The impact of IFRS adoption on IPO management earnings forecasts in Australia

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Abstract

In this study, we investigate the accuracy of management earnings forecasts under International Financial Reporting Standards (IFRS) in the context of an initial public offering (IPO). We observe a decline in management forecast errors (FEs) in Australia following the mandatory implementation of IFRS in 2005. Further evidence suggests that IPO management earnings forecasts become more conservative in post-IFRS periods. We argue that IFRS enables investors to better evaluate IPO firms' performance and demand higher returns from firms that report inflated and inaccurate earnings forecasts. We also show that over-optimistic earnings forecasts and larger forecasting errors result in greater underpricing under the IFRS regime. Overall, this study suggests that IFRS, as a set of high-quality accounting standards, improved corporate disclosure quality and the information environment.

JEL classification: G14; G15; M41

Keywords: IFRS, IPOs, information environment, management earnings forecast accuracy, corporate disclosure

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1. Introduction

The regulatory switch from domestic accounting standards–Generally Accepted Accounting Principles (GAAP)–at a local level to International Financial Reporting Standards (IFRS) has significantly affected financial reporting practices worldwide. By the end of 2018, 166 jurisdictions required or permitted financial statements to be prepared under IFRS[2]. Issued by the International Accounting Standards Board (IASB), IFRS is generally recognized as a set of high-quality and globally applicable financial reporting standards that are based on accounting principles rather than accounting rules (e.g., Barth et al., 2008). Policymakers and financial regulators expect that IFRS will enhance the transparency and comparability of financial statements across different jurisdictions and thereby contribute effectively to the more efficient functioning and global integration of capital markets.

However, there is conflicting evidence from the empirical literature regarding whether the introduction of IFRS has a positive effect on accounting and economic outcomes. On the one hand, proponents argue that IFRS is of higher quality than local standards and constrains accounting discretion, which in turn enhances financial reporting quality by improving market transparency and increasing accounting comparability. As a result, firms experience a reduction in capital cost and an increase in market liquidity (e.g., Daske et al., 2008; Li, 2010), a reduced level of IPO underpricing and increased foreign proceeds (Hong et al., 2014), and improved investment efficiency (Schleicher et al., 2010) . On the other hand, opponents of IFRS argue that the effect of changes in accounting regulations from local standards to IFRS is negligible. In this regard, certain studies have reported that the adoption of IFRS does not impact financial reporting quality (e.g., De George et al., 2013), does not benefit firms from improved stock liquidity (e.g., Christensen et al., 2013), and does not affect capital cost (Daske et al., 2013). However, how IFRS impacts disclosure quality around initial public offering (IPO) events remains unexplored, as an IPO is the watershed of a firm's lifecycle.

[2] See www.ifrs.org

Motivated by the global accounting debate on the application of IFRS and the lack of knowledge about the relationship between IFRS and reporting quality in an IPO context, we pose several interesting questions. Does IFRS improve the accuracy of management earnings forecasts issued in IPO prospectuses? Does the implementation of IFRS impact management forecast directions (e.g., more conservative or more optimistic)? Do investors benefit from an improved information environment with accurate earnings forecasts that lead to better returns in the immediate aftermarket?

Because information about an IPO issuer in the privatization period is scarce, the process of going public for a firm is characterized by a high degree of information asymmetry. This setting specifically allows us to examine whether IFRS contributes effectively to improvement in an information environment where asymmetry is naturally high (Hong et al., 2014). Such information asymmetry obstructs investors from evaluating newly listed firms. Unlike institutional investors, who usually have direct links with investment banks that provide them with superior internal information concerning a new issue, retail investors rely mainly on the information contained in the IPO prospectus to make judgments on their investment decisions[3]. The IPO prospectus, in turn, allows investors to access firm-specific information, such as the details of corporate stewardship, future investment plans, and historical financial performance.

Firth (1998) and Drobetz et al. (2017) reveal that earnings forecasts are one of the most important factors in signaling IPO values. Thus, the inclusion of the predicted earnings in an IPO prospectus is expected to reduce the level of information asymmetry between company insiders and outside investors and to reduce the problems of adverse selection in the IPO market. After all, it is the earnings forecast, and not historical records, that reflects the current changes in operations and the returns on the new issues invested in by IPO firms (Cheng & Firth, 2000). However, because erroneous forecasts are likely to mislead investors, the credibility of the predicted earnings largely

[3] Note that such a situation of unbalanced groups of investors with different information settings was first proposed by Rock (1986), who suggested that it ultimately results in a higher IPO underpricing.

depends on their accuracy. Hartnett and Romcke (2000) and Hartnett (2010) question the credibility of information contained in earnings forecasts as a means of reducing the prevailing information asymmetry in the IPO process in Australia. Thus, we are motivated to examine whether the accuracy of earnings forecasts made during an IPO has improved since the mandatory implementation of IFRS in Australia.

Apart from IPO earnings forecasts, the Australian setting in this study offers several advantages in addressing our research questions. First, Australia is a member of the G4+1 common law countries[4] and has a comparatively developed capital market, matured shareholders' rights, well-scrutinized auditing professions, and other monitoring systems similar to the US (Ball, 2006; De George et al., 2013). This provides us with a simulated environment to explore the situation of whether the US had adopted IFRS. Second, the official implementation of IFRS in Australia was straightforward, without a staggered adoption process, because firms had to prepare accounts for financial periods on or after January 1, 2005. According to De George et al. (2013), almost no firms in Australia voluntarily adopted IFRS in advance (less than 1%)[5]. This is important, as the mandatory enforcement of IFRS adoption in Australia mitigates the endogenous concerns in our study. In a voluntary adoption environment, for instance, managers may be incentivized to prepare financial reporting under IFRS if they believe that their firms can benefit (e.g., Christensen et al., 2015). Third, both private and public firms in Australia were forced to adopt IFRS in 2005, which eliminated the self-selection bias in which firms chose to stay private rather than going public in a new accounting environment.

Our sample consists of 229 hand-collected earnings forecasts disclosed in Australian IPO prospectuses between 2001 and 2009. We classify IPOs as belonging to the IFRS period if their financial statements are prepared under the new accounting standards. Our empirical evidence

[4] These counties are Australia, Canada, New Zealand, the United Kingdom, and the United States.
[5] Barth et al. (2008) report only one firm adopting IFRS in Australia between 1994 and 2003.

indicates that the implementation of IFRS improves the accuracy of IPO earnings forecasts in Australia and, in turn, decrease the forecasting errors. On average, the estimated IPO earnings FEs made in the post-IFRS period are reduced by 26.7% as compared to the previous accounting standard periods (i.e., Australian GAAP (AGAAP)). The results are robust to the application of different time windows and omitted variable concerns, while the study addresses selection bias by using the propensity score matching (PSM) method. We use a variety of alternative measures of earnings forecasts, including logarithmic transformations of absolute forecasting errors (AFEs) and earnings per share (EPS) forecasts. The results remain unchanged. Our findings support previous studies on the improved information environment and enhanced disclosure quality following the adoption of IFRS (e.g., Badertscher et al., 2013; Barth et al., 2008; Houqe et al., 2014; Key & Kim, 2020), enabling managers to provide less subjective earnings forecasts in IPO prospectuses. Our evidence is also in line with agency theory, which implies that a better accounting regime (e.g., IFRS) shapes managers' behavior toward improving the quality of IPO management earnings forecasts, thereby reducing agency conflicts.

Previous studies have also revealed that the adoption of IFRS reduces information asymmetry between investors and IPO firms (Hong et al., 2014) and improves accounting comparability, which allows investors to achieve better stock valuation (Young & Zeng, 2015). Therefore, we hypothesize that investors could anticipate IPO firms' future performance in an IFRS environment. In turn, managers should take this factor into account when issuing earnings forecasts. Our results suggest that IPO earnings forecasts issued in post-IFRS periods are relatively conservative.

To further support our conjecture that investors can better predict IPO firms' future performance in an IFRS regime, we use IPO underpricing to examine whether they are sensitive to earnings FEs. IPO underpricing occurs when the share offer price is below its intrinsic value. Previous studies have suggested that investors are sensitive to the value uncertainty of newly listed firms (Cook et al., 2006). As a result, they usually expect high initial returns on the first day of trading as

compensation for such uncertainty, which results in a greater level of underpricing (e.g., Bradley & Jordan, 2002). We reveal that IPO underpricing increases in conjunction with FEs toward optimism (e.g., over-inflated expected earnings) and FEs with a relatively large bias. The results, in alignment with signaling theory, imply an information asymmetry reduction function of the earnings forecasts disclosed in IPO prospectuses, particularly in an IFRS accounting regime that enables investors to better assess firms' future performance. Thus, the empirical evidence suggests that the adoption of IFRS provides opportunities for investors to improve the comparison of disclosures and acquire additional valuation insights for a firm; consequently, the level of underpricing changes following the direction and accuracy of the earnings errors.

We contribute to the literature dealing with the financial reporting consequences of IFRS in several ways. First, given that the advantages and disadvantages of adopting IFRS are controversial in the existing literature, we find that the management earnings forecasts disclosed in IPO prospectuses are less biased in the post-IFRS period in Australia. Moreover, IFRS benefits market participants by enabling them to obtain insights into the future performance of IPO firms. Thus, our study provides additional support for the proponents' view that IFRS is a set of high-quality accounting standards (e.g., Barth et al., 2008; Daske et al., 2008).

Hlel et al. (2020) indicate that IFRS adoption improves IPO management earnings forecast accuracy in France. Our study can be differentiated from theirs as follows: First, they focus on a country practicing civil law, while our study examines a context following common law. Previous studies have suggested that common law countries have a better institutional environment, more investor protection, and more developed capital markets than civil law counties (Djankov et al., 2008; La Porta et al., 1997). Thus, our study extends the prior evidence and indicates that IFRS improves disclosure quality, even in a common law country (e.g., Australia). Moreover, Hlel et al. (2020) investigate only the relationship between IFRS and the accuracy of management earnings forecasts accuracy. Our study explores how investors react to management earnings forecasts under IFRS by

using IPO underpricing as an information proxy. We show that investors could identify the inflated management earnings forecasts in post-IFRS periods, thereby demanding higher initial returns.

Furthermore, disclosure quality may not only depend on accounting standards but also rely on other external factors, such as the legal system, cultural differences, and the institutional environment in a country. Thus, the use of data samples in multiple countries to explore the effect of IFRS is likely to be distorted by cross-country variations (e.g., Christensen et al., 2013; Hellman, 2011; Jeanjean & Stolowy, 2008). Nevertheless, studies focusing on a single country have shown different results. Prior evidence indicates that the adoption of IFRS has improved the reporting quality in numerous countries, such as France (Zéghal et al., 2011), China (Liu et al., 2011), New Zealand (Houqe et al., 2016), and Korea (Key & Kim, 2020), and globally (Drobetz et al., 2017). Alternatively, Palea (2014), Liu and Sun (2015), and Cussatt et al. (2018) have argued that IFRS has had no impact on reporting quality in Italy, Canada, and Germany. In this regard, we contribute to the growing literature that discusses the positive effect of adopting IFRS on disclosure quality in a homogeneous institutional and national environment.

Unlike previous studies that focused on the accuracy of financial analysts' forecasts under IFRS (e.g., Ashbaugh & Pincus, 2001; Horton et al., 2013), we investigate the accuracy of earnings forecasts made by managers. The evidence suggests that both parties benefit from IFRS: the managers issue more accurate earnings forecasts, and the investors require higher initial returns for inflated and inaccurate forecasts.

Li and Yang (2016) examine the relationship between the mandatory adoption of IFRS and management forecasts. Their study only explains the likelihood and the frequency of the predicted earnings issued by managers in an IFRS environment. We update their work by showing the accuracy of management earnings forecasts made during a firm's IPO process. In addition, Hong et al. (2014) report that IFRS reduces information asymmetry and consequently lowers IPO underpricing. We extend their study to demonstrate that, because of the improved information environment under an

IFRS regime, investors are more sensitive to the consequences of IPO management earnings forecasts and demand initial returns accordingly.

The remainder of this paper is organized as follows: Section 2 discusses the institutional background in Australia. Section 3 summarizes the relevant literature, and Section 4 develops our testable hypotheses. Section 5 describes the sample selection and methodology, while Section 6 presents the empirical results. Finally, Section 7 concludes the study and provides further implications.

2. Institutional environment

2.1 IFRS implementation in Australia

In mandating IFRS, Australia is a frontrunner among countries with prominent capital markets. Since January 1, 2005, all public and private firms in Australia have been required to prepare consolidated accounts following IFRS. As most of the other countries partially adopted the IFRS, this enforcement was taken by Australia to meet the long-term goal designed by IASB. In particular, firms in China are not allowed to use IFRS, while only publicly traded foreign firms were permitted to prepare financial statements under IFRS in the US. In the UK and Switzerland, certain types of listed firms can voluntarily adopt IFRS.

Australia started to converge its national accounting standards (e.g., AGAAP) with IFRS in 1996. Despite the efforts made toward convergence, differences emerged between the two types of reporting practices after IFRS was officially implemented in 2005. Initially, some standards from IFRS did not exist in the previous Australian GAAP. For example, IAS 32 and IAS 39 (now IFRS 9), which are related to the recognition and measurement of financial instruments, were added to the previous AGAAP accounting standards. Second, certain areas were modified; for example, the amortization of purchased goodwill was required in AGAAP but was prohibited with the new IFRS in Australia (IFRS 3)[6]. We have listed some of the differences between the Australian-implemented

[6] Under IFRS, IAS 36 requires firms to carry out an annual impairment test on the purchased goodwill.

IFRS and the prior AGAAP in Appendix B. Nevertheless, note that the IFRS initially implemented by Australia in 2005 was different from the IFRS issued by IASB: some sections were removed from the original IFRS (e.g., the indirect method of calculating cash flows from IAS 7); these were reverted in 2007 (Zeff & Nobes, 2010). Previous studies have revealed that the changes in accounting standards in Australia after 2005 impacted the firm performance. For instance, Chua et al. (2012) suggest that accounting quality in Australia has improved in terms of less smoothed earnings management, more timely loss recognition, and improved value relevance in post-IFRS periods. De George et al. (2013) document that IFRS adoption increases audit fees for listed Australian companies. Thus, from this perspective, our study is designed to investigate whether IFRS adoption affects the accuracy of management earnings forecasts in Australian IPOs.

2.2 IPO litigation environment in Australia

The IPO regulations in Australia have undergone significant changes since 1994. In particular, Artiach et al. (2018) recognize three periods for the increased IPO litigation environment related to prospectus disclosure due to certain important regulatory transformations in Australia. The initial period for Australian public firms' exposure to litigious risk was from January 1, 1994, to March 13, 2000. The main regulatory change in this period was the introduction of the Corporate Law Reform Act 1994, which was intended to increase legislative power for firms that did not comply with listing rules. This period is recognized as having low litigation risk.

The increased IPO litigation environment period was from March 13, 2000, to December 31, 2003. Australia introduced the Corporate Law Economic Reform Program Act 1999, aiming to improve investor protection by imposing liabilities on IPO firms issuing defective prospectus information. This act empowers the Australian Securities and Investment Commission (ASIC) to lodge and expose an IPO prospectus for 7–14 days, which allows investors to evaluate the reliability of the disclosure. In addition, the Corporate Act 2001 and the Financial Services Reform Act 2001

impose penalties on inaccurately predicted financial information and non-compliance for continuous disclosure requirement (CDR) on IPO firms.

The IPO litigation environment was further strengthened between January 1, 2004, and December 31, 2012. For instance, the ASIC takes further action to ensure the reliability of the information contained in the prospectus, such as issuing the Regulatory Guide 228 "*Prospectus: Effective Disclosure for Retail*," which aims to increase the quality of disclosures. IPO firms that do not comply with CDR face a fine of up to AUD 100,000, as well as further class actions against such inappropriate behavior. Thus, the IPO litigation environment in Australia is progressively increasing, making the institutional environment comparable to the US market (e.g., De George et al., 2013).

3. Related literature

3.1 IFRS adoption and IPO markets

Proponents of IFRS claim that it is a superior set of accounting standards for several reasons. First, IFRS can limit the choice of accounting methods, thus curtailing managerial discretion (Ashbaugh & Pincus, 2001; Barth et al., 2008). Second, IFRS requires accounting measurements and assessments that better reflect a firm's underlying economic position, hence providing more relevant information for investment decisions (Landsman et al., 2012). Third, IFRS increases the disclosures required, thereby mitigating information asymmetries between firms and their shareholders (Florou & Pope, 2012; Leuz & Verrecchia, 2000).

The application of IFRS requires increased disclosure and offers higher transparency by reducing accounting discretion, which is expected to better reflect the economic situation of a firm than the application of domestic standards (e.g., Barth et al., 2008; Ewert & Wagenhofer, 2005; Marra et al., 2011). This, in turn, mitigates information asymmetries among the different capital market participants and diminishes the problems of adverse selection (e.g., Lambert et al., 2007; Olibe, 2016), thereby reducing IPO underpricing and encouraging firms to cross-list securities (Chen et al., 2015;

Hong et al., 2014). As a result, the adoption of IFRS is expected to lead to an improvement in the financial information environment.

However, opponents challenge whether IFRS consists of efficient accounting standards, stating, for example, that firms' reporting quality under IFRS is not improved compared with previous accounting standards (e.g., Ahmed et al., 2013; De George et al., 2013; Goodwin et al., 2008; Jeanjean & Stolowy, 2008). Some studies have failed to document that IFRS improves the information environment in IPO markets (e.g., Byard et al., 2021; Lee et al., 2020). Thus, whether IFRS is beneficial to the public capital market remains controversial.

3.2 IPO management earnings forecast

Some of the literature focuses on the background of management earnings forecasting in general. Previous studies have suggested that the accuracy of managerial forecasting is associated with investors' ability to uncover distortions (Rogers & Stocken, 2005) as well as the CEO's capability to anticipate future earnings (Baik et al., 2011). Further, management earnings forecasts contain useful information for shareholders and outsiders to assess the quality of a company, thereby reducing information asymmetry (Cheng & Lo, 2006; Cotter et al., 2006; Lennox & Park, 2006). Thus, management earnings forecasting is an important tool for companies to reduce agency costs and signal quality to outsiders (Firth, 1998).

A high level of information asymmetry and challenges of adverse selection are distinct features of the IPO process, making it a classic "lemon problem," as described by Akerlof (1970). To address this issue, some countries, including Australia, allow local firms to voluntarily disclose earnings forecasts in their IPO prospectuses to signal future profitability to outside investors.

Previous evidence from Australia has documented high levels of error in such forecasts. Hartnett and Romcke (2000) report a mean AFE of 88.29% for Australian IPOs between 1991 and 1996. Some studies document relatively lower AFEs for other countries, including Cheng and Firth (2000), who report a mean AFE of 9.89% for Hong Kong IPOs. Using data from Greece,

Gounopoulos et al. (2019) report that management FEs are reduced under voluntary disclosure regulation, which results in lower IPO underpricing and longer survival periods.

Because public information about newly listed firms is scarce, investors rely on management forecasts disclosed in IPO prospectuses to make judgments in their investment decision-making. Jog and McConomy (2003) report that investors take advantage of IPO earnings forecasts to assess and subscribe to new issues. Boubaker et al. (2017) reveal that the accuracy of IPO management forecasts is positively associated with long-run stock returns, suggesting positive reactions from shareholders to respond to managers' efforts to issue less biased earnings forecasts. Thus, the credibility and usefulness of earnings forecasts depend heavily on their accuracy.

Overall, there is limited research on IFRS adoption and management earnings forecasting. Li and Yang (2016) argue that managers are more likely to issue management forecasts following IFRS. However, their study does not investigate the accuracy of the forecast. As earnings predicted by managers are important for market participants to gain additional information during the IPO, understanding whether the accuracy of IPO management earnings forecasts has improved over time in Australia following a major accounting regime change is vital. Therefore, this study aims to enrich the related literature by providing further evidence on whether IFRS is a set of effective accounting standards.

4. Theoretical framework and hypothesis development

4.1 Theoretical framework

Agency theory

The relationship between agents (e.g., managers) and principles (e.g., shareholders) was first modelled in the classical work of Jensen and Meckling (1976). Agents are expected to manage the company toward maximizing shareholders' interests. On the one hand, because of increased information asymmetry, which is mainly caused by the separation of ownership and managerial control of the firm, shareholders may not be able to monitor agents' behavior efficiently. On the other

hand, such inefficient monitoring leads to the problem that agents pursue self-interest goals in firms at the cost of shareholders. Thus, agency theory focuses on several predictions about managers' behaviors within an organization.

Shareholders may rely on the information released by managers to assess firms' performance, such as predicted future earnings. However, the separation of management and ownership may incentivize managers to manipulate disclosure information for their opportunistic behavior . Thus, inaccurate managerial earnings forecasts could mislead shareholders by either underestimating or overestimating corporate development prospects, thereby deteriorating agency problems. Previous studies have suggested that increased information disclosure can mitigate the agency problem (e.g., Al-Akra et al., 2010). If the adoption of IFRS changes the information environment, shareholders should expect managers to act on shaping the transparency of corporate disclosures accordingly. We attempt to shed light on whether IFRS adoption reduces IPO management FEs, thereby increasing corporate information disclosure.

Signaling theory

While information disclosure contributes to alleviating miscommunication between managers and shareholders, there are further concerns about minimizing information asymmetry between two groups of people when one group has better access to information (Spence, 1973, 2002). Signaling theory asserts that the sender (e.g., firms) of the signal chooses a means to communicate information in the market, and the receiver (e.g., investors) takes advantage of this information by interpreting and analyzing it. Thus, firms may issue certain disclosures voluntarily to differentiate themselves from others in the market (Ross, 1977).

In the IPO background, the information from private stages for newly listed firms is scarce. Investors rely on the limited information disclosed by firms to assess the quality of the stock and therefore make investment decisions. Thus, when information asymmetry increases, investors require additional premiums (e.g., a higher level of IPO underpricing) to compensate for uncertainties (Rock,

1986). Firth (1998) argues that management earnings forecasts can be deemed a positive signal for investors in pre-IPO periods to reduce information asymmetry. Nevertheless, there are concerns about investors' ability to interpret the information contained in the forecast. In the presence of mandatory IFRS adoption, where the information environment is expected to change, the quality of the signal, such as management earnings forecasts, should be subsequently adjusted. Consequently, investors can judge such signals and adjust investment decisions in a new information environment. In this regard, we also examine how investors respond to managerial forecasts under IFRS in the form of IPO underpricing.

4.2 Hypothesis development

In the case of IFRS adoption, we assume the accuracy of management earnings forecasts to be driven by three main factors. First, IFRS requires more detailed treatments for certain items than AGAAP does. For instance, IFRS provides thorough guidance related to the measurement and de-recognition of firms' financial assets and liabilities. However, no such guidance was provided under AGAAP. Moreover, prior accounting standards in Australia did not specify the requirements for conducting impairment testing. Under IFRS, firms are required to follow detailed guidance to calculate the impairment of an intangible asset and to disclose the relevant information in its financial report. These changes should, in turn, improve the internal information environment, which enables managers to better predict future earnings. Consequently, shareholders can obtain more precise knowledge about the firm, thereby mitigating agency problems.

Second, external pressure from institutional investors and financial analysts should serve as a monitoring tool for firms' disclosure quality. Florou and Pope (2012) reveal that emerging institutional investors following the mandatory adoption of IFRS are particularly interested in and rely on the information disclosed in financial statements. In contrast, prior literature has documented an increase in analysts' coverage and the accuracy of forecasts after the IFRS mandate (e.g., Tan et al., 2011). This could be attributed to the more extended earnings guidance provided by managers (Li

& Yang, 2016). In this regard, we should expect that managers tend to prepare financial statements more carefully to meet institutional investors' and financial analysts' needs under IFRS, which in turn enhances the accuracy of earnings forecasts.

Third, the improved information environment under IFRS should impact the accuracy of management earnings forecasts. The earnings forecasts require adequate information access, such as market conditions and industry rivals' strategies. High uncertainty in the operating environment could bias managers' ability to process information (Hirshleifer, 2001), resulting in imperfect assessments of their firms' future performance (Gong et al., 2009). Previous studies have suggested that a better reporting quality environment increases financial comparability among firms in the market, thereby improving managers' decision-making processes (e.g., Badertscher et al., 2013; Shroff et al., 2013). Thus, under the IFRS reporting regime, managers can take advantage of such an improved information environment to appropriately assess the market competition and make more accurate financial performance anticipations for their firms' operations. Moreover, the literature suggests that the introduction of IFRS enhances corporate governance mechanisms by facilitating board monitoring (Marra et al., 2011) and decreasing voting premiums (Hong, 2013), which implies that IFRS improves internal information systems within an organization. Addoum et al. (2017) concluded that managers cannot summarize operating performance perfectly when internal information asymmetry is high within a firm. Thus, the IFRS mandate should enable managers to gather more accurate information in relation to a firm's financial performance.

In light of the above discussion, we expect the change of accounting item treatment, the increased external pressure, and the improved information environment under IFRS to enable managers to prepare predicted accounting numbers that are closer to the next year's actual earnings in the IPO prospectus. The enhanced accuracy of managerial earnings forecasts would meet the information needs of shareholders, thereby mitigating agency problems. Thus, we formulate our first hypothesis as follows:

Hypothesis 1a: IPO management earnings forecast errors are reduced in the post-IFRS period.

However, some studies have argued that mandatory adoption does not necessarily lead to improved reporting quality. In particular, Ball (2006) raises concerns about estimation bias and managerial manipulations of fair value under IFRS. Jeanjean and Stolowy (2008) report that the adoption of IFRS increases earnings management. Further, previous studies have shown that managers can opportunistically manipulate earnings to meet or beat analyst forecasts (e.g., Doyle et al., 2013). In this case, managers may be incentivized to misuse earnings management due to the enhanced analysts' coverage after mandatory IFRS adoption, which results in a lower level of disclosure quality and largely biased IPO earnings forecasts. Thus, we further formulate a competing hypothesis, as follows:

Hypothesis 1b: IPO management earnings forecast errors are amplified in the post-IFRS period.

Some studies have argued that reporting quality and transparency under IFRS are significantly improved, enabling investors to access better information sources. For instance, Young and Zeng (2015) reveal that IFRS improves the comparability of accounting numbers, which benefits investors with better stock evaluations. In this regard, investors can evaluate firms more efficiently by comparing the performance of portfolio firms with that of similar firms in the same industry. Indeed, investors treat accounting numbers as more value-relevant in the IFRS environment (Olibe, 2016). Hong et al. (2014) report that the mandatory adoption of IFRS reduces information asymmetry in a public trading market, suggesting that investors can obtain a better information source about firms in the context of IPOs under the IFRS regime.

The above analysis implies that outside investors can also predict IPO firms' next-year earnings under the IFRS regime. In this regard, managers may want to avoid providing over-optimistic earnings forecasts in the IPO prospectus. Artiach et al. (2018) suggest an increased IPO litigation risk environment due to more rigorous regulations and effective regulatory enforcement in

Australia. After all, inflated earnings forecasts may cause future litigations initiated by investors against misleading information disclosed by managers during the IPO process.

However, other studies have documented that IFRS adoption does not improve the market information environment (e.g., Lee et al., 2020). Lang et al. (2010) document that IFRS increases earnings co-movement but decreases financial statement comparability. Liao et al. (2012) reveal that the comparability of earnings and book values in the IFRS environment diminishes over time. Therefore, if IFRS adoption does not improve the financial environment, investors will not be able to obtain helpful information, which may encourage managers to issue inflated earnings forecasts during the going-public process. Given the above discussion, we formulate our second set of hypotheses:

Hypothesis 2a: Managers issue more conservative IPO earnings forecasts in the post-IFRS period.

Hypothesis 2b: IPO management earnings forecasts tend to be more optimistic in the post-IFRS period.

IPO underpricing occurs when a new share is valued below the stock price on the first day of trading, implying that issuers suffer potential losses. Previous studies have suggested that investors require higher initial returns on the first day of trading (i.e., associated with greater underpricing) as compensation for making investments when there is uncertainty surrounding IPO firms (Bradley & Jordan, 2002; Rock, 1986). Following the mandatory implementation of IFRS in Australia, investors recognize an eventual loss if they can anticipate that the invested IPO firms are less likely to achieve the earnings claimed by managers in the future. In this case, investors may increase their required initial returns to take extra risks in making investments in those firms.

Jog and McConomy (2003) report that investors take advantage of the earnings forecasts disclosed in IPO prospectuses to price new shares. Similarly, Boubaker et al. (2017) report that accurate IPO management earnings forecasts are associated with better post-IPO stock returns. This suggests that investors extract information from the predicted earnings in prospectuses and appreciate managers' efforts toward providing accurate forecasts. These findings align with signaling theory, as IPO firms use managerial earnings forecasts as a signal in the market, while investors interpret the

information contained and make investment decisions. If IFRS provides an improved quality of information disclosures in the market, which assists investors in better predicting the future performance of firms, they should be highly responsive to the direction and accuracy of earnings forecasts issued by managers. After all, investors are sensitive to the value uncertainty per se of newly listed firms (Cook et al., 2006). Thus, we formulate the following hypotheses:

Hypothesis 3a: Underpricing is a negative (positive) function of conservative (optimistic) forecasts, as investors can identify the direction of forecast errors under IFRS.

Hypothesis 4a: Investors expect higher returns following a larger earnings forecast bias under IFRS, resulting in a greater level of underpricing.

Alternatively, if IFRS does not improve the financial information environment, investors will not be able to take advantage of market information, such as comparable accounting numbers, to identify IPO management earnings FEs or directions. In this case, investors should not treat optimistic or biased earnings forecasts as a source of uncertainty.

Hypothesis 3b: Underpricing is a positive (negative) function of conservative (optimistic) forecasts, as investors are not capable of identifying the direction of forecast errors under IFRS.

Hypothesis 4b: Management earnings forecast errors do not affect the level of underpricing in the post-IFRS period.

5. Data and Methods

5.1 Sample selection criteria

To examine the influence of IFRS on IPO management earnings forecasts, our study focuses on all newly listed Australian firms during the period from January 1, 2001, to December 31, 2009. We do not extend the sample to later years, as we intend to create a balanced sample of IPOs from before and after the introduction of IFRS. Further, we consider it important to concentrate on the

crucial years around the phenomenon rather than extend into periods in which other regulatory changes might have impacted the quality of earnings forecasts[7].

The first step in the data collection is to retrieve a list of IPO companies from *Bloomberg Professional*. The initial sample contains 1,023 companies that went public during our sample period. Consistent with previous Australian studies (e.g., Hartnett, 2010), mining companies are excluded, as such firms rarely provide an earnings forecast. This leads us to drop 419 companies, resulting in an overall sample of 604 firms. IPO prospectuses for these firms are hand-collected using *Bloomberg Professional* and *Thomson One Banker*, and all of them are screened for the inclusion of forward-looking financial information. To be included in our sample, companies have to disclose forecasts of future earnings; this results in a final sample of 282 IPOs.

The post-listing financial information is derived from *Bloomberg Professional*, *Thomson One Banker*, and the firms' annual reports. We focus primarily on accounting profit numbers ("the bottom line"). Special care is taken to appropriately match earnings figures, which is difficult because the types of profit figures differed among firms. Consistent with the approach used by Lee et al. (2006), we use pre-tax profit figures to avoid problems with the applicable future tax rate. These include earnings before interest, tax, depreciation, and amortization; earnings before interest and tax; and net profit before tax. Thus, the forecast figures have to be carefully hand-matched with their corresponding actual counterparts. This process reduces the sample to 229 IPOs that have announced profit forecasts and have corresponding valid actual profit figures. Of these, 122 IPOs disclosed earnings forecasts in the era of AGAAP, and 107 IPOs released forecasts under IFRS accounting regulations[8]. We further extract other IPO and firm characteristics from the prospectuses (i.e., firm

[7] A summary of regulatory developments in Australian financial reporting after the 2008 credit crisis can be found at www.rba.gov.au/publications/fsr/2018/apr/regulatory-developments.html.

[8] In this case, companies that were listed in the first half of 2005 and provided a forecast for the financial year end on June 30, 2005, were assigned a value of 0 because their forecasts were prepared according to the existing Australian GAAP. Companies that were listed during the same time period but forecasted beyond this year-end date (e.g., to June 30, 2006) were assigned a value of 1 to account for the reported figures being prepared according to IFRS. This strict classification allowed us to clearly distinguish between the different financial reporting standards applied in the preparation of the forecast financial information. Thus, to the extent that IFRS reduces absolute forecast errors, the dichotomous variable is expected to exhibit a negative coefficient, consistent with the previously defined hypotheses. Almost all the companies included in the sample had their financial year ending on June 30.

age, number of shares retained by insiders, auditor, and underwriter). To mitigate the effects of outliers on our statistical inferences, the overall sample is winsorized at the 1% level.

$$IPO\ underprcing = \frac{Share\ price\ on\ the\ first\ day\ of\ trading - offer\ price}{Offer\ price} * 100 \qquad (1)$$

The third step includes the calculation of IPO underpricing, measured as the percentage change from the stock price on the first day of trading to the offer price (e.g., Nielsson & Wójcik, 2016), as shown in Equation (1). The data are collected from *Compustat* and *Thomson One Banker*. Table 1 provides a summary of the statistics of the sample. Of the 360 IPOs listed during the IFRS period, 107 involved a forecast of their expected future earnings; Panel B provides a quarter analysis that highlights in more detail, the distribution of listings with the associated earnings forecasts[9].

[Please insert Table 1 here]

5.2 Methodology

5.2.1 Error metrics

We use two commonly used error measures in this study, namely FE and AFE. FE is calculated as the difference between the actual profit and the forecast profit divided by the absolute value of the forecast profit:

$$FE_i = \frac{(AP_i - FP_i)}{|FP_i|} \qquad (2)$$

where AP_i = actual profit of the company i and FP_i = profit forecast of the company i.

FE measures the bias in the forecast (e.g., Cheng & Firth, 2000; Keasey & McGuinness, 1991). A positive forecast error (FE > 0) indicates that managers have underestimated the profits disclosed in the IPO prospectus (e.g., a conservative forecast), while a negative forecast error (FE < 0) signals an optimistic forecast with actual profits below the forecast ones. Previous evidence from Lee et al.

[9] The decision to provide quarterly data was intended to shed light on the dramatic reduction of IPOs in Australia following the Lehman Brothers collapse in September 2008.

(1993), as well as from Hartnett and Romcke (2000), shows that, on average, Australian IPOs have negative profit FEs, indicating a tread of overly optimistic forecasts.

AFE is applied to measure the overall accuracy of the forecast. It is calculated as follows:

$$AFE_i = \frac{|AP_i - FP_i|}{|FP_i|} \quad (3)$$

The definitions of the terms used in Equation (3) are the same as those for Equation (2). Note that prior studies have used alternative measures of the denominator to determine these error metrics. For example, Jaggi (1997) and Cheng and Firth (2000) use the absolute value of the actual profits. In the untabulated results, we do not find significant differences when using the alternative denominator.

5.2.2 Determinants of forecast bias and accuracy

To assess the impact of IFRS adoption on the accuracy and direction of IPO management earnings forecasts, we develop the following cross-sectional model:

$$AFE_i\ (FE_i) = \beta_0 + \beta_1\ IFRS_i + \beta_2\ AGE_i + \beta_3\ HORIZON_i + \beta_4\ RETAIN_i + \beta_5\ SIZE_i + \beta_6\ AUDITOR_i + \beta_7\ UNDERWRITER_i + \beta_8\ YEAR_i + \beta_9\ INDUSTRY_i + \varepsilon_i \quad (4)$$

where the variable of interest is *IFRS*, which takes a value of 1 if a firm reports its IPO earnings forecast during the IFRS period and 0 otherwise. The first dependent variable is AFE. A larger value of AFE indicates a greater level of earnings FE (a smaller value implies a lower level), irrespective of its direction (optimistic or conservative). To evaluate the effect of IFRS on managers' forecast directions, we used FE as the dependent variable in the second step.

We incorporate other control variables that appear to impact the accuracy of earnings forecasts. Lee et al. (1993) argued that firms with more extended backtracking periods are more experienced in the industry and are better able to control their operations. We assume that older IPO firms experience reduced levels of earnings FEs. We also include the variable *HORIZON* because a longer forecast horizon results in a less accurate forecast (Pedwell et al., 1994). Pre-IPO shareholders with more retained shares are motivated to provide more accurate forecasting because such insiders are inclined to reduce FEs to encourage investors' participation, hence, the variable *RETAIN*. Large

firms can take advantage of their resources to generate a better quality of forecast (Cheng & Firth, 2000); therefore, we include a firm size variable, measured as the total assets at the time of going public, and expect a negative relationship between this and the forecasting errors. Following Cheng and Firth (2000) and Chong and Ho (2007), we incorporate the "Big Four" auditor (*AUDITOR*) and top-tier underwriter (*UNDERWRITER*) variables in the analysis because these two financial intermediaries have a greater reputation at stake and exercise certification roles during the IPO (Wang & Yung, 2011). Further, to eliminate any effects from the particular year of IPO listing or a firm's operating industry, we include the *YEAR* and *INDUSTRY* dummies in the regression.

5.2.3 Determinants of IPO underpricing

To explore how IPO management earnings forecasts in post-IFRS periods affect underpricing, we develop the following model:

$$\textit{IPO underpricing} = \beta_0 + \beta_1 \textit{IFRS}_i + \beta_2 \textit{Forecast error measure} + \beta_3 \textit{IFRS*Forecast error measure} + \beta_4 \textit{AGE}_i + \beta_5 \textit{SIZE}_i + \beta_6 \textit{RETAIN}_i + \beta_7 \textit{VC}_i + \beta_8 \textit{AUDITOR}_i + \beta_9 \textit{UNDERWRITER}_i + \beta_{10} \textit{YEAR}_i + \beta_{11} \textit{INDUSTRY}_i + \varepsilon_i \quad (5)$$

where the dependent variable is IPO underpricing, measured as the percentage change between the share offer price and the closing price on the first day of trading. To investigate how investors respond to the direction of management earnings forecasts under different accounting regulations, the forecast error measures that we use are *FE* and *FE dummy*. We use AFE as the variable of interest to test the hypothesis regarding whether investors are sensitive to the accuracy of earnings forecasts. In conjunction with the variables of *IFRS* and the forecast error measures (e.g., *FE*, *FE dummy*, and *AFE*) described above, we could, thereby, test for differences in investors' prediction ability depending on the financial reporting standard applied.

The variables *AGE* and *SIZE* are used as proxies for firm-level *ex ante* uncertainty (Chambers & Dimson, 2009; Lee et al., 1996). The variable *RETAIN* is used to identify the relationship between equity ownership by company insiders and first-day returns. Financing by venture capitalists (*VC*)

reduces the level of underpricing because of their certification function during the IPO (Bradley et al., 2015). We use the variables *AUDITOR* and *UNDERWRITER* to capture the certification of the IPO by the most reputable (independent) advisers (Bajo & Raimondo, 2017). These could be used as a means to reduce some of the prevailing *ex ante* uncertainty and result in lower positive initial returns, that is, less underpricing and less "money left on the table" (Bajo & Raimondo, 2017; Liu & Ritter, 2011). Further, we control for year- and industry-specific effects. All variables used in Equations (4) and (5) are defined in Appendix A.

5.3 Descriptive statistics and univariate analyses

The descriptive statistics for the measures of FE and AFE are shown in Panel A of Table 2. The overall mean for FE is −15.36% (the median is −0.32%). The negative sign of FE indicates that, on average, managers overestimate the actual earnings. The mean value of the earnings FE is substantially lower than that reported by Hartnett and Romcke (2000), which indicates a general reduction in the forecast bias of Australian IPOs over time.

[Please insert Table 2 here]

When breaking down the FE by Australian GAAP and IFRS environments, the results reveal a negative mean FE of −21.73% for firms providing IPO earnings forecasts during the AGAAP period, and a negative mean FE of −8.11% for firms providing IPO earnings forecasts during the initial IFRS period. Nevertheless, it seems that managers become more conservative following the mandatory adoption of IFRS because the differences become smaller in the direction of less-negative FEs. A *t*-test shows that the differences are significant at the 10% level.

The results for the accuracy of earnings forecasts, as indicated by the AFE, show an average value of 48.13%. This figure is lower than that reported by Hartnett and Romcke (2000) (i.e., 88.29%) in Australia for the period 1992–1996, which suggests an improved IPO earnings forecast environment over time. More importantly, the average AFE is considerably lower in the IFRS environment than in the AGAAP environment (33.89% *vs.* 60.61%), suggesting that managers

produce less-biased forecasting in the period of the new accounting standard. This is consistent with our argument that the mandating of IFRS improves corporate reporting, making managers better able to judge capital market information and estimate changes in their firms' financial position. The *p*-value (0.09) of the *t*-test implies that the differences in the AFE between the firms in the two groups are significant.

Overall, the average IPO underpricing is 16.66%. Compared with previous Australian evidence, this mean value is higher than that reported by Lee et al. (1996) (i.e., 11.86%) and lower than that reported by Loughran et al. (1994) (i.e., 21.8%) and Dimovski and Brooks (2004) (i.e., 25.6%). Comparative results on the level of underpricing between the different financial reporting environments show that IPO firms preparing reports under IFRS exhibit lower underpricing than those preparing their accounts according to AGAAP (15.15% *vs.* 17.99%). However, the *p*-value of a *t*-test (0.26) refutes the null hypothesis that the differences between the two groups are significant.

Panel B of Table 2 provides the descriptive statistics of the control variables used to explain the FEs. In particular, the mean age (*AGE*) of IPO firms is 18.52 years. Firms went public, with an average market capitalization (*SIZE*) of $230.86 million. The proportion of shares retained (*RETAIN*) and offered to the public is 51.37%. The average time between the prospectus issue and the end of the forecast period is 8.93 months. Over half of the firms select services from the Big Four auditing firms (66%) and top-tier underwriters (65%). Of the IPO firms in our sample, 11% are VC-backed, which is close to the 14% of IPOs with VC support in Australia reported by Suchard (2009).

We further partitioned the total sample into pre- and post-IFRS adoption periods. IPO firms that provided earnings forecasts during the IFRS period are younger than those that went public during the AGAAP period (15.56 years *vs.* 21.11 years). Moreover, in terms of market capitalization, firms that went public following the mandatory introduction of IFRS are larger than those going public in the preceding AGAAP period ($319.24 million *vs.* $153.35 million). Pre-IPO shareholders retain more shares in the IFRS period than in the AGAAP period (53.03% *vs.* 49.92%), although the

differences are not significant. The forecasting horizon is shortened from 9.47 months in the previous accounting standard (AGAAP) period to 8.31 months in the new accounting standard (IFRS) period, and the *p*-value of the difference is 5%. More IPOs in the post-IFRS adoption period use the services of a Big Four firm to audit their financial accounts (i.e., 74%) than in the AGAAP period (i.e., 60%). Because these large audit firms operate in an internationally recognized and well-reputed network, they could adapt more quickly and effectively to a change in accounting regulations. Moreover, IPO firms do not exhibit different preferences between the two periods in their use of top-tier underwriters. Finally, newly listed firms are less likely to be VC supported in the IFRS period than in the AGAAP period (7% *vs.* 13%).

6. Empirical results

6.1 Adoption of IFRS and earnings forecast errors

Next, we examine the effect of IFRS on IPO earnings FEs. We incorporate all control variables, as illustrated in Equation (4). To eliminate any potential effects derived from the listing years and industries, we also consider the year-and industry-fixed effects in the analyses. The results are presented in Table 3.

[Please insert Table 3 here]

In Specification (1), we do not include any control variables or industry dummies. The coefficient on the *IFRS* variable of interest is −0.156 and is statistically significant at the 1% level. We consider the industry effect in Specification (2), and *IFRS* continues to exhibit a negative (−0.152) and significant coefficient (at the 5% level). In Specification (3), we include a rich set of control variables but exclude the industry effects: The coefficient for *IFRS* is −0.255 and is statistically highly significant at the 1% level. Upon also incorporating industry effects, in Specification (4), we continue to find a significant and negative coefficient on *IFRS* (−0.267). This result suggests that, on average, the estimated IPO earnings FEs made in the IFRS period are reduced by 26.7% as compared to the

previous accounting standard (i.e., AGAAP) period. The R-squared value increases from 0.075 in Specification (2) to 0.154 in Specification (4), confirming an incremental explanatory power for the control variables on the accuracy of the earnings forecasts. The results for the total sample reveal that the *IFRS* coefficient estimates display a strongly negative sign across the regression models, which suggests that the IFRS reporting environment improves the accuracy of IPO management earnings forecasts in Australia. Empirical evidence confirms the expectation outlined by agency theory that the adoption of IFRS reduces the information asymmetry between managers and shareholders, thereby reducing agency conflicts.

Among the control variables included in Specification (4) for the full sample, the coefficient estimates for *SIZE* and *HORIZON* affirm the predicted sign and are statistically significant. Our finding on the relationship between *SIZE* and *AFE* suggests that larger firms issue more accurate earnings forecasts around an IPO, which is in agreement with Chan et al. (1996). The signs of *AGE* and *RETAIN* are consistent with those reported in previous studies (Chan et al., 1996; Jaggi, 1997), although they are not significant. For the rest of the control variables, we find a positive sign on *UNDERWRITER* and a negative one on *AUDITOR*, but neither are statistically significant.

In Panel B of Table 3, we split our sample into different periods. In particular, we consider an increasing window of event durations before and after the date of the mandatory adoption of IFRS in Australia. Through Specifications (1)–(3), we observe that IFRS consistently shows a negative and significant coefficient, providing robust evidence that management earnings forecasts issued in IPO prospectuses show less bias in the post-IFRS period. One concern is that the financial crisis increased market uncertainty in terms of the economy, which might have imposed additional difficulties for managers in identifying changes in the firms' underlying financial situations. Thus, in Specification (4), we exclude the observations of IPOs listed during the financial crisis period (e.g., between 2007 and 2009): The coefficient on *IFRS* is −0.284 and highly significant at the 1% level, implying that our results are less likely to have been driven by market disturbance (i.e., the financial crisis).

Overall, the findings show evidence consistent with our first hypothesis that the adoption of IFRS improves the information reporting environment and reduces the earnings FEs disclosed in IPO prospectuses. This in turn mitigates agency problems as shareholders receive less biased and more useful information from managers.

6.2 Omitted variable concern

As discussed in the previous sections, the accuracy of IPO management earnings forecasts significantly improved following mandatory IFRS adoption in Australia. However, the empirical results might be biased because of the omitted variable concerns, which are related to corporate governance and the institutional environment. In this section, we attempt to address these concerns by considering a variety of additional control variables.

Previous studies have reported that the auditor committee is an important corporate governance factor that ensures the quality of accounting numbers prepared in corporate disclosures (Kusnadi et al., 2016). Bédard et al. (2008) argue that the firm auditor committee should serve as a monitoring tool for the accuracy of management earnings forecasts at the time of going public. In addition, Hlel et al. (2020) report a negative relationship between an IPO firm's board size and its managerial FEs. Therefore, we hand-collect from IPO prospectuses the two variables related to an IPO firm's corporate governance: the number of directors on the board and whether the firm organized an auditor committee when going public. In our sample, the average board size is 5.5, and 63% of the firms had an audit committee at the time of their IPO.

Furthermore, the accuracy of management forecasts could be driven by the institutional environment, such as litigation risks. Artiach et al. (2018) identify several regulatory changes chronologically starting in 1994 that incrementally enhanced the IPO litigious environment in Australia. Therefore, we build an index to represent the increasing litigious risks that IPO firms face

in the market[10]. The index ranges from 6 to 12, whereby a higher score indicates a more serious litigious environment in Australia. We re-examine the effect of IFRS adoption on the accuracy of IPO management earnings forecasts by incorporating *BOARDSIZE*, *AUDIT COMMITTEE*, and *LITIGATION*, as given in Table 4.

[Please insert Table 4 here]

In Specification (1), we include three additional controls. *BOARDSIZE* and *AUDIT COMMITTEE* display negative and significant signs, suggesting that better corporate governance reduces management FEs in IPO firms. These results are consistent with those reported by Bédard et al. (2008) and Hlel et al. (2020). In Specification (2), we test all the controls from baseline regressions. Coefficients on the two corporate governance controls remain negative, but *BOARDSIZE* is not significant. Moreover, we do not find evidence for whether increased IPO litigious risks impact the management earnings forecast, as the coefficients on *LITIGATION* are insignificant in both columns. More importantly, the coefficients for the variable of interest *IFRS* are persistently negative and statistically significant, confirming the previous findings. Thus, our results are less likely to be driven by factors other than IFRS adoption.

6.3 Propensity score matching analysis

Although our findings support the idea that mandatory IFRS adoption reduces IPO management earnings FEs, it is still possible for the effect to be partially biased by endogeneity. The results presented in Table 2 imply that IPO firm characteristics in the AGAAP and IFRS regimes vary along many observable dimensions. Moreover, the firm's decision to disclose manager-predicted earnings is voluntary, suggesting that distinct firm characteristics in both accounting regimes might affect the quality of forecasts. In other words, IPO firms with better characteristics, such as those

[10] In particular, a score of one is assigned when each IPO-related law or regulation was introduced in a cohort year. Initially, if there was a law/regulation introduced in the first year, then the index for this year would be one. Further, if two regulations were introduced in the second year, then the index for this year would become three. In the case that in the third year, there was a new regulation/law, the index would become four. We continue in the same manner for the following years with the index increasing with additional regulations and laws. As our sample ranges from 2001 to 2009, we match the index to the sample period.

backed by top auditors, are more likely to issue management earnings forecasts during the IFRS period. In this case, our results could be driven by the voluntary disclosure of management forecasts by firms rather than by the effect of IFRS adoption. To address this possible endogeneity, we use the PSM approach.

PSM enable us to compare an observation from the treated group (e.g., IFRS period) with an observation from the control group (e.g., AGAPP period) based on several parameters. In this regard, we consider a variety of confounding characteristics of IPO firms, such as *AGE*, *SIZE*, *RETAIN*, *HORIZON*, *AUDITOR*, and *UNDERWRITER*, as well as the two corporate governance measures, *BOARDSIZE* and *AUDIT COMMITTEE*. Thus, the observed difference in the means of different firm controls from the two sample groups address the effect that is exclusively due to the IFRS regime. To this end, we use two distinct PSM approaches to reveal the pure effect of IFRS on the accuracy of IPO management earnings forecasts, which are the nearest neighbors and radius matching with a caliper of 0.05. The results are presented in Table 5.

[Please insert Table 5 here]

Panel A uses the nearest-neighbor approach, which matches each IPO firm in the AGAAP period with a counterpart in the IFRS period based on propensity score proximity. The evidence shows that the difference in the FEs among IPOs from the two different accounting regimes is −0.256 and statistically significant at the 5% level. The radius matching in Panel B reports similar results. Thus, the results from the PSM method confirms that IFRS improves the accuracy of IPO management earnings forecasts in Australia, which is consistent with our previous findings.

6.4 Further robustness checks

To further explore the effect of IFRS on IPO earnings forecasts and to investigate the sensitivity of our findings, several supplementary analyses and robustness checks are conducted. The results are presented in Table 6.

[Please insert Table 6 here]

Because the distributions of AFE are positively skewed, Specification (1) involved the use of the logarithmic transformations of AFE. We expect the transformation to increase the explanatory power of the model without any effect on the inferences. As anticipated, the coefficient for *IFRS* is −0.368 and statistically significant at the 5% level. Thus, the magnitude is larger than that reported in the basic regressions in Table 3. Next, we control for the effects of outliers that might distort our results and interpretations. Because we winsorized the sample at the 1% level in previous analyses, Specification (2) presents the findings of cross-sectional regressions based on the sample with the inclusion of outliers. The coefficient for *IFRS* is again negative and significant at the 5% level, thereby supporting our earlier conclusion that the adoption of IFRS reduced the IPO earnings FEs in Australia.

In addition, in Specification (3), we test the accuracy of EPS forecasts disclosed in IPO prospectuses. The coefficient for *IFRS* is −4.406 and is significant at the 5% level, suggesting that the application of IFRS reduces the IPO EPS forecast errors. This result reinforces our main hypothesis, which argues that IFRS improves the information environment and disclosure quality.

Overall, these results indicate that our findings are robust to different modifications of the dependent variables used in the regression analyses, including the logarithmic transformation of AFE and the consideration of outliers, and demonstrate the positive impact of IFRS on the accuracy of EPS forecasts issued at the time of an IPO.

6.5 Detection of forecast errors

In this section, we discuss a test of the impact of the adoption of IFRS on the direction of managers' forecast bias. We incorporate all control variables from Equation (4), as well as the year and industry dummies. We replace the dependent variable with measures of FEs. The results are presented in Table 7.

[Please insert Table 7 here]

In Panel A, we use a logistic regression in which the dependent variable is *FE dummy*, which takes a value of 1 to represent conservative forecasting (i.e., the FE is positive), and 0 otherwise (i.e.,

optimistic forecasts). The coefficient on the variable of interest is positive (1.088) and highly significant at the 1% level. The evidence suggests that managers tend to issue more conservative earnings forecasts in IPO prospectuses during the IFRS period, irrespective of their accuracy. In Specification (2), we further consider the effect of the economic downturn by excluding the financial crisis period. The coefficient for *IFRS* displays the expected sign (i.e., 1.062) and is statistically significant at the 1% level.

In Panel B, we conduct an OLS regression analysis on the continuous variable *FE*. Here, we examine the effect of IFRS adoption on the magnitude of the direction of earnings forecasts. We include all the controls used in previous analyses, as well as the year and industry dummies. The coefficient for *IFRS* is 0.405 and is significant at the 5% level, suggesting that the direction of managers' forecasting during the IPO process is toward conservatism in the post-IFRS period. The findings in Specification (2) are generally consistent with the results from Panel A.

Thus, we find evidence consistent with our second hypothesis, indicating that managers issued more conservative earnings forecasts in IPO prospectuses after the mandatory adoption of IFRS in Australia. In the next section, we discuss the use of underpricing as a proxy to examine whether investors are more sensitive to IPO management earnings forecasts in the post-IFRS period.

6.6 IPO underpricing and management forecast errors

Next, we examine the relationship between the direction and accuracy of FEs and IPO underpricing under the IFRS regime. We include all the control variables from Equation (5), as well as the year and industry dummies. The results are presented in Table 8.

[Please insert Table 8 here]

First, we introduce the interaction term *FE*IFRS* in Specification (1). The coefficient is −24.298, and the significance is at the 1% level, suggesting that investors are sensitive to the shift of FEs toward conservatism in the post-IFRS period and subsequently demand lower underpricing from IPOs. In Specification (2), we observe that the coefficient on *FE dummy*IFRS* is negative (e.g.,

−17.522) and significant at the 10% level. The coefficients on *FE* and *FE dummy* are positively related to underpricing, which is consistent with previous studies (e.g., Lonkani & Firth, 2005). In general, more conservative forecasting resulted in greater underpricing, because investors usually hold optimistic views about the firm's future financial performance (Ljungqvist et al., 2006). However, this assumption is made in a relatively less transparent information environment. After all, in an IFRS environment where the information quality is improved, investors could better evaluate the IPO firm's performance and therefore require higher returns for firms with over-predicted earnings forecasts.

To examine the fourth hypothesis, we use AFE as the variable of interest in Specification (3). The interaction term of *AFE*IFRS* exhibits a positive sign of 23.169 and is highly significant at 1%, suggesting that IPO underpricing increases following larger FEs. This result illustrates that irrespective of the forecasting direction, investors could identify the magnitude of FEs under the IFRS regime and therefore demand higher returns following greater inaccuracy of the earnings forecasts. The evidence supports previous studies that indicate that investors can benefit from IFRS by conducting better comparisons of accounting numbers to obtain more accurate valuations (Young & Zeng, 2015). In addition, the signs on *IFRS* are consistent with Hong et al. (2014), although they are not significant.

In terms of the control variables, we find that *VC* and *UNDERWRITER* are significantly and negatively related to IPO underpricing, supporting the idea that reputable venture capitalists and underwriters provide monitoring and screening functions for IPO firms (Megginson & Weiss, 1991). We report a negatively significant coefficient on *SIZE*, which is consistent with the argument that information asymmetry is reduced in larger firms (Nielsson & Wójcik, 2016). *AUDITOR* is positively related to underpricing, while *AGE* and *RETAIN* exhibit positive signs, although they are not statistically significant. Overall, the signs of the control variables are generally in line with those in the previous literature (Bajo & Raimondo, 2017; Bradley et al., 2015).

The results align with the signaling theory that predicted earnings released by managers serve as an effective signal to investors. Thus, after the adoption of IFRS, where the information environment transforms, investors could better distinguish the directions and accuracy of earnings forecasts and therefore demand higher returns following optimistic and inaccurate predicted future earnings disclosed in the IPO prospectuses.

7. Implication and conclusion

The adoption of IFRS is controversial. Proponents argue that IFRS is a set of accounting standards leading to high reporting quality, while opponents believe that there is little evidence to show that its adoption is beneficial to firms. The information contained in prospectuses is crucial for investors when it comes to evaluating portfolio firms because of the high information asymmetry problem in the IPO market. Therefore, in this study, we examine the accuracy of earnings forecasts issued at the time of going public and explore whether they exhibit differences between the AGAAP and the IFRS accounting standard regimes. Australia implemented the mandatory adoption of IFRS nationwide, which eliminates the endogenous issue of firms choosing the accounting standards that might benefit them the most.

We find evidence that IPO earnings forecasts issued by managers are less biased in the IFRS period than in the AGAAP period. The results support previous studies that described IFRS as a high-quality and principle-based reporting regime that improves the quality of corporate disclosures. Moreover, the accuracy of predicted future earnings also improves corporate transparency, thereby reducing the agency problems incurred between shareholders and managers. Further, the evidence reveals that managers tend to issue more conservative earnings forecasts in the post-IFRS period because of investors' ability to predict IPO firms' future performance.

We use IPO underpricing to test investors' reaction to the predicted earnings forecasts in the IFRS period. Our results show that IPO underpricing increases following the direction of more optimistic (inflated) and less accurate earnings forecasts, which suggests that investors could benefit

from an improved accounting environment under IFRS and recognize whether the forecasted earnings issued by managers would meet their expectations. The evidence suggests an improved information channel after the adoption of IFRS in Australia. Moreover, the results support signaling theory, which states that IPO management earnings forecasts serve as a signal to the market and investors take advantage of the information contained in the signal to make investment decisions.

The incremental contribution of this study is its examination of the informational content of earnings forecasts in IPO prospectuses as an outcome of the IFRS implemented in Australia. Most previous studies focused on the impact of IFRS in EU countries and countries with a civil law system where there is a weak investor protection environment. In contrast, we studied the effect of IFRS in a non-EU country with a common law system that exhibits relatively strong investor protection. Thus, the results could be suggestive for countries that share similar institutional characteristics with Australia but have not adopted IFRS, such as the US.

Moreover, we document that the accuracy and direction of management earnings forecasts diminish the information asymmetry during the IFRS period, thereby reducing IPO underpricing. Our results extend to regulatory change considerations regarding the enforcement of the mandatory status of managerial forecasts in prospectuses. In line with Boubaker et al. (2017), we reveal for Australia that regulators that have mandated IFRS adoption may also need to consider mandating the management earnings forecast in the IPO prospectus.

In conclusion, IFRS enhances the accuracy of IPO management earnings forecasts, thereby improving corporate disclosure quality and the information environment in the financial market. Our study reveals that IFRS improves corporate disclosure quality and contributes to a robust information environment.

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Table 1 Australian IPOs sample description

Panel A: IPO sample distribution by year

IPO year	Total IPOs	IPO profit forecasts (final sample)	
	N	N	%
2001	32	22	68.75
2002	39	24	61.54
2003	55	19	34.55
2004	107	46	42.99
2005	115	41	35.65
2006	92	30	32.61
2007	123	39	31.71
2008	22	3	13.64
2009	19	5	26.32
Total	604	229	37.91

Panel B: IPO listings during IFRS period (2005 to 2009 by quarter)

IPO year	Listed IPOs	Forecast provided	No forecast
2005 Q1	25	4	21
2005 Q2	30	6	24
2005 Q3	28	6	22
2005 Q4	32	14	18
2006 Q1	13	3	10
2006 Q2	27	8	19
2006 Q3	19	6	13
2006 Q4	33	13	20
2007 Q1	13	3	10
2007 Q2	36	11	25
2007 Q3	24	12	12
2007 Q4	50	13	37
2008 Q1	8	0	8
2008 Q2	11	3	8
2008 Q3	1	0	1
2008 Q4	2	0	2
2009 Q1	5	0	5
2009 Q2	0	0	0
2009 Q3	3	2	1
2009 Q4	11	3	8
Total	360	107	253

Notes: The table presents the distribution of the Australian IPOs in the sample. Panel A provides the total number of IPOs listed during the sample period by listing year. Fiscal years are converted to calendar years as follows: fiscal years ending before December 31 are classified into the previous calendar year, while those ending on or after January 1 are classified into the current calendar year. Panel B presents by-quarter listing and earnings forecast disclosure for the IFRS sample.

Table 2 Descriptive statistics

Panel A: Dependent variables

	Full sample						AGAAP regime			IFRS regime			Diff. in means (p-value)
	N	Mean	Std dev.	5th	Median	95th	N	Mean	Std dev.	N	Mean	Std dev.	
FE (%)	229	-15.36	67.44	-146.83	-0.32	55.68	122	-21.73	73.81	107	-8.11	58.85	0.06
AFE (%)	229	48.13	151.59	0.91	18.11	146.83	122	60.61	201.76	107	33.89	50.74	0.09
IPO underpricing (%)	229	16.66	33.84	-21.00	10.00	79.90	122	17.99	2.78	107	15.15	3.59	0.26

Panel B: Control variables

	Full sample						AGAAP regime			IFRS regime			Diff. in means (p-value)
	N	Mean	Std dev.	5th	Median	95th	N	Mean	Std dev.	N	Mean	Std dev.	
AGE	229	18.52	25.03	0	11	69	122	21.11	27.60	107	15.56	21.48	0.04
SIZE	229	230.86	471.58	11	72	930	122	153.35	231.00	107	319.24	634.53	0.00
RETAIN	229	51.37	27.69	0	57.79	87.27	122	49.92	29.67	107	53.03	25.28	0.40
HORIZON	229	8.93	4.63	2	8	16	122	9.47	4.45	107	8.31	4.77	0.03
AUDITOR	229	0.66	0.47	0	1	1	122	0.60	0.49	107	0.74	0.44	0.01
UNDERWRITER	229	0.65	0.48	0	1	1	122	0.65	0.48	107	0.64	0.48	0.48
VC	229	0.11	0.31	0	0	1	122	0.13	0.34	107	0.07	0.26	0.08
BOARDSIZE	229	5.45	1.54	3	5	8	122	5.56	1.69	107	5.34	1.35	0.28
AUDIT COMMITTEE	229	0.63	0.48	0	1	1	122	0.62	0.49	107	0.64	0.48	0.73
LITIGATION	229	9.53	1.43	6	10	11	122	8.73	1.49	107	10.44	0.50	0.00

Notes: The table displays descriptive statistics for variables used in the paper. Panel A shows results for dependent variables; Panel B exhibits results for control variables. All variables are defined in Appendix A.

Table 3 The effect of IFRS on IPO management earnings forecast errors

Panel A: Main regression

	(1)	(2)	(3)	(4)
IFRS	-0.156***	-0.152**	-0.255***	-0.267**
	(-31.49)	(-2.49)	(-6.04)	(-2.54)
AGE			-0.056	-0.053
			(-1.40)	(-1.56)
SIZE			-0.088***	-0.088***
			(-6.16)	(-3.04)
RETAIN			-0.001	-0.001
			(-0.48)	(-0.52)
HORIZON			0.023*	0.022**
			(2.30)	(2.43)
AUDITOR			-0.110	-0.107
			(-0.87)	(-1.23)
UNDERWRITER			0.019	0.001
			(0.21)	(0.01)
Intercept	0.632***	0.564**	2.235***	2.219***
	(1.17)	(2.86)	(7.28)	(3.25)
Year effect	Y	Y	Y	Y
Industry effect	N	Y	N	Y
R^2	0.0476	0.0750	0.1349	0.1543
Obs.	229	229	229	229

Panel B: Different time windows

	(1)	(2)	(3)	(4)
	2004–2006	2003–2007	2002–2008	Excl. financial crisis period
IFRS	-0.336***	-0.260**	-0.256**	-0.284***
	(-2.63)	(-2.40)	(-2.39)	(-2.63)
AGE	-0.066	-0.041	-0.039	-0.063
	(-1.18)	(-1.02)	(-1.11)	(-1.53)
SIZE	-0.111***	-0.091***	-0.097***	-0.085***
	(-2.76)	(-2.70)	(-3.28)	(-2.65)
RETAIN	-0.003	-0.003	-0.002	-0.001
	(-1.17)	(-1.29)	(-1.03)	(-0.45)
HORIZON	0.021*	0.016	0.020**	0.021**
	(1.68)	(1.62)	(2.09)	(2.15)
AUDITOR	-0.246**	-0.149*	-0.183**	-0.153
	(-2.35)	(-1.89)	(-2.16)	(-1.51)
UNDERWRITER	0.120	0.059	-0.039	0.016
	(1.09)	(0.80)	(-0.46)	(0.17)
Intercept	2.758***	1.929**	2.303***	2.284***
	(2.88)	(2.53)	(3.23)	(3.01)
Year effect	Y	Y	Y	Y
Industry effect	Y	Y	Y	Y
R^2	0.2044	0.1674	0.1651	0.1556
Obs.	117	175	202	182

Notes: The t-statistics are included in parentheses and are reported for heteroscedasticity-robust standard errors. *, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively. All control variables are defined in Appendix A.

Table 4: Omitted variable concern

	(1)		(2)	
IFRS	-0.179**	(-2.74)	-0.270**	(-2.40)
AGE			-0.052	(-1.55)
SIZE			-0.086***	(-2.83)
RETAIN			-0.000	(-0.22)
HORIZON			0.019**	(2.14)
AUDITOR			-0.099	(-1.11)
UNDERWRITER			0.032	(0.37)
BOARDSIZE	-0.032**	(-2.95)	-0.009	(-0.38)
AUDIT COMMITTEE	-0.187***	(-3.81)	-0.181*	(-1.94)
LITIGATION	0.030	(1.13)	0.077	(1.26)
Intercept	0.651***	(6.29)	1.811**	(2.58)
Year effect	Y		Y	
Industry Effect	Y		Y	
R^2	0.103		0.173	
Obs.	229		229	

Notes: The t-statistics are included in parentheses and are reported for heteroscedasticity-robust standard errors. *, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively. All control variables are defined in Appendix A.

Table 5 Propensity score matching

	Treated group (IFRS period)	Control group (AGAAP period)	Difference (Treated - control)	t-statistic H0: Treated=control
Panel A: Nearest-neighbor matching				
AFE	0.339	0.595	-0.256	-1.80**
Panel B Radius (with 0.05 caliper) matching				
AFE	0.339	0.588	-0.249	-1.31*

Notes: Panel A uses one-to-one nearest-neighbor matching; Panel B uses radius matching with 0.05 caliper. The outcome variable is absolute forecast error (AFE). *, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively. All control variables are defined in Appendix A.

Table 6 Robustness checks

	(1)		(2)		(3)	
	Log (AFE)		Incl. outliers		EPS	
IFRS	-0.368**	(-2.47)	-1.136**	(-2.52)	-4.406**	(-2.36)
AGE	-0.084	(-1.51)	-0.187	(-1.57)	-0.257	(-1.06)
SIZE	-0.064*	(-1.96)	-0.236***	(-4.19)	-0.925**	(-2.34)
RETAIN	-0.000	(-0.10)	0.004	(0.79)	-0.041*	(-2.18)
HORIZON	0.021	(1.77)	0.074**	(2.45)	-0.135	(-0.98)
AUDITOR	-0.266	(-0.88)	-0.315	(-0.87)	-0.878	(-0.90)
UNDERWRITER	0.194	(1.05)	-0.068	(-0.42)	0.281	(0.26)
Intercept	1.918***	(3.78)	2.209	(1.79)	24.788**	(2.58)
Year effect	Y		Y		Y	
Industry Effect	Y		Y		Y	
R^2	0.061		0.222		0.342	
Obs.	229		229		174	

Notes: The t-statistics are included in the parentheses and are reported for heteroscedasticity robust standard errors. *, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively. All control variables are defined in Appendix A.

Table 7 The effect of IFRS on the direction of forecast errors

Panel A Dependent variable: FE dummy

	(1)		(2)	
	FE dummy		exclude financial crisis period	
IFRS	1.088***	(4.62)	1.062***	(3.49)
AGE	-0.036	(-0.25)	-0.059	(-0.32)
SIZE	0.168	(1.21)	0.123	(0.80)
RETAIN	-0.004	(-0.58)	-0.006	(-0.76)
HORIZON	-0.046*	(-1.69)	-0.048	(-1.23)
AUDITOR	-0.269	(-0.87)	-0.027	(-0.16)
UNDERWRITER	-0.189	(-0.92)	-0.230	(-0.94)
Intercept	-3.051	(-1.15)	-2.398	(-0.80)
Year effect	Y		Y	
Industry Effect	Y		Y	
Pseudo R^2	0.085		0.074	
Obs.	229		182	

Panel B Dependent variable: Forecast errors

	(1)		(2)	
	FE		exclude financial crisis period	
IFRS	0.405**	(2.08)	0.251*	(2.10)
AGE	0.058*	(1.82)	0.120*	(2.20)
SIZE	0.065**	(2.12)	0.048***	(5.26)
RETAIN	0.000	(0.17)	-0.000	(-0.05)
HORIZON	-0.033*	(-1.83)	-0.017	(-1.00)
AUDITOR	0.024	(0.25)	0.047	(0.31)
UNDERWRITER	0.044	(0.48)	-0.001	(-0.01)
Intercept	-1.494**	(-2.08)	-1.543*	(-2.15)
Year effect	Y		Y	
Industry Effect	Y		Y	
R^2	0.132		0.162	
Obs.	229		182	

Notes: The t-statistics are included in the parentheses and are reported for heteroscedasticity robust standard errors. *, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively. All control variables are defined in Appendix A.

Table 8 IFRS, IPO management earnings forecast, and underpricing

	(1)		(2)		(3)	
	Forecast direction				absolute forecast error	
FE	8.806***	(2.84)				
FE*IFRS	-24.298***	(-3.84)				
FE dummy			12.325**	(2.42)		
FE Dummy*IFRS			-17.522*	(-1.82)		
AFE					-6.852*	(-1.93)
AFE*IFRS					23.169***	(3.65)
IFRS	-12.905	(-0.89)	-4.098	(-0.25)	-18.657	(-1.32)
AGE	0.699	(0.40)	1.234	(0.72)	0.988	(0.55)
SIZE	-8.094***	(-3.73)	-8.496***	(-3.86)	-7.550***	(-3.41)
RETAIN	0.061	(0.56)	0.059	(0.53)	0.105	(0.96)
VC	-11.886**	(-2.49)	-15.293***	(-2.99)	-12.258**	(-2.50)
AUDITOR	8.922*	(1.66)	11.142**	(2.10)	9.341*	(1.68)
UNDERWRITER	-8.777*	(-1.74)	-9.095*	(-1.75)	-9.288*	(-1.83)
Intercept	143.839***	(3.34)	142.883***	(3.27)	133.219***	(2.99)
Year effect	Y		Y		Y	
Industry Effect	Y		Y		Y	
R^2	0.260		0.231		0.248	
Obs.	229		229		229	

Notes: The t-statistics are included in the parentheses and are reported for heteroscedasticity robust standard errors. *, ** and *** denote statistical significance at the 10%, 5% and 1% levels, respectively. All control variables are defined in Appendix A.

Appendix A Variable definitions

Variable name	Definition
Panel A: Accounting regulation variable	
IFRS	Dummy variable taking a value of 1 if the firm reports its IPO earnings forecast under the IFRS regime, otherwise 0 (i.e. within the AGAAP period).
Panel B: Dependent variables	
FE	Forecast error is measured as FEi = (APi – FPi) / ⎪FPi⎪, where APi = actual profit of company i, and FPi = forecast profit of company i.
FE dummy	Dummy variable taking a value of 1 if the FE is positive (e.g., conservative forecasting), and 0 otherwise (i.e., optimistic forecasts).
AFE	Absolute value of the forecast error.
Log(AFE)	The logarithm of absolute value of the forecast error.
IPO underpricing	Percentage change between the share offer price and the share price at close of the first day of trading.
Panel C: Control variables	
AGE	The number of years that each listing firm has been in operation before the year of listing. It is measured by using the natural logarithm, as ln(1 + firm age).
SIZE	The natural logarithm of the total market capitalization of the IPO firm.
RETAIN	The proportion of shares retained by pre-IPO shareholders.
HORIZON	The number of months between the issue of the prospectus and the end of the forecast period.
AUDITOR	Dummy variable taking a value of 1 if the IPO firm uses services from a 'Big Four' auditing firm (i.e., PricewaterhouseCoopers, Deloitte, Ernst & Young, or KPMG), and 0 otherwise.
UNDERWRITER	Dummy variable taking a value of 1 if the underwriter of the IPO firm is top-tier, and 0 otherwise.
BOARDSIZE	Number of directors on board at the time of IPO.
AUDIT COMMITTEE	Dummy variable taking a value of one if the IPO firm has an audit committee, and zero otherwise.
LITIGATION	According to Artiachet al. (2018), a score of one is assigned when each IPO related law or regulation introduced in a cohort year. Initially, if there was a law/regulation introduced in the first year, then the index for this year is one. Further, if two regulations were introduced in the second year, then the index for this year becomes three. In the case that in year three there was a new regulation/law, the index becomes four. On the same manner we continue for the following years with the index increasing with additional regulations and laws. Since our sample ranges from 2001 to 2009, we match the index to the sample period.
VC	Dummy variable taking a value of 1 if the IPO firm is VC-backed, and 0 otherwise.

Appendix B: Differences between IFRS and Australian GAAP

Topic	International	Australian	Changes
1. Presentation of Financial Statements (IAS 1 & AASB 1001/1018/1034/1040)			
True and fair override	Departure from IFRS is required where compliance would be misleading or is necessary for fair presentation	Compliance with Australian standards is compulsory with separate disclosures where compliance does not result in true and fair value	Departure from IFRS permitted where compliance would be misleading and the relevant regulatory framework requires such a departure.
2. Inventories (IAS2 & AASB 1019)			
	Differences exist with respect to disclosure and the allowed alternative treatment of LIFO under IFRS is not acceptable in Australia.	Compliance with AASB1019 will ensure compliance with IAS2.	Elimination of the LIFO method
3. Profit or loss for the period, changes in Accounting Policies (IAS 8 & AASB 1001)			
Errors/fundamental errors	Fundamental errors are of such significance that the financial statements of one or more prior periods can no longer be considered to have been reliable at the date of their issue.	All errors must be corrected in the reporting period in which they are discovered unless the entity has amended and re-issued the financial report related to prior reporting period	The distinction between errors and fundamental errors to be removed and accounted for in accordance with the benchmark treatment under IFRS
4. Events after the balance sheet date (IAS 10 & AASB 1002)			
Post balance sheet events	Adjust for events that indicate that the going concern assumption in relation to the whole or part of the enterprise is not appropriate	No Adjustments is made if the event indicates that the entity ceases to be a going concern after the reporting date	
Dividend	A liability must be recognized for dividends declared, determined, or publicly recommended on or before the reporting date.		Dividends declared before reporting date would not be recognized as liabilities if they are subject to approval by the shareholders after reporting date.
5. Income taxes (IAS 12 & AASB 1020)			
Unused Tax losses and unused tax credits	A deferred tax asset should be recognized for the carry forward of unused tax losses and unused tax credits.	Realisation of the benefit must be virtual certain.	
6. Property plant and equipment (IAS 16 & AASB 1015, 1014 and 1021)			
Initial measurement	Where the assets are acquired in exchange for another asset, the cost will be recorded in the case of an asset which has a similar use in the same line of business.	No relief is provided from the acquisition rules in accounting for the exchange of similar assets that are not goods and services.	Relief only to be provided where the fair value of neither of the assets exchanged can be determined reliable.
Residual Value	Residual value is estimated at the date of acquisition and is not subsequent increased for changes in prices, unless the asset is revalued		Residual value is reviewed at each balance date on the current net amount expected from the disposal of the asset.
7. Accounting for leases (IAS 17 & AASB 1008)			
Accounting treatment in the financial statements of lessees – finance lease (or equivalent)	Record an asset and a liability at the lower of: i)the fair value of the asset; ii) the present value of the minimum lease payments	Record an asset and a liability equal in amount to the present value of the minimum lease payment.	
8. Revenue (IAS 18 & AASB 1004)			

Recognition criteria	Based on transfer of risks and reward of ownership	Based on the transfer of control	
Disposal of non-current assets	Net gain recognized as a component of revenue	Proceeds from disposal recognized as a component of revenue.	
9. Employment benefits (IAS 19 & AASB 1028)			
Discounting of non-current employee benefits	High quality corporate bond rate used to discount non-current employee benefits except where no deep market exists.	National governments guaranteed security rates used to discount non-current employee benefits.	
10. Government grants (IAS 20 * UIG 11)			
Criteria for recognition	Government grants should not be recognized until these is reasonable assurance that: i)the enterprise will comply with the conditions attaching and ii) the grants will be received	No standard dealing specifically with government grants. Standards dealing with contributions state that non-reciprocal contributions should be recognized when the enterprise obtain control.	
11. Changes in foreign exchange rates (IAS 21 & AASB 1021)			
Reporting currency	SIC 19 specify that the measurement currency is that currency used to a significant extent in the entity's operation or that currency having a significant impact on the entity.	Australian companies are required to present their financial statements in Australian dollars	
12. Business combinations (IAS 22 & Various AASBs)			
Pooling of interests/ merger accounting	Pooling of interest method used in accounting for uniting of interest.	Pooling of interests method is not an acceptable basis of accounting for a business combination.	Elimination of the pooling of interest method
13. Consolidation and subsidiaries (IAS 27 & AASB 1024)			
Accounting Policies	Uniform accounting policies should be used throughout the group. If it is impracticable to do so that fact should be disclosed together with the proportions of the items in the consolidated financial statements	Uniform accounting policies are to be followed in the preparation of the consolidated financial statements.	Uniform accounting policies are to be followed in the preparation of the consolidated financial statements.
14. Financial instruments: Recognition and measurement (IAS 39 & AASB 1012, 1014)			
Hedging Instruments and hedge accounting	The use of derivatives as hedging instruments is not restricted, except for some written options. However non-derivative financial instruments can only hedge foreign exchange risk.	Foreign currency hedges carried at current spot rate with exchange differences and costs or gains on entering the hedge deferred as an asset or liability until the transaction occurs.	Hedge of firms commitments will be treated as fair value hedges rather than cash flow hedges. When a hedged forecasted transaction actually occurs and results in an asset or liability, the gains or less will not adjust the initial current amount of asset or liability.

Sources: Accounting alerts (provide regular updates of accounting developments in Australia). Available at www.deloitte.com.au. IAS Plus – www.iasplus.com is a Deloitte website dedicates to all things related to IFRS. The website includes summaries of IASB decisions, quarterly newsletter, various IFRS publications and plenty more. AASB – The AASB has published an in-depth analysis of the differences between IFRS and Australian standards. The Australian Convergence Handbook is available at www.aasb.com.au