IFRS Reconciliation Adjustment and Subsequent Meet or Beat Target Earnings*

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Abstract

This study analyzed the association between IFRS adjustments, measured with the IFRS reconciliations, and the subsequent meeting of target earnings. IFRS adjustments include the amounts to be adjusted intentionally, as well as the differences in accounting standards. This study estimated intentional IFRS adjustments and analyzed their association with meeting target earnings. As the results of our analysis, meeting target earnings was associated positively with intentional IFRS adjustments for the total assets, was negatively associated with them for current assets, and was positively associated with them for non-current assets. Since understatement of current assets can be realized into earnings in a short period of time, it seems that current assets were underestimated intentionally in order to meet target earnings subsequently. In contrast, it is considered that non-current assets were overestimated to make them more likely to meet target earnings either by increasing the firm size or by improving financial solvency. The results of this study imply that IFRS adjustments are useful to manage earnings for meeting target earnings. Since accounting standards may be established and revised constantly, which adjustments for them may occur, the results on IFRS adjustments are expected to have implications for investors, policy-makers, and standards establishment entities.

Keywords: IFRS, IFRS Reconciliation Adjustment, Meet or Beat Target Earnings.

JEL Classification Code: M40, M41, M48, M49.

1. Introduction

This study aimed to analyze the association between reconciliation adjustments (hereinafter 'IFRS adjustments'), measured with the IFRS reconciliations after the International Financial Reporting Standards (hereinafter 'IFRS') adoption, and subsequent meeting of target earnings.

Basically, IFRS adjustments are the starting point to make a financial statement according to IFRS and refer to the differences between IFRS and the prior Korea Generally Accepted Accounting Principles (hereinafter 'KGAAP'). However, IFRS adjustments have various implications beyond the simple differences in accounting standards

(Christensen, Lee, & Walker, 2009; Garcia Osma & Pope, 2011; Horton, Serafeim, & Serafeim, 2013). IFRS adjustments include the amounts adjusted intentionally by a firm manager, as well as those of the differences in accounting standards, which are mechanically reflected. The starting point of the changes brought about by IFRS adoption is the numerical fluctuation in each financial statement, which must have affected the quality of financial reporting. It is therefore necessary to understand IFRS adjustments before starting a study on IFRS.

However, most studies were conducted on whether the quality of financial information was improved and on the resultant economic effects through the comparison between before and after IFRS adoption rather than on IFRS adjustments (Armstrong, Barth, Jagolinzer, & Riedl, 2010; Barth, Landsman, & Lang, 2008; Byard, Ying, & Yu, 2011; Brochet, Jagolinzer, & Riedl, 2013; Chen, Young, & Zhuang, 2012; Christensen et al., 2009; Daske, Hail, Leuz, & Verdi, 2008; Daske, Hail, Leuz, & Verdi, 2013; DeFond, Hu, Hung, & Li, 2011; Landsman, Maydew, & Thornock, 2012; Li, 2010; Yip & Young, 2012; Noh & Kim, 2015). The studies on IFRS adjustments analyzed their value relevance, or the

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association between the adjustments and earning management at the time of IFRS adoption (Christensen et al., 2009; Horton et al., 2013). Unlike the previous research, this study focused on the association between IFRS adjustments and the quality of subsequent financial reporting.

This study estimated intentionally adjusted parts (hereinafter referred to as "intentional adjustments") among IFRS adjustments and analyzed the association between intentional adjustments and meeting of target earnings. Intentional adjustments for total, current, and non-current assets were estimated and analyzed. Firms intentionally over-adjusting the total assets at the first-time adoption of IFRS were predicted to more likely meet target earnings by abusing the discretionary accounting standards of IFRS, even after IFRS adoption. In contrast, firms intentionally under-adjusting the total assets are predicted to meet target earnings by realizing under-adjusted assets, for example, through sales after IFRS adoption. Such a prediction may differ between current and non-current assets. This is because the former can be realized into earnings in a short period of time, whereas it takes a long time to realize (sell off) the latter into earnings.

As the results of our analysis, meeting of target earnings was significantly associated positively with intentional adjustments for the total assets, was negatively associated with intentional adjustments for current assets, and was positively associated with intentional adjustments for non-current assets. Since the understatement of current assets, including trade receivables and inventory assets, can be realized into earnings in a short period of time, it seems that current assets were underestimated intentionally to make them meet target earnings. In contrast, it is considered that non-current assets were overestimated to make meeting of target earnings easy either by increasing the firm size or by improving financial soundness. It seems that the total assets led to positive relationship because the effect of adjustments for the non-current assets is larger than it for current assets. The robustness test in which the variables of interest were measured in different ways or only those in a good-quality accounting environment were analyzed obtained the qualitatively same results.

The results of this study imply that IFRS is a financial reporting system useful to manage earnings for meeting target earnings. It seems that the uncertainty of the accounting standards, which has resulted from lots of accounting treatments that requires a manager to estimate and judge, and the principle-based accounting standards have created an environment in which it is easy to manage earnings. This agrees with Ahmed, Neel, and Wang (2013) who reported on the lower quality of financial reporting for firms mandatorily adopting IFRS.

This study is expected to make the following contributions differentiated from the previous research on the effects of IFRS adoption: First, the effects on the quality of subsequent financial reporting were analyzed in a longer period of time than in the previous research that primarily analyzed the association between IFRS adjustments and financial reporting at the time of transition. In addition, IFRS adjustments were divided to determine if they had differential effects on the quality of subsequent financial reporting. Second, since accounting standards may be established and revised constantly, the results of this study on IFRS adjustments are expected to have implications for investors, policy-makers, and standards establishment entities. It is indicated that firms making intentionally significant adjustments (or reconciliations) while establishing and revising accounting standards can have incentives for earnings management contained in the adjustments and can manage earnings constantly. However, this study has a limitation that it committed errors in measurement because of the failure to include all the determinants of IFRS adjustment.

This study has the following composition: Chapter 2 reviews the previous research and develops the hypotheses. Chapter 3 explains the models and makes a sample. Chapter 4 tests the hypotheses through empirical analysis. Descriptive statistics and the results of the correlation analysis are presented before testing the hypotheses; afterwards, the findings from the hypothesis testing are reviewed. Chapter 5 draws a conclusion and presents its contributions and limitations.

2. Related Research And Hypotheses Development

2.1. Previous Studies

In accordance with "The Roadmap toward IFRS Adoption in Korea" of 2007, Korea fully adopted IFRS in 2011. Korea chose to employ a Big Bang approach in adopting full IFRS at a certain point in time instead of taking the phased-in or convergence approach. This approach provides us an ideal condition to analyze the impact of IFRS adoption. IFRS and KGAAP differed fundamentally from each other: the former is principle-based accounting standards and the latter is rule-based ones. Various studies have been conducted on IFRS adoption by South Korea (Lee, Cho, & Kang, 2015; Cho, Kim, & Yoon, 2014).

Of the studies on IFRS, those on IFRS adjustment, which is the topic of this study, can be reviewed as follows:

Capkun, Jeny-Cazavan, Jeanjean, and Weiss (2008) analyzed earnings management presence and value relevance of IFRS adjustment in 1772 European firms mandatorily adopting IFRS. The management was found to utilize IFRS adjustments with the aim of increasing earnings and ROA at the time of IFRS transition. Despite the earnings management presence, IFRS adjustments were characterized by high levels of value relevance; therefore, it was reported that IFRS adoption positively affected value relevance though it lowered the quality of accounting information due to earnings management.

Horton and Serafeim (2010) analyzed market reactions and value relevance of IFRS adjustments when UK firms adopted it for the first time. The abnormal return analysis revealed that firms with negative IFRS reconciliation showed significant negative reactions, whereas there was no significant effect on those with positive IFRS reconciliation. Negative adjustments aroused negative sentiment among investors and positive ones were effective in signaling opportunistic behaviors. Value relevance was found in terms of share based payments, goodwill amortization and impairment, and deferred taxes. While IFRS adoption can be expected to change simple accounting standards and not to affect cash flow, it can have various implications for investors.

Horton et al. (2013) determined if the mandatory adoption of IFRS had improved the information environment and regarded IFRS adjustments as the effects of improving information and increasing earnings management due to better comparability. Christensen et al. (2009) regarded the amount of net profit adjustment as a change in expectation of earnings to come and confirmed that adjustments had different effects on information delivered to the market. Garcia Osma and Pope (2011) reported that IFRS adjustments were utilized to liquidate the accumulation of previous earnings management or reflect large losses in pursuit of earnings reported to come.

De George, Ferguson, and Spear (2012), who conducted a study in Australian firms adopting IFRS, analyzed the amount of net assets adjustment as a proxy of an increase in complexity and found that IFRS adjustments were significantly associated positively with audit fees. The literature review found that IFRS adjustments were utilized with different implications.

2.2. Hypotheses

As the literature review found, IFRS adjustments have many different implications (Christensen et al., 2009; Garcia Osma & Pope, 2011; Horton et al., 2013). First, they reflect economic substance, which K-GAAP failed to reflect, and include improvements in the quality of financial information

(Kim, Liu, & Zheng, 2012). Second, IFRS adjustments result from the accounting method that is absent or different in the existing accounting standards (De George et al., 2012). Third, there can be earnings and net assets intentionally adjusted by the manager. Intentional adjustment can be made to liquidate the accumulation of previous earnings management or to report lots of earnings after IFRS adoption (Capkun et al., 2008; Garcia Osma & Pope, 2011).

Such intentional adjustments can be manipulated easily at the management's discretion. This is because, first, IFRS is principle-based accounting standards by which the management can choose among various accounting methods at their own discretion, and there is lots of accounting treatments that requires a manager to judge and estimate by, for example, measuring fair values; second, there are lots of exemption regulations that firms adopting IFRS for the first time can choose from[2]. While all the accounting standards need to apply retrospectively in principle when making the first financial statement by applying IFRS, choosing an exemption makes it possible to adopt other accounting methods. One of the exemptions is goodwill accounting caused by business combinations. While it is necessary to return depreciation based on K-GAAP in pursuit of the full retrospectiveness of IFRS, depreciations based on K-GAAP are all appreciated if a reporting firm applies exemptions for business combinations (Appendix C, Statements of Korea Accounting Standards No. 1101). Therefore, exemption application can affect the amount of goodwill in a statement of financial position and, subsequently, the amount reflected in a statement of comprehensive income based on impairment losses.

Thus, managers' intentional adjustment can be associated with the subsequent meeting of target earnings. When IFRS is adopted for the first time, managers can make adjustments to increase assets intentionally through various accounting methods from which they can choose. Even after IFRS adoption, it is possible to pursue the meeting of target earnings continuously by using discretion in the accounting standards. The phenomenon of overestimated earnings management, once completed, tends to remain in the next fiscal year because revising the overestimated earnings management in the next fiscal year requires a decrease in profit and loss (Barber, Kang, & Li, 2011).

While a firm can improve its reputation and financial position by increasing assets, there are limited methods to increase assets considerably. A drastic increase in the size of assets is rarely found unless there is a merger based on real transactions or rapid growth of sales. In general

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[2] Paragraph 12 'First Adoption of K-IFRS,' Statements of Korea Accounting Standards No. 1101

situations, it is almost impossible to see a sharp increase in the size of assets only by changing accounting methods. However, adopting IFRS in a Big Bang mode would have been utilized easily to increase the size of assets rapidly. As the first adoption of IFRS enables the fair value evaluation of financial and tangible assets, aggressive appreciation of fair value evaluation is expected to be effective in improving the financial structure by increasing the size of assets rapidly. Such a firm is expected to make it more likely to meet target earnings by using discretionary accounting constantly according to IFRS even after IFRS adoption. An increase in the size of assets due to changed accounting can decrease a debt ratio, improve financial solvency, have positive effects on costs of capital indirectly, and help meet target earnings.

Contrary to this, reducing assets intentionally at the time of the first adoption can make it more likely to meet target earnings after IFRS adoption. Reducing assets by overestimating impairment losses for financial instruments and others at the time of the first adoption can lead to more earnings by means of impairment loss reversal after IFRS adoption. Literature review has proven that IFRS adjustments can be utilized strategically to make more earnings after IFRS adoption (Garcia Osma & Pope, 2011). There are no consistent results on the evidence that investors negatively evaluate a decrease in the size of assets at the time of the first adoption (Capkun et al., 2008). Therefore, intentional adjustment made by the management to reduce assets at the time of the first IFRS adoption in pursuit of more earnings to come would be a feasible strategy. Since intentional adjustments and meeting of target earnings to come are expected to be associated with each other in both ways, the following null hypothesis is developed.

Hypothesis: K-IFRS adjustment is not associated with subsequent meet or beat target earnings

This study analyzed intentional adjustments for the total assets, which need to be divided into current and non-current assets. Since current assets, such as trade receivables and inventory assets, can be realized into earnings within a year, IFRS adjustment can underestimate them to realize earnings in a short period of time. In contrast, it is hard to realize non-current assets into earnings in a short period of time though they are underestimated. It is impossible to sell off tangible and intangible assets firms possess to use in a short period of time and realize them into earnings. As for non-current assets, the strategy of increasing the size of the total assets can be more useful to meet target earnings. As it is predicted that current assets are more likely to meet target earnings through

underestimation and non-current assets are likely to be overestimated, adjustments for the total assets are divided into current and non-current assets.

3. Research Design and Data

3.1. Research Design

This study aimed to analyze the association between intentional adjustments and meeting of target earnings after IFRS adoption. The following regression equation was used to measure intentional adjustments, and abnormal adjustments were assumed as intentional adjustments for total, current, and non-current assets.

$$Adj\_TA_i = \alpha_0 + \alpha_1 LAND_i + \alpha_2 PPE_i + \alpha_3 AR_i + \alpha_4 FA_i$$
$$+ \alpha_5 INTAN_i + \varepsilon_i \qquad (1\text{-}1)$$

$$Adj\_CA_i = \alpha_0 + \alpha_1 AR_i + \alpha_2 FA_i + \varepsilon_i \qquad (1\text{-}2)$$

$$Adj\_NCA_i = \alpha_0 + \alpha_1 LAND_i + \alpha_2 PPE_i + \alpha_3 INTAN_i + \varepsilon_i \qquad (1\text{-}3)$$

Where,

Adj_TA	IFRS Adjustments of total assets deflated by total assets under previous GAAP;
Adj_CA	IFRS Adjustments of current assets deflated by total assets under previous GAAP;
Adj_NCA	IFRS Adjustments of non- current asset deflated by total assets under previous GAAP;
LAND	Land deflated by total assets under previous GAAP;
PPE	Property plant and equipment deflated by total assets under previous GAAP;
AR	Accounting Receivables deflated by total assets under previous GAAP;
FA	Financial Assets deflated by total assets under previous GAAP; and
INTAN	Intangible Assets by total assets under previous GAAP.

This regression equation was made to estimate IFRS adjustments based on the differences in accounting standards, and the parts not explained by the equation were defined as intentional adjustments.[3] Regression equations

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[3] To decide on the items to be included in the regression equation for estimating the differences in accounting standards, *IFRS Adoption, Implementation, and Lessons by South Korea* (2013) published by the Korea Accounting Standards Board was consulted. This report lists those items highlighted by IFRS implementation in two categories: economic substance and fair value evaluation.

containing trade receivables and other financial assets (tangible and intangible assets), as well as real estate, were made for each IFRS adjustment. Tangible and intangible assets for which fair value measurement was permitted were identified as items that caused differences in accounting standards. For indefinite-life assets that include goodwill among intangible assets, in particular, there are differences in accounting standards because impairment test is performed without the depreciation expenses to estimate the carrying amount close to the fair value. For financial instruments, there are also differences in accounting standards caused by different impairment evaluations of receivables, including trade receivables, as well as by a wider scope of fair value measurement.

The regression equations (1-1), (1-2), and (1-3) were analyzed in 15 industrial categories, and residuals not explained by the equations were regarded as intentional adjustments by the firm. This estimation is similar to those in previous studies (Garcia Osma & Pope, 2011).[4]

The meeting status of financial analysts' earnings forecasts is used as a proxy of earnings management. Previous research has proven that financial analysts' earnings forecasts serve as an incentive for earnings management by the firm. Skinner (2003) reported that because a firm's performance failing to meet financial analysts' earnings forecasts can lead to a sharp decline in stock price, the management has an incentive to avoid it. Literature review also has proven that firms meeting financial analysts' earnings forecasts consecutively have higher market values (Bartov, Givoly, & Hayn, 2002; Kasznik & McNichols, 2002; Myers, Myers, & Skinner, 2007). According to Ahmed et al. (2013), this study develops the following regression equation and tests the hypotheses.

$$MBE_{it} = \alpha_0 + \alpha_1 AbAdj\_TA_i \text{ (or } AbAdj\_CA_i \text{ or } AbAdj\_NCA_i) +$$
$$\alpha_2 SIZE_{it} + \alpha_3 ROA_{it} + \alpha_4 LEV_{it} + \alpha_5 CF_{it} + \alpha_6 GRW_{it} +$$
$$\alpha_7 TURN_{it} + \alpha_8 EISSUE_{it} + \alpha_9 DISSUE_{it} + \alpha_{10} AUD_{it} +$$
$$\alpha_{11} MARKET_{it} + \sum IND + \sum YD + \varepsilon_i \quad (2)$$

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[4] Garcia Osma & Pope (2011) drew a regression equation on an industrial basis and defined a residual of the equation as a discretionary adjustment because industries have similar economic events, assets, or debts for accounting. Application status of Nos. 1017 (lease), 1019 (employee's wage), 1103 (business combination), 1036 (asset impairment), 1037 (estimated liabilities), and 1038 (intangible assets) was included as a principal variable to account for IFRS adjustments. However, they had a limitation that it was not taken into full consideration that standards selection was arbitrary and standards significantly affected could differ by business. This study estimated abnormal IFRS adjustments, taking into account the size of account titles, not simply standards application status, on the basis of the report on the analysis of IFRS adoption in South Korea.

Where,

MBE	: 1 if the earnings meet or beat analyst forecasting, and 0 otherwise;
AbAdj_TA	: the residual value of *Adj_TA* from the equation (1-1);
AbAdj_CA	: the residual value of *Adj_CA* from the equation (1-2);
AbAdj_NCA	: the residual value of *Adj_NCA* from the equation (1-3);
SIZE	: the natural logarithm of total assets;
ROA	: the net income divided by total assets;
LEV	: the total debt divided by total assets;
CF	: the cash flow from operating activities divided by total assets;
GRW	: the change of total sales divided by prior total sales;
TURN	: the total sales divided by total assets;
EISSUE	: the amount of seasoned equity offerings divided by total assets;
DISSUE	: the amount of bond issue and borrowing divided by total assets;
AUD	: 1 if auditor is BIG4, and 0 otherwise;
MARKET	: 1 if a company is in KOSPI, and 0 otherwise;
IND	: industry dummy; and
YD	: year dummy.

In Equation (2), the dependent variable, *MBE*, is 1 when a firm's performance meets or exceeds financial analysts' earnings forecasts, and 0 otherwise, which is a dummy variable. Since a null hypothesis was developed with *AbAdj_TA* as a variable estimated by intentional adjustments, the sign of coefficient was not predicted. Such control variables as *SIZE* and *MARKET* were included to control the differences in the accounting environment among firms and financial position (Lee & Liu, 2015), and *ROA*, *LEV*, *CF*, *GRW*, *TURN*, *DISSUE*, *EISSUE*, and *AUD*—known to affect earnings management—were also included(Tendai, 2013; Hussain, Bahadar, & Zia, 2014; Hussain, Ashfaq, & Muhammad, 2016; Shaban & Hamed, 2017; Shamima, Muhammad, & Ghulam, 2018). The sign is expected to be the same as in previous research (Ahmed et al., 2013; Davis, Soo, & Trompeter, 2009; Chae & Ryu, 2018).

3.2. Data and Sample Selection

This study was conducted in South Korean firms listed in the KOSPI and KOSDAQ markets between 2011 and 2013. In pursuit of better inter-sample comparability, a total of 6,937 firms were chosen, with the exception of financial firms and those with no settlement at the end of December (Ryu, 2017). 4,162 firms were left, with the exception of the

firms from which no financial information or IFRS adjustment could be obtained and those with impaired capital; finally, 2,336 firms were reviewed, except for firm-year data from 1,826 firms with no prediction made by financial analysts.[5]

IFRS adjustments were estimated as of December 31, 2010. It is because adjustments were estimated on the differences in the financial statement between IFRA and K-GAAP, and the financial statement was fully notified according to both accounting standards only in the year 2010 as IFRS was first adopted in 2011.

The financial data were drawn from Kisvalue, and Comparable IFRS Financial Information drawn from TS 2000 was used to estimate IFRS adjustments. To control the effects of outliers on the results, variables beyond the scope of the top and bottom 1% were winsorized to 99% and 1%, respectively.

4. Results

4.1. Descriptive Statistics and Correlation Analysis

Table 1 shows descriptive statistics of variables from 2011 to 2013.

Table 1: Descriptive Statistics (N=2,336)

Variables	Mean	Std.	Min	Median	Max
MBE	0.695	0.460	0.000	1.000	1.000
AbAdj_TA	0.011	0.084	-0.192	-0.006	0.534
AbAdj_CA	0.008	0.047	-0.063	-0.004	0.216
AbAdj_NCA	0.011	0.067	-0.122	-0.002	0.353
SIZE	19.323	1.336	17.068	19.080	23.152
ROA	0.038	0.072	-0.238	0.042	0.211
LEV	0.390	0.195	0.044	0.388	0.851
CF	0.066	0.091	-0.214	0.063	0.318
GRW	0.084	0.295	-0.667	0.061	1.360
TURN	0.998	0.591	0.035	0.875	3.337
EISSUE	0.017	0.065	-0.049	0.000	0.391
DISSUE	0.237	0.360	0.000	0.097	1.873
AUD	0.660	0.474	0.000	1.000	1.000
MARKET	0.417	0.493	0.000	0.000	1.000

Notes:

MBE : 1 if the earnings meet or beat analyst forecasting, and 0 otherwise;

AbAdj_TA$_i$: the residual value of *Adj_TA* from the equation (1-1);

AbAdj_CA$_i$: the residual value of *Adj_CA* from the equation (1-2);

AbAdj_NCA$_i$: the residual value of *Adj_NCA* from the equation (1-3);

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[5] Firms with no prediction by financial analysts were included to measure *AbAdj*. This is because industry-based measurement only in samples with financial analysts' predictions can make regression coefficient less reliable if the sample size for each industry is <30.

SIZE: the natural logarithm of total assets;

ROA: the net income divided by total assets;

LEV: the total debt divided by total assets;

CF: the cash flow from operating activities divided by total assets;

GRW: the change of total sales divided by prior total sales;

TURN: the total sales divided by total assets;

EISSUE: the amount of seasoned equity offerings divided by total assets;

DISSUE: the amount of bond issue and borrowing divided by total assets;

AUD: 1 if auditor is BIG4, and 0 otherwise; and,

MARKET: 1 if a company is in KOSPI, and 0 otherwise;

The mean of *MBE*, which is meeting or beating financial analysts' earnings forecasts, is 0.695; that is, 69.5% of the firms met the earnings forecasts.

The mean and the median value of *AbAdj_TA* measured by intentional adjustments are 0.011 and -0.006, respectively; *AbAdj_CA* are 0.008 and -0.004, respectively; and *AbAdj_NCA* are 0.011 and -0.002, respectively. All of these three variables were slanted to the right due to the median values smaller than the mean, and significant inter-firm differences were found in intentional adjustments due to the significant differences in the minimum and in the maximum. All of the three variables had the positive mean because the firms made an adjustment that exceeded the amount of differences in accounting standards on average and increased the size of assets through IFRS adoption.

The mean of *EISSUE* and *DISSUE* was about 0.017 and 0.237, respectively, compared with the size of assets, between 2011 and 2013. The distribution of control variables was similar to the finding of the previous study conducted in South Korean firms (Lee et al., 2015; Cho et al., 2014).

Table 2 shows correlation between intentional adjustments and the variables for analyzing the effects of IFRS adjustments on meeting subsequent target earnings.

Meeting or beating target earnings was positively associated with *AbAdj_TA* and *AbAdj_NCA* and was significantly associated negatively with *AbAdj_CA*, which supports the hypothesis indirectly. In particular, *AbAdj* for current and non-current assets was significantly associated with *MBE* in opposite ways; therefore, it is necessary to analyze current and non-current assets separately in testing hypotheses. The dependent variables, *MBE*, were significantly negatively associated with *SIZE, LEV, DISSUE, AUD*, and *MARKET* and were significantly associated positively with *ROA, CF, GRW*, and *TURN*. This is similar to the finding of the previous study conducted in South Korean firms.

4.2. Hypothesis Test Result

The results of the multiple regression analysis of the association between intentional adjustments and earnings management for meeting of target earnings by a firm in testing the hypotheses are presented in Table 3.

Columns (1), (2), and (3) in Table 3 show *AbAdj_TA*, *AbAdj_CA*, and *AbAdj_NCA*, respectively. The coefficient of *AbAdj_TA* in measuring intentional adjustments for the total assets in Column (1) is 2.666, which is significant at the <1% significance level (t-value=10.10) and supports the hypothesis. The coefficient of *AbAdj_CA* in Column (2) is -2.718, which is significant at the <10% significance level; the coefficient of *AbAdj_NCA* in Column (3) is 5.197, which is significant at the <1% significance level.

Firms that had increased the total assets intentionally when they adopted IFRS for the first time were more likely to meet target earnings after IFRS adoption. However, IFRS adjustments based on an intentional decrease for current assets and those based on an intentional increase for non-current assets made it more likely to meet target earnings.

It seems that firms underestimating current assets intentionally were more likely to meet target earnings because underestimation at the time of the first adoption can realize them into earnings in a short period of time. For example, unlike K-GAAP, IFRS lets generated losses alone be appreciated as damage on trade receivables; thus, it is expected to underestimate current assets by recognizing more allowances for bad debts and make it more likely to meet target earnings through allowance reversal following the term.[6] Overestimating non-current assets when IFRS is first adopted is strategically more useful to meet target earnings to come. It seems that intentional adjustments for the total assets were positive because overestimation of non-current assets had greater effects than underestimation of current assets.

The results of this study are consistent with those of Capkun et al. (2012) that arbitrariness inherent in accounting standards affects the quality of financial reporting; the previous research made an analysis at the first time adoption, whereas this study reviewed the quality of financial reporting after IFRS adoption. Similar to the previous research, *SIZE* and *AUD*, among the control variables, were significantly associated negatively with each other, and *ROA* and *TURN* were significantly associated positively with each other (Davis et al., 2009).

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[6] K-GAAP based the allowance for bad debts on expected loss and permitted using the rate of the allowance recognized practically by the tax law to set the allowance for bad debts. However, as IFRS adoption recognizes generated loss alone as a bad debt, positive adjustments for the allowance for bad debts were generated.

4.3. Additional Test Results

The variable of interest in this study is an estimate of intentional adjustments by the management. For the robustness in testing the hypotheses, the continuous variable, *AbAdj*, was measured as a dummy variable to perform the same regression analysis, the results of which were reported in Table 4.

Columns (1), (2), and (3) in Table 4 show *DAbAdj_TA*, *DAbAdj_CA*, and *DAbAdj_NCA*, respectively. The coefficient of *DAbAdj_TA, DAbAdj_CA,* and *DAbAdj_NCA* was 0.240, -0.309, and 0.309, respectively, which is qualitatively similar to the results of the test with the continuous variable. The coefficient of *DAbAdj_TA* was statistically insignificant. Firms decreasing current assets intentionally are more likely to meet target earnings than those increasing them are; contrary to this, firms increasing non-current assets intentionally are more likely to meet target earnings than those decreasing them.

This result supports the hypotheses robustly. In addition, KOSPI and KOSDAQ firms were analyzed separately, and the results are presented in Table 5.

KOSPI firms refer to the firms listed in the Korea Stock Exchange, with KOSDAQ being the stock market for smaller and venture businesses, which is similar to U.S. NASDAQ. KOSPI firms are larger-sized, make more stable financial performance, and draw more attention from financial analysts than those in KOSDAQ; the management of the former is known to pay greater attention to financial analysts' predictions. Analysis was performed separately for KOSPI and KOSDAQ because they have different accounting environments.

Significant results were obtained from KOSPI firms alone, as in Table 3. For KOSDAQ firms, only *AbAdj_TA* was significant and other types of *AbAdj* were insignificant. As more significant results were obtained from KOSPI firms paying more attention to exceeding financial analysts' predictions, the hypothesis is more robustly supported.

MBE was measured in a period of three years from 2011 and 2013; analysis was made on an annual basis to determine the annual effects, and the results are presented in Table 6.

Panels A, B, and C show *DAbAdj_TA, DAbAdj_CA,* and *DAbAdj_NCA,* respectively. The coefficient of *DAbAdj_TA* was 3.924, 2.220, and 2.577 in 2011, 2012, and 2013, respectively. While *DAbAdj_CA* differed insignificantly by year, its coefficient was negative in every type and had the greatest impact in 2011. *DAbAdj_NCA* was similar to *DAbAdj_TA*. Intentional adjustments had the greatest impact on meeting target earnings in 2011 and affected the meeting of target earnings even by 2013.

Table 2: Pearson Correlation Matrix (N = 2,336)

	B	C	D	E	F	G	H	I	J	K	L	M	N
MBE	0.032	-0.063	0.085	-0.141	0.644	-0.267	0.330	0.207	0.236	0.007	-0.043	-0.048	-0.045
(A)	0.127	0.002	<.0001	<.0001	<.0001	<.0001	<.0001	<.0001	<.0001	0.751	0.037	0.020	0.030
AbAdj_TA	1.000	0.523	0.803	0.103	-0.010	0.039	-0.007	0.006	0.106	-0.018	0.013	0.065	0.107
(B)		<.0001	<.0001	<.0001	0.639	0.058	0.738	0.760	<.0001	0.397	0.543	0.002	<.0001
AbAdj_CA		1.000	-0.033	0.126	-0.035	0.194	-0.023	0.013	0.128	0.006	0.117	0.013	0.067
(C)			0.112	<.0001	0.092	<.0001	0.276	0.533	<.0001	0.761	<.0001	0.525	0.001
AbAdj_NCA			1.000	0.045	0.013	-0.062	0.002	-0.007	0.074	-0.035	-0.035	0.072	0.107
(D)				0.030	0.530	0.003	0.912	0.745	0.000	0.088	0.087	0.001	<.0001
SIZE				1.000	-0.049	0.332	-0.093	-0.044	0.041	-0.129	0.060	0.382	0.646
(E)					0.018	<.0001	<.0001	0.032	0.049	<.0001	0.004	<.0001	<.0001
ROA					1.000	-0.393	0.531	0.302	0.254	-0.015	-0.133	0.022	-0.046
(F)						<.0001	<.0001	<.0001	<.0001	0.455	<.0001	0.298	0.026
LEV						1.000	-0.242	0.047	0.251	-0.046	0.381	0.047	0.155
(G)							<.0001	0.022	<.0001	0.026	<.0001	0.024	<.0001
CF							1.000	0.138	0.164	-0.018	-0.154	0.039	-0.086
(H)								<.0001	<.0001	0.374	<.0001	0.062	<.0001
GRW								1.000	0.292	0.080	0.044	-0.049	-0.093
(I)									<.0001	0.000	0.033	0.018	<.0001
TURN									1.000	0.087	0.195	-0.014	0.062
(J)										<.0001	<.0001	0.490	0.003
EISSUE										1.000	0.021	0.003	-0.128
(K)											0.312	0.868	<.0001
DISSUE											1.000	-0.042	0.051
(L)												0.040	0.013
AUD												1.000	0.294
(M)													<.0001
MARKET													1.000
(N)													

See Table 1 for the definitions of the variables used.

Table 3: Results of Hypothesis test

$MBE_{it}= \alpha_0 + \alpha_1 AbAdj\_TA_i$ (or $AbAdj\_CA_i$ or $AbAdj\_NCA_i$)$+ \alpha_2 SIZE_{it} + \alpha_3 ROA_{it} + \alpha_4 LEV_{it}+ \alpha_5 CF_{it} + \alpha_6 GRW_{it} + \alpha_7 TURN_{it}$
$+ \alpha_8 EISSUE_{it} + \alpha_9 DISSUE_{it} + \alpha_{10} AUD_{it}+ \alpha_{11} MARKET_{it}+ \sum IND + \sum YD +\varepsilon_i$ (2)

Variables	Exp. sign	Dependent = MBE_{it}					
		(1) $AbAdj\_TA_i$		(2) $AbAdj\_CA_i$		(3) $AbAdj\_NCA_i$	
		Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square
Intercept		8.845	32.94 ***	8.256	29.19 ***	8.516	30.39 ***
$AbAdj\_TA_i$	+/−	2.666	10.10 ***				
$AbAdj\_CA_i$	+/−			-2.718	3.23 *		
$AbAdj\_NCA_i$	+/−					5.197	22.38 ***
$SIZE_{it}$	−	-0.558	43.75 ***	-0.530	40.35 ***	-0.547	41.74 ***
ROA_{it}	+	71.616	330.28 ***	70.628	332.20 ***	72.442	330.98 ***
LEV_{it}	+	0.236	0.19	0.343	0.40	0.491	0.82
CF_{it}	−	-1.850	2.51	-1.831	2.44	-1.813	2.40
GRW_{it}	−	-0.208	0.51	-0.227	0.61	-0.215	0.54

		Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square
$TURN_{it}$	+	0.367	5.06 **	0.476	8.66 ***	0.336	4.22 **
$EISSUE_{it}$	+	1.658	0.89	1.410	0.67	1.813	1.10
$DISSUE_{it}$	+	0.291	1.84	0.295	1.90	0.300	1.93
AUD_{it}	−	-0.316	2.94 *	-0.297	2.59	-0.324	3.04 *
$MARKET_{it}$	+	0.298	1.96	0.370	3.07 *	0.256	1.43
Industry fixed effect		Included		Included		Included	
Year fixed effect		Included		Included		Included	
Likelihood ratio		1685.26 ***		1677.80 ***		1699.77 ***	
Pseudo R^2		0.514		0.512		0.517	
Sample Size		2,336		2,336		2,336	

Notes: ***, **, and * represent significance at the 1, 5, and 10 percent levels, respectively. Variable definitions are presented in Table 1.

Table 4: Robustness Test Results

$$MBE_{it}= \alpha_0 + \alpha_1 DAbAdj\_TA_i \ (or \ DAbAdj\_CA_i \ or \ DAbAdj\_NCA_i)+ \alpha_2 SIZE_{it} + \alpha_3 ROA_{it} + \alpha_4 LEV_{it}+ \alpha_5 CF_{it} + \alpha_6 GRW_{it} + \alpha_7 TURN_{it} + \alpha_8 EISSUE_{it}$$
$$+ \alpha_9 DISSUE_{it} + \alpha_{10}AUD_{it}+ \alpha_{11}MARKET_{it}+ \sum IND + \sum YD +\varepsilon_i \qquad (2)$$

Variables	Exp. sign	Dependent = MBE_{it}					
		(1) $DAbAdj\_TA_i$		(2) $DAbAdj\_CA_i$		(3) $DAbAdj\_NCA_i$	
		Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square
Intercept		8.583	31.66 ***	8.362	30.05 ***	8.278	29.40 ***
$DAbAdj\_TA_i$	+/−	0.240	2.47				
$DAbAdj\_CA_i$	+/−			-0.309	4.05 **		
$DAbAdj\_NCA_i$	+/−					0.309	4.15 **
$SIZE_{it}$	−	-0.547	42.84 ***	-0.529	40.04 ***	-0.535	41.07 ***
ROA_{it}	+	70.787	330.01 ***	70.801	331.52 ***	70.863	330.24 ***
LEV_{it}	+	0.192	0.13	0.303	0.32	0.288	0.29
CF_{it}	−	-1.866	2.55	-1.805	2.38	-1.819	2.43
GRW_{it}	−	-0.223	0.59	-0.230	0.62	-0.235	0.65
$TURN_{it}$	+	0.419	6.75 ***	0.454	7.96 ***	0.419	6.77 ***
$EISSUE_{it}$	+	1.513	0.75	1.385	0.65	1.645	0.90
$DISSUE_{it}$	+	0.261	1.50	0.291	1.85	0.277	1.69
AUD_{it}	−	-0.306	2.76 *	-0.293	2.52	-0.328	3.15 *
$MARKET_{it}$	+	0.336	2.51	0.370	3.08 *	0.345	2.66
Industry fixed effect		Included		Included		Included	
Year fixed effect		Included		Included		Included	
Likelihood ratio		1677.05 ***		1678.62 ***		1678.74 ***	
Pseudo R^2		0.512		0.513		0.513	
Sample Size		2,336		2,336		2,336	

Notes: ***, **, and * represent significance at the 1, 5, and 10 percent levels, respectively. *DAbAdj_TA*: 1 if *AbAdj_TA* is greater than 0, and otherwise 0; *DAbAdj_CA*: 1 if *AbAdj_CA* is greater than 0, and otherwise 0; *DAbAdj_NCA*: 1 if *AbAdj_NCA* is greater than 0, and otherwise 0; Other variable definitions are presented in Table 1.

Table 5: Additional Test Results (1)

$MBE_{it}= α_0 + α_1AbAdj\_TA_i$ (or $AbAdj\_CA_i$ or $AbAdj\_NCA_i$) $+ α_2SIZE_{it} + α_3ROA_{it} + α_4LEV_{it}+ α_5CF_{it} + α_6GRW_{it} + α_7TURN_{it} + α_8EISSUE_{it}$
$+ α_9DISSUE_{it} + α_{10}AUD_{it}+ α_{11}MARKET_{it}+ \sum IND + \sum YD +ε_i$ (2)

PANEL A. Test for Sample in KOSPI

Variables	Dependent = MBE_{it}					
	(1) *AbAdj_TA*		(2) *AbAdj_CA*		(3) *AbAdj_NCA*	
	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square
AbAdj_TA (or CA or NCA)$_i$	2.242	5.25 ***	-4.939	5.84 **	5.055	15.59 ***
Control variables	Included		Included		Included	
IND and *YD*	Included		Included		Included	
Likelihood ratio	566.03***		566.50***		578.27***	
Pseudo R^2	0.440		0.441		0.447	
Sample Size	975		975		975	

PANEL B. Test for Sample in KODAQ

Variables	Dependent = MBE_{it}					
	(1) *AbAdj_TA*		(2) *AbAdj_CA*		(3) *AbAdj_NCA*	
	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square
AbAdj_TA (or CA or NCA)$_i$	3.185	3.03 **	1.330	0.23	3.609	2.30
Control variables	Included		Included		Included	
IND and *YD*	Included		Included		Included	
Likelihood ratio	1179.50***		1176.43***		1178.69***	
Pseudo R^2	0.580		0.579		0.579	
Sample Size	1,361		1,361		1,361	

Notes: ***, **, and * represent significance at the 1, 5, and 10 percent levels, respectively. Variable definitions are presented in Table 1.

Table 6: Additional Test Results (2)

$MBE_{it}= α_0 + α_1AbAdj\_TA_i$ (or $AbAdj\_CA_i$ or $AbAdj\_NCA_i$)$+ α_2SIZE_{it} + α_3ROA_{it} + α_4LEV_{it}+ α_5CF_{it} + α_6GRW_{it} + α_7TURN_{it} + α_8EISSUE_{it}$
$+ α_9DISSUE_{it} + α_{10}AUD_{it}+ α_{11}MARKET_{it}+ \sum IND + \sum YD +ε_i$ (2)

PANEL A. Test for *AbAdj_TA* each year

Variables	Dependent = MBE_{it}					
	(1) 2011 year		(2) 2012 year		(3) 2013 year	
	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square
AbAdj_TA	3.924	5.99 **	2.220	2.31	2.577	3.09 *
Control variables	Included		Included		Included	
IND and YD	Included		Included		Included	
Likelihood ratio	554.46***		570.34***		592.27***	
Pseudo R^2	0.501		0.521		0.540	
Sample Size	798		775		763	

PANEL B. Test for *AbAdj_CA* each year						
	Dependent = *MBE* it					
Variables	**(1) 2011 year**		**(2) 2012 year**		**(3) 2013 year**	
	Coefficients	**Wald Chi-Square**	**Coefficients**	**Wald Chi-Square**	**Coefficients**	**Wald Chi-Square**
AbAdj_CA$_i$	-3.526	1.76	-2.367	0.72	-2.140	0.63
Control variables	Included		Included		Included	
IND and *YD*	Included		Included		Included	
Likelihood ratio	549.72***		568.64***		589.61***	
Pseudo R^2	0.498		0.520		0.538	
Sample Size	798		775		763	

PANEL B. Test for *AbAdj_NCA* each year						
	Dependent = *MBE* it					
Variables	(1) 2011 year		(2) 2012 year		(3) 2013 year	
	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square	Coefficients	Wald Chi-Square
AbAdj_NCA$_i$	7.375	12.00***	3.983	4.80**	5.765	7.46***
Control variables	Included		Included		Included	
IND and *YD*	Included		Included		Included	
Likelihood ratio	561.94***		573.09***		598.08***	
Pseudo R^2	0.506		0.523		0.543	
Sample Size	798		775		763	

Notes: ***, **, and * represent significance at the 1, 5, and 10 percent levels, respectively. Variable definitions are presented in Table 1.

5. Conclusion

This study aimed to determine how intentional adjustments caused by the first adoption of IFRS were associated with meeting subsequent target earnings. As for the association between intentional adjustments for total, current, and non-current assets and meeting of target earnings, meeting of target earnings was significantly associated positively with intentional adjustments for the total assets, was negatively associated with intentional adjustments for current assets, and was positively associated with intentional adjustments for non-current assets. Since the understatement of current assets, including trade receivables and inventory assets, can be realized into earnings in a short period of time, it seems that current assets were underestimated intentionally to increase the tendency to meet target earnings. In contrast, it is considered that non-current assets were overestimated to meet target earnings either by increasing the firm size or by improving financial soundness. It seems that intentional adjustments for the total assets were positive because overestimation of non-current assets had greater effects than underestimation of current assets.

IFRS adjustments, which are estimates of the effects of IFRS adoption, have various implications. The previous research used the net assets with adjustments accounted for every account title as an interest variable and could make it likely to underestimate the effects. This study determined how adjustments for current and non-current assets, as well as for the total assets, were associated with the quality of subsequent financial reporting. However, this study has a limitation that it committed errors in measurement because of the failure to include all the determinants of IFRS adjustment.

Financial instruments, lease, and revenue standards have recently been revised, and IFRS is constantly established and revised. The effects caused by different accounting standards are generated when the standards are established and revised, as well as when IFRS is adopted. On the basis of these results, it is necessary to make a system that can put restrictions on arbitrary accounting through detailed practical guidelines, as well as through accounting standards, with the objective of achieving the goal of a financial reporting system.

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