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Earnings management across European Union countries after IFRS adoption

ABSTRACT

Our study investigates the earnings management in the European Union publicly listed firms that adopted IFRS. We also examine whether the incentives of earnings management are likely to be different in Germany and France firms, highlighting the differences from the United Kingdom firms. We use the discretionary accruals model to measure the level of earnings management; this corresponds to the value of the difference between the levels of total and non-discretionary accruals, a model frequently used to measure earnings management practices. Our empirical study is based on listed firms in the United Kingdom, Germany and France, in the period from 2006 to 2009 and using the Thomson Worldscope Database. Our results demonstrate that firms located in United Kingdom have the lower, and firms located in German the higher, level of earnings management, with firms located in France placed in the middle. They confirm findings from literature which indicate that even after IFRS adoption, the difference in the institutional environment and therefore the difference in the earnings management practice in the listed firms would vary across countries. These findings contribute to the literature by providing useful indications to regulators and standard setters interested in evaluating the effectiveness of institutional environment in one setting where high level accounting standards are already in use.

1.   Introduction

In 2005, with the adoption of International Financial Reporting Standards (IFRS), European Union (EU) listed firms faced a major change in their accounting disclosure rules. The proponents of IFRS adoption assert that the implementation of international accounting standards leads to a general improvement in earnings quality (Daske et al., 2008; Barth et al., 2008; Chen et al., 2010). However, while prior research finds some evidence that the potential benefits of mandatory IFRS adoption are likely to vary depending on whether the new rules are effectively enforced (e.g., Ball et al. 2003; Burgstahler et al. 2006), little empirical evidence supports this assertion for mandatory IFRS adoption. In addition, some observers question whether a uniform set of standards adequately accommodates the economic and political differences across countries (e.g., Sunder, 2007). Thus, given the existing institutional variation across EU member states, it is unclear *ex ante* whether IFRS adoption would uniformly reduce firms' earnings management in all financial reporting environments. The purpose of this study is to fill this gap by exploring the earnings management of IFRS adoption in the different institutional arrangements across EU countries.

The manipulation of the firms' earnings reported in the financial statements, also known as earnings management, is common among listed firms (Pfarrer et al., 2008).There are at least two reasons why IFRS adoption is expected to reduce the earnings management in listed firms. First, prior research finds that IFRS requires greater financial disclosure than most local accounting standards (e.g., Ashbaugh and Pincus 2001), thereby mitigating information asymmetries between firms and their shareholders (Leuz and Verrecchia, 2000; Ashbaugh and Pincus, 2001), which in turn is expected to reduce opportunity for earnings management. Second, prior literature argues that one set of uniform accounting standards is likely to reduce the choice of accounting methods, which in turn is expected to constrain managerial discretion (International Accounting Standards Board, 1989; Barth et al., 2008).

Aside from the earnings management argument, however, note that prior research provides some evidence that IFRS adoption is likely to depend on the underlying economic and political institutions influencing the incentives of the managers and auditors responsible for financial statement (e.g., Ball et al., 2003). Thus, considering the role of legal systems in influencing accounting practice, whether IFRS adoption influence the earnings management across EU countries is an empirical question.

To explore the role of legal enforcement in influencing the impact of IFRS, we compare the earnings management across three countries with strong versus weak enforcement mechanisms. We use a sample of 2,728 firms observations in the United Kingdom, Germany and France during the period from 2006 to 2009, from Worldscope databased. We focus our investigation on the three EU countries for several reasons. First, relative to other countries that mandate IFRS, regulatory homogeneity across EU countries reduces the likelihood that earnings management are subject to unspecified cross-country differences. Second, these countries are also originating countries of three distinct legal origins: English common-law, Germany civil-law and French civil-law (La Porta et al., 1998). Hence, the differences in the legal systems and enforcement regime provide a powerful setting to detect the effects of earnings management.

Following previous studies on earnings management (e.g. Warfield et al., 1995; Barth et al., 2008; Chen et al., 2010), we focus on the accruals-based metrics as one dimension of earnings management that is particularly responsive to firm's reporting incentives. This construct is especially relevant to our research because this relies on managerial discretion and is therefore likely to be influenced by the incentives and characteristics of companies preparing the accounting information. Moreover, from a methodological perspective our work improves on previous research since we use a panel data model, that gives more informative data, more variability, less collinearity among variables and more efficiency (Baltagi, 2008).

Consistent with our predictions, we find that firms located in United Kingdom have the lower, and firms located in German the higher, level of earnings management, with firms located in France placed in the middle. For instance, our results indicate that incentives for earnings management across countries with strong legal protection are not the same as for their counterparts with weak legal protection. Elaborating on this, we show that institutional settings is a important characteristic that has a different influence on the level of earnings management practice in firms depending on the degree of the legal enforcement.

Our study offers several contributions to the literature on the effects of ownership concentration and other firm characteristics on the earnings quality. First, we examine firms from three European Union countries with different institutional environments applying the same mandatory accounting regulations. In contrast, prior literature considers only firm-level variables and country-level variables, usually analyses different institutional environments within a single country (Sánchez-Ballesta and García-Meca, 2007; Marra et al., 2011) or different accounting regulations across different countries (Ball et al., 2003). Second, prior research provides some evidence that IFRS adoption is likely to depend on the underlying economic and political institutions influencing the incentives of the managers and auditors responsible for financial statement (e.g., Ball et al., 2003). However, none of the previous studies has thoroughly investigate comparative effect of institutional setting on earnings management in listed firms after IFRS adoption. The findings of this study contribute to the accounting literature, in that we are among the first authors to analyze the difference in the institutional environment, with its ability to influence accounting systems, on the level of

earnings management across three EU countries. We believe that our results may provide useful indications to regulators and standard setters interested in evaluating the effectiveness of institutional environment in one setting where high level accounting standards are already in use.

The remainder of the paper is organized as follows. In Section 2 we develop theoretical background. Section 3 describes the sample selection and research design. Section 4 provide the empirical results. Finally, Section 5 presents the concluding remarks and limitation of the study.

2.   Theoretical background

The firms' financial reports are a central way by which companies manage their institutional impression (Davidson et al., 2004). As in modern corporations ownership is typically separated from control, investors rely on the information provided by the firms' management, and in particular on furnished financial statements. Yet, as accounting principles often require the exercise of business judgment, such as when selecting a particular accounting method or applying different estimations within the method (Schipper, 1989), managers have the opportunity to shape financial reports in a desirable direction.

Since 2005, publicly listed companies in Europe have been required to prepare financial statements in accordance with IFRS. IFRS are designed to enhance the comparability of financial statements, to improve corporate transparency, and to increase the quality of financial reporting in order to benefit investors and to improve the functioning of financial markets. IASB has issued principles-based standards and has taken steps to eliminate accounting alternatives and to require accounting measurements that better reflect a firm's financial position and economic performance. The intent of these guidelines is limit management's opportunistic behavior when determining accounting figures (Ashbaugh and Pincus, 2001; Ewert and Wagenhofer, 2005) and provide for investors useful information (Chen et al., 2009).

Adoption of IFRS have advantages over local accounting standards for several reasons. First, IFRS may be more capital-oriented and, therefore, more useful to investors (Hail et al., 2010). Second, IFRS can reduce the choice of accounting methods, thus constraining managerial discretion (International Accounting Standards Board, 1989; Ashbaugh and Pincus, 2001; Barth et al., 2008). Third, IFRS require accounting measurements and recognition that better reflect a firm's underlying economic position, hence providing more relevant information for investment decisions (IASB, 1989; Barth et al., 2008; Florou and Pope, 2012). Fourth, IFRS increase required disclosures, thereby mitigating information asymmetries between firms and their shareholders (Leuz and Verrecchia, 2000; Ashbaugh and Pincus, 2001). Moreover, harmonization around IFRS increases comparability of firms across markets and countries, hence facilitating cross-border investment and integration of capital markets (Armstrong et al., 2010).

Recent empirical studies confirm that disclosure quality tends to improve for European firms after the adoption of IFRS (Daske and Gebhardt, 2006). Moreover, IFRS adopting firms show an improvement in reporting quality in terms of earnings management, timely loss recognition, and value relevance (Barth et al., 2008). In general, IFRS adoption is likely to increase market liquidity, decrease the firms' cost of capital, and increase equity valuations (Daske et al., 2008). There are empirical evidence that IFRS can reduce earnings management

by limiting opportunistic management discretions in determining accounting numbers (Chen et al., 2010).

On the other hand, there are several reasons why the expected benefits of IFRS can be questioned. First, reducing accounting alternatives may result in a less true and faithful representation of the firm's underlying economics (Barth et al., 2008). Second, increasing managerial flexibility, because of the principles-based nature of IFRS, may augment the opportunity for earnings management.[1] Third, and perhaps most importantly, an increasing number of scholars emphasize that dysfunctional reporting incentives combined with weak enforcement mechanisms can reduce financial reporting quality, even when high-quality accounting standards are implemented (Ball et al., 2003; Burgstahler et al., 2006).

In line with last argument, prior studies suggest that the outcome of implementing accounting standards is determined not only by the quality of the standards, but also by the country's institutional arrangements (Ball et al., 2003). In particular, firms in countries with weak enforcement mechanisms are more likely to abuse the discretion afforded by accounting rules and engage in earnings manipulation (Burgstahler et al., 2006). This pattern suggests that the benefits from mandatory IFRS adoption in terms of a reduction of managerial discretion are expected to be different to whether the new rules are effectively enforced. To explore the role of legal enforcement in influencing the impact of IFRS, we compare the earnings management across three countries with strong versus weak enforcement mechanisms.

According La Porta et al. (1998), there are significant differences across countries in the degree of investor protection. Their empirical evidence indicates that investor protection is stronger in common-law countries (the United Kingdom) than in civil-law countries (France and Germany). Countries with a common-law origin tend to have more extensive disclosure requirements, stronger private and public enforcement of securities regulation, stronger shareholders and creditor rights (La Porta et al., 1998; La Porta et al., 2006). Also, within civil-law countries, France and Germany are distinct from each other in terms of investor protection. La Porta et al. (1998) relates for France more extensive outside investor protection than for Germany. Thus, regarding the investor protection, France is in the middle of the United Kingdom and Germany.

The expected effects of mandatory IFRS adoption are likely to depend on the institutions of the adopting country (Hail et al., 2010). In line with this argument, Daske et al. (2008) and Li (2010) document that the capital market effects of IFRS are more pronounced in countries with stricter enforcement regimes and therefore better IFRS implementation; stronger reporting incentives and therefore higher quality financial reporting; and higher divergence between IFRS and local GAAP and therefore a larger change of domestic accounting rules.

Accounting literature provides evidence that there are distinctions in terms of securities regulation and quality of legal institution between French-civil-law countries and German-civil-law countries. La Porta et al. (2006) find that the securities regulation is high in

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[1] Beuselinck et al. (2007) show that earnings comparability across Europe does not improve after mandatory IFRS adoption in European Union countries. Paananen and Lin (2008) examined the development of accounting quality under IAS and IFRS over time among German companies from 2000 to 2006 and found that accounting quality decreased after IFRS adoption in Germany.

common-law countries, followed by French-civil-law countries, and low in German-civil-law countries.[2]

Following prior studies such as Leuz (2003) and Li (2010), we measure the quality of legal enforcement using the product of "anti-director rights" and "rule of law" (La Porta et al., 1998). [3] Considering the importance of legal system in influencing accounting practices, we predict that firms located in the United Kingdom have the lower, and firms located in Germany the higher, level of earnings management, with firms located in France placed in the middle.

3.   Research design

The sample

To collect data for this study, we used the Worldscope database. Our sample begins with UK, French and German firms listed in the stock market that adopted IFRS by 2005. Consistent with previous research (Becker et al. 1998; Maijor and Vanstraelen, 2006), financial firms (SIC 6000-6999) and utility firms (SIC 4000-4999) were excluded to increase the homogeneity of the sample and the comparability of the results across firms. All companies in our sample are firms listed on a stock exchange. To reduce the effect of outliers, we exclude firms in the top and bottom 1% of absolute discretional accruals and absolute studentized residuals that are higher than value 1.9.

The final sample is composed of 2728 firm-year observations distributed as follows: United Kingdom (1211), France (819) and Germany (698) for the period 2006 - 2009. We don't include observations pertaining to 2005 to remove adoption year effects.

Measurement of earnings management

In order to measure earnings management we use accruals-based metrics. Accruals are likely to capture evidence of earnings management because they reflect managers' accounting estimates and accounting choices (e.g., Dechow et al., 1995; Dechow and Dichev, 2002; Leuz et al., 2003; Larcker and Richardson, 2004; Kothari et al., 2005; Jones et al., 1991). Our dependent variable is the magnitude of absolute value of abnormal accruals, as frequently used to measure the extent of earnings management (Warfield et al, 1995; Barth et al., 2008; Chen et al, 2010).

The magnitude of cross-sectional absolute discretionary accruals is calculated based on estimated abnormal accruals, where estimated abnormal accruals are defined as total accruals minus estimated normal accruals. Estimated normal accruals are determined from the Modified Jones Model (Dechow et al., 1995). We use the absolute value of discretionary accruals, ABS_DA, as the dependent variable to proxy for earnings management in the regression model, which captures the combined effect of income-increasing and income-decreasing earnings management (Warfield et al., 1995; Chen et al., 2010):

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[2] La Porta et al. (2006) provide for United Kingdom 0.83 for Disclosure Requirements, 0.66 for Liability Standard and 0.68 for Public Enforcement; for Germany 0.42 for Disclosure Requirements, 0.00 for Liability Standard and 0.22 for Public Enforcement; for France 0.75 for Disclosure Requirements, 0.22 for Liability Standard and 0.77 for Public Enforcement.

[3] The product of "anti-director rights" and "rule of law" is 42.85 for United Kingdom, 9.23 for Germany and 24.24 for France (La Porta et al., 1998).

$$ABS\_DA = \left| DA_{i,t} \right| \tag{1}$$

where $DA_{i,t}$ is the discretionary accruals for firm i year t; ABS_DA is the absolute value of disretionary accruals.[4]

A higher magnitude of absolute discretionary accruals corresponds to a greater level of earnings management, or lower accounting quality, and vice versa.

Empirical Model

To explore the role of legal enforcement in influencing the impact of IFRS, we compare the earnings management across three countries with strong versus weak enforcement mechanisms. We estimate the following model to examine the relation between discretionary accruals and different institutional environment (COUNTRIES) as a goal factor of management decisions and incentives. Consistent with previous studies on earnings management, the following variables are included in the model to control the earnings management incentives: SIZE, GROWTH, EISSUE, DISSSUE, LEVERAGE, CFO, LOSS, XLIST and INDUSTRY (Chen et al, 2010; Maijor and Vanstraelen, 2006; Barth et al, 2008; Warfield et al., 1995).

$$ABS\_DA_{i,t} = \beta_0 + \beta_1 COUNTRIES_{i,t} + \beta_3 OWNER_{i,t} + \beta_4 SIZE_{i,t} + \beta_5 GROWTH_{i,t} + \beta_6 EISSUE_{i,t} +$$
$$+ \beta_7 DISSUE_{i,t} + \beta_8 LEVERAGE_{i,t} + \beta_9 CFO_{i,t} + \beta_{10} LOSS_{i,t} + \beta_{11} XLIST_{i,t} + \beta_{12} IND_{i,t} + \varepsilon_{i,t} \tag{2}$$

where ABS_DA is the level of discretionary accrausl; COUNTRIES is the countries dummies: $UK_{i,t}=$ is the dummy variable (UK company $=1$ and 0 otherwise); $GER_{i,t}=$is the dummy variable (GER company $=1$ and 0 otherwise); $FR_{i,t}=$ is the dummy variable (FR company $=1$ and 0 otherwise); $OWNER_{i,t}$ is the percentage of shares held by insiders; $SIZE_{i,t}$ is the natural logarithm of end of year total assets for firm i year t; $GROWTH_{i,t}$ is the percentage change in sales for firm i year t; $EISSUE_{i,t}$ is the dummy variable that takes the value 1 if annual percentage change in common stock changes by more than 10% from the previous year and $EISSUE_{i,t}$ equal 0 for otherwise; $DISSUE_{i,t}$ is the is the dummy variable that takes the value 1 if annual percentage change in total liabilities changes by more than 10% from the previous year and $DISSUE_{i,t}$ equal 0 for otherwise; $LEVERAGE_{i,t}$ is total liabilities divided by common shareholders' equity for firm i year t; $CFO_{i,t}$ is cash flow from operation divided by beginning-of-period total assets for firm i year t; $LOSS_{i,t}$ is the dummy variables that takes value 1 if the firm represented negative net income before extraordinary and $LOSS_{i,t}$ equal 0 for otherwise; $XLIST_{i,t}$ is the dummy variable that takes value 1 if the firm is also listed in more than one stock exchange and $XLIST_{i,t}$ equal 0 for otherwise; IND is the industry dummies, SIC10-19 for mining; SIC20-39 and 50-59 for wholesale trade; SIC70-89 for services.

4.   Empirical results

Descriptive analysis and correlations

The empirical analysis relates to the period 2006-2009. Table 1 reports data analysis by country. Table 1, Panel A presents descriptive statistics on the magnitude of discretional accruals in the United Kingdom, Germany and France and presents the results of parametric independent samples t-tests regarding the differences in those means. There is a large cross-country variation on the level of magnitude of discretional accruals (ABS_DA). The level of

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[4] Disretionary accruals model is calculated according Dechow et al. (1995)

discretional accruals is significantly higher in Germany when compared with United Kingdom and France. Differences are also found across civil-law countries. The level of discretional accruals is significantly higher in Germany, when compared with France. This preliminary findings are according our prediction is that, in contrast to the Germany, the France has superior laws facilitating private enforcement through liability standards facing firms when investors seek to recover losses due to the lack of material information (La Porta et al., 2006).[5] Additionally, France has a better level of the legal rules than covering protection of shareholders[6], compared with Germany, and this can explain why we observe a high level of discretionary accruals in Germany (La Porta et al. 1998, 2006).

Overall, this preliminary analysis provide evidence according our prediction that legal countries systems develop a significant role in explaining the level of discretionary accruals within three European countries.

Table 1, Panel B presents descriptive statistics for ownership concentrations and other firm's characteristics in the United Kingdom, Germany and France, as well as presents the results of parametric independent samples t-tests regarding the differences in those means. The level of ownership concentration (OWNER) is significantly higher in Germany (0.51) and France (0.48) when compared with United Kingdom (0.35). La Porta et al. (1998) provide strong evidence that ownership concentration varies by legal origin, and civil-law countries are the ones which present higher concentration of insider ownership comparing with common-low countries. Panel B of Table 1 shows that the results for the control variables are consistent with the literature. The sample total mean values are 12.75 for SIZE, 0.09 for GROWTH, 0.11 for EISSUE, 0.34 for DISSUE, 1.96 for LEVERAGE, 0.09 for CFO, 0.20 for LOSS and 0.23 for XLIST. The value of the average of the calculated variables, match with the recent studies that have been carried out, namely: Chen et al. (2010) reports 0.06 for CFO and 0.23 for LOSS; Maijor and Vanstraelen (2006) reports 12.03 for SIZE, 0.07 for CFO; Barth et al. (2008) reports 0.18 for GROWTH, 0.17 for EISSUE, 0.22 for DISSUE, 3.01 for LEVERAGE and 0.06 for XLIST.

In terms of mean differences regarding the SIZE, the United Kingdom firms are significantly smaller than Germany and France firms. Further, the GROWTH, EISSUE a DISSUE is significantly higher in the firms from United Kingdom, when compared with the Germany's and France's firms. So, there is some evidence that UK firms are more likely to issuer common stock, issue liabilities and have more growth opportunities than Germany and France firms. Although Germany firms have higher EISSUE and DISSUE and lower GROWTH than France firms, the mean difference is not significant. The variables XLIST, SIZE and CFO are statistically different across the all firms in countries analysed. The report of negative earnings (LOSS) is not statistically different across the firms in three countries analyzed. Relating to the LEVERAGE, there is some evidence that France's firms are more highly levered than Germany´s firms and the United Kingdom firms.

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[5] La Porta et al. (2006) create an index to measure the liability standard of each country. The greater the level of the liability standard index, the less is the bureaucratic difficulties in recuperating losses by investors in a particular country. The La Porta et al. (2006) measure for the liability standard in the France is 0.22, which is higher when compared with 0.00 for Germany.

[6] According to La Porta et al. (1998), regarding the shareholders rights for France, it is allowed to vote by e-mail and they have preemptive rights and the level of antidirector rights is 3, on a scale of 1 to 5. In Germany, it is not allowed to vote by e-mail, they do not have preemptive rights and antidirectors rights is 1, on a scale of 1to 5.

Finally, Panel C of Table 1 shows the Pearson correlation among the all continuous variables. The level of discretionary accruals is negatively correlated with OWNER, SIZE, LEVERAGE and positively correlated with GROWTH. Hence, ownership concentration firms, larger firms and leverage firms are more likely to lower discretionary accruals and growth opportunities firms are more likely to higher discretionary accruals. The independent variables included in the regressions are not highly correlated with each other, the absolute value range from 0.035 to 0.277, suggesting that multicollinearity is not likely to be a problem in our study.

Table 1

Regression results

Table 2 presents the random effects regression results for the total sample, with France (C1), Germany (C2) and United Kingdom (C3) as the country of reference.[7] The multivariate results confirm the differences in the level of discretionary accruals across countries. As expected, results of Equations (C1) and (C2) suggests that UK firms provide a significant low level in discretionary accruals compared to Germany at the 5% level and compared to France at the 1% level. These results are consistent with those of Ball et al., (2003) and suggested that the demand for accounting earnings is systematically different in common-low countries compared to civil-low countries. That is, strong enforcement environment seems to induce of firms decrease the level of discretionary accruals, compared to firms in the weak environment. This findings are consistent with the arguments presented in support of the research question developed that countries with a common-law origin tend to have more extensive disclosure requirements, stronger private and public enforcement of securities regulation, stronger shareholders and creditor rights (La Porta et al., 1998; 2006), reducing the level of managerial discretion.

Table 2

Further, results of Equation (C3), between the civil-law countries, the Germany firms provide a higher level of discretionary accruals compared to France at the 1% level. This findings are consistent with the arguments presented in support of the research question developed within civil-law countries, that, in the weak environments (case of Germany and France), compared to Germany, France reported lower level of earnings management (La Porta et al., 1998).

Overall, the results confirms our arguments and demonstrated that the UK firms provide a lower and Germany firms a higher, level of discretionary accruals, with French firms placed in the middle. Thus, our findings indicate lower level of earnings management for the IFRS adoption firms in the strong enforcement environment, consistent with the quality of legal enforcement being an important factor in influencing accounting practices. Overall, this findings suggest that legal countries systems develop a significant role in explaining the level of discretionary accruals within three European countries.

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[7] The Breusch-Pagan Lagrange Multiplier, the Hausman tests[7] and Fixed tests, was developed in order to determine which type of regression: pooled, fixed effects or random effects is more appropriate to describe the relationship between the absolute discretionary accruals and the explanatory variables included in the equations (C1-C3). The Breusch-Pagan test shows rejection of a null hypothesis and Hausman test indicates no rejection of a null hypothesis (the significance is 0.000 and is 0.067 for both statistical tests), what indicates that the random effects is more appropriate for equation (C1-C3).

Table 2 presents the random effects regression results for control variables in the total sample. As expected, SIZE are significantly and negatively related and EISSUE, DEISSUE, CFO and LOSS is significantly and positively related, to the level of discretionary accruals. Contrary to our expectations, variables GROWTH, LEVERAGE and XLIST do not show significance. Results regarding the firms characteristics are generally in line with prior literature. Larger companies engage significantly less in earnings management, and issuer common stock and issuer liabilities companies engage significantly more in earnings management (Barth et al, 2008; Chen et al., 2010). Our results demonstrated that greater cash flow from operating (CFO) and reported of losses companies (LOSS) engage significantly more in earnings management. This confirms that managers use cash flow from operation to exercise their discretion or judgment in opportunistic ways and manipulate earnings activities. In addition, incidences of losses induce managers to use more accruals to mitigate the impact of losses, which negatively affect discretionary accruals. This is consistent with Dechow and Dichev (2002), Francis et al.'s (2004) as well as Gaio's (2010) argument.

5. Conclusions

Considering the role of legal systems in influencing accounting practice, we analyse impact of international differences in earnings management between the United Kingdom, Germany and France non-financial listed firms during the period 2006-2009 that adopted IFRS.

Consistent with our predictions, we find that firms located in United Kingdom have the lower, and firms located in German the higher, level of earnings management, with firms located in France placed in the middle. For instance, our results indicate that incentives for earnings management across countries with strong legal protection are not the same as for their counterparts with weak legal protection. Elaborating on this, we show that institutional settings is a important characteristic that has a different influence on the level of earnings management practice in firms depending on the degree of the severity of legal enforcement. Our findings confirm previous literature (Ball et al., 2003) and also suggest that even after IFRS adoption, legal systems and investor protection are likely to influence the earnings management across EU countries.

Additional research is necessary to improve this research and address limitations. First, the data have some limitations that preclude generalizations to the universe of all firms. We cover only publicly listed firms in the three countries in the years 2006-2009. These findings do not necessarily apply to firms that are not publicly listed. The time period is an other limitation of this study. Further research might examine if the relationships found in this thesis can be extended to other firms and periods. Finally, this study focuses on particular dimensions of earnings management, namely discretionary accruals. The results may change when other dimensions of earnings management are analyzed. Additional tests is necessary to made to indicate that the results are robust after controlling for alternative measures of discretionary accounting accruals.

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TABLE 1
Descriptive statistics
Panel A: Descriptive statistics for absolute value discretionary accruals (ABS_DA) across countries

	United Kingdom	Germany	France	Total	Tests of Means (t-stats)		
					UK vs Germany	UK vs France	Germ. vs France
Mean	0.055	0.062	0.052	0.056	-0.01**	0.00	0.01***
Median	0.039	0.045	0.041	0.041			
SD	0.048	0.060	0.042	0.049			

Panel B: Descriptive statistics for dependents variables across countries

	United Kingdom	Germany	France	Total	Tests of Means (t-stats)		
					UK vs Germany	UK vs France	Germ. vs France
OWNER							
Mean	0.35	0.51	0.48	0.43	-15.61**	-13.16***	2.45*
Median	0.35	0.51	0.50	0.41			
SD	0.20	0.28	0.25	0.25			
SIZE							
Mean	12.49	12.81	13.07	12.75	-0.32***	-0.60***	-2.60*
Median	12.38	12.50	12.65	12.53			
SD	2.02	1.83	2.05	2.00			
GROWTH							
Mean	0.14	0.04	0.05	0.09	0.09***	0.09***	-0.03
Median	0.08	0.04	0.04	0.05			
SD	0.40	0.23	0.16	0.31			
EISSUE							
Mean	0.14	0.10	0.09	0.11	0.04*	0.05***	0.01
Median	0.00	0.00	0.00	0.00			
SD	0.35	0.30	0.32	0.32			
DISSUE							
Mean	0.41	0.10	0.09	0.34	0.12***	0.12***	0.01
Median	0.00	0.00	0.00	0.00			
SD	0.50	0.30	0.28	0.48			
LEVERAGE							

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Mean	1.85	1.83	2.22	1.96	0.02	-0.37**	-0.39**
Median	1.17	1.41	1.50	1.35			
SD	2.51	2.49	2.84	2.61			
CFO							
Mean	0.10	0.09	0.08	0.09	0.01*	0.02***	0.01**
Median	0.10	0.09	0.07	0.09			
SD	0.12	0.10	0.06	0.10			
LOSS							
Mean	0.20	0.20	0.18	0.20	-0.04	0.02	0.02
Median	0.00	0.00	0.00	0.00			
SD	0.40	0.40	0.39	0.40			
XLIST							
Mean	0.07	0.59	0.15	0.23	-0.52***	-0.07***	0.44***
Median	0.00	1.00	0.00	0.00			
SD	0.26	0.49	0.36	0.42			

Panel C: Pearson correlation matrix for continuous variables

	ABS_DA	OWNER	SIZE	GROWTH	LEVERAGE	CFO
ABS_DA	1					
OWNER	-0.035**	1				
SIZE	-0.277***	-0.120***	1			
GROWTH	0.092***	-0.052***	-0.101***	1		
LEVERAGE	-0.063***	0.028	0.204***	-0.055***	1	
CFO	0.016	-0.057***	0.093***	0.137***	-0.092***	1

Variables definitions:

ABS_DA is absolute discretionary accruals; OWNER is the percentage of shares held by insiders; SIZE is the natural logarithm of end of year total assets; GROWTH is the percentage change in sales; EISSUE is the dummy variable that takes the value 1 if annual percentage change in common stock changes by more than 10% from the previous year and EISSUE equal 0 for otherwise; DISSUE is the dummy variable that takes the value 1 if annual percentage change in total liabilities changes by more than 10% from the previous year and DISSUE equal 0 for otherwise; LEVERAGE is total liabilities divided by common shareholders' equity; CFO is cash flow from operation divided by beginning-of-period total assets ; LOSS is the dummy variables that takes value 1 if the firm represented negative net income before extraordinary and LOSS equal 0 for otherwise; XLIST is the dummy variable that takes value 1 if the firm is also listed in more than one stock exchange and XLIST equal 0 for otherwise.

***, ** and * indicate significance at the 0.01, 0.05 and 0.10 levels respectively;

Number of observation is 1211 for the United Kingdom, 698 for Germany and 819 for France.

TABLE 3

Panel-Data Regression Results of IFRS Adoption on Absolute Discretionary Accruals

$$ABS\_DA_{i,t} = \beta_0 + \beta_1 COUNTRY + \beta_2 OWNER_{i,t} + \beta_3 SIZE_{i,t} + \beta_4 GROWTH_{i,t} + \beta_5 EISSUE_{i,t} + \beta_6 DISSUE_{i,t} + \beta_7 LEVERAGE_{i,t} + \beta_8 CFO_{i,t} + \beta_9 LOSS_{i,t} + \beta_{10} XLIST_{i,t} + \beta_{11} IND_{i,t} + \varepsilon_{i,t}$$

Variables	C1	C2	C3
Inrtercept	0.146***	0.152***	0.139***
UK	-0.008**	-0.014***	
GER	0.007*		0.014***
FR		-0.007*	0.007**
OWNER	-0.000***	-0.000***	-0.000***
SIZE	-0.007***	-0.007***	-0.007***
GROWTH	0.004	0.004	0.004
EISSUE	0.007**	0.007**	0.007**
DISSUE	0.011***	0.011***	0.011***
LEVERAGE	-0.000	-0.000	-0.000
CFO	0.037***	0.038***	0.038***
LOSS	0.011***	0.011***	0.011***
XLIST	0.003	0.003	0.003
SIC 10-19	0.009*	0.009*	0.009*
SIC 70-89	0.000	0.001	0.001
R-sq	0.12	0.12	0.12

Variables definitions:

ABS_DA = absolute discretionary accruals

UK is the dummy variable that takes value 1 if company from the United Kingdom and UK equal 0 for otherwise; GER is the dummy variable that takes value 1 if company from the Germany and GER equal 0 for otherwise FR is the dummy variable that takes value 1 if company from France and FR equal 0 for otherwise; OWNER is the percentage of shares held by insiders; SIZE is the natural logarithm of end of year total assets; GROWTH is the percentage change in sales; EISSUE is the dummy variable that takes the value 1 if annual percentage change in common stock changes by more than 10% from the previous year and EISSUE equal 0 for otherwise; DISSUE is the is the dummy variable that takes the value 1 if annual percentage change in total liabilities changes by more than 10% from the previous year and DISSUE equal 0 for otherwise; LEVERAGE is total liabilities divided by common shareholders' equity; CFO is cash flow from operation divided by beginning-of-period total assets ; LOSS is the dummy variables that takes value 1 if the firm represented negative net income before extraordinary and LOSS equal 0 for otherwise; XLIST is the dummy variable that takes value 1 if the firm is also listed in more than one stock exchange and XLIST equal 0 for otherwise; SIC10-19 for mining; SIC70-89 for services.

***, ** and * indicate significance at the 0.01, 0.05 and 0.10 levels respectively.

Number of observation is 2728.