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# IFRS adoption, corporate governance and management earnings forecasts

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## Abstract

**Purpose** – This paper aims to examine whether International Financial Reporting Standards (IFRS) adoption and corporate governance attributes increase the management earnings forecasts' accuracy disclosed in prospectuses for French Initial Public Offerings (IPOs).

**Design/methodology/approach** – The analysis is based on cross-sectional regression explaining the absolute forecast errors by using 45 French firms that made IPOs between 2005 and 2016 in two French financial markets: Euronext and Alternext.

**Findings** – In agreement with the agency theory and the signaling theory, the authors find that the IFRS adoption and the effective corporate governance, proxied by the board characteristics, increase the accuracy of management forecasts. As a result, this latter gives a credible signal in constructing and sustaining shareholders' trust on the transparency and the reliability of such financial information.

**Research limitations/implications** – It is plausible that the limited size of the sample represents a limitation of this study. Another limitation is that no other corporate governance attributes such as board meeting frequency, audit committee measures and ownership structure are used.

**Practical implications** – Shareholders can take benefit from management forecasts accuracy to structure their investment portfolios efficiently to allocate their funds more effectively and mitigate the costs of adverse selection that they have to face. Furthermore, the authors expect the findings to be interesting to IPO firms, as this study highlights the efficiency of larger and independent boards in decreasing managerial discretion, increasing disclosure quality and supervising management. The results could encourage GAAP-adopters countries to move toward IFRS, as this research reinforces the role of IFRS in enhancing the quality of financial disclosure by offering the required information for shareholders.

**Originality/value** – This study is important because the potential investors should assess management earnings forecasts accuracy before they consider it when evaluating IPO firms. Also, this paper has some implications for the financial market. It is recommended that future investors pay more attention, when assessing the accuracy of management earnings forecasts, to the accounting regulations of the financial reporting along with the corporate governance mechanisms. Moreover, this study could incite French regulators to revise the AFEP-MEDEF code. Under this code, it could insist that larger and independent boards are more effective in performing their governing roles than smaller boards.

**Keywords** IFRS, Corporate governance, Management forecasts, Forecasts accuracy, Initial public offering

**Paper type** Research paper

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## 1. Introduction

A distinctive feature of Initial Public Offerings (IPOs) appears in the significant information asymmetry gap between the issuing firm's management and the potential investors. To evaluate the company and to make a decision about investments, potential investors require information about the company's future performance. According to Verrecchia (2001), managers are motivated to issue voluntary information such as the earnings forecasts that represent private information on the future performance of the firm, thus to avoid the information asymmetry and to attract more investors. "Management earnings forecasts" is defined by King *et al.* (1990) as "voluntary disclosures predicting earnings before the planned reporting date". Firth (1998) documented that earnings forecasts can be a major signal of the firm's valuation, and the disclosure of forecasts can decrease information asymmetry, which results in reduction of the agency problem.

Moreover, management can disclose earnings' forecasts in the IPO prospectuses. In France, the issuing firm's management often chooses to disclose a forecast or estimation of the next year's profits in their IPO prospectuses. To attract the potential investors and to alleviate information asymmetry, earnings forecasts need to be accurate, relevant and reliable. The accuracy of management forecasts displays a clear indication regarding the management credibility and establishes a trust toward managers' performance and competence (Tan *et al.*, 2002). As mentioned by Skinner (1994), managers acting in the best interests of the company should improve transparency by conveying more accurate forecasts. Hope (2003) shows that firm-level disclosures convey useful information to the outside.

In this context, the accounting regulations of earnings forecasts and financial reporting should provide higher comparability and transparency. Furthermore, the adoption of the International Financial Reporting Standards (IFRS) offers a positive signal of greater quality and transparency of financial reports (Daske and Gebhardt, 2006). This is due to the fact that quality disclosure has improved significantly under IFRS, more than companies that continued to apply Generally Accepted Accounting Principles (GAAP). Li and Yang (2016) find that IFRS adoption changes firms' disclosure motivation in response to increased capital-market request. The information asymmetry is reduced between companies and their investors as IFRS enhance recommended disclosures and provide reliability and relevance of information for investment decisions (Barth *et al.*, 2008).

In addition, Ajinkya *et al.* (2005) show that efficient corporate governance is considered as a reliable signal to enhance the financial information quality. Hence, the fundamental goal of corporate governance is to increase value creation by decreasing information asymmetries and agency conflicts, and by safeguarding the shareholder's value. Since 1995, the AFEP-MEDEF code promotes good corporate governance practices in France. It has developed a set of recommendations that enable listed firms to enhance their transparency and, thus, respond to the expectations of investors. The recommendation 8.3 of the AFEP-MEDEF code encourages French firms to incorporate independent directors as a half of board members in widely-held corporations without controlling shareholders and a third of board members in controlled companies. The recommendation 2.2 of AFEP-MEDEF allows firms to choose between separation of the chairman and chief executive officer and the aggregation of such duties. The recommendation 24.3.2 of the code states that the board of directors, which appoints the executive officers, is responsible for determining their compensation, and it may also decide to award annual variable compensation. Yet, the code has no recommendations about the size of boards.

The aim of this paper is, thus, to examine whether IFRS adoption and corporate governance attributes increase management earnings forecasts accuracy disclosed in the

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IPO prospectuses in a French context. This research is important because earnings forecasts are the vital valuation parameter for IPOs and the knowledge of the level of forecasts accuracy is crucial for investors, regulators, analysts, financial market makers and stakeholders.

The French market is suitable for the study of the management earnings forecasts accuracy related to IPOs. Major changes have occurred at the beginning of 2005 in the French financial markets. The disclosure of forecasts changed from mandatory to voluntary. According to the Recommendations of the "Autorité des Marchés Financiers" (the AMF position *n*° 2006-17) and the Recommendations of the Committee of European Securities Regulators (CESR Recommendations *n*° 809/2004) concerning the prospectuses (point 13 and paragraphs 38 to 50), the company may *choose* to include forecasts or estimations of their profit in its prospectus. We highlight that the French market in 2005 become organized into two categories. First, the Euronext market in which the accounting standards used is IFRS or US GAAP. Second, the Alternext market in which the accounting standards used is IFRS or European Union Accounting Standards (national standards). This market is dedicated to the small and medium size companies.

In this context, the ownership of French firms is highly concentrated, and the majority of these firms are controlled and managed by families. Hence, in France, companies appear to be reluctant to voluntarily release private information to shareholders. Boubaker and Labégorre (2006b) highlight that increased analyst coverage does not come along with better forecast quality in firms with highly concentrated ownership. This gives us an opportunity to study if the IFRS adoption and the board mechanisms are associated with the accuracy of management earnings forecasts.

Prior research studies in the French context focused on the voluntary disclose and on the management forecast accuracy. Labégorre and Boubaker (2005) analyze the voluntary disclose of forecasts based on IPOs. Boubaker and Labégorre (2006a, 2006b) study the determinants of forecast accuracy using the prospectus of IPO firms.

Furthermore, several research studies in the French context analyze the impact of IFRS on analyst forecasts' accuracy but not the management forecasts accuracy. Rouhou *et al.* (2015) examine the impact of IFRS mandatory adoption by French firms on analysts' earnings forecasts accuracy. De la Bruslerie and Gabteni (2014) investigate whether IFRS adoption increases the voluntary disclosure. However, other research studies focus on the management forecast accuracy. Mnif (2010) examine the association between board attributes and management earnings forecasts accuracy disclosed by French IPOs. Barros *et al.* (2013) investigate IFRS adoption and corporate governance attributes that encourage French IPO firms to voluntarily disclose more accurate management earnings forecasts. Zouari *et al.* (2015) study the relationship between CEO characteristics and the earnings management in France.

The present study extends prior research efforts and demonstrates that, following the agency theory and the signaling theory, IFRS reduce the information asymmetry and increase the disclosure quality by enhancing the forecasts accuracy disclosed in French IPO. In addition, our paper demonstrates the vital responsibility of the board in overseeing the disclosure and the accuracy of forecasts.

Several research studies highlight the association between the IFRS adoption and the likelihood of management earnings forecasts (Ng *et al.*, 2012; Li and Yang, 2016; Firth and Gounopoulos, 2017). However, an unsatisfactory attention has been paid to the effect of IFRS adoption on management earnings forecasts accuracy contained in the IPO prospectuses. Likewise, very few studies have investigated the association between corporate governance attributes and the accuracy of management earnings forecasts. The first research studies

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that examined the link between the management forecasts quality and the corporate governance are accomplished by Karamanou and Vafeas (2005) and Ajinkya *et al.* (2005). Firth and Gounopoulos (2017) examine the effect of mandatory IFRS adoption on IPO earnings forecasts in Australia. They find that the introduction of IFRS is characterized with higher forecast errors relative to the previous Australian GAAP period. Our study extends Firth and Gounopoulos's (2017) study by examining whether both IFRS adoption and corporate governance attributes affect the management earnings forecasts accuracy disclosed in prospectuses for French IPOs.

To the best of our knowledge, this is the first study that seeks the relationship between the accuracy of management earnings forecasts and the IFRS adoption as well as corporate governance mechanisms. It contributes to the French IPO literature and the voluntary disclosure literature (management earnings forecasts accuracy in particular) in different ways. First, we outline that, following the agency theory and the signaling theory, IFRS diminish the information asymmetry and increase disclosure quality through the improvement of financial information. Second, unlike previous studies (Ashbaugh and Pincus, 2001; Bae *et al.*, 2008; Tan *et al.*, 2011; Horton *et al.*, 2013; Rouhou *et al.*, 2015) that emphasize the analyst forecasts' accuracy under IFRS, we stress the management forecasts accuracy provided in IPO which is a crucial information for investors. Third, we shed light on the role of the corporate governance as a control mechanism, as the agency theory indicates, in enhancing financial disclosure by decreasing absolute forecast errors (AFEs) (i.e. increase the accuracy of management forecasts). Finally, our study extends those of Mnif (2010), De la Bruslerie and Gabteni (2014); Zouari *et al.* (2015) and Rouhou *et al.* (2015) by providing new evidence that, in France, an independent and a large board along with IFRS adoption are closely tied with companies' propensity, to issue more accurate earnings forecasts, and not just with the extent of voluntary disclosure.

In this paper, we examine the impact of IFRS adoption and corporate governance attributes (board independence, board size, CEO duality, and CEO incentive compensation) on management earnings forecasts accuracy around the time of (IPO) in France, using a sample of 45 firms that went public between 2005 and 2016 on Euronext and Alternext Paris. First, we find that the introduction of IFRS enhances the ability of French IPO firms to predict accurately. The application of IFRS by French IPOs firm in our sample reduces AFE and improves management forecast accuracy. Second, we find that management earnings forecasts accuracy is negatively associated with the proportion of independent directors on the board. The IPO firms are more likely to issue more accurate earnings forecasts when the proportion of independent directors on the board is high. Third, we find that management earnings forecasts accuracy is positively associated with the board size. Thus, IPO firms are more likely to issue more accurate earnings forecasts when the board size is large.

The rest of this paper is organized as follows: Section 2 develops literature review and hypotheses. Section 3 describes data and methodology. Section 4 presents the results of the paper. We check the robustness of our results in Section 5. Finally, Section 6 concludes the paper.

## 2. Literature review and hypotheses

The agency theory is the fundamental theory that highlights the importance of corporate governance as a tool for oversight system that deters the aberrant activities of managers. Through the transparent voluntary disclosure, the corporate governance reduces agency problems and enhances information quality, which is the crucial means to limit the information asymmetry between investors and managers (Ahmad-Zaluki and Wan-Hussin, 2010). The segregation between ownership and control functions caused the conflict of

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interests between managers and shareholders given that each seeks to maximize its own utility (Jensen and Meckling, 1976). To mitigate this conflict, the agency theory proposes mechanisms of monitor allowing to discipline managers and to force them to act in the interest of owners. Among these mechanisms, the board of directors is often seen as the primary mechanism of control. Under the agency perspective, the switch to IFRS should improve the disclosure quality, the transparency of financial reporting, and should eventually scale down information asymmetry and agency costs.

Furthermore, the signaling theory indicates that the implementation of IFRS can be viewed as a positive signal of greater quality and of the transparency of financial reports disclosed to all market parts through the increase in forecasts accuracy. The signaling theory, also applied to clarify the voluntary disclosure of forecasts. Lev and Penman (1990) explain that earnings forecasts are provided by firms to show that they are better than other firms in the market. Based on the signaling perspective, Williams (1996) highlights that the accuracy of management earnings forecasts can be considered as a signal of the credibility and transparency of managers, and it also indicates that managers are acting for the best interests of the company.

### *2.1 International Financial Reporting Standards adoption and management earnings forecasts*

In fact, a very limited number of studies focus on the effect of IFRS adoption on management forecasts quality. Among them, Ng *et al.* (2012) and Li and Yang (2016) tested whether IFRS implementation motivated firms to supply management earnings forecasts. They reported that companies in the IFRS-adopters countries strongly release management earnings forecasts upon IFRS than companies in the GAAP-adopters countries. However, Rhee *et al.* (2016) exhibited that the likelihood for Korean companies that release management earnings forecasts had declined following mandatorily IFRS implementation unlike the period prior to IFRS adoption. Using a sample of Australian IPO firms, Firth and Gounopoulos (2017) study the accuracy of management earnings forecasts upon IFRS in IPO context. Based on a sample of 221 earnings forecasts of IPOs between 2001 and 2009 divided into before IFRS adoption and after IFRS adoption, the authors find that IPO profit forecasts accuracy has not increased upon IFRS. They also show that management forecasts, prepared according to IFRS, seemed pessimistic while optimistic under GAAP.

In the French context, De la Bruslerie and Gabteni (2014) analyzed annual reports of 67 firms for the period 2003-2008 to investigate whether IFRS adoption increases the voluntary disclosure. Their results show that voluntary disclosure policies experienced an upward swing with IFRS adoption. This study also displayed that, after IFRS, the discretionary communication policies of French companies follow both a long term and short term component to meet analysts' demand for information permitting an increase in earnings forecasts accuracy.

Additionally, Rouhou *et al.* (2015) examine the impact of IFRS mandatory adoption by French firms on analysts' earnings forecasts accuracy. Using 98 French companies between 2003 and 2007, their results exhibited improvements of the accuracy of analysts' earnings forecasts after the mandatory adoption of IFRS in 2005.

Hence, we suppose that the adoption of IFRS improves the accuracy of management earnings forecasts voluntarily disclosed in IPO prospectuses. Our first hypothesis is as follows:

*H1*. There is a positive relationship between IFRS adoption and management earnings forecasts accuracy.

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*2.2 Management earnings forecasts accuracy and corporate governance attributes*
The board of directors is considered by the agency theory as one of the main instruments that allows remedying managers' deficiencies. Indeed, this monitor mechanism is responsible for representing shareholders' interests, defending their interests, and controlling the CEO. Nonetheless, the ability of the board to perform as an effective controlling mechanism depends on its characteristics. It is mainly board independence, board size, and CEO duality. Moreover, to minimize the information asymmetry, shareholders can make an optimal contract that obliges managers to disclose private reliable information that leads the investors to make the best decision (Jensen and Meckling, 1976). In this context, the CEO incentive compensation is also viewed by the agency theory as another control mechanism that unifies the interests of managers and investors.

*2.2.1 Board independence.* Previous surveys on corporate governance reported that independent directors serve as a more effective monitoring mechanism, and that are a signal of transparency and credibility (Fama and Jensen, 1983; Chen and Jaggi, 2000). Moreover, most studies that investigated the association between corporate board and earnings management accentuated that the board independence is positively linked with a greater financial reporting quality (Dechow *et al.*, 1996; Klein, 2002; Chen *et al.*, 2006).

Karamanou and Vafeas (2005) address the issue of how the corporate board mechanisms are connected with the quality of management earnings forecasts. Using a sample of 275 US listed firms that announced 1,621 earnings forecasts between 1995 and 2000, the authors find that firms, which have higher fraction of external directors, issue more accurate earnings forecasts. The same reliable evidence is asserted by Ajinkya *et al.* (2005) who use a sample of 1,253 US listed firms making annual forecasts from 1997 to 2002. They find that firms issue forecasts more frequent when they have greater outside directors.

Furthermore, Mnif (2010) examines the association between board attributes and management earnings forecasts accuracy disclosed by French IPOs. He reported that IPO French firms are more likely to disclose more accurate and conservative earnings forecasts when the proportion of independent directors on the board is higher.

According to previous research studies that have revealed a positive correlation between corporate board independence and management earnings forecasts quality, we expect that firms with higher proportion of independent directors on the board issue more accurate earnings forecasts. Our second hypothesis is as follows:

*H2.* There is a positive relationship between proportion of independent directors and management earnings forecasts accuracy.

*2.2.2 CEO duality.* Jensen (1993) argues that boards of directors are ineffectual monitors when the board is too large, when the board's equity ownership is small, and when the CEO is also the Chairman of the Board. The combination of the roles of Chairman and CEO seems like a barrier to the segregation between the management and monitor functions. Yermack (1996) suggests that the separation between the CEO position and the Chairman position signals stronger governance, greater internal control, and drives to higher market valuation.

Several studies have examined the relationship between corporate governance and earnings management. Dechow *et al.* (1996) find that firms manipulating earnings are more likely to have a CEO who simultaneously serves as Chairman of the board. Bowen *et al.* (2008) prove that smoothing earnings is higher for firms with a CEO-Chairman duality. The authors indicate that the separation of roles between CEO and Chairman of the board can prevent earnings management activities. Davidson *et al.* (2005) predict that firms whose CEO held the role of Chairman at once are more likely to engage in earnings management. Zouari *et al.* (2015) find that the dual CEO-Chair relationship encourages CEOs to manage

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earnings, particularly when CEO-Chairs hold the major proportion of equity in the firm. On the other hand, Xie *et al.* (2003) highlight that CEO duality is unrelated to discretionary current accruals. Likewise, Mnif (2010) find that the CEO duality is not significantly linked with management earnings forecasts accuracy in French IPOs.

Hence, we expect that the accuracy of management earnings forecasts is higher in firms which are prevented from CEO duality. Our third hypothesis is as follows:

*H3*. There is a negative relationship between CEO duality and management earnings forecasts accuracy.

*2.2.3 Board size.* The evidence on the role of board size on firm performance is inconclusive. Jensen (1993) and Yermack (1996) demonstrate that smaller boards are associated with better firm performance. However, Pearce and Zahra (1992) highlight that the huge boards are correlated to the improvement of firms' performance.

Following Beasley (1996), firms with smaller boards exhibit less financial statement fraud. Moreover, Ahmed *et al.* (2006) show that small boards are more efficacious to control earnings quality and consequently enhance earnings informativeness. Smaller boards may provide better financial reporting oversight. On the other hand, Xie *et al.* (2003) explain that large boards are linked to lower levels of discretionary current accruals. Thus, large board may be more likely to have independent, reputable and experienced directors and hence improve firms' performance and reduce earnings management.

Karamanou and Vafeas (2005) study the relationship between corporate board attributes and voluntary disclosure. They show that small boards in US listed firms are closely tied with more accurate and conservative management earnings forecasts. For the French IPOs, Mnif (2010) demonstrate that firms with large boards are greatly expected to issue more optimistic and less accurate earnings forecasts.

Hence, given these conflicting results, we offer no directional expectation between board size and management earnings forecast accuracy. Our fourth hypothesis is as follows:

*H4*. There is a positive/negative relationship between board size and management earnings forecasts accuracy.

*2.2.4 CEO compensation.* Widespread studies investigated the tie between CEO compensation and earnings management. Cheng and Warfield (2005) and Bergstresser and Philippon (2006), highlight that the executive directors who commit to earnings management are those who have higher equity incentive (stock options and stock ownership). Managers engage in this act owing to meet analysts' forecasts. On the other hand, Laux and Laux (2009) and Almadi and Lazic (2016), indicate that the increase in CEO equity incentives does not increase earnings management.

Moreover, the correlation between voluntary disclosure and the distribution of stock option to managers leads to various studies (Nagar *et al.*, 2003; Lakhal, 2006; Chung *et al.*, 2015). They all set out a positive tie between the distribution of stock option to managers and the voluntary disclosure of forecasts. In addition, Otomasa *et al.* (2017) study whether Japanese companies use management earnings forecasts as a performance aim to establish CEO compensation. They find that management forecast error is positively related to the CEO compensation.

Hence, we expect that IPO firms disclose higher accurate management earnings forecasts when their CEOs have greater incentive compensation. Our fifth hypothesis is as follows:

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*H5.* There is a positive relationship between management earnings forecasts accuracy and CEO incentive compensation.

## 3. Data and methodology

### *3.1 Firm sample selection procedure and data collect method*

Our sample includes firms that made IPOs from 2005 to 2016 and were traded in two French markets, Euronext Paris (that required the application of IFRS or USGAAP equivalent standards) and Alternext Paris (that required the application of IFRS or European Union Accounting Standards (national standards). During this period, 130 firms have made IPOs on Euronext Paris and 127 firms made IPOs on Alternext Paris. Out of those 257 IPOs, we drop certain firms for many reasons. First, we drop 46 firms because of the lack of accessible information. Second, we exclude 152 firms that did not issue any earnings forecast. Third, we eliminate 2 firms that have made mergers and acquisitions. Fourth, we exclude 7 firms that issue another type of profit forecasts figures such as EBITDA, free cash flow [. . .] Finally, we exclude 5 financial services firms because their corporate governance attributes and regulations are different from those of other IPO firms. Accordingly, the final sample contains 45 firms that voluntarily disclose their earnings forecast in the IPO prospectuses. Table I describes the procedure for sample constitution.

All the data concerning firms and management earnings forecasts are hand-collected from the IPO prospectuses. For the actual earnings, the variables are hand-collected from the reference documents and annual reports. The data about the IPOs is available on the followings websites: *Yahoo finance, Boursier.com,* www.euronext.com*, and the* "Autorité des Marchés Financiers"*, AMF.*

### *3.2 Models*

*3.2.1 Forecast error metrics: accuracy.* The most used forecast error metric is the AFE. It is the major metric used to evaluate forecast accuracy that allows us to examine the determinants of profits forecasts accuracy. The Mean of the AFEs represents the overall level of the IPO earnings forecasts accuracy. Hence, the AFE for company (i) for the year of the IPO (t) is given by:

| Sample | No. of IPO firms on euronext | No. of IPO firms on alternext |
|---|---|---|
| IPOs on Eurolist of Euronext Paris and Alternext Paris between 2005-2016 | 130 | 127 |
| Firms excluded because of the lack of accessible information | 18 | 28 |
| Mergers and acquisitions | 2 | 0 |
| Financial services firms | 4 | 1 |
| Firms did not issue any earnings forecast | 70 | 82 |
| Firms issue another type of profit forecasts figures | 6 | 1 |
| Final sample | 30 | 15 |
| Total final sample | 45 | |

**Table I.** Sample constitution procedure

**Note:** Table I presents the procedure for sample constitution to study the effect of IFRS adoption and corporate governance on the accuracy of forecasts earnings provided by French firms that went public during the period (2005-2016)

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$$AFE_{it} = |(AP_{it} - FP_{it})|/|FP_{it}|$$

Where:
$AFE_{it}$ = Absolute Forecast Error;
$AP_{it}$ = Actual Profits; and
$FP_{it}$ = Forecast Profits.

*3.2.2 Cross-sectional explanatory model of the management earnings forecasts accuracy.* In accordance with many other studies (Ahmad-Zaluki and Wan-Hussin, 2010; Firth and Gounopoulos, 2017), we use cross-sectional model to explain the magnitude of the AFE. To test whether the IFRS adoption and corporate governance attributes influence the management earnings forecasts accuracy contained in IPO prospectuses, we study the AFE for each IPO. Our model is the following:

$$AFE = \beta_0 + \beta_1 IFRS + \beta_2 Independence + \beta_3 Boardsize + \beta_4 Duality + \beta_5 CEOcomp + \beta_6 ROA + \beta_7 Horizon + \beta_8 Retain + \epsilon$$

$\beta$i represents the regression coefficients; and $\epsilon$ is a standard error term of an OLS.

This model allows us to examine the determinants of earnings forecasts accuracy. We note that the higher the AFE is, the less accurate earnings forecasts are; and the lower the AFE is, the more accurate earnings forecasts are. Table II describes the variables' measures.

Along with the five independent variables (IFRS, Independence, Boardsize, Duality and CEOcomp), we add three control variables that should affect the accuracy of management earnings forecasts (Horizon, return on assets [ROA] and Retain). The horizon of forecast is an important factor that affects the accuracy of management earnings forecasts. Mak (1989) affirms that lower length period of forecast is associated with more accurate earnings forecasts. However, Ferris and Hayes (1977) find a positive relationship between the forecast horizon and the accuracy of management earnings forecasts. Therefore, we expect a

| Variables | Measures |
|---|---|
| AFE | Is measured as the absolute difference between the actual profits (published in the annual report) and the forecast profits (announced in the prospectus of the newly listed firm) scaled by the absolute value of the forecast profits. It is based on forecast of the next year earnings: \|(Actual Profits-Forecast Profits)\|/\|Forecast Profits\| |
| IFRS | A dummy variable: takes 1 if firm adopts IFRS, 0 otherwise |
| Independence | The proportion of independent directors to total directors on the board |
| Duality | An indicator variable: takes 1 if the CEO is also the chairman and 0 otherwise |
| Boardsize | The total number of directors on the board |
| CEOcomp | A dummy variable that equals to 1 if the CEO benefits incentive compensation based on the company's financial performance (EBITDA, Revenue [. . .]) and 0 otherwise |
| ROA | Net profit divided by total assets for the forecast year |
| Horizon | The number of the months from the prospectus date to the end of the period for which the earnings forecast is made |
| Retain | The proportion of retained shares by the pre-IPO shareholders |

**Note:** Table II provides the definition of our variables to study the effect of IFRS adoption and corporate governance on the accuracy of forecasts earnings provided by French firms that went public during the period (2005-2016)

**Table II.**
Variables' measures

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positive/negative relationship between the forecast horizon and the accuracy of management earnings forecasts.

Chen and Firth (1999) show a negative and significant association between ROA and the accuracy of management earnings forecasts. However, Chen *et al.* (2001) find a positive and insignificant relationship between ROA and the accuracy of management earnings forecasts. Thus, we expect a negative/positive correlation between the firm performance (ROA) and the accuracy of management earnings forecasts.

Previous evidence reveals that managers publish more accurate and unbiased forecast earnings when the pre-IPO shareholders retained a greater proportion of shares. The potential explanation is that the original investors avoid legal sanction which can occur if their firm publishes inexact forecasts. On the other hand, they risk the loss of potential investors' trust and the market sanctions (a decrease of firm value) if the forecasts issued by the IPO firm mislead the potential shareholders (Chen *et al.*, 2001; Jog and McConomy, 2003). Hence, we expect a positive relation between the proportion of retain and the accuracy of management earnings forecasts.

## 4. Results and discussion

### *4.1 Descriptive statistics*

Table III presents the descriptive statistics of the sample. The AFE is used to judge the accuracy of the earnings forecasts contained in the IPO prospectus. The mean value of AFE is low and equals to 0.051. The minimum is 0 and the maximum is 0.316. This reveals that the earnings forecasts, in our sample, are more accurate because the mean value of AFE approaches to zero. In our study, the Mean value of AFE is equal to 5.1 per cent. it is lower than results of recent studies which show that French IPOs release biased and inaccurate forecast (Boubaker and Labégorre, 2006a find a value of 48.74 per cent).

The mean of IFRS is equal to 0.666. This means that on average 66.6 per cent of firms adopt the IFRS. The mean of Independence variable is low and takes the value 24.89 per cent while the maximum value is equal to 70 per cent. In addition, the average of Board size is

**Table III.**
Descriptive statistics

| Variables | Observations | Mean | SD | Minimum | Maximum |
|---|---|---|---|---|---|
| AFE | 45 | 0.051 | 0.071 | 0 | 0.316 |
| IFRS | 45 | 0.666 | 0.476 | 0 | 1 |
| Independence | 45 | 24.89 | 19.68 | 0 | 70 |
| Duality | 45 | 0.622 | 0.490 | 0 | 1 |
| Boardsize | 45 | 7.022 | 3.354 | 3 | 21 |
| CEOcomp | 45 | 0.822 | 0.386 | 0 | 1 |
| ROA | 45 | 0.071 | 0.119 | −0.179 | 0.579 |
| Horizon | 45 | 4.955 | 3.430 | 1 | 14 |
| Retain | 45 | 69.68 | 12.37 | 42.4 | 93.67 |

**Notes:** Table III gives the descriptive statistics of the dependent variable: AFE is |(Actual Profits-Forecast Profits)| / |Forecast Profits|. The independent variable: IFRS is a dummy variable that takes 1 if firm adopts IFRS, 0 otherwise; Independence is the proportion of independent directors to total directors on the board; Duality is an indicator variable: takes 1 if the CEO is also the chairman and 0 otherwise; Boardsize is the total number of directors on the board; COEcomp is a dummy variable that equals to 1 if the CEO benefits incentive compensation based on the company's financial performance (EBITDA, Revenue …) and 0 otherwise; ROA is net profit divided by total assets for the forecast year; Horizon is the number of the months from the prospectus date to the end of the period for which the earnings forecast is made; Retain is the proportion of retained shares by the pre-IPO shareholders

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equal to 7.02 with a range from 3 to 21. The mean of the Duality variable is equal to 0.62. The variable CEOcomp shows that, on average, the CEOs benefit from an incentive compensation based on the company's financial performance. The mean value of CEO incentive compensation takes the value 0.82, between 0 and 1.

*4.2 Cross-Sectional regression explaining the absolute forecast errors (forecasts accuracy)*

First of all, we check the multicolinearity problem between the independent variables explaining the AFEs (Forecasts Accuracy). We use the Pearson's Correlations Matrix and VIF Statistics (Variance Inflation Factors Statistics). Results reported on Table IV show that the multicolinearity problem will not affect our analysis.

The VIF statistics confirm our finding. Table IV shows that the higher VIF is equal to 2.54 and that the mean of VIF is lower than 2. Second, to correct the heteroskedasticity between variables, we perform the regression with Robust Standard Errors using the test of White (1980).

Table V shows that the coefficient of IFRS is negative and statistically significant at 1 per cent level. This implies that management earnings forecasts accuracy is positively associated with IFRS adoption. Thus, our *H1* is confirmed. Moreover, this result indicates that the application of IFRS by French IPOs firm in our sample reduces AFE and improves management forecast accuracy. This finding confirms the agency perspective. In fact, by the implementation of IFRS, firms try to enhance the information quality and to diminish the information asymmetry. Hence, this implementation implies reducing of the agency costs and conflicts between investors and managers. Moreover, our finding consents with the signaling perspective. Furthermore, the adoption of IFRS is considered as a positive signal of greater quality and transparency of financial reports disclosed through the increasing of the accuracy of management earnings forecasts. The introduction of IFRS improves the ability of French IPO firms to predict accurately. Our finding is in line with findings of Ng *et al.* (2012), Rouhou *et al.* (2015) and Li and Yang (2016) which show that companies in the IFRS-adopters countries strongly release management earnings forecasts upon IFRS than

| Variables | VIF | *IFRS* | *Indep* | *Boardsize* | *Duality* | *COEcomp* | *ROA* | *Horizon* | *Retain* |
|---|---|---|---|---|---|---|---|---|---|
| IFRS | 2.36 | 1.000 | | | | | | | |
| Indep | 2.54 | 0.605* | 1.000 | | | | | | |
| Boardsize | 2.16 | 0.751* | 0.629* | 1.000 | | | | | |
| Duality | 1.87 | −0.453* | −0.633* | −0.455* | 1.000 | | | | |
| COEcomp | 1.23 | 0.287 | 0.234 | 0.349 | −0.242 | 1.000 | | | |
| ROA | 1.28 | −0.526* | −0.303 | −0.340 | 0.331 | −0.277 | 1.000 | | |
| Horizon | 1.37 | 0.445* | 0.279 | 0.455* | −0.105 | 0.140 | −0.224 | 1.000 | |
| Retain | 1.28 | −0.216 | −0.309 | −0.193 | 0.056 | −0.176 | 0.195 | −0.289 | 1.000 |
| Mean VIF | 1.76 | | | | | | | | |

**Notes:** The Table IV shows the matrix of Pearson correlations between our independent variables and control variables. IFRS is a dummy variable that takes 1 if firm adopts IFRS, 0 otherwise; Independence is the proportion of independent directors to total directors on the board; Duality is an indicator variable: takes 1 if the CEO is also the chairman and 0 otherwise; Boardsize is the total number of directors on the board; COEcomp is a dummy variable that equals to 1 if the CEO benefits incentive compensation based on the company's financial performance (EBITDA, Revenue . . .) and 0 otherwise; ROA net profit divided by total assets for the forecast year; Horizon is the number of the months from the prospectus date to the end of the period for which the earnings forecast is made; Retain is the proportion of retained shares by the pre-IPO shareholders. Coefficient $r \leq |0.3|$: low correlation; $|0.3| < r < |0.7|$: middle correlation; $r \geq |0.7|$: high correlation. The symbol *denote statistical significance at the 0.01 level

**Table IV.** Matrix of pearson correlations

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| Variables | Predicted sign | Coefficient | $P > \|t\|$ | Robust $P > \|t\|$ |
|---|---|---|---|---|
| *IFRS* | − | −0.072 | 0.007*** | 0.003*** |
| *Independence* | − | 0.001 | 0.021** | 0.017** |
| *Duality* | + | −0.001 | 0.952 | 0.941 |
| *Boardsize* | +/− | −0.007 | 0.030** | 0.009*** |
| *CEOcomp* | − | 0.019 | 0.394 | 0.345 |
| *ROA* | +/− | −0.220 | 0.006*** | 0.020** |
| *Horizon* | +/− | 0.013 | 0.000*** | 0.000*** |
| *Retain* | − | 0.002 | 0.004*** | 0.013** |
| *Constant* | +/− | −0.102 | 0.151 | 0.113 |
| $R$-squared | | 0.550 | | |
| Adjusted $R$-squared | | 0.451 | | |
| $F$-value | | 5.52*** | | |

**Notes:** The Table V reports the cross-sectional regression results of the effect of IFRS adoption and corporate governance on the forecasts earnings accuracy for a sample of 45 French firms that went public during the period (2005-2016). The dependent variable: AFE is | (Actual Profits-Forecast Profits) | / | Forecast Profits|. The independent variables: IFRS is a dummy variable that takes 1 if firm adopts IFRS, 0 otherwise; Independence is the proportion of independent directors to total directors on the board; Duality is an indicator variable: takes 1 if the CEO is also the chairman and 0 otherwise; Boardsize is the total number of directors on the board; COEcomp is a dummy variable that equals to 1 if the CEO benefits incentive compensation based on the company's financial performance (EBITDA, Revenue [. . .]) and 0 otherwise. The control variables: ROA is net profit divided by total assets for the forecast year; Horizon is the number of the months from the prospectus date to the end of the period for which the earnings forecast is made; Retain is the proportion of retained shares by the pre-IPO shareholders. $P > |t|$: Robust Test of White; the symbols *, ** and ***denote statistical significance at the 10, 5 and 1% levels, respectively

**Table V.** Cross-sectional regression modeling AFE

companies in the GAAP-adopters countries. However, our result is different from Firth and Gounopoulos (2017) that find that the introduction of IFRS restrains the ability of Australian IPO firms to predict accurately. Our finding confirms that harmonizing accounting practices is more efficient than collecting factors that could guarantee comparable accounting practices. Firth and Gounopoulos (2017) suppose that IASB, the European Commission and SEC should devote more efforts on creating a common business language trough the harmonization of the legal enforcement systems, competition rules, market access conditions, and effectiveness of the legal system. On the other hand, we highlight that the harmonization of accounting practices increases managers' ability to meet the projected earnings.

The coefficient of the independent directors' variable is positive and statistically significant at the level of 5 per cent. This implies that management earnings forecasts accuracy is negatively associated with the proportion of independent directors on the board. Hence, lower proportion of independent directors increases information quality via the improvement of the accuracy of management forecasts. This finding is unexpected and infirm the *H2* which asserts that IPO firms are more likely to issue more accurate earnings forecasts when the proportion of independent directors on the board is high. Our result is not consistent with recent management earnings forecasts studies on US listed firms (Karamanou and Vafeas, 2005; Ajinkya *et al.*, 2005). However, US companies are required to establish corporate boards with a majority of independent directors (according to Sarbane-Oxley Act 2002), but French companies are required to establish corporate boards with a half or a third of independent directors (according to the recommendation 8.3 of the corporate governance code of listed companies "AFEP-MEDEF"). In addition, we can explain the positive coefficient of board independence by the ownership in French firms that

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is very concentrated, and by the fact that the majority of these firms are controlled and managed by families. In this sense, Denis and Sarin (1999) indicate that firms with active founders and CEO ownership have more insiders' directors on the board, while larger and older firms have more outsiders' directors. Moreover, authors affirm that a modification in the firm leads to a change in the board composition. This means that the proportion of directors' independence is directly correlated with firms' performance and firms' characteristics (e.g. leverage, information asymmetry, firms' growth opportunities, and firm size), which could also be tied to the financial disclosure. In addition, it is plausible that the proportion of directors' independence is the result of higher investors' surveillance (Hermalin and Weisbach, 2003) that is the source of enormous disclosure.

The coefficient of the variable Duality is negative (−0.001) instead of positive and not statistically significant. This suggests that board leadership structure has no significant impact on earnings forecasts accuracy. Therefore, *H3* is then not confirmed. Thus, the separation between the roles of CEO and Chairman of the board does not contribute significantly to the accuracy of earnings forecasts. This result can be explained by the effective firm oversight via the mechanisms of control, such as the independent directors, that can influence the CEO behavior and align their interests with the company's aims. Then, our result indicates that firms in our sample have good-governance structure that obliges managers to provide more accurate forecasts.

Table V shows that Boardsize is negative and statistically significant at the level of 1 per cent. This suggests that management earnings forecasts accuracy is positively associated with board size. Thus, IPO firms, examined in this paper, are more likely to issue more accurate earnings forecasts when the board size is large. This result is contrary to that of Mnif (2010) on French IPOs. But, our evidence consents to Xie *et al.* (2003) which indicate that a large board can appeal to numerous reputable and experienced directors and, hence, can improve firms' performance and reduce earnings management. Hence, according to our sample, the large number of directors enhances the quality of information and reduces the information asymmetry through the improvement of the management forecasts accuracy.

Against our expectations, the coefficient of the CEO incentive compensation (CEOcomp) is positive instead of negative and not significant. This suggests that the CEO incentive compensation has no significant impact on the management earnings forecasts accuracy. Hence, the *H5* is not supported. We can explain our result by the impact of effective control of the board on CEO and their role in setting and monitoring the companies' policies for managers' compensation. The board affects the CEO incentive compensation and a company with poor-governance mechanisms implements higher incentive compensation to their CEOs (Hermalin and Weisbach, 2003).

Finally, Table V shows that our three control variables have a significant relationship with the dependent variable. The coefficient of ROA is negative (−0.220), and statistically significant at 1 per cent level. This implies that the profitable firms provide more accurate earnings forecasts contrary to the result of Chen and Firth (1999). The length of the forecast period (Horizon) is positive (0.013), and statistically significant at 1 per cent level. This means that a lower forecasting period was associated with lower AFE. This finding is consistent with this of Mak (1989). The coefficient of the proportion of retained shares by the pre-IPO shareholders (Retain) is positive (0.002), not as expected. Thus, IPO firms in our sample are more likely to release a more accurate earnings forecast when the proportion of shares retained by the pre-IPO shareholders is low. This result is consistent with this of Chen *et al.* (2001), and it can be explained by the high concentrated ownership in the French context.

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## 5. Robustness check

In this section, examine the sensitivity of our findings. Thus, we conduct a Probit regression instead of the ordinary least square (OLS). Furthermore, we change our dependent variable (AFE) to a dummy variable (Forecasts) that takes 1 for IPO firms which have an AFE lower than the mean AFE (5.1 per cent) and, 0 otherwise. Table VI provides our empirical findings.

We run two versions of Probit model: model 1 uses only IFRS and the control variables and Model 2 uses the corporate governance variables and the control variables. The empirical results of model 1 show a positive and significant association (at 1 per cent level) with Forecasts. This supports our previously findings, and it demonstrates that IFRS-adopters firms provide more accurate forecasts.

Indeed, model 2 exhibits similar results to OLS regression. Independence is negative and significant (at 5 per cent level) and the board size is positive and significant (at 5 per cent level). This reveals that firms with larger and independent boards provide more accurate forecast. Moreover, we also find that the impact of the CEO incentive compensation and duality, on the forecast accuracy, are not statistically significant.

## 6. Conclusion

This study investigates whether corporate governance attributes and IFRS adoption have an effect on the accuracy of management earnings forecasts contained in French IPO prospectuses. This study is the first that runs the relationship between the accuracy of management earnings forecasts and the IFRS adoption as well as corporate governance mechanisms. The existing literature seeks just the association between the accuracy of

| Variables | Predicted sign | Model 1 Coefficient | Model 1 $P > \|t\|$ | Model 2 Coefficient | Model 2 $P > \|t\|$ |
|---|---|---|---|---|---|
| *IFRS* | + | 1.913 | 0.000*** | | |
| *Independence* | + | | | −0.040 | 0.030** |
| *Duality* | − | | | −0.367 | 0.576 |
| *Boardsize* | +/− | | | 0.392 | 0.026** |
| *CEOcomp* | + | | | −0.468 | 0.514 |
| *ROA* | −/+ | 4.651 | 0.154 | 2.468 | 0.259 |
| *Horizon* | +/− | −0.302 | 0.000*** | −0.296 | 0.000*** |
| *Retain* | + | −0.030 | 0.209 | −0.046 | 0.016** |
| *Constant* | +/− | 2.793 | 0.151 | 4.212 | 0.043 |
| Wald chi2(4) | | 27.85 | | 17.03 | |
| Prob > chi2 | | 0.000*** | | 0.0172** | |
| Pseudo R2 | | 0.333 | | 0.3495 | |

**Notes:** The Table VI presents the Probit regression results of the effect of IFRS adoption and corporate governance on the forecasts earnings accuracy for a sample of 45 French firms that went public during the period (2005-2016). The dependent variable: Forecasts is takes 1 if IPO firms have an AFE lower than the mean AFE (5.1%) and 0 otherwise. The independent variables: IFRS is a dummy variable that takes 1 if firm adopts IFRS, 0 otherwise; Independence is the proportion of independent directors to total directors on the board; Duality is an indicator variable: takes 1 if the CEO is also the chairman and 0 otherwise; Boardsize is the total number of directors on the board; COEcomp is a dummy variable that equals to 1 if the CEO benefits incentive compensation based on the company's financial performance (EBITDA, Revenue …) and 0 otherwise. The control variables: ROA is net profit divided by total assets for the forecast year; Horizon is the number of the months from the prospectus date to the end of the period for which the earnings forecast is made; Retain is the proportion of retained shares by the pre-IPO shareholders. $P > |t|$: Robust Test of White; the symbols *, ** and ***denote statistical significance at the 10, 5 and 1% levels, respectively

**Table VI.**
Robustness cross-sectional probit regressions

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management earnings forecasts and the IFRS adoption (Ng *et al.*, 2012; Li and Yang, 2016; Firth and Gounopoulos, 2017), or the relation between the accuracy of management earnings forecasts and the corporate governance mechanisms (Karamanou and Vafeas, 2005; Ajinkya *et al.*, 2005).

Our empirical findings show that French firms issue more accurate management earnings forecasts. Moreover, we find that IFRS adoption gives a credible signal of the accuracy of management forecasts. This result supports the idea that the adoption of IFRS promotes managers to disclose more transparent information to stakeholders. In addition, our results provide evidence that the board mechanisms contribute to increase the management earnings forecasts accuracy, consistent with the agency theory. In fact, corporate governance should be effective to perform its role of controlling, ensuring high-quality reporting and promoting transparent information. Our study indicates that the effectiveness of the corporate governance relies mainly on the larger and independent boards for conveying more credible and transparent disclosure.

Shareholders can take benefit from management forecasts accuracy to structure their investment portfolios efficiently, allocate their funds more effectively and mitigate the costs of adverse selection that they have to face. We also expect our findings to be of interest to IPO firms since this study highlights the efficiency of larger and independent boards in decreasing managerial discretion, increasing disclosure quality and supervising management.

Our study confirms that harmonizing accounting practices is more efficient than collecting factors that could guarantee comparable accounting practices. We highlight that the harmonization of accounting practices increases managers' ability to meet the projected earnings. Our findings are not consistent with Firth and Gounopoulos (2017) that suppose that IASB, the European Commission and SEC should devote more efforts on creating a common business language trough the harmonization of the legal enforcement systems, competition rules, market access conditions and effectiveness of the legal system. Our results could encourage GAAP-adopters countries to move toward IFRS, as this research reinforces the role of IFRS in enhancing the quality of financial disclosure by meeting the information needs of shareholders. Moreover, this study could incite French regulators to revise the AFEP-MEDEF code. Under this code, it could insist that larger and more independent boards are more effective in performing their governing roles than smaller boards.

In fact, this study is capital because the potential investors should assess management earnings forecasts accuracy before they consider it when evaluating IPO firms. It is recommended that future investors pay more attention, when assessing the accuracy of management earnings forecasts, to the accounting regulations of the financial reporting along with the corporate governance mechanisms.

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