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姓名職稱：謝佳純副教授

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出席國際學術會議說明及心得報告

摘要

本人此次參加美國會計學會(American Accounting Association) 於美國芝加哥舉辦的 2015 年度研討會，主要之目的有二：(一) 於 Concurrent Session 發表文章（包括以投影片報告並聽取評論人意見）；(二) 擔任八月十二日下午四點場次的 Concurrent Session 主持人(Moderator)。此外，在會議開始前，本人亦自願參與擔任審稿工作。

此次會議獲取了評論人與現場聽眾對於我所發表的文章的寶貴意見，做為修改的參考。另外亦透過旁聽其他場次以及與國外學者的交流學習到許多會計目前的最新課題，包括他們對目前世界經濟局勢的看法。這些交流對於我們的研究與教學都有助益，可謂獲益良多。

目次

壹、目的.....	4
貳、過程.....	4
參、心得.....	5
肆、建議事項.....	5
伍、攜回資料名稱及內容.....	5
[附件 A]：發表於研討會之論文.....	6
[附件 B]：參與研討會之各項書面佐證.....	52
附件一：研討會文章發表接受函、確認參加、及場次、評論人等資訊.....	52
附件二：擔任主持人之 Email 通知.....	57
附件三：研討會網址所列本人參與之場次資訊 (附網頁連結).....	58
附件四：研討會報到後取得之名牌與流程表照片.....	59

壹、目的

本人此次參加於美國芝加哥舉辦的美國會計學會(American Accounting Association)的 2015 年度研討會。該學會是全球幾個主要的會計學會。此行的主要目的有二：(一) 於八月十日的 Concurrent Session 發表文章(題目為企業策略與會計保守性)；(二) 擔任八月十二日下午四點場次的 Concurrent Session 主持人(Moderator)。其他的目的亦包括聆聽其他重要議題的場次，及與各國會計界人士交流等等。

此次會議獲取了評論人與現場聽眾對於我所發表的文章的寶貴意見，做為修改的參考。另外亦透過聆聽其他場次學習到許多會計目前的最新課題。同時，我也透過參加研討會其他活動進行與國外學者的交流。這些交流對於我們的研究與教學都有助益，可謂獲益良多。

貳、過程

一、報告論文

我投稿的文章題目是企業策略與會計保守性(“Business Strategy and Accounting Conservatism”)，本次會議有幸被接受於會上發表。我被安排的場次是八月十日(星期一)下午兩點的會計穩健決定因素(II) (“2.16 Determinants of Conservatism II”)。文章主要研究是否可用投資者在不確定性下採取的謹慎態度來解釋會計穩健性。實證研究發現採取探索策略(prospector)的公司(通常面對較高不確定性的環境)會使用較保守穩健的會計政策，與假說一致。會議安排的評論人是 Professor Olena Watanabe (Iowa State University)。她給了我們許多寶貴的意見做為改進的參考。

二、擔任個別場次主持人

本人亦擔任八月十二日(星期三)下午四點鐘的 Concurrent Sessions 其中之一場次的主持人。主要負責的工作是維持會議的按時進行並協助現場的問答交流。該場次的主題是「揭露需求與策略」(“9.14 Disclosure Demand and Strategy”)。該場次共有三篇論文發表，並有三位評論員評論各文章。這三篇文章都利用新的電腦科技探討公司的財務報導對投資人的影響，並針對非傳統會計主題，例如產業領導者的財務報導、重複多餘的揭露、財務報導公布順序等等的議題，吸引了相當的聽眾參與並積極參與會後的討論。我也從討論中學習到許多。

三、參與其他場次的研討及 CAPANA (Chinese Accounting Professors' Association of North America) 的歡迎會

我另外也聆聽了幾個與個人研究較相關主題的發表場次，並與同場的聽眾交換了一些意見。此外，我參加了八月十日晚間的社團 Reception—北美華人教授協會(CAPANA)的歡迎茶會。參與的來賓多為在北美、台灣、香港、新加坡等地的華人學者。我與之前認識的朋友敘舊，並認識一些新的學者。因為有共同的文化背景，交流起來更加深刻。

參、心得

本次會議的主題是“Building Bridges to Our Future”。對於目前全球環境的變遷，美國會計學會強調的是身為會計的主要學術機構應對全球環境的改變做出應對。會議包含了財務會計、管理會計、審計等等的類別，且每一類別項下的各場次題目都較之前更為豐富，涵蓋的範圍更加廣泛。例如，有許多文章是以國際化為主題，以不同國家的資料做實證研究。另外，會計研究結合非會計的主題也愈來愈常見。此類跨領域的嘗試與我們一般常做的純粹會計課題的研究很不同，帶給聽眾耳目一新的感受，並且也呼應了研討會“Building Bridges”的主題。我在報告與主持會議的過程中，學習到許多先進知識，並得以與各國的會計學者交流。除了研究之外，研討會亦安排了許多與教學有關的場次，包括介紹最新的美國與國際會計準則。這些內容都對我們平常精進教學經驗，很有助益。

在參與此次會議的過程中，見到很多年輕的學者積極地參與研討會的工作，例如自願擔任主持人或評論員等等。這些參與者可能是助理教授甚或是博士生。雖然擔任這些工作屬於「義工」性質，但可以從中得到許多學習的機會，並讓更多人認識自己。這些人積極參與的態度是值得我們學習的。

此外，在此次會議中亦可見到愈來愈多的會計機構（尤其是學校）舉辦歡迎茶會，無論是否為校友皆歡迎大家參加。我參加了其中之一並認識新的會計界的朋友，並與一些老朋友敘舊。參與的過程中，我感到這些團體藉由機會增加本身的影響力與其他團體的交流，提高能見度，並積極成為會計學會的一份子。這樣的積極發展的機會是台灣的學術團體可以多加學習利用的。

肆、建議事項

一、未來多參加此類研討會，以期增進會計研究的能力與了解最新的趨勢。

二、積極鼓勵本校的研究生參與此類大型活動，不但可增進學術交流，更可以擴充人脈，對他們未來找工作有所助益。此外，許多學校都會在開會期間順便面試招聘新老師，也是博士生求職或認識同儕的好機會。

三、以系或校為單位，或與台灣的其他學校聯合，辦理歡迎茶會(Welcome Reception)。可讓參與研討會的各國學者更認識台灣（或本校），增加未來交流的機會。

伍、攜回資料名稱及內容

2015 美國會計學會年度研討會（Annual Meeting of American Accounting Association Conference）之相關資料。

[附件 A]美國會計學會(American Accounting Association) 2015 年度研討會發表之論文

Business Strategy and Accounting Conservatism^{*}

Chia-Chun Hsieh[†]

The Hong Kong University of Science and Technology
achsieh@ust.hk

Zhiming Ma

Peking University
mazhiming@gsm.pku.edu.cn

Kirill Novoselov^{† ‡}

Nazarbayev University
kirill.novoselov@nu.edu.kz

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[‡] Corresponding author.

Business Strategy and Accounting Conservatism

Abstract: We investigate whether accounting conservatism can be explained by investors' caution in the face of radical uncertainty ("unknown unknowns"). Empirical evidence indicates that investors put greater weight on negative than on positive news—i.e., exhibit caution—when faced with radical uncertainty. Accounting conservatism increases the timeliness of negative news that is more relevant under a cautious decision rule and thereby helps investors implement it. We, therefore, hypothesize that firms facing greater radical uncertainty report more conservatively to facilitate investors' decision-making. To proxy for radical uncertainty, we identify firms pursuing the "prospector" business strategy, which involves seeking new business opportunities. Because prospectors actively create their own future, they face greater radical uncertainty than "defenders" (which focus on effectively utilizing existing resources). Our results show that prospectors exhibit higher levels of accounting conservatism. We also conduct an additional set of tests using an alternate proxy for radical uncertainty and report consistent results.

Key Words: radical uncertainty; ambiguity; prudence; caution; accounting conservatism.

JEL Classifications: D81, G32, M41

The Master said: “The cautious seldom err.”
—Confucius, *Analects: Li Ren*, ca. 500 BCE

1. Introduction

In a recent empirical study, Williams (2015) shows that investors put more weight on negative than on positive news—i.e., act cautiously—when they face radical uncertainty (ambiguity), where one has insufficient information to form a unique probability distribution over the possible outcomes.¹ Starting with Ellsberg (1961), a sizeable literature in economics demonstrates that people are generally averse to uncertainty and exhibit caution when they face it (e.g., Gilboa and Schmeidler 1989). In this paper, we investigate whether investors’ caution helps explain accounting conservatism. The two phenomena are closely related: under a cautious decision rule, decision makers respond more strongly to bad outcomes than to good ones; accounting conservatism ensures that bad news is reported sooner (compared with good news) and thus helps investors implement their preferred decision rule. Firms face markedly different levels of radical uncertainty, which is difficult to quantify precisely, especially for outsiders. By reporting in a more conservative manner, firms facing greater uncertainty ensure a match between the properties of information they report and investors’ preferences.

Our paper is motivated by the ongoing debate in the professional and academic literatures over the desirability of accounting conservatism, which is viewed as a desirable property of financial reporting by many academics yet is opposed by standard setters. For example, the Statement of Financial Accounting Concepts (SFAS) No. 2 (FASB 2008, § 93) points out that “conservatism has long been identified with the idea that deliberate understatement is a virtue.

¹ Other terms used in the literature to refer to essentially the same construct include *true*, *fundamental*, *epistemic*, *deep*, *Knightian*, and *Keynesian* uncertainty. For brevity’s sake, we omit the modifier where no ambiguity arises.

That notion became deeply ingrained and is still in evidence despite efforts over the past 40 years to change it.” In 2010, the standard setters’ opposition to conservatism culminated in the decision by both the Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) to remove it from their conceptual frameworks. The FASB has expressed the following opinion in this regard:

Financial information needs to be *neutral*—free from bias intended to influence a decision or outcome. To that end, the common conceptual framework should not include conservatism or prudence among the desirable qualitative characteristics of accounting information. However, the framework should note the continuing need to be careful in the face of uncertainty. (FASB 2005, p. 35) [Emphasis in the original.]

Yet the literature on ambiguity aversion shows that being “careful in the face of uncertainty,” i.e., caution, which is observed empirically and in many settings is justified on theoretical grounds (see the following section), implies that conservative reporting is in fact desirable to shareholders. Therefore, investigating the relation between accounting conservatism and radical uncertainty sheds new light on the debate and thus is relevant to both theory and practice.

One practical problem that we face in this study is that firm-specific radical uncertainty is difficult to measure directly. Following Bloom (2009), the Chicago Board of Options Exchange VIX index is commonly used to measure the economy-wide changes in uncertainty. Our primary focus, however, is on firm-level uncertainty, which we hypothesize to be positively related with the firm-level accounting conservatism. Because Anderson, Ghysels, and Juergens (2009) shows that firm-level stock return volatility largely captures risk, it is not well suited for our purposes.² Given that the positive relation between accounting conservatism and risk is well documented (e.g., Khan and Watts 2009), we control for the level of risk in our tests.

Based on our analysis of the literature, we use the following two proxies to capture

² Throughout, we use the term *risk* in its technical sense to refer to the sources of randomness where the decision maker knows the precise probability distribution over the outcomes at the beginning of the problem.

uncertainty. In our first set of tests, we use a dichotomous empirical measure of business strategy developed in the accounting literature (Bentley, Omer, and Sharp 2013; Ittner, Larcker, and Rajan 1997), which identifies a firm as either a *prospector* or *defender*. Management scholars have shown that firms pursue distinct management strategies, which involve markedly different levels of business risk (March 1991; Miller and Friesen 1982; Miles and Snow 2003). The strategies are remarkably stable over time (Bentley et al. 2013). Prospectors are defined as firms that actively seek new business opportunities, usually by heavily investing in R&D activities and focusing on innovation. Because a firm pursuing a prospector strategy deliberately creates heretofore-unknown opportunities and threats, one cannot estimate the probability of its success *ex ante*: here, uncertainty obtains because “the future is yet to be created” (Dequech 2000: 41). Put differently, prospectors—by definition—face substantial levels of radical uncertainty. Defenders, in contrast, tend to focus on the efficient provision of existing products and services, develop an expertise in a narrow area, maintain their technological advantage by attaining technological efficiency in this area, and generally follow a balanced and steady growth path.

First, we investigate the relation between business strategy and accounting conservatism in the cross-section. Next, we consider the relation between conservatism and shareholder value, as measured by Tobin’s Q. Our empirical results are consistent with the theoretical predictions. First, prospectors exhibit significantly greater levels of conservatism than defenders. Second, we document statistically significant and positive coefficients on the interaction term between our prospector strategy measure and two measures of accounting conservatism out of four. Although far from conclusive, our empirical results thus provide support to the explanation proposed by the ambiguity-aversion literature, which also agrees with the traditional view of conservatism as a prudent response to uncertainty (FASB 2008: §95).

To provide additional assurance that our empirical results are attributable to radical uncertainty rather than some characteristic of a prospector business strategy, we conduct an additional series of tests using an altogether different approach. Building on the literature on environmental scanning (Elenkov 1997) and peripheral vision (Day and Schoemaker 2004), we construct a proxy for firms' ability to identify changes in the environment. Firms differ in the extent to which they actively scan their environment (Daft, Sormunen, and Parks 1988; Hambrick 1982) because the costs often outweigh potential benefits (Boyd and Fulk 1996; Frederickson and Mitchell 1984). Firms that are actively engaged in environmental scanning are more likely to recognize unexpected threats should they emerge; in the spirit of Hirschman (1969), we refer to these firms as *alert*. Several empirical studies (Bloom, Bond, and Van Reenan 2007; Bloom 2009; Julio and Yook 2012) document that, when faced with unexpected developments, firms delay their hiring and capital investment decisions. Such delays result in abnormal cuts in employee count, capital investment, and discretionary spending. Because abnormal cuts in required discretionary expenses have long-term detrimental effects (Bhojraj, Hribar, Picconi, and McInnis 2009; Roychowdhury 2006), the majority of managers will not take them unless there exists a good reason to do so. Thus, the revealed preference argument implies that firms taking the above precautionary actions do so in response to uncertainty. We assume that the style of corporate decision-making is a persistent characteristic (Weick 1979) and identify a firm as alert if it takes the three precautionary actions just described *at any point* during the sample period. This assumption is justified because high-stake corporate decisions are usually made by groups of executives and, for this reason, the effect of one executive's "style" on corporate decisions is rather modest (Chang, Dasgupta, and Gan 2013; Fee, Hadlock, and Pierce 2013). Our results do not change if we assume that the style persists for only five years.

The second set of our empirical results also supports the theoretical predictions: alert firms, which face lower levels of radical uncertainty than inert ones, exhibit lower levels of accounting conservatism. The results are robust to various specifications of our measure of alertness, such as alternative methods of identifying abnormal cuts in hiring, capital investment, and discretionary spending.

In sum, our empirical results based on two different proxies for firm-specific uncertainty support the theoretical prediction that accounting conservatism is positively associated with radical uncertainty after controlling for risk.

The study makes the following contributions. First, it contributes to the emerging literature on investors' asymmetric reaction to good vs. bad news (Williams 2015) by showing that some characteristics of financial reporting—such as conservatism—can be driven by shareholders' desire to be cautious in the face of uncertainty. The literature to date has identified the following explanations for why conservatism may be desirable despite this bias: contracting with creditors and managers, litigation, regulation, and taxation (Ball 2001; Watts 2003). Yet there is evidence that conservatism predates the modern limited-liability corporation by at least a millennium (De Ste. Croix 1956). Given that being cautious in the face of uncertainty has long been recognized as a virtue (cf. the opening quote), fundamental uncertainty serves as an important—yet largely overlooked—rationale for accounting conservatism.

Second, the paper contributes to the accounting literature studying the implications of the firm's business strategy for its reporting policies (Bentley, Omer, and Sharp 2013; Ittner and Larcker 1997; Simons 1987). Dechow, Ge, and Schrand (2010: 345), points out that “we have relatively little evidence about how fundamental performance affects earnings quality.” Our results suggest that considering the firm's business strategy and the style of corporate

decision-making helps researchers better understand the properties of financial reporting

Finally, our results suggest that the theory of decision-making under radical uncertainty, which represents an active area of research (see, e.g., Binmore 2009 and Gilboa 2009 for book-length reviews), offers insights that are relevant to accounting. Specifically, in contrast with the principal–agent theory, which studies conflicts of interest among known parties and offers various solutions to the bargaining problem (such as signaling and commitment mechanisms), the theory of uncertainty studies situations where potential threats emanate from unknown sources and offers an altogether different set of solutions (such as environmental scanning and robust decisions rules, of which caution is a representative example).

The remainder of this paper proceeds as follows. Section 2 reviews the two theories and develops our empirical predictions. Section 3 explains our methodology and reports the first set of empirical results; Section 4 reports the second set of results. Section 5 summarizes the paper and presents our conclusions.

2. Theory and Hypotheses Development

2.1. Theories of uncertainty and caution

Economic theory distinguishes between risk, i.e., the kind of randomness where the precise probabilities of the outcomes are known at the beginning of the problem, and uncertainty, where such probabilities themselves are unknown (e.g., Heinsalu 2012). Frank Knight was among the first economists to point out, in Knight (1921), that the distinction between risk and uncertainty is critical to the understanding of business enterprise:

It is not dynamic change, not any change, as such, which causes profit, but the divergence of actual conditions from those which have been expected and on the basis of which business arrangements have been made. (p. 38) <...> There is a fundamental distinction between the reward for taking a known risk and that for assuming a risk whose value itself is not known. It is so fundamental, indeed, that ...

a known risk will not lead to any reward or special payment at all (pp. 43–44).

The reason, in brief, is that risk can be assessed using standard analytical tools and substantially reduced or eliminated by means of operations management, hedging, or insurance. In contrast, uncertainty can never be eliminated. It is this residual uncertainty, which remains after all risk has been accounted for, that Knight considers a necessary condition for economic profits. Yet the expected utility framework formulated in Savage (1954) in terms of risk proved more tractable and eventually formed the foundation of modern economic analysis in general and game-theoretic models (including principal–agent models) in particular.

Formal investigation of uncertainty started with Ellsberg (1961), which pointed out that people make a clear distinction between risk and uncertainty and prefer the former to the latter. This *uncertainty* (or *ambiguity*) *aversion* is usually interpreted as a preference for acts whose outcomes are more robust to the decision maker’s ignorance. The literature has two major strands. The first one starts with an empirical observation that people are generally uncertainty-averse and builds the requisite analytical apparatus taking this observation as given. One of the early models following this approach is presented in Gilboa and Schmeidler (1989), which uses the now-standard formalization of uncertainty: when there is not enough information to form a unique prior, the decision maker considers a set of priors—i.e., effectively, a range of probabilities—instead. The main result is that an uncertainty-averse decision maker follows a cautious decision rule by putting more weight on negative than on positive outcomes.³

The second strand of research can be viewed as more normative, where the goal of the researcher is to propose a decision rule that a rational decision-maker is advised to adopt. Here, Cerreia-Vioglio, Maccheroni, Marinacci, and Montrucchio (2011) show that cautious decision

³ In fact, decision-makers exhibits extreme caution by only considering the worst possible outcome. Subsequent extensions of the model (e.g., Klibanoff, Marinacci, and Mukerji 2005) obtain intermediate levels of caution.

rule is rational whenever the decision-maker has a reason to believe that she is playing against “(a malevolent) Nature” (p. 1280), i.e., against a strategic opponent. When decision-makers are investors, caution emerges as a rational decision rule in situations “where probabilities may be hard for either side to assess” (Zeckhauser 2006: 25; see also Al-Najjar and Weinstein 2009).

Both strands of research just described take it as given that decision-makers are generally cautious in the face of uncertainty, while several recent studies show that caution is in fact optimal for many decision makers and, especially, for investors. Not surprisingly, the uncertainty paradigm is actively utilized in finance, where it helps explain excess volatility, booms and crashes, asymmetric reaction to good vs. bad news, and the size of equity premium, *inter alia* (e.g., Dow and Werlang 1992; Epstein and Schneider 2008; Epstein and Wang 1994; Maenhout 2004).

2.2. Accounting conservatism

The definition of accounting conservatism as “a prudent reaction to uncertainty” (FASB 2008: § 95) already suggests that the two phenomena are closely related. More specifically, accounting conservatism involves an asymmetric treatment of good vs. bad news: the latter is reported sooner. Because a cautious decision rule puts more weight on the bad news, accounting information reported in a conservative manner facilitates the implementation of such a rule. To see this, note that decision-makers (investors) facing uncertainty do not have sufficient information to form a unique probability distribution over the possible outcomes and thus use actual outcomes to narrow down the range of possible distributions. Because caution implies putting greater probabilities on negative outcomes, it is more important to assess probabilities over these outcomes correctly; this is precisely what the timely reporting of bad news attains.

The argument becomes more transparent if we consider the limiting case of maximum

caution, where (as in Gilboa and Schmeidler 1989) decision-makers only consider the most pessimistic scenario. Epstein and Schneider (2008: 198) explain:

Ambiguous information has two key effects. First, *after* ambiguous information has arrived, agents respond asymmetrically: Bad news affect conditional actions—such as portfolio decisions—more than good news. This is because agents evaluate any action using the conditional probability that minimizes the utility of that action. ... The second effect is that even *before* an ambiguous signal arrives, agents who anticipate the arrival of low quality information will dislike consumption plans for which this information may be relevant. [Emphasis in the original.]

That is, bad news affects a cautious decision-maker's actions more than good news; hence, it is more important to her to receive the former, rather than the latter, in a timely manner.

We summarize the theoretical argument presented above as follows:

Proposition *Accounting conservatism is an increasing function of radical uncertainty.*

Note, however, that radical uncertainty cannot be measured objectively; therefore, we need to formulate our empirical predictions in terms of observable variables.

3. Empirical tests I

3.1. Business strategy as an emergent phenomenon

The management literature has long acknowledged that firms pursue markedly different business strategies. Although the proposed typologies differ in their focus and sometimes include more than two types, the underlying construct is best thought of as a dichotomy between an assertive, bold strategy of actively pursuing new opportunities on the one hand—and a reactive, cautious one of capitalizing on existing strengths on the other. The typologies proposed by Miller and Friesen (1982), who distinguish between entrepreneurial and conservative firms, March (1991), who identifies exploration vs. exploitation as the key distinction, and Miles and Snow (2003), who anchor the endpoints of the strategy continuum as prospectors and defenders, all share the above dichotomy as their key characteristic. Importantly, a strategy only partially stems from

deliberate choices by managers: at least to some extent, it represents an emergent phenomenon (Mintzberg 1978)—i.e., evolves in response to changes in the environment, often without deliberate managerial input. Recent advances in economics (Galeotti and Goyal 2010) and biology (Ward, Herbert-Read, Sumpter, and Krause 2011) confirm the emergent nature of strategies by showing that the welfare of a population—be it a group of consumers, a shoal of fish, or the firms operating in an industry—is maximized when its members pursue distinct strategies: roughly, opinion leaders and followers. That is, business strategy is a real empirical phenomenon. A sizeable literature investigates its implications for financial and managerial accounting (e.g., Gosselin 1997; Ittner and Larcker 1997).

We follow Bentley, Omer, and Sharp (2013), who propose a measure of business strategy that is based only on publicly observable information. Their measure builds upon the earlier work in accounting literature (Ittner, Larcker, and Rajan 1997; Simons 1987). The dichotomous strategy space that Bentley, Omer, and Sharp consider consists of *prospectors* (innovative market leaders who actively pursue R&D activities and rapidly respond to the new developments in the product market) and *defenders* (who tend to maintain a narrow and stable focus on the existing core product).

Because prospectors actively create the future, it is impossible to form a unique probability distribution over the outcomes; therefore, prospectors operate under uncertainty. Accordingly, we state our first hypotheses as follows:

H1a *Prospectors exhibit greater levels of accounting conservatism than defenders.*

3.2. *Measuring business strategy*

The strategy score that we use, which follows Bentley et al. (2013), is a composite measure of six variables measured as the average over a rolling prior five-year window: a) the ratio of

research and development expenditures to sales, b) the ratio of the number of employees to sales, c) one-year percentage change in total sales, d) the ratio of selling, general and administrative expenses to sales, e) the standard deviation of the total number of employees, and f) the ratio of net property plant and equipment to total assets. These measures are calculated for each firm-year and ranked into quintiles in each year and industry (two-digit SIC code). Observations in the highest (lowest) quintile receive a score of five (one). The sum of the six measures are defined as the strategy score (*STRATEGY*), which has a maximum value of 30 and minimum value of 6. Higher scores represent prospector-oriented strategy and lower scores represent defender-oriented strategy. We further create a dummy variable that equals to one if the score is greater than 18, and zero otherwise.⁴

3.3. Tests for accounting conservatism

To test our main hypothesis, we compare the level of accounting conservatism between prospectors and defenders. Our primary measure of conservatism is based on the model proposed in Basu (1997). He estimates the following pooled cross-sectional model:

$$NI_{it} = \alpha + \beta_1 * NEG_{it} + \beta_2 * RET_{it} + \beta_3 * RET_{it} * NEG_{it} + \varepsilon, \quad (1)$$

where i indexes the firm; t indexes time; NI is the net income before extraordinary items and discontinued operations of firm i in year t , deflated by the market value of equity at the beginning of year t ; RET is the CRSP 12-month buy-and-hold return of firm i ending in the month of fiscal year-end t ; and NEG is a dummy variable set to equal one if RET is negative, and zero otherwise.⁵ A positive and significant coefficient β_3 means that bad news (NEG) is more

⁴ Bentley et al. (2013) define prospectors (defenders) as those with the strategy scores between 24 and 30 (6 and 12), while those in the middle (strategy scores between 13 and 23) are “analyzers.” They state that analyzers have attributes of both types of the business strategy. The indicator variable in this paper is to partition the sample into two parts. Based on Bentley et al.’s (2013) definition, our partition results in one group of firms who are prospectors or those closer to prospectors, and the other group with firms who are defenders or those closer to defenders.

⁵ We also measure RET as the CRSP 12-month buy-and-hold return of firm i ending in the third month after the

quickly reflected in financial reporting (NI) than good news, consistent with conservative reporting. Coefficient β_2 measures the timeliness of good news.

Several studies have refined the above empirical measure of conservatism by incorporating additional variables. Although the Basu model has been criticized on various grounds (Dietrich, Muller, and Riedl 2007; Givoly et al. 2007; Patatoukas and Thomas 2011), recent empirical evidence reported by Ettredge, Huang, and Zhang (2012) and Ball, Kothari, and Nikolaev (2013) shows that it does capture conservatism whenever it is present.

We follow LaFond and Roychowdhury (2008) and Ramalingegowda and Yu (2012) and estimate the following specification of the model:

$$\begin{aligned}
 NI_t = & \beta_0 + \beta_1 NEG_t + \beta_2 STRATEGY_t + \sum_{i=3}^8 \beta_i \times CONTROLS_{t-1} + \beta_9 NEG_t \times STRATEGY_t \\
 & + \sum_{i=10}^{15} \beta_i \times NEG_t \times CONTROLS_{t-1} + \beta_{16} RET_t + \beta_{17} RET_t \times STRATEGY_t \\
 & + \sum_{i=18}^{23} \beta_i \times RET_t \times CONTROLS_{t-1} + \beta_{24} RET_t \times NEG_t + \beta_{25} RET_t \times NEG_t \times STRATEGY_t \\
 & + \sum_{i=26}^{31} \beta_i \times RET_t \times NEG_t \times CONTROLS_{t-1}
 \end{aligned} \tag{1}$$

As in Basu (1997), β_{16} measures earnings timeliness with respect to good news and β_{24} measures the asymmetric timeliness with respect to bad news. Our main focus is on the coefficient of $RET \times NEG \times STRATEGY$ (i.e., β_{25}), which captures the effect of prospector-oriented strategy on accounting conservatism. H1a predicts a negative coefficient $CONTROLS$ represent the control variables known to be related to conservatism, measured at year $t-1$. These variables are market-to-book ratio (MB), which reflects growth options; market value of equity ($SIZE$); leverage ratio (LEV), which reflects lenders' demand for conservatism; and litigation risk (LIT), an indicator variable that equals to one if firm i is in a litigious industry (SIC codes 2833–2836, 3570–3577, 3600–3674, 5200–5961, and 7370–7374) in year t and zero otherwise.

Several studies (e.g., LaFond and Watts 2008; and Khan and Watts 2009) have shown that

fiscal year-end; the results remain unchanged.

accounting conservatism is influenced by risk (i.e., quantifiable uncertainty). To control for risk in a firm's operating environment, we include firm age (*AGE*) and return volatility (*STDR*), measured as the standard deviation of market-adjusted daily stock returns.

3.4. Data and descriptive statistics

We obtain firm financial data from COMPUSTAT and stock return data from CRSP during 1988–2012. Following Bentley et al. (2013), we delete utilities and financial industries (SIC 4900–4999; 6000–6999). Each year's strategy score requires a five-year rolling average of data. After deleting observations without sufficient data for calculating *STRATEGY* or controls, our final sample consists of 62,194 firm-year observations from 1991 to 2012⁶ (see Table 1).

Panel A of Table 2 presents the industry distribution of the sample. The 62,194 observations consist of 34,140 prospector-like firms (*STRATEGY* > 18) and 28,054 defender-like firms (*STRATEGY* ≤ 18).⁷ Consistent with Bentley et al. (2013), the percentage of firms adopting the two different strategies are similar in each of the industries, while the distribution of both types of firms mimic the full-sample industry distribution. Panel B reports the descriptive statistics for the variables used in the main regression analysis. We winsorize all continuous variables at the top and bottom 1% of the observations. The average annual buy-and-hold return in our sample is 15.3%, similar to that in LaFond and Roychowdhury (2008). The descriptive statistics on the negative return indicator variable, *NEG*, show that approximately 44% of the firm-years exhibit a negative buy-and-hold return. About a third of the firm-observations (34.2%) in our sample are classified as facing a litigious environment.

Table 3 reports the Pearson correlations between the variables used in the main regressions. The results show that *STRATEGY* is negatively correlated with *NI*, indicating that prospectors are

⁶ We follow Bentley et al. (2013) by requiring a minimum of three-year data in order to preserve observations.

⁷ For robustness, we also divide the observations into three groups instead of two and drop the middle part (i.e., the “analyzers” in Bentley et al.'s (2013) discussion). The regression results are consistent.

less profitable than defenders on average. *STRATEGY* is positively associated with market-to-book ratio (*MB*) but negatively associated with firm age (*AGE*). This suggests that prospectors are younger and grow at a higher rate than defenders. Prospectors also have smaller leverage and higher standard deviation of stock returns, suggesting that they face higher risk.

3.5. Regression analysis

The results of the tests for H1a are reported in Table 4. We adjust for heteroskedasticity and the standard errors are clustered by both firm and year in all the regressions. Following Ramalingegowda and Yu (2012), all variables except *STRATEGY*, *NI*, *RET*, *NEG*, and *LIT* are transformed into decile ranks from 0 to 1. In column (1), *STRATEGY* is the raw strategy score and in column (2), *STRATEGY* is a dummy variable that is set to one if the strategy score is larger than 18 and zero otherwise. Our main variable of interest is the interaction $RET \times NEG \times STRATEGY$. We find that the coefficient for $RET \times STRATEGY$ is significantly negative at 1% level in both columns, while the coefficient for $RET \times NEG \times STRATEGY$ is significantly positive at 5% level (coeff. = 0.005 and 0.031; $t = 1.95$ and 1.81 respectively; one-tailed tests). These results indicate that firms adopting the prospector strategy exhibit greater levels of conservatism than those that adopt the defender strategy, supporting H1a. In addition, we find that conservatism is positively associated with radical uncertainty after risk (*STDR*) is controlled for. It follows that uncertainty and risk (referred to as *idiosyncratic uncertainty* in Khan and Watts, 2009) have distinct implications for financial reporting. This result is consistent with the theoretical prediction that firms facing higher radical uncertainty report more conservatively.

As for the control variables, the coefficients for $RET \times NEG \times MB$ and $RET \times NEG \times SIZE$ are significantly negative. This is consistent with LaFond and Roychowdhury (2008) regarding the negative relation between asymmetric timeliness and market-to-book ratio and between

asymmetric timeliness and firm size. The coefficients for $RET \times NEG \times LEV$ are significantly positive, suggesting that firms that borrow more exhibit greater conditional conservatism.

The result in Table 4 are based on the asymmetric timeliness model for conservatism (e.g., Basu 1997; Ramalingegowda and Yu 2012). To further verify our results, we adopt alternate measures of conservatism. First, we use an accrual-related measure of conditional conservatism, $CONSV_CACC$, which is equal to the ratio of nonoperating accruals to total assets times -1 for the current year. We calculate nonoperating accruals as net income (Compustat NI) + depreciation (Compustat DP) – cash flow from operations (Compustat OANCF) – Δ accounts receivable (Compustat RECT) – Δ inventories (Compustat INVT) – Δ prepaid expenses (Compustat XPP) + Δ accounts payable (Compustat AP) + Δ taxes payable (Compustat TXP). Nonoperating accruals such as restructuring charges represent the recognition of bad news (Zhang 2008). We multiply the ratio by -1 so that the higher the value, the greater the level of accounting conservatism.

Second, because a consistent application of conservative decision rules is likely to result in persistently negative accruals, greater total accruals indicate greater unconditional conservatism (e.g., Givoly and Hayn 2000; Ahmed and Duellman 2007). Therefore, we calculate our second proxy, $CONSV_UACC$, as total accruals scaled by average total assets, multiplied by -1 . This measure is calculated over a rolling window of the current year and the previous two years. We measure total accruals as net income before extraordinary items (Compustat IB) – operating cash flows (Compustat OANCF) + depreciation expense (Compustat DP).

Our third and fourth measures are related to the asymmetric verification model of Basu (1997). Based on Basu's (1997) regression given by (1), the third measure $CONSV_COEFF$ is calculated as $(\beta_2 + \beta_3) \div \beta_2$. This measure captures the sensitivity of earnings to negative returns

(bad news) in relation to the sensitivity to positive returns (good news). Our fourth measure is *CONSV_R2*, which is defined as the explanatory power (R^2) of bad news to earnings, divided by the explanatory power of good news to earnings (i.e., $R^2_{\text{bad}}/R^2_{\text{good}}$). Both R^2 are from the same Basu (1997) regression (1), where R^2_{bad} is from the regression applied only to the negative return period and R^2_{good} is from the regression applied only to the positive return period. Higher values of *CONSV_COEFF* and *CONSV_R2* represent higher levels of conservatism.

Panel A of Table 5 reports the descriptive statistics of the four measures for our sample. The mean values for *CONSV_UACC* and *CONSV_CACC* are positive, suggesting that the sample firms on average recognize negative accruals. Similarly, the mean values of *CONSV_R2* are above unity, suggesting that on average the explanatory power of bad news to earnings is greater than the explanatory power of good news to earnings (Zhang 2008). Panel B compares these four measures for prospectors and defenders. The variable *PROSPECTOR* is set to one if the strategy score is larger than 18 and to zero otherwise. Across all four measures, the mean and median values for the prospector group is higher than those of the defender group and the differences are statistically significant for *CONSV_UACC*, *CONSV_CACC*, and *CONSV_COEFF*. The comparison provides further support that firms that adopt prospector strategy are in general more conservative.

Next, we apply regression analysis for the relations between business strategy and the four alternative conservatism measures. Specifically, we regress our measure of strategy on the four measures of conservatism. We include common controls such as firm size, market-to-book ratio, leverage, the loss and litigation indicators, and the standard deviation of daily stock returns. The results are reported in Table 6. For each of the four measures, we separately use the indicator variable (*PROSPECTOR*) and the original strategy scores (*Strategy Scores*) in our regressions.

Following H1a, we expect that the coefficient on strategy to be positive. As shown in the table, the coefficient on *PROSPECTOR* is statistically significant at a minimum of 10% level for *CONSV_UACC*, *CONSV_CACC*, and *CONSV_COEFF* based on a one-tailed test, consistent with the results from the univariate test. The regressions using *Strategy Scores* also show significant coefficients when the dependent variables are accrual-related measures (i.e., *CONSV_UACC* and *CONSV_CACC*). The coefficient remains positive but is not significant for the regression on *CONSV_COEFF*. In summary, the result in Table 6 further support H1a stating that prospectors exhibit greater levels of accounting conservatism than defenders.

Following H1a, we expect that, if investors are rationally following a cautious decision rule, then being more conservative for firms adopting prospector strategy should result in benefits such as higher firm valuation. Therefore, we further examine whether such firms exhibit higher Tobin's Q. We run the following regression:

$$\begin{aligned} \text{Tobin's } Q = & \delta_0 + \delta_1 \text{CONSV} + \delta_2 \text{PROSPECTOR} + \delta_3 \text{CONSV} \times \text{PROSPECTOR} + \delta_4 \ln AT \\ & + \delta_5 \text{LEV} + \delta_6 \text{LOSS} + \delta_7 \text{LIT} + \delta_8 \text{STDR} + \text{Industry and Year dummies,} \end{aligned}$$

where *CONSV* represent the four conservatism measures. Table 7 reports the result. The coefficients on *PROSPECTOR* are consistently positive and significant for all of the four models, suggesting that the prospector strategy is valued by the market. When conservatism is defined as *CONSV_UACC* or *CONSV_CACC*, the coefficients on δ_1 are significantly positive. Moreover, the coefficients on the interaction term (δ_3) are significantly positive at 5% level. The results suggest that for prospectors, adopting conservative accounting results in higher market valuation. This observation provides further insights as to why prospectors might want to adopt conservative accounting practices. On the other hand, we do not find significant results for the models of *CONSV_COEFF* and *CONSV_R2*. Because these two measures are estimated at firm

level over the firm's history, a likely explanation for the insignificant results is the lack of variation of the two variables.

4. Empirical tests II

4.1. Environmental scanning and alertness

Our second set of empirical tests builds upon the management literature on managerial perceptions of environmental uncertainty (e.g., Downey, Hellriegel, and Slocum 1975; Lorenzi, Sims, and Slocum 1981). The literature shows that and that managers operating in the same environment differ markedly in their perceptions of uncertainty (Bourgeois 1985; Miller 1993) and in the extent to which they are continually scanning the environment for emergent problems and opportunities (Daft et al. 1988; Hambrick 1982). Scanning activities tend to be costly, and in unstable environments the costs often outweigh the potential benefits (e.g., Boyd and Fulk 1996; Frederickson and Mitchell 1984). The literature suggests that firms continually monitoring their environments—which we dub *alert* firms—are more likely to detect the first signs of trouble as soon as they emerge, compared with what we dub *inert* firms, which do not actively monitor the environment.

Next, a large body of literature (reviewed, e.g., in Pindyck 1991) shows that, when corporate decisions are (partially) irreversible, an increase in uncertainty in the wake of an unexpected development increases the value of waiting until uncertainty is resolved. Several empirical studies (Bloom 2009; Bloom et al. 2007; Bontempi et al. 2010; Guiso and Parigi 1999; Julio and Yook 2012) offer overwhelming support for the theoretical prediction that corporate investment drops in response to an increase in uncertainty. Bloom (2009) studies unexpected developments, such as the 9/11 attacks, to infer an increase in uncertainty at the macro level and documents a sizeable drop in hiring and capital investment followed by a rebound and overshoot.

To distinguish a reaction to uncertainty from planned changes in production, we design our empirical measure so that it only captures a *substantial* drop in a corresponding activity, which is more likely when managers are caught by surprise.

Alert firms are more likely to identify the early signs of emerging trouble. In contrast, inert firms, which do not engage in environmental scanning, are likely to learn about unexpected developments with a delay, when it is too late to take precautionary actions. The availability of an early warning system implies that alert firms face lower *ex ante* levels of radical uncertainty than inert ones. Hence our second hypothesis:

H1b *Inert firms exhibit greater levels of accounting conservatism than alert ones.*

4.2. Empirical methodology

The three precautionary actions that we consider are substantial (in the sense to be defined presently) cuts in (1) the number of employees, (2) capital investment, and (3) discretionary expenses. We include discretionary expenses because they contain a large portion of capital expenses (e.g., Banker, Huang, and Natarajan 2011). We expect that managers who become aware of an emerging threat will take all three precautionary actions simultaneously. Because the actions just described represent deviations from the normal levels, they should result in a decrease in the firm's long-run profitability if taken for no good reason, as documented in the literature (e.g., Bhojraj et al. 2009; Roychowdhury 2006). Although we do not specifically test for the differences in operating performance, our univariate results do not support the opportunistic explanation of delayed hiring and investment decisions. We expect that the majority of corporate managers would not deliberately engage in activities that are detrimental to long-term performance. Accordingly, we assume that corporate decision makers are acting in good faith. This assumption is likely to hold most of the time in the U.S. market, which is

characterized by a relatively high level of investor protection. It follows that we can invoke the revealed preference argument and infer decision-makers' perceptions of uncertainty from their observable actions—for otherwise they would have been deliberately reducing the value of the firm, which contradicts our assumption.

4.3. Identifying precautionary actions

Decrease in capital investment. Following Titman, Wei, and Xie (2004), we first calculate the expected level of capital investment using the prior three-year moving average as a benchmark.

We then compute the abnormal level of capital investment as follows:

$$\Delta CI_t = CE_t - \frac{CE_{t-1} + CE_{t-2} + CE_{t-3}}{3},$$

where CE_{t-i} is capital expenditures (Compustat annual item 128) scaled by sales (item 12) for the fiscal year ending in calendar year $t-i$. The investment indicator is set to 1 if ΔCI_t is negative and among the bottom 33% of the 2-digit SIC industry in a given year, and 0 otherwise—i.e., when there is a drastic drop in capital investment. To account for growth, we use sales as the deflator because capital expenditures usually grow proportionately with sales. As a robustness check, we use total assets as the deflator in the above ΔCI measure; the results are similar.

Freeze in hiring. In a similar manner, we calculate the abnormal level of employee count using the prior three-year moving average as a benchmark. Our use of this measure is motivated by the results reported by Bloom (2009), who shows that firms reduce their payroll in response to uncertainty shocks. We define

$$\Delta CT_t = CT_t - \frac{CT_{t-1} + CT_{t-2} + CT_{t-3}}{3},$$

where CT_{t-i} is the number of employees scaled by total assets for the fiscal year ending in calendar year $t-i$. We set the employee indicator equal to 1 if ΔCT_t is negative and is among the

bottom 33% of the industry in a given year, and 0 otherwise.

Cut in discretionary expenses. The normal level of discretionary expenditures is estimated using the following equation:

$$\frac{DISX_t}{A_{t-1}} = \alpha_0 + \alpha_1 \frac{1}{A_{t-1}} + \alpha_2 \frac{S_{t-1}}{A_{t-1}} + \varepsilon_t, \quad (2)$$

where $DISX_t$ is discretionary expenses (the sum of R&D, advertising, and SG&A expenses) in year t , A_{t-1} is total assets in year $t-1$, and S_{t-1} is sales in year $t-1$. When R&D or advertising expense is missing, we replace it with zero. We estimate regression (3) in the cross-section for each industry-year (2-digit SIC). We measure the abnormal level of discretionary expenses as the estimated residual from regression (2). The indicator variable signifying a cut in discretionary expenses is set to 1 if the residual is negative and is among the bottom 33% of the industry in a given year, and 0 otherwise. Our measure of an abnormal decrease in discretionary expenses ($DISX$) has been used in the literature on real earnings management (e.g., Jones 1991 and DeFond and Jiambalvo 1994).⁸ Roychowdhury (2006) finds evidence of manipulation intended to avoid reporting losses. Such activities include, *inter alia*, cutting necessary discretionary expenses such as R&D and SG&A. These activities are influenced by industry membership, stock of inventories, and receivables, among other factors.

To mitigate the effect of business cycles, in the three above measures we compute the cut-off values for each industry-year. We rerun all of our tests using an alternative specification, in which we compute the cut-off values for each industry; the results (not reported) are similar.

4.4. Alertness as a persistent firm characteristic

For each firm-year, we obtain the three indicators just described. To identify firm type, we define

⁸ Incentives to manipulate earnings include maintaining high stock valuation (e.g., Dechow and Skinner 2000) and meeting or beating analyst forecasts (e.g., Bhojraj et al. 2009).

a binary variable *TYPE* that equals 1 if the firm ever takes three precautionary actions (i.e., all three precautionary action indicators are equal to 1) in the same year, and 0 otherwise (see Figure 1). That is, once a firm is identified as having taken precautionary actions, we label all firm-years in our sample before and after the year when the actions are taken as *TYPE* = 1.

We define alertness as a firm-level variable that does not change throughout the sample period for the following three reasons. First, although we can identify the year (or, on rare occasions, years) of precautionary actions taken by alert firms, there is no such “event-year” for inert firms. Therefore, it is impossible to compare the levels of accounting conservatism in the two types of firms in the years that follow precautionary actions. Second, the management (e.g., March 1962; Forbes and Milliken 1999) and law (e.g., Bainbridge 2002) literatures demonstrate that important corporate decisions are always made by groups of executives. Therefore, the style of corporate decision making is determined by the characteristics of the executive group. Recent empirical studies in finance confirm that firms choose CEOs with desirable personal characteristics (Chang et al. 2013); therefore, the effect of the CEO’s personal style on the firm’s decisions is rather modest (Fee et al. 2013). Third, theoretical studies of alertness in biology (Wolf, van Doorn, and Weissing 2008) show that the types are stable over time under mild assumptions. Further, empirical studies (Hambrick 1983; Bentley et al. 2013) document that business strategies tend to persist over time.

4.5. Tests for accounting conservatism

To test our main hypothesis, we compare the level of accounting conservatism between alert and inert firms. Same as in empirical test I, our measure of conservatism is based on the model proposed in Basu (1997). We then follow LaFond and Roychowdhury (2008) and Ramalingegowda and Yu (2012) and estimate the following specification of the model:

$$\begin{aligned}
NI_t = & \beta_0 + \beta_1 NEG_t + \beta_2 TYPE_t + \sum_{i=3}^8 \beta_i * CONTROLS + \beta_9 NEG_t * TYPE_t + \\
& + \sum_{i=10}^{15} \beta_i * NEG_t * CONTROLS + \beta_{16} RET_t + \beta_{17} RET_t * TYPE_t + \sum_{i=18}^{23} \beta_i * RET_t * CONTROLS \\
& + \beta_{24} RET_t * NEG_t + \beta_{25} RET_t * NEG_t * TYPE_t + \sum_{i=26}^{31} \beta_i * RET_t * NEG_t * CONTROLS + \varepsilon,
\end{aligned}$$

where *TYPE* is our variable of interest. As in Basu (1997), β_{16} measures earnings timeliness with respect to good news and β_{24} measures the asymmetric timeliness with respect to bad news. Our main focus is on the coefficient of *RET * NEG * TYPE* (i.e., β_{25}), which captures the effect of alertness on accounting conservatism; we expect it to be negative.

4.6. Data and descriptive statistics

We obtain firm financial data from COMPUSTAT and stock return data from CRSP. Our sample covers a relatively long period, from 1980 to 2010. As it may take a long time for a firm to reveal its type, we exclude firms with less than 5 years of total asset data because these firms are likely to be either at the beginning or the end of their life cycle. Our final sample consists of 126,421 firm-years that have sufficient data to be included in our cross-sectional conservatism tests. The sample is distributed rather evenly across years.

Table 8 compares the differences between alert and inert firms for the variables used in the main regression analysis. Again, we winsorize all continuous variables at the top and bottom 1% of the observations. Net income (*NI*), return on assets (*ROA*), and return on equity (*ROE*) are all greater for alert firms throughout the firm history, and the differences between the two groups are statistically significant (p values < 0.001). These results suggest that alert firms have higher long-term profitability, consistent with the management literature (e.g., Daft et al. 1988). The means and medians of leverage (*LEV*) are smaller for alert firms than for inert ones, indicating that the former use less debt. We also find that alert firms are, on average, smaller and older than inert ones.

Note in particular that there is no significant difference in stock return volatility between alert and inert firms, confirming the observation in Anderson et al. (2009) that uncertainty and stock return volatility are orthogonal. To explore this relation further, we conduct multivariate tests in which we follow Low (2009) in regressing stock return volatility on *TYPE*, firm characteristics (*SIZE*, *ROA*, and market-to-book ratio) and controls (industry and year fixed effects). The results (not tabulated) show that the coefficients on *TYPE* are 0.000 and statistically insignificant ($p > 0.3$), indicating that our empirical measure is not capturing risk aversion.

4.7. Alertness and accounting conservatism

The results of the H1b tests are reported in Table 9. Similar to empirical test I, we adjust for heteroskedasticity and the standard errors are clustered by both firm and year in all the regressions. Following Ramalingegowda and Yu (2012), all variables except *TYPE*, *NI*, *RET*, *NEG*, and *LIT* are transformed into decile ranks from 0 to 1. As discussed earlier, β_{16} (*RET*) measures earnings timeliness with respect to good news and β_{24} (*RET* * *NEG*) measures asymmetric timeliness with respect to bad news. When accounting is conservative, the coefficient for *RET* * *NEG* is positive, implying that firms incorporate bad news into earnings sooner than good news. Our main variable of interest is the interaction between *RET* * *NEG* and *TYPE*. We find that the coefficient for *RET* * *TYPE* is significantly positive (coeff. = 0.019; $z = 4.55$) while the coefficient for *RET* * *NEG* * *TYPE* is significantly negative (coeff. = -0.059; $z = -5.06$). These results indicate that inert firms, which face greater radical uncertainty, exhibit greater levels of conservatism than alert ones, supporting H1b.

We turn next to the association between conservatism and risk. We find a significantly positive coefficient for *RET* * *NEG* * *STDR*, suggesting that firms facing greater risk report more conservatively, consistent with prior studies (e.g., Ramalingegowda and Yu 2012). We find that

conservatism is positively associated with radical uncertainty after risk is controlled for. It follows that uncertainty and risk have distinct implications for financial reporting.

4.8. *Additional Tests*

To check the robustness of our results, we conduct additional tests using alternative measures of conservatism (e.g., Givoly and Hayn 2000; Ahmed and Duellman 2007; Zhang 2008). Specifically, we use the ratio of nonoperating accruals to total assets as a proxy for conditional conservatism (e.g., *CONSV_CACC*), and the ratio of total accruals to total assets as a proxy for unconditional conservatism (e.g., *CONSV_UACC*). The results (untabulated) show that inert firms exhibit significantly greater levels of conservatism using our alternative measures.

5. Summary and Conclusions

In this paper, we empirically investigate the relation between radical uncertainty and accounting conservatism. The literatures in economics and finance demonstrate that studying uncertainty provides useful insights that cannot be derived in the standard Bayesian framework with risk. We, therefore, believe that it is important to develop reliable empirical proxies of firm-level radical uncertainty. One of the goals of our study has been to take a step in this direction.

Although the empirical proxies that we use do not allow us to draw definitive conclusions, our results nonetheless suggest that the theory of uncertainty sheds new light on the relations between the properties of accounting information and firm fundamentals. In contrast with the principal–agent theory, which focuses on negotiations among known parties (typically, managers and the providers of capital), the theory of uncertainty emphasizes unknown threats and for this reason offer a rather different set of insights and solutions. The principal–agent theory studies solutions that improve the efficiency of contracting such as signaling, commitment mechanisms, or strategies that minimize the likelihood of collusion among agents. In contrast, the theory of

uncertainty studies the ways of mitigating the adverse consequences of unknown threats: robust decision rules, environmental scanning, safety in numbers, or becoming “too big to fail” to name a few. Conservative bias can be viewed as a way of making the decision rule more robust to errors stemming from the action of strategic opponents or the decision-makers own cognitive biases. This theoretical explanation supports the traditional rationale of conservatism as a prudent response to uncertainty—i.e., unknown threats.

Our results are relevant to both research and practice. Concerning practice, the decision-theoretic explanation provides a counter-argument to the recent decision by the standard setters to remove conservatism from the conceptual framework. As first pointed out by Knight (1921), real-life firms that expect to earn profits always face radical uncertainty. This observation implies that investors are likely to make better decisions when financial reporting is conservative than when it is unbiased (although their preferences for the *level* of conservatism may differ). The statement that information should be unbiased has been justified theoretically in models with pure risk. The evidence to date suggests that extrapolating the insights derived in such models to settings with uncertainty is not justified in many settings.

Concerning research, the insights from the theory of uncertainty have several implications for financial reporting. First, because uncertainty cannot be objectively measured, statistical tests cannot determine whether the beliefs held by a given decision maker are right or wrong (e.g., Al-Najjar and Weinstein 2015). It follows that decision makers can honestly disagree even in the absence of conflicts of interest. Second, studies in which radical uncertainty is modeled as ambiguity help explain several empirical phenomena that are relevant to accounting. For example, the “zone of inaction” that emerges under ambiguity (e.g., Easley and O’Hara 2009, 2010) offers a simple rational explanation of post-earnings-announcement drift and other forms

of investors' under-reaction to earnings news. Further, a firm that expects to earn economic profits faces radical uncertainty; therefore, its future is unpredictable. Because earnings quality is usually defined as the ability of earnings to predict future operating performance, higher profitability may actually imply *lower* earnings quality.

We believe that developing reliable measures of firm-specific uncertainty and modeling its implications for financial reporting, some of which are mentioned above, would prove to be a fruitful direction for future research.

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Table 1 Sample Selection

Description	Firm-years
COMPUSTAT data for years between 1988 and 2012 (data with zero or negative sales and assets or with missing historical SIC codes are removed)	201,562
Less: Utilities and Financial Industries (SIC 4900–4999 and 6000–6099)	(40,042)
Less: Missing values for calculating <i>STRATEGY</i>	<u>(77,167)</u>
Total observations for <i>STRATEGY</i> composite score data set (1991–2012)	84,353
Less: Observations with missing control variables	<u>(22,159)</u>
Observations used in the regression	<u>62,194</u>

Table 2 Summary Statistics
Panel A Industry Distribution

Two-digit SIC code	Industry affiliation	Full sample (N = 62,194)		Prospectors (N = 34,140)		Defenders (N = 28,054)	
		<u>Number</u>	<u>Percent</u>	<u>Number</u>	<u>Percent</u>	<u>Number</u>	<u>Percent</u>
01–09	Agriculture, Forestry and Fishing	235	0.38	139	0.41	96	0.34
10–14	Mining	3,516	5.65	1,748	5.12	1,768	6.30
15–17	Construction	815	1.31	440	1.29	375	1.34
20–39	Manufacturing	34,343	55.22	18,748	54.92	15,595	55.59
40–48	Transportation and Communications Services	4,183	6.73	2,314	6.78	1,869	6.66
50–51	Wholesale Trade	2,627	4.22	1,455	4.26	1,172	4.18
52–59	Retail Trade	4,854	7.80	2,647	7.75	2,207	7.87
70–89	Services	11,352	18.25	6,469	18.95	4,883	17.41
99	Other	<u>269</u>	<u>0.43</u>	<u>180</u>	<u>0.53</u>	<u>89</u>	<u>0.32</u>
Total		<u>62,194</u>	<u>100.00</u>	<u>34,140</u>	<u>100.00</u>	<u>28,054</u>	<u>100.00</u>

Panel B Descriptive Statistics

Variable	N	Mean	Std Dev	25%	Median	75%
<i>STRATEGY</i>	62,194	18.037	3.656	16.000	18.000	21.000
<i>NI</i>	62,194	-0.016	0.226	-0.028	0.042	0.077
<i>RET</i>	62,194	0.153	0.611	-0.219	0.059	0.368
<i>NEG</i>	62,194	0.440	0.496	0.000	0.000	1.000
<i>MB</i>	62,194	2.686	3.332	1.116	1.873	3.216
<i>LEV</i>	62,194	0.494	0.241	0.311	0.487	0.645
<i>SIZE</i>	62,194	5.659	2.270	3.973	5.598	7.241
<i>LIT</i>	62,194	0.342	0.474	0.000	0.000	1.000
<i>AGE</i>	62,194	19.015	15.041	9.000	14.000	25.000
<i>STDR</i>	62,194	0.037	0.022	0.022	0.032	0.046

STRATEGY is a composite measure of six variables measured as the average over a rolling prior five-year window: a) the ratio of research and development expenditures to sales, b) the ratio of the number of employees to sales, c) one-year percentage change in total sales, d) the ratio of selling, general and administrative expenses to sales, e) the standard deviation of the total number of employees, and f) the ratio of net property plant and equipment to total assets. These measures are calculated for each firm year and ranked into quintiles in each year and industry (2-digit SIC code). Observations in the highest (lowest) quintile receive a score of five (one). The sum of the six measures are defined as the strategy score (*STRATEGY*), which has a maximum value of 30 and minimum value of 6. Higher scores represent prospectors strategy and lower scores represent defenders strategy. Prospectors are firms with *STRATEGY* greater than 18, and defenders are those with *STRATEGY* smaller than or equal to 18.

Table 3 Correlations

	<i>STRATEGY</i>	<i>NI</i>	<i>RET</i>	<i>NEG</i>	<i>MB</i>	<i>LEV</i>	<i>SIZE</i>	<i>LIT</i>	<i>AGE</i>
<i>NI</i>	-0.09								
<i>RET</i>	-0.02	0.21							
<i>NEG</i>	0.05	-0.23	-0.66						
<i>MB</i>	0.12	0.05	0.23	-0.17					
<i>LEV</i>	-0.07	-0.21	-0.06	0.04	-0.01				
<i>SIZE</i>	0.08	0.29	0.14	-0.22	0.23	0.06			
<i>LIT</i>	0.12	-0.08	0.00	0.05	0.11	-0.15	-0.01		
<i>AGE</i>	-0.12	0.12	-0.01	-0.08	0.00	0.11	0.31	-0.14	
<i>STDR</i>	0.08	-0.43	-0.04	0.21	-0.05	0.06	-0.59	0.13	-0.28

STRATEGY is the strategy score (see Bentley et al. 2013 for composition detail). *NI* is net income before extraordinary items divided by the beginning-of-fiscal-year market value of equity. *RET* is the buy-and-hold return over the fiscal year. *NEG* is equal to 1 if *RET* is negative and 0 otherwise. *MB* is the market-to-book ratio at the beginning of the fiscal year. *LEV* is total debt divided by total assets at the beginning of the fiscal year. *SIZE* is the natural log of market value of equity at the beginning of the fiscal year. *LIT* is coded as 1 if a firm is in a litigious industry (SIC codes 2833–2836, 3570–3577, 3600–3674, 5200–5961, and 7370–7374), and 0 otherwise. *AGE* is the number of years a firm has been listed on CRSP. *STDR* is the standard deviation of daily stock returns over the previous year. The correlations in bold are significant at the 5% level or less.

Table 4 Conservatism and Business Strategy

$$NI_t = \beta_0 + \beta_1 NEG_t + \beta_2 STRATEGY_t + \beta_3 MB_{t-1} + \beta_4 LEV_{t-1} + \beta_5 SIZE_{t-1} + \beta_6 LIT_{t-1} + \beta_7 AGE_{t-1} + \beta_8 STDR_{t-1} \\ + \beta_9 NEG_t \times STRATEGY_t + \beta_{10} NEG_t \times MB_{t-1} + \beta_{11} NEG_t \times LEV_{t-1} + \beta_{12} NEG_t \times SIZE_{t-1} + \beta_{13} NEG_t \times LIT_{t-1} \\ + \beta_{14} NEG_t \times AGE_{t-1} + \beta_{15} NEG_t \times STDR_{t-1} + \beta_{16} RET_t + \beta_{17} RET_t \times STRATEGY_t + \beta_{18} RET_t \times MB_{t-1} \\ + \beta_{19} RET_t \times LEV_{t-1} + \beta_{20} RET_t \times SIZE_{t-1} + \beta_{21} RET_t \times LIT_{t-1} + \beta_{22} RET_t \times AGE_{t-1} + \beta_{23} RET_t \times STDR_{t-1} \\ + \beta_{24} RET_t \times NEG_t + \beta_{25} RET_t \times NEG_t \times STRATEGY_t + \beta_{26} RET_t \times NEG_t \times MB_{t-1} + \beta_{27} RET_t \times NEG_t \times LEV_{t-1} \\ + \beta_{28} RET_t \times NEG_t \times SIZE_{t-1} + \beta_{29} RET_t \times NEG_t \times LIT_{t-1} + \beta_{30} RET_t \times NEG_t \times AGE_{t-1} + \beta_{31} RET_t \times NEG_t \times STDR_{t-1}$$

	Expected Sign	(1)	(2)
<i>Intercept</i>		0.027 (0.93)	-0.015 (-0.55)
<i>NEG</i>		0.013 (0.76)	-0.011 (-1.06)
<i>STRATEGY</i>		-0.003*** (-5.61)	-0.014*** (-3.40)
<i>MB</i>		0.005*** (3.84)	0.005*** (3.66)
<i>LEV</i>		-0.004*** (-5.21)	-0.004*** (-5.04)
<i>SIZE</i>		0.002* (1.65)	0.002 (1.28)
<i>LIT</i>		-0.031*** (-5.89)	-0.035*** (-6.31)
<i>AGE</i>		0.006 (0.81)	0.006 (0.86)
<i>STDR</i>		-0.106*** (-6.61)	-0.111*** (-6.89)
<i>NEG × STRATEGY</i>		-0.002 (-1.51)	-0.010 (-1.27)
<i>NEG × Controls</i>		Included	Included
<i>RET</i>		0.215*** (9.38)	0.156*** (7.24)
<i>RET × STRATEGY</i>		-0.004*** (-3.27)	-0.024*** (-2.70)
<i>RET × Controls</i>		Included	Included
<i>RET × NEG</i>	+	-0.035 (-0.59)	0.047 (0.87)
<i>RET × NEG × STRATEGY</i>	+	0.005** (1.95)	0.031** (1.81)
<i>RET × NEG × MB</i>	-	-0.053*** (-12.12)	-0.053*** (-12.44)
<i>RET × NEG × LEV</i>	+	0.015*** (3.27)	0.015*** (3.18)
<i>RET × NEG × SIZE</i>	-	-0.011*** (-3.46)	-0.011*** (-3.72)
<i>RET × NEG × LIT</i>	+	-0.009 (-0.58)	-0.010 (-0.59)
<i>RET × NEG × AGE</i>	-	-0.029 (-1.06)	-0.040* (-1.30)
<i>RET × NEG × STDR</i>	+	0.593*** (10.80)	0.594*** (10.43)
<i>Year fixed effect</i>		Included	Included
<i>Industry fixed effect</i>		Included	Included

Observations	62,194	62,194
R-squared	0.291	0.288

The table reports the results of the pooled OLS regressions over the 1991–2012 period. All variables except *STRATEGY*, *NI*, *RET*, *NEG*, and *LIT* are transformed into decile ranks from 0 to 1. *STRATEGY* is the strategy score (see Bentley et al. 2013 for composition detail) in column (1). *STRATEGY* is a dummy variable which is one if the strategy score is larger than 18 and zero otherwise in column (2). *NI* is net income before extraordinary items divided by the beginning-of-fiscal-year market value of equity. *RET* is the buy-and-hold return over the fiscal year. *NEG* is equal to 1 if *RET* is negative and 0 otherwise. *MB* is the market-to-book ratio at the beginning of the fiscal year. *LEV* is total debt divided by total assets at the beginning of the fiscal year. *SIZE* is the natural log of market value of equity at the beginning of the fiscal year. *LIT* is coded as 1 if a firm is in a litigious industry (SIC codes 2833–2836, 3570–3577, 3600–3674, 5200–5961, and 7370–7374), and 0 otherwise. *AGE* is the number of years a firm has been listed on CRSP. *STDR* is the standard deviation of daily stock returns over the previous year. ***, **, and * indicate significance at the 0.01, 0.05, and 0.10 levels or lower, respectively. Z-statistics reported in parentheses are robust to firm and year clustering.

Table 5 Alternative Measures for Conservatism**Panel A Descriptive statistics**

Variable	N	Mean	Std Dev	25%	Median	75%
<i>CONSV_UACC</i>	61,698	0.015	0.068	-0.018	0.008	0.038
<i>CONSV_CACC</i>	61,971	0.029	0.098	-0.007	0.017	0.050
<i>CONSV_COEFF</i>	59,973	1.001	12.686	-1.318	0.341	2.140
<i>CONSV_R2</i>	54,319	19.960	85.067	0.215	0.940	4.114

Panel B Univariate Tests between Different Strategy Groups

	<i>PROSPECTOR</i> = 1				<i>PROSPECTOR</i> = 0				P value for mean difference	P value for median difference
	N	Mean	Std Dev	Median	N	Mean	Std Dev	Median		
<i>Firm-year observations</i>										
<i>CONSV_UACC</i>	27,176	0.019	0.077	0.010	34,522	0.012	0.060	0.007	0.000	0.000
<i>CONSV_CACC</i>	27,311	0.037	0.109	0.021	34,660	0.023	0.088	0.015	0.000	0.000
<i>Firm level observations.</i>										
<i>CONSV_COEFF</i>	26,261	1.137	12.839	0.360	33,712	0.894	12.565	0.325	0.020	0.099
<i>CONSV_R2</i>	23,434	20.118	85.853	0.955	30,885	19.840	84.467	0.924	0.707	0.790

PROSPECTOR is a dummy variable which is one if the strategy score is larger than 18 and zero otherwise. See Bentley et al. (2013) for the composition detail of strategy scores.

CONSV_UACC is a proxy for unconditional conservatism. It is equal to the ratio of total accruals to average total assets times -1, calculated over a rolling window of the current year and the previous two years. Total accruals are measured as follows: Total accruals = net income before extraordinary items (Compustat IB) – operating cash flows (Compustat OANCF) + depreciation expense (Compustat DP).

CONSV_CACC is a proxy for conditional conservatism. It is equal to the ratio of accumulated non-operating accruals to accumulated total assets times -1 for the current year. Nonoperating accruals = net income (Compustat NI) + depreciation (Compustat DP) – cash flow from operations (Compustat OANCF) – Δ accounts receivable (Compustat RECT) – Δ inventories (Compustat INVT) – Δ prepaid expenses (Compustat XPP) + Δ accounts payable (Compustat AP) + Δ taxes payable (Compustat TXP).

CONSV_COEFF is calculated as $(\beta_{0i} + \beta_{1i}) / \beta_{0i}$ from Basu's (1997) model of firm-specific earnings-returns regression ($E_{it}/P_{it-1} = \alpha_{0i} + \alpha_{1i}DR_{it} + \beta_{0i}R_{it} + \beta_{1i}R_{it} * DR_{it} + \varepsilon_{it}$). E_{it} is the earnings per share (Compustat EPSFX) of firm i in fiscal year t , P_{it-1} is the price per share at the beginning of the fiscal year, R_{it} is the 12-month return ending three months after the end of the fiscal year, and DR_{it} is a dichotomous variable that equal to one if $R_{it} < 0$, and zero otherwise.

CONSV_R2: R^2_{bad}/R^2_{good} , where R^2_{bad} is from the same Basu regression for calculating *CONSV_COEFF*, applied only to the negative return period, and R^2_{good} is from the same Basu regression, applied only to the positive return period.

Table 6 Business Strategy on Alternative Conservatism Measures: Regression

	<i>Expepected Sign</i>	<i>Dependent variable =</i>							
		<i>CONSV_UACC</i>	<i>CONSV_CACC</i>	<i>CONSV_COEFF</i>	<i>CONSV_R2</i>	<i>CONSV_UACC</i>	<i>CONSV_CACC</i>	<i>CONSV_COEFF</i>	<i>CONSV_R2</i>
<i>Intercept</i>		-0.040*** (-3.66)	-0.045*** (-3.79)	-0.022 (-1.57)	-0.040*** (-2.68)	4.009 (0.97)	3.431 (0.83)	2.697 (0.27)	5.296 (0.49)
<i>PROSPECTOR</i>	+	0.002* (1.52)		0.008** *		0.370* (1.42)		0.314 (0.15)	
<i>Strategy Scores</i>	+		0.000* (1.41)		0.001*** (5.83)		0.043 (1.08)		-0.158 (-0.50)
<i>SIZE</i>		-0.000 (-0.55)	-0.000 (-0.58)	-0.001* (-1.81)	-0.001** (-2.05)	-0.217** (-2.32)	* (-2.32)	1.493** (2.04)	1.551** (2.11)
<i>MB</i>		0.001*** (6.55)	0.001*** (6.62)	* (5.32)	0.001*** (5.06)	-0.043 (-1.29)	-0.043 (-1.30)	-0.211 (-1.15)	-0.186 (-1.01)
<i>LEV</i>		0.037*** (11.23)	0.038*** (11.30)	* (8.79)	0.044*** (8.99)	0.627 (1.05)	0.625 (1.05)	4.601 (0.92)	4.190 (0.84)
<i>LOSS</i>		0.033*** (19.40)	0.032*** (19.80)	* (9.76)	0.051*** (9.67)	-0.401* (-1.65)	-0.404* (-1.66)	-0.808 (-0.60)	-0.594 (-0.44)
<i>LIT</i>		0.013*** (6.54)	0.013*** (6.43)	* (3.01)	0.007*** (2.69)	0.102 (0.14)	0.100 (0.14)	4.275 (0.84)	4.732 (0.92)
<i>STDR</i>		0.376*** (9.36)	0.375*** (9.42)	-0.002 (-0.04)	-0.010 (-0.15)	-1.580 (-0.25)	-1.575 (-0.25)	50.492 (1.04)	54.645 (1.12)
<i>Year fixed effect</i>		Included	Included	Include d	Included	Included	Included	Included	Included
<i>Industry fixed effect</i>		Included	Included	Include d	Included	Included	Included	Included	Included
<i>Observations</i>		61,698	61,698	61,971	61,971	59,973	59,973	54,319	54,319
<i>R-squared</i>		0.184	0.184	0.105	0.105	0.017	0.017	0.018	0.018

PROSPECTOR is a dummy variable which is one if the strategy score is larger than 18 and zero otherwise. See Bentley et al. (2013) for the composition detail of strategy scores. *MB* is the market-to-book ratio at the beginning of the fiscal year. *LEV* is total debt divided by total assets at the beginning of the fiscal year. *SIZE* is the natural log of market value of equity at the beginning of the fiscal year. *LIT* is coded as 1 if a firm is in a litigious industry (SIC codes 2833–2836, 3570–3577, 3600–3674, 5200–5961, and 7370–7374), and 0 otherwise. *STDR* is the standard deviation of daily stock returns over the previous year. ***, **, and * indicate significance at the 0.01, 0.05, and 0.10 levels or lower, respectively.

Table 7 Effect of Strategy and Conservatism on Tobin's Q

	<i>Dependent variable: Tobin's Q</i>							
	<i>CONSV = CONSV_UACC</i>		<i>CONSV = CONSV_CACC</i>		<i>CONSV = CONSV_COEFF</i>		<i>CONSV = CONSV_R2</i>	
<i>Intercept</i>	2.350*** (6.61)	2.346*** (6.62)	2.279*** (6.42)	2.279*** (6.42)	2.251*** (6.06)	2.254*** (6.08)	2.340*** (6.23)	2.340*** (6.23)
<i>CONSV</i>	1.839*** (10.84)	1.488*** (6.14)	1.129*** (11.06)	0.944*** (9.19)	-0.002 (-1.15)	-0.001 (-0.54)	-0.000 (-0.61)	0.000 (0.12)
<i>PROSPECTOR</i>	0.370*** (15.17)	0.361*** (14.06)	0.365*** (15.47)	0.355*** (14.78)	0.377*** (15.25)	0.380*** (15.03)	0.376*** (14.19)	0.382*** (14.03)
<i>CONSV × PROSPECTOR</i>		0.626** (2.02)		0.340** (2.03)		-0.003 (-1.57)		-0.000 (-1.08)
<i>lnAT</i>	-0.058*** (-3.58)	-0.058*** (-3.56)	-0.057*** (-3.42)	-0.057*** (-3.40)	-0.059*** (-3.49)	-0.059*** (-3.50)	-0.053*** (-3.11)	-0.053*** (-3.11)
<i>LEV</i>	0.010 (0.10)	0.008 (0.08)	0.020 (0.18)	0.019 (0.17)	0.070 (0.62)	0.070 (0.62)	0.006 (0.05)	0.006 (0.05)
<i>LOSS</i>	-0.139*** (-3.90)	-0.139*** (-3.91)	-0.136*** (-3.69)	-0.136*** (-3.69)	-0.087** (-2.41)	-0.087** (-2.43)	-0.074** (-2.02)	-0.074** (-2.02)
<i>LIT</i>	0.624*** (9.39)	0.624*** (9.40)	0.638*** (9.37)	0.638*** (9.36)	0.660*** (9.63)	0.658*** (9.63)	0.638*** (8.80)	0.638*** (8.80)
<i>STDR</i>	-4.557*** (-4.73)	-4.521*** (-4.70)	-3.915*** (-4.11)	-3.906*** (-4.10)	-3.795*** (-3.87)	-3.779*** (-3.84)	-3.524*** (-3.38)	-3.531*** (-3.39)
<i>Year fixed effect</i>	Included	Included	Included	Included	Included	Included	Included	Included
<i>Industry fixed effect</i>	Included	Included	Included	Included	Included	Included	Included	Included
Observations	56,245	56,245	56,503	56,503	55,198	55,198	50,939	50,939
R-squared	0.161	0.162	0.160	0.160	0.156	0.156	0.158	0.158

CONSV represents four different measures of conservatism: *CONSV_UACC*, *CONSV_CACC*, *CONSV_COEFF*, and *CONSV_R2*. Please refer to Table 5 for the detailed definitions of the four measures. *PROSPECTOR* is a dummy variable which is one if the strategy score is larger than 18 and zero otherwise. See Bentley et al. (2013) for the composition detail of strategy scores. *MB* is the market-to-book ratio at the beginning of the fiscal year. *LEV* is total debt divided by total assets at the beginning of the fiscal year. *lnAT* is the natural log of total assets at the beginning of the fiscal year. *LIT* is coded as 1 if a firm is in a litigious industry (SIC codes 2833–2836, 3570–3577, 3600–3674, 5200–5961, and 7370–7374), and 0 otherwise. *STDR* is the standard deviation of daily stock returns over the previous year. ***, **, and * indicate significance at the 0.01, 0.05, and 0.10 levels or lower, respectively.

Table 8 Descriptive Statistics for Firms taking Precautionary Actions

Variable	<i>TYPE</i> = 1 (N= 38,499)		<i>TYPE</i> = 0 (N= 87,922)		P value for mean difference	P value for median difference
	Mean	Median	Mean	Median		
<i>NI</i>	0.000	0.052	-0.015	0.046	<0.001	0.001
<i>ROA</i>	0.015	0.034	-0.008	0.023	<0.001	<0.001
<i>ROE</i>	0.034	0.091	0.000	0.090	<0.001	<0.001
<i>RET</i>	0.155	0.054	0.146	0.053	0.028	0.002
<i>NEG</i>	0.446	0.000	0.449	0.000	0.279	0.279
<i>MB</i>	2.395	1.596	2.808	1.781	<0.001	<0.001
<i>LEV</i>	0.515	0.513	0.527	0.516	<0.001	<0.001
<i>SIZE</i>	1157	79	1571	134	<0.001	<0.001
<i>LIT</i>	0.253	0.000	0.284	0.000	<0.001	<0.001
<i>AGE</i>	15.212	12.000	11.446	8.000	<0.001	<0.001
<i>STDR</i>	0.036	0.031	0.036	0.031	0.309	0.720

TYPE is coded as 1 if a firm simultaneously cuts capital investment and discretionary spending and reduces employee hiring, and the amount of the reduction is among the largest 33% of the industry in a fiscal year over the firm's history; and 0 otherwise. *NI* is net income before extraordinary items divided by the beginning-of-fiscal-year market value of equity. *RET* is the buy-and-hold return over the fiscal year. *NEG* is equal to 1 if *RET* is negative and 0 otherwise. *MB* is the market-to-book ratio (Compustat #199 * Compustat #25 / Compustat #60) at the beginning of the fiscal year. *LEV* is total debt (Compustat #9 + Compustat #34) divided by total assets (Compustat #6) at the beginning of the fiscal year. *SIZE* is the market value of equity (in millions of dollars) at the beginning of the fiscal year (Compustat #199 * Compustat #25). *LIT* is coded as 1 if a firm is in a litigious industry (SIC codes 2833–2836, 3570–3577, 3600–3674, 5200–5961, and 7370–7374), and 0 otherwise. *ROA* is net income before extraordinary items divided by total assets (Compustat #6) at the beginning of the fiscal year. *AGE* is the number of years a firm has been listed on CRSP. *STDR* is the standard deviation of daily stock returns over the previous year.

Table 9 Conservatism and Firm Type

$$NI_t = \beta_0 + \beta_1 NEG_t + \beta_2 TYPE_t + \beta_3 MB_{t-1} + \beta_4 LEV_{t-1} + \beta_5 SIZE_{t-1} + \beta_6 LIT_{t-1} + \beta_7 AGE_{t-1} + \beta_8 STDR_{t-1} + \beta_9 NEG_t * TYP$$

$$+ \beta_{10} NEG_t * MB_{t-1} + \beta_{11} NEG_t * LEV_{t-1} + \beta_{12} NEG_t * SIZE_{t-1} + \beta_{13} NEG_t * LIT_{t-1} + \beta_{14} NEG_t * AGE_{t-1} + \beta_{15} NEG_t *$$

$$+ \beta_{16} RET_t + \beta_{17} RET_t * TYPE_t + \beta_{18} RET_t * MB_{t-1} + \beta_{19} RET_t * LEV_{t-1} + \beta_{20} RET_t * SIZE_{t-1} + \beta_{21} RET_t * LIT_{t-1} + \beta_{22} R$$

$$+ \beta_{23} RET_t * STDR_{t-1} + \beta_{24} RET_t * NEG_t + \beta_{25} RET_t * NEG_t * TYPE_t + \beta_{26} RET_t * NEG_t * MB_{t-1} + \beta_{27} RET_t * NEG_t *$$

$$+ \beta_{28} RET_t * NEG_t * SIZE_{t-1} + \beta_{29} RET_t * NEG_t * LIT_{t-1} + \beta_{30} RET_t * NEG_t * AGE_{t-1} + \beta_{31} RET_t * NEG_t * STDR_{t-1}$$


Variable	Expected Sign	Coefficient
<i>Intercept</i>		0.080*** (7.81)
<i>NEG</i>		-0.022 (-1.41)
<i>TYPE</i>		0.006** (2.16)
<i>MB</i>		0.012 (1.01)
<i>LEV</i>		-0.013** (-2.10)
<i>SIZE</i>		0.022** (2.57)
<i>LIT</i>		-0.015*** (-3.94)
<i>AGE</i>		-0.008* (-1.88)
<i>STDR</i>		-0.122*** (-10.79)
<i>NEG × TYPE</i>		0.003 (0.70)
<i>NEG × Controls</i>		Included
<i>RET</i>		0.036*** (2.66)
<i>RET × TYPE</i>		0.019*** (4.55)
<i>RET × Controls</i>		Included
<i>RET × NEG</i>	+	0.386*** (6.29)
<i>RET × NEG × TYPE</i>	-	-0.059*** (-5.06)
<i>RET × NEG × MB</i>	-	-0.651*** (-10.69)
<i>RET × NEG × LEV</i>	+	0.291*** (6.70)
<i>RET × NEG × SIZE</i>	-	-0.170*** (-4.32)
<i>RET × NEG × LIT</i>	+	0.009 (0.48)
<i>RET × NEG × AGE</i>	-	-0.007 (-0.32)
<i>RET × NEG × STDR</i>	+	0.366*** (9.36)
Observations		126,421
R-squared		0.263

The table reports the results of the pooled OLS regressions over the 1980–2010 period with available data. All variables except *TYPE*, *NI*, *RET*, *NEG*, and *LIT* are transformed into decile ranks from 0 to 1. *TYPE* is coded as 1 if a firm simultaneously cuts capital investment and discretionary spending and

reduces employee hiring, and the amount of the reduction is among the largest 33% of the industry in a fiscal year over the firm's history; and 0 otherwise. *NI* is net income before extraordinary items divided by the beginning-of-fiscal-year market value of equity. *RET* is the buy-and-hold return over the fiscal year. *NEG* is equal to 1 if *RET* is negative and 0 otherwise. *MB* is the market-to-book ratio ($\text{Compustat \#199} * \text{Compustat \#25} / \text{Compustat \#60}$) at the beginning of the fiscal year. *LEV* is total debt ($\text{Compustat \#9} + \text{Compustat \#34}$) divided by total assets (Compustat \#6) at the beginning of the fiscal year. *SIZE* is the market value of equity (in millions of dollars) at the beginning of the fiscal year ($\text{Compustat \#199} * \text{Compustat \#25}$). *LIT* is coded as 1 if a firm is in a litigious industry (SIC codes 2833–2836, 3570–3577, 3600–3674, 5200–5961, and 7370–7374), and 0 otherwise. *ROA* is net income before extraordinary items divided by total assets (Compustat \#6) at the beginning of the fiscal year. *AGE* is the number of years a firm has been listed on CRSP. *STDR* is the standard deviation of daily stock returns over the previous year. ***, **, and * indicate significance at the 0.01, 0.05, and 0.10 levels or lower, respectively. Z-statistics reported in parentheses are robust to firm and year clustering.

[附件 B] 參與研討會之各項書面佐證

附件一：研討會文章發表接受函、確認參加、及場次、評論人等資訊



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Congratulations! Your paper submission to the 2015 AAA Annual Meeting to be held AUGUST 12, 2015, in Chicago, IL, has been accepted for presentation at **a Concurrent Session.**

Session Title: Determinants of Conservatism II 場次主題
Moderator: [Matt Glendening](#), University of Missouri-Columbia 場次主持人
Discussant: [Olena Watanabe](#), Iowa State University 文章的評論人
Presentation Date/Time: Monday August 10, 2015 - 2:00 pm-3:30 pm 場次時間

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Reviewer Comments (if available): 審稿委員意見

This paper examines the association between business strategy and accounting conservatism. The authors contend that firms with a prospector strategy may be more conservative if they face higher levels of uncertainty and are more cautious. Alternatively, prospectors may be less conservative if they are funded more through equity. I thought the hypothesis development was strong, however the results ran counter to other conservatism research. In tables 4 and 5, ?24 is not significant, indicating firms with a defender strategy are not conservative in either the pre or post period. I would have liked to see some discussion of this. In addition, whether or not prospectors are conservative is measured as the addition of ?24 +?25. There is no analysis of this. If these firms are not conservative either is this counter to the Basu findings? Two technical details: The authors indicate firm and year clustering in the body of the paper and then year fixed effects in the tables. Do they both cluster by year and include year fixed effects? In Table 6, I assume the second NEG x STRATEGY interaction variable should be NEG x Controls.

Publication of Abstract:

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Date of Submission: January 08, 2015

Submission ID Number: 003114

Section Designation: Financial Accounting and Reporting Section

Title of Paper: *Business Strategy and Accounting Conservatism* 文章名稱

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Chia-Chun Hsieh

National Chung Cheng University
Phone: 852-2358-7573
Email: achsieh@ust.hk

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We investigate whether accounting conservatism can be explained by investors' caution in the face of radical uncertainty ("unknown unknowns"). Empirical evidence indicates that investors put greater weight on negative than on positive news—i.e., exhibit caution—when faced with radical uncertainty. Accounting conservatism increases the timeliness of negative news that is more relevant under a cautious decision rule and thereby helps investors implement it. We, therefore, hypothesize that firms facing greater radical uncertainty report more conservatively to facilitate investors' decision-making. To proxy for radical uncertainty, we identify firms pursuing the "prospector" business strategy, which involves seeking new business opportunities. Because prospectors actively create their own future, they face greater radical uncertainty than "defenders" (which focus on effectively utilizing existing resources). Our results show that prospectors exhibit higher levels of accounting conservatism. We also conduct an additional set of tests using an alternate proxy for radical uncertainty and report consistent results.

[Back to Main Page](#)

[AAA Home Page](#)

附件二：擔任主持人之 Email 通知

From: info@aaahq.org
To: [Chia-Chun HSIEH](#)
Subject: AAA 2015 Annual Meeting Moderator Assignment
Date: Monday, May 18, 2015 10:23:12 PM

Dear Chia-Chun Hsieh,

You have been assigned as a moderator for a session at the AAA 2015 Annual Meeting. You may access information regarding your assignment using your user ID (██████████) and your password (██████████) at the AAA Annual Meeting Information Center located at <http://aaahq.org/AM/info.cfm>

Please log in to confirm or decline your assignment as soon as possible.

Thank you for serving as a volunteer moderator for the AAA 2015 Annual Meeting.

Sincerely,
John L. Campbell
Section Liaison
Financial Accounting and Reporting Section
AAA 2015 Annual Meeting
Email: johnc@uga.edu

附件三：研討會網址所列本人參與之場次資訊

1. 文章報告之場次表

(網址連結：<https://www2.aaahq.org/AM2015/concurrent02.cfm>)

2.16 Determinants of Conservatism II

Moderator: Matt Glendening, University of Missouri 場次主持人(請參照附件一)
(NASBA Field of Study: Accounting)

Trends and Consistency in Firm Performance and Accounting Conservatism.

Taewoo Kim, University of Massachusetts Lowell; Inho Suk, State University of New York at Buffalo
Discussant: Matt Glendening, University of Missouri

Information Asymmetry and Accounting Conservatism: Evidence from Exogenous Shock to Analyst Coverage.

Wei Shi, Norwegian School of Economics; Haifeng You, Hong Kong University of Science and Technology
Discussant: Paige D. Bressler, Florida Atlantic University

Business Strategy and Accounting Conservatism. 文章名稱(請參照附件一)

Chia-Chun Hsieh, Hong Kong University of Science and Technology; Zhiming Ma, Peking University; Kirill E. Novoselov, Nazarbayev University

Discussant: Olena Watanabe, Iowa State University 文章評論人(請參照附件一)

2.17 Current Issues in Accounting II

Moderator: Jivas Chakravarthy, Chapman University
(NASBA Field of Study: Accounting)

2. 擔任主持人場次表

(網址連結：<https://www2.aaahq.org/AM2015/concurrent09.cfm>)

主持人(請參閱附件二)

9.14 Disclosure Demand and Strategy

Moderator: Chia-Chun Hsieh, Hong Kong University of Science and Technology
(NASBA Field of Study: Accounting)

Investors' Demand for Disclosures: The Case of Bellwether Firms.

Ayung Tseng, Indiana University
Discussant: To Be Announced

Say Again? Assessing Redundancy in the 10-K.

Rick Cazier, University of Michigan; Ray Pfeiffer, Texas Christian University
Discussant: Anup Srivastava, Dartmouth College

The Effect of Disclosure Sequencing on Investor Attention.

Zachary Kaplan, Washington University in St. Louis; Zawadi R. Lemayian, Washington University in St. Louis
Discussant: Rick Cazier, University of Michigan

9.15 Disclosure in Private Firms

Moderator: Danqi Hu, University of Toronto
(NASBA Field of Study: Accounting)

附件四：研討會報到後取得之名牌與流程表

