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Transitional influences in Accounting Standards on Management of Earnings

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Abstract— This paper examines whether the transition in accounting standards has an effect on the use of management of earnings. Using the item provisions from 4 equally large listed companies in The Netherlands and Germany from before the year 2005 and compare them with the annual reports of these companies after 2005 in order to get a clear picture about the possibilities to apply management of earnings before and after IFRS. Annual reports from before the year 2005 have all been formulated according to Dutch and German GAAP. From the year 2005 onwards Dutch and German listed companies have been obliged to report according to the International Financial Reporting Standards (IFRS). Also I have engaged more specifically into the balance sheet item 'Provisions'. For this item I have debated regulations under Dutch and German GAAP and indicated what has changed after the obligation to report under IFRS. Also in the item provisions it can be clearly seen that IFRS rules are stricter than Dutch and German GAAP. The results show in this paper that the transformation in regulations has an influence on the level of earnings management.

Keywords— Management of Earnings, item provisions, IFRS, and GAAP.

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1 Introduction

Annual reports before 2005 have all been prepared in accordance with Dutch and German GAAP. From the year 2005, it became required for Dutch and German listed firms to report following the International Financial Reporting Standards (IFRS). In this paper, I discussed the regulations under former GAAP's and then indicate what changed after the obligation to report under IFRS. Also in the item provisions it can be clearly seen that the IFRS regulations are stricter than former regulations.

The International Accounting Standards (IAS), now renamed as International Financial Reporting Standards (IFRS), have been developed to harmonize corporate accounting practices and to answer the need for high quality standards to be adopted in the world's major capital markets.

Previous research provides evidence that the extent of earnings management is on average higher in code-law countries with low investor protection rights, compared to common-law countries with high investor protection rights (Leuz et al., 2003). Hence, to assess whether companies that report under IFRS can be associated with higher earnings quality, beside The Netherlands I focus also on Germany, which is a code-law country with relatively low investor protection rights (La Porta et al., 2000). Moreover, a relatively large number of German companies have already voluntarily chosen to adopt IFRS prior to 2005.

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This paper will focus on the legal and regulatory aspects. As I have mentioned, for Dutch and German listed companies it is required since 2005 that the annual report be drawn up on the basis of the IFRS. In the first section, I will discuss a summary of the German Accounting System; also discuss why the IFRS ever came to exist. Then I will discuss why the IFRS also became mandatory for Dutch and German listed companies. Finally, I will compare the IFRS with Dutch GAAP and German GAAP and I will highlight the main differences.

The German Accounting System

Germany can be classified as a code-law country with weak investor protection rights (La Porta et al., 2000). A good overview of the German accounting system is provided by Harris et al. (1994), Ball et al. (2000) and Macharzina and Langer (2002). German companies have historically relied heavily on debt, usually from a few banks. Large ownership blocks by other corporations or individuals are common, with banks often owning shares and acting as trustees for the funds of small investors. The objectives of the German accounting system are to preserve equity, protect creditors and facilitate the computation of taxable income. Financial statements form the basis for tax accounts. Since expenses are only tax deductible if they are included in the commercial accounts, the influence of tax law largely determines accounting for individual company financial statements. Guenther and Young (2000) argue that in countries where there is a conformity between financial and tax accounting rules 'financial accounting information may differ from underlying economic activities because firms attempt to minimize taxable income'. Managers are given a large number of options regarding inclusion and valuation of items in the balance sheet and the opportunity to control net income. The 'true and fair' view concept is subordinated to compliance to individual provisions of law and the dominant principle of valuation is prudence.

As a result, German accounting is in general rather conservative. This tendency towards conservative reporting is reinforced by law, preventing management from retaining more than half of net income for the year, and strong labour unions, with substantial representations on the supervisory boards, strengthening their demands when reported earnings are higher. However, while German accounting is widely presumed to be conservative because of the reduction of reported income during good years, German managers also tend to increase reported income in bad years. German firms can thus be expected to engage particularly in a specific form of earnings management, called earnings smoothing, to reduce the volatility of reported earnings.

Earnings smoothing is facilitated through the allowed use of hidden reserves. This can be created by building up unjustified provisions, recognizing excessive depreciation of assets or setting aside certain profits in tax-free reserves. In this way, a company can build up hidden reserves, which are then charged against income, when profits are high and release them in periods of losses or low earnings (Haller, 1992; Dumontier and Raffournier, 1998).

As in other countries in continental Europe, more and more firms are looking for public equity financing. Hence, the ownership and financing of these companies are changing and investors are becoming a more important user group of financial reporting in Germany. However, potential investors consider the discretion in German standards, which allows firms to manage income using large 'silent reserves', and the influence of tax avoidance strategies as too large and criticize the lack of detailed disclosures designed to satisfy the information needs of investors and financial analysts (Leuz and Verrechia, 2000).

Restructuring and provisions

(IAS 37, *Provisions, Contingent Liabilities and Contingent Assets)* defines a provision as:

a. an enterprise has a present obligation, legal or constructive, as a result of a past event;
b. it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and
c. a reliable estimate can be made of the amount of the obligation.

If these conditions are not met no provisions are allowed. Because the timing as well as the amount often is based on management judgment a restructuring provision and other provision such as a guarantee provision, a provision for environmental pollution and a provision for contract risks are qualified as discretionary.

Dutch legislation

The Dutch legislation concerning provisions has slightly changed since January 1, 2005. From 2005 onwards there is no longer the possibility to include provisions against risks, existing on the date of the balance sheet from certain obligations or expected losses. Before 2005 this was still possible under Dutch law. It is however still possible to create a cost equalization provision after 2005 (article 2:374 paragraph 1 BW).

When recording a provision there should be an obligation There are two possible obligations (IAS 27.10/14, RJ 252.110/201):

- A legal obligation
- A constructive obligation

A legal obligation means an obligation that is the result of an agreement or obligation under the law. In an actual obligation the obligation is due to actions of the legal entity which has no choice but to settle the obligation. Provisions differ from other debts because the amount and timing of settlement are subject to much uncertainty. Two other criteria, apart from the existence of a liability, for a provision to be recorded are probability and reliable estimation. (IAS 37.14, RJ 252.201). One speaks of an obligation if, on the basis of available information from the past, it is likely that the obligation will occur. It is probable if the chance is more than 50%. If it is probable that the obligation exists and meets the other criteria for a provision, then the provision is made. The criterion ''reliable estimate" means that a provision may only be included if the magnitude of the obligation can reliably be determined. The determination of the magnitude of the provision is made by the method of best estimate (IAS 37.36, RJ 252.301). In determining the magnitude of the provision one should take into account the risks and uncertainties associated with the provision. "Best estimate" means the amount that a rationally acting legal entity would pay to take over the obligation, or to transfer it to a third party. Because the determination of the magnitude of the provision brings about many uncertainties, the item "provisions" features a perfect item for applying management of earnings.

1.1 International Financial Reporting Standards (IFRS)

The abbreviation IFRS stands for International Financial Reporting Standards. IFRS is an accounting standard for the preparation of annual reports of companies. The IFRS includes International Accounting Standards (IAS), which have been further developed, and a number of IFRS norms. The International Accounting Standards Board (IASB) keeps track of whether the rules are properly observed. The major difference between IFRS and national legislation is in the way of reporting. The IFRS reporting is based on 'fair value', this means that reporting is against current values.

In The Netherlands the Dutch GAAP is the going regulation. Dutch GAAP stands for Generally Accepted Accounting Principles in The Netherlands. Before 2005 the Dutch GAAP was valid for all companies in The Netherlands. Since 2005 this has changed because of the requirement for listed companies to report under IFRS. Since 2005 Dutch GAAP applies only to non-listed companies although they may also report under IFRS. The guidelines for the Dutch GAAP are established by the Board for Annual Reporting. Additional requirements to Dutch GAAP can be found in Title 9 Book 2 of the Civil Code. There are a number of reasons why listed companies are mandated to report under IFRS since 2005. The first reason is that IFRS is seen as a quality standard that can contribute to the quality of annual reports (Beast, 2008). In IFRS there is, less

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than in Dutch GAAP, attention to the quality of earnings rather than the level of earnings.
Also, the introduction of IFRS led to a better global comparability of financial statements. Every analyst and investor can easily compare financial statement from different countries (Hoogendoorn, 2006). It is also expected that the stricter regulations of IFRS will lead to less earnings management. Dutch GAAP is more principle-based, while IFRS is more rules-based. The IFRS are uniform rules that have to be applied in the same way everywhere (Intermediair, 2004).

1.2 Generally Accepted Accounting Principles (GAAP)

Generally Accepted Accounting Principles (GAAP) have been developed by standards boards throughout the world. While accounting standards vary from country to country, the intent of GAAP is to encourage managers to record similar economic transactions in consistent ways across firms and over time.
GAAP is not so rigid that it offers managers only one choice for every recording decision. For example, within GAAP guidelines managers have several alternatives when deciding how to depreciate assets. Depreciation choice will speed up or slow down expense recognition, which in turn, will reduce or increase income. However, because accrual accounting deals with expectations of the future, GAAP is founded in conventions of conservatism and measurability to help reduce distortions that may arise from over-optimism (Wild, et al., 2007)
In a flawless world, managers would record transactions in the manner that best reflects the underlying economics of the firm. In our flawed world, many managers try to provide meaningful, if not unambiguous, financial information to the market. Others are not as candid, and still others are downright deceptive. As potential or actual shareholders and employees, it would behove us to spend considerable time analysing a firm's financial reports, or at least the reports of those who have the ability to analyse financial statements with some degree of sophistication.

1.3 Legislation and Management of Earnings

It may well be said that a lot has changed for listed companies in 2005 when they were obliged to report under IFRS. The differences between national standards and IFRS mainly relate to pensions, goodwill, income taxes, provisions, financial instruments and share-based payments (Hoogendoorn 2006). But also other balance sheet items are processed differently under IFRS. It is often difficult to determine the fair value of a balance sheet item, which paves the earnings management. It is pretty easy for managers to value a balance sheet item slightly higher (or lower). It is not realistic to compare regulations within Dutch GAAP with comparable regulations in IFRS at each balance sheet item and to investigate whether under the new legislation the ability to influence results of the item has become easier or harder. In this chapter, firstly the regulations concerning provisions item will be discussed. The regulations according to Dutch standards will be looked at and what has changed since the obligation to report under IFRS.

IFRS, Dutch and German Legislation

In this section I will look at which points the regulations concerning provisions changed after listed companies were required in 2005 to report under IFRS. The first difference is found in the valuation of provisions. Under previous law and regulations a company had the choice to value either at nominal value or at present value.

Under IFRS it should be measured at present value if the time value is material. At this point the IFRS is stricter. There are also differences between the previous legislation and IFRS regarding expenditure on major maintenance, the provision for restructuring reorganizational costs, the provision for restoration costs, the provision for disability insurance costs and regarding changes in the provision for restoration costs.

On all these issues, IFRS is stricter than the former legislation. In a stricter way of reporting it can be expected that the use of earnings management is more difficult. Under former law it is permissible to make provisions in good times. In bad times, the company has a buffer on hand to equalize profits.

I expect therefore that the research in this paper will reveal that Dutch and German listed firms have taken greater provisions in the years they could still report under Dutch and German legislation (before 2005), than if they would have had to apply the IFRS rules. This view is descriptive the highest paid executives may be the ones who make the greatest contribution to firm value. For example, (Chang, Dasgupta and Hilary 2010) find that, in a broad cross-section of firms, the level of compensation is positively correlated with the performance of CEO's. Although compensation of sales executives is likely to mainly reflect their capacity to generate sales, the compensation may also reflect other dimensions of the job such as the quality of sales reporting. If this view is empirically descriptive, higher paid sales executives may generate better quality sales reports if these executives have the capacity to affect the quality of financial statements and if it is in the best interest of their employers to provide high quality financial reporting. In contrast to this "pay-for-transparency" view, the agency theory predicts that sales executives behave opportunistically and manipulate the reporting to maximize their compensation, their bonus in particular.

2. Motives of Managers to Manage Earnings

So far discussion explains the phenomenon management of earnings and what the motives of managers to manage earnings are and how accruals are managed. This section discusses the way forward how managers manage their earnings. According to Arthur Levitt (1998), the former president of the Security Exchange Commission (SEC), there are five potential forms of earnings management.

2.1 Big Bath

The strategy of manipulating a company's income statement to make poor results look even worse. The big bath is often implemented in a bad year to enhance artificially next year's earnings. The big rise in earnings might result in a larger bonus for executives. New CEO's sometimes use the big bath

so they can blame the company's poor performance on the previous CEO and take credit for the next year's improvements. For example, if a CEO concludes that the minimum earnings targets can't be made in a given year, he/she will have an incentive to move earnings from the present to the future since the CEO's compensation doesn't change regardless if he/she misses the targets by a little or a lot.

2.2 Acquisition Accounting

This type of management of earnings occurs in acquiring a shareholding. Levitt (1998) declares about creative acquisition accounting as "merger magic." A merger or takeover can occur by two different methods, namely under the purchase method of accounting and pooling of interests'. The main difference between these methods is that with the purchase method, the fair values of the acquire is included in the accounts of the acquirer, while in the pooling method, the step towards market values is not made (Bois Evan & Kuipers, 2005). Levitt emphasized in his speech that a company cannot always choose between the two methods and to choose the purchase method as this can result in lower future profits. This is a result that companies do not want to take; as a result, Creative Acquisition accounting is applied in order to disguise the results. This is done by a portion of the purchase price to be included as in-process research and development, with the advantage that this sum is to be depreciated. Dichev et al. (2012) provided in there research when they interviewed several CFO's mentioned that accounting for acquisitions was common setting for management of earnings:

''acquisitions accounting would be the biggest area where I've seen some CFO's taking advantage. I have seen acquisitions used to establish numerous balance sheet items and those provide huge opportunities in the future to manage the P&L. They would set up provisions that are always worth more than they were set up for''.

2.3 Cookie Jar Reserves

The third category of earnings management is so called "cookie jars reserves". An accounting practice, in which a company uses generous reserves from good years against losses that might be incurred in bad years. Cookie jar accounting is a sign of misleading accounting practices. This gives the sense of "income smoothing", because earnings are understated in good years and overstated in bad years. Several studies have looked at reasons why managers choose to equalize income. Healy (1985) identifies as one possible reason for managers that distort the profits is in order to achieve their bonus, while other researchers believe that managers use income smoothing so that they don't lose their job. (Fudenberg and Tirole 1995, Arya et al 1998). Demski and Frimor (1999) give the 'contracting theory' as a reason for turning profits. According to this theory, they turned to income as an equilibrium situation**.** The above studies reinforce the idea that there may be little value attached to the profits reported since data can be easily twisted. There are also studies that find "income smoothing as a method, managers can use to give information about future earnings. Kirschenheiter and Melumad (2002) give as an explanation, for "income smoothing" that investors on the one hand, can deduce from the reported figures how the future cash flows will be, while on the other hand, the fluctuation of the figures leads to declining confidence in investors.

There is evidence that German firms engage in substantial income smoothing (e.g., Ball et al. 2003; Leuz et al. 2003). On the one hand, this approach is limiting in the sense that it only reports on a subset of earnings management, namely earnings smoothing behaviour. On the other hand, it centers the research on the best documented and probably most prevalent financial accounting issue. It thus provides evidence for an earnings management activity, which is central to German reporting.

If the numbers are evened out by 'income smoothing' principle, the investor confidence is not damaged. Ronen and Sadan (1981) say that only companies with good future prospects use this form of management of earnings application. For companies with less positive expectations it would have disastrous consequences. It is important to determine whether "income smoothing" is done to the profits to twist or to provide information about future earnings. As "income smoothing" is primarily used to distort earnings, little information can be gathered about the future profits. If the purpose of "income smoothing" is to provide information then there exists a strong relationship between earnings and future earnings information.

2.4 Materiality

Material in the pattern for the preparation and presentation of financial statements (1998) is defined as follows: "Information is material if its omission or misstatement of the economic decisions of users based on the financial statements, could be affected". According to Levitt (1998), the concept of 'materiality' is still abused by managers. Then there are deliberately made mistakes in the figures that can be regarded as immaterial because they do not really matter but they still provide for differences.

2.5 Revenue Recognition

The last type of earnings management is revenue recognition that former Securities and Exchange Commission (SEC) Chairman Arthur Levitt listed premature recognition of revenue as one of the five major areas of earnings management (Levitt 1998) An accounting principle under generally accepted accounting principles (GAAP) that determines the specific conditions under which income becomes realized as revenue. Generally, revenue is recognized only when a specific critical event has occurred and the amount of revenue is measurable.

For most businesses, income is recognized as revenue whenever the company delivers or performs its product or service and receives payment for it. However, there are several situations in which exceptions may apply. For example, if a company's business has a very high rate of product returns, revenue should only be recognized after the return period expires.

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Companies can sometimes play around with revenue recognition to make their financial figures look better. For example, if XYZ Corp. wants to hide the fact that it is having a bad year in sales, it may choose to recognize income that has not yet been collected as revenue in order to boost its sales revenue for the year.[1]

It is therefore natural for researchers to investigate the drivers of sales reporting quality. For example, Altamuro, Beatty and Webber (2005) show that board independence or financial covenants are associated with the propensity to manage sales reporting. The literatures in economics, management and accounting have also long discussed the role played by individual executives in the management of the firm. However, most of this debate has focused on CEO's, and to a lower extent on CFO's [2] (e.g. Core, Holthausen and Lacker 1999, Geiger and North 2006).

A related debate is whether the level of compensation reflects the role played by managers. One view is that higher compensation reflects higher executive value. If this view is descriptive, the highest paid executives may be the ones who make the greatest contribution to firm value; Chang, Dasgupta and Hilary (2010), but again most of the research has focused on CEO's behaviour. If the agency theory is empirically descriptive in our setting, highest paid managers may be the most successful manipulators.

In the next section, I will research the use of management of earnings on the item "provisions". The value of the Dutch and German listed companies for 2005 will be compared with values after the year 2005. Therefore it is important to see what exactly has changed in the regulations after the transition to IFRS.

3 Analysing the Level of Management of Earnings under GAAP & IFRS

In this section, I will take the item provisions from 4 equally large listed companies in The Netherlands and Germany from before the year 2005 and compare them with the annual reports of these companies after 2005 in order to get a clear picture about the possibilities to apply management of earnings before and after IFRS.

The companies that will be investigated are:

- Ahold
- Unilever
- Henkel
- Südzucker

I will compare the annual reports of 2003, 2004, 2005, 2006, 2007 and 2008 of above-mentioned companies, in which the annual reports of 2003 and 2004 have been made according to the Dutch and German legalisation, while the annual reports of 2005, 2006 2007, and 2008 have been made according to the IFRS. The most important comparison I make in this research will be between the annual reports of 2003 and 2004 on the one hand, and the annual reports of 2005, 2006, 2007 and 2008 on the other hand.

On the balance sheet of Ahold and Südzucker from before the year 2005 the item provisions is to be found under 'obligations' not shown in the balance sheet . On these balance sheets the item provisions comprises:

- Pensions and other related payments,
- Defferred tax liabilities,
- Restructuring provisions
- Other provisions

In this research, only the values of the other provisions and restructuring provisions are included. The reason for this is that precisely in these forms of provisions management of earnings is applied. The restructuring provisions and other provisions are used as a 'cookie jar'. In good years, with great profit, the jar is being filled and in the years of downturn, the jar is being emptied. As a result that profit is equalised.

On the balance of Ahold and Südzucker from the year 2005, the item provisions separated into non-current and current provisions. The following parts are included under the item provisions in the balance sheets after the year 2005: restructuring, self-insurance program, loyalty programs, and other. As shown in table 2 and 3, the mandatory transition in 2005 to IFRS has had the necessary impact on the net profit. The net profit over 2004 was under IFRS 1,3 billion Euros higher than was determined under Dutch GAAP. [3]

In table 2 and 3 it can be seen that the net result is far from equal. The item provisions seem not to have been used as a ''cookie jar''. An explanation for the negative net result in the first 3 years can be found in the accounting scandal which took place at Ahold.

It is obvious that in these years another form of management of earnings has been applied, namely, 'Big Bath'. This means that in years with bad results, extra costs are added so that in the following years one can start with a clean sheet again. In the year 2005 it can be seen that the total provisions amounted to € 1766 million, while the net income is € 159 million. The following year, the total provisions reduced by half, while the net income was almost fivefold. This could imply that the 'cookie jar' that was full in the year 2005, has been used to increase the result of 2006. However, in 2007 and 2008 the net result has increased again significantly by 2 billion. It is more obvious that Ahold has found the right track again from 2005 onwards and has left all the trouble about the accounting scandal behind.

From the Ahold and Südzucker numbers one can in my opinion not deduct that the item provisions is used to manage earnings. Also based on just these numbers, it is hard to de-

[1] *http://www.investopedia.com/terms/r/revenuerecognition.asp*

[2] *Executives most affected by these governance reforms are the chief executive officer (CEO) and chief financial officer (CFO) (Chang et al. 2006; Zhang 2007)*

[3] *CHANGES IN ACCOUNTING POLICIES*
Adoption of International Financial Reporting Standards. Until 2004, Ahold prepared its consolidated financial statements under generally accepted accounting principles in The Netherlands (Dutch GAAP) as required by a European Union (EU) regulation, from 2005 onwards the consolidated financial statements are prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted by the EU. All standards issued by the International Accounting Standards Board (the "IASB") effective for 2005 and all interpretations issued by the International Financial Reporting Interpretations Committee (the "IFRIC") effective for 2005 have been adopted by the EU.

termine whether under (IFRS) it has become more difficult to manage earnings.
For the Unilever and Henkel- Group the provisions for restructuring and other provisions are included in the item provisions. In the annual reports of 2006, 2007 and 2008 under the provisions are also included provisions relating to preferred shares, provisions for disputed indirect taxes, juridical provisions and provisions for negative net value of an associated company. These provisions have not been included in the research while the data of different years can otherwise hardly be compared. Just as with Ahold and Südzucker, also with Unilever from the year 2005 the item provision is splitting into non-current and current part.

Furthermore in the annual report of 2005 the net income of the year 2004 is given both following the directives of Dutch legislation as following IFRS.
In the table above, two things are striking. Firstly, that the net income in the years that the annual reports are made according to IFRS are higher than in the years when they were made according to the basic principles of Dutch and German GAAP.

Additionally, it attracts the attention that the amount that is included on the balance sheet as ‘other provisions’ is lower from the year 2006 onward, compared to the years before.
This indicates the application of management of earnings. Unilever has more opportunities under the Dutch GAAP and German to oppress profit by means of management of earnings. Due to the stricter rules of IFRS it has become harder to build up ‘cookie jar’ reserves under the item ‘other provisions’ causing the profit to come out higher.

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4 Demonstrating the influence of GAAP & IFRS on Management of Earnings in Relation to Self-Interest factors

Managers have more opportunities and ways to manage earnings under local GAAP than with new IFRS-rules. See also Tables 2, 3, 4, and 5.
A positive relationship has emerged between self-interest of managers on the one hand, and EPS (earnings per share) and net income on the other, Table.5; in other words: in GAAP EPS goes down and managers have a self-interest to depress earnings. While under IFRS it can be seen that, EPS rising even if net income goes down. If managers want to show good performance and keep up their image, they will use both material and moral interest, Table 6. This is reliable with result which provided by Dichev et al. (2012), they show that CFO’s have a clear preference for converging U.S. GAAP and IFRS over the outright adoption of IFRS. They show also in their survey study that in any given period about 20% of firms manage earnings and for such firms 10% of the typical EPS number is managed.
Income is only earned through equity transactions outside the firm, not with those involving the firm's owners. If no gain or loss is on stock buybacks, how can they be used for management of earnings? The answer is that although a stock buyback does not affect earnings, it does affect earnings per share, a widely used earnings surrogate[4]. In a profit-making organization, it is essential for all members of the management team and their staff to work together and to achieve the strategic objectives of the organization[5]. The situation which leads the individuals or groups to take actions which are in their self-interest and also in the best interest of the organization is called Goal Congruence[6]. Table 1 Demonstrates Schedule compression techniques process of IFRS with GAAP

Management of earnings consists in different forms. In this paper I have joined the five forms of the ‘Security Exchange Committee’ (SEC). Those were ‘Big Bath’ accounting, creative acquisition accounting, cookie jar reserves (also known as ‘income smoothing’), materiality and revenue recognition.
In this paper I have engaged more specifically into the balance sheet item ‘Provisions’. For this item I have discussed regulations under Dutch and German GAAP and indicated what has changed after the obligation to report under IFRS. Also in the item Provisions it can be clearly seen that IFRS rules are more strict than Dutch and German GAAP, Table 1
After it has been clear how regulations have changed for Dutch and German listed companies in the year 2005, I have researched in this paper if the change in regulations has had an impact on the use of management of earnings. Based on the results of this research I will come to answer the assumption.
In the research I have compared the annual reports over the years 2003, 2004, 2005, 2006, 2007 and 2008 of 4 equally large listed companies in The Netherlands and Germany.
In the research I have looked at values of the items provisions and net profit. I have specifically looked if from these values it is proven whether the company has applied management of earnings in any given year.
I believe that due to the obligation to report according to IFRS, it has indeed become more difficult to apply management of earnings. In the years that annual reports were formulated according to Dutch and German GAAP it can be clearly seen at multiple occasions that the item provisions has been used to manage net profit.
In general, it is striking that in the years that reporting was made according to IFRS; the net result is higher than in the years 2003 and 2004. This could be the result of the more strict way of regulating. Because of the many rules it has become harder to suppress profit. From the values of the item provisions and net results in the years 2005, 2006, 2007 and 2008 I cannot see the use of management of earnings at all.

[4] *For more info see Kieso, D.E., J.J. Weygandt, and T.D. Warfield. 2001. Intermediate Accounting. New York: John Wiley and Sons, p.952*
[5] *http//lasanthaw.com/hub/potential-strategic-financial-objectives-o-f-an-organization*
[6] *http://www.mbaknol.com/financial-management/concept-of-goal-congruence*

Table 1
Comparison IFRS With GAAP

IAS/IFRS	Topic	IFRS	GAAP	Result
IAS 37	Recognition of provisions	Threshold for recognition is 'possible' (defined as 'more likely than not')	Also uses a 'probable' threshold – but this is interpreted as a higher threshold than 'more likely than not'.	IFRS more strict
IAS 37	Measurement of provisions – range of estimates	Best estimate to settle the obligation, which generally involves the expected value method.	Most probable outcome to settle the obligation. If no one item is more likely than another, use the low end of the range of possible amounts.	IFRS more strict
IAS 37	Measurement of provisions – discounting	Discounting is required.	Unless specifically permitted by an accounting standard, discounting is only allowed where the timing and amount of the future cash flows are fixed and determinable.	IFRS more strict
IAS 37	Disclosures that may prejudice seriously the position of the entity in a dispute	In extremely rare cases amounts and details need not be disclosed, but disclosure is required of the general nature of the dispute and why the details have not been disclosed.	Disclosure is required.	IFRS more strict
IAS 37	Initial measurement of decommissioning provisions	Asset retirement obligation (ARO) liability measured as the best estimate of the expenditure to settle the obligation or to transfer the obligation to a third party at the end of the reporting period.	ARO liability measured at fair value in the period it is incurred if a reasonable estimate of fair value can be made.	IFRS requires more explanation
IAS 37	Recognition of restructuring provisions	Recognise if a detailed formal plan is announced or implementation of such a plan has started.	Recognise when a transaction or event occurs that leaves an entity little or no discretion to avoid the future transfer or use of assets to settle the liability. An exit or disposal plan, by itself, does not create a present obligation to others for costs expected to be incurred under the plan.	IFRS requires more explanation

Source: *Deloitte Touche Tohmatsu London, www.deloitte.com*

Table 2
Ahold Group: Consolidated Balance (in million EUR)

	GAAP 2003	GAAP 2004	IFRS 2005	IFRS 2006	IFRS 2007	IFRS 2008	%
Restructuring	82	61	38	57	44	16	
Other	728	660	52	62	150	106	
Current provisions			222	1,230	2	16	
Non-Current provisions			476	536	18	32	
Total	**810**	**721**	**698**	**1,766**	**196**	**170**	
Net profit	(1208)	898	159	915	2945	1,079	63.4

Table 3
Südzucker Group: Consolidated Balance (in million EUR)

	GAAP 2003	GAAP 2004	IFRS 2005	IFRS 2006	IFRS 2007	IFRS 2008	%
Restructuring		13.4	(32.6)	34.6	35.9	29.0	
Other	1,642	379.1	393.0	395.8	174.1	211.1	
Current provisions			415.4	409.6	181.5	35.8	
Non-Current provision			200.3	222.6	398.9	401.7	
Total	**1,642**	**392,5**	**1006.1**	**662.6**	**789.9**	**677.6**	
Net Profit	307,3	357.5	305	(246.0)	100	183	27

Table 4
Unilever Group: Consolidated Balance (in million EUR)

	GAAP 2003	GAAP 2004	IFRS 2005	IFRS 2006	IFRS 2007	IFRS 2008	%
Restructuring	82	43	23	53	63	91	
Other	728	678	513	128	178	112	
Current provisions Non-Current provision							
Total	**801**	**721**	**536**	**181**	**241**	**203**	
Net profit		898	4 136	4 136	5 015	5 285	26.03

Table 5
Henkel Group: Consolidated Balance (in million EUR

	GAAP 2003	GAAP 2004	IFRS 2005	IFRS 2006	IFRS 2007	IFRS 2008	%
Restructuring			154	-	-		
Other		421	475	884	763	177	
Current provisions Non-Current provision		510 189	664 224	108 126	152 119	866 336	
Total		**1,516**	**1,517**	**1,118**	**1034**	**1,379**	
Net profit		1,738	770	871	941	1,233	89.41

TABLE 6
RELATIONSHIPS BETWEEN SELF-INTEREST OF MANAGEMENT AND NET INCOME

	2003	2004	2005	2006	2007	2008
Ahold						
EPS		0.42	(0.09)	(0.42)	0.52	0.73
Net income	(1208)	898	159	915	2,945	1,079
Henkel						
EPS		1.73	1.75	1.97	2.12	2.81
Net income		1,738	770	871	941	1,233
Unilever						
EPS		2.83	3.88	1.65	1.35	1.79
Net Income		898	4 136	4 136	5 015	5 285
Südzucker						
EPS	1.52	1.48	1.67	1.36	0.10	0.86
Net income	307	357,5	305	(246,0)	100	183

Source: Annual reports of Dutch and German companies from 2003 - 2008

5 CONCLUSION

The requirement for Dutch and German listed companies to report from the year 2005 onwards according to IFRS has had the necessary impact in preparing the financial statements. This paper mainly focuses on the balance sheet item "provisions". Examining the changes in regulations has led to managers making less use of management of earnings.

This paper shows that after the obligation to apply the International Financial Reporting Standards, Dutch and German listed firms have made less use of management of earnings.

Annual reports before 2005 have all been prepared in accordance with Dutch and German GAAP. From the year 2005, it became required for Dutch and German listed firms to report following the International Financial Reporting Standards (IFRS).

In this paper, I discussed the regulations under former GAAP's and then indicate what changed after the obligation to report under IFRS. Also in the item provisions it can be clearly seen that the IFRS regulations are stricter than former regulations. Because of the many principles under IFRS it is difficult for managers to apply management of earnings.

Management of earnings is the influencing of financial reporting in a direction that is favourable to the manager. The manager thus tries to mislead the interested parties, whereby the rules for formulating the annual report have to be taken into consideration. The action of managers is to be explained from the Positive Accounting Theory (PAT), conducted by Watts and Zimmermann (1986).

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