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THE IRISH ACCOUNTING AND FINANCE ASSOCIATION

OBJECTIVES

The Irish Accounting Association was founded in 1987 to bring together academics from all parts of Ireland in order to advance teaching and research in Accounting and related disciplines. In 1991, the name and objectives were changed to include Finance.

MEMBERSHIP

Membership is open to those engaged in teaching, research or educational administration in accounting, finance or related disciplines and to those engaged in similar activities acceptable to the Council for membership purposes.

The Association now has members in virtually all third level colleges that employ accounting and finance academics in both Northern Ireland and the Republic of Ireland. The annual membership fee is €35/£25.

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All enquiries regarding membership should be addressed to:

Eoin Langan
Department of Accounting, Financial Services and Business Computing
Athlone Institute of Technology
Co. Westmeath
Ireland
Telephone: +353 (0)90 64 24521
e-mail: elangan@ait.ie

EDITORIAL POLICY

The *Irish Accounting Review* is published by the Irish Accounting and Finance Association as part of the process of fulfilling its objective to advance accounting and related disciplines in the education and research fields in the Republic of Ireland and Northern Ireland. The *Review*'s policy is to publish suitable papers in any of the areas of accounting, finance and their related disciplines. Papers in all categories of scholarly activity will be considered, including (but not limited to) reports on empirical research, analytical papers, review articles, papers dealing with pedagogical issues, and critical essays.

All submissions that pass an initial editorial scrutiny will be subject to double-blind refereeing. Referees will be asked to assess papers on the basis of their relevance, originality, readability and quality (including, for empirical work, research design and execution). In determining relevance, the editors will be influenced by the Association's objectives; thus, papers reporting on empirical work will be viewed more favourably if they deal with data relevant to those working in Ireland. Similarly, papers that have previously formed the basis of a presentation at the Association's annual conference will be particularly welcomed.

All submissions to the *Irish Accounting Review* should be made to either:

Noel Hyndman
School of Management and Economics
The Queen's University of Belfast
Belfast BT7 1NN
Northern Ireland

Email: n.hyndman@qub.ac.uk

or

Ciarán Ó hÓgartaigh
UCD School of Business
University College Dublin
Belfield
Dublin 4
Ireland

Email: ciaran.ohogartaigh@ucd.ie

Notes for Contributors are contained on pages 73–74.

'A DISTINCT DEGREE IN COMMERCE': CHARLES HUBERT OLDHAM AND THE ESTABLISHMENT OF UNIVERSITY-LEVEL COMMERCE EDUCATION IN IRELAND

Peter Clarke
University College Dublin
Ciarán Ó hÓgartaigh
University College Dublin
and
Margaret Ó hÓgartaigh
All Hallows College, Dublin City University

ABSTRACT

There is a limited prior literature on the development of accounting and business education in third-level institutions in Ireland. This paper attempts to partly fill this vacuum by focusing on Professor Charles Hubert Oldham, who, in 1909, became the first professor of Commerce in the newly created University College Dublin. He was appointed the first dean of the faculty the following year and remained in this position until his sudden death in 1926. A Home Rule Protestant, Oldham was prominent in the Irish 'urban intelligentsia' from 1882 until his death in 1926, a period of significant political and social change in Ireland. This paper provides a greater understanding of his contribution to education and his context as an educator.

INTRODUCTION

> I greatly prefer a distinct degree in Commerce, for if you consider you have pioneer work to do, if you create a distinct degree in Commerce, it will be a decided help towards the object aimed at. Make the qualification as high as possible, but have a distinct degree (Charles Hubert Oldham in evidence to the Dublin Commission, 1909, p. 72).

Charles Hubert Oldham (1859–1926) was an 'important influence' (Foster, 1997, p. 47) and 'prime mover'[1] in cultural and political circles in late nineteenth century

Dublin. He was one of the founders of the *Dublin University Review*, which first published the poetry of W.B. Yeats, and founder and host of the Contemporary Club, whose regular participants included Yeats, Maud Gonne, Douglas Hyde and Arthur Griffith. In 1901, he was appointed the first principal of the Rathmines School of Commerce (which subsequently became part of the Dublin Institute of Technology).[2] In 1909, he became the first professor of Commerce at the newly established University College Dublin (UCD) and, from 1910, was its first dean of Commerce.

This paper sets out and analyses the contribution of Oldham to the development of university business education in Ireland in the early twentieth century. Anderson-Gough (2008, p. 297) writes that 'education is not a subject area yet chosen for significant study by accounting historians'. This paper contributes to Irish accounting and business history by tracing the contribution of Oldham from his days as a '25-year-old Trinity star' (Foster, 1997, p. 39) through to his time as the first professor of Commerce at UCD.

There is no official publication detailing the history of the UCD Faculty of Commerce. The official history of UCD (McCartney, 1999), while lengthy, scarcely mentions the Faculty of Commerce. Clarke (2005) discussed the life of the late Professor Bernard Shields (dean from 1927 to 1951), who became the holder of the first chair in a United Kingdom (UK) university with 'Accounting' or 'Accountancy' in its title when he was appointed as Professor of Commerce and Accountancy at University College Galway in 1914. The considerable contribution of the late Professor George O'Brien (dean of UCD's Faculty of Commerce from 1951 to 1961) has been elegantly covered by Meenan (1980) and James Meenan's own significant achievements (dean from 1961 to 1973) have been outlined by Lysaght (2005). However, Oldham's contribution to the early development of commerce education in UCD and more widely has not yet been discussed.

This paper adds to our understanding of the development of business education at third level in Ireland by reviewing the archival material relating to Oldham, together with his considerable publications and writings about him by others. These are discussed with reference to the evolving political and educational context during the final decades of the nineteenth century and the early years of the twentieth century.

The paper is divided into three main sections. The next section outlines Oldham's background and his contribution to the cultural and political context of late nineteenth century Dublin. The following section then discusses his role, through submissions to the Dublin Commission, in shaping the establishment of the National University of Ireland and its constituent colleges in 1909. The third section discusses Oldham's contribution to UCD and the wider community until his sudden death in 1926.

THE BACKGROUND OF CHARLES HUBERT OLDHAM

In his application to King's Inns in 1888 and for the professorship of Commerce at UCD in 1909, Oldham states that he was born in 1859. He was a twin but his sister, Cecily, died as a young child after a severe attack of scarlet fever – a fever common in children between five and fifteen years of age at that time. Charles Oldham was the eighth child in a family of twelve, of which four died young (Ferguson, 2009).

Oldham's 1888 memorial to King's Inns and his 1909 application to UCD for the professorship of Commerce provide some personal background. He was the youngest son of Mr Eldred Oldham, silk merchant, of 11/12 Westmoreland Street, Dublin and Anne Oldham (née Alker), daughter of a house furnisher (McGee, 2009). He received his secondary education at Kingstown Grammar School, Dún Laoghaire, where he spent eight years 'under a remarkable staff of teachers, five of whom became eventually University professors' (Oldham, 1909), and he was subsequently educated at Trinity College Dublin (TCD), where he won a foundation scholarship in mathematics in his junior freshman year. He obtained first class honours in both mathematical and experimental science subjects at every examination of his degree, graduating in 1882 with a double honours degree, having achieved a gold medal in both mathematics and experimental science (i.e. physics and chemistry) (Trinity College, 1951). He remained in residence in TCD for some three years after he graduated (c. 1882–1885) and describes his work as 'grinding pupils in the subjects of my Honour Degrees, and I had a large experience as a teacher' (Oldham, 1909).

He also tutored in Strangway's, a private day school at 98 St Stephen's Green South run by Leonard R. Strangway (Thom's Directory, 1884). In Strangway's, Oldham taught for three hours per day and two on Saturday, for £120 per annum (Ferguson, 2009). Letters from his mother to his sister Edith in London, where she studied at the Royal College of Music, indicate that money was very scarce around that time in the Oldham household. Oldham provided financial support to his sister, and his mother writes 'Hubert would not allow you to want for absolute necessities [and] only what is absolutely necessary must be taken from him' (Oldham, A., 7 December 1883). His mother subsequently wrote that Charles' political opinions caused Strangway's to give him notice and that his 'pronounced opinions as a politician have seriously injured his prospects as a teacher' (Oldham, A., 12 July 1886), and that these opinions have 'left him without friends or income' (Oldham, A., 30 August 1886). He became editor of a new paper, *North and South*, at a salary of £2-10-0 per week (Oldham, A., 31 December 1886). For reasons that are not clear from the available archival material, it appears that he did not get on well with Webb – the owner – and Oldham received two months' notice to give up the editorship (Oldham, A., 22 April 1887).

In February 1885, Oldham, with T.R. Rolleston, established the *Dublin University Review*, the only monthly magazine published in Ireland at that time – it also circulated in England. Oldham became its managing director for three years (Oldham, 1909). The first edition of the *Review* indicates that a limited company was established to facilitate its publication, which would limit 'the liability of those who have subscribed the capital necessary to start it [and] in no case can any member become liable for more than the amount still remaining unpaid on the shares standing in his name', and it was also indicated that an additional £300 was to be raised (*Dublin University Review*, 1885, inside cover). The *Review*'s contributors were well-known personalities who played a significant role in Irish political and cultural affairs around that time, including Douglas Hyde, Samuel Ferguson and Michael Davitt. An insert in the November 1885 edition announced a change of offices and the relocation of Oldham to 'new chambers' at 116 Grafton Street; and his residence, according to various editions of Thom's Directory, continued at this address for many years thereafter.

Oldham left TCD – both as a tutor and from his lodgings there – around 1885. Chaudhry (2001) suggests that he was dismissed from his teaching post after publishing an article in the *Dublin University Review* by Michael Davitt (Davitt, 1885), the Irish nationalist and founder of an agrarian activist movement, the Land League, in September 1885. Foster comments (1997, pp. 39–40) that UCD (where he later became Professor of Commerce) was 'more hospitable' to Oldham's Home Rule politics than TCD.

Soon after Oldham's dismissal from TCD, he founded the Contemporary Club, which met weekly to debate any subject of interest to the members; the characteristic of the Club was its freedom of thought and expression (see Nicholls, 1965a; 1965b). The Contemporary Club was a setting where current political issues were argued out not only between nationalists and unionists, but also among nationalists themselves: between advocates of constitutional methods such as Oldham and champions of physical force like the Fenian John O'Leary (Daly, 1974). Those attending included political and literary figures such as Douglas Hyde, founder of the Gaelic League and later President of Ireland (1938–1945), Arthur Griffith,[3] the founder of Sinn Féin, Maud Gonne and W.B Yeats.

Oldham was involved in many other activities. He was a council member of the National Literary Society, and his UCD colleague Professor Mary Macken was also a member of the society (*Irish Times*, 16 and 18 June 1913). In addition, Oldham was a member and officer of the United Irish League with UCD colleague Professor Tom Kettle (*Irish Times*, 29 January 1913). The United Irish League was a nationalist political party organised around a programme of agrarian agitation, political reform and Home Rule, and by 1901 it claimed 100,000 members (Hickey and Doherty, 1980).

In 1888, describing himself as a 'college teacher', Oldham registered as a student of King's Inns (Ferguson, 2005). This registration required a payment of £25. It is possible that Oldham was influenced in his choice of study by the repeal of legislation in 1885 that required students reading for the Irish Bar to 'reside' for a specified number of years at one or other of the inns of court in London (Ferguson, 2005). With the repeal of this legislation, qualification for the Irish Bar was less expensive and did not require residency abroad. In 1890, Oldham qualified as a barrister-at-law and his King's Inns memorial further indicates that he attended a variety of lectures during his years of study and that he passed the examinations with honours. These exams included, for example, law of personal property, feudal and English law, and equity law; these disciplines provided him with the ability to subsequently teach various law subjects (King's Inns, undated). In addition, he obtained a Brooke Law prize in his final exam in the amount of £21 and he was called to the Bar in November (*Irish Law Times*, 1890). Subsequently, Oldham is listed as a barrister (Thom's Directory, 1894; Ferguson, 2005) who practiced on the north-western circuit with about 50 other barristers.

Oldham's obituary indicated that his political activities were responsible for the decline in his law practice and the 'severance of his career with the legal profession' (*Irish Times*, 22 February 1926). In his own words in his application to UCD

(Oldham, 1909), 'he travelled the North West Circuit for some years [but] Barrister's work was never quite congenial to me, and since 1895 I have not pursued the profession'. Thom's 1897 Directory lists Oldham as a mathematical and science teacher and residing at 116 Grafton Street.

In 1895 Oldham was appointed a Barrington Lecturer on Political Economy under the auspices of the Statistical and Social Inquiry Society of Ireland (SSISI),[4] and he indicated that for the

> [S]ix ensuing years, it was my duty to give each year a minimum of forty public lectures in the four Irish provinces on economic subjects of contemporary interest, the lectures being analogous to the University extension lectures in Great Britain (Oldham, 1909).

The Barrington Lectures included a special course of six lectures to be delivered in Dublin. The remaining lectures would be given at selected localities in Ulster and Connacht between November and March, and they were to be delivered on the same evening of the week for not more than four successive weeks. The subjects were chosen by the local organising committee from a list of ten topics (Statistical and Social Inquiry Society of Ireland, 1897–1898). The *Irish Times* (28 September 1895, p. 4) reports that one of his lectures on trade unions conveyed a 'great deal of interesting information during the two hours of Mr. Oldham's discourse' to a packed and attentive audience of about 500 persons.

OLDHAM AND THE DUBLIN COMMISSION

After a lengthy campaign (discussed in, for example, Coolahan, 1981), the Irish Universities Act of 1908 established two new universities in Ireland. The old Queen's College in Belfast was raised to the status of a full university with non-denominational status but with a large Presbyterian influence. A federal National University of Ireland was established which would embrace the existing colleges at Cork and Galway and the newly formed UCD. Though legally non-denominational, the geographical location, the background of the students and the religion of the majority of the governing bodies and staff ensured that these institutions would reflect a Catholic ethos, and they were accepted and supported by the Catholic hierarchy (Coolahan, 1981). Bartlett comments (2010, p. 366) that:

> [N]o one appears to have noticed that setting up two universities [Queen's University Belfast and the National University of Ireland], each organised on a different basis, directed at different religious communities, and located in different parts of the country, might presage some form of partition.

The Irish Universities Act of 1908 provided the majority of the Irish nation with a system of education serving the burgeoning Catholic middle classes and their emerging professional cadres. The University of Dublin (TCD) was not affected by the legislation (Maxwell, 1946).

The most immediate of all influences shaping the new university colleges was a statutory body of ten persons, known as the Dublin Commission. This body was exclusively charged with the duty of framing statutes for the administration of the university and of its three constituent colleges at Dublin, Cork and Galway, and alone made all appointments. As part of their work the commissioners visited the universities of Liverpool, Manchester and Leeds to 'study the provision made in the universities in these cities for Technological and Commercial education' (Dublin Commission, 1909, p. 3). The Dublin Commission established thirty-six chairs and fifteen lectureships at UCD (McCartney, 1999).

A few years earlier (1901), the Rathmines School of Commerce (subsequently renamed the College of Commerce and later again a part of the Dublin Institute of Technology) had been established. Oldham was appointed its first principal. The prospectus of the school, reproduced in the *Irish Times* (4 September 1902), stated that its purpose was to provide technical instruction for persons of either gender who are intended for commercial pursuits and that lectures would be given only in the evenings so as to assist those who were already employed. This was in keeping with the growth of education for both men and women of the middle classes. Commercial courses were seen as particularly useful for women and Hanna Sheehy-Skeffington, a well-known suffragist and nationalist, taught in Rathmines prior to the 1916 Rising (Luddy, 1995).

The Lord Lieutenant presented certificates and prizes to successful students of the school at the end of its first academic year (Dudley, 1905). In his speech, Lord Dudley acknowledged the uniqueness of the school in the area of commercial instruction and generally encouraged the teaching of commercial knowledge in preference to the (slower) process of accumulating personal knowledge by way of personal experience. Oldham was responsible for the early organisation of the Rathmines School, including the selection of the large staff of teachers and the mapping out of different courses of instruction (Oldham, 1909). He further pointed out that he had given regular courses of lectures at the school on commercial geography, economics, mercantile law, railway economics, trusts, 'kartels' (the German spelling was his) and combinations in modern business organisations (Oldham, 1909). Since 1898, he acted as lecturer and examiner to the Institute of Bankers in Ireland in political economy and commercial geography and history, and many of his lectures to the Institute were published in the *Journal of the Institute of Bankers in Ireland* (Oldham, 1909). He was their examiner in commercial geography and political economy.

In addition to accounting and commercial courses, Rathmines ran specialised courses for railway clerks, bank clerks and insurance clerks (Duff, Hegarty and Hussey, 2000). The Rathmines School of Commerce enrolled over 350 students per annum, representing a student population that the Commerce faculty in UCD would not match during its first twenty years of existence. It was the first institution of its kind to be started in Ireland.

In his capacity as principal, Charles Oldham, among others, provided important arguments to the Dublin Commissioners and drew their attention to developments in business education taking place in the United States and the continent of Europe around that time. Oldham was very much in favour of a separate Commerce degree rather than having a degree amalgamated with Arts, and this testimony was supported by the arguments of the representatives of the English universities. For example, the dean of the newly formed Faculty of Commerce at the University of Manchester (Professor Chapman) indicated that his university had decided to

> [I]ntroduce a distinct Faculty (of Commerce) because this kind of education is only just beginning, and it will be left much freer to develop itself, and to get advice and hints from outside business people than if it is attached to the Faculty of Arts (Dublin Commission, 1909, p. 39).

Oldham advised:

> I greatly prefer a distinct degree in Commerce, for if you consider you have pioneer work to do, if you create a distinct degree in Commerce, it will be a decided help towards the object aimed at. Make the qualification as high as possible, but have a distinct degree (Dublin Commission, 1909, p. 72).

In a lengthy memorandum to the Commissioners, Oldham pointed out that within the previous decade some 30 of the leading universities in America had developed commerce faculties. These included New York, Columbia, Chicago, Illinois, California, Stanford, Pennsylvania, Michigan, Wisconsin, Harvard, Yale and Vermont. He also argued that, in Great Britain, a similar situation had occurred in London, Birmingham, Manchester, Sheffield, Leeds, Liverpool and Edinburgh (Dublin Commission, 1909).

In addition, the Institute of Bankers, whose primary role was an educational one, asserted that it was 'the first body organised in Ireland for the special training and instruction of those engaged in an important branch of commerce' and argued that 'it is desirable that a fully-equipped Faculty of Commerce, analogous to the Faculties of Medicine, Law or of Engineering, should be established in connection with the National University of Ireland' (White, 1998, p. 19). The above arguments were successful, since both UCD and one of its sister colleges of the National University of Ireland, University College Cork (UCC), were founded with their own commerce faculties. However, largely for financial reasons, none was established in University College Galway (UCG) at that time.

Oldham did not support the establishment of a separate chair in Accountancy within this Faculty of Commerce and, in giving his evidence, he characterised the discipline as the ability to 'handle a balance sheet and to exercise judgement as the head of the firm on the reports which his subordinates give … but it is not expert work, and that is where the university comes in' (Dublin Commission, 1909, p. 69).

His evidence is unequivocal:

> My opinion is there is nothing of a university nature about accountancy work. It is probably the highest level of expert technical knowledge, but I see the type of men year after year … they are experts in their own line, and require expert teaching and not university teaching; the only teaching institution that the accountancy student wants is a grinding shop to prepare him for his own examination, and that is not the function of a university …. I don't think it is right that the University should have

> a Chair for Accountancy. I don't think there would be the work to do to warrant a Chair, but I think it very important that you should have a Lecturer in Accountancy (Dublin Commission, 1909, p. 69).

Oldham's argument against the creation of a chair of Accountancy certainly facilitated the financial viability of the hopelessly under-funded UCD. In an attempt to curb expenditure and to increase the proposed salaries of the more 'important' professorships, especially those in Medicine, the then President of the Catholic University (William Delany SJ) suggested to the Commissioners:

> [T]hat there are certain Chairs the appointments to which might, for the present be postponed[5] … because they are not so essential, and because they may be included in the subjects of some of the other chairs … Accountancy and Banking and Finance. We think that those subjects might be dealt with by the Professor of Commerce (Dublin Commission, 1909, p. 87).

In its report, the Commission explained:

> We need not say that we regard Technological Studies as essential in the University; and were it not that there is in Dublin a College in which these studies can be pursued … we should have felt bound to have instituted professorships in those subjects, at least in University College Dublin, although by so doing we should have rendered the resources of that College insufficient to provide for the teaching of other important subjects in University education (Dublin Commission, 1909, p. 5).

In 1909, Charles Oldham was appointed Professor of Commerce in the Faculty of Commerce at UCD. In his application he indicated that in relation to the Rathmines School:

> [T]he selection of the large staff of teachers and the mapping out of the different courses of instruction, I have been charged with a sole and undivided initiative. In fact, during the eight years of its existence, nothing has been done except on my initiation and nothing has been left undone which I had suggested … under these circumstances I may be allowed [to suggest that] the Rathmines School of Commerce as being the best objective evidence of my own qualifications to the Chair of Commerce in the University College, Dublin (Oldham, 1909).

Around that time Oldham moved from his Leeson Street residence to 55 Terenure Road (Rathmines and Rathgar district) where he lived with his wife, Katherina (commonly known as Kathë), then aged 49 years.[6] Bridget Kelly, who also lived at this address, is described as a 'general domestic servant' (Census, 1911).

At this time, therefore, Oldham moved his intellectual and geographical locale. The man who was a prime mover in the literary and political life of Dublin in the latter decades of the nineteenth century became one of the primogenitors of third-level commerce education two decades later.

OLDHAM AND COMMERCE EDUCATION AT UCD

UCD was founded by the Irish Universities Act 1908 and began life as a teaching institution on 2 November 1909 when it enrolled its first students (McCartney, 1999). Overall student numbers in this new university were small and did not exceed 1,000 during the first five years (in contrast with 350 business students alone enrolling in the Rathmines School each year). In the first academic year (1909/1910), there were a total of 530 students in the university, of which in excess of 90 per cent were male. As Williams (1954, p. 166) notes, in its first year UCD was 'a small college by modern standards; what had been granted was a modest provision for a limited future rather than an expansive or over-generous financial contribution.'

The statutes of the Irish Universities Act 1908 (Chapters XI and XVI) provided for the establishment of a commerce faculty at UCD.[7] The faculty was to have a professor of Commerce, with an annual salary of £400, and lectureships in accountancy, and banking and finance, with annual salaries of £150 and £100 respectively. The positions were advertised in, for example, the *Irish Times*. The closing date for completed applications was 31 August 1909 and appointments were to be made in October (*Irish Times*, 5 August 1909, and earlier dates). In addition, provision was made for two additional professorships, namely in the national economics of Ireland and political economy, both on annual salaries of £500. The offices were tenable for seven years and the holders were eligible for re-appointment.

Having been a prominent contributor to the Dublin Commission's work on the establishment of third level education, Oldham was appointed by the Dublin Commission as Professor of Commerce at UCD on Saturday 23 October 1909. The President of University College Dublin's Report (1925–1926, p. 27) subsequently noted that he had been a prominent worker in economic studies and had much practical experience in the development of schools (sic) of commerce. Oldham was honest enough to admit that his application in 1901 for the chair in Commerce then being established in the new University of Birmingham (England's first Faculty of Commerce) had been unsuccessful (Oldham, 1909).

The first meeting of the UCD Faculty of Commerce was held on 31 March 1910. The meeting was called for 2 p.m. and at 2.25 p.m. Professor Finlay was proposed as chairman. In addition to Professor Finlay, this first meeting was attended by Professors Oldham, Kettle, Cadic and Murnaghan, and Mary Macken, all from UCD; representatives from the sister colleges established under the 1908 Irish Universities Act (UCC and UCG) also attended. The minutes note that on the motion proposed by Finlay and seconded by Macken, it was agreed that Oldham be chosen as dean of the Faculty of Commerce in UCD (Faculty of Commerce, minute book, minutes for 31 March 1910).

The main item for discussion at this first meeting was a comparison of the courses for study in both UCD and UCC. Some minor differences were noted but no changes were recommended to either curriculum. The meeting lasted just over 30 minutes. The second Faculty of Commerce meeting was held on 1 June 1910 and the main item discussed was the proposed certificate in Commerce at UCC. After much discussion it was agreed that this certificate in Commerce would be delivered in UCC; UCD did not express an interest in such a programme. A third meeting followed on 21 November 1912, at which Oldham was reappointed as dean – a post which he retained until his sudden death in 1926. A handwritten note in the faculty minute book, dated 14 June 1927, reads 'The minute book containing the minutes of meetings prior to June 1927 is not available. It was probably in the possession of the late Professor Oldham' (Faculty of Commerce, minute book, p. 20). The UCD Calendar (1910–1911) for that period indicates that the Faculty of Commerce consisted of Oldham (Professor of Commerce), Kettle (Professor of National Economics), Finlay (Professor of Political Economy) and the lecturers in both accountancy, and banking and finance (both vacant), as well as various professors and lecturers in law, history and languages based in other faculties.

Oldham was appointed Professor of National Economics on the death of the incumbent, Professor Tom Kettle, who was killed at the Somme in 1916. Two years earlier, Oldham had been appointed to give lectures on the national economics of Ireland in *locum tenens* for Professor Kettle during the latter's absence on active service with the Irish Brigade (*Irish Times*, 28 November 1914).

Oldham was appointed as temporary Professor of National Economics and he was to be paid one guinea per lecture and £10 for examination work, the fees to be deducted from Professor Kettle's salary (UCD Governing Body, 22 December 1914). Meenan (1980) subsequently informs us that in 1917 the college proceeded to fill the vacancy and advertised it in the usual way. The chair went, after a closely fought contest, to Oldham. (In turn, Oldham's chair was filled by George O'Brien – a former UCD student but an external candidate – who would serve as dean of the Commerce Faculty from 1951 to 1961.)

As far as can be ascertained, Professor Oldham delivered the first lectures in the Faculty of Commerce, commencing on 11 January 1910, dealing with the geographical basis of international commerce. These were delivered on Tuesday and Thursday afternoons at 4.30 p.m. in the Physics Theatre in Earlsfort Terrace in the Hilary and Trinity terms. The minutes of the UCD Governing Body show that it was agreed that these lectures would be free to Commerce students and that others were to pay £1-1-0 (UCD Governing Body, 4 January 1910), and subsequently it was agreed to grant the Professor of Commerce £10 to purchase photographic slides for these lectures (UCD Governing Body, 22 March 1910).

The UCD President's report (President of University College Dublin, 1909–1910) for the first academic session of the university indicated that five (male) students attended Commerce lectures in this first session, and that this required expenditure for class materials of £27.18.9 out of a total university spend of £715.12.7 under this heading. The National University Handbook (National University of Ireland, 1932, p. 101) acknowledges that 'the first organisation of the Courses in Commerce was carried out with great care by the late Professor Oldham'. The following year (1910/1911) it is noted that Oldham delivered a special course of lectures on the subject of national finance during Trinity term; these lectures 'were attended by students of the BA and MA classes in economics as well as by other voluntary students' (President of University College Dublin, 1910–1911, p. 10). It is likely that these are the same series of eight Saturday afternoon lectures reported in the *Irish*

Times as attracting 'a very large audience', which filled the Physics Theatre (*Irish Times*, 8 May 1911).

The first B.Comm. students began their studies in the autumn of 1911 and sat their first Commerce examination in the summer of 1912. Only two examination candidates were listed. Lilian Deignan was awarded 'honours' and Thomas Fitzpatrick a 'pass'. It was reported that the lectures in Commerce and in Banking and Finance were largely attended by non-university students for whom special arrangements were made, and Oldham's special course continued (President of University College Dublin, 1911–1912). At the same time, one hundred students sat their first Arts exams, nineteen sat their first Science exams and seven sat their first Law examinations (University College Dublin Report, 1911–1912). Both aforementioned Commerce students in 1911–1912 completed their B. Comm. studies in 1913–1914 with 'pass' degrees.

C.S. (Todd) Andrews, an early graduate of UCD who was subsequently managing director and chairman of a number of semi-state organisations, recalls (1982, p. 39) that the 'Commerce degree at that time had the lowest standing in Academe, below even the BA pass degree in Trinity College which had an exceptionally poor reputation'. Another student, who was to become a leader of Fine Gael, an independent TD and Minister for Agriculture, James Dillon, became so convinced of the uselessness of the (UCD) Commerce degree that he withdrew from university without ever sitting for his degree (Manning, 1999).

Andrews (1982, p. 40) described Oldham as follows:

> In appearance Oldham was a wiry old man with a rugged face and closely cropped white hair with which he was well endowed even in his late sixties. He had an uncommonly loud, harsh voice which had the effect of unintentionally intimidating his classes. His accent was unmistakably Dublin but of a kind particular to well-educated Protestants and to Catholics of second generation affluence…. I recall a lecture in which he lamented the stoppage of emigration caused by the Great War. The events of 1916 and after were caused, in his view, by this curb on population movements in that it forced the young men, for want of something better to do, to take to the barricades. Feeling this to be a rather simplistic explanation of the rise of the Volunteer movement I stood up in class and said so. Oldham was neither abashed nor annoyed by my interruption. He heard me out and proceeded in his raucous voice and painfully humourless manner to defend his argument with a wealth of statistics.

Under Oldham's deanship, the number of commerce degree awards, and registered students, gradually increased, as reported in Table 1, but the numbers were always going to be small in a university whose arts and medical faculties were the biggest.

While the number of commerce degrees awarded might appear to be small by today's standards, in terms of student numbers, the Faculty of Commerce was the most successful in the (then) United Kingdom, surpassing Birmingham, Belfast and Cork (National University of Ireland, 1919).

Candidates for the first Commerce examination had to present themselves in five subjects as set out in Table 2.

TABLE 1: COMMERCE AND OTHER DEGREES AWARDED AT UCD, 1913/1914–1925/1926

	(a) B.Comm. Degrees	(b) Total Degrees	Percentage of Total Degrees that are B.Comm. Degrees
1913/1914	2	191	1%
1914/1915	3	198	2%
1915/1916	4	171	2%
1916/1917	7	187	4%
1917/1918	10	181	6%
1918/1919	8	190	4%
1919/1920	10	217	5%
1920/1921	14	265	5%
1921/1922	17	268	6%
1922/1923	14	253	6%
1923/1924	21	286	7%
1924/1925	27	360	8%
1925/1926	40	312	13%

Source: Compiled from President of University College Dublin (1935–1936)

The second and third year courses consisted of additional courses in Commerce, Accountancy, Political Economy, Law and Languages. This range of subjects was very similar to those subjects on offer in the recently established Faculty of Commerce in the University of Manchester (Dublin Commission, 1909, p. 27). A volume of handwritten lecture notes (about 200 pages) by Oldham for a course in the B.Comm. degree in UCD on the national economics of Ireland is available in the UCD archives (Oldham, notes undated). These notes focus primarily on, for example, Irish population and emigration figures, including statistics relating to the official censuses of 1821 to 1911, and figures relating to agriculture and industry; imports and exports; international comparisons; topography; local land division; and administration and jurisdiction. Included are occasional examination papers for courses which he taught in UCD. These papers were presented to the Faculty of Commerce around 1933 by his widow, Kathë Oldham (Faculty of Commerce, minute book, minutes of 16 May 1933).

TABLE 2: PAPERS IN THE FIRST COMMERCE EXAMINATION (UCD, 1910/1911)

1	Mathematics
2	One from: Modern Irish, French, German, Italian, Spanish or Welsh
3	English or Modern History
4	(Another) language or Experimental Physics or Chemistry
5	Commerce 1

Source: Compiled from UCD Calendar (1910–1911)

Oldham continued as an active member of the SSISI for nearly forty years. It was through the society that he became well-known as an economist (Black, 1947). Daly (1997) argues that some of Oldham's early papers to the society on Irish industrial history deserve to be ranked among the classical revisionist texts. However, it should be noted that there were revisionist writers long before Oldham and he is part of that distinguished tradition.

In all, he was the author of some twenty papers read before the society, which using today's terminology would include a remarkably wide range of topics in which he was especially interested, including national economics; economic history; education; international business and trade; population and demography; and statistics (see Appendix 1). In addition to presenting papers at regular intervals, Oldham acted as honorary secretary of the SSISI from 1895 to 1908. Appointed a Barrington lecturer in 1895, he was re-appointed annually until 1901 (Millin, 1920).

His contribution to the society is summarised in the following terms (Black, 1947, pp. 83–84):

> During the period 1890–1925 the Statistical Society had scarcely any more active member or frequent contributor than C.H. Oldham [and his] thirty-nine years of membership included those in which the Society's fortunes were at their lowest ebb, and he was instrumental in carrying it on and aiding it towards new development.

He was also a regular contributor to *The Economist* and other periodicals and societies (Black, 1947). One noteworthy publication not previously mentioned is *The Public Finances of Ireland* (Oldham, 1911). This publication coincided with the impending Home Rule Bill and was quoted extensively by Dunraven (1912), and provided solid evidence that under the Act of Union, Ireland was burdened with an unfair share of UK taxation. This was an important consideration in fuelling the nationalistic spirit in Ireland around that time.

Oldham died suddenly on 20 February 1926 at his residence in 5 Victoria Terrace, Rathgar (see Death Certificate, Reg. No. 2711111). The *Irish Times* (24 February 1926) reported on his funeral, at which a message of sympathy was read from William T. Cosgrave, the President of the Executive Council (of the Irish Free State). The attendance included many of his UCD professorial colleagues, including the UCD President, Denis Coffey, and academic colleagues from other Irish universities. He was survived by his wife, but had no children. The service at the grave was conducted by the Rev. John Murray, Oldham's life-long friend who had married Charles and Kathë in London on 11 August 1902 (*Irish Times*, 16 August 1902). In that sense, Oldham's passing was symbolic of his life: he had passed from bring a political figure of some significance in late nineteenth-century Ireland to a personage of largely academic prominence and marginal political involvement. He was also emblematic of an élite, an 'urban intelligentsia' (Goldring, 1993, p. 18) of pre-independence Ireland who were a more faded part of the weave of the newly emergent Irish Free State (Foster, 1988; Goldring, 1993; Fitzpatrick, 1998).

It would be remiss not to include reference to both his wife and his sisters in a paper on Charles Oldham. In 1908, his wife, Kathë, became president of the Irish Women's Franchise League, a suffrage movement at the start of the twentieth century involved with Irish nationalism and the cultural revival (Cousins and Cousins, 1995). Kathë died on 27 November 1946, aged 80 years, and was buried with her husband in Deansgrange cemetery in a private ceremony (*Irish Times*, 29 November 1946).

His sister Alice Oldham, who was appointed to the teaching staff of Alexandra College (Dublin) in 1886, became the leader of the campaign for the admission of women to TCD and was secretary of the Central Association of Irish Schoolmistresses from its foundation in 1882 until 1905. In this capacity, she conducted a continuous correspondence with the board of TCD, arguing the case for the admission of women to TCD, but the board decided that it could not admit women on to a residential male campus and stated that the charter and statutes did not permit it to do so. Eventually, in 1904, the board finally conceded, but women were prohibited from residing in the college and were expected to leave the campus by 6 p.m. each evening (Harford, 2008). Alice Oldham's struggle for the admission of women went largely unacknowledged until recent years (Parkes, 2004). Another sister, Edith Oldham, was an important figure in music in Dublin in the late nineteenth century and into the twentieth century and was the first (joint) honorary secretary of the Feis Ceoil association and a key member of staff of the Royal Irish Academy of Music for nearly fifty years (O'Connor, 2006).

SUMMARY AND CONCLUSION

On Oldham's death, an obituary in the *Irish Times* (22 February 1926) reported that:

> Mr. Oldham was respected by all for his integrity and sincerity, and even his frank expression of his opinions brought him no lasting enmities, while students regarded him with affection. For one whose life work was devoted to an abstract branch of knowledge, his general culture was wide, and it found expression in that generosity which was one of his most noted qualities.

His UCD colleague Professor George O'Brien stated that the study of political economy in Ireland had suffered a heavy loss by the death of Professor Oldham, whose writings, which were mostly on Irish subjects, would, if collected, form a large volume. The UCD President's report stated that 'his personal worth, his great success as an investigator and teacher, and his never failing interest in all that concerned the college and its members won him the abiding regard of his colleagues and his pupils' (University College Dublin Report 1925–1926, pp. 4–5). One of his colleagues at the Contemporary Club, Harry Nicholls (1965b), wrote that Oldham 'had one of the most massive intellects with which I have ever come in contact [and] he was incapable of intellectual dishonesty. To some, he appeared arrogant but the judgement was false. Those who knew him best know how modest he really was.'

This paper has provided a biographical background on Professor Charles Oldham. Further research will assess his 'agential power' (Lloyd, 1993, p .43) in this important period in Irish history and will position him in a historical context. He had an extraordinary background, which included a number of 'firsts', in terms of academic achievements and cultural contributions. His achievements are not only worthy of consideration in their own right but also as signals of a passing age, a passing of power from a largely Protestant Ireland, a Home Rule Ireland to a Catholic Free State.

After a political life in the Home Rule movement of the late nineteenth century, Oldham became part of the intellectual rather than political fabric of the newly independent state. In effect, he belonged to a moderate Protestant establishment which, in the context of the War of Independence, was replaced in the vanguard of the leadership of a newly independent Ireland by a more thrusting republican Catholic élite in a 'putsch of the middle classes' (O'Faoláin, 1943, p. 181). Like many of his generation and class, Oldham found a new intellectual identity in the structures of the newly emergent Free State. The political Oldham of Home Rule and the Liberal Party became the academic Oldham of commerce and UCD.

ACKNOWLEDGEMENTS

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APPENDIX 1

PAPERS AND ADDRESSES OF CHARLES OLDHAM TO THE STATISTICAL AND SOCIAL INQUIRY SOCIETY OF IRELAND

1. The Fluctuating Character of Modern Employment, Vol. X (1895–1896)
2. Economic Development in Ireland, Vol. X (1899–1900)
3. The Bearing on Industry of the Impending Changes in Irish Education, Vol. XI (1900–1901)
4. Technical Education for Commerce, Vol. XI (1901–1902)
5. Kartels and Syndicates in German Industry, Vol. XI (1903–1904)
6. The Economics of 'Industrial Revival' in Ireland, Vol. XII (1907–1908)
7. The Education of American Business Men, Vol. XII (1909–1910)
8. The History of Belfast Shipbuilding, Vol. XI (1910–1911)
9. The Incidence of Emigration on Town and Country Life in Ireland, Vol. XIII (1913–1914)
10. The Economic Interests Involved in the Present War, Vol. XIII (1914–1915)
11. British Finance of the War, Vol. XIII (1915–1916)
12. Industrial Ireland under Free Trade, Vol. XIII (1915–1917)
13. Changes in Irish Exports during Twelve Years, Vol. XIII (1917–1919)
14. Changes in Export Industries of Ireland: 1904–1916, Vol. XIII (1917–1919)
15. The Public Finances of Ireland, Vol. XIV (1919–1920)
16. The Development of Tillage in Ireland during the World War, Vol. XIV (1920–1923)
17. Some Perplexities in Regard to the Agricultural Statistics of Ireland, Vol. XIV (1923–1925)
18. The Interpretation of Irish Statistics, Vol. XIV (1923–1925)
19. The Trade Statistics of the Irish Free State in 1924, Vol. XIV (1923–1925)
20. Reform of the Irish Census of Population, Vol. XIV (1925–1927)

* Dates refer to publication years in the *Journal of the Statistical and Social Inquiry Society of Ireland.*
Source: Hayes, 1970, pp. 261–262.

NOTES

1. Ellen O'Leary in a letter to W.B. Yeats, 12 January 1889 in Yeats (1972, p. 127).
2. See <http://www.dit.ie/about/about-dit/history/>.
3. Oldham supported free trade principles, in contrast to Griffith, who drew on List's infant industry argument to advocate a protectionist policy (Lee, 1989; Johnson, 2005).
4. Since its foundation in 1847, the Society has analysed the major changes that have taken place in population, employment, legal and administrative systems and social services, and its journal provides an insight into the thoughts of a professional and intellectual elite on some of the most important aspects of Irish society.
5. 'Postponement' lasted longer than first anticipated. However, an internal report (National University of Ireland, 1919, p. 15) strongly recommended the appointment of a part-time professor of Accountancy who 'should be a qualified accountant in active practice of his profession [and this recommendation] is to make obvious the indisputable fact that Accountancy requires a very considerable development in the Faculty of Commerce at Dublin [and] that much more time, and more specialised and advanced teaching, for Accountancy should be supplied immediately'. Eventually, a part-time chair in Accountancy was created in UCD and filled by Gerard O'Brien in 1962 – the only applicant for the position (Faculty of Commerce minutes, 11 December 1962). Gerard O'Brien, a partner in the prestigious accountancy firm of Craig Gardner, had been appointed as a lecturer in Accountancy in UCD in 1935 on the death of the incumbent, Donal O'Connor. On O'Brien's retirement, the chair was converted into a full-time one and filled by the late Professor Desmond Hally, who was previously appointed as a college lecturer on 1 February 1965 (Faculty of Commerce minutes, 22 June 1964). The present incumbent is Ciarán Ó hÓgartaigh, who (in 2008) succeeded Professor Francis O'Brien, who had taken over the position from Professor Hally in 1993.
6. Around the time of his appointment to the Rathmines School of Commerce, Oldham travelled overseas and his mother writes (Oldham, A., 30 July 1884) that on one of their trips to Europe Oldham met 'two charming German ladies' with whom he travelled for four days (Oldham, A., 19 March 1885). It is anticipated that one of these 'charming ladies' was Oldham's future wife, Kathë.
7. A School of Commerce was established in TCD in 1925, primarily as a result of pressure from the Protestant middle classes, who wanted their sons to be given some 'polish and the chance of making the right kind of friend'; however 'it did not add much to the lustre of the college, but at least it induced a few commercially minded fathers to give their sons a university education without feeling that they were completely wasting their time' (McDowell and Webb, 1982, p. 449).

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DONORS AND NON-PROFIT ORGANISATIONS' ACCOUNTING MANIPULATIONS: AN OVERVIEW OF THE LITERATURE

Marc Jegers
Vrije Universiteit Brussel

ABSTRACT

There is almost no literature directly linking non-profit organisations' earnings manipulations to expected donor behaviour. Therefore, the literature on non-profit organisations' accounting manipulations is reviewed from the perspective of their expected effects on donations. It becomes clear that manipulations frequently aim at disclosing figures which are documented to be beneficial to the amount of funds raised. This provides enough ground to suggest strict accounting regulations for non-profit organisations, combined with audit engagements extended to the cost accounting information disclosed, despite some evidence that a majority of potential donors might not be interested at all in financial information.

INTRODUCTION

Non-profit organisations can be defined as organisations whose founders and employees are not entitled to (a part of) the organisation's profits (the 'non-distribution constraint' coined by Hansmann (1987, p. 28)). They are confronted with a multitude of stakeholders to which they are accountable, one important group of these being their donors. It goes without saying that overall accountability should relate to the organisation reaching its objectives, and that narrative and non-financial quantitative disclosures are essential for documenting this. Therefore, non-financial performance reporting should have a prominent role in the overall reporting practices of non-profit organisations (Falk, 1992; Hyndman, 1990; Parsons, 2003; Torres and Pina, 2003). However, strictly financial reporting, the focus of the present paper, cannot be discarded as being irrelevant, not only in terms of accountability, but also because of the empirically observed effects on the amount of funds raised. These funds are necessary to enable the organisation to pursue its objectives. Disclosed financial statements, therefore, are one of the ways to mitigate information asymmetries between organisations and their donors, and can be used by the latter to assess the organisations' financial health and needs. If this assessment affects donor behaviour, non-profit organisations have an incentive to present the relevant financial data as favourably as possible, to raise as much funds as possible. One might therefore expect to find numerous research papers on the relationship between accounting manipulations and donations, but nothing is further from the truth.

As far as can be ascertained, there is only one theoretical paper developed on this relationship (Jegers, forthcoming). It proposes a comprehensive formal model of earnings manipulations, taking the impact of disclosed earnings on externally raised funds into consideration. Both risk-neutral and risk-averse managers are assumed to function in a principal–agent setting in which the organisations' boards are the principals. This model remains fundamentally unchanged when donors are considered principals, as long as it is accepted that their objective is activity maximisation. Managerial objectives are assumed to be budget related (Steinberg, 1986). Power distribution between the board and management determines the eventual weights of activity level and budget in the organisational objective function, which is maximised. The impact of reported earnings Π_M on donations F is assessed by assuming $\partial F/\partial \Pi_M$ to be monotonically positive (one of the many forms of 'crowding-in'), zero or monotonically negative ('crowding-out'). It is proved that, without crowding-out or crowding-in, it is not optimal for the organisation to manipulate earnings. Otherwise, under both crowding-out and crowding-in, more managerial power leads to more earnings manipulation, and therefore to a larger impact on donations.

As far as the empirical work is concerned, there is literature available on the impact of disclosed financial data on donor behaviour and non-profit organisations' accounting manipulations. Both strands of the literature will be reviewed in the next section. The extensive literature on donor motives, as described, for example, by Andreoni (1990) or Rose-Ackerman (1996), will not be taken into consideration, as this is only indirectly relevant to the present paper's main topic. The paper closes with some conclusions and policy recommendations.

ACCOUNTING INFORMATION AND DONATIONS

Most of the empirical literature focuses on the relationship of donations with the 'price' of donations: the outlay of the donor net of personal tax advantages ($F(1\text{-}t)$, F being the gross outlay and t the tax rate to be applied), divided by the costs borne by the organisation to pursue its objectives ('programme' costs). The latter can be obtained from published financial statements, as long as they provide the allocation of all costs (C) to cost objects, some of which reflect these objectives. Ignoring for the moment tax deductible costs, a simple system of cost objects consists of having administration costs (A), fundraising costs (f) and programme costs ($C\text{-}A\text{-}f$). The price of programme activities then can be estimated by calculating

$$F(1\text{-}t)/(C\text{-}A\text{-}f) \qquad (1)$$

The literature reviews by Parsons (2003) and Jacobs and Marudas (2009) show that donations, admittedly from all kinds of sources, in general are negatively correlated with this price variable. The strength of the correlation differs between industries (Brookes, 2007) and also depends on the donors' sizes (Tinkelman, 1998). Tinkelman and Mankaney (2007) also establish that there is a relationship between donations and donation prices only when the price data are reliable and relevant. These relationships might partly be induced by the availability and frequent use of watchdog standards (Bhattacharya and Tinkelman, 2009).

However, there are a number of conceptual problems with the donation price variable, apart from the accounting manipulation possibilities discussed in the next section. The first is the observation that only programme costs are taken into consideration, and not output itself, thus ignoring possible efficiency differences between organisations (Parsons, 2003). The second is that, from a theoretical point of view, average values are bad guides when it comes to identifying the organisations to which additional donations would result in a maximal output increase. Admittedly, in practice marginal activities are difficult, if not impossible, to determine. The last point is that subtracting total administrative costs and fundraising costs is not really appropriate, as a certain amount of administration is necessary to make programme activities possible, as are some fundraising efforts to raise funds. Therefore, the mere presence of these costs is not an indication of inefficiency: there can be too much, or too little, of them. Kähler and Sargeant (2002) provide a benchmarking exercise for administration costs, taking into consideration a size effect. This is appropriate as a (large) part of the administration costs can be expected to be fixed. For anecdotal reference, the highest value of A/C observed in their sample of 410 English and Welsh charities was an astonishingly high 0.43 (Kähler and Sargeant, 2002).

On top of these conceptual issues, one cannot be sure that the potential donors bother at all about costs or donation prices (Hyndman, 1990). This has also been observed in a laboratory experiment by Buchheit and Parsons (2006): only 37 per cent of their test subjects (157 undergraduate management accounting students) were interested in making a financial comparison between organisations competing for donations. The good news is that 89 per cent of them eventually donated to the most efficient organisation, as measured by $(C\text{-}A\text{-}f)/C$.

Other ways through which financial information might influence donations are crowding-in and crowding-out mechanisms with respect to subsidies: the knowledge of organisations receiving ample subsidies might either be considered by potential donors as a reliable signal indicating the organisation is trustworthy, making them donate to that organisation (crowding-in), or as a reason to consider their gifts less necessary, so they refrain from donating (crowding-out). The two effects are not mutually exclusive, and their combined result is not *a priori* constant across industries (Smith, 2007) or across different subsidy levels (Borgonovi, 2006). It goes without saying that both mechanisms can only describe reality if potential donors indeed read and correctly understand the subsidy data contained in non-profit organisations' financial statements. Institutional donors can be expected to have the necessary expertise for this, but this is not necessarily the case for individual donors: Horne, Johnson and Van Slyke (2005) establish that, in a sample of 675 donors in the state of Georgia (United States (US)), 45 per cent did not have any clue about the subsidies received by the organisation they donated to, whereas only 28 per cent of the sample managed to make a correct estimate within (broad) 10 per cent limits. Clearly, in such a situation the impact of accounting information on donor behaviour, if any, can only be labelled as modest.

Crowding-in or crowding-out can also be at work in the relationship between a donation and the (reported) wealth of the organisation (Chase and Coffman, 1994): higher levels of wealth are considered to be either a reason to reduce donations (‘political cost’), or a signal of financial viability, entailing more gifts, which are then expected not to be wasted. Apparently, here the public is assumed not to be able to correctly assess the disclosed data.

In countries where tax regulations require non-profit organisations to make a distinction between taxable activities and non-taxable activities, another way to affect donations is the allocation of indirect costs to taxable cost centres and non-taxable cost centres. For the non-taxable cost centres, the aforementioned administration costs, fundraising costs and programme costs are direct costs. Here, organisations could be inclined to allocate as much as possible of their indirect costs to the non-taxable activities, in order to show as high as possible programme costs. This implies balancing higher gifts and lower taxes payable. Note, however, that shifting costs away from non-taxable activities to taxable activities reduces the reported cost of the former, which then appear to have performed more efficiently if output measures are available, possibly inciting potential donors to start or increase donations.

A last way by which accounting information can influence donations is through the assessment of the organisation’s performance by rating agencies, which is predominantly achieved by using disclosed financial data. In a recent paper by Gordon, Knock and Neely (2009), a positive correlation was reported between rating changes and both donation levels and changes in a sample of 405 organisations receiving at least $500,000 USD yearly in public support, followed by the US-based Charity Navigator (website data retrieved in 2007 (Gordon et al., 2009)). Silvergleid (2003) provides an overview of US watchdog agencies and finds mixed results as to their impact on donations.

ACCOUNTINGS MANIPULATIONS POSSIBLY AFFECTING DONATIONS

Definition

If donors are influenced by disclosed accounting data, non-profit organisations experience an incentive to present their financial data in a way that elicits as many donations as possible. This can be done within the confines of accounting regulations, or beyond them. Both types of actions will be called in the present paper ‘manipulations’, as the focus is on presenting financial data differently from how they would be, if their effect on donations and the legality of the actions were not taken into consideration.

Donation-Related Manipulations

When considering potential donors, non-profit organisations have an incentive to guide indirect cost allocations in a way that signals high activity levels (Trussel, 2003), especially when programme costs are disclosed together with administrative costs and fundraising costs. Krishnan, Yetman and Yetman (2004) present empirical evidence of this: comparing the data of 719 hospital-year observations (Californian non-profit hospitals, 1994–1998) in two databases that should contain the same data, they found that, on average, programme expenses reported in the publicly available database exceeded the same expenses reported in the other database, which was non-accessible by the general public, by $13.9 million USD (Krishnan et al., 2004). Furthermore, of the 95 hospitals reporting no fundraising expenses at all, at least 19 appear to have publicly observable fundraising activities (Krishnan et al., 2004), apparently shifting the fundraising costs maximally to programme costs and/or administration costs, and not to the fundraising cost centre. A comparable result is found by Tinkelman (2006): in two samples of, respectively, more than 17,000 New York-based contribution-receiving organisations and more than 16,000 US contribution-receiving organisations (1992–1994), about 50 per cent reported fundraising expenses lower than 1 per cent of contributions. In their later paper, Krishnan, Yetman and Yetman (2006) also found that the probability of not reporting any fundraising costs increases with the intensity of the relationship between donations and the share of the total costs that are programme costs. The same conclusion is reached when looking at the relationship between managerial remuneration and the share of programme costs. Finally, Keating, Parsons and Roberts (2008) establish in their sample of 4,063 observations, on 1,382 US non-profit organisations (1999–2004) located in eight states, that misreporting the cost of telemarketing campaigns might lead to an underestimation of the fundraising share of total costs by up to 15 per cent. The larger, more professional and more intensely monitored organisations are found to publish less misreporting, leading the authors to the suggestion that at least part of the misreporting might be explained by lack of accounting knowledge. Deliberate manipulation is therefore not the only possible explanatory factor.

Jones and Roberts (2006) do not look at programme activity share increasing manipulations, but at manipulations to dampen programme activity share variability. In their sample of 708 organisation-year observations of US non-profit organisations (1992–2000), they indeed see such behaviour. Potential donors might consider less variable activity shares as an indication of lower risk, making them more reassured when donating.

As to wealth reporting, the choice between fair market value reporting of the endowment and reporting the endowment at cost is considered in a sample of 137 private colleges and universities in the US (data pertaining to 1989) (Chase and Coffman, 1994). The results show that the institutions choosing the fair market value method are more endowed, supporting the financial viability reasoning.

The papers by Cordes and Weisbrod (1998; on 1,476 US non-profit organisations from the arts, education, health and human services industries, with data from 1992) and Yetman (2001; on 703 US non-profit organisations from the education, health and charity industries, with data from 1995–1997) document cost-shifting behaviour towards taxable activities. An opposite pattern is not apparent when looking at the allocated (aggregated) revenues (Yetman, Yetman and Badertscher, 2009; on 1,612 US organisation-years for 1995–1997). This is also reported by Omer and Yetman (2003), who show taxable incomes to cluster in a non-random way around zero. A number of organisations seem to be too zealous when shifting costs: in the US, more than half of the organisations reporting 'unrelated business income' report not making profits on it. Furthermore, the aggregate value of losses exceeds that of profits (Sinitsyn and Weisbrod, 2008, referring to work by Riley with Internal Revenue Service data up to 2002). One can only hope that applying creative allocation rules is the explanation for this situation, and not engaging in unprofitable 'profit' activities. This is exactly inferred by Sinitsyn and Weisbrod (2008), who show, in a sample of 11,036 observations (1993–1997) of US non-profit organisations in six broad industries, increased allocation of depreciation costs of assets used jointly for taxable and non-taxable activities to the taxable result when there is a possibility to reduce taxes by doing so. They also observe that the choice of taxable activities is not random, but possibly guided by the presence of assets that can be jointly used.

Finally, to the best of this author's knowledge, no empirical work is available on manipulations of disclosed subsidy levels. Furthermore, the relationship between manipulations and donations is almost never directly assessed (see next section), though researching manipulations is frequently justified exactly by its potential effects on donations, through the well-documented relationships between some financial data and gifts described earlier.

EARNINGS MANAGEMENT AND DONATIONS: DIRECT TESTS

Contrary to the huge amount of accounting manipulations literature for for-profit organisations relating manipulations to the organisation's main objective (profits), there is little of it in the non-profit sphere, and almost nothing on the relationship with donations. This should not be a surprise, as the non-profit character of these organisations implies profits are not the most relevant peformance parameter. Therefore, the for-profit earnings manipulation research is not fully transferable to study non-profit manipulations, even though too high profits or too severe losses might influence donor generosity.

In a way, the aforementioned work by Chase and Coffman (1994) can be interpreted as a direct test of the link between manipulations and donations, when we consider endowment levels to be cumulated donations, including their yields.

There is also some empirical work on manipulations aiming at improving ratings, assuming these might boost donations. This policy is illustrated in the case of the Avon Breast Cancer Walks described by Tinkelman (2009). Bhattacharya and Tinkelman (2009), on the other hand, applying visual inspection and statistical testing of ratio distributions, do not observe manipulations to reach watchdog-issued standards on a programme activity ratio and a fundraising cost ratio (111,894 US organisations for 2001). However, they acknowledge that this does not imply that there is no manipulation, as their sample consists only of organisations reporting non-zero administrative and fundraising costs (only 24 per cent of the total population (Bhattacharya and Tinkelman, 2009)).

CONCLUSIONS

Though there has been ample research on the link between non-profit organisations' financial disclosures and the level of gifts raised, and a substantial amount on non-profit organisations' accounting manipulations, the link between manipulations and donations has hardly been explicitly looked at, either from a theoretical perspective or empirically. Furthermore, the available research on non-profit organisations' earnings management/manipulations, a very popular topic when studying for-profit organisations, is (understandably) scant. There is no empirical work available on manipulations of disclosed subsidy levels, despite their role in crowding-in or crowding-out gifts. On the contrary, much attention has been given to non-profit organisations' cost accounting manipulations, a topic almost never touched upon for for-profit organisations. The reasons for this might be twofold: donors are assumed to be affected by cost accounting data, such as the price of donations, and organisations therefore (have to) disclose them.

When looking at the literature on non-profit organisations' accounting manipulations, we observe that manipulations frequently aim at disclosing financial data in ways known to stimulate potential donors to make or increase gifts, despite some evidence that a majority of potential donors might not be interested at all in financial information. Therefore, from a policy point of view, accounting regulations (for both financial accounting and cost accounting) should be as strict as reasonably possible, narrowing down as much as possible the scope for non-profit organisations to present themselves in a way that would alter potential donors' behaviour. Finally, as also suggested by Tate (2007), extending auditing to cost accounting disclosures might prove useful. From a social welfare point of view, these measures will reduce the problem of misallocating gifts from donors relying on financial information.

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IS CONDITIONAL CONSERVATISM HIGHER FOR OVERSEAS-LISTED CHINESE COMPANIES ON THE HONG KONG STOCK EXCHANGE?

Fan-Hua Kung
Tamkang University, Taiwan R.O.C.
Kieran James
University of Southern Queensland, Australia
and
Chia-Ling Cheng
Fu Jen Catholic University, Taiwan R.O.C.

ABSTRACT

This paper examines the conditional accounting conservatism (Basu, 1997) of Chinese companies that are overseas listed in Hong Kong as H-shares. Due to cultural, historical and political factors, H-share companies are expected to report no more conservatively than their Chinese counterparts that are not overseas listed. The institutional setting of H-share companies, with concentrated state ownership structures, bureaucratic management incentives and political interference, are expected to impede the supply of conservative reporting. Hong Kong-listed H-share companies are exposed to the threat of litigation, competitive market forces and a strict regulatory regime in Hong Kong. However, despite these factors, we expect them to report less conservatively than native Hong Kong companies. This is because of the dominance of local institutional incentives that are culturally based. Consistent with our predictions, we find that H-share companies report aggressively, whereas matched Chinese companies that are not overseas listed report neutrally. In addition, H-share companies are less conservative than native Hong Kong companies. Our evidence suggests that the location of listing has little effect on conditional conservatism because overseas-listed Chinese companies retain a significant exposure to their domestic environment.

INTRODUCTION

China's economic reforms have brought the quality of financial reporting issues to the forefront. In contrast to the progress in developing its capital markets, China's accounting infrastructure has been criticised, the query being whether its institutional, cultural and political foundations can sustain a market-driven financial reporting system. Since the early 1990s, the Chinese government has implemented accounting reforms, making it clear that the development of an efficient accounting system will improve the quality of financial reporting practices. Chinese officials appear to acknowledge that a transparent and reliable financial reporting system is one of the crucial ingredients for long-term economic growth. For example, the former Chinese premier Zhu Rongji, speaking at the opening of the sixteenth World Congress of Accountants, stressed that the demand for 'open, truthful and accurate accounting information had grown stronger, that the role played by accounting has become more important and the responsibility it shoulders more significant' in a market economy (cited in Hong Kong Society of Accountants, 2003, p. 18).

This paper reflects the increasing emphasis that China places on improving the quality of financial reporting practices as part of its efforts to implement and develop the institutions needed to support sustainable economic growth. Following prior literature (Pope and Walker, 1999; Ball, Kothari and Robin, 2000; Ball, Robin and Wu, 2003; Raonic, McLeay and Asimakopoulos, 2004; García Lara, García Osma and Mora, 2005; Huijgen and Lubberink, 2005; Bushman and Piotroski, 2006; Balkrishna, Coulton and Taylor, 2007), the focus of this paper is on international differences in conditional conservatism. Conditional conservatism is generally regarded as being an important attribute of reporting quality.

Conservatism is an established feature of accounting measurement in free-market countries, and is one mechanism used to constrain managerial opportunistic behaviour and to enhance the reliability of financial reporting and disclosure. For this paper, accounting conservatism is defined in the conditional sense of *asymmetrically timely loss recognition*, which requires a higher degree of verification for recognising good news (or positive economic performance) in earnings than for recognising bad news (or negative economic performance) in earnings (see Basu, 1997, p. 4).[1]

This paper assesses whether conditional conservatism is more pronounced for companies that are incorporated in mainland China but are also overseas listed on the Stock Exchange of Hong Kong (SEHK) as H-shares than for non-overseas-listed Chinese companies. In further analysis, we also address whether H-share companies report as conservatively as native Hong Kong-listed companies.

We find cultural, political and historical factors continue to be dominant in China: Chinese companies with H-shares do not report any more conservatively than non-overseas-listed companies.[2] In fact, H-share companies report aggressively and their non-overseas-listed counterparts report neutrally. The state bureaucracy, as a major shareholder of overseas-listed Chinese companies, does not demand conservative reporting and, where it is demanded by minority shareholders, they have insufficient voice and influence to ensure that conservatism is supplied. Our results also indicate that native Hong Kong companies report significantly less aggressively/

more conservatively than both overseas-listed and non-overseas-listed Chinese companies, which is consistent with our prior expectations and the arguments in Bushman and Piotroski (2006). These findings suggest that the location of listing (Hong Kong) has little effect on conditional conservatism, consistent with the prior empirical results of Ball et al. (2003) and Ball, Robin and Sadka (2008).

This paper provides additional support for discriminating among institutional determinants of financial reporting quality. In addition, it adds to the literature by identifying the extent to which conditional conservatism has been incorporated into current accounting practice in China.[3] In particular, it takes into account the institutional, cultural and political characteristics of a major emerging economy that is in the process of transition from communism to capitalism. Our results will have special relevance for other countries attempting the transition from communism to capitalism, such as Russia, Vietnam, the former Soviet Union republics, and the Eastern European countries.

The remainder of this paper is structured as follows. The next section develops the theory of accounting conservatism. The following sections introduce the institutional contexts and then describe the development of our hypothesis. We then present our research design and sample selection process. Further sections discuss our empirical evidence. The last section contains a brief recap and summarises the key findings of the study.

ACCOUNTING CONSERVATISM

The presence of inherent uncertainty, risk aversion and information asymmetry in the real world makes accounting conservatism a desirable feature of accounting practice at least in capitalist countries (Watts, 2003a, 2003b). In capitalist countries, economic forces, generated by the fact that various stakeholders will act in their own economic interests, create a demand for conservatism.

Devine (1963, p. 129) proposes that conservatism 'may be identified with reporting "favorable" indications with some reluctance and reporting "unfavorable" indications promptly and with unmistaken emphasis'. Recent accounting research has identified conditional and unconditional conservatism as related but distinct characteristics of accounting conservatism (Ball and Shivakumar, 2005; Beaver and Ryan, 2005). Beaver and Ryan (2005, p. 269) clarify that, under conditional conservatism, 'book values are written down under sufficiently adverse circumstances but not written up under favorable circumstances.' 'Conditional conservatism' is defined as a tendency to accelerate losses and defer gains. This characteristic of conservatism is referred to in the academic literature as '*asymmetric loss recognition timeliness*' (Chandra, Wasley and Waymire, 2004; Ball and Shivakumar, 2005; Beaver and Ryan, 2005; Balkrishna et al., 2007; Lai and Taylor, 2008). Basu (1997, p. 4) describes this form of conservatism as 'accountants' tendency to require a higher degree of verification for recognizing good news than bad news in financial statements'.

Conditional conservatism exists to constrain managers' asymmetric incentives to report economic good and bad news selectively. For example, timely loss recognition (or conditional conservatism) enhances contracting efficiency and allows stakeholders to protect their economic interests against managerial incompetence or malfeasance (Sunder, 1997). Therefore, Ball and Shivakumar (2005) and Balkrishna et al. (2007, pp. 384–385) assert that conditional conservatism is an important attribute of earnings quality because it makes financial statements more informative and useful, and thus allows stakeholders to better monitor a company's performance. Conditional conservatism gives shareholders and creditors more timely information about loss-making projects, which then allows them to take prompt remedial action (Ball et al., 2003; Balkrishna et al., 2007; Hung, Wong and Zhang, 2008).

Under uncertainty, in common law capitalist economies such as Australia, Canada, New Zealand, the United Kingdom (UK) and the United States (US), the economic interests of shareholders, creditors, auditors, regulators and other stakeholders drive accounting practices in the direction of conservative reporting and away from neutral or aggressive reporting (Sunder, 1997; Bushman and Piotroski, 2006; Roychowdhury and Watts, 2007). Stakeholders' demand for accounting conservatism affects management's supply of accounting conservatism through reporting incentives (Bushman and Piotroski, 2006, pp. 112, 130, 141; Balkrishna et al., 2007, p. 384). Institutions are responsible for the development of financial reporting practices, so the presence or absence of effective institutions, which increase reporting incentives, helps to determine the level of conditional conservatism. On the other hand, accounting conservatism is a function of the varying demands that accounting information satisfies given different institutional, legal and cultural arrangements (Ball et al., 2000, 2003; Bushman and Piotroski, 2006).

The demand for accounting conservatism is driven by the agency relationship between managers and stakeholders. Thus stakeholders' economic and political interests provide important signals about the level of conservatism which should be supplied to meet demand. Specifically, changes in economic and political interests among stakeholders generate pressure to alter such equilibrium via changes in demand and/or supply of conservatism (Bushman and Piotroski, 2006, p. 111). Other things being equal, it is expected that there will be a positive association between the demand for conservatism and the conservatism supplied. In the Chinese context, if senior managers see their most important accountability relationship as being with those further up the chain of command within the Chinese Communist Party (CCP), rather than with the 'market', then the supply of conservatism is likely to respond to this lack of demand from the party hierarchy. Since the CCP holds majority or substantial shares in overseas-listed Chinese companies, the interests of the CCP and (majority) shareholders tend to coincide in practice. Even where minority shareholders demand conservatism they may lack the voice and influence to ensure that it is supplied. Creditors probably will not demand conservatism since banks are state owned. A lack of demand for conservatism is likely to also be true for non-overseas-listed companies, but to a lesser degree due to less government involvement in their activities. Communism creates a culture that is woven into the fabric of all social relationships and becomes embedded within institutions (Zinov'ev, 1985). In the former Soviet Union we saw this process begin during Joseph Stalin's reign, from seven years after Vladimir Ilyich Lenin's 1917 communist revolution, but communism did not become fully stabilised and embedded until as late as the Leonid Brezhnev era in the late 1960s and 1970s (Zinov'ev, 1985). It is impossible to change communist cultures, and modes and norms of social relationships within short spaces of time, regardless of the actors' personal intentions (Zinov'ev, 1985).

INSTITUTIONAL CONTEXTS AND HYPOTHESIS DEVELOPMENT

Institutional Contexts

Recent research suggests that the demand for conservative financial reporting is influenced, either directly or in interaction with managers' reporting incentives, by a country's unique institutional environment (see Ali and Hwang, 2000; Ball et al., 2000; Ball and Shivakumar, 2005).

A growing body of research suggests that cross-country differences in legal tradition is perhaps the most important institutional factor to explain cross-country differences in developing accounting systems (Mueller, 1967; Nobes, 1983; Doupnik and Salter, 1995). As a British colony before July 1997, Hong Kong's exposure to British governance presupposes that it will adopt market-oriented common law accounting systems similar to those found in the West (Wallace and Naser, 1995). In contrast, although China generally does not have all the attributes of a code law accounting system, financial reporting practices in China are characterised as a variant of the code law model. Since inflexible (because it is slow and costly to change statutory law) code law legal traditions open up gaps between legal capabilities and commercial needs, they appear to emphasise the government's rights rather than private property rights (Beck, Demirgüç-Kunt and Levine, 2003).

La Porta, Lopez-de-Silances, Shleifer and Vishny (1998) claim that common law systems generally have stronger legal protection for outside investors and this encourages investors to enter the equity market. From Ball et al.'s (2000) point of view, a strong legal and judicial system is the most important requirement for an efficient financial reporting system because it enacts and enforces accounting and securities regulations which limit management's incentives to manipulate reported accounting information. It is also Basu's (1997) view that high demand for accounting conservatism occurs in common law countries because shareholders can resort to litigation to recover losses.

It is generally agreed that legal protection includes the rights written into regulations and laws, and effective enforcement mechanisms. Private enforcement of accounting regulations is weak in China. China has only recently passed laws to authorise class actions or similar measures to empower investors. Consequently, few lawsuits were filed against company management or auditors by shareholders until recently. This lower expected cost of shareholder litigation reduces management's incentives for reporting earnings conservatively.

In addition, La Porta et al. (1998) claim that political and bureaucratic corruption undermines a country's legal enforcement system, reduces the level of transparency in external reporting and slows financial growth (Rajan and Zingales, 2003). Government control and the regulation of economic resources provide opportunities for corruption. Thus, corruption is a continuing problem for developing financial reporting in certain parts of Asia. In a high corruption environment, the expectation is that legal enforcement is weak and that corporate transparency and the quality of accounting information are questionable. Therefore, it is expected that countries which are generally less corrupt in business practices will disclose conservative accounting information to signal long-run reputation capital (quality) to the capital market.

The development of a country's accounting system is closely associated with the development of its financial markets. It is also argued that a strong equity market with a diverse group of shareholders generally encourages the production and disclosure of sophisticated information (Doupnik and Salter, 1995). Hong Kong is regarded as East Asia's leading international financial centre. Its well-developed and liberal financial system is at the forefront of world commerce (Wallace and Naser, 1995). Stock trading in Hong Kong began in 1866, and a formal stock exchange was established in 1891. The SEHK is the eighth largest stock market in the world, measured by market capitalisation. Hong Kong's role as an international capital window for China is growing.

China is considered a code law country and it tends to develop institutions that advance and consolidate state power. Part of the problem is that the legal system in China is weighted towards criminal prosecution and not self-regulation, a policy that protects creditors, not shareholders. According to Ali and Hwang (2000), countries that protect creditors have larger credit markets. Such countries rely for capital on a few large banks. Given little outside equity participation, companies are therefore less subject to the discipline of the market. Because large banks have access to private company information they often do not demand public disclosure.

Although the banking system in China is extensive, its equity markets are smaller than those in Hong Kong. For example, in China, market capitalisation was only 36 per cent of gross domestic product (GDP) in 2003, compared to 453 per cent in Hong Kong (Census and Statistics Department, 2003). As noted, the state-owned banks are the major capital providers in China and accounting systems are credit-oriented so they often do not accurately reflect economic reality. Moreover, investor protection is weak. Finally, financial accounting in China is heavily influenced by the tax authorities. Thus, it is expected that companies in China are less transparent and demand less accounting conservatism.

On almost any objective level, accounting infrastructure, corporate transparency and investor protection in Hong Kong far exceed those found in China. In addition, Hong Kong, as a former British colony, is likely to have stronger institutions which positively influence the efficiency of the capital markets, an established legal system, strong and well-regulated financial intermediaries, and better property rights protection. It is maintained in this study that, due to the institutional differences discussed above, the shareholder orientation of common law accounting systems in Hong Kong will result in a higher demand for accounting conservatism than demand under the stakeholder model reflected in China.

Hypothesis Development

Over the last decade many Chinese companies have listed their shares on overseas stock exchanges to access external finance from deeper capital markets and a broader investor base (Roëll, 1996). Another advantage of overseas listing, aside from raising capital, is that it increases companies' incentives to improve performance and adopt higher standards of governance and transparency.

However, all Chinese companies must gain approval from the China Securities Regulatory Commission (CSRC) to issue shares overseas. China's overseas-listed companies are often used by the Chinese government opportunistically to 'showcase' China's industrial reforms abroad. There is a clear political aspect involved here. Significantly, only a few of China's most dynamic, successful and economically important companies are selected for listing in Hong Kong (Sun and Tong, 2000).

The headquarters and the dominant operations of these overseas-listed Chinese companies are located in mainland China. H-shares (those traded on the SEHK as opposed to A-shares, which are traded only on the mainland China exchanges) are attractive to institutional and individual investors from Hong Kong and overseas. The attraction is that H-shares provide international investors with investment opportunities in Chinese stocks without having to be concerned about investment restrictions on ownership and language and cultural barriers, which can be major impediments for investors investing directly on the mainland. The market environment of the SEHK differs from that of China's domestic exchanges. The SEHK is well established, open and has rigorous listing requirements and information disclosure rules. This is not the case for the mainland China stock exchanges.

A Chinese company wishing to list on the SEHK must comply with the same set of listing rules and disclosure requirements as native Hong Kong companies. H-share companies can satisfy SEHK listing requirements by preparing financial statements in accordance with Hong Kong's generally accepted accounting principles (GAAP) or with international financial reporting standards (IFRSs) and the disclosure requirements of the Hong Kong Companies Ordinance. Financial statements prepared for H-share companies are audited either by the 'big four' (the largest four global brand-name accounting firms) or by another large international accounting firm.

There are several reasons why the earnings of H-share companies might be expected to be more conservative than those of their non-overseas-listed counterparts in the absence of cultural, historical and political factors. Firstly, global accounting standards permit managers to exercise judgement so as to accurately reflect companies' contemporaneous economic performance.[4] Secondly, an effective system of private litigation and market forces deepens corporate reform, strengthens corporate governance and leads to continuous improvement, management transparency and better financial results. Thirdly, the financial reports of H-share companies are audited by international accounting firms, whereas Chinese companies listed only on the domestic exchanges are audited by local accounting firms. These Chinese accounting firms lag behind in terms of the quality of audits undertaken, lack independence, lack qualified auditors and sometimes operate in a corrupt environment (DeFond, Wong and Li, 2000; Xiao, Zhang and Xie, 2000). Chinese auditing firms may lack the abilities, independence and experience needed to make the professional judgements required to actually implement accounting conservatism in practice. In sum, H-share companies are exposed to the threat of litigation, competitive market forces, better auditing and a stricter regulatory and enforcement system than their non-overseas-listed counterparts.

Equally importantly, the very act of overseas listing by mainland firms on the SEHK may signal high quality reporting to investors. Ball et al. (2000) argue that high quality companies in code law countries signal quality and reduce contracting costs by listing in common law jurisdictions. Likewise, Stulz (1999) and Doidge (2004) theorise that overseas listing commits managers based in weak institutional environments to limit their consumption of private benefits in exchange for increased capital-raising ability and increased share liquidity (the 'bonding hypothesis'). This view is based on Akerlof's (1970) classic signalling model in which he argues that external third-party certification reduces information asymmetry, increases the level of trust in the marketplace and, therefore, increases the equilibrium price that higher quality products can command. Integral to Akerlof's model is the presumption that *false* signals of quality are costly to the signallers.

According to Bartov and Bodnar (1996) and Boone and Raman (2001), actual improved financial reporting quality reduces information asymmetry in the marketplace between informed and uninformed investors, which leads to a reduced bid–ask spread, higher quoted depth, a lower cost of capital and a higher long-run market share price. Thus, it could be argued that code law country companies listing in common law jurisdictions have an increased incentive to report conservatively. However, we argue that cultural, political and historical factors will have a greater effect on conservatism for H-share companies than the factors just explained. As a result, the conservatism of these H-share companies will not differ significantly from their non-overseas-listed counterparts. The majority of H-share mainland companies are restructured state-owned enterprises (SOEs), still owned and controlled by state entities. In addition to publicly tradable shares, a typical overseas-listed Chinese company has a high portion of non-tradable shares.[5] This concentrated ownership of H-shares undermines the formation of a transparent accounting system. Accountability to the CCP tends to be more important than accountability to the 'market', if not in theory then certainly in practice (Hung et al., 2008). The culture of long-established communism becomes embedded in social relationships and practices (Zinov'ev, 1985) and it is very difficult to change this quickly. We saw this in the Serbia of Slobodan Milošević in the 1990s where one-party state communism became multi-party authoritarian nationalism, featuring powerless and confused opposition parties and continued strong media censorship (Stevanovic, 2004). As Bushman and Piotroski (2006, p. 115) argue, 'if benevolent governments intervene when they perceive that firms [and/or managers] are inefficient, firms have an incentive to look healthier through the application of less conservative accounting'. Furthermore, Bushman and Piotroski (2006, p. 109) document that, 'in countries characterised by high state involvement in the economy [even listed] firms speed recognition of good news and slow recognition of bad news in reported earnings relative to firms in countries with less state involvement.' Ms Charmaine Xie (name changed), a Shanghai native who has worked for both Chinese and international accounting firms in Shanghai, made the following observations about the incentives and reporting behaviours of Chinese listed companies (in an e-mail communication with the second-mentioned author, dated 11 April

2008):

> I have … worked in a Shanghai stock listed company. And I know almost all the listed companies are 'reporting less conservative profits'. In China, we always say 'Don't trust the financial reports of those listed companies. They are rubbish', even though they are required to be audited by accounting firms such as [the] big 4. You can imagine what a bad reputation those companies' untrue financial reports have! In my personal opinion, this situation was caused by more economic factors than cultural factors. That's mainly because of [the] incentive-driven [culture]. Managers gotta' exaggerate the profits to pull the share price and to prove his/her good performance and achievement.

We argue that the politically connected H-share companies operate in a cultural, political and institutional environment characterised by 'crony capitalism' (Gul, 2006) where the government is willing to intervene regularly in the companies' activities to achieve political and social objectives (Gul, 2006). The CCP bureaucracy is unlikely to demand conservative reporting and hence it is unlikely to be supplied. Therefore, these companies will have a different set of incentives and constraints than native Hong Kong companies listed on the SEHK, which are totally subject to market forces.

The aforementioned literature and inferences lead to the following hypotheses:

Hypothesis 1: Chinese companies that are overseas listed in Hong Kong are expected to report no more conservatively than Chinese companies that are listed in the domestic exchanges.

Hypothesis 2: Chinese companies that are overseas listed in Hong Kong are expected to report less conservatively than native Hong Kong-listed companies.

RESEARCH METHODOLOGY

Following prior studies, Basu's (1997) conservatism model is used to explain the difference in the speed with which economic gains and losses are captured by accounting earnings. Basu defines 'conditional conservatism' as the immediate recognition of bad news and the gradual recognition of good news in such a way that bad news (negative returns) is incorporated more rapidly into accounting earnings than good news (positive returns).[6] Basu's conservatism regression model takes the following form:

$$\frac{X_{it}}{P_{it-1}} = \alpha_0 + \beta_1 D_{it} + \beta_2 R_{it} + \beta_3 D_{it} \times R_{it} + \varepsilon_{it} \qquad (1)$$

where X_{it} is the earnings-per-share for company i in year t; $P_{it\text{-}1}$ is the stock price-per-share for company i at t-1; R_{it} is the annual stock returns for company i in year t;[7] D_{it} is a dummy variable set equal to one if R_{it} is negative and zero otherwise; and ε_{it} is the disturbance term.

Importantly, this model explains the asymmetric incorporation of contemporaneous economic gains and losses in accounting income, and hence into book values on balance sheets.[8] Equation 1 posits that using accounting earnings (a lagging variable) as the dependent variable and stock returns (a leading variable) as the independent variable better estimates the slope coefficient. A bad news dummy, D_{it}, is included in the regression to distinguish bad news from good news.

The slope coefficients β_2 and β_3 in Equation 1 are used to measure the responsiveness of reported earnings to the news captured in returns. These slope coefficients are termed 'return response coefficients'. Empirical comparisons of conservatism are based on the difference between the slope values for good news, β_2, and for bad news, $(\beta_2 + \beta_3)$. The bad news slope coefficient is higher than the good news slope coefficient when conservatism exists. Under conditionally conservative reporting, the slope coefficient β_3, which measures the incremental response of earnings to bad news over the response to good news, is expected to be positive.[9] This response reflects a stronger return–earnings relationship for companies with bad news. The intercept a_0 is also expected to be positive due to the influence of prior periods' good news in current period earnings, which is recognised gradually over future periods.

Following Beekes, Pope and Young (2004), Ball and Shivakumar (2005), Bushman and Piotroski (2006), and Balkrishna et al. (2007), this paper uses an expanded version of Basu's (1997) basic model:

$$\frac{X_{it}}{P_{it-1}} = \alpha_0 + \beta_1 D_{it} + \beta_2 R_{it} + \beta_3 D_{it} R_{it} + \beta_4 MAT_{it} D_{it} + \beta_5 R_{it} MAT_{it} + \beta_6 R_{it} MAT_{it} D_{it} + \varepsilon_{it} \tag{2}$$

where MAT_{it} is a dummy variable. In the first set of tests the dummy variable is set equal to 1 if company i is an H-share company and 0 if company i is a matched non-overseas-listed Chinese company. In the second set of tests the dummy variable is set equal to 1 if company i is an H-share company and 0 if company i is a native Hong Kong company. All other variables are as defined above.

In Equation 2, coefficient β_3 captures the marginal effect of sensitivity to bad news for companies where MAT_{it} equals 0, and the interaction coefficient β_6 captures the incremental conservatism for companies where MAT_{it} equals 1. It is also expected that, for conservative reporting, the interaction coefficient β_6 will be significantly positive.

Sample Selection and Definition of Variables

Both the China and the Hong Kong samples include all available company-year observations in the *Taiwan Economic Journal* (TEJ) database for the years 1994 to 2003. To be included in the samples, companies had to have sufficient financial data and stock return data to provide a valid data point in the estimation of the conservatism regression models. To measure the change in a company's economic income, inter-announcement stock returns, R_t, were used as a proxy for news. These are the annual returns calculated from nine months before the year-end t to three months after the year-end t to exclude the effect of market response to the earnings release at the previous year-end.[10] The earnings variable is defined as $NI_t = X_t / P_{t-1}$, where X_t is earnings-per-share in year t, and P_{t-1} is the stock price at the beginning of the year t. To be consistent with earnings definitions across countries, earnings-per-share is based on net income (bottom-line earnings) to control for differences in the classification of earnings across countries (Pope and Walker, 1999). Because financial companies are subject to specific regulatory requirements, the financial services industry was excluded. In addition, inactive companies were included to reduce survivorship bias. Since extraordinary items are not presented separately under Chinese GAAP, earnings-per-share was based on net income (bottom-line earnings) in the databases. Moreover, we deleted the top and bottom percentiles of the earnings and returns variables to reduce the effect of outliers on the regression results. Adoption of these sample selection procedures resulted in a final sample of 7,353 and 5,639 company-year observations for China (Shanghai and Shenzhen Stock Exchanges) and Hong Kong (SEHK) respectively.

To examine the behaviour of overseas-listed companies, Chinese companies which issued H-shares in Hong Kong were extracted from the Hong Kong SEHK sample. The overseas-listed Chinese company sample included 373 company-year observations spread throughout the sample period. We computed the stock return for a company issuing *both* A- and H-shares as the adjusted weighted average of A- and H-share returns, the weights being determined by the market value of A- or H-shares at the beginning of the year. We did this to overcome pricing biases or inaccuracies that might exist on one of the exchanges where the company is listed. In addition, earnings-per-share for a company issuing both A- and H-shares was deflated by the weighted average of A-share and H-share prices at the beginning of the year, the weights being determined by the number of A- or H-shares over the total number of outstanding shares of the company. In addition, the H-share company sample was matched, based on industrial affiliation and total assets, with both Chinese companies without overseas listing and with native Hong Kong companies.[11]

RESULTS

Descriptive Statistics

Table 1 reports the descriptive statistics for the H-share company sample. Panel A reports the raw data. The mean annual return (R) for raw H-share company data is 0.2848 with a standard deviation of 0.9598, while the mean earnings variable (NI) is 0.0543 with a standard deviation of 0.2634.

Panel B provides summary statistics for stock returns and accounting income with adjustment of the weights. Overseas-listed company returns are generally higher than returns for those companies that are not overseas listed (shown in Table 2). The weighted mean annual return (R^w) for the overseas-listed companies is 0.2009 with a standard deviation of 0.6758. The accounting income of overseas-listed companies is also higher on average than for their non-overseas-listed counterparts (shown in Table 2, Panel A). The weighted mean earnings variable (NI^w) is 0.0623

TABLE 1: H-SHARE SAMPLE DESCRIPTIVE STATISTICS

Panel A: H-Share Sample Raw Data[a]

		NI[b]		***R***[c]	
Year	***n***	**Mean**	**Std. Dev.**	**Mean**	**Std. Dev.**
1994	3	0.0732	0.0566	-0.3945	0.3938
1995	15	0.0787	0.0552	-0.2184	0.2839
1996	18	0.0490	0.0674	0.2438	0.4975
1997	26	0.0192	0.0883	-0.3931	0.1929
1998	40	-0.0225	0.2712	-0.3233	0.2000
1999	41	0.0513	0.2361	0.1240	1.5110
2000	45	0.0440	0.5357	1.0977	1.0020
2001	53	0.0243	0.2603	0.0645	0.2109
2002	58	0.0787	0.1350	-0.1449	0.3496
2003	74	0.1141	0.1874	1.0806	0.9571
Total	*373*	*0.0543*	*0.2634*	*0.2848*	*0.9598*

Panel B: H-Share Sample Weighted Data[d]

		NI^{w} [e]		***R***^{w} [f]	
Year	***n***	**Mean**	**Std. Dev.**	**Mean**	**Std. Dev.**
1994	3	0.0734	0.0562	-0.4805	0.1304
1995	15	0.0741	0.0506	-0.0197	0.4080
1996	18	0.0391	0.0629	0.7910	0.7193
1997	26	0.0183	0.0629	-0.2365	0.2485
1998	40	0.0124	0.1370	-0.2015	0.3244
1999	41	0.0540	0.1313	0.1311	0.6030
2000	45	0.0959	0.2005	0.6148	0.6827
2001	53	0.0537	0.1286	-0.0118	0.2280
2002	58	0.0685	0.1053	-0.1562	0.3106
2003	74	0.0930	0.1492	0.7201	0.8469
Total	*373*	*0.0623*	*0.1353*	*0.2009*	*0.6758*

[a] The sample consists of companies which issue H-shares in the Hong Kong stock market and have a full set of available data and accounting years falling within the period 1994–2003.

[b] *NI* (X_{it} / P_{it-1}) is defined as earnings-per-share deflated by price at the beginning of year *t*.

[c] *R* (R_{it}) denotes inter-announcement stock returns measured from May of year *t* to April of year *t*+1.

[d] The data for the H-share sample with adjustments of the weights.

[e] NI^{w} is defined as earnings-per-share (Hong Kong GAAP or IFRS) deflated by the beginning-of-the-year H-share price (if the company issues only H-shares), or a weighted average of A- and H-share prices at the beginning of the year, with the weights determined by the numbers of A- or H-shares over the total number of shares issued and outstanding (if the company issues both A- and H-shares).

[f] R^{w} is the inter-announcement period H-share return or a weighted average of A-share and H-share returns, with the weights determined by the market value of A- or H-shares at the beginning of the year.

TABLE 2: DESCRIPTIVE STATISTICS FOR THE CHINA SAMPLE

Panel A: Complete China Sample (Before Matching)

	n	Mean	Median	Std. Dev.	Min.	Max.
NI[a]	7353	0.0255	0.0186	0.0789	-0.7014	1.7561
R[b]	7353	0.1218	-0.0723	0.6743	-0.8617	8.4848

Panel B: Selected Years

		NI[a]		*R*[b]	
Year	***n***	**Mean**	**Std. Dev.**	**Mean**	**Std. Dev.**
1994	249	0.1280	0.1527	-0.0641	0.3573
1995	290	0.1067	0.1632	0.3131	0.4768
1996	330	0.0706	0.1486	1.2998	1.1150
1997	568	0.0340	0.0625	0.0147	0.5149
1998	737	0.0271	0.0664	-0.0892	0.4286
1999	839	0.0304	0.0533	0.7582	0.7259
2000	934	0.0134	0.0398	0.3810	0.8900
2001	1089	0.0066	0.0411	-0.2122	0.2209
2002	1114	0.0059	0.0509	-0.1903	0.2051
2003	1203	0.0084	0.0608	-0.0829	0.2420

[a] *NI* (X_{it} / P_{it-1}) represents earnings-per-share deflated by price at the beginning of year *t*.

[b] *R* (R_{it}) denotes inter-announcement stock returns measured from May of year *t* to April of year *t*+1.

Descriptive Statistics for the Matched Sample

Panel C: Matched China Sample (Non-Overseas-Listed Chinese Companies)

	n	Mean	Median	Std. Dev.	Min.	Max.
NI[a]	373	0.0257	0.0190	0.0798	-0.5445	0.8993
R[b]	373	0.1411	-0.0376	0.6446	-0.6594	4.2160

[a] *NI* (X_{it} / P_{it-1}) represents earnings-per-share deflated by price at the beginning of year *t*.

[b] *R* (R_{it}) denotes inter-announcement stock returns measured from May of year *t* to April of year *t*+1.

(0.0255) for overseas-listed (total non-overseas-listed) companies and the standard deviation is 0.1353 (0.0789).

Table 2 reports Chinese companies listed on the Shanghai Stock Exchange and the Shenzhen Stock Exchange as A-shares.[12] The mean (median) annual returns (*R*) are 0.1218 (-0.0723), with a greater variation over the sample period and a relatively high volatility (standard deviation 0.6743) that is characteristic of emerging markets.[13]

The mean value of earnings variable (*NI*) is close to 0, having mean (median) and standard deviation values of 0.0255 (0.0186) and 0.0789, while the distribution of the *NI* variable tends to decrease over the sample period. Both *R* and *NI* are right-skewed (they exceed the medians), indicating a *low level of accounting conservatism* for the China sample. In addition, the standard deviation of the *NI* variable is always smaller than the standard deviation of *R*, consistent with Ball et al.'s (2000, p. 12) and Ball, Kothari and Nikolaev's (2010, p. 14) argument that accounting income is a lagged function of past and present years' stock returns (i.e. 'prices lead earnings'). Panel C reports descriptive statistics for the matched firms only. These are not very different from those for the whole Chinese market (Panel A). Mean also exceeds median for the matched firms' net income distribution.

Table 3 reports the Hong Kong SEHK-listed companies. The mean (median) annual returns (*R*) for the Hong Kong sample is 0.0869 (0.0505). Returns are left-skewed and display great volatility for the sample, as evidenced by the standard deviation of 0.8597. However, the mean (median) earnings variable (*NI*) for the Hong Kong sample is -0.0389 (0.0505) and the standard deviation is 0.4449, showing less earnings volatility. The accounting income (*NI*) is left-skewed. A left-skew of earnings suggests that Hong Kong companies report occasional large negative

TABLE 3: DESCRIPTIVE STATISTICS FOR THE HONG KONG SAMPLE

Panel A: Complete Hong Kong Sample (Before Matching)[a]

	n	Mean	Median	Std. Dev.	Min.	Max.
NI[a]	5636	-0.0389	0.0505	0.4449	-3.5368	5.2632
R[b]	5636	0.0869	-0.0999	0.8597	-0.9785	9.6796

Panel B: Selected Years for Hong Kong Companies

		NI[b]		*R*[c]	
Year	***n***	**Mean**	**Std. Dev.**	**Mean**	**Std. Dev.**
1994	202	0.0947	0.1422	-0.2966	0.2497
1995	397	0.0577	0.3132	0.2320	0.7412
1996	434	0.0550	0.2995	0.5417	1.0598
1997	477	-0.0165	0.3243	-0.3786	0.4366
1998	479	-0.1567	0.4600	-0.2380	0.1735
1999	448	-0.0255	0.4857	0.5119	1.3701
2000	676	-0.0335	0.3921	-0.1466	0.6102
2001	744	-0.1112	0.4761	0.0551	0.6448
2002	856	-0.1048	0.4475	-0.2818	0.4738
2003	926	0.0045	0.3314	0.6341	0.9819

[a] The Hong Kong sample consists of companies that have a full set of available data and accounting years falling within the period 1994–2003.
[b] *NI* (X_{it}/P_{it-1}) is earnings-per-share deflated by price at the beginning of year *t*.
[c] *R* (R_{it}) denotes inter-announcement stock returns.

Panel C: Matched Hong Kong Sample (Native Hong Kong Companies)

	n	Mean	Median	Std. Dev.	Min.	Max.
NI[a]	373	0.0272	0.0790	0.4117	-2.5277	2.7468
R[b]	373	0.1276	0	0.7990	-0.9334	7.7673

[a] *NI* (X_{it}/P_{it-1}) represents earnings-per-share deflated by price at the beginning of year *t*.
[b] *R* (R_{it}) denotes inter-announcement stock returns measured from May of year *t* to April of year *t*+1.

accruals consistent with the presence of conditional conservatism (Ball et al., 2000, p. 12; Balkrishna et al., 2007, p. 387; Ball et al., 2010, p. 26). Panel C reports descriptive statistics for the matched firms only. Matched firms report higher net incomes and returns than for the whole Hong Kong market (Panel A). However, the matched firms also demonstrate conditional conservatism (the median exceeds the mean for the net income distribution).

Regression Results

Table 4 presents regression results for the overseas-listed Chinese companies sample and the two matched-pairs control groups.

The first row presents the regression results for Equation 1 for the overseas-listed Chinese companies sample of 373 observations. The β_3 coefficient is significantly negative at the 1 per cent level (-0.1977; t = -3.41), indicating a lack of conditional conservatism for the H-share companies sample. In fact, we have evidence of '*conditional aggression*', i.e. good news is captured in earnings at a more rapid rate than bad news. The second row presents regression 1 for the first control group. This group is a matched sample of non-overseas-listed Chinese companies based on industry affiliation and total assets. The coefficient β_3 is not statistically significant (0.0080; t = -0.18) for the matched sample, indicating the absence of *both* conditional conservatism and conditional aggression for non-overseas-listed Chinese matched companies. The third row presents the results for Equation 2 for the combined sample, including overseas-listed companies and matched non-overseas-listed companies. In this estimation, the interaction dummy coefficient β_6 is significantly negative at the 1 per cent level (-0.2056; t = -2.70) and the coefficients ($\beta_5 + \beta_6$ = -0.1502) are significantly negative at the 10 per cent level (t = -1.96; p-value = 0.09).[14] This result implies that the matched non-overseas-listed Chinese companies report less aggressively/more conservatively than their overseas-listed counterparts; therefore, Hypothesis 1 is sustained. For nationalistic reasons, bureaucrats running overseas-listed companies have incentives to report *less conservatively* than senior managers of non-overseas-listed companies where government shareholdings may be lower. In fact, managers of overseas-listed companies *report aggressively* whereas those of their non-overseas-listed counterparts *report neutrally*. This finding suggests that the location of listing and accounting standards are not the primary determinants of conservatism (Ball et al., 2003). As Mao Zedong remarked back in 1957, '[r]egulations alone will not work … men's minds must change' (quoted in Han, 1976, p. 55), and not only men's (sic) minds but also the cultural norms and practices embedded within social relationships (Zinov'ev, 1985). We are not able to report any evidence consistent with the 'bonding hypothesis' of Stulz (1999) and Doidge (2004).

The fourth row of Table 4 presents regression results for Equation 1 for the matched sample of Hong Kong companies. The incremental coefficient β_3 is positive and significant (0.5473; t = 4.03) for the matched sample, indicating a conservative approach to accounting by matched Hong Kong companies. The co-efficient is relatively high compared to the 0.256 (t = 4.00) reported by Bushman and Piotroski (2006, Table 2, p. 121). This may indicate that Hong Kong earnings are becoming more conservative over time, since our sample period is 1994–2003 whereas Bushman and Piotroski (2006) use 1992–2001. In addition, our small matched-firms

TABLE 4: CONDITIONAL CONSERVATISM OF H-SHARE SAMPLE, MATCHED A-SHARE SAMPLE AND MATCHED HONG KONG SAMPLE

(1) $\frac{X_{it}}{P_{it-1}} = \alpha_0 + \beta_1 D_{it} + \beta_2 R_{it} + \beta_3 D_{it} \times R_{it} + \varepsilon_{it}$

(14) $\frac{X_{it}}{P_{it-1}} = \alpha_0 + \beta_1 D_{it} + \beta_2 R_{it} + \beta_3 D_{it} R_{it} + \beta_4 MAT_{it} D_{it} + \beta_5 R_{it} MAT_{it} + \beta_6 R_{it} MAT_{it} D_{it} + \varepsilon_{it}$ [a]

	α_0	β_1	β_2	β_3	β_4	β_5	B_6	Adj R^2 (%)	Number of observations
H-Share Sample									
H-shares sample	0.0319**	-0.0256	0.0842***	-0.1977***				12.59	373
	(2.56)	(-1.17)	(6.26)	(-3.41)					
Matched A-Share Only Sample									
Matched sample[b]	0.0321***	-0.0177	0.0286***	0.0080				9.56	373
	(4.40)	(-1.35)	(3.64)	(0.18)					
Combined sample	0.0320***	-0.0176	0.0287***	0.0080	-0.0082	0.0554***	-0.2056***	14.15	746
	(4.46)	(-1.06)	(2.93)	(0.13)	(-0.39)	(4.68)	(-2.70)		
Matched Hong Kong Sample									
Matched sample[c]	0.1330***	-0.0155	0.0612	0.5473***				6.68	373
	(3.86)	(-0.24)	(1.88)	(4.03)					
Combined sample	0.0887***	0.0288	-0.0385*	0.525***	-0.1113*	0.0805***	-0.6802***	6.71	746
	(4.62)	(0.65)	(-1.70)	(5.22)	(-1.92)	(2.60)	(-4.08)		

Note: *, **, and *** indicate significance at the 10, 5, and 1 percent levels. *t*-statistics are in parentheses.

[a] X_{it}/P_{it-1} is Company *i*'s earnings-per-share deflated by the beginning of the year H-share price (if the company issues only H-shares), or a weighted average of A-share and H-share prices at the beginning of the year, with the weights determined by the numbers of A- or H-shares over the total number of outstanding shares of the company (if the company issues both A- and H-shares). R_{it} is the inter-announcement stock returns measured from May of year *t* to April of year *t*+1 or a weighted average of A-share and H-share returns, with the weights determined by the market value of A- or H-shares at the beginning of the year.

[b] The matched sample is selected A-share-only companies on the basis of industry and company's total assets. Company pairs remain matched to the same partners throughout all years of analysis. MAT_{it} is a dummy variable, with a value of 1 for H-share companies and 0 for matched A-share companies.

[c] The matched Hong Kong sample is selected Hong Kong-listed companies on the basis of industry and company's total assets. MAT_{it} is a dummy variable, with a value of 1 for H-share companies and 0 for matched Hong Kong companies.

sample of n = 373 may exhibit different conservatism than the Hong Kong market taken as a whole.

The regression results for Equation 2 for the combined sample, which includes both overseas-listed Chinese companies and matched Hong Kong companies, are given in the fifth row. The interaction dummy coefficient β_6 is significantly negative at the 1 per cent level (-0.6802; t = -4.08) and the coefficients ($\beta_5 + \beta_6$ = -0.5997) are significantly negative at the 5 per cent level (t = -3.53; p-value = 0.03), implying more aggression/less conservatism for the H-share companies. This is consistent with Bushman and Piotroski's (2006, p. 132) finding of more diffuse ownership being associated with higher conditional conservatism. H-share companies are associated with high levels of state ownership and non-tradable shares, so Hypothesis 2 is sustained. It is also consistent with Bushman and Piotroski's (2006, p. 141) finding that a high level of state ownership in the economy is associated with less conservative reporting from that country's listed companies.

CONCLUDING REMARKS

China's government has made substantial progress in recent years in enacting laws and regulations to improve reporting quality, reduce information asymmetry and, most importantly, encourage investor confidence. However, the results presented in this paper provide important additional evidence that mandating regulations alone, without a revision of the overall infrastructure, incentives and culture, is not sufficient to generate demand for conservative reporting, especially within countries with embedded communist cultures.

We have explored the earnings conservatism of H-share companies. The results presented in this paper indicate that H-share companies are not significantly more conservative than Chinese companies that are not overseas listed. In fact, H-share companies report aggressively and their non-overseas-listed counterparts report neutrally. Both overseas-listed and non-overseas-listed Chinese companies report more aggressively/less conservatively than native Hong Kong companies listed on the SEHK.

These findings suggest that the location of listing has little effect on accounting conservatism because overseas-listed Chinese companies retain a significant exposure to their domestic institutional environment and culture. There are few institutional characteristics in the Chinese economy which provide incentives for management to supply accounting conservatism. Whilst minority shareholders might demand conservatism, the CCP bureaucracy as a major shareholder and owner of the banks does not. The evidence presented in this paper shows consistently that the demand for accounting conservatism arises endogenously in the institutional and cultural contexts of a country and its companies (Ball et al., 2003; Bushman and Piotroski, 2006; Ball et al., 2008; Ball et al., 2010). As Bushman and Piotroski (2006, p. 141) conclude, 'firms in countries with political economies characterized by … high state ownership of enterprises both speed the recognition of good news and slow the recognition of bad news in earnings relative to firms in countries with less political involvement in the economy.' We present no evidence consistent with the 'bonding hypothesis' of Stulz (1999) and Doidge (2004).

Our results are not surprising because, in a country with many elements of communism (or at least communist residues in the area of cultural norms within social relationships) present, reporting losses rapidly to the capital market may not be considered a matter of urgency. Full or excess employment, social order and social stability are likely to be regarded as more important objectives by the CCP. In mainland China, the 'economic' is rarely separated from the 'social' and the 'political'. Instead, what we observe in practice is a complex and somewhat contradictory synthesis of all of these aspects. Accountability to those higher up the chain of command in the CCP, in practice if not in theory, remains more important than accountability to the 'market', especially for overseas-listed companies where government shareholdings are higher. The rise of Dengism and its associated nationalism has meant that overseas-listed companies are seen as 'showcase' companies (Hung et al., 2008). The large and stable reported profits of overseas-listed companies are presented and viewed as evidence of the startling economic transformation of China since 1949 and even more so since 1978. In reality, however, the absence of conservatism in China suggests that Mao-era incentives to overstate production outputs, so characteristic of the 'Great Leap Forward' campaign of the 1950s, still exert an important cultural influence over financial reporting in China today. Lenin once remarked that there is no historical precedent for a peaceful transition from capitalism to communism. The road back to capitalism is probably not much easier. The physical Berlin Wall is easy enough to dismantle but it is harder to dismantle the Berlin Wall inside people's minds (Zinov'ev, 1985). Our results should have special relevance for other countries attempting the transition from communism to capitalism, such as Russia, Vietnam, the former Soviet Union republics and the countries of Eastern Europe.

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APPENDIX A: THE CAPITAL STRUCTURES OF LISTED CHINESE COMPANIES
(in aggregate across the whole market)

	Non-Tradable Shares (Total)				Tradable Shares (Total)			
	State Shares[a]	**LP Shares[b]**	**Others[c]**	**Total**	**A-Shares**	**B-Shares**	**H-Shares**	**Total**
1994	43.31%	22.53%	1.14%	66.98%	21.00%	6.06%	5.96%	33.02%
1995	38.74%	24.63%	1.10%	64.47%	21.21%	6.66%	7.66%	35.53%
1996	35.42%	27.18%	2.15%	64.75%	21.92%	6.45%	6.88%	35.25%
1997	31.52%	30.69%	3.22%	65.43%	22.79%	6.04%	5.74%	34.57%
1998	34.25%	28.35%	3.30%	65.90%	24.06%	5.30%	4.74%	34.10%
1999	36.15%	26.60%	2.26%	65.01%	26.35%	4.61%	4.03%	34.99%
2000	39.60%	23.78%	1.51%	64.89%	28.03%	4.00%	3.08%	35.11%
2001	46.20%	18.59%	0.46%c	65.25%	25.26%	3.13%	6.36%	34.75%
2002	47.20%	17.36%	0.78%	65.34%	25.68%	2.85%	6.13%	34.66%
2003	47.39%	16.65%	0.41%	64.45%	26.67%	2.73%	6.15%	35.55%

Source: China Securities Regulatory Commission (n/a).
[a] State shares denote state shares and state legal person shares.
[b] LP (legal person) shares denote domestic and foreign capital legal person shares.
[c] Others denote internal management or employees shares.

NOTES

1. Ball and Shivakumar (2005) and Ball et al. (2000) refer to this asymmetric loss recognition timeliness characteristic as 'conditional conservatism', which can increase contracting efficiency and effectively capture much of the transparency of financial information, in contrast to 'unconditional conservatism', which is an accounting bias towards reporting low book values.
2. We consider only the profit figures computed using international financial reporting standards (IFRS) or Hong Kong's generally accepted accounting principles (GAAP) and not the figures produced under Chinese GAAP by the overseas-listed firms.
3. Bushman and Piotroski (2006, p. 117), in the largest scale cross-country empirical study on conservative reporting undertaken to date, exclude China and Poland from their 38 countries due to these countries' 'socialist legal origin'. Ball et al. (2003) also do not study China.
4. The quality of IFRS and Hong Kong GAAP are considered equivalent in quality to contemporary common law standards (Ball et al., 2003).
5. The fact that a majority of listed companies in China evolved from SOEs means that a high proportion of their capital consists of non-tradable state-owned and legal persons (LP) shares. In 2003, the percentage of all non-tradable (tradable) shares for China as a whole was 64.45 per cent (35.55 per cent). This percentage does not appear to be declining over time. Appendix A provides information about the capital structure of listed Chinese companies in aggregate in terms of the percentage breakdowns between shares held by the state, legal persons and other (all non-tradable); and between A-, B- and H-shares (all tradable).
6. This model has been widely used in recent empirical literature on accounting conservatism, including papers by Basu (1997), Pope and Walker (1999), Ball et al. (2000, 2003), Giner and Rees (2001), Bushman and Piotroski (2006), and Balkrishna et al. (2007). Critics of the Basu model are unable to explain why the ranking of reported conditional conservatism coefficients across countries in studies such as Ball et al. (2000, 2003), Bushman and Piotroski (2006), and the present paper are exactly in accordance with what the conservatism theory predicts. It is hard to believe that this could happen by chance, which would be the case if the Basu model does not actually capture differences in conditional conservatism (Ball, Kothari and Nikolaev, 2010, p. 28). Readers are referred to Ball et al. (2010) for a detailed discussion and convincing refutation of the main criticisms (or, in their words, 'misconceptions' (p. 4)) of Basu's model.
7. Ryan (2006) suggests that to minimise the biases described by Dietrich, Muller and Riedl (2007), we use fiscal year returns in Basu's model.
8. Prior empirical studies using alternative models to Basu to measure conditional conservatism report equivalent results to those reported when Basu's model is used (Ball et al., 2010, pp. 24, 26). These alternative tests, such as the time-series of earnings changes test, have important deficiencies of their own (Ball et al., 2010, p. 25). Hence we do not undertake these additional tests.
9. According to Roychowdhury and Watts (2007), the Basu model slope coefficient is simply one measure of conditional conservatism and one that has limitations in that it is based on single-year data for each firm-year observation. It is not conservatism per se. Roychowdhury and Watts (2007, p. 10) define NAc or 'true conservatism' as the difference between end-of-period net assets value (NAV) and book value of net assets (NAB). NAc is based on the full period of the firm's life following its initial public offering (see also their Figure 1, p. 7).
10. All Chinese companies have calendar fiscal years, so stock returns are measured from May of the year t to April of year $t+1$.
11. The industry classification adopted is CSRC for matching non-overseas-listed Chinese companies and the Hong Kong Standard Industrial Classification for matching Hong Kong companies.
12. As with Table 3 (Hong Kong companies), Panels A and B are for the entire population of this market that have sufficient accounting and stock price data, i.e. *before* the matching with the overseas-listed Chinese companies is performed.

13. The standard deviations of both *R* and *NI* in the Chinese sample are very similar to the sample in Ball et al. (2000) and to those of the four East Asian country samples in Ball et al. (2003).
14. To assess the statistical significance for $(\beta_5 + \beta_6)$, the following equation is used to calculate the *t*-statistic (t^*):

$$\text{if } \hat{\beta}_i \sim N\left(\beta_i, \sigma^2_{i_i}\right) \text{ then } \bar{\hat{\beta}} = \frac{\hat{\beta}_5 + \hat{\beta}_6}{2} \sim N\left(\frac{\beta_5 + \beta_6}{2}, \frac{\sigma^2_{\beta_5} + \sigma^2_{\beta_6}}{4}\right) \quad t^* = \frac{\beta_5 + \beta_6}{\sqrt{\frac{\sigma^2_{\beta_5} + \sigma^2_{\beta_6}}{4}}}$$

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THE PROFITABILITY OF MOMENTUM TRADING STRATEGIES IN THE IRISH EQUITY MARKET

Fionnghuala O'Sullivan and Niall O'Sullivan
Department of Economics and Centre for Investment Research, University College Cork

ABSTRACT

We examine the profitability of momentum-based trading strategies in the Irish equity market between 1988 and 2007. We investigate a range of trading strategies over alternative backward-looking ranking periods and forward-looking holding horizons as well as for alternative size momentum portfolios. We find that returns to momentum-based strategies are highly non-normally distributed, giving rise to concern about the validity of inferences based on standard statistical tests of their abnormal performance. We therefore apply a bootstrap procedure to construct nonparametric p-values for the portfolio performance measures. Overall, we find little evidence that momentum-based trading strategies would have yielded an abnormal risk-adjusted return over the period. The Irish equity market appears to be quite efficient in this respect.

INTRODUCTION

Momentum-based investment strategies involve holding a portfolio of assets where each period the portfolio holdings are decided by a simple rule of buying past 'winner' assets and selling past 'loser' assets (from among the universe of assets available for selection). The strategy attempts to capture a momentum effect in the price movements of the underlying assets over consecutive time periods. Momentum-based trading strategies are of obvious interest to investors as they may provide an abnormal return at relatively low cost. First, the strategy can be constructed to be low cost where short positions fund long positions. Second, it is simple to implement as it does not require extensive research into asset selection.[1]

The existence of profitable momentum strategies among, for example, equity mutual funds, is well documented for the United States (US) (Jegadeesh and Titman, 1993, 2001), while Fletcher and Forbes (2002) report evidence that a substantial proportion of United Kingdom (UK) mutual funds also attempt to capture a momentum effect. In general, however, momentum effects are an under-explored phenomenon outside of the US equity market. In this study we examine the profitability of equity-based momentum strategies in the Irish market. The Irish market is an interesting case because of its comparatively low liquidity, low trading volume and high concentration of stock ownership, which may permit momentum effects to persist, at least in the short term. Studies of momentum investment strategies are also of general interest to researchers because findings of abnormal returns would be typically in breach of the efficient market hypothesis. However, it should be noted that, in fund performance literature, momentum risk factors are now widely specified in regression models (where the intercept is a measure of stock selection skill) in order to control for performance attributable to momentum effects which do not require ‘skill’, per se, on the part of the fund manager to capture (see Carhart, 1997).

We examine the profitability of momentum trading strategies in the Irish equity market by simulating and evaluating several different momentum portfolios based on alternative size portfolios, ranking periods (used to select equities) and holding periods. We examine the period February 1988 to December 2006. A recent paper by O’Donnell and Baur (2009) also examines momentum trading strategies in the Irish case. Over a similar sample period, the paper fails to find evidence of profitable strategies, although some abnormal returns are found during certain sub-periods. We extend the O’Donnell and Baur (2009) analysis by examining alternative size momentum portfolios and also by specifically investigating the effects of non-normality in the momentum portfolio returns.

The study proceeds as follows: the next section briefly outlines some of the key findings from previous related studies and the following section describes the data and methodology used in this study. Then we describe our empirical findings, while the final section concludes.

REVIEW OF THE LITERATURE

Momentum trading has been widely examined in the literature for a number of alternative markets with variations across studies in terms of, *inter alia*, the length of historical horizons used to select stocks, holding periods lengths, sample periods and portfolio sizes. For example, Rouwenhorst (1998) found that momentum effects exist in European markets, Moskowitz and Grinblatt (1999) found momentum effects across industry-sorted portfolios, and Grundy and Martin (2001) found that momentum strategies have been consistently profitable in the US since the 1920s. There was some focus on relative strength strategies (that buy past winners and sell past losers) in early literature, most notably Levy (1967). However, as Levy arrived at this trading rule after investigating 68 different trading rules, it was believed that his result could be attributed to selection bias (Jegadeesh and Titman, 1993, p. 66).

Jegadeesh and Titman (1993) is a seminal paper in the area of momentum strategies. Using data from 1965 to 1989, the methodology involves selecting stocks based on their returns over the past one, two, three or four quarters and holding stocks for periods varying from one to four quarters. Specifically, securities are ranked in ascending order at the beginning of each period. Based on these rankings, ten equally weighted decile portfolios are formed. In each period, the strategy buys the top 'winner' portfolio and sells the bottom 'loser' portfolio, holding this position for *h* periods. The authors show that stock returns exhibit momentum behaviour at intermediate horizons. They find that a strategy that uses a six-month historical ranking period can earn profits of about 1 per cent per month for the following year, after which the returns begin to dissipate. Their results indicate that these profits can be attributed to delayed stock price reactions to firm-specific information, not common factors. That the strategy is profitable in the medium term but unprofitable in the longer term is seen as evidence that the theories of investors either overreacting (in the case of contrarian strategies) or underreacting (in the case of relative strength strategies) to information are too simplistic. Instead, the authors deduce that investors who buy past winners and sell past losers move market prices from their long-term value temporarily, with a reversal after about a year. An alternative deduction is that the market underreacts to information about the short-term prospects of firms, which tend to be more ambiguous.

The results of Jegadeesh and Titman (1993) prompted a variety of interpretations, ranging from explanations of market inefficiency to compensation for risk and data mining. Conrad and Kaul (1998) argue that the apparent momentum arises because of cross-sectional variation in expected returns in adjacent time periods and is simply a compensation for risk. In direct contrast, others such as Daniel, Hirshleifer and Subrahmanyam (1998), Barberis, Shleifer and Vishny (1998) and Hong and Stein (1999) present behavioural models (see Barberis and Thaler (2003) for an expanded survey), which argue that the momentum effect arises because of a delayed overreaction to information that pushes the prices of winners (losers) above (below) their long-term values and, in subsequent periods, the returns of losers should exceed those of winners as prices re-adjust to the overreaction. Hence, such models predict that, in the 'post-holding' period, returns to a momentum strategy should be negative.

Jegadeesh and Titman (2001) evaluate the various explanations for the profitability of momentum trading strategies identified in the literature following their 1993 study. The authors offer evidence to refute the criticism that the momentum anomaly is a product of data mining by demonstrating that profitable momentum strategies persisted in the 1990s, after initially being identified in their earlier study of the 1980s. Jegadeesh and Titman (2001) do indeed find evidence that the performance of a momentum portfolio in the post-holding period (13 to 60 months) is negative, as predicted by Daniel et al. (1998) and others above.

While the bulk of the extant momentum literature relates to the US market, Rouwenhorst (1998) provides a comprehensive study of the European market, using data from twelve countries: Austria, Belgium, Denmark, France, Germany, Italy, the Netherlands, Norway, Spain, Sweden, Switzerland and the United Kingdom. Employing a similar procedure to that of Jegadeesh and Titman (1993), the paper finds the strategy to be as profitable using European stock prices as it is using US stock prices, yielding approximately 1.16 per cent per month for the following year, with reversal thereafter. However, Rouwenhorst (1998) notes that an international momentum strategy may not be well diversified. A dominant performance by one country will subsequently cause the winner portfolio to overweight that country. In examining this further, the paper constructs momentum portfolios that weight stocks by ranking them based on past performance relative only to stocks listed in the same country. However, momentum portfolio returns using this revised strategy remain highly profitable at 0.93 per cent per month, suggesting that individual country momentum does not explain the success of the European-wide strategy. However, the Rouwenhorst (1998) results do show a variation in excess returns ('winner' portfolio minus 'loser' portfolio) across European countries. Although momentum effects are present in all countries, the strongest profits were experienced by Spain, followed by the Netherlands, Belgium and Denmark. Sweden is the only country that doesn't experience significant profits in this period, with portfolios earning 0.16 per cent excess returns per month.

Moskowitz and Grinblatt (1999) question whether the apparent profitability of momentum strategies arises because of industry effects. They formulate a momentum strategy based on returns of different industries and test it using stock prices from 1963 to 1985 on the NYSE (New York Stock Exchange), AMEX (American Stock Exchange) and NASDAQ (originally the National Association of Securities Dealers Automated Quotations Systems) indices. They also test the individual stock price momentum strategy used by Jegadeesh and Titman (1993) in order to compare the two strategies. They report that momentum returns exist in industry-based portfolios, which are more profitable than individual stock price momentum strategies, claiming that much of the profit derived from the latter is eroded after controlling for industry effects. Of course, the further implication here is that momentum portfolios are not well diversified, as winners and losers are from the same industry; hence momentum returns may be a compensation for risk and not a market inefficiency.

Jegadeesh and Titman (1993) also investigated the hypothesis that stock prices overreact to information in an extension of the contrarian strategies developed by DeBondt and Thaler (1985, 1987). Contrarian strategies involve buying (selling) stocks that have been performing poorly (well) in recent months. DeBondt and Thaler (1985) explore the consequences of people's tendencies to overreact to information such as unexpected or dramatic news events. They find that people tend to emphasise recent information too much and underweight previous information. As a result of investor overreaction, they believe it is possible that stock prices might temporarily depart from their fundamental values. If this is the case, buying past losers would be a more profitable strategy than buying past winners. Their results show that forming portfolios of past 'losers' reaped exceptionally large January returns as far as five years on. Their conclusion is that stocks that experienced extreme long-term gains or losses tended to undergo systematic price reversals. DeBondt and Thaler (1987) form portfolios of the most extreme losers and winners as measured by excess cumulative returns over successive five-year formation periods. Their results show that the loser portfolio outperforms the winner portfolio by an average of 31.9 per cent over the following five-year test period. In order to reconcile the findings that both contrarian strategies and momentum strategies are profitable, even though they consist of taking opposite actions, Jegadeesh and

Titman (1993) consider different time horizons. Contrarian strategies are found to be profitable using returns over the very long term (three to five years) or over the very short term (one week to one month). Relative strength strategies base their selection on price movements over the medium horizon (three to twelve months).

The Irish case has been examined recently by O'Donnell and Baur (2009). Over the period 1984–2007 the authors examine momentum portfolios (winner minus loser) as well as winner and loser portfolios separately. Over the full sample period, the authors find no evidence of profitable momentum strategies, although some evidence is found examining alternative sub-periods of high, low and negative market growth. First, however, O'Donnell and Baur (2009) form momentum portfolios comprising the top and bottom third of stocks. In our paper, we look further into alternative size portfolios to identify possible profitable momentum strategies among the more extreme winner and loser stocks. Second, O'Donnell and Baur (2009) report standard statistical tests of risk-adjusted return. However, we find that portfolios of winner and loser stocks are both highly non-normally distributed and serially correlated – so much so that questions arise as to the validity of the standard statistical tests such as t-tests. To examine the robustness of the O'Donnell and Baur (2009) conclusions, we apply a bootstrap procedure in our paper and derive nonparametric p-values in our statistical tests.

As past findings have been found to be sensitive to using different ranking and holding period lengths, the analysis in this paper is conducted testing alternative time horizons in this regard, as well as alternative size momentum portfolios, in order to capture these dynamics and examine the robustness of results.

In a related area of the literature, the question of momentum effects also arises in fund performance evaluation. As this is somewhat tangential to the focus of this study, we do not propose to discuss it in detail here. Instead, we briefly refer the interested reader to some important contributions to the area. Carhart (1997) demonstrates, *inter alia*, that momentum effects explain around half of the cross-sectional spread between the top and bottom decile portfolios of mutual funds ranked by performance. Chen, Jegadeesh and Wermers (2000) examine the past returns of the *current* constituent stock holdings of winning and losing funds, and find that stocks currently held by winning funds have higher past returns, or momentum, than stocks held by losing funds. The raw returns of the winning funds go on to outperform the returns of losing funds for the subsequent two quarters. The risk-adjusted returns of winning funds go on to outperform those of losing funds, for the subsequent quarter. Grinblatt and Titman (1992) and Hendricks, Patel and Zeckhauser (1993) report some evidence that the source of the fund performance persistence found in their studies lies in a momentum effect in the fund's stock holdings rather than in persistent stock-picking ability on the part of the fund manager.

A summary of the main findings from the momentum strategy literature is presented in Table 1. There is some variability in these findings due to variations in country/index, historical horizons, holding periods and the type of strategy examined, as indicated. All studies find momentum strategies to be profitable to some degree. The majority of the investigations have been carried out on US data, with little research on European indices.

Table 1: Summary of International Findings from Momentum Studies

Author and Year	Momentum Strategy	Country/Index	Sample Period	Historical Horizon (Months)	Holding Period (Months)	Profits
Jegadeesh and Titman (1993)	Individual stock price	USA: NYSE and AMEX	1965–1989	6, 9, 12	3, 6, 9, 12	Around 1% per month for the following year; unprofitable under 1 month and over 1 year
Rouwenhorst (1998)	Individual stock price	12 European countries	1978–1995	6	3, 6, 9, 12	Around 1% per month for the following year with reversal thereafter
Jegadeesh and Titman (2001)	Individual stock price	USA: NYSE, AMEX and NASDAQ	1990–1998	6	3, 6, 9, 12	Around 1% per month for the following year; unprofitable under 1 month and over 1 year
Grundy and Martin (2001)	Individual stock price	USA: NYSE and AMEX	1926–1995	6	1	0.44% per month
George and Hwang (2004)	Individual stock price	USA: CRSP	1963–2001	6	6	0.48% per month
Marshall and Cahane (2005)	Individual stock price	Australian Stock Exchange (ASX)	1990–2003	6	6	0.59% per month
Moskowitz and Grinblatt (1999)	Industry	USA: NYSE, AMEX and NASDAQ	1963–1995	6–12	1–36	1% per month for the following year; strongest at 1 month horizon; unprofitable after a year
George and Hwang (2004)	Industry	USA: CRSP	1963–2001	6	6	0.45% per month
Marshall and Cahane (2005)	Industry	Australian Stock Exchange (ASX)	1990–2003	6	6	0.16% per month
George and Hwang (2004)	52-week high	USA: CRSP	1963–2001	12	6	0.45% per month without a reversal after a year
Marshall and Cahane (2005)	52-week high	Australian Stock Exchange (ASX)	1990–2003	12	6	2.14% per month

DATA AND METHODOLOGY

To construct momentum portfolios, at month t we rank all stocks in ascending order of raw return based on a past period of r months. Based on these rankings, two equally weighted portfolios, each of size s, are formed. The winner (loser) portfolio comprises the top (bottom) performing stocks. The strategy involves buying (selling) the winner (loser) portfolio and holding for h months. The momentum portfolio return between time t and t+1 is the return on the winning portfolio minus the return on the losing portfolio over this holding period. This is then carried out recursively each month to generate a time series of returns. In this study, we examine momentum portfolios for alternative values of r = 3, 6, 11; h = 1, 3, 6; and s = top/bottom 30 per cent of stocks, top/bottom 10 per cent of stocks and top/bottom 5 stocks. We then test for abnormal performance in the momentum portfolio by estimating the risk-adjusted return – α_i – in the least squares regression of the Capital Asset Pricing Model (CAPM), as follows:

$$R_{it} - R_{ft} = \alpha_i + \beta_i(R_{mt} - R_{ft}) + \varepsilon_{it} \qquad (1)$$

where R_{it} is the return on portfolio i, R_{mt} is the return on a market factor-mimicking portfolio and R_{ft} is a risk-free rate. A statistically significant positive value of alpha is taken to indicate superior performance in the momentum trading strategy. Here, R_{mt} is the returns on the Irish Stock Exchange Quotient (ISEQ) index, while R_{ft} is proxied by the one-month interbank rate. Our entire analysis is conducted on monthly returns.

Our data set, which covers the period February 1988 to December 2006, includes all stocks listed on the ISEQ index. This also includes all de-listed and dead stocks over the period. Therefore, portfolios of past winners and losers are calculated at each time t, based on the full set of stocks that were available to fund managers at *that* time historically and *not* just based on the historical time series of stocks that exist at the end of the sample period. This avoids the possible problem of survivorship bias. If a stock drops out of the database during a holding period, the portfolio is rebalanced to be equally weighted across all the remaining stocks.

Our investigation of momentum trading profitability extends that of O'Donnell and Baur (2009) in two key respects. First, we find that all the momentum portfolios demonstrate returns that are highly non-normally distributed, potentially invalidating the inferences from standard statistical tests such as t-tests in Equation 1. This should not be too surprising as momentum portfolios comprise stocks in the tails of the cross-section distribution, where non-normality is typically greatest (see Cuthbertson, Nitzsche and O'Sullivan, 2008). Therefore, we apply a bootstrap procedure to generate nonparametric p-values for the performance estimates of each of the momentum portfolios. To do this, the performance measurement model is first estimated by Ordinary Least Squares (OLS). The estimated coefficients and OLS residuals $\hat{\alpha}_i$, $\hat{\beta}_i$ and $\hat{\varepsilon}_{it}$ are saved. In the next step, a random sample of residuals of size Ti is drawn (with replacement) from $\hat{\varepsilon}_{it}$. Using the estimated factor loadings from step one and the original chronological ordering of R_{mt} and setting $\hat{\alpha}_i = 0$ under the null hypothesis of no abnormal performance, bootstrap simulated returns, $\tilde{R}_{it}$, are constructed. By construction, this bootstrapped or simulated portfolio return has a 'true' abnormal performance of zero. Using these bootstrap fitted returns, the performance measurement model is re-estimated and a bootstrap estimate of abnormal performance under the imposed null hypothesis is obtained, denoted $\tilde{\alpha}_i$. This $\tilde{\alpha}_i$ represents random sampling variation around a true value of zero. This simulation process is repeated B = 1,000 times. The 1,000 values of $\tilde{\alpha}_i$ represent the nonparametric distribution of $\hat{\alpha}_i$ under the null hypothesis. We can then examine where the OLS estimate of $\hat{\alpha}_i$ lies relative to the distribution of $\tilde{\alpha}_i$ to determine a nonparametric p-value for $\hat{\alpha}_i$, which makes no prior assumptions regarding the normality of returns. So, for example, a p-value = 0.10 indicates that only 10 per cent of the values of $\tilde{\alpha}_i$ are greater than $\hat{\alpha}_i$, suggesting that there is only a 10 per cent chance of observing the estimated value of $\hat{\alpha}_i$ where the 'true' value of α_i is zero. We can also use the t-statistic of alpha as a measure of abnormal performance. The t-statistic has the advantage that it controls for the standard error and may therefore give a more reliable estimate of abnormal performance relative to $\hat{\alpha}_i$. The same bootstrap procedure as above can be used to generate $t_{\tilde{\alpha}_i}$ and hence the nonparametric distribution of the t-statistic of $\hat{\alpha}_i$ – denoted $t_{\hat{\alpha}_i}$ – under the null hypothesis. In this study we report the nonparametric p-values of $t_{\hat{\alpha}_i}$. Furthermore, in the calculation of all t-statistics in this study, we use Newey-West serial correlation and heteroscedasticity adjusted standard errors. Adopting such a bootstrap procedure to account for non-normal stock returns is not typically done in the extant momentum literature.

Second, the O'Donnell and Baur (2009) study investigates momentum portfolios comprising the top and bottom third of stocks. One concern is that such large portfolios may disguise profitable momentum-based strategies among more extreme winner and loser stocks, e.g. top and bottom 10 per cent of stocks or, say, top and bottom five stocks. One advantage of these latter cases is that the pursuit of the momentum strategy may involve lower transactions costs on the part of the fund in rebalancing the fund holdings each period. In this study, we also report findings for momentum trading strategies based on the top and bottom 10 per cent and the top and bottom five stocks.

EMPIRICAL RESULTS

Our main findings are presented in Table 2, which shows results for the full sample period February 1988 to December 2006. Performance estimates are reported for momentum-based portfolios for alternative ranking and holding periods as indicated in each column. For example, the column headed '3 – 1' refers to a past ranking period of three months and a holding period of one month. Results are also reported for alternative size momentum portfolios, including the top 30 per cent minus the bottom 30 per cent, the top 10 per cent minus the bottom 10 per cent and the top five minus the bottom five stocks, as indicated. 'Alpha' is the risk-adjusted monthly percentage return from the OLS estimation of Equation 1 while 't-alpha' is the corresponding t-statistic (Newey-West adjusted for serial correlation and heteroscedasticity).

Table 2: The Profitability of Momentum Trading Strategies – Full Sample Period

Table 2 presents performance estimates for momentum-based portfolios for alternative ranking and holding periods, as indicated in each column over the full sample period February 1988 to December 2006. '3 – 1' refers to a past ranking period of 3 months and a holding period of 1 month, and so on. Alpha is the portfolio performance measure from the OLS estimation of Equation 1. In addition, we report the Jarque-Bera normality test statistic, $JB \sim \chi^2_{df=2}$. The table also reports the bootstrapped p-value of the t-statistic of alpha, as described in the data and methodology section. All t-statistics are based on Newey-West serial correlation and heteroscedasticity adjusted standard errors. Performance estimates and associated test statistics are shown for momentum portfolios comprising the top/bottom 30% of stocks, top/bottom 10% of stocks and top/bottom 5 stocks, as indicated.

	3 – 1	**6 – 1**	**11 – 1**	**3 – 3**	**6 – 3**	**11 – 3**	**3 – 6**	**6 – 6**	**11 – 6**
Top 30% – Bottom 30%									
Alpha	0.172	0.227	0.105	0.349	0.176	0.207	-0.402	0.164	-0.032
t-alpha	0.543	0.604	0.248	1.051	0.460	0.485	-1.094	0.431	-0.073
JB normality statistic	30.54	385.12	348.14	58.19	282.19	375.70	239.30	301.38	539.02
Bootstrap p-value	0.360	0.260	0.460	0.180	0.350	0.260	0.850	0.380	0.550
Top 10% – Bottom 10%									
Alpha	-0.222	-0.030	-1.115	0.401	-0.149	-0.547	-0.637	-0.354	-1.695
t-alpha	-0.296	-0.034	-1.206	0.521	-0.172	-0.584	-0.751	-0.396	-1.190
JB normality statistic	259.62	676.22	1384.22	318.12	798.08	1402.52	846.86	773.38	1400.66
Bootstrap p-value	0.580	0.590	0.890	0.280	0.540	0.730	0.790	0.650	0.880
Top 5 – Bottom 5									
Alpha	-1.287	-0.935	-0.952	0.234	-0.616	-0.027	-1.447	-1.537	-1.936
t-alpha	-1.017	-0.584	-0.678	0.181	-0.405	-0.018	-0.965	-0.950	-1.021
JB normality statistic	410.24	1652.22	1114.38	402.59	2032.11	1608.63	889.94	2039.36	1746.81
Bootstrap p-value	0.850	0.660	0.750	0.440	0.610	0.460	0.810	0.790	0.880

From the t-statistics it is clear that none of the momentum portfolios yielded statistically significant positive returns (at the 5 per cent significance level) over the full period, and, indeed, in several cases, returns are negative. Table 2 also shows results of tests of the normality of the regression residuals. Here, we report the Jarque-Bera test statistic, JB ~ $\chi^2_{df=2}$. The χ^2 critical value at 5 per cent significance is 5.99. It is immediately evident that, in the case of all portfolios, the null hypothesis of normally distributed residuals is strongly rejected. In turn, this suggests that the alpha estimates are also non-normally distributed, thus potentially questioning the reliability of findings based on t-tests. This motivates our use of the bootstrap procedure to generate nonparametric p-values in order to investigate the robustness of momentum findings. In Table 2, these p-values are denoted as 'Bootstrap p-value'. The p-values, all greater than 0.05, indicate that none of the momentum portfolios yield positive and statistically significant returns at 5 per cent significance (or even at the 10 per cent significance level).

The full set of results in Table 2 lead us to conclude that, over the full sample period, momentum trading strategies did not yield a positive risk-adjusted return in the Irish equity market. This finding is remarkably robust to alternative ranking windows and holding periods as well as to alternative size momentum portfolios. It also proves robust to alternative statistical testing methodologies, which account for the finding of non-normally distributed returns data. These overall findings are qualitatively similar to those of O'Donnell and Baur (2009).

However, O'Donnell and Baur (2009) go on to explore the profitability of momentum portfolios separately during periods of low versus high growth in the stock market and report evidence of abnormal returns in the latter, but not the former. It is in this analysis that we find that results are somewhat sensitive to (i) the non-normality issue, (ii) the size of momentum portfolios and (iii) the ranking and holding windows. Table 3 presents findings for the later relatively high stock market growth period of September 1995 to December 2006 (dates chosen for consistency of comparison with O'Donnell and Baur (2009)).[2] The upper panel of Table 3 shows results for the largest momentum portfolios of the top 30 per cent minus the bottom 30 per cent of ranked stocks. Here, according to the standard t-statistics, two of the momentum portfolios yield a positive and significant abnormal return at the 10 per cent significance level, i.e. the portfolios of '11 – 3' and '11 – 6' ranking and holding periods. However, examining the nonparametric p-values of the t-statistics from the bootstrap procedure, we find that four of the portfolios are profitable at 10 per cent significance. That is, the parametric t-tests and the more robustly estimated nonparametric p-values from the bootstrap procedure give conflicting inferences regarding the profitability of some the momentum trading strategies, highlighting the potential for non-normality in financial data to invalidate the findings of many standard statistical tests.

From Table 3, we find that one of the smaller momentum portfolios (top 10 per cent minus bottom 10 per cent) with a 3 – 6 ranking/holding period yields a positive and significant abnormal return at 10 per cent significance. However, all other portfolios, regardless of size or holding and ranking periods, yield insignificant (and sometimes negative) returns by both the standard t-tests and the nonparametric p-values.

Table 3: The Profitability of Momentum Trading Strategies – High Stock Market Growth

Table 3 presents performance estimates for momentum-based portfolios for alternative ranking and holding periods as indicated in each column. Results are reported for the later sample period of relatively high stock growth from February 1995. '3 – 1' refers to a past ranking period of 3 months and a holding period of 1 month, and so on. Alpha is the portfolio performance measure from the OLS estimation of Equation 1. In addition, we report the Jarque-Bera normality test statistic, $JB \sim \chi^2_{df=2}$. The table also reports the bootstrapped p-value of the t-statistic of alpha as described in the data and methodology section. All t-statistics are based on Newey-West serial correlation and heteroscedasticity adjusted standard errors. Performance estimates and associated test statistics are shown for momentum portfolios comprising the top/bottom 30% of stocks, top/bottom 10% of stocks and top/bottom 5 stocks, as indicated.

	3 – 1	**6 – 1**	**11 – 1**	**3 – 3**	**6 – 3**	**11 – 3**	**3 – 6**	**6 – 6**	**11 – 6**
Top 30% – Bottom 30%									
Alpha	-0.048	0.346	0.418	0.282	0.374	0.546	-0.011	0.309	0.545
t-alpha	-0.136	1.022	1.173	0.790	1.118	1.562	-0.037	0.945	1.592
JB normality statistic	0.157	10.749	0.517	17.862	46.176	0.763	25.512	18.015	9.676
Bootstrap p-value	0.600	0.140	0.160	0.140	0.060	0.060	0.470	0.070	0.080
Top 10% – Bottom 10%									
Alpha	-0.863	0.013	-0.233	0.101	0.326	0.273	0.834	0.524	-0.163
t-alpha	-1.227	0.019	-0.349	0.142	0.493	0.413	1.348	0.814	-0.273
JB normality statistic	16.967	13.807	13.351	25.193	27.081	4.397	66.494	47.552	6.186
Bootstrap p-value	0.860	0.510	0.590	0.470	0.230	0.320	0.100	0.270	0.600
Top 5 – Bottom 5									
Alpha	-2.003	-1.220	-0.682	-0.256	0.117	0.320	0.698	-0.941	0.248
t-alpha	-1.201	-1.010	-0.594	-0.195	0.099	0.268	0.518	-0.784	0.191
JB normality statistic	51.768	10.100	6.248	120.056	12.682	13.489	165.182	13.243	33.743
Bootstrap p-value	0.880	0.810	0.640	0.610	0.480	0.380	0.330	0.850	0.410

There are some further surprises in the results. First, the finding that profitable momentum strategies are more prevalent among larger rather than smaller portfolios suggests that the momentum effect is not driven by the extreme winner and loser stocks but instead is driven by those slightly further inside the tail of the cross-section distribution of stock returns. Alternatively, there may be more volatility among the more extreme winner and loser stock returns, leading to less persistence, even in the short term. Second, momentum is stronger among portfolios of longer ranking and holding windows. That a longer ranking period provides a more reliable ranking of stocks in the momentum strategy is intuitive, but one might have expected that, in an efficient market, the momentum effect in stocks would dissipate quickly and hence would be better captured by shorter rather than longer holding periods.

Overall, the findings in Table 2 strongly suggest that momentum-based trading strategies in the Irish equity market failed to yield abnormal returns over the longer sample period under investigation. Results presented in Table 3 do show some evidence of momentum trading profitability but highlight the sensitivity of results to non-normality, momentum portfolio sizes, and ranking and holding period lengths. Furthermore, these abnormal returns are found only in conditions of relatively high market growth.[3] As these conditions are comparatively rare and their persistence unreliable, our overall analysis finds against the existence of abnormal returns from momentum-based equity trading in the Irish market. Given this principal finding at the level of gross returns, we do not further explore issues of (i) transactions costs and (ii) market depth and liquidity, i.e. if the stocks which must be traded are only available in small volumes then pursuit of the strategy may affect prices in a manner that would kill off the phenomenon being observed. These issues may eliminate momentum-based returns, if they had been found to exist. In our reading we find these issues are underinvestigated in the momentum literature.

CONCLUSION

This study examines the profitability of momentum-based trading strategies in the Irish equity market between 1988 and 2007. Investigating a range of trading strategies over alternative backward-looking ranking periods and forward-looking holding horizons as well as for alternative size momentum portfolios, we find that returns to momentum-based strategies are highly non-normally distributed, giving rise to concern about the validity of inferences based on standard statistical tests. We apply a bootstrap procedure to construct nonparametric p-values for the momentum portfolio performance measures. Overall, we find little evidence that momentum-based trading strategies would have yielded an abnormal risk-adjusted return over the period. Our overall results are qualitatively similar to those of O'Donnell and Baur (2009) but contribute to this literature by highlighting that (i) the non-normality of stock returns, particularly in the tails of the cross-section distribution, must be considered if robust inferences are to be drawn from this type of study, and (ii) the most extreme winner and loser stock returns appear to detract from rather than drive profitable momentum portfolios, where these exist at all.

It is interesting, perhaps even counterintuitive, that momentum trading does not prove profitable in a smaller, less liquid market, while there is evidence of profitable momentum strategies in larger markets such as the US. It may be that larger, higher volume markets involve relatively high positive feedback (noise) trading compared to smaller markets, which makes the momentum strategy partly self-fulfilling in the short term. We leave this question for future research.

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NOTES

1. Of course, transaction costs incurred will be related to the degree of portfolio turnover, but clearly a portfolio manager has some discretion here.
2. We do not present results for the earlier lower growth period as, similar to Table 2, they consistently show no significant return to momentum trading across all portfolios.
3. In addition, these abnormal returns may disappear if the performance model was expanded from a CAPM single-factor model to the Fama and French three-factor model. However, we do not expand on this here as we don't wish to advance a theory, *a priori*, that the size and value effects would be systematically different in an up- versus down-market.

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THE IRISH ACCOUNTANCY EDUCATIONAL TRUST

The Trust was established in 1981 by the Institute of Chartered Accountants, from which it receives annual funding, to enable it to fulfil the objectives for which it was formed.

GRANT AID FOR ACCOUNTANCY RESEARCH AND PROJECTS

The role of the Irish Accountancy Educational Trust (IAET) is to provide grants for accountancy-related research and other relevant projects. In doing so the objective is:

1. To further and develop the science of accountancy in all its branches and
2. To promote educational facilities for the teaching of accountancy, auditing, finance and other related subjects

AMOUNT OF GRANTS

There is no specific limit to the level of grant support that may be provided by the IAET. Normally, the amount of funding provided is likely to be between €1,000 and €15,000. The exact amount will depend on the nature of the research or project and the level of related expenditure expected to be incurred by the grant applicant.

ACKNOWLEDGMENT OF GRANTS

Recipients of funding will be expected to acknowledge the support provided by the Trust in any publications (or in the publicity associated with other projects) that benefit from such assistance.

SUITABLE AREAS FOR GRANTS

The areas that the Trustees have established in the past as appropriate for grant aid include:

1. Development work and the provision of equipment necessary for research dealing particularly with the impact of information technology on the role of the accountant
2. Research into accountancy education
3. Scholarships or sponsored fellowships
4. New education structures and needs
5. Publication of textbooks or guidance booklets on specific topics

While the Trustees welcome academic publications and papers, for such work to receive grant aid support the content ideally should be of *practical relevance* to the accountancy profession and/or business.

PAST GRANT RECIPIENTS

Since the IAET was formed in 1981 it has supported a wide range of projects, either involving practical research or other initiatives, to promote the interests of the accountancy profession.

Projects that have been supported by grants include:

- Survey of Irish Published Accounts
- The *Irish Accounting Review*
- Development of CBT Courseware for Accountancy Students
- Accountability in the Credit Union Sector
- IT and the Professional Accountant (an assessment of the skills gap and proposed solutions)

HOW TO MAKE A GRANT APPLICATION

Grant applicants should provide the following information:

1. Title of project
2. Details of project
3. Duration of project and expected completion date
4. A budget of anticipated outlay
5. Relevant career details of applicant(s)

Grant applications should be submitted in writing to:

Jacinta Conway
The Irish Accountancy Educational Trust
Charted Accountants House
47–79 Pearse Street
Dublin 2

To obtain further information on any matter relating to The Irish Accountancy Educational Trust, please see http://www.chartedaccountants.ie/en/General/About-Us/Irish-Accountancy-Educational-Trust-IAET/ or contact Jacinta Conway in writing or using Tel (01) 637 7200 or Fax (01) 668 0842 or by email: iaet@icai.ie.

NOTES FOR CONTRIBUTORS

1. Papers should be submitted electronically. Papers should not normally exceed 8,000 words.
2. There should be a separate file containing the title, author(s), affiliation(s) and one address to which correspondence regarding the paper (including proofs) should be sent. An abstract of not more than 100 words should be given at the beginning of the paper.
3. Citations in the text should be by author's name and year of publication, for example, Black (1972) or (Brown, 1972). In the case of citations of books or specific quotations, page numbers should be given, for example (White, 1992, pp. 10–11). Where more than one publication by the same author in a given year is cited, they should be distinguished by lowercase letters after the year, for example (Green, 1987a; Green, 1987b). Where there are more than two authors, all names should be given in the first citation with 'et al.' used subsequently.
4. References should be listed alphabetically at the end of the manuscript in the following style:

DeAngelo, L.E. (1981). Auditor Size and Audit Quality, *Journal of Accounting and Economics*, Vol. 3, No. 3, pp. 183–199.

European Commission (1996). *Green Paper on the Role, the Position and the Liability of the Statutory Auditor Within the European Union*, October, Brussels: European Commission.

Faulkner, R.R. (1982). Improvising on a Triad, in *Varieties of Qualitative Research*, Vol. 5, Van Maanen, J., Dabbs, J.M. and Faulkner, R.R. (eds.), pp. 65–101, Beverly Hills, California: Sage Publications.

Fielding, N.G. and Fielding, J.L. (1986). *Linking Data: Qualitative Research Methods*, Beverly Hills, California: Sage Publications.

Only works referred to in the text should be listed, and a general bibliography should not be included.

5. Essential notes should be included as endnotes rather than footnotes.
6. In initial submissions, tables and diagrams may be either included at the appropriate point in the text or after the references with their positions indicated in the text. Do not submit any separate Excel documents. Any exceptional costs of artwork for diagrams will be charged to authors.

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