The University of Texas at Austin

Fundamentals of Financial Accounting Research (ACC 386K.7)

Fall 2012

Instructor: Yong Yu
Office: CBA 4M.254
Office Hours: Tuesday 4-6PM (appointment recommended)
Phone: 471-6714
E-mail: Yong.Yu@mccombs.utexas.edu

Course objective:

The Fundamentals Seminar is a prerequisite for Empirical Research in Accounting (ACC 386K.3), which covers selected current topics in empirical accounting research, especially recent research that extends the empirical basics introduced in the fundamental Seminar. The direct objectives of these two seminars are (i) provide an introduction to the basic building blocks of market-based accounting research fitting in economics-based asset pricing and signaling theories, (ii) link the motivation behind empirical hypotheses to economic theory, (iii) evaluate empirical methods employed to test those hypotheses. The seminars seek to prepare students for research careers in archival-empirical research (with a focus on market-based financial accounting research).

Course format:

The course is structured in a seminar format. Every student is expected to thoroughly read the assigned readings before class and to fully participate in the in-class discussion. Students should have a working knowledge of background/supplemental readings and should be prepared to discuss them as well.

Each session one student will be assigned to a required paper. This student should prepare and distribute a written summary of the paper (maximum 2 pages), and lead the in-class discussion. The written summary and the in-class discussion should focus on the following questions:

Part 1: Research question and motivation:

- What are the research questions?
- Why is it important? Who cares, and why?
- How do the research questions add to the literature?

Part 2: Theory and hypotheses:

- What are the research hypotheses?
- Do the hypotheses follow the theory?
- Are there credible null hypotheses?
- Are there any competing hypotheses?

Part 3: Empirical methods:

- How did the authors select their sample? What are the implications of the sample selection criteria?
- What is the basic research design? Does the design test the hypotheses? Is the design appropriate? Do the empirical measures capture their underlying constructs? What empirical models are estimated? Are there omitted variables? Are the models appropriately specified? Do the tests cause any bias?

Part 4: Interpretation of the results

- What are the key findings? Are the findings economically meaningful?
- Are the results interpreted appropriately? Do the results answer the questions? Are there competing explanations for the results?

Empirical projects:

This seminar has four to five empirical projects. Those projects require you to replicate (and possibly extend) some major findings in the papers we discuss in class. The data for all the projects should be available on WRDS. The projects can be done in teams (each team should have no more than 2 students).

Grading:

Written summary of assigned readings:	30%
Class participation and discussion:	30%
Empirical projects:	40%

Reading list:

W1 (9/4): Accounting information and stock prices: early studies

- Ball, R., and P. Brown. 1968. An empirical evaluation of accounting income numbers, *Journal of Accounting Research*, 159-178. [Jeanmarie]

- Beaver, W., 1968. The information content of annual earnings announcements, *Journal of Accounting Research*, 67-92. [Prasart]

Background and supplemental readings:

- Kinney, W., 1986. Empirical Accounting Research Design for Ph.D. students. *The Accounting Review*, 338-350.

- Kothari, S.P., 2001. Capital markets research in accounting. *Journal of Accounting and Economics* 31, 105-231.

- Lee, M., 2001. Market efficiency and accounting research: A discussion of "Capital markets research in accounting" by S.P. Kothari. *Journal of Accounting and Economics* 31, 233-253.

Week 2 (9/11): Accounting information and stock prices: Determinants of ERC

- Kormendi, R., and R. Lipe, 1987. Earnings innovations, earnings persistence, and stock returns. *Journal of Business*, 323-346. [Kathleen]

- Easton, P., and M. Zmijewski, 1989. Cross-Sectional Variations in the Stock Market Response to Accounting Earnings Pronouncements. *Journal of Accounting and Economics* 11, 117-141. [Ying]

Background and supplemental readings:

- Lipe, R., 1986. The information contained in the components of earnings. *Journal of Accounting Research*, 37-64.

- Collins, D., and S. Kothari. 1989. An Analysis of Intertemporal and Cross-Sectional Determinants of Earnings Response Coefficients. *Journal of Accounting and Economics*, 143-81.

- Easton, P., T. Harris, and J. Ohlson, 1992. Aggregate accounting earnings can explain most of security returns. *Journal of Accounting and Economics* 15, 119-142.

W3 (9/18): Accounting information and stock prices: Why estimated ERC so small?

- Collins, D., S.P. Kothari, J. Shanken, and R. Sloan, 1994. Lack of timeliness and noise as explanations for the low contemporaneous returns-earnings association. Journal of Accounting and Economics 18, 289-324. [Jeanmarie]

- Hayn, C., 1995. "The Information Content of Losses," *Journal of Accounting and Economics*, 125-153. [Shannon]

Background and supplemental readings:

- Atiase, R., 1985. Predisclosure information, firm capitalization and security price behavior around earnings announcements. *Journal of Accounting Research*, 21-36.

- Freeman, R., 1987. The association between accounting earnings and security returns for large and small firms. *Journal of Accounting and Economics*, 195-228.

- Beaver, W., R. Lambert and S. Ryan, 1987. The information content of security prices: A second look. *Journal of Accounting and Economics* 9, 139-157.

- Basu, S., 1997. The conservatism principle and the asymmetric timeliness of earnings. *Journal of Accounting and Economics* 24, 3-37.

W4 (9/25): Accounting information and stock prices: PEAD 1

- Bernard, V., and J. Thomas, 1989. Post-Earnings Announcement Drift: Delayed Price Response or Risk Premium? *Journal of Accounting Research*, 1-48. [Kathleen]

- Bernard, V. and J. Thomas, 1990. Evidence that Stock Prices Do Not Fully Reflect the Implications of Current Earnings for Future Earnings. *Journal of Accounting and Economics*, 305-340. [Prasart]

Background and supplemental readings:

- Freeman, R., and S. Tse, 1989. The multiperiod information content of accounting earnings: Confirmations and contradictions of previous earnings reports. *Journal of Accounting Research*, 49-84.

- Ball, R., and E. Bartov, 1996. How naive is the stock market's use of earnings information? *Journal of Accounting and Economics* 21, 319-337.

- Bernard, V., J. Thomas, and J. Wahlen, 1997. Accounting-based stock price anomolies: Separating market inefficiencies from risk. *Contemporary Accounting Research* 14, 89-136.

W5 (10/2): Accounting information and stock prices: PEAD 2

- Chardia, T. and L. Shivakumar, 2006. Earnings and Price Momentum. *Journal of Financial Economics*, 627-656. [Ying]

- Garfinkel, J. and J. Sokobin, 2006. Volume, Opinion Divergence, and Returns: A Study of Post-Earnings Announcement Drift. *Journal of Accounting Research*, 85-112. [Jeanmarie]

Background and supplemental readings:

- Doyle, J., R. Lundholm, and M. Soliman, 2006. The extreme future stock returns following I/B/E/S earnings surprises. *Journal of Accounting Research*, 849-887.

- Livnat, J., and R. Mendenhall, 2006. Comparing the post-earnings-announcement drift for surprise calculated from analyst and time series forecasts. *Journal of Accounting Research*, 177-205.

- Ng, J., T. Rusticus, and R. Verdi. 2008. Implications of transaction costs for the post-earnings-announcement drift. *Journal of Accounting Research* 46, 661-696.

W6 (10/9): Accounting information and stock prices: Other accounting anomalies

- Ou, J., and S. Penman, 1989. Financial Statement Analysis and the Prediction of Stock Returns. *Journal of Accounting & Economics*, 295-329. [Shannon]

- Sloan, R., 1996. Do Stock Prices Fully Reflect Information in Accruals and Cash Flows about Future Earnings? *The Accounting Review*, 289-315. [Prasart]

Background and supplemental readings:

- Hand, J., 1990. A test of the extended functional fixation hypothesis. *The Accounting Review*, 740-763.

- Lev, B., and S. Thiagarajan, 1993. Fundamental information analysis. *Journal of Accounting Research*, 190-215.

- Pontiff, J., 2006. Costly arbitrage and the myth of idiosyncratic risk. *Journal of Accounting and Economics*, 35-52.

Week 7 (10/16): Accounting information and analysts' forecasts

- Abarbanell, J. and V. Bernard, 1992. Tests of analysts' overreaction/underreaction to earnings information as an explanation for anomalous stock price behavior. *Journal of Finance* 47, 1181 - 1207. [Kathleen]

- Ali, A., A. Klein, and J. Rosenfeld, 1992. Analysts' use of information about permanent and transitory earnings components in forecasting annual EPS. *The Accounting Review* 67, 183 - 198. [Ying]

Background and supplemental readings:

- Lys, T., and S. Sohn, 1990. The association between revisions of financial analysts' earnings forecasts and security price changes. *Journal of Accounting and Economics* 13, 341-363.

- Easterwood, J., and S. Nutt, 1999. Inefficiency in analysts' earnings forecasts: systematic misreaction or systematic optimism? *Journal of Finance* 54, 1777-1797.

- Abarbnell, J., and R. Lehavy, 2003. Biased forecasts or biased earnings? The role of reported earnings in explaining apparent bias and over/underreaction in analysts' earnings forecasts. *Journal of Accounting and Economics* 36, 105-146.

Week 8 (10/23): Accounting information and stock prices: Residual income model

- Feltham, J., and J. Ohlson, 1995. Valuation and Clean Surplus Accounting for Operation and Financial Activities. *Contemporary Accounting Research*, 689-731. [Prasart]

- Frankel, R., and C. Lee, 1998. Accounting Valuation, Market Expectations, and Cross-Sectional Stock Returns. *Journal of Accounting and Economics*, 283-319. [Jeanmarie]

Background and supplemental readings:

- Bernard, V., 1995. The Feltham-Ohlson framework: Implications for empirists. *Contemporary Accounting Research*, 733-747.

- Feltham, J., and J. Ohlson, 1999. Residual earnings valuation with risk and stochastic interest rates. *The Accounting Review* 74, 165-183.

- Ohlson, J., 2001. Earnings, equity book values, and dividends in equity valuation: an empirical perspective. *Contemporary Accounting Research* 18, 107-120.

Week 9 (10/30): Value relevance

- Barth, M.E., 1994. Fair value accounting: Evidence from investment securities and the market valuation of banks. *The Accounting Review* 69, 1-25. [Shannon]

- Francis, J., and K. Schipper, 1999. Have financial statements lost their relevance? Journal of Accounting Research 37, 319-352. [Kathleen]

Background and supplemental readings:

- Holthausen, R., and R. Watts, 2001. The relevance of value-relevance literature for financial accounting standard setting. *Journal of Accounting and Economics* 31, 3-76.

- Barth, M., W. Beaver, and W. Landsman, 2001. The relevance of the value relevance literature for financial accounting standard setting: Another view. *Journal of Accounting and Economics* 2001, 77-104.

- Brown, S., K. Lo, and T. Lys, 1999. Use of R2 in accounting research: measuring changes in value relevance over the last four decades. *Journal of Accounting and Economics* 28, 83-115.

Week 10 (11/6): Earnings management 1

- Healy, P., 1985. The effect of bonus schemes on accounting decisions. *Journal of Accounting and Economics* 7, 85-107. [Jeanmarie]

- Holthausen, R., D. Larcker, and R. Sloan, 1995. Annual bonus schemes and the manipulation of earnings," *Journal of Accounting and Economics*, 29-74. [Prasart]

Background and supplemental readings:

- McNichols, M. and P. Wilson, 1988. Evidence of earnings management from the provision for bad debts. *Journal of Accounting Research* 26, 1-31.

- Jones, J., 1991. Earnings management during import relief investigations. *Journal of Accounting Research* 29, 193-228.

- Schipper, K., 1989. Commentary on earnings management. *Accounting Horizons* 3, 91-102.

- Healy, P., and J. Wahlen, 1999. A review of the earnings management literature and its implications for standard setting, *Accounting Horizons*, 13, 365-383.

Week 11 (11/13): Earnings management 2

- Burgstahler, D. and I. Dichev, 1997. Earnings Management to Avoid Earnings Decreases and Losses. *Journal of Accounting and Economics*, 99-126. [Ying]

- Degeorge, F., P. Jayendu, and Z. Richard, 1999. Earnings management to exceed thresholds, Journal of Business, 72, 1-33. [Shannon]

Background and supplemental readings:

- Durtschi, C. and P. Easton, 2005. Earnings management? The shapes of the frequency distributions of earnings metrics are not evidence Ipso Facto. *Journal of Accounting Research* 43, 557-592.

- Graham, J., C. Harvey, and S. Rajgopal, 2005. The economic implications of corporate financial reporting. *Journal of Accounting and Economics* 40, 3-73.

- Dechow, P., and D. Skinner. 2000. Reconciling the views of accounting academics, practitioners, and regulators. *Accounting Horizon* 14, 235-250.

Week 12 (11/20): Voluntary disclosure and cost of capital

- Botosan, C., 1997. Disclosure level and the cost of equity capital. *The Accounting Review* 72, 323 - 350. [Jeanmarie]

- Leuz, C., and R. Verrecchia, 2000. The economic consequences of increased disclosure. *Journal of Accounting Research* 38, 91-124. [Prasart]

Background and supplemental readings:

- Modigliani, F. and M. Miller, 1958. The cost of capital, corporate finance and the theory of investment. *American Economic Review* 48, 261-297.

- Lang, M., and R. Lundholm, 1996. Corporate disclosure policy and analyst behavior. *The Accounting Review*, 467-492.

- Healy, P., and K. Palepu, 2001. Information asymmetry, corporate disclosure, and the capital markets: A review of the empirical disclosure literature. *Journal of Accounting and economics* 31, 405-440.

- Easton, P., and S. Monahan, 2005. An evaluation of accounting based measures of expected returns. *The Accounting Review*, 501-538.

Week 13 (11/27): Accounting information and corporate governance

- DeAngelo, L., 1988. Managerial competition, information costs, and corporate governance: The use of accounting performance measures in proxy contests. *Journal of Accounting and Economics* 10, 3-36. [Kathleen]

- Gaver, J., and K. Gaver. 1998. The relation between nonrecurring accounting transactions and CEO cash compensation. *The Accounting Review* 73, 235-253. [Ying]

Background and supplemental readings:

- Jensen, M., and W. Meckling, 1976. Theory of the firm: Managerial behavior, agency costs, and ownership structure. *Journal of Financial Economics* 3, 305-360.

- Bushman R., and A. Smith, 2001. Financial accounting information and corporate governance. *Journal of Accounting and Economics*, 237-333.

- Bushman, R., Q. Chen, E. Engel, and A. Smith, 2004. Financial accounting information, organizational complexity and corporate governance systems. *Journal of Accounting and Economics*, 167-201.

Week 14 (12/4): International Studies

- Ball, R., S.P. Kothari, and A. Robin, 2000. The effect of international institutional factors on properties of accounting earnings. *Journal of Accounting and Economics 29,* 1-51. [Jeanmarie]

- Fan, J., and T.J. Wong, 2002. Corporate ownership structure and the informativeness of accounting earnings in East Asia. *Journal of Accounting and Economics* 33, 401-425. [Shannon]

Background and supplemental readings:

- La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R., 2000. Investor Protection and Corporate Governance. *Journal of Financial Economics* 58, 3-27.

- Ball, R., 2001. Infrastructure requirements for an economically efficient system of public financial reporting and disclosure, *Brookings-Wharton Papers on Financial Services*, 127-169.

- Ball, R,, A. Robin and J. Shuang Wu, 2003. Incentives versus standards: Properties of accounting income in four East Asian countries and implications for acceptance of IAS, *Journal of Accounting and Economics* 36, 235-270.