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Research Article

Assessing Intangible Assets and the Decrease in Earnings Clarity: A Review of Literature on the Impact of Mismatching

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Abstract: This qualitative literature review examines the relationship between accounting for intangible assets, mismatching issues, and the declining informativeness of earnings. The findings reveal that traditional accounting frameworks inadequately address the growing significance of intangible assets, resulting in mismatching between revenues and expenses. Conservative accounting practices further exacerbate this issue by deferring the recognition of intangible-related expenditures, reducing the relevance of earnings as a decision-making tool. The review synthesizes insights from recent studies, highlighting the need for accounting reforms, such as the capitalization of certain intangible investments, to improve financial reporting accuracy. Furthermore, alternative metrics like adjusted earnings and advanced valuation models are discussed as potential solutions for mitigating mismatching effects. This study underscores the importance of evolving accounting standards to better reflect the economic realities of intangible asset-driven businesses

Keywords: Intangible Assets; Earnings Informativeness; Accounting Mismatching; Conservative Accounting; Financial Reporting Reform

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1. Introduction

The informativeness of earnings—their ability to convey useful information to investors and other stakeholders—has long been a cornerstone of financial reporting. However, the modern economic landscape, dominated by knowledge-based industries, presents unique challenges to traditional accounting practices. Intangible assets such as research and development (R&D), intellectual property, and branding have grown to represent significant drivers of corporate value. Yet, the expensing of these investments, as required by current accounting standards, has sparked debates over the extent to which financial statements accurately reflect firms' economic realities.

This literature review investigates the decline in earnings informativeness, focusing on the mismatching of expenses and revenues stemming from the expensing of intangible asset investments. While mismatching is often criticized for distorting financial statements, recent perspectives suggest that it may provide valuable insights into firms' strategic decisions and risk profiles. The integration of intellectual intelligence and emotional intelligence, technological proficiency, and meticulousness forms a comprehensive framework for achieving wise and accurate decisions, ensuring that organizations remain agile and responsive to dynamic environments (Ruslaini, & Ekawahyu Kasih, 2024). By examining the theoretical foundations and empirical evidence, this review aims to reconcile conflicting views on the implications of mismatching and explore potential reforms to enhance the relevance and reliability of financial reporting.

The shift from industrial to knowledge-based economies has elevated the importance of intangible assets, which now constitute a significant proportion of firms' value (Lev, 2018). Despite their economic importance, accounting for intangibles remains fraught with challenges. Current standards often mandate the immediate expensing of intangible-related expenditures, such as R&D, marketing, and employee training, rather than capitalization (Barker et al., 2021). This approach, while adhering to the principle of conservatism, fails to align expenses with the revenues they generate, leading to mismatched income statements (Basu et al., 2016).

The immediate expensing of intangibles has significant implications for financial reporting. On one hand, it reduces earnings volatility by avoiding the speculative nature of capitalizing uncertain future benefits (Lev & Zarowin, 1999). On the other hand, it diminishes the informativeness of earnings by obscuring the relationship between costs and revenues, potentially misleading stakeholders (Bushman et al., 2016). Empirical studies have highlighted the resultant disconnect, with earnings increasingly failing to reflect firms' true economic performance (Francis & Schipper, 1999; Lev, 2001).

Mismatching—the temporal disconnect between when expenses are incurred and when revenues are recognized—has been at the center of debates on earnings quality. Traditional perspectives argue that mismatching distorts earnings, rendering them less useful for decision-making (Dichev & Tang, 2008). For instance, Collins et al. (1997) documented a decline in the value relevance of earnings, attributing it partly to mismatched reporting practices. The good corporate governance and the number of awards received by the companies have a negative, but not significant effect on accrual earnings management and real earnings management practices (Kumandang, C. & Hendriyeni, N.S., 2021).

However, recent research challenges this narrative, suggesting that mismatching may convey valuable information about firms' risk profiles and investment strategies (Oh & Penman, 2024). By expensing intangible investments immediately, firms signal higher risk, which the market prices accordingly (Ciftci et al., 2011). This perspective aligns with the view that conservative accounting practices, despite their limitations, enhance the reliability of financial statements by emphasizing verifiable outcomes (Barker & Lennard, 2021).

The empirical landscape presents a nuanced picture of earnings informativeness amidst evolving accounting practices. Studies like those by Core et al. (2003) and Lev & Zarowin (1999) have documented a decline in the informativeness of financial statements over time. These findings highlight the growing misalignment between reported earnings and firms' underlying economic realities, driven in part by the expensing of intangible investments.

Contrastingly, Oh and Penman (2024) argue that mismatching enhances informativeness by providing insights into firms' strategic decisions and risk management. Their analysis reveals that mismatched expenses often represent higher-risk investments, which the market correctly interprets as signaling greater uncertainty but also potential for higher returns. This perspective challenges the notion that earnings informativeness has uniformly declined, suggesting instead that the decline is context-dependent and influenced by the specific characteristics of mismatched expenditures.

Reconciling the conflicting views on mismatching requires a deeper understanding of its implications for financial reporting. Scholars like Enache and Srivastava (2018) advocate for greater transparency in reporting intangible investments, proposing that firms disclose these expenditures separately from operating expenses. Such an approach could mitigate the adverse effects of mismatching by providing stakeholders with clearer insights into the nature and timing of intangible-related costs.

Additionally, advancements in accounting standards could address the mismatching issue by allowing selective capitalization of intangible investments. Barker et al. (2021) suggest adopting a principles-based approach that balances the need for conservatism with the demand for relevance and reliability in financial reporting. This approach aligns with calls for a conceptual framework that accommodates the unique characteristics of intangible assets (Penman, 2023).

The ongoing debate on intangible asset accounting has significant implications for policymakers, practitioners, and investors. Policymakers must navigate the trade-offs between conservatism and relevance, ensuring that accounting standards reflect the realities of a knowledge-based economy (Barker & Penman, 2020). For practitioners, the challenge lies in providing stakeholders with meaningful insights while adhering to existing standards. Enhanced disclosures and innovative reporting practices could bridge the gap between traditional accounting models and modern economic realities.

For investors, understanding the nuances of mismatching is critical for interpreting financial statements accurately. By recognizing the information content of mismatched expenses, investors can make more informed decisions about firms' risk-return profiles (Oh & Penman, 2024). This underscores the importance of financial literacy and the need for ongoing education in navigating the complexities of intangible asset accounting. Through more accessible financial products, financial education, and improved financial literacy, consumers can make smarter and more structured financial decisions (Benardi, et al, 2024).

The decline in earnings informativeness, attributed to mismatching, reflects broader challenges in accounting for intangible assets in a rapidly evolving economic landscape. While mismatching has been criticized for distorting financial statements, recent evidence suggests it may also enhance informativeness by signaling risk and investment strategies. Reconciling these perspectives requires innovative approaches to accounting standards, enhanced disclosures, and a commitment to aligning financial reporting with economic realities. As the debate continues, this literature review underscores the need for a balanced approach that addresses the limitations of traditional models while embracing the opportunities presented by intangible assets.

2. Literature Review

This literature review examines the relationship between accounting for intangible assets and the observed decline in earnings informativeness. Specifically, it focuses on the role of mismatching between revenues and expenses in financial reporting. The review synthesizes empirical evidence and theoretical insights from contemporary accounting literature to assess whether mismatching has contributed to this decline. Findings suggest that while mismatching plays a role, it is not the sole driver, with other factors such as increased conservatism and the evolving nature of business activities also being significant contributors.

The decline in earnings informativeness over the past decades has raised concerns about the relevance of financial statements for investors and other stakeholders. This phenomenon has been partly attributed to the challenges of accounting for intangible assets and mismatching revenues and expenses (Hyung Il Oh & Penman, 2024). This literature review aims to provide a comprehensive synthesis of prior studies exploring this issue. Capacity development initiatives, such as training programs and educational resources, are essential for enhancing the understanding and professional competence of accounting professionals in implementing IFRS in Indonesia (Muhammad Rizal & Eri Kusnanto, 2021).

Intangible assets, such as research and development (R&D), intellectual property, and brand equity, represent a growing share of corporate value. However, their accounting treatment remains contentious. Lev and Sougiannis (1996) demonstrated that capitalization and amortization of R&D expenditures enhance the value relevance of accounting information. However, current accounting standards generally require expensing these outlays, leading to potential mismatching and a reduction in earnings informativeness (Lev, 2018). Employee engagement behavior has a positive effect on employee creativity (Wajong et al., 2020).

Barker et al. (2021) proposed solutions to improve the accounting for intangible assets, suggesting a hybrid approach that combines elements of capitalization and expensing. Similarly, Penman (2023) emphasized the importance of rethinking the conceptual framework for accounting to better capture the economic realities of intangible investments. Performance management systems are able to provide a framework to support various changes and drive innovation within a company culture (Sugiharti, T., 2022).

Mismatching occurs when revenues and expenses that relate to the same economic activity are reported in different periods. Dichev and Tang (2008) identified this as a critical factor in the declining properties of accounting earnings over the past 40 years. This phenomenon is particularly pronounced in industries with significant intangible investments, where immediate expensing of costs (e.g., R&D) leads to temporal disjunctions in financial statements.

Hyung Il Oh and Penman (2024) countered the assumption that mismatching necessarily reduces earnings informativeness, finding that income statement mismatching has not significantly impaired the predictive power of earnings for future performance. This nuanced view suggests that while mismatching is a concern, its impact may vary across contexts.

Increased conservatism in accounting practices has also been linked to the decline in earnings informativeness. Balachandran and Mohanram (2011) argued that heightened conservatism, while beneficial for risk mitigation, has inadvertently diminished the value relevance of reported earnings. Similarly, Givoly and Hayn (2000) documented a trend toward more conservative reporting, particularly in the treatment of intangible assets, which exacerbates the mismatching problem.

Empirical studies provide mixed evidence on the impact of intangible asset accounting on earnings informativeness. Sougiannis (1994) demonstrated that capitalization of R&D expenditures enhances firm valuation. Banker et al. (2011) extended this analysis to SG&A expenditures, showing that their strategic use can create long-term value. In contrast, Enache and Srivastava (2018) found that commingling intangible investments with operating expenses obscures their economic significance, thereby reducing financial statement clarity.

Bushman et al. (2016) highlighted the changing landscape of accrual accounting, noting a shift away from traditional matching principles. This evolution reflects broader economic changes, including the rise of knowledge-based industries. Chambers et al. (2002) identified excess returns to R&D-intensive firms, suggesting that financial markets partially compensate for the deficiencies of accounting systems.

The literature reveals a complex interplay between mismatching, conservatism, and the accounting treatment of intangible assets. While mismatching contributes to the decline in earnings informativeness, it is intertwined with broader trends in financial reporting and economic activity. Addressing these challenges will require innovative approaches to accounting standards, such as those proposed by Barker et al. (2021) and Penman (2023). Future research should explore the practical implementation of these proposals and their implications for stakeholders.

3. Proposed Method

This study employs a qualitative literature review methodology to explore the relationship between accounting for intangible assets and the decline in earnings informativeness, emphasizing the role of mismatching in financial reporting. A qualitative literature review is well-suited for synthesizing existing research, identifying patterns, and offering theoretical insights into complex phenomena (Snyder, 2019). This approach facilitates a critical examination of diverse studies to uncover trends, inconsistencies, and emerging themes in the context of intangible assets and earnings informativeness.

The literature was sourced from peer-reviewed journals, working papers, and other credible academic repositories. Key search terms included "intangible assets," "earnings informativeness," "accounting mismatching," and "financial reporting conservatism." The review focuses on studies published between 2000 and 2024 to capture contemporary developments and historical trends. Inclusion criteria ensured that selected works directly addressed issues of earnings informativeness, accounting mismatching, or intangible asset valuation, as suggested by Penman and Zhang (2021) and Oh and Penman (2024). Studies that lacked empirical or theoretical relevance were excluded to maintain focus.

To ensure a rigorous analysis, the study adopted a thematic synthesis approach, wherein findings were categorized into key themes, such as the impact of mismatched revenues and expenses on earnings informativeness (Dichev & Tang, 2008) and the challenges of accounting for R&D investments (Lev & Zarowin, 1999). Thematic coding was guided by frameworks established by Braun and Clarke (2006), ensuring systematic identification of recurring and unique patterns.

Validation was achieved through triangulation by comparing insights across multiple studies and theoretical perspectives (Yin, 2018). For instance, the conservative accounting framework proposed by Andronoudis et al. (2019) was juxtaposed with empirical evidence from Balachandran and Mohanram (2011) to evaluate discrepancies and alignments.

This qualitative approach is inherently limited by its reliance on secondary data, which may not fully capture real-time developments in financial reporting practices. Additionally, the subjective nature of thematic analysis introduces potential researcher bias, as noted by Creswell and Poth (2017). Future research could integrate quantitative methods or case studies to complement the insights derived from this literature review.

4. Results

Mismatching between revenues and expenses, particularly in the context of intangible assets, undermines the informativeness of earnings. Dichev and Tang (2008) argue that mismatching distorts the timing and magnitude of reported financial outcomes, leading to a weaker correlation between accounting earnings and firm value. Similarly, Penman and Zhang (2021) highlight that mismatching arises partly from conservative accounting practices, which require immediate expense recognition for intangible investments like R&D, thereby creating temporal distortions.

Recent research by Oh and Penman (2024) challenges the conventional notion that mismatching has reduced earnings informativeness over time. Their findings indicate that the informativeness of earnings remains robust when adjustments are made for inherent mismatches, suggesting that the issue may lie in the interpretation rather than the intrinsic quality of earnings.

Intangible assets, such as intellectual property and R&D investments, have become increasingly critical to firm performance. However, accounting for these assets remains inconsistent and often conservative. Lev and Zarowin (1999) emphasize that the expensing of intangible investments under current standards leads to the systematic undervaluation of firms with significant R&D expenditures. Barker et al. (2021) propose that recognizing intangible assets on the balance sheet could enhance earnings informativeness by aligning accounting practices with the economic realities of modern businesses.

Balachandran and Mohanram (2011) further suggest that increased conservatism in accounting exacerbates mismatching and reduces the value relevance of earnings. Their findings indicate that the immediate expensing of intangibles creates a disconnect between reported earnings and long-term firm performance, contributing to the declining utility of financial statements for investors.

Conservatism in accounting has both advantages and drawbacks. Andronoudis et al. (2019) argue that conservative accounting provides a safeguard against managerial over-optimism by ensuring prudence in financial reporting. However, this conservatism often leads to mismatching, particularly in industries with substantial intangible investments. Bushman et al. (2016) and Givoly and Hayn (2000) note that while conservatism protects against risk, it can also obscure the economic benefits of intangibles, diminishing the informativeness of earnings.

Penman and Zhang (2020) offer a nuanced view, suggesting that conservative accounting conveys important information about firm risk and cost of capital. However, they emphasize the need for nuanced adjustments to better reflect the economic contributions of intangible assets.

The theoretical framework of mismatching highlights its implications for financial statement users. Chambers et al. (2002) and Core et al. (2003) demonstrate that firms with significant intangible investments often experience undervaluation due to accounting mismatches. This has practical implications for investors, policymakers, and standard-setters. Barker and Penman (2020) recommend that accounting standards evolve to better capture the economic value of intangibles, potentially by allowing selective capitalization of certain expenditures.

Additionally, Enache and Srivastava (2018) propose reporting intangible investments separately from operating expenses to enhance transparency and earnings informativeness. This approach aligns with findings from Lev and Sougiannis (1996), who advocate for the capitalization and systematic amortization of R&D expenditures to mitigate mismatching effects.

While mismatching and intangible accounting practices contribute to the decline in earnings informativeness, recent studies suggest potential solutions. Oh and Penman (2024) argue that earnings adjustments can mitigate the distortions caused by mismatching. Similarly, Penman (2023) recommends a principles-based approach to intangible asset accounting to improve financial reporting relevance.

Research by Lev and Gu (2016) and Sougiannis (1994) underscores the importance of refining valuation models to incorporate intangible-driven mismatches effectively. This perspective is critical in addressing the challenges posed by the increasing reliance on intangibles in contemporary economies.

5. Discussion

The relationship between the accounting treatment of intangible assets and the declining informativeness of earnings has generated considerable academic interest. This discussion synthesizes findings from recent literature, critically evaluates the role of mismatching in financial reporting, and highlights theoretical and practical implications. The debate is structured around the themes of mismatching, intangible asset accounting, and conservatism, with comparisons to eight seminal studies to provide a comprehensive perspective.

Mismatching—the misalignment of revenue and expense recognition—has been identified as a critical factor affecting earnings informativeness (Dichev & Tang, 2008). When expenses associated with intangible investments are recognized immediately, while the associated revenues are deferred, earnings lose their ability to convey accurate performance signals (Penman & Zhang, 2021). For instance, Barker and Penman (2020) argue that mismatching contributes to temporal distortions, reducing the value relevance of earnings in decision-making.

Recent studies build on these findings. Oh and Penman (2024) suggest that earnings adjustments can mitigate mismatching's impact, preserving informativeness even under current accounting standards. This perspective contrasts with earlier conclusions by Lev and Zarowin (1999), who highlighted a consistent decline in earnings relevance due to mismatched accounting for intangibles. The divergence suggests evolving methods to address mismatching effectively.

Moreover, Dichev and Tang's (2008) findings resonate with Balachandran and Mohanram (2011), who demonstrated that mismatching reduces the predictive power of earnings for future cash flows. Both studies emphasize the need for adjustments to enhance the utility of financial statements. These results align with recent proposals by Penman (2023), advocating for the refinement of accounting principles to minimize mismatches.

Intangible assets are central to modern economies, yet their accounting remains contentious. Lev and Zarowin (1999) argued that expensing intangible investments underestimates firm value, an assertion supported by Barker et al. (2021). By immediately expensing R&D and similar costs, firms' financial statements fail to reflect their true economic potential (Lev & Sougiannis, 1996).

In contrast, Chambers et al. (2002) emphasized the risk of overcapitalization, where firms might inflate asset values to manipulate earnings. Balancing these perspectives, Enache and Srivastava (2018) proposed separating intangible-related expenses from operating costs, enhancing transparency without sacrificing prudence. This recommendation aligns with findings by Barker and Penman (2020), who argued for selective capitalization as a pathway to improved earnings informativeness.

Comparatively, Givoly and Hayn (2000) identified a broader decline in the value relevance of earnings, attributing it to increasing complexity in financial reporting. This complexity is exacerbated by inconsistent treatment of intangible assets, as noted by Andronoudis et al. (2019). Both studies underscore the need for accounting standards that reflect the economic realities of intangibles.

Accounting conservatism, while valuable for risk mitigation, has implications for the informativeness of earnings. Bushman et al. (2016) noted that conservatism enhances reliability by emphasizing caution in recognizing revenues and gains. However, it also amplifies mismatching, particularly for intangible-intensive industries (Andronoudis et al., 2019).

Givoly and Hayn (2000) identified a shift towards increased conservatism, correlating with reduced informativeness of earnings. Their findings align with Penman and Zhang's (2021) assertion that conservatism's benefits must be weighed against its potential to obscure economic realities. Furthermore, Lev and Zarowin's (1999) critique of conservatism emphasizes its role in distorting earnings when applied to intangible assets.

More recent studies offer nuanced perspectives. Oh and Penman (2024) suggest that conservatism's impact on earnings informativeness is context-dependent, varying with industry characteristics and firm-specific factors. This view is supported by Balachandran and Mohanram (2011), who found that conservatism's effects diminish when adjustments are made for mismatches.

A comparative analysis of eight key studies reveals divergent views on the interplay between intangible asset accounting, mismatching, and earnings informativeness: Lev and Zarowin (1999) argued for a direct link between intangible expensing and declining earnings relevance, a finding echoed in more recent critiques (Barker et al., 2021). Dichev and Tang (2008) highlighted mismatching as a core issue, aligning with Penman (2023), who advocated for principles-based accounting adjustments. Chambers et al. (2002) warned against overcapitalization, contrasting with Lev and Sougiannis (1996), who supported capitalization as a means to enhance earnings informativeness. Givoly and Hayn (2000) observed a systemic decline in earnings relevance, attributing it to broader reporting complexities, a view reinforced by Andronoudis et al. (2019). Balachandran and Mohanram (2011) emphasized the diminishing effects of mismatching adjustments on earnings informativeness, complementing findings by Oh and Penman (2024). Bushman et al. (2016) and Penman and Zhang (2021) provided nuanced discussions on conservatism's dual role, highlighting both its benefits and drawbacks. Enache and Srivastava (2018) and Barker and Penman (2020) proposed innovative solutions for intangible accounting, emphasizing transparency and alignment with economic realities. These comparisons reveal a dynamic field of inquiry, with evolving perspectives reflecting advancements in both theoretical frameworks and empirical methodologies.

The findings have significant implications for accounting theory and practice. Theoretically, the discussion reinforces the relevance of mismatching as a critical concept in financial reporting (Dichev & Tang, 2008; Penman & Zhang, 2021). Practically, it underscores the need for standards that address the unique challenges posed by intangible assets (Barker et al., 2021; Enache & Srivastava, 2018).

From a policymaker's perspective, adopting principles-based approaches to intangible asset accounting could enhance the informativeness of earnings. Such approaches should balance the benefits of conservatism with the need for transparency and alignment with economic realities (Bushman et al., 2016; Penman, 2023). For practitioners, the findings highlight the importance of contextualizing financial statements within the broader economic environment, particularly in intangible-intensive industries.

The interplay between intangible asset accounting, mismatching, and earnings informativeness remains a complex yet critical area of study. This discussion highlights the need for continued research to refine theoretical frameworks and inform practical solutions. By addressing mismatching and improving the accounting treatment of intangible assets, policymakers and practitioners can enhance the utility of financial statements in an increasingly intangible-driven economy.

6. Conclusions

This qualitative literature review investigates the interplay between the accounting treatment of intangible assets, mismatching issues, and the declining informativeness of earnings. The findings reveal that the growing prevalence of intangible assets has exacerbated mismatching between revenues and expenses, diminishing the relevance of earnings as a decision-useful measure (Penman & Yehuda, 2019). Additionally, conservative accounting practices have compounded this effect by systematically deferring the recognition of certain intangible-related expenditures, reducing earnings' ability to convey economic reality (Barker & Penman, 2020).

Comparison with prior studies highlights that mismatching primarily arises from the inability of current accounting standards to adequately align intangible asset recognition with their economic benefits (Dichev & Tang, 2008). Research also shows that firms with higher investments in R&D and SG&A expenditures experience greater mismatching effects, influencing earnings informativeness (Chan et al., 2001; Banker et al., 2011). However, alternative metrics like adjusted earnings and cash flow-based measures provide opportunities for mitigating the limitations of traditional earnings metrics (Francis & Schipper, 1999).

Despite these insights, the study emphasizes the need for accounting reforms, such as the capitalization of certain intangible investments, to improve the alignment between financial reporting and economic performance. Additionally, advanced technologies like AI-driven valuation models could address mismatching and enhance decision-making for investors and stakeholders (Enache & Srivastava, 2018).

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