to predict observations in a wider scope or to predict future events. Friedman (1953) stated that the goal of positive science is to predict the development of theories or hypotheses that produce valid and meaningful information about unobserved phenomena.

Watts and Zimmerman (1986) explain that the purpose of positive accounting theory is to explain and predict accounting practices. Explaining means showing the
reasons why a particular accounting practice is carried out, while predicting means this theory predicts phenomena that have not been researched.

Positive accounting theory has empirical applications that aim to predict and explain events in accounting practice. This helps companies choose appropriate accounting principles and methods. Watts and Zimmerman (1990) divide positive accounting theory into three hypotheses, namely the bonus plan hypothesis, the debt agreement hypothesis, and the political costs hypothesis.

1. **Bonus Plan Hypothesis**: In the bonus plan hypothesis, managers tend to choose accounting policies and methods that increase the company's profits in the current period (Evadine, 2022). It reflects the manager's actions to maximize his utility or personal interest.

2. **Debt Covenant Hypothesis**: This hypothesis states that the higher the debt to equity ratio of a company, the greater the likelihood of using accounting principles and techniques that increase profits. This is caused by the company's proximity to the debt agreement limit which can result in a breach of contract.

3. **Political Cost Hypothesis**: The political cost hypothesis predicts that large companies are more likely to reduce or delay reported earnings than small companies (Idham et al., 2018). This is related to the political costs associated with legislative regulations. Large companies may prefer to reduce profits to avoid political costs, such as paying high taxes.

Positive accounting theory is based on the assumption that individuals, including managers, investors and other parties, act rationally and seek to maximize their utility or personal interests (Nasution et al., 2020). This theory also focuses on empirical testing and validation of prescriptive accounting models before being adopted as accounting standards. In addition, this theory has an economic orientation and tries to answer questions about the costs and benefits of using alternative accounting methods as well as the impact of financial statements on stock prices.

### 2.3 THE POWER OF POSITIVE ACCOUNTING THEORY

Criticism of changes in accounting standards includes the opinion that certain experiments in accounting and auditing practices are not based entirely on identification, empirical observation, or sound methods. Watts and Zimmerman (1986) emphasize that a strong concept requires a specification of objective function and objective function. In this case, these objectives include monitoring and controlling business or economic
decisions, predicting future cash flows, and other aspects that give accountants an advantage over other parties in formulating accounting objectives. An example of an objective function is to show the impact of valuing assets at fair value on the distribution of wealth between shareholders, creditors, and management. It does not simply set a prescriptive objective to change the accounting treatment in measuring fair value.

In normative theory, Popper (1968) stated that there is no empirical test that can prove that a theory is definitely true, but theories can be refuted or refuted. The primary goals of accounting information should be to provide information to investors so they can predict future values, provide a benchmark for valuing the stock market by reporting current fair values, and control management compensation payments through conservative accounting practices.

The primary purpose of accounting information is to provide data that allows investors to predict future values, provide a measure of stock market valuation through reporting current market values, and provide conservative accounting. The practice must also control the payment of executive compensation through certain practice obligations. One normative objective is the assumption that accountants should value assets at their current selling price to provide information to creditors regarding the company's solvency. Another premise of normative theory is that auditors should value assets at market value and demonstrate to investors how their funds will support the company's operational capacity. Normative standards and normative theory are methodologically weak (Godfrey, 2010: 406).

The accounting information generated by fair value actually improves shareholder decision making, because balance sheets and income statements are prepared on a historical cost basis, and alternative historical values show more utility. Therefore, for investors, it is difficult to know how profitable financial statements prepared based on past costs are, whether appropriate information has been conveyed to the market, or whether there has been inadequate information disclosure or inappropriate accounting treatment. whether they were deceived by inefficient market manipulation. Information becomes less relevant.

The value created by fair value actually increases shareholder determination, and balance sheets and income statements are prepared on a historical cost basis, indicating that historical value is a more useful alternative. The development of positive accounting theory can be divided into two stages, namely:

1. Early Stage: Research on accounting and capital market behavior.
Currently, there is no description of accounting practices in the literature. Research at the time looked at the relationship between earnings announcement dates and stock price reactions. This research shows that financial reports prepared based on historical costs can provide information used for stock valuation in the capital market. However, at that time, accounting information was not the only information used in business evaluation. Currently, research cannot answer whether accounting numbers are an important driver of stock prices, suggesting that accounting reports are the best way to explain the stewardship function (the function between owners and managers). Finally, financial economic theory, the efficient markets hypothesis, and the Capital Asset Pricing Model (CAPM) have been added to the literature.

2. Second stage: Trying to explain and predict accounting practices in companies. There are two main focuses, namely companies make accounting decisions for reasons of convenience (ex post opportunistic perspective), and companies choose accounting practices for efficiency reasons (reducing the cost of contracts between the company and the plaintiff). Choosing ex ante accounting methods for efficiency reasons can prevent managers from taking opportunistic decisions ex post because it is inefficient to eliminate opportunistic behavior.

2.4 MARKET RESPONSE TO ACCOUNTING DISCLOSURES

The primary goal of capital markets research is to evaluate whether accounting data provides information that is relevant to value investors, beyond other publicly available sources of information. The information content of accounting numbers can be inferred from changes in the level or variability of stock prices as well as changes in the trading volume of securities during the short period after these data are made public.

Research in Europe examining stock price reactions to earnings announcements confirms the main finding found in the US by Beaver (1968): earnings disclosures lead to significant changes in stock prices or increases in trading volume. For example, in the UK, Firth (1981) reports abnormal absolute stock returns and significant increases in trading volume on annual earnings announcement dates in the period 1976–78, for a sample of 120 firms. Similar results were also found by Pope and Inyangete (1992), who observed an increase in the volatility of security returns around announcement dates for a sample of 3,541 UK annual earnings announcements between 1985 and 1987. Another approach was used by Hew et al. (1996) assert that UK annual earnings provide
significant information for investors, because unexpected annual earnings, whether positive or negative, lead to significant gains.

Thus, research in Europe as a whole provides support for the view that disclosure of accounting information, particularly regarding earnings, has a significant impact on changes in stock prices and trading volumes, indicating that accounting information has an important role in investors' judgments in capital markets.

2.5 CAPITAL MARKET RESEARCH AND EFFICIENT MARKET HYPOTHESIS

Capital market theory provides the basis for the development of financial asset pricing models. The mainstream view in capital markets adopts a perfect world scenario in which markets are considered highly efficient in terms of information, where asset prices reflect new information quickly and accurately when it arrives at the market (Janrosl, 2022). The assumptions behind efficient capital markets include the Efficient Markets Hypothesis (EMH), Markowitz portfolio theory, decoupling theorem, Capital Asset Pricing Model (CAPM), and Arbitrage Pricing Theory (APT).

EMH is considered a fundamental theory that is the basis for various areas of finance. EMH is based on theory price microeconomics in which capital markets are competitive produce cost marginal the same information with income marginal. Fama (1970) explains that the market is considered efficient if price share fully reflects all available information, with assumption that No There is cost transactions, information available in a way free, and available agreement about implications information latest to price current and distribution future prices.

Divided into three forms, Fama (1970) defines markets in weak form, semi-strong form, and strong form:

1. Weak Form market efficiency: Stock prices reflect past information. Today's price changes have nothing to do with price changes that occurred yesterday. This means that if information comes randomly, many people like it because they can profit from random price changes. They believe that if the price of a stock starts to rise, then the stock price will continue to rise over a certain period of time, creating momentum. Although technical analysis is not immune to weak forms of market efficiency.

2. Semi-Strong Form market efficiency: Security prices fully reflect all published information. This information includes historical price and volume data, as well as other publicly available data or information, such as company earnings,
dividends, bonus shares, inflation, and stock splits. This theory emphasizes the speed with which information is received by investors, which means that information is spread and received by investors almost simultaneously, so that prices can adjust quickly.

3. **Strong Form market efficiency**: Share prices reflect all available information, both public and private. This form emphasizes that stock prices can adapt quickly to all information, including information that is not available to all investors (private information). One type of private information is information from “insiders,” who have access to a company's strategic decisions. Thus, private information can provide abnormal profits for investors who have access to that information.

The relationship between these three forms of market efficiency is cumulative, with the weak form being part of the semi-strong form, and the semi-strong form being part of the strong form. This shows that the rejection of market efficiency in the weak form also applies to market efficiency in the semi-strong form and strong form. In other words, if a market is inefficient in weak form, then it is also inefficient in semi-strong or strong form.

Efficient markets in the context of the Capital Market Hypothesis reflect security prices resulting from all relevant information. EMH (Efficient Market Hypothesis) is a theory of price mechanisms in the securities market. Empirical Capital Market Research (CMR) uses statistical methods to test hypotheses about capital market behavior. Most CMRs use market models derived from the Capital Asset Pricing Model (CAPM) to estimate abnormal returns on company shares when certain events occur, such as earnings announcements (Godfrey, 2010: 409).

### 2.6 THE IMPACT OF PROFIT ACCOUNTING ON STOCK PRICES

According to Foster (1986), there are three factors that influence the information content of a company information announcement. First, market expectations of content and time announcement information company. The more big level uncertainty, increasingly big potency revision price letter valuable. Second, implications announcement profit to distribution of future security returns. The more big revision related with expected cash flow, increasingly the implications are huge revaluation price securities to announcement. Third, credibility source information. The more credible a
source is, the greater the information announced, and the greater the implications of the revaluation of the information announcement.

SFAC No. 2 (FASB, 1980) states that income statements have very important predictive value for their users. This is in line with SFAC No. 1 (FASB, 1978), which explains that investors, creditors, and other parties often use information on earnings and its components to assess the cash flow prospects of investments or loans. Scott (2000) adds that earnings information can be useful if it is able to cause investors to change their previous beliefs and actions. Level of usefulness can be measured from extent of change price follow publication information profit.

Godfrey and his colleagues (2010) also present the impact of accounting profits on stock prices by considering several factors:

1. **Direction:** Ball and Brown's study became the basis of positive accounting, showing that if information in earnings is useful and informative in making investment decisions, stock prices will adjust to reflect that information. The market appears to be fairly consistent in anticipating the information in accounting reports.

2. **Magnitude:** Current research focuses on abnormal returns which relate to unexpected changes in earnings. Although the relationship between the magnitude of unexpected changes in earnings and abnormal returns can be investigated, research shows that there is not always a significant sensitivity relationship.

3. **Information asymmetry and firm size:** The information content in unexpected earnings announcements may be inversely related to firm size. Small firms may have more information contained in their accounting reports, and this relationship depends on the fact that the amount of information available from other sources of accounting reports is a function of increasing firm size.

4. **Volatility:** Beaver finds that the variance of a firm's returns increases significantly in the week of earnings announcements. These results are consistent with the hypothesis that price changes are greater than earnings announcement prices.

5. **Association Study and Earnings Response Coefficient (ERC):** ERC is examined using OLS regression with returns as the dependent variable. Some factors that influence ERC involve risk and uncertainty, audit quality, industry, interest rates, financial leverage, company growth rate, and permanent and temporary profits.
6. **Determinants of Company Value**: Factors such as risk and uncertainty, company size, industry, interest rates, financial leverage, potential growth, and interim profits play a role in determining company value.

7. **Factors that Can Influence ERC**: Some factors that influence Profit Coefficient Response include risk and uncertainty, audit quality, industry, interest rates, financial leverage, company growth rate, fixed and temporary profits, non-linear modeling, profit disaggregation, cash flow, balance sheet, and its components.

3 **IMPLEMENTATION METHOD**

This research uses a qualitative descriptive approach to collect and analyze previous literature related to positive accounting theory and capital market research methods. This approach provides a comprehensive overview of the application of positive accounting theory to capital market research.

Williams and Findlay (1980) highlight that the Efficient Capital Market Theory (EMH) has a significant impact on security prices. In contrast, Watts and Zimmerman (1986) argue that managers can use accounting to manipulate markets, or that markets are efficient and do not pay attention to accounting changes that do not create cash flows.

4 **RESULTS AND DISCUSSION**

In this literature review, we describe positive accounting and capital markets research in the corporate context, especially related to the issue of implementing positive accounting. In implementing a positive accounting philosophy, each company has a unique approach, depending on the characteristics and internal conditions of the company. The application of positive accounting can have a significant positive impact on company continuity, as outlined in the results of previous research. Some of these impacts include:

1. **Objective Financial Information**: The application of positive accounting can ensure that the financial information produced is objective and trustworthy. This helps in providing an accurate picture of the company's financial performance.

2. **Company Evaluation**: The implementation of positive accounting allows companies to carry out better self-evaluation. Accurate and objective financial data can be used as a basis for evaluating company performance and identifying
areas that need improvement.

3. Transparency and Accountability: The implementation of positive accounting also encourages transparency and accountability in company financial reporting. By providing clear and reliable information, companies can build stakeholder trust.

4. Guide for Decision Making: Data generated through the application of positive accounting can be used as a guide for making good decisions for the survival of the company. Accurate financial information provides a strong foundation for strategic decisions.

Accordingly, if positive accounting is implemented correctly, it can be a very effective tool to help a company maintain the stability and continuity of its operations.

5 CONCLUSION

Positive Accounting Theory describes social phenomena as the result of individual decision making. Research within this theoretical framework refers to the use of accounting numbers which have the highest connection with the impact of change, especially in the capital market. Assumptions in Positive Accounting Theory include the rational behavior of managers, investors, creditors, and other individuals, who carry out evaluations to maximize utility. Managers are considered to have wisdom in choosing accounting policies to maximize utility and will take action to maximize company value.

Research in capital markets often uses Positive Accounting Theory because it is able to overcome the weaknesses of standard prescriptions based on empirical observations. Meanwhile, Normative Theory relies on practical policies that may not be in accordance with real circumstances. One of the objectives of Positive Accounting Theory is to understand the impact of information that accounting profits have on stock prices. In an efficient capital market, any change in expected cash flows can affect stock prices. Although historical accounting earnings contain important information, research shows that there is continuous information in the marketplace, so accounting is not the only source of information about a company.

The impact of accounting earnings announcements on stock prices also allows researchers to examine the relationship between the magnitude of unexpected earnings changes and stock prices. The theoretical basis here is that if earnings announcements contain information, then the size of share prices can be related to the size of unexpected changes in profits.
REFERENCES


