BA932: PhD Seminar in Accounting Theory: Information in Organization and Accounting Disclosure

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Professors: Qi Chen and Xu Jiang
Office: A438, qc2@duke.edu, 660-7753 for Chen
Office: A434, xj11@duke.edu, 660-7928 for Jiang

Secretary: Galina Meyle
A403F
gmeyle@duke.edu

Objective:

This doctoral course studies the use of analytical models to address accounting questions and this term the focus will be on the economics of how strategic communications (including, but are not limited to, contracting) between parties can be used to solve or alleviate frictions in the economy and the application of the economic insight from this stream of literature into accounting research. The goal is two folds: first is to introduce the basic insights and modeling tools often used in accounting analytical research so that you will have a solid understanding of the basic economic concepts and the underlying mechanisms; and second is to evaluate and discuss the current state of accounting analytical research in the area of strategic communications, identify open questions and explore future research opportunities. Overall, the course is designed to develop your ability to read and understand analytical research and to see their connections with the basic economic concepts, and in doing so, develop an appreciation of high quality research works (both analytical and empirical).

Logistics:

There will be homework assignments (the exact number of assignments to be determined). The homework will require application and perhaps extension of the basic ideas in the course. You may work in groups on the homework assignments. Yet, please turn in one assignment per person.

All classes take place at DeSanctis at Fuqua on Wednesdays from 3:15 pm to 6 p.m. We will have in total 12-13 lectures plus one final exam.

Performance in the course will be assessed by class participation (30%), homework assignments (30%) and a final examination (40%). The final exam will be comprehensive and will be in the form of problems of the type found in the homework assignments. The time of the final exam will be announced later.

General reading:

The course is primarily based on reading original papers, although you may find the following general references useful.

For incentives and contract theories in general:

Lectures on the Theory of Contracts and Organizations, by Lars Stole, available for download at https://sites.google.com/site/zhaoshan75/Stolelecture.pdf?attredirects=0)

The Theory of Corporate Finance, by Jean Tirole, Princeton Press, Princeton, NJ.

Contract Theory, by Patrick Bolton and Mathias Dewatripont, 2005, The MIT Press, Cambridge, MA. [referred to as BD below.]

The Theory of Incentives: The Principal-Agent Model, by Jean-Jacques Laffont, David Martimort, 2002, Princeton Press, Princeton, NJ.

For the specific topic we will cover in the course, you may find the following survey articles helpful.

Bolton, P. and M. Dewatripont. 2011. Authority in organizations: a survey. Handbook of Organizational Economics (Robert Gibbons and John Roberts, ed.). Princeton University Press.

Stocken, P. 2012. Strategic accounting disclosure. *Foundations and Trends in Accounting:* 197-291.

Virtual Issue on Analytical Research in JAR: The Role of Mandatory Reporting and Uniform Standards. Available at http://onlinelibrary.wiley.com/journal/10.1111/(ISSN)1475-679X/homepage/virtual_issue_on_analytical_research_in_jar.htm.

Kanodia, C. 2007, Accounting Disclosure and Real Effects. *Foundations and Trends in Accounting*, Vol. 1, No. 3.

Kanodia, C. and H. Sapra. 2016. A Real Effects Perspective to Accounting Measurement and Disclosure: Implications and Insights for Future Research. Journal of Accounting Research, 2016 54(2): 623-676.

Sims, C. 2011. Rational inattention and monetary economics. Handbook of Monetary Economics, Vol. 3A, Ch. 4.

Veldkamp, Laura. 2011. *Information choice in macroeconomics and finance*. Princeton University Press.

Class Outline and Reading List (those marked with * will be covered in class)

Module 1: Basic building blocks

1. *Moral hazard (when information asymmetry arises after contract is signed)*

*BD: Ch. 4.
*Stole: Chapter 1.1.1

*Holmstrom, B.R. 1979. “Moral Hazard and Observability” *Bell Journal of Economics*, Spring.

*Holmstrom, B. and Milgrom, P., 1991. Multitask principal-agent analyses: Incentive contracts, asset ownership, and job design. *JL Econ. & Org.*, *7*, p.24.

*Holmström, B., 1999. Managerial incentive problems: A dynamic perspective. *The review of Economic studies*, *66*(1), pp.169-182.

2. *Mechanism Design (when information asymmetry arises before contract is signed)*

*BD: Ch. 2 and 3
*Stole: Chapter 2.1, 2.2.1-2.2.5

Myerson, R. and M.A. Satterthwaite. 1983. Efficient Mechanisms for Bilateral Trading. *Journal of Economic Theory* 29, 265-281

3. *Cheap talk (when contracts are not available)*

*Crawford, V. and J. Sobel. 1982. Strategic information transmission. *Econometrica* 50: 1431-1452.

4. *Bayesian persuasion (cheap talk with commitment)*

*Kamenica, E. and M. Gentzkow. 2011. “Bayesian persuasion.” *American Economic Review* 101: 2590-2615.

* Bergemann, D., Bonatti, A. and Smolin, A., 2018. The design and price of information. *American economic review*, *108*(1), pp.1-48.

5. *Verifiable Disclosure (when contracts are not needed)*

*Milgrom, Paul. 1981, “Good news and bad news: representation theorems and applications,” *The Bell Journal of Economics* 12, Autumn, 380-391.

Module 2: Mandatory disclosure

Incentive for voluntary disclosure when such disclosure is verifiable:

*Grossman, S. 1981. The Informational Role of Warranties and Private Disclosure about Product Quality. *Journal of Law and Economics*, Vol. 24, No. 3, 461-483.

* Jung, W. and Y. Kwon. 1988. Disclosure when the market is unsure of information endowment of managers. *Journal of Accounting Research* 26(1): 146-153.

* Jovanovic, 1982. Truthful Disclosure of Information. *The Bell Journal of Economics* 13(1): 36-44.

* Verrecchia, 1983. Discretionary Disclosure. Discretionary disclosure. *Journal of Accounting and Economics, 5*, pp.179-194.

Shin, H. 1994. News Management and the Value of Firms. *The Rand Journal of Economics* 25(1): 58-71;

M. Krishnan, S. Sankaraguruswamy and H. Shin. 1996. Skewness of Earnings and the Believability Hypothesis: How Does The Financial Market Discount Accounting Earnings Disclosures?

Nonverifiable voluntary disclosure

*Gigler, F. 1994. Self-enforcing voluntary disclosures. *Journal of Accounting Research* 32(2): 224-240. (Application of the cheap-talk framework)

*Gigler, F., and T. Hemmer, 1998, On the Frequency, Quality, and Informational Role of Mandatory Financial Reports, *Journal of Accounting Research* 36 Supplement: 117-147. (confirmatory role of mandatory disclosure when voluntary disclosure is nonverifiable but more informative)

*Morgan, J. and Stocken, P.C., 2003. An analysis of stock recommendations. *RAND Journal of Economics*, pp.183-203.

Frictions that (sometimes do not) justify mandatory disclosure

*Fishman, M.J. and Hagerty, K.M., 1989. Disclosure decisions by firms and the competition for price efficiency. *The journal of finance*, 44(3), pp.633-646.

*Admati, A.R. and Pfleiderer, P., 2000. Forcing firms to talk: Financial disclosure regulation and externalities. *The Review of financial studies*, 13(3), pp.479-519.

*Chen, Q., Lewis, T.R., Schipper, K. and Zhang, Y., 2017. Uniform versus discretionary regimes in reporting information with unverifiable precision and a coordination role. *Journal of Accounting Research*, 55(1), pp.153-196.

2.b. Optimal design of mandatory disclosure

When managers can manipulate mandatory disclosure

*Stein, J.C., 1989. Efficient capital markets, inefficient firms: A model of myopic corporate behavior. *The Quarterly Journal of Economics*, *104*(4), pp.655-669.

* Fischer, P.E. and Verrecchia, R.E., 2000. Reporting bias. *The Accounting Review*, *75*(2), pp.229-245.

*Dye, R. 2002. "Classifications Manipulation and Nash Accounting Standards." *Journal of Accounting Research* 40: 1125-62.

*Dye, R. A., & Sridhar, S. S. (2004). Reliability-Relevance Trade-Offs and the Efficiency of Aggregation. *Journal of Accounting Research*, *42*(1), 51-88.

*Gao, P. and Jiang, X., 2020. The economic consequences of discrete recognition and continuous measurement. *Journal of Accounting and Economics*, *69*(1), 101250.

*Chen, Q., T. Hemmer, and Y. Zhang. 2007. On the relation between conservatism in accounting standards and incentives for earnings management. *Journal of Accounting Research* 45: 541-565.

When mandatory disclosure has real effects

*****Kanodia, C. and D. Lee. 1998. Investment and disclosure: The disciplinary role of periodic performance reports. *Journal of Accounting Research* 36(1): 33-55.

*Kanodia, C. and Sapra, H., 2016. A real effects perspective to accounting measurement and disclosure: Implications and insights for future research. Journal of Accounting Research, 54(2), pp.623-676.

Sapra, H. 2002. Do mandatory hedge disclosure discourage or encourage excessive speculations? *Journal of Accounting Research* 40: 933-964.

Ex ante commitment of mandatory disclosure

*Goex, R. F., & Wagenhofer, A. (2009). Optimal impairment rules. *Journal of Accounting and Economics*, *48*(1), 2-16.

*Gigler, F., Kanodia, C., Sapra, H., & Venugopalan, R. (2009). Accounting conservatism and the efficiency of debt contracts. *Journal of Accounting Research*, *47*(3), 767-797.

*Huang, Zeqiong. 2016. “Optimal Reporting System with Investor Information Acquisition. Working paper, Yale University.

Coordinating with auditing

Chen, Q., Jiang, X. and Zhang, Y., 2019. The effects of audit quality disclosure on audit effort and investment efficiency. *The Accounting Review*, *94*(4), pp.189-214.

2.c. Interaction between mandatory and voluntary disclosure

*Gigler, F., and T. Hemmer. 2001. Conservatism, Optimal Disclosure Policy, and the Timeliness of Financial Reports. *The Accounting Review* 76(4): 471-493.

*Chen, Q., Corona, C. and Y. Zhang. 2021. The Usefulness and Endogenous Supply of Disclosure Accessibility. Working paper, Duke, GWU and Ohio State.

*Einhorn, E., 2005. The nature of the interaction between mandatory and voluntary disclosures. *Journal of Accounting Research*, *43*(4), pp.593-621.

Dye, Ronald A. "Mandatory versus voluntary disclosures: The cases of financial and real externalities." *Accounting Review* (1990): 1-24.

Module 3: Rational inattention (time permitting)

[R] Sims, C. 2003. Implications of rational inattention. Journal of Monetary Economics.

[R] Mackowiak, B., Matejka, F., & Wiederholt, M. (2018). Rational inattention: A disciplined behavioral model. *CEPR Discussion Papers*, *13243*.

[R] Blankespoor, B., deHaan, E., & Marinovic, I. Disclosure Processing Costs, Investors’ Information Choice, and Equity Market Outcomes: A Review. *Journal of Accounting and Economics,* forthcoming.

*Veldkamp, L. L. (2006). Media frenzies in markets for financial information. *The American economic review*, 577-601.

*Van Nieuwerburgh, S., & Veldkamp, L. (2010). Information acquisition and under-diversification. *The Review of Economic Studies*, *77*(2), 779-805.

*Myatt, D.P. and C. Wallace. 2012. Endogenous information acquisition in coordination games. *The Review of Economic Studies*, *79*(1), 340-374.

Lin Peng and Wei Xiong (2006), Investor Attention, Overconfidence and Category Learning, *Journal of Financial Economics 80, 563-602.*

Hirshleifer, D., & Teoh, S. H. (2003). Limited attention, information disclosure, and financial reporting. *Journal of Accounting and Economics, 36*(1), 337-386.

Veldkamp, L. L. (2006). Information markets and the comovement of asset prices. *The Review of Economic Studies*, *73*(3), 823-845.

Angeletos, G.M., and K. Sastry (2021). Managing expectations: instruments versus targets. *Quarterly Journal of Economics*, forthcoming.

[e] Cohen, L. and A. Frazzini. Economic links and predictable returns. *Journal of Finance*, *63*(4), 1977-2011.

[e] deHann, E., B. Blankespoor, J. Wertz and C. Zhu (2018). Why do individual investors disregard accounting information? The roles of information awareness and acquisition costs. Conditionally accepted at *Journal of Accounting Research*.

[e] Dyer, Travis A. "The demand for public information by local and nonlocal investors: Evidence from investor-level data." *Journal of Accounting and Economics* (2021): 101417.