IFRS adoption and Management Earnings Forecasts of Australian IPOs

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Abstract

This study contributes to the growing literature on the financial reporting and economic consequences of the introduction of International Financial Reporting Standards (IFRS). Our particular focus is to examine whether IFRS has an impact on the accuracy of profit forecasts made in Australian IPO prospectuses and whether there is an impact on underpricing. As the process of going public is characterised by high levels of information asymmetry this setting allows us to investigate if IFRS contribute effectively to an improvement in the financial information environment. Our findings show that IFRS adoption has not improved IPO earnings forecast accuracy. Furthermore, there is no evidence that the IFRS regime has any impact on initial stock returns.

Keywords Earnings management, Mandatory and Voluntary disclosure environments, Forecast accuracy, IPOs

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1. Introduction

The regulatory switch from domestic accounting standards (local GAAP) to IFRS has significantly affected financial reporting practices worldwide. By 2012, almost 120 countries require or permit financial statements to be prepared in accordance with IFRS (Deloitte, 2011; IASB, 2011). In addition, the U.S. Securities and Exchange Commission (SEC) has proposed a roadmap to potentially allow U.S. issuers to use IFRS for fiscal years beginning in 2014 (SEC, 2008). Issued by the International Accounting Standards Board (IASB), IFRS are a set of high quality and globally applicable financial reporting standards that are based on accounting-principles instead of accounting-rules (IASB, 2011; Carmona and Trombetta, 2008). Policy setters and financial regulators expect that IFRS, as a common set of high quality financial reporting standards, will enhance the transparency and comparability of financial statements across different jurisdictions and thereby contribute effectively to an efficient functioning as well as the global integration of capital markets (European Union (EU), 2002).

However, the empirical literature to date has failed to find consistent evidence of neither positive accounting effects nor positive economic effects from the introduction of IFRS, thus raising doubts about their practical application. On the one hand, proponents argue that IFRS are of higher quality than local standards and restrict accounting discretion. In turn, this improves market transparency and reduces financial reporting uncertainty. As a result, firms experience a reduction in their cost of capital and an increase in market liquidity, e.g. by lower bid-ask spreads (e.g. Daske et al., 2008; Li, 2010). On the other hand, opponents of IFRS believe that the effects of changes in accounting regulations are negligibly small or may even reduce financial reporting quality (e.g. Jeanjean and Stolowy, 2008). Instead, these studies often point to other factors that shape the quality of accounting reports, such as the legal, institutional and cultural background of a country.

Motivated by the global accounting debate on the mandatory application of International Financial Reporting Standards (IFRS)[2], this study investigates the economic effects that result from a change in financial reporting regulations around the time of Initial Public Offerings (IPOs). To do so, we use data from the Australian capital market where firms seeking a listing can voluntarily provide

[2]Prior to 2001, IFRS were named International Accounting Standards (IAS). For reasons of simplicity however, we use the term IFRS throughout the text.

an earnings forecast in their IPO prospectuses. As the process of going public is characterised by a high degree of information asymmetry between company insiders and outside investors, this setting allows us to examine the ability of IFRS to contribute effectively to an improvement in the financial information environment in a previously unexplored field.

We test whether the application of IFRS increases the quality and reliability of accounting information and consequently reduces the amount of information heterogeneity. Specifically, we examine the accuracy of profit forecasts disclosed in IPO prospectuses under different accounting regulations, namely the former Australian Generally Accepted Accounting Principles (AGAAP) and IFRS. Additionally, we investigate whether managers are able to anticipate the direction of the forecast bias and adjust stock prices accordingly on the first day of trading. To the best of our knowledge, this is the first study to provide evidence on the accounting and capital market effects of IFRS in the context of IPOs.

Our study focuses on Australian IPOs for several reasons. First, in line with the mandatory adoption of IFRS in the European Union (EU), the Financial Reporting Council (FRC), the governing body presiding over Australian accounting regulations, announced in July 2002 that Australia will follow the EU resolution. Thus, consolidated financial statements of listed companies in Australia have to comply with IFRS for fiscal years beginning on January 1, 2005 (FRC, 2002)[3]. Second, unlike in a number of other countries (e.g. Germany) early adoption prior to 2005 was not permitted in Australia. This institutional setting allows us to distinguish clearly between the pre- and post-IFRS adoption periods.

Third, IPOs in Australia can voluntarily provide an earnings forecast figure in their prospectus to signal future profitability to investors. Earnings forecasts are expected to reduce the level of information asymmetry between company insiders and outside investors and to reduce problems of adverse selection in the IPO market. Fourth, as erroneous forecasts may mislead investors, the credibility of earnings forecast information largely depends on its accuracy. Previous evidences on

[3] However, as opposed to the directive in the EU, other reporting entities such as private as well as not-for-profit companies were required to comply with IFRS as well, making the consequences of the IFRS application much broader in Australia than for instance in the EU (AASB, 2004). Furthermore, the Australian Accounting Standards Board (AASB) made some additional amendments in the Australian version of IFRS (A-IFRS) that take into account special characteristics of the Australian legislative and economic environment. For a full comparison between A-IFRS and IFRS see Deloitte (2005).

IPOs in Australia has documented high inaccuracy of the profit forecasts included in IPO prospectuses[4]. For example, findings by Lee et al. (1993) critically question the credibility of forecast information as a means to reduce the prevailing information asymmetry among the parties involved in the IPO process as investors cannot rely on the forecasts provided by management when considering investments in the Australian IPO market. We wish to examine whether the accuracy of earnings forecasts have improved overtime and especially since the introduction of IFRS.

Using a sample of 221 profit forecasts of Australian IPOs between 2001 and 2009, we find that managers' behaviour has changed from optimistic forecasts during the AGAAP period to pessimistic forecasts during the IFRS period. Overall, however, the adoption of IFRS does not reduce absolute forecast error. Thus, financial forecasts prepared in accordance with the new set of high quality accounting standards are not easier to make. We also document that under IFRS investors are unable to fully anticipate errors in the forecast profits and therefore do not sufficiently adjust stock prices for the forecast bias on the first day of IPO trading. Our results indicate that the change in accounting regulations has not affected the quality of financial reporting outcomes and has not yielded positive capital market effects in the IPO setting. Furthermore, our results show that Australian IPO profit forecast accuracy has improved markedly over time. Compared to the results reported in Lee et al. (1993), the absolute forecast errors are less than one half the errors in the 1980s. We attribute this improvement to market pressures and to the threat of penalties from the Australian Regulatory Authorities for making inaccurate estimates.

To isolate the effect of IFRS adoption we control for industry year effects to mitigate any industry and year changes in forecast accuracy. We also control for industry-year effects to mitigate any industry and year changes in forecast accuracy. The results are robust to the choice of alternative dependent variables and forecast horizon choices. We further attempt to improve the fit of our basic model making use of logarithmic transformations of AFE. Our results are consistent across these different research designs.

[4] Lee et al. (1993) report an absolute forecast error of 1138% for Australia (period 1987-1989), Hartnett and Romcke (2000) for the period 1991-1996 indicate an AFE of 88.29% and Hartnet (2010) for the period 1998-2002 reveal an AFE of 73.3%.

We contribute to the literature that deals with the financial reporting consequences in several ways. First, we document management earnings forecast under two different regulatory regimes (AGAAP and IFRS). Uniquely, we make a direct comparison of management earnings forecast accuracy on a sample of IPOs that were listed under the accounting requirements of the traditional Australian GAAP with a sample of IPOs that are obliged to follow the accounting rules of IFRS. Our findings shed light on a number of issues that have not been addressed previously. These findings relate to changes in the accuracy of earnings forecast after the adoption of IFRS, the trend of the forecast (i.e. optimistic – pessimistic) after the regulatory change.

Second, we complement studies that investigate the ability of IFRS to reduce informational asymmetries in capital markets and to contribute effectively to an improvement in the financial information environment. Our study therefore adds to Leuz (2003) who investigates information asymmetry as measured by the level of bid-ask spreads and share turnover for firms either applying U.S. GAAP or IFRS. Third, unlike previous studies that focus on analyst forecast accuracy under IFRS regulations (e.g. Ashbaugh and Pincus, 2001; Byard et al. 2011; Horton et al., 2012), we focus on the accuracy of forecasts made by management. Further, by examining investors' abilities to adjust stock prices for the bias in the forecast on the first day of trading, we also contribute to the literature on capital market effects following the introduction of IFRS (e.g. Daske et al., 2008).

Finally, this study examines the determinants and consequences of forecast disclosures published at the time of IPOs and whether there are differences across AGAAP and IFRS periods. Overall, the incremental contribution of this study is the examination of the informational content of earnings forecasts as an outcome of the financial reporting standard regime.

Our study is related to the work of Firth and Smith (1992), Jaggi (1997), Jelic et al. (1998), Hartnett and Romcke (2000), Karamanou and Vafeas (2005), Cormier and Martinez (2006), Cazavan-Jeny and Jeanjean (2007), Keasey and McGuiness (2008), and Gounopoulos and Skinner (2010) who all empirically examine the relations between management earnings forecasts and IPO outcomes. We update their work using a comprehensive sample of AGAAP and IFRS listed firms, as well as by considering earnings forecast on the associated relationships. In contrast to previous empirical

evidence, all the regression models in our study are characterised by high explanatory power of the variation in AFE.

The remainder of this paper is organised as follows. Section 2 discusses the relevant literature. Section 3 develops our testable hypotheses. Section 4 describes our sample selection and study design. Section 5 provides the results of univariate and multivariate analyses. Finally, section 6 concludes our findings and offers suggestions for further research.

2. Literature review

2.1 Literature on the application of IFRS

Proponents of IFRS claim that IFRS are superior accounting standards for several reasons. First, IFRS can reduce the choice of accounting methods, thus constraining managerial discretion (IASC, 1989; Ashbaugh and Pincus, 2001; Barth et. al., 2008). Second, IFRS require accounting measurements and recognition that reflect better a firm's underlying economic position, hence providing more relevant information for investment decisions (IASC, 1989; Barth et al., 2008). Third, IFRS increases required disclosures, thereby mitigating information asymmetries between firms and their shareholders (Ashbaugh and Pincus, 2001; Leuz and Verrecchia, 2000).

Besides the higher financial reporting quality argument, it is also claimed that IFRS increases comparability of firms across markets and countries. Evidences have shown that accounting comparability reduces home bias (Bradshaw et al., 2004; Covrig et al., 2007), and improves the efficiency of information intermediaries (Bae et al., 2008; Bradshaw et al., 2010). Covrig et al. (2007) show that voluntary IFRS adoption facilitates cross-border equity investments. Yu (2010) shows that mandatory IFRS adoption also increases cross-border equity holdings. Horton et al. (2012) find that analyst forecast errors decrease for firms that mandatorily adopt IFRS relative to forecast errors of other firms.

Empirical studies on the economic effects of the IFRS adoption can broadly be classified into three categories: those that investigate financial reporting quality, those that explore capital market effects following the introduction of IFRS, and those that challenge the assumptions that a mandated

change in accounting standards enhances financial reporting practices. These studies highlight a number of factors influencing the quality of corporate accounting.

In the financial reporting quality arena, Ewert and Wagenhofer (2005) derive analytically that tighter accounting standards such as IFRS are positively related to earnings quality by limiting managers' discretionary accounting behaviour and earnings management practices. In this vein, Barth et al. (2008) show that accounting numbers reported under IFRS exhibit higher reporting quality relative to those reported in accordance with domestic standards. Their results are robust to various metrics of accounting quality. Similarly, Landsman et al. (2011) report a greater increase in the information content of earnings announcements in countries that adopted IFRS as compared to their domestic standards benchmarks. Further, Gebhardt and Novotny-Farkas (2011) find a positive association between the forced change to IFRS and bank accounting in the case of loan loss provisioning.

Other studies, however, failed to confirm these findings. Ahmed et al. (2010), for instance, find that the introduction of IFRS results in lower financial reporting quality. They attribute this to a lack of implementation guidance when applying principles-based standards. In addition, Jeanjean and Stolowy (2008) document that IFRS have not decreased the level of earnings management in Australia and the United Kingdom (UK). In fact, the pervasiveness of earnings management even increased in France. Thus they are sceptical on whether simply changing accounting standards *per se* will change the quality of financial reporting amounts.

On the capital market field effects, studies primarily focus on the association between the disclosure of accounting information and predicted capital market effects such as the cost of capital (e.g. Barry and Brown, 1985; Lambert et al., 2007) and market liquidity (e.g. Diamond and Verrechia, 1991; Verrechia, 2001). The application of IFRS requires increased disclosure and offers higher transparency by reducing accounting discretion. This is expected to better reflect the economic situation of the firm relative to the application of domestic standards. In turn, this reduces information asymmetries among the different capital market participants and reduces the problems of adverse

selection (Welker, 1995; Healy et al., 1999; Lambert et al., 2007). As a result, it should ultimately lead to an improvement in the financial information environment.

Numerous studies argue that focusing exclusively on exogenously-imposed accounting standards to determine the quality and usefulness of financial reporting is insufficient. Other studies, which challenge the assumptions that a mandated change in accounting standards enhances financial reporting practices, identify other factors that influence the quality of accounting numbers. For example, Ball (2006) notes that "international differences in financial reporting occur as an endogenous function of local political and economic institutions". Ball et al. (2000) and Ball et al. (2003) show that political and economic forces strongly affect the incentives of account preparers. Likewise, Ball and Shivakumar (2005) and Burgstahler et al. (2006) point out that capital market forces also determine reporting incentives.

In addition, Leuz et al. (2003), Holthausen (2009), and Christensen et al. (2011) stress the importance of the country's enforcement regime in the application of accounting standards. In sum, the existing evidence indicates that the implementation of a single set of high quality accounting standards is only one of many factors that shape the financial information environment. This argument is largely based on the assumption that the application of any set of accounting standards requires the use of managerial discretion as well as the use of private information. However, it is the institutional framework that determines to what extent and how managers use this discretion in the preparation of financial reporting information.

2.2 Literature on IPO earnings forecasts

A high level of information asymmetry and problems of adverse selection are distinct features of the IPO process making it a classic 'lemon problem' as described by Akerlof (1970). To address this issue, some jurisdictions (e.g. Australia, Canada, Hong Kong, among others) allow IPO firms to voluntarily disclose an earnings forecast figure in their prospectuses in order to signal future

profitability[5]. Potential investors use this information for IPO valuation (e.g. Firth, 1998; Kim and Ritter, 1999). However, the credibility and usefulness of earnings forecasts is heavily dependent on their accuracy.

Previous evidence from Australia has documented high forecast errors. For example, Lee et al. (1993) report mean forecast errors (FE) as high as 994.3% as well as mean absolute forecast errors (AFE) of 1,138.3%. These results indicate that managers systematically overestimate their firms' future profitability and act as an impediment for potential investors in making IPO valuations. In contrast to Australian IPOs, Chan et al. (1996), Jaggi (1997), and Cheng and Firth (2000) report relatively low mean AFE of 18%, 12.86%, and 9.89%, respectively for firms seeking a listing in Hong Kong. In addition, Gounopoulos and Skinner (2010) for Greece report earnings forecasts under two different capital market regimes (Mandatory vs Voluntary). Managers tended to be pessimistic under the mandatory regime as they, on average, underestimated earnings (FE = 8.65%). However, earnings forecasts became rather optimistic under the voluntary regime (FE = -9.58). Overall the absolute forecast error in Greece has been 36.83%.

A well-documented phenomenon in the post-listing period is that IPOs tend to be underpriced i.e. they have a positive first-day return (e.g. Ibbotson, 1975; Ritter, 1984; Loughran and Ritter, 1994; Thomadakis et al., 2012). It is important to notice that if investors are able to anticipate the direction of the bias in IPO profit forecasts, they can adjust stock prices accordingly on the first day of trading. The underlying premise is that the issue price is a function of the earnings forecast and if investors believe the forecasts are biased they will drive the post-listing price up or down from the issue price. Thus, underpricing is expected to be a positive function of FE as Firth (1997, 1998), Keasey and McGuiness (1991) and Chen et al. (2001) support with their empirical evidence.

3. Hypotheses Development

As IFRS are generally expected to be of superior quality relative to domestic standards, we predict a positive relation between the change in accounting regulations and IPO earnings forecast accuracy.

[5] In contrast, IPO earnings forecasts are mandatory in Malaysia, New Zealand, Singapore, Taiwan and Thailand (e.g. Firth and Smith, 1992; Firth, 1998; Lonkani and Firth, 2005). Forecasts in prospectuses of U.S. IPOs are rather uncommon due to the litigious environment.

IFRS reduces accounting choice and thus limits the use of earnings management. Thus, our first hypothesis, stated in alternative form, is:

> ***Hypothesis 1 (H1):*** *The mandatory application of IFRS reduces information asymmetries about an IPO's valuation by improving the accuracy of IPO earnings forecasts.*

Our second hypothesis investigates the effects of forecast errors on IPO initial returns following the introduction of IFRS. We predict that prior to the application of IFRS investors are less able to anticipate deviations from the forecast profits. This is largely due to the unrestricted judgement managers could exercise in financial reporting practices to deliberately distort accounting figures. Therefore, we hypothesize that forecast errors under local GAAP are not related to first day-returns as investors fail to anticipate actions taken by managers in the preparation of financial accounts. However, the application of IFRS demands restricted accounting choices and measurement methods that constrain managers' opportunistic behaviours and will improve accounting transparency. Consequently, this will reduce investors' uncertainty about reporting practices as financial information becomes more predictable. Accordingly, investors are better able to predict future earnings and thereby adjust stock prices on the first day of trading. Thus, our second hypothesis, stated in alternative form, is twofold:

> ***Hypothesis 2a (H2a):*** *Under AGAAP, initial returns on the first day of IPO trading are not associated with forecast errors as investors are unable to infer deviations from actual profits.*

> ***Hypothesis 2b (H2b):*** *Following the mandatory application of IFRS, initial returns on the first day of IPO trading are a positive function of the forecast errors as investors are able to distinguish between optimistic and pessimistic forecasts.*

4. Sample selection and study design

4.1 Sample selection criteria

To examine the influence of IFRS on IPO earnings forecast accuracy and first day-returns, our study focuses on all Australian IPOs during the period January 1, 2001 – December 31, 2009. In the first step, we retrieve a list of IPO companies from *Bloomberg Professional*. The initial sample contained 1,098 companies going public during our sample time period. Consistent with previous Australian studies (e.g. Brown et al., 2000; Hartnett, 2010) mining companies were excluded as these firms rarely provide an earnings forecast. This led us to drop 494 companies and resulted in an overall sample of 604 firms. IPO prospectuses for these firms were hand-collected using *Bloomberg Professional* and *Thomson One Banker*. All prospectuses were screened for the inclusion of forward-looking financial information. Therefore, to be included in our sample, companies had to disclose future earnings information. This resulted in a sample of 282 IPOs.

Post-listing financial information was derived from *Bloomberg Professional*, *Thomson One Banker*, and the companies' annual reports. We focus primarily on accounting profit numbers ("the bottom line"). Special care was taken to properly match earnings figures. We faced difficulties as the type of profit figures differed across firms. Pre-tax profit numbers were selected to avoid problems with the applicable future tax rate, consistent with Lee et al. (2006). These include earnings before interest, tax, depreciation and amortization (EBITDA), earnings before interest and tax (EBIT), and net profit before tax. Thus, forecast figures had to be carefully hand-matched with their corresponding actual counterparts. This process reduced the sample to 232 IPOs that announce a profit forecast and had a corresponding actual profit number. To mitigate the effects of large outliers on our statistical inferences the overall sample is winsorised at the 5% level. This further reduced the final sample to 221 profit forecasts. In total, 124 IPOs released profit forecasts in the era of AGAAP whereas 97 IPOs released forecasts under the accounting regulations of IFRS. The sample size exceeds the sample sizes in previous Australian studies[6]. Information on the companies' age, the auditor, number of shares

[6] The sample size is 98 in Lee et al. (1993), 134 in Hartnett and Römcke (2000) and 179 in Lee et al. (2006), respectively.

retained by insiders, the name of the underwriter, the offer price and the closing date were also extracted from the prospectuses.

The third step includes calculating initial stock price as well as stock index data collection (All Ordinaries Accumulation Index) from *Compustat* and *Thomson One Banker*. We are unable to assign initial returns to all firms in our sample. Table 1 provides summary statistics of the sample indicating that among the 704 listed IPOs during IFRS period, 159 announced a forecast about their expected future earnings. Panel B provides quarter analysis highlighting in more detail the distribution of listings with the associated earnings forecasts.

< insert table 1 about here>

4.2 Methodology

4.2.1 Error metrics

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

$$FE_i = (AP_i - FP_i)/\left|FP_i\right| \quad (1)$$

where:

AP_i = actual profit of company i, FP_i = forecast profit of company i

The forecast error measures the bias in the forecast (e.g. Keasey and McGuinness, 1991; Cheng and Firth, 2000; Gounopoulos, 2011). A positive forecast error (FE > 0) indicates that managers have underestimated the profits disclosed in the IPO prospectus (pessimistic forecast) while a negative forecast error (FE < 0) signals an optimistic forecast with actual profits below forecasted profits. Previous evidence by Lee et al. (1993) as well as Hartnett and Römcke (2000) show that, on average, Australian IPOs have negative profit forecast errors indicating overly optimistic forecasts.

The absolute forecast error is applied to measure the overall accuracy of the forecast. It is calculated as:

$$AFE_i = \left| (AP_i - FP_i) \right| / \left| FP_i \right| \quad (2)$$

The definition of the terms used in the equation is as defined above. Nevertheless, it is worth noting that prior studies have used alternative measures of the denominator to determine these error metrics. For example, Keasey and McGuinness (1991), Chen et al. (2001), Lonkani and Firth (2005), and Gounopoulos (2011) use the absolute value of the forecast profits as the denominator, whereas Jaggi (1997) and Cheng and Firth (2000) use the absolute value of the actual profits. Although the results tend not to differ substantially, this alternative denominator will further be considered in supplementary analyses to ensure robustness of the findings.

4.2.2 Determinants of forecast bias and accuracy

Past research has identified a number of factors that may be potential determinants of the accuracy of earnings forecasts provided in IPO prospectuses. However, no study has ever taken different accounting regulations as a factor into consideration. Based on the year of the earnings forecast announcement, this study classifies firms into two groups: (i) forecasts for financial years prior to the application of IFRS (the pre-adoption period) and (ii) forecasts for financial years following the application of IFRS (the post-adoption period).[7] Hence, our key variable *IFRS* is dichotomous. It takes the value of 0 for forecasts up to the financial year end June 30, 2005, and the value of 1 for all forecasts thereafter.[8]

To control for other factors that may influence forecast accuracy, seven additional variables were identified, namely company age (*AGE*), length of the forecast horizon (*HORIZON*), proportion of shares retained by insiders (*RETAIN*), company size (*SIZE*), auditor reputation (*AUDITOR*), and the

[7] Generally, the first financial year end for Australian companies to publish their annual reports under IFRS regulations is June 30, 2006.

[8] In this case companies that list in the first half of 2005 and provide a forecast for the financial year end at June 30, 2005 are assigned a value of 0 as forecasts are prepared according to former Australian GAAP. However, companies that list in the same time period but forecast beyond this year end date (e.g. to June 30, 2006) are assigned a value of 1 to account for reported figures being prepared according to IFRS. This strict classification allows us to thoroughly distinguish between the different financial reporting standards that were applied in the preparation of the forecast financial information. Thus, to the extent that IFRS reduce absolute forecast errors, the dichotomous variable is expected to exhibit a negative coefficient, consistent with the hypotheses as defined previously. Almost all companies included in the sample had financial year ends at June 30.

presence of an underwriter (*UNW*).[9] Lastly, the two vector dummies *INDUSTRY* and *YEAR* are included in the model to control for industry and year effects, respectively. The cross-sectional model used to identify the effect of accounting regulations on forecast bias and accuracy is as follows:

$$AFE_i = \beta_0 + \beta_1 IFRS_i + \beta_2 AGE_i + \beta_3 HORIZON_i + \beta_4 RETAIN_i + \beta_5 SIZE_i + \beta_6 AUDITOR_i + \beta_7 UNW_i + \beta_8 INDUSTRY_i + \beta_9 YEAR_i + \varepsilon_i \quad (3)$$

Determinants of initial returns

To explore the effects of accounting standards changes on investors' ability to anticipate the deviations of actual profits from forecast profits, cross-sectional regression models that use the 'raw' (*RIR*) as well as the 'market-adjusted' initial return (*MAIR*) as dependent variables are investigated. Generally, if investors are able to identify the direction of the forecast bias, then initial returns are a positive function of FE. While positive initial returns (underpricing) are likely to be associated with pessimistic forecasts (FE > 0), optimistic forecasts (FE < 0) are expected to result in negative initial returns. To investigate this proposition under different accounting regulations, an interaction term (*IFRS*FE*) is introduced in the cross-sectional regression model. In conjunction with the variables *IFRS* and *FE* as described above, we can therefore test for differences in investors' prediction ability depending on the financial reporting rules applied.

The variables *AGE* and *SIZE* are used as proxies of firm level ex-ante uncertainty (e.g. Lee et al., 1996; Chambers and Dimson, 2009). The variable *RETAIN* is used to identify the relation between equity ownership by company insiders and first day returns. We employ the variables *AUDIT* and *UNW* to capture the certification of the IPO by independent advisers. These may be used as a means to reduce some of the prevailing ex-ante uncertainty and results in lower positive initial returns, that is, less underpricing and 'less money left on the table' (e.g. Carter and Manaster, 1990; Michaely and Shaw, 1995). Further, we control for year- and industry specific effects.

Overall, the combination of all the variables results in the following cross-sectional regressions:

[9] Appendix A provides an explanation of all independent variables.

$$MAIR_i \text{ or } (RIR_i) = \beta_0 + \beta_1 IFRS_i + \beta_2 FE_i + \beta_3 IFRS*\mathrm{FE}_i + \beta_4 AGE_i + \beta_5 SIZE_i + \beta_6 RETAIN_i + \beta_7 AUDITOR_i + \beta_8 UNW_i + \beta_9 INDUSTRY_i + \beta_{10} YEAR_i + \varepsilon_i \quad (4)$$

5. Results

5.1 Descriptive statistics and univariate analyses

The summary statistics of forecast errors and absolute forecast error measures are shown in Table 2. The means, medians and standard deviations of errors are broken down by the Australian GAAP and IFRS disclosure environments. Panel A shows that the mean FE of the overall sample is positive for earnings forecasts (1.11%). Positive signs (FE > 0) indicate that, on average, managers underestimate actual earnings. The mean earnings forecast error is substantially lower than the figure reported by Hartnett and Römcke (2000) and Lee et al. (1993), which indicates a general reduction in the forecast bias of Australian IPOs over time.

Panels B and C present interesting findings on the forecast bias under the two accounting regimes. Breaking down the forecast error by Australian GAAP and IFRS environment, the results reveal a negative mean error of -13.34% for IPOs providing an earnings forecast in their prospectuses during the AGAAP period and a positive mean error of 2.95% for IPOs providing an earnings forecast during the IFRS period. This indicates that Australian newly-listed companies provide liberal forecasts during the less restricted AGAAP regulation as earnings forecast are typically higher than the actual figures. Once the regime moves to IFRS, Australian IPOs behave more conservative and the forecast error sign indicates more pessimistic forecasts than the actual earnings announcement.

<Insert table 2 about here>

Results on the accuracy of earnings forecasts as indicated by AFE show a mean (median) AFE of 34.49% (17.94%). The mean AFE is lower than has been previously reported by Lee et al. (1993). However, the forecast errors are relatively high compared to other countries, e.g. Hong Kong where mean AFEs are below 20% (Chan et al., 1996; Jaggi, 1997; Cheng and Firth, 2000) and considerably low compared to New Zealand (Firth and Smith, 1992) and Canada (Pedwell, Warsame and Neu,

1994). Furthermore, the absolute forecast error is lower under IFRS than under AGAAP. However, the difference in means is not significant (*p*-value = 0.48).

Of particular importance are rules regarding the option of fair value accounting and, as a result, increased earnings volatility (e.g. Ball, 2006; Fiechter, 2011) as well as the recognition of loan losses (e.g. Gebhardt and Novotny- Farkas, 2011) as set out by IAS 39 *Financial Instruments: Recognition and Measurement*. Both aspects may impede managers' ability to predict the future performance and particularly to provide financial forecasts. As a result of this pervasive uncertainty and difficulty, it seems natural that IPOs in the financial industry apply rather conservative forecasting techniques thus underestimating future profits.

Panel A of Table 3 summarizes the forecast errors for the IPOs across years. The results show similar numbers of IPOs with positive and negative forecast errors (63 vs 61 during AGAAP and 49 vs 48 during IFRS). Panel B shows the absolute forecast error during each year in the sample period. Sixty-eight IPOs during the AGAAP sample period and 49 listed during the IFRS sample period have AFEs of less than 20%.

<Insert table 3 about here>

Table 4 provides descriptive statistics of the control variables that are used to explain forecast accuracy. The mean age (*AGE*) of listing companies that issue an earnings forecast is 18.52 years. The proportion of shares retained (*RETAIN*) and offered to the public is 51.37% (mean) and 57.79% (median). Panels B and C partition the total sample in the pre- and post-IFRS adoption periods. IPOs that provide an earnings forecast during the IFRS period are younger than the IPOs going public during the AGAAP period. Moreover, larger IPOs list following the mandatory introduction of IFRS. Further, there are many more IPOs in the post-IFRS-adoption period that use the services of a Big 4 member to audit their financial accounts. As these large audit firms operate in an internationally recognised and well-reputed network, they may adapt more quickly and effectively to a change in accounting regulations. Thus, IPOs may place greater reliance on these high quality auditors to ensure that their financial statements present a true and fair view of the underlying economic situation.

<insert table 4 about here>

In addition to descriptive statistics on the bias and accuracy of earnings forecasts, summary statistics on 'raw' and 'market-adjusted' IPO initial returns are presented in table 5. Panel A reports that 'raw' and 'market adjusted' mean (median) initial returns were 19.92% (10%) and 19.89% (9.13%). Compared to previous Australian evidence, the mean results are higher than those reported by Lee et al. (1996) (11.86%), but lower than those reported by Dimovski and Brooks (2004) (25.6%). Comparative results on the level of underpricing between the different financial reporting environments (Panels B and C) show that IPOs reporting under IFRS exhibited less underpricing (16.93% and 16.59%) than IPOs preparing their accounts according to AGAAP (21.29% and 20.97%). However, additional tests reveal that the differences between the two periods are not significant.

<insert table 5 about here>

5.2 Regression Analyses

Table 6 presents the regression results of the overall sample that includes 221 IPOs that released a profit forecast between 2001 and 2009 as well as for the sample partitioned into IPOs in the pre- IFRS and post-IFRS adoption period. The regression specifications of equation (5) differ in the application of vector dummy variables which control for industry- and year-effects. As was shown in table 3 the level of forecast errors differs substantially across industry groups. Therefore, these approaches examine the influence of IFRS on forecast accuracy with (specification 1) as well as without (specification 2) controlling for industry- and year specific effects.

Coefficient estimates and *t*-statistics are based on White's (1980) heteroskedasticity-consistent standard errors (in parentheses) for our model specifications. There is a positive intercept term (*Constant*) that is significant at the 1% significance-level. In contrast to previous evidence on IPO forecast accuracy (e.g. Jaggi, 1997; Chen and Firth, 1999) all regression models are characterised by relatively high explanatory powers of the variation in AFE as indicated by high R^2s.

To test our first hypothesis (H1), we examine the coefficients on the *IFRS* variable. If the application of IFRS reduces AFE and in turn, improves forecast accuracy, the *IFRS* coefficient should

be reliably negative. The results on the total sample reveal that the *IFRS* coefficient estimates differ in magnitude and sign across the regression models. When controlling for industry- and year-effects (specification 1) the *IFRS*-coefficient has the predicted negative sign (-0.0898) but lacks statistical significance (*t*-stat. = -0.81). Without controlling for industry- and year-effects yields a positive coefficient estimate for *IFRS* (0.0371). However, the results are insignificant (*t*-stat. = 0.64). Nevertheless these findings indicate that the effect of the IFRS introduction seems to be mixed and inconclusive and could have even decreased forecast accuracy. On the whole, these results from multivariate analyses corroborate the previous findings from the univariate analyses. Together they show that there appears to be no unambiguous and statistically significant association between the mandatory introduction of IFRS and higher IPO earnings forecast accuracy. To conclude, the application of IFRS in Australia does not improve the credibility of forecast financial information as a signalling device in the IPO setting. Thus, we are unable to find empirical evidence to support our first hypothesis (H1) that is stated in alternative form.

Among the control variables included in models 1 and 2 of the full sample, only the coefficient estimates for *HORIZON* and *SIZE* show the predicted sign and are also statistically significant. Although several previous studies (e.g. Chan et al., 1996; Jaggi, 1997; Chen et al., 2001; Gounopoulos, 2011) identified a positive association between *HORIZON* and AFE, their findings did not prove to be statistically significant. As a result, this study is among the first to attribute a statistically significant positive impact to the length of the forecast horizon on AFE. Yet, this is the case only under the IFRS regime.

Similarly, previous findings between *SIZE* and AFE have revealed inconsistent results. While Chan et al. (1996) and Chen and Firth (1999) identified a negative relation between the size of the company and AFE, which is in line with our predictions, others found contrary results. Lonkani and Firth (2005), for example, find a positive and significant relation between *SIZE* and AFE, which indicates that larger firms provide less accurate forecasts. Nevertheless, it must be noted that the proxies for firm size are not consistent across studies. This likely hampers universal interpretations and comparisons.

<insert table 6 about here>

Similar to the overall sample findings, the results for the partitioned sample (AGAAP and IFRS subsamples) on *SIZE* are significant with the predicted negative sign. Therefore, during both the pre- and post-IFRS periods forecasts provided by larger companies have higher accuracy. Substantial differences are also reported on the effect of employing a high quality auditor (*AUDITOR*). Focusing on the AGAAP period earnings forecasts indicates that management of companies audited by a Big 4 auditor tend to achieve a significantly higher level of accuracy. In contrast, both specifications show a positive relation between the use of a reputable auditor and AFE for forecasts prepared under IFRS, although none is significant. This finding is rather surprising as one might have expected that reputable auditors adapt more quickly and effectively to the new set of internationally recognised accounting regulations due to their global network and internal knowledge base.

Results of initial returns tests

We examine the association between initial returns and the regulatory change to IFRS as stated in the second set of hypotheses (H2a and H2b). If investors are able to infer the direction of the bias in IPO earnings forecasts we expect initial returns to be a positive function of FE. Table 7 presents our results for equation (6).

To investigate investors' anticipations of forecast bias on the first day of trading under different accounting regulations, we are particularly interested in the coefficient estimates on *FE* and *IFRS*FE*. The coefficients on *FE* reflect the association between forecast bias and initial returns in the AGAAP period. The analyses reveal a non-significant relation between returns and *FE*, which is in line with the expectation that investors are unable to anticipate deviations of actual profits from forecast profits prior to the introduction of IFRS (H2a). The findings concur with the conclusions of Firth and Smith (1992) and Jelic et al. (2001), which were unable to find evidence that the stock market anticipates the bias in IPO prospectus forecasts.[10]

<insert table 7 about here>

[10] In contrast, Chen et al. (2001) as well as Lonkani and Firth (2005) report that investors in Hong Kong and Thai IPOs are able to infer the direction of the forecast bias.

Coefficient estimates on *IFRS*FE* show differential investor reactions to *FE* under IFRS regulations, i.e. when *IFRS* = 1. In line with our prediction (H2b), the coefficients have positive signs[11] in both the RIR and MAIR regressions indicating that investors can differentiate between optimistic and pessimistic forecasts. However, the difference is not statistically significant. Accordingly, we cannot provide empirical evidence that IFRS allow investors to better distinguish between optimistic and pessimistic forecasts relative to AGAAP. As a result, we fail to reject the null form of H2a. The adoption of high quality and globally applicable IFRS do not affect the level of underpricing in the immediate aftermarket.

6. Additional robustness checks

To further explore the effect of IFRS on IPO earnings forecasts and to investigate the sensitivity of our findings, several supplementary analyses and robustness checks have been conducted. In particular, we test the effect of modifications of the dependent variable (AFE) used in the regression analyses, examine the findings when large AFE (outliers) are included, and investigate the role of the auditor to signal forecast financial information. All findings are presented in table 8.

A. Modifications of the dependent variable

As the distributions of AFE are positively skewed, our first modification (1) in column 1 of Table 8 involves the use of logarithmic transformations of AFE[12]. The regression model is highly significant as the *p*-values of the *F*-statistics approaches zero. Regarding the key variable *IFRS*, the findings confirm results of our previous cross-sectional analyses that the introduction of IFRS has not improved earnings forecast accuracy. The coefficient estimate on *IFRS* is positive (0.288) but remains insignificant.

[11] The appropriate coefficient estimates of FE under the new set of accounting standards are (-9.5947+12.4921) = 2.8974 for RIR and (-9.5671+12.2820) = 2.7149 for MAIR.

[12] Weisberg (1985) proposes the use of various variance stabilizing transformations if there are signs that the error variance is non-constant and thus contradicts the basic assumptions made in OLS regressions. In line with his suggestions, Hartnett and Römcke (2000) use a log-transformation of the independent variable (AFE).

In addition, we also test the accuracy of earnings per share (EPS) forecasts in IPO prospectuses (modification 2). The result shows low overall significance while the coefficient estimate of *IFRS* is negative but insignificant. This confirms our previous findings that the introduction of IFRS does not improve profit forecast accuracy.

Finally, we also follow the approach used by Jaggi (1997) and Cheng and Firth (2000). These studies use the absolute value of the actual profit as a deflator in the calculation of FE and AFE. However, cross-sectional regression results of the *IFRS* coefficient (not reported here) are not significant. Thus, this further evidence corroborates previous findings.

B. Consideration of outliers

To control for the effects of the few outliers that may distort our results and interpretations, our samples had previously been winsorised at the 5% level so that eleven profit forecasts were dropped from the sample. Modification 3 presents findings of cross-sectional regressions on the sample including large outliers. This increases the sample size to 232 observations for IPO profit forecasts. As expected, we report a general deterioration in the fit of the model and also low overall significance of the regression. The coefficient of *IFRS* is negative but insignificant (-0.8279; *t*-stat. = -1.49). Similar findings are reported when EPS forecast accuracy is used as the dependent variable (not reported here). Further, we find that a long time horizon forecast is associated with an inaccurate forecast. In addition, small firms provide a more accurate earnings forecasts.

C. The role of the auditor

Previous cross-sectional results have reported mixed and inconsistent results on the role of the auditor, particularly following the introduction of IFRS. Theoretical models (Titman and Trueman, 1986; Datar et al., 1991) consider the choice of the auditor as an additional device to signal the superior quality of shares to the market. Consequently, we examine differential effects of forecast accuracy between Big 4 and non-Big 4 audit firms when applying IFRS (modification 4). The interaction term *IFRS*AUDIT* is therefore added to equation (5) in order to capture any potential association:

$$AFE_i = \beta_0 + \beta_1 IFRS_i + \beta_2 IFRS*AUDIT + \beta_3 AGE_i + \beta_4 HORIZON_i + \beta_5 RETAIN_i +$$
$$\beta_6 SIZE_i + \beta_7 AUDITOR_i + \beta_8 UNW_i + \beta_9 INDUSTRY_i + \beta_{10} YEAR_i + \varepsilon_i \quad (7)$$

<Insert table 8 here>

The coefficient estimate on *IFRS* is negative and significant at the 10% level for earnings forecasts. Moreover, the coefficient estimate of *IFRS*AUDIT* is positive and significant at the 5%-level indicating that the effect of IFRS on forecast accuracy is lower when financial information is audited by a member of the Big 4. These results also contradict general theory (DeAngelo, 1981) as well as earlier Australian evidence (Lee et al., 2006) on the role of high-quality auditors. We show that the effect of IFRS on accounting quality as measured by AFE is higher if the auditor is not a member of the Big 4 audit firms. To conclude, the choice of a reputable auditor does not serve as a credible means to signal superior quality in the IFRS-environment.

7. Conclusion

Motivated by the current debate about the merits and consequences of a regulatory accounting change to IFRS, this study contributes to the literature by providing first-time evidence on its financial reporting consequences in the context of Australian IPO earnings forecasts. We find that in line with self-selection theory the study shows that a manager's behaviour changes as they tend towards optimism by overestimating earnings during the AGAAP period (2001-2004) and convert to pessimism in the IFRS period (2005-2009). This behavioural change implies that the more restricted IFRS regulatory environment associated with increased level of comparability brought greater concerns to management and turned their optimistic forecasts into pessimistic forecasts. Adoption of IFRS has not improved IPO forecast accuracy as univariate and multivariate analyses consistently fail to identify a link between the application of IFRS and forecast accuracy. These findings are robust to a number of modifications of our research design.

Cross-sectional regressions are used to model earnings forecast accuracy and reveal some differences between the AGAAP and IFRS regulatory periods. Specifically, small firms that go public during the AGAAP environment experience high absolute forecast errors. A similar level of

inaccuracy applies to IPOs that employ a non reputable auditor to review their financial statements paying low fees. On this basis the size and the audit variables signal that small companies with low budget have difficulties in providing accurate earnings. A switch to the IFRS regime indicates that the type of auditor is no longer a significant variable. In contrast, the period between the issue of the prospectus and the end of the forecasting period has an effect on forecast accuracy as the longer the period the higher the forecast error.

Findings of supplementary analyses question the use of a reputable auditor to credibly signal the high quality of shares. We show that the effect of IFRS on accounting quality as measured by AFE is higher if the auditor is not a member of the Big 4 audit firms. Thus, reputable auditors have inferior expertise in applying IFRS in the context of IPO profit forecasts. Overall, we conclude that simply applying IFRS neither reduces the level of information asymmetry nor diminishes problems of adverse selection in the IPO context. Accordingly, the IPO process in Australia is still subject to a relatively high amount of ex-ante uncertainty.

Our study confirms previous evidence that the quality of financial reporting outcomes is not solely determined by the application of exogenously-imposed accounting standards (e.g. Ball et al., 2000; Ball, 2006; Burgstahler et al., 2006). In fact, they strongly underline the dominant role of endogenous factors that shape the accounting environment such as the country's institutional framework and managers' reporting incentives. Further, relative to other jurisdictions, in particular the U.S., companies in Australia operate in a rather low-litigation environment. Neither managers nor auditors have to fear severe legal suits if financial forecasts turn out to be wrong or misleading.

Apart from subsequent negative stock price reactions to adjust for the forecast error, managers lack additional (ex-ante) incentives to provide accurate and trustworthy profit forecasts. Accordingly, this study confirms that the quality of forecast financial information is independent of the set of accounting standards. It is rather an endogenous function determined by the interaction between the legal environment, capital market forces and financial reporting incentives. Therefore, in order to improve the credibility of financial forecasts as part of the listing process these factors have to receive particular attention.

In response to the concerns raised in the introduction, the findings of this paper have three major implications: i) the change to the IFRS regulatory regime brought uncertainty that did not help improve the accuracy of earnings forecasts and consequently did not improve the financial information environment; ii) issuers are concerned with the increased pressure associated with the introduction of IFRS and turned their forecasts from optimistic to pessimistic and iii) adopting IFRS and allowing adequate time for market adaptation is expected to help on achieving forecast accuracy. Overall, this paper shed lights in the long-standing puzzle of accuracy in management earnings forecasts – an important financial reporting issue.

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Appendix A: Independent variables definition and measurement

Variable name	Predicted sign	Variable measurement
Panel A: Accounting regulations variable		
IFRS	-	Dummy variable: 1 if forecasts have been prepared in accordance with IFRS; 0 if forecasts have been prepared in accordance with AGAAP.
Panel B: Control variables		
AGE	-	The number of years that each listing firm has been in operation before the year of listing.
HORIZON	+	The number of months between the issue of the prospectus and the end of the forecasting period.
RETAIN	-	The proportion of retained shares by the pre-IPO shareholders.
SIZE	-	The logarithm of the total market capitalisation of the IPO.
AUDITOR	-	Dummy variable: 1 for reputable auditors defined as one of (PriceWaterhouseCoopers, Deloitte and Touche, Ernst and Young, and KPMG); 0 for non-reputable auditors (all other audit firms).
UNW	-	Dummy variable: 1 if the offer has been underwritten; 0 otherwise.

Table 1: Australia IPOs sample description

Panel A: IPO sample distribution year classification				
	Total IPOs	IPOs with forecast	IPO profit forecasts (final sample)	%
2001	39	23	21	9.50
2002	82	24	24	10.86
2003	93	22	19	8.60
2004	180	54	46	20.81
2005	165	50	38	17.19
2006	186	45	28	12.67
2007	247	52	37	16.74
2008	69	6	3	1.36
2009	37	6	5	2.26
Total:	**1098**	**282**	**221**	**100**

Panel B: IPOs listings during IFRS period (2005 and 2009 by quarter)			
Event Year	Listed IPOs	Provide Forecast	No Forecast
2005 Qrt1	28	4	24
2005 Qrt 2	46	15	31
2005 Qrt 3	40	14	26
2005 Qrt 4	51	17	34
2006 Qrt 1	21	3	18
2006 Qrt 2	54	13	41
2006 Qrt 3	38	11	27
2006 Qrt 4	73	18	55
2007 Qrt 1	34	3	31
2007 Qrt 2	72	16	56
2007 Qrt 3	58	15	43
2007 Qrt 4	83	18	65
2008 Qrt 1	32	2	30
2008 Qrt 2	17	4	13
2008 Qrt 3	16	0	16
2008 Qrt 4	4	0	4
2009 Qrt 1	6	1	5
2009 Qrt 2	0	0	0
2009 Qrt 3	6	2	4
2009 Qrt 4	25	3	22
Total	**704**	**159**	**545**

This table presents details of the Australian IPOs. Panel A provides the total number of IPOs listed during the sample period and classifies the companies by year of listing. It shows the IPO firms that decided to announce earnings forecast during the IFRS period in addition to the final sample after excluding shows observations without sufficient data. Fiscal years are converted to calendar years as follows: fiscal years ending before December 31st are classified into the previous calendar year, while those ending on or after January 1st are classified into the current calendar year. Panel B presents quarter listing and earnings forecast disclosure of the IFRS sample.

Table 2: Descriptive statistics of FE and AFE

	FE (%)	**AFE (%)**
Panel A: Total Sample		
N=221		
Mean	1.11%	34.49%
Median	0.08%	17.94%
Std. Dev.	39.64%	47.59%
Min	-298.34%	0.039%
Max	189.92%	298.34%
Panel B: AGAAP environment		
N=124		
Mean	-13.34%	36.52%
Median	-0.07%	17.22%
Std. Dev.	62.84%	52.75%
Min	-298.34%	0.039%
Max	189.92%	298.34%
Panel C: IFRS environment		
N=97		
Mean	2.95%	32.00%
Median	0.05%	19.07%
Std. Dev.	39.10%	40.48%
Min	-77.32%	0.37%
Max	143.86%	231.27%
Panel D: Test for difference in means		
***t*-statistic**	-1.22	0.71
***p*-value**	0.2241	0.48
Panel E: Test for difference in medians		
***z*-statistic**	-0.688	-0.119
***p*-value**	0.4916	0.9049

This table presents summary descriptive statistics of the error metrics, FE and AFE. The samples comprise a total of 221 IPOs. Panels A, B and C further report results of one sample *t*-tests (Wilcoxon signed-rank tests) to test whether the means (medians) differ significantly from zero. Panel D displays results of two sample *t*-tests with unequal variances using Welchs's degrees of freedom to test equality of error means of the partitioned samples. Panel E displays results of Wilcoxon-Mann-Whitney-tests to test equality of error medians of the partitioned samples.

Table 3: Summary of FE and AFE by year of listing/accounting regulations

Panel A: Percentage Forecast Error					
AGAAP (2001-2005)					
Listing Year	<-25%	-25% to 0%	0% to 25%	Over 25%	**Total**
2001	11	5	1	4	**21**
2002	8	6	7	3	**24**
2003	2	6	10	1	**19**
2004	9	9	15	13	**46**
2005	3	4	6	1	**14**
2001-2005	**33**	**30**	**39**	**22**	**124**
IFRS (2005-2009)					
2005	3	8	9	4	**24**
2006	7	8	6	7	**28**
2007	9	13	12	3	**37**
2008	1	0	1	1	**3**
2009	0	0	2	3	**5**
2005-2009	**20**	**29**	**30**	**18**	**97**
Total	**53**	**59**	**69**	**40**	**221**
Panel B: Percentage Absolute Forecast Error					
AGAAP (2001-2005)					
Listing Year	<20%	20% to 40%	40% to 60%	Over 60%	**Total**
2001	6	7	4	4	**21**
2002	13	3	1	7	**24**
2003	14	4	0	1	**19**
2004	25	9	5	7	**46**
2005	10	1	0	3	**14**
2001-2005	**68**	**24**	**10**	**22**	**124**
IFRS (2005-2009)					
2005	14	6	2	2	**24**
2006	11	10	5	2	**28**
2007	21	6	2	8	**37**
2008	1	0	1	1	**3**
2009	2	1	0	2	**5**
2005-2009	**49**	**23**	**10**	**15**	**97**
Total	**96**	**64**	**56**	**65**	**221**

Table 4: Descriptive statistics of control variables

	AGE (years)	***RETAIN (%)***	***SIZE ($m)***	***HORIZON (months)***	***AUDIT (% Big 4)***	***UNW (% underwritten)***
Panel A: Total Sample						
Mean	18.52	51.37	230.53	8.93	66.38	64.63
Median	11.00	57.79	71.69	8.00		
Std. Dev.	24.97	27.63	469.76	4.62		
Min	0.00	0.00	1.14	0.00		
Max	177.00	99.51	3,286.00	26.00		
Panel B: AGAAP environment						
Mean	20.98	50.59	149.31	9.26	59.52	64.29
Median	13.00	57.24	41.95	8.50		
Std. Dev.	27.11	29.49	227.87	4.50		
Min	0.00	0.00	1.14	0.00		
Max	177.00	99.51	1,184.63	24.00		
Panel C: IFRS environment						
Mean	15.52	52.33	329.89	8.51	74.76	65.05
Median	10.00	58.14	110.00	8.00		
Std. Dev.	21.70	25.14	639.66	4.72		
Min	0.00	0.00	7.50	0.00		
Max	123.00	92.79	3,286.00	26.00		
Panel D: Test for difference in means						
***t*-statistic**	1.6484	-0.4719	-2.9355	1.2169	-2.4486	-0.1196
***p*-value**	0.1006	0.6374	0.0037	0.2249	0.0151	0.9049
Panel E: Test for difference in medians						
***z*-statistic**	1.9650	-0.2420	-3.4360	1.1200	-2.4220	-0.1200
***p*-value**	0.0494	0.8090	0.0006	0.2628	0.0154	0.9046

This table presents summary descriptive statistics of the control variables included to explain forecast accuracy. The control variables are: AGE - the number of years that each listing firm is in operation since its inception before the year of listing, RETAIN - proportion of retained ownership by the pre-IPO shareholders, SIZE - the logarithm of the total market capitalisation of an IPO, HORIZON - the number of months between the issue of the prospectus and the end of the forecasting period, AUDIT - auditor reputation: '1' for reputable auditors defined as one of (PriceWaterhouse Coopers, Deloitte and Touche, Ernst and Young and KPMG) and '0' for non-reputable auditors, UND – underwriter presence: '1' if the offer has been underwritten and '0' if there was no underwriter. Panel D displays results of two sample *t*-tests to test equality of means of the partitioned samples. Panel E displays results of Wilcoxon-Mann-Whitney-tests to test equality of medians of the partitioned samples.

Table 5: Descriptive statistics on ‘raw’ and ‘market adjusted’ initial returns

Panel A: IPO mean and median underpricing							
	Raw' initial returns				Market-adjusted' initial returns		
Year	No of IPOs	Mean	Median	Year	No of IPOs	Mean	Median
2001	17	2.81%	-0.02%	2001	17	3.12%	0.05%
2002	19	30.41%	4%	2002	19	31.61%	8.32%
2003	17	27.32%	14.99%	2003	17	26.55%	13.97%
2004	44	26.33%	10.42%	2004	44	25.47%	10.66%
2005	36	6.63%	4.50%	2005	36	5.86%	3.45%
2006	29	16.82%	15%	2006	29	16.15%	12.55%
2007	37	22.63%	17.25%	2007	37	22.77%	16.97%
2008	3	18.66%	15.99%	2008	3	23.65%	21.12%
2009	5	27.69%	12.52%	2009	5	23.79%	10.15%
Total	**207**	**19.92%**	**10%**	**Total**	**207**	**19.89%**	**9.13%**

Panel B: Underpricing in the AGAAP environment			
Mean	21.29	Mean	20.97
Median	10.00	Median	8.62
Std. Dev.	45.05	Std. Dev.	44.99
Min	-39.00	Min	-40.49
Max	290.00	Max	291.25
Panel C: Underpricing in the IFRS environment			
Mean	16.93	Mean	16.59
Median	11.21	Median	10.07
Std. Dev.	25.13	Std. Dev.	25.54
Min	-33.89	Min	-34.26
Max	140.00	Max	140.00
Panel D: Test for difference in means			
t-statistic	0.8590	t-statistic	0.8647
p-value	0.3913	p-value	0.3882
Panel E: Test for difference in medians			
z-statistic	-0.7590	z-statistic	-0.7100
p-value	0.4477	p-value	0.4780

This table presents summary descriptive statistics on 'raw' and 'market-adjusted' initial returns on the first day of trading. Panel D displays results of two sample t-tests to test equality of error means of the partitioned samples. Panel E displays results of Wilcoxon-Mann-Whitney-tests to test equality of error medians of the partitioned samples.

Table 6: Regression results for earnings forecast accuracy

		Total sample		AGAAP sample		IFRS sample	
	Predicted sign	**1**	**2**	**1**	**2**	**1**	**2**
Constant	+/-	2.6788***	1.8486***	2.6207***	1.6551**	2.8403***	2.0282***
		(4.49)	(3.73)	(3.19)	(2.42)	(3.38)	(2.71)
AGE	-	-0.0009	-0.0015	0.0002	-0.0012	-0.0012	-0.0010
		(-0.76)	(-1.52)	(0.13)	(-0.82)	(-0.60)	(-0.96)
HORIZON	+	0.0164*	0.0173**	0.0024	0.0149	0.0298*	0.0216*
		(1.78)	(2.34)	(0.19)	(1.55)	(1.96)	(1.96)
RETAIN	-	-0.0000	0.0006	0.0002	0.0012	-0.0005	-0.0001
		(-0.01)	(0.51)	(0.14)	(0.79)	(-0.20)	(-0.03)
SIZE	-	-0.1083***	-0.0864***	-0.0853**	-0.0729**	-0.1484***	-0.1007***
		(-3.84)	(-3.51)	(-2.28)	(-2.05)	(-3.59)	(-2.77)
AUDITOR	-	-0.0968	-0.1144	-0.2419**	-0.2297**	0.0783	0.0462
		(-1.33)	(-1.60)	(-2.24)	(-2.14)	(0.86)	(0.49)
UNW	-	-0.0484	-0.0523	0.0054	-0.0411	-0.1124	-0.0574
		(-0.66)	(-0.79)	(0.04)	(-0.40)	(-1.28)	(-0.66)
IFRS	-	-0.0898	0.0371				
		(-0.81)	(0.64)				
Industry effects		Yes	No	Yes	No	Yes	No
Year effects		Yes	No	Yes	No	Yes	No
No of IPOs		221	221	124	124	97	97
R^2		0.220	0.139	0.254	0.165	0.302	0.135
Adj. R^2		0.131	0.111	0.126	0.122	0.139	0.0793
F-statistic		2.436	5.046	3.854	4.075	2.471	2.413

This table presents results from OLS regressions with AFE as the dependent variable for the overall (2001-2009), pre-IFRS (2001-2004), and post-IFRS (2005-2009) periods. The pre-IFRS and post-IFRS sample sizes consist of 121 and 97 profit forecasts, respectively. The independent variables are: AGE - the number of years that each listing firm has been in operation before the year of listing, HORIZON - the number of months between the issue of the prospectus and the end of the forecasting period, RETAIN - proportion of retained ownership by the pre-IPO shareholders, SIZE - the logarithm of the total market capitalisation of an IPO, AUDIT - auditor reputation: '1' for reputable auditors defined as one of (PriceWaterhouseCoopers, Deloitte and Touche, Ernst and Young and KPMG) or '0' for non-reputable auditors, UND - underwriters reputation: '1' for underwriter presence: '1' if the offer has been underwritten and '0' if there was no underwriter; and IFRS – If the IPO has gone public using traditional Australian GAAP for its profit numbers it receives the value of '0' otherwise if the IPOs has gone public using IFRS accounts it gets the value of '1'. *** Significant at the one per cent level. **Significant at the five per cent level *Significant at the ten per cent level, t-statistics are robust for heteroskedasticity using the White (1980) method.The *t*-statistics (in parentheses) are based on White's (1980) heteroscedasticity-consistent standard errors. The model specifications differ in their application of industry and year effects. *, ** and *** denote statistical significance at the 10%, 5% and 1% significance-level (two-tailed), respectively.

Table 7: Regression results for initial returns

	RIR			MAIR		
	Total sample	**AGAAP sample**	**IFRS sample**	**Total sample**	**AGAAP sample**	**IFRS sample**
Constant	104.5752*	202.2624**	36.2175	100.8526*	194.8143**	33.0989
	(1.90)	(2.20)	(0.71)	(1.83)	(2.11)	(0.64)
AGE	0.1067	0.1060	0.0761	0.1110	0.1063	0.0770
	(1.26)	(0.91)	(0.68)	(1.33)	(0.92)	(0.68)
SIZE	-6.9303**	-11.9322***	-0.4724	-6.7453**	-11.6140**	-0.4483
	(-2.59)	(-2.63)	(-0.18)	(-2.52)	(-2.55)	(-0.17)
RETAIN	0.2050	0.0962	0.4264***	0.2145*	0.1095	0.4296***
	(1.65)	(0.50)	(2.86)	(1.72)	(0.57)	(2.81)
AUDITOR	-1.0281	2.3754	-3.8573	-0.8595	2.3157	-3.5211
	(-0.20)	(0.25)	(-0.76)	(-0.17)	(0.25)	(-0.67)
UNW	5.9883	6.7602	3.0099	5.6163	6.2198	2.9649
	(0.99)	(0.61)	(0.56)	(0.92)	(0.57)	(0.53)
IFRS	12.3193			12.5149		
	(1.06)			(1.05)		
FE	-9.5947			-9.5671		
	(-0.59)			(-0.59)		
IFRS*FE	12.4921			12.2820		
	(0.78)			(0.77)		
Industry effects	Yes	Yes	Yes	Yes	Yes	Yes
Year effects	Yes	Yes	Yes	Yes	Yes	Yes
No of IPOs	207	110	97	207	110	97
R^2	0.211	0.194	0.418	0.210	0.193	0.409
***Adj.* R^2**	0.109	0.150	0.289	0.108	0.0437	0.277
F-statistic	3.789	2.564	3.389	4.126	2.432	3.725

This table presents results from OLS regressions with the 'raw' (RIR) and 'market-adjusted' (MAIR) initial return as the dependent variables. The sample sizes consist of 214 initial return measures for profit forecasts. The *t*-statistics (in parentheses) are based on White's (1980) heteroskedasticity-consistent standard errors. The other control variables are as described previously. *, ** and *** denote statistical significance at the 10%, 5% and 1% significance-level (two-tailed), respectively.

Table 8: Robustness checks and additional analyses

	(1)	(2)	(3)	(4)
Constant	3.911**	21.23***	2.690*	2.634***
	(2.10)	(2.71)	(1.94)	(4.43)
AGE	-0.005	-0.007	0.0015	-0.0005
	(-1.18)	(-1.07)	(0.28)	(-0.45)
HORIZON	0.045	-0.080	0.0902*	0.015*
	(1.61)	(-0.59)	(1.81)	(1.76)
RETAIN	0.004	-0.012	-0.0078	0.0002
	(1.06)	(-0.74)	(-0.93)	(0.13)
SIZE	-0.287***	-0.290	-0.1264*	-0.104***
	(-3.04)	(-0.72)	(-1.89)	(-3.76)
AUDITOR	-0.290	0.325	-0.1374	-0.204*
	(-1.34)	(0.60)	(-0.82)	(-1.97)
UNW	-0.067	0.537	0.1316	-0.039
	(-0.30)	(0.70)	(0.73)	(-0.54)
IFRS	0.288	-0.356	-0.8279	-0.251*
	(0.50)	(-0.24)	(-1.49)	(-1.86)
IFRS*AUDIT				0.266**
				(2.07)
Industry effects	Yes	Yes	Yes	Yes
Year effects	Yes	Yes	Yes	Yes
No of IPOs	221	194	232	221
R^2	0.198	0.205	0.180	0.235
Adj. R^2	0.106	0.097	0.102	0.143
F-statistic	3.209	0.913	1.306	2.349

This table presents OLS regression results from various robustness checks. Modification 1 uses the logarithm of AFE as the dependent variable, modification 2 uses the AFE of forecasted EPS as the dependent variable, modification 3 includes large outliers of AFE, and modification 4 examines the role of the auditor. The *t*-statistics (in parentheses) are based on White's (1980) heteroscedasticity-consistent standard errors. The control variables are as described previously. *, ** and *** denote statistical significance at the 10%, 5% and 1% significance-level (two-tailed), respectively.