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Earnings management under German GAAP versus IFRS

Brenda van Tendeloo & Ann Vanstraelen

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These findings contribute to the current debate on whether high quality standards are sufficient and effective in countries with weak investor protection rights. They indicate that voluntary adopters of IFRS in Germany cannot be associated with lower earnings management.

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Notes

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commercial income in order for them to be tax deductible, but when reported as a 'special item with equity element' the depreciated asset can be represented in the balance sheet with its 'real commercial book value'. Companies are however not obliged to report tax induced higher depreciations this way. According to a 1987 study, less than one-quarter of the German companies actually do so (Haller, [1992](#)).

⁴First time applications of IFRS could not have its full effect yet or result in substantial changes in the computations of earnings causing high abnormal accruals that would incorrectly be attributed to earnings management.

⁵Average adjusted R^2 is 30% and ranges from 0.2 to 77%.

⁶While most earnings management studies assume earnings are managed for opportunistic reasons, the exercised discretion can also be used to signal private information and thus reduce information asymmetry (e.g. Subramanyam, [1996](#)). However, because accounting systems likely underreact to economic shocks, using accruals to signal firm performance results on average in a less negative (and in specific cases even positive) correlation with cash flows (Leuz et al., [2003](#)).

⁷This variable appears to be highly significant in the IFRS model ($p < 0.01$).

⁸Non-parametric tests (Wilcoxon Mann-Whitney test) yield the same result regarding the discretionary accruals but indicate a significant ($p = 0.016$, two-tailed) difference between the two groups regarding accruals.

⁹Non-parametric tests yield similar results.

¹⁰As measured by the amount of excessive depreciation, firms that report certain profits in tax returns are more likely to have accrued profits. It is argued that certain profits are not reported due to limitations, but are filtered out because they are not reported. This is not true for all firms.

¹¹Firms that switch from US GAAP to IFRS or vice versa are more likely to have accrued profits.



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