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# MARKET PERCEPTION IN COUNTRY FUND AND ISHARE RELATIONSHIPS

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## ABSTRACT

*This study analyzes the market perceptions in the country fund and iShare markets. It investigates if there are fundamental relationships between the two markets or if the relationships are solely based on investor perceptions. iShares, which trade in the US, mimic the MSCI (Morgan Stanley Capital Index) for the respective country. Thus iShares represent a broad index for that country. Country funds, on the other hand, are actively managed mutual funds investing in stocks of a specific country. Thus, a country fund represents a subset of stocks for a particular country. The above would imply that iShares would affect country funds. It is, however, possible that there is no such fundamental relationship, only that market participants perceive it. Fundamental relationships are investigated using the net asset values (NAVs) of these assets. On the other hand, market relationships are investigated using prices for iShares and country funds. The existence of price relationships in the absence of NAV relationships, may lead us to believe that market perceptions are at work, rather than fundamental relationships.*

*Country funds from three European (Germany, Spain and Switzerland) and three Asian (Japan, Malaysia, Singapore) countries are used to investigate such relationships. Results show that in European NAVs there are no relationships from iShares to country funds. However, we do find relationships in prices from iShares to country funds. On the other hand, in Asia relationships are found from the Japanese iShare NAV to all Asian country fund NAVs. Also, all country iShares together affect all Asian country funds. Such relationships are also found in the prices.*

*These results indicate the possibility that investors perceive an effect from iShares to country funds in Europe. However, in Asia, relationships may have a more fundamental basis.*

*From a diversification standpoint, these results have implications for investors. Regardless of whether the relationships are fundamental or as a result of market perception, investors may not be able to effectively diversify.*

# THE CHANGE OF CORPORATE DOMICILE, TAX PLANNING AND LEGAL ENVIRONMENT

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## ABSTRACT

*This paper empirically evaluates the practitioner anecdotal evidence that good state and local tax planning dictates a Delaware or Nevada domicile for corporations in and environment in which the tax benefit of a holding company has been severely limited. It examines a sample of 142 active COMPUSTAT companies changing corporate domicile during the period 2000 through 2006. It finds that the incidence of corporations selecting a Delaware or Nevada domicile to be significantly greater than that which would be expected by chance. It also determines that Delaware is chosen with greater frequency than other states which would provide an identical tax benefit. It suggests that when tax planning and other administrative motivations present themselves they are preferred to tax benefits alone. These results support the hypothesis that taxpayers act with self-interest. This study contributes to the literature on state and local tax planning. The work has implications for business planners seeking to increase return on investment and legislators seeking to encourage investment in their respective states.*

# FINANCIAL ILLITERACY: THE STRESS FACTOR

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## ABSTRACT

*A startling trend is beginning to emerge in America. A generation of "baby boomers" are reaching retirement. Many of these Americans who were born during the prosperous years after World War II may find themselves totally dependent on the Social Security System to fund their retirement. The savings rate for Americans is lower than it has been in 73 years. Another startling statistic indicates that the average credit card debt per household is $9312 (Wallechinsky, 2006). These types of financial concerns are even disabling workers and costing corporations $7000 per employee each year in lost productivity (LFE, 2004). Additionally, debt is literally consuming our nation. Americans are taking on more and more debt each year and the average American household now has more than $10,000 in credit card debt (LFE, 2007). Our nation has become one that is "financial illiterate", and Americans are in desperate need of education in the area of managing finances. This paper compares the survey results of two groups of people and addresses more statistics concerning financial issues. The paper also offers some suggestions and sources for educating the American people on how to better manage their money.*

# BEWARE OF THE HYPE! RETURNS FROM UNSOLICITED STOCK RECOMMENDATIONS

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## ABSTRACT

*I examine whether unsolicited stock "hype" induces individuals to trade. "Hype sheets," which are released by compensated third parties, typically use sensational language to describe the prospects of a featured company's stock. Such language is intended to draw attention to the featured stock and create an emotional response that leads to a purchase. The impact of emotional responses on investor choices has become better understood in recent years, with a number of studies demonstrating investor mood has a direct impact on stock prices. Thus, to the extent that these hype sheets create a positive view of the featured company, investors may be induced to trade in that company's stock.*

*Using a unique sample of companies which had hype sheets sent to numerous fax machines, I find that the hyped stocks have an impressive average return of over 50% for the two weeks prior to the hype sheet release. For the two days that include the hype sheet release date and the following trading day, the return on these stocks averages an additional 11%. For the two weeks after this period, however, returns are essentially zero. An analysis of average volume for these stocks indicates that volume is approximately twice as high in the two weeks after compared to the two weeks before to the hype sheet release. This implies that the hype sheet precipitates a large increase in the level of trading. Further, I find that the stocks in my sample fail to live up to the hype. The average return over the two month period after the hype release is approximately -31%, while the average return over the three month post-release period is approximately -35%. Further, less than 15% of the sample firms have a positive holding period return over either of these periods. Thus, individual investors should be wary of the information contained in hype sheets. While it is unclear why there is a dramatic increase in stock price prior to the hype sheet release, it is clear that the longer-term prospects are far different than those implied by the hype.*

# SHOULD HOME MORTGAGE INTEREST AND PROPERTY TAXES BE DEDUCTABLE FOR FEDERAL INCOME TAXES?

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## ABSTRACT

*Significant changes in the tax code affecting home ownership have been proposed by Congress in the past and will surface again. The home mortgage interest deduction (HMID) and the deductibility of property taxes were recommended to be eliminated or significantly modified by President's Bush's 2005 Advisory Panel on Tax Reform. In the interest of clarifying this complex issue, this paper presents the economic benefits and costs to society for maintaining these controversial home ownership tax incentives. A simulated model is shown for two families with large home price and income level differences. It is found that both families gain economically from the current tax code, however the higher utility and the higher relative economic return accrues to the family with the lower income.*

*The purpose of this research is to investigate the costs and benefits of current tax rules regarding the home mortgage interest deduction and the home property tax exclusion. Past studies have established a strong case that federal tax laws favor investment in owner-occupied housing over investment in many other financial and real assets (Aaron, 1972). Under current tax law, capital gains on owner-occupied housing can be deferred from federal income taxes if the sale proceeds are reinvested in a replacement residence within a prescribed time period.*

# ARE WE OVERDOING COST ALLOCATION TO SUPPORT MANAGEMENT DECISION MAKING?

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## ABSTRACT

*In the 1980s, Activity Based Costing (ABC) rose to prominence with the publication of "Relevance Lost: The Rise and Fall of Managerial Accounting." From ABC, the profession moved to Activity Based Management (ABM) and now we are talking about Value Chains and Supply chains to evaluate products and customers. The underlying methodology to develop the costs to be used in these evaluation processes relies heavily on the techniques inherent in ABC and ABM. ABC and ABM have as there foundation a thorough analysis of the activities and the associated costs for performing those activities. Through the use of "cost drivers" these costs are then assigned to products or customers. But will this approach give managers the information that they need to properly evaluate products and customers?*

*This paper examines the underlying methodology being utilized in Value Chain and Supply Chain evaluations to determine its suitability to support the management decision making process. In addition an alternative approach is also examined.*

# IS THIS REALLY SPECIAL OR EXTRAORDINARY? A STUDY OF HOW GOVERNMENTS REPORT THESE AND OTHER ITEMS

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## ABSTRACT

*Governmental Accounting Standards Board Statement No. 34, Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Government (GASB 34) required governments to produce new business-type financial statements. Two new financial reporting items, special and extraordinary items, were included in the operating statement under GASB 34. These reporting categories provide governments the ability to report certain significant items separately from normal operations. Gains and losses from the sale of capital assets are also recorded in the operating statement. In the operating statement, GASB has adopted an all inclusive approach.*

*This study examines the June 30, 2005 statements of activities for the 95 counties and 34 cities in Virginia. One purpose of this study is to examine how often and what types of events local governments are reporting as special and extraordinary items. A second purpose of this study is to examine how gains and losses from the sale of capital assets are being reported by local governments. The study identified certain problem in reporting these items.*

## INTRODUCTION

The purpose of the statement of activities under Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Government* (GASB 34) is to report the results of operations for the government. Two new financial reporting items, special and extraordinary items, were included in the statement of activities under GASB 34. These reporting categories provide governments the ability to report certain significant items separately from normal operations.

In the statement of activities, GASB has adopted an all inclusive approach. Under this approach, all transactions that affect net assets are reported in the statement of activities. As it relates to revenues, GASB 34 lists the following reporting categories: program revenues, general revenues, contribution to term and permanent endowments, contributions to permanent fund principal, special and extraordinary items and transfers.
All revenues should be reported as part of one of these categories.

This study examines the June 30, 2005 statements of activities for the 95 counties and 34 cities in Virginia. One purpose of this study is to examine how often and what types of events local governments are reporting as special and extraordinary items. A second purpose of this study is to examine how gains and losses from the sale of capital assets are being reported by local governments.

## SPECIAL ITEM AND EXTRAORDINARY ITEMS

GASB 34 defines an extraordinary item as a significant transaction that is both unusual in nature and infrequent in occurrence. A special item is a significant transaction within the control of management that is either unusual in nature or infrequent in occurrence.

APB Opinion No. 30 defines the terms unusual in nature and infrequency of occurrence as follows:

> Unusual nature – the underlying event or transaction should posses a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the entity, taking into account the environment in which the entity operates.
> Infrequency of occurrence – the underlying event or transaction should be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates.

Reporting extraordinary items has been part of business financial statements for quite awhile. Reporting such items is new for governments. Special items are unique to governments and give them an additional opportunity to report certain significant items separately from other revenues.

## WHAT IS BEING REPORTED?

Table 1 provides a summary of the number of governments reporting special and extraordinary items:

Table 1

| | Extraordinary Item | | Special Item | | Total | |
|---|---|---|---|---|---|---|
| | Number | Percentage | Number | Percentage | Number | Percentage |
| Cities (34) | 1* | 2.9 | 6** | 17.6 | 7 | 20.6 |
| Counties (95) | 1 | 1.1 | 2 | 2.1 | 3 | 3.2 |
| Total (129) | 2 | 1.6 | 8 | 6.2 | 10 | 7.8 |

*one city reported both a special and extraordinary item
** one city reported two special items

One of the extraordinary items was related to disaster costs caused by hurricane damages. That city also reported a special item related to recovery of such disaster costs. The other extraordinary item was related to a landfill settlement. As a percentage of change in net assets, these extraordinary items ranged 10.4% to 86.1% (the average is 48.2%).

Two of the special items were related to the gain on sale of land. One special item was due to a significant external support agreement. Another was related to a write-off of a FEMA grant. As a percentage of change in net assets, these special items ranged 2.0% to 44.9% (the average is 18.6%).

The remaining three special items were related to the gains and losses from the sale of capital assets (including one city that reported this for both governmental and business- type activities). As a percentage of change in net assets, these items ranged from less than 1 percent to 13.4%. Normally gains and losses from the sale of capital assets would not meet the criteria to be reported as special items.

## SALE OF CAPITAL ASSETS

Governments are generally required to depreciate capital assets and to record the depreciation expense as a direct expense of the appropriate function, unless the capital asset serves essentially all functions of government*. When capital assets are sold, the difference between the

carry value of the assets and the sale price will result in a gain or loss. How should these be reported?

Conceptually, there are several places such gains and losses could be reported. Some may argue that for depreciable assets, the gain or loss just represents an adjustment to the amount of deprecation charged over the asset life and should be report as direct expense to the appropriate function. Others may suggest that gain and losses be reported as program revenues. A third alternative would be to report gain and losses as part of general revenue. Gain and losses may also be reported as a special item if they meet the criteria discussed earlier.

What does the professional guidance say about the sale of capital assets? Question number 7.204 of GASB Comprehensive Implementation Guide states that such losses are not a direct expense of the program and gains are not derived directly from the program. Therefore, losses should be reported as general government-type expense and gains reported as general revenues. This guidance is somewhat unclear when it comes to losses. It appears that losses should be report with other expenses, perhaps as a separate line item.

A somewhat different approach is taken in GASB Statement No.42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. An impairment loss should be reported in the statement of activities as program expense, unless it meets the criteria to be reported as a special or extraordinary item. The Board does not consider an impairment loss to be similar to a gain or loss on the disposal of a capital asset. Instead, the impairment loss represents service utility of a program that has been lost and should be reported as a direct expense to the program that used the capital asset.

## WHAT IS BEING REPORTED?

Table 2 provides a summary of the number of governments reporting gains and losses as a part of general revenue.

Table 2

| | Gains | | Losses | | Total | |
|---|---|---|---|---|---|---|
| | Number | Percentage | Number | Percentage | Number | Percentage |
| Cities (34) | 10 | 29.4 | 3 | 8.8 | 13 | 38.2 |
| Counties (95) | 9 | 9.5 | 10 | 10.5 | 19 | 20.0 |
| Total (129) | 19 | 14.7 | 13 | 10.1 | 32 | 23.9 |

Two cities and two counties reported both gains and/or losses for both governmental and business-type activities.

Of the thirty-two gains and losses that were reported, five were related to business-type activities and twenty-seven were related to governmental activities. Table 3 reports the relative size of the gains. It breaks the information down between governmental and business-type activities

Table 3
Gains as a Percentage of Change in Net Assets

| | % average | Range |
|---|---|---|
| Governmental Activities (17) | 80.4 | 0.0 – 867.7 |
| Business-Type Activities (2) | 1.8 | 0.3 – 3.2 |

The average for governmental gains was very high due to a few extremes. Eight of the gains reported were less than five percent of the change in net assets.

Table 4 reports the relative size of the losses. It breaks the information down between governmental and business-type activities. The average and the range of percentages were smaller for losses than gains.

Table 4
Losses as a Percentage of Change in Net Assets

| | % average | Range |
|---|---|---|
| Governmental Activities (10) | 10.7 | 0.2 – 47.3 |
| Business-Type Activities (3) | 4.7 | 3.6 – 6.9 |

It should be noted that just over 10 percent of the governments reported losses as part of general revenues. None of the governments reported losses as separate line items under expenses. However, several governments did report an expense item labeled “nondepartmental”, which could include losses.

It does not appear that the reporting guidance on reporting losses from the Comprehensive Implementation Guide is being followed by local governments.

## SUMMARY

Governments are taking advantage of reporting unusual and/or infrequent items as special and extraordinary. However, there were a few instances where items that were reported as special did not appear to meet the criteria to report as such.

Close to a quarter of the governments did report gains and losses from the sale of capital assets as part of general revenue. It does not appear that governments were following the guidance for reporting losses as part of expenses. GASB may want to review the existing guidance for reporting gains and losses. One approach would be to report such items as part of program expense, similar to impairment losses. A second possible approach would be to treat both gains and losses as part of general revenue.

* Depreciation is not recorded for certain infrastructure assets reported under the modified approach.

# FACTORS RELATED TO THE LEVEL OF SUPERFUND LIABILITY DISCLOSURE IN 10K REPORTS: 1991-1997

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## ABSTRACT

*This study examines factors related to the level of Superfund disclosure in 10K reports. Sample firms consist of Fortune 500 companies identified by the Environmental Protection Agency as Potentially Responsible Parties. The study utilizes a comprehensive environmental disclosure index based on Generally Accepted Accounting Principles, to measure the extent to which sample firms disclose environmental liability information. Empirical tests demonstrate that the extent of environmental disclosure is associated with size, profitability, industry classification and regulatory influence.*

*The study uses data from COMPUSTAT, EDGAR, and the Superfund Public Information System for years 1991-1997. The environmental disclosure index is compiled based on relevant authoritative guidance contained in Regulation S-K, SAB 92, and SFAS 5. Policy implications indicate that the Securities and Exchange Commission must improve monitoring and enforcement efforts designed to promote adequate recognition and disclosure related to environmental liabilities.*

## INTRODUCTION

Over the past fifteen years, there has been increased attention on the environment and how companies measure and report environmental exposure (Cox, 2001). In light of the magnitude of estimated costs, the reporting of environmental costs and obligations has become a prominent issue with accounting regulatory and professional bodies, such as the Securities Exchange Commission (SEC), Financial Accounting Standards Board (FASB), American Accounting Association (AAA) and American Institute of Certified Public Accountants (AICPA) (Sack et al, 1995). Of specific concern are the recognition of environmental liabilities and the adequacy of related environmental disclosures (ED).

Recent accounting scandals have resulted in increased public scrutiny of corporate governance and disclosures, and have further heightened the attention on ED (Bibler, 2003). The new regulatory requirements promulgated by the Sarbanes-Oxley Act of 2002 have implications for companies with environmental obligations. United States Senators have asked the Government Accounting Office to examine whether SEC requirements for ED are adequate (Sissell, 2002).

The public scrutiny of ED as well as the findings of early research led to additional reporting requirements with respect to environmental liabilities, as well as increased oversight of environmental matters by the SEC. Two studies suggest that firms have increased the extent of ED in response to Staff Accounting Bulletin No. 92 (SAB 92, issued in 1993); however, they have not increased disclosure of accrued amounts for environmental remediation (Stanny, 1998; Barth et al., 1997). Thus, Stanny and Barth et al. conclude that accounting guidance is not successful in promoting the recognition of environmental liabilities.

The current study maintains that while much discretion exists under Generally Accepted Accounting Principles (GAAP), firms are subject to specific, mandatory recognition and disclosure requirements with respect to environmental liabilities. Thus, the current study compiles a comprehensive index of GAAP disclosures related to environmental liabilities, based on relevant authoritative guidance provided by the FASB and SEC. The index is used to measure the extent of ED in the 10K filings of 182 Fortune 500 companies with known potential environmental liabilities,

for years 1991-1997. The research question is: Are firm characteristics associated with the amount of ED included in 10K reports? The study examines whether size, industry classification, profitability, and regulatory influence affects the extent of ED provided in 10K reports.

This study contributes to the understanding of ED practices of publicly traded U.S. firms, which may assist investors, creditors, regulators and standard setters in determining the adequacy of ED, and to assess the need for additional reporting guidance. Such understanding may also assist researchers that seek to develop a theory of social responsibility disclosure.

## FRAMEWORK

Statement of Position 96-1, Environmental Remediation Liabilities, summarizes the regulatory process with regard to the Superfund Act (AICPA, 1996). The Superfund Act regulates the cleanup of inactive waste disposal sites and spills. The Superfund Act adopted a "polluter pays" philosophy by establishing the right to bill firms associated with sites for their portion of the remediation costs and levying a tax on certain industries to fund orphan sites. Several features of the Superfund Act present challenges for estimating a firm's liability under its provisions. Environmental obligations arising under the Superfund Act are the prime focus of this paper because they include some of the largest cleanup obligations of publicly traded corporations.

## ACCOUNTING PRINCIPLES

GAAP provides specific recognition and disclosure requirements with respect to environmental liabilities. The focus of this study includes Statement of Financial Accounting Standards Number 5 (SFAS 5), Accounting for Contingencies (FASB, 1975), which establishes both recognition rules and disclosure rules for contingent liabilities. In addition to the requirements of SFAS 5, firms must comply with guidance issued by the SEC. Most relevant to the current study is Regulation S-K (revised in 1986): Items 101, 103, and 303 (SEC, 2000), and Staff Accounting Bulletin 92 (SAB 92) (SEC, 1993). Regulation S-K provides standard instructions for filing forms under the Securities Act of 1933, Securities Act of 1934, and Energy Policy and Conservation Act of 1935. SAB 92 was issued specifically to improve the disclosure of environmental liability information.

SFAS 5, Regulation S-K and SAB 92 provide ED requirements for firms with known environmental obligations. Based on this authoritative guidance, the current study utilizes a comprehensive ED index to measure the extent of ED in the 10K reports of sample firms. The resulting measure provides the basis for the examination of factors associated with the level of ED.

## LITERATURE

Studies that investigate the amount and content of ED in annual reports and 10Ks suggest that ED has been largely voluntary (Berthelot et al., 2003). Prior studies, however, do not attempt to determine whether environmental disclosures are consistent with GAAP requirements, thereby utilizing a comprehensive ED index. In addition, the studies are conducted in a vastly different regulatory environment—prior to SAB 92 and increased SEC oversight. Moreover, the studies do not utilize EPA liability data to determine the potential liability exposure of the sample firms. Thus, the current study contributes to this area of research by examining the disclosure practices of firms with known environmental liability exposure, as determined by the EPA. Also, the current study focuses on ED outlined by GAAP, in order to determine the level of GAAP disclosure provided over time.

The current study differs from previous studies in several ways. Most importantly, the level of ED is measured based on a comprehensive disclosure index of GAAP requirements. In addition, the sample is limited to firms with known potential environmental obligations. Proxies for

environmental liability are based directly on cost estimates provided by the EPA in its Record of Decision (ROD). The ROD contains the first publicly available cleanup cost estimates, and it is completed after an extensive EPA investigation. The current study also examines a longer and more recent sample period (1991-1997) than previous research on ED. Moreover, in addition to examining the impact of regulation on ED, the current study examines whether firm characteristics such as size, industry and profitability affect the extent of ED.

## METHODOLOGY

The sample is taken from the 1997 Fortune 500, which represents companies with the highest revenues, or "the deepest pockets". The sampling procedures are designed to obtain a sample of public U.S. firms with known estimated environmental liabilities (which proxies for regulatory influence), and the ability to pay (as remediation is most often paid by the deep-pocketed firms). To be included in the sample 1) the company must be named as a PRP on at least one Superfund Site throughout the entire sample period (1991-1997), and 2) the Form 10K data must be available from 1991-1997.

The Dependent Variable is based on a comprehensive listing of environmental liability disclosures (ED Index), compiled based on Regulation S-K (items 101, 103 and 303), SAB 92, and SFAS 5. Firm 10K reports are examined for the presence or absence of specific statements as outlined in the ED Index (for fiscal years 1991-1997). The firms' final score for each sample year represents the percentage of GAAP disclosure (EDgaap). The variable (EDgaap) equally weights the disclosure items.

The Independent Variables are size, industry, profitability, and regulatory influence. I hypothesize a positive relationship between size and ED (H1). In addition, I hypothesize that companies in five industries (petroleum, chemical, electric power, paper and pulp, and steel) will disclose more than companies in other industries (H2). I hypothesize a positive relationship between profitability and ED (H3). Finally, similar to Barth et al. (1997), an environmental liability estimate based on data provided by the EPA proxies for regulatory influence. I hypothesize larger liabilities to be associated with increased disclosure (H4).

The current study estimates the model using ordinary least squares regression, where, Size = total assets; Industry = dummy indicators for classifications in oil (2-digit SIC 13), chemical (2-digit SIC 28), power (2-digit SIC 49), paper and pulp (2-digit SIC 26), and steel industries (2-digit SIC 33); Profitability = return on assets; Regulatory Influence= total average liability (proxy based on liability estimates provided in EPA Records of Decision).

## RESULTS

The results indicate a positive association between company size and the amount of ED, which supports H1. The results indicate that companies in the petroleum, chemical, paper and pulp, and steel industries provide more ED than companies in other industries (H2). A negative association between profitability and the amount of ED is shown, which is opposite of my prediction (H3). The results reveal a positive association between the log of total average liability and the amount of ED, which indicates that firms with higher environmental liabilities disclose more (H4).

Empirical results indicate that the level of environmental disclosures is associated with size, industry, profitability, and regulatory influence. As firms continue to exercise much discretion with respect to environmental disclosure, understanding the determinants of environmental disclosure choice may help regulators in their monitoring and enforcement activities. In addition, the findings may help standard setters determine whether more guidance is needed specifically related to environmental liabilities. Socially conscious investors may find this information useful when evaluating firms' environmental disclosures.

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# INTELLECTUAL CAPITAL REPORTING: A HUMAN CAPITAL FOCUS

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## ABSTRACT

Within the field of intellectual capital), human capital has received significant emphasis. This paper examines the reporting of human capital performance in the Australian banking sector, a context where human capital is important to competitive advantage. Utilising Sveiby's (1997) Intangible Assets Monitor, a content analysis is performed of annual and special purpose reports. The paper finds significant diversity in levels and focus of human capital reporting and significant reporting that exhibited corporate social responsibility-stakeholder concerns. These findings have implications for policy and research in terms of extended performance reporting.

## INTRODUCTION

In the transition to the information age, the intellectual capital (IC) of organisations, such as competencies, processes and people have become the central sources of current and future wealth (Kaplan & Norton 1996; Petty & Guthrie 2000). Concurrently, businesses are beginning to embrace formalised approaches to manage and report IC, with the ascribed benefits of doing so including business growth, improved financial performance, more effective strategic planning and enhanced productivity (Department of Industry, Science, & Resources, 2001).

Within the IC discipline, human capital has often been singled out as being of prime importance in organisational value creation (Fitz-enz, 2000; Bontis and Fitz-enz, 2002) and a significant influence as a source of innovation (Sveiby, 1997). In light of this, this paper examines how key performance indicator (KPI) reporting discloses the performance of organisations in managing their human capital (as one component of IC). The reason for focusing on KPI reporting specifically is that these quantitative indicators of performance are often considered to be a form of high quality disclosure (Patten, 1995; van der Laan Smith, 2005). The research site is the Australian banking industry, a sector that is both one of the fastest growing segments of the Australian economy (Australian Bureau of Statistics, 2005) and one where human capital is important.

## INTELLECTUAL CAPITAL AND HUMAN CAPITAL

There is general consensus that IC can be usefully characterised in terms of a tri-partite model comprising human capital, relational capital and structural capital components (Edvinsson and Malone 1997; Sveiby 1997). Human capital (employee competences) in particular refers to the skill, training and education, and experience and value characteristics of an organisation's workforce. In the process of creating value from IC, the role of human capital is central. Skilled and engaged employees are required to drive innovation and both create and subsequently realise the benefits of favourable customer, supplier and broader external relations. It is for these reasons that the management of human capital has been cited as critical for businesses if they are to compete effectively (Sveiby, 1997).

Indeed, within the IC literature, human capital has often been singled out as being of prime importance (Fitz-enz, 2000; Bontis and Fitz-enz, 2002), where "people, not cash, buildings or equipment, are the critical differentiators of business enterprise", (Fitz-enz, 2000, p.1).

Measuring and reporting IC and human capital in particular can be an important means of ensuring that all stakeholders are fully informed of the value creation potential of the business. While a plethora of models for the measurement of IC have been developed, one of the earlier and better-known frameworks is the Intangible Assets Monitor developed by Sveiby (1997). The Intangible Assets Monitor focused on the identification of measures based on four different intangible asset value creation modes: growth, renewal and innovation, efficient utilisation and stability. Based on the relative emphasis of these modes in the firm's strategy, corresponding indicators are chosen across the three IC components of employee competence, internal structure and external structure (Sveiby, 1997). Consistent with the focus on human capital here, only those relating to employee competence are outlined below:

- Growth – Example indicators include number of years in profession, level of education, competence index, competence turnover
- Renewal/Innovation – Example indicators include the number of competence-enhancing customers, diversity, training and education costs
- Efficiency/Utilisation – Example includes the proportion of professionals in the company, value added per employee/professional, profit per employee/professional
- Stability – average age, seniority, relative pay position, turnover rate of professional component of workforce.

While the Intangible Assets Monitor recognises that value can be created in four different ways across the three IC components, at its centrepiece is the notion of people as the organisation's profit generators (Sveiby, 1997). As such, it is particularly relevant to the examination of how human resources are accounted for, and comprises the framework that will be utilised in the empirical section of this study.

## RESEARCH SAMPLE AND METHOD

Banks are the largest deposit-taking and financial institutions in Australia. At the end of June 2004 there were 52 banks operating in Australia. Furthermore, as service organisations, they are primarily reliant on their human capital for competitive advantage. Four major banks: the Australia and New Zealand Banking Group (ANZ), Commonwealth Bank of Australia (CBA), National Australia Bank (NAB), and the Westpac Banking Corporation (WBC), account for over half the total assets of all banks (Australian Bureau of Statistics, 2005). Given the size of the four major banks in Australia, these organisations are selected as the research sample.
Content analysis is used as the research methodology for this empirical study. It is widely used to evaluate the nature and extent of disclosure (Guthrie and Parker, 1990; Hackston and Milne, 1996). Content analysis requires the selection of a 'unit of analysis' (Holsti, 1969). The unit of analysis for the empirical research was the non-financial key performance indicator (KPI) in line with prior studies that have used the presence of quantitative information as a proxy for a level of quality in the disclosure (Patten, 1995; van der Laan Smith, 2005). The content analysis was thus limited to the non-financial data available through company annual reports and special purpose reports that contained stakeholder information. Reports for the year ended 2005 were analysed. The results of the coding process are presented in the next section.

## RESULTS

Table 1 presents the results of analysing the KPIs reported by the sampled banks in terms of the Intangible Assets Monitor. As indicated, there is variety both in terms of the number of KPIs reported and the proportion that can be related back to the individual value creating dimensions of Sveiby's (1997) intangible assets. Bank A reports the lowest number of KPIs at 6, while Bank D reports the highest at 22. In contrast, however, Bank A reported the highest proportion of KPIs that related to Sveiby's (1997) value creation modes (6/6 or 100%) while Bank D reported the lowest (8/22 or 36%), with Bank B and Bank C reporting intermediate proportions (7/14 or 50% and 6/15 or 40% respectively). Indeed, in relation to KPIs that could not be related directly to the Intangible Assets Monitor, these tended to focus on workforce diversity, health/injury and work/life balance. As such, they reflect a more stakeholder-oriented or corporate social responsibility (CSR) perspective where the focus on reporting is not on ‘value created from human capital' but on ‘value provided to employees as a stakeholder group'.

Comparing across the banks also reveals significant diversity in the KPIs reported against the value creation modes of growth, renewal/innovation, efficiency/utilisation and stability. Bank A focused more on the efficiency/utilisation (50%) and the stability (33%) of its human capital. In contrast, Bank D exhibited more CSR/stakeholder concerns (other KPIs were 64%) and within the IC framework, focused more on stability (23%) and renewal/innovation (14%). In terms of IC focus, Banks B and C were again different, with Bank B emphasising stability (21%) and growth (14%) while Bank C emphasised renewal/innovation (20%) and stability (13%). Relatively less attention was placed on the growth aspect of human capital.

## CONCLUSIONS AND IMPLICATIONS

Overall, the findings of the paper indicate diversity in human capital reporting levels, the co-existence of IC and CSR/stakeholder concerns in reporting on human capital, and variation in the value creation focus of organisations when reporting their performance in managing human capital.

While the findings above need to be interpreted with caution given the small sample size and the focused examination of KPI reporting of human capital within banking, they nevertheless have implications for practice and research. Firstly, the question of mandating reporting of extended performance needs to be examined. Currently, IC reporting is predominantly voluntary. Although studies that find performance benefits for better disclosers (for example, Linstock Consultants, 2004; Petty and Cuganesan, 2005) support arguments for voluntary disclosure regimes, the heterogeneity in observed disclosure suggests that greater consistency in reporting practice is required if comparability across organisations is to be attained.

Table 1 – Coding Results: Sveiby Intangible Assets Monitor

| | Bank A | Bank B | Bank C | Bank D |
|---|---|---|---|---|
| Growth | | • B1 - New hires<br>• B2 - New customer facing hires | • C1 – New hires | |
| Renewal/ Innovation | • A1 – Training programs attended/completed | • B3 - Training programs attended/completed | • C2 - Training programs attended/completed<br>• C3 - Average training and development spend/employee<br>• C4 - Number of feedback/comments and amount implemented | • D1 - Training programs attended/completed<br>• D2 - Employee satisfaction - training and development<br>• D3 - Number and $-value of employees accessing external tertiary training |

Table 1 – Coding Results: Sveiby Intangible Assets Monitor

| | Bank A | Bank B | Bank C | Bank D |
|---|---|---|---|---|
| Efficiency/ Utilisation | • A2 - Product sales per retail staff member<br>• A3 - Total operating income per full-time (equivalent) employee<br>• A4 - Staff expense/Total operating income (%)<br>• A5 - Staff Numbers and Expenses | • B4 - Staff Numbers and Expenses | | |
| Stability | • A6 - Engagement percentile ranking | • B5 - Engagement score<br>• B6 - % of staff with positive perceptions about career opportunities<br>• B7 - Employee turnover | • C5 - Satisfaction/ Engagement[1]<br>• C6 - Average staff turnover | • D4 - Employee commitment<br>• D5 - Employee morale<br>• D6 - Employee satisfaction[2]<br>• D7 - Staff turnover<br>• D8 - Retention of graduates |
| Number of Other KPIs and Theme | | • 7 KPIs focusing on workforce diversity, code of conduct compliance and health/injury. | • 9 KPIs focusing on workforce diversity, work/life balance and health/injury. | • 14 KPIs focusing on workforce diversity, work/life balance, health/injury and access to employee-support facilities provided by the organisation. |

A second issue involves the issue of convergence between IC and CSR concerns. Both were evident in the reporting practices observed and both movements are interested in issues of sustainability, with IC focused more on the sustainability of future economic cash flows through knowledge flows while CSR/stakeholder considerations emphasise questions of the environment, society and broader stakeholder groups. Thus the issue of convergence in reporting needs to be further examined.

A final issue for consideration by future research in particular is the alignment between externally reported KPIs, internal measures and incentive systems and the management practices actually enacted within organisations. Future research needs to investigate the linkages between extended performance management, measurement and reporting and the consequences of particular approaches to the task of managing IC, which at best is a problematic task (Cuganesan, 2005).

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# TESTING THE THEORY OF CULTURAL INFLUENCE ON INTERNATIONAL ACCOUNTING PRACTICE

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## ABSTRACT

*The issue of cultural influence in explaining behaviour in social systems has been recognised for some time, however its impact on accounting as a social system is a more recent field of study. This paper will examine the theory of cultural influence on the international practice of accounting and critique the research methodologies used to test this theory.*

## INTRODUCTION - MEASURING INTERNATIONAL CULTURE

Environmental factors including legal systems, sources of external finance, taxation systems, representation by professional accounting bodies, historical inflation, economic and political events are used to help explain international differences in accounting practices (see Nobes and Parker, 2004, pp. 17-31). Another environmental factor that is seen as an influencer on international accounting practice and financial reporting is culture.

Culture may be defined as 'the collective programming of the mind which distinguishes the members of one human group from another' (Hofstede, 1980, p. 25). Each human group shares its own societal norms, consisting of common characteristics, such as a value system which is adopted by the majority of constituents. Values are defined by Hofstede (1980, p. 19) as 'a broad tendency to prefer certain states of affairs over others'. It is these definitions that have been widely adopted in accounting research to develop a cultural framework to investigate international accounting differences.

Hofstede's (1980) work on culture represents the most extensive research on national cultural differences to date (Doupnik & Tsakumis, 2004). From attitude surveys collected from approximately 116,000 IBM employees across 39 countries, Hofstede identified four underlying value dimensions along which each country can be positioned. These societal values are: individualism versus collectivism; large versus small power distance; strong versus weak uncertainly avoidance, and; masculinity versus femininity. Across these dimensions, Hofstede's framework provides quantitative measures for each of the sample countries. This broad sample of quantitative data has attracted many researchers studying cross-cultural differences because the measures are seen as reliable for use as independent variables in statistical analysis. Some of these empirical studies will be examined later in this paper.

## THE IMPACT OF CULTURE IN ACCOUNTING

From the literature and practice, Gray (1988) identified four accounting value dimensions that can be used to define a country's accounting (sub)culture: professionalism versus statutory control; uniformity versus conformity; conservatism versus optimism, and; secrecy versus transparency. The first two dimensions relate to authority and enforcement of accounting practice at a country level, and the second two relate to the measurement and disclosure of accounting information at a country level.

Gray (1988) extends Hofstede's model by overlaying accounting values and systems and their links to societal values and institutional norms. Gray posits that accountants' value systems are related to and derived from the unique societal values in each country. Essentially, accounting values, in turn, affect accounting systems, therefore cultural factors directly influence the development of accounting and financial reporting systems at a country level (Doupnik & Tsakumis, 2004).

Gray introduced four propositions that hypothesise relationships between Hofstede's cultural dimensions and his accounting value dimensions. Gray argues that shared cultural values within a country lead to shared accounting values, which in turn influences the nature of a nation's accounting system (Doupnik & Tsakumis, 2004). Gray never operationalised the hypothesis or conducted empirical tests to support his framework, rather this has been left to other accounting researches to prove its validity and this is the focus of the next section.

## EMPIRICAL TESTS OF THE HOFSTEDE–GRAY FRAMEWORK

There have been several contributions in the literature attempting to extend or refine the Hofstede–Gray framework in understanding the influence of culture on accounting (e.g., Perera 1989; Fechner and Kilgore 1994; Baydoun and Willett 1995). Chanchani and MacGregor (1999) have examined the literature focused on the conceptual and theoretical issues of the Hofstede–Gray model, while Doupnik & Tsakumis (2004), have investigated the literature concerning the empirical testing of the theory relating culture to global diversity in financial reporting. Doupnik & Tsakumis (2004) attempted to determine whether the Gray (1988) framework had been subjected to adequate empirical inquiry so as to prove its validity, and summarised the research methodologies employed to test the theory by looking at: country level tests; studies testing all four hypotheses; studies testing one hypotheses only, and; testing at an individual level only (rather than a collective level).

Eddie (1990) provided the first empirical test of Gray's framework, testing all four hypotheses. The research methodology to test the theory constructed an index of accounting values for thirteen Asian-pacific countries and then correlated them with Hofsteded's cultural dimensions. Encouragingly, the predicted signs of association were confirmed, however, the accounting value constructs and their method of measurement were not rigorous and had no independent validation, and as such these findings were quickly dismissed.

Salter and Niswander (1995) use regression analysis to test Gray's hypotheses holding Hofstede's cultural dimensions as the independent variables. Expanding Eddies (1990) study to include 29 countries, Salter and Niswander (1995) found significant correlation between only six of the 13 relationships Gray hypothesised between cultural dimensions and accounting values, suggesting that only some elements of Gray's theory were valid.

Sudarwan and Fogarty (1996) independently developed their own measure of cultural values abandoning the Hofstede (1980) index score. Their research methodology used structural equation modelling to test Gray's hypotheses against a longitudinal study of a single country, Indonesia. Overall, they find support for only four of the Gray's 13 hypotheses, suggesting a general lack of support for the framework.

Moving away from testing all hypotheses, Gray and Vint (1995) tested only one dimension of Gray's (1988) hypothesis; that of secrecy. The attitudes of local partners of an international accounting firm were surveyed to understand secrecy with respect to disclosure practices. The results covered 27 countries and using regression, Gray and Vint (1995) found correlations that supported Grays' (1988) original hypotheses with respect to secrecy.

Zarzeski (1996) looked at not only culture being a determinant of accounting practice, but also the demands of international owners of the firm. She found correlations that supported some of Grays' (1988) hypotheses and evidence that firms disclosure differently (different accounting practices) in their host country depending upon the internationality of the firm.

Wingate (1997) also looked at a single dimension and examined the influence of culture on amount of disclosure. Using independent data on financial disclosure as the dependent variable, and Hofstede's (1980) index score as the independent variable for all 39 countries, she found that, contrary to Gray's (1988) hypotheses, Power Distance is not significantly related to disclosure.

Using the same independent data on financial disclosure as Wingate (1997), Jaggi and Low (2000) look at the issue of culture, accounting disclosure and another environmental factor, the legal

system, using data from three code law countries and three common law countries. For the common law countries, none of the cultural variables were significant. For the code law countries, all of the cultural variables were significant but only one dimension acted along Gray's (1988) hypothesised direction. Jaggi and Low (2000) concluded not only that Gray's (1988) hypotheses with regard to single dimension of secrecy versus transparency was not valid, but also that the Hofstede culture indices, originally developed in the 1970's, may be outdated.. Also, because the Hofstede culture indices were obtained from only one company, IBM, they may not reflect the diversity of attitudes within each of the 39 countries. The findings put forward by Jaggi and Low (2000) suggest that "culture has little or no influence on the disclosure levels once legal system is considered" (Doupnik and Tsakumis, 2004).

However, Hope (2003) carried the Jaggi and Low (2000) study across all 39 counties for a three-year period (1993 to 1995). Using a larger sample he gets mixed results across Gray's (1988) hypotheses, but triumphantly declares that "it is too early to write off culture as an explanatory variable for annual report disclosure levels" (Hope, 2003, p. 23).

## CONCLUSION

Understanding the impact that environmental factors such as culture have on accounting practice and financial disclosure is important as we move towards international accounting harmonisation. Any insights into how local values may percolate through the accounting treatment and ultimately impact financial disclosure is important to ensure the comparability of international financial reporting.

Gray's (1988) framework has raised expectations about how culture may influence accounting practice at a national level. However, empirical research into this question has not demonstrated satisfactorily any proof to support the hypotheses.

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# GEORGE DAVIS BAILEY FIRST EXECUTIVE PARTNER OF TOUCHE, NIVEN, BAILEY, AND SMART (A PREDECESSOR FIRM TO DELOITTE TOUCHE TOHMATSU)

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## ABSTRACT

*George D. Bailey was a practitioner who was active in the profession. He founded one of the three firms which merged, and which, with additional mergers, would become Touche Ross & Co., a predecessor firm to Deloitte Touche Tohmatsu. He served on many professional committees, including the Committee on Accounting Procedure, and was president for a year of the American Institute of Accountants (now the American Institute of Certified Public Accountants). Some of the issues he dealt with are still the subject of discussion today within the accounting profession.*

# REAL EXCHANGE RATE BEHAVIOR UNDER PEG: EVIDENCE FROM THE CHINESE RMB AND MALAYSIAN MYR

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## ABSTRACT

*The exchange-rate behavior of the Chinese yuan (RMB) and the Malaysian ringgit (MYR) indicates that under the pegged regime, the real exchange rate volatility of both the pegged currency/the anchor currency (the U.S. dollar), and the pegged currency/the non-anchor currencies (Japanese yen and British pound) that float to the dollar are lower, and the dynamic behavior of the pegged currencies' real exchange rates is consistent with that of the anchor currency as the speed of convergence of the Big Mac real exchange rates of the RMB, MYR, and the dollar against the floating currencies are almost identical during the pegged period. An interpretation is similar inflation rate movements in the related economies.*

# USING THE ANNUAL REPORT TO CONVEY CORPORATE SOCIAL RESPONSIBILITY

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## ABSTRACT

*We are seeing a continuous uptrend in the number of corporations reporting on corporate social responsibility (CSR) activities. Many companies provide separate reports, but CSR information is also found in annual reports. A review of some prominent U.S. conglomerates, deemed to have superior CSR reporting practices, indicate that these companies are choosing to report their socially responsible activities using venues other than the annual report. This practice may marginalize the role of the accountant in conveying useful and relevant information to stakeholders.*

## INTRODUCTION

Triple Bottom Line Accounting is a term created by John Elkington, the founder of Sustainability Online (www.sustainability.org), in the late 1990s. It is a reporting model that enables companies to convey information about their CSR activities. The triple bottom line accounting model supplements financial accounting information.

## THE ANNUAL REPORT

The overriding responsibility of accountants is to protect the public and provide confidence in corporate communication of financial information to external parties. Accountants provide audited financial statements and comprehensive footnotes in the widely distributed annual reports and the 10-K's filed with the Securities and Exchange Commission (SEC).

Accountants have the traditional role of measuring and quantifying transactions that affect firm and stakeholder value and can contribute effectively to measuring the value of a company's CSR activities. Playing the role of a "scorekeeper" (Gray, 1992), accountants have the responsibility to associate financial numbers with CSR activities as a part of an ongoing effort to provide more transparency to a corporations efforts and its impact on the financial bottom line. Yet, most discussions about CSR and triple bottom line accounting appear in disciplines outside the realm of accounting.

## PURPOSE OF STUDY

More than half, i.e. 63 percent of the top 250 companies of the Fortune 500 global companies report on CSR activities (KPMG, 2005). The majority of companies issue standalone reports, but an increasing number is including CSR information in their annual reports.

Currently CSR reporting is more prevalent in Europe and some other parts of the world than in the U.S. Many foreign annual reports typically contain considerably more social disclosures than those of U.S. companies (Saudagaran, 2003). The focus of this investigation is on the use of the annual report to convey CSR information by some U.S. conglomerates since our interest is in the

accountant's role in the U.S. However, US conglomerates have global operations and may therefore be affected by practices in other countries.

## REVIEW OF ANNUAL REPORTS AND FINDINGS

We manually reviewed the most recent annual report of the ten U.S. Companies included in a report entitled "Trust Us (Sustainability Online, 2002)." It is a global report that lists companies that have superior CSR reporting standards. We looked for references to triple bottom line accounting and CSR activities. The specific terms investigated were: Triple bottom line accounting; sustainability; corporate responsibility; social responsibility; and environmental performance.

Table 1
General CSR Terms Used in the Annual Reports

| Ticker Symbol | Triple Bottom Line Accounting | Sustainability | Corporate or Social Responsibility | Environmental Performance |
|---|---|---|---|---|
| Baxter Intereernational Inc. | No | Yes | Yes | Yes |
| Bristo-Myers Squibb Company | No | Yes | Yes | No |
| Chiquita Brands International Inc. | No | Yes | No | No |
| ConocoPhilips | No | No | No | Yes |
| Ford Motor Company | No | Yes | Yes | No |
| General Motors Corporation | No | Yes | Yes | No |
| Internaitonal Business Machines Corp. | No | No | Yes | Yes |
| Proctor & Gamble Company | No | Yes | No | No |
| Sunoco, Inc. | No | No | No | Yes |
| TXU Corp. | No | No | Yes | Yes |

These terms are broadly descriptive of the companies' activities in the various areas of corporate social responsibility. We made no other qualitative judgments or an attempt to rank the information since the primary interest was to determine whether or not the annual report is used to communicate this type of information.

Our investigation indicated that annual reports contain very little information about a company's CSR activities. Among the ten US companies, none used the term triple bottom line accounting in their financial reports. The most prevalent term used was sustainability. Almost all the companies in the sample referred to the term somewhere in the middle of their annual reports, accompanied by references to websites. In some cases, the reference appeared in the letter to the stakeholders.

## CONCLUDING REMARKS

The growing importance of corporate social responsibility makes it important for companies to report on such activities so that they can maximize stakeholder values. Accountants have been the main providers of information about a company to date. Annual reports may become less relevant to future users if much of the key, market driven information comes from other sources and accountants may be sidelined in what is their primary field.

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# REPORTING ON CORPORATE CITIZENSHIP, USING THE GLOBAL REPORTING INITIATIVE GUIDELINES

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## ABSTRACT

*The current framework of financial accounting and reporting was designed to meet the needs of investors and creditors in localized merchandizing and manufacturing financial systems. In today's global economy, however, companies have transformed themselves into multi-billion dollar conglomerates whose activities have far reaching impact not only on people's lives but also on whole nations.*

*Companies must now answer to a diverse group of stakeholders ranging from consumer advocates to human rights groups. Global pressures and competition, as well as the demand for a scandal free, ethical business community are further revolutionizing business practices. Not surprisingly, new trends are emerging that are emphasizing transparency and open dialogue in reporting practices.*

*The skills and experience of the accounting profession has much to offer in terms of measurement, assurance and standard setting. At present, the content of many corporate citizenship reports tends to appear in forms and units that are not readily comparable. One attempt at standardization, which is rapidly gaining credibility, is the Global Reporting Initiative (www.globalreporting.org), which provides a framework for reporting on economic, social and environmental performance.*

*The aim of the Global Reporting Initiative is to increase the level, rigor and comparability of CSR reporting by creating guidelines using performance indicators. The organization hopes that one day comprehensive reporting will be the norm and as good as financial reporting.*

# PLANNING WITH 401(k) SAVINGS PLANS

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## ABSTRACT

*For almost twenty years, taxpayers have had available to them several types of tax-deferred savings in the form of Individual Retirement Accounts (IRAs), 401(k), and 403(b) savings plans. These original tax favored savings vehicles have in the last few years been expanded and augmented but the addition of Roth IRAs, Section 485 plans, and most recently, Roth 401(k) and Roth 403(b) plans. These plans have varying contribution limits and also differing tax advantages. The most recent addition of the Roth 401(k) and Roth 403(b) plans raises a fundamental question: Which plan should one choose? Is one plan always superior or does it depend on the particular tax circumstances of the individual and that individual's expectations about the future?*

*This paper will model several scenarios for different taxpayers to answer these questions. The paper will also explore choices that most individuals have to make in funding the savings plans. This paper extends earlier research concerning traditional 401(k) and 403(b) savings plans to include the newer Roth plans.*

*All individuals who invest in any of these savings plans should be aware of these issues. This paper will aid investors in making decisions appropriate to their individual situation.*

# SURPRISE EARNINGS ANNOUNCEMENT: A TEST OF MARKET EFFICIENCY

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## ABSTRACT

*This study tests efficient market theory by examining the effect of the announcement of third quarter positive earnings surprises on stock price's risk adjusted rate of return. The event study analyzed 50 randomly selected firms from randomly selected date (October 17, 2006, November 10, 2006, and November 13, 2006). The work analyzed 11,183 observations using standard risk adjusted event study methodology and the market model from the finance literature. In conducting this event study, appropriate statistical tests for significance were conducted. Results show a significant positive market reaction just prior to the firms' positive surprise earnings announcements. Results from these tests support semi-strong form market efficiency, purporting that the firms' stock prices reflect all publicly available information.*

*When a firm announces positive surprise earnings, investors perceive a positive signal about the firm's future cash flows which causes an increase in the firm's stock price. This study's results suggest that positive surprise earnings announcements do indeed send a positive signal about the profitability and future success of a firm. As a result of this positive signal, stock prices do increase and the market reacts quickly to publicly available information.*

## INTRODUCTION

When firms release their earnings, analysts compare them to their predetermined estimates for the quarter. The estimates are based on the firm's previous performance, recent good or bad news about the firm, and any outside effects (i.e economic conditions) that may affect the firm's performance. Earnings reports higher or lower than analysts' estimates comprise earnings surprises. Surprise earnings announcements can significantly affect stock prices. Positive surprise earnings announcements typically drive up the firm's stock price by sending a positive signal to investors about the firm's future cash flows. Conversely, a negative earnings surprise announcement exerts downward pressure on stock price as investors perceive a negative signal about the firm's future.

How fast does the stock market react to publicly announced information? According to Eugene Fama (1970), market efficiency can take on three forms: weak form efficiency, semi-strong form efficiency, and strong form efficiency. This study investigates whether an investor can achieve an above normal return by acting on public announcements of positive surprise earnings. The purpose of this study is to test the semi-strong form efficient market hypothesis by analyzing the effects of a sample of positive surprise earnings announcements on stock price. Likewise, the study examines the exact timing of the stock price reaction to the positive surprise earnings news around the announcement date. The purpose of this study is to test market efficiency theory by analyzing the impact of a sample of 50 firms' positive surprise earnings announcements on the risk adjusted stock return using the standard risk adjusted event study methodology. Specifically, how quickly does the market price of the firms' stock react to the sample of positive surprise earnings announcements examined? This research tests whether the announcement of surprise earnings directly incorporates

the strong form, semi-strong form, or weak form of the efficient market hypothesis based on the timing of the announcements and the changes in stock price that occur.

## LITERATURE REVIEW

Market efficiency can be tested on three levels of information: information on past prices, all publicly available information, and all public and private information. Fama (1970) defines three forms: weak form efficient, semi-strong form efficient and strong form efficient. Weak form efficiency hypothesizes that stock prices reflect all the information found in past stock prices. If the market is weak form efficient, then stock price reacts so fast past information that no investor can earn an above normal risk adjusted return by acting on this level of information.

Semi-strong form efficiency suggests that stock price immediately reflects all available information. Included in this information are published financial statements and any historical information. A test of semi-strong form efficiency (Fama, Fisher, Jensen, and Roll, 1969) indicated that investors cannot earn an above normal return on publicly available information such as historical prices, volume information, accounting statements, annual reports, stock splits, dividend announcements, new issues of stock announcements, and earnings announcements. When a market is semi-strong efficient, stock prices should reflect all information released making it impossible to earn above abnormal returns by acting on public announcements.

Strong form efficiency hypothesizes that stock prices immediately incorporate all information, both public and private. Further, strong form efficiency indicates that any information that is related to the stock's value and "is known to at least one investor" should be immediately reflected in the stock price (Ross, 357). According to strong form efficiency, even t insider trading would not yield an abnormal return since the firm's stock price has already reacted to the inside information. "It is difficult to believe that the market is so efficient that someone with valuable information cannot prosper from it" (Ross, 357). It is more likely to believe that inside information can allow someone to earn abnormal returns.

## METHODOLOGY

This study sample includes 50 randomly selected firms with third quarter positive surprise earnings announcements on the randomly selected dates of October 17, 2006, November 10, 2006, and November 13, 2006. The random sample was selected from third quarter positive surprise earnings announcements traded either on the NYSE or NASDAQ.

In order to test semi-strong market efficiency with respect to public announcements of earnings, this study proposes the following hypotheses:

**$H1_0$:** The risk adjusted return of the stock price of the sample of firms announcing third quarter positive surprise earnings is not significantly affected by this type of information on the announcement date.
**$H1_1$:** The risk adjusted return of the stock price of the sample of firms announcing third quarter positive surprise earnings is significantly positively affected by this type of information on the announcement date.
**$H2_0$:** The risk adjusted return of the stock price of the sample of firms announcing third quarter positive surprise earnings is not significantly affected by this type of information around the announcement date as defined by the event period.
**$H2_1$:** The risk adjusted return of the stock price of the sample of firms announcing third quarter positive surprise earnings is significantly positively affected around the announcement date as defined by the event period.

This study uses the standard risk adjusted event study methodology from the finance literature. The announcement date (day 0), obtained from http://finance.yahoo.com/, is the date of the firm's announcement of the third quarter positive surprise earnings. The required historical financial data, i.e. the stock price and S&P500 index during the event study period was also obtained from the internet website http://finance.yahoo.com/.

The historical stock prices of the sample companies, and S&P 500 index, for the event study duration of -180 to +30 days (with day –30 to day +30 defined as the event period and day 0 the announcement date) were obtained. Then, holding period returns of the companies (R) and the corresponding S&P 500 index ($R_m$) for each day in this study period was calculated using formula:

$$\text{Current daily return} = \frac{\text{(current day close price – previous day close price)}}{\text{previous day close price}}$$

A regression analysis was performed using the actual daily return of each company (dependent variable) and the corresponding S&P 500 daily return (independent variable) over the pre-event period (day –180 to –31 or period prior to the event period of day –30 to day +30) to obtain the intercept alpha and the standardized coefficient beta. For this study, in order to get the normal expected returns, the risk-adjusted method (market model) was used. The expected return for each stock, for each day of the event period from -30 to +30, was calculated as:

**E(R) = alpha + Beta ($R_m$)**, where **$R_m$** is the return on the market (i.e. the S&P 500 index).
Then, the Excess return (**ER**) was calculated as:
**ER** = the Actual Return (**R**) – Expected Return **E(R)**
Average Excess Returns (**AER**) were calculated (for each day from -30 to +30) by averaging the excess returns for all the firms for given day.
**AER** = Sum of Excess Return for given day / n, where n = number of firms is sample i.e. 10 in this case

Also, Cumulative AER was calculated by adding the AERs for each day from -30 to +30. Graphs of AER and Cumulative AER were plotted for the event period i.e. day -30 to day +30. Also, standard deviation and correlation were computed. Chart 1.0 depicts Average Excess Return (**AER**) plotted against time. Chart 2.0 depicts Cumulative Average Excess Return (**CAER**) plotted against time.

**Chart 1.0 Average Excess Return over Event Period**

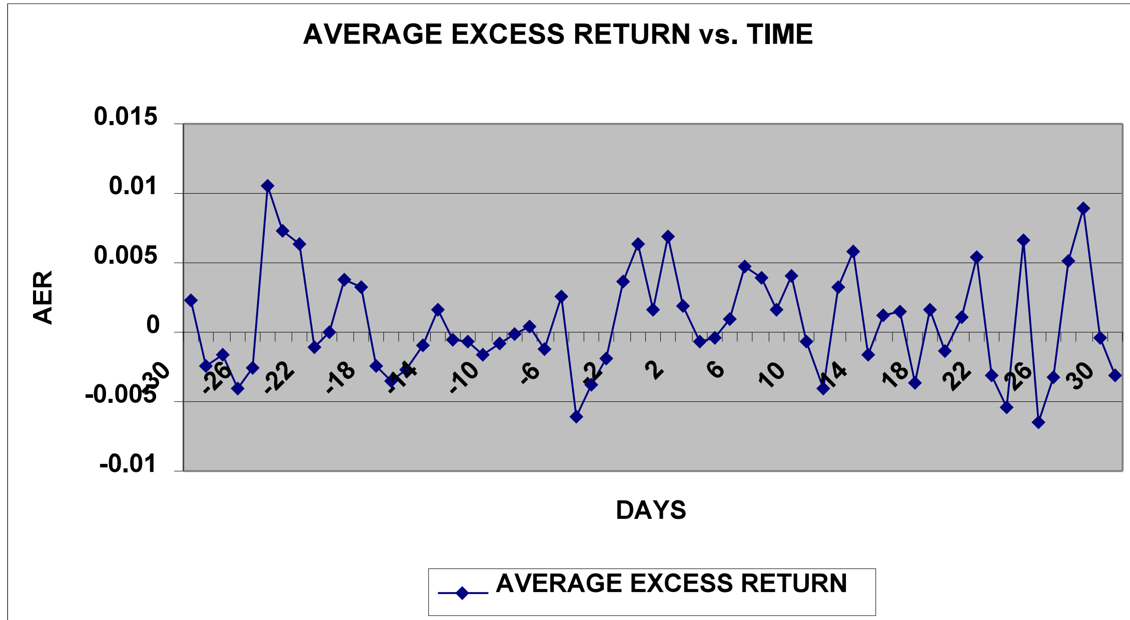
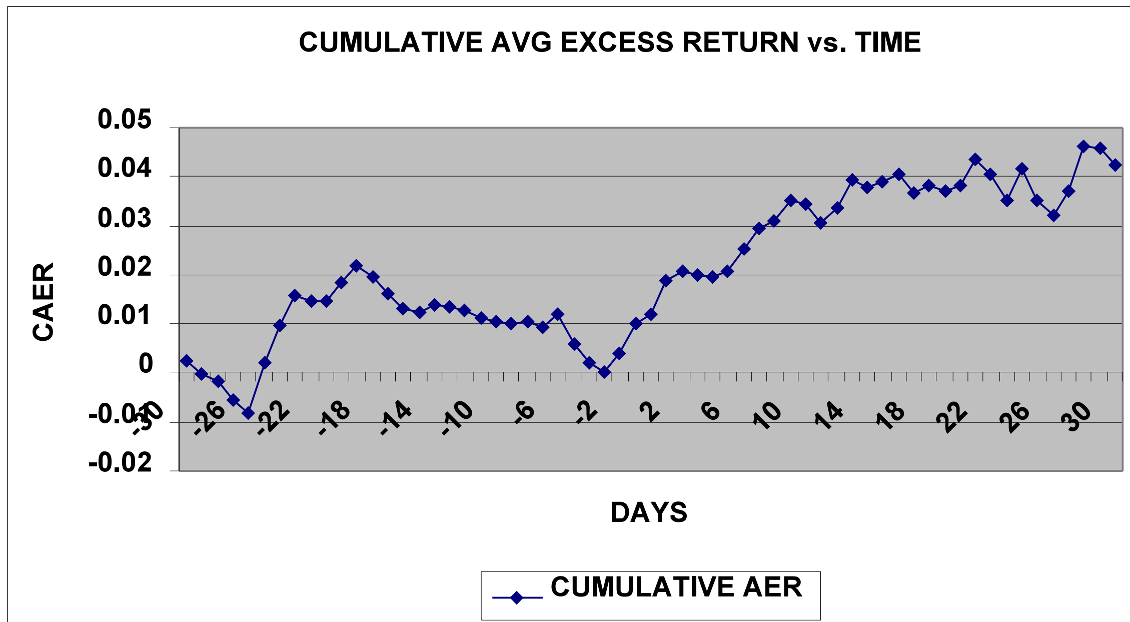



**Chart 2.0 Cumulative Average Excess Return over Event Period**




## QUANTITATIVE TESTS AND RESULTS

Did the market react to the announcements of positive surprise earnings? Was the information surrounding the event significant? It would be expected that there is a significant difference in the daily Actual Average Returns (Day -30 to Day +30) and the daily Expected Average Returns (Day -30

to Day +30) if the information around the event includes new, significant information on the market price of the firms' stock (see Average Excess Return graph in Chart 1.0 above). If a significant risk adjusted difference is observed, then the hypothesis is supported that this type of information did in fact significantly increase stock prices. To statistically test for a difference in the daily Actual Average Returns (for the firms over the time periods day -30 to day +30) and the daily Expected Average Returns (for the firms over the time periods day -30 to day +30), a paired sample t-test was conducted and found a significant difference at the 5% level between actual average daily returns and the risk adjusted expected average daily returns. Results here support the alternate hypothesis $H2_1$: The risk adjusted return of the stock price of the sample of firms announcing positive earnings surprises is significantly positively affected around the announcement date as defined by the event period. This finding supports the significance of the information around the event since the market's reaction was observed.

Is it possible to isolate and observe the sample's daily response to the announcement of a positive earnings surprise from day -30 to day +30? If so, at what level of efficiency (weak, semi-strong, or strong form according to efficient market theory) did the market respond to the information and what are the implications for market efficiency? Another purpose of this analysis was to test the efficiency of the market in reacting to the announcement of a positive earnings surprise. As the tests were conducted, was the market efficiency found to be weak, semi-strong, or strong form efficient as defined by Eugene Fama, (1970) in the efficient market hypothesis (EMH)? The key in the analysis or tests is to determine if the AER (Average Excess Return) and CAER (Cumulative Average Excess Return) are significantly different from zero or that there is a visible graphical or statistical relationship between time and either AER or CAER. See AER and CAER graphs in Charts 1 and 2 above. T-tests of AER and CAER both tested different from zero at the 5% level of significance. Likewise, observation of Chart 2 (graph of CAER from day –30 to day +30) confirms the significant positive reaction of the risk adjusted returns of the sample of firms tested, up to 2 days prior to the positive earnings surprise announcements.

The graph in Chart 2 demonstrates that the positive earnings surprise announcements had a significant positive impact on the firm's share price up to two days prior to announcement day 0, the surprise earnings announcement date. The evidence supports the null hypothesis $H1_0$: The risk adjusted return of the stock price of the sample of firms announcing third quarter positive surprise earnings is not significantly affected by this type of information on the announcement date when made public. For the sample of firms analyzed, an investor is unable to earn an above normal risk adjusted return by acting on the public announcement of positive earnings surprises. As of the announcement date, the firms' stock prices had already adjusted to the new information embedded in the positive surprise earnings announcements. These results are consistent with the semi-strong form market efficiency hypothesis claiming that stock price immediately reflects all available information.

## CONCLUSION

This study tested the effect of the announcement of third positive quarter earnings surprises on stock price's risk adjusted rate of return for 50 randomly selected firms from the randomly selected dates of October 17, 2006, November 10, 2006, and November 13, 2006. This study analyzed 11,183 observations using standard risk adjusted event study methodology with the market model on 50 publicly traded firms. In conducting this event study, appropriate statistical tests for significance were conducted. Results show a significant positive market reaction just prior to the firms' positive surprise earnings announcements. The results from these tests also support semi-strong form market efficiency, which states that a market is semi-strong efficient if it reflects all available information.

When a firm announces positive surprise earnings, investors appear to perceive a positive signal about the firm's future which causes an increase in the firm's stock price. This study's results suggest that positive surprise earnings announcements do indeed send a positive signal about the

profitability and future success of a firm. As a result of this positive signal, stock prices do increase and the market reacts quickly to available information.

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# THE ETHICS OF TAX EVASION: EMPIRICAL STUDIES OF JEWISH OPINION

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## ABSTRACT

*This paper begins with a review of the literature and identifies the main issues and summarizes the three main viewpoints that have emerged over the centuries. It then reports on the results of two surveys of members of the Jewish faith who were asked their opinions on the ethics of tax evasion. The results of the two surveys were then compared. Male scores were also compared to female scores to determine if the responses differed by gender.*

## INTRODUCTION

The vast majority of articles that have been written about tax evasion have been written from the perspective of public finance. They discuss technical aspects of tax evasion and the primary and secondary effects that tax evasion has on an economy. In many cases there is also a discussion about how to prevent or minimize tax evasion. Very few articles discuss ethical aspects of tax evasion. Thus, there is a need for further research, which the present study is intended to partially address.

As part of this study a survey instrument was developed based on the issues that have been discussed and the arguments that have been made in the tax evasion ethics literature over the last 500 years. Similar survey instruments were used to test sample populations in Romania (McGee, 2005), Guatemala (McGee & Lingle, 2005) and a few other countries. Space constraints do not permit a full comparison with these other studies. The present study reports on the findings of a survey that was distributed to undergraduate Orthodox Jewish students at a branch of Touro College in New York. The results of the present study are also compared to the findings of a human values study that touched on the ethics of tax evasion (Inglehart et al, 2004).

## THREE VIEWS ON THE ETHICS OF TAX EVASION

Over the centuries, three basic views have emerged on the ethics of tax evasion. These three views have been explored in depth elsewhere (McGee, 2006) but a brief overview is called for.

### View One

View One takes the position that tax evasion is always, or almost always unethical. There are basically three underlying rationales for this belief. One reason is the belief that individuals have a duty to the state to pay whatever taxes the state demands (Cohn, 1998; Smith & Kimball, 1998; Tamari, 1998). This view is especially prevalent in democracies, where there is a strong belief that individuals should conform to majority rule.

The second rationale for an ethical duty to pay taxes is because the individual has a duty to other members of the community (Crowe, 1944; Cohn, 1998; Tamari, 1998). This view holds that individuals should not be freeloaders by taking advantage of the services the state provides while not contributing to the payment of those services. A corollary of this belief is the view that if tax dodgers do not pay their fair share, then law-abiding taxpayers must pay more than their fair share.

The third rationale is that we owe a duty to God to pay taxes, or, stated differently, God has commanded us to pay our taxes (Cohn, 1998; Smith & Kimball, 1998; Tamari, 1998). This view holds no water among atheists, of course, but the view is strongly held in some religious circles.

**View Two**

View Two might be labeled the anarchist view. This view holds that there is never any duty to pay taxes because the state is illegitimate, a mere thief that has no moral authority to take anything from anyone (Block, 1993). The state is no more than a mafia that, under democracy, has its leaders chosen by the people.

**View Three**

View Three holds that tax evasion may be ethical under some circumstances and unethical under other circumstances. This view is the prevalent view, both in the literature (Crowe, 1944) and according to the results of some of the surveys (McGee, 2005; McGee & Lingle, 2005).

## JEWISH VIEWS

Not much has been written on the ethics of tax evasion from the Jewish perspective. The two seminal articles on this topic were written by Cohn (1998) and Tamari (1998). A human beliefs and values survey (Inglehart et al. 2004) gathered some data on Jewish views but the data was never analyzed. One aim of the present study is to analyze this data.

### Human Beliefs and Values Survey

The Human Values and Belief Surveys (Inglehart et al. 2004) collected responses to scores of questions from 200,000 people in 81 societies representing 85 percent of the world's population. The survey differed by country. Not all questions were asked in all countries. One question was:

> Please tell me for each of the following statements whether you think it can always be justified, never be justified, or something in between: Cheating on taxes if you have a chance. [Question F116]

The range of responses was from one to ten where one (1) represented "never justifiable" and ten (10) represented "always justifiable." The survey included 324 Jews from more than 40 countries. The range of scores for the overall study and for the four countries that included more than 20 Jews in the survey is listed in Table 1.

Table 1: Jewish Responses
Range of Scores (%) (1 = never justifiable; 10 = always justifiable)

| Score | % | | | | |
|---|---|---|---|---|---|
| | Total Sample | France | Georgia | Tanzania | USA |
| 1 | 56.4 | 33.8 | 55.6 | 82.9 | 48.7 |
| 2 | 12.9 | 17.9 | 12.5 | 2.4 | 15.7 |
| 3 | 8.5 | 19.2 | 11.1 | 2.4 | 10.0 |
| 4 | 5.5 | - | 5.6 | 2.4 | 4.3 |
| 5 | 6.2 | 14.4 | 8.3 | 2.4 | - |
| 6 | 2.2 | - | 1.4 | - | 6.3 |
| 7 | 1.0 | 4.3 | 1.4 | - | 1.6 |

| Table 1: Jewish Responses<br>Range of Scores (%) (1 = never justifiable; 10 = always justifiable) | | | | | |
|---|---|---|---|---|---|
| Score | % | | | | |
| | Total Sample | France | Georgia | Tanzania | USA |
| 8 | 1.5 | 4.3 | 1.4 | - | 2.8 |
| 9 | 1.5 | - | 1.4 | - | 4.3 |
| 10 | 4.2 | 6.0 | 1.4 | 7.3 | 6.3 |
| Sample Size | 324 | 21 | 72 | 41 | 50 |
| Mean | 2.49 | 3.24 | 2.33 | 1.90 | 3.00 |
| Standard Deviation | 2.412 | 2.665 | 2.056 | 2.447 | 2.912 |

The most frequent response is one (1), meaning that tax evasion is never justified. For the sample as a whole more than half (56.4%) gave this response. The percentage for Tanzania was the highest at 82.9%. The lowest was France, with a 33.8% score.

## THE PRESENT STUDY

The present study builds on the prior study although the authors were not aware of the Human Beliefs and Values Study when they started their study. The present study also replicates a few other studies, which are mentioned elsewhere in this paper.

### Methodology

The survey instrument used in the present study was very similar to the instrument used in the Romania (McGee 200b), Guatemala (McGee & Lingle, 2005) and other empirical studies. The survey consisted of eighteen (18) statements that generally began with the phrase "Tax evasion is ethical if…" and included a seven-point Likert scale. Those who agreed strongly with the statement were instructed to select one (1) as their response. Those who disagreed strongly were instructed to select seven (7) as a response. The statements reflected the three views on the ethics of tax evasion that have emerged in the literature over the last 500 years.

Respondents consisted of undergraduate students in a branch of Touro College in New York. Respondents were all Orthodox Jewish. Many of the male students had rabbinical training. Many of them also studied Jewish law extensively in high school. Most of the female students had a strong high school background in Jewish studies as well as post high school education. One hundred and seven usable responses were received – 65 male, 40 female and 2 unknown.

### Survey Findings

Table 2 ranks the eighteen statements from most acceptable to least acceptable. Scores ranged from 3.12 to 6.57, indicating that there are circumstances when tax evasion can be ethically justified. Respondents believed that the strongest case for tax evasion was in cases where a Jew is living in Nazi Germany. Surprisingly, however, the score for that statement was not even close to 1.0, which indicates there is a belief, even among Jews, that there is some duty to pay taxes even to Hitler.

| Table 2: Ranking<br>(1 = strongly agree; 7 = strongly disagree) | | |
|---|---|---|
| Rank | Statement | Score |
| 1 | Tax evasion would be ethical if I were a Jew living in Nazi Germany in 1940. (S16) | 3.12 |
| 2 | Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background. (S17) | 3.30 |
| 3 | Tax evasion is ethical if a significant portion of the money collected winds up in the pockets | 4.61 |

| | | |
|---|---|---|
| | of corrupt politicians or their families and friends. (S11) | |
| 4 | Tax evasion is ethical if the government imprisons people for their political opinions. (S18) | 4.81 |
| 5 | Tax evasion is ethical if the tax system is unfair. (S3) | 4.84 |
| 6 | Tax evasion is ethical if a large portion of the money collected is wasted. (S4) | 5.24 |
| 7 | Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of. (S6) | 5.34 |
| 8 | Tax evasion is ethical if I can't afford to pay. (S14) | 5.46 |
| 9 | Tax evasion is ethical if tax rates are too high. (S1) | 5.95 |
| 10 | Tax evasion is ethical if everyone is doing it. (S10) | 6.19 |
| 11 | Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me. (S8) | 6.28 |
| 12 | Tax evasion is ethical even if tax rates are not too high because the government is not entitled to take as much as it is taking from me. (S2) | 6.34 |
| 13 | Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust. (S13) | 6.38 |
| 14 | Tax evasion is ethical even if it means that if I pay less, others will have to pay more. (S15) | 6.39 |
| 15 | Tax evasion is ethical even if most of the money collected is spent wisely. (S5) | 6.44 |
| 16 | Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects. (S7) | 6.49 |
| 17 | Tax evasion is ethical if the probability of getting caught is low. (S12) | 6.54 |
| 18 | Tax evasion is ethical even if a large portion of the money collected is spent on projects that do benefit me. (S9) | 6.57 |

Females had higher scores in all 18 cases. In two cases they were significantly different at the 1% level; in six cases at the 5% level; and in 2 cases at the 10% level.

## CONCLUDING COMMENTS

The purpose of this study was to learn the views of educated Orthodox Jews on the ethics of tax evasion. This goal has been achieved. This study replicates several other studies and reaches the same basic conclusions – that some arguments supporting the concept that tax evasion is ethical are stronger than others; and that none of the arguments supporting tax evasion on ethical grounds are very strong.

This study ranks the various arguments that have evolved over the last 500 years and also finds that women are significantly more opposed to tax evasion than are men, which confirms some of the other studies. The present study also analyzes for the first time the data on tax evasion under Judaism that were gathered from the Human Beliefs and Values Survey.

If one were to summarize the results of this study in a few words one might say that Orthodox Jews believe that tax evasion is ethical in some cases, although the view that tax evasion is justifiable is generally frowned upon.

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# THE EFFECT OF THE LEVEL OF ACCOUNTING DEGREE OBTAINED ON RECRUITERS' PERCEPTIONS OF ACCOUNTING GRADUATES

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## ABSTRACT

*Most states have a 150-hour coursework requirement to qualify to take the CPA exam, but the requirements do not mandate a master's degree. Students planning to take the CPA exam must obtain additional hours by taking more courses, but not all students pursue a master's degree.*

*This study is divided into two phases. The first phase examines whether recruiters of accounting graduates pursue a student receiving a master's degree more aggressively than a student receiving a bachelor's degree. The results show no difference in how actively a graduate is recruited based on the level of degree obtained. The second phase examines the relative importance that recruiters place on certain characteristics of the recruit. The results show that recruiters fell that a master's degree is not important, but communication skills and computer skills are important.*

*Master's degree programs need revision to make them valuable to recruiters, and accounting programs need to broaden the goals of their curricula. The results provide useful information to administrators who are making changes to their curricula because of the 150-hour requirement. The results also provide students and companies that plan to hire accounting graduates with useful information to plan their education and recruiting tactics, respectively.*

# TAXES ARE STILL CERTAIN: INDIVIDUAL TAX CONSEQUENCES UNDER SARBANES OXLEY

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## ABSTRACT

*With the advent of the Sarbanes-Oxley Act of 2002, corporate executives, if convicted under certain provisions of the act, may have to reverse certain payments received from the corporation or give up profits gained on transactions of corporate stock. Since many of these transactions initially had tax consequences to the executive, reversal also creates tax consequences. In this paper, we delineate the transactions that would have tax consequences to the individual executive and explain the tax effects.*

## INTRODUCTION

Conventional wisdom says the only certain things in life are death and taxes. Both consequences may occur under provisions of the Sarbanes-Oxley Act of 2002. Death here refers to the potential death of a CEO's or CFO's career, if he is charged and convicted of violating the Sarbanes-Oxley Act (hereafter, the Act). The taxes occur because of several provisions in the Act that require certain individuals to disgorge any profits they have made during the term of the financial malfeasance.

Five types of economic transactions can trigger tax consequences under the Act. They include

1. Bonuses or incentive-based compensation received during the period of financial malfeasance.
2. Equity-based compensation during this time period.
3. Profits realized from security sales during this time period.
4. Profits realized from the sale of stock during any blackout periods.
5. Forgiveness of previously granted loans that cannot be renewed under the Act.

For each of the above provisions of the Act, we explain the provisions set forth in the Act and analyze the tax consequences as they relate to a fictional executive found to have violated each specific section. For purposes of illustration of these provisions, we use John Smith, CEO of ZYX, Inc., as an example, and we assume that John Smith is in the top marginal tax bracket. While we use a CEO in the examples, these consequences could also apply to a CFO.

## BONUSES AND INCENTIVE PAY

When a company is required to restate its financial data as a result of material misconduct under the Act, the CEO and/or the CFO must reimburse the company for any bonuses and incentive-based pay received and gains on stock sales in connection with the filing of an "accounting restatement due to material noncompliance of the issuer, as a result of misconduct, with any financial reporting requirement under the securities laws" during he specific recapture period. In most industries, incentive-based compensation also includes stock options. Receiving stock options doesn't provide cash to the holders at the time of the grant, but it can create a taxable event, and the holder needs to pay taxes when stock options are granted or exercised depending on the grant restrictions. If the grant

occurs during the period of financial misconduct, the Act requires that the incentive-based pay must be reimbursed to the company. With the reimbursement, any tax consequences recognized would also be reversed.

If the non-qualified stock options are not traded on an open market and do not have a fair market value (FMV), then the stock options are not taxable to the employee on the grant date. Instead, the stock options are taxable at the exercise date. The employer receives a deduction in the year the employee recognizes compensation income either on the grant date or, more likely, the exercise date.

Let's assume that during FY 2007, Smith received a bonus of $6.5 million. This bonus must be returned to ZYX. Because the repayment is required under the Act, Smith is allowed a deduction for the repayment of the bonus in the year it is paid. Smith needs to calculate his current year's tax with a deduction for the bonus of $6.5 million and recalculate the 2007 tax liability excluding the bonus from his income. Smith gets a tax benefit for the *lesser* of either the current year's reduction in tax or the change in the prior year's tax. If we assume that Smith is in the top marginal tax bracket in both years (2007 and the current year), he would receive a tax benefit of $2,275,000 upon repaying the bonus.

Smith also received two stock option grants at two different times during FY 2007. The first consisted of 1,000,000 options at an exercise price of $13.75, which is more than the fair market value of the stock on the grant date. The second, later grant consists of 200,000 options with an exercise price of $15.00; again, the fair market value is less than the exercise price. Since the fair market price of the stock options on both grant dates was lower than the stated exercise price, there were no tax consequences to Smith on either grant date. Therefore, as long as Smith does not exercise the stock options, there will be no tax consequences to him when he returns the options to ZYX.

Now, let's assume that Smith has exercised the options from the earlier grant of stock options. When Smith exercised the options, the FMV was $14.75 and the exercise price was $13.75. Smith would recognize ordinary income of $1,000,000, which is the difference between the exercise price and the FMV ($1 times the 1,000,000 options exercised). Smith would have tax consequences when he returns the gain of $1,000,000 to ZYX, Inc., and he would be entitled to reduce his income by that amount. Using the top bracket for 2007, the repayment - deduction of $1,000,000 would result in a tax savings of $350,000.

As long as Smith hasn't exercised the later group of stock options, the return of the stock options to ZYX creates no taxable event.

## EQUITY-BASED COMPENSATION

Other forms of equity-based compensation, such as restricted stock awards, received during the period of financial misconduct, also must be paid back to the company. Deferred compensation also falls under this category so that any such benefits received by the CEO/CFO will be returned to the company. (The American Jobs Creation Act of 2004 added more restrictions on how deferred compensation should be treated.) Employees who receive restricted stock as compensation for the performance of services do not recognize the fair market value of the stock as income until the year in which the risk of forfeiture lapses. Employees may elect, however, to recognize the fair market value as income in the year of receipt. However, the employee has only 30 days after receipt to make the election. An employee would consider this election only if he expects the fair market value of the stock to increase significantly during the restriction period.

Smith received a restricted stock award with a value of $1,500,000 in 2006. Assuming he did not elect to recognize the fair market value as income in the year of receipt, there are no tax consequences to either Smith or the corporation when he gives the stock back.

If, however, Smith made an election to recognize $1,500,000 as ordinary income in 2006, then ZYX would have been allowed a compensation deduction in the amount of $1,500,000 for the 2006 tax year. Consequently, Smith's tax basis in the stock is $1,500,000. Even though he must return the

stock awarded to the corporation in 2007, Smith may not deduct his $1,500,000 unrecovered basis in the forfeited shares.

When Smith returns the shares to ZYX, there are no personal tax consequences whether or not he made the election. However, if he made the election, he recognized $1,500,000 as ordinary income in 2006, which he cannot deduct in 2007 when he returns the shares.

## REALIZED SECURITY GAINS

The Act also requires that any profits realized from the sale of the company's securities during the year of the financial misconduct be reimbursed to the company. This section not only refers to stock received as part of a compensation plan but also any stock individually owned by the CEO/CFO.

Assume that in 2006 Smith sells the 1,000,000 shares he received when he exercised the first grant of stock options at $15.25 a share. His realized gain is the difference between the exercise price of the stock options and the sales price, less any selling commissions. Ignoring the effect of sales commissions, his proceeds from the sale total $15,250,000. Subtracting the basis of $13,750,000, Smith's realized gain is $1,500,000. He must reimburse this amount to ZYX, Inc.

For the options not exercised during the period of misconduct, Smith has an unrestricted right to the options. Under the claim-of-right doctrine, if a taxpayer is required to pay back an amount in the current year which was included in income in the previous year, a deduction in the current of previous year is permitted. Therefore Smith is entitled to the claim of relief when the realized gain was restored to the company.

Smith may deduct the $1,500,000 realized gain in the year it is repaid. Smith must recalculate his 2001 tax liability, excluding the realized gain from his income. Smith receives a tax benefit for the *lesser* of either the current year's reduction in tax or the change in the prior year's tax.

To illustrate the amount of tax relief available, we use the following assumptions:

The realized gain is $1,500,000 and it is a long term capital gain (if exercised at $13.75),
The marginal tax rate for the year 2003 was 39%, assuming Smith's income placed him in the highest tax bracket,
The marginal tax rate for the year 2006 was 35%,
The tax relief is calculated by applying the top marginal tax rate to the realized gain.

Tax relief is $525,000 as calculated based on the following:

The lesser of: 35% * $1,500,000 = $525,000 or
39% * $1,500,000 = $585,000.

Under the claim of right, provision of federal law, a taxpayer is entitled to recalculate taxes previously paid, but subsequently discovered to have been paid in error. The federal statute allows the taxpayer to recalculate taxable income and taxes for the year during which the amount is returned, and take either a deduction or a credit.

However, in Smith's case, for the options exercised and sold during the period of misconduct, he will not be entitled to the claim of relief. Therefore, not only does Smith have to restore the realized gain back to ZYX, he is not entitled to the tax relief of the restoration for the shares that were both exercised and sold during the period of malfeasance.

## BLACKOUT PERIOD PROFITS

Companies can declare "blackout" periods during which employees owning company stock in the pension or 401(k) plans cannot trade or sell their shares. If, during this blackout period, an executive or director sells, purchases, or transfers any company security acquired, as a result of his or her employment, then the company can recover any realized profits. These profits can be recovered

in court proceedings by either the company or other owners on behalf of the company, if the company fails to institute legal proceedings. A "blackout" period means "any period of more than three consecutive business days during which the ability of no fewer than 50 percent of the participants or beneficiaries under all individual account plans maintained by the issuer to purchase, sell or otherwise acquire or transfer an interest in any equity security of such issuer held in such an individual account plan is temporarily suspended by the issuer or by a fiduciary of the plan."

To illustrate, assume that a blackout period occurs in 2003 with respect to the company's pension plan. Smith realizes profit on the sale of ZYX stock during the "blackout" period. He acquired the stock outside his pension account through his employment as an executive officer. The transaction is subject to the Act. In order to prevent directors and executive officers (corporate insiders) from trading stock to their advantage when employees of the issuer cannot trade their securities in their retirement plan accounts, any proceeds must be returned to the firm.

The Sarbanes-Oxley Act requires, any profit realized by a director or executive officer from any sale in violation of the Act to inure to and be recoverable by the issuer. Therefore, the profits realized by Smith are recovered by ZYX. The fact that the profit would be recovered by ZYX does not necessarily mean that Smith is entitled to deduct the amount that he repaid.

Taxpayers, who had an apparent unrestricted right to the income in a prior year, qualify for the special relief provision in the year of repayment. However, since Smith realized the profit as the result of fraudulent/prohibited actions, he did not have a legitimate, unrestricted claim to the proceeds. Therefore, even though the profit would be recovered by ZYX, Smith is not allowed a deduction.

If these shares were held in Smith's 401(k), Smith's distributions from his 401(k) plan to repay ZYX are taxable income and are subject to an additional 10% penalty if made before age 59 ½.

## LOANS TO EXECUTIVES

The Act prohibits new loans to executives and renewal of existing ones. This section also prohibits the company from arranging loans for executives. This prohibition does not include loans such as home improvement loans, credit card balances incurred in the ordinary course of business, or other loans that a company might, in the normal course of business, grant to customers. However, existing loans to executives are grandfathered as of the date of the Act, if there are no material modifications of the terms or extensions of the loans.

Assume that on December 31, 2003, Smith had a loan of $25,000,000 from ZYX. Assume the loan was made before 2001 and was originally due on December 31, 2004. If Smith is unable to repay the loan in full by the date required by the Act, ZYX might forgive the loan.

Cancellation or forgiveness of a debt results in gross income to the debtor unless he is either in bankruptcy or insolvent. Special mandatory relief provisions apply to debt discharge income of bankrupt or insolvent taxpayers. Assuming Smith is not in bankruptcy or insolvent, debt forgiveness results in either a constructive dividend as defined by the IRS or ordinary income to Smith depending on whether he is a shareholder/employee or employee when the loan was forgiven. Smith owes tax of $3,750,000 and the corporation losses the deduction resulting in additional corporate tax as well.

## OTHER TAX CONSEQUENCES

In addition to the provisions of Sarbanes-Oxley, a CEO can still be subject to the usual fines and judgments for insider trading and securities fraud. For example, assuming an executive engages in insider trading, the SEC can prosecute the CEO and assess, under the RICO provision, up to triple the amount of damages suffered by other shareholders in addition to the return of any trading profits. If the SEC finds that Smith violated federal or state statutes, he may be liable for antitrust triple damages, fines, penalties, and/or civil damages. Smith may not deduct two-thirds of the antitrust damages paid or incurred. In addition, Smith may not deduct any fines and penalties paid. However,

he may be able to deduct civil damages paid. Smith's legal fees paid to defend him may also be deductible if the payment was made to benefit the business and the expenses are ordinary and necessary.

## CONCLUSION

The Sarbanes-Oxley Act of 2002 is intended to thwart financial scandals and increase the criminal penalties for violations of securities laws. Any financial benefits received by an executive during a period of financial misrepresentation are only short-lived because they must also be repaid to the corporation. Moreover, the executive may also face criminal and civil charges in addition to fines and penalties. An executive should be aware that there are severe tax consequences from repaying the income or profits to the corporation and for which the executive may not receive a deduction. In conclusion, violating the provisions of the Sarbanes-Oxley Act of 2002 not only brings harsh tax consequences, but also the demise of the executive's business reputation and a good portion of his or her personal wealth.

# CHALLENGES FOR FIRMS IN DISCLOSING THE VALUE OF THEIR INTELLECTUAL CAPITAL

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## ABSTRACT

Many commentators have identified the pivotal role of intellectual capital in the valuation of firms and the determination of their future earnings. Innovation in voluntary disclosure of intellectual capital lead by European firms, such as Celemi and Skandia, has generated a plethora of new reporting frameworks such as the Balanced Scorecard. However, there has been little support by the accounting profession to recognise the value of intellectual capital or adopt a common disclosure framework. There has also been very little progress by firms in extending their voluntary reporting frameworks, beyond just rhetoric, and attempting to quantify their intellectual capital. This paper will critically evaluate the challenges faced by firms in disclosing the elements and value of their intellectual capital to the market.

## THE IMPORTANCE OF INTELLECTUAL CAPITAL

There is increasing evidence that the drivers of value creation in modern competitive environments lie in a firm's intellectual capital rather than its physical and financial capital. Studies of listed companies consistently find significant gaps between the accounting book value of organisations and their market value (Cuganesan et al., 2006). Analysis made publicly available by the consulting firm Accenture indicates that, for knowledge intensive firms, tangible assets and resources typically comprise between fifteen and twenty-five percent of company value (Ballow et al., 2004). The same study also finds that, across the majority of listed companies in the United States, expectations of future growth value (as opposed to current earnings) comprise almost sixty percent of current company value. Adopting a formal framework to facilitate intellectual capital reporting is a way for firms to explicitly identify, audit and manage intangible sources of value creation and communicate these both internally and externally.

## WHAT IS INTELLECTUAL CAPITAL

The Organisation for Economic Co-operation and Development (OECD, 1999) describes 'intellectual capital' as the economic value of two categories of intangible assets of a company: (a) organisational ("structural") capital; and (b) human capital. Petty and Cuganesan (2005) assert that the term 'intellectual capital' is often treated as being synonymous with 'intangible assets'. The definition offered by the OECD, however, distinguishes the two by locating intellectual capital as a subset of, rather than the same as, the overall intangible asset base of a firm.

Over time, a broad consensus has developed that intellectual capital can be characterised in terms of a tripartite model comprising human capital, external capital and internal capital components (Edvinsson and Malone, 1997; Stewart, 1997; Sveiby, 1997), where:

- *human capital* refers to the skills/competences, training and education, and experience and value characteristics of an organisation's workforce;
- *external capital* comprises relationships with customers and suppliers, brand names, trademarks and reputation; and
- *internal capital* refers to the knowledge embedded in organisational structures and processes, and includes patents, research and development, technology and systems.

While there is a legal requirement for firms to disclose in their financial statements on certain types of purchased intangible assets (AASB 138 – *Intangible Assets*), firms are currently not required by accounting standards or by law to report on most of their intellectual capital, however they may voluntarily elect to disclose such information.

## THE MOTIVATION TO DISCLOSE INTELLECTUAL CAPITAL

There are a number of incentives that may accrue to firms who chose to voluntarily disclose intellectual capital. Petty (2003) identifies that the predominate incentive for firms to disclose their intellectual capital is to 'render the invisible visible' (Cooper and Sherer, 1984) in line with the axiom 'what gets measured gets managed' (Stewart, 1997). This supposes that if intellectual capital is not reported, there is a risk that it is not receiving sufficient attention from management and other stakeholders (Guthrie and Petty, 2000), potentially diluting firm value.

Other evidence suggests that capital markets respond favourably towards a firm who reports on their intellectual capital (Garcia-Ayuso, 2003; Lev 1999, 2001). It is posited that reporting on intellectual capital may attempt to resolve uncertainty about the firm, thereby improving the stock price (Edvinsson and Malone, 1997; Stewart,1997) and leading to a reduction in volatility of stock prices, a decrease in firm cost of capital, and an increase in intrinsic value (Garcia-Ayuso, 2002). Lev (1999) suggests there is a positive correlation between intellectual capital disclosure and market capitalisation which is also likely to be a key motivator for listed firms to voluntarily adopt disclosure of intellectual capital. More broadly, several other theories might also explain why companies choose to report voluntarily on their intellectual capital, including legitimacy theory (Suchman, 1995) and institutional theory (Sethi, 1979).

## THE EMERGENCE OF VOLUNTARY REPORTING

The voluntary reporting activities of several European firms have spearheaded a rethink of traditional financial accounting practice and disclosure. In 1994, a Swedish consulting firm, Celemi, pioneered a new approach to annual reporting by including in its annual report an 'Intangible Assets Monitor' (Sveiby, 1997). In substance, the monitor is designed to report on Celemi's stock of intellectual capital and to show how this intellectual capital wealth is enhanced or diminished over time. Around the same time, another Nordic firm in the financial services sector, Skandia, also began reporting on its intellectual capital. Skandia's 'Navigator' reporting system is the product of work into valuing the knowledge capital of Skandia that originally commenced in 1991 (Roy, 1999; Edvinsson and Stenfelt, 1999).

Both Celemi and Skandia became celebrated entities within some sectors of the business community that believe there is a need for companies to measure and report on intellectual capital (Brooking, 1996). Interestingly, the professional community of accountants – arguably the group that should be most active in overseeing new reporting initiatives - has been somewhat slow to recognise

the importance of the new European reporting model (Barth et al, 2001). The language of management is increasingly non-financial, yet accountants persist in reporting using metrics that are solely financial (Guthrie, Petty & Ricceri, 2005).

Some commentators are arguing that organisations need to go beyond the accepted practice of disclosing financial performance metrics to start reporting non-financial indicators as well, claiming this will enable a more balanced approach to the evaluation of intellectual capital (Ittner and Larcker, 1998), and a better understanding and improved transparency about drivers of firm performance.

## INTELLECTUAL CAPITAL REPORTING FRAMEWORKS

In response, the field of intellectual capital has received significant professional and academic interest. Specifically, a plethora of intellectual capital measurement and reporting models have been developed by academics, consultants and practitioners.[1]

Popular models used to construct reports on intellectual capital include Kaplan and Norton's Balanced Scorecard (Kaplan and Norton, 1992), Karl-Erik Sveiby's Intangible Assets Monitor (Sveiby, 1997) and Skandia's Value Scheme (Edvinsson and Malone, 1997). Each of these reporting frameworks will be briefly discussed below.

### Balanced Scorecard

The Balanced Scorecard views business unit performance from four perspectives: financial, customer, internal business process, and, learning and growth. All four perspectives combined provide an understanding of the vision and strategy of the business unit. Each perspective is articulated by identifying the core activities that influence most positively the value created for the business unit. The Balanced Scorecard attempts to broaden the focus of managers encouraging them to look beyond short-term financial information towards other intangible items that are implicated in the value generation process.

### Intangible Assets Monitor (IAM)

Similar to the Balanced Scorecard, Karl Erik Sveiby's (1997) Intangible Assets Monitor (IAM) reports on qualitative and other information related to a firm's intellectual capital. Working from the purely financial reporting perspective adopted by most firms, the IAM aims to present a more complete and realistic account of company performance and future business potential. Sveiby classifies intangibles into three parts: internal capital, external capital, and employee competence. Internal capital includes the organisational structure, legal parameters, manual systems, research and development, and software. External capital includes brands, and customer and supplier relationships. Employee competence includes education and training of the professional staff who are the principal generators of revenue.

Within Sveiby's IAM reporting framework, individual attributes relating to each of the three parts of a firm's intellectual capital are reported upon using measures that indicate an improvement or decline in the 'value' of the attribute from one period to the next.

### Skandia Value Scheme (SVS)

The Skandia Value Scheme (Edvinsson and Malone, 1997) offers a conceptual understanding of how Skandia views the relationship between intellectual capital and financial (traditional accounting) capital in determining the market value of the firm. Market value is seen as the product of financial capital and intellectual capital, which in turn comprises human capital, structural capital, customer capital, organisational capital, innovation capital and process capital.

These three popular frameworks incorporate different elements in the foundations of the valuations. For example: The Balanced Scorecard focuses on internal processes, customers, learning & growth, and a financial perspective; the IAM focuses on internal capital, external capital and competence of personnel; while the Skandia Value Scheme attempts to measure human capital, structural capital and organisational capital. What is apparent is there is little consistency between these models.

## LACK OF CONSISTENCY BETWEEN REPORTING MODELS

Guthrie and Petty (2000) conducted a cross-sectional content-analysis study of intellectual reporting practices across Australia's 20 largest firms and found that intellectual capital was not reported within a consistent framework, when reported at all. Their study concluded that there is no established and mutually agreed framework for reporting intellectual capital by large Australian companies or from the accounting profession. This lack of consistency in reporting frameworks by Australian firms presents a challenge for organisations considering embarking on intellectual capital reporting.

> The biggest challenge by far is establishing a consensus about the need to report, what to report, and how to report it. Much of what has been done in the field to date has intuitive appeal, but is this enough to attract and convince the critical mass within the accounting profession which is necessary if any real change is to occur? (Guthrie, 1999, p. 4)

In similar international studies, Bontis (2003) found insignificant reporting of intellectual capital from an analysis of 10,000 annual reports in Canada, and other studies utilising content analysis methods have found corresponding low levels of intellectual capital reporting (Brennan, 2001; April et al. 2003; Ordonez de Pablos, 2003) confirming that this is not a phenomenon unique to the Australian reporting landscape.

Without a consensus as to the need to report and other related issues, there is little hope that the reporting of intellectual capital will become standardised without intervention by regulators (Guthrie and Petty, 2000). If and when consensus is reached, then the next major challenge is either to refine the reporting models in use or to develop new models.

This absence of a standardised framework is clearly and obstacle for many firms considering disclosing their intellectual capital. Also, without consistency in the methods used to disclose intellectual capital, any attempts to value it will likely be met with considerable scepticism.

## NO BASIS FOR VALUATION OF INTELLECTUAL CAPITAL

In a recent study by Guthrie, Petty and Ricceri (2006) content analysis was again used to scrutinise the disclosure of firms in both Australia and Hong Kong over a five-year period. The results showed that nearly every instance of intellectual capital reporting involved expression in 'discursive rather than numerical terms'.

> What is lacking is a clear attempt to translate the rhetoric of intellectual capital reporting into benchmark measures that enable the performance of a firm in managing intellectual capital to be assessed in a systematic fashion. This is to some extent understandable given the difficulty involved in trying to quantify what is, in many instances, essentially a qualitative item (Guthrie et al. 2006, p. 268).

The low incidence of quantitative disclosures of intellectual capital seems to confirm the view that firms are unable to assign dollar values to intellectual capital, implying that the reporting frameworks are neither: (a) rigorous enough to be used for measurement; or (b) do not have sufficient utility to allow users to conduct meaningful comparisons between firms.

## CHALLENGES IN DISCLOSURE OF INTELLECTUAL CAPITAL

With commentators such as Ballow et al. (2004) advocating the pivotal role of intellectual capital in driving firm value and influencing share price, and Lev (1999) identifying the possible link between the reporting of intellectual capital and market capitalisation, one would presume that intellectual capital reporting would have been fervently adopted by firms, especially listed firms.

However, the practice of intellectual capital reporting has not been universally adopted. This resistance or lethargy would suggest that many firms may face significant challenges in identifying and disclosing the elements and value of their intellectual capital to the market.

The literature suggests that the greatest obstacles for firms wishing to adopt intellectual capital reporting are: (a) the lack of consistency in methodologies for disclosure; and (b) difficulties in assigning meaningful and reliable quantitative values to identifiable intellectual capital. While these obstacles persist, it is likely that few firms will see any of the 'promised' benefits accruing to them as a reward for their efforts in extending their voluntary disclosures.

## CONCLUSION

The important challenge ahead is not the adoption by more firms of voluntary disclosure in an attempt to create a critical mass, but rather consensus by stakeholders of the type of disclosures that they believe will be meaningful. Once this hurdle is overcome, and there is a greater standardisation of intellectual capital identification and reporting in an unambiguous quantitative non-discursive format, then the next step of the valuation of intellectual capital can be reliably straddled by firms. This pathway will ensure a higher degree of utility to stakeholders; and, uniformity in disclosure practices, will allow a reliable comparison of intellectual capital values between firms.

## ENDNOTE

1. As an indication of the rapid growth in the field, an article by Sveiby (2004) identifies 28 different models for the management and measurement of IC.

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# CORPORATE GOVERNANCE CHARACTERISTICS OF GROWTH COMPANIES: AN EMPIRICAL STUDY

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## ABSTRACT

*In the pre-Enron business world, corporate governance was defined as a mechanism to maximize firm value. Empirical research over the past decade has shown a causal relationship between governance and market value. This evidence comes from both single-country studies (Black, 2001 on Russia; Black, Jang and Kim, 2006 on Korea; Gompers, Ishii and Metrick, 2003 on the U.S.) and multi-country studies (Durnev and Kim, 2005; Klapper and Love, 2004).*

*The advantages of corporate governance have been well documented. Good governance systems lead to better access to capital, improved performance, and reduction of risk. However, implementing effective governance systems also comes at a cost. Technology constraints, lack of financial and business understanding of the system, and the cost of implementing and communicating corporate governance policies throughout the organization are crucial barriers which many firms, especially small ones face.*

*In today's high risk, high growth economy, companies need to set a strong strategic course and have the capability to survive in the fiercely competitive environment. Rapid growth firms have many challenges to face, starting from cash flows, human resources, product quality, imminent deadlines and customer satisfaction. Once a successful working environment is established, a well-oiled system of corporate governance will be highly rewarding. However, in the growth phase of a company's life cycle, the tendency of management will be to focus resources on revenue increase, and the value chain that links vendors and customers through their organizations.*

*The hypothesis of this paper is that high growth companies will have less time to spend on formulating and disseminating a structured policy of corporate governance. To test this hypothesis, a corporate governance scoring system was developed, based on the guidelines of accountability, responsibility, internal controls, and audit procedures. A governance score was computed for 100 growth companies (as defined by growth in earnings, revenues and market value) and for a random sample of 100 companies in the S&P 600 list.*

*The results indicate that "growth" companies have statistically significant lower scores than the control group.*

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# A TEMPLATE FOR TEACHING THE CASH FLOW STATEMENT

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## ABSTRACT

*The Cash Flow Statement tends to be the most difficult financial statement for students to learn to prepare and comprehend. I believe this is due, at least in part, to the fact that our accounting curriculum is based on accrual accounting concepts which we incorporate into all accounting courses, beginning with principles. After constant repetition and drills on the necessity of accrual accounting to insure matching to produce a high quality of earnings on the income statement, students are indoctrinated with accrual accounting. The cash flow statement, however, requires that students "undo" the accrual and convert net income to a cash basis number, cash flow from operations. Since accounting systems are designed to produce accrual basis numbers, cash flow data is not readily available. Therefore, the income statement must be converted to a cash basis using a series of adjustments. After the emphasis placed on the income statement and accrual accounting, students experience a great deal of confusion in attempting to prepare a cash flow statement. Even the indirect method requires numerous adjustments that are difficult for students to comprehend.*

*I have developed a template for teaching the cash flow statement that breaks down the adjustments into a series of sequential, interrelated steps that, if followed, will always lead the student to the correct balance, the net change in cash for the period. I have tested this teaching template empirically in numerous accounting classes at various levels in the accounting curriculum, from principles to advanced accounting classes. I have administered pretests and posttests to each class and statistically evaluated the results of my teaching model. The results indicate that use of the teaching template has a significant positive effect on learning.*

*The significance of this paper lies in its pedagogical value to improve teaching effectiveness and promote learning in regard to the cash flow statement. The template can be applied to both the indirect and direct methods. With the increased emphasis on cash flow information, it is crucial that students be able to prepare and interpret the cash flow statement. Often, the cash flow statement provides greater transparency than the income statement with regard to a company's performance. This is due to the many accruals and estimates on the income statement, which can cloud performance evaluation. Cash flow patterns from the cash flow statement can address a company's financial health and provide clear, early warning signals of distress. Therefore, it is vital that students have a clear understanding of the cash flow statement. My teaching model demonstrates the articulation of all the financial statements and promotes better understanding of the cash flow statement and its relevance.*

# EXAMINING DIFFERENCES BETWEEN ACCOUNTING AND NON-ACCOUNTING STUDENTS, AND THE DIFFERENTIAL IMPACT OF GENDER AND ETHNICITY, ON ORAL COMMUNICATION APPREHENSION: AN EXPLORATORY STUDY

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## ABSTRACT

*Accounting students in introductory accounting classes have been shown to be more oral communication apprehensive than students in introductory non-accounting business classes (Stanga & Ladd, 1990; Simmons, Higgins, & Lowe, 1994). To ameliorate this deficiency among accounting majors, a College of Business & Economics in a San Francisco Bay Area public university introduced curriculum and pedagogical strategies to increase communication competence for its students. McCroskey and Beatty (1984) defined oral communication apprehension (OCA) as "an individual's level of fear or anxiety associated with communication across a wide variety of situations such as speaking in a group."*

*Using McCroskey's (1984b) 24-item Personal Report about Communication Apprehension (PRCA), this study examines if there is a significant difference between accounting majors and non-accounting business students in their self-reported levels of oral communication apprehension at the College of Business and Economics in a San Francisco Bay Area public university. The study also investigates the differential impact of gender and ethnicity on oral communication apprehension among business students.*

*The results indicate accounting students were more oral communication apprehensive than their non-accounting counterparts in spite of institutional efforts to reduce their levels of oral communication apprehension. Overall, females reported higher levels of OCA than males. The effect of ethnicity on OCA was mixed. Compared to White students, Asians and Blacks reported higher levels of OCA; Pacific-Islanders, and Hispanics reported lower levels of OCA.*

*The results of this study point to a dire need for accounting programs to examine their curriculum geared towards increasing oral communication competence among accounting students, and to determine ways of strengthening accounting programs by increasing the number of communication-related courses as well as oral communication opportunities for accounting students.*

# ASSESSING THE RISK OF DERIVATIVE SECURITIES IN HEDGE FUNDS

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## ABSTRACT

*Derivative securities are financial assets with unique risks of their own. Identifying and tracking these risks has become increasingly complicated as investment in these securities has increased. Recently new systems for tracking derivative orders have appeared. These new systems seem to be driven by a few hedge funds.*

*In this paper, we identify the common characteristics of derivative securities. Further, we outline the development of these unique investments and examine the unique risk issues that are inherent in derivatives. In addition, we assess the use of derivatives as a tool for diversification. Finally, many top-performing hedge funds are using derivatives; we explore the attraction of derivatives for hedge fund*