

Collected Abstracts: Full Parallel Sessions

EAA

**Analytical Research
in Accounting and Auditing**

Code: EAA001
Abstract ID: 0271

Day: Wednesday
Time: 16.00-17.30
Room: Q011

On the appropriateness of performance based compensation for supervisory board members - an agency theoretic approach

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Several Central European countries require public firms to set up an executive board (EB) and a supervisory board (SB). As part of the recent debate on corporate governance, the expansion of comprehensive performance based compensation to include members of the SB has been heavily discussed. As a result, e.g. the German Corporate Governance Code suggests to base SB compensation on short term as well as long term performance measures. We use a 2-stage principal-agent model to investigate incentive effects arising from such contracting. The first agency relationship is established between the SB and the EB. The SB offers an incentive contract to the EB that motivates effort and requires a possibly biased report to be produced by the EB. The second agency problem involves the owners and the SB. The owners offer an incentive scheme to the SB in order to motivate appropriate contracting with the EB and to induce a monitoring effort to restrict the EB's incentive to bias the report. Allowing the report provided by EB and the market price of the firm to be contractible, we obtain the following results regarding appropriate contracting with the SB: If the report is used as a single performance measure, no incentive alignment between the owners and the SB can be achieved at all and a purely fixed compensation is strictly preferred. If both performance measures are considered a purely market price-based compensation provides proper incentives in some settings, but not in others.

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Day: Wednesday
Time: 16.00-17.30
Room: Q011

Fair value accounting and incentives

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There is a tendency amongst the most influential international standard setters to move towards a fair value accounting regime. International standard setters clearly focus on aspects of decision usefulness and they argue that fair values provide more relevant information for investors even though these values are less reliable than historical cost. Surprisingly, there is little discussion about the effects of fair value accounting on the second major objective of accounting, the stewardship and performance measurement role. This paper investigates the incentives created by a full fair value accounting regime compared to a historical cost accounting regime in a multiperiod agency model. Fair values are defined as the expected discounted cashflows and they bear a measurement risk. The owners of a company hire a manager to provide strategic and operational effort. If the owners and the manager can commit to long-term contracts, fair value accounting will provide more incentives for strategic effort but less congruent performance measures. In a setting with short-term contracts, fair value accounting leads even to higher congruence but the preferability of the fair value accounting regime by the principal is more sensitive to measurement risk than with long-term contracts. Further, the paper considers effects of renegotiation and shows that a mixed measurement model can be preferable to the principal.

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Day: Wednesday
Time: 16.00-17.30
Room: Q011

Insider Trading: The Value of Asymmetric Information created by Tradable Securities and its Implications for Disclosure

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While tradable securities remain a popular means of compensating managers, there is constant discussion on the need for tighter regulation, including disclosure requirements, to prevent employees from actually being able to gain from trading these securities based on their private information. The purpose of this paper is to provide insights into the role and economic consequences of disclosures aimed at reducing the ability to gain from insider trading. Using the principal-agent framework I show that in some situations allowing the agent to trade undetected on his private information increases production and, more importantly, generates a Pareto improvement compared to the case where changes in an agent's incentives are required to be carried out in public. The intuition for this result is that the bid-ask spread imposed by the market maker makes it costly for the agent to sell his shares and get full insurance if he has taken a low-cost action. As a consequence, the agent takes the high-cost action with higher probability, which in turn makes the overall economy better off.

Code: EAA004
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Day: Thursday
Time: 11.00-12.30
Room: Q010

Non-audit services and audit independence: An analysis using the informativeness of earnings

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Econometric analysis – using panel data methods – of data on securities traded on the Dhaka Stock Exchange, Bangladesh, over the period 1995-99 indicates that audit quality may not necessarily increase with auditor size. However, choice of a large auditor does seem to alleviate any negative impact of non-audit services on the confidence of investors. A lesson from this seems to be that companies requiring a relatively large amount of non-audit services from their auditor should find it worthwhile to hire a big audit firm albeit with a fee premium. Another interesting result is that companies declaring negative earnings do not appear to suffer any detriment to their share returns as the link between earnings and returns is significantly weakened when announced earnings are negative

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Day: **Thursday**
Time: **11.00-12.30**
Room: **Q010**

Is auditors' third party liability needed in Germany?

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Internationally compared the auditors' liability against third parties is restrictive for mandatory audits in Germany. In the German Commercial Code third party liability is not addressed and several legislative proposals concerning auditor liability did not include these kind of liability rule. However the German Federal Court of Justice has issued a contradicting opinion, thinking that a third party liability could exist even under the given law. This is important because all legislative parties agree about the non-existence of third party liability. Due to this fact and because of the internationalization of capital markets and the audit business third party liability becomes an important topic, again. The goal of our paper is to analyze under which conditions both –auditors and investors– would prefer a third party liability regime compared to the present German regime of liability which steps in only in cases of intentional breach of duty but not in cases of negligent breach of duty. Therefore a game in extensive form is developed representing the economic situation. Condensing the game to its strategic form and identifying the equilibria in pure strategies shows that cases of multiple Nash equilibria exist, indicating that both regimes could exist simultaneously. These cases are investigated in depth by means of evolutionary game theory. Major results are that both regimes are stable in the sense of dynamics, however the third party liability harms audit quality.

Code: EAA006
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Day: **Thursday**
Time: **11.00-12.30**
Room: **Q010**

The effects of awarding multi-period audit contracts on auditors' independence

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In recent years the auditing profession has been exposed to a multitude of regulations within the European Union and the intention to harmonise statutory audits and improve auditor independence. This paper deals with the effects of awarding multi-period audit contracts on auditor's independence because long-term audit contracts are common practice in some European countries. Offering those contracts leads to a temporary audit monopoly over a fixed period. The auditor's independence, however, is only ensured if a renewal of contract is impossible. The extent to which the independence is impaired due to the possibility of re-election is reflected in the consideration of fee setting to maintain the mandate. The possibility of re-election is modified by compliance with a cooling-off period and the length of the cooling-off period influences both competition conduct and auditor's independence. Regarding auditor specialisation in industries makes it necessary to analyse competition among auditors who are specialised in the same industry and among auditors who are specialised in different industries. Dependent on the length of the cooling-off period it is possible for specialist auditors to earn real rents. Modifying the restrictions concerning the length of the cooling-off period contrasts the results of awarding multi-period audits to DeAngelo (1981). The results confirm that awarding long-term audit contracts enhances the auditor's independence in contrast to annual appointment.

Code: EAA007
Abstract ID: 0322

Day: **Friday**
Time: **9.00-10.30**
Room: **Q010**

Strategic Delegation of R&D investment and pricing decisions in a Bertrand duopoly game

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Performance Measurement in R&D received a lot of attention in the last few years. Some of the main problems regarding the measurement of performance in general are even worse in the intangible area of research and development. Decisions for R&D projects are characterized as strategic, committing time, capital and other resources within a firm for a long period. Therefore measuring the efficiency and effectiveness of R&D projects is an important issue where management accounting information is required to support decisions. The literature on performance measurement in R&D focuses on intrafirm effects, generally motivation aspects in agency settings. This paper follows another line of research, which investigates competition effects of performance measurement in R&D by using a strategic delegation model and extending it with the possibility of R&D investment with spillover effects. The paper analyzes the optimal strategies for two firms within a Bertrand market, who can either delegate the decisions concerning R&D and prices to managers by offering a compensation contract based on the performance measures profit and revenues or decide on their own. Two opposite effects are influencing the results in this setting. As delegation is known to soften the competition in Bertrand markets, process R&D investments tend to enforce the price competition by lowering the production costs. It is shown that the dominant strategy will depend on the market parameters and the level of spillover.

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Day: **Friday**
Time: **9.00-10.30**
Room: **Q010**

Input substitutability and pricing and capacity decisions under uncertainty

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This paper explores the role of input substitutability in pricing and capacity decisions under uncertainty. This relaxes a basic assumption of prior literature, i.e. the assumption that inputs are combined in completely fixed proportions, such as when the technology is Leontief. Consistent with the literature, the model combines the possibility of adjusting (*soft*) or not (*hard*) initial capacity after actual demand is realised with three demand scenarios, *certainty*, *partial uncertainty* and *uncertainty*. When the technology is Leontief, full cost-based prices are optimal only under *certainty* and *uncertainty* (Gox, 2002). By contrast, in the model developed here, full cost-based prices are optimal under all the demand scenarios analysed. The normative implication of this is that full cost-based prices might be more theoretically justifiable when the technology allows some substitution between inputs. With respect to the capacity decision, the firm always sets initial capacity based on the expected capacity decision under certainty, reflecting the fact that the cost of investing too much or too less in capacity is equal.

Code: EAA009
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Day: Friday
Time: 9.00-10.30
Room: Q010

**French Accounting and Auditing Research Practices:
An Exploration of Researchers' Strategy on
Communication and Publication**

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Considering the development of Accounting and Auditing Research in France, our paper aims at discussing the manner of diffusing scientific knowledge (through various outlets) in this discipline. In fact our study aims at analyzing researchers' behaviour (Faculty and Ph.D. Students) in order to determine if there is a single strategy in diffusing scientific knowledge. Existing literature on research productivity, in particular in the United States, suggests that several variables can influence the communication and publication behaviour. We integrated two variables (grade and gender) in a questionnaire in order to measure the researchers' productivity (number of papers in various outlets), and to determine the perception that researchers have of communication and publication requirements. Statistical differences were examined and results showed that there is no consensus on the research practices.

Code: EAA010
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Day: Wednesday
Time: 17.30-18.30
Room: Theatre R

**The degree of integrating corporate and capital gains tax
into income tax and its impact on investment decisions**

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We investigate the influence of current income and capital gains taxation on investor's decision to either carry out an investment in corporate shares or to invest funds alternatively on the capital market. Three basic tax systems with different degrees of corporate tax integration are analyzed, a classical corporate tax system with double taxation of profits on corporate and personal level, a shareholder relief system that reduces double taxation and a tax system with full imputation of corporate tax avoiding double taxation completely. Applying a growth model under certainty, we find that the shareholder relief system invokes more severe distortions than the full imputation system. Trying to prove this in a more realistic setting with uncertainty we employ Monte Carlo Simulation for random rates of return and random income tax rates. In contrast to traditional findings, now, full imputation causes more severe distortions and more tax-induced uncertainty than shareholder relief whenever personal income tax rates are low. In light of international tax competition this is an important result as a reduction of tax rates is taking place or is likely to take place in several countries. Furthermore, the simulation clarifies the trade-off of the opposing effects, i.e. tax and interest rate effects, and the overwhelming impact of capital gains taxation. Apart from tax parameters, we identify the dividend rate and the point in time of selling the shares as important value drivers.

