

Accounting Theory

Master program: ACM 9, 12, 15 / FCM 13 / CfM 10 / MCM 16 (6 ETCS)
Structured PhD program: B, C credit

I. Course description

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
- 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. The points of focus lie 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
- running regressions using STATA and EViews
- ARIMA time-series models, models of expectations
- Dummy variable and truncated variable models

The objective of this course is to develop your ability to critically evaluate existing research and to conduct own empirical research (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

II. Course details

The course consists of two parts, a lecture (5 weekly appointments) and a two-day seminar.

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

The second part of the course will be held as a two-day seminar. The seminar will be held jointly with Prof. Dr. Christiane Pott (TU Dortmund) and students from the TU Dortmund University. The seminar will focus on 'capital-market based accounting research'. You are expected to take an active part in discussing and evaluating the readings assigned for each class and during the seminar. 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. The structure of your presentation should include the following aspects:

- research question
- motivation, contribution
- theory, hypotheses
- empirical design
- data and descriptive statistics
- results
- conclusion

For a more detailed description we will distribute a template for how to summarize a paper in one of the first classes.

III. Course requirements and grading

You will be graded based on three performances:

- your research paper presentation during the seminar (25%)
- your class and seminar participation (25%)
- a written critique of the research paper which you presented during the seminar (50%)

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

Note the emphasis on "you" in the course objectives. What you take away from this seminar varies in direct proportion to what you give to it. 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. We will allocate about 40 minutes for every paper presentation during the seminar (20 min presentation and 20 min for the discussion).

Quality participation in class 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 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 micro, stats, econometrics, accounting, and finance 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!

IV. Schedule

- Lecture (weekly):
 - Thursdays, starting on November 3rd through December 1st, 2016
 - 2.15 pm to 3.45 pm, J 372
- Two-day seminar
 - December 7th, 2016, 9.00 am to 5.00 pm, JO 101 (Johannisstraße 4, Religion und Politik)
 - December 8th, 2016, 9.00 am to 5.00 pm, Karl-Bender-Saal (Juridicum)

Lectures

Class 1: Thursday, November 3rd, 2016 — 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: Thursday, November 10th, 2016 — Information content

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

Class 3: Thursday, November 17th, 2016 — 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: Thursday, November 24th, 2016 — 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: Thursday, December 1st, 2016 — 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.

V. Selection of papers for the seminar

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
Francis, J. and Schipper, K., "Have Financial Statements Lost Their Relevance?" *Journal of Accounting Research* (Autumn 1999), pp. 319-352.
11. Measuring Expected Risk Premia
Botosan, C., and Plumlee, M., "Assessing Alternatives Proxies for Expected Risk Premium," *The Accounting Review*, (January 2005), 21-53.
12. 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.
13. 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.
14. Price and Return Models
Kothari, S. P., Zimmerman, J. L., „Price and Return Models“, *Journal of Accounting and Economics*, 20, (1995), pp. 155-192.
15. Earnings Quality Overview
Dechow, P., Ge, W., Schrand, C., „Understaing earnings quality: A review of the proxies, their determinants and their consequences“, *Journal of Accounting and Economics*, 50, (2010), pp. 344-401.
16. Dividend Payout Ratios and ERCs
Kallapur, S., „Dividend payout ratios as determinats of earnings response coefficients – A test oft he free cash flow theory“, *Journal of Accounting and Economics*, 17, (1994), pp. 359-375.
17. 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.
18. 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.

19. 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 are uploaded at the learnweb: <https://www.uni-muenster.de/LearnWeb/learnweb2/> → Accounting theory WS 2016/17.

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