

Capital Allocation Effects of Accounting Regulation



CAR's Roland Königsgruber has published a paper, titled "Capital Allocation Effects of Financial Reporting Regulation and Enforcement", in the second issue of this year's volume of the *European Accounting Review*. In this

article, Königsgruber develops a model of a capital market relying on a potentially manipulated financial report in order to value a company. Entrepreneurs carry out a project and subsequently use the capital market to sell their venture and withdraw to private life. The model shows that in equilibrium the market will put more emphasis on the financial reporting in its valuation decision, the stricter the enforcement is. Under very lax enforcement, entrepreneurs with bad – negative expected value – projects have incentives to carry these out anyway since the market cannot distinguish successful from failed projects and value them identically. Stricter enforcement discourages bad projects from being carried out and thus improves capital allocation. Surprisingly, the model shows that a fairly low level of enforcement is sufficient to ensure optimal capital allocation and stricter enforcement may lead to 'overdeterrence' of viable projects.

To know more:

Königsgruber, R. (2012). Capital Allocation Effects of Financial Reporting Regulation and Enforcement. *European Accounting Review* 21, pp.283-296.

Accounting Standards and the Quality of Financial Reporting

A new working paper by CAR's Ralf Ewert and Alfred Wagenhofer, titled "Accounting Standards, Earnings Management, and Earnings Quality", investigates how different characteristics of accounting systems and institutional factors that influence financial reports affect earnings quality. It presents a rational expectations equilibrium model that features a steady state firm with investment in every period, an accounting system, non-accounting information, and earnings management. In equilibrium the accounting standards and earnings management jointly

determine the information content of earnings. Some intuitive results are confirmed: For example, earnings quality increases in accounting precision. But there are also counter-intuitive results: An accounting standard that recognizes a greater portion of future cash flows does not always increase earnings quality, and an increase in the cost of earnings management reduces earnings quality. The impact of operating risk on earnings quality is also analyzed. Finally, it is shown that value relevance measures trace the changes in earnings quality induced by a variation of accounting characteristics well for some characteristics, but may lead to wrong conclusions for other characteristics.

To know more:

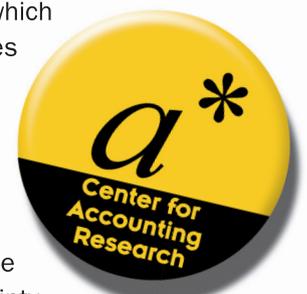
Ewert, R., Wagenhofer, A. (2012). Accounting Standards, Earnings Management, and Earnings Quality. Available in the SSRN library.

Discretion in Transfer Pricing

A new paper by CAR's Rainer Niemann and Christine Schultermandl in co-authorship with Branka Niemann has been published in one of the latest issues of *Österreichische Steuerzeitung*. Multi-jurisdictional companies have to use arm's-length prices for their intra-firm cross-border transactions to achieve an appropriate distribution of taxable income between the involved countries. This paper analyzes the discretion of transfer pricing documentations based on data from balance sheet databases. In a case study using the transactional net margin method, the authors show that variation in search criteria for comparable companies can induce considerable changes in the comparable net margins. Based on this result they discuss under which conditions arm's-length prices based on balance sheet databases are reliable instruments for transfer pricing. Standardized access to balance sheet databases could reduce tax planning and compliance costs and improve legal certainty.

To know more:

Niemann, B., Niemann, R. and Schultermandl, C. (2012). Verrechnungspreisgestaltung mit Datenbankstudien – eine Fallstudie. *Österreichische Steuerzeitung* 65, pp. 283–287.



CAR Papers in Recent Conferences

CAR's Roland Königsgruber presented a joint paper with Anna Boisits – from the DART program – at the Workshop on Accounting and Economics in Segovia and at the annual conference of the German Academic Association for Business Research in Bolzano. The paper, titled “Information Acquisition and Disclosure by Firms in the Presence of Additional Available Information” develops a model of a firm's disclosure decision. It shows that there exists an equilibrium where only firms of average quality will commit to disclosure whereas good and bad firms do not.

Stefan Schantl from the DART program presented his paper, “Earnings Management, Investor Sophistication, and Investors' Overconfidence”, at the Workshop on Accounting and Economics and at the annual meeting of the American Accounting Association (AAA) in Washington. The paper develops a model which investigates the effects of investors' differential information interpretation on the incentives to manage earnings.

At the AAA meeting, David Windisch (Institute of Accounting and Control) presented “Managerial Discretion in Accruals and Informational Efficiency”, coauthored by CAR's Pietro Perotti. Marina Ebner from the DART program also attended the AAA meeting.

Pietro Perotti presented “Earnings Quality Measures and Excess Returns”, jointly written with CAR's Alfred Wagenhofer, at the annual meeting of the European Financial Management Association in Barcelona. The paper examines the association between earnings quality measures and abnormal trading profitability.

Prize of the German Academic Association for Business Research (VHB)

In the annual meeting of the German Academic Association for Business Research (VHB) in Bozen in June, CAR's Rainer Niemann was awarded the VHB Best Paper Award for his article “Transfer Pricing or Formula Apportionment? - Tax-Induced Distortions of Multinationals”. The article is coauthored by Thomas Martini (University of Bielefeld) and Dirk Simons

(University of Mannheim), and was recently published in Contemporary Accounting Research.

To know more:

Martini, T., Niemann, R., Simons, D. (2012). Transfer Pricing or Formula Apportionment? - Tax-Induced Distortions of Multinationals. Contemporary Accounting Research 20, pp. 1-27.

Prizes of the Akademie der Wirtschaftstreuhänder



In June 2012, the Österreichische Akademie der Wirtschaftstreuhänder granted three main awards and one award of distinction to promising research projects of young researchers in the field of accounting and taxation. An international jury of recognized experts, chaired by Anton Egger, granted two of the main awards to researchers from the University of Graz – CAR's Martina Rechbauer and David Windisch from the Institute of Accounting and Control. Martina Rechbauer, who is also a research assistant at the Institute of Accounting and Taxation, received the award for a project in which she is going to examine the accuracy of database-driven methods used in empirical research to identify firms with tax-loss carryforwards. As part of her research project, she has already written a working paper together with CAR's Rainer Niemann in which they analyze these methods' accuracy for a sample of Austrian firms. David Windisch, formerly at CAR and now Institute of Accounting and Control, was awarded for his project on managerial discretion in accounting numbers. His current working paper, jointly written with CAR's Pietro Perotti, examines the association between managerial discretion in accruals and stock price informational efficiency. Both researchers received their awards during the celebration of the academy's 20-year jubilee, which took place at Schönbrunn Palace in Vienna.

To know more:

Niemann, R., Rechbauer, M. (2011). Wie können Unternehmen mit steuerlichen Verlustvorträgen identifiziert werden? – Ergebnisse einer Replikationsstudie. Arqus Working Paper No. 118.

Perotti, P., Windisch, D. (2012). Managerial Discretion in Accruals and Informational Efficiency. Available in the SSRN library.

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