University of Basel

Faculty of
Business and Economics

Management Accounting

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Seminar: Management Accounting (31955)
Spring Term 2022

Supervision: Prof. Dr. Sabine Böckem, Dr. Sebastian Fleer, Lars Fluri

General topic: Banking and Disclosure

Basic information: In this seminar, each student will work on their topic independently. One particular topic can be assigned to a maximum of two candidates; independent seminar papers are expected from each student.

A suggestion is provided on how to approach each topic. However, this is meant as a mere suggestion and is not a necessary requirement.

Topics

1. Jeremy Bertomeu; Iván Marinovic: A Theory of Hard and Soft Information. The Accounting Review (2016)

ABSTRACT
We study optimal disclosure via two competing communication channels: hard information whose value has been verified, and soft disclosures such as forecasts, unaudited statements, and press releases. We show that certain soft disclosures may contain as much information as hard disclosures, and we establish that: (1) exclusive reliance on soft disclosures tends to convey bad news, (2) credibility is greater when unfavorable information is reported, and (3) misreporting is more likely when soft information is issued jointly with hard information. We also show that a soft report that is seemingly unbiased in expectation need not indicate truthful reporting. We demonstrate that mandatory disclosure of hard information reduces the transmission of soft information, and that the aggregation of hard with soft information will turn all information soft.

<u>Suggestion for a seminar paper:</u> International accounting standards (IFRS) shift towards fair value accounting which is considered as soft information. Discuss the implications of this change in the light of the paper by Bertomeu & Marinovic and how is it related to a broader stream of literature?

2. RONALD A. DYE AND SRI S. SRIDHAR: Reliability-Relevance Trade-Offs and the Efficiency of Aggregation. Journal of Accounting Research (2004).

ABSTRACT
This paper studies how an accountant's method of aggregating information in a financial report is affected by differences in the reliability and relevance of components of the report. We study a firm that hires an accountant to produce a report that reveals information to investors regarding the returns to the firm's past investments. In constructing the report, the accountant must combine information elicited from the firm's manager with other information directly observable to the accountant. The manager's information is assumed to be directly observable only by the manager and to be of superior quality to the other information available to the accountant. Reliability-relevance tradeoffs arise because as the accountant places more weight on the manager's report, potentially more useful information gets included in the report, at the cost of encouraging the manager to distort his or her information to a greater extent. Capital market participants anticipate this behavior and price the firm accordingly. We show how the market's price response to the release of the firm's aggregate report, the efficiency of the firm's investment decisions, and the manager's incentives to manipulate the soft information under his or her control are all affected by—and affect—the aggregation procedure the accountant adopts. In addition, we identify a broad range of circumstances under which aggregated reports are strictly more efficient than disaggregated reports because aggregation tempers the manager's misreporting incentives. We also demonstrate that, as any given component of the aggregated accounting report becomes softer, the equilibrium level of the firm's investment diminishes and the market places greater weight on the remaining components of the report.

Suggestion for a seminar paper: Relate the results of the paper to the accounting literature that discusses rules-based vs. principles-based accounting standards.

3. Henry L. Friedman; John S. Hughes; Beatrice Michaeli: Optimal reporting when additional information might arrive. Journal of Accounting and Economics (2020)

ABSTRACT
We study how the potential for discretionary disclosure affects the way a firm designs its reporting system. In our model, the firm's primary but nonexclusive concern is to induce beliefs that exceed a threshold. Such thresholds arise in numerous contexts, including investing decisions, liquidation/continuation choices, covenants, audits, impairments, listing requirements, index inclusion, credit ratings, analyst recommendations, and stress tests. The optimal reporting system is characterized by informative good reports when the threshold is high and, potentially, uninformative reports when the threshold is low. Under an optimal impairment-type reporting system, the likelihood of reported impairments and the information content of non-impairment reports both increase in the probability of the firm observing private information. We provide a novel motivation for

the quiet period around an IPO and empirical predictions relating the probability of discretionary disclosure to the properties of financial reports. In extensions, we consider disclosure mandates, report manipulation, endogenous thresholds, and alternative payoff functions.

Suggestion for a seminar paper: Conduct a literature survey on the interdependencies of a firm's mandatory and voluntary disclosures. As an alternative approach, focus on a paper that considers only one disclosure type (e.g., Göx Wagenhofer 2009 JAE) and discuss the changes that arise by introducing the second disclosure type.

4. CHANDRA KANODIA and HARESH SAPRA: A Real Effects Perspective to Accounting Measurement and Disclosure: Implications and Insights for Future Research. Journal of Accounting Research (2016).

ABSTRACT
Accounting measurement and disclosure rules have a significant impact on the real decisions that firms make. In this essay, we provide an analytical framework to illustrate how such real effects arise. Using this framework, we examine three specific measurement issues that remain controversial: (1) How does the measurement of investments affect a firm's investment efficiency? (2) How does the measurement and disclosure of a firm's derivative transactions affect a firm's choice of intrinsic risk exposures, risk management strategy, and the incentive to speculate? (3) How could marking-to-market the asset portfolios of financial institutions generate procyclical real effects? We draw upon these real effects studies to generate sharper and novel insights that we believe are useful not only for the development of accounting standards, but also for guiding future empirical research.

Suggestion for a seminar paper: IFRS 9 and US GAAP recently introduced an expected credit loss impairment rule for holders of financial assets. Discussing the literature on these loan loss provisioning rules in the light of real effects could provide interesting insights.

5. MICHAEL J. FISHMAN and KATHLEEN M. HAGERTY: Disclosure Decisions by Firms and the Competition for Price Efficiency. THE JOURNAL OF FINANCE (1989)

ABSTRACT
This paper develops a model of the relationship between investment decisions by firms and the efficiency of the market prices of their securities. It is shown that more efficient security prices can lead to more efficient investment decisions. This provides firms with the incentive to increase price efficiency by voluntarily disclosing information about the firm. Disclosure decisions are studied. It is shown that firms may expend more resources on disclosure than is socially optimal. This is in contrast to the concern implicit in mandatory disclosure rules that firms will expend too few resources on disclosure.

Suggestion for a seminar paper: The novelty insight provided by the paper is that firms compete for the attention that traders allocate to the firm-specific disclosure.
The result is that readers of financial reports (traders, investors, auditors) pay more attention to some reports than to others: provide an analysis of how this result developed.

6. Tri Vi Dang, Gary Gorton, Bengt Holmström and Guillermo Ordoñez: Banks as Secret Keepers. American Economic Review (2017).

ABSTRACT
Banks produce short-term debt for transactions and storing value. The value of this debt must not vary over time so agents can easily trade it at par like money. To produce money-like safe liquidity, banks keep detailed information about their loans secret, reducing liquidity if needed to prevent agents from producing costly private information about the banks' loans. Capital markets involve information revelation, so they produce risky liquidity. The trade-off between less safe liquidity and more risky liquidity determines which firms choose to fund projects through banks and which ones through capital markets.

Suggestion for a seminar paper: The paper portrays a drastic view on accounting for banks. It would be interesting to connect this paper with differing views in literature and discuss underlying assumptions that shape the theoretical results.

7. Pingyang Gao and Xu Jiang: Reporting choices in the shadow of bank runs. Journal of Accounting and Economics (2018).

ABSTRACT
This paper investigates banks' reporting choices in the context of bank runs. A fundamental-based run imposes market discipline on insolvent banks, but a panic-based run closes banks that could have survived with better coordination among creditors. We augment a bank-run model with the bank's reporting choices. We show that banks with intermediate fundamentals have stronger incentive to misreport than those in the two tails. Moreover, reporting discretion reduces panic-based runs, but excessive discretion also reduces fundamental-based runs. The optimal amount of reporting discretion increases in the bank's vulnerability to panic-based runs. Finally, a given bank's opportunistic use of reporting discretion exerts a negative externality on other banks. Our paper answers the call by Armstrong et al. (2016) and Bushman (2016) to understand better the effects of banks' special features on their reporting choices.

Suggestion for a seminar paper: The paper has some interesting results on the disclosure choices of banks. It would be interesting to discuss the results on disclosure choices in light of the last financial crises (An overview is provided in: Bischof, Laux, Leuz (JFE 2021)) and connect it with theoretical predictions of different papers on the crises.

8. Anthony C. Ng, Zabihollah Rezaee: Business sustainability factors and stock price informativeness. Journal of Corporate Finance (2020)

ABSTRACT
This paper investigates whether and how business sustainability performance and disclosure factors affect stock price informativeness (SPI). We find that non-financial environmental, social, and governance (ESG) sustainability performance factors are positively associated with idiosyncratic volatility (our proxy for SPI) after controlling for financial-economic performance. We further show that the association between sustainability performance factors and SPI is stronger for firms with higher sustainability disclosure. We find that the association between ESG sustainability performance factors and SPI is stronger when economic performance is weaker, suggesting that investors tend to pay more attention to ESG performance factors when firms are financially underperforming. This study shows that investors pay attention to both firm economic performance (corporate profitability and growth prospect) and ESG sustainability performance and disclosure factors, which have implications for policymakers, regulators, investors, businesses, and researchers.

<u>Suggestion for a seminar paper:</u> Explore the relationship between business sustainability factors and stock price informativeness with suitable empirical methods.

9. Cindy Durtschi, William Hillison, Carl Pacini: The Effective Use of Benford's Law to Assist in Detecting Fraud in Accounting Data. Journal of Forensic Accounting (2004)

ABSTRACT
Benford's law has been promoted as providing the auditor with a tool that is simple and effective for the detection of fraud. The purpose of this paper is to assist auditors in the most effective use of digital analysis based on Benford's law. The law is based on a peculiar observation that certain digits appear more frequently than others in data sets. For example, in certain data sets, it has been observed that more than 30% of numbers begin with the digit one. After discussing the background of the law and development of its use in auditing, we show where digital analysis based on Benford's law can most effectively be used and where auditors should exercise caution. Specifically, we identify data sets which can be expected to follow Benford's distribution, discuss the power of statistical tests, types of frauds that would be detected and not be detected by such analysis, the potential problems that arise when an account contains too few observations, as well as issues related to base rate of fraud. An actual example is provided demonstrating where Benford's law proved successful in identifying fraud in a population of accounting data.

Suggestion for a seminar paper: Explain Benford's law and how it is applicable to accounting and fraud detection. Find additional examples where Benford's Law is used and ideally provide a short numerical example of your own.

10. Zhe An, Donghui Li, Jin Yu: Firm crash risk, information environment, and speed of leverage adjustment. Journal of Corporate Finance (2015)

ABSTRACT
This paper examines the effect of a firm's crash-risk exposure on its speed of leverage adjustment (SOA), and how this effect is influenced by the information environment of the country in which the firm is located. We employ a panel of 19,247 firms across 41 countries from 1989 to 2013, and we find that firms with a higher crash-risk exposure tend to adjust their financial leverages more slowly toward their targets. This evidence supports the dynamic trade-off theory that firms with larger transaction costs adjust their capital structures less often. Equally important, we document that the negative link between crash-risk exposure and SOA is less pronounced in countries with a more transparent information environment.

Suggestion for a seminar paper: Empirically explore the connection between crash-risk and other relevant firm characteristics.

Format

You will use the provided LaTeX format for the written work. It will be provided to all participants after the topic have been assigned. The format template works both in the original LaTeX, as well as in Overleaf or any other TeX IDE compatible system.

Time schedule

Preliminary discussion	By arrangement
Submission of the written work	24 April 2022, at the latest at 24:00
Feedback meeting	according to agreement
Presentations	12 May and 19 May

Evaluation

For successful completion of this course, the following four aspects must be completed satisfactorily:

Task	Share in final grade
Written work	70%
Presentation	20%
Co-presentation	5%
Oral participation	5%

Topic allocation

Your preferences will be taken into account as far as possible when assigning the topics. Please submit a preference list of the following format in the next 3 days: 1st preference topic a, 2nd preference topic b, 3rd preference topic c.