



These certainly are interesting times. As I take over as the new Director of the School of Accountancy, the changing world offers both challenges and opportunities. There is increased interest in an accounting education, partly because it provides a clear path to employment and the start of a professional career. At the same time, there are budget constraints that hamper our efforts to meet the new demands placed on the school and the university at large. As described below, we are taking proactive steps to build on our past successes and to increase the value of an accounting education from ASU.

#### **Undergraduate Programs**

Our faculty and staff now serve almost 1,000 undergraduate accounting majors. These numbers include students who started their education at the ASU Tempe and West campuses. On November 20, 2008, the Academic Affairs Committee of the Arizona Board of Regents approved ASU's academic re-organization that disestablished the School of Global Management and Leadership, housed on the West campus, and consolidated its students and faculty into the W. P. Carey School of Business. We will now be one School

## DIRECTOR'S UPDATE

MICHAEL MIKHAIL, *Director*

of Accountancy, delivering classes on the Tempe campus and on the West campus.

We have had many reasons to celebrate over the past academic year. Our undergraduate students continue to distinguish themselves in a variety of national competitions. Last year's victory of the National KPMG /ALPHA case competition was followed this year by a win in the PricewaterhouseCoopers National xTax competition. The quality of our students and programs has not gone unnoticed. In 2007, the Public Accounting Report ranked the undergraduate program 17th and *U.S. News & World Report* ranked us 15th, higher than the rankings for 2006 and 2005. To put these rankings in perspective, it's important to note that as of April 2008, more than 550 institutions held business accreditation from the AACSB.

Beginning fall 2009, the School of Accountancy will introduce "LEAP," a new required course for all incoming accounting majors as well as other incoming students interested in accounting. LEAP will focus on many of the aspects critical to our profession - Leadership, Ethics, Accountability and Professionalism. In addition to providing an understanding of the benefits of an accounting career, the program is designed to enhance competency in the soft skills and many of the intangibles required for success as an accounting professional. Classes will include topics such as leadership development; group processes and team dynamics; conflict management;

business ethics; independence; workplace skills, including negotiation and communication skills; and various aspects of social responsibility. Upon completion of the LEAP program, students will be better prepared to meet the demands and rigors required of them in today's ever-changing environment.

#### **Graduate Programs**

Our school now serves more than 100 graduate students enrolled in our Master of Accountancy, Master of Taxation and other post-baccalaureate programs. The market for graduates from our master's programs is strong. Almost all of our domestic students over the last several years had full-time job offers prior to graduation. Many received multiple offers. Not only do the Big 4 firms and the next tier of national firms recruit our students, a significant number of local firms (including some from Tucson and Southern California) conduct on-campus interviews. The School of Accountancy is a recognized leader in graduate accounting education. In 2007, the Public Accounting Report ranked the graduate program 14th in the nation. We were also recognized as a top-25 program by *U.S. News & World Report*.

Beginning in fall 2009, we will offer three new platforms within our graduate accountancy programs to accommodate those with and without accounting degrees. In addition to the current full-time format, we will offer a part-time evening Master of Taxation program at the ASU Tempe

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campus and two part-time Master of Accountancy programs, one at the ASU Tempe campus and one at the ASU West campus.

The Master of Taxation program will offer classes in the evenings from 6 p.m. to 10 p.m. This program will be offered as a lock-step, cohort-based program that can be completed in six trimesters (two academic years). The part-time Master of Accountancy program on the Tempe campus will offer classes early in the morning, from 7 a.m. to 8:50 a.m., to accommodate working professionals who may not be able to pursue an evening program because of professional or family obligations. The part-time program at the West campus will offer evening classes from 6 p.m. to 10 p.m. Both Master of Accountancy programs are offered as lock-step, cohort-based programs that can be completed in five trimesters for students whose bachelor's degrees are in accounting or in six trimesters for students whose bachelor's degrees are in an area of business other than accounting. The additional trimester required of non-

accounting students will include two special 10-week condensed prep courses. The prep courses will cover the equivalent of intermediate financial accounting, audit and tax and will provide students with the knowledge necessary to succeed in the program. All the part-time programs will allow students to pursue a master's degree while simultaneously continuing their careers full time. Additionally, these programs will enable students to meet the enhanced education requirements for CPA certification. For more information, please visit the School of Accountancy Web site at: [wpcarey.asu.edu/acc](http://wpcarey.asu.edu/acc) or send an e-mail to [wpcareyacc@asu.edu](mailto:wpcareyacc@asu.edu).

#### Faculty

Our faculty members continue to distinguish themselves among the best of the best. The School of Accountancy was recently ranked eighth by the Chronicle of Higher Education in its 2007 Top Research Universities Faculty Scholarly Productivity Index. This fall we welcomed three new full-time faculty members. Melissa Martin and Artur Hugon join us as assistant professors,

and Lynn Pringle joins us as a clinical professor. They have all won teaching awards prior to joining our faculty. We look forward to their many contributions in the years to come. A brief bio of each of them is included in the following pages.

#### Alumni and Friends

As we move forward in our efforts to serve our students, the State of Arizona and our rapidly changing profession, I would like to thank those of you who have supported us over the years. We would not be the school that we are today without your generosity. Your contributions enable us to make the changes that allow us to excel and enhance the value of your degrees. We need you now more than ever and ask that as we approach the end of the year, you remember us. If you have not contributed to the School of Accountancy in the past, we ask you to please consider making your first contribution this year. A pledge envelope is included in this newsletter.

#### Michael Mikhail

Director, School of Accountancy

## FACULTY RESEARCH:

### “Stock Options, R&D, and the R&D Tax Credit”



–Jennifer Brown, Assistant Professor

In “Stock Options, R&D, and the R&D Tax Credit” we investigate how the R&D tax credit and stock options issued to R&D employees impact firms’ R&D investment decisions.

For many years, regulators and academics have been concerned about the opportunistic management of accruals to meet earnings benchmarks. Recently, researchers have become increasingly interested in real earnings management, the reduction of discretionary expenditures such as R&D and capital investment to meet short-term earnings targets. While accruals management appears to have decreased since the passage of the Sarbanes Oxley Act, evidence suggests that real earnings management has increased. We study one type of real earnings management, myopic R&D investment, and investigate whether the R&D tax credit and stock option exercises mitigate myopic R&D investment decisions.



The literature on real earnings management suggests that managers are willing to cut R&D spending to meet short-term earnings constraints. While short-term earnings constraints appear to have a negative effect on R&D investment, the R&D tax credit is designed to have a positive effect on R&D spending. Indeed, studies show that firms that stand to benefit from the R&D credit in a particular year spend more on R&D relative to those firms that are not eligible for R&D tax credits. Given the potentially offsetting effects of financial reporting constraints and the R&D credit, we investigate whether the R&D credit can mitigate myopic R&D investment.

R&D tax credits allow firms to reduce their federal tax liability for a percentage of qualified R&D expenditures, including in-house payments for salaries and wages, supplies and contract R&D payments. Congress enacted the R&D tax credit to encourage managers to invest in more R&D by decreasing the after-tax cost of R&D spending. A stream of academic literature on the R&D tax credit over the years generally finds that R&D credits are effective at spurring additional R&D spending. However, this literature ignores the role of stock options, which are used extensively in R&D intensive industries. In calculating the R&D credit, firms can include the spread on stock options exercised by R&D employees as qualified R&D expenditures.

We study the pre-SFAS 123R period before recording an expense for stock option compensation was mandatory. During this period, cash and option compensation were both eligible for the R&D tax credit, but since most companies did not record an expense for stock option compensation, only cash compensation reduced financial statement earnings. The tax credits generated when R&D employees exercise their stock options increase earnings, while the exercises themselves do not directly affect earnings. Therefore, stock options decrease the after-tax impact of R&D spending on financial statement earnings.

We hypothesize that R&D options are important in the context of myopic R&D investment because they decrease the financial reporting costs of R&D spending. R&D option exercises themselves do not directly affect earnings, while the tax credits they generate reduce income tax expense. Because R&D options do not reduce financial statement earnings but do reduce the after-tax cost of R&D spending, firms near an earnings benchmark can invest in more R&D before falling short of their earnings goals.

Existing research finds that firms decrease R&D spending to avoid losses and earnings decreases. Similarly, we document in our sample that firms facing short-term earnings constraints reduce their R&D spending relative to other firms. Separately, we find that the R&D credit has the opposite effect on R&D spending. Firms that are eligible for the R&D credit spend more on R&D relative to other firms. Pressure to meet an earnings benchmark has a negative effect on R&D spending, while the R&D tax credit has a positive effect on R&D spending.

We then investigate how these two opposite effects interact to impact the firm's overall R&D investment decision. We find that the positive effect of the R&D tax credit on R&D spending increases as firms have more R&D stock option exercises. We also find that this positive effect is greater for firms facing potential earnings decreases. Our results suggest that the positive effect of the R&D tax credit and R&D options on R&D spending helps offset the pressure to cut R&D spending to meet earnings benchmarks.

We find that R&D tax credits generated by R&D option exercises significantly reduce the magnitude of R&D cuts made to avoid earnings decreases. Specifically, we find that firms reduce R&D spending by 0.46 percent of total assets to avoid earnings decreases, but R&D tax credits generated by stock option exercises offset this decrease by up to 42 percent. Our study suggests that the R&D tax credit and R&D stock options mitigate myopic R&D investment. As the tax credits from R&D stock option exercises increase, firms are less likely to forego or postpone R&D spending to avoid missing an earnings benchmark.

Managers appear to cut R&D investment to meet short-term earnings benchmarks despite the fact that these cuts are likely detrimental to investors in the long-run. Prior studies find that institutional investors and compensation committees can mitigate managers’ opportunistic reductions in R&D. We find that an additional factor, R&D tax credits from stock option exercises, can also mitigate myopic R&D investment. Further, we show that stock options are an important component of the R&D tax credits and should be considered when regulators evaluate the effectiveness of the R&D credit at increasing R&D investment.

Published in *The Accounting Review*, May 2008

# HONORS AND AWARDS

## Henry & Horne Faculty Fellowships

Henry & Horne, one of the leading accounting firms in Arizona, has awarded three faculty fellowships to School of Accountancy faculty. **Joe Schultz**, **Kurt Pany** and **Steve Kaplan** have been selected as the inaugural Henry & Horne Faculty Fellows for their many valuable contributions to service, teaching and research. The School of Accountancy would also like to recognize Chuck Inderieden and Mark Eberle, Partners at Henry & Horne, for their continued support to the School.

## Annual Faculty Awards

The W. P. Carey School of Business celebrated excellence and teaching, research and service at the Annual Faculty Awards and Recognition event on April 9, 2008. Among the recipients, were three SOA faculty:

### HUIZINGH AWARD FOR CLASSROOM INNOVATION



**Perseus B. Munshi, CPA**, Faculty Director, Accountancy Masters Programs, Lecturer, Sr. Munshi redesigned the ACC 444 Business Process Analysis course, which is required for Accountancy and Computer Information Systems majors. He gained support for the redesign from Big Four public

accounting firms and transformed the course into one focused on business process and internal control.

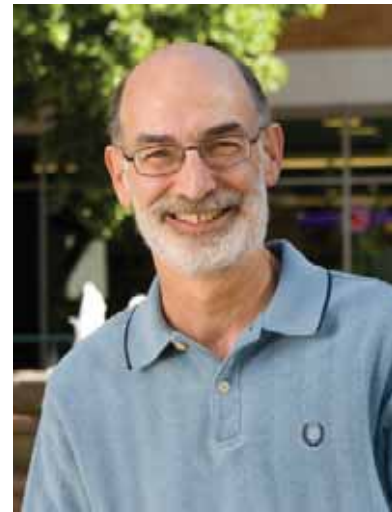
### OUTSTANDING TEACHING AWARD MBA AND MASTER'S PROGRAMS



**Joseph J. Schultz**, Professor of Accountancy Schultz has taught in the full-time and working professional MBA platforms. His classes are organized to provide students with opportunities to learn and apply their knowledge to make better decisions as managers. His managerial

accounting class is known for its rigor, but he also is known for his sense of humor and his responsiveness to students.

## Goldman Named Professor of Practice



The School of Accountancy is pleased to announce that upon the recommendation of the Dean and approval of the Provost and President Crow, **Don Goldman** has been appointed "Professor of Practice." This appointment is for full-time faculty whose expertise, achievements, and reputation developed over a sustained period

of time qualify them to be distinguished professionals in an area of practice or discipline, although they may not have academic experience. The responsibilities of this position are teaching courses, seminars, and independent studies to undergraduate and graduate students or other duties that the dean determines are consistent with this definition.

Please join us in congratulating Don on his appointment and thanking him for his many contributions to our programs, and especially to our students.

### FACULTY HALL OF FAME

The Faculty Hall of Fame was established in 1977 to recognize retired and semi-retired faculty members who have made extraordinary contributions to the advancement of business education and the W. P. Carey School.

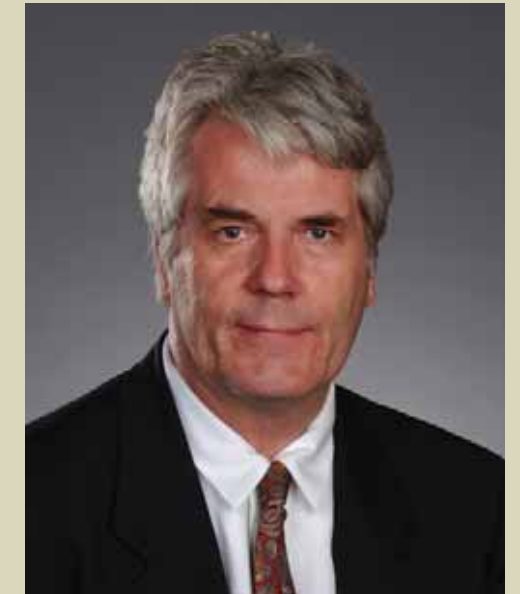


**Doug Johnson**, Professor of Accountancy Johnson served the business school for 30 years before his retirement last year. He held many leadership positions in the department, the business school and the university. His achievements were so exemplary that he was designated as Professor Emeritus

by the provost on retirement. Johnson's most enduring contributions are not captured in his list of accomplishments, but instead by his camaraderie, his positive outlook, his willingness to assist, his contributions to student success, and the wide-ranging knowledge that he shared so generously.

# OHLSON NAMED REGENT'S PROFESSOR

Jim Ohlson, the W. P. Carey Chair of Accountancy, has been named ASU Regents' Professor. The designation of Regents' Professor is reserved for faculty members at Arizona's public universities who have demonstrated exceptional scholarship and outstanding achievements. Ohlson was the principal author of a stream of research studies beginning in the early 1990s that fundamentally changed how academics view the role of accounting in security valuation and how analysts, auditors and other practitioners use accounting data. His work has been recognized by the American Accounting Association with two Notable Contributions to Accounting Literature Awards. On the teaching front, the "Ohlson" valuation model plays a central role in many financial accounting and financial statement analysis texts targeted to MBA students. Ohlson's valuation research has also impacted practice. His valuation model has been part of the investment banking and strategy consulting tool kit for many years. He has also consulted with the Financial Accounting Standards Board on a variety of issues.



# NEW FACULTY



This year the School of Accountancy was pleased to welcome three new award winning faculty.

**Melissa Mortin**, Assistant Professor, comes to us from the University of Southern California where she earned her doctoral degree. During her time at USC she earned the Mary Pickford teaching award and served as president of the PhD Project. Prior to attending USC she received a MS in finance and BS in accounting from Texas A&M University. Her research is centered in the area of managerial accounting examining both issues in compensation systems and non-financial performance measures.



**Artur Hugon**, Assistant Professor, most recently from Georgia State University, received his undergraduate and masters degrees from Miami University and a Ph.D. from the University of Southern California. His research examines the economics of financial intermediation; in particular the quality of earnings forecasts, stock recommendation credibility, brokerage industry team performance, celebrity analysts, and the financial performance implications of ethics.



**Lynn Pringle**, Clinical Professor, earned his B.B.A. at the University of Iowa, his masters at the University of Arizona, and his Ph.D. at the University of Colorado. He comes to ASU from the University of Iowa where he was Director of the Master of Accountancy Program and Director of the Professional Program in Accounting. In addition to Iowa, he has taught at Penn State University and Santa Clara University. Lynn is a licensed CPA in the state of Arizona and practiced in the Tucson office of Ernst & Young.

# SCHOOL OF ACCOUNTANCY'S TEAM WINS ANNUAL PRICEWATERHOUSECOOPERS XTAX CHALLENGE



From left to right:  
Rick Stomm, Lisa Wiley, Mackenzie Gaughan,  
Nick Arambula, Jurgen Weber, Michael Rogers  
and Harriet Maccracken.

On February 5, 2008, PricewaterhouseCoopers announced the team from Arizona State University as the winners of the firm's annual xTAX Challenge. xTAX, short for "Extreme Tax", is a case competition designed to give undergrads exposure to real world tax policy and planning issues.

Teams from five schools: ASU, Baylor, Binghamton University, Michigan State University and the University of Notre Dame were chosen from 273 teams from 39 top colleges and universities, to compete in the national finals held in Washington D.C. The finalists were required to present

their case solutions, which focused on tax incentives and other methods to embrace the use of "green" technologies within an industry.

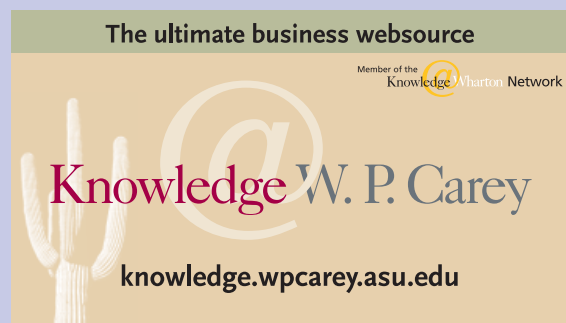
The teams earned \$10,000 each and an all-expense paid trip to Washington D.C. Congratulations to our students, Mackenzie Gaughan, Michael Rogers, Jurgen Weber, Nicholas Arambula, Lisa Wiley and their faculty advisor Harriet Maccracken for a job well done!

## KNOWLEDGE AT W. P. CAREY

Use *Knowledge@W. P. Carey* when you are looking for insights on business and the economy from the faculty of a top business school and other experts. The database currently contains more than 700 articles, podcasts and videos.

*Knowledge@W. P. Carey* is a rich guide to faculty sources at the W. P. Carey School of Business. To date, about 150 faculty members have been quoted. Use the Knowledge search to find the right source for your question.

*Knowledge@W. P. Carey* now offers access to *Economy@W. P. Carey*, the school's new portal to economic information and data concerning Arizona and the western United States.



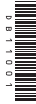
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