

April 23–25, 2015 Cherry Hill, NJ

Refereed

Proceedings

Editor Shifei Chung, Ph.D., CPA (inactive) Rowan University

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President's Welcome to the... Mid-Atlantic Region Meeting

Dear Colleagues, Friends, and Guests,

Welcome to Cherry Hill and the 2015 Mid-Atlantic Region Meeting. We have an exciting program ahead of us, and I hope you will take advantage of the opportunity to attend some very interesting sessions and catch up with old friends and make some new ones.

The program begins early on Thursday with our sixth annual doctoral student/ junior faculty consortium, as well as a professional program for both academics and practitioners. The doctoral student/junior faculty program includes presentations from Stephen G. Ryan of New York University, Shyam Sunder of Yale University, Daniel Taylor of the University of Pennsylvania, and M. H. Franco Wong of the University of Toronto. I strongly recommend doctoral students and junior faculty to participate in these excellent sessions. While I am not a junior faculty, I am planning to participate in these sessions myself and I encourage non-junior faculty to participate as well, if they have the time.

The professional program's sessions cover various topics such as fraud risk assessment, FASB update, XBRL, and COSO's 17 principles. I am sure that some, if not all, of these will be of interest to you and will enable you to expand your horizons. Also take advantage of the breaks and receptions to interact with other attendees and extend your professional and social network.

Organizing an excellent conference like this takes a lot of time and dedication from many people whom I would like to thank. First of all, I thank Rowan University for hosting this year's meeting. I also thank Shifei Chung, Program Chair and President-Elect, the program committee, and the many liaisons and reviewers for their valuable time and hard work. I also thank all of the presenters, discussants, and moderators for their time and effort before and during this conference. This vibrant program would not be possible without the help of our many dedicated members and volunteers. My thanks also go to the AAA staff and to the exhibitors for their support of our conference. Please take some time to visit the exhibitors' tables and review their products.

I look forward to meeting you, and I hope everyone will have a productive and enjoyable conference.

Sincerely,

Mostafa M. Maksy, President, American Accounting Association Mid-Atlantic Region

Program Chair and President-Elect's Welcome to the Mid-Atlantic Region Meeting

Hello everyone,

I welcome all of you to this year's AAA Mid-Atlantic Region's Annual Meeting in Cherry Hill. I hope you will find the meeting to be interesting and rewarding. After the meeting, please take advantage of the local attractions, or go shopping at the nearby Cherry Hill Mall and Moorestown Mall. You can also visit the historic sites in Philadelphia, such as the Liberty Bell and Independence Hall.

Our program begins on Thursday with a doctoral student/junior faculty consortium and CPE workshops. In the consortium, Daniel Taylor of the University of Pennsylvania will provide *Advice for Surviving the Ph.D. Program and Beyond.* Shyam Sunder of Yale University will present *Statistical Inference in Accounting Research.* After lunch, Stephen Ryan of New York University will discuss *Banks' Financial Reporting and Financial System Stability.* M. H. Franco Wong of the University of Toronto will explain *The Effect of Recognition versus Disclosure on Investment Efficiency.*

CPE workshops' topics are Assessing Fraud Risk from an Auditor's Perspective; Introduction to XBRL and the Audit Data Standards; FASB Update for Selected Broad-Based FASB Topics; and Back to School with COSO: Exploring the 17 Principles of COSO 2013. They are presented by academics and professional experts in these areas.

Friday's and Saturday's main programs include a variety of paper sessions, emerging research sessions, panel discussions, and Effective Learning Strategies (ELS) presentations. Our Friday's luncheon speaker is Christine Botosan, President of the AAA, who will speak to us on *Building a Bridge to Our Future*. I hope you will take advantage of these sessions. Please also make the most of everything the meeting has to offer, including the opportunity to renew your friendships from past meetings and make new ones. There are ample networking opportunities during this meeting to expand your circle.

Putting together a meeting like this is not possible without the assistance of many. At the outset I would like to thank all of those who submitted papers, panels, emerging research and ELS proposals, and all the reviewers for their diligence and hard work in submitting the extensive reviews, comments, and recommendations. My sincere thanks also go to those who volunteer to discuss and moderate. People of the AAA in the national office, Peggy Turczyn and Suzanne Mullinnix in particular, provided invaluable assistance in the submission and review process. The members of the steering committee gave me advice as I needed it. I thank region coordinators, J. K. Aier and Joseph Trainor in particular, for their help in the review process. I also thank our Interim Dean, Daniel McFarland of Rohrer College of Business at Rowan University, for his support in general. Ultimately the success of the meeting depends on your participation and for that I thank each and every one of you for taking the time to participate and for coming from different parts of the world to attend this meeting.

Please let me know if there is anything I can help you with during the meeting and please provide any suggestions and comments to improve this conference in the future. I look forward to meeting you all at the conference! Sincerely,

Shifei Chung, 2015 Program Chair and President-Elect, AAA Mid-Atlantic Region

Mid-Atlantic Region 2014–2015 Officers

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We'd like to thank our reviewers

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We'd like to thank our reviewers (continued)

Ramesh Narasimhan KoEun Park Janet F. Phillips Maria Pirrone Neel Kamal Purohit John D. Rossi Thomas Ruchti **Yoshie Saito** Kristy Schenck Janet Lynn Souza Daniel Tinkelman Joseph Trainor Nancy Uddin Gnanakumar Visvanathan Peihwang Wei Edward M. Werner **Donald Thomas Williamson** Fengyun Wu Wan-Ting Wu Minna Yu Mei Zhang Suning Zhang Aleksandra B. Zimmerman

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We'd like to thank our discussants

Khalid Rasheed Al-Adeem Steven Balsam Loretta N Baryeh Hanmei Chen **Jierong Cheng** Kang Cheng Yu-Ho Chi Bea B.H Chiang Joseph Patrick Cunningham **Brent Steven Daulton** Zhanel DeVides David J. Emerson Mackenzie M Festa Lori R. Fuller Kwangjoo Koo Xin Geng Anna Hickev **Darin Kip Holderness Jinglin Jiang** Han Jin Megan Jones Natalya V. Khimich Jung Yeun Kim Brian Knox Abdullah Kumas Peter L Lohrey Mostafa M Maksy Henry Mburu Ramesh Narasimhan Alyssa Ong Erlina Papakroni Han-Up Park Janet F Phillips Maria Pirrone Silvia Romero John D Rossi

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We'd like to thank our discussants (continued)

Yoshie Saito Kristy Schenck Benjamin R Silliman Janet Lynn Souza Fang Sun Donald Thomas Williamson Nancy Uddin Stephanie Weidman Neil A. Wilner Wan-ting Wu Rong Yang Mei Zhang Aleksandra B Zimmerman Old Dominion University Bucknell University St John's University Pennsylvania State University -- Abington College Queens College, CUNY American University Monmouth University Rowan University University of North Texas University of Massachusetts-Boston Rochester Institute of Technology Rowan University Case Western Reserve University

We'd like to thank our Moderators

Khalid Rasheed Al-Adeem Loretta N Baryeh Hanmei Chen Jierong Cheng Kang Cheng Yu-Ho Chi Bea B.H Chiang Shifei Chung Seong Cho Paul Cowley Joseph Patrick Cunningham Zhanel DeVides Burak Dolar Linda J Flaming Margaret Horan Amy E. Ji Jung Yeun Kim Brian Knox Kwangjoo Koo Abdullah Kumas Marco-Antonio La Cruz Mostafa M Maksy Henry Mburu Ramesh Narasimhan Elizabeth Goad Oliver Janet F Phillips Maria Pirrone Robert F. Scarpa Kristy Schenck Benjamin R Silliman Janet Lynn Souza Daniel Tinkelman Donald Thomas Williamson Stephanie Weidman Neil A. Wilner Rong Yang Mei Zhang

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Best Paper Award

"An Assessment of the Roles of Stress Arousal, Resilience, and Burnout in the Stress Dynamic Among Auditors"

Kenneth J. Smith

Salisbury University

David J. Emerson

Salisbury University

Best Paper Award By a Doctoral Student

"Does the Audit Market Price Big 4 Experience in Non-Big 4 firms?"

Aleksandra B. Zimmerman

Case Western Reserve University

Best Paper Award Teaching, Learning and Curriculum Section

"A Methodology for Evaluating the Effect of Grade Inflation and Course Duration on Student Performance in Accounting Courses"

Jierong Cheng

Rutgers University, Newark New York City College of Technology (CUNY)

Yaw M. Mensah

Rutgers University, New Brunswick

Program Information April 23–25, 2015

Thursday, April 23, 2015

9:00 am–5:00 pm	Doctoral/Junior Faculty Consortium Coordinators: Shifei Chung, Rowan University Ramesh Narasimhan, Montclair State University
	Presenters: Stephen G. Ryan, New York University Shyam Sunder, Yale University Daniel Taylor, University of Pennsylvania M. H. Franco Wong, University of Toronto
7:00 am–7:00 pm	Registration
9:00 am–10:30 am	Advice for Surviving the Ph.D. Program and Beyond Auditing - 1.5 CH Daniel Taylor, University of Pennsylvania
10:30 am–10:45 am	Break
10:45 am–12:15 pm	Statistical Inference in Accounting Research Auditing - 1.5 CH Shyam Sunder, Yale University
10:45 am–12:15 pm 12:00 pm–1:45 pm	Statistical Inference in Accounting Research Auditing - 1.5 CH Shyam Sunder, Yale University Lunch
10:45 am–12:15 pm 12:00 pm–1:45 pm 1:45 pm–3:15 pm	Statistical Inference in Accounting Research Auditing - 1.5 CH Shyam Sunder, Yale UniversityLunchBanks' Financial Reporting and Financial System
10:45 am–12:15 pm 12:00 pm–1:45 pm 1:45 pm–3:15 pm Stability	Statistical Inference in Accounting Research Auditing - 1.5 CH Shyam Sunder, Yale UniversityLunchBanks' Financial Reporting and Financial SystemAuditing - 1.5 CH Stephen G. Ryan, New York University
10:45 am–12:15 pm 12:00 pm–1:45 pm 1:45 pm–3:15 pm Stability 3:15 pm–3:30 pm	Statistical Inference in Accounting Research Auditing - 1.5 CH Shyam Sunder, Yale UniversityLunchBanks' Financial Reporting and Financial SystemAuditing - 1.5 CH Stephen G. Ryan, New York UniversityBreak
10:45 am–12:15 pm 12:00 pm–1:45 pm 1:45 pm–3:15 pm Stability 3:15 pm–3:30 pm 3:30 pm–5:00 pm	Statistical Inference in Accounting Research Auditing - 1.5 CH Shyam Sunder, Yale UniversityLunchBanks' Financial Reporting and Financial SystemAuditing - 1.5 CH Stephen G. Ryan, New York UniversityBreakThe Effect of Recognition versus Disclosure on

Thursday, April 23, 2015

9:00 am–5:00 pm	Continuing Professional Education Workshops Coordinators: Shifei Chung, Rowan University Ramesh Narasimhan, Montclair State University
7:30 am–7:00 pm Crystal Ballroom Foyer	Registration
9:00 am–10:30 am Perspective	Workshop 1: Assessing Fraud Risk from an Auditor's
Plaza 4 and 5	Accounting - 1.5 CH Presenters: Danielle Lombardi, Villanova University Ronald Lombardi, The College of New Jersey
10:30 am–10:45 am Plaza Level Foyer	Break
10:45 pm–12:15 pm	Workshop 2: Introduction to XBRL and the Audit Data
Standards Plaza 6	Accounting - 1.5 CH Presenter: Skip White, University of Delaware
12:00 pm–1:45 pm	Lunch
1:45 am–3:15 pm	Workshop 3: FASB Update for Selected Broad-Based
Plaza 4 and 5	Accounting - 1.5 CH Presenter: John M. Fleming, SmartPros, LTD
3:15 pm–3:30 pm Plaza Level Foyer	Break
3:30 pm–5:00 pm Plaza 6	Workshop 4: Back to School with COSO: Exploring the 17 Principles of COSO 2013 Accounting - 1.5 CH Presenters: Maureen P. Breen, Drexel University
4:00 pm–7:30 pm Crystal 2 and 3	Exhibits
5:30 pm–7:30 pm Crystal 2 and 3	Reception

Friday, April 24, 2015

7:00 am–7:00 pm Crystal Ballroom Foyer	Registration
7:00 am–4:00 pm Crystal 2 and 3	Exhibits
7:30 am–8:30 am Crystal 2 and 3	Breakfast
8:30 am–10:00 am	Concurrent Sessions
Plaza 1	1.01 Auditing 1 <i>Auditing - 1.5 CH</i> Moderator: Kang Cheng, Morgan State University
	Does the Audit Market Price Big 4 Experience in Non- Big 4 Firms? Aleksandra B. Zimmerman, Case Western Reserve
	University Discussant: Henry Mburu, Morgan State University
	Does the Market Value Auditors' Industry Expertise? Evidence from Restatements Setting Amy E. Ji, Saint Joseph's University Hang Pei, The George Washington University Krishna R. Kumar, The George Washington University Discussant: Hanmei Chen, Rowan University
	Insider Ownership and Auditor Monitoring: Evidence from Dual-Class Firms Arno Forst, Kent State University Barry R. Hettler, Kent State University Discussant: Beixin Betsy Lin, Montclair State University
Plaza 2	1.02 Financial Accounting and Reporting 1 Accounting - 1.5 CH Moderator: Daniel Tinkelman, Hofstra University
	Labor Unemployment Concern and Corporate Discretionary Disclosure Yuan Ji, The George Washington University Liang Tan, The George Washington University Discussant: Han Jin, West Virginia University
20	Do Manufacturing Firms Manage Nonoperating Costs to Meet the Earnings Benchmark at Zero? Steven C. Hall, University of Nebraska at Kearney William W. Stammerjohan, Louisiana Tech University Laurie S. Swinney, University of Nebraska at Kearney Discussant: Mostafa M. Maksy, Kutztown University of Pennsylvania

Plaza 3	1.03 Management Accounting 1 Accounting - 1.5 CH Moderator: Stephanie Weidman, Rowan University
	When Subtle Performance Monitoring Helps, Really Helps, and Hurts: The Impact of Psychological Entitlement and Monitoring Environment on Performance and Misreporting Darin Kip Holderness, West Virginia University Discussant: Steven Balsam, Temple University
	The Choice of Performance Measures in Performance-Vested Equity Compensation Wan-Ting Wu, University of Massachusetts Boston Discussant: Han-Up Park, Temple University
	An Effective Response: Smoldering Crisis and Capacity Cost Management Charles R. Thomas, École hôtelière de Lausanne C. J. Connolly, United States Coast Guard Academy Discussant: Brian Knox, University of Pittsburgh
Plaza 4	1.04 Financial Accounting and Reporting 2 Accounting - 1.5 CH Moderator: Zhanel DeVides, Rutgers University of New Jersey, Camden
	Fair Value Accounting Treated Unfairly by Accountants Sadaharu Takeshima, Kanazawa University George H. Sorter, New York University Discussant: Megan Jones, West Virginia University
	How Diversification, Acquisitions, and R&D Influence Decisions to Discontinue Operation Yoshie Saito, Old Dominion University Richard Lord, Montclair State University Discussant: Natalya V. Khimich, Drexel University
	Entrepreneurial Bias in Management Earnings Forecasts Yu-Ho Chi, The University of North Carolina at Pembroke David A. Ziebart, University of Kentucky Discussant: Alyssa Ong, West Virginia University
Plaza 5	1.05 Emerging Research and Research Interaction 1 Accounting - 1.5 CH Moderator: Joseph Patrick Cunningham, Albright College
	The Auditor Effects on the Deterrence of SEC Enforcement Actions Kristy Schenck, Bucknell University
	An Examination of the Impact of Culture on IFRS Risk Disclosures for Firms That Cross-List in the U.S. Carmen B. Rios-Figueroa, University of Puerto Rico, Rio Piedras

	An Investigation of the Use and Impact of Big Data Analytics—The Case of Nonprofit Organizations Janet F. Phillips, Southern Connecticut State University
Plaza 7	1.06 Panel Discussion 1 <i>Accounting - 1.5 CH</i> Moderator: Paul Cowley, Cabrini College
	Technological Advantages and Pitfalls of Delivering Accounting Content Panelists: Ann D. Servey, Cabrini College Carlo Silvesti, Gwynedd Mercy University
10:00 am–10:30 am Crystal 2 and 3	Break
10:30 am–11:45 am	Concurrent Sessions
Plaza 2	2.01 Financial Accounting and Reporting 3 Accounting - 1.5 CH Moderator: Ramesh Narasimhan, Montclair State University
	Financial Engineering and the Arms Race between Accounting Standard Setters and Preparers Ronald A. Dye, Northwestern University Jonathan Glover, Carnegie Mellon University Shyam Sunder, Yale University Discussant: Steven Balsam, Temple University
Plaza 1	2.02 Public Interest 1 <i>Accounting - 1.5 CH</i> Moderator: Mostafa M. Maksy, Kutztown University of Pennsylvania
	The Role of Adverse Selection, Moral Hazard and Operational Inefficiency in Bank Failures: An Emerging Market Evidence Ihsan Isik, Rowan University Hulusi C. Uysal, University of Pennsylvania Daniel Folkinshteyn, Rowan University Discussant: Abdullah Kumas, University of Richmond
	The Impact of EPA Penalties on Financial Performance Jorge Romero, Towson University Martin Freedman, Towson University Discussant: Stephanie Weidman, Rowan University

	A Closer Look at the Surrounding of Auditors: Good Relationships withCorporate Clients' Management, How May Auditors Sustain It? Khalid Rasheed Al-Adeem, King Saud University Discussant: Yu-Ho Chi, The University of North Carolina at Pembroke
Plaza 3	2.03 Teaching, Learning and Curriculum 1 Accounting - 1.5 CH Moderator: Bea B H, Chiang, The College of New Jersey
	Using Guided Readings Questions to Motivate Student Reading and to Help "Flip" the Intermediate Accounting Classroom Charles A. Brown, The Pennsylvania State University, The
	Benrend College Kreag Danvers, The Pennsylvania State University, The Behrend College
	David T. Doran, The Pennsylvania State University, The Behrend College Discussant: Janet F. Phillips, Southern Connecticut State
	What Do We Mean by Accounting Program Quality? A Decomposition of Accounting Faculty Opinions Timothy J. Fogarty, Case Western Reserve University Aleksandra B. Zimmerman, Case Western Reserve University Vernon J. Richardson, University of Arkansas Discussant: John D. Rossi, Moravian College
	A Methodology for Evaluating the Effect of Grade Inflation and Course Duration on Student Performance in Accounting Courses Jierong Cheng, Rutgers University - Newark Yaw Mensah, Rutgers University – New Brunswick Discussant: Bea B. H. Chiang, The College of New Jersey
	<i>Cost Accounting Variance: Blended Learning</i> R. Mithu Dey, Howard University Discussant: Loretta N. Baryeh, Coppin State University
Plaza 4	2.04 Financial Accounting and Reporting 4 Accounting - 1.5 CH Moderator: Kristy Schenck, Bucknell University
	Disclosure Timing and Real Earnings Management Dina F. El-Mahdy, Morgan State University Discussant: Joseph Patrick Cunningham, Albright College
	Accounting for Accrued Workers' Compensation Costs: A Complex Adaption of Incurred but Not Reported Liabilities Alan Reinstein, Wayne State University Avinash Arya, William Paterson University of New Jersey Natalie T. Churyk, Northern Illinois University 2015 AAA Mid-Atlantic Proceedings - 19 -

	Discussant: Peter L. Lohrey, Montclair State University
	The Effect of the SEC's Accelerated Filing Deadline on Earnings Timeliness Amy E. Ji, Saint Joseph's University Discussant: Zhanel DeVides, Rutgers University - Camden
Plaza 5	2.05 Emerging Research and Research Interaction 2 Accounting - 1.5 CH Moderator: Neil Wilner, University of North Texas
	Accounting Certifications and Designations in the United States: A History of Stress, Conflict, and Consensus and the Market for Certifications George Romeo, Rowan University Larissa S. Kyj, Rowan University
	<i>Teaching a Capstone Course with a Supply Chain Approach</i> Buagu Musazi, Morgan State University
	Developments in New Jersey Transfer Taxation Richard Marmon, Rowan University
Plaza 7	2.06 Panel Discussion 2 Accounting - 1.5 CH
	Mini-APLG Session 1: Issues Facing Department and Program Heads Moderator: Elizabeth Goad Oliver, Washington & Lee University
	Panelists: Hubert Glover, Drexel University Michael Peters, Villanova University Nancy Uddin, Monmouth University
12:00 pm–1:15 pm Grand Ballroom B	Business Meeting and Luncheon Personal Development - 1.0 CH Introduction: Shifei Chung, Program Chair, Rowan University
	Welcome Remarks from the Mid-Atlantic Region President Mostafa M. Maksy, Kutztown University of Pennsylvania
	Welcome Remarks from the Host School Interim Dean Daniel J. McFarland, Rowan University
	Building a Bridge to Our Future Speaker: Christine Botosan, AAA President, The University of Utah

1:30 pm–3:00 pm	Concurrent Sessions
Plaza 1	3.01 Accounting Information Systems 1 Accounting - 1.5 CH Moderator: Jierong Cheng, Rutgers University - Newark
	Designing Continuous Auditing/Monitoring to fit Not-for-Profit Organizations Deniz A. Appelbaum, Rutgers University - Newark Stephen Kozlowski, Rutgers University - New Brunswick Miklos A. Vasarhelyi, Rutgers University - Newark Discussant: David J. Emerson, Salisbury University
	Responses of Small and Large Investors to XBRL Disclosure to the SEC Shiyou Li, Texas A&M University–Commerce Discussant: Kristy Schenck, Bucknell University
	Using Accounting, Psychological, Information Visualization, and Graphic Design Concepts to Display Interim Income Statement Data Daniel Tinkelman, Hofstra University Amy M. Masnick, Hofstra University Discussant: Erlina Papakroni, West Virginia University
Plaza 3	3.02 International Accounting 1 Accounting - 1.5 CH Moderator: Kwangjoo Koo, William Paterson University of New Jersey
	The Governance Gene of Blockholders: Block Acquisition and Earnings Management around the World Lili Dai, Australian National University Ravi Dharwadkar, Syracuse University Linna Shi, Binghamton University, SUNY Bohui Zhang, UNSW Australia Discussant: Mackenzie M. Festa, West Virginia University
	Audit and Accounting Quality in an International Setting: Impact of Religion, Culture, Income, and Legal Code on National Regulatory Efforts Gary Kleinman, Montclair State University Beixin Betsy Lin, Montclair State University Discussant: Silvia Romero, Montclair State University
	Examining the Current Legal Environment Facing the Public Accounting Profession: Lessons to Be Learned from the U.K.` and EU Alan Reinstein, Wayne State University Carl Pacini, University of South Florida Brian Patrick Green, University of Michigan–Dearborn Discussant: Janet F. Phillips, Southern Connecticut State 2015 AAA Mid-Atlantic Proceedings - 21 -

University

Plaza 2	3.03 Financial Accounting and Reporting 5 <i>Accounting - 1.5 CH</i> Moderator: Abdullah Kumas, University of Richmond
	<i>Managerial Ownership, Earnings Management, and Leveraged Stock Repurchases</i> Stefan Schantl, Purdue University Discussant: Jinglin Jiang, Rutgers University - New Brunswick
	Insider Trading Activity around Auto Recalls Abdullah Kumas, University of Richmond Musa Subasi, University of Missouri Sami Keskek, University of Arkansas Omer Gokalp, Suffolk University Discussant: Jung Yeun Kim, Binghamton University, SUNY
	<i>Tournament Incentives and Real Activities Manipulation</i> KoEun Park, University of Massachusetts Boston Discussant: Xin Geng, West Virginia University
Plaza 4	3.04 Financial Accounting and Reporting 6 <i>Accounting - 1.5 CH</i> Moderator: Mei Zhang, Rowan University
	Accounting Conservatism and Debt Contract Renegotiation Yuan Ji, The George Washington University Liang Tan, The George Washington University Discussant: Brent Daulton, West Virginia University
	<i>R&D Expense Management during Initial Public Offerings</i> Natalya V. Khimich, Drexel University Tatiana Fedyk, University of San Francisco Discussant: Wan-Ting Wu, University of Massachusetts Boston
	Management Decisions and Accounting Reports in Rural SMEs Kalinga Jagoda, Mount Royal University Desiree Zander, Mount Royal University Discussant: Yoshie Saito, Old Dominion University
Plaza 5	3.05 Emerging Research and Research Interaction 3 <i>Accounting - 1.5 CH</i> Moderator: Hanmei Chen, Rowan University
	The Effect of Output-Based Contracts on the Flow of Lower- Level Employee Feedback: A Proposal Brian Knox, University of Pittsburgh
	Budgetary Slack: The Interaction of Ethics, Risk and Information Asymmetry Stephanie Weidman, Rowan University Larissa S. Kyj, Rowan University 2015 AAA Mid-Atlantic Proceedings - 22 -

	Yang Yang, Rowan University
	Financial Auditor Effect on Sustainability Reporting: An Exploratory Study Silvia Romero, Montclair State University Belen Fernandez-Feijoo, Universidade de Vigo Silvia Ruiz, Universidade de Vigo
Plaza 7	3.06 Panel Discussion 3 Accounting - 1.5 CH
	Mini-APLG Session 2: How Do Students Move Successfully Toward the Profession? Moderator: Elizabeth Goad Oliver, Washington & Lee University
	Panelists: John D. Rossi, Moravian College Scott Graham Collins, The Pennsylvania State University Michael Poersken, EY Bernadette M. Ruf, Delaware State University
3:00 pm–4:00 pm	4.01 Ice Cream Social with ELS Posters and Research Interaction
Crystal 2 and 3	Accounting - 1.0 CH Ice Cream provided by the Teaching, Learning, and Curriculum Section Effective Learning Strategies (ELS)
	Board 1: Fraud Awareness (and More) in Nonprofit Organizations: A Service-Learning Project Richard G. Brody, The University of New Mexico
	Board 2: Teaching Professional Skepticism John D. Rossi, Moravian College
4:00 pm–5:30 pm	Concurrent Sessions
Plaza 1	 5.01 Auditing 2 Auditing - 1.5 CH Moderator: Loretta N. Baryeh, Coppin State University An Experimental Investigation of Auditor Professional Skepticism in Client Email Inquiries Aleksandra B. Zimmerman, Case Western Reserve University
	Discussant: Mei Zhang, Rowan University

	 Equity-Based Compensation and the Effectiveness of Audit Committees Gopal V. Krishnan, American University Hung-Chao Yu, National Chengchi University Discussant: Mei Zhang, Rowan University Audit Risk, Perceived Audit Risk and the Financial Crisis of 2008 Hanmei Chen, Rowan University Mei Zhang, Rowan University Discussant: Xin Geng, West Virginia University
Plaza 2	5.02 Financial Accounting and Reporting 7 Accounting - 1.5 CH Moderator: Lori R. Fuller, West Chester University of Pennsylvania
	Accounting Policies and Price Stability under Market Disruption Jinglin Jiang, Rutgers University - New Brunswick Vikram Nanda, Rutgers University - New Brunswick Steven Chong Xiao, Rutgers University - New Brunswick Discussant: Alyssa Ong, West Virginia University
	Irresponsible Corporate Social Activities, Stakeholders, and Board Legal Expertise Jun Guo, Rutgers University - Camden Linna Shi, Binghamton University, SUNY Rong Yang, Rochester Institute of Technology Discussant: Henry Mburu, Morgan State University
	Financial Reporting Conservatism and Voluntary Non-Financial Disclosure: A Case from Corporate Social Responsibility Disclosure Seong Cho, Oakland University Cheol Lee, Wayne State University Pyung K. Kang, Wayne State University Chung Park, Ajou University Discussant: Kang Cheng, Morgan State University
Plaza 3	5.03 Public Interest 2 <i>Accounting - 1.5 CH</i> Moderator: Janet F. Phillips, Southern Connecticut State University
	What Are the Root Causes for Corporate Unethical Behavior: Do Colleges and Universities Have a Role? Joseph Riotto, New Jersey City University Discussant: Arron Scott Fleming, West Virginia University
	Accounting for and Reporting Sustainability in Higher Learning Institutions: A Status Report and Recommendations for Improvement Areas Bethany Naccarato, Southern Connecticut State University Discussant: Jierong Cheng, Rutgers University - Newark
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	Does Gender Affect the Academic Performance of Transfer Students Compared to Native Students in Accounting? Hossein Nouri, The College of New Jersey Maria Domingo, The College of New Jersey Discussant: Neil Wilner, University of North Texas
Plaza 4	5.04 Financial Accounting and Reporting 8 Accounting - 1.5 CH Moderator: Brian Knox, University of Pittsburgh
	Managerial Choice between Earnings Management Alternatives Han Jin, West Virginia University Arron Scott Fleming, West Virginia University Discussant: Janet Lynn Souza, Pennsylvania State University Abington
	Propensity Score Matched Discretionary Accruals Gerald Abdesaken, West Chester University of Pennsylvania Roberto Steri, University of Lausanne Discussant: Silvia Romero, Montclair State University
	CFOs' Gender and Real Earnings Management Dina F. El- Mahdy, Morgan State University Discussant: Fang Sun, Queens College–CUNY
Plaza 5	5.05 Emerging Research and Research Interaction 4 <i>Accounting - 1.5 CH</i> Moderator: Khalid Rasheed Al-Adeem, King Saud University
	Informing the IASB Standard-Setting Process: A Reporting Frequency Proposal Marco-Antonio La Cruz, University of Curaçao
	Goodwill Accounting by Pharmaceutical Companies: Assessing Reporting Informedness and Value Relevance after SFAS No. 142 Anthony DelConte, Saint Joseph's University George P. Sillup, Saint Joseph's University A. J. Stagliano, Saint Joseph's University
	Accounting for Contracts in the Construction Industry: Possible Impacts of the New Revenue Recognition Standard Shifei Chung, Rowan University Ramesh Narasimhan, Montclair State University
Plaza 7	5.06 Panel Discussion 4 Accounting - 1.5 CH
	Community Based/Service Learning in the Accounting Classroom Moderator: Robert F. Scarpa, Rowan University
	Panelists: Margaret Van Brunt, Rowan University Roberta Smith, Roberta Smith, CPA LLC
6:00 pm–8:00 pm	Reception 2015 AAA Mid-Atlantic Proceedings - 25 -

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7:00 am–11:00 am Crystal Ballroom Foyer	Registration
7:15 am–8:15 am Grand Ballroom B	Breakfast
8:15 am–9:45 am	Concurrent Sessions
Plaza 3	6.01 Forensic and Investigative Accounting <i>Accounting - 1.5 CH</i> Moderator: Janet Lynn Souza, The Pennsylvania State University Abington
	Target Security Breach Case Study: Hackers Hit the Jackpot at the Expense of Customers Margaret O'Reilly-Allen, Rider University Dorothy Ann McMullen, Rider University Maria H Sanchez, Rider University Discussant: Nancy Uddin, Monmouth University
	Fraud Detection Suicide: The Dark Side of White-Collar Crime Richard G. Brody, The University of New Mexico Frank S. Perri, Public Defender's Office of Winnebago County Discussant: Joseph Patrick Cunningham, Albright College
	The Valuation of Economic Damages: A Case Study for the Forensic Accountant Peter L. Lohrey, Montclair State University James A. DiGabriele, Montclair State University Discussant: Ramesh Narasimhan, Montclair State University
Plaza 5	6.02 Taxation <i>Accounting - 1.5 CH</i> Moderator: Robert F. Scarpa, Rowan University
	Revised Streamlined Filing Compliance Procedures for the Disclosure of Foreign Assets Donald Thomas Williamson, American University Discussant: Maria Pirrone, St. John's University
	The Tenth Circuit Rules the 23 Notice Requirement Is Mandatory for a Third-Party Summons Maria Pirrone, St. John's University Discussant: Donald Thomas Williamson, American University
	A Comparative Analysis of the Impact of Taxation on Revenue Generation in the Developing Countries of Ghana and Nigeria Loretta N. Baryeh, Coppin State University Hyacinth Ezeka, Coppin State University Gertrude A. Eguae-Obazee, Albright College
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	Discussant: Benjamin R. Silliman, St. John's University
Plaza 1	6.03 Management Accounting 2 <i>Accounting - 1.5 CH</i> Moderator: Henry Mburu, Morgan State University
	The Effect of the Strategy Map on the Flow of Lower-Level Employee Feedback to Upper Management Brian Knox, University of Pittsburgh Discussant: Henry Mburu, Morgan State University
	The Control of Generalist on Internal and External Governance Mechanisms Kwangjoo Koo, William Paterson University of New Jersey Discussant: Arron Scott Fleming, West Virginia University
	Soup Kitchens, Service Learning, and Managerial Accounting C. Andrew Lafond, La Salle University Bruce A. Leauby, La Salle University Discussant: Erlina Papakroni, West Virginia University
Plaza 2	6.04 Financial Accounting and Reporting 9 <i>Accounting - 1.5 CH</i> Moderator: Yu-Ho Chi, The University of North Carolina at Pembroke
	The Segment Disclosures Decision-Context Framework and the Decision-Usefulness Prediction Model Cynthia Tollerson, Morgan State University Wynne W. Chin, University of Houston George O. Gamble, University of Houston Discussant: Abdullah Kumas, University of Richmond
	Transitory Income Components and Risk Andrew Ayimbila Anabila, The University of Texas–Pan American Discussant: Megan Jones, West Virginia University
	Effects of Business Combination on Accounting Information's Value Relevance in the New Economy Kang Cheng, Morgan State University Discussant: Khalid Rasheed Al-Adeem, King Saud University
	<i>Cost of Debt and Auditor Choice</i> Fengyun Wu, Manhattan College Fang Sun, Queens College–CUNY Sherry Li, Rider University Discussant: Han-Up Park, Temple University
Plaza 4	6.05 Auditing 3 <i>Auditing - 1.5 CH</i> Moderator: Robert F. Scarpa, Rowan University
	Managerial Overconfidence and Internal Control Weaknesses 2015 AAA Mid-Atlantic Proceedings - 27 -

	Jong Eun Lee, Sungkyunkwan University Discussant: Brent Steven Daulton, West Virginia University
	An Assessment of the Roles of Stress Arousal, Resilience, and Burnout in the Stress Dynamic among Auditors Kenneth Jonathan Smith, Salisbury University David J. Emerson, Salisbury University Discussant: Mostafa M. Maksy, Kutztown University of Pennsylvania
	Audit Firm Rotation or Partner Rotation? Bea B. H. Chiang, The College of New Jersey Michael Palantone, The College of New Jersey Discussant: Mostafa M. Maksy, Kutztown University of Pennsylvania
Plaza 7	6.06 Panel Discussion 5 Accounting - 1.5 CH
	Before-Retirement Planning for the College Professor Moderator: Margaret Horan, Wagner College
	Panelists: Thomas Horan, O'Connor Davies, LLP and St. Joseph's College, Brooklyn Margaret Horan, Wagner College Yalin Chen, Wagner College Ian E. Wise, Wagner College Michael Mahoney, Wagner College
9:45 am–10:15 am Plaza Level Foyer	Break
10:15 am–11:45 am	Concurrent Sessions
Plaza 1	7.01 Teaching, Learning and Curriculum 2 Accounting - 1.5 CH Moderator: Margaret Horan, Wagner College
	An Exploration of Accounting Grading Practices in the U.S. Hossein Nouri, The College of New Jersey Abdus Shahid, The College of New Jersey Bea B. H. Chiang, The College of New Jersey Discussant: Nancy Uddin, Monmouth University
	Factors Associated with Student Performance in Upper Level

	Application of Integrative Learning to Introductory Managerial Accounting Fengyun Wu, Manhattan College Aileen Lowry Farrelly, Manhattan College Discussant: Lori R. Fuller, West Chester University of Pennsylvania
Plaza 3	7.02 International Accounting 2 Accounting - 1.5 CH Moderator: Maria Pirrone, St. John's University
	Does the Adoption of IFRS Increase the Usefulness of Voluntary Bank Disclosures Globally? Mohamed A. Elbannan, The American University in Cairo Discussant: Loretta N. Baryeh, Coppin State University
	Accounting-Education Trends by Authors from Australia, Canada, New Zealand, and the United Kingdom Richard A. Bernardi, Roger Williams University Taylor L. Delande, Property Management Kimberly A. Zamojcin, Consulting Firm Discussant: Janet Lynn Souza, The Pennsylvania State University Abington
	The Economic Growth in Peru and the Economic Struggles of Zimbabwe Michael Joseph Gallagher, DeSales University Susan Sundai Muzorewa, Delaware State University Discussant: Kwangjoo Koo, William Paterson University of New Jersey
Plaza 2	7.03 Financial Accounting and Reporting 10 <i>Accounting - 1.5 CH</i> Moderator: Marco-Antonio La Cruz, University of Curaco
	Managerial Ability, Credit Ratings, and the Cost of Debt Kimberly Cornaggia, American University Gopal V. Krishnan, American University Changjiang Wang, Florida International University Discussant: Brian Knox, University of Pittsburgh
	What Story Does an Inconsistent Analyst Forecast Tell? Sanghyuk Byun, Sogang University Kristin Roland, The University of North Carolina at Charlotte Discussant: Darin Kip Holderness, West Virginia University
	Managerial Ability and Accounting Conservatism Sam Han, Korea University Discussant: Kang Cheng, Morgan State University

Plaza 4	7.04 Public Interest 3 Accounting - 1.5 CH Moderator: Donald Thomas Williamson, American University
	A Historical Case Study of the Debate over College Tuition Tax Credits during the 95th Congress (1977—1978) Benjamin R. Silliman, St. John's University Discussant: Han Jin, West Virginia University
	The Role of Gatekeepers in a Shifting Accounting Research Agenda: Empirical Evidence from The Accounting Review Khalid Rasheed Al-Adeem, King Saud University Discussant: Peter L. Lohrey, Montclair State University
	Increasing Diversity through University Multi-faceted Mentoring Programs Evelyn A. McDowell, Rider University Maria H. Sanchez, Rider University
	Margaret O'Reilly-Allen, Rider University Discussant: Mackenzie M. Festa, West Virginia University
	Journal Lists and Steps to Develop Them Alan Reinstein, Wayne State University Mohammad J. Abdolmohammadi, Bentley University Discussant: Yu-Ho Chi, The University of North Carolina at Pembroke
Plaza 5	7.05 Emerging Research and Research Interaction 5 Accounting - 1.5 CH Moderator: Amy E. Ji, Saint Joseph's University
	Voluntary Clawback Provisions and Executive Risk Taking Henry Mburu, Morgan State University Alex Tang, Morgan State University
	Deficiencies in Audit/Attestation Engagements for Non-Big 4 Accounting Firms Shifei Chung, Rowan University Ramesh Narasimhan, Montclair State University
	Industry Balanced Value versus Growth Stocks Jia Wang, Rowan University Zugang Liu, The Pennsylvania State University Hazleton Ben Branch, University of Massachusetts Amherst

DOES THE AUDIT MARKET PRICE BIG 4 EXPERIENCE IN NON-BIG 4 FIRMS?

Aleksandra B. Zimmerman Case Western Reserve University

ABSTRACT

This study investigates whether Big 4 experience persists in non-Big 4 firms at the individual auditor level. In particular, I use hand-collected data to examine whether non-Big 4 firms command higher audit fees for the prior Big 4 experience of their audit partners. Drawing on credence goods theory and signaling theory, I posit that non-Big 4 auditors' prior Big 4 experience, by virtue of signaling reputation for expertise to buyers and reducing uncertainty about audit quality, allows auditors to command higher audit fees. Results are consistent with expectations and indicate that there is an average audit fee premium of approximately 24 percent for partners with any prior Big 4 experience. Moreover, there is a premium of approximately 1.4 percent for each 1 percent increase in the proportion of an office's partners with Big 4 experience of their audit partners. The study provides evidence that a Big 4 reputation is not just a firm-level phenomenon; it persists at the individual level when auditors leave the Big 4 and transfer to non-Big 4 firms. Big 4 experience in non-Big 4 firms is perceived as valuable and priced as such by the audit market.

DOES MARKET VALUE AUDITOR'S INDUSTRY SPECIALIZATION? EVIDENCE FROM RESTATEMENT'S CONTAGION EFFECT

Amy E. Ji Saint Joseph's University

Krishna R. Kumar The George Washington University

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ABSTRACT

This study investigates whether an auditor's reputation as an industry specialist adds value to its clients in the capital market. Using a research design that tests the contagion effects of restatements, we control for the confounding effects of client characteristics and the endogeneity problem embedded in auditor choice. We find support for market's pricing for auditor industry specialization. The *non-restating clients* of a city specialist auditor experience an average of -0.8 percent return when the restating clients of the auditor announce the restatement. In contrast, we do not find a significant negative return for the *non-restating clients* of national specialists. In additional tests, we show that the damage to reputation of city-level specialization is more profound when the restatement involves fraud. We also document that reputation as a national-level industry specialist is damaged when (i) the restatement involves fraud, (ii) the restating company experiences large share price declines around restatement announcement date, or (iii) the restating firm is large. Our results support that investors use the auditor's within-industry market share to form initial assessment of auditor industry specialization and that investors update the assessment with additional signals such as restatements.

THE CHOICE OF PERFORMANCE MEASURES IN PERFORMANCE-VESTED EQUITY COMPENSATION CONTRACTS

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ABSTRACT

This paper examines the choice of performance measure in performance-vested (p-v) equity compensation. Based on a sample of S&P 500 firms that granted p-v equity compensation to executives between 2006 and 2008, this paper shows that p-v equity compensation is very distinctive from annual bonus in the types and numbers of performance measures used to evaluate executive performance. Consistent with the Informativeness Hypothesis, the likelihood of a performance measure's usage in p-v equity compensation decreases with its relative nosiness. This paper find that past performance, business complexity and growth potentials are also associated with the choice of performance measures. The results are robust in the cluster analysis and after controlling for the decisions to adopt p-v equity compensation and the industry effects.

AN EFFECTIVE RESPONSE: SMOLDERING CRISIS AND CAPACITY COST MANAGEMENT

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ABSTRACT

When risk mitigation fails, a company is often faced with one or more crisis events. Crisis can take many forms. A type of crisis, a smoldering crisis, can continue gaining momentum over time, slowly eroding the future success of an organization. This paper uses archival case analysis to look at how two airlines—Southwest Airlines and US Airways—responded to the smoldering crisis of loss of profitability and ridership in their short-haul markets over the period from the early 1990s to mid-2000s. Viewed from the perspective of strategic cost management these two companies made very different responses to the smoldering crisis, with US Airways choosing a structural response, triggering a cascade of smoldering and acute crisis, while Southwest emphasized executional strategic adjustments that allowed it to maintain profitability as it transitioned to new operating conditions.

FAIR VALUE ACCOUNTING TREATED UNFAIRLY BY ACCOUNTANTS

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George H. Sorter New York University

ABSTRACT

Most would agree that fair value accounting is one of the most controversial issues in current accounting research. However, they may not agree with how to approach the issue. In a revision of the existing conceptual framework for financial reporting, the International Accounting Standards Board (IASB) views the faithful representation of assets and liabilities as a central purpose of accounting and discusses the issue of fair value accounting from the view of the classification of assets and liabilities. This paper questions the approach approved by the IASB and suggests a different approach emphasizing accounting events. We classify accounting events according to the timing of recognition and their measurements. Based on the classification of accounting events, we analyze current accounting practices and identity inconsistencies about the treatment of changes in fair value. We suggest a solution to fair value accounting from the view of the classification of accounting events.
AN EXAMINATION OF THE IMPACT OF CULTURE ON IFRS RISK DISCLOSURES FOR FIRMS THAT CROSS- LIST IN THE U.S.

Carmen B. Ríos-Figueroa University of Puerto Rico

ABSTRACT

Accounting disclosures is an important factor in the decision making process of users of financial statements. Past studies suggest how disclosure requirements can be different among countries and how some disclosures are more needed than others. Differences in cultural values across countries may result in different opinions regarding the adequacy or extent of the disclosures on the financial statements. IFRS disclosures such as business combinations (IFRS 3), financial instruments (IFRS 7) and impairment tests (IAS 36) are highly demanded (Riise and Plenborg, 2013). The objective of this study is to examine the effect of culture on IFRS 7 risk disclosures in firms that cross-list in the United States. This study will extend the current literature in the area of culture and IFRS risk disclosure requirements.

The study sample consists of 97 international firms that trade in the New York Stock Exchange. A cross country analysis related to IFRS 7 disclosure level of financial risk will be prepared for each firm. Using Hofstede (1983) and Gray's theory (1988), each company country will be divided by cultural area and by a level of secrecy and conservatism scale. A scale level of disclosure will be created for each company after considering the extension of the IFRS 7 disclosures in their annual reports. Each company scale level of secrecy and conservatism will be compared with the scale level of risk disclosures to analyze their relationship. A statistical analysis will be prepared to explore the study's research questions of interest more in depth. The study results will help understand if cultural values have an effect on financial risk disclosures levels and how these disclosures required by new international accounting norms supports Grays' theory of secrecy and conservatism.

Keywords: Culture, IFRS 7, risk disclosures, secrecy, conservatism

Sustaining Mutual and Market Interests in the Auditor and Corporate Client Relationship

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Note: This paper was presented under this title:

A Closer Look at the Surrounding of Auditors: Good Relationships with Corporate Clients' Management, How May Auditors Sustain it?

ABSTRACT

This paper reviews the accounting literature on the audit function, the auditor-client manager relationship, and the possible influence of these relationships on auditor independence. The negotiation interactions between client managers and auditors and the distribution of power reveal the superior position of client management. The interactions also reveal that auditors participate in potential joint ventures. Auditor independence may be subject to compromise to sustain effective relationships with corporate client management even with the presence of a monitoring mechanism such as a board of directors. To ensure favorable opinions from their current auditors, managers may utilize any available possible means. A thorough audit that displeases client management comes at a cost for auditors who can be viewed as economic agents serving their own interests. To sustain confidence in attesting and assurance services, auditors must appear independent to external parties to provide assurance that auditors provide valuable services that support a 'functional' market. Trust placed in auditors and, thus, the capital market is possible as long as auditors appear independent.

Key words: Auditor Independence, Client-Auditor Relationship, Power, Negotiation.

INTRODUCTION:

he accounting profession has been marred by the unethical behavior of some auditors leading governments—recently, for example, the US government—to question the behavior of all auditors. Recent scandals in corporate governance were associated with immoral auditing, for example, the auditing of Enron and WorldCom by Arthur Andersen. According to Cheney (2002, p.3), "It's only slightly encouraging to think that 99 per cent of accountants are unassailably ethical. The terror is that one per cent is enough to contaminate the profession's regulations." Levitt and Breeden (2003) suggest that Enron's filing for bankruptcy in 2002 implied that, "investors' trust was taken for granted and abused" through "the market system." Trust is essential to the market. Levitt and Breeden (2003 cited in Robertson and Louwers 2002, p.iii) argue, "markets rely more than anything else on trust." Carey (1946, p.2) emphasizes, "The very existence of the accounting profession depends on public confidence incertified public accountants to safeguard the public interest. The US government recently took action, represented by the Sarbanes-Oxley Act, to ensure confidence in the capital market.

Auditors have a role to play in society (Shockley, 1981) and bear a social responsibility to the public. There is an implicit contract between society and auditors that Previts (1992) calls a "social contract." "When an accountant signs his name to an annual report, a lot of investors, widows, and retirees place trust in the name" (Berton, 1985, p.1) (see Figure 1). Such trust is based upon the true independence of auditors. Firth (1980) states:

"if an auditor is not truly independent then his opinion on a company's financial statements will be of no value. This, in turn, will mean that users will have less confidence in financial statements and that there will be greater uncertainty in the capital markets" (p.451).

FIGURE 1 IDEAL AUDITOR RELATIONSHIPS



For auditors, sustaining independence is a dream that has not become a reality. The concept of independence has been broken into sub-concepts: independence *in fact* and independence *in appearance*. Practically, the latter is considered to be of greater importance because independence is a state of mind and, thus, it is sufficient for auditors to be independent in appearance without being bothered by being independent in fact. This paper argues that independence in appearance may not suffice to serve the public interest. The *status quo* for auditors is such that many sources of influence can cause unacceptable professional behavior. This paper describes the underlying influences that can cause auditors to lack true independence and potentially depart from their original contracts with shareholders. This paper argues that those underlying influences may leave auditors, willingly or unwillingly, with no choice but to cooperate with client management. Such a departure may affect their role described in the original contract with society in general and with the shareholders in particular. This paper claims that the distributive negotiation between managers and auditors suggests that auditors may forcefully participate in cooperation with client management. Otherwise, auditors may have

to bear the consequences of their resistance. This paper highlights the experience of Abdullah Shaher, a certified public accountant, who suffered the consequences of resistance to the management demands of the corporation that he was auditing.

The remainder of this paper is organized as follows. Section 2 highlights the role of auditor opinion in creating confidence in the capital market, which explains why managers are concerned with auditors' opinions. The third section reveals that, at the firm level, auditors are concerned with the return on their investments. Audit firms expect a return on investment (ROI) from technology and the hiring of highly skilled and talented accountants. Section 4 discusses incentives for partners who lead audit engagements to cooperate with managers in what can be seen as joint ventures. Factors that may prevent auditors from exercising their professional power are explained in Section 5. Section 6 discusses the consequences of situations where managers are superior to auditors in the negotiation setting and situations whereby auditors may be forced to join managers in their ventures. Section 7 demonstrates that managers continue to prefer to have a close relationship with their auditors despite the requirements of the Sarbanes-Oxley Act. Section 8 argues that despite the inability of auditing to detect fraud, the public believes that auditing is a valuable commodity. Section 9 concludes that it is challenging for an auditor to conduct a fair and honest audit.

AUDITOR OPINION AND CONFIDENCE IN CAPITAL MARKETS

Auditor opinion has value to capital market participants. The auditor's role is to inspect the "correspondence between the corporate financial statements and the underlying economic reality" (Kleinman and Palmon, 2001, p.3). If financial statements are not certified as free from material errors, investors and debt holders doubt the "accuracy" of the information presented in the financial statements, which limits their ability to make "informed estimates of...the relative size and riskiness of the firm's future earnings and cash flows" (Kleinman and Palmon, 2001, p.4).

Capital market participants consider any opinion other than an unqualified opinion a negative signal. Participants must be assured that everything is sound with their corporate investments. Thus, market participants react to auditor opinions rather than unqualified opinions. Firth (1978) finds that qualified audit opinions receive various reactions from investors depending on the significance of the information contained in the qualification. The consequence of such reactions is that investors ask for an "uncertainty premium into their stock price bids, which will increase the cost of capital" (Kleinman and Palmon, 2001, p.4). The high cost of raising capital negatively affects manager compensation. As economic agents, managers are concerned with their compensation, which is linked to company performance. Managers exercise power to influence how their own compensation is determined (see Bebchuk et al., 2002); hence, manager compensation is not a result of "arm's length bargaining." Because the market valuation of a company affects managers' compensation, managers are incentivized to influence auditors and to encourage them to issue an unqualified opinion.

Moreover, managers of some corporations target brand-name audit firms to provide "external credibility" (Neu, et al., 1991). The loss of confidence in Enron's auditor (Arthur

Andersen) caused companies to avoid it as an external auditing firm. This market reaction occurred because Arthur Andersen was no longer considered a source of credible audits. Arthur Andersen's reputation was damaging to associated clients who thus refused to use the firm's services.

Familiarity with big audit firms reduces the cost of capital and facilitates entry and access to capital markets (United States General Accounting Office [GAO], 2003a, p.45; United States General Accounting Office [GAO], 2003b, p.14). Some respondents to the GAO survey noted shareholders "would not want a non-Big 4 firm" (2003b, p.14). This attitude is explained by another study (GAO, 2003a, p.49), which found that smaller audit firms cannot establish credibility. Some respondents to the GAO survey stated, "Only a global firm can deal with this complexity in a cost-effective manner and give us the continuity of support" (2003b, p.5).

In summary, auditor opinion creates public confidence in financial reporting (Kleinman and Palmon, 2001, p.5). The reaction of capital market participants is reflected in the premiums that are requested in addition to the price of company stock. The credibility offered by the Big 4 firms in the form of opinions on the management of public companies is of greater value from the market participants' perspective.

THE BURDEN ON AUDIT FIRMS TO SEEK RETURN ON INVESTMENTS

Audit firms rely mostly on intellectual capital. Ideally, the more talent and skills the firm employees possess, the higher the quality of services and, hence, the higher the fees the audit firm can bill its clients. According to Michael Epstein (as quoted in *Tax Practice Management*, 2004, p.14), accounting firms cannot charge high billing rates with staff that lack experience. Firms with experienced staff can charge their clients higher fees. Similar to any other commodity, experience has a price.

Craig Jr. and Morris (2000) stated, "Without question, getting good people is the No. 1 challenge facing the profession." Certified Public Accountants (CPAs) may receive offers of employment from accounting firms and from companies that demand accounting professionals, particularly when economic conditions improve. Randy Gartz (as quoted in *the CPA Management Partner Report*, 2004, p.7) uses the term "bidding war" to label the offers received by candidates recognized as being at the top of their field. The *Tax Practice Management Report* (2004, p.13-14) presents an analysis of accounting profession salaries. The two factors creating demand for accounting professionals are: (a) the recent slow economic recovery and (b) the Sarbanes-Oxley Act, which requires publicly traded corporations to seek accounting professionals. The effect of the recovery has affected smaller companies and larger companies. According to Richard Caturano (as quoted in *the CPA Management Partner Report*, 2004, p.6), smaller companies are beginning to hire seniors, managers, and partners. Additionally, the cost of hiring CPAs is already high. For example, Weiner (as documented in Craig Jr. and Morris, 2000, p.41) reported that the 150-hour requirement increases the cost of CPA candidates.

These highly skilled professionals must be completely satisfied in term of compensation. Randy Gartz (as quoted in *the CPA Management Partner Report*, 2004, p.7) believes that the compensation of top talented professionals should not be limited to a generous 401(k). Gartz (as quoted in *The CPA Management Partner Report*, 2004, p.7) further claims that these talented individuals are looking for "the opportunity to take on new challenges beyond what they're currently doing." Rita Keller (as quoted in *Tax Practice Management*, 2004, p.7) stated "It's been expensive for the firm [BradyWare] the last couple of years to keep pace." However, the high payments and the increased offers are based on the talents, skills, and experience that a CPA possesses. Michael Epstein (as quoted in *Tax Practice Management*, 2004, p.14) emphasizes that CPA firms cannot meet the expense of high salaries for those who have no experience.

Audit firms also require other assets to provide services. The cost of assets incurred by CPA firms is high. Menon and Williams (2001) analyzed trends in audit fees from 1980 through 1997. One of their findings was the increased need to invest in new technology. The costs of these assets are fixed, which suggests that they are not affected by the amount of work or by revenue. Menon and Williams (2001) also noticed that the audit profession was experiencing "growth."

Firms that incur the high cost of intellectual and physical capital are forced to seek efficiency while providing services to their clients. Particularly, the Big 4 have reached such a scale that the return of doing small services for relatively small businesses may add insignificant marginal value such that the increased ROI may not be observable by Big 4 leaders. Returns must be sufficiently high for the increase in value to be visible. For example, the Sarbanes-Oxley Act imposed new requirements with which companies must comply, such as Section 404. This section requires management to assess the company's internal controls (Hamilton and Trautmann, 2002). The work and the amount of time required to comply with the Sarbanes-Oxley Act have increased. Helping companies in these matters creates revenues for audit firms. Ernst & Young CEO, James Turley, (as quoted in Partner's Report, 2004 p.2) stated, "The Sarbanes-Oxley Act's requirements and pressures put a great strain on our ability to retain sufficient personnel." The Security and Exchange Commission (SEC) chief accountant Donald Nicolaisen (as quoted in Partner's Report, 2004, p.2) suggests, however, that the Big 4 use the new requirement as an excuse to drop smaller audit clients. Those smaller clients could, as a result, face an increase in the cost of capital (GAO, 2003a, p.6) because capital providers could require premiums to compensate for the lack of an audit by a Big 4 firm.

The Big 4's substantial capital investments have yet another impact. Firms are obligated to be attentive to client wishes. Xu and Wang (2004) cite several studies (e.g., DeAngelo, 1981; Imhoff, 1978; Louwers, 1998; Trompeter, 1994) that demonstrate, "auditors have incentives to please the clients who pay for their services and that auditors are sure they can benefit or avoid loss by compromising independence under various situations" (p.17). Fogarty (2010) analyzes the advertisements of large accounting firms from 1993 to 1997. One research finding was that advertisements commenced a dialogue with top corporate managers regarding their personal interests. Fogarty (2010) mentions that Arthur Andersen concentrated on bonus compensation. Fogarty (2010) also considers the Ernst & Young advertisement entitled, "Your House. Your Competitor's House. How Come?" as an example of the attention that audit firms give to the personal wealth interests of top officials. Fogarty (2010) concludes that the services of public accounting firms are intended to be recognized as having private utility and that such a practice can be considered *apparent harmony*.

AUDIT FIRM INCENTIVE TO ESTABLISH HARMONY WITH CLIENT MANAGEMENT

Services are provided to clients in the form of engagements. In each engagement, the scope of services an accounting firm will provide is determined in advance. Different factors determine engagement characteristics (such as the risk associated with the engagement and the level of management aggressiveness). Auditors from different levels are involved in an engagement and form an organization hierarchy. Auditor supervision is the first rule of fieldwork (Kiger and Scheiner, 1997). For the purpose of implementing the rule of supervision, each auditor is supervised by the auditor located on the hierarchal level above. Managers, who are senior auditors, supervise junior auditors, who may be just-qualified professionals, and junior auditors supervise tasks (Hinings, et al., 1991). Kiger and Scheiner (1997) emphasize that, "ultimate authority and responsibility for supervision rests with partners" (p.374). Partners are at the top; they "deal externally with client relations and internally with the policy and direction of the firm" (Hinings, et al., 1991, p.377) (see Figure 2).

FIGURE 2 ENGAGEMENT AUDITOR LEVELS



In an urgent meeting with his team, David Duncan, Arthur Andersen's lead partner on the Enron engagement, ordered the team to "shred" or "dispose of" documents related to the engagement (Hays, 2002, p.1). Torriero (2002, p.1) states, "No one at Andersen instructed him to destroy specific documents." Of course, Duncan decided to destroy such documents after the faulty practices of the client (Enron) began to attract attention. Thus, he might have thought that destroying the documents would mean no evidence would be found. A discussion of the Enron case is beyond the scope of this paper, but the Andersen experience illustrates the power the partner had over the participants (other auditors) in the engagement. Therefore, it is logical and fair to assume that the partner is the most powerful individual in the engagement and is granted definitive authority.

Moreover, auditing firm partners are owners and can be considered business people who seek profit. A major criteria for the promoting of an auditor to the partner level is their ability to bring in new clients—in other words, their abilities as "salesmen" (Belkaoui, 1989, p.102). An auditor must have "extensive contacts" (Belkaoui, 1989, p.102) to be promoted to partner, which is the goal of most auditors once they become qualified professionals (Hinings et al., 1991). Partner preferences for favorable client relations should not be surprising "because that is the source of professional satisfaction and sustained billing that provide a strong power base with which to influence internal affairs" (Hinings et al., 1991, p.377). A study of a Montreal office of a Big 4 firm showed that an auditor partner "expressed the importance of client relationships for the firm and the need to better understand what type of relationship the client wants to have with the auditor" (Fontaine and Pilote, 2012, p.2).

Therefore, any individual with authority who is willing to cooperate with clients should be a partner as long as there are incentives for the cooperation of the audit firm in general. Audit partners own the audit firms. Individuals typically value the success of their work and strive to take occasional risk to survive or improve their situation.

RESTRAINT IN AUDITOR PROFESSIONAL POWER

An auditor enjoys "the monopoly of professional power" (Lipartito and Miranti, 1998, p.315; for more, see West, 2003). Auditors possess the power to criticize the work of bookkeepers (Sprague, 1901). Expertise in a client's particular industry increases the power of the auditor, which reduces the need for negotiations with client management (Gibbins, et al., 2001). This "expertise power" is wielded when clients switch from non-specialized auditors to specialized auditors believing that the specialists provide "higher quality services" (Hogan and Jeter, 1999). However, expertise power depends on the ability and skills of individuals, and only those auditors with substantial industry experience can claim such expertise.

Because managers have an incentive to utilize accounting standards selectively, auditors have a duty to force clients to report "neutrally" (Watts and Zimmerman, 1979, as cited in Hackenbrack and Nelson, 1996). If the auditor and management do not reach consensus on some practices or accounting treatments and, if "the standards" and the "statutory powers" related to the subject matter are clear and "unambiguous," the auditor has greater power and influence in the negotiation (Gibbins, et al., 2001, p.539).

However, in some circumstances, it may be advantageous for an auditor not to exercise power. Neu et al. (1991) emphasize that networking is significant in the audit industry, which is evidence of the critical role of word of mouth. If the auditor's position is firm concerning management's desire to use an accounting treatment, the managers may refrain from referring their colleagues to this particular auditor. An adverse opinion on the financial statements of Bishah Agriculture Development Corporation prevented Abdullah Shaher, a Saudi CPA, from obtaining new clients (Abdullah Shaher, personal communication, January 19, 2014). This represents a dilemma forcing the auditor to reconsider resistance to a management demand to use an accounting treatment that the auditor may not condone.

Another factor reducing the likelihood of auditor power influence is the expectation that alternative treatments are sought when standards are unclear. In such a case, it is difficult for the

auditor to "oppose" management (Gibbins, et al., 2001). An additional burden upon auditors that could restrain auditor influence is that clients can replace auditors with greater ease than auditors can replace clients (Kleinman and Palmon, 2001). Auditors can reduce client pressure and resistance to their position if they approach clients strategically (Sanchez et al., 2007). Therefore, although the auditor has power, rarely does the auditor exercise that power. The rare issuance of adverse opinions by auditors is evidence. Giant corporations collapsed, but virtually no adverse opinions were issued prior to their fall, at least not in the case of Enron and WorldCom, both of which were audited by Arthur Andersen. In Saudi Arabia, Abdullah Shaher, auditor of Bishah Agriculture Development Corporation, issued an adverse opinion that resulted in considerable media coverage and public scrutiny, particularly from those whose wealth was affected. The Saudi Capital Market Authority (CMA) stopped the company from trading its shares in the Saudi capital market as a consequence.

MANAGEMENT NEGOTIATING POWER

In their study of the negotiation between management and auditors, Gibbins et al. (2001) considered two necessary factors. First, negotiators are self-interested and rational (Raiffa, 1982 as cited in Gibbins, et al., 2001). Second, "private information" exists (Bazerman, 1990, as cited in Gibbins, et al., 2001; Pruit and Carnevale, 1993, as cited in Gibbins, et al., 2001). Such "unequal initial information" implies that the "initial" beliefs and performance differ (Gibbins, et al., 2001). In a manager-auditor negotiation, the initial beliefs of auditors and managers concerning potential outcomes (Gibbins, et al., 2001) are established prior to the start of negotiations.

Although Gibbins et al. (2001) limit their study to two factors in the negotiation setting, this paper adds one more factor: power. According to the negotiation literature, power plays a critical role in the bargaining process because "people who are more powerful are probably going to be more ambitious and to be viewed as such" (Lewicki, et al., 2003, p.185).

In their study, Gibbins et al. (2001) first found that it is normal for negotiations to occur between managers and their auditors. The audited financial statements emerge from the discussion, and negotiations that take place between the finance director and the company auditor (Beattie et al., 2001, p.3). Second, managers and their auditors always reach agreement, and managers always reselect their auditor. Third, and most significantly, the negotiation is

distributive when the parties compete to win limited resources. Gibbins et al. (2001) attributed this last finding to the likelihood that a new solution might be considered costly by both parties.

The negotiation literature reveals that there are two types of negotiations (Lewicki et al., 2003). The first type is integrative negotiation, in which parties attempt to maximize the outcome and divide it among themselves. Integrative negotiation requires cooperation between the negotiating parties (Lewicki, et al., 2003). The second type is distributive negotiation. When a party obtains certain resources, the other party cannot obtain those resources; a party cannot gain what the other party gains. Distributive negotiation implies that some players in the negotiation are in a loss position (Lewicki, et al., 2003).

Acknowledging that the negotiation between managers and their auditor is distributive suggests that management and the auditor do not cooperate but compete. The lack of an integrative-type negotiation between managers and their auditors does not eliminate possible cooperation between managers and their auditors. The parties may still collaborate under distributive negotiation. The following discussion provides a possible justification for existing cooperation between managers and their auditors, although Gibbins et al. (2001) found negotiation distributive.

Given the assumption that management is more powerful in some cases and that the negotiation is distributive, and recalling that underlying influences may cause auditors to depart from their original contract, the auditor is most likely to lose. Sanchez et al. (2007, p. 244) argue, "the resulting financial statements are dependent on the negotiation strategy employed by the auditor." This assertion complements Gibbins et al.'s (2001) finding that the management and auditor always agree. That is, for an agreement to occur, the auditor in some cases cooperates with management by, first, responding to management's power and, second, and most importantly, by compromising and enabling the agreement to take place. "Standing up for accounting principles and walking away from a client did not carry the same kind of financial consequences that walking away from a multimillion-dollar engagement does today" (Squire et al. 2012, p.166). Additionally, a distributive negotiation losing position has the consequence of cost; therefore, the type of cost imposed on the auditor is significant. The cost represents the management risk with respect to the corporation's future stability. By holding CEOs and CFOs officially responsible for financial statements along with their auditors, the Sarbanes-Oxley Act increases the existing jointness between officials and their auditors. CEOs, CFOs, and their auditors are linked, which increases harmony. Therefore, a losing position and bearing the costs of such a negotiation causes the auditor to become even more *attached* to management.

In summary, as agency theory suggests, managers run corporations to access benefits for themselves in the form of stock options, for example. However, managers require an external party that appears to be independent to issue an opinion that sanctions the managers' performance. This opinion is important for other external parties who finance the corporations' activities: mainly shareholders and debt holders. Those external parties rely on the opinion to assess management decisions. As an economic agent, this independent party is protecting its own interests and not fully representing the interests of the parties who have entrusted the auditor. Based on this argument, auditor lobbying of management is no surprise.

MANAGEMENT AND AUDITOR HARMONIZATION

Auditors and managers collaborate to produce audited financial statements, resulting in the joint products of financial statements and the auditor's report (Gibbins et al., 2001, p.540). While the preparation of the financial statements is the responsibility of the officers and directors of a public company, the external auditors decide whether the "financial statements fully and accurately reflect the company's condition" (GAO, 2003b, p.4). Auditors provide "assurance by attesting to the fairness of the financial information presented by company management" (GAO, 2003a, p.5). Given the subjectivity associated with the meaning of "fairness," the previous quote is considered an ideal in this paper.

However, an auditor cannot perform an effective audit without client cooperation and evidence provided by management (Communale, et al., 2003, as cited in Fontaine, 2010). At the same time, audit clients prefer to have a cooperative relationship with their auditors (Beattie, 2000, 2004, as cited in Fontaine, 2010). Auditors' dependence on the willingness of client management to cooperate may harmonize and align their interests. These "joint interests" exist between management and the auditor because both parties require an unqualified audit opinion (Gibbins, et al., 2001). Gibbins et al. (2001, p.540) list the reasons for such jointness. First, the auditor wishes to be re-selected. Second, the auditor desires non-audit services. After the passage of the Sarbanes-Oxley Act, the second reason no longer creates jointness. The third reason is the sharing of legal liability. Having the same objective with respect to a corporation's future strengthens joint interests. Fourth, management requires the auditor's opinion, which assists in attracting external capital. Jointness can be considered motivation for the engagement partner to cooperate with managers. The use of the word *allied* in the accounting literature (e.g., Gibbins, et al., 2001) describes the interests of each party and its treatment of the other party.

Additionally, management shopping for an auditor who would be willing to issue an unqualified opinion is not risk- or cost-free because the market watches and reacts accordingly. If the management discharges its current auditor, who is not willing to issue a favorable opinion, and decides to seek an opinion from another auditor, the management will bear the cost of such a decision. This cost is represented by the reaction of market investors who would question why the auditor changed. Studies conducted on this subject (e.g., Fried and Schiff, 1981; Smith and Nichols, 1982) find that the stock price of a client's firm drops when the auditors change. The management of a corporation is thus under pressure to be meticulous when choosing an auditor for the first time. The choice represents a long-term relationship, and management will not benefit from replacing the auditor later. However, management may not hesitate to influence the board of directors or exercise its power by threatening the current auditor with management consideration of a replacement to influence the auditor and cause reconsideration of a refusal to issue an unqualified opinion. This management action is relatively preferable to shopping for a favorable opinion. The accounting literature reveals that auditor shopping subjects management to a market curse represented by a drop in the price of the company stock. Based on the cost/benefit approach, it could be economically optimal for the management to bear the cost of forcing the current auditor to issue a favorable opinion to save the cost of searching for another auditor.

For this reason, the law intends to exclude managers from dealing directly with their auditors to protect auditors from their influence. The law intends to ensure that the auditor is

away from the influence of managers because, as Brandies (1914 p.56, as cited in DeLong, 1991, p.212) stated, "No man can serve two masters". In an attempt to protect auditors from managers, the Sarbanes-Oxley Act emphasizes the role of audit committees by requiring audit committees to deal directly with auditors. Academics, however, have expressed doubts concerning the ability of audit committees to perform effectively as governing mechanisms in corporations (Adelopo, 2012). Sanchev et al. (2007) argue that "even though Sarbanes-Oxley significantly increased the role of the audit committee, client management remains most influential with regard to issues such as auditor retention and compensation." Healy and Wahlen (1999, as cited in Nelson et al. 2002, p.176) add that, "managers can intervene by modifying how they interpret financial accounting standards and accounting data or timing or structuring transactions." Managers still favor close relationships with their auditors (Fogarty, 2003). By claiming that sustaining such a relationship is in the best interests of the corporation, managers may be able to convince the audit committee to have a close relationship (Fogarty, 2003).

Managers are still the most powerful individuals in their corporations. The commission to exercise power on a daily basis is a critical reason managers have power in corporations (Fogarty, 2003). Based on this rationale, CEOs can dominate boards of directors. If the compensation from the corporation bestowed on the CEO is a reflection of the CEO's value, then the board plays only a small roll (Fogarty, 2003).

BALANCING CLIENT RELATIONS AND THE PUBLIC INTEREST

Despite auditing's inability to detect fraud (see Bayou and Reinstein, 2000; Belkaoui, 1989; Carmichael, 1975; Sanchev, 2002), the public is still led to believe that auditing offers investors and creditors, who rely on the financial statements, valuable information. The public believes that auditors act in the public interest. The belief that certified accountants possess technical knowledge (see West, 2003) that qualifies them to represent third party interests while negotiating with managers is accepted by society in general and by investors and creditors in particular. Auditors are expected to provide audit services that matter to third parties' investment decisions by attesting to and assuring the fairness and faithfulness of the financial statements prepared by management. Such services cause the public to accept that the role of auditors is necessary for the contemporary model of modern corporations and to willingly and eagerly sacrifice a portion of the value (wealth) of their corporation in the form of audit fees.

The analysis presented in this paper suggests that with respect to the negotiation between managers and their auditors, auditors should be the parties to show concern for shareholders. While managers and their auditors negotiate issues, both parties consider third party interests in addition to their own interests, but auditors sense additional responsibility because of the professional commitment to third parties (Gibbins et al. 2001). A possible interpretation of this attitude of auditors is that the auditors must sustain their reputation and image. Reputation in the audit industry is significant and secures the continuation of the public accounting profession. Auditors are worthless if they do not hold the confidence of those that read their audit opinions (Fogarty, 2003). Auditors do not disregard third party interests entirely. Rather, they show some consideration of third parties' interests in their efforts to survive.

Auditor advocacy of client interests contradicts their claim to maintain an image of independence (Fogarty, 2003). Auditors are the only professionals paid by clients who claim to be independent. As KPMG puts it:

"Auditors are tasked with ensuring that financial statements are free from material misstatements while at the same time maintaining a financial working relationship with client management who have responsibility for creating the financial statements and have substantial influence over issues such as auditor retention and compensation." (KPMG, 2004, as cited in Sanchev, et al., 2007, p.259)

Auditors must, at least in appearance, protect the interests of third parties that rely upon their opinions. Auditors must balance managers' requests and external party interests so that the external parties believe that auditors represent their interests. Difficulty, however, exists in maintaining a "balance between the need for sound and constructive client relations and the auditors' obligation to shareholders and regulators" (Sanchev, et al., 2007, p.242). Even "rules cannot fully replace personal integrity or remove the inherent conflict between serving the public and maintaining profitability" (Squires et al., 2003, p.122).

CONCLUDING REMARKS

While "the social allegiances and biases of accounting are rarely apparent," they are masked by the self-importance of objectivity and independence (Tinker et al., 1982, p.167). Public accountants' ability to survive is conditioned upon their apparent independence from the perspective of external parties, which causes external parties to accept that auditors provide valuable services that benefit the public. Generous materiality thresholds suggest that auditing is not as reliable as the public is led to believe (Fogarty, 2003). Perhaps "real" auditing does not exist, that is, auditing performed effectively, efficiently, and independent of influences and forces that may affect its integrity and without negative consequences for auditors who perform accurate audits.

In conclusion, this paper does not propose that auditing is unimportant or that auditors cannot perform reliable audits. Rather, this paper emphasizes the efforts of auditors in conducting fair and honest audits. Abdullah Shaher, a CPA in Saudi Arabia, was one of them. His adverse opinion on the financial statements of Bishah Agriculture Development Corporation was provided at substantial personal cost. Shaher battled a lawsuit brought against him by the corporation's board of directors (see العمران [AlEmraan], 2007). Other publicly held Saudi corporation management groups and boards of directors were hesitant to contract with Abdullah Shaher to audit their financial statements, which represented personal loss for performing a reliable audit at the risk of displeasing management and the board of directors (Abdullah Shaher, personal communication, January 19, 2014).

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USING GUIDED READINGS QUESTIONS TO MOTIVATE STUDENT READING AND TO HELP "FLIP" THE INTERMEDIATE ACCOUNTING CLASSROOM

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ABSTRACT

Although upper-level accounting majors tend to be more motivated than introductory-level students, or non-accounting majors, it can still be challenging to motivate such students to complete and understand assigned readings. Without essential preparation, students may be unable to adequately participate in class discussions or perform well across other course dimensions, especially in a "flipped" classroom setting. We assigned guided reading questions related to two required intermediate financial accounting textbook presentations (one course specifically for accounting majors and the other for non-accounting majors) to investigate the issues of class preparation and motivation for upper-division accounting and non-accounting majors. Students in our study were required to complete responses to specified reading questions before each class meeting where the material was to be discussed. Our results indicate that requiring students to answer guided readings questions has positive effects on student motivation, reading comprehension, effort and understanding. These results allow for a more vibrant, flipped classroom experience for both the students and instructor. We note that the effects are more significant for non-accounting majors. These results have implications for CPA Exam performance, particularly given the intermediate financial accounting emphasis within the Uniform CPA Examination. Finally, a higher level of motivation and comprehension can help accounting students succeed in their professional careers.

INTRODUCTION

Active learning teaching techniques have been used for many years to help motivate student effort to enhance learning. The most recent technique that has taken hold is the flipped classroom. While many instructors have been using the technique for years, Bergmann and Sams (2012) are credited with this teaching method that shifts the classroom instructional content outside of the classroom via the usage of technology and brings the problem solving and collaborative learning opportunities into the classroom (Milman, 2012). The out-of-class instructional content typically takes the form of video recorded lectures, listening to podcasts, or searching the internet for subject content. Once completed, students bring that knowledge into the classroom to apply it in various active learning opportunities while the instructor becomes more of a facilitator and mentor.

The driving force behind this active learning technique is the millennial generation those individuals born between 1982 and 2002 (Wilson and Gerber, 2008). This generation has been exposed to technology their whole lives and is used to acquiring information via the internet. However, one issue that plagues this generation is the lack of focused, in-depth reading for understanding. While some subjects may lend themselves more easily to a typical flipped classroom method, other more technical subjects like accounting, finance, law and medicine, require a significant amount of in-depth reading and focused study so students can learn and comprehend the complexities and intricacies of the material at hand.

One of the biggest challenges instructors have dealt with for many years is getting students to read their required textbooks. However, instructors have fed students' unwillingness to read by regurgitating the textbook content in their traditional classroom lectures. In addition, with the almost limitless access to free multi-media, the challenge is exacerbated. More and more, our students' time outside of class is constrained by many external factors including: part-time and full-time jobs to pay for the ever rising cost of higher education, commuting time, families, social media, athletic activities, etc. Thus, the necessity of doing school work outside of the classroom is becoming one of the lowest priority items. So while we would like to believe that all students will freely use an hour or two of their precious free time to read for tomorrow's class discussion, it is unlikely; unless there is a carrot at the end of the stick.

To motivate student effort, we employ the flipped classroom technique in the first course of our two-course intermediate financial accounting sequence, as well as in our intermediate financial accounting course for non-accounting majors. However, we do not utilize multi-media to shift the instructional content outside of the classroom. Instead, we implement guided readings questions for each chapter of the required text to motivate student reading. Accounting instructors understand that the intermediate financial accounting major and provides the foundation for most all accounting courses taught in the accounting major and provides the basis for financial reporting within the profession. Therefore, it is critical that accounting majors acquire the breadth and depth necessary in their intermediate financial accounting courses to have future success. To assure that students are exposed to this breadth and depth, focused reading of the intermediate accounting textbook is warranted. It is this breadth and depth that is unable to be attained in short video snippets and/or podcasts.

The purpose of this study is to use guided readings questions to help flip the first course in the intermediate financial accounting sequence. We also introduce this technique in our intermediate accounting course for non-accounting majors, which is a required course for our finance majors. To assess whether the guided readings questions satisfied their intended purpose, which is to prepare students for the in-class collaborative learning opportunities, we surveyed students on a number of factors including: reading motivation, better material understanding, proper focus, reading importance, grading, class engagement, time spent, question order, and assignment collection. We assess each factor's importance using a 7-point Likert scale. The remainder of this paper begins by discussing the flipped classroom technique as well as the related literature on the reading behavior of students. We then explain how we implement the guided readings questions into the intermediate financial accounting courses and how they were utilized to help flip the classroom. We then discuss the results of our student survey and assess whether the guided reading questions satisfied their intended purpose.

PRIOR LITERATURE

As previously mentioned, Bergmann and Sams (2012) are credited with the phrase, flipping the classroom, when they pushed the normal in-class learning content outside of the classroom via the usage of technology to allow for collaborative learning opportunities in the classroom. Others have done the same at a number of colleges and universities in a variety of different disciplines – including accounting. For example, Berrett (2012) notes that for years humanities professors have required students to read novels or poetry outside of the classroom so the in class time can be devoted to exploring symbolism, themes or meaning. Similarly, traditional law school preparation requires significant out of class reading and study so students are prepared for the in-class question and answer sessions. While flipping the classroom seems like a new phenomenon, it's another one of many active learning techniques that have been implemented over the years (Roehl et al. 2013); the primary goal of which is to shift learning away from surface learning toward deep learning, such that students develop their understanding through active and constructive processes (Ritchhart et al. 2011).

Professors who have implemented the flipped classroom technique support its effectiveness and suggest many benefits. For example, Missildine et al. (2013) find that examination scores were higher for the flipped classroom versus the traditional lecture-type courses in two adult health nursing courses. The University of Michigan has flipped its teaching of calculus since the mid-1990's. In 2008, it gave "concept inventories" to students before they started calculus and after they finished and found that the flipped courses showed gains at about twice the rate of those in traditional lectures at other institutions who took the same inventories (Berrett 2012). Stone (2012) found that exam scores, class attendance, and students' attitudes toward learning all improved after flipping a Genetic Diseases class and a General Biology class. Finally, Albrecht (2012) began flipping his accounting courses in 2005 and he finds that students like his transcribed lectures for outside reading and prefer to work problems together in class.

While many studies report that flipping the classroom provides enhanced learning over the traditional lecture-based methods, others purport differing results. Atteberry (2013) reports that professors at Harvey Mudd College who started flipping their STEM classrooms in 2012-2013 reported no "demonstrable differences between the two class types" – flipped versus traditional. Findlay-Thompson and Mombourquette (2013) found no significant final grade differences between their flipped versus non-flipped introductory to business administration courses. In addition, student exit interview comments indicate that while the flipped class was more work, students felt it didn't help to improve their final grades. Finally, Ash (2012) notes that the flipping techniques can be quite valuable, but instructors need to be careful about what content should be flipped and to then appropriately implement it. Too often, some critics say that the flipped classroom is just a high-tech way of shifting the lecture method to video. The key is to find way the actively engage students into learning. We've done this by utilizing guided readings questions to enhance student reading.

While there have been a number of different teaching styles and methods instituted over the years - teaching in small groups, flipping the classroom, etc. - one of the continued challenges is getting our students to read and understand the assigned chapter readings from the required textbook. While Millennials are those who have grown up in the age of technology and multi-tasking (internet, videos, books on tape, social media, etc...) one issue that plagues this generation is the lack of focused reading for understanding. However, this lack of reading isn't a recent phenomenon. Burchfield and Sappington (2000) investigated the compliance with the required text reading over a 16 year period from 1981-1997 and found a significant negative correlation. On average, they identify that less than a third of all students will have read the required readings for any given day. However, they note that the more advanced class level, the greater likelihood that students have read. Debevec et al. (2006) found that approximately 38% of students "rarely" or "never" read before class, and only about a third of the students indicate that they "usually" or "always" read before class. Sikorski et al. (2002) found that most students read less than three hours per week, and Clump et al. (2004) show that only about 28% of psychology students read before class and about 70% read before the exam. There are also findings that students don't value the text as a primary source of information (Murden and Gillespie, 1997), and there's a perception that the lecture represents a substitute for the text instead of being complementary. Thus, this lack of reading continues even though it's been shown that more reading leads to better grades (Wandersee, 1988), and that reading before class is more likely to lead to higher course performance (Phillips and Phillips, 2007).

Thus, a tool that we've used to combat this lack of reading, which helps us to "flip" our intermediate accounting classrooms, is the usage of guided readings questions. This tool has allowed us to engage our students in higher quality class discussions and provides more class time for problem solving. In addition, the students come to class more prepared and ready to tackle each day's topic(s). Below, we discuss the development of the guided readings questions and how we implement their usage in our courses. We then report student feedback pertaining to their usage of the guided readings questions.

IMPLEMENTING THE USAGE OF GUIDED READINGS QUESTIONS

Student participation is difficult when students arrive to class unprepared. Reading the assigned material is an essential component of adequately preparing for class, participating, and contributing to the flipped classroom. To address the issue of poor student preparation, we employed guided readings questions in two courses: Intermediate Accounting I and Intermediate Accounting for Non-Accounting Majors. These guided readings questions are intended to motivate students to prepare for class by reading the required textbook material and improve participation in class discussions and problem solving. Indeed, such preparation is essential to

achieving success in the classroom, but more importantly, success within professional accounting and business environments.

In spring 2010, one of the authors taught intermediate accounting for non-accounting majors for which there was not a relevant textbook. Thus, the author wrote all course materials and assigned guided readings based on this material. Students were required to complete the assigned reading before each class meeting when the material was to be discussed. To motivate students to read the material and complete the questions before class, the author used in-class student responses as their class participation grade. During class, individual students were randomly selected to provide their answers, which were graded on a zero to three-point scale. Three points were awarded if the student provided a complete correct answer, two points if only partially correct or complete, one point if student was present but unprepared, and zero points if absent. These scores were used for assigning class participation grades, which was weighted as approximately 10% of the course. The usage of the guided readings questions worked so well (i.e. enhanced student participation and improved class preparedness) that the same method was implemented into the required intermediate accounting I course for accounting majors in fall 2010.

To understand how the guided readings questions helped "flip" the classroom, the assigning of the guided readings questions allowed for more in-class completion of sample exercises and problems. For each chapter, students were required to provide answers for approximately 20-25 readings questions. These answers would be found within the assigned textbook chapter reading. Students' written solutions were not collected, but were to be used as the basis for their in-class responses. For example, a typical class period would consist of a question and answer session on the first four to five readings questions. Subsequent to this discussion, students were provided an in-class exercise that related to the readings questions discussed. Students first completed the exercise individually and then in small groups. Once the exercise was completed and an accurate solution was attained (with or without the instructor's help), a new question and answer session on the next four or five readings questions would commence until it was time for another in-class exercise to be completed. This back and forth between the readings questions Q&A and the completion of the in-class exercises and problems put the learning into the hands of the students, and allowed the instructor to be more of a facilitator versus a lecturer.

STUDENT FEEDBACK SURVEY AND RESULTS ON THE USAGE OF THE GUIDED READINGS QUESTIONS

The Survey

As mentioned above, the purpose of this study is to use guided readings questions to help flip the first course in the intermediate financial accounting sequence as well as the intermediate financial accounting course for non-accounting majors. To assess whether the guided readings questions satisfied their intended purpose, which is to prepare students for the in-class collaborative learning opportunities (in-class exercises) and to motivate textbook reading, we surveyed students on a number of criteria. Table 1 presents a summary of the ten survey questions and purpose of each question. The survey questions focus on the following ten items: motivation, effort, focus, understanding of the material, comparison to other courses, class engagement, amount of time spent reading, question ordering, importance of the material, and the collection for grading. We started collecting survey responses only from the Intermediate Accounting I students (the accounting majors) beginning fall 2011 – the initial focus of the study. However, because we thought it would be intriguing to see if there was a significant difference between our accounting majors versus our non-accounting majors, we began to collect student survey data from the intermediate financial accounting course for non-majors beginning in spring 2013. We only offer our courses once per year in multiple sections so our survey was administered in the fall semester for Intermediate Accounting I (majors) and in the spring semester for Intermediate Financial Accounting for Non-Majors. The results from the survey are discussed below.

(See Table 1)

Results

Tables 2 and 3 present the results, which investigates whether the assigning of guided readings questions helps to motivate student reading and enhances class preparation and participation. Table 2 presents the class-by-class results on a year-by-year basis, and Table 3 shows comparative results between Intermediate Accounting I and Intermediate Financial Accounting for Non-Majors.

(See Table 2)

As shown in Table 2, for both courses, the mean ratings for most all questions were greater than 5.0 out of 7.0. Students from both courses felt that the readings questions *motivated* them to complete the reading assignments on time and they would have spent *less time and effort* answering the readings questions if they weren't included in determining the class participation grade. Students felt that the readings questions helped them to stay *focused* while reading the chapter material and answering the questions helped them to *better understand* the material. They believed that completing the readings questions on a timely basis kept them *more engaged* in the class discussion and they spent *more time reading* the chapters that they would have otherwise if there were no assigned readings questions. The students felt that the readings questions were more beneficial because they were numbered consistent with the *order* of the material's presentation in the text. Finally, the students felt they were better able to identify which chapter *material was more/less important*.

Based on the survey results shown in Table 2, we can ascertain that the guided readings questions are serving their intended purpose – to help "flip" the first course in the Intermediate Accounting sequence as well as the intermediate accounting course for non-accounting majors. Given this assertion, we determine if there are differences in the impact of the readings questions between the accounting majors versus the non-accounting majors. Thus, we compute overall survey means between the two groups and compare whether one group has stronger opinions on the criterion surveyed. These results are presented in Table 3.

(See Table 3)

We see in Table 3 that for all but one survey question (collection for grading), the nonmajors felt they gained more benefit (have higher mean results) from answering the guided readings questions versus the accounting majors. In addition, there were three areas that the nonmajors rated significantly higher that the accounting majors. The non-majors more strongly agreed that: 1) answering the readings questions enhanced their understanding of the chapter material, 2) they spent more time reading the chapters than they otherwise would have if they were not assigned the readings questions, and 3) the readings questions helped them identify chapter material that the instructor felt was relatively more/less important. From these results, we can conclude that while answering the readings questions were beneficial for all students they were significantly more beneficial for those students who were non-accounting majors.

Note that the comparisons on Table 3 are based on survey data from Fall 2011-2013 for Intermediate Accounting and Spring 2013-2014 for Intermediate Accounting for non-majors. These sections were all taught by the same professor. In fall 2014, a different professor taught Intermediate Accounting I but also integrated the readings questions into his sections. The survey results for fall 2014 are shown in the far right columns in Table 2. We see that comparable results are attained, except for one question that pertains to effort for grade, which was significantly less important. However, four of the ten survey questions were significantly stronger for the fall 2014 accounting majors, meaning that having the readings questions were deemed even more important to these students when it comes to understanding the material, desiring other classes to implement readings questions, and helping to identify the most important topics within each chapter. The fourth item, which relates to collecting the readings questions for grading, is significantly more important based on a change that the fall 2014 instructor implemented. In fall 2014, the readings questions were collected for grading versus non-collection, which was different than previous years. While the sections before 2014 indicated that the they neither agreed nor disagreed that it would have been more beneficial if the readings questions were collected for grading (overall mean of 3.5430 - Table 3), the fall 2014 students agreed (mean of 5.7347, - Table 2) that it was beneficial that the instructor collected the questions for grading.

CONCLUSION

The purpose of this study is to use guided readings questions to help flip the first course in the intermediate financial accounting sequence along with the intermediate accounting course for non-accounting majors. To assess whether the guided readings questions satisfied their intended purpose, we surveyed students on a number of criteria. In general, our results indicate that requiring students to answer guided readings questions has positive effects on student motivation, reading comprehension, effort and understanding. These results allow for a more vibrant, flipped classroom experience for both the students and instructor. We note that the effects are more significant for non-accounting majors. Finally we note that implementing the technique by another instructor in the same course strengthened our results.

TABLE 1SURVEY INSTRUMENT QUESTIONS

Question	Question	
Number	Purpose	Survey Question
1	Motivation	I feel that the reading questions motivated me to complete reading assignments on time.
2	Effort for Grade	I would have spent less time answering the reading questions if they weren't included in determining my class participation grade.
3	Focus	The reading questions did NOT help me stay focused while reading the material.
4	Understanding of Material	Answering the reading questions enhanced my understanding of the chapter material.
5	Other Classes	I wish other instructors would require students to answer similar type questions when readings are assigned.
6	Class Engagement	Completing the reading questions on time kept me more engaged in the discussion when we went over them in class.
7	Time Spent Reading	I spent more time reading the chapters than I otherwise would have if there were no assigned reading questions.
8	Question Order	The reading questions were more beneficial because they were numbered consistent with the order of the material's presentation in the text.
9	Importance of Material	The reading questions helped me identify chapter material that the instructor felt was relatively more/less important.
10	Collection for Grading	I feel that it would have been more beneficial if the instructor had collected a copy of student responses to the assigned reading questions on the day they were due.

Students documented their responses on 1 to 7 scale with 1 being strongly disagree to 7 being strongly agree

TABLE 2

STUDENT SURVEY RESPONSES – YEAR-BY-YEAR INTERMEDIATE ACCOUNTING I (REQUIRED FOR MAJORS) INTERMEDIATE FINANCIAL ACCOUNTING FOR NON-MAJORS

Panel A: Intermediate Accounting I (required for accounting majors)

	2011	% of students who responded w/ 6 or 7 ^a	2012	% of students who responded w/ 6 or 7 ^a	2013	% of students who responded w/ 6 or 7 ^a	2014	% of students who responded w/ 6 or 7 ^a
	Fall		Fall		Fall		Fall*	
N =	54		39		59		49	
	Mean		Mean		Mean		Mean	
1. Motivation	5.6610	71.2%	6.1795	79.5%	5.9630	74.1%	6.0000	69.4%
2. Effort for Grade	5.6271	64.4%	5.7692	66.7%	5.5556	61.1%	4.6735 ^(#)	36.7%
3. Focus	2.4915	69.5%	2.0000	79.5%	2.3889	66.7%	2.2857	65.3%
4. Understanding of Material	5.4068	55.9%	5.4103	59.0%	5.5741	55.6%	5.9592#	69.4%
5. Other Classes	4.8644	40.7%	4.5128	30.8%	4.9630	31.5%	5.1429###	49.0%
6. Class Engagement	5.1864	57.6%	5.5128	64.1%	5.6481	63.0%	5.6735	59.2%
7. Time Spent Reading	5.4576	62.7%	5.4103	59.0%	5.7778	66.7%	5.8163	73.5%
8. Question Order	6.3390	89.8%	6.4103	84.6%	6.5926	94.4%	6.4286	85.7%
9.Importance of Material	5.6610	62.7%	5.7949	69.2%	6.1481	81.5%	6.2653##	83.7%
10. Collection for Grading	3.7966	23.7%	3.1795	15.4%	3.7222	16.7%	5.7347#	59.2%

^a Except for the 3rd question related to "*focus*" where the expected response was 1 or 2

* Intermediate Accounting was taught by a different professor (one of the other authors) in Fall 2014.

(#) Significantly lower than the combined means from 2011-2013 that were taught by another professor (See Table 3) at the .01 level.

###, ##, # Significantly higher than the combined means from 2011-2013 that were taught by another professor (See Table 3) at the .01, .05, and .10 levels, respectively.

TABLE 2 - CONTINUED STUDENT SURVEY RESPONSES – YEAR-BY-YEAR INTERMEDIATE ACCOUNTING I (REQUIRED FOR MAJORS) INTERMEDIATE FINANCIAL ACCOUNTING FOR NON-MAJORS

Panel B: Intermediate Financial Accounting for Non-Majors (required for finance majors, offered Spring semester only)

	2013 Spring	% of students who responded w/ 6 or 7 ^a	2014 Spring	% of students who responded w/ 6 or 7 ^a
N =	46		47	
	Mean		Mean	
1. Motivation	5.9783	73.9%	5.8298	68.1%
2. Effort for Grade	5.8043	76.1%	5.7660	70.2%
3. Focus	1.9674	71.7%	2.3617	63.8%
4. Understanding of Material	6.0000	76.1%	5.7021	61.7%
5. Other Classes	5.2717	47.8%	4.6383	29.8%
6. Class Engagement	5.5435	58.7%	5.6170	63.8%
7. Time Spent Reading	5.7609	71.7%	6.0638	80.9%
8. Question Order	6.5435	93.5%	6.4468	89.4%
9.Importance of Material	6.2174	78.3%	6.0638	80.9%
10. Collection for Grading	3.2065	8.7%	3.8723	19.1%

^a Except for the 3rd question related to "*focus*" where the expected response was 1 or 2

TABLE 3

STUDENT SURVEY RESPONSES - COMBINED SUMMARIES INTERMEDIATE ACCOUNTING I (REQUIRED FOR MAJORS) – INT ACCTG I INTERMEDIATE FINANCIAL ACCOUNTING FOR NON-MAJORS – INTER-4NM

	INTER- 4NM 2013-14	% of students who responded w/ 6 or 7 ^a	INT ACCTG I 2011-13	% of students who responded w/ 6 or 7 ^a	
N =	93		152		
	Mean		Mean		T-test
1. Motivation	5.9032	71.0%	5.9013	74.3%	0.4954
2. Effort for Grade	5.7849	73.1%	5.6382	63.8%	0.2298
3. Focus	2.1667	67.7%	2.3289	71.1%	0.1759
4. Understanding of Material	5.8495	68.8% ^{###}	5.4671	56.6%	0.0095
5. Other Classes	4.9516	38.7%	4.8092	34.9%	0.2473
6. Class Engagement	5.5806	61.3%	5.4342	61.2%	0.2088
7. Time Spent Reading	5.9140	76.3%##	5.5592	63.2%	0.0460
8. Question Order	6.4946	91.4%	6.4474	90.1%	0.3553
9.Importance of Material	6.1398	79.6% ^{###}	5.8684	71.1%	0.0495
10. Collection for Grading	3.5430	14.0%	3.6118	19.1%	0.3877

^a Except for the 3rd question related to "*focus*" where the expected response was 1 or 2

###, ## Significantly higher than the combined means from 2011-2013 that were taught by another professor (See Table 3) at the .01 and .05, respectively.

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WHAT DO WE MEAN BY ACCOUNTING PROGRAM QUALITY? A DECOMPOSITION OF ACCOUNTING FACULTY OPINIONS

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ABSTRACT

Institutional quality has been, and will continue to be, an important dimension of academic accounting. How we measure it, by increasingly featuring objective output measures, has taken the construct away from demonstrated meaningfulness among its most important constituency. This paper forms several research propositions that attempt to identify the antecedents of perceived accounting program quality. Using accounting faculty judgments about accounting programs provided to a popular press request – the *Public Accounting Report*, the results show that an institution's educational success is more important than its research productivity. More general school characteristics, including the program's accreditation profile and the reputation of the business school in which the program is embedded, are also significant in their direct association with perceived program quality. These more remote factors also indirectly impact program reputation through their significant direct effect on educational outcomes. Implications for further research are drawn.

A METHODOLOGY FOR EVALUATING THE EFFECT OF GRADE INFLATION AND COURSE DURATION ON STUDENT PERFORMANCE IN ACCOUNTING COURSES

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ABSTRACT

This paper examines the relationship between course duration, grade inflation and transfer student performance in accounting courses. We examine the effect of course duration (compressed two-week winter and six-week summer courses versus traditional 14-week semesters) on student performance in later accounting courses. Our results suggest poorer retention leading to lower performance for the students who took the earlier courses in the compressed format. Our second focus is on the effect of comparative grade inflation on subsequent student performance in more advanced accounting courses. By decomposing student grades into components reflecting individual student performance and relative section grade inflation (or deflation), we find a systematic negative of grade inflation (at the section level) on student performance in more advanced accounting courses. We conjecture that this result may be due to the possibility that grading policies in community colleges are less rigorous than those in four-year colleges, given the greater competitiveness of student admissions in the latter institutions.

Keywords: Grade Inflation, compressed intensive class delivery, summer and winter session, accounting courses, transferred students

I. Introduction

Grade inflation is an important topic since it impacts universities, students' job placements, and the society. This paper follows the definition of grade inflation as "an increase in grade point average without concomitant increase in achievement" (Boretz 2004). The concern with grade inflation is that it undermines the perceived quality and credibility of higher education because employers and other parties reliant on the report GPA cannot count on the degree of mastery of the subject matter that the grades purport to indicate. Potential employers do not have much information to differentiate a good employee from a mediocre one, so GPA is often used as an indicator of quality in the recruiting process. Empirically, grades are among the factors associated with favorable outcomes to education (i.e., wages and job placements), along with other factors such as the students' background, and the reputation of the university from which a student graduates (Popov and Bernhardt 2013; Schwager 2012).

Evidence suggests that grade inflation has increased in recent years. For example, the average study time declined between 1960s and the 2000s while the grade point average (GPA) increased during the same period (Kuh and Hu 1999; Babcock 2010). However, grade inflation has been difficult to measure directly because independent measures of student learning are often not available (Eiszler, 2002; Boretz, 2004).

This paper has two main objectives. The first one is to examine the effects of grade inflation on student learning using a new methodology. The context of the study is an undergraduate accounting program where knowledge acquired in earlier courses (and thus the grade obtained by students) are hypothesized to be related to the students' performance (as measured by grades) in higher level accounting courses. This dependence provides an independent measure of student learning from the earlier courses and thus a means to examine if inflated grades in these earlier courses reduce the benefits of the earlier courses in the later senior level courses.

The second objective of this paper is to examine the effect of the duration of the introductory and intermediate courses over which the courses are taken on the students' future academic performance. Most universities offer summer courses in six-week periods, and other universities on a bi-semester or trimester system offer winter intercession courses that last about four weeks. In contrast, for universities on a trimester or bi-semester system, the typical duration of a regular semester is 13 to 14 weeks. Many institutions provide these summer / winter sessions to expedite the graduation speed of their students. The question is whether students taking the introductory and/or intermediate courses in the shortened period retain as much knowledge as students who take these courses in the regular semester. Some recent research suggests that students' grade and outcomes do not suffer from the compressed intensive delivery method (Anderson and Anderson 2012; Ho and Polonsky 2009). However, these researches only focus on comparing the performance of students taking the regular semester course to the summer/winter session courses with no independent control over potential differences in grade inflation. Our re-examination of this issue uses the direct measure of outcomes (defined as performance in the higher level accounting courses) as the criterions measure against which the effect of the duration of introductory courses is measured.

The rest of the paper proceeds as follows. We present a discussion of the literature on grade inflation and the hypotheses development for this research in Section II. In Section III,

we describe our methodology, followed in Section IV by the results. The conclusions of the paper are presented in the final Section V.

II. Literature Review and Hypotheses Development

2.1 The Effect of Course Duration on Learning

One issue that has increasing relevance to institutions of higher education is the duration of courses. For universities on a semester system, the traditional semester for undergraduates is usually 12 to 14 weeks long. However, courses offered in the summer are usually of six weeks' duration, implying a greater compression of the materials. Increasingly, more universities are offering an undergraduate winter intersession, which is of four weeks duration. Much of the pressure for such compressed time frames for offering undergraduate courses stems from the need to generate more tuition revenue (and also better utilize the teaching facilities of the university). On the other hand, it has often been argued that students taking courses within such compressed time frames may retain less of the material studied.

Some empirical studies have been conducted to examine whether student performance suffers when courses are taken over the shorter duration period. Anderson and Anderson (2012), Ho and Polonsky (2009), and Inglis, Broadbent, and Dall'Alba (1993) reported that, on average, students taking courses in the compressed format did better (in terms of grades obtained) than those taking the course during the regular (uncompressed) semesters.) However, Anderson and Anderson (2012) and Ho and Polonsky (2009) examined only the short-term performance of the students. Thus, the potential for deficiencies in retention was not examined. The Inglis, Broadbent, and Dall'Alba (1993) paper compared an intensive summer semester where the delivery method was different from the traditional lecture and tutorial format, which the delivery method is different in nature other than just the semester delivery difference. Since our research uses the same traditional classroom lecture format and the only difference is the duration of the class time, we examine the effect of course duration in this first hypothesis:

H1. The higher-level accounting course performance of students who took the early accounting courses in a compressed format (in the six-week summer or four-week winter sessions) is not significantly different from those of students who took the same courses in the regular semesters. Thus, duration of the introductory and intermediate courses does not have an impact on the performance of students in higher level accounting courses.

2.2 Grade Inflation

Two issues are of relevance in the context of the discussion of grade inflation in this paper: (1) why it exists; and (2) why grade inflation is objectionable.

On the first issue, the push towards more inflation in recent years has been attributed to several factors. Love and Kotchen (2010) provided a theoretical model of grade inflation which relates universities' policy of using student evaluation of faculty teaching effectiveness as part of the materials used in the promotion and/or tenure evaluation process for faculty. Empirical researchers have also reported findings supporting this theme (Kezim, Pariseau, and Quinn 2005; Kirk and Spector 2009; Moore and Trahan 1998; Kuh and Hu 1999). At the same time, research has shown a strong linkage between instructors' grading
policies and student evaluations of teaching effectiveness, with easier instructors generally receiving higher student evaluations (with other factors controlled for – see Ellis, 2003; Eiszler, 2002). Typically, however, there is rarely any attempt in universities to correct for the known positive effect of easier grading on student evaluations of instructors. Thus, an upward bias is created for instructors to assign higher grades to students, regardless of their mastery of the knowledge to be conveyed in a course. Empirical studies have found the adjunct faculties have the most inflated grades, followed by non-tenured faculty and tenured faculty (Kezim, Pariseau, and Quinn 2005; Kirk and Spector 2009; Moore and Trahan 1998). These results are consistent with the inference that the more vulnerable faculty (i.e., subject to dismissal if student evaluations are low) are more likely to engage in grade inflation in order to obtain higher student teaching effectiveness evaluations. Butcher et al (2014) report findings that the humanities departments have the highest-grade inflation tendency at one end, and the science and technology departments have the lowest tendency. Thus, discipline may also be a factor.

Another factor, which has been identified as contributing to greater grade inflation, is the circular argument that failure to assign higher grades to students in an institution may create a bias against the graduates of that institution in the job market relative to graduates from other institutions with a more lax grading policy (Wilkstrom and Wilkstrom, 2005). Essentially, the argument is that students with comparatively lower grade point averages (GPAs) may be disadvantaged in the job market when competing with students with higher GPAs. Because prospective employers use GPA as one of the most important assessment tool when screening job applicants if employers do not know that different institutions are applying different grading policies, the graduates from the more stringent institution may be screened out more frequently than those from the more lenient institutions. Thus, to preserve the ability to attract students through greater post-graduation employability, university administrators may encourage or at least tolerate grade inflation.¹

The arguments against grade inflation have usually been based on both philosophical grounds and economic grounds. This paper aims to provide the basis for a third line of argument against grade inflation, i.e., on the pedagogical grounds that grade inflation tends to diminish student learning as demonstrated by performance in more advanced courses of the same discipline.

Grade inflation has been objected to the philosophical grounds that mislabeling is morally wrong and poorly serves any society. Specifically, to the extent that a grade represents a presumed assessment by a competent authority of the degree of mastery acquired by a student in any subject matter, assigning a grade higher than what the student's knowledge mastery represents unfairly blurs the differences between students. Thus, a society's ability to assess subject matter competence is severely compromised by grade inflation ((Crumbley, Flinn, and Reichelt 2010)

The economic argument against grade inflation is that, to the extent that employers use student GPAs as an initial indicator of student academic aptitude, grade inflation severely degrades GPA as a first-best initial screening tool. This will force potential employers to resort to other measures of academic aptitude that are less reliable and/or more costly to

¹ With regard to what policies can be adopted to combat grade inflation, the most popular appears to be the establishment of a grading policy at the department or school level. See Nagle (1998) for an alternative approach involving the use of a "relative performance index" to evaluate teaching effectiveness.

acquire. Thus, a dead-weight cost is imposed on the economic system when grade inflation is practiced at the discretion of different instructors since employers have no a priori way to determine its existence (Chan, Hao, and Suen 2007)

The pedagogical argument against grade inflation, which we propose to test in this paper, is that the practice tends to reduce student learning overall. Philosophically, students taking a course in a section with inflated grades will need to register to take more advanced course with students who may have taken the same course without the grade inflation. The mentality of students who took the section with inflated grades may have an exaggerated sense of their own competence, or they may have a mistaken idea about the level of effort required to master the subject matter in the advanced course (Kohn 2002).

Because the contexts in which the empirical tests are developed involve elementary and more advanced accounting courses, some foundation for the hypothesis to be presented is necessary. Prior literature in accounting education has focused on various factors that affect student performance in accounting courses. Eskew and Faley (1988) studied the relationship between the mathematical background and accounting grade, and reported a positive relationship. Mutchler, Turner, and Williams (1987) suggested female students outperformed male students, but Lipe (1989) reported finding opposite results. Buckless, Lipe, and Ravenscroft 1991) reported no statistical difference in gender performance when individual students' academic ability is controlled for. Other research reported that the status of students as either full time or part time students were found to outperform their full-time peers, with the ostensible reason being that part-time students are usually more mature, more highly motivated, and employed.

Irrespective of the influence of these factors, we theorize that student performance in the sophomore and junior-level accounting courses (Introduction to Financial Accounting/Accounting Principles I; Introduction to Managerial Accounting/Accounting Principles II; Intermediate Accounting I, and Intermediate Accounting II) would be highly predictive of their performance in the higher level accounting courses (Advanced Accounting; Auditing; Cost Accounting; and Income Tax Accounting). Maksy and Zheng (2008) reported just such dependence by showing that student performance on Intermediate Accounting is related to performance in Advanced Accounting and Auditing. This dependence may arise from several factors: (1) the conceptual (knowledge-based) foundations laid in these earlier courses in students' minds for the later courses; (2) the development of a professional mindset and approach to problem-solving introduced in the early courses and required to be applied in the later courses; and (3) the level of effort required to do well in accounting courses.

Based on this line of reasoning, the second hypothesis we propose and test can be outlined as follows (in alternative form):

H2. The relative performances of students in the early accounting courses are positively related to their performances in the later (more advanced) accounting courses.

Our third hypothesis relates to the effect of grade inflation on the relationship hypothesized in H1. Specifically, to the extent that students who take sections where grading was easier have to take the higher level courses with students not so handicapped, we hypothesize that the grades of students from the easier sections will be systematically lower. This leads to the hypothesis below (in alternative form):

H3. Students who took sections of early accounting courses where average grades were relatively high (compared to other sections of the same course regardless of time when the course was taken) will tend to do poorer in higher level accounting courses compared to other students.

III. Data Sources and Methodology

3.1 Data Source

The data for the study came from the undergraduate accounting program of a large public university in the Mid-Atlantic Region. Like many other undergraduate accounting programs, the first two accounting courses (Introduction to Financial Accounting and Introduction to Managerial Accounting) were offered to not only business school majors, but also to majors in other allied disciplines where some knowledge of accounting was required. The data gathered covered the period from Fall 2009 to the Winter Session in 2014 (December 2013 to January, 2014).

Figure 1 Insert Here

Besides the two basic accounting courses (coded as 272 and 275 respectively), the sequence of the other accounting courses are as described in Figure I. Course Code 272 was a pre-requisite to all the other accounting courses required to be taken by accounting majors. In this financial accounting sequence, students take Intermediate Accounting I (code 325), followed by Intermediate Accounting II (code 326), then Advanced Accounting (code 401). Subsequent to taking Intermediate Accounting I, students can take Auditing (code 415) and Income Tax (421).

In the managerial accounting track, students take Introduction to Managerial Accounting (code 275) after taking the introductory financial accounting course. Cost Accounting (code 451) may be taken in the senior or advanced junior year after students have taken the introductory managerial accounting course. Finally, Accounting Information Systems (code 458) may be taken in any semester after the introductory financial accounting course.

The university's grading system for undergraduates consists of the following: A (4 points), B+(3.5 points), B (3.0 points); C+ (2.5 points), C (2 points), D (1 point), and F (Fail =0 points). There are 6891 students in Introduction to Financial Accounting, with a mean of 2.329 and median of 2.5. This introduction class is the only course that has a median score of 2.5. For all the other courses, the median grade is 3. Roughly 22 percent of all scores in this course were D,F, or W (for Withdraw) for Introductory Accounting 272.

Only business school students are allowed to register for the Introduction to Managerial Accounting course. A further restriction is imposed such that only students who declare an accounting major can take any of the other courses listed in Figure I, except that Finance majors are allowed to take Intermediate Accounting I.

Table 1 Insert Here

Table I presents summary statistics on the sample used in the study. As can be seen in the table, over the period studied, 999 students took the Intermediate Accounting I course where 24.8 percent of the students earned a B, and 8.81 percent of the students failed. There is a 20% decline in number of students enrolled from Intermediate Accounting I to Intermediate Accounting II (802). The highest average grade is in Auditing with a mean of 3.155, which is the only course with an average above 3. This course also has the highest percentage of students in A and lowest in the failing grade of D and F, with 22.5% and 1.5% respectively.

1.2 Methodology

Since the four courses, Advanced Accounting, Auditing, Income Tax Accounting, and Cost Accounting are the courses most likely to be taken in the senior year of an accounting major, grades in these courses were used as the dependent variables in a test of the hypotheses presented earlier. The regressions estimated can be written generically as follows:

 $GRD_401 = F0(Control variables) + F1(SUM_xxx; WIN_xxx)$ + F2(SG001 xxx, SG101 xxx, SG201 xxx, NT401 xxx) + F3(SEC001_xxx, SEC101_xxx, SEC201_xxx) (1) $GRD_{415} = F0(Control variables) + F1(SUM_xxx; WIN_xxx)$ + F2(SG015 xxx, SG115 xxx, SG215 xxx, NT415 xxx) + F3(SEC015_xxx, SEC115_xxx, SEC215_xxx) (2) $GRD_451 = F0(Control variables) + F1(SUM_xxx; WIN_xxx)$ + F2(SG051_xxx, SG211_xxx, SG251_xxx, NT451_xxx) + F3(SEC051_xxx, SEC211_xxx, SEC251_xxx) (3) $GRD_421 = F0(Control variables) + F1(SUM_xxx; WIN_xxx)$ + F2(SG021 xxx, SG121 xxx, SG221 xxx, NT421 xxx) + F3(SEC021_xxx, SEC121_xxx, SEC221_xxx) (4)

The following definitions apply to Equations (1) to (4):

GRD_yyy = Grade earned by the student in the course yyy

WIN_xxx = Dummy variable for Course xxx taken in the Winter session (4 weeks' duration).

SUM_xxx = Dummy variable for Course xxx taken during the Summer session

(6 weeks' duration).

GRD_xxx = Grade earned by the student in the course xxx

AVSEC_xxx = Average grade of that section of course xxx for that semester

AVCOR_xxx = Average grade of all sections of course for all semesters.

STGRD_xxx = GRD_xxx/AVSEC_xxx

= student grade relative to the average grade for the section

= measure of relative student performance adjusted for possible

grade

inflation

in the section.

RSECGRD_xxx = AVSEC_yyy/AVCOR_xxx

= average section grade relative to average course grade

= measure of relative grade inflation (> 1.0 indicates relative inflation)

STG0yy_xxx = Grade in Course xxx taken concurrently (in the same semester) as

Course yy.

STG1yy_xxx = Grade in Course xxx taken one semester before Course yyy.

STG2yy_xxx = Course xxx taken at least two semester before Course yyy.

SEC0yy_xxx = Relative grade inflation of section of Course xxx taken concurrently

with Course yyy.

SEC1yy_xxx = Relative grade inflation of section of Course xxx taken one semester

before Course yyy.

SEC2yy_xxx = Relative grade inflation of section of Course xxx taken at least two

semesters before Course yyy.

NTyyy_xxx = Course xxx not taken when course yyy was taken.

The coefficients in function F0 relate to the control variables in the equations. These are principally the planned graduation year of the student (dummy variable), the relative degree of grade inflation in the dependent variable (RSECGRD_yyy), and the degree of

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aptitude displayed by the student in the basic introductory accounting course (Course code 272). Finally, if the student either took these courses from a community college (or took them from another school), this was coded as NO_272.

The coefficients in function F1 are needed to evaluate Hypothesis H1. If shorter course duration of the lower level accounting courses negatively impact student performance in the higher-level accounting courses, these coefficients should be negative.

Function F2 allows the validity of Hypothesis H2 to be evaluated. As presented in Hypothesis H2, all the coefficients of F2 are expected to be positive, reflecting the arguments that accounting knowledge and professional training through the course work is cumulative. Thus, even for nominally unrelated courses like Intermediate Accounting II and Cost Accounting, the expectation is that the discipline acquired from the former course is transferable to the latter. This is a rebuttable argument, so the findings here should be instructive.

Function F3 permits the validity of Hypothesis 3 to be evaluated. Based on the arguments advanced to support the hypothesis, the coefficients computed under this function should be all negative, implying that students in sections of courses with relatively high average grades tend to do poorer than students in sections with lower average grades in the higher level accounting courses.

IV. Results

The results of estimating Equations (1) to (4) are presented in Tables 2 to 5. Although the results are generally similar, there are enough differences to justify discussing these tables in detail.

Table 2 Insert Here

Table 2 presents the results obtained when Advanced Accounting (course 401) is the dependent variable. Half of the control variables classified under Function F0 are statistically significant, including accounting aptitude (ACCT_APT) as reflected in performance in the introductory accounting courses. The students in the sample who were graduating in 2013 and 2014 did slightly poorer than students who graduate in the earlier years.

With respect to Hypothesis H1 (the impact of lower level course duration on higher level accounting course performance), the results are decidedly mixed. Only about half of the coefficients are negative, but very few of them are statistically significant. Thus, it would appear that, at least for Advanced Accounting, the duration of the early courses does not make a difference in the students' performance.

The results for Hypothesis H2 (knowledge gained from other accounting courses positively affecting performance in the accounting course under study) are generally supportive of the hypothesis. For Advanced Accounting, students who had taken in prior semesters or are taking contemporaneously Auditing (Course 415) did relatively better that those who had not taken the course. A similar conclusion applies to students who had taken (or are taking contemporaneously) Cost Accounting (Course 451), and Income Tax Accounting (Course 421). All of these courses have positive and statistically significant

coefficients, in contrast to the generally statistically insignificant coefficients for those marked as "NT" – not having taken the course. The odd exception relates to students who take Accounting Information Systems (Course 458) contemporaneously with Advanced Accounting where the performance is significantly poorer. The reason appears to be that the course appears to be extremely demanding of student's time and effort. Thus, time that could have been devoted to studying Advanced Accounting was taken up completing assignments for Course 458.

Finally, the effect of grade inflation at the lower level courses on upper level courses can be examined. Of the 14 coefficients grouped under Function F3 using the seemingly unrelated regressions approach, 13 show negative signs, although only three of them are statistically significant. The overall impression conveyed by these findings is that grade inflation at the lower levels definitely does not benefit students taking the upper level accounting course, Advanced Accounting.

Table 3 Insert Here

Table 3 presents the results obtained when Concepts of Auditing (course 415) is the dependent variable. With respect to Hypothesis H1 (the impact of lower level course duration on higher level accounting course performance), the results are again mixed. Only three of the nine coefficients calculated are negative, but only two are statistically significant. Thus, once again, it would appear that, for Concepts of Auditing, the duration of the early accounting courses does not affect students' performance in the course.

The results for Hypothesis H2 (knowledge gained from other accounting courses positively affect performance in the accounting course under study) are generally supportive of the hypothesis. With the exclusion of Accounting Information Systems (Course 458), all but one of the 22 coefficients for the other accounting courses (Advanced Accounting, Cost Accounting, and Income Tax Accounting, and Intermediate II) are all positive, although only seven are statistically significant. For Accounting Information Systems, the signs are mostly negative but not statistically significant. Thus, overall, there is support for the proposition that knowledge or concepts gained from other accounting courses tend to enhance performance in Auditing.

The effect of grade inflation at the lower level courses on Auditing is more muted. While most of the coefficients grouped under unction F3 are not statistically significant, those that are significant have positive coefficients. Thus, it cannot be said that grade inflation at the lower levels has an adverse effect on student performance in Auditing.

Table 4 Insert Here

Table 4 presents the results obtained when Cost Accounting (course 451) is the dependent variable. For Hypothesis H1, six of the nine coefficients evaluating the impact of lower level course duration on higher level accounting course performance are negative. Of these six, three are statistically significant. Thus, the general weight of the evidence supports the interpretation that shorter course duration of the lower level courses tends to have a negative impact on performance in cost accounting.

The results for Hypothesis H2 are also generally supportive only for Advanced Accounting (Course 401), Concepts of Auditing (Course 415) and Intermediate Accounting I (Course 325). For these three courses, students who have taken them tended to do better in Cost Accounting (regardless of whether contemporaneous or with a lag), while those who have not taken them (labelled NT_xxx) tended to do poorer. These results are in contrast to Income Tax Accounting (Course 421), Accounting Information Systems (Course 458), and Intermediate Accounting II (Course 326). Here students tagged as NT_xxx tended to do as well (and in some cases better) in Cost Accounting than those who had taken the courses.

The effect of grade inflation at the lower level courses on Cost Accounting is also mixed. Of the 16 coefficients grouped under function F3, equal numbers have negative coefficients as those with positive signs. Moreover, there are almost equal numbers of statistically significant coefficients in the positive and negative camps. The one distinct finding here is that grade inflation in Advanced Accounting has a profound negative effect on performance in Cost Accounting when the two courses are taken contemporaneously. Thus, while it cannot be said that grade inflation at the lower levels have an adverse effect on student performance in Cost Accounting, the exception appears to be for Advanced Accounting.

Table 5 Insert Here

Table 5 presents the results obtained when Income Tax Accounting (Course 421) is the dependent variable. For Hypothesis H1, none of the nine coefficients evaluating the impact of lower level course duration on higher level accounting course performance is statistically significant. Thus, the conclusion that shorter course duration of the lower level courses tends to have no adverse effect on performance in Income Tax Accounting is justified.

The results for Hypothesis H2 are also strongly supported for all the courses except Cost Accounting. For Advanced Accounting (Course 401), Concepts of Auditing (Course 415), Accounting Information Systems (Course 458), Intermediate Accounting II (Course 326) and Intermediate Accounting I (Course 325), concepts and knowledge gained from these antecedent or contemporaneous courses have a positive effect on performance in Income Tax Accounting as compared to those who have not taken those courses. For Cost Accounting (Course 451), in contrast, there is no relationship, thus suggesting that the courses required different thinking patterns that do.

Finally, with respect to the effect of grade inflation at the lower-level courses on Income Tax Accounting, the findings are also mixed. With the exception of Advanced Accounting (Course 401) and Concepts of Auditing (Course 415), for all the other courses, grade inflation does not have the hypothesized negative effect on performance in Income Tax Accounting.

V. Conclusions

This study was designed to evaluate three hypotheses: (1) the hypothesis that shorter duration courses would adversely impact performance in higher level courses; (2) the hypothesis that knowledge and concepts gleamed from other accounting courses would cross-feed any higher level accounting course and thus improve performance; and (3) that grade inflation defined as easier grading policies by instructors would tend to diminish effort

expectations in higher level courses and thus lead to poorer performance. The results we found offer limited support for all three hypotheses. Below is a succinct summary of our findings:

	Hypothesis I Negative effect of short course duration	Hypothesis 2 Positive Cross- feeding of knowledge gained from other courses	Hypothesis 3 Negative Effect of Grade Inflation
Advanced Accounting (Course 4010)	Not supported	Generally supported	Generally supported
Concepts of Auditing (Course 415)	Not supported	Generally supported	Not supported
Cost Accounting (Course 451)	Generally supported	Not supported in general	Not supported
Income Tax Accounting (Course 421)	Not supported	Strongly supported	Not supported

These results offer some insight into issues that have intrigued educators in general, and accounting educators in particular. Further research can be conducted into whether the concepts and knowledge gained in accounting courses cross-feed into non-accounting courses and vice-versa.

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Figure 1 Typical Sequence of Accounting Courses

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Table 1 – Descriptive Data

										Percentage in
Accounting Courses		Maan	Madian	Ctal Dave	Percentage	Percentage	Percentage	Percentage	Percentage	D, F, W, and
Accounting Courses	N	Mean	Median	Std Dev	in A	IN B+	in B	in C+	in C	others
Introduction to Financial Accounting	6891	2.329	2.5	1.254	12.83%	12.52%	18.26%	14.18%	20.30%	21.91%
Introduction to Managerial Accounting	3047	2.715	3	1.102	19.26%	16.61%	18.97%	16.31%	17.79%	11.06%
Intermediate Accounting I	999	2.821	3	1.026	17.82%	19.12%	24.82%	17.12%	12.31%	8.81%
Intermediate Accounting II	801	2.864	3	0.957	19.23%	16.85%	26.59%	14.36%	16.85%	6.12%
Accounting Information System	838	2.668	3	0.911	8.83%	14.44%	28.76%	25.78%	13.13%	9.07%
Advanced Accounting	715	2.828	3	0.854	16.64%	14.69%	26.57%	15.52%	21.96%	4.62%
Auditing	747	3.155	3	0.720	22.5%	25.4%	28.8%	13.0%	8.8%	1.5%
Income Tax Accounting	746	2.936	3	0.871	18.77%	18.77%	30.29%	11.93%	14.21%	6.03%
Cost Accounting	858	2.836	3	0.940	18.76%	16.90%	23.31%	15.27%	19.35%	6.41%

Results of A	nalysis with Pe	erformance i	n Advanced Acc	ounting (401) as Dep	endent Vari	able
		PAN	EL A		PAN	EL B
	OLS with W Errors	hite-Correct	ted Standard	Seemingly U Results	nrelated Re	gression
	OLS with W	hite-Correc Errors	cted Standard	Seemingly	Unrelated Results	Regression
	Coefficient	T-value	Significance	Coefficient	T-value	Significance
Control Variables						
Intercept	1.73188	1.52	0.1285	2.068937	1.75	0.0805
SEN_12	-0.12469	-1.3	0.1944	-0.19263	-2.22	0.0266
SEN_13	-0.16005	-1.76	0.0782	-0.24219	-2.69	0.0073
SEN_14	-0.2117	-1.95	0.0512	-0.29859	-2.9	0.0039
ACCT_APT	0.11409	1.79	0.0746	0.1358	1.76	0.0788
NO_272	0.33633	1.52	0.1288	0.355368	1.36	0.1738
RSEGRD_401	0.72482	1.16	0.2451	0.253493	0.4	0.691
Duration of the Courses						
SUM_272	-0.13033	-0.92	0.3572	-0.03427	-0.13	0.8959
SUM_275	0.1382	0.95	0.3408	0.150079	1.07	0.2847
SUM_325	-0.23265	-1.43	0.1519	-0.31409	-1.86	0.064
SUM_326	-0.20869	-1.37	0.1707	-0.10608	-0.53	0.5946
SUM_451	0.16726	1.15	0.2506	0.089007	0.47	0.6357
SUM_415	0.23938	1.45	0.1467	0.328388	1.31	0.1921
SUM_421	-0.20485	-1.16	0.2471	-0.21056	-1.2	0.2315
SUM_458	-0.05656	-0.2	0.8417	-0.32678	-1.12	0.2631
WIN_275	0.04453	0.32	0.7469	0.020446	0.06	0.9491

TABLE 2

Effect of Sequences for Advanced Courses

Concepts of Auditing	- 415			_		
SG001_415	0.64253	2.47	0.0137	0.270781	0.48	0.6323
SG101_415	0.36729	2.35	0.0189	0.343478	2.17	0.0302
SG201_415	0.29338	0.53	0.5947	0.227394	0.42	0.6713
NT401_415	-0.0208	-0.04	0.9673	0.093829	0.18	0.8596
Cost Accounting - 45	1					
SG001_451	0.99519	7.15	<.0001	1.210598	8.63	<.0001
SG101_451	0.73347	4.2	<.0001	0.855777	3.92	<.0001
NT401_451	-0.16141	-1.47	0.1426	-0.31766	-2.28	0.0227
Income Tax Accounti	ing - 421					
SG001_421	0.91766	3.14	0.0018	1.045899	3.38	0.0008
SG101_421	1.04365	7.42	<.0001	0.945873	6.44	<.0001
SG201_421	0.42992	1.2	0.2303	0.537153	1.34	0.1811
NT401_421	0.17329	0.27	0.7909	0.120352	0.19	0.8525
Accounting Informat	ion System - 45	8				
SG001_458	-1.48772	-3.56	0.0004	0.159772	0.04	0.9641
SG101_458	0.2657	0.6	0.5515	0.596497	1.23	0.2178
SG201_458	0.28606	2.07	0.0387	0.290437	2.03	0.043
NT401_458	0.75377	1.68	0.093	0.687156	1.47	0.1429
Intermediate Account	ting II					
SG101_326	0.88856	1.51	0.1321	0.658153	1.08	0.28
SG201_326	0.38975	2.88	0.0041	0.328798	2.36	0.0184
NT401_326	0.1014	0.22	0.824	0.315981	0.56	0.5767
Intermediate Account	ting I					
SG201_325	0.39518	2.53	0.0116	0.382646	2.4	0.0167
NT401_325	-1.20527	-2.81	0.0052	-0.55163	-1	0.316
Grade Inflation Effect			· · · · · · · · · · · · · · · · · · ·			
SEC001_415	-0.83646	-1.5	0.1336	-0.54596	-0.73	0.4639
SEC101_415	-0.43581	-0.95	0.3418	-0.56563	-1.17	0.2425

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SEC201_415	-0.54028	-0.72	0.4718		-0.59475	-0.86	0.3883
SEC001_451	-1.10487	-6.23	<.0001		-1.39868	-8.24	<.0001
SEC101_451	-0.69443	-3.7	0.0002		-0.86772	-3.75	0.0002
SEC001_421	-0.644	-0.94	0.3475		-1.1483	-1.67	0.0953
SEC101_421	-0.49018	-0.83	0.4064		-0.80242	-1.31	0.1902
SEC201_421	0.28119	0.4	0.6921		-0.23652	-0.32	0.7523
SEC001_458	1.45432	2.96	0.0032		-0.05001	-0.01	0.9887
SEC101_458	0.1873	0.34	0.7333		-0.17704	-0.29	0.7753
SEC201_458	0.21199	0.62	0.5365		0.263085	0.7	0.486
SEC101_326	-0.71166	-1.03	0.3025		-0.33369	-0.51	0.6111
SEC201_326	-0.54805	-1.52	0.1296		-0.25262	-0.65	0.5151
SEC201_325	-1.03063	-3.08	0.0022		-0.55779	-1.43	0.1544
	Number of obse	rvations		661	·		
	Adjusted F	R-square		0.4723			
	System-weighted F	R-square		0.5375			

TABLE 3Results of Analysis with Performance in Concepts of Auditing (415) as Dependent Variable

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	OLS with Wh Errors	PANEI ite-Corrected	A I Standard	Seemingly Un	PANEI arelated Regr	- B ession Results
	Coefficient	T-value	Significance	Coefficient	T-value	Significance
Control Variables		-			-	
Intercept	-3.513	-3.01	0.0027	-4.117	-3.15	0.0017
SEN_12	-0.032	-0.51		-0.068	-0.9	
SEN_13	-0.235	-3.36	0.0008	-0.32	-4.03	<.0001
SEN_14	-0.231	-2.93	0.0035	-0.33	-3.5	0.0005
ACCT_APT	-0.038	-0.59		-0.036	-0.52	
NO_272	-0.047	-0.22		-0.104	-0.44	
RSEGRD_415	3.524	8.33	<.0001	3.836	8.53	<.0001
Duration of the Courses						
SUM_272	-0.07	-0.27		0.014	0.06	
SUM_275	0	0		0.018	0.15	
SUM_325	0.146	1.14		0.004	0.02	
SUM_326	-0.055	-0.35		0.03	0.16	
SUM_4 01	-0.151	-1.2		-0.218	-1.5	
SUM_451	-0.091	-0.45		-0.35	-1.7	0.0902
SUM_421	-0.125	-0.89		-0.289	-1.72	0.0858
SUM_458	0.023	0.17		0.107	0.43	
WIN_275	0.113	0.58		0.261	1.03	
Effect of Sequences for Ad	lvanced Cours	es				
_ Advanced Accounting	g - 401					
SG015_401	0.807	2.36	0.0183	0.672	1.32	
SG115_401	0.844	2.22	0.0264	1.178	2.63	0.0089
NT415_401	0.892	3.92	<.0001	0.964	2.27	0.0237
Cost Accounting - 451	l					

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SG015_451	0.468	2.31	0.0214	0.36	1.57	
SG115_451	0.326	1.97	0.0493	0.306	1.64	
SG215_451	-0.52	-1.34		-0.646	-1.81	0.0702
NT415_451	0.29	0.44		-0.216	-0.3	
Income Tax Accountin	ng - 421					
SG015_421	0.569	5.07	<.0001	0.963	7.47	<.0001
SG115_421	-0.045	-0.15		0.453	1.48	
SG215_421	3.929	3.5	0.0005	3.748	2.16	0.0311
NT415_421	0.762	1.39		1.766	2.84	0.0047
Accounting Information	on System - 458					
SG015_458	-0.097	-0.18		-0.086	-0.18	
SG115_458	0.685	1.81	0.0707	0.26	0.52	
SG215_458	0.126	1.12		-0.034	-0.26	
NT415_458	0.008	0.02		-0.235	-0.56	
Intermediate Accounti	ng II					
SG015_326	0.289	1.21		0.189	0.31	
SG115_326	0.491	4.19	<.0001	0.446	3.52	0.0005
SG215_326	0.541	1.24		0.704	1.61	
NT415_326	0.696	1.51		0.845	1.67	0.0946
Intermediate Accounti	ng I					
SG115_325	0.198	0.6		0.017	0.03	
SG215_325	0.353	2.33	0.02	0.162	1.1	
NT415_325	0.387	0.83		0.32	0.83	
Grade Inflation Effect		-			-	
SEC015_401	-0.089	-0.22		-0.066	-0.1	
SEC115_401	-0.145	-0.27		-0.541	-0.84	
SEC015_451	-0.165	-0.26		-0.563	-0.79	
SEC115_451	0.059	0.09		-0.4	-0.54	
SEC215_451	0.589	0.84		0.3	0.4	

SEC015_421	0.148	0.28			0.787	1.31	
SEC115_421	1.064	1.73	0.0839		1.795	2.5	0.0128
SEC215_421	-2.843	-2.39	0.0171		-1.481	-0.82	
SEC015_458	0.198	0.3			-0.324	-0.53	
SEC115_458	-0.368	-0.74			-0.179	-0.29	
SEC215_458	0.058	0.19			-0.237	-0.7	
SEC015_326	0.256	0.51			0.075	0.11	
SEC115_326	0.192	0.47			0.219	0.5	
SEC215_326	0.19	0.33			-0.108	-0.17	
SEC115_325	0.318	0.69			1.007	1.65	0.0987
SEC215_325	0.273	0.61			0.714	1.92	0.0549
	Number of observ	vations	- -	736	-	<u> </u>	
	Adjusted R-	square	0	.3164			
	System-weighted R-	square	0	.5375			

		PANEL A			PANEL B	
	OLS with White-Corrected Standard Errors			Seemingly Un	related Reg	ression Results
	Coefficient	T-value	Significance	Coefficient	T-value	Significance
Control Variables						
Intercept	-3.83156	-3.17	0.0016	-4.349	-3.37	0.0008
SEN_12	-0.173	-2.85	0.0045	0.011	0.13	
SEN_13	-0.03	-0.43		0.075	0.81	
SEN_14	-0.065	-0.84		0.103	1.02	
ACCT_APT	0.234	3.5	0.0005	0.131	1.76	0.0784
NO_272	0.725	3.17	0.0016	0.508	2.01	0.0447
RSEGRD_451	2.196	4.26	<.0001	1.702	3.17	0.0016
Duration of the	-					
<u>Courses</u>						
SUM_272	-0.361	-2.4	0.0168	-0.501	-1.99	0.0468
SUM_275	-0.057	-0.43		0.064	0.45	
SUM_325	0.049	0.33		-0.163	-0.86	
SUM_326	-0.599	-3.65	0.0003	-0.439	-2.18	0.03
SUM_401	-0.042	-0.29		-0.081	-0.56	
SUM_415	0.096	0.5		0.16	0.64	
SUM_421	-0.305	-2.21	0.0275	-0.256	-1.7	0.0896
SUM_458	0.499	3.66	0.0003	-0.272	-0.93	
WIN_275	0.069	0.4		0.201	0.66	

TABLE 4 Results of Analysis with Performance in Cost Accounting (451) as Dependent Variable

Effect of Sequences for Advanced Courses Advanced Accounting - 401

SG051_401	0.845	5.93	<.0001	1.069	7.39	<.0001
SG151_401	-0.717	-1.60		0.181	0.39	
NT451_401	-0.25	-0.71		0.267	0.86	
Concepts of Auditing -	415					
SG051_415	1.405	3.62	0.0003	1.047	2.9	0.0038
SG151_415	0.743	4.27	<.0001	0.774	4.12	<.0001
SG251_415	3.187	3.71	0.0002	2.725	2.88	0.0042
NT451_415	0.518	0.98		0.533	0.95	
Income Tax Accountin	g - 421					
SG051_421	0.257	1.05		-0.136	-0.56	
SG151_421	0.543	3.3	0.001	0.291	1.54	
SG251_421	-0.159	-0.18		-1.446	-2.39	0.0173
NT451_421	1.828	2.48	0.0132	1.648	2.2	0.0285
Accounting Informatio	on System - 458					
SG051_458	1.062	2.56	0.0108	1.531	3.62	0.0003
SG151_458	0.617	2.9	0.0039	0.18	0.72	
SG251_458	0.228	1.57		0.308	1.9	0.0574
NT451_458	0.793	1.8	0.0726	1.247	2.76	0.0059
Intermediate Accounti	ng II					
SG051_326	0.619	3.69	0.0002	1.203	4.62	<.0001
SG151_326	0.202	0.73		0.466	1.69	0.0911
SG251_326	0.161	1.03		0.222	1.3	
NT451_326	0.752	1.6		1.371	2.51	0.0124
Intermediate Accounti	ng I					
SG151_325	0.791	4.6	<.0001	1.407	4.73	<.0001
SG251_325	0.411	2.38	0.0176	0.346	1.93	0.0546
NT451_325	0.198	0.93		0.454	1.69	0.0915
Grade Inflation Effect						
SEC051_401	-1.05	-3.04	0.0024	-1.036	-3.35	0.0009

SEC151_401	0.462	0.94		-0.156	-0.31	
SEC051_415	-1.215	-1.95	0.0514	-0.94	-1.43	
SEC151_415	-0.422	-0.85		-0.493	-0.92	
SEC251_415	-2.798	-2.78	0.0057	-2.356	-2.34	0.0195
SEC051_421	1.715	2.32	0.0204	1.85	2.47	0.0138
SEC151_421	1.418	1.97	0.0497	1.436	1.96	0.0509
SEC251_421	2.538	2.13	0.0333	3.551	3.58	0.0004
SEC051_458	-0.315	-0.56		-0.684	-1.22	
SEC151_458	0.152	0.37		0.818	1.91	0.056
SEC251_458	0.702	1.8	0.0718	0.888	2.26	0.0243
SEC051_326	-0.046	-0.1		-0.284	-0.53	
SEC151_326	0.65	1.49		0.853	1.73	0.0841
SEC251_326	0.497	1.11		1.109	2.15	0.0324
SEC151_325	-0.463	-1.9	0.0584	-0.983	-2.68	0.0077
SEC251_325	-0.161	-0.59		0.172	0.56	

Number of observations 748

Adjusted R-square 0.4234

System-weighted R-square 0.5375

TABLE 5
Results of Analysis with Performance in Income Tax Accounting (421) as Dependent Variable

	PANEL A OLS with White-Corrected Standard Errors			PANEL B Seemingly Unrelated Regression Results			
	Coefficient	T-value	Significance	Coefficient	T-value	Significance	
Control Variables			-				
Intercept	-3.592	-2.66	0.0081	-3.708	-2.55	0.0111	
SEN_12	0.081	1.11		0.043	0.54		
SEN_13	0.053	0.75		-0.003	-0.04		
SEN_14	-0.195	-2.27	0.0235	-0.303	-3.08	0.0022	
ACCT_APT	0.131	1.76	0.0781	0.192	2.68	0.0075	
NO_272	0.671	2.62	0.0089	0.865	3.57	0.0004	
RSEGRD_421	2.079	3.77	0.0002	2.474	4.08	<.0001	
Duration of the			· · · ·			-	
<u>Courses</u>	0.100	0.04		0.000	0.22		
SUM_272	-0.188	-0.84		0.082	0.32		
SUM_275	-0.091	-0.67		0.018	0.14		
SUM_325	0.196	1.13		0.115	0.69		
SUM_326	-0.357	-1.55		-0.142	-0.77		
SUM_401	0.076	0.51		0.076	0.52		
SUM_451	-0.074	-0.3		0.206	1		
SUM_415	0.088	0.47		0.168	0.66		
SUM_458	0.179	0.62		-0.054	-0.2		

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WIN_275	0.174	1.07		0.28	0.96	
Effect of Sequences for Adva	unced Courses					
Advanced Accounting -	401					
SG021_401	0.625	1.68	0.093	0.77	2.14	0.0328
SG121_401	1.349	2.67	0.0078	1.682	3.04	0.0025
NT421_401	0.069	0.21		0.329	0.59	
Concepts of Auditing - 4	15					
SG021_415	0.644	5.13	<.0001	1.16	7.94	<.0001
SG121_415	1.041	2.52	0.0119	1.853	4.36	<.0001
SG221_415	4.266	2.24	0.0257	6.689	3.71	0.0002
NT421_415	0.142	0.32		0.915	1.87	0.0626
Cost Accounting - 451						
SG021_451	0.405	1.77	0.0769	-0.164	-0.7	
SG121_451	0.197	0.93		0.012	0.06	
SG221_451	-0.168	-0.48		0.147	0.42	
NT421_451	1.371	1.85	0.0654	1.06	1.52	
Accounting Information	System - 458					
SG021_458	0.227	0.39		0.368	0.67	
SG121_458	0.525	1.26		0.933	1.92	0.055
SG221_458	0.626	4.81	<.0001	0.482	3.6	0.0003
NT421_458	0.726	1.8	0.0728	0.554	1.29	
Intermediate Accounting	g II					
SG021_326	0.739	2.64	0.0084	1.336	2.28	0.0231
SG121_326	0.503	3.75	0.0002	0.334	2.46	0.0142
SG221_326	0.901	1.99	0.0474	0.247	0.67	

NT421_326	0.018	0.04		-0.068	-0.13	
Intermediate Accounting I						
SG121_325	1.132	3.22	0.0014	0.009	0.02	
SG221_325	0.902	5.87	<.0001	0.852	5.49	<.0001
NT421_325	1.761	2.56	0.0108	0.949	1.38	
Grade Inflation Effect			-		-	
SEC021_401	-0.532	-1.11		-0.685	-1.1	
SEC121_401	-1.186	-1.65	0.0992	-1.388	-1.77	0.0781
SEC021_415	-0.397	-0.96		-0.3	-0.65	
SEC121_415	-0.9	-1.57		-1.009	-1.58	
SEC221_415	-3.353	-2.1	0.0363	-5.012	-3.15	0.0017
SEC021_451	0.818	1.13		1.127	1.63	
SEC121_451	1.118	1.54		1.035	1.52	
SEC221_451	1.431	2.12	0.0345	0.938	1.4	
SEC021_458	0.293	0.42		0.108	0.16	
SEC121_458	0.337	0.56		-0.046	-0.07	
SEC221_458	0.058	0.17		0.084	0.23	
SEC021_326	-0.591	-1.07		-1.186	-1.39	
SEC121_326	-0.193	-0.45		-0.096	-0.21	
SEC221_326	-0.599	-0.95		0.102	0.19	
SEC121_325	0.157	0.28		0.471	0.56	
SEC221_325	0.331	0.58		-0.427	-0.69	
		Number of o	bservations	720		

Adjusted R-square 0.4806

System-weighted R-square 0.5375

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THE EFFECT OF THE SEC'S ACCELERATED FILING DEADLINE ON EARNINGS TIMELINESS

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ABSTRACT

I examine whether the accelerated 10-K filing deadline affects earnings timeliness. The SEC's acceleration of the filing deadline of Form 10-K took effect in 2003. In proposing a new rule, the SEC asserted that the usefulness of the 10-K would increase because of the improved timeliness of the report. On the other hand, opponents claimed that the quality and accuracy of the report could be impaired. I compare timeliness of pre-acceleration period to that of post-acceleration period. Overall, my findings provide little support for the SEC's claim that the accelerated deadline would improve timeliness of periodic reports.

AUDIT QUALITY REGULATION IN AN INTERNATIONAL SETTING: TESTING THE IMPACT OF RELIGION, CULTURE, INCOME AND LEGAL CODE ON NATIONAL REGULATORY EFFORTS

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Beixin (Betsy) Lin Montclair State University

ABSTRACT

Assuring the quality of international auditing is a partial function of the strength of national auditing enforcement efforts. Several potential determinants of the strength of these efforts were postulated in Kleinman, Lin and Palmon (2014). The postulated determinants include national culture, religion, source of auditing and accounting standards, and legal code origin. The authors, however, did not test the relationship of the postulated determinants to auditing enforcement efforts. This study undertakes the task of investigating these postulated determinants, using the Brown, Preiato and Tarca (2014) measures of auditing enforcement efforts. We find that religion's importance, culture, legal code and the market and economic variables of market liquidity, foreign direct investment as a percent of GDP and financial market development were determinants of auditing enforcement efforts. The implications of these findings are presented.

ACCOUNTING CONSERVATISM AND DEBT CONTRACT RENEGOTIATION

ABSTRACT:

Yuan Ji, George Washington University Liang Tan, The George Washington University

We examine the effect of borrowing firms' accounting conservatism on debt contract renegotiations outside of default. We find that financial covenants in the debt contract are more likely to be renegotiated when borrowers' accounting is more conservative. Financial covenants are also renegotiated sooner for more conservative borrowers than less conservative ones. Furthermore, the negative association between conservatism and *ex ante* cost of debt documented in prior literature is driven by the implication of conservatism on future renegotiation. Additional analyses confirm that the impact of conservatism on renegotiations occurs in the absence of any covenant violation and is not driven by other earnings attributes. Our study demonstrates the role of conservatism in the renegotiation process and expands the debt contracting explanation for conservatism (Watts, 2003) to a broader set of states, including those that are outside of default and financial distress.

JEL Classification: G32, M41

Keywords: Accounting Conservatism; Debt Contracting; Renegotiation; Control Rights

BUDGETARY SLACK: THE INTERACTION OF ETHICS, RISK AND INFORMATION ASYMMETRY

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ABSTRACT

Participative budgeting has been widely accepted as a best practice in management planning and control for decades in US companies. Many organizations that employ participative budgeting find that performance-based pay schemes often provide incentive for the creation of budgetary slack, defined as the difference between planned performance targets and real performance capability (Douglas & Wier, 2000). Budgetary slack may also be motivated by employees' desire to mitigate the uncertainty surrounding operating goals and associated budgeting targets (Dunk, 1995).

Prior research has identified a number of factors that influence the creation of budgetary slack, the most salient of which include pay scheme (e.g., Chow, et.al., 1988; Waller, 1988), information asymmetry (e.g., Chow, et.al., 1988), risk (e.g., Dunk, 1995; Waller, 1988; Young, 1985), and personal characteristics of the participants (e.g., Stevens, 2002; Douglas & Wier, 2000). The role of ethics as a personal characteristic has gained traction in recent studies as an important influence over the budgeting process and a factor contributing to the creation of budgetary slack (Hobson, et.al., 2011; Stevens, 2002; Douglas & Weir, 2000). No prior studies have examined the combined effects of three of most important influences – opportunity, risk and ethics.

This paper extends the research on the moral content of participative budgeting by examining the interaction of ethics, risk and information asymmetry by utilizing an experimental setting. It further contributes to the literature on budgetary slack by suggesting an organizing framework which can be used to classify and understand the factors contributing to budgetary slack.

The benefits of the study to accounting research and practice is to provide a better understanding of the factors that contribute to the creation of budgetary slack, potentially enabling organizations to reduce slack and its detrimental effects on efficient resource utilization.

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AN EXPERIMENTAL INVESTIGATION OF AUDITOR PROFESSIONAL SKEPTICISM IN CLIENT EMAIL INQUIRIES

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ABSTRACT

While academic research has been conducted on auditors' ability to detect deception in face-toface client interviews, little is known about how auditors apply professional skepticism in email communication with the client. The purpose of this paper is to examine the factors that impact auditors' level of professional skepticism exercised in process of conducting client inquiries through email. A 2X3 between-subjects experiment was conducted with 12 auditors and 127 auditing students serving as surrogates for staff-level auditors. The experimental design crossed two levels of client expressed confidence (high and low) and three levels of client response timeliness to the auditor's email inquiry (earlier than expected, when expected, and later than expected). Results indicate that in the *when expected* condition, auditor professional skepticism *decreased* with increasing client confidence, which is consistent with the use of the confidence heuristic. In the *earlier than expected* response condition, auditor professional skepticism *increased* with increasing client confidence, which is indicative of a quick, confident client response activating the presumptive doubt view of professional skepticism. The study should be of interest to audit firms as it provides evidence on how auditors use nonverbal cues such as chronemics, or time-related messages, in email communication to judge audit client and evidence reliability and credibility.

IRRESPONSIBLE CORPORATE SOCIAL ACTIVITIES, STAKEHOLDERS, AND BOARD LEGAL EXPERTISE

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ABSTRACT

Motivated by the continuing controversy over the need for corporate lawyers in the post-Sarbanes-Oxley (SOX) era, we examine the causes and consequences of the appointment of directors with legal expertise in the context of irresponsible corporate social activities. First, we find that firms with more corporate social responsibility (CSR) concerns are more likely to hire directors with legal expertise to serve on the board, and the reduced firm value due to CSR concerns is mitigated after hiring lawyers for the board. Further, in response to the recent call by Moser and Martin (2012), we classify CSR concerns into two categories related to different types of stakeholders. Specifically, we classify CSR concerns as either external concerns which can do damage to external stakeholders, such as shareholders, customers, communities, and society, or internal concerns which can do damage to internal stakeholders, such as employees. We find that firms are likely to hire directors with legal expertise for CSR concerns related to external stakeholders only, since legal experts on the board only mitigate the negative effect of external CSR concerns on firm values. Collectively, our findings suggest that boards caring for shareholders' interests are motivated to maximize firm value by appointing legal experts to serve on the board in the presence of irresponsible CSR activities, and boards care about other stakeholders only when their interests are aligned with shareholders'.

WHAT ARE THE ROOT CAUSES FOR CORPORATE UNETHICAL BEHAVIOR DO COLLEGES AND UNIVERSITIES HAVE A ROLE?

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ABSTRACT

There has been an explosion of interest in ethical behavior. This attention has been the result of the continuous notoriety of the corporate, community, and educational misdeeds. As a result, this trend has called for increased organization governance and accountability (Rezaee, Elmore, and Szendi March 2001). This interest has been fueled by the wrongdoings at Enron, WorldCom, Martha Stewart, Tyco, Galleon, AIG, Citigroup, Qwest, Arthur Andersen, Adlephia, and United Way to name a few. To mitigate these activities, an effort is underway at the higher education level to incorporate "ethics" into business school curriculum (Farnsworth and Kleiner 2003). State colleges and universities are being scrutinized because they are using public funds for their curriculum. Graduate programs are being revived; however, academic credibility is being damaged. Business schools are being held accountable for much that is wrong with corporate management today (Economist, 2005). Consequently, the public, regulators, and the accounting profession want to hold these institutions accountable in light of the extensive exposure of corporate misdeeds (Swanson and Frederick Spring 2003 and Rezaee, Elmore, and Szendi March 2001). Some business schools speculate if they should also share the blame for these misfortunes (Economist, 2005; Nicklaus, November 2003; and Swanson, December 2002). The ethics coverage would ultimately lie with the individual school. Unfortunately, a student will not become instantaneously ethical with the taking of a three credit hour course. There has been a revival of business graduate programs after a somewhat weak four years (Economist, 2005). A review of the literature covering the national trend on organizational governance and accountability will be reviewed; coupled with the status of teaching business ethics in the classroom at the higher education level.

CFOs' GENDER AND REAL EARNINGS MANAGEMENT

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ABSTRACT

Using accruals as a proxy for financial reporting quality, Peni and Vahamaa (2010) and Barua, Davidson, Rama, and Thiruvadi (2010) provide evidence that female Chief Financial Officers (CFOs) are more moral than male CFOs. Using 120,179 U.S. firm-years observations from 1997-2011, I re-examine this stereotyped relationship by empirically testing the association between gender of CFOs and Real Earnings Management (REM). Although the results suggest that female executives are, on average, 2% less likely to manipulate REM, empirical evidence shows that female CFOs are 5% more likely to manipulate individual REM through excessively reducing discretionary expenses. Interestingly, the results show a significant positive association between female CFOs and REM aggregate measures and this significant association is more pronounced pre Sarbanes-Oxley Act (2002) period and among high-performing firms. One possible explanation for these results is that female CFOs signal their managerial abilities by manipulating REM, which does not subject the firm to legal litigation and artificially inflates short-term cash flows and operating performance.

Keywords: Chief Financial Officers; Gender; Real Earnings Management.
CFOs' GENDER AND REAL EARNINGS MANAGEMENT

"Behavior in organizations is, when all is said and done, adaptive".

-Rosabeth Moss Kanter (1993, 251)

INTRODUCTION

Investigating the determinants of financial reporting quality has been a critical issue in the accounting literature, particularly after the collapse of major U.S. firms such as Enron, Tyco and WorldCom. One major reason to blame for diminishing the reliability of financial reporting quality is earnings management, a managerial behavior that distorts the firm's bottom line income numbers and creates a false impression of business performance. It exists in all publicly-traded companies (Graham, Harvey and Rajgopal 2005). Recognizing who is responsible for earnings management has been debated in prior literature. For example, managers are mostly blamed for manipulating earnings (Nelson, Elliott, and Tarpley 2002) for the sake of either maximizing their bonus plans and compensations, income smoothing, avoiding reporting losses, or even for career concerns (Demers and Wang 2010). Therefore, the Sarbanes-Oxley Act of 2002 (SOX) was initiated in 2002 and mandated that Chief Financial Officers (CEOs) and CFOs of publicly-listed firms certify the truthfulness of financial statements before SEC filings.

Prior literature also suggests gender differences in risk-taking (Jianakoplos and Bernasek 1998), conservatism, diligence, ethical attitude and firm performance (Strelcova 2004). Males are consistently stereotyped in prior research as more likely to engage in riskier business decisions than their female counterparts. Proponents of gender-diversity argue that females allocate more resources to monitor the firm, have higher board attendance rates, and are more likely to hold CEOs accountable for poor financial performance (Adams and Ferreira 2009), improve the financial reporting quality (Krishnan and Parsons 2008; Srinidhi, Gul, and Tsui 2011), improve the firm's informational environment (Gul, Srinidhi, and Ng 2011) and are associated with better corporate governance (Hambrick, Werder, and Zajac 2008).

Attributing earnings management directly to a specific executive gender has been scant in the accounting literature, especially the gender of CFOs. On one hand, prior research finds evidence that female CFOs are associated with less earnings management (Peni and Vahamaa 2010) and high accrual quality (Barua et al. 2010). On the other hand, female CFOs have been facing enormous pressure to break the glass ceiling in order to reach the top of the executive ladder. A recent survey shows that only 11% of U.S. public and private corporations are female while only 4.9% of Fortune 500 companies are led by females.¹ That is largely because the business world is still controlled by males. Additionally, some female business leaders have been suffering also from paternalistic micromanagement, a situation where males place females in the leadership role, but tell females what exactly they need to do. ² Female CFOs are therefore facing "pressures" above and beyond those faced by male CFOs in order to show off their managerial abilities. For example, females are treated with double-standards in regard to behaviors. While males are allowed to occasionally break etiquette rules, females are always under scrutiny and each action counts against them. At the executive level, a female's physical appearance might even control how much she could earn and affect her ability to obtain a promotion.³ These

societal pressures altogether contributed to suppressing females from reaching the top of the managerial ladder and focusing on core duties and responsibilities.

Discretionary accruals and REM are substitute tools to manipulate earnings (Cohen and Zarowin 2010; Zang 2012). Manipulating earnings using accruals is illegal and subjects the firm to SEC penalties as well as increases litigation risk (Cohen and Zarowin 2010). Since males are more likely to be risk takers, it is not surprising that prior research documents earnings management through accruals by male CFOs. Manipulating earnings using REM is, however, different for many reasons. First, REM is not illegal and does not subject the firm to legal litigation. Second, it is indistinguishable from optimal business processes (Cohen and Zarowin 2010), artificially increases the firm's short term cash flows, and improves the firm's short-term operating performance. According to Roychowdhury (2006), REM alters business operating decisions and artificially inflates earnings by either (1) sharply reducing discretionary expenses such as R&D, Advertising, and SG&A expenses, creating abnormal negative discretionary expenses, (2) increasing production costs by increasing the number of units produced so that the cost per unit goes down and consequently the cost of goods sold, but the overall holding and productions costs will go up, creating abnormal positive production costs, and/or (3) decreasing cash flow from operations through giving excessive discounts and offering more lenient credit terms to increase the current period's sales, creating abnormal negative cash flow from operations.

The end results of REM are a higher-than-normal bottom line earnings for the current period, but significantly lower future cash flow (Gunny 2005; Taylor and Xu 2010). Therefore, my research is motivated to investigate whether female CFOs would be inclined to manage earnings using REM due to the absence of litigation risk and assumed short-term benefits to the firm that might be reflected in the performance of female CFOs. While this construct is not novel, my study builds upon the existing literature to identify whether the gender of CFOs is as stereotyped in relation to financial reporting quality. My study is also motivated by the claims that SOX 2002 has altered the way managers are manipulating earnings and are switching from manipulating accruals to REM (Cohen, Dey and Lys 2008; Zang 2012).

The empirical tests and results of my study provide empirical evidence of REM by female CFOs. In line with prior research, I first document a significant negative association between female executives, in general, and REM. Female executives, on average, are 2% less likely to manipulate REM directly. However, further analysis shows that female CFOs are 5% more likely to manipulate REM through excessively suppressing discretionary expenses. Additionally, I find evidence that the association between REM and female CFOs is more pronounced pre-SOX 2002 and among high performing firms. A possible explanation for my results is that female CFOs signal their managerial ability by manipulating REM. Alternatively, female CFOs' behavior could be situation-specific when their decision is simply not illegal.

My study contributes to prior literature on gender and earnings management in several ways. First, to the best of my knowledge my study provides the first empirical evidence on earnings management behavior through REM by female CFOs. Second, my study extends the literature on the determinants of earnings management and gender-ethics studies. Third, in addition to the methodological issues associated with discretionary accruals (McNichols 2002; Kothari, Leone and Wassley 2005), not all discretionary accruals are opportunistic behavior that expropriates shareholders' wealth and/or reduces firm value (Adut, Holder and Robin 2013).⁴ My study attempts to accurately capture the female CFOs' opportunistic behavior. Fourth, prior research

on gender differences and ethical orientation uses either *students* (e.g., Ruegger and King 1992), or *practitioners* (Weeks, Moore, McKinney, and Longenecker 1999) as a proxy for gender in the workplace, or uses *cross-culture* data (Ye, Zhang, and Rezaee 2010). Using a archival methodology and a large sample of U.S. firms, my study extends prior research by investigating whether CFOs intrinsic gender differences are associated with REM practices. Finally, prior research documents inconsistent evidence on executives' gender in relation to earnings quality. Barua et al. (2010) find evidence that accrual quality is higher for female CFOs than male CFOs, but female CEOs do not exhibit the same pattern of behavior. Ye et al. (2010) find no statistical differences between gender of executives and earnings quality in China. None of these studies provide a direct test on the likelihood of REM, as a substitute to accruals, by female CFOs. My study, then fills this gap in prior literature and attempts to resolve the documented mixed evidence.

This study is composed of six sections. Section one is an introduction. Section two discusses the literature review and hypothesis development. Section three introduces the research method. Section four discusses the empirical results. Section five concludes, and finally section six presents the discussion and directions for future research.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Proponents of gender differences in relation to business ethics argue that gender differences exist from childhood and that these gender differences are responsible for the differences between female and male behavior in the workplace in terms of interests, decisions and practices. Underlying the Gender Socialization Theory, men are placing too much weight on money, advancement, power, and tangible measures of personal performance, but women are placing too much value on helping and caring for people (Clikeman, Geiger and O'Connel 2001). Ameen, Guffey, and McMillan (1996); Weeks et al. (1999); and Shawver, Bancroft, and Sennetti (2006) use the Gender Socialization Theory and provide evidence on gender differences. For example, Ameen et al. (1996) suggest that female accounting students are less skeptical, less tolerant, and less likely to participate in unethical academic activities. Related, Shawver et al. (2006) find that female accountants are less likely to manipulate earnings.

Few studies investigate the association between executives' gender and earnings management (Clikeman et al. 2001; Krishnan and Parsons 2008; Peni and Vahamaa 2010 and Barua et al. 2010). For example, Clikeman et al. (2001) investigate whether gender across different cultures affects the students' perceptions of earnings management and find very small differences in the students' perceptions of earnings management across the U.S. and five Asian countries. Krishnan and Parsons (2008) investigate whether gender diversity among top management affects earnings quality and find that firms with more gender diversity are more profitable, have higher stock returns after the initial public offerings than those with less gender diversity.

Opponents of the Gender Socialization Theory claim that it suggests *distal* causes of gender behavior such as heredity and early socialization (Deaux and Major 1987). They claim that contextual factors (e.g., convergence of the expectations of others, work environment, and individual's goal, perceiver's expectations and self-negotiation) might affect the way a male or female behaves. For example, Dwyer, Gilkeson, and List (2002) find that women are more risk averse than men are in making mutual fund investment decisions, but these gender differences

are reduced by 50% when they control for investor knowledge of financial markets and investment. Therefore, sociological theories such as the Social Role Theory, the Self Selection Theory and the Expectation States Theory suggest that gender differences are eliminated when women and men play social roles because these social roles are standardized and therefore women demonstrate traits against their gender stereotype and instead exhibit the same traits adopted by men in the workplace. Underlying this context, prior research shows no gender differences regarding ethical behavior of males versus females (e.g., Radtke 2000; Owhoso 2002). For example, Owhoso (2002) suggests that although female auditors are more sensitive in recognizing ethical versus unethical events than their male counterparts, neither female nor male auditors are sensitive to the presence or absence of positive ethical signals when evaluating the client's likelihood of fraud risk. Likewise, Radtke (2000) finds no gender differences in relation to ethically-sensitive decisions.

Kanter (1993, 250) argues that "[p]ositions carry a particular structure of rewards....[t]he structures of rewards, in turn, channel behavior, setting people on a course which ties them further into their roles, makes them even more a product of their situations". Based on the sensitive and demanding position held by women at the highest level of the managerial ladder, I predict that female CFOs would be more likely to manipulate REM for a number of reasons. First, Chava and Purnanandam (2010) find that CEOs are more concerned about capital structure and cash flow policies, but delegate other specialized finance decisions (e.g., debt maturity and accrual management) to CFOs who have much control and influence over these decisions. Related, Geiger and North (2006) find that CFOs have significantly more control over the accounting numbers than do CEOs. Jiang, Petroni and Wang (2010) argue that CFOs have more incremental influence over earnings management than CEOs do and that the magnitude of earnings management is more sensitive to CFOs' than CEOs' equity incentives.

Dowdell and Krishnan (2004) suggest that affiliated CFOs are likely to manipulate earnings regardless of their gender. Additionally, Feng, Ge, Luo, and Shevlin (2011) document that the SEC charges, on average, 60% of CFOs with earnings management. Collectively, this evidence suggests that CFOs have more interest and access to earnings numbers than CEOs do. Unlike earnings manipulations through accruals, I would assume that REM is of specific interest to female CFOs because it directly affects short-term cash flows and liquidity without subjecting the firm to litigation (Gunny 2005; Taylor and Xu 2010).

Second, women are reportedly having difficulties in advancing their careers as well as facing inequality in pay. For example, female executives in the Standard & Poor's 500 are paid 18% less than male executives.⁵ The glass ceiling⁶ phenomenon and the pipeline problem⁷ have been cited in prior research as a key barrier to female success in climbing the corporate ladder. Therefore, female CFOs would be more concerned about showing off their managerial talents while maintaining their reputation, creating a "pressure" on female CFOs to take advantage of the "opportunity" of manipulating REM. Third, Deaux and Major (1987) argue that gender-related behavior is influenced by the expectations of perceivers and proximal causes. For example, executives use earnings management to enhance their reputation with various stakeholders, including customers, suppliers, and creditors (Bowen, Ducharme and Shores 1995). Because female CFOs need to show off their capabilities as successful CFOs and because REM does not subject the U.S. firm to regulatory oversight, it is more likely to find female CFOs manipulating REM. My expectations are in contrary to those by Barua et al. (2010) and Peni and Vahamaa (2010) who argue that female CFOs are significantly associated with conservative

financial reporting standards. That is possibly due to the use of REM in my study as an alternative tool to manipulate earnings. Based on the above discussion, I predict the following relationship in my research hypothesis:

H1: Female CFOs are more likely to manipulate REM.

RESEARCH METHOD

Data and Sample Selection

I started with 230,942 executive-years observations from ExecuComp database for 1997-2011. I removed 49,039 firm-years observations from regulated and utilities industries.⁷ I then merged ExecuComp data with 131,200 firm-years observations of REM variables obtained from Compustat database and the resulting sample is 181,903 firm-years observations. I then merged the resulting sample with a set of control variables obtained from Compustat. The final sample is composed of 120,179 executive-years observations. The sample covers a wide variety of industries. As shown in Table 1, almost 55%, 17%, 12% and 5% of my final sample is drawn from manufacturing, services, retail trade, and mineral industries respectively.

[Insert Table 1 here]

Empirical Models

Real Earnings Management

I use a cross-sectional Probit regression Maximum Likelihood model to examine the likelihood of REM by female CFOs. I first estimate the three individual measures of REM (1) the abnormal level of cash flow from operations (ACFO); (2) the abnormal level of production costs (APROD); and (3) the abnormal level of discretionary expenses (ADISC) as in Roychowdhury (2006). The abnormal levels of individual REM measures (ACFO, APROD, and ADISC) are the residuals from regression models (1), (2), and (5) respectively. I then use three aggregate measures of REM, namely, RM1, RM2 and RM3 for validation. I follow Cohen and Zarowin (2010) to calculate RM1 and RM2. According to Cohen and Zarowin (2010), RM1 is the average of the absolute value of ADISC and APROD; RM2 is the average of the absolute value of ACFO and the absolute value of ADISC. Roychowdhury (2006) and Cohen and Zarowin (2010) argue that combing the three individual measures of REM into one measure is not reliable because APROD and ACFO share similar characteristics. To create a conclusive measure of REM out of the three individual measures and avoid the overlap between APROD and ACFO, I calculate RM3 by taking the average of the sum of "the average of APROD and the absolute value of ACFO" and the absolute value of ADISC. The higher the absolute value of the three REM aggregate measures (RM1, RM2 or RM3), the more likely there is evidence of REM.

I estimate the normal level of discretionary expenses as in Roychowdhury's research (2006) by first calculating the actual discretionary expenses, which are the sum of Research and Development expenses, General Selling and Administrative Expenses. I then regress the discretionary expenses on the reciprocal lagged total assets and prior period lagged sales to estimate the normal level of discretionary expenses as follows.

$$DE_{it}/A_{it-1} = \alpha_0 + \alpha_1 (1/A_{it-1}) + \beta_1 (S_{it-1}/A_{it-1}) + \varepsilon_{it} (1)$$

Where DE_{it} is the discretionary expenses, A_{it-1} is the lagged total assets at the end of period it -1, and S it -1 is the prior period sales. The residual from equation (1) is the abnormal discretionary expenses (ADISC). Negative ADISC is an indication of REM manipulation.

To calculate ACFO, I estimate the normal level of cash flow from operations by using the cash flow from operations as the dependent variable and the reciprocal of lagged total assets, current sales, change in sales as the independent variables as shown in equation (2).

$$CFO_{it} / A_{t-1} = \alpha_0 + \alpha_1 1 / A_{it-1} + \beta_1 S_{it} / A_{it-1} + \beta_2 \Delta S_{it} / A_{it-1} + \varepsilon_{it}.$$
(2)

Where CFO_{it} is the cash flow from operation, A _{it -1} is the lagged total assets at the end of period _{it -1}, S _{it} is the sales during period, Δ St _{it} is the change in sales calculated as (s _{it} - s _{it-1}). The residual value from equation 2 is the ACFO. Negative ACFO is an indication of REM manipulation.

To calculate APROD, I estimate the actual production costs, which is the sum of cost of goods sold (equation 3) and change in inventory (equation 4) and then estimate the normal level of production costs using equation 5, the difference between the actual and estimated production costs is the APROD. I estimate the components of production costs as in equations (3) and (4) as follows:

$$COGS_{it} / A_{it-1} = \alpha_0 + \alpha_1 (1/A_{it-1}) + \beta (S_{it} / A_{it-1}) + \varepsilon_{it} (3)$$

Where $COGS_{it}$ is the cost of goods sold, A_{it-1} is the lagged total assets, S_{it} is the current period's sales. I then estimate the change in inventory as in equation (4):

$$\Delta INVT_{it} / A_{it-1} = \alpha_0 + \alpha_1 1 / A_{it-1} + \beta_1 \Delta S_{it} / A_{it-1} + \beta_2 \Delta S_{it-1} / A_{it-1} + \varepsilon_{it} (4)$$

Where \triangle INVT _{it} is the change in inventory measured as (INVT _{it} – INVT _{it} -1), A _{it} -1 is the lagged total assets at the end of period _{it} -1, \triangle St _{it} is the change in sales calculated as (s _{it} – s _{it} -1), \triangle St _{it} is change in prior period's sales calculated as follows (s _{it} – s _{it} -2). I then combine equation (3) and (4) to estimate the normal level of the production costs as follows:

$$PC_{it} / A_{t-1} = \alpha_0 + \alpha_1 1 / A_{it-1} + \beta_1 S_{it} / A_{it-1} + \beta_2 \Delta S_{it} / A_{it-1} + \beta_3 \Delta S_{it-1} + \varepsilon_t$$
(5)

Where PC it is the production costs, A it -1 is the lagged total assets at the end of period it -1, S it is the current period's sales, Δ St it is the change in sales calculated as (s it - s it-1), Δ St it-1 is change in prior period's sales. The residual from equation (5) is APROD. Positive APROD is an indication of REM.

Research Models

To test my research hypothesis, I use REM individual (APROD, ADISC, and ACFO) as well as REM aggregate measures (RM1, RM2 and RM3) as the dependent variables and gender of

CFOs (GEN*CFOs) as the independent variable of interest in addition to a set of control variables as shown below in equation 6:

 $Pr (REM_{it}=1) = F (\beta_0 + \beta_1 \text{ GEN}_{it} + \beta_2 \text{ CFOs}_{it} + \beta_3 \text{ GEN} * \text{CFOs}_{it} + \beta_4 \text{ AGE}_{it} + \beta_5 \text{ WAGE}_{it} + \beta_6 \text{ AT}_{it} + \beta_7 \text{ ABSDA}_{it} + \beta_8 \text{ BIG}_N_{it} + \beta_9 \text{ ROA}_{it} + \beta_{10} \text{ LIT}_{it} + \beta_{11} \text{ LOSS}_{it} + \beta_{12} \text{ EXTRA}_{it} + \beta_{13} \text{ FOR}_{it} + \beta_{14} \text{ REST}_{it} + \beta_{15} \text{ BUSYR}_{it} + \beta_{16} \text{ SOX}_{it} + \beta_{17} \text{ IND}_{it} + \beta_{18} \text{ FIXED}_EFFECT}_{it} + \varepsilon_{it}) \quad (6)$

Where REM is an indicator variable equals one if any of REM variables (*individual* measures "APROD it, ADISC it and ACFO it" and *aggregate* measures "RM1 it, RM2 it, and RM3 it") is above the sample median and zero otherwise. GEN it is an indicator variable equals one for female executives and zero otherwise. CFOs_{it} is an indicator variable equals 1 for CFOs and zero otherwise. Gender * CFOs_{it} is an interaction-term between GEN it and CFOs_{it}. Following prior research, I also include a list of firm-specific as well as characteristics of executives as control variables as described below:

AGE= Natural Logarithms of executives' age.

WAGE= Natural Logarithms of total wages (salary+bonus) of executives.

AT = Natural Logarithms of total assets.

ABSDA = The absolute value of discretionary accruals, estimated as in Dechow, Sloan and Sweeney (1995).

BIG_N = Indicator variable if the audit firm is Big N, zero otherwise.

ROA = Net income / lagged total assets.

LIT = Indicator variable equals 1 if the industry is in high risk-litigation according to Cohen and Zarowin (2010).

LOSS = Indicator variable if the firm reported net losses, zero otherwise.

EXTRA= Indicator variable equals 1 if the firm reports extraordinary transactions, zero otherwise.

FOR = Indicator variable equals 1 if the firm engages in foreign transactions, zero otherwise.

REST = Indicator variable equals 1 if the firm restated financial statements, zero otherwise.

BUSYR = Indicator variable equals 1 if the fiscal year-end is December, zero otherwise.

SOX = Indicator variable equals 1 if the sample period is post 2002, zero otherwise.

IND = Indicator variables to represent nine industry categories listed in Table 1.

FIXED_EFFECT = Indicator variables to represent years' sample period to proxy for fixed-year effect.

Descriptive Statistics and Univariate Analysis

The Univariate Analysis⁸ in Table 2 suggests that the means of individual REM measures in the full sample are 0.0855, 0.0352, -0.1023 for ACFO, ADISC, and APROD respectively. The mean of discretionary accruals is 0.0583. The aggregate measures of REM show the following means: 0.1161, 0.3338, and 0.2220 for RM1, RM2 and RM3 respectively. Roughly 6% of my final sample is composed of female executives. The average age of executives in the full sample is 58 years and average wages (salaries and bonuses) are \$635,100. 11% are CEOs, and 6% are CFOs. The average size of the full sample is \$523M with 92% audited by Big_N audit firms. The average ROA is 0.0314. 22% of the sample is in litigious industries, 19% are suffering losses; 25% and 61% are reporting extraordinary activities and engaging in foreign activities respectively. Almost 9% of my sample restated the financial statement and 62% are releasing the financial statement in December (busy year-end). Finally, 54% of my sample is post SOX.

Test of differences of means and medians between male and female executives in table 2 suggests that male executives, on average, manipulate earnings more than female executives do using ADISC and APROD (significant at 1%). The descriptive statistics of the median discretionary accruals (DA) suggest that male executives manipulate discretionary accruals more than females do. On average, men are also exhibiting higher means and medians RM1 and RM3. Surprisingly, the means of CFOs for females are significantly higher than male CFOs. The univaritate analysis suggests that male executives are, on average, significantly older and more highly paid than female executives. Firms that are run by male executives are, on average, significantly larger in size, more subject to litigation, more engaged in foreign activities, more complex, and releasing the financial statement in December (busy year-end) more than firms that are run by female executives. Table 2 also suggests that the percentage of female executives are higher than the percentage of male executives are by 50X 2002.

Using a 0.5 cutoff, the Pearson correlation matrix (untabulated) suggests the absence of multicollinearity among my independent variables. It shows strong positive correlations among the aggregate measures of REM, including RM3. It also shows significant negative (but weak in magnitude) correlations among REM and GEN. There are negative significant weak correlations between REM measures and AGE, WAGE, AT, ROA, and EXTRA. The correlation matrix shows significant negative correlations between GEN and CFOs. CFOs are significantly positively correlated with ROA, FOR, BUSYR, and SOX, but significantly negatively correlated with AGE, WAGE, BIG_N, LIT, LOSS, EXTRA, and REST.

[Insert Table 2 here]

EMPIRICAL RESULTS

Table 3 summarizes the results on the association between female CFOs and REM. The results of Panel A in table 3 suggest that female CFOs (CFO_GEN) are exhibiting evidence of REM through ADISC. There is a significant negative association at 1% between CFO_GEN and ADISC (β_1 =-0.1439). The marginal effect analysis suggests that female CFOs are 5% more likely to manipulate ADISC. The results in Panel B from the aggregate measures of REM's models suggest the same conclusion; female CFOs are 5% more likely to manipulate aggregate REM. The decision of female CFOs to manipulate REM is highly influenced by the probability of manipulating discretionary accruals, as suggested by the marginal effects between REM and

ABSDA. The results in this section support the research hypothesis that female CFOs are more likely to manipulate REM.

This latter result is consistent with prior research (Geiger and North 2006) that CFOs, in general, have access to accounting numbers and are motivated to manipulate earnings. It is, however, contrary to prior research that documents a significant negative association between female CFOs and discretionary accruals (Barua et al. 2010) or significant positive association between female CFOs and accrual quality (Peni and Vahamaa 2010). This is possibly due to the use of large samples and/or alternative, not illegal, measures of earnings management, such as individual and aggregate measures of REM, which are fundamentally different from manipulating earnings using discretionary accruals (Cohen and Zarowin 2010).⁹

[Insert Table 3 here]

Additional Analysis

I ran model 6 by including CEOs and gender of CEOs as additional control variables to examine the association between gender of CEOs and REM and to rule out the possibility that my results are influenced by CEOs earnings management rather than CFOs. I expect female CEOs to show evidence of REM based on my prediction that females on the highest managerial level face "pressure" to show off their managerial talents and REM is a good "opportunity" to achieve this target. I, however, expect gender of CFOs to still show evidence of REM based on the assumption that CFOs have more control over accounting numbers than do CEOs. As expected, the results in Table 4 suggest that female CFOs are 5% more likely to manipulate ADISC and still show evidence of REM using the aggregate measures.

[Insert Table 4 here]

One possible explanation for the reported results in my study is that female CFOs signal their managerial abilities by manipulating REM since it artificially increases short-term firm performance. If this explanation is true, I would expect REM behavior to be more prevalent among high-performing firms. I therefore run model 6 after splitting the sample into high and low-performing firms¹⁰ based on the ROA. The results (not tabulated) are as expected; there is empirical evidence that female CFOs in high-performing ROA firms are 8% (5%) more likely to manipulate APROD (ADISC) but only 5% more likely to manipulate ADISC among low-performing firms. The results of the aggregate measures of REM models support the same conclusion.¹¹

I further split the final sample into before and after SOX 2002 periods to rule out the possibility that managers resort to REM post-SOX 2002 (Cohen et al. 2008). For individual REM measures' models, I find evidence that female CFOs are 4% more likely to manipulate ADISC post SOX 2002, but no evidence for such manipulation exists pre-SOX 2002. The results of the aggregate measures of REM show overall consistently positive associations between the female CFOs and REM, but the significance of this association seems stronger in pre-SOX 2002 than post-SOX 2002 periods. Perhaps tightened regulations have decreased (but not eliminated) the female CFOs' tendency to manipulate REM or perhaps females became aware of the economic consequences of manipulating REM in the post-SOX 2002 period.¹³

To control for risk-taking incentives of CFOs and to test whether the results are affected by omitted-correlated variables, I re-estimate model 6 by adding leverage (LEV), MTB, and Z-

Score and the results (not tabulated) are almost identical to the results of primary tests. Therefore, I conclude that my basic models are robust to alternative model specifications.

Furthermore, to test whether the results are affected by redundant variables, I re-estimate a parsimonious model by including firm size as proxied by total assets (AT), firm performance (ROA) and firm growth (MTB) as my only control variables. The results for CFO models still suggest a significant positive association between CFO_GEN and aggregate REM variables, suggesting that female CFOs are more likely to manipulate REM.

I finally used a sub-sample of only CFOs instead of using a full sample of all executives and run model 6 without the interaction term (CFO_GEN) and CFOs variables and with REM measures as my dependent variables. The results (not tabulated) of REM models show consistent positive (non-significant) association between aggregate REM and GEN. The non-significant association could be due to the use of smaller sample.

SUMMARY AND CONCLUSION

The main purpose of my study is to investigate the association between gender of CFOs and REM. In contrary to the findings of Peni and Vahamaa (2010) and Barua et al. (2010), my study suggests that on the CFOs level, the structural approach dominates the Gender Socialization Theory. I find that female CFOs are more likely to manipulate REM through excessively reducing discretionary expenses and this association is more pronounced pre-SOX 2002 and among high-performing firms.

One possible explanation for these results is that female CFOs signal their managerial abilities by manipulation of REM because the empirical evidence suggests stronger REM among high-performing firms. Another possible explanation for my results is that CEOs might indirectly put pressure on CFOs to maximize bottom line earnings to meet or beat market expectations (Mei, Ge, Luo, and Shevlin 2011). The Glass Ceiling and the pipeline problem might also be used to explain the kind of pressure female CFOs face in the workplace. For example, Hull and Umansky (1997) argue that women have not been working long enough in the profession in order to reach out the top management team, which is referred as a pipeline problem. One way for female CFOs to show off their managerial talents is to manipulate earnings legally through REM without subjecting the firm to litigation. Taken together, female CFOs are motivated to manipulate earnings when their decisions are likely not triggering litigation and artificially enhancing short-term cash flow and performance.

DICUSSION AND FUTURE RESEARCH

To enhance our understanding of men's and women's psychology, gender differences can be explained by their surrounding social construct that includes, but does not solely rely on biological, psychological, and social experiences. My study attempts to shed some light on gender differences when it comes to using a benign – from the legal point of view – earnings management tool, which is REM.

My study is subject to limitations. For example, I could not control for the executives' behavioral characteristics such as overconfidence, managerial talent, and risk preferences, which are found to play important roles in corporate decisions (Schrand and Zechman 2012). I also

could not control for endogeneity, it is likely for boards of directors of firms with poor financial reporting quality to appoint reputable male CFOs (Habib and Hossain 2013) and since in some cases recruiting talented CFOs is hard, especially when the firm's performance is deteriorating, boards might recruit less talented female CFOs who would be more inclined to manipulate REM to show off their managerial abilities.

Future research may extend my study by examining whether the results will hold true when CFO compensation is closely tied to the value of stock and option holdings. Another avenue for future research is to examine the effect of corporate governance on the association between CFOs' gender and real earnings management. While the impact of corporate governance on earnings management is not insignificant, board interlock and social networking create a puzzling phenomenon regarding the assumed benefits of corporate governance in curbing earnings management activities. This puzzling phenomenon calls for future research to investigate the mediating effect of social ties of boards on the association between gender of CFOs and REM.

FOOTNOTES

¹Tulshyan, R. 2014. The highest-paid woman in corporate America is a CFO. Forbes Magazine. Available at: <u>http://www.forbes.com/sites/ruchikatulshyan/2014/07/24/the-highest-paid-woman-in-corporate-america-is-a-cfo/</u>

²Bryant, A. 2014. Executive women, finding (and owning) their voice. The New York Times. Available at: <u>http://www.nytimes.com/interactive/2014/11/16/business/corner-office-women-executives-owning-their-voice.html?smid=fb-</u> nytimes&smtyp=cur&bicmp=AD&bicmlukp=WT.mc_id&bicmst=1409232722000&bicmet=1419773522000

³ Marks, G. 2011. Why most women will never become CEO. Forbes Magazine. Available at: <u>http://www.forbes.com/sites/quickerbettertech/2011/10/31/why-most-women-will-never-become-ceo/2/</u>

⁴ For example, Adut et al. (2013) provide empirical evidence that predictive earnings management using managerial discretion to enhance realized cash flow reduces the firm's informational risk.

⁵http://www.bloomberg.com/news/2013-08-13/best-paid-women-in-s-p-500-settle-for-less-with-18-gender-gap.html.

⁶ The Glass Ceiling is a phenomenon known in the literature to describe a vertical job separation for female (Hull and Umansky 1997). It has been variously explained by either (1) The Person-Centered Theory which states that woman's personality traits as lacking the necessary interpersonal skills to succeed in leadership positions. (2) The Structural-Centered Theory which contends that work environment 'the practices in organizational power and control structure' favors male supremacy over female. (3) Bias-Centered Theory claims that bias is the key factor beyond the glass ceiling phenomenon. This bias is inherent in the sex-characteristics stereotypes and sex-role stereotypes.

⁷ For example, Hull and Umansky (1997) argue that women have not been working long enough in the profession in order to reach out the top management team, which is referred to as a pipeline problem.

⁸ Regulated industries are firms with SIC code between 4900-4999, financial services firms industries are firms with SIC code between 6000-6999.

⁹Using a 0.5 cutoff, the Pearson correlation matrix (not tabulated) suggests the absence of multicollinearity among my independent variables. It shows strong positive correlations among the aggregate measures of REM, including RM3.

¹⁰ I run the same regression model using the absolute value of discretionary accruals instead of the REM measures and the result shows positive non-significant association between female CFOs and the absolute value of discretionary accruals. The association between GEN and ABSDA is still negative significant at 5% significance level with a marginal effect of 1.41%.

¹¹I categorize the firm as a high ROA performing firm if its ROA is higher than the sample median ROA, otherwise the firm is categorized as a low ROA performing firm.

¹² I run the regression model using the absolute value of discretionary accruals instead of the REM for high versus low ROA samples. For high-ROA sample firms, the result shows negative non-significant association between female CFOs and the absolute value of discretionary accruals. The association between GEN and ABSDA is negative significant with a marginal effect of -2.14%. For low-ROA sample firms, the result shows positive non-significant association between female CFOs and the absolute value of discretionary accruals.

¹³ I run the same model using the absolute value of discretionary accruals instead of the REM for pre- versus post-SOX 2002 samples. For pre-SOX 2002 sample firms, the result shows negative non-significant association between female CFOs and the absolute value of discretionary accruals. The association between GEN and ABSDA is also negative non-significant. For post-SOX 2002 sample firms, the results are still showing non-significant associations between female CFOs and the absolute value of discretionary accruals and between GEN and ABSDA.

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TABLE 1SAMPLE SELECTION

Panel A: Sample Selection			# Obs.
		_	
The ExecComp Data			230,942
(-) Financial Services and utilities industries*			(49,039)
=			181,903
(-) Firms with missing REM or control variables in Compustat			(27,190)
=Final Sample			120,179
Panel B: Sample Distribution by Industry Type			
Industry	Codes	# Obs.	% Obs.
Agriculture	10	455	0.38%
Mineral	12,13	6451	5.37%
Construction	15-17	1327	1.10%
Manufacturing	20,22,24-30,32-39	65549	54.54%
Transportation, Communication, and Utilities	40,42,45,47-49	5646	4.70%
Wholesale Trade	50,51	5032	4.19%
Retail Trade	52-59	14293	11.89%
Service Industries	70,73,78,79,80,82,87	20891	17.38%
Others	>87	535	0.45%
	-	120,179	100%

*Regulated industries are firms with SIC code between 4900-4999, financial services firms industries are firms with SIC code between 6000-6999

	Full Sample n=120,179		Male <i>n</i>	Male <i>n</i> =113,349		Female <i>n</i> =6,830		Differences	
	Mean	Median	Mean	Median	Mean	Median	t-test	Wilcoxon-test	
ACFO	0.0855	0.0661	0.0856	0.0662	0.0838	0.0641	-1.10	-0.86	
ADISC	0.0352	0.0109	0.0344	0.0102	0.0482	0.0260	4.14***	4.78***	
APROD	-0.1023	-0.0812	-0.1011	-0.0798	-0.1218	-0.1060	-9.29***	-9.53***	
DA	0.0583	0.0105	0.0583	0.0106	0.0580	0.0062	-0.09	-1.41*	
RM1	0.1161	0.0749	0.1171	0.0760	0.0994	0.0995	-6.95***	-7.13***	
RM2	0.3338	0.2787	0.3338	0.2789	0.3346	0.2765	0.30	-0.04	
RM3	0.2220	0.1749	0.2224	0.1755	0.2143	0.1664	-3.64***	-3.86***	
GEN	0.0568	0.0000	-	-	-	-	-	-	
CFO	0.0639	0.0000	0.0620	0.0000	0.0947	0.0000	10.73***	10.72***	
AGE	57.5902	57.0000	57.9116	57.0000	52.2567	52.0000	-47.91***	-49.92	
WAGE	0.6351	0.4336	0.6434	0.4385	0.4968	0.3725	-12.06***	-19.46***	
AT	5.2276	1.0108	5,2496	1.0170	0.4862	0.9004	-1.44	-3.79***	
BIG_N	0.9196	1.0000	0.9187	0.9187	0.9347	1.0000	4.73***	4.73	
ROA	0.0314	0.0524	0.0312	0.0523	0.0341	0.0546	0.74	4.57***	
LIT	0.2184	0.0000	0.2205	0.0000	0.1830	0.0000	-7.28***	-7.28***	
LOSS	0.1929	0.0000	0.1927	0.0000	0.1953	0.0000	0.52	0.52	
EXTRA	0.2472	0.0000	0.2472	0.0000	0.2474	0.0000	0.05	0.05	
FOR	0.6102	1.0000	0.6128	1.0000	0.5666	1.0000	-7.60***	-7.60***	
REST	0.0856	0.0000	0.0855	0.0000	0.0862	0.0000	0.21	0.21	
BUSYR	0.6218	1.0000	0.6243	1.0000	0.5794	1.0000	-7.44***	-7.44***	
SOX	0.5366	1.0000	0.5270	1.0000	0.6955	1.0000	27.20***	27.11***	

TABLE 2UNIVARIATE ANALYSIS

Notes to table 2: ***, **, and * indicate significance levels at 1%, 5% and 10% respectively. Earnings management data are winsorized at 1% 99%.

ACFO= Estimated as in Roychowdhury (2006). It is an indicator variable that takes the value of 1 if the firms' ACFO is above the sample median, zero otherwise.

ADISC= Estimated as in Roychowdhury (2006). It is an indicator variable that takes the value of 1 if the firms' ADISC is above the sample median, zero otherwise.

APROD= Estimated as in Roychowdhury (2006). It is an indicator variable that takes the value of 1 if the firms' APROD is above the sample median, zero otherwise.

DA=Discretionary accruals, estimated as in Dechow, Sloan and Sweeney (1995).

RM1= Estimated as in Cohen and Zarowin (2010) and is equal (absolute value of ADISC+APROD)/2. It is an indicator variable equals 1 if the firms' RM1 is above the sample median, zero otherwise.

RM2= Estimated as in Cohen and Zarowin (2010) and is equal (absolute value of ACFO+ absolute value of ADISC)/2. It is an indicator variable that equals 1 if the firms' RM2 is above the sample median, zero otherwise.

RM3 = = [(APROD + absolute value of ACFO)/2] + absolute value of ADISC. It is an indicator variable that takes the value of 1 if the firms' RM3 is above the sample median, zero otherwise.

GEN=An indicator variable = 1 for female executives and 0 otherwise.

CFOs= An indicator variable = 1 for CFO and zero otherwise.

AGE= Natural Logarithms executives' age.

WAGE= Natural Logarithms of total wages (salary+bonus) of executives.

AT= Natural Logarithms of total assets.

BIG_N=An indicator variable if the audit firm is Big N, zero otherwise.

ROA= Net income / lagged total assets.

LIT= An indicator variable =1 if the industry is in high risk-litigation according to Cohen and Zarowin (2010).

LOSS=An indicator variable if the firm reported net losses, zero otherwise.

EXTRA= An indicator variable = 1 if the firm reports extraordinary transactions, zero otherwise.

FOR= An indicator variable = 1 if the firm engage in foreign transactions, zero otherwise.

REST= An indicator variable = 1 if the firm restated financial statements, zero otherwise.

BUSYR= An indicator variable = 1 if the fiscal year-end is December, zero otherwise.

SOX= An indicator variable = 1 if the sample period is post 2002, zero otherwise.

IND= Indicator variables to represent nine industry categories listed in Table 1.

FIXED_EFFECT= Indicator variables to represent fifteen years sample period to proxy for fixed-year effect.

TABLE 3

PROBIT REGRESSION OF REM MEASURES ON FEMALE CFOS

Panel A: Regression of Individual REM on Female CFOs

Parameters	Predicted Sign	Individual REM					
		APR	OD	AC	FO	ADI	SC
		Coefficient	Marginal Effect	Coefficient	Marginal Effect	Coefficient	Marginal Effect
Intercent	9	1.0353***	(/0)	1 1102***		1.0701***	(70)
CEN		0.1226***	1 52%	0.0133	0.47%	0.0826***	3 110/
GEN	т 9	0.0331**	1 22%	0.0200	0.75%	0.0301	0.76%
		-0.0331	-1.2270	0.0209	0.73%	0.0201	0.70%
CFO_GEN	-/+	0.0745	2.75%	0.0292	1.04%	-0.1439***	-5.41%
AGE	+	0.3312***	12.20%	-0.1958***	-6.99%	-0.2814***	-10.58%
WAGE	-	-0.0552***	-2.03%	0.0292***	1.04%	0.0504***	1.90%
AT	+	0.0736***	2.71%	-0.0360***	-1.29%	-0.0556***	-2.09%
ABSDA	-	-0.2643***	-9.74%	0.7750***	27.68%	-0.0440*	-1.66%
BIG_N	-	-0.0302**	-1.11%	0.0604***	2.16%	-0.0332**	-1.25%
ROA		-0.1326***	-4.89%	0.2195***	7.84%	-0.0307**	-1.15%
LIT	+	-0.5720***	-21.07%	0.4158***	14.85%	0.4867***	18.30%
LOSS	?	0.4295***	15.82%	-0.7479***	-26.71%	0.0881***	3.31%
EXTRA	+	0.1492***	5.50%	-0.2182***	-7.79%	-0.0907***	-3.41%
FOR	+	-0.0785***	-2.89%	0.0569***	2.03%	-0.0349***	-1.31%
REST	+	-0.0422***	-1.56%	0.0161	0.58%	0.1074***	4.04%
BUSYR	+	0.0463***	1.71%	0.0601***	2.15%	-0.0229***	-0.86%
SOX		0.1310***	4.83%	-0.0761***	-2.72%	0.2762***	10.39%
IND		Included		Included		Included	
FIXED-EFFECT		Included		Included		Included	
#OBS.		120,179		120,179		120,179	
Likelihood Ratio χ^2		11,875		16,531		8,800	
Pseudo R-Square		0.10		0.13		0.07	

Panel B: Regression of Aggregate REM on Female CFOs

Parameters	Predicted Sign	Aggregate REM						
		RM1		RM	42	RM	RM3	
		Coefficient	Marginal Effect (%)	Coefficient	Marginal Effect (%)	Coefficient	Marginal Effect (%)	
Intercept	?	-0.0289		1.6557***		1.0912***		
GEN	+	-0.0753***	-2.84%	-0.0007	-0.02%	-0.0478***	-1.69%	
CFO	?	-0.0380**	-1.43%	0.0066	0.22%	-0.0203	-0.72%	
CFO_GEN	-/+	0.1316**	4.97%	0.0137	0.46%	0.1139**	4.02%	
AGE	+	0.1107***	4.18%	-0.2307***	-7.71%	-0.1120***	-3.96%	
WAGE	-	-0.0107**	-0.41%	0.0447***	1.49%	0.0250***	0.88%	
AT	+	-0.0342***	-1.29%	-0.1133***	-3.79%	-0.0838***	-2.96%	

Panel B: Regression of Aggregate REM on Female CFO (Continued)

Parameters	Predicted		Aggregate REM							
	Sign	RM	/11	RN	M2	RI	M3			
		Coefficient	Marginal Effect (%)	Coefficient	Marginal Effect (%)	Coefficient	Marginal Effect (%)			
ABSDA	-	1.2812***	48.37%	2.2680***	75.81%	2.1092***	74.48%			
BIG_N	-	0.0078	0.29%	-0.0081	-0.27%	-0.0013	-0.05%			
ROA		-0.1392***	-5.25%	0.2113***	7.06%	-0.0293*	-1.03%			
LIT	+	0.0246**	0.93%	0.5848***	19.55%	0.3376***	11.92%			
LOSS	?	0.3066***	11.58%	-0.2423***	-8.10%	-0.012	-0.42%			
EXTRA	+	0.0549***	2.07%	-0.1285***	-4.30%	-0.0173*	-0.61%			
FOR	+	0.0038	0.14%	0.0972***	3.25%	0.0655***	2.31%			
REST	+	0.0830***	3.14%	0.0767***	2.56%	0.1079***	3.81%			
BUSYR	+	-0.0258***	-0.97%	-0.0443***	-1.48%	-0.0315***	-1.11%			
SOX		0.1795***	6.78%	-0.0396*	-1.33%	-0.0274	-0.97%			
IND		Included		Included		Included				
FIXED-		Included		Included		Included				

EFFECT			
#OBS.	120,179	120,179	120,179
Likelihood Ratio χ ²	8,321	25,607	17,968
Pseudo R- Square	0.07	0.21	0.15

Notes to table 3: ***, **, and * indicate significance levels at 1%, 5% and 10% respectively. The dependent variables in panel A are individual REM (APROD, ACFO and ADISC), in panel B are aggregate REM (RM1, RM2 and RM3). REM is an indicator variable = 1 if any of the REM measure is above the sample median, 0 otherwise. CFOs is an indicator variable equals I for CFOs, 0 otherwise. The independent variable of interest is gender of CFOs (CFO_GEN), it is an indicator variable equals 1 for female CFOs, 0 otherwise. The control variables are defined below.

AGE= Natural Logarithms of executives' age.

WAGE= Natural Logarithms of total wages (salary+bonus) of executives.

AT = Natural Logarithms of total assets.

ABSDA = The absolute value of discretionary accruals, estimated as in Dechow, Sloan and Sweeney (1995).

BIG_N = Indicator variable if the audit firm is Big N, zero otherwise.

ROA = Net income / lagged total assets.

LIT = Indicator variable equals 1 if the industry is in high risk-litigation according to Cohen and Zarowin (2010).

LOSS = Indicator variable if the firm reported net losses, zero otherwise.

EXTRA= Indicator variable equals 1 if the firm reports extraordinary transactions, zero otherwise.

FOR = Indicator variable equals 1 if the firm engage in foreign transactions, zero otherwise.

REST = Indicator variable equals 1 if the firm restated financial statements, zero otherwise.

BUSYR = Indicator variable equals 1 if the fiscal year-end is December, zero otherwise.

SOX = Indicator variable equals 1 if the sample period is post 2002, zero otherwise.

IND = Indicator variables to represent nine industry categories listed in Table 1.

FIXED_EFFECT = Indicator variables to represent years' sample period to proxy for fixed-year effect.

TABLE 4

PROBIT REGRESSION OF REM MEASURES ON FEMALE CFOS & CEOS

Panel A: Regression of Individual REM on Female CFOs & CEOs

Parameters	Predicted Sign	Individual REM					
		APR	OD	ACFO		ADISC	
			Marginal Effect		Marginal Effect		Marginal Effect
		Coefficient	(%)	Coefficient	(%)	Coefficient	(%)
Intercept	?	-1.0383***		1.1103***		1.1541***	
GEN	+	-0.1354***	-4.99%	0.0262	0.94%	0.0833***	3.13%
CFO	?	-0.0293*	-1.08%	0.0241	0.86%	0.0121	0.46%
CFO_GEN	-/+	0.0864	3.18%	0.0155	0.55%	-0.1519***	-5.71%
СЕО	+	0.0228*	0.84%	0.0199	0.71%	-0.0489***	-1.84%
CEO_GEN	-/+	0.1892***	6.97%	-01599**	-5.71%	-0.0376	-1.41%
CONTROL VARIABLES		Included		Included		Included	
IND		Included		Included		Included	
FIXED-EFFECT		Included		Included		Included	
#OBS.		120,179		120,179		120,179	
Likelihood Ratio χ^2		11,889		16,538		8,816	
Pseudo R-Square		0.10		0.13		0.07	

Panel B: Regression of Aggregate REM on Female CFOs & CEOs

Parameters	Predicted Sign		Aggregate REM					
		RN	Л1	RM	M2	RM	M 3	
		Coefficient	Marginal Effect (%)	Coefficient	Marginal Effect (%)	Coefficient	Marginal Effect (%)	
Intercept	?	-0.0218		1.6702***		1.1020***		
GEN	+	-0.0796***	-3.00%	-0.0005	-0.02%	-0.0444**	-1.57%	
CFO	?	-0.0406**	-1.53%	0.0001	0%	-0.0259	-0.92%	
CFO_GEN	-	0.1344**	5.07%	0.0134	0.45%	0.1124**	3.97%	

СЕО	+	-0.0178	67%	-0.0412***	-1.38%	-0.0359***	-1.27%
CEO_GEN	-	0.0459	1.73%	-0.0337	-1.13%	-0.0777	-2.74%
CONTROL VARIABLES		Included		Included		Included	
IND		Included		Included		Included	
FIXED- EFFECT		Included		Included		Included	
#OBS.		120,179		120,179		120,179	
Likelihood Ratio χ²		8,323		25,618		17,978	
Pseudo R-Square		0.07		0.21		0.15	

Notes to table 4: ***, **, and * indicate significance levels at 1%, 5% and 10% respectively. The dependent variables in panel A are individual (APROD, ACFO and ADISC) in panel B are aggregate REM (RM1, RM2 and RM3). REM is an indicator variable = 1 if any of the REM measure is above the sample median, 0 otherwise. CFO is an indicator variable equals I for CFOs, 0 otherwise. The independent variable of interest is gender of CFOs (CFO_GEN), it is an indicator variable equals 1 for female CFOs, 0 otherwise. CEO is an indicator variable equals I for CEOs, 0 otherwise. The independent variable of interest is gender of CFOs, 0 otherwise. The independent variable of interest is gender of CFOs, 0 otherwise. The independent variable of interest is gender of CEOs, 0 otherwise. The independent variable of interest is gender of CEOs, 0 otherwise. The independent variable of interest is gender of CEOs, 0 otherwise. The independent variable of interest is gender of CEOs, 0 otherwise. The independent variable of interest is gender of CEOs, 0 otherwise.

CONTROL VARIABLES = are the same controls listed in table 3.

IND = Indicator variables to represent nine industry categories listed in Table 1.

FIXED_EFFECT = Indicator variables to represent years' sample period to proxy for fixed-year effect.

A SPLIT IS CREATED AS THE TENTH CIRCUIT RULES THE 23 DAY NOTICE REQUIREMENT FOR THIRD-PARTY SUMMONS IS MANDATORY UNDER SECTION 7609 OF THE INTERNAL REVENUE CODE

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ABSTRACT

In Jewell v United States of America, 749 F.3d 1295, the Tenth Circuit Court of Appeals recently ruled that the Internal Revenue Service could not obtain an order enforcing the third-party summonses at issue because the 23- day notice requirement in Section 7609 of the Internal Revenue Code was mandatory and an "administrative step", and the Internal Revenue Service admittedly violated the tax code by failing to give the taxpayer 23 days' notice. The Internal Revenue Service issued four summonses to banks in the Eastern and Western Districts of Oklahoma for records involving nursing homes owned by Mr. Sam Jewell. Under federal law, the Internal Revenue Service was required to notify Mr. Jewell at least 23 days before the examination date. The Internal Revenue Service failed to timely provide notice to Mr. Jewell, and he filed petitions to quash the summonses in the district courts for the Eastern and Western Districts of Oklahoma. The Eastern District granted Mr. Jewell's motion to quash, while the Western District denied it. The decision of the Tenth Circuit Court of Appeals creates a split, ruling that the U.S. Supreme Court's decision in United States v. Powell, 379 U.S. 48 (1964), required it to rule in favor of Mr. Jewell because the plain language of 26 U.S.C. § 7609(a) (1) mandated 23 days' notice by the Internal Revenue Service prior to enforcing its summonses. The ruling of the Eastern District of Oklahoma was affirmed and the ruling of the Western District was reversed.

INTRODUCTION

While it is recognized that the U.S. federal income tax system is based upon self-assessment by taxpayers, the Internal Revenue Service is given certain authority in the Internal Revenue Code of 1986, as amended (Code) to oversee the collection of the tax revenues necessary for the government to function and the appropriate enforcement of the Code. The Internal Revenue Service is authorized, by statute to examine any relevant documentation and summons any person in possession of any relevant information documentation when conducting an investigation. To achieve this goal, the Internal Revenue Service may serve a summons upon a third party. However, to prevent an abuse of discretion, certain procedures are in place to protect the rights of

taxpayers. Controversies sometimes arise when taxpayers assert that the Internal Revenue Service did not adhere to mandated procedures. The case of *Jewell v United States*, 749 F.3d 1295, created a circuit split based on the assertion of a taxpayer's alleged late receipt of a third party summons.

STATUTORY OVERVIEW

The IRS is authorized by statute, Code § 7602 in particular, to examine any relevant documentation and summon any person in possession of any relevant documentation when conducting a tax investigation.

Specifically, Code § 7602(a) addresses the authority to summons. It provides in pertinent part... For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary is authorized—

7602(a)(1)

To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

7602(a)(2)

To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry....

To achieve its goal, the IRS may serve a summons upon a third party record such as a bank or other financial institution. In Code Section 7609, the Internal Revenue Service lists special procedures for the IRS's summonses to third parties.

Code§ 7609 provides in relevant part, If any summons to which this section applies requires the giving of testimony on or relating to, the production of any portion of records made or kept on or relating to, ..., any person (other than the person summoned) who is identified in the summons, then notice of the summons shall be given to any person so identified within 3 days of the day on which such service is made, but no later than the 23rd day before the day fixed in the summons as the day upon which such records are to be examined.

Though the statute creates an obligation, the obligation must be examined to be classified as an administrative step under the landmark case of *United States v. Powell*, 379 U.S. 48, 57-58 (1964). In *Powell*, the Supreme Court listed four requirements for the IRS to make a prima facie case for enforcement of an administrative summons. The IRS must establish: (1) that there is a *legitimate purpose* for the investigation pursuant to which the summons is being sought, (2) that the inquiry or the materials sought may be relevant to that purpose, (3) that the information

sought is not already within the Commissioner's possession, and (4) that the administrative steps required by the Code have been followed.

JEWELL V UNITED STATES OF AMERICA

Facts

The facts in Jewell are not overly complex. Mr. Sam Jewell was being investigated by the Internal Revenue Service for allegedly failing to pay employment taxes for Legacy Convalescent Care Management LLC ("Legacy") for the first and second quarters of 2010. As part of that proceeding, the Internal Revenue Service, through its Revenue Officer, issued four summonses to banks in the Eastern and Western Districts of Oklahoma for records involving nursing homes owned by Mr. Jewell. Under federal law, the Internal Revenue Service was required to notify Mr. Jewell at least 23 days before the examination date. Because the Internal Revenue Service waited to mail the notices to Mr. Jewell, he received the notices less than 23 days before the records were to be examined. Mr. Jewell filed petitions to squash the summonses in the Eastern and Western Districts of Oklahoma alleging inadequate notice.

Lower Courts' Holdings and Analysis

The Eastern District of Oklahoma

The Eastern District of Oklahoma granted Mr. Jewell's petition to squash the IRS's Third-Party Summonses. Mr. Jewell's primary contention was that the summonses should be squashed because the IRS failed to provide the adequate notice required by Code § 7609. The Court ruled that the undisputed facts established that Mr. Jewell did not receive the notice of the summonses until October 5, 2012, only 18 days before the examination Legacy's records. The affidavit of the Revenue Officer conceded that the IRS did not comply with the notice requirement of Code §7609. The IRS has the burden of demonstrating that the IRS has completed all of "the administrative steps required by the Internal Revenue Code." The IRS argued that the failure to provide Mr. Jewell with the statutorily required notice does not mandate that the summonses be quashed. Citing Cook v United States, 104 F.3d 886 (6th Cir. 1997), the IRS contends that its failure to comply with the 23 day requirement constituted a "technical breach" absent a showing by Jewell the he suffered actual prejudice as a result of the untimely notice. The Court opined that it was not bound by the Cook decision and that the parties could not cite, nor could the Court locate, any on-point decisions originating in the United States Court of Appeals for the Tenth Circuit addressing this issue. The Court found that the plain language of §7609 mandates that if the IRS fails to provide a taxpayer with notice that the summonses have been issued to a thirdparty at least 23 days before the date specified on the summons for the production of records, then the summons must be quashed. The government appealed to the Tenth Circuit Court of Appeals.

The Western District of Oklahoma

The Western District of Oklahoma **denied** Mr. Jewell's petition to squash the IRS's Third-Party Summonses. The parties agreed that whether or not the summons should be quashed is governed by United States v Powell, 379 U.S. 48 (1964). In this case, the parties' dispute revolved around two of the four elements. First, Mr. Jewell argued that the summonses requested records which were already in the possession of Respondent. According to Mr. Jewell, on March 21, 2012, two administrative summonses were issued to BancFirst seeking the exact same documentation on

March 21, 2012 .Although the summonses were withdrawn because they were not properly issued, the documents were submitted to the IRS. The Revenue Agent then forwarded the unopened documents from the bank directly to Mr. Jewell's counsel. Mr. Jewell's counsel argued that he then produced all of the documentation received from the bank to the Revenue Officer on April 27, 2012. Mr. Jewell argued that any additional information could not be produced because it did not exist. However, the Court held that the summonses at issue requested information broader in scope than the previously forwarded records. Mr. Jewell's first challenge was found to be without merit.

Mr. Jewell's second challenge concerned the procedural correctness of the summonses. He received notice of the summonses on October 4, 2012 and the summonses commanded production on October 22, 2012. Mr. Jewell argued that the summonses were procedurally defective and should be quashed because 23 days' notice was required under Code § 7609.

The Court looked to the fifth circuit which set forth the standards to view the Internal Revenue Service's failure to satisfy the timeliness requirement. Quoting the fifth circuit, the court opined, "We, too, decline to elevate form over substance and reject the suggestion that every infringement of a requirement of the Internal Revenue Code absolutely precludes enforcement of an Internal Revenue Service summons. Nothing in the language of the Code itself mandates this sanction for infringement. The correct approach for determining whether to enforce a summons requires the court to evaluate the seriousness of the violation under all the circumstances, including the government's good faith and the degree of harm imposed by the unlawful conduct." United States v. Bank of Moulton, 614 F.2d 1063, 1066 (5th Cir. 1980).

The Western District noted, "While Mr. Jewell is correct that the Internal Revenue Service did not timely serve the summonses, the simple fact remains that Mr. Jewell received notice of the summonses in time to file the present Petition to Quash, and have his concerns regarding the sufficiency of the summonses fully considered by this Court. After that consideration, the Court finds that there are no grounds to quash the summonses, as they were properly issued. Therefore, that Internal Revenue Service may have made a three-day error is not grounds to quash the summonses." Mr. Jewell appealed to the Tenth Circuit Court of Appeals.

Tenth Circuit

The Tenth Circuit Court of Appeals held that the Internal Revenue Service failed to give adequate notice to a taxpayer named in a third-party summons, ordering two lower courts to grant the Mr. Jewell's petition to quash the summonses and creating a split in the federal circuit courts. The Eastern and Western Districts of Oklahoma disagreed on whether the Internal Revenue Service gave proper notice to the taxpayer, but the Tenth Circuit ruled that the Internal Revenue Service had not given proper notice.

The Supreme Court, in U.S. v. Powell, 379 U.S. 48 (1964) outlined the four requirements the Internal Revenue Service must follow to make a case for enforcement of an administrative summons:

- 1. The investigation must be conducted for a legitimate purpose.
- 2. The summons must be relevant to that purpose.

- 3. The IRS must not already have the information sought.
- 4. The IRS must have followed "administrative steps" required by the tax code.

Mr. Jewell and the Internal Revenue Service agreed that only the fourth prong of the test was at issue; whether the Internal Revenue Service followed the fourth factor of the *Powell* analysis pertaining to the "administrative steps" required by the tax code. The Tenth Circuit began its analysis by considering whether the Internal Revenue Service complied with Code § 7609 which statutorily requires that the taxpayer receive 23 days' notice before the examination. The Tenth Circuit looked at the plain language of the statute which provides that the notice of the summons "shall" be given within 23 days before the date of the examination.

The court decided the meaning of the term "shall" indicates a mandatory intent. The Tenth Circuit noted, "This term indicates a mandatory intent. *United States v. Myers*, 106 F.3d 936, 941 (10th Cir. 1997) ("It is a basic canon of statutory construction that use of the word 'shall' indicates a mandatory intent."); *Forest Guardians v. Babbitt*, 174 F.3d 1179, 1187 (10th Cir. 1999) ("The Supreme Court and this circuit have made clear that when a statute uses the word 'shall,' Congress has imposed a mandatory duty upon the subject of the command.")."

The Internal Revenue Service argued that "shall" does not *always* signify a mandatory intent, relying on *Barnhart v. Peabody Coal Co.*, 537 U.S. 149 (2003), and *Dolan v. United States*, 560 U.S. 605 (2010). However, the court was not convinced with the government's reliance on the two separate cases and concluded that age-old percept that "shall" means "shall."

The Tenth Circuit reasoned that Code § 7609(a) (1) says the Internal Revenue Service "shall" give adequate notice, and that "shall" indicates a "mandatory intent." The court rejected the Internal Revenue Service's arguments that in some cases, "shall" does not signal mandatory intent, holding that in this case, the Internal Revenue Service was not obligated to issue the summons, but chose to.

Having found that the 23-day requirement is a mandatory obligation, the court next considered whether that obligation involves an "administrative step" under *Powell*. The court noted that the Supreme Court did not define the term "administrative step." The court again began with the plain meaning of the word looking at a leading dictionary for a meaning and looked at the government's understanding of the term. The court noted. The term is broad, defined in one leading dictionary as "pertaining to, or dealing with, the conduct or management of affairs." I The Oxford English Dictionary 163 (2d ed. 1989). The court pointed out that the Internal Revenue Service acknowledged that the 23-day notice provision is "a procedural requirement for the issuance of an administrative summons." Appellee Br. (W.D. Okla. appeal) at 39. The court decided that the requirement was not only "procedural," but also "administrative." The Internal Revenue Service characterized the notice defect as a mere "technical defect. The court found the characterization as immaterial even if the term was accurate.

Having determined that the 23-day notice requirement was mandatory and an "administrative step," the Tenth Circuit applied the Supreme Court's opinion in *Powell*. In that case, the Supreme Court held that the Internal Revenue Service cannot make a prima facie case for enforcement of a summons until it shows it complied with the Code's administrative steps. According to the Tenth

Circuit, these steps included the 23-day notice requirement and the IRS admitted that it did not give Mr. Jewell 23 days' notice. The Tenth Circuit concluded that, under Powell, that failure prevented the IRS from making a prima facie showing for enforcement of the summonses. Thus, Powell prevented enforcement of the summonses.

The court acknowledged that five other circuit courts (the First, Second, Fifth, Sixth and Eleventh Circuits) have declined to apply Powell in the same manner. The court stated, "We are mindful of the fact that five other circuit courts have declined to apply Powell in this manner. Adamowicz v. United States, 531 F.3d 151, 161 (2d Cir. 2008) (per curiam); Cook v. United States, 104 F.3d 886, 889-90 (6th Cir. 1997); Sylvestre v. United States, 978 F.2d 25, 28 (1st Cir. 1992) (per curiam); United States v. Bank of Moulton, 614 F.2d 1063, 1066 (5th Cir. 1980) (per curiam); Azis v. U.S. IRS, 522 F.App'x 770, 777 (11th Cir. 2013) (per curiam)." The court discussed the approaches taken in the different circuits noting that four of the circuits acknowledged Powell, but declined to enforce the 23-day requirement as mandatory. Two different approaches were taken by four circuits. According to the Tenth Circuit, one approach (taken by the First Circuit) was to acknowledge that Powell requires the IRS to comply with all of the required administrative steps, but then to ignore the fact that the 23-day notice is one of the administrative steps required in the Code. A second approach (taken by the Second, Sixth, and Eleventh Circuits) was to assume that the courts have equitable power to excuse the notice defect if the taxpayer was not prejudiced. The Tenth Circuit observed that none of these courts denied that the 23-day requirement was mandatory or an administrative step under the Code. The Fifth Circuit declined to apply Powell when the IRS violated a separate notice provision. Though the IRS violated the notice requirement, the Fifth Circuit allowed enforcement of the summons to avoid elevating "form over substance."

The Tenth Circuit opined, "The Supreme Court's decision in Powell is clear, in that "if the IRS does not comply with the administrative requirements of the Internal Revenue Code, its summons are unenforceable." The Tenth Circuit admitted some hesitation in creating a circuit split, but felt obliged to follow Supreme Court precedent, even when it might be viewed as "inequitable" or as "form over substance."

The dissent specifically noted that Section 7609 does not specify the penalty if the IRS does not meet the 23-day notice requirement. It specifically disagreed with the severity of the penalty, especially when the recipient was not prejudiced. However, the Internal Revenue Service rarely takes a "no harm no foul" approach if a taxpayer fails to meet an administrative requirement.

CONCLUSION

Although the U.S. federal income tax system is based upon self-assessment by taxpayers, the IRS is given summons authority in the Code to ensure the proper enforcement of the Code. At times, tension between the authority of the Internal Revenue Service and the rights of taxpayers lead to controversy. Given the importance of third party summons, this case will have widespread implications and quite possibly lead to the Supreme Court for final resolution.

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GOODWILL ACCOUNTING BY PHARMACEUTICAL COMPANIES: ASSESSING REPORTING INFORMEDNESS AND VALUE RELEVANCE AFTER SFAS 142

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ABSTRACT

Companies in the pharmaceutical sector add value for owners and grow in somewhat unique ways. In addition to volume and product-price increments, the largest companies in this industry have a penchant for acquiring other firms, buying product lines, and purchasing in-process research and development. Non-organic growth through acquisition often is manifested on drug company balance sheets through large goodwill valuations.

When the Financial Accounting Standards Board (FASB) proposed movement away from the commonly used pooling of interest accounting for business combinations and the arbitrary 40-year amortization of goodwill, the promise was that financial reporting would improve and that better decision-relevant information would be generated. Having a sizeable number of homogeneous companies in a single high-tech type industry provides a special opportunity to assess whether—15 years after implementation—Statement of Financial Accounting Standards (SFAS) 142 has brought about outcomes that validate the initial claim made by the FASB. By observing the goodwill amortization and impairment charges in the pre- and post-SFAS 142 periods, an assessment can be made regarding informedness and the value relevance of the financial accounting/reporting.

Typically, empirical researchers have used unexpected price changes as a measure of the information content in public disclosures. Certainly, the SFAS 142 change from pro-rata absorption of the goodwill intangible asset to abrupt impairment write-off after negative valuation determination would seem to be an excellent case to test whether accounting model alteration was a step forward in the provision of decision-relevant data. The current research project intends to make that determination by developing a partially revealing rational expectations model of stock price behavior for all the nearly 400 publically traded firms in SIC 2834—Pharmaceutical Preparations.

This research has practical usefulness. In an era when fair value determination is important to statement users, knowing whether the accounting treatment for an inherently difficult to judge asset like goodwill is of assistance will be valuable. The outcome of this empirical project should help regulators understand the consequences of their rule-making processes.

THE EFFECT OF THE STRATEGY MAP ON THE FLOW OF LOWER-LEVEL EMPLOYEE FEEDBACK TO UPPER MANAGEMENT

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Abstract

Feedback from lower-level employees can provide upper management with information that is important for the review of the firm's strategy. Prior accounting research has not directly examined the flow of feedback regarding firm strategy from lower-level employees to upper management but has provided evidence that a strategy map can improve middle managers' judgments about the relevance of external information to the firm's strategy. In my experimental study, participants act as middle managers who receive feedback from lower-level employees that is relevant to the review of the firm's current strategy and must decide whether to pass this feedback along to upper management. I find that middle managers are less likely to report this feedback to upper management when the feedback is incompatible with the firm's current strategy. This effect is mediated by middle managers' cognitive dissonance and their efforts at impression management. Consistent with prior research, I find evidence that when middle managers are provided with a strategy map—as compared to a non-causal list of the same strategic objectives-cognitive dissonance does not affect the likelihood that middle managers' will report feedback from lower-level employees to upper management. However, this mitigating effect is limited to a setting in which the cost of reporting the information is low. In that low-cost setting, I also find that providing a strategy map to middle managers decreases the likelihood that middle managers' will report feedback from lower-level employees to upper management.

THE MULTIPLE ROLES OF GENERALIST ON INTERNAL AND EXTERNAL GOVERNANCE MECHANISMS

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Abstract

Most governance literature investigate the effects of corporate governance mechanisms on firm outcomes, but neglects which influence variations in the effectiveness of corporate governance mechanisms. This study examines how CEO general human capital affects internal corporate governance (monitoring) and external corporate governance (institutional investors) across firms by developing an human capital approach. Our findings provide that CEO general human capital has a significant effect on corporate governance mechanism even after controlling for CEO characteristics and firms characteristics. Further, we show that generalist CEOs with strong general human capital moderate relations between the status of corporate governance and cash compensations schemes. These results can be helpful to regulators' decision for governance rules and useful to shareholders that CEO managerial general human capital with his or her bargaining power influence on internal and external corporate governance regardless of governance regulations. Therefore, our findings advance the academic understanding of managerial general human capital effect with bargaining power as well as provide practical implications to regulations.

Keywords: Generalists; Board; Institutional investors; Cash Compensation; Governance

APPLICATION OF INTEGRATIVE LEARNING TO INTRODUCTORY MANAGERIAL ACCOUNTING

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ABSTRACT

This paper presents a project that applies the integrative learning approach to the introductory managerial accounting course. The Association of American Colleges & Universities (AACU) considers integrative learning as essential to prepare students to deal with complex issues and a key benchmark of a quality undergraduate education today. To help students build the connection between managerial accounting and their personal experience and activate their tacit knowledge, we design a personal finance project that is introduced to students at the beginning of the semester. Students are required to prepare a personal budget, capture and categorize expenses, analyze variances between their actual spending and the budget, and prepare an income statement and a net worth statement using Excel templates. They are also required to answer a few related open-ended questions. This project helps students understand how their different experiences fit together and promote better understanding of conceptual subtlety. It also promotes financial literacy, which was found largely lacking in young adults (NFCC 2013).
FACTORS ASSOCIATED WITH STUDENT PERFORMANCE IN UPPER LEVEL UNDERGRADUATE ACCOUNTING COURSES: AN EMPIRICAL COMPARATIVE STUDY AT COMMUTER AND RESIDENTIAL SCHOOLS

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ABSTRACT

This paper studies the possible associations between some motivation, distraction, and other factors and student performance in Advanced Accounting, Auditing, and Senior Seminar in Accounting at a commuter and a residential school. Of the three motivation factors, the grade the student intends to earn had strong association with student performance, however defined, at the residential school but only when performance is defined as "grade" at the commuter school. Intention to take the CPA exam had strong association with student performance, however defined, at both schools. Intention to attend graduate school had strong association with student performance but only when it is defined as "points" and only at the commuter school. Self-perceived writing and math abilities had no associations with student performance at either school. Self-perceived reading abilities had moderate to weak associations with student performance at the residential school but strong *negative* associations with student performance at the commuter school. Self-perceived listening abilities had moderate to strong associations with student performance at both schools. GPA is a strong predictor of student performance at both schools. Intermediate Accounting II grade is a strong predictor of student performance, however defined, at the residential school but only when it is defined as "grade" at the commuter school. Surprisingly, work hours, job type, and course loads have no significant *negative* effects on student performance. Actually, there is strong evidence that higher course loads had *positive* effects on student performance at the residential school.

The Economic Growth in Peru and the Economic Struggles of Zimbabwe

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Abstract

The Economic Growth in Peru and the Economic Struggles of Zimbabwe

Peru has experienced the highest economic growth in Latin America as measured by the Gross Domestic Product (GDP) during the last decade. The Peruvian economy struggled in the 1980's and the 1990's because of inflationary pressures and a lack of a consistent economic strategy. "Over the period 2002 - 2012, the Peruvian economy almost doubled in size" (Vera, M. and Wong, Y., 2/22/2013). The economy of Zimbabwe has struggled and has not experienced the growth identified in Peru. "Zimbabwe's economy remains in a fragile state, with an unsustainably high external debt and massive deindustrialisation and informalisation" (Zimbabwe Economic Outlook, 8/12/2014).

This paper will analyze the changes of the gross domestic product (GDP) of the Peruvian economy compared to the changes of the gross domestic product of the Zimbabwe economy. One of the authors visited Peru in May of 2013 and the other author was in Zimbabwe during the summer of 2014.

The micro-lending (microfinance), domestic investment strategies and infrastructure (large loans and financing capabilities) financing will be compared in these two countries. Peru is considered a developing economy with a limited global presence but with an economic growth of 9 percent in 2007 (the largest growth rate in the world) whereas Zimbabwe is also a developing economy but experienced a negative growth rate of 14 percent in 2008.

Key words: globalization, Zimbabwe economy, Peruvian economy, Micro-lending

An Exploration of Accounting Grading Practices in the USA

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ABSTRACT

Despite the difference of opinion in relation to influence of grades on assurance of learning, grades are commonly used to measure student learning of a course activities. One of the key concerns of using letter grading as an assessment tool is the consistency of grading practice across different contexts. The aim of this paper is to explore factors at both macro and micro levels that may affect grading practices in accounting education. This study surveys accounting instructors to explore factors that potentially relate to difference in grading practices in the USA. This study finds that significant differences in grading practice exist among different regions, course types, academic titles, tenured status, type of degree programs, years of teaching, and teaching and research quality of accounting programs. Gender and faculty education are not significant contributing factors of different grading practice.

COST OF DEBT AND AUDITOR CHOICE

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ABSTRACT

This paper examines whether auditor choice affects a firm's cost of debt. It further examines whether the source of debt matters in the relation. We find that the choice of a brand name or industry specialist auditor decreases a firm's cost of debt in general. However, the additional impact of industry specialization is not significant when we analyze the relation using a subsample of Big N audited firm-years. For the sub-sample of non-Big N audited firm-years, engaging an industry specialist auditor appears to increase cost of debt. A further breakdown of the full sample into a sample with both public and private debt and a sample with only private debt provides more insight. For the sample with both public and private debt, engaging a brand name and specialist auditor decreases cost of debt. The result holds for industry specialization when a sub-sample of Big N audited firm-years is used. But for the sample with only private debt, engaging a specialist auditor increases cost of debt for both Big N audited firms and non-Big N audited firms. Our findings contribute to the literature in three ways. First, we provide additional evidence for the role of external auditing in reducing cost of debt with a more comprehensive dataset. Secondly, we show differences between brand name reputation and industry specialization. Thirdly, our results indicate the choice of an industry specialist auditor has different impact on cost of debt for firms that have only private debt and firms that also have public debt.

AUDIT FIRM ROTATION VS. PARTNER ROTATION WHICH ROTATION DOES A MORE SUFFICIENT JOB OF IMPROVING AUDIT QUALITY

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ABSTRACT

Since the enactment of the Sarbanes-Oxley Act (SOX) in 2002, there has been an ongoing debate over the auditing independence rules within the United States. Section 203 of SOX requires that the lead and concurring partner must rotate off the client after five years, in addition to another five-year "cooling off" period before they may work on the same client again. Meanwhile, a few foreign countries require auditors to rotate their entire firm, not just their partners, off the client after a specific number of years. After years of discussion, it appears that the United States will maintain partner rotation, as the Public Company Accounting Oversight Board finally decided to abandon the idea of requiring audit firm rotation in February 2014. On the other hand, the European Union is moving closer and closer to mandating audit firm rotation for listed companies and financial institutions every ten years. The question thus looms of which rotation type is more sufficient in terms of preserving auditor independence and enhancing audit quality. Only a handful of countries have instituted mandatory audit firm rotation, and therefore past research has provided unconvincing conclusions. The purpose of this paper, however, is to compare the audit quality in three particular countries with firm rotation experience-Brazil, Indonesia, and South Korea-to that of the United States (a country with partner rotation experience) before and after their current rotation rules were implemented to attempt to answer the enduring controversy. Audit quality will be measured in terms of the accuracy of audit reports, or more precisely, the percentage of reports that lacked an emphasis of matter paragraph or going concern opinion for companies that subsequently filed for bankruptcy.

APPLICATION OF INTEGRATIVE LEARNING TO INTRODUCTORY MANAGERIAL ACCOUNTING

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ABSTRACT

This paper presents a project that applies the integrative learning approach to the introductory managerial accounting course. The Association of American Colleges & Universities (AACU) considers integrative learning as essential to prepare students to deal with complex issues and a key benchmark of a quality undergraduate education today. To help students build the connection between managerial accounting and their personal experience and activate their tacit knowledge, we design a personal finance project that is introduced to students at the beginning of the semester. Students are required to prepare a personal budget, capture and categorize expenses, analyze variances between their actual spending and the budget, and prepare an income statement and a net worth statement using Excel templates. They are also required to answer a few related open-ended questions. This project helps students understand how their different experiences fit together and promote better understanding of conceptual subtlety. It also promotes financial literacy, which was found largely lacking in young adults (NFCC 2013).

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A HISTORICAL CASE STUDY OF THE DEBATE OVER COLLEGE TUITION TAX CREDITS DURING THE 95TH CONGRESS (1977-1978)

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ABSTRACT

College tuition tax credits have been a phenomenon in the U.S. for nearly seventeen years since they were first enacted as part of the Taxpaver Relief Act of 1997 (P.L. 105-34), creating the HOPE and Lifetime Learning tax credits (§25A), as well as the Economic Growth and Tax Relief Reconciliation Act of 2001 (P.L. 107-16), creating the Qualified Tuition and Related Expenses tax deduction (§222), and the American Recovery and Reinvestment Act of 2009 (P.L. 111-5), which created the American Opportunity Tax Credit (§25A), temporarily increasing the HOPE limits through December 31, 2017. Tax credits and deductions to pay college tuition costs has become a significant part of the financial aid subsidy provided to students and parents, costing approximately \$18.7 billion in tax subsidies in 2013-14 benefiting approximately 13.8 million taxpayers (College Board, 2014). Since the late 1950s, prior to the enactment of the Higher Education Act of 1965 (P.L. 89-329), tuition tax credits were debated by various congresses as a means of assisting families pay college costs. While there were significant debates to enact tuition tax credits early on in the 1960s through the early 1970s, the debate that occurred during the 95th Congress (1977-78) was one of the most spirited and influential ones on this legislation. The purpose of this paper is to examine the central issues of this historic tax policy debate in a case study on tuition tax credits and some of the policy dynamics that resulted from the structure of executive and legislative branches of government in 1977 and 1978.

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INTRODUCTION

In the mid-1970s, nearly ten years after the passage of the Higher Education Act of 1965 (P.L. 89-329), which focused solely on economically needy families, a new concern revolved around financing college tuition costs: rising tuition costs were squeezing students from middle-income families (Hansen, 1978, p. 1). By 1976, America was in a period of double-digit inflation,

rising oil costs, widespread joblessness, a rising federal budget deficit, and high interest rates. After focusing on lower-income families in several congresses in the 1960s and 1970s, the 95th Congress (1977-1978) was confronted with economic policies that were aimed at middle-income taxpayers, in particular high college tuition costs.

In 1978, a middle-income family was one where annual incomes fell between \$15,000 and \$25,000 (Hansen, 1978). From 1967 to 1976, the Congressional Budget Office reported a 74 percent increase in college tuition costs at public institutions and a 77 percent increase at private institutions (Hansen, 1978). Congress took up this cause in the 95th Congress by focusing on two potential remedies: 1. expanding the existing federal student aid programs to reach those families at middle-income levels, or 2. providing tax relief in the form of tuition tax credits. While these two remedies were similar to the ones debated during the Higher Education Act in 1965, the midseventies debate shifted to middle-income families. Several variables impacted the progression or hindrance of the tuition tax credit bills, including the Social Security bill, a major push by Catholic organizations to carve out an exception for elementary and secondary tuition credits, the Carter administration's desire for federal tax reform, the growing federal budget deficit, and President Carter's commitment to public education. While tuition tax credits were not included in the Revenue Act of 1978 (P.L, 95-600), the debate serves as a case study of how tax policy can collide with other social policy issues.

The purpose of this paper is to examine the central issues of this historic tax policy debate on tuition tax credits and some of the policy dynamics that resulted from the structure of executive and legislative branches of government in 1977 and 1978. Moreover, this paper serves as a case study on how tax policy is legislated.

POLITICAL ACTORS IN THE TAX CREDIT DEBATE

Political actors change as each congress is sworn in every two years and president is sworn in every four years. The 95th Congress was sworn in with a U.S. House of Representatives comprised of 291 Democrats, 144 Republicans; a U.S. Senate comprised of 61 Democrats, 1 Independent, and 37 Republicans; and, a newly sworn in president, Jimmy Carter, a Democrat. Of the members in the House, nearly 223 members (77 percent) were considered members from the liberal wing of the Democratic Party. According to Bond (1990), liberal Democrats had become a growing faction in the House due to a sizeable number of seats being picked up in 1974 from the Watergate scandal. In the Senate, approximately 44 members (72 percent) of the Democrats were from the liberal wing of the party. President Carter had the benefit of working with a unified government, with a filibuster-proof Senate. However, House and Senate leaders found strained relations with the newly elected president, who was not as liberal as the members on Capitol Hill. Generally, with a unified congress, issue congruence often can lead to legislative productivity. After the previous few years of President Gerald R. Ford's "veto strategy" (Light, 1999), where President Ford vetoed significant bills passed by Congress from 1974 to 1976, the new congressional majority of the 95th Congress worked hard to move on several spending bills early on-only to be vetoed or have veto threats by President Carter. This situation was summarized in President Carter's diary:

The congressional leadership . . . members [Speaker] Tip O'Neill, Shirley Chisholm, [and] John Brademas [expressed] that we were neglecting social programs in

order to try to balance the budget in four years. I take very strong exception to this... Because the Congress doesn't oppose what we put forward, there's been very little acknowledgement of the progress that we're trying to make. In my opinion there is no way to have available financial resources in two or three years for better health care, etc., if we don't put some tight constraints on unnecessary spending quite early. Some of these leaders have been counting on a free-spending policy now that a Democrat was back in the White House, and would not acknowledge that one of the reasons I had been elected was to bring fiscal responsibility to the federal government [insert] (Carter, 1995, p. 81).

President Carter was determined to balance the federal budget within four years, reform the federal tax code, while dealing with the major economic uncertainty that impacted the beginning of his presidency—which ended up lasting throughout his four years in office. As the tax credit debate unfolds, there is significant issue incongruence between congressional leaders and the White House, which was not expected given that the White House and congressional majority were from the same political party. In order to understand legislative behavior with the existence of divided or unified government, a brief discussion on the theories of political gridlock is warranted.

THEORIES OF POLITICAL GRIDLOCK

In understanding legislative behavior, the focus of analysis of often begins with the existence of either divided government, where one or both chambers of Congress are controlled by members of the opposite party, versus unified government where the executive branch and both chambers of Congress are from the same party. David Mahew (1991) argues that members of Congress are motivated mainly by actions that will get them re-elected, such as voting in favor of bills that will move monies and resources to their districts or states, and other pieces of legislation that will enhance their images to their voters. This "self-centered" behavior by members of Congress, according to Mahew, has assisted in producing gridlock at times within the legislative process. Members become more individualized and concerned about re-election and may defy their party leadership at times to protect their seats. Keith Krehbiel (1998) argues that divided government does not explain why and when gridlock will occur and that political parties do not matter. Krehbiel's pivot politics theory is based on collective choice settings where issues are well-defined and decision-makers' preferences are well-ordered, a specific decision-maker is shown analytically to be pivotal to the final policy choice.

Krehbiel argues that divided government does not explain why and when gridlock will occur but that his model of pivotal voters does; his theory drills deeper into Mahew's theory. Since all policy making in Congress is incremental, Krehbiel's median voter theory can assist in understanding how tax policy is impacted. Krehbiel's model assumes the following: all players are arranged along a single dimensional policy space. Parties are not a considered, just "liberal" or "conservative," and the status quo is assumed to be exogenously given. The model is based on the concept of a pivot, meaning "a person or thing around which something turns or depends" (Krehbiel, 1998, p. 23). The pivotal players in the model (see Figure 1 below) are as follows:

l = liberal predisposition

c = conservative predisposition

m = median voter

f = the Senate filibuster pivot (60 votes or 3/5)

v = the veto override pivot (2/3 vote in each chamber)

p = the President

q = status quo

MEDIAN VOTER THEORY

Krehbiel argues that policy positions are reflected through the median voter, which in a democracy is reflected through its legislative members by open elections. In other words, voters tend to vote for individuals who share their policy preferences. Elections are viewed as exogenous determinants of legislators' preferences, which are sometimes called "induced preferences" (p. 13). Krehbiel argues that changes are reflected by the median voter through the median legislator after each election:

After each election, [legislator] preferences may and usually do change. Any time the position of the median legislator changes—as in the case of national partisan tides, for example—the old status quo (the previous-period median legislator's ideal point) is out of equilibrium. A new play of lawmaking game then occurs, and the new median voter's ideal point is selected via majority rule as the new policy (1998, p. 13)

In the case of the 95th Congress, which was sworn in in January 1977, the median voter shifted slightly rightward—almost to a negligible extent: Control of the U.S. House was maintained by the Democrats, who lost 3 seats after the 1976 election, with Republicans picking up 3. In the U.S. Senate, which was also controlled by the Democrats, there was no net change in seats. Therefore, the 1976 election was essentially a relative status-quo election, producing no material changes in either chamber of congress. The change in that election was the White House, with Governor Jimmy Carter succeeding President Gerald R. Ford. Where Krehbiel's median voter model is relevant is in the House and Senate, where a significant portion of the composition of members of the caucus were from the more liberal wing of the Democratic Party. As discussed, these members were quite anxious to move on stalled legislation from the Ford years. Moreover, while filibusters were not as prevalent at that time as they are today (known as procedural votes in the Senate), the Democrats maintained a filibuster-proof majority in the 95th Congress.

THE FILIBUSTER PIVOT

The filibuster pivot (f) is only relevant if the president is ideologically opposite of 40 members of the U.S. Senate; at least 40 votes required to sustain a filibuster. For example, the

recent 113th Congress (2013-2014) had a Senate comprised of 47 members of the opposition party to the President and could (and did at times) filibuster certain legislation that is predisposed towards the President. If a filibuster is sustained, then the bill does not come up for a vote and dies. If, however, the filibuster is blocked (at least 60 members vote to proceed with the bill), then an up-or-down vote can proceed, then requiring a simple majority of votes (51) for passage.

In the example of the 95th Congress, the filibuster pivot was neutralized as an issue since there was unified government. However, if a controversial measure reached the Senate, the filibuster pivot (f) can prevent that measure from progressing to an up-or-down vote, killing the bill. If the filibuster pivot is not sustained, and the bill reached the floor of the Senate for an up-or-down vote and secured at least 51 votes, the president have to veto the bill in order to prevent it from becoming law.

THE VETO PIVOT

The veto pivot is relevant usually when there is complete divided government, where the executive branch (the president) is in an opposite party than both chambers of Congress. This existed during the latter six years of the Clinton presidency (104th through the 106th Congresses) and during the last two years of the Bush (43) presidency (110th Congress). If a president vetoes legislation under these circumstances, both chambers of Congress would have to secure 2/3 of the chamber to override a veto (290 votes in the House; 67 in the Senate). In the 95th Congress, the Democrats had at least 291 votes, but in the Senate, the majority party only had 61, six votes away from a super-majority.

Figure 1 below highlights the difference between the 94th Congress (1975-1976) and the 95th Congress (1977-78). There was a negligible change in congress after the 1976 election, but the major change was the shift from Ford to Carter.



Figure 1: Median Voter Comparision between 94th and 95th Congresses

As Figure 1 illustrates, the median voter shifted slightly rightward due to a couple of House seats shifting to conservative members. Also, on the continuum, Ford, while viewed as a moderate president, vetoed several bills while in office causing him to be more on the conservative side of the line. Carter, on the other hand, while a Democrat, was more a centrist (sometimes conservative Democrat) and was closer to the median voter pivot. As this paper examines the tuition tax credit debate, it highlights how President Carter viewed such a policy as "fools' gold," rejecting it as a policy option even though there was strong congressional push towards passage. While no evidence exists, given the composition of the 94th Congress and White House, tuition tax credits might have been received better by a Republican White House—but that is not how history played out here.

The history of the college tuition tax credit debate is discussed below; further, many of the significant actions by the U.S. House are summarized in Tables 1A and 1B, as well as significant actions by the U.S. Senate in Tables 2A and 2B below.

THE SOCIAL SECURITY BILL

In 1977, Congress took up a bill to reform the Social Security system. It was during this debate that tuition tax credits emerged. As indicated earlier, bills for college tuition tax credits, as well as tuition tax credits for elementary and secondary education, had been introduced and debated in the 1960s and early 1970s—however, this was the first serious legislative challenge. The tax writing committee chairmen, Rep. Al Ullman (D-OR) in the House, and Senator Russell Long (D-LA) in the Senate, "used their influence and parliamentary skills to prevent [tuition tax credits] from coming to a conclusive vote" (Rosenbaum, 1977, p. 17). Prior to Rep. Ullman, the House Ways and Means Committee had been led by Wilbur D. Mills (D-AR) from 1958 to 1974. Rep. Mills killed every tuition tax credit bill that came before him. In the Senate, there was a much stronger momentum for tuition tax credits over the years leading up to 1977.

In September 1977, after the House voted on the Social Security bill, the Senate took up the measure. During the Senate deliberations, an amendment to the Social Security legislation allowing across-the-board tax cuts was introduced, but was defeated; however, the chamber did approve an amendment by Senator William V. Roth (R-DE), known today for the "Roth IRA", allowing for tax credits for college tuition. On December 9, 1977, the amendment was later expanded to include tax credits for private school elementary and secondary tuition and attached as a rider to the Social Security bill. The Roth amendment ended up being contained in the conference report after contentious negotiations. However, the two tax writing committee chairmen were at odds on how to proceed to final floor votes. Health, Education, and Welfare Secretary Joseph Califano, Jr. argued that the tuition tax credits were not relevant to the larger Social Security bill if it contained the tax credits. Rosenbaum (1977) writes that the tuition tax credits had "enormous appeal" among middle-income families and that any "senator or representative who defends their cause cannot help but score political points" (p. 17).

On December 13th, Senator Long convinced Senator Roth to allow for the tuition tax credit rider to be removed from the Social Security conference report and attach it to a minor tariff bill that had been passed by the House. Senator Roth agreed to table the measure after

Long agreed to allow for two days of hearings by the Finance Committee in 1978 on tuition tax credits. On December 14th, a clean Social Security bill proceeded to floor votes and passed. This 1977 debate on tuition tax credits moved into the second session of the 95th Congress in early 1978.

President Carter's relations with congress were significantly strained at this point in his presidency largely due to the continuous changing of his policy preferences (Fink, 1998). This was also due to Carter's lack of effectiveness in deliberating with members of congress, diluting his influence in trying to bring wavering lawmakers toward his position on controversial bills (Neustadt, 1990; Light, 1999). Early in the first 100 days of his presidency in 1977, President Carter urged the congress to pass a \$50 rebate per taxpayer as a stimulus measure. The House voted and passed the measure only to be informed later that the president canceled the request, citing a lack of necessity for the bill due to new data showing and improving economy. This angered many lawmakers who believed the president vacillated in his positions. Moreover, Carter believed that the president proposes legislation and the congress is to pass such proposals. The president lacked Washington experience, coupled with his lack of interest in deliberating heavily with members of Congress, isolating him and reduced his influence—something a president must have in order to effectively gain momentum on his agenda (Neustadt, 1999).

CARTER TAX CUT AND BUDGET PROPOSALS

In January, 1978, unemployment had dropped from 7.1 percent to 6.4 percent, showing improvement. The president was still interested in pursuing his \$25 billion tax cut and reform package. The White House proposal was broadly constructed to include \$34.5 billion in tax cuts along with \$10 billion in revenue raising reforms, for a net cut of approximately \$25 billion (Cowan, 1978, p. A1). Nowhere did the White House include tuition tax credits in its proposal. Congress did not receive the proposal positively, arguing that it did not provide enough simulative effect. In addition, Senate Finance Committee Chairman, Russell Long, as a Senator from Louisiana, greatly disliked the president's desire to impose higher energy taxes, attempting to force down oil and gas consumption (Mann, 1992, p. 343). Some critics believed the tax proposals were too large, other members believed they were too small, and many were concerned it lacked enough business tax cuts.

In addition to the tax proposals, on January 23, 1978, the administration released its Fiscal Year 1979 budget (FY 79). The \$500 billion budget request aimed at bringing the federal budget into balance by 1981. Unlike other Democratic presidents, most notably President Lyndon B. Johnson, Carter did not offer any major social initiatives in his budget. However, the budget did set aside approximately \$700 million for college aid initiatives (Cowan, 1978, Jan 24). As with the tax bill, there was no mention of tuition tax credits.

TUITION TAX CREDITS CONSIDERED BY THE SENATE FINANCE COMMITTEE

President Carter's proposal for expanding the federal student aid programs was intended to also put an end to any discussion of college tax credits. As this case study points out, it did not stall the interest in the idea. Carter's spending initiatives (known as direct expenditures) would be subjected to the annual appropriations process, while tuition tax credits are tax expenditures, which are revenue losses—and are not subject to annual appropriations. Tax expenditures are often known as "spending through the tax code" (Howard, 1997). One significant factor in the debate was the veto threat by President Carter on April 10, 1978 when asked at a press conference about the tuition tax credits:

No. I don't favor tuition tax credits under any circumstance, even if it was at a very slight level, because this would inevitable rapidly grow with each succeeding budget and the first that you know, tuition tax credits would be the major federal expenditure for all education in the United States (New York Times, 1978, p. 22).

While President Carter's veto threat highlighted his veto pivot, Congress proceeded without any caution, ignoring his warning.

HOUSE ACTION ON THE TUITION TAX CREDITS

Several legislative maneuvers were made to progress the tuition tax credit policies through the U.S. House of Representatives. These actions were summarized in Tables 1A and 1B below with respective recorded vote tallies. In examining these House actions, the most significant one was on June 1, 1978, when H.R. 12050 was voted on by the floor of the chamber. This was the first floor action on any tuition tax credit measure in the House; the Senate had nearly six floor votes prior to the 95th Congress. In the House bill, H.R. 12050 allowed for a nonrefundable tax credit equal to 25 percent of college tuition and fees up to a maximum of \$100 in 1978, \$150 in 1979, and \$250 in 1980. The bill passed 237-158. In addition, an amendment was added to the bill allowing for a tax credit for elementary and secondary private tuition up to 25 percent of tuition and fees up to \$50 per pupil in 1978, 1979, and 1980. The amendment passed 209-194. The tuition tax credits were to take effect on August 1, 1980 and expire after December 31, 1980. Of the votes for the amendment for elementary and secondary tuition tax credits, 107 votes were from Democrats, 102 from Republicans. This demonstrated that the president's own party was in favor of the elementary and secondary tax credits. The House bill would cost \$25 million in lost revenues in Fiscal Year (FY) 1978, \$635 million in FY 1979, and \$1.1 billion in FY 1980, and \$1.2 billion in FY 1981. It was estimated that approximately 70 percent of the tax credits would be for college tuition and the other 30 percent for elementary and secondary private tuition (Donnelly, 1978, p. 1379). There are several additional details that are beyond the scope of this paper, which ultimately impacted the legislative actions in the House; however, this researcher focuses on the recordable, material events impacting this debate.

DATA ARE RELEASED ON COLLEGE TUITION COSTS

Prior to the June 1 vote, the Congressional Budget Office (CBO) released a report comparing college costs to family income from 1967 to 1976. See Table 1 below.

TABLE 1										
		COLLEGE	COSTS VS	S. FAMILY	Y INCOMI	E				
			Tuition	& Fees +	Percent of					
			Room a	nd Board	Income fo	Consumer				
			Co	sts	with 18-24 year olds		Price			
		Families					Index			
	All	with 18-24	Public	Private	Public	Private	1967 = 100			
Year	Families	Year Olds	Colleges	Colleges	Colleges	Colleges				
1967	6,811	7,923	1,063	2,205	13.4	27.8	100.0			
1970	8,268	9,624	1,288	2,739	13.4	28.5	116.3			
1973	10,273	11,897	1,517	3,164	12.8	26.6	133.1			
1974	11,025	12,561	1,617	3,386	12.9	27.0	147.7			
1975	11,505	13,199	1,748	3,667	13.2	27.8	161.2			
1976	12,199	14,164	1,854	3,896	13.1	27.5	170.5			
Percentage										
Change from	79.1%	78.8%	74.2%	76.7%	-2.3%	-1.1%	70.5%			
1967-1976										
Source: CBO Statistics in Pine, 1978, p. A5										

The results in the CBO report indicated that while college tuition costs had been rising sharply since 1967, median family income "climbed even faster, particularly middle income families" (Pine, 1978, p. A5). The report seemed to contradict the overriding argument that middle income family household income had not kept pace with rising college tuition costs. According to Table 1, tuition and other costs increased sharply from 1967 to 1976: a 74.2 percent increase at public colleges and universities, and 76.7 percent for private institutions. At the same time, the report indicated that median family income grew by 79.1 percent and median income for families with college-age children increased approximately 78.8 percent. As a result, the proportion of family income spent on college tuition costs declined during the nine-year period by approximately 2.3 percent for students attending public institutions and 1.1 percent for those attending private institutions. The CBO report suggested that middle income families were not experiencing a real tuition squeeze, but that parent discretionary income was limited in periods when the student was in school (Pine, 1978, p. A5).

The report was used by the editors of the *New York Times* and *Washington Post* to argue that the entire tuition tax credit idea was unnecessary. The *Post* editorial argued that when inflation was removed from the analysis, "you discover that the real cost of going to college has not risen over the past decade . . . one more good reason for Congress to abandon the mischievous idea of a tuition tax credit . . . [i]t isn't needed . . . [t]he present system—a mixture of federal, state and private funds—with varying purposes and conditions—is working" (Washington Post, 1978, p. A18). The *Times* education editor, Edward Fiske, argued that the real issue behind the middle class' angst over college costs came down to the following: "Are middle class Americans less 'able' to finance college or simply less 'willing'" (Fiske, 1978, p. 9). The

report may have contributed to the eventual downfall of the tuition tax credit movement in this congress.

One variable that was significant and fell outside of the legislative process was the coming California Primary on June 6, 1978, which included Proposition 13—which changed the argument for taxes for decades. Proposition 13 was a ballot initiative, which passed with nearly 64 percent of the vote, that allowed California property owners to freeze their property values at 1978 market levels in an effort to avoid paying higher property taxes due to escalating property tax values. The fervor and national press that resulted from the Proposition 13 debate illuminated the intensity of anger that was manifesting with middle class voters. Members of both parties were aware of the impending vote when they cast their votes in the House on H.R. 12050.

	TABLE 1A	
U	S. HOUSE ACTIVITY ON TUITION TAX CREDIT BILLS	
		Vote
Date	Action	(if any)
3/8/1978	House Education and Labor Committee altered the	32-3
	Carter student aid proposals by adding a larger grant	
	aid component as well as modifying the student loan	
	guarantee by allowing families with incomes below	
	\$40,000 to participate in the federal student loan programs.	
4/4/1978	Ways and Means Committee marked up a scaled-back	
	version of the tuition tax credit, allowing for \$100 tax	
	credit for each child attending private elementary or	
	secondary schools, and \$250 for each student attending	
	a post-secondary college on a full-time basis.	
4/14/1978	Ways and Means Committee voted for tuition tax credits	23-14
	for college, allowing for up to \$100 for each dependent	
	college student in 1978, up to \$150 in 1979, and up to	
	\$250 in 1980.	
	The panel voted to remove tax credits for elementary and	20-16
	secondary tuition, based on arguments that such	
	provisions were considered unconstitutional.	
4/18/1978	House Ways and Means Committee, in several votes,	
	rejected several aspects of the Carter Administration's	
	tax proposals, including reform items, significantly	
	scaling back or eliminating many of the administration's	
	proposals.	
5/4/1978	House passed the Fiscal Year 1979 budget resolution,	
	which is unbinding, that included elementary and	
	secondary, and college tuition tax credits.	
5/10/1978	House Rules Committee votes to allow for an up or down	
	vote on the floor.	
6/1/1978	House votes on H.R. 12050, allowing for a non-refundable	237-158
	tax credit equal to 25% of college tuition combined with	
	academic fees up to a maximum of \$100 in 1978, \$150 in	
	1979, and \$250 in 1980.	
	An amendment was allowed inserting elementary and	209-194
	secondary tax credits, which was narrowly approved. The	
	bill allowed up to 25% of tuition and fees up to \$50	
	per pupil in 1978, 1979, and 1980.	
	Both tax credits were scheduled to take effect on	
	August 1, 1978, expiring after December 31, 1980.	

TABLE 1B									
U.S. HOUSE ACTIVITY ON TUITION TAX CREDIT BILLS									
Date	Action	(if any)							
9/28/1978	House-Senate conferees approved a college tuition tax								
	credit bill costing \$400 million in Fiscal Year 1979 and \$1								
	billion in Fiscal Year 1980, which was less costly than the								
	two versions. The credit was computed at 35% of tuition								
	and related fees up to \$250 in 1980 and only applied to								
	students attending college full-time.								
10/13/1978	House rejected the compromise on college tuition tax	207-185							
	credits because the conference dropped the elementary								
	and secondary tax credits. The bill was sent back to								
	conference.								
10/15/1978	Al Ullman and Russell Long agree to drop tuition tax								
	credit measure in order to allow the tax legislation to move								
	to passage and to enactment.								
10/15/1978	Revenue Act of 1978 passes the House with tuition tax								
	credits removed. P.L. 95-600 signed into law on 11-1-78.								

SENATE ACTION ON THE TUITION TAX CREDITS

Several legislative maneuvers were made to progress the tuition tax credit policies through the U.S. Senate. These actions were summarized in Tables 2A and 2B below, similar to the House. The U.S. Senate also had some significant proponents of tuition tax credits, including Senator Bob Packwood (R-OR), Senator Daniel Patrick Moynihan (D-NY), and Senator William V. Roth (R-DE), who held up the Social Security bill in late 1977 in exchange for tuition tax credits, as discussed earlier. The most powerful member in the debate was Senator Russell Long (D-LA), Chairman of the Finance Committee. As indicated in Table 2A, the Senate Finance Committee began the process early by approving H.R. 3946 allowing for a \$20 refundable tax credit for "college, vocational, elementary or secondary" tuition, beginning after August 1, 1978. A \$500 refundable credit (limited to half of the tuition and fees) for elementary and secondary as well as undergraduate tuition, would go in effect beginning August 1, 1980. Further, the credit would be expanded to include graduate students beginning August 1, 1981. The Senate's bill was more expensive than the House as the credit significantly increased in 1980.

Similar to the House, the majority of the drama was with the elementary and secondary tuition credits. The powerful president of the American Federation of Teachers, Al Shanker, argued that the legislation was "set[ting] off the worst political conflict this country has ever seen since the Civil War (Shanker, 1978, p. 9). Shanker considered Senator Moynihan an enemy after the Senator had promised to not support elementary and secondary tax credits in the 1976 Senate race; Moynihan became one of the most significant proponents. Prior to the floor vote, the Senate Finance Committee in August reduced the elementary and secondary tax credit from \$500 to \$250; in addition, it removed the refundability feature and limited deductibility to for students attending college part-time.

The senators objecting to the elementary and secondary tax credits were Ernest Hollings (D-SC) and Kaneaster Hodges, Jr. (D-AR). These two southern Democratic senators believed the tax credits would undermine "two decades of efforts to integrate schools in the South," leading to possible resegregation. Senator Hodges argued, "rapid growth in Arkansas and other southern states of private, 'white flight' academies set up to avoid integrated public schools . . . [i]f students of such schools could get federal aid [in the form of a tuition tax credit], . . . more whites would depart the public schools, leaving blacks isolated again" (Donnelly, 1978, p. 2057). The elementary and secondary tuition tax credits were ultimately viewed as shifting money away from public schools to private schools. The arguments were significant enough that the elementary and secondary part of the bill was removed, by 56-41 vote on August 15, 1978, right before the vote for college tuition tax credits. This ended the debate on the elementary and secondary tax credits; but, eventually after this debate ended, the school choice debate began in the 1980s and 1990s.

When the college tuition credit plan was voted on the Senate floor that same day, the bill had changed significantly from the one reported out of the Finance Committee earlier that year. H.R. 12050 phased in the college tuition tax credits retroactive to August 1, 1978, allowing a student or their parents if dependent, to claim a credit up to \$500 for up to half the combined cost of tuition and fees paid for full-time undergraduate or vocational school, up to \$250 a student in 1978. The maximum credit would not be available until 1980 and would expire after December 31, 1983. The Senate approved the bill by a vote of 65-27, a significant margin. The bill was then moved along with the broader tax bill to the House-Senate conference in order to iron out differences in the bills.

	TABLE 2A	
U.	S. SENATE ACTIVITY ON TUITION TAX CREDIT BILLS	5
		Vote
Date	Action	(if any)
12/9/1977	An amendment by Senator Roth (R-DE) allowing for	
	tuition tax credits (elementary, secondary, and college) is	
	attached to the Social Security bill. Senator Roth refused	
	to remove the amendment, holding up the legislation.	
12/14/1977	Roth amendment was deleted from the final Social Security	
	bill; Senator Roth is promised by Finance Committee	
	Chair, Senator Russell Long (D-LA), that the tuition tax	
	credit legislation would be debated in 1978.	
2/23/1978	Senate Finance Committee approves H.R. 3946 allowing	14-1
	for a \$20 refundable tax credit for "college, vocational,	
	elementary or secondary" tuition, beginning after August	
	1, 1978. A \$500 refundable credit (limited to half of the	
	tuition and fees) for elementary and secondary as well as	
	undergraduate students, beginning August 1, 1980; the	
	credit would be expanded to include graduate students	
	beginning August 1, 1981.	
2/24/1978	Senate Human Resources Committee votes to approve the	14-0
	Carter Administration's student aid proposals, in particular	
	providing federal loan guarantees for families earning up to	
	\$40,000 a year.	
8/3/1978	Senate Finance Committee scales back H.R. 3946 by	
	reducing the elementary and secondary tax credit	
	deductibility from \$500 to \$250 a year. In addition, the	
	bill eliminated deductibility for part-time college enrollment	
	as well as the refundability feature. These modifications	
	reduced the cost of the bill significantly.	
8/15/1978	Senator Howard Metzenbaum (D-OH) proposed an	39-58
	amendment to the tax credit bill, limiting income eligibility	
	to phase out for taxpayers with income between \$30,000	
	and \$40,000. The amendment was defeated.	
	Senator Russell Long (D-LA) proposed an amendment on	31-62
	the floor to reinsert the refundability feature back into the	
	bill. The amendment was defeated.	
8/16/1978	Concerns over the elementary and secondary tax credits	56-41
	was debated, not only due to the constitutionality of	
	the credits, but also two southern senators objected to the	
	use of such credits to subsidize segragative efforts that had	
	occurred in the 1950s and 1960s. The full Senate voted to	
	delete the elementary and secondary tax credits from the	
	bill.	

	TABLE 2B	
U	S. SENATE ACTIVITY ON TUITION TAX CREDIT BILLS	
		Vote
Date	Action	(if any)
8/15/1978	H.R. 12050 was brought up for a vote, phasing in tuition	65-27
	tax credits retroactive to 8-1-78, a studentor their parents	
	if dependent, could claim a credit up to \$500 for up to half	
	the cost of tuition and fees paid for full-time undergraduate	
	tuition or vocational school, up to \$250 a student. The	
	maximum credit of \$500 would not be realized until 1980	
	and would expire after December 31, 1983.	
8/16/1978	S. 2539 was passed and expanded existing federal student	68-28
	aid programs, allowing 1.5 million more students to	
	participate in federal grant programs. Grants were to	
	range between \$1,000 per student at the \$15,000 income	
	level to \$300 at a \$24,000 income. The bill also allowed	
	families at any income level to participate in a federally	
	subsidized student loan.	
9/28/1978	House-Senate conferees approved a college tuition tax	
	credit bill costing \$400 million in Fiscal Year 1979 and \$1	
	billion in Fiscal Year 1980, which was less costly than the	
	two versions. The credit was computed at 35% of tuition	
	and related fees up to \$250 in 1980 and only applied to	
	students attending college full-time.	
10/15/1978	Al Ullman and Russell Long agree to drop tuition tax	
	credit measure in order to allow the tax legislation to move	
	to passage and to enactment.	
10/16/1978	Revenue Act of 1978 passes the Senate with tuition tax	
	credits removed. P.L. 95-600 signed into law on 11-1-78.	

HOUSE-SENATE CONFERENCE: THE FINAL BILL

Prior to the House-Senate conference, both the House and Senate separately passed S. 2539, which expanded existing student aid programs: the bill allowed 1.5 million more students to participate in need-based grant programs by upping the income eligibility parameters. The bill also allowed for all families to participate in the federal subsidized guaranteed student loan program to pay for tuition costs—at all income levels (a ceiling would later be inserted by the Reagan administration). The bill also created a parent loan program, where the parent could borrow additional monies to pay for unmet costs. This bill was a major counter to the college tuition tax credits and passed the Senate 68-28, by nearly the same margin as the tax credits.

The House-Senate conference was the final leg in the legislative process and had a very strong chance of passage having survived this far on the continuum. According to Mann (1992), Senator Long had a "sudden willingness to work with Carter . . . seek[ing] legislation that

the president could sign by trimming or eliminating some of the more excessive House proposals [in conference]. The conference agreed to a tuition tax credit on September 28, 1978 that cost \$400 billion in FY 1979 and \$1 billion in FY 1980. This was less costly than the two versions brought to the conference. The maximum credit allowed was \$250 in 1980, which was half of the Senate-approved amount. Also, the mechanics of the credit allowed up to 35 percent against tuition expenses and only applied to college student attending on a full-time basis. The House and Senate separately voted on the measure and passed it—tuition tax credits were to be melded into the larger tax bill.

As it turned out, Senator Long used the tuition tax credits as a bargaining chip with the Carter administration on other tax issues. According to Pine (1978), Long revealed that he did not prefer college tuition tax credits and only wanted them to bargain the larger tax bill:

[Senator] Long has suggested that a veto of the tuition tax credit bill be what is needed to prevent the major tax cut bill for individuals and business, now pending in the Senate from overshooting congressional budget limitations . . . [t]he larger tax bill has pushed the Senate about \$1.3 billion over its budget (Pine, 1978, p. A2).

Senator Roth waged a major fight on the Senate floor when the tax credit provision was not added to the tax legislation. By adding tuition tax credits to the larger tax legislation, Roth argued that the president would be less likely to veto. Months earlier, Senator Long promised Senator Roth that he would allow hearings on tuition tax credits, which he did—and the measure was reported out of Long's Finance Committee. In October 1978, Russell Long had the upper hand and single-handedly killed college tuition tax credits. The Revenue Act of 1978 was approved on October 16, 1978 allowing for a \$19 billion tax cut measure, without tuition tax credits.

In the end, President Jimmy Carter signed the tax bill with no fanfare at Camp David on November 7, 1978.

SUMMARY: VARIABLES IMPACTING THE TUITION TAX CREDIT PROPOSALS

To summarize this case study on the tuition tax credit debate during the 95th Congress, Table 3 highlights the variables that impacted the progression or hindrance of the tax credit bills. In the end, the tax credits did not progress for a variety of reasons, listed below. However, since college tuition tax credits did eventually get enacted nineteen years later, this earlier debate had relevance. Interestingly, in the 1990s, it was a Democratic president (Bill Clinton) advocating college tuition tax credits against a divided government—different political conditions, which led to a different outcome in that case study.

				TABLE 3							
	VARIABLES IMPACTING TUITION TAX CREDIT PROPOSALS										
Main fact	tors progre	ssing tuitio	on tax cred	lits propos	als:						
 high colle 	ge costs										
•middle-in	come taxpa	yer squeeze	e								
•earlier de	liberations of	of tuition ta	x credits in	the 1960s a	and early 19	970snot a	new concept	:			
•appearan	ce of issue-	congruence	with a unif	fied congres	S						
•public ap	proval of th	e tax credit	bills								
Main fact	tors hinder	ing tuition	tax credit	proposals							
 President 	Carter's ve	to threats									
•Carter's s	upport for	public educ	ation (Amy	Carter atte	nded a pub	lic school i	n D.C.)				
•the const	itutionality of	of elementa	ry and seco	ondary tax c	redits						
•Al Shank	er and AFT										
•the admir	nistration's c	lirect spend	ing proposa	als to increa	se student	aid eligibilit	у				
•when the	•when the elementary-secondary tax credits were removed, there was no powerful										
advocat	e for the co	llege tuition	tax credits								
 Senator I 	Long's using	the tuition	tax credits	as a bargaii	ning chipr	emoving th	em				
from co	nsideration	in the Reve	enue Act of	1978							

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VOLUNTARY CLAWBACK PROVISIONS AND EXECUTIVE RISK-TAKING

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ABSTRACT

In this study, we examine whether voluntary clawback adoption leads to changes in executive risk-taking behavior and how that impacts the output from innovative activities. We use a difference-in-difference research design on a propensity score-matched sample of 418 firms for the period 2010-2013. Our findings are consistent with more risk-averse executives in clawback firms compared to those in non-clawback firms. We also find that executives' risk-averseness is associated with decreasing innovative output in clawback firms compared to non-clawback firms. Moreover, our findings show that the causal hypothesis better explains voluntary clawback adoption than does the signaling hypothesis. Our study adds to our knowledge of the consequences of voluntary clawback provisions by documenting the empirical evidence of the association between voluntary clawback adoption and specific firm activities. Overall, this study contributes to the ongoing debate on whether clawback provisions should be mandatory for all publicly traded firms in the U.S.

Keywords: Executive risk-taking, voluntary, firm-initiated, clawback provisions, information environment, innovation, analyst following, forecast accuracy

JEL classifications: G24, G38, K22, M41

DISCLOSURE TIMING AND REAL EARNINGS MANAGEMENT

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ABSTRACT

Using 14,721 firm-years observations from 1997-2011, this study investigates the association between firms that file forms NT 10-K, according to the SEC Rule No. 12b-25, and real earnings management. The preliminary results suggest a significant association between late filers and abnormal discretionary expenses, suggesting the existence of real earnings manipulations among late filers. The results also suggest that firms that file financial statements after the fiscal year end, but do not necessarily end up filing the form NT 10-K, are also manipulating real earnings management through abnormal production costs and discretionary expenses. The empirical results in this paper are of interest to policy makers and academicians as they point to a possible link between late filing and financial reporting quality.

INTRODUCTION

This study empirically investigates the association between late filers of forms NT 10-K and real earnings manipulation in the U.S. market. According to the SEC Rule No. 12b-25, the SEC requires firms, which fail to meet the SEC filing deadlines, to file From NT¹ no later than one day after the original filing due date. Once the firms file Form NT they will be given a one-time automatic grace period to file their financial statements (Bartov, Defond, Konchitchki 2011). The SEC original filing requirements² differ among firms. For small firms (non-accelerated filers with firm size less than 75 million), the filing requirement for Form 10-K is 90 days with 15 days as automatic/grace extension period and for Form 10-Q, it is 45 days with 5 days extension period. For accelerated filers, forms 10-K are 75 days and 15 days extension period, large accelerated filers are given 60 days period with 15 days of the due date of the financial statements and are firms are given 5 days automatic extension.⁴

Late filing creates discrepancies on the timeliness of financial reporting and consequently imposes significant opportunity costs to the firm from losing prospective investors. Understanding the economic effects of late filers are hence crucial. Additionally, a survey by the Compliance Week in 2007 reveals that the number of late filers has increased from 2004 to 2006 by 19% (1211 firms). The top-five reasons for filing late have been listed as (1) restatement of financials, (2) equity pay/option issues, (3) investigation underway, (4) acquisition, merger issues and (5) auditor change (Aguilar 2007a). Therefore, this study is motivated by two important points. First, the need to assess the current SEC regulations regarding disclosure timing, and second, the increased use of real earnings management (Cohen and Zarowin 2010) by firms relative to using discretionary accruals after Sarbanes-Oxley Act 2002 (SOX 2002, hereafter) and the importance of identifying the determinants and motives of real earnings management. Third, the topic of late filing is of significance to academicians as well as policy marker. On the one hand, not all delinquent filers are perceived negatively by the market (Badertscher and Burks 2011). Badertscher and Burks (2011) argue that delayed restated financial statements are favored over timely restated financial statement with errors. This is mainly because disclosure lags for restated financial statements, which might take 12 months according to the 2008 Advisory Committee on Improvements to Financial Reporting (CIFR), are attributable to fraud investigation or large errors. Related, Cao et al. (2010) suggest that Forms NT are value relevant. On the other hand, Delinquent filers are subject to the negative market response to late filers as well as the SEC imposed penalties, which include de-listing, de-registration, and delaying stock issuance until financial statements are disclosed. Late filing also prohibits the firm from issuing Form S-8 for employee benefits plan as well as Form S-3 for stock issuance (Bartov et al. 2011).

According to the SEC filing deadlines, accounting information is naturally lagging the market (e.g., the time between fiscal year-end and the earnings release date) according to the original SEC deadlines. It would be interesting to investigate whether the accounting lag is beneficial to the market participants or harmful and contribute to creating agency costs by allowing managers to manipulate earnings. Therefore, I am motivated to examine the association between late filing and real earnings management to provide new evidence on the consequences of late filing on financial reporting quality.

Extant literature suggests that earnings manipulation occurs when managers use either discretionary accruals or real earnings management as substitute earnings management tools (Cohen and Zarowin 2010; Zang 2010). Furthermore, For example, managers use their

discretion in selecting accounting reporting methods, estimates, and disclosure that increase the firm's value of accounting (Healy and Wahlen 1999). Prior research (Teoh, Welch and Wong1998a, 1998b; Roychowdbury 2006; Bartov et al. 2002; Degeorge et al. 1999; Burgstahler and Dichev 1997) provides evidence that managers are motivated to manipulate earnings. Real activities manipulations are the use of operational activities to artificially inflate earnings as the bottom line measure of the firm's profitability. According to Roychowdhury (2006), real earnings management can be achieved through three methods: (1) granting discounts to temporarily increase sales, which result in abnormal cash flow from operations, (2) overproduction to lower the cost of goods sold, which will results in abnormal production costs, or (3) engaging in aggressive reduction in discretionary expenses such as: Research and Development, which will results in abnormal discretionary expenses. I use these three individual measures of real earnings management and provide empirical evidence on whether late filers manipulate earnings.

This study contributes to the literature of disclosure timeliness and earnings management in a number of ways. First, to the best of my knowledge, it is the first study that links real earnings management to late filing into one research construct. Although prior research discussed discretionary accruals and disclosure timing (Russ 2005), results on this association were insignificant and subsequently the relationship between disclosure timing and earnings management remains unexplained. Second, there has been significantly increase in the use of real earnings management post Sox 2002 and stock exchanges regulations relative to the use of discretionary accruals because the latter is against GAAP, triggers litigation and subjects the firm to penalty by the Securities and Exchange Commission (SEC) (Cohen and Zarowin 2010). Related, Chi, Lisic and Pevzner (2011) find that management with high incentives to manipulate earnings and good monitoring environment (e.g., auditor industry specialist and higher audit fees), resort to real earnings management. Therefore, examining the real earnings management practices among late filers significantly contribute to the literature. Third, the preliminary result of my study further provides recommendations to the SEC and regulators regarding the economic significance of disclosure timing in the U.S. market.

This paper consists of five sections. Section 2 discusses the literature review and hypothesis development. Section 3 demonstrates the research methodology. Section 4 presents the results of the empirical testing. Section 5 concludes and discusses the research limitations.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Prior research on disclosure timing has been focusing on the market perceptions and consequences of late filings. For example, Bartov, Defond and Konchitchki (2011) examine the short-term market reaction to management announcements of filing late financial statements. They find that the market reacts negatively to late filing even if the firm intends to file within the grace period allowed by the SEC. They also document that this negative reaction is more sever to10-Qs more than to 10-Ks. This market reaction is intensified when the reason for the delay in filing is due to accounting issues. Additionally, investors perceive 10-Qs to require fewer efforts in preparation because 10-Qs are unaudited. Further, they find that the late filer's operational performance continues to decline post the management announcements of submitting Form NT.

Research on the association between disclosure timing and financial reporting quality is, however, limited. Russ (2005) investigates the association between disclosure timing and discretionary accruals and documents mixed evidence. Chai and Tung (2002) document that

companies that manipulate earnings tend to file earnings later than firms that do not manipulate earnings. Related, Alford (1994) argue that late filers are poor performers and smaller in size; these later characteristics might motivate managers to manipulate earnings. Krishnan and Yang (2009) find no deterioration in the quality of financial reporting post the SEC accelerated filings deadlines of 2003. They argue that the market-wide imposed regulations might lessen the unintended negative impact of shortening the reporting deadlines requirements on financial reporting quality. They find mild evidence that firms that file their financial statements close to the filing deadline and before issuing the audit reports are mildly suffering lower financial reporting quality. Related, Alford et al. (1994) examine the characteristics of late filers prior to SOX and finds that late filers are financially distressed. However, little research post SOX is available to examine such firms with untimely reporting. Related, Cao et al. (2010) find that financial distress has no association with market response to Form NTs, indicating that the structures of firms are no longer the same during the last decade. Therefore, I predict that firms that file financial statements with a delay will engage in real earnings management and set my main research hypothesis is as follows:

H1: There is a significant positive association between late filing and real earnings management.

RESEARCH DESIGN AND METHODOLOGY

Data Collection

My sample period extends from 1997-2011. I obtained data about late filers firms from AuditAnalytics database. I obtained real earnings management raw data from Compustat database and further calculated the three main proxies of real earnings management following Roychowdhury (2006) and the two aggregate measures following Cohen and Zarowin (2010). I then merged late filers' data with real earnings management data. I further collected and calculated the set of control variables from Compustate and AuditAnalystics databases and then merged the control variables with late filers and real earnings management merged data. The final sample is composed of 14,721 firm-years observations.

Research Models

The dependent variable(s) in my study are proxies for real earnings management. Following Roychowdhury (2006). In line with Roychowdhury's (2006), I use the reduction of discretionary expenditures such as R&D, selling, general and administrative and advertising expenses to calculate abnormal discretionary expenses (AEXP). I also estimate the abnormal Cash Flow from Operations (CFO), abnormal production costs (APROD) as proxies for real earnings management. I then estimate real earnings manipulations as the residuals from the following models:

$$EXP_{it}/A_{it-1} = \alpha_1 * (1/A_{it-1}) + \alpha_2 * (REV_{it}/A_{it-1}) + \varepsilon_t$$
(1)

Where: EXP_{it} is the discretionary expenditures, defined as the sum of advertising, selling, general and administrative and R&D expenses. A_{it-1} is the lagged total assets. REV_{it} is the net revenues.

 $CFO_{it} / A_{t-1} = \beta_1 + \beta_2 1 / A_{it-1} + \beta_3 S_{it} / A_{it-1} + \beta_4 \Delta S_{it} / A_{it-1} + \varepsilon_{it}$ (2)

Where: CFO_{it} is the cash flow from operating activities, $1/A_{it-1}$ is lagged assets, S_{it}/A_{it-1} scales sales, $\Delta S_{it}/A_{it-1}$ is scaled changes in sales.

I estimate the actual production costs PROD as the sum of cost of goods sold COGS and change in inventory and then estimate the APROD as the difference between actual production

and estimated production costs from model 3. Stated differently, the APROD is the residual from the following model:

 $PROD_{t}/A_{t-1} = \beta_1 + \beta_2 \ 1/A_{it-1} + \beta_3 \ S_{t}/A_{t-1} + \beta_4 \ (\Delta S_{t}/A_{t-1}) + \beta_5 \ \Delta S_{t-1}/A_{t-1} + \varepsilon_t$ (3)

Following Cohen and Zarowin (2010), I use two aggregate measures of real earnings management to capture the magnitude of real earnings management. The first aggregate measure (REM1) is calculated as follows: (AEXP*-1)+APROD and the second aggregate measure (REM2) is calculated as follows: (AEXP*-1)+(ACFO*-1). I then use model 4 to test my main research hypothesis.

REM_{it} = $\beta_0 + \beta_1 \text{Late_filers}_{it} + \sum_{j=1}^{n_j} \delta_j$ Control Variables_j + ε_{it} (Model 4)

Where REM it is Real Earnings Manipulations measured by three proxies, (1) abnormal discretionary expenses (AEXP), (2) abnormal Cash Flow from Operations CFO, and (3) abnormal production costs APROD. The independent variable of interest in my study is Late filers. Late filers variable captures the disclosure timing and is proxied by two variables: Test and Late year. Test is an indicator variable=1 if the firm filed financial statements after the fiscal year end date, and zero otherwise. Late year is an indicator variable =1 if the firm actually a late filer (missed the SEC due date), zero otherwise. I also add a set of control variables to model 4(Control Variables_i) that would explain the variations. These control variables are described below. Discretionary accruals as measured by the correct model of the Modified Jones Model as in Dechow et al. (1995) (ABS STD DECHOW) and using Jones Model (1991) (ABD JONES). I also control for real earnings management other individual and aggregate measures not tested as a dependent variable, total assets (AT), Market-to-Book ratio (MTB), Return on Assets (ROA), Losses firms (LOSS), litigation industries (LIT), SOX 2002 (SOX), restatements (RESTAT), leverage (LEV), regulated industries (REG), percent institutional holdings (HOHDINGS), number of unique analysts' earnings forecasts in the year (Analysts), number of geographic (Geo Segs) and business (BUS Segs)segments, Big N audit firms (BIG N), indicator variables to proxy for industry (IND), an indicator variable to proxy for the recent financial crisis (Crisis), and indicator variables to proxy for fixed year-effects.

EMPIRICAL RESULTS

The Univariate Analysis in Table 1 suggests that firms that file the financial statements after the fiscal year-end is exhibiting significant earnings management through discretionary accruals as well as real earnings management, specifically abnormal cash flow from operations and abnormal production costs. Similarly, firms that do file late financial statements are exhibiting the same pattern of earnings management behavior. As expected, firms that file late are having significantly lower institutional holdings and analysts following than timely filers. Late filers are also smaller, audited less by Big_N audit firms, experience losses frequently, and low performing that firms that file on-time.

The results from the Pearson and Spearman correlation matrix are shown in Table 2 and suggest positive significant correlations between discretionary accrual measures and late filers. Table 2 also suggests a negative significant correlation between late filers and abnormal cash flow from operations and a positive significant correlation between late filers and abnormal production expenses.

Table 3 summarizes the results of the Multivariate Analysis Linear Regression (Model 4) that captures the association between real earnings management and firms that file after the fiscal year-end. As expected, the results show a significant negative association at 1% between

abnormal discretionary expenses and firms that file after the fiscal year-end. The results also suggest a significant positive association between abnormal production costs at 1% and firms that file after the fiscal year-end. The results in Table 4 suggest that firms that file late (form NT 10-K) are significantly manipulating abnormal discretionary expenses.

I further run model 4 with discretionary accruals measures as the independent variables and the results (untabulated) provide consistent evidence that firms that file financial statements after the fiscal year-end and late filers are significantly associated with discretionary accruals. Following Cohen and Zaorwin (2010), I also run model 4 using aggregate earnings management measures (RM1& RM2)⁵ as the dependent variable The results (untabulated) suggest a non-significant evidence that late filers are significantly associated with real earnings management using the aggregate measures. This latter result suggests doing further analysis to validate the results of the preliminary analysis.

CONCLUSION AND LIMITATIONS

This study empirically investigates the association between late filers of form NT 10-K and real earnings manipulation in the U.S. market. I predict that late filers are motivated to manipulate earnings using real earnings manipulation. In line with my prediction, the preliminary results of this present study suggest that firms that file form NT 10-K are more likely to manipulate discretionary expenses and productions costs. However, the results suggest that actual late filers manipulate earnings using only abnormal discretionary expenses. The preliminary results of this study should be interpreted with caution as the results might be subject to selection bias. For example, Brazel and Dang (2008) argue that firms intentionally manage the release time of financial reporting. Also, further analysis is needed to control for other earnings management motives such as: manager's over-confidence and risk taking propensity. This study may be extended by examining the association between late filings and real earnings management moderated by the reasons for late filings (e.g., audit delay, accounting reasons) in order to gain an understanding on the determinants of real earnings management among late filers.

FOOTNOTES

¹ NT stands for Not-Timely.

² <u>http://www.sec.gov/rules/final/33-8128.htm</u>

³ Non-accelerated filers are firms with market capitalization less than \$75 million, accelerated filers are firms with market capitalization greater than \$75 million and less than \$700 million, large accelerated filers are firms with market capitalization greater than \$700 million. The market value of equity is based on the last business day of the firm's most recent second fiscal quarter.

⁴ Appendix A summarizes the filing deadlines by SEC pre and post SOX 2002.

⁵ RM1=(DISC*-1)+APROD. RM2=(ACFO*-1) + (DISC*-1). DISC is the abnormal discretionary expenses. APROD is the abnormal production costs. ACFO is the abnormal cash flow from operations.

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	Filing Deadlines by SEC post SOX								
	2002	2003	2004	2005					
Non-Accelerated	10-K:90	10-K:90	10-K:90	10-K:90					
Filers	10-Q:45	10-Q:45	10-Q:45	10-Q:45					
Accelerated Filers	10-K:90	10-K:75	10-K:75	10-K:75					
	10-Q:45	10-Q:45	10-Q:40	10-Q:40					
Large Accelerated	10-K:90	10-K:75	10-K:75	10-K:75 before Dec. 15,					
Filers	10-Q:45	10-Q:45	10-Q:40	2006 and 60 days after					
				Dec. 15, 2006					
				10-Q:40					

Appendix A *The filing deadlines by the SEC pre and post SOX 2002*

The original filing deadlines prior to SOX have been constant for nearly three decades from 1970-2002. It was SOX that considerably changed SEC's perspective regarding filing deadlines. The final rules of the SEC deadlines for filing are effective on or after December 2006 as follows.

Variables' definitions							
Variable	Abb.	Definition & measurement					
Late filers1	TEST	An indicator variable = 1 for all years for any firm that has filed late at least once					
Late filers2	LATE-YEAR	An indicator variable = 1 only for the years in which one of the above firms actually filed late					
Discretionary Accruals	ABS_STD_D ECHOW	I measure the discretionary accruals using the correct model of the Modified Jones Model as in Dechow et al. (1995). This measures the absolute value of the standard deviation of Dechow's model.					
Absolute Value of Discretionary Accruals	ABS_JONES	Absolute value of discretionary accruals using Jones Model (1991)					
Abnormal Cash Flow from Operations	ACFO	Actual CFO – normal CFO. I measure CFO as in Cohen and Zarowin (2010)					
Abnormal Discretionary Expenses	DISC	Actual expenses - normal Expenses. I measure DISC as in Cohen and Zarowin (2010)					
Abnormal Production Expenses	APROD	Actual production costs – normal production costs. I measure PROD as in Cohen and Zarowin (2010)					
First Aggregate Measure of Real Earnings management	RM1	(DISC*-1)+APROD. I measure RM1 as in Cohen and Zarowin (2010)					
Second Aggregate Measure of Real Earnings management	RM2	(ACFO*-1) + (DISC*-1). I measure RM2 as in Cohen and Zarowin (2010)					
Total Assets	AT	Natural log of total assets					
Market-to-Book Ratio	MTB	Market value of equity/common total equity					
Losses Firms	LOSS	An indicator variable =1 if the firm is incurred losses in the last two years					
Restatements	RESTAT	An indicator variable =1 if the firm restated current year's retained earnings, zero otherwise					
Leverage	LEV	Total debt/total assets					
Return on Assets	ROA	Income before extraordinary items/lagged assets					
Litigation	LIT	An indicator variable = 1 if the firm is a in litigous industry, any industry within these SIC codes: 2833-2836, 8731-8734, 7371-7379, 3570-3577, and 3600-3674.					
Regulated Industries	REG	An indicator variable = 1 if the firm is a regulated industry (firms with SIC codes: 6000-6999 or 4900-4999), zero otherwise					
Financial Crisis	CRISIS	An indicator variable = 1 for the fiscal year between 2007 and 2010, zero otherwise					
Sarbanes-Oxley Act 2002	SOX	An indicator variable = 1 for period post SOX (year 2002) and 0 otherwise					
Holdings	HOLDINGS	percent institutional holdings					
Analysts	ANALYSTS	number of unique analysts' earnings forecasts in the year					
Geographic segments	GEO_SEGS	number of geographic segments					
Business segments	BUS_SEGS	number of business segments					
Big N	BIGN	An indicator variable that flags Big 4 auditors					

Appendix B	
riables' definitions	

	test=1		test=0		Differe	Difference Tests		Late_year=1		Late_year=0		Difference Tests	
	<i>n</i> =4	,188	<i>n</i> =10	,533			n=0	546	<i>n</i> =14,075				
	Mean	Median	Mean	Median	t test	Wilcoxon- test	Mean	Median	Mean	Median	t test	Wilcoxon- test	
ABS_JONES	0.0545	0.0316	0.0371	0.0223	***	***	0.0660	0.0362	0.0410	0.0238	***	***	
ABS_STD_DECHOW ACFO	$0.0266 \\ 0.0778$	0.0182 0.0525	0.0186 0.0926	0.0128 0.0738	*** ***	*** ***	0.0306 0.0552	0.0219 0.0261	$0.0204 \\ 0.0899$	$0.0204 \\ 0.0696$	*** ***	*** ***	
DISC	0.0375	0.0130	0.0351	0.0150			0.0557	0.0230	0.0348	0.0139			
APROD	-0.0998	-0.0757	-0.1080	-0.0893	**	***	-0.0815	-0.0568	-0.1068	-0.0869	***	***	
RM1	-0.1618	-0.0920	-0.1566	-0.1068			-0.1518	-0.0667	-0.1583	-0.1039			
RM2	-0.0567	-0.0672	-0.0642	-0.0866		***	-0.0360	-0.0497	-0.0633	-0.0828		**	
HOLDINGS	0.6495	0.6635	0.6662	0.6953	***	***	0.6370	0.6576	0.6626	0.6884	*	**	
ANALYSTS	4.9441	3.0000	6.7725	5.0000	***	***	4.3545	3.0000	6.3395	4.0000	***	***	
GEO_SEGS	2.9628	2.0000	2.9439	2.0000		**	3.1471	2.0000	2.9402	2.0000	**		
BUS_SEGS	2.2178	1.0000	2.4395	2.0000	***	***	2.4087	2.0000	2.3749	2.0000			
BIGN	0.8083	1.0000	0.9068	1.0000	***	***	0.7570	1.0000	0.8843	1.0000	***	***	
AT	733.3200	275.6380	1794.5400	576.9130	***	***	672.9239	223.2105	1530.2500	466.1000	***	***	
МТВ	2.9519	1.9508	3.3751	2.1794		***	2.4127	1.7979	3.2934	2.1326		***	
LOSS	0.4358	0.0000	0.2725	0.0000	***	***	0.6161	1.0000	0.3053	0.0000	***	***	
RESTAT	0.0267	0.0000	0.0205	0.0000	**	**	0.0449	0.0000	0.0212	0.0000	***	***	
LEV	0.4795	0.4498	0.4612	0.4562	***	*	0.5456	0.4926	0.4628	0.4529	***	***	
ROA	-0.0003	0.0328	0.0487	0.0580	***	***	-0.0829	-0.0022	0.0402	0.0541	***	***	
LIT	0.2858	0.0000	0.2382	0.0000	***	***	0.2941	0.0000	0.2498	0.0000	**	***	
CRISIS	0.2168	0.0000	0.1913	0.0000	***	***	0.1966	0.0000	0.1987	0.0000			
SOX	0.6005	1.0000	0.5524	1.0000	***	***	0.7941	1.0000	0.5556	1.0000	***	***	

TABLE 1UNIVARIATE ANALYSIS

Notes to table 1: ***, **, and * indicate significance levels at 1%, 5% and 10% respectively. Variables' definitions are in Appendix B.
	TEST	LATE_YEAR	ABS_JONES	ABS_STD_DECHOW	ACFO	DISC	APROD	RM1	RM2
TEST		0.33975 ^a	0.13915 ^a	0.15905 ^a	-0.0417 ^a	0.00334	0.01972 ^b	-0.0053	0.0020
LATE_YEAR	0.33975 ^a		0.09076 ^a	0.09129 ^a	-0.0444 ^a	0.01295	0.02763 ^a	0.0030	0.0032
ABS_JONES	0.13915 ^a	0.09076 ^a		0.28285 ^a	-0.0364 ^a	0.0854^{a}	-0.0543 ^a	-0.0837 ^a	-0.0077
ABS_STD_DECHOW	0.15905 ^a	0.09129 ^a	0.28285 ^a		-0.0273 ^a	0.06122 ^a	-0.0441 ^a	-0.0655 ^a	-0.0029
ACFO	-0.0417 ^a	-0.04444 ^a	-0.03635 ^a	-0.02725 ^a		-0.2992 ^a	-0.2749 ^a	0.03225 ^a	0.21688 ^a
DISC	0.0033	0.0130	0.0854 ^a	0.06122 ^a	-0.2992 ^a		-0.3123 ^a	-0.8369 ^a	-0.5788 ^a
APROD	0.01972 ^b	0.02763 ^a	-0.05426 ^a	-0.04414 ^a	-0.2749 ^a	-0.3123 ^a		0.59479 ^a	0.06168 ^a
RM1	-0.0053	0.0030	-0.0837 ^a	-0.06546 ^a	0.03225 ^a	-0.8369 ^a	0.59479 ^a		0.54833 ^a
RM2	0.0020	0.0032	-0.0077	-0.0029	0.21688 ^a	-0.5788 ^a	0.06168 ^a	0.54833 ^a	

TABLE 2PEARSON AND SPEARMAN CORRELATION COEFFICIENTS, N = 14,721

Notes to table 2: a, b, and c indicate significance levels at 1%, 5% and 10% respectively. Pearson correlation is the upper diagonal and Spearman correlation is the lower diagonal. Variables' definitions are in Appendix B.

		ACFO		DISC		APROD	
Parameter	Predicted Sign	Coeff.	t-value	Coeff.	t-value	Coeff.	t-value
INTERCEPT	?	0.1975	7.91***	-0.0016	-0.06	0.0813	3.42***
TEST	+	-0.0023	-0.96	-0.0126	-4.56***	0.0094	4.14***
ABS_JONES	+	0.0711	3.56***	0.0685	2.97***	-0.0596	-3.14***
ABS_STD_DECHOW	+	-0.0567	-1.16	-0.0485	-0.86	0.0352	0.76
DISC	+	-0.3214	-48.43***			0.2164	32.99***
ACFO				-0.4287	-48.43***	-0.1338	-17.21***
APROD	-	-0.1479	-17.21***	0.3190	32.99***		
RM1	-	-0.1592	-26.53***	-0.6608	-145.65***	0.4315	93.15***
RM2	+	0.0033	4.00***	-0.0096	-10.1***	-0.0312	-42.32***
HOLDINGS	-	0.0088	2.46**	0.0034	0.83	0.0077	2.26**
ANALYSTS	+	0.0021	9.52***	0.0007	2.81***	-0.0013	-6.18***
GEO_SEGS	+	0.0009	1.62	0.0002	0.27	-0.0004	-0.81
BUS_SEGS	+	-0.0004	-0.55	-0.0010	-1.22	0.0038	5.96***
BIGN	+	0.0027	0.8	-0.0050	-1.28	0.0041	1.28
AT	-	0.0000	-3.04***	0.0000	1.04	0.0000	2.93***
MTB	-	0.0000	2.68***	0.0000	1.04	0.0000	0.57
LOSS	-	-0.0314	-12.06***	0.0029	0.97	0.0059	2.35**
RESTAT		0.0181	2.58***	0.0139	1.72*	0.0056	0.84
LEV		-0.0212	-4.75***	-0.0060	-1.16	0.0099	2.33**
ROA		0.1038	15.77***	-0.0044	-0.58	-0.0858	-13.67***
LIT		0.0297	10.99***	0.0362	11.59***	-0.0377	-14.69***
CRISIS		0.0178	2.42**	-0.0802	-9.51***	-0.0326	-4.69***
SOX		-0.0172	-2.62***	0.0023	0.3	-0.0093	-1.48
Industry indicators		Included		Included		Included	
Year indicators		Included		Included		Included	
F Value		230.81		1516.87		534.06	
# Obs.		14,721		14,721		14,721	
Adjusted R ²		39%		81%		60%	

 TABLE 3

 CROSS-SECTIONAL REGRESSION OF REAL EARNINGS MANAGEMENT ON LATE FILERS

Notes to table 3: ***, **, and * indicate significance levels at 1%, 5% and 10% respectively. Variables' definitions are in Appendix B.

		ACFO		DISC		APROD	
Parameter	Predicted Sign	Coeff.	t-value	Coeff.	t-value	Coeff.	t-value
INTERCEPT	?	0.1974	7.91***	-0.0052	-0.18	0.0843	3.54***
LATE_YEAR	+	-0.008	-1.53	-0.0133	-2.20**	0.0067	1.35
ABS_JONES	+	0.0709	3.56***	0.0641	2.78***	-0.0558	-2.94***
ABS_STD_DECHOW	+	-0.0577	-1.19	-0.0668	-1.19	0.0501	1.08
DISC	+	-0.3214	-48.45***			0.2158	32.88***
ACFO				-0.4291	-48.45***	-0.1341	-17.24***
APROD	-	-0.148	-17.24***	0.3180	32.88***		
RM1	-	-0.1591	-26.52***	-0.6607	-145.53***	0.4314	93.06***
RM2	+	0.0033	3.99***	-0.0096	-10.13***	-0.0313	-42.33***
HOLDINGS	-	0.0087	2.43**	0.0027	0.64	0.0083	2.44**
ANALYSTS	+	0.0021	9.59***	0.0008	3.07***	-0.0014	-6.43***
GEO_SEGS	+	0.0009	1.61	0.0001	0.14	-0.0004	-0.69
BUS_SEGS	+	-0.0004	-0.53	-0.0009	-1.16	0.0038	5.91***
BIGN	+	0.0028	0.82	-0.0038	-0.98	0.0032	0.97
AT	-	0	-3.02***	0.0000	1.31	0.0000	2.68***
MTB	-	0	2.67***	0.0000	1.05	0.0000	0.56
LOSS	-	-0.0313	-12.02***	0.0025	0.81	0.0063	2.54**
RESTAT		0.0183	2.61***	0.0136	1.68*	0.0060	0.90
LEV		-0.0209	-4.70***	-0.0063	-1.23	0.0103	2.43**
ROA		0.1033	15.67***	-0.0046	-0.59	-0.0861	-13.68***
LIT		0.0297	10.98***	0.0359	11.49***	-0.0375	-14.60***
CRISIS		0.0178	2.44**	-0.0797	-9.45***	-0.0331	-4.75***
SOX		-0.0174	-2.65***	0.0015	0.20	-0.0087	-1.40
Industry indicators		Included		Included		Included	
Year indicators		Included		Included		Included	
F Value		230.87		1514.84		533.13	
# Obs.		14,721		14,721		14,721	
Adjusted R ²		39%		81%		60%	

 TABLE 4

 CROSS-SECTIONAL REGRESSION OF REAL EARNINGS MANAGEMENT ON LATE FILERS

Notes to table 4: ***, **, and * indicate significance levels at 1%, 5% and 10% respectively. Variables' definitions are in Appendix B.

SEGMENT DISCLOSURES DECISION-CONTEXT FRAMEWORK AND DECISION-USEFULNESS PREDICTION MODEL

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ABSTRACT

Fundamental analysis investors are of the opinion that improved accounting standards would increase their confidence in employing financial disclosures. They maintain segment disclosures are crucial to their decision processes. For these reasons, research into defining and modeling decision usefulness warrants greater attention. We developed a segment disclosures decision-context framework, decision-usefulness prediction model, and definitions for the data qualities that compose our model. We developed these tools using the classical grounded theory methodology and data from these literatures: value-focused thinking, segment reporting, investment professionals, and data qualities. We find that decision usefulness is a general measurable construct that pertains to all data—financial and non-financial. Future accounting researchers and standard-setters could modify our tools to test and improve standard-setting. Furthermore, researchers in other disciplines could modify them to test and improve the decision usefulness of crucial data employed by decision-makers in their fields.

Keywords: segment disclosures, decision usefulness, data qualities, prediction model, decision-context framework, fundamental analysis investors, investment professionals, value-focused thinking, classical grounded theory.

*This study's data came from my dissertation. I gratefully acknowledge the financial support I received from these sources during my doctoral studies: the KPMG Foundation Doctoral Scholarship Fund; and these of the University of Houston C.T. Bauer College of Business: the Tillie and Tom McDonald Scholarship Fund, the Jessie Jones Leadership Development Scholarship Fund, and the International Institute for Diversity and Cross Cultural Management Research. I am the corresponding author; my e-mail address is Cynthia.Tollerson@Morgan.edu.

**Wynne W. Chin and George O. Gamble co-chaired my dissertation.

This paper benefited from insightful comments received during workshops at Morgan State University, Southern Illinois University Carbondale, and the University of Houston. We appreciate the helpful observations of Phyllis Keys and Kelly Carter.

INTRODUCTION

Fundamental analysis investors say they could more confidently employ financial disclosures if accounting standards were better (Schapiro, 2011). Thus, a primary issue facing the Financial Accounting Standards Board (FASB) is the following: What data qualities should standard-setters advance to improve financial disclosures' decision usefulness?

The aforementioned issue is the root of professional investors' discontent with United States (U.S.) firms' pre-1998 segment reporting disclosures. They maintain that segment disclosures are crucial to professional investors. However, pre-1998 disclosures were not as understandable, relevant, reliable, detailed, or issued as frequently as they desired (Knutson, 1993). Hence, in order to mitigate the above mentioned concerns of professional investors, the FASB issued Statement of Financial Accounting Standards Number 131 (SFAS No. 131), "Disclosures about Segments of an Enterprise and Related Information" (Financial Accounting Standards Board, 1997), to replace SFAS No. 14, "Financial Reporting for Segments of a Business Enterprise" (Financial Accounting Standards Board, 1976).

Prior researchers report under SFAS No. 131, firms are releasing dissimilar segment profit measures (Street, Nichols, & Gray, 2000). However, other researchers report post-1998 segment disclosures, compared to pre-1998 disclosures, reveal more segments and more data about each segment (Herrmann & Thomas, 2000; Street et al., 2000); greater cross-segment earnings growth differences (Wang, Ettredge, Huang, & Sun, 2011); only certain firm types are disclosing more segments (Berger & Hann, 2007; Ettredge, Kwon, & Smith, 2000); and firms which heavily rely on external funding disclose greater differences in segment profitability (Ettredge, Kwon, Smith, & Stone, 2006). Despite prior researchers' findings and the FASB's motivation for issuing SFAS No. 131, researchers have not presented a means for predicting investors' segment data decision-usefulness perceptions.

This study's purpose is to present a theory for predicting investors' segment data decision-usefulness perceptions. First, we identify a decision context (contemplated activities) framework (Keeney, 1996) that represents decisions made by fundamental analysis investment professionals—the investors most interested in segment disclosures (American Institute of Certified Public Accountants, 1994a, 1994b). Second, we identify the data qualities that predict these investors' perceptions. Finally, we develop a model that conveys the relations among these data qualities. We employ the classical grounded theory (CGT) research methodology to develop our theory.

This study is significant for two reasons. First, it presents a decision-context framework that abstracts the relations among fundamental analysis investors, their common investment decision model, the data they employ, and their desired segment data decision-usefulness qualities. This is of import because the accounting literature has debated whether standard-setters should emphasize decision-makers' or decision models' needs (American Institute of Certified Public Accountants, 1994a; Sterling, 1972). We assert both should be explicated, and the decision contexts the standards are to facilitate.

Second, it presents three data quality definition sets, and a decision-usefulness prediction model. One set pertains to segment disclosures, another to all financial disclosures, and the last to all data. We demonstrate that decision usefulness is a definable general concept. This is of import because the lack of a measurable decision usefulness definition at the individual decision-maker level has stymied prior researchers' efforts to assess firms' responses to standard-setting¹, and thus has limited researchers efforts to inform standard-setters.

Third, it suggests that researchers in other disciplines could modify our decision-context framework, prediction model, and data quality definitions to explore the decision usefulness of data crucial to decision-makers in their fields.

The rest of this paper is organized as follows. First, we describe our methodology and research procedures. Then we present our results and discussion.

METHODOLOGY AND RESEARCH PROCEDURES

To execute our study we employed the CGT methodology (Glaser, 1978, 1998; Stern & Porr, 2011); it is one of several competing grounded theory methodologies (Charmaz, 1990; Corbin & Strauss, 1990; Elharidy, Nicholson, & Scapens, 2008; S. G. Sutton, Reinking, & Arnold, 2011). We employed CGT because it best enabled us to develop a testable theory for predicting investors' segment data decision-usefulness perceptions. The reason is that CGT leads to a conceptual theory capable of empirical testing. While other variants lead to more descriptive findings (Glaser, 2003).

In the accounting literature, one seldom finds a study employing grounded theory. Moreover, researchers disagree about whether prior studies were executed consistent with core grounded theory canons (Gurd, 2008; Joannides & Berland, 2008). Consequently, we next describe CGT and our research procedures.

Classical Grounded Theory

CGT is a set of inductive and deductive procedures for developing theory. Business researchers have employed CGT to develop information systems (Evermann & Tate, 2009; Urquhart, Lehmann, & Myers, 2010), management (Isabella, 1990; Suddaby, 2006; R. I. Sutton, 1987), and accounting (Anderson & Widener, 2007; Barker, 1998; Gibbins, Richardson, & Waterhouse, 1990; J. Holland, 1998; J. B. Holland, 1998; von Alberti-Alhtaybat & Al-Htaybat, 2010) theories.

The purpose of a CGT study is not established before the study is initiated. Instead, it emerges from the data as the study progresses (Glaser, 1992). A CGT study begins by identifying an initial dataset² requiring analysis. Initial data are broken apart (fractured) to facilitate identifying its similarities and differences. Then fractured data are compared, categorized, and named (substantively coded) (Glaser, 1978, 1998). Conceptual likeness rather than description is the substantive coding aim (Glaser, 2003, 2007; Glaser & Holton, 2005; Holton, 2009). Data are substantively coded to identify their latent patterns, and conceptual properties or conceptual dimensions or both³ (Holton, 2010).

To identify new data for analysis CGT employs theoretical sampling, which is an iterative logical reasoning process. One theoretically samples to select data that will lead to identifying related latent patterns. Theoretical sampling stops when the theory explains, predicts, and interprets the phenomenon of interest; when this occurs the latent patterns are saturated (Glaser, 1978, 1998).

Classical grounded theorists analyze latent patterns to identify the most pressing issues expressed in the substantively coded data. The core or most important issue becomes the core category (core variable). All other latent patterns of interest characterize properties or dimensions of the core variable (Glaser, 1978, 1998; Glaser & Holton, 2005).

CGT includes theoretical coding, which is a deductive reasoning process for abstracting identified relations among latent patterns (Glaser, 1978, 1998, 2005). Glaser (1978) presents thirty abstract relations sets; these are called theoretical coding families⁴. Individual codes within

a family are called theoretical codes. Theoretical coding is central to the aim of CGT studies, which is to produce conceptual hypotheses grounded in empirical data (Glaser, 1998; Glaser & Holton, 2005).

Throughout the CGT process, memos are prepared and used to record ideas, hunches, and questions. Memos are sorted at the theoretical coding stage to facilitate pattern abstraction, and are used at the report writing stage to write the findings and discussion (Stern and Porr 2011).

Our Classical Grounded Theory Research Procedures

Our CGT procedures were a team effort. The team was comprised of two representatives from the accounting field and one from decision sciences. Prior to the study, the accounting representatives were familiar with some of the employed data. The decision science representative was knowledgeable of CGT procedures.

In keeping with the CGT methodology, we did not develop our research purpose before we initiated our CGT procedures. We selected SFAS No. 131 as our initial data. The reason is, investment professionals' perceptions of segment data is our research interest. Executing the theoretical sampling process led us to employ additional data. We employed literature concerning analysts that use segment data and how they use it (American Institute of Certified Public Accountants, 1994a, 1994b; Boersema & Van Weelden, 1992a, 1992b). We employed literature that describes the fundamental analysis investment decision model (Damodaran, 2002; Graham & Zweig, 2003; Whitman & Shubik, 2006).

Next we employed literature that describes investment professionals and their decision contexts (Gardner, 2003; Investment Adviser Association, 2006a, 2006b, 2006c, 2006d, 2006e, 2006f; Investment Adviser Association & National Regulatory Services, 2006; LeBlanc & Fisher, 2004; Trone, Allbright, & Taylor, 1996). We employed pre-2010⁵ accounting literature concerning data qualities⁶ (American Accounting Association, 1966; American Institute of Certified Public Accountants' Accounting Objectives Study Group, 1973; American Institute of Certified Public Accountants' Accounting Principles Board, 1976; Financial Accounting Standards Board, 1980; Snavely, 1967)⁷. Finally, we employed a reference (Keeney, 1996) from the value-focused thinking literature. It presents a framework for articulating the relations among decision-makers, decisions, values, decision contexts, and information.

During our data quality literature fracturing and substantive coding procedures, we recognized the general nature of data qualities. That is, they pertain to all data. We employed various dictionaries to develop definitions for each quality.

Though not part of CGT, we conducted eight talk-aloud interviews (five with accounting professors, one with a marketing professor, and two with Ph.D. students [one accounting and one decision sciences]). During the interviews, the prediction model and its variable definitions were examined. Minor definition amendments were suggested; model amendments were not suggested.

We employed memos throughout our research procedures. They identify our theoretical sampling procedures, and relationships among our substantive and theoretical codes. Further, our memos reflect how our study's purpose emerged. Next, we present the results of our fracturing procedures and of our substantive and theoretical coding.

RESULTS

Fracturing and Substantive Coding Results—Value-Focused Thinking Literature

Our value-focused thinking literature fracturing and substantive coding identified a theoretical coding family that conveys a framework for articulating the relations among these concepts: decision-makers, decisions, values (including data qualities), decision contexts, fundamental objectives, decision frames, a strategic decision context, a strategic objective, and information. This literature defines each concept, except for information⁸. Figure 1 depicts the framework, which Keeney (1996) calls the "Value-Focused Thinking Framework with Flow of Information Indicated."

FIGURE 1 VALUE-FOCUSED THINKING FRAMEWORK WITH FLOW OF INFORMATION INDICATED. ADAPTED FROM KEENEY (1996) PAGE 46.



Keeney's framework is central to conveying how values and information link decision-makers that employ a common decision model⁹. Furthermore, his framework illustrates our decision-usefulness prediction model's universality. Keeney's framework is the fundament of our overarching theoretical framework. We accept his framework as given, and next define its concepts and explain the relations among them.

A *decision-maker* is any decision-making entity; it could be a person, organization, or society.

A *decision* is the act of allocating resources. These are resource examples: time, money, and property. An *alternative* is a different resource allocation, or an allocation of a different resource.

Values are the things about which a decision-maker cares. Some are tangible; others are intangible. An articulated value definition includes a value's distinguishing attribute(s), and its aim. Values are used to evaluate the consequences of an alternative or decision. Data qualities are a type of value.

A *decision context* is a contemplated activity. A *fundamental objective* is a statement that identifies the most pressing reason for making a decision. A fundamental objective has three distinguishing attributes: a decision context; an object, which is the thing one most hopes to achieve; and a preference direction.

A *decision frame* is the condition for making a decision. A decision frame includes at least one decision context and one compatible fundamental objective.

A *strategic decision context* is the most general decision context facing a decision-maker. It is the complete available alternatives set.

The fundamental objective of the strategic decision context is the decision-maker's *strategic objective*. Objectives other than the strategic objectives are a means to achieve the later. All decision-makers have strategic objectives, whether articulated or not. Strategic objectives guide decision-making. *Strategic decisions* are made over time and are the way strategic objectives are pursued.

Figure 1 represents a value-focused thinker's decision set. Two decision contexts are depicted: a strategic and non-strategic decision context. These decision-makers make decisions only after articulating their values. Consequently, they specify each value by identifying its distinguishing quality(ies). They identify their rationale for each value, and employ values to assess the consequences of a particular decision or alternative. For value-focused decision-makers, values are the mechanism for increasing the likelihood that their fundamental objectives will align with their strategic objective. Their aim is to align their decision contexts with the strategic decision context.

Fracturing and Substantive Coding Results—Segment Reporting Literature

Our segment reporting literature fracturing and substantive coding identified that segment disclosures' decision usefulness is of particular interest to one investor type: those that employ the fundamental analysis approach (decision model) to support their equity investment decisions. The reason is, by comparatively analyzing data, these investors devise or employ analyses that identify mispriced equity securities. These mispriced equity analyses are supported by three kinds of comparative analyses: cross-sectional, time series, and financial ratio. Moreover, these investors either derive or employ segment analyses that support long-term firm-wide market value forecasts (American Institute of Certified Public Accountants, 1994a, 1994b; Boersema & Van Weelden, 1992a, 1992b). Fundamental analysis decision-makers' use segment disclosures "to better understand firms" (Boersema & Van Weelden, 1992b; Financial Accounting Standards Board, 1997).

Fracturing and Substantive, and Theoretical Coding Results—Investment Professionals Literature

Our fracturing and substantive coding of literature concerning investment professionals revealed six decision contexts that represent the equity contemplated activities of fundamental analysis decision model users: fundamental analysis research, equity valuations, equity selections, equity allocations, portfolio strategy, and portfolio management. We named these professionals fundamental-equity investors. Figure 2 (a theoretical code) conveys their decision contexts. Fundamental analysis research is their core decision context, and is the foundation for the remaining five decision contexts. Portfolio management is their strategic decision context; it embodies their complete set of fundamental-equity investment decisions and alternatives.

FIGURE 2 FUNDAMENTAL EQUITY INVESTORS' SIX DECISION CONTEXTS



Figure 3 is a Venn diagram (a theoretical code), that depicts the decisions made by fundamental analysis investors who make decisions concerning U.S. equity securities. The bottom center portion represents decisions made by fundamental-equity investors.

FIGURE 3 VENN DIAGRAM OF FUNDAMENTAL EQUITY INVESTORS' INVESTMENT DECISIONS



We define U.S. fundamental-equity investors as those that primarily make U.S. equity investment decisions, rather than decisions concerning bonds, asset backed securities, cash equivalents, or other securities. These investors make decisions involving fundamental analysis research and perhaps one or more of these: equity valuations, equity selections, portfolio strategy, equity allocations, or portfolio management. Further, their decisions are one of three types: buy-side, investment adviser-side, or sell-side.

We define buy-side decision types as those made to represent the interests of banks, foundations or endowments, government or regulatory agencies, insurance companies, investment companies, mutual funds, corporate plan sponsors, public plan sponsors, or unions. We define investment adviser-side decision types as those made to represent the interests of investment management counseling firms, investment consulting firms, or financial publishers. We define sell-side decision types as those made to represent the interests of brokers, dealers, or investment banks.

Fracturing and Substantive, and Theoretical Coding Results—Data Qualities Literature

Our data qualities literature fracturing and substantive coding identified fourteen latent patterns (variables) that represent the qualities of decision-useful segment data. These procedures led us to induce the qualities' generality. That is, they pertain to segment disclosures, all financial disclosures, and all data. Consequently, we developed and present, in Appendix A Tables $A.7 - A.10^{10}$, variable definition sets for these three data types.

Decision Usefulness is our core variable. We deduced that these variables predict it: Ease of Comparing, Relevance, Reliability, Sufficiency, and Satiation. These predict Ease of Comparing: Ease of Complete Intelligibility, and Ease of Integrating. These predict Ease of Complete Intelligibility: Readableness, Consistency with Users' Accounting Constructs, and Ease of Interpreting Accounting Estimates. Lastly, these predict Reliability: Representational Faithfulness, Degree of Verification, and Neutrality.

Figure 4 (a theoretical code) depicts our Decision-Usefulness Prediction Model. It resulted from our theoretically coding the decision-usefulness variables. Therein each predicted variable has a direct positive association with its antecedent variables

FIGURE 4 DECISION-USEFULNESS PREDICTION MODEL



Theoretical Coding Results—Value-Focused Thinking Literature

Our fracturing procedures, and our substantive, and theoretical coding of the previously discussed literatures led us to theoretically code Keeney's (1996) framework in the context of segment data, U.S. fundamental-equity investors' six investment decision contexts, and their value judgments. Given that these investors employ a common decision model, they also have a common values set regarding the information they employ. These values include the qualities of decision-useful segment data. Their use of these data in any of their decisions contexts facilitates their "understandings of firms." They decide what segment data to employ, for what purposes, based on the fundamental-analysis decision model and their decision-usefulness value judgments.

Figure 5 (a theoretical code) depicts fundamental-equity investors' decision contexts. It shows the relation among their six decision contexts and their values. Their decision-usefulness

values and value judgments are a mechanism that increases the likelihood that the objectives of their decision contexts will be aligned.





DISCUSSION

Key Assertions and Findings

This research employs the classical grounded theory methodology to develop a theory that predicts investors' segment data decision-usefulness perceptions. Our theory consists of a decision-context framework, decision-usefulness prediction model, and definitions for the data qualities that compose the model.

Our decision-context framework includes decision-makers, decision contexts, decisions, values, and segment data. The decision usefulness of segment data is of particular interest to one decision-maker class: fundamental equity investors. The reason is that segment data are important to the fundamental analysis decision model¹¹, which they employ. These investors primarily make equity investment decisions, and use segment data to *improve their understandings of firms*.

Six decision contexts jointly represent the decisions made by fundamental equity investors: fundamental analysis research, equity valuations, equity selections, equity allocations, portfolio strategy, and portfolio management. Fundamental analysis research is the core decision context. However, portfolio management is the strategic decision context because it comprises all alternative actions available to them. Fundamental-equity investors make one of three decision types: buy-side, investment adviser-side, or sell-side. The accounting literature reflects research addressing buy- and sell-side decisions (Berger, 2011; Beyer, Cohen, Lys, & Walther, 2010; Schipper, 2002). However, we could not find studies exploring adviser-side decisions¹². We define investment adviser-side decisions as those made to represent the interests of investment management counseling firms, investment consulting firms, or financial publishers. Future researchers should address this decision type. We acknowledge, however, that they may find it difficult to access these decision-makers.

Fundamental-equity investors' common decision model gives them a common set of data values. These values include the qualities of decision-useful data, and increase the likelihood that investors' decision contexts align.

Fourteen data qualities comprise our decision-usefulness prediction model. These are the data qualities that standard-setters should advance to improve segment data decision usefulness. In Appendix A Tables A.7 - A.10 we define each quality in the context fundamental equity investors' use of segment data. Each predicted quality has a direct positive association with its antecedent qualities.

These qualities are the direct antecedents of Decision Usefulness: Ease of Comparing, Relevance, Reliability, Sufficiency, and Satiation. Moreover, these predict Ease of Comparing: Ease of Complete Intelligibility, and Ease of Integrating. While these predict Ease of Complete Intelligibility: Readableness, Consistency with Users' Accounting Constructs, and Ease of Interpreting Accounting Estimates. Lastly, these predict Reliability: Representational Faithfulness, Degree of Verification, and Neutrality.

We find that data decision usefulness is a general definable construct. Consequently, we devised two additional definition sets for each of our fourteen data qualities. The first set pertains to all financial disclosures, and the second to all data. Appendix A Tables A.7 - A.10 present these definitions.

Limitations of this Study and Future Research and Standard-Setting Suggestions

A principle limitation of all grounded theory studies is that the developed theory is the research product. Thus, our theory is untested. However, we provide future researchers with a segment data users' decision-context framework, prediction model, and data quality definitions that suggest empirical measures. They could survey fundamental-equity investors to obtain segment data decision-usefulness measures. Using partial least squares to analyze the measures, researchers could inform standard-setters of SFAS No. 131's decision-usefulness. Should the FASB revise SFAS No. 131, to assess the decision usefulness of the new data releases, relative data quality measures could be devised, obtained, and analyzed. The lack of a means for measuring decision usefulness, at the decision-maker level, has stymied prior researchers' efforts to directly assess firms' responses to standard-setting¹³. We suggest a means for doing so.

In 2010 the FASB revised its accounting quality definitions (Financial Accounting Standards Board, 2010). However, these definitions do not facilitate predicting the decision usefulness of data. The primary reason is that neither usefulness, nor decision usefulness are defined therein. Thus, the FASB has not explicated a basis that researchers can employ to assess whether financial disclosures are decision useful. Our financial disclosures data quality definitions provide researchers with a model for developing such a basis. The FASB might advance standard-setting by employing a decision-context framework, decision-usefulness prediction model, and data quality definitions similar to ours.

We assert that decision usefulness is a general measurable construct. For that reason we suggest future accounting and non-accounting researchers could amend our decision-context framework, prediction model, and data quality definitions to explore the decision usefulness of any data—be it financial or non-financial.

FOOTNOTES

¹ Value relevance researchers have attempted to provide standard-setters with decision usefulness assessments of certain accounting measures. However, their analyses are market level and there is contention about the extent to which these studies inform standard-setting (Barth, Beaver, & Landsman, 2001; Holthausen & Watts, 2001).

² "All is data" is a CGT dictum. It means that any data source may compose the initial or subsequent datasets. Hence, employed data may be from interviews, observations, documents etc. Initial data are selected based on the researcher's interests (Glaser, 2007).

³ Latent patterns are latent variables. Latent variables with conceptual properties are those that have reflective latent variables. A reflective latent variable is one of at least two latent variables that move in tandem with the reflected variable. Latent variables with conceptual dimensions are those that have formative latent variables; the later compose the former. A formative latent variable does not move in tandem with the latent variable it forms, or with other formative variables (Chin, 1998).

⁴ All literatures employ theoretical coding families. Coding families facilitate abstracting a theory and expressing it diagrammatically. The most familiar theoretical code is the independent-dependent variable model (Glaser (1978).

⁵ We employed pre-2010 literature. Consequently, we did not employ the FASB's (2010) recent Conceptual Framework accounting quality definitions. We observe, however, that the FASB did not define usefulness or decision usefulness.

⁶ Appendix A Table A.1 lists these qualities by source.

⁷Appendix A Tables A.2 – A.6 provide the quality definitions by source.

⁸ We searched several literatures (accounting, information systems, library sciences, economics, and psychology), but could not find a non-tautological definition for information.

⁹ A means of linking seemingly diverse decision-makers and their common decision model is important, because accounting theorists have debated whether firms should disclose information based decision-maker needs or decision model needs. For examples of this debate see (I. A. M. Fraser & C. W. Nobes, 1985; I. A. M. Fraser & C. W. Nobes, 1985; Sterling, 1972).

¹⁰ These definition sets suggest how future researchers could modify and employ our definitions and Decision-Usefulness Prediction Model.

¹¹ This decision model focuses on understanding firms and the factors that affect them. Discounted cash flow techniques are employed to estimate their long-term firm-wide market values (Damodaran, 2002; Whitman & Shubik, 2006).

¹² It is possible prior researchers have included these decisions as a subset of buy-side decisions.

¹³ Prior accounting researchers have measured decision-usefulness, however, it has been indirectly at the market level. Further, there is contention in the literature as to the extent to which indirect measures inform standard-setting (Barth et al., 2001; Holthausen & Watts, 2001).

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	Data source(s)					
				AICPA		
				Objectives	E + CB	E + CB
			AICPA	of Financial	FASB	FASB
	AAA ASOBAT	Snavely	APD No 4	Statements	SFAC No 2	SFAC No 8
Qualities	(1966)	(1967)	(1970)	(1973)	(1980)	(2010)
Consistency	No	Yes	No	Yes	Yes	Yes
Comparability	No	Yes	Yes	Yes	Yes	Yes
Complete	No	No	No	No	No	Yes
Completeness	No	No	Yes	No	Yes	No
Confirmatory Value	No	No	No	No	No	Yes
Conservatism	No	No	No	No	Yes	No
Decision	No	No	No	No	Yes	No
Usefulness						
Faithful						
Representation	No	No	No	No	No	Yes
Feedback Value	No	No	No	No	Yes	No
Freedom from Bias	Yes	No	No	Yes	No	No
Free from Error	No	No	No	No	No	Yes
Materiality	No	No	No	Yes	Yes	Yes
Neutral	No	No	No	No	No	Yes
Neutrality	No	No	Yes	No	Yes	No
Predictive Value	No	No	No	No	Yes	Yes
Practicality	No	Yes	No	No	No	No
Quantifiability	Yes	Yes	No	No	No	No
Relevance	Yes	Yes	Yes	Yes	Yes	Yes
Reliability	No	Yes	No	No	Yes	Yes
Representational Faithfulness	No	No	No	No	Yes	No

TABLE A.1DATA QUALITIES LISTING BY DATA SOURCE(S)

	Data source(s)					
				AICPA		
				Objectives		
			AICPA	of	FASB	FASB
	AAA		APB	Financial	SFAC	SFAC
	ASOBAT	Snavely	No. 4	Statements	No. 2	No. 8
Qualities	(1966)	(1967)	(1970)	(1973)	(1980)	(2010)
Simplicity	No	Yes	No	No	No	No
Significance	No	Yes	No	No	No	No
Sufficiency	No	Yes	No	No	No	No
Timeliness	No	No	Yes	No	Yes	Yes
Understandability	No	Yes	Yes	Yes	Yes	Yes
Usefulness	No	Yes	No	No	No	No
Verifiability	Yes	No	Yes	No	Yes	Yes

TABLE A.1 DATA QUALITIES LISTING BY DATA SOURCE(S) (continued)

	TABLE A 2					
A A	A A A SOBAT (1966) DATA OUALITIES DEFINITIONS					
Qualities	Definitions					
Freedom from Bias	Free from bias means facts have been impartially determined and reported. Techniques used in developing data should be free of built-in bias (p.7).					
Quantifiability	Quantifiability means numbers are assigned to reported information (p.7).					
Relevance	Relevant information must bear upon or be usefully associated with the action it is intended to facilitate or the result it is desired to produce. This requires that the information, or the act of communicating it, exert influence or have the potential for exerting influence on the designated actions (p.9).					
Verifiability	Information is verifiable if essentially similar measures, or conclusions would be reached if two or more qualified persons examined the same data (p.7).					

Qualities	Definitions
Consistency	"Consistency with users' concepts recognizes that, for information to be understandable, it must agree–at least to some extent–with the existing ideas of financial statement users as to the meaning of the data communicated" (p. 229).
Comparability	"Comparability means financial statement information is more understandable when it is presented so that it can be compared with similar information concerning other firms and other periods of the same firm" (p. 230).
Practicality	Practicality means information must be worth more than it costs to present, and it must timely. Information's usefulness is destroyed if it does not meet the practicality criterion (p. 231).
Quantifiability	"Quantification enables events within and comprising a given venture to be brought into meaningful relationship with each other" (p. 229).
Relevance	Relevant information assists in valuing a firm, or evaluating management, or its policies (p. 228).
Reliability	Reliability means a user must be able to depend on information as a representation of what it purports to be (p. 228).
Simplicity	"Simplicity recognizes the intellectual limitations of people" (p. 230).
Significance	Significance is determined by assessing whether including financial statement data would affect a user's decision or actions (p. 230).
Sufficiency	Sufficiency means "if information is to be useful, a certain quantity and quality must be available" (p. 230).
Understandability	Understandability is the need for users of information to be able to comprehend the message(s) being communicated (p. 229).
Usefulness	Useful information is sufficient for action (p. 226).

 TABLE A.3

 SNAVELY (1967) DATA QUALITIES DEFINITIONS

Qualities	Definitions
Comparability	"Comparable financial accounting information presents similarities and differences that arise from basic similarities and differences between enterprises and their transactions and not merely from differences in financial accounting treatments. Comparable information facilitates conclusions concerning relative financial strengths and weaknesses, and relative successes between periods for an enterprise and likewise for two or more enterprises" (p. 457).
Completeness	"Complete financial accounting information includes all financial accounting data that reasonably fulfill the requirements of" (p. 456) the other data qualities.
Neutrality	Neutral financial accounting information is directed towards the common information users' needs and is independent of presumptions about particular needs and desires of specific information users (p. 456).
Relevance	"Relevant accounting information bears on the economic decisions for which it is used" (p. 456). Relevance helps in selecting measurement and reporting methods that assist users in making economic decisions (p. 456).
Timeliness	"Timely financial accounting information is communicated early enough to be used for the economic decisions which it might influence and to avoid delays in making those decisions" (p. 456).
Understandability	Understandability "requires that the users have some understanding of the complex economic activities of enterprises, the financial accounting process, and the technical terminology used in financial statements" (p. 456).
Verifiability	Verifiability means that "the attribute or attributes selected for measurement and the measurement methods used provide results that can be corroborated by independent measurers" (p. 456).

 TABLE A.4

 AICPA APB NO. 4 (1970) DATA QUALITIES DEFINITIONS

Qualities	Definitions
Consistency	Consistency "is a valuable adjunct to comparability" (p.60).
Comparability	"Comparability means to have like things reported alike, and unlike things reported differently" (p.59).
Freedom from Bias	Freedom from bias is "characterized as neutrality and fairness" (p.58).
Materiality	Materiality is defined as information that is likely to influence users' economic decisions (p.58).
Relevance	Relevance "is inseparable from the concept of purposeful information Information that does not bear on the problems for which it is intended is not useful, regardless of its other qualities" (p.58).
Understandability	"Understandability requires that information be expressed as simply as permitted by the nature and circumstances of what is being communicated" (p.60).

TABLE A.5AICPA OBJECTIVES OF FINANCIAL STATEMENTS (1973)DATA OUALITIES DEFINITIONS

Qualities	Definitions
Consistency	Consistency is "conformity from period to period with unchanging policies and procedures" (glossary).
Comparability	Comparability is "the quality of information that enables users to identify similarities in and differences between two sets of economic phenomena" (glossary).
Completeness	Completeness is "the inclusion in reported information of everything material that is necessary" (glossary).
Conservatism	Conservatism is not defined as an attribute of information. Instead it is defined as "a prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in business situations are adequately considered" (glossary).
Decision Usefulness	Decision usefulness is not defined as an attribute of information. Instead, it is defined as a judgment which is made explicitly or implicitly by individual decision-makers. That judgment considers these principal elements: the decisions to be made, the decision-making approach to be employed, the information in hand or accessible elsewhere, and the decision-maker's capability with or without the help of advisors to process the information (p.27).
Feedback Value	Feedback value is "the quality of information that enables users to confirm or correct prior expectations" (glossary).
Materiality	Materiality is not defined as an attribute of information. Instead, it is defined as a minima recognition threshold. Materiality is "the magnitude of an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement" (glossary).
Neutrality	Neutrality is the "absence in reported information of bias intended to attain a predetermined result or to induce a particular mode of behavior" (glossary).
Predictive Value	Predictive value is "the quality of information that helps users to increase the likelihood of correctly forecasting the outcome of past or present events" (glossary).
Relevance	Relevance is "the capacity of information to make a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events or to confirm or correct prior expectations" (glossary).
Reliability	Reliability is "the quality of information that assures that information is reasonably free from error or bias and faithfully represents what it purports to represent" (glossary).

TABLE A.6FASB SFAC NO. 2 (1980) DATA QUALITIES DEFINITIONS

Qualities	Definitions
Representational Faithfulness	Representational faithfulness is the "correspondence or agreement between a measure or description and the phenomenon that it purports to represent (sometimes called validity)" (glossary).
Timeliness	Timeliness is "having information available to a decision-maker before it loses its capacity to influence decisions" (glossary).
Understandability	Understandability is "the quality of information that enables users to perceive its significance" (glossary).
Verifiability	Verifiability is "the ability through a consensus among measurers to ensure that information represents what it purports to represent or that the chosen method of measurement has been used without error or bias" (glossary).

 TABLE A.6

 FASB SFAC NO. 2 (1980) DATA QUALITIES DEFINITIONS (continued)

FINANCIAL AND SEGMENT DISCLOSURES							
Latent		Definitions					
variables	All data	Financial disclosures	Segment disclosures				
Decision Usefulness	Decision usefulness is the quality of data that represents a judgment deduced when considering whether to utilize knowledge received about a fact or circumstance, to make one or more determinations.	Decision usefulness is the quality of financial disclosures that represents a judgment deduced by financial reporting data users when considering whether to use the disclosures for one or more determinations.	Decision usefulness is the quality of segment disclosures that represents a judgment deduced by fundamental-equity investors to assess whether segment disclosures improve their understandings of firms.				
Ease of Comparing	Ease of comparing is the state or the quality of data that facilitates comparison.	Ease of comparing is the quality of financial disclosures that makes them facilitate users' comparisons.	Ease of comparing is the quality of segment disclosures that represents the extent to which fundamental-equity investors perceive segment disclosures make their comparisons easy.				

TABLE A.7 DECISION USEFULNESS AND ITS ANTECEDENT LATENT VARIABLE DEFINITIONS—ALL DATA AND FINANCIAL AND SEGMENT DISCLOSURES

	FINANCIAL AND SEGMENT	DISCLOSURES (cont	inued)
	I	Definitions	
Latent			Segment
variables	All data	Financial disclosures	disclosures
Relevance	Relevance is the quality of data	Relevance is the	Relevance is the
	that makes it relevant. Relevant	quality of a financial	quality of segment
	means that two facts are so related	disclosure that makes	disclosures that
	to each other that, according to	it relevant. Relevant	represents the
	some common course of events,	financial disclosures	fundamental equity
	connection with other facts proves	are so related to each	investors perceive
	or renders probable the past	other that according	segment disclosures
	present, or future existence or	to common analysis	have a bearing on
	nonexistence of the other.	practices, one taken	their knowledge of
		either by itself or in	firms.
	Knowledge is an organized body	connection with the	
	of facts (information), or the	other, proves or	
	comprehension and understanding	renders probable the	
	consequent on having acquired	past, present, or	
	and organized a body of facts.	future existence or	
		nonexistence of the	
	knowledge and information are	other. Relevant	
	through reading study and	hear on one's	
	practical experience. Thus	knowledge of a firm	
	relevant facts have a bearing on	knowledge of a fiffi.	
	one's knowledge, only if one has		
	previous knowledge of related		
	information.		
	If one has knowledge of related		
	information, newly disclosed		
	relevant facts increases one's		
	knowledge. However, disclosure		
	of relevant facts that one is		
	already aware of, merely,		
	commissione s knowledge. While		
	contradict one's knowledge		
	creates incongruity		
	ereales meengrany.		

TABLE A.7 DECISION USEFULNESS AND ITS ANTECEDENT LATENT VARIABLE DEFINITIONS—ALL DATA AND FINANCIAL AND SEGMENT DISCLOSURES (continued)

	Definitions		
Latent		Financial	
variables	All data	disclosures	Segment disclosures
Reliability	Reliability is the quality of data that makes it reliable. Reliable means dependable in achievement, accuracy, honesty, etc. That which is dependable is worthy of trust. Reliable connotes consistent dependence.	Reliability is the quality of financial disclosures that makes them suitable to depend on, for one or more purposes.	Reliability is the quality of segment disclosures that represents the extent to which fundamental-equity investors perceive segment disclosures are suitable to depend on, to improve their understandings of firms.
Sufficiency	Sufficiency is the quality of data that makes it sufficient. Sufficient means to be adequate for some purpose. To be sufficient is to be of such quality, number, force, or value as is necessary for a purpose.	Sufficiency is the quality of financial disclosures that makes them adequate for users to use them, for one or more decisions.	Sufficiency is the quality of segment disclosures that represents the extent to which fundamental-equity investors perceive segment disclosures provide adequate segment disclosures for improving their understandings of firms
Satiation	Satiation is the quality of data that makes it able to satiate. That which is satiated lacks nothing desired for one or more purposes.	Satiation is the quality of financial disclosures that makes them capable of revealing all the disclosures users desire for one or more decisions.	Satiation is the quality of segment disclosures that represents the extent to which fundamental-equity investors perceive segment disclosures reveal all the segment disclosures they desire for improving their understandings of firms.

TABLE A.7DECISION USEFULNESS AND ITS ANTECEDENTLATENT VARIABLE DEFINITIONS—ALL DATA ANDFINANCIAL AND SEGMENT DISCLOSURES (continued)

	FINALCIAL AND SEGULENT I	JISCHOSUKES	
	Definitions		
Latent		Financial	Segment
variables	All data	disclosures	disclosures
Ease of	Ease of complete intelligibility is the	Ease of	Ease of complete
Complete	quality of data that facilitates lucidity.	complete	intelligibility is the
Intelligibility	That which has <i>lucidity</i> is lucid. It is	intelligibility	quality of segment
	easily understood. It is completely	is the quality	disclosures that
	comprehendible.	of financial	represents the
		disclosures	extent to which
	To <i>understand</i> is to be fully aware not	that makes	fundamental-equity
	only of the meaning of something, but	them capable	investors perceive
	also of its implications. Understanding	of being	segment
	is the mental process of one who	lucid.	disclosures are
	comprehends; it is		lucid.
	comprehension—the act of process of		
	interpretention, it is personal		
	interpretation.		
Ease of	Ease of integrating is the quality of	Ease of	Ease of integrating
Integrating	data that facilitates integration.	integrating is	is the quality of
	Integration is the act of combining	the quality of	segment
	parts into a complete whole. To	financial	disclosures that
	integrate is to incorporate.	disclosures	represents the
		that makes	extent to which
		them easy to	fundamental-equity
		integrate into	investors perceive
		users	disaloguras ara
		(decision	answ to integrate
		(uccision models) of	into their system
		understanding	(fundamental
		firms.	analysis decision
			model) of
			understanding
			firms.

TABLE A.8 EASE OF COMPARING ANTECEDENT LATENT VARIABLES—ALL DATA AND FINANCIAL AND SEGMENT DISCLOSURES

			пристер
Latent		Definitions	
variables	All data	Financial disclosures	Segment disclosures
Readableness	Readableness is the quality of data that makes it readable. That which is readable is easy or interesting to read.	Readableness is the quality of financial disclosures that makes them easy for users to read.	Readableness is the quality of segment disclosures that represents the extent to which fundamental-equity investors perceive segment disclosures are easy for them to read.
Consistency with Users' Constructs	Consistency with users' constructs is the quality of data that represents the degree of agreement, between a sender's representation (a word or a symbol) and a receiver's image (construct) or directly conceived or intuited object of thought (concept). That which has a high degree of agreement is equivalent in function; it corresponds; it is similar; it is analogous.	Consistency with users' accounting constructs is the quality of financial disclosures that enables users to perceive the accounting concepts therein, are equivalent in function with users' accounting concepts.	Consistency with users' accounting constructs is the quality of segment disclosures that represents the extent to which fundamental-equity investors perceive segment disclosure accounting concepts are equivalent in function to their accounting concepts.
Ease of Interpreting Estimates	Ease of interpreting estimates is the quality of data that facilitates estimate interpretations. To interpret estimates is to provide their meanings, to make their meanings clear, to render the estimates understandable.	Ease of interpreting accounting estimates is the quality of financial disclosures that makes them facilitate users' accounting estimate interpretations.	Ease of interpreting accounting estimates is the quality of segment disclosures that represents the extent to which fundamental-equity investors perceive segment disclosure accounting estimates are easy for them to interpret.

TABLE A9 EASE OF COMPLETE INTELLIGIBILITY ANTECEDENT LATENT VARIABLES—ALL DATA AND FINANCIAL AND SEGMENT DISCLOSURES

		Definitions	
Latent variables	All data	Financial disclosures	Segment disclosures
Representational	Representational	Representational	Representational
Faithfulness	faithfulness is a	faithfulness is the	faithfulness is the
	quality of data that	quality of financial	quality of segment
	adheres to a rule,	disclosures that makes	disclosures that
	which is used as a	them correspond with	represents the extent to
	basis for a	the phenomenon they	which
	judgment, to	purport to represent.	fundamental-equity
	accurately describe		investors perceive
	is identifiable from		segment disclosures
	knowledge of its		nhenomenon the
	appearance or		disclosures claim to
	characteristics.		describe.
Degree of Verification	Degree of verification is a quality of data that has been verified to an extent. That which is verified is substantiated. That which is substantiated is established by proof or by adequate evidence.	Degree of verification is the quality of financial disclosures that makes it possible to establish the extent to which they are supported by adequate evidence.	Degree of verification is the quality of segment disclosures that represents the extent to which fundamental-equity investors perceive segment disclosures are supported by adequate evidence.

TABLE A.10 RELIABILITY ANTECEDENT LATENT VARIABLES—ALL DATA AND FINANCIAL AND SEGMENT DISCLOSURES

		Definitions	
Latent variables	All data	Financial disclosures	Segment disclosures
Neutrality	Neutrality is the quality of data that makes it neutral. That which is neutral, is not aligned with or supportive of any side or position in a debate.	Neutrality is the quality of financial disclosures that makes them neutral. Neutral financial disclosures are the result of an ideal regulatory environment. Such a regulatory environment issues standards which are not unduly influenced by any particular regulatory constituency. These standards require firms to disclose information which is not unduly supportive of a position in a financial disclosures debate.	Neutrality is the quality of segment disclosures that represents the extent to which fundamental-equity investors perceive segment disclosures are not unduly supportive of a particular position in the segment reporting disclosure debate.

TABLE A.10 RELIABILITY ANTECEDENT LATENT VARIABLES—ALL DATA AND FINANCIAL AND SEGMENT DISCLOSURES (continued)