Backgrounder:

RSM McGladrey Institute of Accounting Education and Research

Founded in 1984 with contributions from University of Iowa graduates who are McGladrey & Pullen partners, the RSM McGladrey Institute fosters excellence in accounting education and research at the University of Iowa. Its activities have included:

- Hosting annual public forums on contemporary accounting and auditing issues. Past speakers have included Mr. Michael Crooch, currently a member of the Financial Accounting Standards Board, and Dr. Zoe-Vonna Palmrose, Professor of Auditing at the University of Southern California and former member of the Public Oversight Board.

- Sponsoring research conferences and workshops that attract scholars from throughout the U.S. Recent topics have included: Are investors misled by “pro forma” earnings? Does consulting compromise auditor independence? Do stock prices already reflect the cost of employee stock options?

- Sponsoring and disseminating faculty and Ph.D. student research (see abstracts below).

- Providing undergraduate and graduate student access to professional research and educational materials.

- Serving as an expert resource for regional media personnel on accounting, auditing and stock market valuation topics.

Current director of the RSM McGladrey Institute is W. Bruce Johnson, Arthur Anderson Professor of Accounting, who joined The University of Iowa in 1988. He received his Ph.D. from Ohio State University and has held faculty appointments at the University of Wisconsin, Northwestern University and the University of Chicago. His teaching and research interests include corporate financial reporting, financial statement analysis, stock valuation, value-based management systems and investment strategies, and executive compensation practices. He is co-author of Financial Reporting and Analysis (2nd Ed.), a textbook for securities analysts, credit analysts, accountants and auditors. He has been a research consultant to the Financial Accounting Standards Board and to emerging and established companies, legal and public accounting firms and the investment community. In addition to his teaching, research and administrative responsibilities at the University of Iowa, he is a visiting faculty member at Northwestern University’s semiannual “Credit Analysis and Equity Valuation” program and at the China Europe International Business School’s (CEIBS) executive MBA programs in Shanghai and Beijing, China. He is currently President-Elect of the American Accounting Association’s Financial

1 Authors affiliated with The University of Iowa are denoted in bold.
investors mitigate the mispricing. Our results indicate there is less mispricing among firms with high institutional ownership. This result is robust across several alternative specification tests.

**Douglas V. DeJong**, Abe de Jong (Erasmus University Rotterdam), Gerard Mertens (Nyenrode University), Charles Wasley (University of Rochester). *The Role of Self-Regulation in Corporate Governance: Evidence from The Netherlands*. This paper assesses the effectiveness of the Netherlands’ private sector initiative on self-regulation to improve corporate governance. We compare corporate governance characteristics, and the relation between firm value and these characteristics, before and after the private sector initiative. We find that the recommendations of the private sector initiative had no substantive effect on corporate governance characteristics or their relationship with firm value. Using event study techniques, we document the market’s skepticism about the successful evolution of corporate governance practices in the Netherlands through self-regulation. The one exception to this general conclusion is the market for new listings. The Netherlands initiative suggests that little can be expected from self-regulation initiatives that rely on monitoring without enforcement.

**W. Bruce Johnson** and William C. Schwartz Jr. (University of Arizona) *Evidence that Capital Markets Learn from Academic Research: Earnings Surprises and the Persistence of Post-Announcement Drift*. We investigate the relation between earnings surprises and post-announcement stock returns for 1991-1997, and show that the profit opportunities previously associated with simple trading strategies designed to exploit the drift phenomenon have now been substantially eliminated. This profitability decline does not appear to be due to increased earnings “noise” from transitory items or to structural changes in the serial correlation of earnings surprises. The post-announcement drift persists where arbitrage costs are highest; that is, among small NYSE/AMEX firms, and among firms with little or no analyst following or with low stock prices. The evidence is consistent with the notion that investors used earnings surprise trading strategies to arbitrage the drift once the phenomenon had been well documented in academic research.

**Morton Pincus**, John Phillips (University of Connecticut), **Sonja Rego**. *Earnings Management: New Evidence Based on Deferred Tax Expense*. We examine the usefulness of deferred tax expense as compared to various accrual measures employed in prior research in detecting earnings management in three settings where earnings management likely occurs. Our results provide evidence of the incremental usefulness of deferred tax expense in detecting earnings management activities vis-à-vis total accruals and abnormal accruals derived from two versions of the Jones model. Deferred tax expense is generally incrementally useful beyond all three accruals-based measures with regard to detecting earnings management to avoid an earnings decline and with regard to detecting earnings management to avoid a loss. We also find that deferred tax expense is significantly more accurate than any of the accrual measures in classifying firm-years as successfully avoiding a loss, whereas no one measure is relatively more accurate than the others in classifying firm-years that successfully avoid an earnings decline. With regard to meeting analysts’ earnings forecasts, only total accruals detects earnings management.
sample under examination – i.e., significant within-sample differences in slope coefficients lack external validity.

**Sonja Rego. Tax Avoidance Activities of U.S. Multinational Corporations.** This paper investigates whether multinational corporations avoid more taxes than U.S. domestic-only companies. While the empirical results indicate that *ceteris paribus*, larger corporations have higher effective tax rates, firms with greater pre-tax income have lower effective tax rates. The negative relation between ETRs and pre-tax income is consistent with firms with greater pre-tax income having more incentives and resources to engage in tax planning. I find that multinational corporations with more extensive foreign operations have lower worldwide ETRs than other firms do. Finally, in a sample of multinational corporations only, I find that higher levels of U.S. pre-tax income are associated with lower U.S. and foreign ETRs, while higher levels of foreign pre-tax income are associated with higher U.S. and foreign ETRs. Thus, large amounts of foreign income are associated with higher corporate tax burdens.

Scott Vandervelde (University of South Carolina), Richard Tubbs, Albert Schepanski, and Will F. Messier, Jr. (Georgia State University). **Experimental Tests of a Descriptive Theory of Auditee Risk Judgment.** This research experimentally investigates how auditors make auditee risk judgments during the planning of the audit of an account balance in a client’s financial statements. If auditors fail to assimilate risk factors according to normative criteria, inefficient or ineffective audits may result. Experiment 1 examines whether the predictions deduced from three normative models of auditee risk assessment proposed in the auditing literature are descriptive of auditors’ judgments. In experiment 2, a descriptive model of auditee risk assessment is induced from data by the methods of psychological measurement. The results of experiment 1 indicate that none of the normative models are totally descriptive of auditors’ judgments. The results of experiment 2 suggest that auditors’ judgments of auditee risk assessments can better be explained by the range model, a configural weight model, than by alternative descriptive models. Therefore, the results of the two experiments suggest that auditors’ judgments deviate from normative criteria.

Michelle Yetman, Mark Lang (University of North Carolina), Jana Raedy (University of North Carolina). **How Representative Are Firms That Are Cross Listed in the United States? An Analysis of Accounting Quality.** We provide evidence on the characteristics of local-GAAP earnings for firms cross listing on US exchanges relative to a matched sample of foreign firms currently not cross listing in the US to investigate whether US listing is associated with differences in accounting data reported in local markets. We find that cross-listed firms differ in terms of the time series properties of earnings and accruals, and the degree of association between accounting data and share prices. Cross-listed firms appear to be less aggressive in terms of earnings management, and report accounting data that are more conservative, take account of bad news in a timelier manner, and are more strongly associated with share price. Further, the differences appear to result partially from changes around cross listing and partially from differences in accounting quality prior to listing. We do not observe a similar pattern for firms cross listed on other non-US exchanges or on the US Over-the-Counter market, suggesting a unique quality to cross listing on US exchanges.

Michelle Yetman and Robert Yetman. **The Effect of Nonprofits’ Taxable Activities on the Supply of Private Donations.** Prior research indicates that donations respond to