Accounting Theory

Winter Term 2019/2020

Prof. Dr. Christoph Watrin
Dr. Adrian Kubata

I.   Time Schedule

Lectures

Room: J 372 (*except on November 7, 2019 (class 5). This day the lecture will be in room S 055 (Schloss)).

Time: 2.15pm – 3.45pm

Class 1:	10.10.2019	
Class 2:	17.10.2019	(Assignment 1 will be due)
Class 3:	24.10.2019	
Class 4:	31.10.2019	(Assignment 2 will be due)
Class 5:	07.11.2019*	
Class 5:	14.11.2019	(Assignment 3 will be due)
Class 7:	21.11.2019	
Class 8:	28.11.2019	(Assignment 4 will be due)
Class 9:	05.12.2019	
Class 10:	12.12.2019	(Assignment 5 will be due)
Class 11:	19.12.2019	
Class 12:	09.01.2020	(Assignment 6 will be due)

Integrated Computer Labs and Assignments

The lectures will include integrated computer labs in which we will give short introductions into the statistical software STATA and will discuss the STATA assignments.

We will buy a STATA license for each registered participant. The license is valid for 6 months. The students can install the license on their personal notebook and use it for free during this period. The STATA license is primarily intended to allow students to solve the assignments. However, it can also be used for any other analysis during this period.

Seminar where students will hold their own presentations

Room: to be announced

Time: 9am – 5pm (January 30, 2020)

II.   Course Concept

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

- lectures (12 weekly appointments)
- integrated computer lab sessions (6 weekly appointments)
- and a one-day seminar (on January 30, 2020).

Each lecture's content will be centered around one or two 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 necessary fundamentals of econometrics and statistics to be able to better understand the empirical analysis in the assigned readings for their presentations during the seminar.

Second, to teach students the fundamentals of how to conduct an own research project (e.g. your master thesis or PhD thesis in accounting or finance). This is especially important for those students who aim to write an empirical master thesis in one of the two areas.

Based on the knowledge gained from the lectures and the computer lab sessions the third part of the course will be held as a one-day seminar. The seminar will be held jointly with JProf. Dr. Nadine Georgiou (TU Dortmund) as well as students from the TU Dortmund. During the seminar, the students will take over and the lecturers will have only a moderating function. Each student will have to give a 20 min. presentation of a chosen research paper, followed by a joint 10 min. discussion.

III.   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:

- concept and measurement of the constructs 'information content' and 'value relevance' of accounting numbers (i.e. 'decision usefulness' of accounting numbers)
- determinants of market reactions to accounting news
- alternative accounting performance measures
- different valuation/return models (DCF, Price and Return Models, CAPM, etc.)
- tests of market efficiency with respect to accounting information
- the role of accounting information in fundamental analysis and valuation

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 the accounting/finance area. For this purpose, we will mainly focus on:

- the introduction to the statistical software package STATA
- the repetition of the classical linear regression model and its underlying assumptions
- the consequences and remedy of the violation of some of the classical assumptions
- the estimation of basic linear regression models and the statistical interpretation of the results

IV.   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 will be 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 of the underlying analysis? What are the properties of the research design? The idea is to understand why the study was conducted the way it was conducted.

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 to 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!

V.   Course Requirements and Grading

You will be graded based on three performances:

- Your oral participation during the class/seminar and the assignment discussions (25%)
- Your paper presentation in the seminar (25%)
- A paper review of the paper you have presented in the seminar. The paper review is a written exam (12-15 pages) in which you critically evaluate your presented paper (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/seminar and assignment discussions (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/solve the assignments 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 30 min for each paper in the seminar; 20 min for your presentation and 10 min for a joint discussion. We expect you to prepare a 20 min. PowerPoint presentation about your chosen paper.
    - A detailed description and a template on how to summarize a research paper will be uploaded into the learnweb.
    - **Please send your PowerPoint presentation no later than 23.01.2020 to: adrian.kubata@wiwi-uni-muenster.de**
- Paper review (12-15 pages) (50%)
    - Detailed information and a template on how to review a research paper will be uploaded into the learnweb.
    - **Please send your written exam (both as a word document and as a pdf document) via email to: adrian.kubata@wiwi.uni-muenster no later than 20.03.2020 (Notenaushang: 28.03.2020).**

VI.   Registration

You must register officially at the examination office (PAM) to be able to participate in this course! The online registration period starts on **07.10.2019** and ends on **21.10.2019**. In addition, we would

like to ask you to sign-in for the course at: adrian.kubata@wiwi.uni-muenster or using the tool on the institute's website.

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

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

VII. Detailed Overview Lectures' Contents

Class 1: 10.10.2019 – Overview of capital market-based accounting research I

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

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

Class 2: 17.10.2019 – Overview of capital market-based accounting research II

Lev, B. (1989): On the Usefulness of Earnings and Earnings Research: Lessons and Directions from Two Decades of Empirical Research. Journal of Accounting Research, 27 Supplement, 153-92.

Class 3: 24.10.2019 – Earnings Response Coefficient I

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

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 4: 24.10.2019 – Earnings Response Coefficient II

Freeman, R. N., Tse, S. (1992): A Nonlinear Model of Security Price Response to Unexpected Earnings. Journal of Accounting Research, 30, 185-209.

Kothari, S. P., Sloan, R. G. (1992): Information in Prices about Future Earnings – Implications for earnings response coefficients. Journal of Accounting and Economics, 15, 143-171.

Class 5: 24.10.2019 – Earnings Response Coefficient III

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

Hayn, C. (1995): The information content of losses. Journal of Accounting and Economics, 20, 125-153.

Class 6: 07.11.2019 – Earnings Response Coefficient IV

Kubata, A., Shevlin, T., Watrin, C. (2019): Stock Price Associations with Expected, Reported and Unexpected Earnings. Working Paper.

Class 7: 14.11.2019 – Analysts' and Time Series Forecasts of Investors' Expectations

Fried, D., Givoly, D. (1982): Financial Analysts' Forecasts of Earnings – A Better Surrogate for Market Expectations. Journal of Accounting and Economics, 4, 85-107.

Bradshaw, M., Drake, M., Myers, J., Myers, L. (2012): A re-examination of analysts' superiority over time series forecasts of annual earnings. Review of Accounting Studies, 944-968.

Class 8: 21.11.2019 – Market Inefficiency and the Price Adjustment Process

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.

Class 9: 28.11.2019 – P/E Anomaly

Basu, S. (1977): Investment Performance of Common Stocks in Relation to their Price-Earnings Ratios: A Test of the Efficient Market Hypothesis. The Journal of Finance, 32, 663-682.

Class 10: 21.11.2019 – Post Earnings Announcement Drift I

Foster, G., Olsen, C., Shevlin, T. (1984): Earnings Releases, Anomalies, and the Behavior of Security Returns. The Accounting Review, 59, 574-603.

Class 11: 21.11.2019 – Post Earnings Announcement Drift II

Bernard, V., Thomas, J. (1989): Post-Earnings Announcement Drift: Delayed Price Response or Risk Premium? Journal of Accounting Research, 27, 1-36.

Class 12: 21.11.2019 – Price-Earnings Relations in the Presence of Market Inefficiency

Beaver, W. H., McNichols, M. F., Wang, Z. Z., (2019). Increased Market Response to Earnings Announcements in the 21st Century: An Empirical Investigation. Journal of Accounting and Economics. Forthcoming.

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.ku-bata@wiwi.uni-muenster.de](mailto: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. Conservatism

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

4. 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.

5. 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.

6. Pricing Implications of Earnings Management

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

7. 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.

8. 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.

9. 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.

10. 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.

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. 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.

15. 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.

16. 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.

17. 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.

18. 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: "Accounting Theory WS 2019/20".

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