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Earnings and Impression Management in Financial Reports: The Case of CEO Changes

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Abstract

This article examines earnings management, as well as the presentational format of graphs (impression management) in the financial reports of sixty-three Australian listed public companies that changed chief executive officers (CEOs). Prior U.S. evidence generally suggests downward earnings management in the year of senior management changes and upward earnings management in the following year (Pourciau, 1993). We argue that new managers not only have incentives to manage earnings but also have similar incentives to manipulate the impressions created by graphs in financial reports. Examining earnings and impression management at the same time also provides an opportunity to distinguish between alternative explanations for any observed earnings management. In the year of CEO change, we hypothesize and find evidence of downward earnings management and some limited evidence of unfavourable impression management of the key financial variables (KFVs) graphed. As posited, we find evidence of upward earnings management and some evidence of favourable impression management in the year after a CEO change. These results are strongest for the subsample in which the CEO change was prompted by a resignation rather than a retirement.

Citing Literature

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