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Effect of IFRS adoption on reported earnings: Empirical study on Germany and Spain

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Abstract

Since 2005, when the IFRSs were mandatorily adopted for publicly traded companies within the European Union, their influence on accounting quality began to grow in importance. This paper examines the effect of the International Financial Reporting Standards (IFRSs) on earnings quality during the period 2000–2013. The research sample consists of 358 companies from 2 European countries – Germany and Spain. The sample contains companies that firstly used local accounting standards and later on switched to reporting under IFRSs. This paper contributes to the current academic discussion more empirical evidence from a typically strong European economy (Germany) and from an opposite representative (Spain). It investigates the IFRSs' influence on earnings quality by small reported profits to small reported losses ratios. The research findings do not support the aim of the IFRSs to improve the reporting quality in the examined countries.

Keywords

Accounting standards, earnings quality, international financial reporting standards, loss avoidance.

JEL Classification: M41, G38

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1. Introduction

In the current age, the timeliness, quality and reliability of information represent one of the key instruments to success in a highly developed competitive market. Diversity in accounting systems – as the bearer of financial information for investors – causes difficulty in comparing companies' financial statements. For this and similar reasons, the European Union (EU) decided to harmonize accounting regulation. However, the implementation of Council Directives (European Union, 1978, 1983, 1986, 1991) was not a satisfactory solution. Later on, consistent with their objectives, the European Union selected the International Financial Reporting Standards (IFRSs, which include old and revised International Accounting Standards) as an appropriate approach to meet the increasing market demand for greater transparency and comparability of reported performance, especially for cross-border companies. The movement towards IFRSs, when their adoption became mandatory for publicly traded companies starting in the year 2005, was an important milestone in accounting history. More than 100 jurisdictions, which already permit or allow IFRSs, underlie its global importance.

After almost 10 years of mandatory IFRS use in the European Union, the IFRSs are an icon within the accounting world, but the net IFRS effect is not as obvious and needs to be investigated. Thus, many accounting research studies were devoted to the measurement of reporting quality around the date of the IFRS implementation. Their findings support a positive effect of IFRSs (e.g. Covrig et al., 2007), but on the other hand, the other economic factors, such as the national legal system and the enforcement mechanism, play a significant role in the entire issue. Nevertheless, some papers document a negative influence of IFRSs on earnings management (e.g. Jeanjean and Stolowy, 2008).

This paper analyses the influence of uniform accounting rules on earnings manipulation in 358 companies in two European countries – Germany and Spain – during periods before and after IFRS adoption (in total during the years 2000–2013). The research sample consists of companies that firstly used national accounting standards and later on switched to reporting in accordance with the IFRSs. The aim of the

paper is to examine whether the ability of companies to avoid small reported losses was affected by IFRS adoption – whether small reported losses significantly decreased or increased after IFRS adoption. In Germany, around half of the sample companies had to be excluded because they reported under the US General Accepted Accounting Principles (US GAAPs). This paper contributes to the current accounting debate more empirical evidence from a typically strong European economy (Germany) and an opposite representative (Spain). The research investigated the IFRSs' influence on earnings quality by calculating small reported profits to small reported losses ratios.

2. Definition of Earnings Management

Accounting, in any form, financial or managerial, is a constantly growing and developing discipline. Financial accounting must meet requirements based on the accounting standards followed. The aim of accounting standards is to provide quality, timely and responsible financial information to all parties involved. On the other hand, managers may try to manipulate the reported numbers to present a better financial situation of the company and enhance the remunerations and bonuses. The manipulation of earnings in order to report greater financial performance is called earnings management.

Earnings management is an issue that has been researched for several decades in the United States of America, and for this reason most substantial studies address US environments. Later on, earnings management became a popular academic topic both in Europe and around the globe. Earnings management includes a wide range of activities; thus, it is important to define the term. A significant number of definitions of earnings management or earnings manipulation exist. One of them, provided by Healy et al. (1999), became popular: *Earnings management occurs when managers use judgment in financial reporting and in structuring transaction to alter reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers.*

Nevertheless, earnings management may be classified into more accurate sections, while real earnings management occurs when managers undertake actions that deviate from the first-best practice reported earnings (Gunny, 2005). Real earnings management includes the activities when accounting methods are not changed but instead some specific items are manipulated. Those items are commonly research and development expenses (R&D expenses), selling, general and administrative expenses (SG&A expenses), the elimination of investments in fixed assets, etc. These and similar activities represent managers' intentions to increase the reported profits and avoid reported losses.

3. Relevant Background of the Influence of IFRSs

The widespread acceptance of the International Financial Reporting Standards confirms their growing importance. Supporting arguments for the advantages of the IFRSs are based on the assumption that they improve the comparability and enhance the transparency of financial reporting. The previous legal environment in the European Union was based on Council Directives 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC. The reporting requirements arising from these directives were not able to ensure the high quality level of financial reporting that is a necessary condition for creating an integral capital market that operates smoothly and effectively. Therefore, the EU implemented a legal framework applicable to all publicly trading companies. A single set of high-quality international accounting standards contributes to more efficient and cost-effective functionality of the internal market, protects investors, maintains confidence in the financial markets, increases the global competitiveness of EU companies and improves the EU economy. The international acceptance by community companies participating in financial markets confirms the IFRSs to be truly global standards, implying increasing convergence of accounting standards (EU, 2002).

Since 2005, when the European Union mandatorily accepted the IFRSs for publicly traded companies, studies focusing on the relationship between IFRSs and earnings management started to be favoured. Later on, either mandatory or voluntary IFRS adoption by other countries, currently exceeding 100 jurisdictions, contributed to that fact and created new questions for future research. Barth et al. (2008) supported a positive influence of the IFRSs on earnings manipulation and earnings smoothing in a sample of companies from 21 countries. Despite the topic's popularity, some other relevant consequences and factors – the enforcement mechanism, the connection with the legal

framework and the influence of managers' incentives – are also subjects of this academic literature.

Amstrong et al. (2010) investigated the equity market reactions to sixteen events associated with IFRS adoption in Europe. They found a significant positive reaction in response to the events, increasing the likelihood of IFRS adoption. They identified a more positive reaction for European companies with lower pre-adoption information quality and higher pre-adoption information asymmetry. Therefore, investors in European Union firms are aware of the net convergence benefits associated with the IFRSs. Ismail et al. (2013) tested whether the level of earnings management was significantly lower after the IFRS adoption and the reported earnings are more value relevant during the IFRS period on a sample consisting of 4010 firm-year observations. They confirmed the hypothesis about the positive effect of the IFRSs on higher reporting quality.

A uniform accounting language brings at least two advantages. Firstly, the IFRSs require greater disclosure than various national accounting standards. The commitment to increasing the level of disclosure of financial statements should reduce companies' cost of capital by lowering the information asymmetry (Leuz and Verrecchia, 2000). Secondly, one set of accounting rules might improve the information comparability across companies, expecting to decrease the cost of capital (Li, 2010).

These relatively positive research results for the IFRSs, thanks to the continuously changing worldwide economic environment, are also reasons to be suspicious of reaching the goals established by the IFRSs on every point. The evidence found in the study by Ball et al. (2003) shows only a limited influence of international accounting standards on reporting quality. The IFRSs may provide improvement and become uniform worldwide, but the desired uniformity may remain an elusive achievement due to the lack of contemporary changes in other accompanying institutions (Ding et al., 2007). Then, the IFRSs aim to be the international accounting rule but the national environment and legal systems remain local. Moreover, the national patterns of IFRS practice continue throughout the period so that international comparability remains in doubt (Kvall and Nobes, 2012).

Countries requiring the use of local standards have national standards that are more oriented toward the satisfaction of regulatory needs, rather than investors' needs. The accounting quality appears to be significantly lower in these countries both prior to and after IFRS adoption (Macías and Muino, 2011). Morris et al. (2014) revealed a very small negative tone among a sample of Australian companies reflecting concerns about the problems of IFRS implementation and the

low level of expected benefits. Jeanjean and Stolowy (2008) investigated the prevalence of earnings management after mandatory IFRS adoption in Australia, France and the United Kingdom. They found in a sample of 1146 companies that one set of accounting standards does not have any effect on earnings management; in fact, earnings management has increased in France.

From the research findings presented above, the net influence of the IFRSs on accounting quality is still open question. This paper contributes to the current academic debate more empirical results related to the followed hypothesis: *Accounting quality, measured by small reported profits to small reported losses, increased after IFRS adoption in Germany and Spain.*

4. Research Design

The measurement of total accruals (TA), more precisely discretionary accruals (DA), which are hard to manipulate, is one of most frequently used methods for detecting and quantifying earnings management (e.g. Callao and Jarne, 2010; Gorgan et al., 2012). The second part, non-discretionary accruals (NDA), is considered not to be easily manipulated. Thus, the methods concentrate on the quantification of discretionary accruals rather than total accruals.

The other frequently conducted methods are those that focus on thresholds, as used in this paper. This research investigates the distributions of earnings for discontinuities by measuring them against thresholds in both Germany and Spain. The research's aim is to examine whether the ability of companies to avoid small reported losses was affected by IFRS adoption. The period before IFRS adoption (*pre-IFRS*), when companies reported under national accounting regulation, and the period after IFRS adoption (*post-IFRS*), when companies reported in accordance with the IFRSs, are compared.

4.1 Sample

The research sample comprises 358 companies (3713 firm-year observations) listed in Germany (245; 2450) and Spain (113; 1263). The analysis covers the period 2000–2013 divided into two sub-periods, before IFRS adoption and after IFRS adoption. This separation reflects reporting under national accounting standards (*pre-IFRS*) as well as accounting entity reports in accordance with the IFRSs (*post-IFRS*). Table 1 shows the total sample size.

In the case of Germany, a considerable part of the sample must be excluded because companies reported in accordance with the US GAAPs. Then, the companies that did not have at least one firm-year of obser-

vations before IFRS implementation and at least one firm-year of observations after IFRS implementation could not be included in the research.

Table 1 Sample Size

Country	Germany	Spain
Total firms	245	113
Total observations	2450	1263
<i>Pre IFRS</i> Observations	468	443
<i>Post IFRS</i> Observations	1878	760

Source: Thomson Reuters Datastream

4.2 Methodology

Following the study by Jeanjean and Stolowy (2008), the *loss avoidance thresholds* are tested by analysing the distribution of income before extraordinary items (IBEX) scaled by the lagged total assets. Firm-year observations are categorized as a small reported loss if the income before extraordinary items (IBEX) scaled by the lagged total assets falls within the range $[-0.01; 0]$. A small reported profit is determined when a firm-year observation of IBEX/total assets falls within the range $[0; 0.01]$. Ultimately, the focus is on the number of observations falling into the range $[-0.1; 0.1]$, of which firm-year observations falling into the range $[-0.01; 0.01]$ are considered as small (cases) and the other observations are controls.

Germany and Spain were chosen because they are both European countries and thus they both had to adopt the IFRSs for listed companies in the year 2005. The research also considers companies that voluntarily adopted the IFRSs at the same moment of mandatory IFRS adoption, contributing to my research a comparable period of time in both countries and an adequate sample size of companies during the *pre-IFRS* and *post-IFRS* periods. Moreover, Germany is a typical representative of a stable and strong economy and Spain is one of the European countries with lower economic performance.

The aim of the research is to find out whether IFRS adoption is associated with a lower amount of earnings management. For the research design given above, the following data were needed: income before extraordinary items (IBEX) and total assets. IBEX was calculated scaled by lagged total assets for the years 2000–2013 except the first year of IFRS adoption. The transition year (the first year of IFRS adoption) was excluded because no restated data were available for the previous accounting period. In fact, when the IBEX/lagged total assets was calculated for the year 2005 and the year 2005 considered as a transition year, the research considered IBEX from 2005 but total assets from 2004. Then, IBEX was reported under the IFRSs but the total assets were reported under the local accounting rules. Despite the

requirements of the IFRSs to restate financial statements when the company initially reported under the IFRSs, databases do not always provide the restated data. Unfortunately, within the Datastream databases (Thomson Reuters), the restated data could not be accessed.

Datastream uses several different codes to differentiate the accounting standards that accounting entities follow. The codes are (1) local standards; (2) international standards; (3) US standards (GAAPs); (4) Commonwealth countries' standards; (5) EU standards; (6) international standards and some EU guidelines; (7) specific standards set by the group; (8) local standards with EU and IASC guidelines; (9) not disclosed; (10) local standards with some EU guidelines; (11) local standards – inconsistency problems; (12) international standards – inconsistency problems; (13) US standards – inconsistency problems; (14) Commonwealth standards – inconsistency problems; (15) EEC standards – inconsistency problems; (16) international standards with some EU guidelines – inconsistency problems; (17) local standards with some OECD guidelines; (18) local standards with some IASC guidelines; (19) local standards with some OECD and IASC guidelines; (20) US GAAPs reclassified from local standards; (21) local standards with a certain reclassification from foreign companies; (22) other; (23) IFRSs.

Companies were considered that first reported under local standards and second in accordance with the IFRSs. Local standards were considered as the following codes: (1) local standards, (10) local standards with EU guidelines, (17) local standards with some OECD guidelines, (18) local standards with some IASC guidelines, (19) local standards with some OECD and IASC guidelines and (21) local standards with a certain reclassification for foreign companies. The International Financial Reporting Standards were considered as code (23) IFRSs.

To assess the change in earnings management before and after IFRS adoption, the study presents histograms of a number of observations of IBEX/lagged total assets for both periods, including all the observations when the IBEX/lagged total asset fell within the range $[-0.1; 0.1]$. Then, odds ratios were calculated to quantify how strongly the absence or presence of small reported profits was associated with the absence or presence of small reported losses.

5. Research Results

The research results are divided into three parts: *descriptive statistics, distribution of profits and losses and measurement of asymmetry.*

5.1 Descriptive Statistics

Descriptive statistics (means, medians, maximums and minimums) were calculated for both selected countries. Table 2 presents the descriptive statistics of the income before extraordinary items (IBEX) and total assets (TA) variables based on the sample size presented in Table 1.

In Table 2, the means for both examined variables are visibly higher than the medians and the total assets are very close together in both countries, especially the medians of the total assets. The mean of IBEX in Germany is higher than that in Spain but the median of IBEX in Germany is lower than that in Spain. The maximum IBEX in Germany is more than twice as high as the maximum IBEX in Spain. The minimum IBEX in Germany is lower than that in Spain but less significant than the maximum IBEX. In addition, the maximum TA is almost twice as high in Germany as in Spain.

Table 2 Descriptive Statistics (IBEX, Total Assets)

Country	Germany	Spain
Mean IBEX	293 430	288 502
Median IBEX	29 700	36 403
Max IBEX	21 717 000	10 167 000
Min IBEX	-24 587 000	-19 056 404
Mean TA	22 651 381	22 497 496
Median TA	1 028 641	1 029 398
Max TA	2 193 953 000	1 249 871 000
Min TA	266	4 524

Source: Thomson Reuters Datastream

Table 3 shows the IBEX/lagged total assets (mean, p25 and p75) divided into categories based on the accounting standards used.

In Table 3, the first quartile (p25), median and third quartile (p75) after IFRS adoption are slightly higher than in the period before IFRS adoption in Germany and they are moderately lower in Spain. The mean decreased in both examined countries after IFRS adoption. The difference between the *pre-IFRS* and the *post-IFRS* period in maximum values of IBEX/lagged total assets in Germany is more significant than for the maximum values in Spain. Table 3 presents an illustrative example as the research sample may include extreme values (the maximum IBEX scaled by lagged total assets is 14.442 but the median is 0.030 and the mean 0.069).

Because of the increase in some descriptive statistics (p25, median, p75) in Germany, a Wilcoxon rank-sum test, which is a non-parametric statistical hypothesis test, was carried out and it tested unmatched data. In practice, the Wilcoxon rank-sum test assesses whether medians change during two periods (in this

case, before and after IFRS adoption). The result confirms that the distributions of income before extraordinary items scaled by lagged total assets neither increased nor decreased in both countries.

Table 3 Descriptive Statistics (IBEX/Lagged Total Assets)

Country	Germany Pre IFRS	Germany Post IFRS	Spain Pre IFRS	Spain Post IFRS
Number of observations	468	1 878	443	760
Mean	0.069	0.050	0.056	0.034
p25	0.007	0.011	0.020	0.005
Median	0.030	0.042	0.042	0.028
p75	0.077	0.079	0.082	0.065
Max	14.442	0.767	1.479	1.247
Min	-0.438	-1.057	-0.478	-1.103

Source: Thomson Reuters Datastream

5.2 Distribution of Profits and Losses

Table 1 presents the entire sample size, but to evaluate earnings quality measured by the loss avoidance threshold method, the observations close to zero are considered. The small reported losses are classified as those in which the income before extraordinary items scaled by lagged total assets fell into the range $[-0.01; 0]$, while small reported profits are those in the range $[0; 0.01]$. Therefore, the observations immediately to the left of zero are attributable to the range $[-0.01; 0]$ and the observations immediately to the right of zero are attributable to the range $[0; 0.01]$. In total, the observations within the range $[-0.01; 0.01]$ are considered.

Figure 1 (Germany) and Figure 2 (Spain) show the distributions of income before extraordinary items scaled by lagged total assets for each country divided into two sub-figures: before and after IFRS adoption. The interval width for the histograms is 0.01 (income before extraordinary items scaled by lagged total assets).

The histograms for both countries show a significant amount of observations immediately to the left of zero, indicating small reported losses $[-0.01; 0]$ – the dark highlighted column. The interval immediately to the right of zero, which indicates small reported profits $[0; 0.01]$, the dark highlighted column, contains a low number of observations in comparison with the small reported losses' interval. The most important factor in the study is the analysis of any changes that occur between the histograms showing observations *pre-IFRS* (Figure 1 a) and Figure 2 a)) – a) represents the situation *pre-IFRS* – and those that portray observations taken *post-IFRS* (Figure 1 b) and Figure 2 b)) – b) represents the situations *post-IFRS*. The maxi-

imum value on axis y – the density of the number of observations of IBEX/lagged total assets – is 22.

The values higher than 0.1 and lower than -0.1 are excluded from the histograms. Therefore, the number of observations shown is lower than the number of observations mentioned in the tables above.

The situation before IFRS adoption (Figure 1 a)) shows a higher density of small reported profits within the range $[0; 0.01]$ in comparison with the situation after IFRS adoption (Figure 1 b)) and a modest decrease in small reported losses within the range $[-0.01; 0]$. However, the decrease in small reported profits is more significant than the decline in small reported losses, showing the tendency toward a decline in earnings management and therefore an improvement of accounting quality.

The histograms presenting the Spanish situation (Figures 2 a) and b)) look significantly different in the two periods. There is an increase in the density of small reported profits within the range $[0; 0.01]$ associated with IFRS adoption. The frequency of small reported losses within the range $[-0.01; 0]$ is difficult to assess because it is not a visible change. Because of the increase in small reported profit, the prevalence of earnings management is higher after IFRS adoption. To accept or reject the null hypothesis, the change in the frequencies of variables must be quantified (see the following sub-section).

Overall, the histograms present a visible change in a number of observations *pre-IFRS* and *post-IFRS*. The situations in Germany tend toward a decline in earnings management and on the other hand the situations in Spain lead to an increase in earnings management. Therefore, the significance of the change must be quantified. The small reported profits to small reported losses ratios are used for this quantification.

5.3 Measurement of Asymmetry

The histograms in Figure 1 and Figure 2 provide a visual representation of the discontinuities. This asymmetry must be measured. The ratio of small reported profits to small reported losses, as calculated in prior studies (e.g. Jeanjean and Stolowy, 2008), is also used in this paper. The classification for small losses is used if the income before extraordinary items scaled by lagged total assets falls into the range $[-0.01; 0]$, and small profits correspond to the range $[0; 0.01]$.

Table 4 provides the results of the small reported profits to small reported losses ratios calculated by the odds ratio – formula 1. The odds ratio was originally designed for epidemiologists and quantifies how strongly the absence or presence of A is associated with the absence or presence of B.

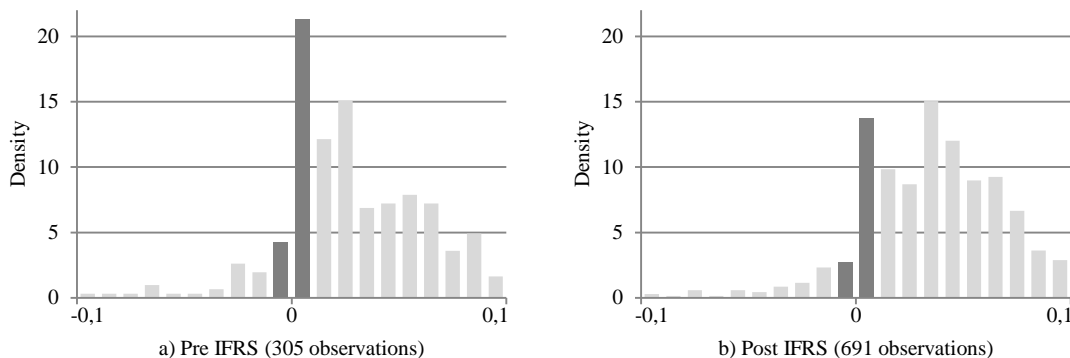


Figure 1 Distribution of IBEX/Lagged TA in Germany

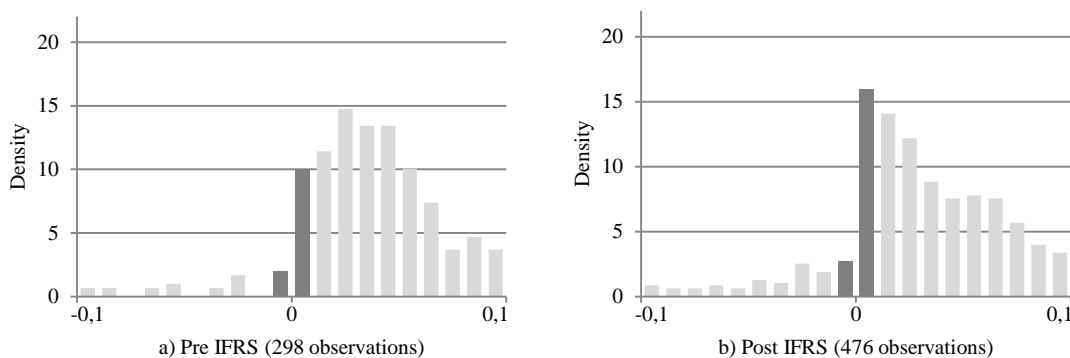


Figure 2 Distribution of IBEX/Lagged TA in Spain

$$odds\ ratio = \frac{a/c}{b/d} \tag{1}$$

where a is the number of exposed cases, b is the number of exposed non-cases, c is the number of unexposed cases and d is the number of unexposed non-cases.

The odds ratio has frequently been used in observational studies and has already been calculated in similar research (e.g. Jeanjean and Stolowy, 2008). According to the change in the odds ratio, it can be clarified whether IFRS adoption had a significant influence on earnings management.

Table 4 shows a number of cases (small profits), a number of controls (small losses), the odds ratios and both the upper and the lower level of the confidence interval (CI) for the odds ratios quantified for the *pre-IFRS* period. In Figure 1, the density of small profits decreases, while the total number of small reported profits increases (from 65 to 95). The total number of firm-year observations, which was higher in the *post-IFRS* period, must be considered. On the other hand, Figure 2 presents a higher density of small reported profits after IFRS adoption and Table 4 presents an increase from 30 to 76.

In Table 4, the odds ratio changes in different directions in each country and but the changes are not significant. The confidence interval is used to determine the significance.

The odds ratio in Germany moderately decreased (from 0.591 to 0.423), while the ratio for Spain increased (from 0.325 to 0.848). To evaluate the significance of the odds ratios, the confidence interval was quantified for the odds ratios for the *pre-IFRS* period. Later on, the odds ratios were evaluated for the *post-IFRS* period with the quantified confidence interval.

As a result, it can be demonstrated with 95% confidence that the situation after IFRS adoption was the same if the odds ratio for observations after IFRS adoption falls within the confidence interval (0.285; 1.227). Because the odds ratio after IFRS adoption is within the confidence interval, there is neither a significant increase nor a significant decrease in earnings management associated with IFRS adoption in Germany.

When looking at the situation in Spain, there is an increase in the odds ratio. The odds ratio quantified for the *pre-IFRS* period is 0.325 and the confidence interval for that period is (0.118; 0.895). The odds ratio quantified for the *post-IFRS* period (0.848) is

very close to the upper level of the confidence interval quantified for the *pre-IFRS* period (0.895). The change in the odds ratio is considerably greater in Spain than in Germany, but the odds ratio quantified for the *post-IFRS* period still falls within the confidence interval quantified for the *pre-IFRS* period, which means there was no significant increase in earnings manipulation.

Table 4 Small Profits to Small Losses Ratios

Country	Cases (small profits)	Controls (small losses)	Odds ratio
Germany			
Pre IFRS	65	13	0.591
CI lower level			0.285
CI upper level			1.227
Post IFRS	95	19	0.423
Spain			
Pre IFRS	30	6	0.325
CI lower level			0.118
CI upper level			0.895
Post IFRS	76	13	0.848

Source: Thomson Reuters Datastream

No significant decrease or increase in earnings management results in no significant change in accounting quality, which implies no significant effect of the adoption of the International Financial Reporting Standards on accounting quality. A similar study undertaken by Jeanjean and Stolowy (2008) also did not quantify any effect of IFRSs on earnings management in the United Kingdom and Australia.

Nevertheless, the examined data are homogeneous, which was proven by using the chi-squared test presented in Table 5.

Table 5 Chi-Squared Test

Country	Germany	Spain
Chi2	21,560	10,245
p value	4,35E-46	0,983

Overall, the histograms for Germany show a slight improvement in earnings quality; on the opposite site, the histograms for Spain show a moderate decline in earnings quality. Those changes were visible from the histograms, but after quantification – made by odds ratios – the changes are not significant. Hence, it can be concluded that the IFRSs had no significant influence on earnings management.

6. Discussion

Previous research studies differed as a consequence of different samples, methods, variables and assump-

tions. This paper does not support the aim of the International Financial Reporting Standards calling for an improvement in accounting quality implying higher cross-border comparability and transparency of financial statements. The mandatory adoption of the IFRSs in the European Union represents an important accounting milestone. It meant a shift from a rules-based system to a principle-based approach (Callao and Jarne, 2010). The principle-based system, which the International Accounting Standards Board (IASB) leans towards, might support an improvement of the faithful reflection of economic substance and transactions. The opposite rules-based accounting approach leaves little space for professional judgement (Wüstermann and Kiezek, 2005).

Ewert and Wagenhofer (2005) measured earnings quality by the variability of reported earnings and the association between the reported earnings and the market price reaction. Their result states that tighter accounting standards increase the earnings quality. Aubert and Grudnitski (2012) investigated earnings manipulation in 20 European countries during the *pre-IFRS* period from 1997 to 2003 and during the *IFRS* period from 2006 to 2008, supporting the positive influence of the IFRSs. According to Ball (2006), the major IFRS advantages are the lower risk and costs for investors, the elimination of international differences in financial reporting, the expected increased market efficiency and the removal of barriers to cross-border acquisition.

Despite the benefits of the IFRSs, the desired uniformity of reporting quality still remains an illusion due to the lack of adequate changes in other accompanying institutions (Ding et al., 2007). According to the research conducted by Ali and Hwang (1999), countries with a low demand for information from published financial reports might be reluctant to adopt any common accounting standards that emphasize value relevance. They lead to use accounting practice producing financial data with low value relevance. Ahmed et al. (2013) investigated the influence of the mandatory adoption of the IFRSs by the discretionary accruals method on 1631 firms from 20 countries and another 1631 companies from 15 countries that did not adopt the IFRSs. Their findings show that the value relevance of the book value of equity did not increase after IFRS adoption. This paper also does not support the positive impact of the IFRSs. Its limitations lie in the assumption that managers try to avoid small reported losses and further reported losses are not considered. Other research methods to measure the effect of IFRS adoption and compare the results might be considered.

Nowadays, the IFRSs have increasing importance, but other economic factors, such as the national legal

system and managers' incentives, affect the reporting quality. Countries with a weaker enforcement mechanism have a higher level of earnings manipulation (Burgstahler et al., 2006) and a stronger influence of the IFRSs appears in countries with a strong legal enforcement mechanism (Ahmed et al., 2013). In addition, the legal environment in a particular jurisdiction should be prepared to implement the IFRSs. The absence of effective control and infrastructure might be a relevant driver of IFRS failure (Dao, 2005).

Due to the differences in the previous results concerning the influence of the IFRSs on accounting quality, earnings manipulation and management, a simple uniform verdict does not exist and the topic is still open for future research. In particular, other factors, such as the enforcement mechanism, market access conditions and effectiveness of the legal system, are relevant drivers of IFRS success.

7. Conclusion

The International Financial Reporting Standards (including International Accounting Standards) represent uniform accounting rules with the aim of enhancing comparability and transparency and improving the quality of financial statements. The mandatory IFRS adoption for companies listed in the European Union market – as a reaction to Council Directives' failure – represents an important moment in accounting history. The IFRSs' consequences for accounting quality are a popular subject for academic research, implying that plenty of relevant studies have been published (e.g. Zeghal et al., 2012). Their results support both positive and no influence of the IFRSs on the reporting quality; therefore, the net effect of the IFRSs is still not clear.

This paper examined the IFRSs' influence on earnings management in a sample of 358 companies in 2 European countries – Germany and Spain – during periods before and after IFRS adoption (2000–2013). The research contributes to the current academic discussion more empirical evidence from a typically strong European economy (Germany) and an opposite representative, Spain. Loss avoidance was investigated by quantifying small reported profits to small reported losses ratio. The results do not support the aim of the IFRSs to improve the accounting quality because the change in ratios is not significant. Moreover, the situation in Spain approaches the upper level of the confidence interval, representing borderline significance. Therefore, the finding in Spain is especially brittle. Based on my result, it is suggested that the European Union should devote more attention to common goals rather than the convergence of accounting standards.

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