The impact of introducing estimates of the future on international comparability in earnings expectations

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Abstract

The objective of this paper is to assess whether the inclusion of improved estimates of the future in corporate annual financial statements has brought about greater international comparability. It is argued that including more relevant information in financial reporting enables users to estimate earnings that are more able to reflect current economic conditions and up-to-date expectations of the future and thus recognize news more timely. More important, it is claimed that earnings that are more able to reflect the underlying economics of integrating financial markets are not only more timely but more comparable as well. More specifically, the study examines the comparability of earnings expectations in fourteen long-standing members of the European Union before and after the mandatory IFRS implementation. The empirical findings support that users' earnings estimates have become more timely in recognizing market news and significantly comparable.

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Introduction

The objective of this paper is to assess whether the inclusion of improved estimates of the future in corporate annual financial statements has brought about greater international comparability. In an international setting, comparability can be defined as the qualitative characteristic of financial reporting information that leads to similar decision-making when the underlying economics are also similar in firms that operate in different countries. The present study addresses users' earnings estimates as a proxy for their inputs in firm valuations and decision making. It is argued that including more relevant information in financial reporting enables users to estimate earnings that are more able to reflect current economic conditions and up-to-date expectations of the future and thus recognize news more timely. More important, it is supported empirically that earnings that are more able to reflect the underlying economics of integrating financial markets are not only more timely but more comparable as well.

More specifically, the present study assesses international comparability in terms of the rate of recognition of economic income in the users' earnings estimates. This approach is quite unique in comparison to the existing literature on comparability which assesses *reported* accounting numbers directly such as Land and Lang(2002) and Beuselinck, Joos, Van der Meulen (2007), Jaafar and McLeay(2007) or indirectly, such as Ball, Kothari and Robin(2000), Ball, Robin and Wu(2003). The present study takes a different approach as it focuses on the financial reporting implications for decision making

motivated by suggestions in Barth (2006) and Ronen (2008) that introducing more estimates of the future (either in fair values or disclosure) in financial reporting provide a means to assist providers of capital in predicting, evaluating, and most important, *comparing* the amounts, timing and uncertainty of future cash flows. Barth (2006) argues that fair values enhance comparability as the fair value of any particular asset or liability is the same for every entity. Moreover, disclosure is likely to enhance the decision usefulness of fair values (and in an international context, comparability) by providing financial statement users with information about the variance of the future expectations such as risk assessments or by communicating the entity's expectations of the future, at a level that the users can relate the entity's estimates to other available benchmarks, for example, by providing the inputs of these estimates.

The contribution of the present study then, is to provide empirical evidence in terms of the degree of international comparability of news recognition in expected earnings consistent with Barth(2006) and Ronen(2008)'s arguments. Such an exercise has become especially desirable and feasible since the introduction of IFRS with their definite fair value orientation in the integrating European markets. In other words, the question that we examine here is whether users' future cash flow estimates have become more comparable in terms of their amounts and timing across integrating European markets for similar type of economic events after the IFRS implementation. While integrating markets present a common market factor in market news, a single set of financial reporting promises that these news are similarly recognized across countries. Moreover,

including more estimates of the future is predicted to not only yield more timely news recognition but also to enhance comparable news recognition across integrating markets.

Introducing estimates of the future and international comparability

Under IFRS, the objective of financial reporting is "to provide information that is useful to present and potential investors and creditors and others in making investment, credit, and similar resource allocation decisions"(IASB, 2006, para OB2). In their attempt to imbue financial reporting more relevance with respect to the decision making needs of users, standard setters have introduced more financial statement requirements that reflect current economic conditions and up-to-date expectations of the future. Further to that, as not all expectations of the future could be recognized in financial statements - particularly those that do not arise from verifiable events or transactions that have occurred- the standard setters have also required greater disclosure regarding such expectations (Barth, 2006).

Nevertheless, financial reporting still follows a mixed model that includes both historical cost measurements and fair values (and their variations). Historical cost measurements may inhibit the role of financial reporting in providing comparable information that is useful for decision making as they initiate country specific information costs in the form of making growth estimates. That could be seen in the context of Penman (2007)[1] who

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[1] The Penman's (2007) analysis assumes that earnings are clean-surplus. It is shown that deviations from clean surplus has little impact on valuations (see Isidro, O'Hanlon and Young, 2006 for empirical evidence on this issue) and therefore would not affect stock returns.

describes the impact of the measurement basis on valuation in terms of the canceling balance sheet error. In his analysis:

$$Stock\ return_t = Earnings_t + (P_t - B_t) - (P_{t-1} - B_{t-1}) \tag{1}$$

Where P is the equity price and B is the book value of equity. He then shows that under fair value accounting $P=B$ and earnings equal the stock return. In the spirit of Barth (2006), accounting numbers in this case reflect the current economic conditions and can be more easily comparable internationally[2]. With regard to historical cost measurement, it is only under the unrealistic assumption of no growth that the error in the balance sheet P-B is the same between the end and the beginning of the year (*i.e.* the balance sheet errors cancel) and that the equation (1) yields similar results to the fair value measurement. Under an assumption of positive growth $(P_t - B_t) > (P_{t-1} - B_{t-1})$, *Stock return*$_t$ is greater than *Earnings*$_t$ and growth induces a change in price premium over book value and further information costs for decision makers in estimating the future growth in earnings and required rates of return. In an international setting, this aggravates comparability as growth and required rate of return estimates usually implies a good knowledge of the circumstances of the firm and its environment.

Historical cost measurements will continue to be included in financial statements being unavoidable especially in cases where the firm adds value for shareholders by buying at (input) market prices and selling at (output) market prices (Penman, 2007). Furthermore,

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[2] The present analysis takes the perspective of comparability and leaves the debate on the pros and cons of fair values to other research such as Penman(2007), Barth(2005) etc.

Ball and Kothari (2007) point out that some components of the firm value would not be recorded at all in book value; they bring as an example the operating synergies among assets that are central to the existence of the firm (Coase, 1937), but they are not recorded on balance sheets until they are realized over time as net revenues from the firm's operating activities.

As stated, financial reporting is a mixed model and contains both historical cost and fair values which necessitate estimates of expected earnings and the required rate of return. The implications of different measurement bases for international comparability can then be identified in their estimation errors, their *relative* magnitude and their correlation.

From the analysis so far, it is not assumed that fair values imply no estimation error. As the focus of the study is international comparability, and since we can reasonably assume that fair values are not subject to the balance sheet error, the related estimation error should be correlated with a market factor which is common among integrated markets. On the other hand, the estimation error emanating from historical cost measurements is expected to be country and industry specific since this is a function of the knowledge of the circumstances of the firm and its environment, as explained above. The mix of these different types of estimation errors is predicted to influence international comparability; increasing the fair value content of financial statements might lead to accounting numbers that might be less reliable but also more timely and in the same time more correlated with the common market factor in integrating markets and therefore more comparable. On the other hand, increasing the historical cost measurement content of financial statements

may provide more reliable accounting numbers but also may lead to considerable information costs in delegating growth forecasting to decision makers, a task which assumes local knowledge and therefore introducing country effects in the estimation error.

To see that, let's assume the signal of financial reporting y about the firm value x such as $y=x+\varepsilon$, where ε is the estimation error. In the case of two countries j and k, comparable financial reporting would yield similar signals $y_j = y_k$ for similar firms with similar value x as long as the estimation errors ε_j and $_k$ are equal. Further to that, we can reasonable assume that both ε_j and ε_k are normally distributed and have respectively variances $\sigma^2_{\varepsilon j}$ and $\sigma^2_{\varepsilon k}$. This makes clear that financial reporting in these two countries is comparable when the estimation error in these two countries ε_j and ε_k is identical and perfectly correlated (see Barth, Clinch and Shibano,1999 on a similar approach for the definition of harmonization). In other words, assessing the comparability of the financial reporting between the two countries then, is given by the variance of $(\varepsilon_j - \varepsilon_k)^2$ which equals:

$$(\varepsilon_j - \varepsilon_k)^2 = \sigma^2_{\varepsilon j} + \sigma^2_{\varepsilon k} - 2\, \rho_{jk}\sigma_{\varepsilon j}\, \sigma_{\varepsilon k} \qquad (2)$$

The above equation shows that comparability does not necessarily depends on precise estimates, *i.e.,* small $\sigma^2 \varepsilon_j$ and $\sigma^2 \varepsilon_k$. For example, developing high quality financial reporting which addresses local institutional factors might reduce estimation error but it would probably reduce its cross-country correlation. Historical cost measurements also, are probably more reliable and may yield more precise estimates for the users that are

familiar with the firm. However, global financial reporting is not necessarily higher quality reporting as its success rather depends on the relative magnitudes of the estimation error and most important on the correlation of estimation errors among countries. In this respect, more estimates of the future reflecting current economic circumstances albeit rather unreliable and less precise, can encourage comparability.

In the case of integrating financial markets, including more relevant (either in terms of recognized amounts or in disclosure) information to reflect current economic conditions and up-to-date expectations of the future, is likely to increase the correlation of estimation errors as these economic conditions are likely to correlate as well. As shown above, in the context of a mixed reporting system, a considerable amount of estimates of future earnings and discount rates are delegated to users. Financial markets' integration can facilitate the estimates of the required rate of return for similar firms in different countries with the related estimation error to be at least similar as well. The variable of interest in this study is *earnings expectations* since the estimation error associated with them in a mixed reporting system may not be possible to correlate across markets as the determinants of historical cost measurement can be quite country specific. The above analysis suggests that the implementation of a single set of accounting standards whose aim is to provide more "relevant" information in integrating markets[3] is expected to have brought more homogeneity in the estimation error associated with earnings expectations.

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[3] Finance research already demonstrates an increased synchronization of macroeconomic activities, converging equity premia and a decrease in the importance of country factors in European financial market (Adjaoute and Danthine, 2004). Finance practitioners were the first to notice such a development. Galati and Tsatsaronis (2001) report that 75% of European equity managers believe in the superiority of allocation strategies based on industries and 10% on allocation strategies based on countries, whereas back in 1997 these proportions were 20% and 50% respectively (surveys of asset managers conducted on behalf of

Early evidence on comparability under IFRS

The early evidence on the impact of a single set of accounting standards for comparability focuses on the assessment either in terms of accounting choice (e.g. Nobes and Kvaal,2008) or in terms of reported earnings (Beuselinck, Joos, Van der Meulen,2007) . Nobes and Kvaal (2008) select 16 accounting issues for which variation within IFRS is allowed and examine policy choices by all the domestic IFRS reporters in the stock indices of five major capital markets for the first year of compulsory IFRS adoption. Their results suggest that companies are likely to pursue policies adopted previously under local GAAP and that reporting practices tend to vary according to a company's attention to international markets. Institutional factors on the country level and firm-level incentives are also found to affect reported numbers, namely earnings and their accrual and cash flow components in Beuselinck, Joos, Van der Meulen (2007). While they find that financial reporting has become relatively comparable under the implementation of IFRS, convergence is yet to be complete. However, the above studies can not inform on whether the implementation of IFRS has achieved comparability of users' estimates of accounting numbers. For instance, users seldom use reported accounting numbers as such for valuation purposes but instead, they rely on their own pro-forma estimates. While the above studies point out to "nostalgic" accounting choices,

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Merill Lynch). In the same vein, Moerman (2004) finds that an investment strategy focused on diversification over industries yields more efficient portfolios than diversification over countries. Not surprisingly, Estrada *et al* (2003) also report that investment banks, institutional investors and asset managers have restructured their research and trading departments, previously organized along country lines, to emphasise industry specialisation. This market integration seems to have been more of a process than a discrete change, with increasing convergence around the introduction of the euro. Tsatsaronis and Galati (2001), show that sector effects appear to subsume country effects in realized returns starting from 1998. Moreover, according to Hardouvelis, Malliaropoulos and Priesley (2001) cross-country variation in the cost of equity in the Eurozone, have declined dramatically after sometime between in 1997 and 1998.

where firms tend to choose policies that are consistent with the policies they practiced before IFRS, it is reasonable to assume that at least expert users of financial reporting are aware of this[4] and adjust accounting numbers based on their expertise of the national environment.

The present study addresses analysts' earnings forecasts as proxies for the pro-forma earnings users employ. Nevertheless, the present study differs with respect to the Wang Young and Zhuang (2008) or Horton, Serafeim and Serafeim(2008) study which focus on the impact of IFRS on the analysts' forecasts properties. These studies show that there has been a considerable improvement in the European firms' information environment after the mandatory IFRS implementation with some firms being more influenced than others. The present study focuses on comparability of users' estimates and not on the magnitude of their estimation error; therefore, it allows for it, arguing that this is not likely to affect comparability as long as it is of a similar nature.

Methodology

As shown above, the variable of interest in this study is users' expected earnings which are addressed by analysts' forecasts. These earnings expectations are assessed with respect to the degree by which they reflect market news in the form of the change in the firm value. Since the focus of this study is on comparability, we extent this model to accommodate country-specific response coefficients. It is predicted that the contribution

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[4] Anecdotal evidence from a series of interviews among French expert users (AFG & FFS, 2007) confirms this.

of these country specific response coefficients become statistically un-significant as users form similar expectations (in terms of mean and standard deviation) of earnings based on similar events so that the contribution of these country specific coefficients in the model becomes obsolete, notifying comparability. More to the point, the model is tested by means of a regression of earnings forecasts $\tilde{e}_t$ on market value changes P_t - P_{t-1} as follows:

$$\frac{\tilde{e}_t}{P_{t-1}} = a_0 + \sum_{s=1}^{S} a_s I_s + \sum_{c=1}^{C} a_c K_c + \sum_{c=1}^{C} b_c K_c \frac{P_t - P_{t-1}}{P_{t-1}} + \sum_{t=1}^{T} a_t Y_t + u_t \qquad (3)$$

where:

a_s, a_c, a_t represents the fixed component of each sector s, country c and year t effect;

I_s, K_c, Y_t are dummy variables equal to 1 if the firm belong to sector s, country c and year t respectively and zero otherwise.

b_c represents the country c specific response to price changes $P_t - P_{t-1}$; the cross-country variation then is assessed by testing for the equality of the country-specific response to price changes b_c

The dependent variable in (3) is the earnings forecasts made in the month of the financial year-end for the same year $\tilde{e}_t$ and for the year ahead $\tilde{e}_{t+1}$. The reason that the one year ahead forecast $\tilde{e}_{t+1}$ is also included in the tests is to acknowledge that news is likely to be incorporated into accounting earnings with different speed across firms and industries.[5] In

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[5] Dargenidou, McLeay and Raonic(2007) provide empirical evidence on the differences in the speed of news recognition in earnings expectations. Roychowndhury and Watts(2007) also apply a similar model employing future reported earnings as the dependent variable showing that the recognition of news increases as the horizon in the dependent variable becomes larger.

other words, we allow for certain firms to be slower in the recognition of news. In order to allow a fairer assessment of comparability, inferences will be drawn by both specifications and with emphasis on the regression that employs one year ahead expected earnings.

Furthermore, a dummy to proxy for "bad news" is introduced and interacted b_c, the country c specific response to price changes $P_t - P_{t-1}$ because prior literature suggests that it is reasonable to expect a different rate between positive and negative "news" recognition. It is important to note that the issue examined here is the comparability in the news recognition allowing for different types of news and not the differential recognition between "bad" and "good" news itself. [6] In assessing comparability allowing for different types of news, the model which employs again forecasts for both current and forthcoming earnings forecast $\tilde{e}_{t+1}$ acknowledging that news is likely to be incorporated into accounting earnings with different speed across firms and industries for reasons other than the ability of a single set of accounting standards to bring comparability. [7]

As argued here, comparability is lead by the introduction of more relevant (either in recognized amounts or in disclosure) information. In this respect, it is predicted that statistical evidence of comparability should be also simultaneous with larger news recognition coefficients in the same period that comparability has been achieved. More to

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[6] The regression of earnings on returns has been heavily criticised in the past. As Ball and Kothari (2007) argue, as long as the research objective is to estimate the extent to which all the available information about economic gains and losses is incorporated in accounting earnings in a timely fashion, regardless of whether the source of new information is accounting earnings itself, the specification is correct and econometrically consistent.

[7] The forthcoming earnings forecast is also very popular as a means of multiple based valuation (the PE ratio) and as such is found to enable more accurate company valuations than other methods (Liu, Thomas and Nissim,2007).

the point, this hypothesis is tested by means of (3a) which assesses the timely recognition of positive and negative "news" in the same periods that we test for comparability.

$$\frac{\tilde{e}_t}{P_{t-1}} = a_0 + a_1 D + b_0 \frac{P_t - P_{t-1}}{P_{t-1}} + b_1 D * \frac{P_t - P_{t-1}}{P_{t-1}} + \sum_{s=1}^{S} a_s I_s + \sum_{c=1}^{C} a_c K_c + \sum_{t=1}^{T} a_t Y_t + u_t \quad \text{(3a)}$$

where:

D represents a binary variable, taking the value of 1 if the changes in the value of the firm is negative and 0 otherwise.

Data

The sample consists of firms reporting under their local GAAP, voluntary adopters of IFRS and firms reporting under IFRS after 2005 originating from 14 long-standing EU jurisdictions (Austria, Belgium, Denmark, Finland, France, Germany, Greece, Italy, Ireland, the Netherlands, Portugal, Spain, Sweden, and the UK). The sources employed are IBES for earnings forecasts for the current year and one year ahead, and also for industry classification, and Worldscope for market capitalisation data necessary to deflate earnings forecasts and to calculate ex-dividend returns. The sample includes those firms for which all the above data are available for a firm year observation for both active firms at the census date and inactive firms that ceased operations during the periods 2000 to 2001, 2002 to 2003 and 2005 to 2006.

An important issue that arises when combining data from various databases concerns the different adjustment factors employed to render earnings per share and prices comparable over time, mostly by adjusting for capital issues and stock splits. To circumvent this

problem, earnings per share forecasts in IBES are multiplied by the number of shares provided in IBES and then divided by market capitalisation at the beginning of the year. The sample is restricted to firms that report in local GAAP with a December year end. The model requires earnings forecasts for the year underway and the year following the current forecast. The current forecast is the mean of December forecasts for the accounting year ending on that date. For the predictions of forthcoming earnings, the mean of December forecasts is again employed, this time for the accounting year ending 12 months later. Appropriate controls have been taken to ensure that the forecasts satisfy the 12 month period. A further restriction first to ensure an adequate information environment at the time of the earnings forecast and second that the consensus forecasts are meaningful has limited the firm-year observations only to those where there were at least three analysts following the firm. By requiring no missing observations for the current and one year ahead earnings yield and ex-dividend return, and further controls for the robustness checks (opening market to book ratio, short and long term debt to equity, analysts' following, standard deviation of forecasts and the ratio of earnings before extraordinary items and preferred dividends to actual IBES earnings which proxies for the analysts' adjustments) and finally deleting outliers based on a Hadi(1994) procedure, the final sample includes 5820 observations. . Descriptive statistics are provided in Table 1 (Panels A and B).

In Table 1 Panel A, it can be seen that there is substantial variation in the representation of the countries in the sample, mostly due to the relative size of the domestic economies. Note also that the sampling procedure relies heavily on the IBES following of each of

these markets under the restriction of at least three analysts making a forecast, and therefore the number of firm-year observations represents the most visible firms in each market.

With regard to the descriptive statistics presented in Panel B , it can be observed that the first period examined 2000-01 is characterised by consistently negative annual returns, while in the second period 2002-2003 these become positive and in the third period 2005-2006 returns are substantially high. Both earnings yields follow this trend, with the lower yields in 2000-01 and the highest in 2005-06.

Results

Table 2 sets out the estimates from the regression of the earnings forecast yield $\tilde{e}_{t(t+1)}/P_{t-1}$ on the scaled change in firm value $(P_t/P_{t-1}-1)$ adjusted for industry I_s, country K_c and time Y_t effects. The regression is run in three different periods. The first one which is characterised as pre-IFRS, when the IFRS mandatory adoption was a distant concept. The second period (2002-2003) coincides with the European Commission issuing a regulation requiring publicly listed firms in European Union (EU) member states to adopt IFRS in 2005. Armstrong et al.(2007) find that investors during this transition period were following the developments in accounting standards setting and were positively to events that increased the likelihood of adoption of IFRS, and negatively to events that decreased the adoption likelihood. Note that in both the pre-IFRS and the transition period, the observations employed are for firms reporting under local GAAP (the early IFRS adopters are excluded). The third period is characterized as post-IFRS as firms had to

report their financial statements under IFRS. Note that the observations in the post-IFRS period refer to firms that had to adopt IFRS (again, early adopters are excluded). It is considered that in both 2005 and 2006 users have not become entirely experts with the new accounting standards and that their beliefs should represent rather their perception of IFRS than their informed interpretation. In this respect, we could expect that the anticipation of IFRS adoption in the transition period (2002-03) would yield results very similar to the post-IFRS period. In fact, there is a significant increasing trend towards more timely recognition of good news for both current and forthcoming earnings (positive news coefficient for current earnings: 0.0141 to 0.0258 to 0.0408; positive news coefficient for forthcoming earnings: 0.0249 to 0.048 to 0.0535, all significant at 5%). In both cases, the coefficients between pre-IFRS and post-IFRS have more than doubled and this increase is significant at 1%. On the other hand, such trend is not observed with respect to the recognition of negative changes in market value, possibly because negative news is quite timely recognized anyway. Overall the evidence in Table 2 points to more timely earnings with emphasis to the positive news recognition.

Consistent with the arguments developed earlier, it is found that the IFRS implementation have initiated expectations of earnings that are not only more timely in recognizing news but also, more comparable. Evidence on the comparability of earnings under IFRS is given here by means of a Wald test of equality of the country specific estimates of news recognition b_c in the equation (3). The prediction is that under IFRS, users perceive earnings to recognise economic events in a comparable manner across countries which is suggested by *insignificant* Wald tests as the post-IFRS column shows in Table 3. The

elimination of country effects in the post-IFRS period holds for both positive and negative returns. On the other hand, it is shown that under the transition period, evidence of comparability can be found only under negative news. Such finding can not really be predicted ex-ante. One possible reason is that as negative news recognition tends to be quite timely, earnings in these cases may tend to better reflect the economics of integrating markets. It is not surprising that while there is not specific trend towards IFRS with respect to negative news, the coefficient for the transition period has significantly increased.

Finally, Table 4 reports robustness checks where a number of control variables are introduced separately as main effects and are also allowed to interact with the news recognition. The opening Market to Book value of equity and Leverage (short and long term debt to equity) are introduced as prior literature has suggested that they exert a significance influence in news recognition in reported earnings. Analysts' following, standard deviation of forecasts and the ratio of earnings before extraordinary items and preferred dividends to actual IBES earnings (to proxy for the extent of analysts' adjustments) are introduced to control for the quality of the information environment around these forecasts. Although most of them are significant , none has altered the inference from Table 3. A final control, for further information and learning effects is also introduced in the post-IFRS period, where the sample increases by the firms that are

voluntary early adopters of IFRS;   a binary variable is also introduced taking the value of one if the firm is an early adopter and 0 if not. Again inference ahs not changed.

Conclusion

The demand for a universally accepted set of accounting principles emanates from particularly strong economic forces, namely the globalization of capital markets. In this context, whilst high quality financial reporting would enhance the trust of investors to abandon their "home-bias" (*i.e*. the tendency to over-invest in their domestic portfolios), financial reporting developed with a strong comparability perspective would further alleviate the information costs related to international comparisons. Although it is still very unclear whether IFRS will succeed in this role (see Beneish and Lombardi Yohn,2008), this study shows that based on the early evidence after the IFRS mandatory implementation, the steps taken towards providing more relevant and timely information have promoted the alleviation of information processing costs and enabled comparable earnings expectations. Future research will show whether this is just a veneer of comparability or whether convergence has realistically taken place..

Table 1

Descriptive statistics

Panel A: Number of firm-year observations

	2000-01	*2002-03*	*2005-06*
Austria	30	25	31
Belgium	83	73	80
Denmark	61	55	66
Finland	121	120	141
France	335	320	336
Germany	226	187	211
Greece	121	73	88
Ireland	36	18	34
Italy	200	180	198
Netherlands	168	128	150
Portugal	48	34	41
Spain	161	140	144
Sweden	175	159	162
UK	260	250	351
Total	2025	1762	2033

Panel A presents the country distribution of the 5820 firm-year observations after the sample selection process (*i.e.* no missing observations for the current, one year ahead earnings yield, ex-dividend current returns and control variables for a given firm-year observations that satisfies that there are at least three analysts following the firm at the time of the forecast. Further to that, 3.16% of observations have been characterised as outliers after applying the Hadi (1992,1994) method).

Panel B: Medians of scaled current earnings (e_t/P_{t-1}), one year ahead earnings (e_{t+1}/P_{t-1}) and change in firm value ($P_t/P_{t-1}-1$)

	2000-2001			2002-2003			2005-2006		
	$(\tilde{e}_t/P_{t-1})$	$(\tilde{e}_{t+1}/P_{t-1})$	$(P_t/P_{t-1}-1)$	$(\tilde{e}_t/P_{t-1})$	$(\tilde{e}_{t+1}/P_{t-1})$	$(P_t/P_{t-1}-1)$	$(\tilde{e}_t/P_{t-1})$	$(\tilde{e}_{t+1}/P_{t-1})$,	$(P_t/P_{t-1}-1)$
Austria	0.0939	0.0967	-0.0980	0.0903	0.1028	0.1412	0.0851	0.0968	0.3849
Belgium	0.0574	0.0640	-0.1508	0.0680	0.0835	-0.0037	0.0704	0.0795	0.1932
Denmark	0.0493	0.0567	-0.0417	0.0491	0.0692	0.0088	0.0642	0.0767	0.3621
Finland	0.0531	0.0628	-0.0883	0.0538	0.0766	0.0734	0.0648	0.0759	0.2006
France	0.0439	0.0545	-0.1131	0.0517	0.0667	0.0207	0.0677	0.0811	0.2497
Germany	0.0337	0.0472	-0.1719	0.0478	0.0667	-0.1377	0.0655	0.0787	0.2583
Greece	0.0312	0.0341	-0.3801	0.0640	0.0756	-0.0824	0.0783	0.0929	0.3502
Ireland	0.0922	0.1060	0.0599	0.0837	0.1010	0.4107	0.0892	0.0966	0.2407
Italy	0.0425	0.0506	-0.1013	0.0584	0.0710	0.0365	0.0609	0.072	0.2098
Netherlands	0.0831	0.0925	-0.0272	0.0662	0.0840	-0.0554	0.0804	0.0959	0.2993
Portugal	0.0611	0.0719	-0.0624	0.0643	0.0720	0.0127	0.067	0.0701	0.28
Spain	0.0752	0.0866	-0.0049	0.0808	0.0895	0.1361	0.068	0.0808	0.3306
Sweden	0.0497	0.0535	-0.0371	0.0516	0.0628	0.0037	0.0621	0.0727	0.2922
United Kingdom	0.0939	0.0967	-0.0980	0.0903	0.1028	0.1412	0.0851	0.0968	0.3849
	0.0534	**0.0615**	**-0.0861**	**0.0597**	**0.0730**	**0.0262**	**0.0696**	**0.0803**	**0.2563**

Table 2

The IFRS impact on the recognition of news in expected earnings

Dependent variable: Current earnings: $(\tilde{e}_t/P_{t\text{-}1})$

	Pre-IFRS 2000/01		Transition 2002/03		Post-IFRS 2005/06	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
Positive news (b_0)	**0.0141**	0.036	**0.0258**	0.000	**0.0408**	0.000
Negative news (b_0+b_1)	**0.0788**	0.000	**0.1037**	0.000	**0.0737**	0.000

Comparison between Pre-IFRS, Post –IFRS and Transition

	Post-IFRS vs Pre-IFRS 2005/06-2000/01		Post-IFRS vs Transition 2005/06-2002/03		Transition vs Pre-IFRS 2002/03-2000/01	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
Positive news (b_0)	**0.0266**	0.000	**0.0149**	0.022	0.0117	0.178
Negative news (b_0+b_1)	-0.0052	0.791	-0.0301	0.155	**0.0249**	0.016

Dependent variable: Forthcoming earnings: $(\tilde{e}_{t+1}/P_{t-1})$

	Pre-IFRS 2000/01		Transition 2002/03		Post-IFRS 2005/06	
	Coefficient	p-value	Coefficient	Coefficient	p-value	Coefficient
Positive news (b_0)	**0.0249**	0.000	**0.0458**	0.000	**0.0535**	0.000
Negative news (b_0+b_1)	**0.0724**	0.000	**0.0841**	0.000	**0.0751**	0.000

Comparison between Pre-IFRS, Post –IFRS and Transition

	Post-IFRS vs Pre-IFRS 2005/06-2000/01		Post-IFRS vs Transition 2005/06-2002/03		Transition vs Pre-IFRS 2002/03-2000/01	
	Coefficient	p-value	Coefficient	p-value	Coefficient	p-value
Positive news (b_0)	**0.0286**	0.000	0.0077	0.182	**0.0209**	0.009
Negative news (b_0+b_1)	0.0027	0.877	-0.0090	0.613	0.0117	0.095

Table 2 presents the estimates from the regression (3a) of the earnings forecast yield $\tilde{e}_{t(t+1)}/P_{t-1}$ on the scaled change in firm value $(P_t/P_{t-1}-1)$ adjusted for industry I_s, country K_c and time Y_t effects.

$$\frac{\tilde{e}_t}{P_{t-1}} = a_0 + a_1 D + b_0 \frac{P_t - P_{t-1}}{P_{t-1}} + b_1 D * \frac{P_t - P_{t-1}}{P_{t-1}} + \sum_{s=1}^{S} a_s I_s + \sum_{c=1}^{C} a_c K_c + \sum_{t=1}^{T} a_t Y_t + u_t$$

Table 3

Comparability of news recognition in expected earnings – test of member state effects

Dependent variable: Current earnings: $(\tilde{e}_t/P_{t-1})$

	Pre-IFRS 2000/01		Transition 2002/03		Post-IFRS 2005/06	
	F(13,1703)	*p-value*	*F(13,1448)*	*p-value*	*F(13,1725)*	*p-value*
Positive news	**5.15**	0.0000	**4.10**	0.0000	1.57	0.0858
Negative news	**2.02**	0.0163	1.11	0.3474	0.79	0.6672

Dependent variable: Forthcoming earnings: $(\tilde{e}_{t+1}/P_{t-1})$

	Pre-IFRS 2000/01		Transition 2002/03		Post-IFRS 2005/06	
	F(13,1703)	*p-value*	*F(13,1448)*	*p-value*	*F(13,1725)*	*p-value*
Positive news	**6.63**	0.0000	**6.29**	0.0000	1.20	0.2707
Negative news	**3.13**	0.0001	1.15	0.3149	0.95	0.5027

Table 3 presents the country specific partial correlation coefficients from the following regression (for positive and negative returns):

$$\frac{e_t}{P_{t-1}} = a_0 + \sum_{s=1}^{S} a_s I_s + \sum_{c=1}^{C} a_c K_c + \sum_{c=1}^{C} b_c K_c \frac{P_t - P_{t-1}}{P_{t-1}} + \sum_{t=1}^{T} a_t Y_t + u_t \qquad \textbf{(3)}$$

The reported findings are the Wald statistics on a test of equality of the country specific estimates of news recognition b_c. The prediction is that under IFRS, users perceive earnings to be recognise economic events in a comparable manner across countries which is suggested by insignificant Wald tests.

Table 4

Robustness checks

Current earnings: $(\tilde{e}_t/P_{t-1})$

Positive news	Pre-IFRS 2000/01			Transition 2002/03			Post-IFRS 2005/06		
	Controls' significance	F(13,1699)	p-value	Controls' significance	F(13,1444)	p-value	Controls' significance	F(13,1721)	p-value
EARLY ADOPTION F(13,1974)							0.1668	1.60	0.0774
ANALYST FOLLOWING	**0.0282**	**6.59**	**0.0000**	0.2305	**4.10**	**0.0000**	0.2914	1.39	0.1543
FORECAST DISPERSION	0.2445	**9.13**	**0.0000**	**0.0329**	**6.28**	**0.0000**	**0.0002**	1.16	0.3059
BM	**0.0000**	**5.58**	**0.0000**	**0.0038**	**4.20**	**0.0000**	**0.0002**	**1.87**	**0.0295**
LEV	0.0796	**6.92**	**0.0000**	0.9905	**6.56**	**0.0000**	0.1174	1.57	0.0862
ANALYST ADJUSTMENTS	**0.0434**	**7.45**	**0.0000**	0.2814	**4.19**	**0.0000**	0.0816	1.62	0.0736

Negative news	Pre-IFRS 2000/01			Transition 2002/03			Post-IFRS 2005/06		
	Controls' significance	F(13,1699)	p-value	Controls' significance	F(13,1444)	p-value	Controls' significance	F(13,1721)	p-value
EARLY ADOPTION F(13,1974)							0.1668	0.82	0.6406
ANALYST FOLLOWING	**0.0282**	**2.47**	**0.0024**	0.2305	1.09	0.3612	0.2914	0.77	0.6886
FORECAST DISPERSION	0.2445	**4.32**	**0.0000**	**0.0329**	1.11	0.3497	**0.0002**	0.85	0.6117
BM	**0.0000**	**2.06**	**0.0141**	**0.0038**	1.38	0.1613	**0.0002**	0.91	0.5398
LEV	0.0796	**3.26**	**0.0001**	0.9905	1.28	0.2203	0.1174	0.84	0.6125
ANALYST ADJUSTMENTS	**0.0434**	**2.22**	**0.0073**	0.2814	1.37	0.1684	0.0816	0.79	0.6694

Dependent variable: Forthcoming earnings ($\tilde{e}_{t+1}/P_{t-1}$)

Positive news	*Pre-IFRS*			*Transition*			*Post-IFRS*		
	2000/01			*2002/03*			*2005/06*		
	Controls' significance	*F(13,1699)*	*p-value*	*Controls' significance*	*F(13,1444)*	*p-value*	*Controls' significance*	*F(13,1721)*	*p-value*
EARLY ADOPTION F(13,1974)							**0.0102**	1.10	0.3528
ANALYST FOLLOWING	**0.0019**	**10.72**	**0.0000**	0.2481	**6.26**	**0.0000**	0.5091	1.13	0.3316
FORECAST DISPERSION	0.4664	**5.2**	**0.0000**	**0.0249**	**4.00**	**0.0000**	**0.0159**	1.50	0.1084
BM	**0.0000**	**6.53**	**0.0000**	**0.0272**	**5.99**	**0.0000**	**0.0000**	1.18	0.2905
LEV	0.2114	**5.33**	**0.0000**	0.3571	**4.06**	**0.0000**	**0.0470**	1.45	0.1308
ANALYST ADJUSTMENTS	0.0894	**6.75**	**0.0000**	0.2259	**6.25**	**0.0000**	0.2059	1.18	0.2891

Negative news	*Pre-IFRS*			*Transition*			*Post-IFRS*		
	2000/01			*2002/03*			*2005/06*		
	Controls' significance	*F(13,1699)*	*p-value*	*Controls' significance*	*F(13,1444)*	*p-value*	*Controls' significance*	*F(13,1721)*	*p-value*
EARLY ADOPTION F(13,1974)							**0.0102**	0.71	0.7556
ANALYST FOLLOWING	**0.0019**	**3.35**	**0.0000**	0.2481	1.25	0.2391	0.5091	1.10	0.3569
FORECAST DISPERSION	0.4664	**2.01**	**0.0169**	**0.0249**	1.11	0.3452	**0.0159**	0.77	0.6944
BM	**0.0000**	**3.11**	**0.0001**	**0.0272**	1.17	0.2929	**0.0000**	0.95	0.5009
LEV	0.2114	**2.03**	**0.0156**	0.3571	1.09	0.3587	**0.0470**	0.81	0.6505
ANALYST ADJUSTMENTS	0.0894	**3.14**	**0.0001**	0.2259	1.16	0.3051	0.2059	1.01	0.4395

Table 4 presents the country specific partial correlation coefficients from the following regression (for positive and negative returns):

$$\frac{e_t}{P_{t-1}} = a_0 + \sum_{s=1}^{S} a_s I_s + \sum_{c=1}^{C} a_c K_c + \sum_{c=1}^{C} b_c K_c \frac{P_t - P_{t-1}}{P_{t-1}} + \sum_{t=1}^{T} a_t Y_t + Controls + u_t \qquad (3)$$

The reported findings are the Wald statistics on a test of equality of the country specific estimates of news recognition b_c. The prediction is that under IFRS, users perceive earnings to be recognise economic events in a comparable manner across countries which is suggested by insignificant Wald tests. Controls here refer to the MB, the opening market to book ratio, LEV short and long term debt to equity, analysts' following, standard deviation of forecasts and the ratio of earnings before extraordinary items and preferred dividends to actual IBES earnings which proxies for the extent of analysts' adjustments. In the Early Adoption case, the sample increases by the firms that are voluntary early adopters of IFRS; EARLY is then a binary variable is also introduced taking the value of one if the firm is an early adopter and 0 if not. The controls are introduced as main effects and are also allowed to interact with the news recognition.

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