

## 2019-2020 AFAANZ GRANT OUTCOMES

### (1) Name, Position, Contact Details for each applicant

Dr. Lu Yang (main applicant), Lecturer of Accounting department, Monash University,

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### (2) Project Title

CSR contracting and management earnings guidance

### (3) Updated Project Summary (500 words) including any variations between the project undertaken and the original application

We have finished the preliminary manuscript of this project. The manuscript has been presented on the 2020 AFAANZ conference and Monash university management accounting cluster meeting.

This project investigates the relationship between CSR contracting and management earnings guidance. From the perspective of trust building, we argue that CSR contracting could encourage more management guidance through accruing social capital to CSR firms and building trust with their investors and, in turn, bolstering the credibility of such voluntary disclosures. However, on the other hand, CSR contracting could also decrease management guidance, as CSR contracting represents firms' long-term orientation and thus firms with CSR contracting may not engage in issuing short-term oriented earnings guidance. From the perspective of monitoring, CSR contracting may work as a substitute for monitoring, thereby reducing the demand for management forecasts. In light of these alternative views, it is an interesting empirical question of how CSR contracting influences management forecasts.

We document a positive (negative) and significant relation between CSR contracting and frequency of management earnings forecasts (market reaction to management forecasts). When decomposing management forecasts into good versus bad news forecasts, we find that the aforementioned relations apply to bad news forecasts only. Overall, our findings are consistent with the notion that CSR contracting could develop trust and social capital that alleviate managers' career concern about delivering bad news forecasts.

Overall, our study contributes to the literature and practice in several different ways: First, our investigation sheds first light on the relation between CSR contracting, a management control instrument, and management earnings forecasts, a financial reporting tool. As a complement to the prior research, we empirically show that the design of management control function is an important determinant of financial reporting choices, thereby adding to our understanding of the interplay between the two accounting regimes. Second, the current study extends our current knowledge of CSR contracting by examining its implications for voluntary disclosures. Although CSR contracting is becoming increasingly pervasive in executive compensation practices, little research has examined its economic consequences. Our study looks into the financial reporting effect of CSR performance metrics and thus adds to this line of research. Third, this investigation contributes to our knowledge of trust as a determinant of corporate disclosures. Our study is also meaningful to regulators and policymakers. Corporate disclosures provide a strong channel for the capital market to impound value relevant information into share prices and thus enhance market efficiency. For stewardship, accounting information is also used by the capital providers to monitor the use of their capital by management (Beyer et al. 2010; Kothari 2001). Both the valuation and the stewardship roles of financial reporting help make better allocation of capital and facilitate economic growth and social efficiency (Pevzner et al. 2015). Our analysis, anchored in these two roles of management forecasts, therefore has regulatory implications.

(4) Funds Granted

AFAANZ 2019 Research Fund – Mentoring Developing Researchers (A\$7500)

(5) Detailed Report on Expenditure of Funds against Budget Items, with variations explained

The fund was used to hire a research assistant to hand-collect detailed CSR contracting data from proxy statement. By doing that, we seek to not only capture whether the firm uses CSR contracting but also the intensity of CSR contracting in CEO incentive plans. This more granular data will help us to better understand the interplay between CSR contracting and management earnings forecasts. We hired one research assistant to manually collect CSR contracting data of SP500 firms during fiscal year 2015 to 2018. In total, the RA spent around 167 hours to finish this job.

(6) Outcomes, for example, working papers, presentations and publications (give full details, including abstracts)

Abstract: Motivated by a long-standing call for studying the interplay between management control system and financial reporting system, we investigate how an emerging management control function—that is, tying corporate social responsibility (CSR) and sustainability targets to executive compensation (i.e., CSR contracting)—affects an important source of accounting information (i.e., management earnings forecasts). Theorizing the relation between CSR contracting and management forecasts does not lack tension. From the supply side of earnings forecasts, CSR

contracting could encourage more management guidance through accruing social capital to CSR firms and building trust with their investors and, in turn, bolstering the credibility of such voluntary disclosures. However, CSR contracting also represents a firm's long-term focus on social value and thus may signal the firm's commitment to quitting playing earnings game and thus fewer earnings forecasts. From the demand side, trust and social capital derived from CSR commitment could substitute for monitoring, thereby reducing the stewardship demand for management forecasts. Furthermore, CSR contracting suggests that a firm is wanting to shift its objective function from shareholder value maximization to stakeholder orientation; this helps foster close relationships with its stakeholders and therefore gives rise to private communication rather than public disclosures, which predicts fewer earnings forecasts. Our results support a positive relation between CSR contracting and the frequency of management forecasts, mainly driven by bad news forecasts. We also find that the stock market reacts less negatively to such bad news.

Outcomes: This paper has been presented in the 2020 AFAANZ conference and Accounting department management accounting cluster meeting at Monash University.

#### (7) Future Intentions for this Project (give full details)

a. Conferences: We plan to submit this project to 2021 AAA Annual Conference and 2021 EAA conference

b. Journal submissions: The outcome of this project is targeted at top accounting journals such as Journal of Accounting and Economics, Journal of Accounting Research, and The Accounting Review. We believe that our research addresses a timely and important issue and makes several nontrivial contributions to the literature on both management control design and voluntary disclosure choices. To our best knowledge, our research idea is unique and novel. It will not only contribute to our understanding about the interplay between financial accounting information and management incentive design, but also illustrate the mechanism of how management incentive information is interpreted by external investors.

c. Future plans: Up to now we have manually collected detailed CSR contracting data from proxy statements issued by SP500 firms. In the next step, we are going to incorporate analysis using this more detailed CSR contracting data to see if our results still hold. We are also working on comments we obtained from conferences and presentations to further polish this paper. We expect to submit this paper to a first-tier journal by the end of 2021.

#### (8) Summary of Outcomes and Benefits

The selection into the 2019-2020 AFAANZ grant benefits our project in following ways: First, the grant supported us to hire an research assistant to complement manually collected CSR contracting data from proxy statements. This more granular data helps us to better understand the interplay between CSR contracting and management earnings forecasts. By drawing on manually collected data, we

are able to distinguish between symbolic CSR contracting users and substantive users by analysing how intensive users of CSR contracting interacts with earnings management forecast. In addition to that, we can describe a more comprehensive pattern of CSR contracting, not only the adoption, but also how firms dynamically change their CEO compensation contract to incorporate CSR-related performance measures. Second, with the support of AFAANZ grant, we are able to document a more detailed relationship between CSR contracting and management earnings forecast, thereby further contributing to our understanding of the interplay between compensation design and financial disclosure choice, thus providing deeper insights to regulators, policymakers and academic.