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President's Message

Eternal vigilance is the price of liberty.

— Wendell Phillips

I do not know if Wendell Phillips meant to include commerce in the scope of his words, but surely his words are as relevant to business, financial reporting and corporate governance, as they are to politics and society. In financial reporting and investment analysis the human tendency to steal and

misrepresent when nobody is watching on one hand, and to free ride on the presumed vigilance of others on the other, are ever present. It is clear that princes of commerce, too, must be carefully monitored. Unfortunately, the incentives to do the monitoring weaken as more investors come to believe that the market is, or is close to being, efficient. Private equity helps balance the monitoring incentives diluted by diffuse ownership in equity markets.

Though markets without regulation cannot help us prosper, I have deep reservations about the efficacy of how the Securities and Exchange Commission, the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and the International Accounting Standards Board have tried to improve financial reporting. In a world where investors have access to multiple sources of information, and everyone can learn from history, it is not clear which of the alternative accounting methods will prove to be better. Considering the value of information provided to investors through financial reports as well as other channels, potential changes in investor and managerial behavior in response to such information present difficult challenges for regulators' centralized decision making.

Accounting is only one of several instruments in the managerial bag of decision instruments. We want managers to manage the company well (e.g., from the investors' point of view, create as much wealth as possible), and to tell the investors truthfully how much wealth they have created. Due to incompetence, laziness or malfeasance, managers may create insufficient wealth, or may not reveal truthfully the results of their endeavors to the investors. Financial reporting standards are an attempt to induce managers to tell the truth. The problem is that when we tighten the screws on financial reporting, in trying to shut the door on manipulation and window dressing of financial reports, we also force the opportunistic managers to turn to making suboptimal substantive decisions (e.g., investment, research and development), actions which may not be in the best long-term interest of the firm or its investors.

This interaction between financial reporting and substantive decisions of operating the firm, confronts investors with a difficult corporate governance dilemma: Do we want to induce the managers (assuming that they are selfish like the rest of us) to create as much wealth as

possible for the corporate pot (even if they do not accurately tell us how much), or do we require them to report accurately on the wealth (even if the price of learning the truth is that there will be less wealth in the pot)?

Corporate transparency, with all its appearance of unassailable virtue, is not without cost to the investors. Suppose we ask ourselves: How shall we react if asked to work in an office with glass walls? Why not? What do you do in your office that you do not wish others to see? What about a short afternoon nap in the office chair? Would we still take the nap in a glass-walled office if everyone knew that it increases our productivity for the rest of the afternoon? Chances are that we shall not, and will pay attention not only to what we do, but also to what we appear to be doing. We shall, in Jonathan Glover's words, be inclined to do some "posturing," incurring costs to ourselves and our organization.

Paradoxically, forcing people to tell the truth against their will (even if it were possible to do so) is not necessarily in our own best interests. We have to be careful that in hot pursuit of crooks, we do not demolish the town. The regulators in Washington, Norwalk or London have to make difficult judgments in deciding how far they can advantageously go in inducing truth-telling by managers.

Unfortunately, regulators have little basis on which to make sound judgments on such matters. A judicious combination of judgments and some feedback from the markets, even imperfect markets, can help them make better decisions. That is why a financial reporting standards monopoly in U.S., Europe, or the world as a whole, is, in my view, a step we shall come to regret. Such a "cure" will prove to be worse than the disease.

Having been charged with overseeing the markets frequented by crooks and manipulators, regulators tend to have a deep distrust of the ability of markets to help them in any way. This is exemplified by their disregard for the market-based solution for expensing of employee stock options.

Accounting and auditing standards have had major influence on what happens in accounting and auditing classrooms and what kind of students are attracted to these classes. In the absence of standards, instructors can present various business events and transactions to the class, and explore alternative perspectives on how they might be treated, and the consequences of each treatment for individual decisions and organizations. For many decades, such mind and judgment-expanding classroom exercises constituted the intellectual challenge of accounting and attracted high quality undergraduates to accounting majors.

When the "correct" method of dealing with a transaction is a matter of memorizing the appropriate accounting or auditing standard, accounting classrooms tend to be transformed, becoming less challenging and less attractive

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2007 Recipients of Steve Berlin/CITGO Grants

The purpose of the Steve Berlin/CITGO Grant program is to foster academics' understanding of the contemporary external reporting and governance challenges faced by preparers. Proposals are evaluated by a four-person committee chaired by the American Accounting Association's Vice President—Research (Arnie Wright) and representatives from the Financial Accounting and Reporting, Management Accounting, and Auditing Sections of the AAA. This year the following two grants were awarded.

Darrell Brown, R. Scott Marshall (both at Portland State University), and Marlene Plumlee (University of Utah). Voluntary disclosures and firm choices across time: The case of environmental disclosures.

This study seeks to provide a deeper understanding of the complex interrelationship between a firm and its stakeholders in the voluntary disclosure decision. Voluntary disclosures provide a unique and efficient method for a firm to distinguish itself from its competitors. In this study, environmental voluntary corporate disclosures are examined by investigating the interaction between investors and corporate reporters through both in-depth interviews and empirical observations. By gathering both field-based interview data from experts involved in preparing and using the disclosures and corporate report-derived empirical data, this study examines corporate responses to investor demands for voluntary corporate disclosures. From the interviews a set of propositions relating to the quality and influence of the investor/firm relationships will be developed.

Cheryl L. Linthicum (The University of Texas at San Antonio), Ann Tarca (The University of Western Australia), and Walter Aerts (University of Antwerpen Belgium). Factors affecting informative MD&A disclosures by SEC domestic and foreign registrants.

The aim of this study is to investigate the extent to which listed companies following the Securities and Exchange Commission's Management Discussion and Analysis (MD&A) requirements provide informative reports and to identify factors that are associated with such disclosures. The investigation centers on SEC registrants, which are leading international firms, from four countries (the USA, Canada, UK and Australia). This study will contribute evidence from archival and field research that, taken together, will identify firm-level and country-level factors that are associated with informative MD&A reporting practices. An analysis will be conducted of the explanatory cause and effect statements included in MD&A reports based on an established methodology of attribution analysis. ■

Kachelmeier Named TAR Senior Editor

Steven J. Kachelmeier, the Charles T. Zlatkovich Centennial Professor of Accounting at The University of Texas at Austin, has been named the next senior editor of *The Accounting Review*. Professor Kachelmeier has investigated a wide variety of issues involving auditing, financial reporting, international accounting, management accounting, and taxation. His scholarly work has been published in *The Accounting Review*, *Accounting Horizons*, *The American Economic Review*, *Auditing: A Journal of Practice & Theory*, *Contemporary Accounting Research*, *Issues in Accounting Education*, *Journal of Accounting and Public Policy*, *Journal of Accounting Research*, *The Journal of the American Taxation Association*, *Journal of Management Accounting Research*, *Review of Accounting Studies*, and other journals. Professor Kachelmeier has served as an associate editor at *The Accounting Review* (1999–2002) and *Accounting Horizons* (2003–2006), and he has also been a member of the editorial boards of five academic journals. On four occasions he has been honored with excellence-in-teaching awards. Professor Kachelmeier received an undergraduate degree in business from the University of New Mexico and earned his doctorate from the University of Florida. Prior to beginning his Ph.D. studies, he worked in public accounting, and is a CPA. He will assume the duties of TAR senior editor in late spring 2008 when Professor Dan Dhaliwal completes his three-year term.

—Mort Pincus, Vice President—Publications

President's Letter

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to talented youth. Admittedly, standards may make it easier for some of us to prepare for our classes. Adverse impact on education and the ability of the profession to attract talent are unintended consequences of accounting and audit regulation that deserve more attention.

Members of the AAA community around the world are actively engaged in analyzing, understanding, helping, critiquing, and teaching accounting and audit regulation. This decentralized critical engagement of thousands of independent minds with accounting practice, markets and their regulation is essential for better financial reporting and our economic well-being. Perhaps eternal vigilance is also the price of prosperity. ■

FINANCIAL STATEMENTS

Audited Financial Statements and Independent Auditor's Report for the fiscal years ended August 31, 2006, 2005, 2004, and 2003 are published in their entirety on the Association website at: <http://aaaahq.org/about/financials/TOC.htm?> ■

AAA Policy Change

Please note this new policy from the November 2006 Executive Committee meeting.

"Members of the AAA Executive Committee and nominees for those positions are not eligible to be nominated for editor positions for association-wide journals." ■