

Professor Gil Sadka

## Empirical Research in Accounting

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### **Format of the seminar:**

- The seminar is organized around a set of required readings. The readings are selected to give a balanced coverage of both the development of the major areas of empirical research in financial accounting, and the principal current controversies in those areas.
- Responsibility for each required presentation will be assigned to one person (however, all persons attending are expected to have read the papers closely). The assigned person is expected to summarize, discuss the paper's contribution, offer commentary on, and lead the discussion on the particular reading.
- There are four required readings in each three-hour week, so plan on each reading occupying approximately 40 minutes. Naturally, actual discussion times will vary.
- There will be no restriction on bilateral trading in reading assignments. Please let me know about trades.
- Course grades will be based upon:
  1. Presentation of readings (45%)
  2. Comments made during class (15%)
  3. A research proposal (30%)

## Course Schedule

*Registered:*

Yu Fang Chu (YFC)

Nur Pinar Gencer (NPG)

Devendra Kale (DK)

Pil-Seng Lee (PSL)

Chenchen Li (CL)

Gurvinder Sandhu (GUS)

Venu Madhav Tatiparti (VMT)

*Professor:*

Gil Sadka (GS)

Week	Topic	Responsible for Presenting Required Reading No.			
		1	2	3	4
1	Asset Pricing Introduction	GS	GS	GS	VMT
2	Asset Pricing	YFC	NPG	DK	PSL
3	Earnings and Stock Prices	CL	GUS	VMT	YFC
4	Earnings and Stock Prices	NPG	GS	GS	DK
5	Earnings and Stock Prices	PSL	CL	GUS	VMT
6	Earnings Dispersion	YFC	NPG	GS	GS
7	Debt Contracting	DK	PSL	CL	GUS
8	Debt Contracting	VMT	YFC	NPG	DK
9	Debt Contracting	PSL	CL	GUS	VMT
10	Debt Contracting	YFC	NPG	DK	PSL
11	Analyst Forecast	CL	GUS	VMT	YFC
12	Analyst Forecast	NPG	DK	PSL	CL
13	Liquidity	GUS	VMT	YFC	NPG
14	Liquidity	DK	PSL	CL	GUS

## ***Empirical Research in Accounting: Seminar Syllabus***

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### **1. Earnings and Stock Prices**

#### **1 Asset pricing introduction**

1. Introduction
2. Cochrane, John, 2001, Asset Pricing. Chapter 20.
3. Campbell, John Y., 1991, A variance decomposition for stock returns, *The Economic Journal*, 101, 157 – 179.
4. Vuolteenaho, Tuomo, 2002, What drives firm-level stock returns? *Journal of Finance*, 57, 233-264.

#### **2 Asset Pricing**

1. Fama, Eugene F., and Kenneth R. French, 1989, Business conditions and expected returns on stocks and bonds, *Journal of Financial Economics*, 25, 23-49.
2. Cohen, Randolph B., Christopher Polk, and Tuomo Vuolteenaho, 2003, The value spread, *Journal of Finance*, 58, 609-641.
3. Callen, Jeffrey L., and Dan Segal, 2004, Do accruals drive stock returns? A variance decomposition analysis, *Journal of Accounting Research*, 42, 527-560.
4. Campbell, John Y., and Tuomo Vuolteenaho, 2004, Bad beta, good beta, *American Economic Review* 94, 1249-1275.

#### **3 Earnings and stock prices**

1. Hecht, Peter and Tuomo Vuolteenaho, 2006, Explaining returns with cash-flow proxies, *Review of Financial Studies*, 19, 159-194.
1. Kothari, S.P., Jonathan W. Lewellen, and Jerold B. Warner, 2006, Stock returns, aggregate earnings surprises, and behavioral finance, *Journal of Financial Economics*, 79, 537-568.
2. Cready, William M., Umit G. Gurn, 2010, Aggregate market reaction to earnings announcements, *Journal of Accounting Research*, 48 (2), 289-334.
3. Hirshleifer, David, Kewei Hou, and Siew Hong Teoh, 2009, Accruals, cash flows and aggregate stock market returns, *Journal of Financial Economics*, 91 (3) 389-406.

#### **4 Earnings and stock prices**

1. Chen, Nai-Fu, 1991, Financial investment opportunities and the macroeconomy, *Journal of Finance*, 46, 529-554.
2. Sadka, Gil, 2007, Understanding stock price volatility: The role of earnings, *Journal of Accounting Research* 45: 199-228.
3. Sadka, Gil and Ronnie Sadka, 2009, Predictability and the earnings-returns relation, Forthcoming *Journal of Financial Economics*.
4. Choi Jung Ho, Alon Kalay and Gil Sadka. 2016. Earnings news, expected earnings and aggregate stock returns, *Journal of Financial Markets* Vol. 29, 110-143

#### **5 Earnings and stock prices**

1. Dechow, P., 1994, Accounting earnings and cash flows as measures of firm performance: The role of accounting accruals, *Journal of Accounting & Economics* 18, 3-42.
2. Collins, Daniel W., S.P. Kothari and Judy Dawson Rayburn, 1987, Firm size and the information content of prices with respect to earnings, *Journal of Accounting and Economics* 9, 111-138
3. Collins, D., and S. P. Kothari, 1989, An analysis of the intertemporal and cross-sectional determinants of earnings response coefficients, *Journal of Accounting and Economics* 11, 143-181.
4. Brown Stephen, kin Lo, and Thomas Lys, 1999, Use of  $R^2$  in accounting research: measuring changes in value relevance over the last four decades, *Journal of Accounting and Economics* 28, 83-115.

#### **6 Earnings Dispersion**

1. Bloom, N., 2009, The impact of uncertainty shocks. *Econometrica*, 77, 623--685.
2. Lilien, D.M., 1982. Sectoral shifts and cyclical unemployment. *The Journal of Political Economy* 90, 777--793.
3. Uncertainty and Sectoral Shifts: The Interaction between Firm-Level and Aggregate-Level Shocks, and Macroeconomic Activity, 2017, *Forthcoming Management Science* (with Alon Kalay and Suresh Nallareddy)\

4. Cross-Sectional Dispersion, Expected Loan Losses, and Debt Cycles, 2017, (with Xanthi Gkougkousi and Suresh Radhakrishnan)

## Readings

Ball, Ray and Philip Brown, 1968, An empirical evaluation of accounting income numbers, *Journal of Accounting Research*, 6, 159-178.

Beaver, William H., Roger Clarke, William F. Wright, 1979, The association between unsystematic security returns and the magnitude of earnings forecast errors, *Journal of Accounting and Economics*, 17, 316-340.

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

Easton, Peter D., Trevor S. Harris, and James A. Ohlson, 1992, Aggregate accounting earnings can explain most of security returns: The case of long returns intervals, *Journal of Accounting and Economics*, 15, 119-143.

Kothari, S.P., and Jerold L. Zimmerman, 1995, Price and return models, *Journal of Accounting and Economics*, 20, 155-192.

Collins, Daniel W., S.P. Kothari, Jay Shanken and Richard G. Sloan, 1994, Lack of timeliness versus noise as explanations for low contemporaneous return-earnings association. *Journal of Accounting and Economics* 18, 289–324.

Freeman, Robert N., and Senyo Y. Tse, 1992, A nonlinear model of security price response to unexpected earnings. *Journal of Accounting Research* 30, 185–209.

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

Campbell, John Y., and Robert J. Shiller, 1988a, The dividend-price ratio and expectations of future dividends and discount factors, *Review of Financial Studies*, 1, 195-227.

Campbell, John Y., and Robert J. Shiller, 1988b, Stock prices, earnings, and expected dividends, *The Journal of Finance*, 43, 661-676.

Cochrane, John H., 1991, Explaining the variance of price-dividend ratios, *Review of Financial Studies*, 5, 243-280.

Fama, Eugene F., and Kenneth R. French, 1988, Dividend yields and expected stock returns, *Journal of Financial Economics*, 22, 3-25.

Aggregate Earnings and Why They Matter, 2015, *Journal of Accounting Literature* Vol. 34, 39-57 (with Ray Ball)

Gkougkousi, Xanthi, 2014, Aggregate earnings and corporate bond market, *Journal of Accounting Research*, 52, 75-106.

Hann, Rebecca N., Maria Ogneva and Horacio Sapriza, 2014, Forecasting the Macroeconomy: Analysts versus economists, Working paper.

He, Wen, Maggie Rong Hu, 2012, Aggregate earnings and market returns: International Evidence, Forthcoming *Journal of Financial and Quantitative Analysis*.

Konchitchki, Yaniv and Panos N. Patatoukas, 2014a, Accounting earnings and gross domestic product, *Journal of Accounting and Economic*, 57(1): 76--88.

Konchitchki, Yaniv and Panos N. Patatoukas, 2014b, Taking the pulse of the real economy using financial statement analysis: Implications for macro forecasting and stock valuation. *The Accounting Review*, 89(2): 669--694.

Patatoukas, Panos N. 2014. Detecting news in aggregate accounting earnings: Implications for stock market valuation, *Review of Accounting Studies*, 19-134-160.

Shivakumar, Lakshmanan, 2007, Aggregate earnings, stock market returns and macroeconomic activity: A discussion of does earnings guidance affect market returns? The nature and information content of aggregate earnings guidance, *Journal of Accounting and Economics* 44, 64-73.

Anilowski, Carol, Mei Feng, and Douglas J. Skinner, 2007, Does earnings guidance affect market returns? The nature and information content of aggregate earnings guidance, *Journal of Accounting and Economics*, 44, 36-63.

## **7 Debt Contracting**

1. Leftwich, R., 1983. Accounting information in private markets: evidence from private lending agreements, *Accounting Review* 58, 23--42.
2. Beneish, Messod, and Eric Press, 1993, Costs of technical violation of accounting-based debt covenants, *The Accounting Review* 68, 233--257.
3. Beneish, Messod, and Eric Press, 1995, The resolution of technical default, *The Accounting Review* 70, 337--353.
4. Beatty Anne, K. Ramesh, and Joseph Weber, 2002, The importance of accounting changes in debt contracts: the cost of flexibility in covenant calculations. *Journal of Accounting and Economics* 33: 205-227.

## **8 Debt Contracting**

1. Dichev, Ilia D., and Douglas J. Skinner, 2002, Large sample evidence on the debt covenant hypothesis, *Journal of Accounting Research* 40, 1091--1123.
2. Healy, P.M., Palepu, K.G., 1990. Effectiveness of accounting-based dividend covenants, *Journal of Accounting and Economics* 12, 97-124.
3. Sweeney, A.P., 1994. Debt-covenant violations and managers' accounting responses, *Journal of Accounting and Economics* 17, 281--308.
4. Wittenberg-Moerman, Regina, 2008, The role of information asymmetry and financial reporting quality in debt trading: Evidence from the secondary loan market, *Journal of Accounting and Economics*, 46, 240-260.

## **9 Debt Contracting**

1. Easton Peter, Steven Monahan, and Florin Vasvari, 2002, Initial evidence on the role of accounting earnings in the bond market, *Journal of Accounting Research* 47, 721-766.
2. Costello, Anna M., and Regina Wittenberg Moerman, 2011. The impact of financial reporting quality on debt contracting: Evidence from internal control weakness reports, *Forthcoming Journal of Accounting Research*.
3. Kraft, Pepa. Rating agency adjustments to GAAP financial statements and their effect on ratings and bond yield, Working Paper.
4. Beatty Anne, Joseph Weber, and Jeff J. Yu, 2008, Conservatism and debt, *Journal of Accounting and Economics*, 45, 154-174.

## **10 Debt Contracting**

1. Zhang, J., "The Contracting Benefits of Accounting Conservatism to Lenders and Borrowers." *Journal of Accounting and Economics*, 2008: 27-54.
2. Bharath, S.T, J. Sunder, and S.V. Sunder, 2008, "Accounting quality and debt contracting," *The Accounting Review* 83, 1-28.
3. Aier, J.K., L. Chen, and M. Pevzner. "Debtholders' Demand for Conservatism: Evidence from Changes in Directors' Fiduciary Duties." *Journal of Accounting Research*, 2014: 993 – 1027.
4. Defond, M., and J. Jimabavalo, 1994. Debt covenant violation and manipulation of accruals. *Journal of Accounting and Economic*, January 1994, 145-176.

## **Analysts' Forecasts**

### **11 Analyst Forecasts**

1. Brown, Lawrence D. and Michael S. Rozeff, 1978, The superiority of analyst forecasts as measures of expectations: evidence from earnings, *Journal of Finance*, 33, 1-16.
2. Abarbanell, Jeffrey and Reuven Lehavy, 2003, Biased forecasts or biased earnings? The role of reported earnings in explaining apparent bias and over/underreaction in analysts' earnings forecasts, *Journal of Accounting and Economics*, 36, 105-146.
3. Gu, Zhaoyang and Joanna Shuang Wu, 2003, Earnings skewness and analyst forecast bias, *Journal of Accounting and Economics*, 35, 5-29.
4. Keane, Michael P. and David E. Runkle, 1998, Are financial analysts' forecasts of corporate profits rational? *Journal of Political Economy*, 106, 768-805.

### **12 Analyst Forecasts**

1. Abarbanell, J., 1991, Do analysts' earnings forecasts incorporate information in prior stock price changes? *Journal of Accounting and Economics* 14, 147-165.
2. Lys, Thomas and Sungkyu Sohn, 1990, The association between revisions of financial analysts' earnings forecasts and security-price changes, *Journal of Accounting and Economics* 13, 341-363.
3. Easterwood, John C. and Stacey R. Nutt, 1999, Inefficiency in analysts' earnings forecasts: Systematic misreaction or systematic optimism? *Journal of Finance*, 54, 1777-1797.
4. Jegadeesh, Narasimhan, Joonghyuk Kim, Susan Krische, and Charles Lee, 2004, Analyzing the analysts: When do recommendations add value? *Journal of Finance*, 59, 1083-1124.

### **Readings**

Abarbanell, J., 1991, Do analysts' earnings forecasts incorporate information in prior stock price changes? *Journal of Accounting and Economics* 14, 147-165.

Abarbanell J. and Bernard V., 1992, Tests of analysts' overreaction/underreaction to earnings information as an explanation for anomalous stock price behavior, *Journal of Finance* 47, 1181-1207.

Ali A., A. Klein and J. Rosenfeld, 1992, Analysts' use of information about permanent and transitory earnings components in forecasting annual EPS. *Accounting Review* 67, 183-198.



Brown L., 2001, A temporal analysis of earnings surprises: profits versus losses. *Journal of Accounting Research* 39, 221–241.

### **13 Liquidity**

1. Amihud, Yakov, 2002, Illiquidity and stock returns: cross-section and time-series effects, *Journal of Financial Markets* 5, 31--56.
2. Pástor, Lubos, and Robert F. Stambaugh, 2003, Liquidity risk and expected stock returns, *Journal of Political Economy* 111, 642--685.
3. Easley, David, Soeren Hvidkjaer, and Maureen O'Hara, 2002, Is information risk a determinant of asset returns? *Journal of Finance*, 57, 2185-2221.
4. Sadka, Ronnie, 2006, Momentum and post-earnings-announcement drift anomalies: The role of liquidity risk, *Journal of Financial Economics*, 80 309--349.

### **14 Liquidity**

5. Acharya, Viral V., and Lasse Heje Petersen, 2005, Asset pricing with liquidity risk, *Journal of Financial Economics*, 77, 375-410.
6. Brown, Stephen, Stephen A. Hillergeist, and Kin Lo, 2009, The effect of earnings surprises on information asymmetry, *Journal of Accounting and Economics* 47 (3), 208-225.
7. Lang, Mark H, Karl Lins, and Mark Maffett, 2011, Transparency, liquidity and valuation: International evidence on when transparency matters most, working paper.
8. Lang, Mark H, and Mark Maffett, 2011, Transparency and liquidity uncertainty in crisis periods, *Journal of Accounting and Economics*, 52 (2-3) 101-125.