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# Earnings management under German GAAP versus IFRS

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Pages 155-180 | Published online: 12 Apr 2011

▶ https://doi.org/10.1080/0963818042000338988 **66** Cite this article

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erman GAAP.

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.

## Acknowledgements

The authors are grateful for the comments received from Bill Rees, Christian Leuz, the participants of the 26th Annual European Accounting Association Congress 2003 in Sevilla, the participants of the 2003 European Institute for Advanced Studies in Management (EIASM) Workshop on implementing IFRS in Brussels, Workshop participants of the University of Amsterdam and the Catholic University Leuven, the participants of the Business Economics Seminar of the University of Antwerp and the participants of the 2004 Doctoral Colloquium of the European Accounting Association. Thanks also to Rick Cuijpers and an anonymous reviewer.

## Notes

<sup>1</sup>For con tional audit firm net nergers resulted <sup>2</sup>Conser et conserv vmmetric timeline equity. rnings than Earn good ne <sup>3</sup>Tax-free tance for realized new assets in the ne ted as income ssive deprecia nus reduce

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).

<sup>4</sup>First 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.

<sup>5</sup>Average adjusted R <sup>2</sup>\_is 30% and ranges from 0.2 to 77%.

<sup>6</sup>While 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, <u>1996</u>). 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., <u>2003</u>).

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

<sup>8</sup>Non-parametric tests (Wilcoxon Mann-Whitney test) yield the same result regarding the discr ifference betweer ing accruals. <sup>9</sup>Non-pa similar results. <sup>10</sup>As me g excessive deprecia rtain profits ccruals in tax red that mea limitations, certain e filtered all of the out beca ves. <sup>11</sup>Firms ner IFRS or **US GAAF** 

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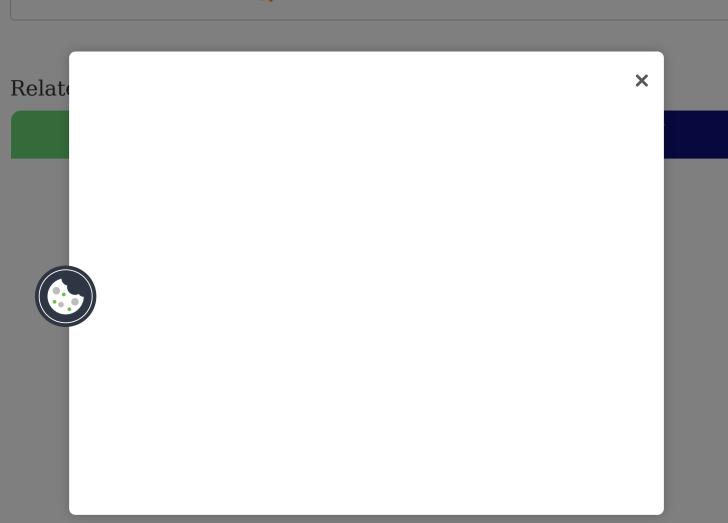
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