

Course Outline

Subject to change. This version June 4, 2010 at 11:55AM

Problems should be turned in for grading on the day they are assigned.

Part 1. Introduction

1. Monday, August 23 Introduction

Read: Paul Krugman, 1997, The accidental theorist. Reprinted in Krugman, 1999, *The Accidental Theorist and Other Dispatches from the Dismal Science*, W. W. Norton & Company: New York.

Hal R. Varian, 1997, How to build and economic model in your spare time, Working paper, University of California, Berkeley.

John Fellingham, 2006, Is accounting an academic discipline? Plenary Address, 2006 Meetings of the American Accounting Association, Washington DC.

Joel S. Demski, 2005, Analytic modeling in management accounting research. Working paper, University of Florida.

Reference: Greek letters and pronunciation

2. Wednesday, August 25 Background

Read: Chapters XVI, XVII, and XVIII of Littleton, A.C. *Accounting Evolution to 1900* American Institute Publishing Company, 1933, 259–304.

Anthony G. Hopwood, 2007, Whither Accounting Research? *The Accounting Review* 82:5 1365–1374.

Pieters, R., and Baumgartner, H., 2002, Who talks to whom? Intra- and interdisciplinary communication of economics journals, *Journal of Economic Literature* 40:2, 483–509.

Robert Bloomfield, 2010, Traditional vs. Behavioral Finance, working paper, Cornell University.
http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1596888

Demski, Chapters 1, 2, and 3

Problems: 2–6, 2–7, 2–8, 2–9, 3–10, and 3–14

3. Monday, August 30 Economic Behavior and the Accountant's Art

Skim: Demski, Chapters 4, 5, 6, and 7

Read: Mathematica tips and pointers (There is both a Mathematica notebook and pdf file.)

Richard P. O'Neill, Paul M. Sotkiewicz, Benjamin F. Hobbs, Michael H. Rothkopf, and William R. Stewart Jr., 2005, Efficient market-clearing prices in markets with nonconvexities *European Journal of Operations Research* 164:1 269–285.

Question: What fraction of the economy is devoted to accounting?

Problems: 7–11, 7–14

Supplemental problem: Code up and solve the Scarf (1994) problem that is described in the O'Neill et al. reading. Here are some tips: (1) Revise the statement of the problem so that new variables, z_1 and z_2 , represent the number of Smokestack and High Tech plants, respectively. (2) The constraint that requires z_1 and z_2 to be integers may be coded as follows: `Element[z1 | z2, Integers]`.

4. Wednesday, September 1 Framing

Read: Demski, Chapter 8

Problems: 8–2, 8–5, 8–6, 8–9, 8–10, 8–11

5. Wednesday, September 8 Uncertainty I
 Read: Demski, Chapter 9
 Problems: 9–11 (Note the typo. The problem should read: “ $U(w) = 10 - \exp(-0.001w)$ ”), 9–12, 9–14, 9–15
 Ingersoll, J. 1987, *Theory of Financial Decision Making*
 Rowman and Littlefield: Totowa, NJ pp. 19–44.
 Postulates of a Personalistic Theory of Decision. From
 Leonard J. Savage, 1972, *The Foundations of Statistics*
 2nd edition, Dover: New York.
6. Monday, September 13 Uncertainty II
 Daniel Ellsberg. 1961. Risk, Ambiguity, and the Savage
 Axioms *The Quarterly Journal of Economics* 75:4 643–
 669.
 Problems: 9–16, 9–17, 9–18, 9–19, 9–20

Part 2. Contracting

7. Wednesday, September 15 Strategic Interaction
 Read: Demski, Chapter 10
 Problems: 10–1, 10–6, 10–11
8. Monday, September 20 Strategic Interaction II
 Problems: 10–12, 10–13, 10–14, 10–16
9. Wednesday, September 22 Performance Evaluation
 Read: Demski, Chapter 13
 Problems: 13–1, 13–2, 13–3, 13–4, 13–5, 13–6, 13–7, 13–8, 13–9, 13–10
10. Monday, September 27 Performance Evaluation II
 NOTE: SPECIAL ROOM LOCATION TODAY
 Problems: 13–13, 13–14, 13–15
 Tax planning and employee contracting problem
 Taxation of stock options problem

11. Wednesday, September 29 Equity Compensation
Problems: Gamblers'R'Us: Devote particular effort to questions 15 through 19 of this problem. For these questions, you may try to state and solve an agency problem.
12. Monday, October 4 Information
Read: Demski, Chapter 14
Kreps, Chapter 16
Problems: 14-9, 14-10, 14-11, 14-12, 14-13, 14-14
13. Wednesday, October 6 Task Allocation and LEN Models
Read: Demski, Chapter 15
Negative exponential utility functions and normally distributed wealth
Skim: Holmstrom, B., Milgrom, P., 1991, "Multi-Task Principal-Agent Analyses: Incentive Contracts, Asset Ownership, and Job Design," *Journal of Law, Economics, and Organization*, 7:24-52.
Problems: 15-4, 15-5, 15-6, 15-7, 15-9, 15-13
14. Monday, October 11 LEN Models II
Read: Robert Gibbons and Kevin J. Murphy, 1992, Optimal incentive contracts in the presence of career concerns: theory and evidence *Journal of Political Economy* 100:3 468-505.
Florin Şabac, forthcoming, Dynamic incentives and retirement, *Journal of Accounting & Economics*.
Problems: Accounting in Partnerships
15. Wednesday, October 13 Controllability
Read: Demski, Chapter 16
Antle, R., Demski, J., 1988, The controllability principle in responsibility accounting, *The Accounting Review*, 63:4 700-718.
Problems: 16-7, 16-11, 16-12

16. Monday, October 18 Communication
 Read: Demski, Chapter 17
 Problems: 17-4, 17-5, 17-13, 17-16
17. Wednesday, October 20 Coordination and Renegotiation
 Read: Demski, Chapters 18 and 19
 Problems: 18-15, 18-16, 19-4, 19-5
18. Monday, October 25 Ethics
 Read: Brian Mittendorf, Infectious ethics: how upright employees can ease concerns of tacit collusion, *Journal of Law, Economics, and Organization* 24:2 (October 2008) 356-370. doi:10.1093/jleo/ewm056.
 Paul Fischer and Steven Huddart, Optimal contracting with endogenous social norms, *American Economic Review* 98:4 (September 2008) 1459-1475. <http://ssrn.com/abstract=528842> DOI: 10.2139/ssrn.528842.
 Social norms for ethical behavior in business settings
 Problems: Social Norms in a LEN Setting
19. Wednesday, October 27 Exam 1

Part 3. Markets and Disclosure

20. Monday, November 1 Before mandatory disclosure
 Read: Conditional Distributions and Bayesian Updating
 Sudipta Basu and Gregory Waymire, 2005, Recordkeeping and human evolution, working paper, <http://ssrn.com/abstract=762004>.
 Davis, L., Neal, L., and White, E. N., 2003, How it all began: the rise of listing requirements on the London, Berlin, Paris, and New York stock exchanges. *International Journal of Accounting* 38, 117-143.
 Kirsten Ely and Gregory Waymire, 1999, Intangible Assets and Stock Prices in the Pre-SEC Era *Journal of Accounting Research* 37:Supplement 17-44.

Robert Verrecchia, 1983, Discretionary disclosure, *Journal of Accounting and Economics* 5:3 179–194.

Problems: Work through the problems in the note.

21. Wednesday, November 3 Bayesian Nash equilibria in production choices

Read: Equilibrium Notes

Skim: Reis, Ricardo F., and Stocken, Phillip C., 2007, “Strategic consequences of historical cost and fair value measurements,” *Contemporary Accounting Research* 24:2 557–584.

Problems: Work through the problems in the note.

22. Monday, November 8 The market response to disclosure

Read: The market response to disclosure

Fischer, P. E., and Verrecchia, R. E., 1997, “The effect of limited liability on the market response to disclosure,” *Contemporary Accounting Research*, 14:3 515–541.

Skim: Holthausen, R. W., and Verrecchia, R. E., 1988, “The effect of sequential information releases on the variance of price changes in an intertemporal multi-asset market,” *Journal of Accounting Research*, 26:1 82–106.

Skim: Demski, J., 2004, “Endogenous Expectations,” *The Accounting Review* 79:2 519–539.

Problems: Work through the problems in the note.

23. Wednesday, November 10 Information and prices

Read: Some Know and Some Don’t Part 1: Kyle Model

Albert S. Kyle, 1985, “Continuous auctions and insider trading” *Econometrica* 53: 6 1315–1336. (Focus on the analysis leading to the first result.)

Steven Huddart and Bin Ke, 2007, “Information asymmetry and cross-sectional determinants of insider trading” *Contemporary Accounting Research*, 24:1 195–232. (Focus on the appendix.)

Skim: Thomas C. Newkirk and Melissa A. Robertson¹, 1998, Insider Trading—A U.S. Perspective, speech delivered September 19, 1998 at the 16th International Symposium on Economic Crime Jesus College, Cambridge, England.
<http://www.sec.gov/news/speech/speecharchive/1998/spch221.htm>.
 Alan D. Jagolinzer, 2009, SEC Rule 10b5-1 and Insiders' Strategic Trade, *Management Science*, 55:2 224–239.

Problems: Work through the problems in the note.

24. Monday, November 15 Information gathering

Read: Paul E. Fischer and Robert E. Verrecchia, 1998, “Correlated forecast errors” *Journal of Accounting Research* 36(12): 91–110.

Problems: What information should I chase?

25. Wednesday, November 17 Mandatory disclosures

Problems: Public information in capital markets

26. Monday, November 29 Earnings management I

Read: Paul E. Fischer and Robert Verrecchia, 2000, “Reporting bias”, *The Accounting Review* 75:2, 229–245.

Problems: Shooting Yourself in the Foot (or Not)

27. Wednesday, December 1 Earnings management II

Read: Jeremy C. Stein, 1989, “Efficient capital markets, inefficient firms: a model of myopic corporate behavior”, *Quarterly Journal of Economics* 104: 4 655–669
 Joseph Farrell and Matthew Rabin, 1996, “Cheap Talk,” *Journal of Economic Perspectives* 10:3, 103–118

Problem: Cheap Talk Problem

¹ respectively, Associate Director, Division of Enforcement and Senior Counsel, Division of Enforcement, U.S. Securities & Exchange Commission

28. Monday, December 6 Earnings management III
Read: Anil Arya, Jonathan Glover, and Shyam Sunder, 1998, "Earnings management and the revelation principle," *Review of Accounting Studies* 3: 7–34.
Roger Myerson, "Revelation Principle," undated.
Problem: The Curse of the Revelation Principle
29. Wednesday, December 8 Reviewing assignment
Read: TBA
30. BONUS CLASS Listing decisions
Read: Steven Huddart, John S. Hughes, and Markus Brunnermeier, 1999, "Disclosure requirements and stock exchange listing choice in an international context" *Journal of Accounting & Economics* 26:1-3 237–269.
Leuz, C., Triantis, A., Wang, T. Y., 2008, Why do firms go dark? Causes and economic consequences of voluntary SEC deregistrations, *Journal of Accounting Research* 45:2-3 181–208
31. University exam period Final examination