



Economic Modeling of Accounting Issues

Business 30901

Spring 2023: Tuesdays from 8:30 AM to 12:00 PM.

Room C09 (Harper Center)

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Course Description:

This course develops the following core analytical methodologies used in modeling asymmetric information settings:

- Voluntary Disclosure games
- Signaling and Screening games
- Rational Expectations models
- Global games and higher order beliefs

These methodologies would be used to study accounting disclosure and measurement issues. This course is targeted towards doctoral students in Accounting, Finance, and Economics who want to conduct analytical and/or empirical research in accounting and corporate finance issues.

Course Materials:

Any materials distributed for the course including assignments would be available for download from chalk at <https://canvas.uchicago.edu>.

Useful References:

Mas-Colell, A., Whinston M., and J. Green (1995): Microeconomic Theory. Oxford University Press.

Tirole, Jean (2006): The Theory of Corporate Finance. Princeton University Press.

Course Prerequisites:

There are no strict prerequisites. However, I strongly recommend that students have taken Price Theory I (Econ 30100) and Price Theory II (Econ 30200). If you haven't taken both classes, please reach out to me before registering for the course.

Course Grade

This course **may not** be taken for a Pass or Fail grade. Your overall grade for the course will be determined as follows:

Item	Weight
Assignments	25%
Paper Presentation	25%
Take-Home Final Exam	50%

- Assignments: There will be about five (5) individual assignments throughout the quarter. These assignments are meant to test your knowledge of the methodologies discussed in class. You will usually have about a week to work on these assignments. While you are welcome to discuss these assignments with me, you should not discuss this assignment with anyone else.
- Paper presentation: During week 8 of the quarter, I will assign an applied theory paper to each student. The paper could either be a working paper or a published paper. Each student will get a different paper. During finals week (Week 11), each student would present the assigned paper to the class. I will make the requirements for each presentation very specific.
- Final Exam: A 3-hour closed-book and closed-notes take-home final exam.

Tentative Topics and Reading List**Voluntary Disclosure Models**

Grossman, S. "The Informational Role of Warranties and Private Disclosure About Product Quality," *Journal of Law and Economics* (1981).

Dye, R. "Disclosure of Nonproprietary Information," *Journal of Accounting Research*: (1985) and Kwon, Y.K., and W. Jung. "Disclosure When the Market is Unsure of Information Endowment of Managers," *Journal of Accounting Research*, (1988).

Shin, H.S. "News Management and the Valuation of Firms," *Rand Journal of Economics*, (1994): 58-71

Shin, H. S. "Disclosures and Asset Returns," *Econometrica*, (2003): 105 – 133.

Screening and Signaling Methodologies

Spence M, "Competitive and Optimal Responses to Signals: Analysis of Efficiency and Distribution." *Journal of Economic Theory* (1974).

Mussa M, and S. Rosen, "Monopoly and product quality", *Journal of Economic Theory* (1978).

Baron, D. and R. Myerson: "Regulating a monopolist with unknown costs", *Econometrica* (1982).

Kanodia, C. and A. Mukherji: "Audit Pricing, Lowballing and Auditor Turnover" A Dynamic Analysis," *The Accounting Review*.

Laffont J.J. and J. Tirole, "Using Cost Observation to Regulate Firms." *Journal of Political Economy*, 1986.

Rational Expectation Models

Grossman S. and J. Stiglitz. "On the Impossibility of Informationally Efficient Markets," *The American Economic Review*, (1980).

Diamond, D. "Optimal Release of Information by Firms," *Journal of Finance* (1985)

Real Effects of Disclosure and Measurement Issues

Kanodia, C., and D. Lee, "Investment and Disclosure: The Disciplinary Role of Periodic Performance Reports." *Journal of Accounting Research*, (1998).

Kanodia, C, R. Singh, and A. Spero, "Imprecision in Accounting Measurement: Can it be Value Enhancing? *Journal of Accounting Research*, 2005.

Kanodia, C., H. Sapra, and R. Venugopalan, "Should Intangibles be Capitalized: What are the Economic Trade-offs?" *Journal of Accounting Research*, (2004)

Gigler, F., C. Kanodia, H. Sapra, and R. Venugopalan, "How Frequent Financial Reporting Can Cause Managerial Short-Termism: An Analysis of the Costs and Benefits of Increasing Reporting Frequency." *Journal of Accounting Research* (2014).

Goldstein, I. and H.Sapra, "Should Stress tests results be disclosed: An Analysis of the Costs and Benefits." *Foundations and Trends® in Finance* (2014).

Higher Order Beliefs

Allen, F., S. Morris, and H.S. Shin: "Beauty Contests, Bubbles and Iterated Expectations in Asset Markets," *Review of Financial Studies* (2006).

Angeletos, G. M, and A. Pavan: "Efficient Use of Information and Social Value of Information," *Econometrica*, Vol. 75, No. 4 (July, 2007), 1103–1142

Morris, S and H.S. Shin "Global Games and Applications," forthcoming in *Advances in Economics and Econometrics*, the Eighth World Congress

(edited by M. Dewatripont, L. Hansen, and S. Turnovsky), Cambridge University Press.

Kondor, P: "The More We Know the Fundamental, the Less We Agree on the Price," *Review of Economic Studies* (2012).

Morris S. and H. S. Shin: "Coordination Risk and the Price of Debt," *European Economic Review* (2004).

Plantin G, H. Sapra, and H.S. Shin, "Marking-to-Market: Panacea or Pandora's Box?" *Journal of Accounting Research* (2008).

Morris S, and H.S. Shin: Social Value of Public Information
American Economic Review, (2002).

Rational Inattention or Limited Attention Models

Lu, J. "Limited Attention: Implications for Financial Reporting," Working Paper, (2021), City University of Hong Kong.

Sims, C. "Implications of Rational Inattention", *Journal of Monetary Economics*, 50, 665-690.

Myatt D., and C. Wallace: "Endogenous Information Acquisition in Coordination Games RESTUD (2012) 79, 340-374.