Accounting Theory

Winter Term 2017/18

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JProf. Dr. Nadine Georgiou
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I.   Time Schedule

Lectures

- Room: J 372
- Time: 2.15pm – 3.45pm
    - Class 0: 12.10.2017
    - Class 1: 02.11.2017
    - Class 2: 09.11.2017
    - Class 3: 16.11.2017
    - Class 4: 23.11.2017
    - Class 5: 30.11.2017
- Computer Labs
    - Room: Juridicum - JUR 002 (Wiwi Pool 1) (CIP-Pool)
    - Time: 6.15pm – 7.45pm
        - Lab 1: 09.11.2017
        - Lab 2: 16.11.2017
        - Lab 3: 23.11.2017
        - Lab 4: 30.11.2017
- 2 to 4-Day Seminar in December 2017
    - Day 1:
        - Monday, 04.12.2017 in room (tba)
        - Time: 9am – 5pm
    - Day 2:
        - Tuesday, 05.12.2017 in room (tba)
        - Time: 9am – 5pm
    - Day 3:
        - Wednesday, 06.12.2017 in room (tba)
        - Time: 9am – 5pm
    - Day 4:
        - Thursday, 07.12.2017 in room (tba)
        - Time: 9am – 5pm

Depending on the number of course participants the seminar will be held on 2 to 4 days. The number of participants is limited to 20-25 students.

II.   Registration

You must register officially at the examination office (PAM) to be able to participate in this course! The online registration period starts on **09.10.2017** and ends on **15.10.2017**. The last chance to register in person at the examination office is: **16.10.2017**. In addition we would like to ask you to sign-in for the course at: https://www.wiwi.uni-muenster.de/iub/de/studierende/aktuelle-anmeldungen-am-institut/anmeldung-accounting-theory-im-ws-20172018

This course can be selected within the curriculum of the Master and PhD program:

- Master Program
    - ACM 9, 12, 15, 18 / FCM 13 / CfM 10 / MCM 16
    - 6 ETCS
- Structured PhD Program
    - B, C credit

III.   Course Concept

The course may be held in German or English. It consists of three parts:

- a lecture (5 weekly appointments in November, 2017),
- computer lab sessions (4 weekly appointments in November, 2017)
- a 2 to 4-day seminar (in December, 2017).

Each lecture's content will basically be centered around one research paper (see section VII for details). The lecture's aim is to introduce students to the subject of 'capital-market based accounting research' and to teach them the basic theoretical foundations of this subject.

The computer labs will focus on applied econometrics. The goal here is twofold. First, to teach students the fundamentals of how to conduct an own small research project (12-15pages). This is especially important for those students who aim to write an empirical master thesis. Second, to teach students the necessary fundamentals of econometrics and statistics to be able to better understand the empirical analysis in the assigned readings.

Based on the knowledge gained from the lectures and the computer lab sessions the third part of the course will be held as a 2 to 4-day seminar. The seminar will be held jointly with JProf. Dr. Nadine Georgiou (TU Dortmund) as well as students from the TU Dortmund.

IV.   Course Content

The course 'accounting theory' provides an introduction to empirical research on the relation between capital markets and financial statements. We first provide an overview of the broad area of market-based accounting research. In doing so, we mainly focus on the following topics:

- information content and value relevance of accounting numbers ('decision usefulness')
- determinants of market reactions to accounting news
- tests of market efficiency with respect to accounting information
- the role of accounting information in fundamental analysis and valuation
- measurement and valuation implications of earnings quality

Since our focus is on archival studies, we also explore and discuss basic research design issues that must be considered when conducting empirical studies in this area. In doing so, we mainly focus here on:

- repetition of the classical linear regression model and its underlying assumptions
- consequences and remedy of the violation of some of the classical assumptions
- provide an introduction to statistical software packages as STATA and EViews
- introduce students to the estimation of basic linear regression models and the statistical interpretation of the results
- provide theoretical background on ARIMA time-series models and economic models of investors' expectation formation
- Dummy variable and truncated variable models

V.   Course Objective

The objective of this course is to develop your ability to critically evaluate existing research and to conduct own empirical research (either a master or doctoral thesis) in the above mentioned areas. Important elements of this course include developing:

- an appreciation for the role of accounting and finance theory in applied work
- an understanding of research designs commonly used in accounting and finance research
- the necessary skills to assess, design, and conduct empirical research in accounting and finance

We expect each of you to take an active role in the class and seminar sessions. This requires in-depth reading and critical analysis of the assigned papers prior to the class in which they are discussed.

The purpose of the class and seminar discussions is not only to summarize the assigned papers. The focus should also be on addressing questions such as: Why was the topic chosen? What is the theoretical basis underlying the analysis? What are the properties of the research design? The idea is to understand why the study was conducted in the manner it was.

Quality participation in class and seminar discussions can take several forms including: clarifying issues raised in the assigned readings to enhance the understanding of the class; asking questions; providing supportive comments or constructively challenging what other participants have said; integrating the material covered both within and across class sessions; and offering new ideas!

For those who will aim writing a thesis (master or doctoral) in the archival/empirical area, we view the class as a very important one. We cannot stress this point enough – this is where much of what you have learned in accounting, finance, micro, stats, and econometrics classes all comes together. Thus, we expect and strongly recommend you allocate lots of your time to reading and thinking about the papers before you come to class. Do not just quickly skim the paper before class!

VI.   Course Requirements and Grading

You will be graded based on three performances:

- Your oral participation during the class and seminar (25%)
- Your paper presentation in the seminar (25%)
- A written exam in form of a 12-15 pages seminar paper (Seminararbeit) (50%)

Master students will receive a grade (6 credit points); doctoral students will be graded with passed/failed (6 credit points).

- Oral participation during the class and seminar (25%)
    - You are expected to take an active part in discussing and evaluating the readings assigned for each class and during the seminar. Although the class will mainly be held using traditional frontal teaching method, there will be some room for questions and discussion. We expect you to read the assigned papers prior before coming to class and to be prepared and able to ask questions and participate in the discussions.
- Paper presentation in the seminar (25%)
    - During the seminar the student participants will take over and the lecturers will have only a moderating function. Each student will have to present a research paper. Papers for presentation can be chosen from the selection in part VIII of this course syllabus. We will allocate 45 min for each paper in the seminar; 30 min for your presentation and 15 min for a joint discussion. We expect you to prepare a 30 min. PowerPoint presentation about your paper. The structure of your presentation should cover the following contents and aspects included in your paper:
        - research question
        - motivation, contribution
        - theory, hypotheses
        - empirical design
        - data and descriptive statistics
        - results
        - conclusion

A more detailed description and a template on how to summarize a research paper will be distributed in one of the first classes.

Please send you PowerPoint presentation until **01.01.2018** to: adrian.kubata@wiwi-uni-muenster.de

- 12-15 pages seminar paper (50%)
    - You have the choice to conduct your seminar paper either
        - a 12-15 pages paper discussion of the research paper that have been assigned to you and that you already presented during the seminar
        or
        - an own 12-15 pages research project on a topic of your choice.

Detailed information and templates on (i) how to discuss a research paper and (ii) how to conduct an own research project will be provided in one of the first classes.

All grades from winter term's 2017/18 assignments will be announced by the examination office (PAM) on 30.03.2017. We will need about two weeks to grade your written exams. The deadline for handing in your written exams will therefore be on **16.03.2018**.

Please send your written exam (both as a word document and as a pdf document) via email to: adrian.kubata@wiwi.uni-muenster as well as hand in a printed version of your work to our secretary Ms. Anna-Lena Hernández Ballester (room J 381) at latest on **16.03.2018**.

VII.   Detailed Overview Lectures' Contents

Class 1: 02.11. 2017 – Overview of capital market-based accounting research

Kothari, S. P. (2001): Capital markets research in accounting. Journal of Accounting and Economics, 31, 105-232.

Class 2: 09.11.2017 – Information content

Ball, R., Brown, P. (1968): An Empirical Evaluation of Accounting Income Numbers. Journal of Accounting Research, 6, 159-178.

Class 3: 16.11.2017 – Earnings response coefficient I

Kormendi, R., Lipe, R. (1987): Earnings Innovations, Earnings Persistence, and Stock Returns. The Journal of Business, 60, 323-345.

Class 4: 23.11.2017 – Earnings response coefficient II

Collins, D., Kothari, S. P. (1989): An Analysis of Intertemporal and Cross-Sectional Determinants of the Earnings Response Coefficients. Journal of Accounting and Economics, 11, 143-181.

Class 5: 30.11.2017 – Market Inefficiency

> Lee, C. (2001): Market Efficiency and Accounting Research: A Discussion of Capital Market Research in Accounting by S. P. Kothari. Journal of Accounting and Economics, 31, 233-253.

VIII.   Selection of Papers for the Seminar

Course participants can choose one of the papers listed below for their presentation in the seminar. The papers assignment and allocation to course participants will be on the 'first come, first served' principle. Once you have chosen a paper, sign up with Adrian Kubata at: adrian.kubata@wiwi.uni-muenster.de

1. Information Content

> Beaver, W. H., "The Information Content of Annual Earnings Announcements," Supplement to the Journal of Accounting Research (1968), pp. 67-92.

2. Stock Price Adjustment

> Fama, E. F., Fisher, L., Jensen, C. M., Roll, R., "The Adjustment of Stock Prices to New Information", International Economic Review, 10, No. 1 (1969), pp. 1-21.

3. Information Content and Losses

> Hayn, C., "The Information Content of Losses," Journal of Accounting and Economics (September 1995), pp. 155-192

4. Conservatism

> Basu, S., "The Conservatism Principle and the Asymmetric Timeliness of Earnings," Journal of Accounting & Economics (December, 1997), pp. 3-37.

5. Pricing Implications of Earnings and Cash Flows

> Dechow, P., "Accounting Earnings and Cash Flows as Measures of Firm Performance: The Role of Accounting Accruals," Journal of Accounting and Economics (July 1994), pp. 3-42.

6. Pricing Implications of Alternative Performance Measures

> Bowen, R., G. Biddle and J. Wallace. "Does EVA beat Earnings? Evidence on Associations with Stock Returns and Firm Values," Journal of Accounting and Economics (December 1997) pp. 301-306.

7. Pricing Implications of Earnings Management

> Subramanyam, K. R., „The pricing of discretionary accruals". Journal of Accounting and Economics, 22, pp. 249-281.

8. Market Pricing of Earnings and Cash Flows

Sloan, R. "Do Stock Prices Fully Reflect Information in Accruals and Cash Flows About Future Earnings?" The Accounting Review (July 1996) pp. 289-316.

9. Market Pricing of Accrual Quality

Francis, J, Lafond, R., Olsson, P., and Schipper, K., "The Market Pricing of Accruals Quality," Journal of Accounting and Economics 39(2) (2005), 295-327.

10. Value Relevance of Financial Statements I

Francis, J. and Schipper, K., "Have Financial Statements Lost Their Relevance?" Journal of Accounting Research (Autumn 1999), pp. 319-352.

11. Value Relevance of Financial Statements II

Collins, D., Maydew, E., Weiss, I., "Changes in the value-relevance of earnings and book values over the past forty years". Journal of Accounting and Economics 24(1) (December 1997), pp. 39-67.

12. Measuring Expected Risk Premia

Botosan, C., and Plumlee, M., "Assessing Alternatives Proxies for Expected Risk Premium," The Accounting Review, (January 2005), 21-53.

13. Measuring Expected Rates of Return

Easton, P., and Monahan, S., "An Evaluation of Accounting Based Measures of Expected Returns," The Accounting Review, (April 2005), pp. 501-538.

14. Aggregate Level ERCs

Kothari, S. P., Lewellen, J., Warner, J. B., "Stock returns, aggregate earnings surprises and behavioral finance", Journal of Financial Economics, (September 2006), pp. 537-568.

15. Price and Return Models

Kothari, S. P., Zimmerman, J. L., „Price and Return Models", Journal of Accounting and Economics, 20, (1995), pp. 155-192.

16. Earnings Quality Overview

Dechow, P., Ge, W., Schrand, C., „Understanding earnings quality: A review of the proxies, their determinants and their consequences", Journal of Accounting and Economics, 50, (2010), pp. 344-401.

17. Dividend Payout Ratios and ERCs

Kallapur, S., „Dividend payout ratios as determinants of earnings response coefficients – A test of the free cash flow theory", Journal of Accounting and Economics, 17, (1994), pp. 359-375.

18. Persistence and Pricing of Earnings, Accruals, and Cash Flows

Hanlon, M., "The Persistence and Pricing of Earnings, Accruals, and Cash Flows When Firms have Large Book-Tax Differences", The Accounting Review, 80, (2005), pp. 137-166.

19. Earnings Levels and ERCs

Ali, A. A., Zarowin, P., "The Role of Earnings Levels in Annual Earnings-Returns Studies", Journal of Accounting and Economics", 30, (1992), pp. 286-264.

20. The Effect of Permanent and Transitory Earnings on ERCs

Ali, A., Zarowin, P., "Permanent versus transitory components of annual earnings response coefficients", Journal of Accounting and Economics", 15, (1992), pp. 249-164.

All papers will be uploaded at the learn web: https://www.uni-muenster.de/LearnWeb/learnweb2/ → Accounting Theory WS 2017/18.

We might add some additional papers to the selection provided above within the next few weeks.

Students can also provide suggestions of other papers that they would like to present in the seminar. Those papers should have been published in one of the below listed Journals:

- The Accounting Review (TAR)
- Journal of Financial Economics (JFE)
- Journal of Accounting and Economics (JAE)
- Contemporary Accounting Research (CAR)
- Journal of Accounting Research (JAR)

If you wish to present another paper and have a specific suggestion, please send your suggestion to: adrian.kubata@wiwi-uni-muenster.de

IX.   Research Question Suggestions for Students Research Projects

1. Do accounting numbers contain value relevant information?
2. Does the market value earnings management?
3. Do accounting earnings follow a Random Walk?
4. Do stock prices follow a Random Walk?
5. Has the value relevance of accounting numbers changed over time?
6. Has the earnings quality changed over time?
7. How do losses affect the earnings response coefficient?
8. Are accounting earnings or analysts forecast better surrogates of investors' expectations?

    etc.