NEW YORK UNIVERSITY
Stern School of Business
THEORY AND RESEARCH IN ACCOUNTING
Spring 2006

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Off. Hrs: By appointment
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Course Description

This course is about the role of information in capital markets. The primary purpose is to introduce students to the economics of uncertainty in capital markets and the critical role that accounting information plays in resolving this uncertainty. The course focuses on analytical research involving the demand for and the supply of information in capital markets with only brief consideration of related empirical research. It does not analyze the role of information in principal agent contracting settings. You are encouraged to explore and discuss the relation between our analyses and empirical examinations of similar phenomena.

The foundation of capital market research in accounting is anchored in the decision-facilitating and decision-influencing roles it plays in the functioning of capital markets and within organizations. The driving factor here is uncertainty and the role that information, particularly accounting information, plays in resolving uncertainty as well as facilitating risk sharing among market agents. Since information is valuable only under uncertainty, there would be no role for information in the absence of uncertainty. Hence, any investigation of the role of accounting information in capital markets must be cognizant of the uncertainty faced by decision makers about the consequences of their actions. One of the objectives of this course is to study the processes by which decision makers utilize information to resolve uncertainty about future and other realized but as yet unknown events. The consequences of using information to resolve uncertainty in capital market settings are typically manifested in observable events such as changes in market prices and trading volume. A significant segment of the capital market research literature in accounting focuses on evaluating the association between these manifestations and accounting policy choices in an attempt to assess the value relevance of accounting policy choices.

Deliverables:

1. The class will meet weekly. You are expected to come to class fully prepared to discuss the assigned papers. Students are expected to present one or more of the assigned papers in each of the topics covered in course. For each paper, the designated student will be responsible for presenting the issues discussed and to critically evaluate the paper’s contribution to the accounting literature. The presenting student is expected to explain the structure of the model and the major results of the paper to the class. In addition, he or she has to submit a brief
summary of the paper (no page limits) and any other handouts considered necessary to me with
copies for the other students in the class. The summary should contain but not necessarily
limited to the following topics:

i. Identification of primary research question.

ii. Description of the formulation of analytical model and a discussion of the
major assumptions and how they relate to the model.

iii. Analysis of the underlying economic and mathematical concepts of the model.

iv. Presentation of key results - students are encouraged to construct examples to
illustrate key results.

v. Critical evaluation of the paper and its contribution to the literature.

vi. Discussion of possible empirical research implications and where applicable, a
sketch of the research design that you would use and the type of data that would
be needed to test the empirical implications of the analytical results.

vii. Finally, it is always a useful exercise to think about possible generalization or
extensions of the model and the results discussed in the paper.

The rest of the class would be required to submit, individually, a one-page summary of the
paper discussed by the lead student. At a minimum, the summary should convey the paper’s
purpose and results and should be written in a non technical, executive-summary-like
manner that can be read and understood by the typical second year MBA student or an
undergraduate honor student at Stern.

2. Students are to submit a term paper. The term paper will be presented in class with a copy
submitted to me. The term paper can be one of two forms. You can either formulate an
analytical model of an issue of interest to accounting researchers using an appropriate paradigm
discussed in the course or you can submit a paper describing possible empirical implications of
the analytical results of any of the papers discussed in class and to design an empirical test that
can be used to verify these results. Term papers would be presented in class during the last
three sessions. You are to submit a draft of your paper at the time of your presentation to be
followed by a revised draft two weeks after the end of the semester.

Course Grade:
The course grade will be based on the in-class presentations, paper summaries,
participation in class discussions and a term paper. You are free to discuss the
assignments with your fellow students, but the final analyses and presentation must be
your own work. The course grade will be determined as follows:

<table>
<thead>
<tr>
<th>Component</th>
<th>Percentage</th>
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<tbody>
<tr>
<td>Class Presentations. Paper Summaries and Participation</td>
<td>60%</td>
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<tr>
<td>Term Paper</td>
<td>40%</td>
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Topical Outline

Week 1&2: Introduction to the Economics of Uncertainty and the Role of Information

Required Reading:
   Edgartown Fisheries Illustration - Emanuel

Background Reading:
   Chapters 1 & 2 *The Economics of Uncertainty and Information*, N. D. Hill 2005.

Week 3: Demand for Public Information in Equity Markets

Required Reading:

Background Reading:

Week 4,5: Information Asymmetry and Private Information Acquisition in Equity Markets

   – Introduction to Noisy Rational Expectations Models

Required Reading:

Background Reading:

Week 6: Modeling the Impact of Accounting Disclosures on Market Prices

Required Reading:

Week 7: Modeling the Impact of Accounting Disclosures on Trading Volume

Required Reading:

Background Reading:


**Week 8: Voluntary Disclosure of Private Information**

Required Reading:


Background Reading:


**Week 9: Voluntary Disclosure of Proprietary Information**

Required Reading:


Background Reading:  

**Week 10: Reliability of Accounting Disclosures**

Required Reading:
i. The Economics of Fraudulent Accounting, 2005 NBER Working Paper 11573, Simi Kedia, Thomas Philippon - Alina


**Week 11: Analytical Investigation of Anomalous Findings in Empirical Research.**

Required Reading:
i. Post Announcement Drift Phenomena – . *General Discussion*  
ii. Price Momentum


**Weeks 12-14: Term Paper Presentations**

- Week 12: Kalin and Alina
- Week 13: Richard and Lior
- Week 14: Karthik and Emanuel