2012 Pan Pacific Business Research Conference

February 10 -11, 2012
Santos Manuel Student Union,
California State University San Bernardino, California, USA

Pan Pacific Business Research Institute

2012 Pan Pacific Business Research Conference
Program Schedule

February 10 -11, 2012
Santos Manuel Student Union,
California State University San Bernardino, California, USA
(www.ppbri.org)

Registration	8:30 am – 4:00 pm
Tea Time	8:30 am – 9:00 am
The 1st Paper Presentation Session	9:00 am – 10:30 am
The 2nd Paper Presentation Session	11:00 am – 12:30 pm
Lunch	12:30 pm – 2:00 pm at Sushi Tomo 4275 N. University Parkway #103, San Bernardino, CA 92407. 909) 887-8600
The 3rd Paper Presentation Session	2:00 pm – 3:30 pm
The 4th Paper Presentation Session	3:40pm – 4:40 pm
Dinner and Award Receptions:	5:40 pm at *Giuseppe's* *2433 N. Euclid, Upland, CA91784*
Executive Committee Meeting	8:30 pm at *Giuseppe's* *2433 N. Euclid, Upland, CA91784* (909) 946-5979

1st Session: Accounting Research1

9:00 am to 10:30 am on February 10, 2012
@ Room 209

Session Chair: Byunghwan Lee

1. **The Effects of Business Cycles on the Value Relevance of Earnings and Equity Book Value for Korean Firms**

By

Kyung Joo Lee*, University of Maryland-Eastern Shore,

Hye-Jung Jung, Jeju National University, Jeju, Korea, &

Jin-Ah Kim, Jeju National University, Korea

2. **Effect of consolidation scope changes on security returns**

By

Naechul Kang, Hongik University, Korea

Taewon Yang, California State University-San Bernardino &

John Jin, California State University-San Bernardino*

3. **Financial Effects of the Right-To-Use Model for Lessees**

By

Hong S Pak, California State Polytechnic University, Pomona
Byunghwan Lee, California State Polytechnic University, Pomona, &
Heung Joo Cha, University of Redland

2nd Session: Accounting Research2

11:00 am to 12:30 am on February 10, 2012
@ Room 209

Session Chair: Samantha Liu

4. **Auditor Switching Effects on Audit Pricing**

By

Nancy M. Fan, California State Polytechnic University, Pomona
Jiuzhou Wang, Norwegian School of Economics and Business Administration

5. **Target Costing and Manufacturing Environments: An empirical Study**

By

Il-woon Kim, University of Akron

6. **The Effects of single audit act amendment in 1996 on the internal control system and compliances of county governments in California**

By

Sung Kyu Huh, California State University-San Bernardino &
John J Jin, California State University-San Bernardino

3rd Session: Accounting Research 3

2:00 pm to 3:30 pm on February 10, 2012
@ Room 209

Session Chair: Nancy Fan

**7. Monitoring or moral hazard?
Evidence from real activities manipulation by venture-backed companies**

By

Xiang Liu, California State University- San Bernardino

8. Association between the Firm's Social Performance and Its Financial Performance

By

Kyung Joo Lee*, University of Maryland-Eastern Shore, Princess Anne, MD 21853
Mi-Young Kang, Jeju National University, Jeju, Korea

9. Towards Paradigmatic Pluralism in Applied Accounting Research

By

Byunghwan Lee, California State Polytechnic University-Pomona &
J James Kim, California State Polytechnic University- Pomona

4th Session: Accounting Research 4 & Future Direction

3:40 pm to 4:40 pm on February 10, 2012
@ Room 209

Accounting Chair: S. K. Huh

10. An empirical evaluation of fair value accounting numbers: Evidence from the investigation of goodwill accounting

By

Sohyung Kim, Brock University &
Sung Wook Yoon, California State University- Northridge

1st Session: Inter-disciplinary Research

9:00 am to 10:30 am on February 10, 2012
@ Room 211

Session Chair: Haakon Brown

11. Improving Software Learning Experience through Peer Learning with the Aid of a Wiki and Screencasts

By

Frank Lin, California State University-San Bernardino,
Tai-Yin Chi*, Claremont Graduate University, &
Ying LIU, California State University-San Bernardino.

12. A Sustainable Framework As an Organizational Asset for SOX Compliance and Execution

By

Michael Fredendall, California State University-San Bernardino

13. Why peoples watch Super Bowl?

By

Haakon Brown, California State University-San Bernardino

2nd Session: Finance Research1

11:00 am to 12:30 am on February 10, 2012
@ Room 211

Session Chair: Heung Joo Cha

14. Intertemporal Relations between the VIX Market Volatility Index and Stock Market Returns

By

Ghulam Sarwar, California State University-San Bernardino

15. Is Sentiment Risk Priced by Stock Market?

By

Francisca Beer, California State University-San Bernardino,
Mohamed Watfa, ITIC Paris, &
Mohamed Zouaoui, Université of Franche-Comté.

16. Dynamic Relationship Between Stock Prices and Equity Unit Trust Flows in the U.K. Market

By

Heung-Joo Cha, University of Redlands

3rd Session: Finance Research 2

2:00 pm to 3:30 pm on February 10, 2012
@ Room 211

Session Chair: Hua Sun

17. Loss Aversion in the Housing Market: A Revisit
By
Hua Sun, California State University-San Bernardino

18. Pre-takeover Institutions and Risk Arbitrage
By
Ben Branch, *University of Massachusetts, Amherst,*
Seung-Hyun Lee, *University of Texas, Dallas*, &
Taewon Yang, *California State University- San Bernardino*

19. Effect of IFRS Adoption on Risk Assessment in Korea
By
Sung Kyu Huh, California State University-San Bernardino
Dong Man Kim*, California State University-San Bernardino
John J Jin, California State University-San Bernardino
Nae-Chul Kang, Hongik University, Korea, &
Taewon Yang, California State University-San Bernardino

4th Session: Finance Research 3 &Future Direction

3:40 pm to 4:40 pm on February 10, 2012
@ Room 211

Finance Chair: Ghulam Sarwar

20. Straddle and Strangle trades depend on percent profitable in Korea option market
By
Young Hoon Ko, HyupSung University, Korea &
Taewon Yang, California State University-San Bernardino

4th Session: Inter-disciplinary Research 2 & Future Direction

3:40 pm to 4:40 pm on February 10, 2012
@ Room 210

Inter-disciplinary Chair: Frank Lin

Internet Session:

8:30 am to 10:30 am on February 11, 2012

https://groups.google.com/group/ppbri2012?msg=new&lnk=gcis

Inter-disciplinary Chair: S. W. Yoon

21. Earnings Management and Operating Performance of Corporate Spin-offs

By

Yingchou Lin, Missouri University of Science and Technology &
Deqing Diane Li, University of Maryland Eastern Shore

ABSTRACTS

1. The Effects of Business Cycles on the Value Relevance of Earnings and Equity Book Value for Korean Firms

Kyung Joo Lee*, University of Maryland-Eastern Shore,
Hye-Jung Jung, Jeju National University, Korea &
Jin-Ah Kim, Jeju National University, Korea

* The corresponding author.

Abstract: This study provides further evidence on the determinants of the value relevance of accounting information. Specifically, we examine whether the time-series variations in the value relevance of earnings and equity book value depend on the fluctuations in macroeconomic conditions, as measured by business cycles. Business cycles are classified into two stages: expansions and recessions. The value relevance of accounting information is measured by the earnings response coefficients (ERC) and the explanatory power (R^2) of both earnings and equity book value on stock prices. Using a sample of 142 firms listed in the Korean Stock Exchange during 20 years (1981-2000), we found the following results. First, while statistically insignificant, ERC is lower in expansions than in recessions. Second, explanatory power of accounting information is higher in recessions than in expansions. Third, value relevance of earnings is higher in expansions, while equity book value is more value relevant in recessions. Overall, these results show that business cycles have systematic impacts on the value relevance of accounting information for the Korean firms.

2. Effect of consolidation scope changes on security returns

Naechul Kang, Hongik University, Korea
Taewon Yang, California State University-San Bernardino &
John Jin, California State University-San Bernardino*

*The corresponding author.

Abstract: The purpose of this study is to examine if financial leverages of the marginal subsidiaries affect bond returns and stock returns of the parent company. The marginal subsidiaries are those dropped from consolidations with applications of more stringent consolidation scope criterion of 50% ownership interests under IFRS than that under Korean GAAP requiring only 30% ownership interests. This research question was addressed using two methodologies. First, compare the explanatory power of full regression models with financial leverages of the marginal subsidiaries versus that of reduced regression models without financial leverages of the marginal subsidiaries. Second, examine the partial regression coefficient of financial leverages of the marginal subsidiaries, an independent variable, in the full regression models. Empirical results from the two methodologies suggest that financial leverages of the marginal subsidiaries do affect bond returns of the parent company but do not affect the stock returns of the parent company. The results are robust across different measures of variables and methods.

3. Financial Effects of the Right-To-Use Model for Lessees

Hong S. Pak*, California State Polytechnic University, Pomona
Byunghwan Lee, California State Polytechnic University, Pomona, &
Heung-Joo Cha, University of Redlands

*The corresponding author

Abstract: To examine the financial effects of the proposed right-to-use model (or capitalization of operating lease) for lessees with the U.S. public firms, we analyze randomly selected 80 experimental firms and 88 control firms. Our results show that the adoption of the right-to-use model has significant negative effects on the financial flexibility measured by the debt-to-equity ratio. However, it has insignificant effects on the liquidity measure of the current ratio. We find that it has significant effects on the size-scaled profitability measures of EBIT and EBT. Thus, our findings indicate that the adoption of the right-to-use model has significant economic consequences to the firms with large operating leases.

JEL Classification: M41

Keywords: right-of-use model, operating lease, capitalization, financial ratio analysis

4. Auditor Switching Effects on Audit Pricing: New Evidence Post Andersen and SOX

Nancy Fan*, California State Polytechnic University-Pomona
Jiuzhou Wang, Norwegian School of Economics and Business Administration

*The corresponding author

Abstract: The purpose of this paper is to examine auditor switching effects on audit pricing pre and post the Arthur Andersen scandal and the passage of the Sarbanes-Oxley Act (SOX). Design/methodology/approach – A sample of 17,820 firm-year observations from 2000 to 2005 were employed to examine both the overall effects of auditor switches and the switches in different directions on audit pricing, along the timeline of the changing audit environment. The audit fee determination model was also employed to estimate and calculate audit fee. Findings – Empirical results indicate no auditor switching effects on audit fees before the demise of Arthur Andersen and the passage of SOX. Contrary to fee cutting for initial audit engagements, we find positive effects of auditor switches on audit fees after the scandal and SOX, namely, auditors charge higher fees to the initial audit engagements. Those positive effects are mainly attributed to the Big N clients downward switching to the second and third tiers of auditors. The higher fees can be explained by risk (risk premium) and competition (start-up costs) together. Originality/value – The results suggest a reduced competition of the audit market for the low quality clients after the dramatic changes in 2002. It also contributes a solution to deal with the problem of duplicate audit fees in an auditor switching year.

Keywords: Auditor switches, Duplicate audit fees, Lowballing, Start-up costs.

5. Target costing and manufacturing environments: an empirical study

Keun-Hyo Yook, Pusan University of Foreign Studies, Korea
Il-woon Kim*, The University of Akron

*The corresponding author.

Abstract: Previous studies have shown that many tools and techniques are required to implement target costing successfully. It has also been known that target costing is not a simple combination of individual tools and techniques, but rather is a dynamic and comprehensive system, integrating several factors, such as strategy, production method, and organizational structure in an efficient way. Based on the data collected from 99 manufacturing companies in Korea, this study investigates the relationships among target costing, manufacturing strategies, and advanced manufacturing technologies (AMT) and their interactive effects on business performance. The results show that three-way interaction effects are not significant, but the fit between the AMT level and level of target costing has a significant, positive effect on operating performance, regardless of strategy types. It is suggested that AMT should be well established as part of the infrastructure for successful implementation of target costing.

6. Effects of single audit act amendment in 1996 on the internal control system and compliances of county governments in California

Sung Kyu Huh*, California State University-San Bernardino &
John J Jin, California State University-San Bernardino

*The corresponding author

Abstract: The federal government disburses approximately 400 billion dollars in the form of financial assistance to state and local governments each year. These funds are subject to Single Audit Act (SAA) passed in 1984 and subsequently amended in 1996. Passage of the amendment on SAA is considered to represent a major step in improving the federal government's oversight over federal financial assistance to local governments. The SAA requires any government receiving $500,000 or more in federal financial assistance to conduct a single comprehensive audit on the total Federal financial assistance awarded.

The purpose of this study is to investigate how city and county governments in California, recipients of federal assistance funds, have responded to the SAA: in other words, whether California recipient cities and local governments improve their audit practices and internal control systems 1996 amendment on SAA. The auditors' reports on the California recipient municipalities' uses and record keepings of federal funds for the period from year 2000 through year 2009 are examined to identify internal control weaknesses and non-compliance findings.

7. Monitoring or moral hazard?
Evidence from real activities manipulation by venture-backed companies

Xiang Liu, California State University-San Bernardino

Abstract: I study the relation between venture capitalist presence and real earnings management. Using a sample of IPO firms between 1987 and 2002, after controlling for the magnitude of accruals manipulation, I compare the magnitude of real activities manipulation between venture-backed and non-venture-backed companies. I find that relative to non-venture-backed companies, venture-backed companies show significantly less RM in the first post-IPO fiscal year. The results are robust after controlling for the VC selection endogeneity. This is consistent with the argument that VCs tighten their direct control during the lockup expiration period when insiders such as managers or founders have strong incentives to inflate earnings. By the end of the second post-IPO fiscal year when VCs exit the portfolio companies, their impact on portfolio companies' real activities manipulation decreases dramatically. This suggests that the impact of VCs on portfolio companies is mainly through direct monitoring rather than the established governance structure. Furthermore, I find that within sample variation of real activities manipulation is negatively associated with VC reputation. Companies backed by high-reputation VCs show significantly less RM than those backed by low-reputation VCs in the first post-IPO fiscal year. The results are robust to alternative VC reputation proxies.

Key words: Venture capital; real activities manipulation; accruals manipulation; initial public offerings; monitoring; moral hazard

8. Association between the Firm’s Social Performance and Its Financial Performance

Kyung Joo Lee*, University of Maryland-Eastern Shore &
Mi-Young Kang, Jeju National University, Korea

* The corresponding author.

Abstract: The purpose of this study is to examine whether the firm’s social performance is systematically related to its financial performance. Based on the argument that corporate social activities would play the role of mitigating conflicts between firms and society, we hypothesized that the firm’s social performance would enhance its financial performance. Specifically, the firms with higher social performance are predicted to have higher financial performance than those with lower social performance. This hypothesis was tested using 244 Korean firms over five-year period. An index published by Korean Economic Justice Institute (KEJI) was used as the measure of social performance. Our empirical results suggest that the firms with higher social performance generally exhibit better financial performance as measured by profitability, growth and safety. In particular, the firms’ financial performances are strongly related to their social performance measures such as soundness (SDN) and fairness (JST) of business activities, environmental protection (ENV), and contribution to economic development (ECD).

9. Towards Paradigmatic Pluralism in Applied Accounting Research

By

Byunghwan Lee, California State Polytechnic University-Pomona &
J James Kim*, California State Polytechnic University- Pomona

*The corresponding author

Abstract: The prevalence of a single paradigm in mainstream accounting research has contributed to the steady accumulation of knowledge; however, we argue that this development has come at the cost of theoretical and empirical narrowness which in turn has kept the accounting discipline and profession blinded from some very important problems. In particular, we consider the impact of this shortcoming with respect to hybrid securities in financial statements. Lastly, we suggest ways to address this shortcoming with greater openness and tolerance to a more synergistic approach to applied accounting research.

Key Words: accounting theory, financial reporting, hybrid securities, liability and equity, paradigms, positive theory.

10. An empirical evaluation of fair value accounting numbers: Evidence from the investigation of goodwill accounting

Sohyung Kim, Brock University
Sung Wook Yoon*, California State University, Northridge

*The corresponding author

Abstract: This paper examines the usefulness of fair value accounting numbers by investigating whether they reflect existing information in the capital markets and convey new information to the markets. Specifically, we focus on fair value accounting for goodwill stipulated in SFAS No. 142. To effectively address the concerns raised by the critics of fair value accounting, we identify firms that are most likely to be required to report impairment losses (i.e., firms with market-to book ratio below one) independent of whether they actually report or not. We hypothesize and find that firms that delay write-offs have significantly higher buy-and-hold abnormal returns prior to the announcement than those that report impairment losses after controlling for other factors that are known to be associated with the write-offs decision. We also hypothesize and find that deferral of write-offs has information content at the announcement after controlling for news in the simultaneous earnings announcement. Taken together, our results suggest that fair value accounting numbers reflect existing information in the capital markets and convey new information to the markets.

Keywords: fair value accounting; goodwill; impairments; SFAS No. 142; write-offs

JEL Classification: G14, M41, M48

11. Improving Software Learning Experience through Peer Learning with the Aid of a Wiki and Screencasts

Frank Lin, California State University-San Bernardino,
Tai-Yin Chi, Claremont Graduate University, &
Ying LIU, California State University-San Bernardino

*The corresponding author.
Abstract: In this paper we explore the feasibility of incorporating wikis and screencasts to support peer learning in the software training context. A case study was conducted to collect data. Wikispaces and Screencast-O-Matic were used during software training sessions to support learning in an Information Management course. Screencasts were produced by students to promote peer learning. We present the results of our three-month study which found that a wiki and screencasts with peer-learning design were a feasible combination to improve software-learning experience.

Keywords: software training, wiki, screencasts, peer learning

12. A Sustainable Framework as an Organizational Asset for SOX Compliance and Execution

Michael Fredendall, California State University-San Bernardino

Abstract:

13. Why people watch Super Bowl?

Haakon Brown, California State University-San Bernardino

Abstract:

14. Intertemporal Relations between the VIX Market Volatility Index and Stock Market Returns

Dr. Ghulam Sarwar. California State University- San Bernardino

Abstract: This study examines the intertemporal relationships between CBOE market volatility index (VIX) and returns of the S&P 100, 500, and 600 indexes during 1992-2009. We conduct the VIX-return analysis separately for 1992-1997, 1998-2009, and 2004-2009 subperiods to account for previous evidence of structural shifts in VIX between these subperiods.

Our results suggest a strong negative contemporaneous relation between daily changes (innovations) in VIX and S&P 100, 500, and 600 returns. This negative relation grows much stronger as we shift analysis from 1992-1997 to 2004-2009. The results suggest that the strength of contemporaneous VIX-returns relation depends on the mean and volatility regime of VIX, and that this relation is much stronger when VIX is both high and more volatile. Our results also indicate a strong asymmetric relation between daily stock market returns and innovations in VIX, suggesting that VIX is more of a gauge of investor fear than investor positive sentiment. However, the asymmetric relationship between stock market returns and VIX is much weaker when VIX is large and more volatile. In fact, during 2004-2009, the contemporaneous negative relation between market returns and changes in VIX was the only significant relationship between VIX and stock market returns.

15. Is Sentiment Risk Priced by Stock Market?

Francisca Beer California State University - San Bernardino,
Mohamed Watfaitic Paris, &
Mohamed Zouaoui† Université of Franche-Comté

Abstract: This study tests if the financial markets price the investor's sentiment risk. We construct portfolios based upon the stock returns' exposure to sentiment. Our results show that the portfolio returns are positively correlated with the exposure of stock to sentiment. The strategy that consists of buying stocks with the highest exposure to sentiment and selling stocks with the lowest exposure to sentiment generates a significant raw profit. Exploring the sources of profit, we find that neither the traditional risk factors nor the momentum factor can account for the profit. However, we find that the addition of the sentiment risk premium contributes to explain the profit.

JEL Classification : G11, G12, G14

Keywords: Investor sentiment, Stock returns, Noise trader risk

16. Dynamic Relationship between Stock Prices and Equity Unit Trust Flows in the U.K. Market

Heung-Joo Cha. University of Redlands

Abstract: We study dynamic relations between stock returns and aggregate equity mutual fund flows in the U.K. market. Our empirical evidence from cointegration, ECM and Granger causality tests indicates that there is a long-run relationship between the two variables but the flows do not Granger cause the stock returns. Further, if there is a deviation from long-run equilibrium, the stock returns force the deviation to go toward the long-run. Thus, stock returns might lead stock fund flows and seem to be the most important element explaining equity mutual fund flows in the U.K. market.

JEL classifications: G11; C22

Keywords: Equity mutual fund flows; Cointegration; Causality; Unit root

17. Loss Aversion in the Housing Market: A Revisit

Hua Sun, California State University-San Bernardino

Abstract: The seminar work on prospect theory by Kahneman and Tversky [1979] and Tversky and Kahneman [1991] defines loss aversion as the phenomena of asymmetric response in the value function, i.e., an equal-size loss looms larger than an equal-size gain. They further argue that people have diminishing sensitivity in both loss and gain dimensions. The empirical literature on testing loss aversion in housing market, lead by Genesove and Mayer [2001], finds that: 1) compared to potential gainers, a house seller subject to a bigger potential loss[1] sets a higher asking price and realizes a higher transaction price if sold; and 2) the marginal markup declines with the size of a seller's potential loss. Genesove and Mayer interpret finding 1 as a test of loss aversion effect and finding 2 as a test of diminishing sensitivity in value function. This paper proposes a search model which incorporates Tversky and Kahneman's prospect utility as a special case. In our model, we show that finding 1 does not have a necessary relationship with loss aversion, nor does finding 2 have a necessary relationship with diminishing sensitivity. As a result, there is a conceptual mismatch between both empirical findings and their theoretical counterparts. Instead, we show that both effects jointly imply an S shape asking price curve along reference values. We propose a new test base on this prediction and are able to find evidence that is consistent with the predications made by prospect theory. Finally, our model also helps to explain the positive price-volume relationship and why the price dispersion in a cold market is bigger than in a hot market.

[1] Here loss and gain are measured relative to the expected market price. Conditional on the expected market price, a bigger potential loss means a higher reference value for the seller.

18. Pre-takeover Institutions and Risk Arbitrage

Ben Branch . University of Massachusetts, Amherst,
Seung-Hyun Lee University of Texas, Dallas,
Taewon Yang*, California State University, San Bernardino,

*the corresponding author

Abstract: Herein we report that 1) the target firm's number of pre-takeover institutional owners is a useful indicator of the potential losses for a risk arbitrage position in cases where the takeover attempt fails. This relationship may be due to the passive role which pre-takeover institutional owners typically take in order to obtain the proposed offer premium. 2) The number of pre-takeover institutional owners, G-index, and initial spread nonlinearly relate to the performance of risk arbitrage, depending upon whether or not the takeover attempt is successful. 3) A simple profitability estimation model based on our findings and our out of sample results indicate that these findings should help risk arbitrageurs enhance their performance.

19. Effect of IFRS Adoption on Risk Assessment in Korea

Sung Kyu Huh, California State University-San Bernardino,
Dong Man Kim*, California State University-San Bernardino,
John J Jin, California State University-San Bernardino,
Nae-Chul Kang, Hongik University, Korea, &
Taewon Yang, California State University-San Bernardino.

*the corresponding author

Abstract: This paper investigates whether the scope of subsidiaries in consolidated financial statements affects risk assessments in Korea. Korean firms used to use more lenient standards for the inclusion of subsidiaries in consolidated financial statements. New adoption of IFRS will require a little bit restrictive standard to define subsidiaries and lead Korean firms to include fewer subsidiaries and hence less information in their consolidated financial statements. In this paper we explore how new adaptation of IFRS will influence the parent company's risk assessment. The risk is measured by a market beta of the parent company. Our test results indicate there is a relationship between the inclusion of subsidiaries and risk assessment. The debts of subsidiaries also influence the parent's risk assessment.

20. Straddle and Strangle trades depend on percent profitable in Korea option market

Young Hoon Ko. HyupSung University, Korea
Taewon Yang*, California State University-San Bernardino

*the corresponding author

Abstract: The option market in South Korea began on 7 July 1997. Since then, the average daily deposit of put option has exceeded one trillion won in May 2010. Due to high risks of holding a position over night, investors tend to focus on day trading liquidated within a day. When 2010, 8, 30, Additional option market has open in Eurex for night trading. So investors get a chance to avoid unpredictable risk by night trading. In previous paper, I propose BuythenSell and SellthenBuy Strategies. They earn profit when the investors find a low commission brokerage company. Since the Eurex market open, the importance of percent profitable is increasing. If percent profitable is below 50 %, the numbers of losing trade is more than the number of winning trades. So the profit of one winning trade muse be big enough. If percent profitable is over 50%, the investor feel comfortable and need small seed money because of low MDD. This percent profitable is the biggest in OTM 2.5 by SellthenBuy strategy. So this paper proposed 1-contract trade of BuythenSell in ATM and 2-contract trade of SellthenBuy in OTM 2.5. This combination gets higher profit with lower MDD.

21. Earnings Management and Operating Performance of Corporate Spin-offs

Yingchou Lin, Missouri University of Science and Technology &
Deqing Diane Li, University of Maryland Eastern Shore*

*the corresponding author

Abstract: This study investigates whether managers adopt earnings management during corporate spinoffs. Due to the inefficiency and information asymmetry before the spinoff, we expect managers of spinoff firms have strong motives and opportunities to control earnings to achieve their objectives. By using a sample of 226 spinoffs during 1985 to 2005, we find evidence suggesting that firms report significant positive discretionary current accruals in the year preceding spinoff announcement. After the spinoff, the significant pre-spinoff discretionary current accruals are diminished. We also identify that the level of earnings management is positively associated with the level of information asymmetry and growth opportunity but is negatively associated with the change in focus. Finally, we find that a spinoff parent adopting aggressive earnings management before the spinoff is likely to be the one that has poor operating performance and tend to borrow future earnings from its spun-off division.