

Version: Monday, August 29, 2005

ACC 6013-02 Financial Accounting Theory

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Office Hours: 8:00-9:00 AM Monday-Friday or by appointment.

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Course Prerequisites: Doctoral classification and permission of instructor.

UTSA Honor Pledge: "On my honor, as a student of The University of Texas at San Antonio, I will uphold the highest standards of academic integrity and personal accountability for the advancement of the dignity and the reputation of our university and myself."

Purposes of the Class:

This class will (1) prepare you to utilize contemporary capital market research tools to investigate novel accounting research questions and (2) provide you with a sense of the major themes found in the capital markets literature over the past 40 years, which you will supplement on your own with a Level 2 reading (defined below) of all articles in *The Accounting Review*, *Journal of Accounting Research*, and *Journal of Accounting & Economics* published between August 2005 and the date you sit for your qualifying (comprehensive) examination.

Class Format:

I expect you to read (at varying levels of depth) a significant number of papers in preparation for each class meeting. Papers denoted a "Level 3 Reading" are to be read in great depth so that you will be prepared to engage in a thoughtful, detailed class discussion of the paper. As a rule of thumb, you should invest no less than 4 hours in completing a Level 3 Reading. Papers denoted a "Level 2 Reading" should be read quickly to get the gist of the paper (i.e., understand the motivation, results, and insights gained from the paper). I estimate that you should plan on investing 30 minutes to 1 hour in a Level 2 Reading. Finally, a Level 1 Reading is intended to provide context for the Level 2 & 3 Readings. Therefore, you may skip the Level 1 Readings if you feel you have a firm grasp on the Level 2 and 3 Readings **but** you should plan on completing the Level 1 Readings prior to the final exam.

Our class time primarily will involve a detailed discussion of the Level 3 Readings coupled with a limited discussion of Level 2 Readings as needed to supplement the primary discussion. To facilitate preparation for the primary discussion, I ask that you

prepare (and hand in at the beginning of class) a one or two page summary of each Level 3 Reading that addresses each of the following points.¹

The motivation -- Why is this research being done? What is the missing link in the (then) current state of the literature that this paper is trying to address?

The research objectives/questions -- What is (are) the specific research question(s)?

The theory -- What is the underlying theoretical framework? What assumptions are made in constructing the arguments?

The specific hypotheses. Do you agree that the hypotheses follow from the logical development of the arguments?

The basic model(s). How well does the model represent reality? What sacrifices are being made? What key insights does the model provide? How does the model differ from/improve upon models used in other studies?

The research method/design -- What are the features of the research design -- how do these features affect external and internal validity, are there sufficient controls for competing explanations, and are there any inherent biases or other features that may lead to misinterpretations (e.g., lead to type I and type II errors). What were the key research design choices made? What were the alternatives? Did the author(s) make the best choice?

Interpretations, conclusions and cautionary notes. What do we know after reading the study that we didn't know before? Are the author's (s') conclusions consistent with the evidence presented? What are the limitations of the evidence? What was great about this paper? What was not so great about the paper? What can we learn from it to help us in our own work?

Future research issues suggested by this research. What questions remain unanswered? What new questions are raised?

You should plan to spend around 20 hours in preparing for each 3 hour session. A necessary (but not sufficient) condition for adequate preparation is the ability to explain the purpose of and inferences drawn from each table in each Level 3 Reading.

¹ Drawn from <http://fars.org/pfeiffer.pdf>

Term Paper:

You will design and present to the class a proposed empirical capital markets-based study of an accounting research question. The proposal, which can be an original idea or an extension of an existing piece of research, will include sections that discuss the motivation, literature review, hypotheses, and research design (you will not actually collect and analyze data). That is, the paper should be similar in structure and organization to a research paper published in *TAR*, *JAR* or *JAE* excluding the sections that discuss empirical findings and conclusions. Your papers will be presented to the class at the end of the course in a workshop-type format. You should plan to incorporate PowerPoint (or equivalent) visual aids in your presentation.

You should plan on achieving the following milestones as you progress toward completion of your term paper:

10/15 Three paragraph outline (what, why, how)

11/15 First draft submitted to me for my review and feedback.

12/13 Workshop and second draft submitted to me for my review and feedback.

Final:

The final exam will consist of one or more essay questions intended to provide me a sense of your progress and help you prepare for the comprehensive exam.

Grading:

Quality of class discussion and written paper summaries	25%
Term paper	20%
Presentation of term paper to the class	10%
Final exam	45%

Schedule of Class Activities

Date	Topic	Level 3 Reading	Level 2 Reading	Level 1 Reading	Written Deliverable
8/30	Statistical primer (3 hours)	Chapters on hypothesis testing in your stat book.			Handout of problem set. Request WRDS acct.
9/6	Introduction to research and philosophy of science (1.5 hours)		<p>Ball, R. and G. Foster. 1982 Corporate financial reporting: A methodological review of empirical research. <i>Journal of Accounting Research</i>. Supplement: 161-234.</p> <p>Abdel-khalik, R. and B. Ajinkya. 1979. <i>Empirical research in accounting</i>. Sarasota, FL: American Accounting Association. pp 9-48.</p> <p>Searcy, D. and J. Mentzer. 2003. A framework for conducting and evaluating research. <i>Journal of Accounting Literature</i>. 22: 130-167.</p> <p>Wallace, W. 1991. <i>Accounting research methods</i>. Homewood, IL: Irwin.</p>	<p>Watts, R. and J. Zimmerman. 1986. <i>Positive accounting theory</i>. Upper Saddle River, NJ: Prentice Hall. pp 1-14.</p> <p>Smith, M. 2003. <i>Research methods in accounting</i>. Thousand Oaks, CA: Sage Publications. Chapters 1,3, 6 and 9.</p>	Prepare a brief paper (no more than 5 pages) that (1) demonstrates your understanding of the meaning of and trade-offs among the various types of validity in quasi-experimental work and (2) summarizes the sort of world-view that underpins contemporary archival/empirical accounting research.
9/6	Early classics (1.5 hours)	<p>Beaver, W. 1968. The information content of annual earnings announcements. <i>Journal of Accounting Research</i> (Supplement) pp. 67-92.</p> <p>Ball, R., & Brown, P. (1968). An empirical evaluation of accounting income numbers. <i>Journal of Accounting Research</i>, (Autumn) pp. 159-78.</p>	<p>Nichols, D. and J. Wahlen. 2004. How do earnings number relate to stock returns? <i>Accounting Horizons</i>. 18 (4): pp. 263-270.</p> <p>Easton, P. 1999. Security returns and the value relevance of accounting data. <i>Accounting Horizons</i>. 13 (4): p. 399-401.</p>	<p>Brown, P. 2001. <i>Capital markets-based research in accounting: an introduction</i>. Coopers & Lybrand (Australia). pp. 3-32.</p> <p>Watts, R. and J. Zimmerman. 1986. <i>Positive accounting theory</i>. Upper Saddle River, NJ: Prentice Hall. pp 15-70.</p> <p>Kothari, S. 2001. Capital markets research in accounting. <i>Journal of Accounting and Economics</i>. 31: 112-119.</p>	Level 3 summaries.

Date	Topic	Level 3 Reading	Level 2 Reading	Level 1 Reading	Written Deliverable
9/13	Earnings response coefficients (3 hours)	<p>Kormendi R. and R. Lipe. 1987. Earnings innovations, earnings persistence, and stock returns. <i>Journal of Business</i>. 60(3): 323-345.</p> <p>Easton, P. and M. Zmijewski. 1989. Cross-sectional variation in the stock market response to accounting earnings announcements. <i>Journal of Accounting and Economics</i> 11 (2): 117-141.</p> <p>Collins, D. and S. Kothari. 1989. An analysis of intertemporal and cross-sectional determinants of earnings response coefficients. <i>Journal of Accounting and Economics</i>. 11: 143-181.</p>	<p>Teets, W. and C. Wasley. 1996. Estimating earnings response coefficients: pooled versus firm-specific models. <i>Journal of Accounting and Economics</i>. 21(3): 279-296.</p>	<p>Brown, P. 2001. <i>Capital markets-based research in accounting: an introduction</i>. Coopers & Lybrand (Australia). pp. 33-43.</p> <p>Kothari, S. 2001. Capital markets research in accounting. <i>Journal of Accounting and Economics</i>. 31: 123-143.</p> <p>Donnelly, R. 2002. Earnings persistence, losses and the estimation of earnings response coefficients. <i>Abacus</i> 38 (1): 121-133.</p>	Level 3 summaries.
9/20	Noise in earnings/Prices lead earnings (3 hours)	<p>Beaver, W. Lambert, R. and S. Ryan. 1987. The information content of prices: a second look. <i>Journal of Accounting and Economics</i>. 9: 139-157.</p> <p>Kothari, S. and R. Sloan. 1992. Information in prices about future earnings: implications for earnings response coefficients. <i>Journal of Accounting and Economics</i>. 15: 143-172.</p> <p>Collins, D., Kothari, S, Shanken, J. and R. Sloan. 1994. Lack of timeliness and noise as explanations for the low contemporaneous return-earnings association. <i>Journal of Accounting and Economics</i>. 18: 289-324.</p>	<p>Kothari, S. 1992. Price-earnings regressions in the presence of prices leading earnings. <i>Journal of Accounting and Economics</i>. 15: 173-202.</p>	<p>Kothari, S. 2001. Capital markets research in accounting. <i>Journal of Accounting and Economics</i>. 31:123-143.</p> <p>Brown, P. 2001. <i>Capital markets-based research in accounting: an introduction</i>. Coopers & Lybrand (Australia). pp. 101-104</p>	Level 3 summaries

Date	Topic	Level 3 Reading	Level 2 Reading	Level 1 Reading	Written Deliverable
9/27	The earnings metric. (1.5 hours)	<p>Kothari, S. 1992. Price-earnings regressions in the presence of prices leading earnings. <i>Journal of Accounting and Economics</i>. 15: 173-202.</p> <p>Ohlson, J. and P. Shroff. 1992. Changes versus levels in earnings as explanatory variables for returns. <i>Journal of Accounting Research</i>. 30: 210-226.</p>	<p>Ali A. and P. Zarowin. 1992. The role of earnings levels in annual earnings-returns studies. <i>Journal of Accounting Research</i>. 30(2): 286-296.</p> <p>Easton, P. and T. Harris. 1991. Earnings as an explanatory variable for returns. <i>Journal of Accounting Research</i>. 29(1): 19-36.</p>	<p>Kothari, S. 2001. Capital markets research in accounting. <i>Journal of Accounting and Economics</i>. 31:128-129.</p> <p>Brown, P. 2001. <i>Capital markets-based research in accounting: an introduction</i>. Coopers & Lybrand (Australia). pp. 44-46</p>	Level 3 summaries
9/27	Nonlinearities (1.5 hours)	<p>Basu, S. 1997. The conservatism principle and the asymmetric timeliness of earnings. <i>Journal of Accounting and Economics</i>. 24: 3-37.</p> <p>Lipe, Bryant and Widener. 1998. Do nonlinearity, firm-specific coefficients and losses represent distinct factors in the relation between stock returns and accounting earnings? <i>Journal of Accounting and Economics</i>. pp. 195-214.</p>	<p>Hayn, C. 1995. The information content of losses. <i>Journal of Accounting and Economics</i> 20: 125-153.</p>	<p>Kothari, S. 2001. Capital markets research in accounting. <i>Journal of Accounting and Economics</i>. 31:134-135.</p>	Level 3 summaries
10/04	Residual income valuation (RIV) model (3 hours)	<p>Dechow, P., Hutton, A., Sloan, R., 1999. An empirical assessment of the residual income valuation model. <i>Journal of Accounting and Economics</i> 26,1 –34.</p> <p>Myers, J., 1999. Implementing residual income valuation with linear information dynamics. <i>The Accounting Review</i> 74,1 – 28.</p> <p>Ohlson, J.A. 1995. Earnings, Book Values, and Dividends in Equity Valuation. <i>Contemporary Accounting Research</i> 11: 661-687.</p>	<p>Lo, K. and T. Lys. 2000. The Ohlson model: Contribution to valuation theory, limitations, and empirical applications. <i>Journal of Accounting, Auditing and Finance</i>. 15, 337-xxx.</p> <p>Liu, J. and J. Ohlson. 2000 The Feltham-Ohlson (1995) model: Empirical implications. <i>Journal of Accounting, Auditing and Finance</i>. 15, 31-xxx.</p>	<p>Lundholm, R. 1995. A tutorial on the Ohlson and Feltham/Ohlson models: Answers to some frequently asked questions. <i>Contemporary Accounting Research</i>. 11, 749-762.</p> <p>Bernard, V. 1995. The Feltham-Ohlson framework: implications for empiricists. <i>Contemporary Accounting Research</i>. 733-747.</p> <p>Ohlson, J. 2001. Earnings, book values and dividends in equity valuation: an empirical perspective. <i>Contemporary Accounting Research</i> 18(1): 107-120.</p> <p>Kothari, S. 2001. Capital markets research in accounting. <i>Journal of Accounting and Economics</i>. 31:175-183.</p>	Level 3 summaries.

Date	Topic	Level 3 Reading	Level 2 Reading	Level 1 Reading	Written Deliverable
10/11	Price-level regressions (1.5 hours)	<p>Kothari, S. and J. Zimmerman. Price and return models. <i>Journal of Accounting and Economics</i>. 20: 155-192.</p>	<p>Barth, M., Kallapur, S., 1996. The effects of cross-sectional scale differences on regression results in empirical accounting research. <i>Contemporary Accounting Research</i> 13: 527 –567</p> <p>Brown, S, Lo, K. and T. Lys 1999. Use of RSQ in Accounting Research. <i>Journal of Accounting and Economics</i> 28: 83-115.</p> <p>Barth, M. and G. Clinch. Scale effects in capital markets-based research.</p> <p>Easton, P. and G. Sommers 2003. Scale and the scale effect in market-based accounting research. <i>Journal of Business, Finance and Accounting</i>. 30: 25-55.</p>	<p>Easton, P. 1998. Discussion of revalued financial, tangible, and intangible assets. <i>Journal of Accounting Research</i>: 235-247.</p> <p>Christie, A., 1987. On cross-sectional analysis in accounting research. <i>Journal of Accounting and Economics</i> 9:231 –258.</p> <p>Landsman, W., Magliolo, J., 1988. Cross-sectional capital market research and model specification. <i>The Accounting Review</i> 64: 586 –604.</p> <p>Kothari, S. 2001. Capital markets research in accounting. <i>Journal of Accounting and Economics</i>. 31:143.</p> <p>Brown, P. 2001. <i>Capital markets-based research in accounting: an introduction</i>. Coopers & Lybrand (Australia). pp. 53-57</p>	Level 3 summaries
10/11	Accounting-based stock market anomalies (1.5 hours)	<p>Collins, D. and P. Hribar. 2000. Earnings-based and accrual-based anomalies: one effect or two? <i>Journal of Accounting and Economics</i>. 29: 101-123.</p> <p>Burgstahler, D., J. Jiambalvo, T. Shevlin. 2002. Do stock prices fully reflect the implications of special items for future earnings? <i>Journal of Accounting Research</i>. 40 (3): 585-612</p>	<p>Bernard, V., J. Thomas and J. Wahlen, 1997. Accounting-based stock price anomalies: Separating market inefficiencies from risk. <i>Contemporary Accounting Research</i> 14, 89-136.</p> <p>Bernard, V., Thomas, J.. 1990. Evidence that stock prices do not fully reflect the implications of current earnings for future earnings. <i>Journal of Accounting and Economics</i> 13: 305-340.</p>	<p>Barber, B. and Lyon, J. 1997. Detecting long-run abnormal stock returns: The empirical power and specification of test statistics. <i>Journal of Financial Economics</i> 43: 341-372.</p> <p>Kothari, S. 2001. Capital markets research in accounting. <i>Journal of Accounting and Economics</i>. 31: 186-207</p> <p>Brown, P. 2001. <i>Capital markets-based research in accounting: an introduction</i>. Coopers & Lybrand (Australia). pp. 85-98</p> <p>Lee, C. 2001. Market efficiency and accounting research. <i>Journal of Accounting and Economics</i>. 31: 233-253</p>	Level 3 summaries.

Date	Topic	Level 3 Reading	Level 2 Reading	Level 1 Reading	Written Deliverable
				<p>Watts, R. and J. Zimmerman. 1986. <i>Positive accounting theory</i>. Upper Saddle River, NJ: Prentice Hall. pp 71-110.</p> <p>Beaver, W. 1998. <i>Financial reporting: An accounting revolution</i>. 3rd Edition. Upper Saddle River, NJ: Prentice Hall. pp 125-158.</p>	
10/18	Comparing alternative performance metrics (3 hours)	<p>Francis, J., K. Schipper, L. Vincent. 2003. The relative and incremental explanatory power of earnings and alternatives (to earnings) performance measures for returns. <i>Contemporary Accounting Research</i>. 20: 121-164.</p> <p>Dhaliwal, D. K. Subramanyam, and R. Trezevant. 1999. Is comprehensive income superior to net income as a measure of performance? <i>Journal of Accounting and Economics</i>. 26:43-67.</p> <p>Bradshaw, M. and R. Sloan. GAAP versus the Street. 2002. <i>Journal of Accounting Research</i>. 40(1): 41-66.</p>	<p>Biddle, G. R. Bowen, J. Wallace. 1997. Does EVA beat earnings? <i>Journal of Accounting and Economics</i>. 24: 301-336</p> <p>Harris, T. M. Lang and H. Moller. 1994. The value relevance of German accounting measures. <i>Journal of Accounting Research</i>. 32 (2): 187-209.</p> <p>Dechow, P. 1994, Accounting earnings and cash flows as measures of firm performance. <i>Journal of Accounting and Economics</i>. 18: 3-42.</p>	<p>Biddle, G. G. Seow, and A. Siegel. 1995. Relative versus incremental information content. <i>Contemporary Accounting Research</i> 12(1): 1-23.</p> <p>Kothari, S. 2001. Capital markets research in accounting. <i>Journal of Accounting and Economics</i>. 31:167-171.</p>	Level 3 summaries.
10/25	Accruals and cash flows (3 hours)	<p>Dechow, P.M. 1994 Accounting earnings and cash flows as measures of firm performance: The role of accounting accruals. <i>Journal of Accounting and Economics</i> X(X): pp. 3-42.</p> <p>Barth, Cram, and Nelson. 2001 Accruals and the prediction of future cash flows. 76(1): 27-58.</p> <p>Bowen, Burghstahler & Daley. 1987. The incremental information content of accrual versus cash flows. <i>The Accounting Review</i>. 62(4): pp. 723-747</p>	<p>Barth, M., W. Beaver, J. Hand, and W. Landsman, "Accruals, Cash Flows, and Equity Values," <i>Review of Accounting Studies</i> (December 1999): 205-229.</p>	<p>Sloan, R., 1996, "Do stock prices fully reflect information in accruals and cash flows about future earnings?," <i>The Accounting Review</i> 71, 289-315</p>	Level 3 summaries.

Date	Topic	Level 3 Reading	Level 2 Reading	Level 1 Reading	Written Deliverable
		<p>Rayburn, J. 1986. The association of operating cash flow and accruals with security returns. . <i>Journal of Accounting Research</i>, 24: 112-133.</p>			
11/01	Discretionary accruals (3 hours)	<p>Subramanyam, K.R., “The Pricing of Discretionary Accruals,” <i>Journal of Accounting and Economics</i> (August-December 1996): 249-281.</p> <p>Xie, H. 2001. The mispricing of abnormal accruals. <i>The Accounting Review</i>. 76, 357-xxx.</p> <p>Collins, D.W., G. Gong, and P. Hribar. 2003. Investor sophistication and the mispricing of accruals. <i>Review of Accounting Studies</i> 8, 251-276.</p>	<p>Sloan, R., 1996, “Do stock prices fully reflect information in accruals and cash flows about future earnings?,” <i>The Accounting Review</i> 71, 289-315</p> <p>Guay, W. S. Kothari, and R. Watts. 1996. A market-based evaluation of discretionary accrual models. <i>Journal of Accounting Research</i>. 34: 83-105.</p>	<p>Dechow, P. R. Sloan and A. Sweeney. 1995. Detecting earnings management. <i>The Accounting Review</i>. 70, 193-xxx.</p>	Level 3 summaries.
11/8	Financial statement relevance – Part I (3 hours)	<p>Francis, J., and K. Schipper. 1999. Have Financial Statements Lost Their Relevance? <i>Journal of Accounting Research</i> (Autumn 1999): 319-352.</p> <p>Lev, B. and P. Zarowin. 1999. The Boundaries of Financial Reporting and How to Extend Them. <i>Journal of Accounting Research</i> (Autumn): 353-386.</p> <p>Collins, D., Maydew, E., Weiss, I., 1997. Changes in the value-relevance of earnings and book values over the past forty years. <i>Journal of Accounting and Economics</i> 24: 39 –67.</p>			Level 3 summary.
11/15	Financial statement relevance – Part II (3 hours)	<p>Francis, J., K. Schipper, and L. Vincent. 2002. Expanded disclosures and the increased usefulness of earnings announcements. <i>TAR</i> 77(3): 515-546.</p>			Level 3 summary.

Date	Topic	Level 3 Reading	Level 2 Reading	Level 1 Reading	Written Deliverable
		<p>Francis, J., K. Schipper, and L. Vincent. 2002. Earnings announcements and competing information. <i>Journal of Accounting and Economics</i>. 33: 313-342.</p> <p>Landsman, W., Maydew, E., 1999. Has the information content of annual earnings announcements declined in the past three decades? <i>Journal of Accounting Research</i>. 40: 797-807.</p>			
11/22	Fundamental analysis (1.5 hours)	<p>Piotroski, Joseph, 2000. Value investing: The use of historical financial information to separate winners from losers. <i>Journal of Accounting Research</i>. 38: 1-41.</p> <p>Abarbanell, J., and B. Bushee. 1998. Abnormal Returns to a Fundamental Analysis Strategy. <i>The Accounting Review</i> 73(1): 19-45.</p>	<p>Guay, W. 2000. Discussion of Value Investing: The Use of Historical Financial Statement Information to Separate Winners from Losers. <i>Journal of Accounting Research</i> 38 (Supplement): 43-51.</p>	<p>Lee, C. 1999. Accounting-based valuation. <i>Accounting Horizons</i>. 13(4): 413-425.</p> <p>Ou, Jane and Stephen Penman, 1989, Financial statement analysis and the prediction of stock returns. <i>Journal of Accounting and Economics</i>, 295-330.</p> <p>Abarbanell, Jeffrey, and Brian Bushee, 1997, Fundamental analysis, future earnings, and stock prices. <i>Journal of Accounting Research</i>, 1-24.</p> <p>Lev, B. and S. R. Thiagarajan. 1993. Fundamental Information Analysis. <i>Journal of Accounting Research</i> 31(2): 190-215.</p>	Level 3 summaries.
11/22	Value relevance and standard setting (1.5 hours)		<p>Holthausen, R., Watts, R. 2001. The relevance of the value relevance literature for financial accounting standard setting. <i>Journal of Accounting and Economics</i> 3-75.</p> <p>Barth, M., Beaver, W., Landsman, W. 2001 The relevance of the value relevance literature for financial accounting standard setting: Another view. <i>Journal of Accounting and Economics</i> 76-104.</p>	<p>Barth, M. 2000. Valuation-based accounting research. <i>Accounting and Finance</i>. 40, 7-31.</p>	Prepare a brief paper that discusses the meaning, strengths and weaknesses of so-called “value relevance studies.”

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Date	Topic	Level 3 Reading	Level 2 Reading	Level 1 Reading	Written Deliverable
			Barth, M.E. 1994. Fair value accounting: Evidence from investment securities and the market valuation of banks. <i>The Accounting Review</i> 69: 1-25.		
11/29	Exam				
12/13	Paper presentation				