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EFFECT OF INTERNATIONAL FINANCIAL REPORTING STANDARDS ON EARNINGS
MANAGEMENT: EVIDENCE FROM GHANA

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EARNINGS MANAGEMENT: EVIDENCE FROM GHANA

BY

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THESIS SUBMITTED TO THE DEPARTMENT OF ACCOUNTING, SCHOOL OF
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SEPTEMBER, 2019

DECLARATION

Student

I hereby declare that this thesis is the result of my own original work and that no part of it has been presented for another degree in this University or elsewhere:

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Supervisor

I hereby declare that the preparation and presentation of this thesis was supervised in accordance with guidelines on supervision of dissertation/thesis laid down by the University for Development Studies.

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ABSTRACT

This study relies on data from 19 listed companies in Ghana for the period 2004- 2014 to examine the impact of International Financial Reporting Standards adoption on the earnings management. In addition, I investigate the impact of big four auditor type and firm Size on Earnings Management. The study adopts the Generalized Method of Moments with extensive reliance on secondary data from the financial statement of quoted company's annual report. The research focuses on nonfinancial firms since financial institutions have a different method of determining Earnings Management. Secondary data sourced from financial statements of quoted companies retrieved from the Ghana Stock Exchange and websites of the sampled companies for the study. The study makes use of the two-step generalized method of moments to examine how the explanatory variables (IFRS, firm size, audit firm type and control variables) impact on earnings management using discretionary accruals measure. The study finding indicates the existence of negative significant relationship between IFRS, firm size and earnings management while auditor type affect earnings management positively. The recommendation is that there is the need for companies to consider an increase in the application of IFRS in all areas of financial reports and for standard setters to reduce the level of discretion or flexibility in applying the standards. Again companies must ensure that the auditors' they engage are credible and have a track record of delivering reports that show the actual state of affairs of a company. Finally, Financial Reporting Council and Regulators like the Security Exchange Commissions should have a stiffer penalty for companies caught engaging in the act of earnings management.



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DEDICATION

This work is dedicated to my entire family.

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LIST OF ACRONYMS

BoG-----Bank of Ghana

CF-----Cashflow

DA -----Discretionary Accruals

EM-----Earnings Management

GAAP-----Generally Accepted Accounting Principles

GMM-----Generalised Method of Moments

GNAS -----Ghana National Accounting Standards

GSE-----Ghana Stock Exchange

IASB-----International Accounting Standards Board IASB

IASC-----International Accounting Standard Committee

IAS-----International Accounting Standards

ICAG-----Institute of Chartered Accountants Ghana

IFAC-----International Federation of Accountants

IFRS-----International Financial Reporting Standards

IMF-----International Monetary Fund

MJM-----Modified Jones Model



NDA-----Non-Discretionary Accruals

NGO-----Non- Governmental Organization

NP-----Net profit

OCF-----Operating Cash Flow

OECD-----Organization for Economic Cooperation and Development

RA-----Real Accruals

SEC-----Securities Exchange Commission SEC

SMEs-----Small and medium enterprises

TA -----Total Assets

TURN-----Turnover

UK-----United Kingdom

VAS-----Vietnamese Accounting Standards



CHAPTER ONE

INTRODUCTION

1.1 Background of the Study

The concept of globalisation seemingly draws all continents, nations, and activities to a common center for the good of all without difficulties. Globalisation has permeated the fabric and sphere of all societies and nations and also exerts significant influence on the way members and citizens conduct themselves and their activities (Barrie, 1995). It must be stated that globalisation has

shaped and transformed the governing structures, the economic systems, the development patterns, the educational and health systems, the communication systems, the accounting standards, the legal regimes, and many others of countries. The Globalisation of economies, the trans-nationalization of companies and the openness of the markets of capitals, increased the need for information of a high quality which is required to be comparable among companies, ignoring any cultural or economic boundary. With the globalization of international financial markets, the idea of adopting a common language for financial reporting to develop international

comparability has become widespread. Of all the possible ways of implementing a single financial reporting language, adoption of International Financial Reporting Standards (IFRS,

which include old and revised IAS) was the approach selected by Europe and many other countries. For that purpose, the International Accounting Standards Committee (IASC) was established since 1973 and came up with 41 International Accounting Standards (IAS) in order to harmonize national accounting systems. In 2001, the IASC was replaced by the International Accounting Standards Board (IASB) as an international accounting standard-setting body. The objective of the IASB is to develop a single set of high quality. Thus, this compelling influence of globalisation that led Ghana and many other countries across the world to adopt, implement,

and use IFRS for the preparation and reporting of financial and economic activities or transactions (Jeanjean & Stolowy, 2006). The IFRS have been developed to serve as a global accounting benchmark for harmonising and reporting financial and economic activities in a manner that is widely accepted by all stakeholders within or abroad (Chunhui Liu, Yao, Hu, & Liu, 2011) (Jeanjean & Stolowy, 2006).

The application of the IFRS therefore transcends and defies all geographical borders, economic classes, or development status of all the countries on the globe.

In spite of a few criticisms against the holistic nature of the IFRS and failure to make provisions for continents or countries specifications and uniqueness, the standards have been widely accepted by countries across the globe for their financial reporting. Critics argue that the IFRS do not take into cognisance the political regimes, cultural orientations, economic performance and

development needs or levels of all the participating countries (Liu et al, 2011; Chamisa, 2000; Jeanjean & Stolowy, 2008; Chua & Taylor, 2008). This, they contend would derail the full and

effective implementation of the standards in most developing countries since they were developed with much attention on the developed or advanced countries. This notwithstanding, countries, especially developing countries, were strongly admonished to adopt and implement the IFRS to enable them to deal effectively with donor agencies, foreign investors and partners, other governments, World Bank, International Monetary Fund (IMF) and the likes. With this background, the developing countries, therefore, had no option left for them than adopting and

implementing the IFRS in place of their country-specific Generally Accepted Accounting Principles (GAAP).

Ghana, like most countries, adopted and implemented the IFRS in 2007 to replace the GAAP referred to as the Ghana National Accounting Standards (GNAS). Notably, the GNAS was drawn from pre-IFRS or the International Accounting Standards (IAS) and the Financial Reporting Standards (FRS) of the United Kingdom. However, following a review of Ghana's accounting and auditing practices by the World Bank in 2004, it was found that the GNAS was obsolete and significantly fell short of the requirements of the IFRS. Based on these findings, the World Bank strongly recommended that Ghana should adopt the IFRS that were developed by the International Accounting Standards Board (IASB). In pursuance of the World Bank recommendations, the Government of Ghana and the Institute of Chartered Accountants, Ghana (ICAG) directed that all financial reports from 2007 onwards should be prepared and presented in compliance with the IFRS. According to Herath & Melvin, (2017)Abedana, Omane-Antwi &

Oppong (2016); Agyei Mensah ,(2013);agyei Mensah (2012). It has been indicated by Herath & Melvin that the world bank, Government of Ghana and the ICAG strongly believed that the adoption of IFRS would enhance and improve the quality of financial reporting and above all safeguard the interest of stakeholders. IFRS which is often referred to as the IAS is made up of a detailed set of accounting standards prepared and issued by an independent, non-profit organisations known as the International Accounting Standards Board (IASB). The main purpose of the IFRS is to provide an elaborate principles-based set of financial standards other than the simple rules-based approach usually referred to as GAAP that were used (Gill, 2007). Thus, the focus of the IFRS is more on the financial or economic objective of the transactions reported on

and the basic rights and obligations, but not on just providing or prescribing rules. It is against this backdrop that Herrmann (2006) explains that the introduction and integration of the IFRS by the IASB is to ensure that financial reporting standards are consistent and also make financial statements more transparent to respond appropriately to the complex financial and economic transactions that are occurring across the globe. Besides, the application of the IFRS ensures that the diverse interests of the stakeholders are met and protected. Therefore, the introduction of the IFRS has made countries to become more integrated and connected in terms of reporting their financial activities and transactions with universally acceptable financial standards. The IFRS suite is a fundamental agent in the process of globalisation. It is clear that the adoption and implementation of the IFRS has yielded numerous positive results for the adopting countries and the companies. For instance, the IFRS has improved the quality and credibility of financial reports and provided a means for comparing financial reports across the globe.

Earnings is a measure that provides an indication of the inherent value transformation of a company, in essence how well a company transform their assets, knowledge, experience and expertise into monetary values. It is an indication of the company's ability to generate value for the shareholders, which means that it is a principal point in determining share price (Cotter, 2009). Hence, an adjustment of earnings could change the view of a company and how it performs. Therefore, not surprisingly, Burgstahler and Dichev (2008) argue that earnings is the single most important measure for managers and therefore represents a focal point. Burgstahler and Dichev (2005) continue by stating that consistent earnings with a slight upward trend is a desirable pattern for managers, in other words, surprises are not suitable. DeAngelo, and Skinner (2006) argues that, on average, a company interrupting their upward trend could expect a 14%

negative return the same year as the interruption. One could, therefore, suggest that there is a lot of incentive to keep earnings positive since a negative message to the market could have sincere ramifications on the company's performance in the stock market.

Hence, earnings is an essential part of financial reporting, it is also a measure that communicates to owners, stakeholders and the market how well the company is managed and performs, which in turn has a profound impact on the company's share price. Therefore, the incentives to keep earnings within the "correct" interval is great, keeping in mind the downside.

Earnings management, in general, is defined by (Healy and Wahlen, 2002) as follow: "Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial 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". According to Degeorge (2009) managers practice earnings management to exceed thresholds like profits or specific values reflecting the firm's performance in order to meet the analysts' predictions. For the reference Burgstahler, (2002) said Earnings can be influenced by the managers in order to avoid earnings falls and losses. For that purpose, managers disclose small increases and small positive profits instead of losses. Following karampinis (2009), earnings management is defined as the alteration of firms economic performance reported by insiders to either mislead some stakeholders or to influence contractual outcomes.

For many researchers, the adoption of IFRS would tend to reduce earnings management and managerial discretions. Consistent with this, (Barth, et al 2008) examined the accounting quality of firms in 21 countries that adopted IAS between the year 1994 and 2003. The study compares quality metrics for firms that apply IAS to those for a matched sample of firms that do not. The results of the study show that companies applying IAS exhibit higher accounting quality in terms of less income smoothing, less management of earnings towards a target, more timely recognition of losses, and higher association of accounting information with share prices and returns. In addition, those firms also display an improvement in accounting quality between the pre and post IAS adoption period. This study, therefore, seeks to examine whether compliance with international financial reporting standards has constrained earnings management for Ghanaian listed companies in their financial reporting processes.

1.2 Research Problem

In recent years, corporate accounting fraud and scandals uncovered in the stock markets have once again confirmed the existence of ethical failures and the importance of transparency and reliability of the financial information provided to markets (Lang and Lundholm 2000). The regulatory response to financial scandals has been to take measures to protect information transparency, mitigate conflicts of interest and ensure the independence of auditors, all in order to increase the confidence of capital markets and protect the investors interests' (Leuz et al. 2003). A weak financial reporting standards structure may provide an opportunity for managers to engage in behavior that would eventually result in a lower quality of reported earnings, which is a strong indication of a serious decay in Business ethics. Undoubtedly, globalisation has greatly shaped and transformed the governing structures, the economic systems, the development

patterns, the educational and health systems, the communication systems, the accounting systems, and the legal regimes of various countries, reducing corruption, strengthening the rule of law or improving the effectiveness of government, this leads to a reduction in firm earnings management.

It appears that the development of the International Financial Reporting Standards by the International Accounting Standard Board was largely to satisfy the rapid demands of globalisation. This irresistible and compelling influence of globalisation that led Ghana and other countries across the globe to adopt, implement, and use the IFRS as a common and uniform method for preparing and reporting financial and economic activities or transactions (Jeanjean & Stolowy, 2008). Thus, the main objective of the IFRS is to serve as a global accounting benchmark or yardstick for harmonising, reporting financial and economic activities and measuring in a manner that is widely acceptable and understood by all the stakeholders within or outside the reporting country (Liu et al, 2011; Chamisa, 2000; Jeanjean & Stolowy, 2008; Chua & Taylor, 2008).



For many researchers, the adoption of IFRS tend to reduce earnings management and managerial discretions. Consistent with this vein Barth, et al (2008) examined the accounting quality of firms in 21 countries that adopted International Accounting Standards between the year 1994 and 2003. The study compares several accounting quality metrics for firms that apply IAS to those for a matched sample of firms that do not. The results of the study show that companies applying IAS exhibit higher accounting quality in terms of less income smoothing, less management of

earnings towards a target, more timely recognition of losses, and higher association of accounting information with share prices and returns. In addition, those firms also display an improvement in accounting quality between the pre and post IAS adoption periods.

In spite of a few criticisms advanced by some scholars against the holistic nature of the IFRS and failure to make provisions for continents or countries specifications, the standards have been widely accepted and implemented by various countries across the globe to enhance and improve the quality of their financial reporting processes. For instance, scholars such as Agyei-Mensah (2012), Tsakumis (2009), and Gebhardt & Novotny-Farkas (2011) argue that the IFRS have often not made provision for the different political regimes, cultural orientations, economic performance, and development needs in the countries adopting and using this international accounting. This has the tendency of derailing the effective adoption and implementation of these international standards in most developing countries simply because the standards were developed to suit or reflect the values and attributes of the advanced or developed countries.

This, however, has not hindered these developing countries from accepting, adopting, and implementing the IFRS. Again, the strong admonishing of all countries to adopt and implement the IFRS to enable them to deal effectively with donor agencies, foreign investors and partners, governments, the World Bank, and IMF has strengthened the decision of the developing countries. Hence, the replacement of GAAP with the IFRS.

Although Ghana adopted and implemented the IFRS in 2007 as a replacement of the GAAP known GNAS in pursuance of the World Bank recommendations, the country does not seem to

be reaping the full benefits of these International Accounting Standards. It has been observed from available literature on Ghana that researchers in this field focused on the impact of IFRS on tax (Abedana, Omane-Antwi & Oppong; 2016), impact of IFRS on disclosures (Agyei-Mensah, 2012), and adoption of IFRS and quality financial statement disclosures (Agyei-Mensah, 2013).

Corporate accounting scandals that have occurred in the last decade around the world, for example in the United States (Xerox, Enron, WorldCom, Health South, etc.), in Europe (Parmalat, Vivendi, etc.) and Asia (Satyam Computer Services, Sino-Forest, etc.) were usually accompanied by a number of accounting manipulations. Business operations of these companies ranged from allowed creative shaping of financial results to the fraud or misrepresentation of financial statements. Earnings management is the active manipulation of accounting results for the purpose of creating an altered impression of business performance (Mulford & Comiskey, 2002).



It is imperative to highlight that though earnings management (EM) is not based on fraud, its decisions on specifically formulated alterations that have been defined by the accounting regulations (Martinez, 2001). There have been many studies done about earnings management, especially in the last two decades; for instance, Jones (1991), Dechow et al. (1995), Kang and Sivaramakrishnan (1995), Teoh et al. (1998), Dechow and Dichev (2002), Kothari et al. (2005) and Ball and Shivakumar (2008). Earnings management can be restricted by accounting regulations, particularly those issued by the regulatory agencies of capital markets that aim to ensure quality, comparability and transparency of information as well as the disclosure of the

firm's patrimonial position and performance. To the best of my knowledge, little research has been conducted on the effect of IFRS on earning management in the financial reporting processes of listed companies in Ghana.

Callao & Jose (2010) in their work made a recommendation that some work should be extended to other continents. Similarly, Landsman et al (2006) also made some recommendation that further works to should be looked at in other continents especially Africa and developing countries. Aslo, Barth et al (2007) on International Accounting Standards and Accounting Quality with focus on earnings management made same recommendations. Finally, in the recent 2018 IFRS conference “How far we have come with Standards” the chairman of ISAB Mr. Hans Hoogervorst made a statement that “we are yet to see the full impact of IFRS in some part of the globe like Africa in the areas of earnings and other balance sheet items”. Based on this recommendations I seek to fill this gap by investigating into the area using the Generalised Method of Moments as a data analysis tool. This method helps in dealing with the poor instrument arising from measurement error.

The two-step system GMM enhances the efficiency and effectiveness of our estimation compared to the difference GMM.

1.3 Research Objectives

The research generally seeks to investigate the impact of IFRS compliance on earnings management among listed companies in Ghana.

In order to achieve the purpose or the general objective of this research, the researcher is guided by three specific objectives. Thus, the research specifically seeks to:

1. Determine the relationship between IFRS and Earnings Management
2. To examine the relationship between auditor type and earnings management
3. To evaluate the relationship between firm size and earnings management.

1.4 Research Questions

To achieve the general objective of the study, the researcher is also be guided by the following three fundamental research questions;

1. What is the impact of IFRS on EM among listed companies in Ghana?
2. What is the impact of auditor type on earnings management among listed companies?
3. What is the effect of firm size on EM among Ghanaian listed companies?

1.5 Significance of the Research

The findings of this research will be beneficial and relevant to initiate a process of discussions and or deliberations on IFRS with respect to earnings management practices in Ghana. To accumulate empirical evidence with reference to such trends that give rise to EM. To determine

and share possible implications of EM practices in Ghana with policy formulators and research networks, to give a basic accounting framework related to EM to Institute of Chartered Accountants of Ghana (ICAG) and International Accounting Standards Board (IASB). Again, compared to previous studies, the study depart from the rhetoric by employing econometric strategy that deal with endogeneity eminent in the variables leading to the provision of consistent, precise and valid estimates. The key contribution lies on the assessment of IFRS on earnings management which to the best of our knowledge has not been done in Ghana, Africa and the world at large.

The study is expected to have a positive impact on the quality and processes of financial reporting systems that will ensure that companies in Ghana, especially listed companies have the full complements or benefits of the IFRS. The research is also intended to serve as a guide for the Government of Ghana, Non-Governmental Organisations (NGOs), Public and Private Companies, and Government Agencies on the effective adoption and implementation of the IFRS on EM. Again, the findings of this research will serve as a foundation for future researchers to rely on for the furtherance of knowledge, since little attention has been given to the area under study. Finally, It will also enrich the body of literature on the effect of the IFRS on earnings management in the financial reporting processes of listed companies in Ghana.

1.6 Scope of the study

The scope of this study is influenced by; the context, geographical coverage, time period and methodology. Contextually, the study is to assess companies who have adopted and applying IFRS with compliance level and Geographically, the study focused on listed companies in

Ghana, Accra. The time period covers the period 2004-2014 adoption where the levels of compliance with IFRS were assessed.

1.7 Limitations of the study

The research of this thesis is characterised by some main limitations. Data on the financial statement of firms were only available from 2004 at the time of conducting this research.

Therefore, the study sample was restricted to the period 2004-2014. It would have been interesting if the period was relatively longer in examining the associations between the IFRS and the degree of earnings management behaviour. According to Siregar and Utama (2008), there is still doubt regarding the ability of the Net Profit approach to accurately estimate earnings management components. The possibility of misclassification of earnings management could lead to erroneous classifications of some variables of nondiscretionary accruals as discretionary accruals, which may explain the positive association between discretionary accruals and auditor type. Finally, there may also be omitted variables in this thesis and dissimilar variable qualifications may lead to different findings.



1.8 Organisation of the Study

The research is organised in five chapters. Chapter One is the introduction, this entails the background of the study including previous studies on the topic, the problem statement, research questions, the objectives of the study, significance of the study, and the organization of the study. Chapter Two includes review of relevant literature to the study and the conceptual framework relevant to the study.

Chapter Three also deals with the methodology, data gathering hypothesis developed. It provides scientific explanation to support the research.

Chapter Four involves the findings and discussion of the study. Analysis and interpretation of results with the aid of diagrams where necessary, tables and figures

Chapter Five deals with possible conclusions on the basis of the findings and an indication of their relevance or policy-making implications. Recommendations will also be made in this chapter.



CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This section reviews the necessary literature on impact of IFRS on earnings management being investigated in order to provide a solid theoretical grounds for the study. The literature review covers definitions and concept of IFRS, the objectives, benefits and challenges of IFRS. Earnings management definitions, motivations, its effect and approaches in measuring earnings management.

2.2 International Financial Reporting Standards Definition and Concept

The first IAS was published in 1975, with the International Accounting Standards Committee (IASC) undertaking its Comparability Project in 1987; this became effective in 1995. However, the existence of a number of deficiencies led to the 'Core Standards Project', which included vital revisions completed in 1999. Precisely, 12 IAS were substantially revised from 1998 to 2001, 11 of them between 1998 and 1999. Later, from 2003 to 2004, 23 International Accounting Standards were revised or issued. The IASC has evolved, including in 2001 a restructuring of the IASC into the IASB. It has been issuing principles-based standards and limiting accounting alternatives, especially over the last decade. Its aim is to provide a basis for the use of judgment in resolving accounting issues and at the same time, reduce managerial opportunistic discretion.



The IFRS or International Accounting Standards (IASs) are principles and rules for reporting financial information, as established and approved by the International Accounting Standards Board (IASB) to ensure proper and acceptable accounting reporting and practices (Herath & Melvin, 2017). Similarly, Alistair (2010) and Papadatos & Bellas (2011) posit that IFRS are a sequence of accounting pronouncements published by the International Accounting Standard Board (IASB) to guide the preparation of financial statements across the globe, provide and present high-quality financial reports, and provide transparent and comparable financial reporting system for all stakeholders. This informs the assertion of (Appiah, Awunyo-Vitor, Mireku, & Ahiagbah, 2016) that IFRS or international accounting standards developed and instituted to ensure easy communication of financial information among countries, companies, management, and other stakeholders.

Scholars in financial accounting suggest that the IFRS have been developed and instituted to serve as a global accounting benchmark for harmonising and reporting financial and economic activities in a manner that is widely accepted by all stakeholders within or abroad (Liu et al, 2011; Jeanjean & Stolowy, 2008; Chua & Taylor, 2008). Therefore, the application of the IFRS transcends all geographical borders, economic classes, or development status of all the countries on the globe.



2.2.1 The IFRS Evolution

Herath & Melvin (2017) explained that the IFRS is a set of accounting guidelines developed and published by the International Accounting Standards Boards (IASB) in 1997. The Accounting Standards had been developed to calm any uneasiness among investors and other financial report users following the wake of recent financial scandals, and the collapse of many blue-chip organisations (Liu et al, 2011; Chua & Taylor, 2008). Largely, Liu et al (2011) and Chua & Taylor (2008) suggested that these crises motivated and inspired accounting regulatory bodies to develop comprehensive financial reporting guidelines to ensure globally acceptable and transparent reporting of financial and business activities. To buttress the above assertions, Ernest & Young (2014) posit that the issue of implicit and emerging economic pressure on several nations including the Sub-Sahara African countries to replace their local accounting guidelines and standards with the IFRS which is globally acceptable and more transparent; this was more necessary after the 2007-2010 financial crises.



Besides, the rapid globalisation of financial markets and business transactions has hastened the demands for more understandable and internationally recognised financial reporting standards, hence the evolution of the IFRS (Jeanjean & Stolowy, 2008). Hence, the contention of Cascino & Gassen (2012) that the development or evolution of the IFRS has led to the harmonisation of local financial accounting practices with the IFRS with the main aim of enhancing consistency, transparency and comparability of financial statements across the globe with ease. Again, Eiteman et al. (2007) suggest that the development of the IFRS is meant to aid stakeholders' understanding of financial statements and any other accounting information. They add that the introduction of the IFRS enables the various users of accounting information to conveniently

acquire and use the information their diverse purposes and also encourages investors to diversify their portfolio internationally in an optimal manner.

2.2.2 IFRS Objectives

The International Accounting Standards Board (IASB) has become increasingly influential in the world. Its principal objective is to issue International Accounting Standards (IAS) or IFRS in order to enhance transparency, consistency, and comparability in financial reports produced by companies regardless of their country of origin (Choi *et al*, 2002). Accordingly, the objectives of the IFRS include:

- To ensure transparency in financial reporting and enhance international comparability and quality of financial information that will enable investors and other market participants to make informed financial or economic decisions with ease.
- To strengthen and improve accountability by bridging the information gap between the providers of capital and the people to whom they have entrusted their money. Thus, the IFRS ensures all relevant pieces of information are properly disclosed to the stakeholders.
- To contribute to financial and economic efficiency by helping investors to identify opportunities and risks across the world, thus improving capital allocation. Use of a single trusted accounting language lowers the cost of capital and reduces international reporting costs for businesses.



2.2.3 Ghana and International Financial Reporting Standard (IFRS) adoption

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Ghana financial reporting processes are influenced with factors such as law, politics, economy, educational system and international relations (Assenso-Okofu et al., 2011). For example, political instability, due to the several military coups, affected negatively on both press and economic freedom and on the whole, the financial reporting process in Ghana (Amankwah-Amoah and Debrah, 2010; Appiah et al., 2014). In 1990, the Ghana Stock Exchange was set up to provide monitoring, evaluation and enforcement by placing surcharges for non-compliant listed firms. The Securities Exchange Commission (SEC) and Ghana Stock Exchange (GSE) require all listed companies to comply with their regulations as far as financial reporting are concerned. The Ghana Stock Exchange, however, had weak institutions and poor capacity, suggesting enforcement gaps. The multi-party democratic system in 1992 necessitated press freedom, freedom of speech and economic freedom, and this enhanced corporate reporting in the country. The improved corporate reporting was also heightened by the micro-economy. However, the World Bank in its efforts to ensure transparency among its members conducted a survey to assess and appraise the accounting and auditing practices in Ghana and concluded that the accounting and auditing reporting standards were outdated for the purposes of effective disclosure of financial activities (World Bank, 2004). Hence, the assertion of Irvine (2008) that this urgent need for updated accounting standards necessitated the increased pressure from the World Bank, Accounting Firms and Multinational Corporations for the adoption of the IFRS by Ghana.

Formally, Ghana adopted IFRS wholly calling on all companies in Ghana whether listed or not to comply with the standard. The official marked the move from the use of our Local Accounting

Standard to International Financial Reporting Standards, which currently are embraced and used as a benchmark for reporting both locally and internationally. Furthermore, ROSC (2005) nonetheless, observed a number of deficiencies in the corporate environment. These included lack of quality corporate governance, compliance issues and weak monitoring and evaluation institutions including the Parliament of Ghana, the Ghana Stock Exchange and Institute of Chartered Accountants Ghana. In short, the existing reporting framework was not only ineffective but also inefficient as well (Assenso-Okofu et al., 2011). The need for attracting international investors and the application of Ghana for the full International Federation of Accountants (IFAC) membership, nevertheless, required Ghana to adopt, implement and comply International Financial Reporting Standards. Effective 2007, Ghana moved from adaptation to adoption of International Financial Reporting Standards. A significant development in reference to the wider adoption and implementation of International Financial Reporting Standards in Ghana was the notice issued by ICAG and in conjunction with the Government led by the then president of Ghana; John Agyekum Kuffour. The notice which mandates listed companies, government business enterprises, banks and insurance companies, public utilities, pension funds, and security brokers to present their financial statements in accordance with International Financial Reporting Standards from the fiscal year beginning after January 1, 2007. Thus, all existing 28 Ghana accounting standards were replaced with the over 40 International Accounting Standards and 16 International Financial Reporting Standards. This, in turn, aided international understanding of Ghanaian financial statements and, thus, enhanced global investors' community confidence in securities listed on the GSE (Appiah et al., 2016). The World Bank Investment Climate Surveys showed that international investors were showing optimism because of an improved political climate and financial reporting (Abor, 2007). The net inflows of foreign direct



investment, for example, increased from US\$1,519m in 2000 to US \$2139m in 2007 (The World Bank Annual Report, 2009). Therefore, Ghana represents an interesting environment within which to examine empirically the incentives for the extent of compliance with International Financial Reporting Standards. Countries across the globe were strongly admonished and encouraged to adopt and implement the International Financial Reporting Standards to enable them (the countries) deal effectively with donor agencies, foreign investors and partners, governments, the World Bank, and the International Monetary Fund (IMF). This led to the overwhelming acceptance and adoption of the International Financial Reporting Standards by both developed and developing countries.

Ghana, as a developing country, adopted and implemented the IFRS in 2007 as a replacement of the GAAP known GNAS in fulfillment of the World Bank recommendations (Agyei-Mensah, 2013). Hence, the explanation of Agyei-Mensah (2013) and Agyei-Mensah (2014) that the Ministry of Finance and Economic Planning and the Institute of Chartered Accountants of Ghana (ICAG) in 1999 called on companies operating within Ghana to adopt the IFRS and IAS for their financial reporting and 2007 was set as the likely deadline for the compliance and implementation of the standards. According to Fekete (2008), prior to Ghana's adoption of the IFRS, the General Accepted Accounting Principles then referred to as Ghana National Accounting Standards (GNAS) that were partly based on the International Accounting Standards (IAS) and UK accounting standards, had been adopted and applied as Ghana's accounting standards.

2.2.4 Benefits of IFRS Adoption

The adoption of IFRS leads to accurate, timely and comprehensive financial statements in line with the national standards (Madawaki, 2012). Besides, Hossain, Niaz & Moudud-Ul-Huq (2015) contend that the adoption of the IFRS enhances and improves companies' compliance with international and national financial regulations and ensures financial reliable and accurate financial reporting.

Similarly, Papadatos & Bellas (2011) and Patro & Gupta (2012) suggest that adopting the IFRS will improve the credibility, comparability and transparency of financial statements; this invariably will lead to market efficiency. It is the contention of Sidik & Abdul Rahim (2012) that the adoption of the IFRS improves comparability level between companies' financial statements since they are prepared using better and acceptable financial standards. Again, Bhargava & Shikha (2013) and Daske & Gebhardt (2006) assert that adopting the IFRS improves the quality of disclosures and enhances international comparability and understanding of financial statements. Hence, the conclusion of Vinayaga and moorthy (2014) that the adoption of the IFRS assists in attracting greater cross-border investment and presenting a financial statement on a single set of high quality and global standards. On the other hand, Odia & Ogiedu (2013) assert that with the adoption of the IFRS, investors will pay less for adjusting financial statements, they will be able to understand them and will get a reduction in the cost of finalising the statements.

In addition, Athma & Rajyalaxmi (2013) confirm that the adoption of the IFRS enhances comparability between the financial statements of various companies across the globe and

reduces different accounting requirements prevailing in various countries. They further state that adoption of the IFRS provides a foundation for integrating financial standards with the common Accounting International Standards. Again, Nkundabanyanga (2004) explains that IFRS help and facilitate the harmonisation of accounting procedures and processes across the world. For instance, IAS one (1) requires an enterprise to select and apply appropriate accounting policies complying with IFRS to ensure that financial statements provide information that is relevant to the decision making needs of users and reliability in terms of fair presentation, prudent, complete and economic substance.

It is obvious that the adoption of the IFRS by countries and companies has numerous benefits to all the stakeholders and partners in the financial market or environment. The adoption and implementation of the IFRS facilitate global partnerships, investments, trade, comparison of financial statements and others.



2.2.5 Challenges of IFRS Adoption

Nonetheless, there were challenges encountered in African countries especially at the first adoption (Agyei-Mensah, 2014) (Amoako & Sandra 2016). These challenges among others include:

- i. Understanding the meaning of pre and post international convergence challenges.
- ii. Translation of the international standards
- iii. Complication and structure of the international standards.

- iv. Frequency, volume and intricacy of changes to the International Standards.
- v. Challenges for small and medium-size enterprises and accounting firms
- vi. Implications of endorsements of IFRS

These challenges are inconsistent with (Obazee, 2007) who said that one of the principal impeding factors in the adoption process of IFRS in Europe, America and the rest of the world are not necessarily technical but cultural issues, mental models, legal impediments, educational needs, and political influences. This suggests that cultural diversities in Sub-Sahara Africa are indeed challenges of International Financial Reporting Standards.

Rong- Ruey (2006) and (Ball, Robin & Wu, 2000) opined that there are likely implementation challenges which include: timely interpretation of standards, continuous amendment to IFRS, accounting knowledge and expertise possessed by financial statement users, preparers, auditors and regulators, and managerial incentive.



Hanefah and Singh, (2012) investigated challenges faced in Malaysia as a result of adopting International Financial Reporting Standards. They uncovered challenges to standard-setters and stakeholders need to enhance cross-border comparability of Islamic financial transactions, while being mindful of religious sensitivities. They concluded that Malaysian education system is very much in line with the current developments in the accounting and business fraternity.

Zakari (2014) used a questionnaire survey to locate challenges that face implementing of IFRS by Libyan firms. He found the majority of who took part in the survey agreed that the weakness of national professional accountancy body is main challenge facing IFRS adoption by Libyan companies. He also found lack of technical skills and inadequate knowledge of Libyan professional accountants have major impact on IFRS implementation. The problems administered in the available literature with the compliance of IFRS are inconsistent with what the institute of chartered accountant Ghana member (Omane 2017) illustrated in their work perceive benefit and challenges of adopting of IFRS in Ghana.

2.3 Listed Companies in Ghana

Publicly limited Companies listed on the Ghana stock exchange who comply with the rules and regulation of the security exchange commission and the stock exchange. Criteria for listing include capital adequacy, profitability, the spread of shares, years of existence and management efficiency, currently there is 42 listed equity with 37 companies. Papadatos and Bellas (2011) examined the attitude of listed companies towards the mandatory adoption of IFRS in Greece.

They found small firms and low-income firms have a negative attitude towards IFRS. They also found firms with a higher level of fixed assets to be more optimistic about the benefits of IFRS to investors. In a related type of research, Dritsas and Petrakos (2014) studied whether significant differences exist between the IFRS and the Greek General Accepted Accounting Principles with publicly listed companies. They noticed that listed companies with a foreign transaction and huge leverage converting statutory financial statements to IFRS has significant impact on historical financial information regarding financial structure and viability. Below is list of tables the of companies listed on the Ghana stock exchange market and the industry type.

Table 2.1 Listed Companies

SN	Name of Firm	
1	AFRICAN CHAMPIONS GHANA LTD	ACG
2	ANGLO GOLD ASHANTI	AGA
3	ARYTON DRUG MANUFACTURING	ADM
4	BENSO OIL PLANTATION	BOP
5	CAMELOT GHANA	CGL
6	CLYDONE STONE LTD	CSL
7	COCOA PROCESSING COMPANY	CPC
8	FAN MILK GHANA	FMG
9	GOLDEN STAR RESOURCE	GSR
10	GUINNESS GHANA BREWER LTD	GGB
11	MECHANICAL LLYOD COMPANY	MLC
12	POINEER KITCHEN LTD	PKL
13	PRODUCE BUYING COMPANY	PBC
14	PZ CUSSONS LTD	PCL
15	SAM WOODE	SML
16	STARWIN PRODUCT	SPL
17	TOTAL PETROLEUM GHANA LTD	TPG
18	TULLOW OIL UNILEVER GHANA	TOU
19	UNILEVER GHANA	UGL



Table 2.2 Industry type

Industry type	Frequency	Percentages
Paper Conversion / IT	4	21%
Manufacturing / Trading Agric /	5	26%
Agro Processing	3	16%
Metals / oils	3	16%
Pharmacy / Beverages	4	21%
Total	19	100%

2.4 Compliance with IFRS

Application and Compliance with international financial reporting standards is a contentious issue. Cairns (1999) documents nine categories of firm compliance with IFRS, ranging from full compliance to “unqualified description of differences.” Cairns (1998, 1999) finds that some companies use a mixture of IFRS and home-country GAAP, while others use IFRS with stated exceptions. Street et al. (1999) report significant non-compliance in many areas. In a subsequent study, Street and Bryant (2000) report that the overall level of compliance for all sample firms is equal to or less than 75% for many of the standards examined, and that firm compliance is higher for firms with U.S. listings vs. those without such a listing. Thus, while firms may be claiming full compliance with IFRS, significant deviations exist. Concerned about the casual approach many companies were taking towards the application of IFRS, the International Accounting Standards Committee issued IAS 1 Revised “Presentation of Financial Statements” in 1997. IAS 1 Revised states “Financial statements should not be described as complying with International

Accounting Standards unless they comply with all the requirements of each applicable Standard and each applicable Interpretation of the Standing Interpretations Committee.” In spite of the passage of IAS 1 Revised, compliance continues to be an issue.

Research on compliance and application of IFRS especially in developing countries, however, remains scant (Lin et al., 2012). Owusu-Ansah (2002), for example, examines the challenges firms encounter with the mandatory adoption of IFRS. Hassan et al. (2006) examine voluntary disclosure practices for a sample of 66 companies in Egypt over the period 1995-2002. Hassan et al. (2006) find positive relationships between the extent of voluntary disclosure and firm size, cross-listing, stock activity and profitability.

Chen et al. (2010), Christensen et al. (2008), Barth et al. (2007), Zeghal and Mhedhbi (2006), Ball (2006), for example, find that firms’ motivation for compliance to IFRS in developed economies may be anticipated through demands of investors, government policies, professionalism and globalization of stock markets.

Liu et al (2010) examines the cost of equity and mandatory adoption of IFRS in the European Union (EU) in 2005 and concludes that IFRS mandate significantly reduces the cost of equity for mandatory adopters and that this reduction is only present in countries with a strong-level environment.

Amiraslani et al. (2013) also investigate IAS 36 compliance across Europe and highlight on the lack of uniformity in the application of IAS 36 reporting. Glaum et al. (2013) examine compliance with disclosures required by IFRS 3 and IAS 36 and conclude that reporting practices vary systematically across Europe even though there is the adoption of IFRS.

Demir and Bahadir (2014) find that the level of compliance to IFRS is positively correlated to firms' audited by the Big 4 auditing firms. Further evidence from Demir and Bahadir (2014) shows a negative association between IFRS compliance and leverage but not profitability, firm size and firm age.

Byard et al. (2011) examine the effect of the mandatory adoption of IFRS on financial analysts' information environment and find that forecast errors and dispersion decrease more for firms with robust incentives for clear financial reporting. Thus, firm-level reporting plays a major role

in determining the effect of compulsory IFRS adoption (IASB), formerly known as International Accounting Standards Committee (IASC).

Djatej et al. (2012) used Planned Behavior Theory to identify a wide variety of relevant factors influencing the intention of early implementation of IFRS in the United States. They showed that an accountant's decision to adopt IFRS is a function of subjective norm and perceived behavioral control, which is consistent with the theory. Joos and Leung (2013) examined whether investors perceive the switch to IFRS as being beneficial or costly. They reported that investors' reaction

to IFRS adoption is more positive in cases where IFRS is expected to lead to convergence benefits.


Helen and Kh (2013) examined students' knowledge and interest in adopting IFRS and the usefulness of learning IFRS in Hong Kong. They found most Hong Kong students are eager to learn IFRS and they understand the positive effect of learning IFRS. They also observed that students' knowledge of IFRS would help them in their professional examinations and future career development. They advised accounting professionals and education providers to develop materials on IFRS.

Mensah (2013) examined the quality of financial reports of firms listed on the Ghana Stock Exchange before and after adopting IFRS. He found that company size, represented by net assets and auditor type are statistically associated with the quality of financial information disclosed.

He observed that big firms audited by big audit firms tend to produce high-quality accounting reports. Another more recent study undertaken in Ghana by Abedana et al. (2016) examined the impact of adopting IFRS on the quality of corporate financial reporting found a significant positive correlation between the disclosure quality of listed firms and the adoption of IFRSs. They concluded that companies wishing to make quality disclosure should continue to comply with the IFRSs rigorously.

Chebaane and Othman (2013) considered the impact of IFRS adoption on the frequency of earnings managements towards small positive profits. They found that mandatory IFRS adoption in Turkey reduces the scope of earnings management towards small positive profits in the post-adoption periods. Balsari and Varan (2014) looked at the application of IFRS in Turkey and established that both businessmen and accountants showed resistance despite professional accounting body and academia support to IFRS adoption. The researchers also found major impact of IFRS on financial statement analysis. Kılıça et al. (2014) gathered the perception of the accounting professionals regarding IFRS for small and medium-sized enterprises (SMEs). They detected that most of the accounting professionals are aware of IFRS for SMEs adoption process and attended training programs about IFRS for SMEs. They also noticed that lack of training and costs are seen as the main obstacles to the IFRS for SMEs implementation.

Phan et al. (2014) pursued the perceptions of public auditors, corporate accountants and accounting academics about issues relevant to adopting and implementing IFRS in Vietnam.

 They found Vietnamese accounting professionals are optimistic about potential benefits from IFRS adoption. They strongly supported the gradual switch from Vietnamese accounting standards (VAS) to IFRS, though the level of support varies amongst the three different sub-groups of accountants.

Others also consider corporate mandatory disclosure practices (Akhtaruddin, 2005); IFRS for small and medium-sized enterprises (SMEs) (Van and Rossouw, 2009). Value relevance of accounting information (Alfaraih, 2009); the development of accounting and reporting (Assenso-

Okofu et al., 2011); suitability of IFRS for SMEs (Aboagye-Otchere and Agbeibor, 2012); the determinants and consequences of heterogeneous IFRS compliance levels (Lin et al., 2012); and economic determinants and consequences of IFRS (Bova and Pereira, 2012). Put differently, studies on application of IFRS in developing economies are at its infancy (Lin et al., 2012). Evidence on the level and determinants of compliance of IFRS in Ghana remains scanty despite its adoption over a decade ago. To fill the gap in the literature, this study draws on Hossain et al. (1995), Demaria and Duffour (2012) and Agyei-Mensah's (2014) framework to examine the Ghanaian listed firms' level of application and disclosure of IFRS and its effect on earnings management. Examining the 1998 annual reports of 279 companies that claim to comply with IFRS, post IAS 1 Revised, Street and Gray (2001) report considerable variation in the level of compliance with IFRS disclosures and find that the level of compliance varies with certain corporate characteristics (e.g., non-regional listing, Big 5+2 audit, country of domicile). In a study examining the extent to which companies listed on Germany's New Market comply with IFRS disclosure requirements in their 2000 annual reports, Glaum and Street (2003) find that compliance ranges from 100% to 41.6%, with an average of 83.7%. The results of these studies reveal a considerable amount of noncompliance despite the requirements of IAS 1 Revised. When compliance with IFRS varies among firms, comparability of financial information may be compromised. Thus, the omission of compliance from studies of IFRS adoption may lead researchers to draw incorrect conclusions, especially if noncompliance is widespread. The study also examines the firm-specific characteristics influencing IFRS compliance in Ghana, a sub-Saharan African country. But, one may ask why sub-Saharan Africa in general and Ghana in particular?

First, Lin et al.'s (2012) study call for more research on the factors influencing the level of IFRS compliance and how it has improved accounting quality in developing including Ghana. However, five years after Lin et al.'s (2012) call, research on the determinants of compliance of IFRS in developing countries has disappeared. This study attempts to fill this gap. Second, we contribute to the literature by providing evidence from Ghana, a country where the capital market is quite open and implementation of IFRS is lax (Bova and Pereira, 2012). Third, in 2007, the government in corroboration with the Institute of Chartered Accountant Ghana adopted the IFRS. This notwithstanding, ten (10) years after the adoption of IFRS, compliance of IFRS has received little research attention in the Ghanaian context, except studies such as Owusu-Ansah (1998), Assenso-Okofu et al. (2011), Aboagye-Otchere and Agbeibor (2012) and Agyei-Mensah (2014). Therefore, further compliance of IFRS and its effect on earnings management research in the Ghanaian context should be welcomed.

Street et al. (1999) studied compliance with the ten IASs issued as part of the IASCs comparability project. Using a survey instrument based on the text in the ten revised IASs, the authors inspected the 1996 annual report of 49 large companies that claimed to comply with IAS in their accounting policy notes. They found that non-compliance was common when the sample companies presented an extraordinary item, the revaluation of property plant and equipment, pension disclosures, the valuation of inventories, the restatement of foreign entities for companies operating in hyperinflationary economies and the amortisation of goodwill. Street and Gray (2001) used the financial statements of two hundred and seventy nine companies appearing on the 1999 IASC list of companies referring to their use of IAS and found that there was significant non-compliance with IAS requirements. Street and Gray found that, among other

things, compliance tends to be greatest for companies domiciled in China and most problematic for companies domiciled in France. Using a sample of 22 companies listed on the Kuwait Stock Exchange, Albdelrahim, Hewaidy, and Mostafa (1997) examined companies' compliance with mandatory IAS requirements in 1995 financial statements. The study investigated three IAS that relate to fixed assets: IAS 16, IAS 20, and IAS 23. The data required for the study was obtained from a questionnaire and interviews with financial managers and accountants. The findings of the study show that companies fully complied with some requirements but not with other requirements. They stressed the importance of further training for accountants who are responsible for applying IAS in Kuwaiti companies to promote compliance. Tower et al. (2005) undertook an empirical study of listed companies' compliance with IASs in Asia-Pacific countries. They measured compliance with IAS by extensive analysis of 1997 annual reports selected randomly from each of Australia, Hong Kong, Malaysia, Philippines, Singapore and Thailand. The twenty-six IAS standards applicable to 1997 fiscal year ends were examined. Each annual report was carefully examined for compliance with IASC rules. Tower et al coded compliance into seven categories as compared to the eleven categories used by Cairns (2002).

Tower et al. (2005) computed two compliance ratios. Ratio 1, with non-disclosure indicating "non-applicability" of particular accounting issues and ratio 2 with non-disclosure indicating "non-compliance" with IAS guidelines. The authors found that, ratio one revealed overall high mean of 90.68% compliance and stricter ratio two however revealed a much lower overall mean of 42.2%. Their study also revealed high compliance in Australia (94%) and Thailand (93%) as compared to Singapore (90%), Malaysia (90%), Philippines (88%), and Hong Kong (88%). Tower reported an adjusted R² of 0.224 for company attributes influencing IFRS compliance level. Ballas and Tzovas (2010) have further affirmed significant non-compliance by examining

the extent to which Greek firms comply with the disclosure requirements of IFRS. Financial statements of 32 Greek firms were examined for compliance. Disclosure compliance of a company was depicted as the value of a compliance ratio computed for each company. The compliance ratio was computed as what a company disclosed in its report to what it is obliged to disclose for each category. The study revealed that no single firm fully complied with disclosure requirements while the average compliance rate was 62.9%. The study also revealed that the level of compliance was positively related with company attributes such as listing status, size, and profitability while a negative relationship was established for sector classification. Mutawaa and Hawaidy (2010) empirically investigate the extent of compliance of Kuwaiti listed companies (KSE) with IFRSs disclosure requirements. They further examined the factors associated with the level of compliance. The 2006 annual report of 48 non-financial companies were randomly sampled from 121 Kuwaiti companies listed on KSE and carefully scrutinized for compliance with IFRSs disclosure compliance. Standards examined were IAS 1, 10, 14, 16, 18, 21, 23, 24, 27, 28, 32 and 34. Mutawaa and Hawaidy measured compliance with a self-developed checklist based on IASB required disclosures and reference to checklist used in prior research as well as checklist published by Deloitte and KPMG. The study revealed an overall average compliance rate of 70%. IAS 18 was reported as the standard with the highest mean compliance score of 95%. 79.3% was reported as the highest overall compliance scored by an industry (investment companies) with 96.7% and 64% being the maximum and minimum within the industry, respectively. Al-Shammari (2011) extends the study of IFRS compliance by investigating the extent to which 168 companies listed on KSE comply with the disclosure requirements of IFRSs. The annual reports of 2008 were examined using a self constructed checklist based on 21 selected standards. Disclosure index was computed consistent with prior



research (Mutawaa & Hawaidy, 2010; Ballas & Tzovas, 2010) by dividing the total number of disclosure provided in company's annual reports by the total applicable score. The study of Al-Shammari (2011) revealed compliance mean of 82% which was lower than that observed in developed countries such as Australia 94% (Tower et al. 1999), and Germany 81% (Glaum & Street, 2003). The study therefore concluded that incentives for compliance are less in Kuwait than developed countries. The study further determined whether certain company attributes influence compliance level among companies. The study revealed that size, auditor type, liquidity, industry type, and internationality influenced the level of compliance among firms. Al-Shammari reported an adjusted R2 of 0.407.

2.5 Impact of IFRS/IAS on Financial Statements

Several studies in various parts of the world have analysed and examine the impact of IFRS/IAS on Financial Statements, (Stent, Bradbury & Hooks, 2010; Blanchette, Recicot & Sedzro, 2013). On companies performances (Rainsbury, San Diego & Walker 2010); on taxation (Samuel, Samuel & Obiamaka, 2013); on financial statements and ratios (Bharagava & Shikha, 2013); on the value relevance of book value and earnings (Clarkson, Hanna, Richardson, & Thompson, 2011); and on the tax burden of companies (Haverals, 2005). They all suggest that the adoption and implementation of IFRS/IAS have had a positive impact on entities, financial reporting and financial ratios as well as on the wider economic settings.

2.6 Earnings Management (EM) Definition, Motivation, Effect and Measuring Methods

2.6.1 EM definitions

EM is defined as a “purposeful intervention in the external financial-reporting process, with the intent of obtaining some private gain” (Schipper, 1989). It occurs “when managers use judgment in financial reporting and in structuring transactions to alter financial 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” (Healy and Wahlen, 1999),

Karampinis, (2009) defined earnings management as the alteration of firms’ reported economic performance by insiders either to mislead some stakeholders or to influence contractual outcomes. We argue that incentives to misrepresent firm performance through earnings management arise, in part, from a conflict of interest between firms’ insiders and outsiders. Insiders, such as controlling owners or managers, can use their control over the firm to benefit themselves at the expense of other stakeholders. Earnings management, is defined also by (Healy and Wahlen 2002) as follow: “Earnings management occurs when managers use judgment in

financial reporting and in structuring transactions to alter financial 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”. According to Degeorge (2005) , managers practice earnings management to exceed thresholds like profits or specific values reflecting the firm’s performance in order to meet the analysts’ predictions. For the reference (Burgstahler, 2006) Earnings can be influenced by the managers in order to avoid earnings falls and losses. For that purpose, managers disclose small increases and small positive profits instead of losses. For many researchers, the adoption of IFRS would tend to reduce earnings management and managerial discretions. Consistent with this,(Barth, M. et al 2008)

examined the accounting quality of firms in 21 countries that adopted IAS between the year 1994 and 2003. The study compares quality metrics for firms that apply IAS to those for a matched sample of firms that do not. The results of the study show that companies applying IAS exhibit higher accounting quality in terms of less income smoothing, less management of earnings towards a target, more timely recognition of losses, and higher association of accounting information with share prices and returns.

2.6.2 Motivation of earnings management by managers

Healy and Wahlen (1999) give three main incentives for earnings management: capital market expectation and valuation, contracts written in terms of accounting numbers and antitrust or other governmental regulation. The first incentive, the capital market expectation, and valuation, is about the influence of earnings on the stock price. Managers can increase earnings, in order to increase the stock price, for example, to meet analysts' expectations (Burgstahler and Eames, 1998). This can be important for the managers since they will be held responsible for the results

of a company. They, therefore, will think it is important to meet analysts' expectations, in order to avoid disappointed investors. The second incentive that explains earnings management according to Healy and Wahlen, the contracts are written in terms of accounting numbers, has to do with all the contracting agreements a company has. In order to align the interests of managers and stakeholders, a lot of contracts are in place. According to Watts and Zimmerman (2000), these contracts give rise to an increase in possibilities for earnings management. An example is that companies that are close to lending contracts manage earnings. Banks, for example, increase the interest rate when the risk of their client becomes higher. This can be a reason to manage earnings by presenting a better result in order to avoid an interest increase resulting in higher

costs. Another, maybe more familiar example is management compensation contracts. (Healy and Wahlen 2002). When the compensation of a manager depends on the results of the company, there will be an incentive to manage the earnings in a positive way. The reason for this is that the manager will receive a personal benefit as a result of the numbers presented. The third incentive for earnings management, the antitrust or other governmental regulation, has to do with the eventual intervention of the government or another institution, for example when industrial regulations are violated. This is also known as the political cost theory. (Deegan and Unerman 2006, 241) In order to avoid such intervention, management tries to manage earnings in such a way that the intervention is not needed. An example of this situation can be that a bank which is close to a minimum capital requirement recognizes abnormal gains, which will lead to a better capital position. (Healy and Wahlen 2002, p. 378) But also the government or lobby groups can put pressure on a company. According to Deegan and Unerman (2006) especially large companies have to deal with such political costs since they attract more attention as they are more visible than small companies.



2.6.3 Consequences of Earnings Management

The manipulation of financial statements is a narrower term or is only one of the possible forms of criminal activities affecting the financial statements (Jakšić & Vuković, 2012). Due to the inaccurate, imprecise and generally inadequate valuation of balance sheet positions, there is a phenomenon of false balance sheets, hidden financial results, concealed reserves, and losses. The underestimation of assets and overestimation of liabilities in the balance sheet leaves room for the creation of latent reserves. The hidden losses are due to overestimation of assets and underestimation of liabilities and affect the inclusion of lower expenses in the income statement

and increase in financial results. Manipulative financial reporting has many adverse consequences (Collingwood, 2001):

1. Loss of confidence of users of financial statements in the credibility and reliability of financial reporting,
2. Loss of credibility of the accounting and auditing profession,
3. Degradation of the efficiency and effectiveness of corporate governance,
4. Bankruptcy and huge financial losses of the company that resorts to manipulative financial reporting, and
5. The reduction of efficiency of the financial markets and the economy as a whole.

2.6.4 Impact of IFRS on Earnings Management

The paper of Callao & Jarne, (2010) examines whether mandatory adoption of accounting standards, IAS/IFRS, by French international companies is associated with lower earnings management. Based on a sample of 353 French listed groups relating to the period 2003–2006, our show that the mandatory results adoption of IAS/IFRS is associated with a reduction in the earnings management level. Mandatory adoption of IAS/IFRS has decreased earnings management level for companies with good corporate governance and those that depend on foreign financial markets.

Paola Paglietti (2009) using a sample of Italian firms indicates that accounting quality decreases after the adoption of IFRS considering earnings management and timely loss recognition.

Vanstraelen and Van Tendeloo (2005) investigate firms in Germany and find that the implementation of IFRS cannot be connected with lower earnings management. Guenther et al. (2009) argue that the extent of earnings management decreases only for voluntary IFRS adopters, while for mandatory adopters earnings management would be more severe after the adoption implementation.

Barth et al (2008) investigate a sample of firms in 21 countries that adopted IAS between 1994 and 2003 and find that the adoption of IAS significantly improves accounting quality by reducing earnings management. This is because firms applying IAS have a significantly higher variance of the change in net income, less negative correlation between accruals and cash flows,

higher frequency of large negative net income, and higher value relevance of net income and equity book value for share prices. Liu et al. (2011) reveal that earnings management decreases with new substantially IFRS-convergent accounting standards in China. Aubert and Grudnitski (2012) suggest a decline in the magnitude of earnings manipulation (as measured by the difference between a firm's reported earnings and ex-post estimate of earnings by financial analysts) with IFRS adoption among European countries.

On the contrary, reasons exist that could lower the positive effect of the introduction of IASB Standards on the reduction of earnings management, and more generally, on the accounting quality. First of all, the literature pointed out that the improvement of an accounting system cannot be achieved by simply adopting IASB standards (Ding, Hope, Jeanjean and Stolowy 2007) because there are features that affect the effect of the introduction of IASB standards on accounting quality. One of the most cited examples is that if the enforcement mechanism was too lax, it could impair the positive effect of the adoption of new standards (Ball, Robin and Wu 2003; Hope 2003; Barth, Landsman and Lang 2008).

In addition, some other studies consider that IFRS adoption tends to increase the scope of earnings management. Reference (Callao & Jarne, 2010) examined whether the adoption of IFRS in the European Union has increased or decreased the scope for discretionary accounting practices by comparing discretionary accruals in the periods preceding and immediately after the regulatory change. They considered a sample of non-financial firms listed on 11 EU stock markets. The results obtained intensified since the show that earnings management has adoption of IFRS in Europe, as discretionary accruals have increased in the period following.

More recently, (Jeanjean, 2008) analyzed the effect of the mandatory introduction of IFRS standards on earnings quality, and more precisely on earnings management. They concentrated their study on three IFRS first-time adopter countries: Australia, France, and the United Kingdom. They found that the pervasiveness of earnings management did not decline after the introduction of IFRS. More than that, it increased in France. According to them, sharing rules is

not a sufficient condition to create a common business language, and that management incentives and national institutional factors play an important role in defining financial reporting characteristics. The limitation of the research of Tendeloo and Vanstraelen does also count for this research. Because of the focus on early adopters, the results might be biased since these companies are likely to expect that they benefit from the introduction of IFRS.

As discussed before, accruals management is not the only way of earnings management. Lippens (2010) recognizes this, and investigates not only the influence of IFRS on accruals management, but also on real earnings management. He states that accruals based earnings management is expected to decrease as a result of the mandatory introduction of IFRS, because of the stricter rules and the lower level of tolerance against earnings management. However, the incentives for earnings management will not be taken away. Therefore, he expects that the level of real earnings management will increase as a substitute for accruals based earnings management (Lippens 2010, p. 87). His argument for this statement is that "earnings are thought to become more volatile, while previous research shows that management likes to present a smooth earnings path". The timing of activities, an example of real earnings management, can be used in this situation for making the earnings less volatile again.

Just like the research described before, Lippens uses the Modified Jones Model to explain accruals based earnings management. For the real earnings management he uses the abnormal level of cash flows from operations and the abnormal level of production costs as proxies for earnings management (Lippens 2010, p. 91). The normal level of cash flows from operations is a

function of the sales and the change in sales. The normal production costs are defined as the costs of goods sold and the change in inventory. Both the abnormal level of cash flows and production costs are calculated by taking the difference between the normal level and the actual level.

Lippens' sample contains financial statements from listed companies from Belgium, Denmark, Finland, Italy, Sweden and The Netherlands in the period 2000-2006. The country of origin is one of the variables in his models. His conclusions are that both accruals based earnings management as well as real earnings management has increased after the implementation of IFRS. However, he did observe that the substitution effect indeed takes place. There is no difference in outcome between the countries.

The above mentioned discretionary accruals approach, used by Tendeloo and Vanstraelen (2005), Heemskerk and van der Tas (2006) and Lippens (2010), is just one of three main

approaches. The other two are the specific accruals approach and study statistical properties of earnings to identify thresholds. (Jeanjean and Stolowy 2008, p. 485) These three approaches are already explained in chapter 2, with reference to McNichols. In their paper, Jeanjean and Stolowy use the third method in order to investigate “whether companies managed their earnings to avoid losses any less after the implementation of IFRS” (Jeanjean and Stolowy 2008, p. 485). As said in chapter 2, their reason for choosing the method of statistical properties of earnings, is that they face constraints with respect to data availability and difficulties with respect to the accruals approach. So instead they "analyze irregularities in distributions as an indication of earnings management". (Jeanjean and Stolowy 2008, p. 481) They use a statement of Glaum et al

(2004) which explains why irregularities in distributions are an indication of earnings management: "Such irregularities in distributions indicate that companies avoid reporting net income below thresholds by managing it upwards. Without earnings management, we would expect the distribution to be relatively smooth around the thresholds." (Glaum et al. 2004, p. 50) Their data set includes financial statements from 2002 until 2006 from 1146 companies in Australia, France and the UK. The difference between this investigation and that of Tendeloo and Vanstraelen and that of Heemskerk and Van der Tas is that Jeanjean and Stolowy study first-time adopters. Early adoption was not possible in these countries, so they all implemented IFRS in 2005. This is also the reason they have chosen these countries. Another difference is that Jeanjean and Stolowy did not use the Modified Jones Model in order to determine nondiscretionary accruals as an indication for earnings management, but they study the distribution of earnings. For this, the variables Income Before Extraordinary Items (IBEX), Total Assets and Sales are used and they perform a Wilcoxon rank-sum test, which compares medians before and after the implementation of IFRS (Jeanjean and Stolowy 2008, p. 488). It is not about the absolute value of these variables, but about whether there is an asymmetry between the frequencies of reporting small losses and the frequencies of reporting small profits. Their conclusion was that there is no significant decline in earnings management as a consequence of the implementation of IFRS. Instead, in France the level of earnings management did even increase. Although the method is different, the outcome is in line with the research of Tendeloo and Vanstraelen (2005) and Heemskerk and Van der Tas (2005). One major limitation of this research which Jeanjean and Stolowy acknowledge their selves is that the databases contain financial information for 2004 under local GAAP and for 2005 under IFRS. This is a problem, because they scale the IBEX of year t by the ASSETS of year $t-1$. The numerator and



denominator are not calculated under the same standard, making the variable less valid. Although they recognize this limitation, they still calculate it this way because of the non availability of data.

2.7 Determinants of earnings management

2.7.1 Firm Size

Firm size is related to the number of resources owned by the company; the size of a firm can be presented by total assets, number of sales, average sale and average total assets. Assets size is considered to be the most appropriate as a proxy for firm size (Makaryanawati, 2003). It is often argued the larger the firm the less likely they may want to engage in creative accounting practices and the more likely they will be concerned with improving the quality of financial reporting. The finding is consistent with previous research documenting a positive relation between firm size and disclosure policy decisions (Lang and Lundholdm, 2005). According to O' Donovan, (2012) larger companies come under more scrutiny than smaller companies. These

companies thus feel the pressure to disclose more information and improve the quality of financial reporting and thus reduce the level of information asymmetry. Larger firms are also perceived to be important economic entities and therefore have greater demands placed on them to provide quality financial reports (Cooke, 2002). A positive association between size of a cooperation and the extent of has been consistently confirmed by prior studies (Stanny and Ely, 2008; Ho and Taylor, 2007). In addition, large firms may also have the resources to put in place effective structures and processes to ensure improved quality reporting. There seems to be some level of consensus the literature on the positive relationship between the firm's size and the quality of its financial reporting process. The reasons for this according to studies (Bujaki and

Richardson, 1997) is that large firms are more willing to reduce information asymmetry and thus reduce their political costs since their size makes them quite visible in the corporate environment and could make them an easy target for litigation and other regulatory sanctions.

2.7.2 Auditor Type

Watts and Zimmerman (2000) consider that auditors play a major role in limiting opportunistic behavior by managements that may result in creative accounting. Watts and Zimmerman (2000) argued that auditors incur costs from entering contracts with audit clients, and so will influence clients to disclose as much information as possible in their annual reports. Nevertheless, empirical studies that examine the between the size of audit firms and the extent of earnings management by companies are contradictory. Craswell and Taylor (2002) found a positive relationship between auditor and the tendency for earnings management identified through low reserve disclosure in the Australian oil and gas industry. It is assumed that size (Big 4) of audit firm suggest reputation, international affiliation, and integrity which are reflected in the audit

report on the accounts of their clients. It has severally been argued that the large audit firms significantly determine the disclosure of policies of the companies they audit. Studies that have used size of audit firms in measuring the existence of creative accounting and earnings management include Kim, Chung and Firth, (2003) and Krishnan, (2003). Lennox (2009) looked at the two explanation of why the presence of a BIG 4 audit firm may deter the practice of earnings management. The first explanation was in regards to the “reputation” hypothesis suggested by DeAngelo (1981). The explanation is that large auditors have more incentives to be accurate because they have more client-specific rents to lose if their reports are not accurate. The second explanation is referred to as the “deep” pockets hypothesis used by Dye (2016) who

argued that large auditor will be more accurate because they have greater wealth that is exposed to risk in case of any litigation.

2.7.3 Financial Performance

In Companies with higher level of profitability, the tendency to engage in earnings management practices may be reduced since the pressure to perform will tend to be reducing than companies with a lower level of profitability. According to Stakeholders theory, the economic performance of a firm affects management's decisions either engage or not to engage in earnings management accounting practices which will indicate the extent of financial reporting quality. When companies are not performing well, economic demands and the anticipated benefits will determine the nature of the firm's information environment (Roberts, 2002). Ang and Chen (2006) argued that firms endogenously choose the level of information and how credible the information could be based on the costs and benefits of direct communications with the market.

In this regards, several studies (Darrough and Stoughton, 1990; Feltham and Xie, 2002)

hypothesize that a situation of endogenous information asymmetry can be created by the firm if the decision to disclose information to investors is influenced by concern that such disclosures can damage their competitive position. Freedom & Jaggi (1992) argues that economic performance (measured by profitability) of firms can influence the level of reporting quality. Thus if management is performing badly financially, the tendency to want to manipulate the reporting process may be higher in order to impress shareholders and potential investors.

2.7.4 Leverage

Another variable tested for a possible influence of IAS/IFRS adoption and earnings management is Leverage. Lopes and Rodrigues (2007) explain the linkage with agency cost theory. According to the Researchers, higher level of leverage induces more agency costs, and compliance IFRS. A. Uyar et al., (2009) review in his work that, leverage can be used to reduce information asymmetry and agency costs between debt holders and managers. However, prior research provides conflicting results in relation to the association between leverage and IAS/IFRS compliance. While some researchers found a negative association between leverage and IAS/IFRS compliance Kim et al., 2011), Al-Shammari et al. (2008) and Iatridis and Rouvolis (2010) found a positive association, while many others found an insignificant relationship Hodgdon et al., 2009; Lopes & Rodrigues, 2007; Tower et al., 2005).

2.7.5 Foreign ownership

Bova and Pereira (2012) argue that foreign investors are expected to induce greater IFRS compliance in the firms they invest in due to two reasons: to improve firm monitoring and to reduce information asymmetries, both of which are more important for foreign investors compared to domestic investors. Their findings provided evidence that foreign ownership is positively and significantly correlated with IFRS compliance.

2.8 Measurement of Earnings Management

2.8.1 Discretionary accrual

EM takes place in three ways namely, by the use of the certain revenue structuring and/or transactions of expense; the use of accounting procedures changes; and/or the use of accruals

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management (Schipper, 2002). Among these techniques of EM, accruals management is the most harmful to the accounting reports value because the investors are unconscious of the amount of accruals (Mitra & Rodrigue, 2002). Accrual can be defined as the difference between the earnings and cash flow from operating activities. The quality of earnings is, according to Christensen, Frimor, and Saba (2013), to a large extent, dependent on the quality of the accruals. According to Callao and Jarne (2010), accruals can be divided into discretionary and non-discretionary accruals. A main difference between the two is that non-discretionary accruals typically do not allow for management modifications, as the accounting models limit management choice. Instead, non-discretionary accruals are dependent on the company's specific business environment and its business model. Hence, the change in non-discretionary accruals represents the company's organic growth (Christensen et al., 2013). Discretionary accruals do allow management modifications and are more accessible for modifications by management compared to the non-discretionary accruals, hence they are more exposed to opportunism and in turn manipulation. Roychowdhury (2006) describes the change in discretionary accruals as a means to alter earnings without affecting cash flow, which can be done by for instance delaying write-offs regarding assets and bad debt expenses that are under-provisioned. Therefore, many papers have used an approach examining the balance of accruals, and specifically the industry normal levels of accruals against the actual levels to identify abnormal accruals (Mostafa, 2017; Callao & Jarne, 2010).

Most of the models used to measure AM focus on the estimation of abnormal levels of discretionary accruals, which can be estimated by subtracting non-discretionary from total accruals, according to Defond (2010) and (Dechow et al., 1995). Hence, according to these

models, actions affecting AM are limited to areas where managers have the ability to use their discretion. This implies that managers have the ability to increase or decrease the total amount of accruals. According to (Trejo-Pech et al., 2016), overall, a popular choice seems to be manipulation of timeliness in accounting. For instance, by modifying the time of write-offs earnings can be adjusted (Graham, Campbell, & Rajgopal, 2005; Trejo-Pech et al., 2016). Trejo-Pech et al. (2016) also mention the provisioning of bad debt as an area prone to adjustments, this since it is reviewed yearly and is a measure largely made up by managers judgment, which should be based on experience and historical data. By increasing or decreasing provisions, earnings can be adjusted with no effect on cash flow. Another possibility mentioned by Trejo-Pech et al. (2016) is for management to manipulate the impairment of goodwill. Goodwill impairments imply subjectivity due to the inherent need for management judgment, which in turn means that there is an apparent opportunity for managers to adjust measurement. Finally, Trejo-Pech et al. (2016) also mention restructuring charges as an area prone to manipulation. Simply put, recognizing the cost only to, later on, reversing part of in order to increase earnings. The extant literature deems discretionary accruals to be the main proxy for earnings management (see for example Teoh et al. 2005). Discretionary accruals are the component of total accruals subject to manipulation because they require judgment and estimation of management. Nondiscretionary accruals are however applied on a regular basis and do not result from earnings manipulation.

2.8.2 Real Activities Manipulations

Healy and Wahlen (1999), Fudenberg and Tirole (1995), and Dechow and Skinner (2000) point to an acceleration of sales, alterations in shipment schedules, and delaying of research and development (R&D) and maintenance expenditures as earnings management methods available

to managers. I define real activities manipulation as departures from normal operational practices, motivated by managers' desire to mislead at least some stakeholders into believing certain financial reporting goals have been met in the normal course of operations. These departures do not necessarily contribute to firm value even though they enable managers to meet reporting goals. Certain real activities manipulation methods, such as price discounts and reduction of discretionary expenditures, are possibly optimal actions in certain economic circumstances. However, if managers engage in these activities more extensively than is normal given their economic circumstances, with the objective of meeting/beating an earnings target, they are engaging in real activities manipulation according to the definition in this paper. We use discretionary accruals as a 'proxy' of earning management. To measure discretionary accruals, we have first to calculate total accruals. Consistent with my definition, Graham et al.'s (2005) survey finds that (a) financial executives attach a high importance to meeting earnings targets such as zero earnings, previous period's earnings, and analyst forecasts, and (b) they are willing to manipulate real activities to meet these targets, even though the manipulation potentially reduces firm value. Real activities manipulation can reduce firm value because actions taken in the current period to increase earnings can have a negative effect on cash flows in future periods.

For example, aggressive price discounts to increase sales volumes and meet some short-term earnings target can lead customers to expect such discounts in future periods as well. This can imply lower margins on future sales. Overproduction generates excess inventories that have to be sold in subsequent periods and imposes greater inventory holding costs on the company. Despite the costs associated with real activities manipulation, executives are unlikely to rely solely on accrual manipulation to manage earnings. Even though real activities manipulation potentially imposes greater long-term costs on the company, there are reasons to believe that managers

expect to bear greater private costs, at least in the short term, when they engage in accrual manipulation. In the surveys conducted by Bruns and Merchant (1990) and Graham et al. (2005), financial executives indicate a greater willingness to manipulate earnings through real activities rather than accruals. There are at least two possible reasons for this. First, accrual manipulation is more likely to draw auditor or regulator scrutiny than real decisions about pricing and production. Second, relying on accrual manipulation alone entails a risk. They realized year-end shortfall between manipulated earnings and the desired threshold can exceed the amount by which it is possible to manipulate accruals. If that happens, and reported income falls below the threshold, real activities cannot be manipulated at year-end.

2.8.3 Detecting EM through Real Activities Manipulation

Schipper, (1989) argued that the manipulating of operational activities in order to purposefully intervene in financial reporting and achieve personal gain should be defined as a type of earnings management. Burgstahler and Dichev, (1997) found that corporations often used cash flows from operating activities and working capital to manage earnings. Managers changed operational activities or decisions in order to produce earnings that met specific targets. This type of earnings management is called real activities manipulation. Dechow and Skinner, (2000) indicated that managers could manipulate earnings by moving forward the recognition of revenues, changing delivery schedules, or delaying the recognition of research and development to maintain expenses. According to (Graham, Harvey, & Rajgopal, 2005), the most commonly used method in earnings management is the manipulation of discretionary accruals analysis because it is easy to practice, has low manipulation costs, and is not easily identified by readers of financial reports. However, as measurement models of discretionary accruals are becoming increasingly

robust, the manipulation of discretionary accruals is increasingly easy to detect. Roychowdhury, (2006) found that many companies have abandoned earnings management with discretionary accruals, and there is growing evidence that the manipulation of discretionary accruals is no longer the main method for earnings management. Gunny, (2010), found that real activity management (RM) involves changing the firm's underlying operations in an effort to boost current-period earnings. Such activities include overproduction to decrease the cost of goods sold (COGS) expense, cutting desirable research and development (R&D) investments to boost current period earnings, postponing or eliminating expenses such as hiring, advertising, travel, and maintenance, cutting back on capital expenditures to avoid depreciation expense. In order to increase accounting earnings, Erickson and Wang (2002) also mention that managers have recourse to mechanisms of accelerating revenues collection, deferring expenses or use accounting procedure manipulations. Furthermore, Healy and Wahlen (2006) suggest that managers can defer expenditures (research and development (R&D), advertising, and maintenance), and choose accelerated depreciation or inventory valuation methods. Likewise, Callao et al (2008) underline that investors perceive that firms have tax incentives to adopt LIFO when input prices rise.

Penman and Zhang, (2002) suggested that under a conservative accounting regime, companies enhance earnings by reducing capital investments Soderstrom, 2011 conducted their research on earnings management using real activities with evidence from nonprofit hospitals. The research found evidence of the use of real operating decisions to manage earnings.

2.9 Theoretical Framework

There is no single theory in the earnings management literature that provides an adequate explanation for earnings management activities. The two prevailing conditions for earnings management activities in the relevant literature are information asymmetry and agency theory (Sun and Rath, 2008). Information asymmetry occurs when one participant in a market has knowledge pertaining to an asset being traded that the other participant does not know about (Scott, 2009). Since managers possess private information about the firm and its current and prospective earnings streams that current and potential shareholders do not have, then information asymmetry exists between managers and shareholders, which could lead to earnings management activities (Scott, 2000). Agency theory posits that when the goals of management are aligned with the goals of shareholders, no conflict of interest would exist between these two parties. According to this theory, principals use contracting to motivate agents to prevent this conflict of interest (agency conflict). Despite the fact that contracting is primarily designed to align the incentives between principals and agents (Deegan and Unerman 2006), agency concerns are created as a result of incompleteness and the rigidities in the binding of contracts, which lead to the manipulation of the reporting process (Sun and Rath, 2008). According to Soderstrom and Sun (2007), adoption of a common set of accounting standards such as IFRS improves earnings quality because management is under pressure to report a true and fair view and engage in fewer earnings management activities. Reflecting this line of thought, (Barth et al. 2006) find that high-quality accounting standards reduce earnings management and improve reporting quality. Barth et al. (2006) suggest that firms that adopt IFRS are less prone to engage in earnings smoothing and are more likely to recognize losses in a timely manner.



2.9.1 Information Asymmetry

Information asymmetry is considered to be a likely explanation for earnings management. Asymmetric information makes it possible for managers to manage earnings since it may be difficult for investors to ascertain the extent of earnings manipulation in firms characterized by an opaque information environment (Liu et al., 2010). When information asymmetry is high, stakeholders lack the sufficient resources, incentives, or access to relevant information to enable them to monitor the actions of managers, giving rise to the practice of earnings management (Richardson, 2000). Further, Liu et al. (2010) argue that a higher degree of asymmetric information makes it more difficult for shareholders to monitor the behaviour of managers, giving managers greater ease in terms of abusing their discretion in financial reporting.

2.9.2 Agency Theory

Agency theory is a prominent explanation of earnings management behaviour in the extant literature. According to Liu et al. (2010)), a conflict of interest between management and shareholders exists when managers seek to maximize their utility in a way that is not in the best interest of shareholders. As a result of this conflict, costs are incurred which are known as agency costs.

Bhundia (2012) explains that in order to maximize their interests or keep their position, agents are willing to present a good picture of the firm's financial position to shareholders. However, agency problems arise when the maximization of the agent's wealth does not necessarily lead to the maximization of shareholders' wealth. Managers or agents may have an incentive to

manipulate earnings in order to maximize their self-interest. The author argues that if earnings management is conducted opportunistically, then firms will have higher agency costs. However, if shareholdings are held by managers of the firm, the goals of managers and shareholders should be aligned and less earnings management will occur since the interests of managers and shareholders are the same. Bhundia (2012) argue that this incentive alignment effect is expected to have more impact as managerial ownership increases, which suggests that corporate performance improves and opportunistic managerial behaviour decreases as managerial ownership increases in the firm. It can also be argued that, more dominant managerial ownership leads to a greater degree of earnings management since greater ownership provides managers with deeper entrenchment and thus greater scope for opportunistic behaviour (Bhundia 2012).

Jiraporn et al. (2008) argue that where agency costs are high, firms should exhibit a high degree of opportunistic earnings management. Conversely, if earnings management enhances the information content of earnings and is beneficial to shareholders by conveying private

information, then earnings management is expected to be low since managers should not engage in earnings management for the sake of their private benefits. The empirical evidence in this study for the years 1993, 1995, and 1998 shows a negative relationship between agency costs and earnings management. This indicates that in firms where agency costs are lower, the extent of earnings management is higher, suggesting that earnings management does not appear to provide private benefits to management.

Other activities that may hinder earnings manipulation is enforcement of securities laws. Enforcements of law may deter insiders from manipulating earnings in order to profit from trading in the firm's shares (Jiraporn et al. 2008). Beneish and Vargus (2002) provide evidence that insider trading is associated with earnings management. Jiraporn et al. (2008) find that privately informed traders earn greater profits when trading stocks with high earnings quality risk factors. Enforcement of accounting standards may be as important as the accounting standards (e.g. Sunder 1997). Strong IFRS enforcement puts pressure on management and auditors who have thus less scope to exercise discretion. Jiraporn et al. (2008) provides evidence that adopting IAS2 with weak investor protection will likely lead to reduction in the perceived quality of the international accounting standards, and suggests that it would be useful for the literature to begin to structure and quantify the country descriptions by developing more informative tests. Yu (2005) finds that IAS, accrual-based accounting standards, accounting standards with increased disclosure requirements, and separation of tax and financial reporting all constrain earnings management. He also suggests that high-quality accounting standards decrease analyst forecast error. Francis et al. (2003) find no evidence that better accounting alone independent of a country's underlying legal systems is positively related to financial market development. Jiraporn et al. (2008) develops a comprehensive measure of accounting standards enforcement and suggests that strong investor protection encourages managers to follow the rules. Judicial independence measures the "efficiency and integrity of the legal environment as it affects business" (Francis and Wang 2008). A country's judicial system might be functioning well but enforcement of accounting regulations may be lacking. It is difficult, however, to think of a situation in which the judicial system in general works poorly but enforcement of accounting regulation is strong.

2.10 Conceptual framework

Based upon empirical evidence and theoretical literature reviewed a conceptual framework is developed to show how IFRS helps to improve on earnings management. If there were no framework for preparing financial statement, accounting standards would be developed in a random, haphazard way to deal with issues as they arise. This would result in standards that would be inconsistent with each other or legislation.

By having a single conceptual framework, preparers and users of financial statements understand that accounting practices and accounting standards are based on this common ideology.

A framework also provides guidance for unusual transactions, which may be otherwise open to interpretation. Some people believe that by having a conceptual framework, it improves the credibility of the accounting profession overall (www.ifrs.org).



The Conceptual Framework addresses:

- The objective of financial reporting;
- the qualitative characteristics of useful financial information;
- the reporting entity
- the definition, recognition and measurement of the elements from which financial statements are constructed; and

- concepts of capital and capital maintenance.

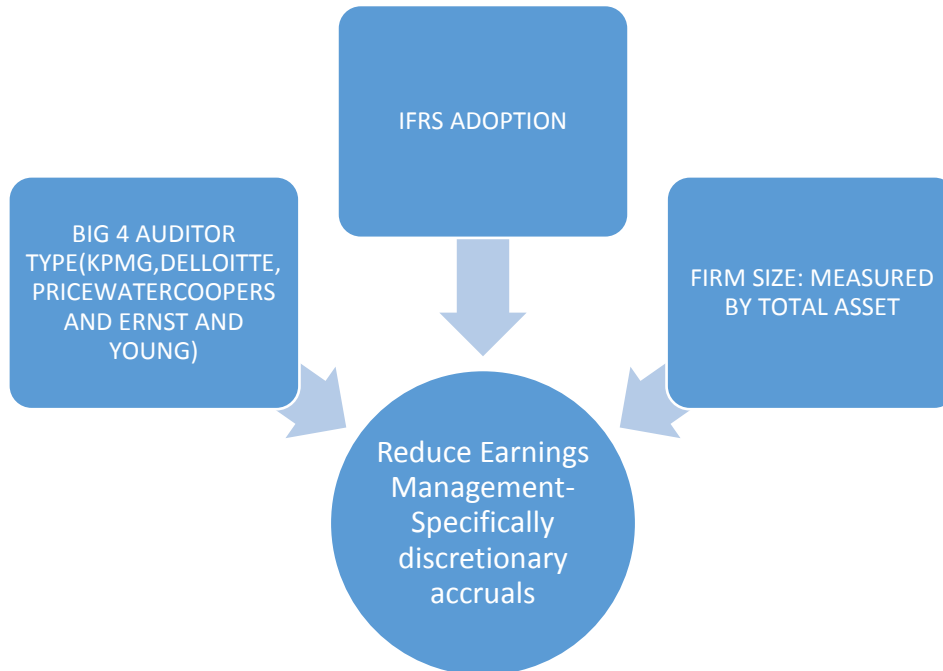
In effect the conceptual framework of international accounting standards seeks to define;

- the objective of financial reporting (which is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions about providing resources to the entity);
- the qualitative characteristics of useful financial information (relevance, faithful representation, comparability, verifiability, timeliness and understandability); and
- the definition, recognition and measurement of the elements from which financial statements are constructed (assets, liabilities, equity, income and expenses).

The conceptual framework explains the interrelationship between IFRS compliance and earnings management in listed companies in Ghana. Thus, the adoption and compliance of international financial reporting standards constrain earnings management in Ghana listed companies.



Figure 2.1 Conceptual Framework of IFRS on Earnings Management



Source: Researcher's Construct

2.11 Conclusion

Corporate accounting scandals that occurred in the past across the world like, the Xerox, Enron, Worldcom, Parmalt and Sino-Forest were usually accompanied by a number of accounting manipulations. The international financial reporting standards are principles and rules for the reporting financial information as established by the international accounting standard board. IFRS was step up to harmonise financial reports of companies around the world. The main objective of IFRS is to enhance, transparent and consistent in financial reporting by companies regardless of their country of origin.

The financial reporting process in Ghana is influenced by factors such as law, politics, economy, educational systems and international relations. In 1990, the Ghana stock exchange was established to provide monitoring and enforcement by sanctioning non-complaint listed companies. The need for attracting international investors and application for full international federation accountant (IFAC) membership, nevertheless require Ghana to and implement IFRS. The impact of IFRS adoption has been enormous, the world reported in their 2009 annual report that, the net inflow of foreign direct investment into Ghana increased from US\$1519m in 2000 to US\$2139m in 2007. Researchers have examined the impact of IFRS and whether the compliance of IAS /IFRS has improved accounting quality and in their findings has agreed that the compliance of IFRS has indeed reduced earnings management and improve accounting quality. On the contrary, many other types of research have come out to say that, by just adopting IFRS does not ensure accounting quality because many features such as enforcement affect IFRS compliance. In addition, research conducted in the European Union with much attention on first-time adopters and was concluded that earnings management has increased. Despite the numerous research available in the developed economy, to the best of my knowledge the compliance of IFRS with focus on earnings management has not be conducted in sub- Sahara Africa. The research is with focus on Ghanaian listed companies on the stock exchange market since its (Ghana) was the first sub- Sahara African country to adopt IFRS.



CHAPTER THREE

METHODOLOGY

3.1 Introduction

This chapter is made up of specific methods employed by the study to achieve the three specific objectives stated in chapter one. The chapter is made up of the research design, scope of the study, nature of the data and their sources. This is followed by discussions of econometric tools employed and conclusion.

3.2 Research Philosophy And Design

Research philosophy and design Research process builds on development of knowledge of the subject matter under study.

Saunders et al. (2011) presented three views on research philosophy, namely; interpretivism, realism and positivism. Interpretivism posits that to develop knowledge, interpreting and understanding the situation being studied is required in order to appreciate the motives, actions and intentions of the research participants. According to this view, knowledge is developed from the understanding that organizations experience frequent changes that makes what was relevant yesterday irrelevant to the same organization in the future. The second view is realism. Realism develops knowledge on the premise that external social factors and processes independent of human thoughts and beliefs exists, which make people interpret situations differently and arrive at different conclusions on the same subject matter, without their knowledge of existence of such factors. The last one is positivism. Positivism assumes that the researcher is independent of, and



neither affects nor is affected by the subject of the research. Another assumption is that, the researcher is an objective analyst who interprets collected data in an unbiased manner emphasizing the use of highly structured method and quantifiable observations that uses statistical analysis. Under positivism approach, knowledge is built from using quantitative data which undergoes statistical processing, analysis and interpretation. Since the causal relationships between the dependent and independent variables of earnings management and its determinants as well as consequence are to be tested and analysed statistically, positivism approach is selected for the development of knowledge of this study. With the research philosophy for the study in place, the choice of research approach is the next logical step. Saunders et al. (2011) identifies two research approaches: deductive and inductive. Inductive approach first collects data and develops theory based on the results of data analysed. The deductive approach on the other hand explains causal relationships between variables. Research hypothesis are developed and research strategies designed to test them. Quantitative data is used in testing hypotheses even though qualitative data can also be used. In deductive approach, the researcher is independent of observed phenomenon and the research uses highly structured methodology to facilitate replication (Gill and Johnson, 2010). A further argument is that the concepts of the research are operationalized to measure quantitatively the relationship between relevant variables. This study establishes the causal relationships between the dependent and independent variables of IFRS and earning management through quantitative operationalization of the identified variables. The quantified observations are processed and the results measured statistically to obtain evidence on the relationships between the variables.



Quantitative research is an approach for testing objective theories by examining the relationship among variables (Creswell, 2013). These variables can be measured using instruments so that numbers can be analysed using statistical procedures. In sum, this study adopts the positivism philosophy through a deductive approach using quantitative approach for testing the variables identified to establish the relationship that exist among them.

3.3 Scope of the study

The study is restricted non-financial companies listed on the stock exchange. Consistent with Klein, et. al., (2002) bank and insurance companies were excluded because they have unique working capital system distinct regulations and disclosures together with the complexity of determining accruals. The non-financial listed companies is utilized in the study is made up of African Champions Ghana Ltd, Anglo Gold Ashanti, Aryton Drug Manufacturing, Benso Oil Plantation, Camelot Ghana, Clydone Stone Ltd, Cocoa Processing Company, Fan Milk Ghana, Golden Star Resource, Guinness Ghana Brewer Ltd, Mechanical Llyod Company, Poineer Kitchen Ltd, Produce Buying Company, Pz Cussons Ltd, Sam Woode, Starwin Product, Total Petroleum Ghana Ltd, Tullow Oil, Unilever Ghana and Unilever Ghana.

3.4 Data and Data Sources

The study relies of panel dataset spanning from 2004 to 2014 for 19 non-financial companies listed on Ghana Stock Exchange. Our variables earnings management, firm size, auditor type, International Financial Reporting Standard, cash flow, firm growth and turnover. The variables for the study was selected in accordance to standard literature with the time period 2004 to 2014

solely based on the availability of data for the 19 companies considered for the study. Bank and insurance companies have unique working capital system distinct regulations and disclosures in addition to the complexity of determining accruals, we follow Klein, et. al., (2002) to exclude them from this study.

It is worth mentioning that this compilation of companies changes on a regular basis due to market effects such as mergers, acquisitions, buy outs and bankruptcies which can lead to delisting of companies. The sample consists of companies active at the time of data collection, which means companies that has not been delisted, some newer and some that has been listed during the entire time period (2004-2014). The issue with this approach is that, the study could be skewed by a survivorship bias since the study does not include companies that have been delisted. Unfortunately, the database available does not have the option to include companies that have been delisted, hence the sample is comprised of companies active at the time.



The data is sourced from the audited financial statements of the 19 companies published in annual report Ghana website. Measurement of individual variables and their proxy are discussed below;

3.4.1 International Financial Reporting Standard (IFRS)

The main goal of implementing IFRS was making financial statements more reliable and transparent. According to Soderstrom and Sun (2007: 676) the "improvement is based upon the

premise that change to IFRS constitutes change to a GAAP that induces higher quality financial reporting". As mentioned in chapter 1, it is assumed that IFRS leads to a higher quality reporting, including a lower level of earnings management. Prior research has found a lot of evidence that earnings management has not decreased as a result of IFRS. The reason that was given most for this phenomenon is that accounting in accordance with IFRS is based on fair value measures. This subjectivity in estimating assets and revenues gives managers more room for managing the earnings of the company. The researches that did find a decrease in earnings management as a result of IFRS, focused on early adopters. As mentioned by Christensen, Lee and Walker (2008) it is expected that voluntary adopters indeed show a decrease in earnings management because of the incentives they seem to have in favor of IFRS. This study therefore hypothesize a negative relationship between IFRS adoption and earnings management.

IFRS is a dummy variable that indicates whether the financial disclosure is done according to the International Standard. Since Ghana adopted the IFRS in 2007 we divided and sampled into pre and post adoption period. In the study, the post adoption period were considered as follows 2007-2014 which is devoted 1 : while the pre adoption period is (2004-2006=0).

3.4.2 Firm Size (FS)

Firm size is related to the number of resources owned by the company; the size of a firm can be presented by total assets, number of sales, average sale and average total assets. Assets size is considered to be the most appropriate as a proxy for firm size (makaryanawati, 2003). In addition, large firms usually produce more information of better quality than smaller companies

and their activities are monitored more closely by financial analysts, which could limit the earnings management (Bozec, 2008). Therefore, in our research, we expect that the level of earnings management, after adopting IAS/IFRS, is linked to the company's size.

To measure the size, we used logarithm base 10 of total assets (L.TA) of the years studied. This measure was also used by Street and Gray (2002), Othman and Zéghal (2006) and Bozec (2008)

3.4.3 Auditor Type (ADT)

The Big 4 audit namely KPMG, Deloitte and Touche, Ernst and Young and Pricewatercoopers firms are assumed to provide higher audit quality than other audit firms and they should do a better job in financial reporting enforcement (DeFond & Jiambalvo, 1994; Van Tendeloo & Vanstraelen, 2005). According to Ben Othman and Zéghal (2006), it is reported in the literature that a high-quality audit frequently translates into lower earnings management. Several studies

have shown that Big 4 auditors constitute a constraint on earnings management. On the other hand, Street and Gray (2002) showed that being audited by a Big 4 audit firm is positively related to compliance with IFRS, for both disclosure requirements and presentation and measurement requirements. Van Tendeloo and Vanstraelen (2005), showed that German companies that have voluntarily adopted IAS/IFRS engage more in earnings smoothing, but this effect is significantly reduced when they are audited by a Big 4 auditor. Watts and Zimmerman (1983) and Craswell and Taylor (1992) put forward the view that choice of external auditor is a mechanism that helps alleviate conflicts of interest between managers and shareholders. Jensen and Meckling (1976) and Watts and Zimmerman (1983) also argued that large audit firms act as

a mechanism to reduce agency costs and exert more of a monitoring role by limiting opportunistic behaviour by managers. A significant number of empirical studies yielded consistent results with regard to the relationship between the type of auditor and compliance with IFRSs. Street and Gray (2001) reported that the level of compliance with IAS disclosure and measurement requirements was positively associated with companies in developed countries being audited by “Big four” auditing firms.

3.4.4 Cash Flow (CF)

CFO is cash flow from operations, calculated indirectly as the first difference between operating income and accruals. i and t are firm and year subscripts respectively. Cash flow from Operating income is computed as the sum of net income, income taxes and financial expense. Street and Gray (2001) reported that the level of operating cash flow with IAS disclosure and measurement requirements reduced earning management by managers.



3.4.5 Growth

According to Uyar et al., (2009) growth in Companies with higher level of growth through expansion, profitability and investments, the tendency to engage in earnings management practices maybe reduced since the pressure to perform will tend to be reducing than companies with lower level of growth.

Growth is measure of changes in turnover expressed in percentages, thus sales growth rate, defined as the sales in year t minus sales in t-1 and scaled by sales in year t-1.

3.4.6 Leverage

Leverage of the firm is total liabilities divided by total assets. Glaum and Street (2003) used leverage as a measure to determine if earning management reduced. Likewise Wallace and Naser (1995) found that the extent of compliance with mandatory disclosure was negatively associated with companies when use leverage as a measure and finally, Patton and ZeleNka (1997) found a negative association in the Czech Republic. Lopes and Rodrigues (2007) explain the linkage with agency cost theory. According to the Researchers, higher level of leverage induces more agency costs, and compliance IFRS. Uyar et al., (2009) review in his work that, leverage can be used to reduce information asymmetry and agency costs between debt holders and managers



3.4.7 Turnover

I define sales manipulation as managers' attempts to temporarily increase sales during the year by offering price discounts or more lenient credit terms. One way managers can generate additional sales or accelerate sales from the next fiscal year into the current year is by offering 'limited-time' price discounts. The increased sales volumes as a result of the discounts are likely to disappear when the firm re-establishes the old prices. The cash inflow per sale, net of discounts, from these additional sales is lower as margins decline. Total earnings in the current period are higher as the additional sales are booked, assuming positive margins. Another way to

boost sales volumes temporarily to increase earnings is to offer more lenient credit terms. For example, retailers and automobile manufacturers often offer lower interest rates (zero-percent financing) toward the end of their fiscal years. These are essentially price discounts and lead to lower cash inflow over the life of the sales, as long as suppliers to the firm do not offer matching discounts on firm inputs. In general, I expect sales management activities to lead to lower current-period CFO.

3.4.8 Financial Performance

Freedom & Jaggi (1992) argues that the economic performance (measured by profitability) of firms can influence the level of reporting quality. Thus if management is performing badly financially, the tendency to want to manipulate the reporting process may be higher in order to impress shareholders and potential investors. Performance measured in Profit is the net profit of the firm scaled by total asset.

Table 3.1 Measurement of variable

SN	VARIABLE	TYPE	MEASUREMENT
1	Earnings Management	Dependent	We measure EM using net profit method. This method focuses on the value of net profit scaled by total assets. The idea is found in other research studies according to which a higher volatility of net profit is related with a lower value of earnings management. Its variability is found by

			conducting a regression using the value of net profit as dependent variable on several specific individual factors
2	IFRS	Independent	1 for period before adoption and 0 for otherwise
3	Firm size	Independent	To measure the size, we the total assets of the years studied
4	Turnover	Independent	Is measured by the revenue of the firm
5	Growth	Independent	Growth is the measure of changes in turnover expressed in percentages, thus sales growth rate, defined as the sales in year t minus sales in t-1 and scaled by sales in year t-1
6	Debt	Independent	Leverage of the firm is total liabilities divided by total assets
7	Cash flow	Independent	Cash flow from operations
8	Auditor type (big 4)		Big 4 and Non- Big 4(1 for big 4 firms and 0 for otherwise)

3.5 Hypothesis Developed

Mandatory IFRS adoption has no clear ex ante effect on financial reporting. Arguments suggest both positive and negative potential effects on earnings management practices as well as reasons to expect negligible changes after mandatory IFRS adoption. The following hypothesis were developed to help answer the research questions.

H1: Adoption of IFRS by Ghanaian listed companies contributes to the reduction of earnings management.

H2: Adoption of IFRS has a greater effect on reducing the level of earnings management when a company is audited by a Big 4 audit firm

H3: There is a negative significant relationship between firm size and earnings management

3.6 Empirical Strategy

This section espoused the empirical strategy employ to determine the relationship between IFRS and Earnings Management proxy by discretionary management, to examine the relationship between auditor type and earnings management and to evaluate the relationship between firm size and earnings management as stated in chapter one. We pay attention to IFRS, earnings management, auditor type and firm size as the interest variables for this study. We set up a model that explains the relationship between IFRS and earnings management, auditor type and earnings management, and firm size and earnings management by following the empirical strategy of Ibrahim and Sare (2018). Following Ibrahim and Sare (2018), we establish the relationship amongst earnings management, IFRS, auditor types and firm size by setting up a model where

earnings management is explained by IFRS, auditor type, firm size and other control variables. Specifically, we specify that earnings management is a function of IFRS, auditor type, firm size and other control variables in the following manner;

$$EM_{it} = f(IFRS_{it}, ADT_{it}, FS_{it}, CONT_{it}) \quad (1)$$

Where EM_{it} is Earnings management proxy by accruals (Since the study is using the netprofit to estimate Earnings management for the regression analysis, our Earning management is proxy by NP) for firm i at time t; $IFRS_{it}$ and ADT_{it} , are international financial reporting standard and auditor type for firm i which is a dummy variable while FS_{it} is firm size. $CONT_{it}$ is a vector of the control variables such as growth and turn over.

There is potential of endogeneity in the Eq. (1) specified above which may produce biased results. For example, while firm size and auditor type enhances earnings management, desire for good earnings management may also leads to the selection of quality auditor and increase in firm

size.

The study seeks to deal with the potential endogeneity issue by utilizing Generalized Method of Moments (GMM). We expand Eq1 specify earnings management using the initial values of earnings management, auditor type, firm size and other control variables of the form:

$$EM_{it} = \alpha_0 EM_{it-1} + \alpha_1 IFRS_{it} + \alpha_2 ADT_{it} + \alpha_3 FS_{it} + \alpha_4 CONT_{it} + \epsilon_i + \phi_t + \mu_{it} \quad (2)$$

Where EM_{it-1} is the lagged of earnings management; ϵ_i is unobserved country-specific effects, ϕ_t is the time effects, μ_{it} is the idiosyncratic error term while other variables are same as previously defined.

From Eq 2 α_1 , α_2 and α_3 measures the direct impact of international financial standard, auditor type and firm size on earnings management.

The simultaneous existence of EM_{it-1} and ϵ_i confirms potential presence of endogeneity since EM_{it-1} correlate with the error term. The use of GMM and fixed effect is a logical first step to deal with potential endogeneity. In addition, the application of GMM mandates us to use additional moments that make use of the stationarity property of the variables under consideration (Ibrahim and Sare 2018, Blundell and Bond, 1998). Based on the assumption of no correlation of the original error term and the weak exogenous nature of our regressors the

following moment conditions were applied:

$$E(\Delta EM_{i,t-k} \mu_{it}) = 0 \quad \text{for } k \geq 2; t = 3, \dots, T$$

$$E(\Delta VEC_{i,t-k} \mu_{it}) = 0 \quad \text{for } k \geq 2; t = 3, \dots, T$$

Where $VEC_{i,t-k}$ is the lag of all the explanatory variables except $EM_{i,t-1}$ while k is the lag structure. So the lagged levels from $k \geq 2$ are utilized as valid instruments. However, these lagged regressors can be poor instrument when difference at first order emanating resulting from



error in measurement (Ibrahim and Sare 2018, Blundell and Bond, 1998). In dealing with the poor instrument arising from measurement error, we use both the two-step system approach of GMM which includes the lagged differences as instrument in the level equation and the lagged levels of the regressors as instrument in the first difference equation to estimate the equation.

The two-step system GMM enhances the efficiency and effectiveness of our estimation compared to the difference GMM, however, the approach this study adopted requires the imposition of the following orthogonal restrictions:

$$E(\Delta EM_{i,t-k} \mu_{it}) = 0 \quad \text{for } k = 1$$

$$E(\Delta VEC_{i,t-k} \mu_{it}) = 0 \quad \text{for } k = 1$$

The adequacy of our instrument is measured using the Sargan test of over-identifying restrictions.



3.7 Discretionary Accruals (DA)

Accrual management has been considered the most harmful method in accounting reporting since investors are unconscious of the amount of accruals (Mitra & Rodrigue, 2002). There are two methods of accrual discretionary and non-discretionary. The discretionary allow for manipulations while non-discretionary does not. This research is based on discretionary accrual which allows modifications of the financial statements. It is measured as the difference between earnings and cashflow. There are various model for accrual determination; model constructed by

DeAngelo is one good model, however it represents a model that views non-discretionary accruals as constant, which according to Dechow et al. (2000) is a faulty assumption. If chosen, this would mean that if non-discretionary accruals actually do change, the DeAngelo model will estimate non-discretionary accruals wrong (Dechow et al., 2001), which is not desirable. Another possibility is the Industry model, this was not chosen since it, according to Dechow et al. (2000) have difficulties in extrapolating the correct amount of non-discretionary accruals. Thereby diminishing its ability to estimate discretionary accruals, which this model relies on.

The original Jones model was also excluded since it does not take into account revenue manipulation. According to Dechow et al. (1995), revenue manipulation is present in modern businesses by postponing recognition, which makes this model unsuitable. Also, another issue with the original Jones model is that it suffers from a downward inclination due to the exclusion of revenue manipulation, which makes the measure biased.

Therefore, for the purpose of this study the model that remain useful and mostly recommended is the net profit method of estimation. The method takes into account management of revenues, hence it does not suffer from the same criticism as the original Jones model. Also, according to Dechow et al. (1995), who reviewed various Accrual Manipulation estimation models, argues that it captures earnings management most accurately. Therefore, not surprisingly, it represents the framework most commonly used in detecting AM (Callao & Jarne, 2010; Mostafa, 2017; Kargin, 2013).

$$\text{Total Accruals} = \text{Netprofit} - \text{Cash flow from Operating Activities}$$

(3)

$$TA = NI_{it} - CFO_{it}$$

In order to provide evidence if there is any significant difference between the values of earnings management from 2004-2014, we look at most popular the net profit method of estimation.

This method focuses on the value of net profit scaled by total assets. The idea is found in other research studies according to which a higher volatility of net profit is related with a lower value of earnings management. Its variability is found by conducting a regression using the value of net profit as dependent variable on several specific individual factors. In order to test the difference, the variability of residuals of the net profit is compared between the two periods of time (each residual series takes into account the accounting measures); (Brad et. al. 2012)

$$\Delta NP_{it} =$$

$$\alpha_0 + \alpha_1 IFRS_{it} + \alpha_2 Size_{it} + \alpha_3 Growth_{it} + \alpha_4 auditor\ type_{it} + \alpha_5 turnover_{it} + \alpha_6 debt_{it} + \alpha_7 cfo_{it} + \varepsilon$$

(4)

3.8 Conclusion

This chapter described the nature of data and sources of data. Our data is 11years panel and spans from 2004 to 2014 for 19 non-financial companies listed on Ghana Stock Exchange. In terms of our estimating approach, we rely on the system GMM to determine the relationship between IFRS and Earnings Management, to examine the relationship between auditor type and

earnings management and to evaluate the relationship between firm size and earnings management. The next chapter analyses and discusses the empirical results.



CHAPTER FOUR

FINDINGS AND DISCUSSIONS

4.1 Introduction

The analysis of the finding is divided into two sections. The first section provides a descriptive statistics summary table which is aimed at addressing the main objective of the study. The section seeks to highlight key issues relating IFRS and earning management. The second section used the statistical model of panel regression using GMM to examine the relationship between IFRS and EM.

4.2 This section discusses the descriptive statistics


Table 4.1: Descriptive statistics

	NP	IFRS	SIZE	GROWTH	AUDIT	TURNOV	DEBT	CF
Mean	-2619225	0.730	1.57e+09	20.1775	0.788461	2.13e+08	138.597	-30809.46
Std. dev	7.70e+08	0.444	5.66e+09	118.6716	0.4093845	9.16e+08	157.7307	258488.2
CV	2.940	0.608	3.605	5.881	0.519	4.300	1.138	0.827
Min	-7.98e+09	0	323038	-100	0	-1.06e+09	13.01	-2714693
Max	3.51e+09	1	4.45e+10	1110.7	1	6.19e+09	1309.33	351820
Skewness	-5.778	-1.041	4.768092	6.307992	-1.412645	4.772618	3.462949	-8.510819
Kurtosis	67.761	2.083	28.20656	53.89369	2.995565	26.13709	19.65698	79.82818

Notes: NP = Net profit; IFRS = International financial reporting standards; size=total assets; growth = change in total assets; audit= auditor type by big 4(Ernst and young, KMPG, pricewatercoopers and Delllote); turnover =changes in sales; debt =total liabilities to total asset; CF= Cash flow from operations Cv= coefficient of variations, min = minimum, max =maximum

From Table 4.1, average Net profit is Ghc-2,619,225 confirming poor performance of the companies considered for the studies over the period 2004 to 2014. The net profit standard deviation value of Ghc 7.70e+08 indicates some degree of dispersion which is confirmed by the coefficient of variation value of 2.940. Net profit skewness value of -5.778 indicates the net profit is negatively skewed and is distorted from normal distribution while the Kurtosis value of 67.761 confirms the platykurtic nature of net profit of the studied companies for the period 2004 to 2014. Skewness value of -1.041 and Kurtosis value of 2.083 for International financial reporting standards confirm that International financial reporting standards data is asymmetrical and leptokurtic.

Total assets of the companies are 1.57e+09 on average with a standard deviation of 5.66e+09 revealing volatility in the size of the firms studied. The skewness value of -1.041 for firm size variables indicates the variable is not normally distributed and is platykurtic with Kurtosis value of 2.083.

 On growth, the firms experienced average growth of 20.1775% with high degree of volatility as reveal by the high standard deviation value of 118.6716%. The high growth volatility is confirmed by the high coefficient of variable of 5.881, the highest amongst the variables being studied. The growth variable is positively skewed, asymmetrical and leptokurtic juxtaposed by the skewness of 6.307992 and Kurtosis of 53.89369.

From Table 4.1, most of the companies studied are audited by the big four auditing firms as standard deviation of 0.4093845 and CV of 0.519 indicates less variability translating into

quality financial reporting but is asymmetrical and platykurtic base on the skewness and kurtosis values.

Turnover of the firms for the sampled period averaged $2.13e+08$ with high absolute dispersion confirmed by high standard deviation value of $9.16e+08$. Turnover recorded second highest volatility with coefficient of variation value of 4.300 as shown in Column 6 of Table 4.1.

Total liabilities for the sampled period exceeded total assets on average by 38.597% with standard deviation value of 157.7307% indicating high absolute dispersion albeit low volatility. The debt variable is positively skewed, asymmetrical and leptokurtic. Cashflow from operations averaged Ghc-30809.46 for the sampled firms for the period 2004 to 2014 albeit very low volatility. However, cashflow from operations is negatively skewed, asymmetrical and leptokurtic.

From Table 4.1 growth is the most volatile variable with CV of 5.881 followed by turnover with CV of 4.300 with cashflow from operations being the least volatile variable with CV of 0.827.

All the variables are asymmetrical with majority being leptokurtic. Beyond the descriptive statistics, the next section discussions the strength and direction of correlation amongst the variables under consideration.

From Table 4.2, earnings management proxied by net profit correlates weakly and negatively with all the variables except growth which it's positively correlates. By implication, there is

likelihood observing negative relationship between earnings management and IFRS, firm size and auditor type in the GMM results.

Table 4.2: Correlation matrix

	NP	IFRS	SIZE	GROWTH	AUDIT	TURNNOV	DEBT	CF
NP	1.000							
IFRS	-0.0141	1.000						
SIZE	-0.1980	0.1237	1.000					
GROWTH	0.0413	-0.0543	-0.0467	1.000				
AUDIT	-0.0025	0.0041	0.1405	-0.1916	1.000			
TURNNOV	-0.0221	0.1216	0.9197	-0.0503	0.1178	1.000		
DEBT	0.0086	-0.0681	-0.1708	-0.0003	-0.3396	-0.1407	1.000	
CF	-0.0003	-0.0763	0.0332	-0.1492	-0.0621	0.0278	-0.0851	1.000

On the strength of association, IFRS correlates weakly with all the variables albeit positive relationship with growth and debt variables with the rest correlating negatively. Excluding turnover, firm size has weak relationship with all the variables. On the direction of effect, firm size correlates negatively with net profit, growth and debt with remaining variables having positive correlation.

Auditor type has negative relationship with net profit but positive relationship with IFRS and firm size albeit weak association. Growth, turnover, debt and cashflow from operations all correlates weakly with each other and other variables.

Given that the study aims to examine how IFRS influence accruals or earning management, we discuss our empirical strategy in the next section.

Table 4.3 contains the empirical results of the impact of IFRS on earnings management. The GMM was sequentially performed to determine the robustness of the interest variable IFRS.

4.3 Empirical Findings

Table 4.3: EM and IFRS

	1	2	3	4	5
Constant	4.51e+07 (419692.1)	4.08e+07 (817438)	8.28e+07 (1920575)	9.45e+07 (7035454)	9.84e+07 (2.01e+08)
LEM	.1818267*** (8.95e-07)	.1772596*** (.000021)	.1776809*** (4.96e-06)	.1273084*** (.0000962)	.126715*** (.0784245)
IFRS	-6.79e+07*** (422265.7)	-7.00e+07*** (803390.6)	-7.86e+07*** (1296160)	-1.93e+08 *** (6406959)	-1.98e+08*** (1.97e+08)
GROWTH		396245.4* (2415.662)	371669.9* (683.694)	674808.5* (10985.9)	714248.6* (639030.1)
DEBT			-244415*** (11496.11)	-3555.817*** (9406.661)	26162.04* (702991)
TURNOVER				.1773728*** (.0001721)	.1776896*** (.1776896)
CASHFLOW					97.98875* (377.1111)

DIAGNOSTICS					
Wald chi square	2.02e+11	5.13e+09	3.92e+13	5.69e+08	15.15
p-value	0.0000	0.0000	0.0000	0.0000	0.0000
Sargan test	18.92459	14.91515	16.76359	13.47087	16.49939
AR(1)	-.52127	-.54082	-.53999	-.44733	-.77548
p-value	0.6022	0.5886	0.5892	0.6546	0.4381
AR(2)	-1.165	-1.1677	-1.1677	-1.2059	.27176
p-value	0.2440	0.2429	0.2429	0.2279	0.7858

Note: *, ** and *** respectively denote significance at 10%, 5% and 1%. Values in () are the standard errors.

We included the initial values of earnings management to ascertain the convergence or divergence of current earnings management. From Table 4.3, the coefficient of lagged earnings management is positive in all the models. This indicates that lagged earnings management significantly spurs current earnings management by 0.18% (see Column 1). The positively significant coefficient suggest divergence. Column 1 of Table 4.3 presents the findings of the effect of IFRS on earnings management. When we apply IFRS as the only independent variable, the probability for earnings management increase is reduce by 6.79e+07%. This reduction is not surprising as IFRS require higher disclosure information which increases the manipulation risk of being detected, thus increasing the cost of earnings management. Also, adopting IFRS will improve the quality of financial reporting and significantly improve stakeholders ability to assess and compare foreign company financial statements and understand the financial statement. According to Barth, et.al (2008) adopting IFRS would result in significant cost savings and eliminate financial statement reconciliation or restatement which make its difficult for managers to alter reported earnings.

The impact of initial earnings management on the current earnings management by firms is qualitatively similar when control for growth, IFRS, debt, cashflows from operations and turnover albeit huge when we control for only IFRS and growth (see Column 2 and 3). The huge impact when control for growth and IFRS stem from the fact that big firms massage their financial report more to present huge growth to its stakeholders by circumventing the IFRS. This is not surprising as firms have to continuously manipulate their financial reports to meet the expectations of stakeholders once it is done in the previous year else they would be exposed.

Healy and Wahlen M, (2000) indicated that earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial 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. Supporting Healy and Wahlen M, (2000) assertion, Karampinis (2009) iterated that earnings management is the alteration of firms' reported economic performance by insiders either to mislead some stakeholders or to influence contractual outcomes. In terms of direction of effect, the lagged earnings management is insensitive to model specification. However, the magnitude of impact is sensitive to model choice.

The reduction in earnings management resulting from IFRS is huge when we control for growth (Column 2) and debt (Column 3) but less when we control for turnover (Column 4) and cash flow (Column 5). On the contrary, Jeanjean, (2008) found that the pervasiveness of earnings management did not decline after the introduction of IFRS in France. According to them sharing rules is not a sufficient condition to create a common business language, and that management incentives and national institutional factors play an important role in defining financial reporting

characteristics. Interestingly, Callao & Jarne, (2010) observe that the mandatory results adoption of IFRS is associated with a reduction in the earnings management level for companies with good corporate governance. By implication the reduction effect of IFRS on earnings management is dependent on the level of a firm's corporate governance. Does it mean the negative effect of IFRS on earnings management is dependent on certain organizational characteristics?

Turning to the control variables, growth has positive effect on earnings management and this effect is significant and robust (Column 2). Not surprising, the quest to report high growth serves as an incentive to manipulate financial reports leading to high earnings management. Consistent with Healy and Wahlen (2002), the authors observed that when the compensation of a manager depends on the results of the company, there will be an incentive to manage the earnings in a positive way. The reason for this is that the manager will receive a personal benefit as a result of the numbers presented. Hence growth numbers encourage firms to massage their financial report in order to report high growth rate to meet analyst expectations and avoid disappointing investors.



Debt has negative effects on earnings management (Column 3 and 4) albeit positive effect when we control for turnover and cashflow from operations. This effect is significant but not robust. Lopes and Rodrigues (2007) indicated debt linkage with agency cost theory. According to the authors, higher level of debt induces more agency costs, and compliance IFRS which in turn reduces earnings management (Column 5). The positive effect of debt on earnings management is consistent with the findings of Kim et al., (2003), and Al-Shammari et al. (2008) where the

authors observed that debt dampens IFRS compliance which translates into increase in earnings management. The largely negative effect of debt on earnings management is in synch with Iatridis and Rouvolis (2010) where the authors that high debt spurs IFRS compliance thereby reducing earnings management (Column 3 and 4).

Turnover has positive effect on economic growth where 1% increases in turnover increases earnings management by 0.177% (Column 4). The effect is significant at all conventional levels and robust. The finding in Column 4 of Table 4.3 is qualitatively similar when control for cashflow from operations and is not sensitive to model choice (Column 5). Cashflow from operations depicts positive relationship with earnings management, the higher the operations cashflow the higher the earnings management as it facilitates the manipulations of the financial reports (Column 5).

On model adequacy, the Sargan test indicates that our test for over-identifying restrictions supports the validity of the instruments therefore we do not accept our null hypothesis. Our serial correlation tests reject the null hypothesis of absence of first-order correlation. We also do not find support for existence of second-order correlation. Our overall models are significant at conventional levels given the high Wald test statistics and their associated low p -values. Thus, the findings presented in this study are coherent and consistent on the back of valid instruments.

Beyond the effect of IFRS on earnings management, we explore the impact of auditor type on earnings management. The next section discusses the findings of auditor type on earnings

management. Column 1-5 of Table 4.4 presents the findings of auditor type on earnings management. The variables were sequentially added to ascertain its robustness especially the interest dummy variable auditor type.

Table 4.4: EM and Auditor Type

	1	2	3	4	5
Constant	-1.26e+09 (7.17e+07)	-5.25e+08 (4.67e+08)	-1.32e+08 (8.88e+08)	-1.15e+08 (8.93e+08)	-1.75e+08 (9.59e+08)
L.EM	.18189*** (2.26e-06)	.1771326*** (.0000363)	.1285698*** (.0787041)	.1280054*** (.0789801)	.1278922*** (.0792289)
AUDITOR TYPE	1.56e+09** (7.17e+07)	8.21e+08** (4.67e+08)	9.73e+07** (1.13e+09)	7.89e+07 ** (1.14e+09)	1.32e+08 ** (1.18e+09)
GROWTH		418939.4* (1594.95)	641409.3* (610471.5)	676283.5 * (629494.6)	693321.3* (639985)
TURNOVER			.1613066*** (.0667801)	.1618747*** (.0670265)	.1618682*** (.067234)
CASHFLOW				90.95643* (369.4179)	103.2232* (377.7239)
DEBT					124674.9* (724801.5)
DIAGNOSTICS					
Wald chi square	1.14e+10	2.90e+12	14.20	14.17	14.11

p-value	0.0000	0.0000	0.0067	0.0145	0.0284
Sargan test	15.23847	39.73091			
AR(1)	-.52147	-.54287			
p-value	0.6020	0.5872			
AR(2)	-1.1638	-1.1668			
p-value	0.2445	0.2433			

Note: *, ** and *** respectively denote significance at 10%, 5% and 1%. Values in () are the standard errors.

On lagged earnings management, the positive effect of lagged earnings management on the current earnings management is similar to the result of Table 4.3. However, on the magnitude of effect, it is huge when we control for growth in Table 4.3 (Column 3) as compared to controlling for growth and debt in Table 4.3. This again confirms that current earnings management magnifies future earnings management since management has to keep on massaging financial statements to satisfy their own interest and interest of outsiders.

Column 1 of Table 4.4 presents the result of the effect of auditor type on earnings management. We noticed that when auditor type is employ as the only independent variable, there is positive relationship between auditor type and earnings management where companies audited by the reputable auditing firms have 1.56e+09 more earnings management compared to companies audited by less reputable firms. This is quite interesting as the study expected that companies audited by reputable auditing firms have lower chance of manipulating their financial reports

compared to companies working with less reputable auditing firms. It is assumed that Big 4 audit firms suggests reputation, international affiliation, and integrity which are reflected in the audit report on the accounts of their clients. It has severally been argued that the large audit firms significantly determine the disclosure of policies of the companies they audit which decelerate earnings management. This debunks the reputation hypothesis of DeAngelo and Dichev (2006) where the author observed that large auditors have more incentives to be accurate because they have more client-specific rents to lose if their reports are not accurate. Our findings also contravenes the “deep” pockets hypothesis used by Dye (2016) who argued that large auditor will be more accurate because they have grater wealth that is exposed to risk in case of any litigation. Our findings also contravenes with Craswell and Taylor (2015) who found a positive relationship between auditor and the tendency for earnings management identified through low reserve disclosure. The results also confirms some of the corporate accounting scandals that have been discovered recently around the world and the collapse of some financial institutions in Ghana and accross the world. Examples of such scandals and some headlines captured in the Newspapers ‘Enron, WorldCom, in Europe and Asia Satyam Computer Services and recent headlines “FRC takes Deloitte to tribunal for \$5 billion Autonomy scandal and KPMG fined £2.1m for misconduct over work for Ted Baker”. These scandals were usually accompanied by a number of accounting manipulations and were audited by some of these BIG 4 firms.. The effect of auditor type on earnings management is significant and robust.

Growth and turnover exhibited positive and significant effect on earnings management which is qualitatively similar to the result in Table 4.3 even when the interest variable is changed from IFRS to auditor type. This indicates that the effect of growth and turnover on earnings

management is insensitive to the model specification and robust. Cash flow from operations also has positive and significant effect on earnings management similar to the result in Table 4.3 which confirms that it is not sensitive to the model choice.

On model adequacy, our failure to reject the null hypothesis based on the Sargan test indicates that our test for over-identifying restrictions supports the validity of the instruments. Our serial correlation tests accept the null hypothesis. We also do not find support for existence of second-order correlation. Our overall models are significant at conventional levels given the high Wald test statistics and their associated low p -values. Thus, the findings presented in this study are coherent and consistent on the back of valid instruments.

The next section discusses the findings of firm size on earnings management. Column 1-5 of Table 4.5 presents the findings of the impact of firm size on earnings management. The variables were sequentially added to ascertain its robustness especially the interest variable firm size.



We notice that our lagged earnings management is sensitive to the model specification unlike our findings in Table 4.3 and Table 4.4. Our initial values of earnings management has positive effect on earnings management when we control for firm size (Column 1), growth (Column 2) and debt (Column 3) but negative effect on earnings management when we control for turnover (Column 4) and Cashflow from operations (Column 5). But the impact is qualitatively similar in Table 4.4 (Column 1) and Table 4.3 (Column 1) but not robust because of difference in direction of effect.

Table 4.5: EM and SIZE

	1	2	3	4	5
Constant	1.38e+07 (42418.87)	8379824 (199142.5)	6.55e+07 (378817.9)	1.50e+08 (1811106)	1.47e+08 (1838613)
L.EM	.1839842 *** (5.90e-06)	.1804488*** (.000021)	.1812025 *** (.000011)	-.082212*** (.0001162)	-.0827296 *** (.0001343)
SIZE	-.0139155*** (9.43e-07)	-.0132504*** (.0000102)	-.0144018 *** (2.49e-06)	- .1932716*** (.0000412)	-.1932246*** (.000048)
GROWTH		290465.1* (1685.785)	241899.9* (693.3559)	495236.8* (8127.551)	533771.9* (8643.727)
DEBT			-391497.9 *** (6237.144)	- 664126.6*** (25771.79)	-628744.1*** (28841.21)
TURNOVER				1.106957** (.0001241)	1.107166** (.000206)
CASHFLOW					34.19594* (45.76029)
DIAGNOSTI CS					
Waldchi square	2.40e+10	8.06e+09	1.59e+14	2.66e+10	1.84e+11
p-value	0.0000	0.0000	0.0000	0.0000	0.0000

Sargan test	18.66019	14.82548	22.81363	14.12531	16.49939
AR(1)	-.5821	-.59168	-.59746	-.77447	-.77548
p-value	0.5605	0.5541	0.5502	0.4387	0.4381
AR(2)	-1.1589	-1.1612	-1.1619	.26946	.27176
p-value	0.2465	0.2456	0.2453	0.7876	0.7858

Note: *, ** and *** respectively denote significance at 10%, 5% and 1%. Values in () are the standard errors.

Column 1 of Table 4.5 presents the result of the effect of firm size on earnings management. We noticed that when firm size is employ as the only independent variable, there is negative relationship between firm size and earnings management where 1% increase in firm size reduces earnings management by 0.0139% and this effect is significant and robust. By implication large firms already have their brand accepted and are major players in their industry of operation hence finds no need to massage their financials. Also, as a firm grows, their operations are strengthened, stakeholder hold managers accountable hence makes it difficult for managers to manipulate transactions. Larger firms are also perceived to be important economic entities and

therefore have greater demands placed on them to provide quality financial reports which reduce earnings management. The larger the firm the less likely they may want to engage in creative accounting practices and the more likely they will be concerned with improving the quality of financial reporting. Consistent with O' Donovan, (2012), the author observe that larger companies come under more scrutiny than smaller companies. These companies thus feel the pressure to disclose more information and improve the quality of financial reporting and thus reduce the level of information asymmetry. In addition, large firms may also have the resources to put in place effective structures and processes to ensure improved quality reporting. There



seems to be some level of consensus the literature on the positive relationship between the firm's size and the quality of its financial reporting process. The reasons for this according to studies (Bujaki and Richardson, 1997) is that large firms are more willing to reduce information asymmetry and thus reduce their political costs since their size makes them quite visible in the corporate environment and could make them an easy target for litigation and other regulatory sanctions.

Growth again demonstrated positive and significant relationship with earnings management confirming growth's insensitive nature to model specification. This gives interesting results as firm size has negative relationship with earnings management growth which also means increase in size exhibited positive relationship. The difference may be due to difference in the proxies used to measure growth and firm size. The positive effect of growth on earnings management once again confirms the assertion of (Healy and Wahlen 2002), where the authors observed that when the compensation of a manager depends on the results of the company, there will be an incentive to manage the earnings in a positive way.



Turnover again exhibited positive relationship with economic growth in the presence of IFRS, auditor type and firm size confirming its robustness, and insensitive to the model specification. However, debt differs from our previous findings where it exhibited all negative relationship with earnings management (Column 3,4, and 5) and this effect is significant, robust but sensitive to model specification compared to our earlier findings in Table 4.4 and Table 4.3. Lopes and Rodrigues (2007) indicated debt linkage with agency cost theory. According to the authors,

higher level of debt induces more agency costs, and compliance IFRS which in turn reduces earnings management. Cashflow from operations maintain it positive effect on economic growth which is again significant and robust.

On model adequacy, our failure to accept the null hypothesis again based on the Sargan test indicates that our test for over-identifying restrictions supports the validity of the instruments.

Our serial correlation tests reject the null hypothesis of absence of first-order correlation. We also do not find support for existence of second-order correlation. Our overall models are significant at conventional levels given the high Wald test statistics and their associated low p -values. Thus, the findings presented in this study are coherent and consistent on the back of valid instruments.

4.4 Conclusions

In our objective one relative to pre-adoption period, the adoption of IFRS decreases EM and the probability for earnings management increase is reduce. From the results, we found out that IFRS has negative effect on earnings management and this effect is significant, robust and insensitive to model specification.

Also, we noticed that when auditor type is employed as the only independent variable in objective two, there is positive relationship between auditor type and earnings management where companies audited by the reputable auditing firms have more earnings management compared to companies audited by less reputable audit firms.

Finally there is negative relationship between firm size and earnings management where 1% increase in firm size reduces earnings management by 0.0139% and this effect is significant and robust.



CHAPTER FIVE

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

This chapter presents the summary, conclusions and recommendations of the study. It begins with, an overview and summary of the study. Conclusions are drawn based on the findings of the study, and the study objectives followed by recommendations to help improve IFRS and Earnings Management discussions.

5.2 Summary of Findings

IFRS is to enhance, transparent and consistence in financial reporting by companies regardless of their country of origin.

The financial reporting process in Ghana is influenced by factors such as law, politics, economy, educational systems and international relations. Researches have been conducted on the impact of IFRS and whether the compliance of IAS /IFRS has improved accounting quality and in their


findings has agreed that the compliance of IFRS has indeed reduce earnings management and improve accounting quality. Earnings management has become a significant issue in the accounting literature and has attracted much research attention. The topic is an important issue for academics and practitioners (Dechow and skinner 2011) since earnings management can mislead stakeholders, and thus the earnings management literature is extensive. A review of the literature in this thesis shows that a range of incentives available for managers to engage in Earnings Management. Managers can manage earnings for the sake of huge compensation benefits. Managers may also indulge in earnings management to avoid the penalties associated



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with breaching debt covenants, or to avoid governmental and other regulatory interference. Also, earnings can be managed to inflate stock prices prior to initial public offerings and seasoned equity offerings in order for the firm to be able to issue shares at higher prices. The study was based on a sample of 19 non-financial listed companies on the Ghana stock exchange market considering that they have to report their individual financial statements using the IFRS accounting measures. In order to be in line with the purpose of research, a comparison between the variability of the residuals of net profit the residuals of accruals was tested using the GMM sargan two step approach. On the strength of association, IFRS correlates weakly with all the variables albeit positive relationship with growth and debt variables with the rest correlating negatively. Excluding turnover, firm size has weak relationship with all the variables. On the direction of effect, firm size correlates negatively with net profit, growth and debt with remaining variables having positive correlation. The study made a number of findings which are detailed below;

5.2.1 Determine the relationship between IFRS and Earnings Management

 The first objective sought to determine the relationship between IFRS and Earnings management of firms on the GSE and specifically asking for the impact between the two main variables. From the results, we found that IFRS has negative effect on earnings management and this effect is significant, robust and insensitive to model specification. Thus, relative to pre-adoption period, the adoption of IFRS decreases EM and the probability for earnings management increase is reduce. The reduction in earnings management resulting from IFRS is huge when we control for growth and debt but less when we control for turnover and cash flow.

5.2.2 To examine the relationship between Auditor Type and Earnings Management

We noticed that when auditor type is employed as the only independent variable, there is positive relationship between auditor type and earnings management where companies audited by the reputable auditing firms have more earnings management compared to companies audited by less reputable audit firms. This is quite fascinating as we expected that companies audited by the BIG 4 auditing firms have lower chance of manipulating their financial reports compared to companies working with other auditing firms. This results confirms some of the corporate accounting scandals that have occurred in the last decade around the world in the United States, Europe, Asia and Africa and some of the recent 2018 headlines we have seen, such as “FRC takes Deloitte to tribunal for \$5 billion Autonomy scandal and KPMG fined £2.1m for misconduct over work for Ted Baker”

5.2.3 To evaluate the relationship between firm size and earnings management

There is negative relationship between firm size and earnings management where 1% increase in firm size reduces earnings management by 0.0139% and this effect is significant and robust. By implication large firms already have their brand accepted and are major players in their industry of operation hence finds no need to massage their financials. Also, as a firm grows, their operations are strengthened which leads to accurate financial reporting. Larger firms are also perceived to be important economic entities and therefore have greater demands placed on them to provide quality financial reports which reduce earnings management. The larger the firm the less likely they may want to engage in creative accounting practices and the more likely they will be concerned with improving the quality of financial reporting.

5.3 Conclusion

The purpose of this study was to examine whether mandatory adoption of IFRS by Ghanaian listed companies is associated with lower earnings management. Another objective was to determine if some firms' features, size and auditor type explain or not the earnings management. The first objective sought to determine the relationship between IFRS and Earnings management of firms on the GSE and specifically asking for the impact between the two main variables.

The second objective sought to ascertain the effect of auditor type on earnings management. We conclude that when auditor type is employ as the only independent variable, there is positive relationship between auditor type and earnings management where companies audited by the reputable auditing firms have more earnings management compared to companies audited by less reputable audit firms. This is quite fascinating as we expected that companies audited by the BIG 4 auditing firms have lower chance of manipulating their financial reports compared to companies working with other auditing firms.



The third and final objective sought to explore the impact of firm size on earnings management. We conclude that there is negative relationship between firm size and earnings management and this effect is significant, robust and insensitive to model specification.

We also noticed that the lagged effect of earnings management on the current earnings management is dependent on the model specification. On the control variables, growth had

positive effect on earnings management which is significant, robust and insensitive to model specification.

We found that turnover and cash flow from operations have positive effect on earnings management and this effect is not sensitive to model choice. However, the effect of debt on earnings management is dependent on the model specification

5.4 Policy implications and Recommendations

Based on the conclusions the following recommendations are made:

There are several recommendations that can be made for future research in the field of IFRS and earnings. First, in addition to examining the for only listed firms on IFRS and earnings management, future research should also employ for private firms and SMEs since they also adopt IFRS and IFRS for SMEs. Similar search should be done for financial firms on the listed companies. The recent collapse of banks due to unstable liquidity will be a fascinating to search

on EM on such firms in Ghana.



In fact, because of the relatively newer environment of the introduction of IFRS in Ghana, our findings suggest that a stronger enforcement mechanism for the implementation of IFRS must be instituted to ensure its positive impact on the quality of accounting information. The Institute of Charatered Accountants Ghana should intensify their enforcement and with due diligent exercise professionalism before issuing license to some of these auditing firms. A review and regular check ups , coupled with Continuos Development Programs for auditing firms and Accountans

who are managers should be improved. Our results also may help standard setters to improve the process of reinforcement of IFRS for all Ghanaian companies.

Regulatory bodies in Ghana should pay much attention to the auditing firms since the size, reputation and other good will of an auditing firm do not necessarily translate into reduction in earnings management. Regulatory bodies should ensure strict adherence to the auditing standards set out in the country as well as IFRS.

Contribution to literature

Our paper contributes to the prior literature examining the adoption of IFRS in several ways. First, we present evidence on the effects of mandatory adoption of IFRS on EM in Ghanaian listed companies. By focusing on Ghana, we study a country which has undergone a major change from following GAAP to IFRS. Analysis of mandatory adoption effect of IFRS in Ghana has allowed us to avoid this bias, since the compulsory nature of the change across all Ghanaian companies has removed any sample selection bias. In fact, the convergence of accounting practices requires effective implementation and enforcement of accounting standards (Ball et al., 2003; Burgstahler, Hail, & Leuz, 2006). The study results contribute to the current debate on whether high quality standards are sufficient and effective in Ghana.

The study results should be of interest to all parties seeking to evaluate the costs and benefits of adoption of IFRS, as they suggest a reduction of earnings management level and consequently some improvements in the quality of accounting information. In highlighting the presence of



improvement in financial reporting quality, these findings are potentially useful for a number of organizations and decision makers, including accounting standards setters, governments, financial markets regulators and investors, preparers and users of accounting information. Furthermore, the study results useful for, financial analyst's investors, and practitioners regulatory and authorities since the study provides insight into the factors some variables that influence Earnings management.



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