Pre and Post IFRS Loss Avoidance in France and the United Kingdom

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Abstract—This paper analyzes the effect of a single uniform accounting rule on reporting quality by investigating the influence of IFRS on earnings management. This paper examines whether earnings management is reduced after IFRS adoption through the use of "loss avoidance thresholds", a method that has been verified in earlier studies. This paper concentrates on two European countries: one that represents the continental code law tradition with weak protection of investors (France) and one that represents the Anglo-American common law tradition, which typically implies a strong enforcement system (the United Kingdom).

The research investigates a sample of 526 companies (6822 firm-year observations) during the years 2000 – 2013. The results are different for the two jurisdictions. This study demonstrates that a single set of accounting standards contributes to better reporting quality and reduces the pervasiveness of earnings management in France. In contrast, there is no evidence that a reduction in earnings management followed the implementation of IFRS in the United Kingdom. Due to the fact that IFRS benefit France but not the United Kingdom, other political and economic factors, such legal system or capital market strength, must play a significant role in influencing the comparability and transparency cross-border companies' financial statements. Overall, the result suggests that IFRS moderately contribute to the accounting quality of reported financial statements and bring benefit for stakeholders, though the role played by other economic factors cannot be discounted.

Keywords—Accounting Standards, Earnings Management, International Financial Reporting Standards, Loss Avoidance, Reporting Quality.

I. INTRODUCTION

THE globalization of the international capital market has generated pressure to increase the comparability and transparency of reported financial performance of companies worldwide. Demand for internationally comparable accounting information has increased significantly in recent years with the growth of cross-country investments. The adoption of a single uniform accounting language would seem to be an appropriate instrument to satisfy this emerging demand. The selected approach to meet these market requirements are International Financial Reporting Standards (IFRS that include old and revised International Accounting Standards, IAS), which are used by the European Union and also by a significant number of other countries.

More than 100 countries have already adopted IFRS on either a mandatory or a voluntary basis. Even the United States of America made a convergent step toward IFRS when the US Securities and Exchange Commission (SEC) agreed to eliminate reconsolidation requirements for non-US companies using IFRS in 2007 [38].

Wide acceptance of IFRS supports the idea that a shared set of accounting standards established to enhance comparability and transparency across different countries is conducive to a more efficient and effective international market. According to the European Union [20], to supplement the applicable legal framework for publicly traded companies, it is necessary to build an integrated capital market which operates more efficiently and smoothly. Nevertheless, despite the benefit of international IFRS implementation, there is evidence that a single unique accounting language plays only limited role in reporting quality e.g. [13], [14], [28],

This paper analyzes whether the adoption of IFRS has an impact on reporting quality, with an emphasis being placed on earnings management. This research contributes to the current debate in two ways. First, it is considered IFRS adoption in two countries. One country represents the continental code law tradition (France) with weak investor protection and the other (the UK) represents Anglo-American common law tradition—a tradition which includes a strong enforcement system and a national UK general accepted accounting principles are closer to IFRS. Secondly, most literature that concentrates on IFRS effect on earnings management (especially that which uses the "loss avoidance" method) considers only short term time-series data. This tendency can be attributed to research limitations and the difficulty of investigating the real net influence of IFRS adoption.

Reference [26] studied the effects of mandatory IFRS adoption during period 2002-2006. Reference [42] investigated whether mandatory IFRS adoption was associated with reduced earnings management in the year 2005 in 15 European countries. The sample period is expanded, as this paper considers 14 accounting years.

From the contradictory research results (e.g. [3], [5], [39]), the net effect of IFRS adoption is still not clear. My findings contribute to the current debate by offering more empirical evidence from France and the United Kingdom. It is investigated the effect that IFRS adoption has on the pervasiveness of earnings management within two European countries during the period 2000-2013. It is investigated loss avoidance in the periods preceding and following IFRS adoption in each country. Overall, it was found that IFRS adoption has only a modest positive impact on earnings management.

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II. METHODS OF DEFECTING EARNINGS MANAGEMENT

The ability to compare financial statements from different countries has become more important with the integration of capital markets and the growing demand for cross-border investment. IFRS have potential to improve reporting quality, contribute to higher effectiveness in international capital markets, decrease information asymmetry, and reduce the cost of capital for firms. That earnings management plays a significant role in this issue is apparent from the extensive amount of research that has been devoted to this topic (e.g. [5], [6], [25], [39], [41]).

Earnings management is an issue that has been researched for several decades in the United States of America, and for this reason most significant studies are addressed to U.S. environments. Lately, it has become a focus of attention both in Europe and around the globe. Reference [37] defines earnings management as *"...purposeful intervention in the external financial reporting process with the intent of obtaining some private gain"*.

Previous literature provides plenty of models showing how to detect and measure the existence of earnings management. According to [13], recent studies (e. g. [19], [23], [29]) use four different proxies to obtain a range of earnings management activities:

- *"the tendency of firm to avoid small losses,*
- *the magnitude of total accruals,*
- *the smoothness of earnings relative to cash flows,*
- *the correlation of accounting accruals and operating cash flow."*

The above method, *magnitude of total of non-discretionary and discretional accruals,* is the one most commonly applied in detecting earnings management e. g. [13]. This paper investigated earnings management as *the tendency of a firm to avoid small losses*. This method is based on the premise of hiding of small financial losses. Following the study [26], this paper examined the frequency of occurrences of small profits and small losses and compared the odds ratios of income before extraordinary items (IBEX) scaled by lagged total assets during the two periods – before and after adoption of IFRS – in two European countries (France and the United Kingdom).

III. ROLE OF IFRS IN EARNINGS QUALITY

Both accounting convergence and information quality [41] have a significant role in corporate reporting globally. European Union Council Directive 78/660/EEC, 83/349/EEC, 86/635/EEC and 91/674/EEC as a previous legal environment do not satisfactorily ensure a high level of transparency and comparability in financial markets. Therefore, the European Union has chosen an International Financial Reporting Standards—an international accounting legal framework—for European Union members as an appropriate approach to meet the increasing demand for more comparable and transparent financial information.

Mandatory adoption of IFRS for listed companies in the EU was an important milestone in accounting history. The regulation change, which signaled movement towards IFRS, might improve the integrity of the capital market, causing higher efficiency and smoothness, enhance cross-border accounting quality of financial statements, and create new expectations for involved parties. Global widespread acceptance by the community of companies participating in financial markets confirms IFRS as truly international standards, which implies increase in convergence of accounting standards [20].

More than 100 jurisdictions, including the G20, have completed IFRS profiles as agreements to require or allow IFRS adoption or to create established timelines for the adoption of IFRS. According to reference [36] 83% of jurisdictions have already required IFRS for most or all of their domestic listed firms. Remaining countries permit IFRS for at least some publicly listed companies (e. g. Japan), require IFRS for financial institutions (e. g. Saudi Arabia), are in progress of adopting the standards (e. g. Thailand) or use national accounting standards (e. g. China).

The significant number of jurisdictions that require or allow IFRS underlines their growing importance. Investors in European Union companies react positively and are aware of net convergence benefits associated with IFRS adoption [4]. Financial analysts, as some of the most important financial statements users, need greater international comparability [39] and lower analysis forecast earnings error [10] which IFRS provide.

There are at least two arguments for an improvement in accounting quality associated with implementing IFRS. Firstly, IFRS require larger disclosure than various national standards, which should reduce cost of capital. Secondly, uniform accounting rules might improve information comparability across companies expecting to decrease cost of capital [31]. Reference [8] indicates that major advantages of IFRS include an expected increased market efficiency, the removal of barriers to cross-border acquisition and a decrease of total investor costs. IFRS might benefit both companies which switch from national accounting standards to IFRS and cross-section companies [17]. Accounting diversity could affect the level of cross-border investment [11].

IFRS contributes to improving reporting quality by increasing the amount of disclosure required of companies and decreasing information asymmetry. Reference [30] found that the information asymmetry component of a company's cost of capital should be reduced by higher disclosure requirements. These requirements, which IFRS ensure, are associated with a high level of legal enforcement. Still, some firms do not meet minimum disclosure requirements [40].

Reference [17] shows evidence that both mandatory and voluntary adoption of IFRS or U.S. GAAP improves reporting quality significantly. Reference [15] confirms that investors benefit from voluntary IFRS adoption and state that capital market effects are more pronounced for voluntary IFRS adopters in the years in which they switch to IFRS than they are for mandatory adopters [18]. But reference [24] is opposed to the idea that benefit for voluntary adopters is greater than that which is gained by mandatory IFRS adopters.

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These findings, and others that are similar, point to the idea that IFRS are beneficial. Other studies, however, suggest that uniform accounting rules play only a limited role in the entire matter (e.g. [13], [28]). The impact of a single set of accounting standards might differ in each particular jurisdiction (e.g. because of national patterns in IFRS application). Systematic differences in accounting practice and IFRS application exist in both trivial and more complex matters [32]. Diversity in IFRS disclosure and compliance issues is consistent with the differential economic effects of IFRS adoption [40]. Similarities between local accounting standards and IFRS have limited some research studies. The effect of IFRS adoption on reporting quality depends on whether IFRS are of lower or higher quality than comparable national accounting standards and how they affect the efficacy of the enforcement mechanism [3]. In some cases, IFRS allows for greater latitude in accounting policies.

To reach the IFRS target of improving reporting quality satisfactorily, the other relevant economic and legal factors must be considered. If these factors are disregarded, IFRS will not necessarily ensure an increase in comparability and transparency of financial statements. Major factors include political and economic components—components which include the strength of capital markets, enforcement mechanisms and legal systems [13] with respect to managers' and auditors' incentives [7]. Absence of effective controls and infrastructure could potentially lead to IFRS failure [16]. Reference [27] examines accounting data for cross-listed firms (European/other), and finds more evidence of earnings management, less evidence of timely loss recognition and a lower association with share price despite the use of the same accounting standards.

The relationship between earnings management and IFRS is a complicated issue, and one that becomes even more complex when one compares countries that have enforced mandatory IFRS adoption with those which have favored a voluntary approach. Regardless of implementation factors, the importance of the relationship has been proven by a great number of research studies (e. g. [3], [5], [6], [9], [14], [16], [21], [26], [39], [41],).

Reference [12] discusses empirical evidence on the economic consequences of mandatory IFRS adoption in the European Union and summarizes financial reporting effects into three categories: compliance and accounting choice studies, accounting properties studies and value relevance studies. They conclude that on the one hand, empirical research on these intended consequences fails to conclusively document enhanced comparability and transparency of financial reporting, and that on the other hand there is a significant amount of evidence showing positive capital-market and macroeconomics effects.

Reference [6] investigated earnings manipulation in 20 European countries during the pre-IFRS period from 1997 to 2003 and during the post-IFRS period from 2006 to 2008, and together these periods showed that earnings manipulation is reduced by IFRS. Reference [9] confirmed IFRS benefit, and concluded that accounting quality increased within companies from the 21 countries that adopted IFRS between the years 1994 and 2003. Authors found out that applying IFRS leads to a decrease in earnings management, a reduced amount of earnings smoothing, a more timely recognition of losses, and more value relevance of accounting amounts than is present when applying non-U.S. domestic standards. Research findings from the study [41] also support the idea that there is advantage to be gained from IFRS adoption. According to these findings, both accounting convergence and higher quality information are likely drivers of the comparability improvement demonstrated within the sample of 17 European countries.

Reference [31] analyzed 6456 firm observations of 1082 European Union companies during the period 1995 – 2005. Research findings support the idea that while shareholders benefit from mandatory IFRS adoption, this benefit critically depends upon the strength of the enforcement system. Reference [5] debates the relative benefit of IFRS regarding the sample from 33 countries during the years 2002 – 2008. Authors investigate domestic accounting standards (U.S. GAAP and non-U.S. DAS) and the IFRS influence on earnings persistence, as well as the relationship with current earnings and future cash flow. They found no significant difference in the persistence of positive earnings reported under IFRS versus those reported according to both U.S. GAAP and non-U.S. DAS standards. Reference [1] states that IFRS adoption enhances the value relevance of three variables (goodwill, research & development expenses, and fixed assets) for investors in equity markets within the European Union.

In contrast, studies such as [26] note that mandatory IFRS adoption in France, the UK and Australia was not accompanied by an improvement in reporting quality, and suggest that instead of simply harmonizing accounting rules, these countries must agree to common goals. Moreover, Australian companies (sample of respondents from 305 firms) do not benefit significantly from IFRS [34]. Reference [14] examines earnings transparency during 2003 – 2006 in 11 European Union countries and supports the high intensity after the adoption of IFRS in Europe.

References [2], [3] present evidence that while the value relevance of book value of equity has not increased adoption, and while discretionary accruals have not been reduced, the financial accuracy of analysts' forecasts have increased significantly after IFRS adoption.

This paper shows evidence from France, as a representative of continental code law tradition and from the United Kingdom, as a representative of the Anglo-American common law tradition. Reference [35] agrees with study [26] that IFRS fail to benefit the UK due to the fact that the UK is a country with a strong enforcement system and national accounting standards that are similar to IFRS. To summarize these two studies, the pervasiveness of earnings management remained constant in the UK and in Australia after IFRS were introduced, and these standards actually caused the amount of earnings manipulation in France to increase. The prevalence of earnings management in Italy did decrease, however, after the country implemented mandatory IFRS adoption. *The research*

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prediction is that International Financial Reporting Standards will decrease the prevalence of earnings management as measured by "loss avoidance thresholds" after their adoption in France and the United Kingdom.

IV. RESEARCH DESIGN

Following the study [26], earnings management is classified into three categories: studies using discretionary accruals (e. g. [14], [19]), studies using specific accruals (e. g. [33]) and studies that use a statistical proportion of earnings to identify thresholds (e. g. [22], [26]).

Because of the difficulty associated with the method that uses discretionary accruals, earnings management is investigated using the third method. It was calculated and analyzed the distributions of earnings for discontinuities by measuring them against thresholds in both France and the United Kingdom. It was wanted to examine whether the ability of companies to avoid small financial losses was impacted by IFRS adoption, and it was done this by comparing the period prior to their adoption with the period after. Similar research studies (e. g. [22], [26]) analyze the distribution of reported earnings, and these studies show that the amount of small losses is abnormally low, and that frequencies of small profit are unexpected high.

Following the study [26], it is tested the "loss avoidance threshold" by analyzing the distribution of income before extraordinary items (IBEX) scaled by accounting variables (total assets). It is categorized firm-year observations as a small loss if income before extraordinary items scaled by total assets fell within range [-0.01; 0). A firm's yearly observation was classified as a small profit if income before extraordinary items scaled by total assets fell within the range [0; 0.01]. With that explanation, it is used the ratio of small reported profits to small reported losses and it is separated the number of observations within the two mentioned intervals as left of zero (small reported losses) and right of zero (small reported profit) for both countries.

It was chosen two European countries for my research: France and the United Kingdom. Firstly, both countries are members of European Union that experienced mandatory IFRS adoption in the year 2005. Despite my research considering mandatory and voluntary IFRS adoption, the assumption that mandatory IFRS adoption was in the same year for both selected countries contributes to research by comparable period length before and after IFRS adoption. Secondly, the chosen countries represent different law traditions. France represents continental code law tradition with weak investor protection and the United Kingdom represents the Anglo-American common law tradition. The UK is a nation with strong enforcement, and there is a close relationship between national UK GAAP and IFRS. Thirdly, they represent significant statistical populations with relatively large numbers of observations.

The research aim was to find out whether IFRS adoption is associated with a lower amount of earnings management. For the research design presented above, it is needed the following data: income before extraordinary items (IBEX) and total

assets.

It was calculated income before extraordinary items scaled by total assets for the years 2000 – 2013 and excluded the year that IFRS were first adopted. The transition year (the first year of IFRS adoption) was excluded because no relevant data were available for the previous accounting period. Within the calculation of IBEX scaled by lagged total assets for year 2005, which uses company reports under IFRS, total assets (2004) would need to be calculated using the same standards. In reality, when companies reported their financial statements under IFRS in the year 2005—the first year of IFRS adoption—they restated their financial statements for 2004 using IFRS as well. Despite the restatements that were required, this 2004 financial data is not available in many databases. Unfortunately, within the Datastream (Thomson Reuters) database, this restated data cannot be accessed. For this reason, data from the first year of IFRS application in each company was excluded.

To determinate the first year of IFRS adoption was important, so it was used the following codes to differentiate accounting standards in Datastream: (1) Local Standards; (2) International Standards; (3) U.S. standards (GAAP); (4) Commonwealth countries standards; (5) EU standards; (6) International standards and some EU guidelines; (7) Specific standards set by the group; (8) Local standards with EU and IASC guidelines; (9) Not disclosed; (10) Local standards with some EU guidelines; (11) Local standards – inconsistency problems; (12) International standards – inconsistency problems; (13) US standards – inconsistency problems; (14) Commonwealth standards – inconsistency problems; (15) EEC standards – inconsistency problems; (16) International standards with some EU guidelines – inconsistency problems; (17) Local standards with some OECD guidelines; (18) Local standards with some IASC guidelines; (19) Local standards with some OECD and IASC guidelines; (20) US GAAP reclassified from local standards; (21) Local standards with a certain reclassification from foreign companies; (22) Other; (23) IFRS.

It was considered that the first year of IFRS application is when the code for "accounting standards followed" is (23) IFRS and as local standards are considered codes (01) Local standards, (10) Local standards with EU guidelines, (17) Local standards with some OECD guidelines, (18) Local standards with some IASC guidelines, (19) Local standards with some OECD and IASC guidelines and (20) Local standards with a certain reclassification for foreign companies. The research sample of companies contains only companies reported firstly under (01), (10), (17), (18), (19) and (20) and secondly compiles their financial statements under IFRS – using code (23).

To maximize the sample size, data for the period spanning from 2000 to 2013 is used. Because extracting financial statements in the first year of IFRS adoption was impossible, observations in the transition year were excluded. Moreover, because the threshold approach is used, it was necessary to compare the same firms before and after IFRS; thus, those companies which did not have at least one observation of

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IBEX lagged by total assets before and after IFRS adoption were excluded, taken together at least two firm-year observations—one in each period examined.

The research sample comprises a total of 526 companies (6822 total firm-year observations, 2557 firm-year observations before IFRS, 3846 firm-year observations after IFRS): 215 (2713, 991, 1566) for France and 311 (4109, 1566, 2280) for the United Kingdom.

V. RESEARCH RESULTS

A. Descriptive Statistics

Descriptive statistics (means and medians) for both selected countries were calcuated. Table I contains variables Income before extraordinary items (IBEX) and Total assets and sample size. Table II presents descriptive statistics (medians, first and third quartiles) for IBEX lagged by total assets.

TABLE I
DESCRIPTIVE STATISTICS (IBEX, TOTAL ASSETS)

Country	France	UK
Number of firms	215	311
Number of observation	2 713	4 109
Mean IBEX	280 971	264 841
Median IBEX	42 936	34 258
Mean Total Assets	32 722 846	20 351 172
Median Total Assets	1 563 000	841 592

In Table I, the means for both IBEX and Total assets are visibly higher than the medians. Because this paper focuses on observations close to zero (small losses and small profits), this extreme difference between the means and medians does not represent any complication.

TABLE II
DESCRIPTIVE STATISTICS (IBEX SCALED BY TOTAL ASSETS)

Country	France	UK
Number of firms	215	311
Number of observations	2713	4109
Number of observations before IFRS	991	1566
p25	0,0104	0,0167
Median	0,0343	0,0529
p75	0,0613	0,0962
Number of observation after IFRS	1566	2280
p25	0,0114	0,0241
Median	0,0375	0,0576
p75	0,0672	0,0992

Table II presents a number of observations both before and after IFRS and other statistics (p25, medians, p75). Because the statistics are slightly higher after IFRS adoption, the it was carried out a Wilcoxon rank-sum test, which is a non-parametric test with a null hypothesis that states the two populations are the same (testing unmatched data). In practice, the Wilcoxon rank-sum test assesses whether medians changed before or after IFRS adoption. The result of this test confirmed that the distributions of medians IBEX/Lagged total assets neither increased nor decreased in either country examined.

B. Distribution of Small Losses and Small Profits

Table I and Table II show descriptive statistics for the entire research sample. To evaluate earnings management using the threshold method, it was considered only observations for which IBEX scaled by lagged total assets was close to zero. It was classified small reported losses as being those in which IBEX scaled by the lagged total assets fell into the range [-0.01; 0), while small reported profits were those in the range [0; 0.01]. In total, it was focused on observations in the range [-0.01; 0.01]. Figures below (Figs. 1 (a) and (b), 2 (a) and (b)) show distributions of IBEX/Lagged total assets for each country divided into two sub-figures: before and after IFRS adoption. The interval width for my histogram is 0.01 (IBEX scaled by lagged total assets).

Both histograms (Figs. 1 and 2) show a significant number of observations immediately to the right of zero, which indicates small reported profit. The interval immediately to the left of zero—small reported losses—contains few observations compared with the intervals to the right of zero, but more observations than the other intervals to the left of zero. The most important factor in my study is the analysis of any changes that occur between the histogram showing observations before IFRS was implemented and that which portrays observations taken after the standards were enforced.
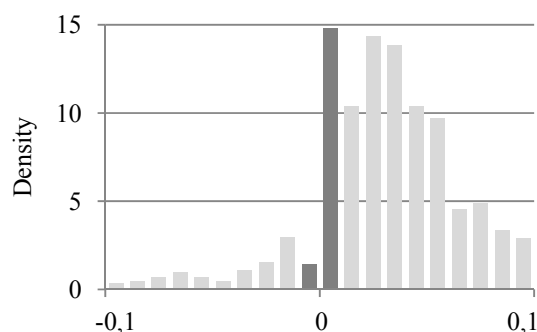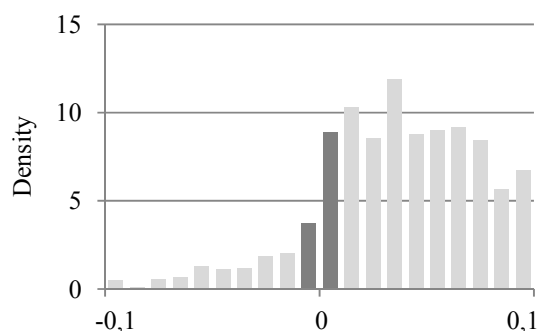

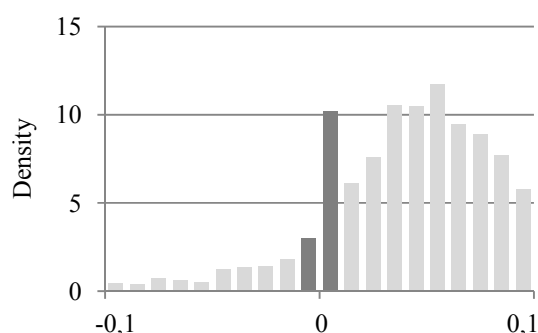(a) FRA before IFRS Adoption (836 firm-year observations)
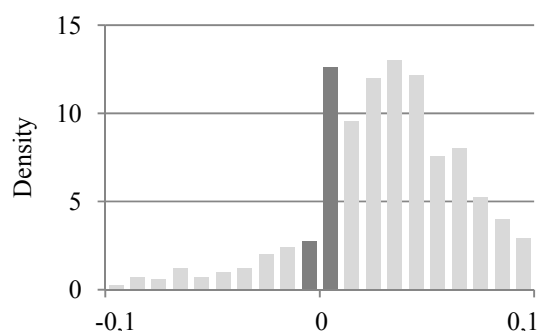
(b) FRA after IFRS Adoption (1298 firm-year observations)

Fig. 1 Loss Avoidance - Distribution of IBEX / Total Assets in France (total 2134 firm-year observations)

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IFRS adoption in France led to an improvement in reporting quality, for while some discontinuities continued to exist, after IFRS adoption their number was moderately lower. The frequency of observations representing small reported losses increased, and the frequency of small reported profits did not visibly changed after IFRS adoption. Change in the density of observations does not tend to increase "loss avoidance behavior" of managers; thus, it was led to accept my null hypothesis. It must been quantified the change in density to accept or reject the null hypothesis (see section *C. Measure of asymmetry*).

(a) UK before IFRS Adoption (1104 firm-year observations)

(b) UK after IFRS Adoption (1537 firm-year observations)

Fig. 2 Loss Avoidance - Distribution of IBEX / Total Assets in the United Kingdom (total 2641 firm-year observations)

Histograms showing observations in the UK also show the existence of discontinuities, for there is a significant increase in small reported profit, but there is no visible difference in small reported losses after IFRS adoption. Thus, the entire change in the situation before and after IFRS adoption needs to be quantified.

C. Measure of Asymmetry

The histograms in Figs. 1 and 2 provide a visual representation of discontinuities, and these discontinuities needed to be measured prior to conclusions being made. It was measured asymmetry as the ratio of small reported profits to small reported losses as was made in study [29]. The classification for small losses is if income before extraordinary items scaled by lagged assets falls into range [-0.01; 0], and

small profits corresponds to the range [0; 0.01].

Table III displays results of the small profits/small losses ratio using odds ratios. Odds ratios represent one of the major methods to quantify how strongly the absence or presence of A is associated with the absence or presence of B. Odds ratios were originally designed for epidemiologists, were widely used in observational studies, and moreover have already been calculated in similar research studies (e. g. [26]). This calculation uses case-control and cross-sectional data to tabulate the odds of failure against a categorical explanatory variable. According to the chance presented in the odds ratio, it can be clarified whether IFRS adoption had significant influence on earnings management.

TABLE III
MEASUREMENT: SMALL PROFITS/SMALL LOSSES

	France	UK
Before IFRS adoption		
Cases (small profit)	124	98
Controls (small loss)	12	41
Odds ratio	1,296	0,276
CI lower	0,685	0,182
CI upper	2,452	0,420
After IFRS adoption		
Cases (small profit)	164	157
Controls (small loss)	36	48
Odds ratio	0,617	0,351
Chi2	6,400	72,637
p value	0,094	1,11E-15

In Table III, the odds ratios show change in different directions in each country. The odds ratio in France decreased (from 1,296 to 0,617), while the ratio for the United Kingdom slightly increased (from 0,276 to 0,351). The hypothesis is that *International Financial Reporting Standards will decrease the prevalence of earnings management as measured by "loss avoidance thresholds" after their adoption in France and the United Kingdom.*

To evaluate whether the change in odds ratios is significant, which would point to a change in earnings management after IFRS, the confidence interval was quantified for the odds ratios prior to IFRS adoption. The lower level of the confidence interval for France's odds ratio is 0,685 and upper level is 2,451. As a result, it can be demonstrated with 95% confidence that the situation after IFRS adoption was the same if the odds ratio for observations after IFRS adoption falls within confidence interval (0,685; 2,451). Because the odds ratio after IFRS adoption is lower than the lower level of confidence interval, positive influence of IFRS adoption exists in France. The lower level of the confidence interval and the odds ratio after IFRS adoption fall close together; hence, the improvement in reporting quality is moderate. French data are homogenous, which was proved using a Chi2 test.

When looking at IFRS in the United Kingdom, the change in odds is not significant. The odds ratio after IFRS adoption period falls into confidence interval (0,182; 0,420), which implies no IFRS influence on earnings management.

Overall, both histograms and the evaluation of odds ratios

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in France show modest improvement. The frequency of small reported losses is relatively higher after IFRS adoption; thus, there is low "loss avoidance behavior". France, as a typical country with civil law tradition, has fewer enforcement mechanisms; thus, IFRS demonstrate visible positive effect. Histograms and odds ratios in the UK, a country that—in keeping with its common law tradition—has strong enforcement, do not show any significant improvements in reporting quality associated with IFRS adoption.

VI. CONCLUSION

International Financial Reporting Standards have been selected as a representative uniform accounting language that can be used to gain greater reporting quality. This increase in quality is due to increased international transparency and comparability across companies worldwide. Implementation of IFRS by European Union members for publicly traded companies represented an important milestone in accounting history. Despite the IFRS target to enhance accounting quality within financial statements, there is evidence (e. g. [13], [28]) that IFRS has only a limited role in this regard. In contrast, other research findings confirm that there is benefit to be gleaned from IFRS adoption (e. g. [9], [41]).

This paper examines differences in loss avoidance before and after IFRS adoption. It was investigated IFRS influence on earnings management through the examination of the "small reported profit/small reported losses ratio" in both legal traditions: the code-law tradition with relatively weak investor protection (France) and the common-law tradition with a characteristically strong enforcement mechanism (the United Kingdom). It was used a sample of 526 companies (6822 firm-year observations) during the years 2000 – 2013. In France, 215 companies were analyzed, and the research findings supported an improvement in reporting quality after IFRS adoption. On the other hand, the pervasiveness of earnings management did not decline after IFRS implementation in the UK. The results are consistent with study [35], in that IFRS adoption in the United Kingdom—a country with strong enforcement and national accounting standards equivalent to IFRS—brought no improvement. Reference [35] investigated IFRS adoption in Italy, a country that—like France—has weak investor protection. In both Italy and France, IFRS increased accounting quality.

Overall, the results suggest that the convergence of international accounting standards is vitally important, as it improves reported financial statements and contributes to a reduction in earnings management. This being stated, the level of enforcement mechanisms, institutional factors, and management incentives should been taken into consideration when debating the merits of the accounting harmonization process.

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