**LIMPERG INSTITUTE**

**PhD Seminar: An Introduction to Capital Markets Research. December 2015**

**Syllabus and reading list**

The research area discussed in this seminar falls into two closely related categories: (1) studies of the usefulness of accounting information to security market participants, and (2) use of security returns as a tool for validating accounting principles and practices. Any study which relates accounting information and stock market metrics (e.g., volume of shares traded, return-based measures of risk (e.g., beta, implied expected rates of return), share prices, abnormal returns at the time of the announcement of information, returns over very long intervals (such as a year) etc.,) are candidates for this course. This is a vast research literature that is the core of at least half of the research effort in accounting over the past four decades. Although the reading list is considerable, it represents the set of papers that must be well known by all Ph.D. graduates in accounting.

Each session will have four parts. We will begin with a presentation of a paper that is central to the topic being discussed. One student will present the paper as if they are the author. That is, their aim will be to present the main ideas of the paper as if they were one of the original authors. They should be prepared to defend and explain all of its contents, and to respond to questions/comments/suggestions from the other participants in the seminar. This presentation may take up to 80 minutes, though time constraints may necessitate much shorter presentations. The second session will be a critique of the key paper (also presented - with questions of clarification only - by one of the students). The main idea of this session will be to provide a list of reasons why the paper should be accepted/rejected for publication in one of the major accounting research journals. This presentation should take about 30 minutes. All students must submit a written recommendation to an editor of one of these journals recommending publication/re-submission/out-right rejection from publication. The third session will be a presentation (also by a student) of a paper that is very closely related to the key paper. The emphasis of this presentation will be on the connection to the key paper and the contribution beyond the key paper. This presentation should take about 30 minutes. The final session (which will take about 60-90 minutes) will be a discussion of the related papers. In order to prepare for this session, students are required to prepare a literature review that describes each of the papers on the reading list and any other papers that are arguably closely related or central to the theme of the main paper. As with all literature reviews, this review should include a summary of the main points of each paper and a clear indication of the thread that connects the papers together.

Assessment will be allocated as follows:

Replication\*\* write-up and presentation 15%(1) Presentation of key paper 15%(2) Critique of key paper 15%(2) Presentation of related paper 15%(2) Literature review 15%(3) Exam\* 25%(4)

\* the exam will be a one-week take-home in which students will be required to write a referee report in much the same spirit of the reports associated with the critiques during the course

**\*\*** Students are required to replicate a well-known published paper using data on Dutch or other European company data. This should be completed before the first class. The write-up should include (1) a brief discussion of aims, methods, and contributions of the paper, (2) replication of all graphs and tables, (3) discussion and analyses of any differences in results, and, (4) possible extensions and analyses of alternate ways that the fundamental question in the paper could be addressed/analyzed. Students may encounter some (possibly serious) limitations. These should be viewed as a challenge and every effort should be made to overcome – or, otherwise avoid -- them.

(1) The replication must be completed before the classes begin. Time will be allocated for a presentation: (a) of a brief discussion of the replicated papers; (b) of the results of the replication; and, (c) of the difficulties encountered in the replication. Grades will be based on my assessment and assessment by classmates.

(2) Assessments will be based on rankings by classmates.

(3) The literature review must be handed in at the beginning of the day in which the papers will be discussed. My aim is to ensure that every student has carefully read every paper and thought carefully about the way they are connected. I realize that this is a time- consuming task. It is, however, essential to becoming prepared to embark on an academic career in accounting. Assessment will be based on the written literature review and participation in class discussion.

(4) The exam should be handed in one week after the end of the course. I will assign the exam grade.

**Reading list: (\*\* represents key paper, \* represents key related paper)**

**The Beginning: Value Relevance and Information Content Studies**

\*\*Ball, R. and P. Brown, “An Empirical Analysis of Accounting Income Numbers,” *Journal of*

*Accounting Research* (1968): 159-78.

\*Beaver, W., “The Information Content of Annual Earnings Announcements,” *Journal of*

*Accounting Research* (1968): 67-92.

Ball, R. and P. Brown, “Ball and Brown (1968): A Retrospective,” *The Accounting Review* (2014), 89: 1-26.

Ball, R. and L. Shivakumar, “How much New Information is there in Earnings?” *Journal of*

*Accounting Research* (2008): 975-1016.

Beaver, W., R. Clarke and W. Wright, “The Association between Unsystematic Security Returns and the Magnitude of the Earnings Forecast Error,” *Journal of Accounting Research* (1979): 316-40.

Chambers, R., “Financial Information and the Securities Market,” *Abacus* (1965): 3-30. Fama, E., I. Fisher, M. Jensen, and R. Roll, “The Adjustment of Stock Prices to New

Information,” *International Economic Review* (1969): 1-21.

Patell, J. and M. Wolfson, “The Intraday Speed of Adjustment of Stock Prices to Earnings and

Dividend Announcements,” *Journal of Financial Economics* (1984): 223-252.

**Earnings Response Coefficients**

*The papers that started it all:*

\*\*Easton, P. and M. Zmijewski, “Cross-sectional Variation in the Stock Market Response to

Accounting Earnings Announcements,” *Journal of Accounting and Economics* (1989):

117-141.

\*Collins, D. and S. Kothari, “An Analysis of Intertemporal and Cross-sectional Determinants of

Earnings Response Coefficients,” *Journal of Accounting and Economics* (1989): 143-

181.

Kormendi, R. and R. Lipe, “Earnings Innovations, Earnings Persistence and Stock Returns,”

*Journal of Business* (1987): 323-45.

*Refinements and specification issues:*

Freeman, R., and S. Tse, “A Non-linear Model of Security Price Responses to Unexpected Earnings,” *Journal of Accounting Research*, (1992): 185-209.

R. Lipe., Bryant, L., and S. Widener, “Do Non-Linearity, Firm-specific Coefficients, and Losses Represent Distinct Factors in the Relation between Stock Returns and Earnings?” *Journal of Accounting and Economics* (1998).

Teets, W., and C. Wasley, “Estimating Earnings Response Coefficients: Pooled vs Firm-specific

Models,” *Journal of Accounting and Economics* (1996): 279-296.

*Applications:*

Gipper, B., C. Leuz, and M. Maffett, “Public Audit Oversight and Reporting Credibility: Evidence from the PCAOB Inspection Regime,” (2015) Working paper, Chicago Booth School of Business.

Elliot, J., and D. Hanna, “Repeated Accounting Write-offs and the Information Content of

Earnings,” *Journal of Accounting Research* (1996): 135-155.

Francis, J., K. Schipper, and L. Vincent, “Earnings Announcements and Competing

Information,” *Journal of Accounting and Economics* (2002): 313-342.

Kross, W. and D. Schroeder, “An Investigation of Seasonality in Stock Price Responses to Quarterly Earnings Announcements,” *Journal of Business, Finance, and Accounting* (1990): 649-675.

Teoh, S., and T. Wong, “Perceived Auditor Quality and the Earnings Response Coefficient,” *The*

*Accounting Review* (1993): 346-367.

**Association Studies**

*Prices lead earnings:*

Beaver, W., R. Lambert, and D. Morse, “The Information Content of Security Prices,” *Journal of*

*Accounting and Economics* (1980): 3-28.

Beaver, W., R. Lambert, and S. Ryan, “The Information Content of Security Prices: a Second

Look,” *Journal of Accounting and Economics* (1987): 139-157.

*Introduction of earnings as an explanatory variable for returns:*

Easton, P. and T. Harris, “Earnings as an Explanatory Variable for Returns,” *Journal of*

*Accounting Research* (1991): 19-36.

*Longer return intervals:*

\*\*Easton, P., T. Harris, and J. Ohlson, “Aggregate Accounting Earnings Can Explain Most of Security Returns: the Case of Long Event Windows,” *Journal of Accounting and Economics*, (1992): 119-142.

\*Kothari, S., and R. Sloan, “Information in Prices About Future Earnings: Implications for

Earnings Response Coefficients,” *Journal of Accounting and Economics*, (1992): 143-

171.

Ohlson J., and S. Penman, “Dis-aggregated Accounting Data as Explanatory Variables for

Returns,” *Journal of Accounting, Auditing, and Finance* (1992): 553-573.

**Earnings Recognition Timeliness**

\*Ball, R., and P. Easton, “Dissecting Earnings Recognition Timeliness,” *Journal of Accounting Research* (2013): 1099-1132.

Ball, R., S. Kothari, and V. Nikolaev, “On Estimating Conditional Conservatism,” *The Accounting Review* 88 (2013): 755-787.

Ball, R, and L. Shivakumar, “Earnings Quality in UK Private firms: Comparative Loss

Recognition Timeliness,” *Journal of Accounting and Economics*, (2005): 83-128.

\*\*Basu, S., “The Conservatism Principle and the Asymmetric Timing of Earnings,” *Journal of*

*Accounting and Economics*, (1997): 3-37.

Easton, P., “Financial Reporting: An Enterprise Operations Perspective,” (2015): Forthcoming *Journal of Financial Reporting*.

Easton. P, P. Vassallo, and E. Weisbrod. “A New Approach to Empirical Analysis of the Relation between Change in Value and Earnings.” (2015), CARE working paper.

Easton, P., and X. Zhang, “Mixing Fair-Value and Historical-Cost Accounting: Predictable OCI and Mispricing of Bank Stocks,” (2015), CARE working paper.

Patatoukas, P., and J. Thomas. “More Evidence of Bias in Differential Timeliness Estimates of

Conditional Conservatism,” *The Accounting Review* (2011) 1765-

Penman, S., and X. Zhang. “Accounting Conservatism, the Quality of Earnings, and Stock

Returns.” *The Accounting Review* (2004): 237-264.

Watts, R., “Conservatism in Accounting Part I: Explanations and Implications,” *Accounting*

*Horizons* 17, 3 (2003): 207-221.

Watts, R., “Conservatism in Accounting Part II: Evidence and Research Opportunities,”

*Accounting Horizons* 17, 4 (2003): 287-301.

**Earnings Management**

*Detecting earnings management*

Bloomfield, M., J. Gerakos, and A. Kovrijnykh, “Accrual Reversals and Cash Conversion,” (2015), University of Chicago working paper.

Dechow, P., R. Sloan, and A. Sweeney, “Detecting Earnings Management”, *The Accounting*

*Review*, (1995): 193-225.

Dechow, P. and Dichev, I. “The Quality of Accruals and Earnings: The role of Accrual

Estimation Errors.” *The Accounting Review* (2002): 35-59.

\*Guay, W., S. Kothari, and R. Watts, “A Market-based Evaluation of Discretionary Accrual

Models”, *Journal of Accounting Research*, (1996): 83-106.

Dechow, P., A. Hutton, J, Kim and R. Sloan, “Detecting Earnings Management; A New Approach”, *Journal of Accounting Research*, (2012): 275-334.

Gerakos, J., “Discussion of Detecting Earnings Management; A New Approach”, *Journal of*

*Accounting Research*, (2012): 335-347.

\*\*Jones, J., “Earnings Management During Import Relief Investigations”, *Journal of Accounting*

*Research*, (1991): 193-228.

**Earnings Management around Thresholds**

\*\*Burgstahler, D. and I. Dichev, “Earnings Management to Avoid Earnings Decreases and

Losses,” *Journal of Accounting & Economics* 24 (1997): 99-126.

\*Burgstahler, D., and E. Chuk. “Do Scaling and Selection Explain Earnings Discontinuities,” *Journal of Accounting and Economics,* 60, 1 (2015): 168-186.

Das, S., and H. Zhang, “Rounding up in Reported EPS, Behavioral Thresholds and Earnings

Management,” *Journal of Accounting and Economics,* 2003: 31-50.

Degeorge, F., J. Patel, and R. Zeckhauser, “Earnings Management to Exceed Thresholds”,

*Journal of Business* (1999): 1-33.

Donelson, D., McInnis, J., and R. Mergenthaler, “Discontinuities and Earnings Management: Evidence from Restatements Related to Securities Litigation,” *Contemporary Accounting Research*, (2013): 242-268.

\*Durtschi, C., and P. Easton, “Earnings Management? The Shapes of the Frequency Distributions of Earnings Metrics are not Evidence Ipso Facto,” *Journal of Accounting Research*, 2005: 557-592.

\*Durtschi, C., and P. Easton, “Earnings Management? Erroneous Inferences based on Earnings

Frequency Distributions.” *Journal of Accounting Research*, 2009: 1249-1282.

Gunny, E., J. Jacob, and B. Jorgensen, “Implications of the Integral Approach and Earnings Management for Alternate Annual Reporting Periods," *Review of Accounting Studies* (2013): 868-891.

\*Jacob, J., and B. Jorgensen, “Earnings Management and Accounting Income Aggregation,”

*Journal of Accounting and Economics*, (2007): 369-390.

Lawrence, A., Discussion of “Implications of the Integral Approach and Earnings Management for Alternate Annual Reporting Periods," *Review of Accounting Studies* (2013): 892-898.

**Estimation of the Cost of Capital Using Forecasts of Earnings and Earnings**

**Growth**

Da, Z., P. Easton, and K. Hong, “The Expected Rate of Return on Equity Capital Implied by Analysts’ Forecasts of Earnings and Target Prices,” CARE working paper (2014).

Easton, P. “Estimating the Cost of Capital Implied by Market Prices and Accounting Data,”

*Foundations and Trend in Accounting.* Now Publishers. (2007): 241-364.

\*Easton, P. “PE ratios, PEG ratios, and Estimating the Implied Expected Rate of Return on

Equity Capital,” *The Accounting Review* (2004): 73-96.

\*\*Gebhardt, W., C. Lee and B. Swaminathan, “Towards an Implied Cost of Capital,” *Journal of*

*Accounting Research* 39 (2001): 135-176.

Gerakos, J., and R Gramacy. “Regression-based Earnings Forecasts,” Working paper, University of Chicago (2013).

Hou, K., van Dijk, M., Zhang, Y., “The Implied Cost of Capital: A New Approach. *Journal of Accounting and Economics* 53 (3), (2012): 504-526.