

Fall 2010
Empirical Research in Financial Accounting
Shu Yeh

Course Objectives

1. To familiarize you with the empirical research in accounting.
2. To provide an understanding of the methodology that underlies the literature.
3. To gain an understanding of the research process and the key elements of appropriate research design.
4. To enable you to critically evaluate existing research.

Grading Policy

- (1) A research proposal, about 25% of the grade. Choice of specific topic should be discussed with the instructor, and tentatively decided upon within 7 weeks.
- (2) A final exam, about 35%.
- (3) Seminar presentation and participation, about 40%.

Class format

Classes will consist of student presentation. When presenting each paper, please keep the following critical questions in mind:

1. What is (are) the research question(s)? What is the paper's motivation? Is (are) the question(s) interesting? Why (not)?
2. What is the study's research design? Consider the sample (firms, time period, special data requirements, etc.), model, and statistical / econometric method(s).
3. What is (are) the paper's major result(s)?
4. What are the paper's major contribution(s) and weaknesses(s)? Does the paper achieve its objective(s)?
5. What questions / issues are left unresolved (i.e., warrant further research)?

Reading List

1. Accounting information and security prices: An introduction

Week 1

Ball, Ray and Philip Brown, 1968, "An empirical evaluation of accounting income numbers", *Journal of Accounting Research*, 159-178.

Beaver, William H., 1968, "The information content of annual earnings announcements", *Journal of Accounting Research*, Supplement, 67-92.

2. Accounting information and security prices: Economic and econometric issues

Week 2

Beaver, William H., Richard A. Lambert and Dale Morse, 1980, "The information content of security prices", *Journal of Accounting & Economics* 2, 3-28.

Beaver, W., R. Lambert and S. Ryan, "The Information Content of Prices: A Second Look," *Journal of Accounting and Economics*, July 1987, 139-157.

Beaver, W., M. McAnally and C. Stinson, "The Information Content of Prices: A Simultaneous Equations Approach," *Journal of Accounting and Economics*, 1997, 53-81.

Week 3

Kormendi, Roger C. and Robert C. Lipe, 1987, "Earnings innovations, earnings persistence, and stock returns", *Journal of Business* 60, 323-345.

Kothari, S.P., 1992, "Price-earnings regressions in the presence of prices leading earnings: Earnings level versus change specifications and alternative deflators", *Journal of Accounting and Economics* 15, 173-202.

Easton, Peter D., Trevor S. Harris and James A. Ohlson, 1989, Accounting earnings can explain most of security returns: The case of long event windows, *Journal of Accounting and Economics* 15, 119-142.

3. Accounting-based valuation model

Week 4

Ohlson, James A., 1995, "Earnings, book values, and dividends in equity valuation", *Contemporary Accounting Research* 11, 661-687.

Feltham, Gerald A., and J. Ohlson, Valuation and Clean Surplus Accounting for Operating and Financial Activities. By: Contemporary Accounting Research,

Spring 1995, Vol. 11 Issue 2, p689-731

Feltham, G.A. and J. Ohlson, 1996, "Uncertainty Resolution and the Theory of Depreciation Measurement", *Journal of Accounting Research*, 209-34.

Barth, M.E., W.H. Beaver and W.R. Landsman, 1998, "Relative valuation roles of equity book value and net income as a function of financial health," *Journal of Accounting and Economics* 25, 1-34.

Week 5

Timothy Bell, Wayne Landsman, Bruce Miller, and Shu Yeh, 2002, "The Valuation Implications of Employee Stock Option Accounting for Profitable Computer Software Firms", *The Accounting Review* 77, 971-996.

Wayne Landsman, Ken Peasnell, Peter Pope and Shu Yeh, 2006, "Which Approach to Accounting for Employee Stock Options Best Reflects Market Pricing?", *Review of Accounting Studies* 11(2-3), 203-245.

Wayne Landsman, Bruce Miller, Ken Peasnell, and Shu Yeh, Do Investors Understand Really Dirty Surplus? (July 25, 2010). *Accounting Review*, Forthcoming. Available at SSRN: <http://ssrn.com/abstract=1648485>

4. The usefulness of alternative accounting measures

Week 6

Dechow, Patricia M., 1994, "Accounting earnings and cash flows as measures of firm performance: The role of accounting accruals", *Journal of Accounting and Economics* 18, 3-42.

Biddle, Gary, R. Bowen and J. Wallace, 1997, "Does EVA beat earnings? Evidence on associations with stock returns and firm values", *Journal of Accounting and Economics* 24, 301-336.

5. Accounting information and Market efficiency research

Week 7

Bernard, V., and J. Thomas, "Post-earnings Announcement Drift: Delayed Price Response or Risk Premium," *Journal of Accounting Research*, Supplement 1989, 1-36.

Bernard, Victor L. and Jacob Thomas, 1990, "Evidence that stock prices do not fully reflect the implications of current earnings for future earnings", *Journal of Accounting and Economics* 13, 305-340.

Sloan, Richard G., 1996, "Do stock prices fully reflect information in accruals and

cash flows about future earnings?" *The Accounting Review* 71, 289-315.

6. Earnings management and contracting theory

Week 8

Hand, J.R.M., 1990, "A Test of the Extended Functional Fixation Hypothesis." *The Accounting Review* 65(4), 740-763

Hand, J.R.M., 1989, "Did firms undertake debt-equity swaps for an accounting paper profit or true financial gain?" *The Accounting Review*, 587-623.

DeFond, Mark L. and Jim Jimbalvo, 1994, "Debt covenant violation and manipulation of accruals", *Journal of Accounting & Economics* 17, 145-176.

Dechow, Patricia, Richard G. Sloan, and Amy P. Sweeney, 1994, "Detecting earnings management", *The Accounting Review* 70, 193-225.

7. Discretionary Disclosure

Week 9

Botosan, C, 1997, "The Impact of Annual Report Disclosure Level on Investor Base and the Cost of Capital", *The Accounting Review* 72, 323-350

Skinner, D.J., 1994, "Why firms voluntarily disclose bad news?" *Journal of Accounting Research* 32, 38-60.

Lang, M., and R. Lundholm, 1993, Cross-sectional Determinants of Analysts Ratings of Corporate Disclosures, *Journal of Accounting Research* 31, 246-271.

Lang, M., and R. Lundholm, 1996, "Corporate disclosure policy and analyst behavior", *The Accounting Review* 71, 467-492.

8. Accounting information and compensation

Week 10

Lambert, R. and D. Larcker, 1987, "An Analysis of the Use of Accounting and Market Measures of Performance in Executive Compensation Contracts", *Journal of Accounting Research* 25 Supplement, 129-149.

9. Analysts forecasts

Klein, A. 1990, "A direct test of the cognitive bias theory of share price reversals", *Journal of Accounting and Economics* 13: 155 - 166.

Keane, M. And D. Runkle. 1998. "Are financial analysts' forecasts of corporate profits rational?" *Journal of Political Economy* 106: 768 - 805.

Empirical Research in Audit Market and Accounting Profession
Fall 2010
Professor Chan-Jane Lin

Objectives:

This seminar attempts to introduce accounting doctoral students to the important issues faced by the audit market and the accounting profession. Topics to be discussed include demand and supply of the audit market, audit risk management and client acceptance decision, audit reputation and auditor choice, audit tenure, and audit independence and audit and non-audit pricing etc. By completion, you are expected to learn what the relevant and current audit research issues are, how to identify them, how to conduct a quality audit study and make a publishable paper.

Class discussion:

For each reading assigned, you ought to be prepared for class discussion. You will assume the role of discussion leader for the paper you are assigned to present. For the papers you are not assigned to present, you will become a discussant. To encourage your participation and help you be ready for class discussion, I'll collect your written comments, at least two for each paper that you are not presenting.

In reading an article, you are expected to critically evaluate the following aspects: motivations/objectives, related literature, research design and methodology, and the implications of the major conclusions. You are also encouraged to propose alternative approaches to the research design and possible extension of the work, including the application to the audit market and accounting profession in Taiwan.

Grading:

Presentation and class participation	50%
Final	30%
Term paper (proposal)	20%

(* for class discussion)

Week 1-2 (5 papers)

I. Accounting Profession and Audit Research- background reading

DeAngelo, L., 1981, "Auditor size and audit quality." Journal of Accounting and Economics, vol. 3, pp. 183-199.

DeAngelo, L., 1981, "Auditor independence, "low balling" and disclosure regulation." Journal of Accounting and Economics, vol. 3, pp. 113-127.

Francis, J., 2004, "What do we know about audit quality?" The British Accounting Review 36(4), pp. 345-368.

DeFond, M. and J. Francis, 2005, "Audit research after Sarbanes-Oxley", Auditing: A Journal of Practice & Theory, V.24, supplement, pp. 5-30.

Kinney, W., 2005, "Twenty-five years of audit deregulation and re-regulation: What does it mean for 2005 and beyond?" Auditing: A Journal of Practice & Theory, V.24, supplement, pp. 89-109.

Roles of Auditor and Auditor Choice

Johnson, W. and T. Lys., 1990, "The market for audit services: Evidence from voluntary auditor changes" Journal of Accounting and Economics, 12, pp.281-308.*

Shu, S., 2000, "Auditor resignations: clientele effects and legal liability", Journal of Accounting and Economics, 29, pp.173-205.

Wallace, W.A., 2004, "The economic role of the audit in free and regulated markets: A look back and a look forward" Research in Accounting Regulation, pp. 267-298. *

Fan, J. and T. Wong, 2005, "Do external auditors perform a corporate governance role in emerging markets? Evidence from East Asia." Journal of Accounting Research, pp. 35-72.*

Blouin, J., B. Grein and B. Rountree. 2007, "An analysis of forced auditor change: The case of former Arthur Andersen clients", The Accounting Review, May, pp.621-650. *

Wang, Q., T.J. Wong, L. Xia. 2008, "State ownership, the institutional environment, and auditor choice: Evidence from China" Journal of

Accounting and Economics, 46, 112-134

Landsman, W. R., K. K. Nelson, and B. R. Rountree. 2009. "Auditor switches in the pre and post-Enron eras: Risk or realignment?" The Accounting Review, 84, pp.531-558. *

Week 3 (2 papers)

III. Audit Risk Management and Client Acceptance Decisions

1. Francis, J. and J. Krishnan. 2003, "Evidence on accounting firm risk-management strategies before and after the Private Securities Litigation Reform Act of 1995." Asia-Pacific Journal of Accounting and Economics, pp.135-157.
2. Johnstone, K. and J. Bedard, 2004, "Audit firm portfolio management decisions." Journal of Accounting Research, pp. 659-690.*
3. Choi, J., R. Doogar and A. Ganguly, 2004, "The riskiness of large audit firm client portfolios and changes in audit liability regimes: Evidence from the US audit market." Contemporary Accounting Research, winter, pp. 747-85.
4. Bedard, J., D. Deis, M. Curtis and J Jenkins. 2008. "Risk monitoring and control in audit firms: A research synthesis." Auditing: A Journal of Practice & Theory. May, pp.187-218.
5. Kohlbeck, M., B. Mayhew, P. Murphy, and M. Wilkins, 2008, "Competition for Andersen's clients." Contemporary Accounting Research, winter, pp. 1099-136 (and discussion)*

Week 4-6 (7 papers)

IV. Audit Tenure, Auditor Rotation , Auditor Specialization and Audit Quality

1. Johnson, V., I. Khurana, and J. Reynolds, 2002, "Audit firm tenure and the quality of financial reporting" Contemporary Accounting Research, 19(4), pp.637-660
2. Chaney, P. and K. Philipich. 2002. "Shredded reputation: The cost of audit failure," Journal of Accounting Research 40, pp 1221-1246.*
3. Myers, J., L. Myers and T. Omer, 2003, "Exploring the term of the auditor-client relationship and the quality of earnings: A case for mandatory auditor rotation?" The Accounting Review, pp. 779-99.
4. Mansi, S., W. Maxwell and D. Miller. 2004. "Does auditor quality and tenure matter to investors? Evidence from the bond market. Journal of accounting Research, 42(4), pp.755-93.

5. Ghosh, A. and D. Moon. 2005. "Auditor tenure and perceptions of audit quality." The Accounting Review, 80(2), pp. 585-612 *
6. Carey, P. and R. Simnett. 2006. "Audit partner tenure and audit quality" The Accounting Review, 81(3), pp. 653-76. *
7. Chen, C.Y., C.J. Lin, and Y.C. Lin. 2008," Audit partner tenure, audit firm tenure, and discretionary accruals: Does long auditor tenure impair earnings quality?" Contemporary Accounting Research, summer, pp 415-45.*
8. Weber, J., Willenborg, M., and J. Zhang. 2008. "Does auditor reputation matter? The case of KPMG Germany and ComROAD AG," Journal of Accounting Research 46, pp. 941-972 *
9. Gul, F., S. Fung and B. Jaggi, 2009, "Earnings quality: Some evidence on the role of auditor tenure and auditors' industry expertise", Journal of Accounting and Economics, 47, 265-87
10. Chi, W. , H. Huang, Y. Liao and H.Xie, 2009, "Mandatory audit partner rotation, audit quality, and market perception: Evidence from Taiwan", Contemporary Accounting Research, summer, pp 359-91 (also discussion by Bamber and Bamber, 393-402)*
11. Davis, L., B. Soo and G. Trompeter, 2009, "Auditor tenure and the ability to meet or beat earnings forecasts" Contemporary Accounting Research, summer, pp 517-548
12. Reichelt, K. and D. Wang, 2010, "National and office-specific measures of auditor industry expertise and effects on audit quality" Journal of Accounting Research, 48 (3), pp. 647-686*

Week 7-8 (6 papers)

V. Audit Fees, Non-audit Fees, Client Importance and Auditor Independence

1. Simunic, D., 1980, "The pricing of audit service: theory and evidence." Journal of Accounting Research, spring, pp. 161-90 *
2. Bell, T., W. Landsman, and D. Shackelford, 2001, "Auditors' perceived business risk and audit fees: analysis and evidence." Journal of Accounting Research, June, pp. 35-43.
3. Craswell, A., D. Stokes, and J. Laughton, 2002, "Auditor independence and fee dependence," Journal of Accounting and Economics, June, 253-275.*
4. Frankel, M., F. Johnson and K. Nelson, 2002, "The relation between auditors' fees for non-audit services and earnings management." The Accounting Review, pp.71-103. (also the discussion by Kinney and Libby, pp. 107-114.)
5. Ashbaugh, H., R. LaFond, and B. Mayhew, 2003, "Do nonaudit services

- compromise auditor independence? Further evidence.” The Accounting Review, pp. 611-39.
6. Chung, H. and S. Kallapur, 2003, “Client importance, non-audit fees, and abnormal accruals.” The Accounting Review, 931-55.
 7. Ferguson, A., J. Francis and D. Stokes, 2003, “The effects of firm-wide and office-level industry expertise on audit pricing.” The Accounting Review, pp.429-48. *
 8. Lennox, C. 2005, “Audit quality and executive officers’ affiliations with CPA firms” Journal of Accounting and Economics, 39, pp 201-231. *
 9. Hay, D., W. Knechel, N. Wong, 2006, “Audit fees: A meta-analysis of the effect of demand and supply attributes”, Contemporary Accounting Research, pp. 1-49.
 10. Ruddock, C., S. Taylor, S. Taylor. 2006. “Nonaudit services and earnings conservatism: Is auditor independence impaired?” Contemporary Accounting Research, fall, pp.701-46. *
 11. Francis, J., 2006, “Are auditors compromised by nonaudit services? Assessing the evidence”, Contemporary Accounting Research, fall, pp.747-60. *(also comments on Ruddock et al., 2006)
 12. Lim, C. and H. Tan 2008, “Non-audit service fees and audit quality: The impact of auditor specialization” Journal of Accounting Research, March, pp.199-246
 13. Li, C., 2009, “Does client importance affect auditor independence at the office level? Empirical evidence from going concern opinions” Contemporary Accounting Research, spring, pp.201-230. *