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COUNTRY VERSUS INDUSTRY EFFECT ON BOARD STRUCTURES

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ABSTRACT

We examine the board structures of US and Indian firms in two industries. We examine three aspects of board structures: board size, board independence, and board leadership. The two industries selected for analysis are information technology and capital goods. While Indian information technology firms have close ties to the American economy, capital goods firms have a domestic focus. Thus, we are able to analyze differences in board structures of firms in two countries and two industries, one of which is closely related and the other relatively unrelated. We do not find any significant differences in board size and board leadership for US and Indian firms in either industry. However, we find that US boards are more independent than Indian firms, both for information technology firms and capital goods firms. These findings are more supportive of the country effect than for the industry effect on board structures.

JEL: F23; G34; N20

KEYWORDS: Board of Directors, Corporate Governance, and Board Composition.

INTRODUCTION

In a survey paper, Adams, Hermalin, and Weisbach (2010) state that "The two questions most asked about boards are: "What determines their makeup and what determines their actions?" This study contributes to the literature by examining factors relating to the first issue, i.e., factors affecting board structures. We study this issue in a cross-country setting and compare board structures of US and Indian firms in two different industries: information technology and capital goods. We examine the three variables of 'the number of directors,' 'the percentage of independent directors,' and 'the CEO also holding the chairperson position' to compare board size, board independence, and board leadership respectively.

While the Indian information technology industry is closely related to the American economy, Indian capital goods firms operate with a domestic focus. Thus, we are able to examine differences in board structures across two countries and two industries where the industries are related at different levels between the two countries.

If the country effect is more dominant in shaping boards then we expect to find differences in board structures of US and Indian firms irrespective of industry affiliation. However, if the industry effect is more dominant then we expect to find similar board structures for US firms and Indian technology firms, but not for US firms and Indian capital goods firms.

Our findings are supportive of the country effect being the more dominant force in shaping board structures. While we find that US firms and Indian firms are similar in board size and board leadership structures, we also find that Indian firms are less independent than US firms. This finding is true for both technology and capital goods firms.

ARE BUYBACKS INCREASING EPS?

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ABSTRACT

Trends indicate that treasury shares or buyback shares are gaining new momentum and intensity and maybe effecting reported earnings per share. This study was undertaken by evaluating the buyback activity of the Standard and Poor's 500, for the period of 2005-2008 to the Hribar et al (2004 and revised 2006) study of buybacks for their period of 1988-2001. Their study reflected that buybacks were not dominant due to their tri-model of low number of share being repurchased, the high number of companies experiencing a loss and high P/E multiples.. This study experienced greater frequency and intensity of buybacks, due to a reversal in the three conditions being a larger number of shares purchased,) lower incident of losses and lower P/E multiples. The findings are that buybacks are more frequent, more intense, and are having an increased accretive effect on EPS. As a solution proposed here is a new EPS model that reports EPS in segments; those from operations and those from buybacks when the effect is $.01 or more. This new EPS model is responsive to the changing financial landscape and is deserving of attention at this time of international accounting assessment.

JEL: M41, G35

KEYWORDS: Buybacks, Treasury Shares, Stock Repurchases, Earnings Per Share,

INTRODUCTION

When a company buys its own stock back, the repurchased stock is referred to as treasury stock in accounting terminology. The more generic term of this is "buybacks". One could suppose that the term comes from putting it back into the treasury or as the Merriam Webster dictionary defines treasury as a "place in which stores of wealth are held." The Merriam Webster defines treasury stock as stock that is repurchased and held as an asset. This is partially untrue since treasury stock is not held as an asset but as negative equity. When treasury stock is purchased, the account Treasury Stock is debited and Cash is credited. However, the treasury-stock account is not included in the asset section of the balance sheet but it is included as a contra-equity account since it is subtracted from equity. Besides, any gains or losses realized from the purchase or sale of treasury stock are not reported on the income statement, even though they have tax consequences. The gains or losses are added or subtracted from equity and circumvent the income statement. Treasury stock does not vote and it does not collect dividends. It is more or less taken out of circulation for the time being.

Treasury stock affects earnings per share (EPS) since the denominator of the EPS is outstanding stock, which excludes treasury shares. Thus when treasury shares are purchased the outstanding stock is reduced; and if it is of magnitude, it may result in increasing EPS even though net income has not increased. The following is the formula for EPS.

$$EPS = \frac{Net\ Income - Preferred\ Dividends}{Issued\ Shares - Treasury\ Shares} \quad (1)$$

Surprisingly, EPS was not originally an accounting item; rather it emerged from the finance community. The financial community was the creator of EPS, which is used to report as a one-liner the results of a company's performance. In actuality, it reports on the income of a company and gives no reflection of the resources used to create those returns. In the earlier days of accounting development the Committee on Accounting Procedure, specifically Accounting Research Bulletin (ARB) No. 32 in 1947 "admonished

AN EMPIRICAL ANALYSIS OF MARKET REACTION TO CORPORATE ACCOUNTING MALFEASANCE

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ABSTRACT

This study examines corporate accounting malfeasance from an exploratory and empirical perspective for 100 companies to determine if there is an association between the Jenkins recommendations and SOX requirements and to determine if there are any differences between the internal and external monitoring characteristics of malfeasance and non-malfeasance companies. The exploratory perspective discusses the types of corporate malfeasance and gives an accounting and market dollar impact ($140 and $857 billion respectively) of 100 companies with publicly announced malfeasance and supports previous studies findings that revenue was the most common area of corporate malfeasance and theft was the least. The empirical study examined internal (corporate governance) and external (auditor and financial analysis) monitoring characteristics by matching the malfeasance companies with non-malfeasance companies. This empirical study did not find any significant differences in the monitoring characteristics of the companies even though these characteristics were chosen based on an examination of recommendations/requirements for business reporting for SOX and several accounting committees over the years. Previous studies indicated a difference.The research contributes to contemporary accounting literature by providing a dollar measurement of the accounting and related market impact for malfeasance companies and a systematic investigation testing monitoring characteristics between malfeasance and non-malfeasance companies.

JEL: -M4, M40, M41, M48, M49.

KEYWORDS: Accounting Restatements, Accounting Malfeasance, Corporate Malfeasance, SOX, Jenkins Report, Jenkins Recommendations.

INTRODUCTION

Announced corporate malfeasance has increased significantly since the mid-1990s resulting in a significant increase in the number of previously issued financial statements having to be restated. This has also resulted in increased dissatisfaction with the current financial reporting process by regulators and investors. Arthur Levitt's speech, The "Numbers Game" in 1998 highlighted the Securities and Exchange Commission's (SEC) discontentment with the volume of corporate malfeasance, emphasized the need for reform in the financial reporting arena and called on the accounting profession to help in the reformation process. The Enron and WorldCom accounting scandals in late 2001 and 2002 refueled the reform issue compelling regulatory and political intervention to change the financial/business reporting process with an implied objective that the reforms would reduce or eliminate corporate malfeasance.

Congress' passage of the Sarbanes-Oxley Act of 2002 (SOX) was a direct response to the accounting scandals and an attempt to reform the financial/business reporting process. But there have been several other efforts during the 20th century to reform or improve the financial reporting process due to misleading or fraudulent financial reporting: the Special Committee on Co-operation with Stock Exchanges of the American Institute of Accountants during the early 1930s (Storey 1964) in response to the stock market crash of 1929; the National Commission on Fraudulent Financial Reporting formed in 1985, chaired by James C. Treadway (the Treadway Commission), (Minter 2002); etc. In 1991 the American Institute of Certified Public Accountants (AICPA) formed the Special Committee on Financial Reporting, later deemed the Jenkins' Committee since it was chaired by Edmund Jenkins, then a partner

PORTRAIT OF A COMPANY: DEFINED BENEFIT PENSION PLAN SPONSORS

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ABSTRACT

This study describes firms that sponsor defined benefit pension plans (DBPP) based on firm specific characteristics, financial and operating performance. Firms are classified into portfolios based on their funding levels and described accordingly. The results suggest that firms in the most underfunded portfolio are on average smaller and value firms, with negative stock returns, poor financial and operating performance, lower profitability, invest smaller amounts in advertising, research and development and capital assets and are more indebted with higher probabilities of bankruptcy. The opposite is seen for the least and overfunded firms. The portrayal of these characteristics can help regulators in the effective identification of firms that may confront funding problems before it is too late. The detection of risk behavior or tendencies in terms of firm characteristics can help regulators in establishing policies to decelerate and improve pension plan funding levels and to protect the public interest.

JEL: G11, G23, M48

KEYWORDS – Defined benefit, pension plans, pension management, pension regulation

INTRODUCTION

How do firms that sponsor pension plans look? Do they all look alike? Firms that sponsor pension plans can be described based on their funding levels, size, financial and operating performance, to mention a few. Most importantly, they can be described based on the type of plan they sponsor. A pension plan is defined as an arrangement whereby an employer provides benefits (payments) to retired employees for services provided in their working years. Employers fund pension plans by making payments to a funding agency. The two most common types of pension plans are defined contribution (DC) plans and DBPP. In a DC plan, the employer agrees to contribute to a pension trust a certain sum each period, based on a formula. A company usually turns over to an independent third-party trustee the amounts originally contributed. The trustee, acting on behalf of the beneficiaries, assumes ownership of the pension assets and is accountable for their investment and distribution. The trust is separate and distinct from the employer. In terms of risk, the employee gets the benefit of gain (or the risk of loss) from the assets contributed to the plan.

In contrast, DBPP delineates the benefits that employees will receive when they retire. To meet the DB commitments that will start at retirement, a company must determine what the contribution should be today. Companies may use many different contribution approaches. However, the funding method should provide enough money at retirement to meet the benefits defined by the plan. The employees are the beneficiaries of a DC trust, but the employer is the beneficiary of a DB trust. Under a DB plan, the trust's primary purpose is to preserve and invest assets so that there will be enough to pay the employer's commitment to employees. The trust is a separate entity but the trust assets and the liabilities belong to the employer. That is, as long as the plan continues, the employer is responsible for the payment of the defined benefits (DB) (without regard to what happens in the trust). The employer must make up any deficit in the accumulated assets held by the trust. On the other hand, the employer can recapture any excess accumulated in the trust, either through reduced future funding or through a reversion of funds.
For years, firms that sponsor DBPP have been hard-pressed by regulators, government and employees to meet their pension funding obligations. As a result of these pressures, laws and regulations have arisen in

THE ETHICS OF TAX EVASION: A SURVEY OF HISPANIC OPINION

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ABSTRACT

The present paper is an empirical study, the goal of which is to determine the strength of various arguments that have been used to justify tax evasion and to determine whether results differ based on certain demographic variables. A survey instrument was constructed using a seven-point Likert and distributed to 316 business students at a university in South Texas. The 18 arguments were ranked in terms of strength, from strongest to weakest. Comparisons were also made according to gender, age, and academic major to determine if the viewpoints for these demographics were significantly different. Academic major was the only demographic variable where significant differences in opinion were found. For some of the 18 arguments justifying tax evasion, accounting students were significantly more averse to tax evasion than were business and economics majors. Some arguments justifying tax evasion were stronger than others. The strongest arguments for evading taxes were in cases where the government engaged in human rights abuses. Other strong arguments were in cases where the tax system was perceived as unfair, where tax rates were too high, where government officials were corrupt or where tax funds were not spent wisely.

JEL: H26; J1; J14; J15; J16; K34; M4

KEYWORDS: tax evasion, Hispanic, gender, age, major, demographic

INTRODUCTION

The research issue we focus on is tax evasion. Tax revenues are important because the governmental services necessary for modern civilization must be funded by tax revenues. More government services could be provided if there was no tax evasion. Joel Slemrod (2007) has noted that determining the extent of tax evasion is not straightforward. He observes that the most careful and comprehensive estimates of the extent of tax compliance have been made by the U.S. Internal Revenue Service (IRS). The dollar estimate of annual tax evasion is labeled as the “tax gap” by the IRS. A 2009 Department of Treasury document (no author designated) reports that for Tax Year 2001 the “tax gap” was $345 billion dollars. Further the IRS observes this represents a noncompliance rate of 16.3%. Detail in the document reveals that over $255 billion dollars of the total tax gap is due to the individual income tax, which suggests that studying individual attitudes toward tax evasion is most appropriate.

Tax evasion is studied by researchers from multiple disciplines and with different perspectives. As will be discussed further in the literature review, which is the next section of the paper, the scholarship on tax evasion is exceedingly diverse and includes both theoretical and practical orientations with little observable convergence of the many research streams at this point in time. This research effort is one of a tiny number which approach tax evasion from an ethical viewpoint. This is a necessary perspective because the psychologists, economists, and legal experts who build models and attempt to make assist in the development of tax policy will be limited in the contribution they can make if they and tax policy makers are not familiar with the ethical reasoning of individuals who make the choice to evade or not evade the individual income tax. Our research is also valuable because it seeks to examine an understudied but unique and increasingly important segment of Americans, Hispanics

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A COMPARISON OF GRADIENT ESTIMATION TECHNIQUES FOR EUROPEAN CALL OPTIONS

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ABSTRACT

Assuming the underlying assets follow a Variance-Gamma (VG) process, we consider the problem of estimating gradients of a European call option by Monte Carlo simulation methods. In this paper, we compare indirect methods (finite difference techniques such as forward differences) and two direct methods: infinitesimal perturbation analysis (IPA) and likelihood ratio (LR) method. We conduct simulation experiments to evaluate the efficiency of different estimators and discuss the advantage and disadvantage of each method.

JEL: G13, G15, G17

KEYWORDS: Greeks, IPA, LR, Variance-Gamma

INTRODUCTION

Gradients estimates have been useful in hedging risks in markets in the finance community. Thus many techniques of calculation of gradients including direct methods and indirect methods have been broadly developed. Many studies have been obtained to study the gradients of estimation under a geometric Brownian motion (GBM) model. However, the GBM model has some imperfections in illustrating the statistical properties of empirical results of market prices. In this paper, we assume stock prices follow a Variance-Gamma (VG) process and develop gradient estimates of a European call option under this assumption. The Variance Gamma process is one of the Levy processes, which are determined by a random time change. It is a pure-jump process with finite moments and no diffusion component. The VG process has been studied in a vast literature and empirical evidence shows that it can yield much better fits to stock prices than the geometric Brownian motion process.

In this paper, we first price a European call option and then turn to gradient estimation to calculate the Greeks by indirect method: forward difference (FD), the direct methods of IPA and LR. Finally, an analysis of the strengths and weakness of each method is provided. The remaining of this paper is organized as follows. A literature review of gradient estimation techniques and Variance Gamma processes are first provided. Then, the introduction of Greeks which is also called the sensitivities of options is shown. In the third part, details of VG processes, as well as gradient estimation techniques including forward direct method (FD), IPA and LR are provided. Furthermore, gradient estimators of Greeks of options under the VG model are shown. Finally, a numerical experiment of estimating Greeks of a European call option is conducted using estimators we calculated. In the last section, analysis of results from the numerical experiment is provided.

LITERATURE REVIEW

A Variance Gamma (VG) Process was introduced to the finance community as a model for log-price returns and option pricing by Madan and Seneta (1990). Madan and Milne (1991) consider equilibrium option pricing for a symmetric variance gamma process in a representative agent model; while Madan, Carr and Chang (1998) develop the method of pricing options by a Variance Gamma process. Fu (2007) gives a general introduction to the VG process in the context of stochastic (Monte Carlo) simulations and

A TEST OF THE OHLSON MODEL ON THE ITALIAN STOCK EXCHANGE

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ABSTRACT

This article belongs to the current in research literature, which is concerned with value relevance. Its main aim is to test the impact of the current and future accounting variables on the firm's market value, by analyzing these relations with reference to the financial sector of the Italian Stock Exchange. To pursue this objective we carried out a multiple linear regression analysis, within a model inspired by the Ohlson model (1995). The model employed verified the research hypotheses for following (subsequent) stages by testing at first the impact of the current accounting variables, then of the future ones on the firm's market value. The results of the analysis show that the relation between the accounting variables (current and future) and the market price, after controlling for market risk, is fully proved on the Italian market, meaning that investors price accounting data in their firm's evaluation process. The article contributes to expand the number of empirical research studies on the value relevance of accounting variables, by analyzing this theme on a Stock Exchange market not yet explored from this perspective. The main originality of the article consists in its being one of the first research studies to test the validity of the Ohlson model (1995) in its original version on the Italian market.

JEL: G14, G21, G22, M41

KEYWORDS: Value relevance, Ohlson model, analysts' forecasts, financial sector.

INTRODUCTION

The present work belongs to the strand of literature known as *Value Relevance Analysis* (VRA), which, since 1995, has seen significant development and whose objective is that of estimating the relevance of an accounting value in the determination of market value. (Courteau, 2008). The theoretical basis on which the study is founded is represented by the Ohlson model (1995) - the main point of reference in market based accounting research (Giner and Iniguez, 2006 b) - the success of which amongst accounting scholars is due to its development of a rigorous theory for firm evaluation in terms of accounting. In this model, market evaluation is a function both of the fundamental accounting variables, and the "other information" variable (v), which contains all the information affecting future firm profitability and thus market forecasts. Although the model undergone to several empirical tests, particularly in the United States, much has yet to be learned on the market value/accounting values ratio in other geographical contexts, as well in as environments characterized by different forms of accounting regulation (Courteau, 2008). For the above reasons, we have chosen to test the validity of the model on a national market, which presents different characteristics both in terms of size (number of quoted firms), and orientation- towards the market or towards banks (Brealey *et al.*, 2007).

The present work has two aims: 1) To test the influence of the accounting variables *earnings* and *book value* on the firm's market value. 2) To test the influence of future profitability (approximated by financial analysts' forecasts on future earnings) on the market value of the firm. To verify the research hypotheses we conduct a regression analysis with a model inspired by the original version of the Ohlson model (1995). The research model tested the hypotheses in stages: first by testing the impact of the accounting variables on market value, and later the impact of financial analysts' forecasts on market value. The findings confirm the existence of a positive relationship between accounting values and market values.

THE RELATIONSHIP BETWEEN ACCRUALS, EARNINGS, AND CASH FLOWS: EVIDENCE FROM LATIN AMERICA

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ABSTRACT

The relationships between earnings, accruals, and cash flows for selected Latin American countries (Mexico, Chile, and Argentina) are investigated in this study from 1990 to 2009. We find a negative relationship between accruals and cash flow across decile portfolios. More importantly, firms reporting the highest level of accruals, have the worst level of cash flows, but not the worst level of earnings. This relationship is of economic importance given that investors are very oriented towards firms yielding high earnings and might fail to realize that earnings are not always accompanied by strong levels of cash flows. Results are disaggregated by years and countries, and compared to previous results for U.S. firms.

JEL: G3, M4.

KEYWORDS: Finance; Earnings and Cash; Financial Accounting; Latin American Public Firms.

INTRODUCTION

The importance of the relationships among earnings, accruals, and cash flows was illustrated in a *Wall Street Journal* article by Laucirella (2008). In the WSJ article Matthew Rothman of Lehman Brothers talks about the company's investment strategy of screening stocks based on changes in accruals. In the same article Richard Sloan, of Barclays Global Investors, notes that investors should "expect to see more strains on companies with rising accrual." Sloan (1996) documented the so called accrual anomaly, another deviation from the market efficiency theory widely accepted in the academic literature. In this study we partially replicate Sloan's to shed light on the relationships among accruals, cash flows, and earnings for Latin America firms. International studies on accruals have not studied this sample yet.

The paper is organized as follows: In the next section we provide a review of relevant literature. A description of the sample and methods follows. We then present the empirical results and finally provide concluding remarks.

LITERATURE REVIEW

In a seminal paper related to accruals and stock returns Sloan (1996) analyzes the U.S. market from 1962 to 1991, and documents a systematic relationship between current period's accruals and future period's stock returns. He further argues that few investors pay attention to this relationship, opening the possibility for arbitrage. In particular, he shows that by following an accruals trading rule, a 10.4% above expectation (abnormal) returns could have been obtained in that period of study. This possibility of arbitrage is termed the accrual anomaly in the financial and accounting economics literature. Several studies have replicated, extended, and challenged the accrual anomaly (Richardson, Sloan, Soliman and Tuna (2005), Chan, Chan, Jegadeesh and Lakonishok (2006), Kraft, Leone and Wasley (2006), Kothari, Loutskina and Nikolaev (2006); and most recently Shon and Zhou (2010) and Hafzalla, Lundholm and

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FINDING THE OUTER LIMITS OF IRS ACCOUNTING DISCRETION: THE KOLLMAN CASE

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ABSTRACT

The statutory language of the Internal Revenue Code gives cognizance to the methods of accounting used by taxpayers for their financial reporting. The 1979 U.S. Supreme Court opinion of Thor Power acceded to the Internal Revenue Service a significant amount of discretion in its attempt to require taxpayers to change and adapt their accounting methods to its satisfaction. In particular, the Commissioner of Internal Revenue's seemingly absolute authority to prohibit lower of cost or market inventory valuation was upheld. Until the recent Tax Court decision in the case of United States v. Kollman, in fact, there were few guidelines that helped to delineate the outer limits of the IRS's discretion in demanding taxpayer adherence to its preferred tax accounting methods. This paper considers how the parameters for a taxpayers' ability to challenge this discretion have been significantly clarified, if not changed, by the Kollman case. We discuss the clear reflection of income doctrine as it has evolved over time and examine the impact of recent judicial decisions – especially Kollman – on this standard and consider whether or not there is need for revision on the law in this area. We conclude that the Commissioner's authority to arbitrarily require specific methods of accounting is in fact limited, and that the Kollman case serves as a helpful marker of the outer limits of such authority.

JEL: M4, M40, M41

KEYWORDS: Tax accounting, lower of cost or market, inventory valuation, tax administration

INTRODUCTION

Tax accounting in the United States is not a science. Indeed, it is not even an art. It is more of a dance, a negotiated process that involves a leader and a follower. The leader, at least since the U.S. Supreme Court decision in the case of *Thor Power Tool Co. vs. Commissioner* (439 U.S. 522, 1979), is the Internal Revenue Service (or, more properly, its head, the Commissioner of Internal Revenue). The followers are the U.S. taxpayers, that is, those individuals, business organizations and other entities that must rely on tax accounting principles in the derivation of the taxable income that they report for federal income tax purposes.

Generally, such entities are allowed to choose their own method of accounting for both tax and financial purposes. However, Internal Revenue Code (IRC) §446 appears to grant broad discretion to the Commissioner of Internal Revenue (Commissioner) to make determinations regarding a taxpayer's method of reporting income for tax purposes. A significant number of court cases have supported and even expanded on this provision while others have supported challenges to the apparently broad authority granted to the Commissioner. This paper will look at the determination of the Commissioner's authority by examining cases that appear to have been influential in establishing this authority. We will look at the relationship between financial and tax income and the implications of this relationship for the Commissioner's authority to require changes of accounting method under the clear reflection of income standard. We will examine the idea of the Commissioner's ability to determine what method clearly reflects a taxpayer's taxable income in general and in the context of inventory valuation. We will look at cases that have addressed this issue in prior years and compare/contrast the findings with a more recent case which appears to challenge the Commissioner's authority to change an entity's method of reporting

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