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The Effect of Mandatory Adoption of IFRS on Transparency for Investors

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Abstract

This paper examines the effect of the mandatory adoption of the International Financial Reporting Standards (IFRS) on transparency for investors by measuring the increase in earnings management during the post-adoption period of IFRS. One sign of earnings management is current year earnings being only slightly higher than the previous year's earnings. An increase in earnings management means a decrease in accounting quality and a decrease of transparency for investors. By comparing firms that mandatorily adopted IFRS to similar benchmark firms in terms of strength of legal enforcement, book-to-market ratios, market values and net incomes, I am able to run empirical regressions examining variables of growth, equity issuance, leverage, debt issuance, turnover, size, cash flow, and time period in order to determine the effect of the adoption on IFRS on earnings growth. After looking at 516 firms from 20 countries for the years of 2002-2007, I conclude that IFRS is decreasing financial reporting quality and decreasing transparency for the investing public, and therefore is not accomplishing its goal of bringing efficiency, accountability, and transparency to global financial markets.

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I. Introduction

The International Financial Reporting Standards (IFRS) were developed to attempt to create a single set of high quality global accounting standards. In order to test whether IFRS actually achieves this goal of high quality standards, one may explore the change in earnings management for firms that adopted IFRS. Earnings management can be described as management taking advantage of accounting techniques and using them to portray an overly positive financial position ("Earnings Management"). If there is an increase in earnings management, there is a decrease in financial reporting quality. Using sustaining the previous year's income as a threshold for earnings management, this study explores whether the adoption of IFRS increases or decreases earnings management. By matching firms that mandatorily adopted IFRS to benchmark firms by comparing strength of legal enforcement, book-to-market ratios, market values and net incomes, I am able to run empirical regressions using variables of growth, equity issuance, leverage, debt issuance, turnover, size, cash flow, time, and IFRS in order to determine the effect of the adoption of IFRS on earnings management. Surprisingly, the results show that when countries mandatorily adopted IFRS in 2005, earnings management increased and accounting quality decreased. I come to the conclusion that the adoption of IFRS decreases transparency for investors due to an increase in earnings management.

In 2001 the International Accounting Standards Board (IASB) replaced the International Accounting Standards Committee with the intention of better serving the public interest. Since the establishment, the IASB has continuously developed the International Financial Reporting Standards and as of 2018, approximately 120 countries have adopted these standards ("IFRS FAQs."). However, some powerful and influential

countries such as the United States and China still use a set of their own domestic accounting standards. For the United States, this is the U.S. Generally Accepted Accounting Principles (GAAP).

The United States, which has the largest capital market in the world, is reluctant to adopt IFRS. On the U.S. Securities and Exchange Commission's strategic plan for 2014-2018, the SEC stated that it will "continue to promote the establishment of high-quality accounting standards in order to meet the needs of investors. Due to the increasingly global nature of capital markets, the agency will work to promote higher quality financial reporting worldwide and will consider, among other things, whether a single set of high-quality global accounting standards is achievable" (Bogopolsky 2015). Although this plan hinted towards the U.S. adopting a set of global standards such as IFRS, as we reach the end of 2018, it does not seem likely that the U.S. will be adopting IFRS in the near future.

The U.S. and all countries that use IFRS have the same objective, "to develop a set of standards that will bring transparency, accountability and efficiency to financial markets around the world" ("IFRS-Home"). In order to know if IFRS is truly beneficial for financial reporting quality we must first understand the differences between IFRS and other accounting standards such as U.S. GAAP. The main differences between U.S. GAAP and IFRS are listed in Table 1.

Table 1. Main Differences between U.S. GAAP and IFRS

Topic	U.S. GAAP	IFRS
Classification of Liabilities	Current liabilities are expected to be settled within 12 months and noncurrent liabilities are expected to be settled after 12 months.	There is no differentiation between classifications of liabilities (all debts are considered noncurrent).
Consolidation	Prefers a risks-and-rewards model.	Favors a control model.
Development costs	Development costs are considered expenses.	Development costs can be capitalized if certain criteria are met.
Earnings-per-Share	The computation of EPS averages the individual interim period incremental shares.	The earning-per-share calculation does not average the individual interim period calculations.
Fixed Assets	Fixed assets must be valued using the cost model (take into account historical value minus accumulated depreciation).	The revaluation model (fair value at the current date minus accumulated depreciation and impairment losses) is used for fixed assets.
Intangibles	Intangibles are recognized at fair value.	Intangibles are recognized if the asset will have a future economic benefit and has a certain measure of reliability.
Inventory	Companies have the choice between LIFO and FIFO.	LIFO cannot be used.
Quality Characteristics	Works within a hierarchy of characteristics like relevance, reliability, comparability, and understandability to make informed decisions based on user-specific circumstances.	Works within the same characteristics as GAAP with the exception that decisions can not be made on the specific circumstances of an individual.
Statement of Income	Extraordinary items are shown separately under the net income.	Extraordinary items are not segregated and are included in the income statement.

(Forgeas 2008); ("IFRS and GAAP Accounting: Top 10 Differences & Effects on Business")

The United States may want to consider adopting IFRS in order to have a single set of globally-accepted accounting standards. This will allow for easier investing for non-U.S. stakeholders in U.S. firms and easier investing for U.S. investors in non-U.S. firms. Non-U.S. stakeholders sometimes require audited financial statements and budget and management information prepared under IFRS from U.S. firms. If U.S. firms had the same accounting standards as most other countries, it would be easier for all stakeholders to make investment decisions and would improve efficiency in markets.

If IFRS truly increases financial reporting quality, then the US, among other countries, should adopt this set of accounting standards. Increasing accounting quality leads to more transparency between firms and investors, leading to better investment decision-making.

Since it is generally accepted that an improvement of accounting quality is defined as a feature that reduces earnings management, it is necessary to assess IFRS effect on earnings management. One proxy for earnings management is sustaining the previous year's income. If the current year's income is only slightly above the previous year's earnings, then the manager could have managed earnings to present an overly positive view of the firm's financial position. This could possibly alter investment decisions and mislead investors. To truly know whether IFRS is increasing quality of financial statements, it is necessary to determine the effect IFRS has had on year over year income.

The next section analyses current literature and discusses the gap in the literature that needs to be filled. Next will be the explanation of the data and the methodology used

to run the empirical regressions. Once the results are obtained, the findings and its implications on investors will be discussed.

II. Literature

120 countries have adopted IFRS as their own domestic financial reporting standards. Since IFRS spans much of the world, and there are so many stakeholders that are affected by the standards, many researchers are interested in the financial effects that IFRS have on firms and their stakeholders. The stakeholders, including all financial statement users, should have the confidence that the IASB is providing the best standards that truly benefit the public. In order to do so, IASB hopes to continuously increase financial reporting quality.

Through empirical study, Degeorge, Patel, and Zeckhauser (1998) find that there are three thresholds for earnings management. These include sustaining recent performance, positive profits, and meeting the market's expectations. Brown and Caylor (2005) also find these to be the main thresholds of earnings management and find meeting the market's expectations to be at the top of the threshold hierarchy in the early 2000's. The current literature discussing the effect of IFRS on accounting quality has mainly focused on positive profits and meeting the market's expectations, therefore leaving a knowledge gap in the literature when it comes to the effect of IFRS on the threshold of firms sustaining recent performance.

Barth, Landsman, and Lang (2008) investigate 327 firms between 1994 and 2003. The study suggests IFRS can lead to improvements in accounting quality by removing some accounting options that managers can use to manipulate earnings. This reduces

managerial discretion and therefore can reduce earnings management and improve financial reporting quality. To account for earnings management, the study uses three metrics for income smoothing (variability of the change in net income scaled by total assets, ratio of the variability of the change in net income to the variability of the change in operating cash flows, and correlation between accruals and cash flows) and one metric for managing earnings towards a target (positive or negative net income). Barth, Landsman, and Lang (2008) conclude that the adoption of international standards decreases earnings management and therefore increases accounting quality.

Horton (2013) confirms Barth, Landsman, and Lang's findings by also examining the effect of IFRS on earnings management. Horton however uses the threshold of meeting analyst benchmarks. Horton discovers that there is an improvement in analyst forecast accuracy after the adoption of the international reporting standards. If there is an increase in analyst forecast accuracy, there is also an increase in transparency for financial investors and therefore an increase in accounting quality.

Ahmed, Neel, and Wang (2012b) looked at the preliminary effects of mandatory adoption of IFRS on accounting quality and found contrasting results to both Horton (2013) and Barth, Landsman, and Lang (2008). Examining a wide set of firms from 20 countries that adopted IFRS in 2005 and matching them to firms that did not adopt IFRS, they focus on finding the effect on income smoothing, reporting aggressiveness, and earnings management. The study looks at earnings management by focusing on two thresholds, positive earnings and beating analyst forecasts benchmarks, the same two thresholds that Horton (2013) and Barth, Landsman, and Lang (2008) analyze. Although

Ahmed, Neel, and Wang hypothesize that accounting quality does not change after the mandatory adoption of IFRS, the research concludes IFRS adoption results in a decline in accounting quality. Although their research finds no change in meeting earnings targets for IFRS firms, there is evidence of accrual aggressiveness, income smoothing, and decrease in timeliness of loss recognition. Ahmed concludes that IFRS decreases accounting quality.

Ahmed, Chalmers, and Khlif (2013a) also provide a meta-analysis of IFRS adoption effects. They investigate financial reporting effects, specifically looking at quality of analysts' earnings forecasts. By meta-analyzing 14 studies, they confirm their hypothesis and Horton's findings that analysts forecast accuracy has increased significantly since the adoption of IFRS, allowing for more transparency.

Some of the studies mentioned above use data from companies that voluntarily adopted IFRS and some of the studies use data from companies that mandatorily adopted IFRS. In Ahmed, Neel, and Wang's preliminary evidence, only mandatory adoptions are used in the regressions while Barth (2008) consider voluntary adopters also. Ahmed, Neel, and Wang argue that Barth's findings cannot be generalized to mandatory adopters since voluntary adopters have a stronger incentive to report higher quality financials since they chose to adopt IFRS. Besides Ahmed, Neel and Wang's study, the only other relevant research that looks at mandatory adoption is from Chen (2010). Chen researches discretionary accruals of 15 firms between 2000 and 2007 and finds that after the mandatory adoption of IFRS, the discretionary accruals decrease significantly. This means that after IFRS adoption, there is less earnings management towards a target,

which means there is higher quality of financial reporting after IFRS. This contradicts Ahmed, Neel and Wang's findings that IFRS actually reduces the quality of financial reporting. More research needs to be completed before one could be able to draw a sufficient conclusion.

Several studies, as mentioned, explore the mandatory adoption of IFRS on meeting analysts' expectations and reporting positive income, but there has been no research specifically looking at sustaining the previous year's earnings. This motivates us to research the effect of IFRS on this threshold. If a firm reports a year's earnings that are slightly more positive than last year's earnings, it is likely that there is earnings management occurring and therefore financial reporting quality is declining.

This paper will research the effect of the adoption of IFRS on earnings management by looking at year over year earnings scaled by total assets. Since there is limited research on mandatory adoption of IFRS on earnings management, this paper will look exclusively at mandatory adoption of IFRS instead of voluntary adoption of IFRS. This paper will provide further empirical analysis on the benefits of IFRS as an international standard. By researching the effect of the mandatory adoption of IFRS on sustaining previous year's earnings, I fill a gap in the current literature.

III. Data

This study uses data of earnings growth to further explore the effect of IFRS on earnings management. To explore sustaining previous year's income as an earnings benchmark, firms that mandatorily adopted IFRS will be matched and compared to

benchmark firms that did not adopt IFRS. The firms will first be matched based on their strength of legal enforcement.

Ali and Hwang (1999) found that countries with stricter legal enforcement tend to have higher quality accounting. Other researchers have confirmed this such as Burgstahler, Hail, and Leuz's study (2006). For the strength of legal enforcement, a value of 0 for weak legal enforcement countries and a value of 1 for strong enforcement countries have been assigned to each country. This study uses Ahmed's values for each country's strength of legal enforcement. Ahmed uses the rule of law variable for the year 2005 to assign the values. The rule of law variable captures "perceptions of the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, property rights, the police, and the courts, as well as the likelihood of crime and violence" (Kaufmann et al. 2007). If Ahmed found that a country scored above a 1.30 then the country is considered to have strong legal enforcement, and if the country scored below a 1.30 then the country was considered to have weak legal enforcement. Table 2 shows the legal enforcement scores of the countries in the data set after removing firms with missing data.

Table 2: Legal Enforcement Values

Country	Rule of Law Score	Legal Enforcement Where 1= Strong
IFRS		
Australia	1.7	1
Austria	1.8	1
Belgium	1.4	1
Denmark	1.9	1
Finland	1.9	1
France	1.3	1
Germany	1.7	1
Greece	0.7	0
Hong Kong	1.5	1
Italy	0.5	0
Ireland	1.6	1
Netherlands	1.7	1
Norway	1.9	1
Philippines	-0.4	0
Portugal	1.1	0
Spain	1.1	0
South Africa	0.2	0
Sweden	1.8	1
Switzerland	2.0	1
United Kingdom	1.6	1
Benchmark		
Argentina	-0.55	0
Brazil	-0.5	0
Canada	1.8	1
Chile	1.2	0
India	0.1	0
Israel	0.7	0
Japan	1.4	1
Korea Rep.	0.8	0
Malaysia	0.6	0
Mexico	-0.5	0
New Zealand	1.9	1
Pakistan	-0.9	0
Taiwan	0.9	0
Thailand	0.1	0
United States	1.5	1

(Ahmed et. al. 2012b)

Once matched on legal enforcement strength, the firms will then be matched based on size, performance, and book-to-market. The equation is shown below where MV=Market Value, BTM=Book-to-market, and NI=Net Income. Subscript "I" refers to IFRS firms and subscript "B" refers to benchmark firms.

$$\left(\frac{MV_I - MV_B}{MV_I}\right)^2 + \left(\frac{BTM_I - BTM_B}{BTM_I}\right)^2 + \left(\frac{NI_I - NI_B}{NI_I}\right)^2 \quad (1)$$

The firms will be matched by which benchmark firm minimizes equation (1) for each IFRS firm. Once an IFRS firm and a benchmark firm are matched, they are unable to be matched to any other firms (matched without replacement). This basis of matching which allows us to control for differences in market value of equity, book value of equity, and net income, comes from Johnson, Moorman, and Sorescu (2009) and is also used by Ahmed Neel and Wang (2012b).

After matching the firms and deleting any firms that were left unmatched, empirical regressions on earnings growth will be run. By looking at the growth of current year's earnings, and determining whether that earnings increase is less than 0.5%, 1%, and 1.5% of total assets, it is possible to see if earnings management has occurred. Three percentages are used because there is not a universal threshold and it is preferable to test the data at three levels of significance and see if each percentage will give a similar result. Of each of the three equations below, I will run an ordinary least squares regression and a probit model regression. The ordinary least squares regression finds the betas of variables on a linear function by minimizing the sum of the squares of the difference of the observed dependent variable and the predicted dependent variable given by the function. The probit model is a type of regression that only allows the dependent

variable to take two values. In this case the value of earnings increase can either be less than the specified percentage of total assets or more than the specified percentage of total assets. The variables are defined on the next page in table 3.

$$HalfofAsset = \beta_1 IFRS + \beta_2 Post + \beta_3 PostIFRS + \beta_4 Growth + \beta_5 Eissue + \beta_6 Lev + \beta_7 Dissue + \beta_8 Turn + \beta_9 Size + \beta_{10} CF + \varepsilon \quad (2)$$

$$OneofAsset = \beta_1 IFRS + \beta_2 Post + \beta_3 PostIFRS + \beta_4 Growth + \beta_5 Eissue + \beta_6 Lev + \beta_7 Dissue + \beta_8 Turn + \beta_9 Size + \beta_{10} CF + \varepsilon \quad (3)$$

$$OneandHalfofAsset = \beta_1 IFRS + \beta_2 Post + \beta_3 PostIFRS + \beta_4 Growth + \beta_5 Eissue + \beta_6 Lev + \beta_7 Dissue + \beta_8 Turn + \beta_9 Size + \beta_{10} CF + \varepsilon \quad (4)$$

Where:

Table 3: Variables

Variables	
IFRS= $\begin{cases} \textbf{1 if a mandatory IFRS adopter} \\ \textbf{0 if for a benchmark firm} \end{cases}$	**Lev=** $\frac{\text{End of Year Total Liabilities}}{\text{End of Year Average Total Assets}}$
Post= $\begin{cases} \textbf{1 if in 2006 – 2007} \\ \textbf{0 if not in 2006 – 2007} \end{cases}$	**Dissue**=%Δ in Total Liabilities
PostIFRS= Post*IFRS	**Turn=** $\frac{\text{Sales}}{\text{End of Year Total Assets}}$
Growth= %Δ in Sales	**Size=** Natural Logarithm of Average Total Assets
Eissue= %Δ in Common Stock	**CF=** $\frac{\text{Net Cash Flow from Operating Activities}}{\text{Average Total Assets}}$
Halfofassets= $\begin{cases} \textbf{0 if Earnings Growth} < \textbf{0.5\% of Total Assets} \\ \textbf{1 if Earnings Growth} > \textbf{0.5\% of Total Assets} \end{cases}$	**OneofAsset=** $\begin{cases} 0 \text{ if Earnings Growth} < 1\% \text{ of Total Assets} \\ 1 \text{ if Earnings Growth} > 1\% \text{ of Total Assets} \end{cases}$
OneandHalfofAsset== $\begin{cases} \textbf{0 if Earnings Growth} < \textbf{1.5\% of Total Assets} \\ \textbf{1 if Earnings Growth} > \textbf{1.5\% of Total Assets} \end{cases}$	

The data comes from a widely known database dedicated to financial, statistical, and market information on global companies, Compustat Global. After the data is compiled and the firms are matched, I am able to conduct the regression analysis.

After removing firms that did not have all sales, common stock, liabilities, assets, net cash flow from operating activities, book-to-market ratio, market value, net income, accounting standard, and date data for the years 2002-2007, and matching the IFRS firms to similar benchmark firms using equation (1) above, there are 516 firms from 20

countries that are left to run the regression. Most countries adopted IFRS in 2005 and therefore by using years 2002-2007 I can examine the pre and post adoption periods.

To deal with outliers, on each tail, 5% of the observations were modified. Summary statistics for the variables can be found in Table 4 below and the univariate correlation between the variables can be found in Table 5.

Table 4: Summary Statistics for Independent and Dependent Variables

	Mean	Standard Deviation	25th Percentile	50th Percentile	75th Percentile
IFRS	0.50	0.50	0	1	1
Post	0.33	0.47	0	0	1
Post IFRS	0.17	0.42	0	0	1
Growth	0.07	0.17	-0.02	0.05	0.14
Eissue	0.03	0.09	0	0	0.01
Lev	0.56	0.19	0.43	0.56	0.69
Dissue	0.07	0.24	-0.08	0.02	0.15
Turn	0.96	0.55	0.55	0.86	1.26
Size	8.05	2.30	6.48	8.04	9.64
CF	0.09	0.07	0.05	0.09	0.13

Table 5: Univariate Correlation Between Variables

	IFRS	Post	Post-IFRS	Growth	Eissue	Lev	Dissue	Turn	Size	CF
IFRS	1.00									
Post	0.06	1.00								
PostIFRS	0.32	0.83	1.00							
Growth	-0.14	0.10	0.05	1.00						
Eissue	-0.09	0.02	-0.01	0.18	1.00					
Lev	0.21	-0.02	0.07	-0.11	-0.03	1.00				
Dissue	-0.01	0.06	0.05	0.40	0.20	-0.05	1.00			
Turn	0.18	-0.02	0.03	-0.06	-0.10	0.27	-0.09	1.00		
Size	-0.14	0.03	-0.02	-0.05	-0.07	0.13	-0.02	-0.17	1.00	
CF	0.16	-0.02	0.01	-0.08	-0.16	-0.08	-0.03	0.14	0.17	1.00

The correlation table shows that there are no variables that are highly correlated except for the variables that are expected to be highly correlated such as IFRS and PostIFRS with a correlation of 0.32, and Post and PostIFRS with a correlation of 0.83. These are expected to be highly correlated because PostIFRS is simply the product of Post and IFRS.

I hypothesize that the variable PostIFRS will have a positive coefficient with a significant p-value because previous studies have found that the adoption of IFRS increases financial reporting quality. I predict that transparency for investors will increase.

IV. Results

Below are the results for the OLS and probit model regressions on equations (2), (3), and (4) that were defined previously. In the following regression results, examining the PostIFRS variable will show the effect of IFRS on firms post adoption. The cluster-robust standard error is used to account for the within-cluster correlation or heteroscedasticity. The p-value shows the probability that one sees a result as extreme as the one obtained by chance. We will use the p-value to look for significant variables at the 10%, 5%, and 1% levels.

Table 6: Probit and OLS Regression Results with Earnings Increase Criteria

Variable	Coefficient	Cluster-Robust Standard Error	P-Value
Probit with 1.5% Criteria			
IFRS	0.08	0.08	0.32
Post*	0.19	0.12	0.10
PostIFRS*	**-0.20**	**0.13**	**0.10**
Growth	-1.31	0.20	0.14
Eissue	-0.09	0.31	0.76
Lev	0.10	0.15	0.51
Dissue**	0.59	0.14	0.02
Turn	0.05	0.05	0.30
Size	0.05	0.01	0.11
CF*	-1.73	0.43	0.06
Constant	-0.14	0.14	0.30
OLS with 1.5% Criteria			
IFRS	0.03	0.03	0.32
Post*	0.07	0.04	0.09
PostIFRS*	**-0.08**	**0.05**	**0.10**
Growth**	-0.49	0.07	0.02
Eissue	-0.04	0.12	0.71
Lev	0.04	0.06	0.46
Dissue***	0.22	0.05	0.01
Turn	0.02	0.02	0.28
Size	0.02	0.01	0.58
CF**	-0.65	0.16	0.04
Constant***	0.45	0.05	0.01
Probit with 1% Criteria			
IFRS	0.07	0.08	0.42
Post**	0.22	0.11	0.05
PostIFRS**	**-0.25**	**0.13**	**0.05**
Growth	-1.40	0.20	0.19
Eissue	-0.25	0.31	0.42
Lev	0.16	0.14	0.26
Dissue	0.53	0.13	0.12
Turn*	-0.01	0.05	0.10
Size**	0.02	0.01	0.07
CF**	-1.96	0.40	0.03
Constant	-0.07	0.15	0.63

Table 6: Continued

Variable	Coefficient	Cluster-Robust Standard Error	P-Value
OLS with 1% Criteria			
IFRS	0.03	0.03	0.40
Post**	0.09	0.04	0.04
PostIFRS**	**-0.09**	**0.05**	**0.05**
Growth	-0.54	0.07	0.14
Eissue	-0.10	0.12	0.40
Lev	0.07	0.05	0.23
Dissue***	0.20	0.05	0.01
Turn	0.01	0.02	0.91
Size**	0.01	0.01	0.04
CF**	-0.75	0.16	0.03
Constant***	0.47	0.06	0.01
Probit with 0.5% Criteria			
IFRS	0.07	.08	0.41
Post**	0.22	0.11	0.05
PostIFRS**	**-0.25**	**0.13**	**0.05**
Growth	-1.40	0.20	0.11
Eissue	-0.26	0.31	0.42
Lev	0.16	0.14	0.26
Dissue	0.53	0.13	0.31
Turn	0.01	0.04	0.92
Size**	0.02	0.01	0.04
CF**	-1.96	0.41	0.05
Constant	-0.07	0.15	0.63
OLS with 0.5% Criteria			
IFRS	0.02	0.03	0.46
Post	0.07	0.04	0.11
PostIFRS**	**-0.10**	**0.05**	**0.05**
Growth	-0.51	0.07	0.01
Eissue	-0.01	0.11	0.94
Lev**	0.10	0.05	0.04
Dissue	0.18	0.05	0.42
Turn	-0.01	0.02	0.77
Size	-0.01	0.01	0.93
CF**	-0.84	0.16	0.03
Constant***	0.46	0.05	0.01

In all six regressions, the adoption of IFRS decreases the amount of positive earnings growth. The probit and OLS regression for the requirement of earnings growth being less than 1.5% of assets both resulted in negative coefficients for PostIFRS, meaning that the increase in earnings growth was small, and therefore likely due to earnings management. The p-values for the 1.5% criteria were both 0.1, meaning the result is significant at the 10% level. The probit and OLS regression for the requirement of earnings growth being less than 1% of assets also both resulted in negative coefficients for PostIFRS. For these regressions, PostIFRS is significant at the 5% level. Finally, the probit and OLS regression for the requirement of earnings growth being less than 0.5% of assets resulted in negative coefficients for PostIFRS at a level of 5% significance. These results are evidence of a significant increase in earnings management for firms that mandatorily adopted IFRS. It is concluded that after the mandatory adoption of IFRS financial reporting quality and transparency for investors declines. The results did not support my hypothesis.

The more often that current year incomes are barely beating last year's earnings, the more likely that companies are managing their earnings. The smaller the earnings growth and the more earnings management that is occurring, then the less transparent the financial statements are and the worse off investors are. Although this result opposes Ahmed, Neel, and Wang's (Ahmed et al. 2012b) finding that earnings management is not affected by IFRS, it confirms their overall conclusion that IFRS decreases financial reporting quality. Beyond Ahmed, Neel, and Wang's study, this conclusion finds opposing results with most other studies that look at IFRS effect on financial reporting quality.

For investors, these results are very important because if there is a lack of transparency, there is a lack of certainty. Without transparent financials, investors cannot be sure about the risk involved when investing in the company. For example, if, through earnings management, a company is hiding their true debt, then investors may not be aware of the company's true level of bankruptcy risk. This may therefore mislead an investor to invest in the company when they might not have if there was 100% transparency surrounding the firm's financial position.

V. Conclusion

IFRS is not accomplishing its mission to develop standards that "bring transparency, accountability, and efficiency to financial markets around the world." This study examines the effect that the mandatory adoption of IFRS has on accounting quality using earnings growth as a percentage of total assets as a proxy. It looks at a sample of 258 firms from 20 countries that mandatorily adopted IFRS in 2005 and compares those firms to 258 benchmark firms that did not adopt IFRS. The empirical regressions find a significant decline in financial reporting quality for firms that adopted IFRS in 2005. IFRS decreases transparency for investors and therefore negatively affects the investing public. This lack of transparency could alter investment decisions and mislead investors.

This study adds to Ahmed's study (2012b) by researching the third commonly accepted threshold for earnings management, sustaining previous year's income, which Ahmed did not research. I conclude that sustaining previous year's income, unlike positive earnings and analyst consensus earnings forecast, confirms Ahmed's conclusion

that there is a decline in financial reporting quality when countries mandatorily adopted IFRS.

One limitation to this study is that it is assumed that the change in earnings growth is due to managements' judgments rather than a natural result of a change in properties of the accounting standard. Another limitation is that the data only looks at a 2-year post adoption period. In further research, researchers can extend this study to look at the long-term effect of IFRS on earnings management and its implications on investors.

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