IFRS Adoption and Changes in Managerial Behavior to Beat Market Expectation
- An International Study -*

국제회계기준 도입 이후 시장기대치 달성을 위한 경영자의 행태 변화*

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Abstract: This study examines, after mandatory International Financial Reporting Standards (IFRS), whether managers change their behavior to meet or beat market expectation and whether investors change their response to meet or beat analyst expectation. Recent accounting studies report that managers tend to manage earnings upward and/or guide analyst expectations downward to avoid negative earnings surprises at the earnings announcement. Since the stock market reaction to negative earnings surprises tends to be asymmetric and larger than the reaction to positive earnings surprises, missing analyst expectation drives a high cost to managers. A sudden price drop can increase shareholders’ litigations and decrease the value of managers’ compensation.

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Over 100 countries have recently adopted the IFRS which the International Accounting Standards Board (IASB) introduces as a goal of developing an internationally acceptable set of high quality financial reporting standards. Many researches show that application of IFRS is associated with higher accounting quality than application of domestic standards. However, others claim IFRS may not lead to higher quality financial reporting since the inherent flexibility in principle-based standards can increase managers' opportunistic behavior for their own interests.

Using the data after mandatory IFRS reporting in 20 countries around the world between 1996 and 2007, this study investigates (1) whether managers change their behavior to use earnings management and/or expectations management; and (2) whether stock market changes the rewards on meeting or beating analyst expectations. Our observations are selected from companies listed on the S&P Global 1200 index as of December 31, 2007. A total of 7,920 country-firm-year observations are used for our analysis.

First, we find that the reliance on income-increasing discretionary accruals declines and managers appear to emphasize expectations management more in post-IFRS period. Moreover, managers are more likely to use downward forecast guidance after mandatory IFRS adoption, in particular, in the countries with strong-investor-protection law. Given the relative difficulty to manage earnings in post-IFRS period, these findings suggest that managers choose to use downward expectations management in the environments where the regulation of forecast guidance is less strict than that of earnings management.

Second, we reveal that the market premium to meet or beat analyst expectations disappears in post-IFRS period, suggesting the stock market becomes increasingly suspicious of the firms just meet or narrowly beat analyst forecasts. The evidence from further analysis suggests that, in post-IFRS, meeting or beating expectations become a stronger signal of future performance, which is consistent with the observed decrease in the use of earnings management. Thus, it is possible the decline in market premium associated with meeting or beating expectations is the result of increased investor skepticism.

Our paper contributes to an emerging literature on financial reporting practices in post-IFRS period, the majority of which concentrate on the effect of IFRS on earnings quality. The findings imply that managers' behavior to increase downward forecast guidance, rather than to use earnings management to beat market expectation, may not be good news to investors regardless of the improvement of earnings