

Topics in International Business - IBUS 6354 001

Seminar in Accounting and Contracting

Fall 2017

Tuesday 1:30pm-4:20pm, COBA 307

This syllabus serves as an outline and guide for the course. Please note that I may modify it at any time with reasonable notice to students. I may also modify the schedule at any time to accommodate the needs of the class. If you have any questions or concerns about the syllabus, it is your responsibility to contact me for clarification.

1 Contact Information

Professor Richard Carrizosa, Ph.D.

Office: COBA 209

Phone: 915-747-7750

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Office Hours: By appointment. Email with detailed questions required in advance of office hours.

2 Course Description and Objectives

This course surveys the empirical research on accounting information and decisions and contracting. The two main contracting areas we will focus on are executive compensation and debt contracting. The various issues we will examine include:

1. the problems that contracts aim to address using accounting (or related) information
2. the factors that impact selection of various accounting (or related) measures to include in contracts
3. the reporting incentives associated with the inclusion of accounting (or related) measures in contracts

An additional objective of the course will be to help students develop certain data search, extraction, and organization skills. This will require students to learn to use Python to construct customized data sets using data from the SEC EDGAR website. The overall objectives of the course are:

1. to provide a broad overview of accounting-related executive compensation and debt contracting research
2. to help students learn how to assess empirical studies
3. to help students learn how to initiate and develop research projects
4. to help students learn to create customized data sets to expand their set of possible research projects

To achieve these goals students will be expected to lead and participate in research paper discussions, write referee reports, and complete data assignments. The final project will consist of identifying a potential research question and writing up the relevant literature and motivation, and providing an appropriate research design and corresponding detailed plan to obtain the required data (see Section 3.4).

The readings for this course primarily consist of published articles and working papers. The weekly readings are listed in Section 5.

3 Assessment

Component	Percentage of final grade
Class participation	25%
Referee reports	20%
Data Exercises	25%
Research proposal	30%
Total	100%

3.1 Class Participation

During class we will discuss the papers in the course outline below. I will assign presenters for several of the papers included for each topic. The presenter will provide a brief summary of the paper and lead the discussion on the motivation, research design etc. Everyone is expected to participate in the discussion of every paper, regardless of whom the paper has been assigned to. To help you critically evaluate the papers, also consider the referee report guidelines provided.

In our discussion we will focus on the several key features of the papers:

1. Research question and motivation
2. Hypothesis development
3. Research design
4. Main results
5. Follow-up questions (e.g., what question(s) would you like to ask the author? How could the work have been improved?)

We will not spend equal time on every paper, and will not necessarily cover all aspects of each paper. You are however expected to prepare to discuss each aspect of every paper.

3.2 Referee Report

You will be required to evaluate several working papers for possible publication in top accounting journals. You may use whatever reference materials you wish, but you are not to discuss the papers or your evaluations of the papers with anyone. You are to work completely independently.

I will provide you with guidelines you may use to evaluate the papers. You are responsible for determining what aspects of the papers to discuss in your reviews. You should use whatever format you find most useful. A fully informative review of an assigned paper will be no longer than approximately five pages.

3.3 Data Exercises

You will complete several data exercises throughout the semester. You may assist one another with the exercises but must submit your own work. Submissions may include input or output files and the corresponding Python, SAS, or STATA code used to create them. All code must include comments that describe the operation of the code. You may use shared code fragments but may not use shared files. If you are unable to explain how a particular piece of code works, then you may not include it as part of your submission. I will provide you with detailed instructions for each exercise and all files submitted must be in the exact format specified in the instructions.

To facilitate interaction among students, all materials that you submit may be made available to all students currently taking the class. If you wish to reuse code that a classmate has previously submitted you must get the permission of that student in advance. No materials may be shared with anyone outside of the class except by the author/creator of the materials.

3.4 Research Proposals

As the final project in the course you are required to identify an interesting research question and write a proposal for a research study. The proposal should describe the following:

1. The research question and motivation (i.e., why is it interesting)
2. A brief literature review focused on how your research would add to the existing literature (must be concise, focus on the most relevant prior work, and organized).
3. Research design (i.e., how would you test your question):
 - (a) What data would you use? How would you obtain the data? How would you measure the variables?
 - (b) What control variables would you need, how would you measure them?
 - (c) What empirical methods would you use?
4. Possible implications of your research, e.g., what does it mean if you find the results you predicted (what if you don't)? How would your findings affect other research?

The topic should be based on your research interests and is not limited to the research areas covered in this course. The proposal is an individual project; you should not discuss this with others. It should also be a new project; past work, such as summer papers and assignments for other classes cannot be used again for this class. The proposal should be double-spaced and typically should not exceed 10-12 pages. In particular, if your literature review is longer than three pages, you should rewrite it.

To help you develop your ideas I will meet with you individually throughout the semester to discuss your research ideas. For this purpose, I will require interim write-ups of your ideas (1-2 pages). For the first of those, due October 3rd, you should identify several research questions with motivation (point 1 above only). Further interim reports may be required prior to the final proposal, which is due on November 28th. Depending on the topic of your proposal, I may involve other faculty in the evaluation. You will also be required to present your final idea during our last class on December 5th.

4 Miscellaneous

4.1 Academic Misconduct

Academic misconduct of any kind will not be tolerated. Detailed regulations regarding scholastic dishonesty, as printed in the Handbook of Operating Procedures (HOOP), are available in the Office of Student Conduct and Conflict Resolution (OSCCR). Also available at: <http://sa.utep.edu/osccar/>. Students that are reported to OSCCR, could face various disciplinary actions, from disciplinary probation, to a failing grade on the work in question, to a failing grade in the course, to suspension or dismissal, among others. Examples of behaviors that are not tolerated include, but are not limited to:

- Cheating: Copying from another student's test paper, quiz, assignment other report, or computer files and listings;
- using, during any academic exercise, material and/or devices not authorized by the person in charge of the test;
- collaborating with or seeking aid from another person during a test or laboratory without permission; knowingly using, buying, selling, stealing, transporting, or soliciting in its entirety or in part, the contents of a test or other assignment unauthorized for release; substituting for another student or permitting another student to substitute for oneself.
- Plagiarism: The appropriation, theft, purchase or obtaining by any means another's work, and the unacknowledged submission or incorporation of that work as one's own offered for credit. Appropriation includes the quoting or paraphrasing of another's work without giving credit therefore.
- Collusion: The unauthorized collaboration with another in preparing work offered for credit.

4.2 Student Standards of Conduct:

Each student is responsible for notice of and compliance with the provisions of the Regents' Rules and Regulations and the rules of the University. Copies of the Regents' Rules and Regulations and all University rules are available for review in the office of: President, Vice President for Student Affairs, Dean of Student Life, Student Activities, and the University Library. All students are expected and required to obey the law, to comply with the Regents' Rules and Regulations, with System and University rules, with directives issued by an administrative official in the course of his or her authorized duties, and to observe standards of conduct appropriate for the University. A student who enrolls at the University is charged with the obligation to conduct him/herself in a manner compatible with the University's function as an educational institution. Any student who engages in conduct that is prohibited by Regents' Rules and Regulations, UT System or University rules, specific instructions issued by an administrative official or by federal, state, or local laws is subject to discipline whether such conduct takes place on or off campus or whether civil or criminal penalties are also imposed for such conduct.

4.3 Policy on Disruptive Acts:

The obstruction or disruption of any teaching, research, administrative, disciplinary, public service or other authorized activity on campus or under the authority of the University or on property owned or controlled by the University is prohibited and will subject the student or group of students to disciplinary action.

4.4 Students with Special Needs

If you have, or believe you may have, a condition requiring special accommodations, contact the Disabled Student Services Office (DSSO) located in room 306 Union East. Their phone number is (915) 747-5148. Their email address is dss@utep.edu. Only students registered with DSSO may receive special accommodations. Your accommodation letter should be returned to me by the end of the second week of class.

4.5 Additional Services

The following is a list of student services that you may find useful while you are attending UTEP.:

- Student Counseling Center (202 Union West, (915) 747-5302):
 - <http://sa.utep.edu/counsel/>
 - Walk-ins encouraged.
- Student Health Center ((915) 747-5624):
 - <http://chs.utep.edu/health>
 - Many services free to students paid for through a student health fee.

- Center for Accommodations and Support Services (106 Union East, (915) 747-5148):
 - <http://sa.utep.edu/cass>
 - For disability accommodations.
- Student Engagement and Leadership Center (106 Union West, (915) 747-5670):
 - <http://sa.utep.edu/selc>
 - Includes study space with workstations and a family friendly room.
- Career Center (103 Union West, (915) 747-5640):
 - <http://sa.utep.edu/careers>

5 Course Structure and Reading List

The material in Sections 5.1 and 5.2 will be covered in the order shown and the papers for a specific topic may span multiple weeks. The material in Section 5.3 will be spread over the entire semester. Supplemental reading is indicated by (S), while highlighted reading is indicated by *.

5.1 Executive Compensation

1. Theory

- *Jensen, M. C., and W. H. Meckling. “Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure.” *Journal of Financial Economics* 3 (1976): 305–60.
- Fama, E. “Agency Problems and the Theory of the Firm.” *Journal of Political Economy* 88 (1980): 288-307.
- Fama, E., and M. Jensen. “Separation of Ownership and Control.” *Journal of Law and Economics* 26 (1983): 301-325.

2. Agency theory and compensation design

- Jensen, M.C., and K.J. Murphy. “Performance Pay and Top-Management Incentives.” *Journal of Political Economy* 98 (1990): 225 – 264.
- Lambert, R.A.; Larcker, D.F.; and R. Verrecchia. “Portfolio Considerations in Valuing Executive Compensation.” *Journal of Accounting Research* 29 (1991): 129-149.
- Dechow, P., and R. Sloan. “Executive Incentives and the Horizon Problem.” *Journal of Accounting and Economics* 14 (1991): 51-89.
- *Core, J., and W. Guay. “The Use of Equity Grants to Manage Optimal Equity Incentive Levels.” *Journal of Accounting and Economics* 28 (1999): 151-184.

- *Guay, W. “The Sensitivity of CEO Wealth to Equity Risk: An Analysis of the Magnitude and Determinants.” *Journal of Financial Economics* 53 (1999): 43-71.
- Core, J., and W. Guay. “Estimating the Value of Employee Stock Option Portfolios and their Sensitivities to Price and Volatility.” *Journal of Accounting Research* 40 (2002): 613-630.

3. Choice of performance measure

- Lambert, R.A., and D.F. Larcker. “An Analysis of the use of Accounting and Market Measures of Performance in Executive Compensation Contracts.” *Journal of Accounting Research* 25 (1987): 85-125.
- *Ittner, C.D.; Larcker, D.F.; and M.V. Rajan. “The Choice of Performance Measures in Annual Bonus Contracts.” *The Accounting Review* 72 (1997): 231-255.
- Core, J.; Guay, W.; and R. Verrecchia. “Price versus Non-Price Performance Measures in Optimal CEO Compensation Contracts.” *The Accounting Review* 78 (2003): 957-981.
- *Gerakos, J.J.; Ittner, C.D.; and D.F. Larcker. “The Structure of Performance-Vested Stock Option Grants.” *Essays on Accounting Theory in Honor of Joel S. Demski*, New York Springer (2007).
- Bettis, C.; Bizjak, J.; Coles, J.; and S. Kalpathy. “Stock and Option Grants with Performance-based Vesting Provisions.” *The Review of Financial Studies* 23 (2010): 3849–3888.

4. Compensation and accounting decisions

- *Healy, P. “The Effect of Bonus Schemes on Accounting Decisions.” *Journal of Accounting and Economics* 7 (1985): 85-107.
- Holthausen, R.W.; Larcker, D.F.; and R.G. Sloan. “Annual Bonus Schemes and the Manipulation of Earnings.” *Journal of Accounting and Economics* 19 (1995): 29-74.
- *Bartov, E., and P. Mohanram. “Private Information, Earnings Manipulations, and Executive Stock-Option Exercises.” *The Accounting Review* 79 (2004): 889-920
- *Burns, N., and S. Kedia. “The impact of performance-based compensation on misreporting.” *Journal of Financial Economics* 79 (2006): 35-76 .
- Armstrong, C. S.; Jagolinzer, A. D.; and D.F. Larcker. “Chief Executive Officer Equity Incentives and Accounting Irregularities.” *Journal of Accounting Research* 48 (2010): 225–271.

5. Regulation and compensation design

- Perry, T., and M. Zenner. “Pay for Performance? Government Regulation and the Structure of Compensation Contracts.” *Journal of Financial Economics* 62 (2001): 453-488.

- *Robinson, J.R.; Xue, Y.; and Yong Yu. “Determinants of Disclosure Noncompliance and the Effect of the SEC Review: Evidence from the 2006 Mandated Compensation Disclosure Regulations.” *The Accounting Review* 86 (2011): 1415-1444.
- *Hayes, R.; Lemmon, M.; and M. Qiu. “Stock Options and Managerial Incentives for Risk-Taking: Evidence from FAS 123R.” *Journal of Financial Economics* 105 (2012): 174-190.

5.2 Debt Contracting

Debt contracting is a broad area of research that includes both public and private debt. We will focus on accounting issues as they relate to loan contracting (private debt). Read the “Syndicated Loan Primer” document (resource #1 below) to familiarize yourself with the setting and general contract design considerations before we begin this section. Resources #2 and #3 are more comprehensive and should be useful for the remainder of the course and beyond.

- Loan contract resources:

1. A Syndicated Loan Primer, Standard and Poor, 2016. (PDF)
2. Taylor, Allison, and Alicia Sansone. *The Handbook of Loan Syndications and Trading*. McGraw-Hill, 2007.
3. Wight, Richard, et al. *The LSTA’s Complete Credit Agreement Guide*. McGraw-Hill, 2009. (newer version also available)

1. Theory

- Diamond, D.W. “Financial Intermediation and Delegated Monitoring.” *Review of Economic Studies* 51 (1984): 394–414.
- Diamond, D.W. "Monitoring and Reputation: The Choice between Bank Loans and Directly Placed Debt." *Journal of Political Economy* 99 (1991): 689-721.
- Aghion, P., and P. Bolton. “An Incomplete Contracts Approach to Financial Contracting.” *Review of Economic Studies* 59 (1992): 473–94.
- Rajan, R. G. “Insiders and Outsiders: The Choice Between Informed and Arm’s-Length Debt.” *Journal of Finance* 47 (1992): 1367–400.
- Rajan, R., and A. Winton. “Covenants and Collateral as Incentives to Monitor”. *The Journal of Finance* 50 (1995): 1113–1146.
- Garleanu, N., and J. Zwiebel. “Design and Renegotiation of Debt Covenants.” *Review of Financial Studies* 22 (2009): 749–81.
- Christensen, H. B.; Nikolaev, V. V.; and R. Wittenberg-Moerman. “Accounting Information in Financial Contracting: The Incomplete Contract Theory Perspective”. *Journal of Accounting Research* 54(2) (2016):397-435.

2. Accounting measurements and contractual adjustments

- Beatty, A.; K. Ramesh; and J. Weber. “The Importance of Accounting Changes in Debt Contracts: The Cost of Flexibility in Covenant Calculations.” *Journal of Accounting and Economics* 33 (2002): 205–27.
- Beatty, A.; J. Weber; and J. J. Yu. “Conservatism and Debt.” *Journal of Accounting and Economics* 45 (2008): 154–74.
- Frankel, R.; C. Seethamraju; and T. Zach. “GAAP Goodwill and Debt Contracting Efficiency: Evidence from Net-Worth Covenants.” *Review of Accounting Studies* 13 (2008): 87–118.
- Li, N. “Negotiated Measurement Rules in Debt Contracts.” *Journal of Accounting Research* 48 (2010): 1103–44.

3. Accounting properties and contract design

- Zhang, J. “The Contracting Benefits of Accounting Conservatism to Lenders and Borrowers.” *Journal of Accounting and Economics* 45 (2008): 27–54.
- Ball, R.; R. M. Bushman; and F. P. Vasvari. “The Debt-Contracting Value of Accounting Information and Loan Syndicate Structure.” *Journal of Accounting Research* 46 (2008): 247–87.
- Nikolaev, V. V. “Debt Covenants and Accounting Conservatism.” *Journal of Accounting Research* 48 (2010): 51–89.
- Demerjian, P. “Accounting Standards and Debt Covenants: Has the Balance Sheet Approach Led to a Decline in the Use of Balance Sheet Covenants?” *Journal of Accounting and Economics* 2–3 (2011): 178–202.

4. Accounting quality and contract design

- Bharath, S. T.; J. Sunder; and S. V. Sunder. “Accounting Quality and Debt Contracting.” *The Accounting Review* 83 (2008): 1–28.
- Costello, A. M., and R. Wittenberg-Moerman. “The Impact of Financial Reporting Quality on Debt Contracting: Evidence from Internal Control Weakness Reports.” *Journal of Accounting Research* 49 (2011): 97–136.
- Kim, J. B.; Song, B. Y.; and L. Zhang. “Internal Control Weakness and Bank Loan Contracting: Evidence from SOX Section 404 Disclosures.” *The Accounting Review* 86 (2011): 1157–1188.
- Baylis, R. M.; Burnap, P.; Clatworthy, M. A.; Gad, M. A.; and C. K. M. Pong. “Private Lenders’ Demand for Audit.” *Journal of Accounting and Economics* 64 (2017): 78–97.

5. Contingency selection and design

- Asquith, P.; A. Beatty; and J. Weber. “Performance Pricing in Bank Debt Contracts.” *Journal of Accounting and Economics* 40 (2005): 101–28.
- Christensen, H. B., and V. V. Nikolaev. “Capital Versus Performance Covenants in Debt Contracts.” *Journal of Accounting Research* 75 (2012): 75–116.

- Li, N.; F. P. Vasvari; and R. Wittenberg-Moerman. “Dynamic Threshold Values in Earnings-Based Covenants.” *Journal of Accounting and Economics* (2015).

6. Accounting information acquisition

- Plumlee, M.; Xie, Y.; Yan, M.; and J. J. Yu. “Bank Loan Spread and Private Information: Pending Approval Patents.” *Review of Accounting Studies* 20(2) (2015): 593-638.
- Minnis, M. and A. Sutherland. “Financial Statements as Monitoring Mechanisms: Evidence from Small Commercial Loans.” *Journal of Accounting Research* 55(1) (2017): 197-233.
- Carrizosa, R. and S. G. Ryan. “Borrower Private Information Covenants and Loan Contract Monitoring.” *Journal of Accounting and Economics*, forthcoming.

7. Contract design and accounting decisions

- DeFond, M. L. “Debt Covenant Violation and Manipulation of Accruals.” *Journal of Accounting and Economics* 17 (1994): 145–76.
- Dichev, I. D., and D. J. Skinner. “Large-Sample Evidence on the Debt Covenant Hypothesis.” *Journal of Accounting Research* 40 (2002): 1091–123.
- Donovan, J.; Frankel, R. M.; and X. Martin. “Accounting Conservatism and Creditor Recovery Rate.” *The Accounting Review*, 90(6) (2015): 2267-2303.

5.3 Python / Creating Customized Data Sets

1. Understanding SEC EDGAR data

- Understanding the set of filings and filing requirements
- Understanding filing components:
 - Index pages, HTML or XML file, text submission
- EDGAR filing indices:
 - Selecting filings from universe of filings

2. Developing essential Python skills

- Using Python libraries
- Accessing files
 - Reading / writing to local files
 - Downloading files from EDGAR
- Using regular expressions
- Reading a list of files and writing to an output file
- Processing HTML/XML

3. Developing a systematic data extraction process

- Analyzing a random sample
- Developing code to avoid overfitting
- Out-of-sample testing
- Utilizing post-processing for challenging tasks

4. Advanced topics

- Using NLTK
- Document classification
- Shell scripts / parallel processing