

Subject Code	AF6107
Subject Title	Incentives and Monitoring in Accounting
Credit Value	3
Level	6
Normal Duration	One Semester
Pre-requisite / Co-requisite/ Exclusion	None
Role and Purposes	This subject contributes to the achievement of the DBA/DMgt outcome by acquiring an in-depth knowledge of a specialist area (Outcome 2). Effective corporate operation demands correct incentive structure and appropriate monitoring system. Good corporate governance provides both incentives and monitoring. The overall aim of this course is to familiarize students with the broad framework of corporate governance that relates to incentive and monitoring. Special focus will be on accounting and auditing that act as corporate governance devices.
Subject Learning Outcomes	<p>Upon completion of the subject, students will be able to:</p> <ol style="list-style-type: none"> understand the basic theories behind the need for incentives and monitoring in modern corporations. understand the governance structure in developing internal incentive and monitoring systems. appreciate the interactions between internal incentive/monitoring system with the external environment understand accounting/auditing as special corporate governance devices. analyze and evaluate different accounting/auditing issues as related to incentives and monitoring. identify possible research topics .
Subject Synopsis/ Indicative Syllabus	<p>Topic 1. Corporate governance (as an internal system to develop incentive-compatible contracts and effective monitoring system)</p> <p>Topic 2. Incentives and earnings management</p> <p>Topic 3. Agency theory and incentive scheme for executives</p> <p>Topic 4. Information environment and external monitoring (Security Analysts and takeover)</p>
Teaching/Learning Methodology	The format of the classes will be workshops in which the professor will provide a broad overview of the topics, following which related research papers in top-tier journals will be discussed. There will also be team presentation of research paper.

Assessment Methods in Alignment with Intended Learning Outcomes	<table border="1"> <thead> <tr> <th rowspan="2">Specific assessment methods/tasks</th> <th rowspan="2">% weighting</th> <th colspan="6">Intended subject learning outcomes to be assessed (Please tick as appropriate)</th> </tr> <tr> <th>a</th> <th>b</th> <th>c</th> <th>d</th> <th>e</th> <th>f</th> </tr> </thead> <tbody> <tr> <td>1. Class participation</td> <td>20%</td> <td>✓</td> <td>✓</td> <td>✓</td> <td>✓</td> <td>✓</td> <td>✓</td> </tr> <tr> <td>2. Presentation</td> <td>30%</td> <td>✓</td> <td>✓</td> <td>✓</td> <td>✓</td> <td>✓</td> <td>✓</td> </tr> <tr> <td>3. Final Exam</td> <td>50%</td> <td>✓</td> <td>✓</td> <td>✓</td> <td>✓</td> <td>✓</td> <td>✓</td> </tr> <tr> <td>Total</td> <td>100 %</td> <td colspan="6"></td> </tr> </tbody> </table>	Specific assessment methods/tasks	% weighting	Intended subject learning outcomes to be assessed (Please tick as appropriate)						a	b	c	d	e	f	1. Class participation	20%	✓	✓	✓	✓	✓	✓	2. Presentation	30%	✓	✓	✓	✓	✓	✓	3. Final Exam	50%	✓	✓	✓	✓	✓	✓	Total	100 %						
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<p>Explanation of the appropriateness of the assessment methods in assessing the intended learning outcomes:</p> <p><i>To pass this subject, students are required to obtain Grade D or above in BOTH the Continuous Assessment and Exam components.</i></p> <p>Each 3-hour module will focus on assigned papers. The lecturer will provide a general overview of the area followed by a detailed discussion of the assigned papers. The student will give a 30 – 40 minute presentation to the class that focuses on summarizing the paper’s main findings, the specific hypotheses tested, the methodology used to test the hypotheses, and a critique of the paper. These presentations will identify the paper’s contribution to the literature, its strengths and weaknesses, and potential extensions by future research. The student should be prepared to moderate a discussion about the paper including answering questions from the class or from the lecturer. Discussions are highly interactive.</p>																																															
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Reading List and References	<p>Background (General):</p> <p>Scott, William R., Financial Accounting Theory, 2014, 7th edition, Pearson (Prentice Hall) Education Canada Inc., Toronto, Ontario</p> <p>Topic 1. Corporate governance (23 September 2017 – Agnes Cheng)</p> <p><u>Larcker, D., E.C. So, and C.C.Y. Wang. 2013.</u> Boardroom Centrality and Firm Performance. <i>Journal of Accounting and Economics</i>, 55 (2-3), 225-250.</p> <p><u>Skaife, H. A., D. Veenman, and D. Wangerin. 2013.</u> Internal Control over Financial Reporting and Managerial Rent Extraction: Evidence from the Profitability of Insider Trading. <i>Journal of Accounting and Economics</i>, 55(1), 91-110.</p>																																														

Cheng, C. S. A., H. H. Huang, Y. H. Li, and J. Stanfield. 2012. The Effect of Hedge Fund Activism on Corporate Tax Avoidance. *The Accounting Review*, 87(5), 1493-1526.

Bruynseels, L. and E. Cardinaels. 2014. The Audit Committee: Management Watchdog or Personal Friend of the CEO? *The Accounting Review*, 89 (1), 113-145.

Supplementary reading

Jiang, F. X. and K. A. Kim. 2015. Corporate Governance in China: A Modern Perspective. *Journal of Corporate Finance*, volume 32, June, 190-216.

Dey, A. 2008. Corporate Governance and Agency Conflicts. *Journal of Accounting Research*, 46(5), 1143-1181.

Background reading

Chapter 9 (*An Analysis of Conflict*), p.357-p.391
William R. Scott, *Financial Accounting Theory* (7th Edition), Pearson Press

Topic 2. Incentives and earnings management (24 September 2017 – Agnes Cheng)

Chen, X., Q. Cheng, and X. Wang. 2015. Does Increased Board Independence Reduce Earnings Management? *Review of Accounting Studies*, 20(2), 899-933.

Cheng, Q., J. Lee, and T. Shevlin. 2016. Internal Governance and Real Earnings Management. *The Accounting Review*, 91(4), 1051-1085.

Lo, K., F. Ramos, and R. Rogo. 2017. Earnings Management and Annual Report Readability. *Journal of Accounting and Economics*, 63(1), 1-25.

Hail, L., A. Tahoun, and C. Wang. 2014. Dividend Payouts and Information Shocks. *Journal of Accounting Research*, 52(2), 403-456.

Supplementary reading

Burgstahler, D. and E. Chuk. 2017. What Have We Learned About Earnings Management? Integrating Discontinuity Evidence. *Contemporary Accounting Research*, 34(2), 726-749.

Hou, Q.H., Q.L. Jin, R. Yang, H. Q. Yuan, and G. C. Zhang. 2015. Performance Commitments of Controlling Shareholders and Earnings Management. *Contemporary Accounting Research*, 32(3), 1099-1127. (Chinese context)

Background reading

Chapter 10 (*Executive Compensation*), p.403-p.432
Chapter 11 (*Earnings Management*), p.444-p.473
William R. Scott, *Financial Accounting Theory* (7th Edition), Pearson Press

Topic 3. Agency theory and incentive scheme for executives (4 November 2017 – JC Lin)

(i) Agency theory and asymmetric information theory

1. Jensen, M. and W. Meckling, 1976, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, *Journal of Financial Economics* 3, 305-360.
2. Myers, S. C. and N. S. Majluf, 1984, Corporate Financing and Investment Decisions When Firms Have Information That Investors Do Not Have, *Journal of Financial Economics* 13, 187-221.
3. Michael C Jensen, 1986, Agency Costs of Free Cash Flow, Corporate finance, and Takeovers. *American Economic Review* v76n2, 323–329.
4. James S Ang, Rebel A Cole and James Wuh Lin, 2000, Agency Costs and Ownership Structure, *Journal of Finance*, v55n1, 81-106.

Supplementary reading

1. Jeremy C. Stein, 2003, Chapter 2 – Agency, Information and Corporate Investment, *Handbook of the Economics of Finance*, v1, part A, 111-165.

(ii) Incentive scheme for executives

1. Jensen, Michael C. and Kevin J. Murphy, 1990, Performance pay and top-management incentives, *Journal of Political Economy*, v98n2, 225-264.
2. Judith Chevalier and Glenn Ellison, 1997, Risk taking by mutual funds as a response to incentives, *Journal of Political Economy*, v105n6, 1167-1200.
3. Gabaix, Xavier and Landier, Augustin, 2008, Why has CEO pay increased so much? *Quarterly Journal of Economics*, v123 (1), 49-100.
4. Vivian W Fand, Thomas H Noe and Sheri Tice, 2009, Stock market liquidity and firm value, *Journal of Finance Economics*, 94, 150-169.
5. Radhakrishnan Gopalan, Todd Milbourn and Fenghua Song, 2010, Strategic Flexibility and the Optimality of Pay for Sector Performance, *Review of Financial Studies*, v23 (5), 2060-2098.

Supplementary reading

1. Steven N Kaplan, 2013, CEO Pay and Corporate Governance in the U.S.: Perceptions, Facts, and Challenges, *Journal of Applied Corporate Finance*, v25, 8-26.
2. Core, John E. and Robert W. Holthausen, David F. Larcker, 1999, Corporate governance, chief executive officer compensation, and firm performance, *Journal of Financial Economics*, 51 (1999) 371-406.
3. Kevin J Murphy, 2002, Explaining Executive Compensation: Managerial Power versus the Perceived Cost of Stock Options, *The University of Chicago Law Review*, v69n3, 847-849.
4. Gerald T Garvey and Todd T Milbourn, 2006, Asymmetric benchmarking in compensation: Executives are rewarded for good luck but not penalized for bad. *Journal of Financial Economics*, 82, 197-225.
5. Murphy, Kevin, Executive Compensation: Where We Are, and How We Got There, 211 – 356, in George Constantinides, Milton Harris, and René Stulz (ed), *Handbook of the Economics of Finance* Volume 2A, Elsevier Science North Holland, 2013.
6. Radhakrishnan Gopalan, Todd Milbourn, Fenghua Song, and Anjan V Thakor, 2014, Duration of Executive Compensation, *Journal of Finance*, v69n6, 2777-2817.

Topic 4. Information environment and external monitoring (5 November 2017 – JC Lin)

(i) Information environment

1. Robert A Korajczyk, Deborah J Lucas and Robert L McDonald, 1991, The Effect of Information Releases on the Pricing and Timing of Equity Issues, *Review of Financial Studies*, v4n4, 685-708.
2. Randall Morck, Bernard Yeung, and Wayne Yu, 2000, The information content of stock markets: why do emerging markets have synchronous stock price movements?, *Journal of Financial Economics*, 58, 215-260.
3. Jeffrey Wurgler, 2000, Financial markets and the allocation of capital, *Journal of Financial Economics*, v58, 187-214.
4. Yihui Pan, Tracy Yue Wang, and Michael S. Weisbach, 2015, Learning About CEO Ability and Stock Return Volatility, *Review of Financial Studies*, 28 (6): 1623-1666.

Supplementary reading

1. Paul Brockman and Dennis Y Chung, 2003, Investor Protection and Firm Liquidity, *Journal of Finance*, v58 (2), 921-938.
2. Mark L Defond and Mingyi Hung, 2004, Investor protection and corporate governance: Evidence from worldwide CEO turnover, *Journal of Accounting Research*, v42n2, 269-312.
3. Luo, Yuanzhi, 2005, Do Insiders Learn from Outsiders? Evidence from Mergers and Acquisitions, *Journal of Finance*, v60n4, 1951-1982.
4. Li Jin and Stewart C Myers, 2006, R² around the world: New theory and new tests, *Journal of Financial Economics*, v79, 257-292.
5. Shane A Johnson, Ji-Chai Lin and Kyojik Roy Song, 2006, Dividend policy, signaling, and discounts on closed-end funds, *Journal of Financial Economics*, 81, 539-562.
6. Chen, Q., I. Goldstein, and W. Jiang, 2007, Price Informativeness and Investment Sensitivity to Stock Price. *Review of Financial Studies*, 20, 619-650.

(ii) Security Analysts as a monitoring mechanism

1. Michaely, R., K. Womack, 1999, Conflict of interest and the credibility of underwriter analyst recommendations. *The Review of Financial Studies* 12(4), 653-686.
2. Lang, M., K. Lins and D. Miller, 2004, Concentrated Control, Analyst Following, and Valuation: Do Analysts Matter Most When Investors Are Protected Least? *Journal of Accounting Research* 42(3), 589-623.
3. Moyer, C., R. Chatfield and P. Sisneros, 1989, Security Analyst Monitoring Activity: Agency Costs and Information Demands. *The Journal of Financial and Quantitative Analysis* 24(4), 503-512.
4. Bushman, R., J. Piotroski, and A. Smith, 2005, Insider Trading Restrictions and Analysts' Incentives to Follow Firms. *The Journal of Finance* 60(1), 35-66.

(iii) Takeover as the ultimate external monitoring device

1. Kathleen Fuller, Jeffrey Netter, and Mike Stegemoller, 2002, What Do Returns to Acquiring Firms Tell Us? Evidence from Firms That Make Many Acquisitions, *Journal of Finance*, v57i4, 1763-1793.
2. Lehn, Kenneth and Mengxin Zhao, 2006, CEO turnover after acquisitions: Are bad bidders fired? *Journal of Finance*, v61n4, 1759 - 1811.
3. Isil Erel, Rose C. Liao, and Michael S. Weisbach, 2012, Determinants of Cross-Border Mergers and Acquisitions, *Journal of Finance*, v67n3, 1045-1082.

Supplementary reading

1. Mark L. Mitchell and Kenneth Lehn, 1990, Do Bad Bidders Become Good Targets? *Journal of Political Economy*, v98n2, 372-398.
2. Michael C Jensen, 1993. The modern industrial revolution, exit, and the failure of internal control systems. *Journal of Finance*, 48, 831-880.
3. Gordon M. Phillips and Alexei Zhdanov, 2013, R&D and the Incentives from Merger and Acquisition Activity, *Review of Financial Studies*, v26 (1), 34-78.