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Earning Management by Canadian acquirers: Pre- versus Post- IFRS

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Earning Management by Canadian acquirers: Pre- versus Post- IFRS

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DECLARATION

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ABSTRACT

Purpose: This study investigates the occurrence of pre-acquisition accrual-based earnings management for a sample of stock- and cash- financed Canadian acquirers between 2005 and 2015 before and after transitioning IFRS in 2010.

Design/methodology/approach: Both parametric (t-test) and non-parametric (Wilcoxon test) tests are used to examine the occurrence of accrual-based earnings management in the year preceding the announcement of acquisition. These are compared across stock and cash acquirers as well as before and after the implementation of the IFRS.

Findings: Unlike cash acquirers, the results reveal some evidence of upward pre-acquisition accrual-based earnings management by stock-financed acquirers in order to achieve higher stock market price and lower acquisition costs. Furthermore, significant changes in the post-IFRS period are detected which indicate that the recommendations put forth by IFRS may be successful in mitigating earnings management.

Research limitations/Implications: This research provides evidence of the existence of earnings management prior to acquisition announcement and the ability of IFRS to mitigate it. This also might signal mitigation of the agency problem. However, this research faces some limitations. The main limitation is represented by the disproportionate numbers of stock acquirers to cash ones. Moreover, the size of the sample became small because of the exclusion of many observations due to the implementation of several criteria and the missing data from DataStream.

Practical implications: The results of this study provide evidence for policy makers on the effectiveness and influence of IFRS. This is also of interest to investors whom might benefit from a more efficient market for investment decisions.

Originality/value: Despite the considerable number of studies that have investigated the effectiveness of IFRS on earnings management; the acquirers' tendency to manipulate earnings after the passage of IFRS in Canada remains an unexploited research area. Therefore, the originality of this research is in its contribution to filling a research gap by studying earnings management in the Canadian acquisition market.

Keywords: Mergers and Acquisitions, Earnings Management, Accrual- Based Measures, IFRS.

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Chapter One: Introduction

1.1 Introduction

This chapter introduces the general topic being discussed in the research by shedding light on its originality and contributions. It centers on providing general background about the key elements of this research in section two; these are mainly earnings management activities prior to acquisitions and IFRS enactment. The purpose of the research is stated in section three followed by highlighting the originality of the topic of interest in section four. Section five provides a summary of the main findings while the contributions of these findings to the relevant literature are presented in section six. Section seven provides the structure of the rest of the thesis.

1.2 General Background

The recent acquisitions' rapid expansion is basically due to managers' perception that this strategy is able to create value for their firms as it is considered one of the most important and observable examples of growth strategies (Masulis et al, 2007). Acquisition enables the involved firms to survive the economic turbulences and allows them to protect their position in the market. Filipovic et al (2012) defined acquisition as the purchase of one company to another in an attempt to control the latter. The cost of this purchase could be financed through the exchange of cash, stocks or combination of both.

The motives for acquisition activities are mainly explained in two groups of theories that have been proposed by Seth (1990). The first group of theories, referred to as 'value maximizing theories', suggests that managers engage in acquisitions to maximize the welfare of the firms' shareholders. The second group of theories referred to as 'non value maximizing theories' explains motives for managerial self-interest rather than shareholders wealth.

In an attempt to reduce the cost of acquisition, acquiring firms may have an incentive to increase accounting earnings prior to the acquisition date to achieve higher stock market price and lower acquisition costs (Botsari and Meeks, 2008). This issue was of the main triggers for the extensive breakthrough of earnings management practices that was adopted by acquirers to achieve their plans. To understand

earnings management, Ardekani et al (2012) defined it as the act of manipulating accounting information in order to achieve certain goals. It is essential to differentiate between the real-activities and accrual-based techniques of earnings management. For instance, Roychowdhury (2006) and Cohen and Zarowin (2010) basically introduced in their researches how firms can manage earnings by altering real earnings management activities using operational costs, production costs and discretionary expenses as proxies. On the other hand, Louis (2004) and Botsari and Meeks (2008) focused exclusively on accrual-based measure of earning management which is considered one favored instrument for managing earnings as approved by most managerial perspectives.

Stock markets around the world has increased their need for transparency since its deficiency fuels the act of manipulation of accounting information and thus may lead to negative impacts especially in the presence of merger and acquisition settings. Thus, in response to the market pressure to enhance the quality of financial reporting, a series of consistently accounting standards were required to boost investors' confidence and increase transparency in stock markets. International Financial Reporting Standards (IFRS) is a single set of accounting standards developed by the International Accounting Standards Board and transitioned to Canadian enterprises on January 1, 2010 after the approval of Canada's Accounting Standards Board (ACSB).

In summary, earnings management is the firm's management willingness to give a misleading image regarding its true financial position by manipulating reported earnings towards a particular direction. Earnings management is of a particular concern to securities regulators due to their impact on the quality of reported earnings (Breeden, 1994) and hence IFRS was needed to play a role in this issue. One of the factors enhancing the implementation of IFRS in numerous countries is the general perception that it enhances content of financial reports, accounting information comparability, relevance, reliability, transparency, and quality. It accordingly affects capital markets, contractibility, and could eliminate earnings management. In detecting whether the introduction of IFRS is an effective solution to the above mentioned debates, Ball (2006) and Ismail and Adibah (2013), for instance, revealed that this act has eliminated some of investor's concerns about the

quality of financial reports provided by firms adopting IFRS. Whereas Elbannan (2010) and Bruggeman et al (2013) showed that IFRS did not succeed in enhancing transparency.

1.3 Purpose of the Study

As previously mentioned, adopting acquisition strategies has been increasing rapidly in the light of the fierce competition dominating markets; and its seriousness lies in managers' likelihood to rely on earnings management to achieve their takeover goals. Similarly, IFRS has been gaining increased attention due to its significant role in strengthening the quality of financial reporting and enhancing transparency. Due to the considerable importance of these topics, this research aims to study Canadian acquiring firms' tendency to manipulate earnings prior to acquisition in pre- versus post-IFRS comparative approach. More specifically, as finance literature highlighted the different financing methods of acquisition and the different measures of earnings management, this research attempts to investigate whether stock bidders and cash bidders tend to manipulate earnings prior to the announcement date of the acquisition process by focusing on accrual-based measure of earnings management. In more explicit terms, although real earnings management activities is important and was examined in several previous researches, this research attempts to focus on the change in the accrual-based earning management for the Canadian stock acquirers and cash acquirers before and after the passage of IFRS act.

Therefore, this research attempts to answer the following research questions:

- Has the Canadian successful stock acquirers managed their earnings in the accounting year immediately preceding the acquisition announcement?
- Has the Canadian successful cash acquirers managed their earnings in the accounting year immediately preceding the acquisition announcement?
- Is the magnitude of accrual-based earnings management in the accounting year immediately preceding the acquisition announcement larger for successful stock acquirers than for successful cash acquirers?

- Is there a change in the accrual-based earning management for the Canadian stock acquirers before and after the adoption of the IFRS?
- Is there a change in the accrual-based earning management for the Canadian cash acquirers before and after the adoption of the IFRS?

1.4 Originality of the Study

Earnings management activities by corporate managers ahead of acquisition announcement have been an appealing research topic for researchers who has studied its motives and examined both real and accrual-based earnings management activities. An extensive stream of research has investigated the presence of earnings management prior to acquisition announcement (Erickson and Wang, 1999; Rahman and Bakar, 2002; Louis, 2004; and Botsari and Meeks, 2008). Also, IFRS has received considerable attention from researchers who has published substantial number of studies that investigated its effect on transparency, the quality of accounting information and consequently on earnings management (Elbannan, 2010; Bruggeman et al, 2013; Negakis, 2013; and Murtini and Lusiana, 2016). Despite that these topics were the focus of attention of academics, yet their studies did not cover all markets. Therefore, the originality of this research lies in the choice of the Canadian market as the field of study; especially that Canadian stock market (TSX) is the third largest exchange in North America by capitalization after NYSE and NASDAQ, and the largest exchange in the world by number of listed securities. Consequently, it would be predictable that Canadian firms are abundant to such corporate event. Moreover, IFRS was transitioned to Canadian enterprises from 2010, and there is a research gap in studying earnings management by Canadian acquirers after the passage of this act that caused corporate governance changes.

1.5 Major Findings of the Study

The findings of this study show evidence of accrual-based earnings management on the aggregate level prior to the acquisition announcement. However, this is not fully evident after splitting the sample into stock and cash subsamples. Stock-financed acquirers appear to engage in accrual-based earnings management, more precisely, accrual-based earnings management was significant in the pre-IFRS period and

showed a substantial decline after the adoption of IFRS. Furthermore, reported results show no significant evidence of accrual-based manipulation by cash bidders either before or after the enactment of IFRS. When comparing stock and cash bidders, results show that stock acquirers engage in accrual-based earnings management more than cash bidders particularly in the pre-IFRS period, but this finding has not proven to be statistically significant. The significant decline in the use of earnings management by stock acquirers associated with the enactment of IFRS could be explained by the fact that the introduction of IFRS succeeded in improving accounting quality and financial reports by reducing earnings management. Cash acquirers did not witness a significant change in accrual-based earnings management in the post-IFRS period. This stability in cash acquirers' performance can be explained due to the initial independence on the use of earnings management by this type of acquirers.

1.6 Implications and Contributions to the Literature

The results of the study pose substantial theoretical and practical implications. On the theoretical level, the existence of earnings management prior to acquisition announcement and the ability of IFRS to mitigate it could pave the way for future research that aims at investigating a causal effect relationship between the implementation of IFRS that represent the cause, and the change in the use of earnings management that represent the effect. Also, the decline in the use of earnings management by Canadian acquirers might signal mitigation of the agency problem. Moreover, the findings of this study might have favorable implications on the professional fields. Since the results of this research prove that IFRS would contribute to minimizing earning management, this could be of interest for regulators as well as investors and academicians. Mainly, for policy makers, the effectiveness of IFRS legislation can be a clue to achieve their future objectives of controlling and regulating financial institutions. Regarding market participants, since the findings of this study prove that IFRS could contribute to ceasing ratios' manipulation and improving the quality of financial reporting, they will no longer have fears of moral hazard problem. Accordingly, investors will make more efficient investment decisions, as their trust in the financial system is enhanced provided the discipline of firms accounting reports insured by IFRS.

This research has various contributions to the literature. First of all, this study examines the tendency of stock and cash Canadian acquirers to engage in accrual-based earnings management prior to acquisitions announcement. Also, this research hypothesizes and finds different results that create support for previous research that found significant upward accrual-based earnings management by acquirers in general and stock acquirers in particular prior to acquisition. Furthermore, this study contributes to filling a certain gap in literature where, to my best knowledge, this study conducts the first analysis of the effect of IFRS in the acquisition setting in Canada by comparing the magnitude of pre-acquisition accrual-based earnings management activities in pre- and post-IFRS periods. Thus, this study contributes to the stream of literature that aims at studying the effectiveness and advantages that could result from the passage of such acts.

1.7 Structure of the Study

The rest of the thesis is organized as follows

Chapter two starts by providing an overview about acquisition and an empirical research review that discusses and covers the history, types and motives of this strategy in section two of this chapter. This section also highlights acquirer's market performance at different stages and tackles the financing method of acquisition as well as the target's attitude towards the bid. Section three introduces an overview about earnings management, its motives and determinants. A brief research review on the measures of earnings management is also provided in this section. Section four discusses International Financial Reporting Standards (IFRS) which is a keystone of investigation in this thesis; this section sheds light on the effectiveness of this accounting standard in several fields but focuses on IFRS effect on earnings management. Section five concludes this chapter.

Chapter three explains the methodology utilized in serving the objective of this research. It starts by highlighting the philosophical approach of this research in section two. Section three discusses the reasoning approach of this thesis. Research Strategy is discussed in section four. Section five introduces the research hypotheses development. Research methods and procedures are explained in section six. Statistical tests used to test the results are introduced in section seven. Data sources

and samples procedures are explained in sections eight and nine respectively. Section ten concludes.

Chapter four presents the empirical results of this research. Section two provides the analysis framework used in this chapter. Descriptive statistics for discretionary total accruals (DAC) and discretionary current accruals (DCAC) variables are presented in section three. Section four reports the results, explains the significance of DAC and DCAC and compares it with previous research findings. Empirical results and their relevance to the research hypotheses are discussed in section five. Section Six concludes.

Chapter five presents the conclusion of this study and opens a research window for future research. Section two in this final chapter summarizes the results of this study. Section three discusses the validity of the results. Section four highlights the limitations for this research. Section five presents the theoretical and practical implications. Section six suggests avenues for future research.

2 Chapter Two: Literature review

2.1 Introduction

One of the most important corporate strategies that have long been considered vital for surviving the market's challenges and the fierce competition is mergers and acquisitions. Various theories discussed the motives of mergers and acquisitions and extensive literature investigated their effects on shareholders wealth. A key characteristic in implementing the acquisition process is the manager's tendency to increase their earnings prior to a takeover to lower its cost, from here the use of earnings management started to accelerate and became a topic of interest for researchers and economists to determine the factors, evidence and motives of earnings management in relation to acquisition.

This chapter starts by providing an overview about acquisition and an empirical research review that discusses and covers the history, types and motives of this strategy in section two. This section also highlights acquirer's market performance at different stages and tackles the financing method of acquisition and the target's attitude towards the bid. Section three introduces an overview about earnings management, its motives and determinants. A brief research review on the measures of earnings management is also provided in this section. Section four discusses International Financial Reporting Standards (IFRS) which is a keystone of investigation in this thesis; this section sheds light on the effectiveness of this accounting standard in several fields but focuses on IFRS effect on earnings management. Section five concludes this chapter.

2.2 Mergers and Acquisitions

The following paragraphs present the definition, types and motives of mergers and acquisition. This section also introduces the market performance of acquirers and targets, the financing methods of acquisition and the target's management attitude towards the bid.

2.2.1 Definition

One of the most important corporate strategies that have long been a topic of interest to researchers is acquisition. It is defined as the purchase of one company to another in an attempt to control the latter (Filipovic et al, 2012). It is vital to differentiate between acquisition and mergers. Filipovic et al (2012) also defined mergers as the combination of two or more companies to form a new entity where the former merging companies no longer exist.

Acquisition is perceived by companies as the act or solution to adopt various growth strategies that enable them to enlarge their customer base and thus expand their size and sustainability. Hence, in the light of the fierce competition between companies and as a response to the increasing economic and market pressures , companies now are extensively engaging in acquisition practices in order to strengthen their position in the market and survive all market turbulences.

2.2.2 Types of mergers and acquisitions

In discussing the types for such growth strategies, Weston et al (1990) classified mergers and acquisitions into three distinct categories and used the term "mergers" as a general term for " Mergers and Acquisitions" since despite the differences between the two strategies, yet they have common classifications. Starting with the first type, Weston et al (1990) defined horizontal mergers as the mergers that take place between two firms that are functioning and competing in the similar activities or productions and tend to create a larger firm. It is worth mentioning that this type of mergers might have negative consequences such as forming monopolies or crashing among industry members, thus to avoid such consequences; mergers are usually strictly regulated by governments. Vertical mergers is the second category of this growth strategy, it takes place between two different firms with different operations, for instance, vertical mergers could occur at the stage of research and development or production of a certain product. The importance of this stage lies in its ability to make transactions of different levels more coherent within one combined firm eliminating the conflicting interests of each independent entity for the sake of the common ownership welfare. Particularly, the uncertainty detected in the input supply and the high costs of contracting are the motives of this type of mergers.

Finally, the third type of mergers is called conglomerate merger and occurs when two different firms operating in distinct business activities combines into one entity. This type of mergers can be divided into sub-categories; the product extension merger is the first sub-category that aims at extending the product line of the involved firms. The geographic extension merger is the second sub-category and takes place when the two firms involved in the merger are of different non-overlapping geographic areas. The pure conglomerate merger is the third sub-category and as its name indicates, it is the type of merger when the involved firms have completely different operations.
On the other hand, various considerable aspects of acquisition strategy are to be discussed, starting with the motives of acquisition, its effect on the market performance of the acquiring firms; acquired firms and the combined entity, and the benefits of these companies involved in acquisition activities.

2.2.3 Evolution

Mariana (2012) suggested that takeovers move in waves. For instance, the first takeover took place in Europe between 1880 and 1904. After this period, countable acquisitions were experienced in both Europe and US. Europe had witnessed a second takeover between 1919 and 1925 and was characterized by its vertical integration type among firms. The third wave occurred in the 1950s in an attempt to achieve diversification and peaked in 1965. The forth takeover took place from 1983 to 1989 and was accompanied by technological improvements in electronics, biochemistry and the development of the European financial markets. The fifth wave was led by the economic boom and the advancements in the internet and telecommunication industry between 1993 and 2000.

Whereas in USA, the first acquisition wave occurred during the period 1895-1904 and was classified as horizontal wave that led to more concentrated industries and considerable expansion of the economy. Unfortunately, the economic recession that was experienced in 1903 by the country, restricted the expansion of this movement. The second wave took place between 1922 and 1929, the enhanced economic conditions activated the acquisition waves and the inception of the great depression in 1929 curbed them. The period from 1940-1947 experienced remarkable economic growth and considerable acquisition activities that was provoked and eased by

government regulations and taxation policies rather than technological developments. The following years witnessed a conglomerate wave knowing that this type of mergers and acquisitions gained more importance over vertical and horizontal mergers in the 1960s. Furthermore, after recovery from recession that occurred over the period 1974-1975, a new wave has emerged in 1976 in the US economy and involved sectors that have been gaining remarkable importance such as finance, investment banking, insurance, and health care (Weston et al, 1990).

At the end of 1980, great takeovers started to accelerate (Holmstrom and Kaplan, 2001), however the acquisition process was financed by leverage rather than stock or cash financing. Gorton et al (2005) documented that new industries were involved in the acquisition trend such as telecommunication, hotels and most importantly commercial banking where the takeover volume jumped from $800 billion in 1995 to $1.8 trillion in 2000.

2.2.4 Motives of acquisition

Strategy literature has meticulously discussed the motives of acquisition. Value maximizing theories and non-value maximizing theories have been proposed by Seth (1990) and considered among the strongest theories in exploring the motives for corporate takeovers.

1- Value Maximizing Theories:

The first group of theories focuses on motives to maximize shareholders value and includes:

- Equity theory which states that acquisition motives arise from the aim to attain synergies at three levels: Operational, Financial and Managerial (Seth, 1990). Operational synergy is the benefit that results from the combination of two independent entities facilitating the transfer of knowledge between them. These benefits were summarized by Trautwein (1990) as the reduced costs and superior production attaining economies of scale and scope.

  Chatterjee (2002) defined financial synergy as the benefit that results from the reduction of cost of capital and showed that it could be achieved as follow: when two firms are combined, increased diversification of their

investment portfolio will be noted and eventually; reduction in their cost of capital will be realized. In addition, firms engaged in the merger and acquisition strategies could create coinsurance where the deficient firm can be supplied with cash by the other firm. Cost of capital could also be reduced by increasing the size of the firm and establishing an internal capital market that can efficiently allocate capital.

Finally, managerial synergy is the benefit that results when a firm that enjoys an excess in its managerial resources decides to acquire a firm with inefficient managerial resources.

- Valuation theory which suggests that acquisition motives stem from managers' knowledge about the value of the target (Trautwein, 1990). Particularly, acquirers are more likely willing to pay premiums on the prices of the target shares knowing that this target firm is undervalued. In addition, Weston et al (1990) stated that valuation theory also includes the cost of replacing assets that can be diversified by acquisition, in other words, acquiring a firm with established facilities could be less costly than paying for the new assets.
- Market power is another motive for firms to engage in acquisition activities and hence increase their power and ability to control prices and products (Singh and Montgomery, 1987). Market power could be enhanced by either acquiring firms with the same product market (horizontal acquisitions) or by acquiring firms with different products and markets.
- Managerial discipline theory: shareholders may fail to discipline management behavior therefore investors will engage in acquisitions to induce a change in incumbent management (Matusaka, 1993).
- Tax considerations: the acquisition motive of this theory is to minimize tax. For instance, an acquiring firm with positive cash flows can benefit from target firm's accumulated tax losses by sheltering its positive earnings from taxes.

2- Non-Value Maximizing Theory:

The second group of theories explains motives for managerial self-interest rather than shareholders' wealth and includes:

- Hubris Motive: this theory suggests that managers commit innocent mistakes with no bad intentions when valuing targets and engaging in acquisitions that do not lead to gains (Weston et al, 1990). In this case, wealth is transferred from the acquirer to the target and thus the total gain for both parties is zero.
- Agency Motive: managers engage in acquisitions to serve their interest rather than maximizing shareholders wealth or profits through diversifying their own investment portfolio, using the free cash flow to increase the size of the firm, and increasing the firms' dependence on their skills by acquiring firms with inefficient management (Berkovich and Narayanan, 1993). Mueller (1969) suggested that managers would aim to maximize the size of the firms on the expense of maximizing profits or shareholders' wealth to increase managerial compensations such as salaries, stock options, promotions bonuses as well as power and prestige.

Furthermore, according to Gort (1969) there are additional theories that don't belong to the above mentioned groups such as "The Economic Disturbance theory". It states that economic disturbance makes the future more unpredictable especially that historical information become less beneficial in predicting the future and hence this leads to valuation differences between owners and non-owners; such that the valuation of the non-owner should be greater than the valuation of the owner and the difference between the valuation of the non-owner and the market value should be greater than any other valuation difference of any other available investment. Therefore, under these conditions acquisitions would take place.

Another theory that explains the motives for acquisition is "Process Theory" which states that takeover might be an outcome of potential games between the units within a company and outsiders (Trautwein, 1990).

2.2.5 Acquirer's Market Performance

1- Pre- announcement period:

Business literature has also shed lights on acquirers' market performance at the three stages of acquisition, the pre-announcement; around and/or on announcement; and post announcement. The results varied among several researchers.

A large body of research has been interested in studying the pre-announcement market performance. For instance, Firth (1980) and Sudarsanam et al (1996) found insignificant positive returns in the pre-announcement period for UK acquirers. Similarly, Goergen and Renneboog (2004) examined the pre-announcement performance of European takeovers and showed that bidders' shareholders earn insignificant returns. Same findings were noted by Smith and Kim (1994) and Francis et al (2008) in their study of the U.S. acquirers' performance prior to acquisition process where the results of their research confirmed that bidders earn insignificant returns in the pre-announcement phase.

Whereas Dodd and Ruback (1977) and Bradley and Sundaram (2006) concluded consistent results that U.S. bidders earn significant positive returns enjoying a good performance before acquisition offers.

2- Around the announcement period:

The research on markets' reaction to acquisition announcements has gained an equivalent interest. For instance, Firth (1980); Sudarsanam et al (1996); Holl and Kyriazis (1997) Sudarsanam and Mahate (2006); and Antoniou et al (2007) showed consistent results in confirming the negative market performance of U.K. acquirers around the announcement day.

However, a favorable market reaction was demonstrated by Goergen and Renneboog (2004) in their study on a set on European countries and Alexandridis et al (2010) in their study on Japanese acquirers.

In a similar attempt but in the U.S. market, Dodd (1980) and Franks et al (1991) showed that U.S. bidders witness insignificant negative returns around the announcement day. Whereas Masulis et al (2007) and Chronopoulos et al (2013) showed that around the announcement day, U.S acquirers earn significant negative returns.

In contrary to the above results, Smith and Kim (1994) and Dube et al (2011) concluded that U.S. bidders earn insignificant positive returns around the announcement day. However, Francis et al (2008) showed significant positive returns indicating a favorable market performance of U.S. shareholders on acquisition announcement day.

3- Post-announcement period:

The pre and around announcement stages were not the only focus of attention for researchers, yet they also investigated the performance of acquirers after the acquisition announcement. Dodd and Ruback (1977) found that US bidders earn insignificant returns after the announcement date. Similarly, Sudarsanam and Mahate (2006) found consistent results for UK market. Moreover, Sudarsanam et al (1996); Bradley and Sudaram (2006) and Oler (2008) demonstrated a significant negative returns two months after the announcement day.

On the contrary, Smith and Kim (1994) showed that bidders witness significant positive returns in the post announcement periods.

Target firm's performance:

Many researchers examined returns to target firms, Manne (1965) and Jensen and Ruback (1983) found that most of the gains from acquisitions accrue to shareholders of the acquired firm. This result was confirmed by Jarrell et al (1988), Franks et al (1991) and Agrawal and Jaffe (2000) whom has shown that average returns to acquirers are either statistically equivalent to zero or lower.

2.2.6 Financing methods of acquisitions

As previously mentioned, acquisitions could be financed through the exchange of cash, stocks or both (Filipovic et al, 2012) or by issuing debt to finance the purchase. The choice of financing was an appealing topic for researchers in which they have been concerned about testing the effect of method of payment on shareholders wealth. According to Myers' and Majluf's (1984) explanation, firms that choose to pay for the acquisitions process through cash are relatively cash rich firms unlike those that choose to finance their purchase through stocks signaling that they have

relatively normal or low level of cash, the authors added that shareholders prefer debt financing over equity financing. Travlos (1987) reported that cash bidders earned insignificant positive abnormal returns whereas stock bidders earned significant negative abnormal returns. His results were consistent with those of Franks et al (1991), they confirmed in their study that cash acquirers earn insignificant positive return whereas stock acquirers suffer from significant negative returns; the authors related these negative returns of equity financed takeovers to the devaluation of stocks that usually follow the equity financed offers. Unlikely, the results of the study of Sung (1993) indicated that significant negative returns are experienced in both cash and stock financed bids. Moreover, he suggested that firms with excess cash holdings are more likely to use stock financing while firms with excess cash flow tend to use cash payment method as source of financing. In the same context, Yook (2003) suggested that a significant advantage results from cash acquisitions, mainly, when a company issue debt to be used for cash acquisitions, managers would be more cautious and work harder to repay debt, and hence this would reduce agency cost and avoid bankruptcy. In addition, he investigated the return differential market performance among a sample of 199 cash financed acquisitions and 112 stock financed acquisitions; he found insignificant negative abnormal return to cash acquirers while significant negative abnormal return for stock acquirers over the period covering the announcement day. Furthermore, Antoniou et al (2007) demonstrated that stock acquirers witness significant negative return due to the asymmetric information problem that governs the stock acquisition process and leads to negative market reactions.

Rani et al (2014) also studied the effect of the method of payment on acquirers' market performance by showing that the market reacts favorably to cash financed acquisitions, particularly, cash acquirers enjoyed significant positive returns around the announcement period while stock acquirers suffered insignificant returns indicating that this return differential might be an evidence for the asymmetric information hypothesis.

2.2.7 Target's management attitude towards the bid

One interesting issue that affects the acquisition strategy is the mood of the bid, or in other words, the targets' management attitude towards the acquisition offer.

Accordingly, acquisitions could be classified as either friendly or hostile. Filipovic et al (2012) defined friendly acquisition as the acquisition that takes place when the target's management agrees on selling their shares and encourages shareholders to sell their shares effortlessly to acquirers as they are motivated by the perceived favorable effects and synergies between the target and acquirer.

On the other hand, hostile acquisition was defined by DePamphilis (2008) as the acquisition that takes place when the target's management refuses the offer of the acquirer and hence obliges the latter to twist to shareholders to try to convince them to sell their shares directly without referring to the target's management. According to Franks and Mayer (1996), some researchers viewed hostile acquisition as an ineffective means for corporate governance due to its enormous costs and useless solutions; others viewed it as a disciplinary means for correcting managerial misconduct.

The effect of the mood of the bid on acquirers' market performance has paved the way to stream of research that investigated the return differential between hostile and friendly acquisitions. Starting by Lang et al (1991) who found that in hostile acquisitions acquirers earn insignificant negative return, while in friendly acquisitions, acquirers earn insignificant positive return over an eleven-day event window. Parkinson and Dobbins (1993) inspected shareholders' wealth of companies engaging in hostile takeovers and noted a sharp drop of their return from significant 8.84% to an insignificant -0.36% during the announcement period.

Tse and Soufani (2001) also studied the effect of mood of targets on shareholders' wealth during high and low merger and acquisition eras. In low merger and acquisition periods, the authors reported insignificant positive return for friendly acquirers whom outperformed hostile acquirers that earned insignificant negative return in the pre-announcement period. Likewise, in high merger and acquisition periods, friendly bidders earn a significant high return indicating better performance than hostile bidders with insignificant low returns in the pre-event period. Nevertheless, in the post announcement period, hostile bidders perform better than friendly bidders in both low and high acquisition eras. Opposing results were found by Rajand and Forysth (2002) in which they provided evidence showing hostile bidders earn significant positive returns in the preannouncement period whereas

insignificant negative returns for friendly acquirers. On the announcement day, the authors found significant negative returns for hostile bidders reflecting investors fear that the bidder will overpay premium to win the offer; and insignificant negative return for friendly takeovers suggesting that bidders earn normal returns.

Georgen and Renneboog (2004) in their turn examined the hostile-friendly return differential, their results showed significant positive return foe friendly acquirers and significant negative return for hostile acquirers over a period covering the pre and around the announcement day, consistent results were reported by the authors in the post announcement period.

The effect of the target's attitude towards the acquisition offer was also highlighted by the results of Sudarsanam and Mahate (2006) that reported that hostile acquirers outperform all other types of acquirers such as the friendly, single hostile and white knights. Consistent with Sudarsanam and Mahate (2006), Oler (2008) found that hostile acquisitions performed better than friendly acquisitions.

2.3 Earnings Management

This section presents the definition, evidence and motives, determinants and measures of earnings management.

2.3.1 Definition

As a fundamental step to perform the acquisition, both acquirers and target firms used earnings management as a tool to achieve their plans. The relationship between earnings management and performance of both acquiring and acquired firms was the purpose of investigation to many researchers.

Earnings management is the act of manipulating accounting information in order to achieve certain goals (Ardekani et al, 2012). Fok and Franses (2013) presented overwhelming evidence on the increasing use of earnings management to avoid earnings decreases and losses. Similarly, Piloto et al (2016) documented that there is a wide relines on earnings management activities especially in periods preceding debt issue events.

Previous studies showed an increased interest in understanding how firms manage their earnings and differentiated between the real-activities and accrual-based techniques of earnings management. Roychowdhury (2006) for instance provided evidence showing the use of multiple earnings management methods by firms to meet specific benchmarks in their financial reporting. His study and that of Cohen and Zarowin (2010) concentrated on how firms can manage earnings by altering real activities that mostly refer to managers' actions, which in turn deviate from normal business practices. In other words, Roychowdhury (2006) and Cohen and Zarowin (2010) basically focused in their research on real earnings management activities using operational costs, production costs and expenses as proxies. In fact several other studies (such as DeFond and Jiambalvo, 1994; Subramanyam, 1996; Peasnell, 2000; Louis, 2004 and Botsari and Meeks, 2008) focused exclusively on accrual-based measure of earning management which is considered one favored instrument for managing earnings as approved by most managerial perspectives. From different perspective; Na and Hong (2017), in their study on the CEO gender effect on earnings management, found that male CEOs use both aggressive discretionary accruals and real activities operation in order to report earnings improvements.

Three main theoretical justifications constitute support for the existence of earnings management. Relevant prior researches rely on the prepositions of a well-known assumption in finance which is Efficient Market Hypothesis (EMH). According to Fama (1965) who introduced EMH, many assumptions are to be considered in this theory such as:

1. Successive prices do not depend on previous period.
2. Stock prices follow an identified probability distribution.
3. Investors have homogeneous expectation.
4. No transaction costs are incurred.
5. Information is free.
6. Investors are rational at valuating stocks
7. If investors are irrational, decision are random and tend to nullify the effect of irrationality when aggregated,

8. If investors are irrational and their irrational decisions are nonrandom and do not nullify, the effects of such irrational decisions are eliminated by rational arbitrageurs.

Indeed, Jensen and Ruback (1983, p 20) commented that the "*post-outcome negative abnormal returns are unsettling because they are inconsistent with market efficiency and suggest that changes in stock prices during takeovers overestimate the future efficiency gain from mergers.*"

In this context, the above hypothesis constitutes support in processing manipulated accounting reports and provides explanation to the post-acquisition underperformance (Louis, 2004).

On the other hand, Jensen (2004) supported the Bidder Overvaluation Hypothesis. Particularly, bidders may manipulate their earnings prior to the offer to exhibit overvaluation of their firm (Erickson and Wang, 1999). Consequently, this overestimation will increase management discretion and hence triggering managers to make poor acquisitions.

Many studies also supported the Managerial Economic Incentive Hypothesis where managers are perceived to be opportunistic on accounting choices (Groff and Wright, 1989).

Acquisitions are considered as a transverse field of study, for their ability to create value for the involved firms. For this reason, bidder managers increase earnings and accounting ratios by accelerating revenues collection, deferring expenses or using other accounting procedure manipulations prior to acquisition announcements (Erickson and Wang, 1999). Healy and Wahlen (1999) suggested that managers can rely on inventory valuation methods and defer advertising and maintenance expenditures.

In the context of corporate takeover, examining earnings management must cover the evidence and motives of this manipulating act, and its determinants by acquirers.

2.3.2 Evidence and motives of earnings management by acquirers

As previously mentioned, one motivation for accounting policy choices is defined by the managerial economic incentives hypothesis. According to Watts and Zimmerman (1990), managers tend to manage their earnings when the cost of earnings management is less than the cost of undoing earnings management. Gaver et al

(1995) showed that corporate managers have strong incentives to manage earnings for the sake of increasing their compensation and job security knowing that their compensation is usually associated to firm performance. According to Jensen (2004), managers might manage earnings in order to meet analysts' expectations. Jirapoin (2005) also suggested that managers focus on presenting best image of their firms' performance to meet investors' expectation. Likewise, Ali and Zhang (2015) proposed that CEOs overestimate earnings in their early years of CEOs' service to influence market's perception of their qualified ability.

Nonetheless, in order to examine which entity in the acquisition process is more likely to manage earnings, Abarbanell and Lehavy (2003) found in their study that firms that receive "buy" recommendations are more inclined to manage earnings while those who receive "sell" recommendations are more likely to show negative unexpected accruals.

Wu (1997) agreed with previous studies that managers manipulate earnings, yet he measured earnings management using an industry adjusted change in earnings. He argued that bidder managers manipulate downward earnings prior to announcing acquisitions.

In contrast to above literature review, Koumanakos et al (2005) found weak evidence for earnings management by bidder managers in the pre-acquisition announcement period and after the completion of the deal.

Recent literature shed light thoroughly on bidder earnings management considering the method of payment to finance the acquisition and came out with controversial results. Erickson and Wang (1999) noted that as a response of the anticipated market behavior of discounting firms' stock price at the announcement of stock swap, managers tend to manipulate earnings upward to raise back the market price. Their findings were consistent with those presented by Loughran and Vijh (1997), Easterwood (1998), Rau and Vermaelen (1998), Louis (2004) and Botsari and Meeks (2008) postulating that acquiring firms aggressively use discretionary accruals to manipulate reports by overstating their earnings prior to stock acquisition announcements. In a similar context, Baik et al (2007) confirmed in their study that managers manipulate earnings upward to prevent overpayments. In addition, and consistent with the above findings, Kassamany et al (2017) recently found evidence of upward pre-merger accrual-based earnings management by stock-financed UK acquirers.

Furthermore, in his turn, Louis (2004) provided strong evidence that there is a significant negative relationship between discretionary accruals and abnormal returns in stock swap acquisition. However, Hamza and Lakhal (2010) found strong evidence that bidder firms manipulate earnings either downwards or upwards regardless of the method of payment.
Regarding cash acquisitions, Erickson and Wang (1999) showed that firms do not rely on earnings management acts unlike stock acquisitions. Whereas Pungaliya and Vijh (2009) underlined that insignificant difference occurs between discretionary accruals of cash and stock acquisitions.

2.3.3 Evidence and motives of earnings management by target firms

As previously mentioned, extensive research has first shed light on the earnings management around acquisition from the acquirers' side perceiving earnings management by targets firms as more limited and its motives are more challenging and hard to tackle as compared to those of acquirers.

As with the characteristics of target firms, previous research has observed a number of different motivations behind issuing a "seeking buyer" announcement. Palepu (1986) suggested that the scope to attract a buyer by target firms could provide motivation to manipulate earnings in order to achieve a deal. In their turn, Erikson and Wang (1999) provided evidence of insignificant positive earnings management by target firms prior to announcing the deal.

Easterwood (1998) distinguished between friendly and hostile acquisitions and realized no earnings management by targets being acquired friendly, however upward earnings management by targets engaging in hostile takeovers. Likewise, Eddey and Taylor (1998) detected positive earnings management for hostile takeovers but downward earnings management by targets that are convinced with the deal and facilitated the takeover. This was also justified by Ben-Amar and Misisoner-Piera (2008) who pointed out that in an opposite case where takeovers take place in hostile environment, target firms are motivated to inflate earnings as a way of disabling the deal.

Anilawski et al (2009) distinguished between the methods of sale allowing the takeovers to occur, that are between auctions versus negotiation, in relation with

earnings management. They observed upwards earnings management by target firms when the acquisition is applied via an auction as opposed to a negotiation.

Furthermore, prior literature also differentiated between the takeover's deals initiators in relation with earnings management by target firms, more precisely, in case the takeover is bidder-initiated, target firms are perceived deprived from incentives and even opportunities to manipulate their earnings. However, when "seeking buyer" firms are the initiators of the deal, targets are more likely to manage earnings as they can anticipate both if and when the bid will be received (Skaife and Wangerin, 2012). In a similar context, Lim and Chang (2017) found a low financial reporting quality for target candidates due to their wide engagement in earnings management activities and consequently high likelihood of deal withdrawal.

2.3.4 Determinants of bidder's earnings management

The investigation on the existence of earning management prior to acquisition was the main objective of extensive previous research. Several studies provided robust evidence that acquirers do manipulate their earnings; others conversely showed no earnings management prior to acquisition. Indeed, a stream of literature developed the determining factors that analyze the relationship between earnings management and corporate takeover, and are presented below:

1- Managerial ownership:

In reference to previous theoretical and empirical literature, several reasons were pointed out as triggers to managers to use discretionary accruals to increase their earning-based compensations. From their point of view, Erickson and Wang (1999) showed that managers manipulate earnings in order to minimize dilution voting and control power of shareholders; particularly, they increase accounting ratios prior to acquisition, yet the authors showed insignificant relationship between discretionary accruals and managerial ownership. According to Jensen (2004), since earning manipulation adds to the overvaluation process; managers rely on earning management to achieve high stock valuation and thus increase their discretion.

Other results pointed out that managerial ownership is likely to align the incentives of CEOs and shareholders; and then affects earnings management (Louis, 2004). On

the other hand, Roll (1986) and Malmendier and Tate (2005) suggested that managers do not seek to manipulate earnings.

In analyzing the relationship between earnings management and managerial ownership, Warfield et al (1995) showed a negative relationship between discretionary accruals and managerial ownership. Contrasted results were demonstrated by Yeo et al (2002) and Gabrielsen et al (2002) who reported positive relationship between discretionary accruals and managerial ownership.

2- Bidder's toehold:

As defined by several studies (such as Claessens et al, 2000), owners with more than 10% of capital are referred to controlling shareholders. Betton and Eckbo (2000) claim that a key element that determines optimal bidding strategies is the size of bidder toehold, and accordingly this element signals that the acquisition decision aims to achieve profit maximization motives. Johnson et al (2000) noted that this mechanism benefits the acquirer controlling shareholders at the expense of minority shareholders. Thauvron (2000) suggested that an information asymmetry rise with the existence of bidder's toehold and hence allows controlling shareholders to prevent earnings management. This is not the case in the target firm where controlling shareholders may allow earnings manipulation to generate private benefits.

Moreover, a tunneling mechanism takes place in which the size of bidder toehold determines the number of shares necessary for a takeover and affects the operational and research cost of the firm to be acquired, consequently controlling shareholders of the target firm achieve private benefits upon the acquisition announcement as the target shares value increase (Hamza, 2009).

3- Method of payment:

The relationship between market reaction and announcement of equity offerings was revealed by several studies to be significantly negative and supported by the claim that the equity offering convey negative information about bidder firm overvaluation. Previous research (such as Easterwood, 1998; Erickson and Wang, 1999; Botsari and Meeks, 2008 and Kassamany et al 2017) delivered robust

evidence that managers manipulate earnings prior to stock swap financed acquisitions rather than cash acquisitions. Erickson and Wang (1999), for instance, confirmed that the reversal of the price effect resulting from manipulating earnings in the pre- acquisition period remarkably attributes to the post-acquisition underperformance of the bidder. The authors also argued that firms do not manipulate earnings in cash-financing acquisitions. Similarly, Easterwood (1998), Baik et al (2007) and Botsari and Meeks (2008) found similar results assuring that acquiring firms overstate their earnings reports prior to the announcement of stock swap acquisitions. They also showed evidence that the bidders report abnormal accruals when applying their strategy. This is consistent with the results of Loughran and Vijh (1997) and Rau and Vermaelen (1998) who argued that manipulating earnings is done based on discretionary accruals.

Likewise, Heron and Lie (2002) reported that acquiring firms experience negative abnormal returns around stock-swap acquisition announcements while normal returns around cash acquisitions. They concluded that negative effect on the post-acquisition performance is resulted from earnings management before the acquisition.

In contrast, insignificant difference between discretionary accruals of cash and stock-swap acquisitions was observed in Heron and Lie (2002) as well as Pungaliya and Vijh (2009) studies.

4- Book to market ratio of the bidder Vs. the target:

To compare the acquirer's growth potential as well as the target's growth potential, the relative book to market ratio should be identified by dividing the bidder book to market to that of the target and hence the gap between the two firms' profiles can be specified. If this ratio exceeds 1, it signals that bidders are seeking high growth potential targets (Hamza and Lakhal, 2010).

Recently, Dumontier and Pecherot-petitt (2002) and Hamza (2009) proved that significant gains can be achieved by acquirers when the latter records high book to market value and acquirers target with weak one. Their outcomes were consistent with the previous findings reported by Rau and Vermaelen (1998) that added that

acquirers have incentives to manage their earnings and tend to overestimate their own abilities prior to adopting acquisition.

One point of view sheds light on the fact that significant levels of book to market ratio can be an indicator of a systematic risk factor and thus a distressed firm profile (Fama and French, 1993). For this reason, Jiraporn (2005) provided strong evidence that bidder with high book to market is more likely to manipulate earnings when acquiring a target with high growth opportunities.

5- Relative deal size:

Inasmuch that the relative deal size affects earnings management as most studies suggest, the deal size can be considered a proxy for the benefits produced from manipulating earnings, that is when the size of the target firm is relatively small as compared to that of the acquirer, the benefits from manipulating earnings will also be small and hence the acquiring firm will no more has incentives to manipulate earnings (Erickson and Wang, 1999).

Conversely, Heron and Lie (2002) and Siregar and Utama (2008) found no evidence that the performance of bidder firm and their earnings management is related to the relative deal size.

6- Takeover premium:

The takeover premium is defined as the difference between the bid price and the pre-bid market price of the target firm. Since the market reaction to the acquisition announcement is highly correlated with the premium paid over the target price (Louis, 2004), the market will consider the acquirer who pays a large premium as overpaying for the acquisition (Roll, 1986). This will happen when market bidders expect high potential gain and benefits from the takeover (Marck et al, 1990).

According to Easterwood (1998), a low level of takeover premium indicates positive forecasts; he argued that a favorable takeover premium is the result of the use of earnings management to enhance the acquirer's pre-offer market price. His preceding discussion suggests a negative relationship between bid premium level and earnings management prior to acquisition.

On the other hand, Amel-Zadeh et al (2008) found evidence insuring that bidding firms use forecasts that convince target firms to accept lower premium thus the market's reaction significantly benefits bidding firm by enforcing favorable earnings forecasts and hence acquire the target on better terms.

2.3.5 Measures of earnings management:

1- Accrual-Based measures of earnings management:

One favored instrument for manipulating earnings as approved by most managerial perspectives is through discretionary accruals. Many motives behind accruals led managers to rely on it when managing their earnings. From theoretical perspective, manipulating accruals is appealing because accruals can aggregate into a single number and thereby capture the portfolio nature of income determination (Watts and Zimmerman, 1990).

Peasnell (1998) justified that accruals are characterized by their relatively low cost, in contrast to other operating decisions such as reducing shareholders' value. Another motive behind manipulating accruals was revealed by Young (1999) in which he shed light on the opaque nature of accrual-based models making them more difficult to directly be observed; and even if manipulating accruals was detected, unavailable information makes it harder for managers to undo the accrual changes and adjust away their effects, unlike other highly visible accounting procedure changes that can be easily undone by external parties.

- Measuring Accruals:

Two main issues are to be considered when discussing the measurement of accruals. The first issue is the treatment of depreciation which, in reference to most recent studies, is excluded from total accruals. For instance, DeFond and Jiambalvo (1994), Peasnell et al (2000) and Louis (2004) focused on working capital accruals in measuring total accruals without taking into account depreciation and amortization. This is due to the fact that depreciation is considered a weak instrument for earnings management especially that managers do not rely on depreciation in neither smoothing earnings nor lowering them (Hunt et al, 1996). Sloan (1996) also presented empirical evidence that most of the variation in total accruals is only

regarded to current accruals. Consistent results were found by Beneish (1998) and Young (1999) in which they argued that depreciation's visibility and predictability weakens its potential to be used in manipulating accounting ratios.

In a takeover setting, Louis (2004) noted that acquirers rely on earnings before interest, taxes, depreciation and amortization in managing their earnings, confirming that managers tend to manage their current accruals to manipulate earnings as previously discussed. Unfortunately, it is not the case in other studies, where total accruals were the main instrument in measuring earnings management (Ferentinou &Anagnostopoulou, 2014 and Ipino & Parbonetti, 2017). Furthermore, many studies used both current and total accruals, one instrument for investigating earnings management, and the other for robustness (Botsari and Meeks, 2008 and Kassamany et al, 2017).

The second issue regarding the measurement of accruals relates to the balance sheet versus cash flow approach. According to Hribar and Collins (2002), the articulation between the changes in balance sheet working capital accounts and the changes in the income statement revenues and expenses breaks down when acquisitions events take place. The authors supported their argument by the fact that those changes in the balance sheet working capital accounts would consequently be invalidly shown under the discretionary accruals in the balance sheet. Therefore, Hibar and Collins (2002) concluded that when a firm acquires another firm, the net current assets tend to increase and thus acquisitions may induce a positive bias to accruals in favor to the earnings management hypothesis under the balance sheet approach. Ball and Shivakumar (2007) agreed with Hribar's and Collins' conclusion and added that the discretionary accruals reported in some empirical studies of earnings management are too large to be credible and can easily be identified by financial analysts or even naïve investors.

In contrast to the above evidence and conclusions, Gore et al (2001) argued that the process of measuring total accruals using the cash flow statement is itself problematic; the difference between profits and cash flows usually includes accruals that cannot be easily known if they underlie discretionary accruals or non-discretionary accruals.

2- Real earnings management:

Despite the importance of and the increasing interest in accrual-based earnings management, real earnings management succeeded in capturing researchers' attention. Previously, Graham et al (2005) found that managers when managing their reported earnings prefer real activities manipulation, such as reducing discretionary expenditures or capital investments, over accrual-based manipulation since these real economic actions have direct effect on cash flows and consequently affects the earnings target.

Although real earnings management has not been as widely studied as accrual-based earnings management, yet many researchers have documented the reasons for executives' willingness to manage earnings through real activities rather than through accruals. Dechow and Sloan (1991) provided evidence that executives reduce R&D expenditures to boost their earnings to meet their earnings benchmarks. Likewise, Baber et al (1991) and Bushee (1998) reported consistent analysis showing that firms reduce R&D expenditures to record positive earnings. Bartov (1993), for instance, found that when firms experience negative earnings, managers tend to blunt the bad earnings by reporting higher profits from asset sales.

In his turn, Roychowdhury (2006) defined real earnings management as management activities that deviate from normal business practices and aims at showing that a firm's earnings benchmarks have been met normally, thereby misleading shareholders. He added three ways in which a firm would be capable of avoiding reporting losses, first through boosting sales by increasing price discounts; second lowering the cost of goods sold; and finally significantly reducing discretionary expenditures when the latter do not generate immediate revenues.

In analyzing the tradeoffs between real earnings management and accrual-based earnings management, Zang (2006) found that accrual and real manipulations are negatively correlated whereas real manipulation and the costs of accrual manipulation are positively correlated. Her findings led her to suggest that executives when managing earnings treat both strategies as substitutes and usually their decision to manipulate real activities precede accrual-based manipulation decision.

On the contrary, Gunny (2005) examined real earnings management activities and their capital market consequences, he found a strong evidence of real earnings management's significant negative impact on the future operating performance especially that market participants are aware of future earnings implications of managers' biased behaviors.

2.3.6 Corporate governance and earnings management

In modern corporations, management has become increasingly independent from non-executive members and shareholders. Within this context, it has been questioned the intentions of managers and their tendency to maximize their wealth at the expense of the economic value of the firm and the interest of shareholders. Monsen and Downs (1965) argued that managers tend to pursue their own personal goals such as increased salaries and security, enhanced powers and prestige; and hence direct funds to activities that may not contribute to the maximization of the firm's value. These ambitions of managers may lead them to manipulate the reported earnings of their firms to provide a favored picture of the firm's financial position (Watts and Zimmerman, 1986).

In summary, earnings management is the firm's management willingness to give a misleading picture regarding its true financial position by manipulating reported earnings towards a particular direction. One of the objectives of the corporate governance mechanism is to restrict the use of earnings management to influence reported accounting figures.

Within this context, Parka and Shinb (2004) suggested that including independent non-executive members in a firm's financial figures can be beneficial. Particularly, this participation in the board of directors ensures that managers execute their duties effectively such that they operate more likely to safeguard shareholders' interest and maximize their wealth rather than manipulating profits (Dechow et al, 1996). According to Klein (2002), the participation of independent non-executives in the board of directors increases the reliability of the published financial statements and hence leads to a true and fair value of the firm's financial position as the non-executives have no motive to avoid fulfilling their legal obligations. Monks and

Minow (2004) noted that appropriate incentives play a major role in inducing independent directors to effectively perform their job.

Furthermore, in light of the strong labor market competition for managerial skills, independent directors tend to restrain managers from manipulating reported earnings, thereby enhancing their professional reputation and proving their managerial skills (Chtourou et al, 2001).

Many researchers linked the presence or absence of earnings management to the length of the professional experience of independent directors. Beasley (1996) found a positive significant relationship between the length of the period that independent directors participate in the board of directors and the ability to prevent managers from manipulating earnings, whereas Parka and Shinb (2004) argued that the length of experience of independent managers do not affect their ability to restrain earnings management.

According to the corporate governance policies, another main element to consider is internal audit committee. This committee plays a major role in reducing managers' ability to manipulate their firm's reported earnings as it defines a responsibility framework for the firm's governing bodies and departments, and imposes transparency in all firm's operations.

In order to investigate the impact of corporate governance mechanisms on earnings management, Defond and Jiambalvo (1991); Beasley (1996); Dechow et al (1996); McMullen (1996); and Peasnell et al (2000) studied the impact of internal audit committee on earnings management, they found that when an internal audit committee functions properly; managers tendency to manipulate earnings is reduced and it is less likely to mark a financial statement that doesn't represent the firm's real financial position. Moreover, Klein (2002) found a negative relationship between the existence of an independent audit committee and managing earnings.

Under these circumstances, many corporations have implemented corporate governance regulations in order to restrain earnings management and ensure that management of the firm works towards maximizing the economic value of the firm. As a result, investors are more likely to invest in firms that adopt corporate governance mechanisms where their interests are more protected.

2.4 International Financial Reporting Standards (IFRS)

The following paragraphs present the definition of IFRS and its effect on contractibility, auditors, earnings-return relationship and earnings management.

2.4.1 Definition

In response to the market pressure to enhance the quality of financial reporting, a series of consistently accounting standards were required to boost investors' confidence and increase transparency in stock markets. International Financial Reporting standard (IFRS) is a single set of accounting standards developed by the international accounting standards board. Deloitte (2013) reported that in recent years; reporting under IFRS became mandatory in more than 100 countries and the number of firms adopting it continues to increase. It is not surprisingly that IFRS was examined extensively as it is the largest reporting standards change in accounting history (Barth, 2006; Soderstorm and Sun, 2007; Hail et al, 2010).

The IFRS Foundation was established in 2001 in order to develop a single set of high quality, understandable, enforceable and globally accepted financial reporting standards based upon clearly articulated principles. The vision of these global accounting standards has been publicly supported by many international organizations, including the G20, World Bank, IMF, Basel Committee, IOSCO and IFAC (IFRS.ORG, 2017).

The progress of IFRS towards global accounting standards started in 2002 when the US IASB and FASB agreed joint program in order to improve respective standards and bring about their convergence. In the same year, the European Union announced their acceptance to adopt IFRS starting from year 2005. In 2003, Australia, Hong Kong, New Zealand and South Africa also agreed to implement IFRS starting from year 2005. Then, the Japanese IASB and ASBJ agreed to converge IFRS and Japanese GAAP in 2004. Year 2005 was a remarkable year in which almost 7000 companies in 25 countries in Europe simultaneously switched from national GAAP to IFRS. IFRS became adopted or permitted by 100+ countries by year 2007. In 2011, Canada commenced the use of IFRS and then Argentina, Mexico and Russia joined it as well. Up until these days, IFRS foundation and IOSCO are working hard to facilitate greater consistency in application of IFRS globally (IFRS.ORG, 2017).

2.4.2 IFRS vs. US GAAP

Regulators, standards setters and academics have called for research comparing the quality of the relatively rules-based US Generally Accepted Accounting Principles (GAAP) and the more principles-based International Financial Reporting Standards (IFRS). US GAAP contains elements that caused some commentators to classify it as rules-based view of accounting (Schipper, 2003); whereas IFRS appeared to be more principles-based as they are written standards largely derived from the US and UK national standards (Hove, 1990; Nelson et al, 2003). Former empirical research on the quality differences between US GAAP and IFRS provided mixed results (Van der Meulen et al, 2007). Starting with Leuz (2003) and Bartov et al (2005), the two accounting standards were documented to be of similar quality. Van der Meulen et al (2007) agreed that IFRS and US GAAP are of similar quality, particularly in value relevance, earning timeliness and accrual quality, but they noted that the US GAAP outperforms IFRS in earnings predictive ability. In contrast, Gordon et al (2008) argued that US GAAP shares common accrual quality, earnings and cash predictability with IFRS, but exhibits value relevance higher than IFRS.

Despite the above findings that confirm on the similar accrual quality between IFRS and US GAAP, Barth et al (2006) showed in their study on a wide range of IFRS firms as compared to US firms sample; that earnings smoothing is greater in IFRS companies relative to US companies. However, their findings were weakened by the limitations of the study that did not consider the institutional factors differences and corporate governance issues. Furthermore, Van der Meulen et al (2007) agreed in their discussion with prior findings about the similarity between IFRS and US GAAP when considering earnings management through discretionary accruals. However, they added that IFRS firms are more likely to manage earnings with real activities manipulation such as discretionary research and development expenditures. Research is yet to reveal more differences between IFRS and US GAAP especially in terms of earnings management.

2.4.3 IFRS impact on capital markets

To date, most of previous literature pointed out the enhanced quality and content of financial reports of firms worldwide and examined the substantial positive capital-

market effects around IFRS introduction. Daske and Gebhardt (2006) noticed an increase in disclosure quality after IFRS adoption. Aharony et al (2010) realized that IFRS adoption increases value relevance of good will, R&D, and assets revaluations. Armstrong et al (2010) documented in his study positive abnormal stock returns during important events leading up to IFRS implementation. In their turn, Daske et al (2008), Li (2010) and Florou and Kosi (2013) noticed an increase in market liquidity and decrease in cost of capital of firms domiciled in IFRS adopting countries. Together, Beneish et al (2010) and Defond et al (2011) found an increase in foreign investments in debt and equity instruments of firms that adopt IFRS. Furthermore, Beuselinck et al (2009) found an increase in stock price information due to IFRS and Horton et al (2013) pointed the improvements in financial analysts' information environment. Likewise, Yip and Young (2012) showed the increased similarities of accounting functions and increased information transfer. Thus, this body of evidence is consistent with the widely held belief that mandatory IFRS adoption yields better reporting and disclosure that benefit capital markets through improving transparency and comparability of financial statements, reducing asymmetries, increasing liquidity and lowering the cost of capital (Hail et al, 2010).

Based on these findings, it could be noticed that mandatory IFRS adoption played a primary role for the observed capital-market benefits; however, many researchers argued that this conclusion is premature for several reasons. Ball et al (2003) stated that it is doubtful that the adoption of new standards can alert managers reporting incentives especially that the new standards might not fit a country's institutional environment. It is worth mentioning that IFRS mandate does not introduce accounting rules for the first time, many countries had local accounting standards that were quite similar to IFRS such as UK, Norway and Netherlands (Bae et al, 2008). Within this context, Daske et al (2008) interpreted that IFRS yields significant capital-market benefits as long as the countries that adopt IFRS have strong legal and institutional system to ensure that IFRS is properly implemented, for instance these countries include mostly European ones. Byard et al (2011) stated that analysts' forecast errors and dispersions decrease around the implementation of IFRS, but only in countries with strong rules of law that differentiate between local GAAP and IFRS. Similarly, Landsman et al (2012) argued that the increase in information

content of earnings announcement depends highly on the strength of the countries legal regimes, agreeing with Daske et al (2008) especially in Europe.

In light of prior evidence, it can be noticed that most of the significant capital-market benefits are concentrated in Europe (Hail and Luez, 2007; Daske et al, 2008) where the switch to IFRS involves changes in measurement rules as well as disclosure extensions. Berger (2010) ensured that for the Europe member states, IFRS enforcement marked an important regulatory event for the accounting systems knowing that the member states governs the new reporting standards by taking appropriate measures to assure compliance with this enforcement. These latter studies indicated that informativeness increased in the post-IFRS periods only for firms with greater incentives to comply, or in countries improving its enforcement of IFRS, doubting that IFRS adoption could lead to changes in informativeness or transparency.

2.4.4 IFRS usefulness in contracting context

In terms of debt contracting around mandatory IFRS adoption, changes in the rules governing financial statement preparations were realized easing the investigation of the contractibility of financial information.

Previous studies on IFRS adoption generally focused on equity markets benefits addressing the enhanced transparency of financial statements information. However, contractibility of information and its usefulness for valuation was also central to many researchers' analysis although it is difficult to be precisely observed in the data. Many researchers proposed that the debt contracting effects of IFRS are significantly considerable by providing robust evidence confirming their point of view.

There are several logically feasible debt-contracting responses to IFRS enforcement, Samuelson (1965) showed that IFRS adoption make more use of fair value accounting and consequently reduce the effectiveness of financial statement information in debt contracting. Particularly, he reported that fair value gains and losses include shocks to the transitory assets' cash flows leading the earnings to be no more a prediction of future debt contracting. Similarly, Li (2010) noted that the IFRS adoption fair value gains and losses incorporate shocks to assets' expected

returns making both current-period earnings and balance sheet less efficient with poorer predicting ability of debt service capacity. Furthermore, the use of fair value accounting due to the adoption of IFRS allows to fair value certain financial liabilities and hence results in lowering its contracting value as the debt contracts do not require the repayment of the debts' fair value but its principal and interest (Ball et al, 2015).

2.4.5 IFRS effects on auditors

As the adoption of IFRS affects the quality and content of financial reports of firms worldwide; it also affects auditors, the audit markets and auditor-client relationships (Kim et al, 2012). Researchers have dedicated substantial effort to estimate how IFRS impacts auditors knowing that auditors play a significant role in providing market participants with a signal that the financial statements are credible (Francis and Wilson, 1988). Atkinson et al (2002) hypothesized that IFRS drives client firms to switch auditors due to disagreements over the implementation of this new reporting standard. In addition, Joos and Leung (2013) shed light on the difficulty that governs the implementation on IFRS that might lead to agency issues between managers and shareholders. To resolve this issue, clients switch to auditors perceived as IFRS experts.

Benefits notwithstanding, considering these advantages, audit firms' charges will be more costly around IFRS adoption as the audit fees will increase (Kim et al, 2012) and consequently this will direct clients more likely to choose small audit firms to avoid increased costs. Furthermore, auditor replacement may negatively affect the quality of financial reports as the new auditors may not be aware or may not clearly understand their clients operations, in contrast to longer audit-client relationships that help auditors know clients' operations better and hence facilitate higher quality reports (Ghosh and Moon, 2005).

Prior literature has shown that the strength of the country-level regulations might be affected by the IFRS expertise of global auditors. Fan and Wong (2005), for instance, provided evidence supporting a signaling role of auditors with high quality IFRS expertise in countries with weaker regulations. Consistent results were reported by Choi and Wong (2007), they argued that firms domiciled in countries with weaker

regulations are more likely to hire qualified auditors with IFRS experts to increase reporting quality and signal better governance. Considering these findings, Kim et al (2012) concluded that firms located in countries with weak financial regimes tend more to switch to IFRS-expert auditors as compared to firms in stricter regulated countries, and thus auditor expertise can be considered as substitutes for a country's financial regime upon adopting IFRS.

2.4.6 IFRS effect on earnings-returns relationship

The introduction of IFRS has led the quality financial reporting standards to dominate the financial reporting process and to significantly increase the association between accounting variables and returns (Negaksi, 2013). Soderstrom and Sun (2007) found that the adoption of IFRS induced important changes in the financial reporting especially in European countries; they argued that IFRS has given new insights to provide information of better quality to investors; particularly IFRS are designed to provide fair value valuation and higher timeliness of accounting members. Thus, these changes resulted from IFRS adoption alter the earnings-return relationship (Negakis, 2013). Furthermore, Jermakowicz et al (2007) argued that the IFRS earnings are more contemporaneously correlated to stock returns, their findings engendered from the significant relationship found between them. This finding is consistent with Hellman's (2008) findings, in which he added that the higher the earnings conservatism enforced by IFRS, the higher the timeliness of earnings through earlier expense recognition.

In the same context, Negakis (2013) indicated that the mandatory use of IFRS has a substantial effect on the explanatory power of earnings for stock returns. He argued that the information content for stock returns was reduced after the adoption of IFRS. His results were consistent with the findings of Hung and Subramanyam (2007); that confirmed that the information content of book values of equity and earnings is reduced in the post-IFRS periods.

2.4.7 IFRS effect on earnings management

Earnings management is of a particular concern to securities regulators due to their impact on the quality of reported earnings (Breeden, 1994). It has been used for various reasons, Palmrose (1987) suggested that earnings management can cover up

financial difficulties, Zucca and Campbell (1992) indicated that earnings management can smooth income, and Tucker and Zarowin (2006) added that earnings management can be used to transmit private information to investors. Several prior researches focused on providing insight into whether the introduction of IFRS can limit earnings management, or instead, it allows a higher degree of earnings management. For instance, Barth et al (2006) found that the introduction of IFRS succeeded in improving accounting quality by reducing earnings management. They provided strong evidence showing that firms applying IFRS records higher variance of the change in net income, less negative correlation between accruals and cash flows, higher frequency of large negative net income and higher value relevance of net income and equity book value for share prices. Similarly, Ball (2006) showed that IFRS promises more transparency in terms of reducing agency costs, asymmetric information and increasing efficiency of stock markets and thus reducing earning management practices. Moreover, Liu et al (2011) revealed that the new substantially IFRS-convergent accounting standards were associated with a significant reduction in earnings management. Consistent results were found by Aubert and Grudnitski (2012); they noted a decline in the magnitude of earnings manipulation among European countries with the enforcement of IFRS. Likewise, Rohaeni and Aryati (2012), Palea (2013), Ismail and Adibah (2013), Grecco (2013) and Nanok (2016), pointed out the positive effects of IFRS adoption as it can improve the quality of accounting information and consequently reduce earnings management activities.

However, some researchers suggested that the more principles-based IFRS might permit higher degree of earnings management. Van Tendeloo and Vanstraelen (2005) recorded an increase in the magnitude of discretionary accruals and thus earnings management upon the introduction of IFRS. In his turn, Selling (2007) reported that the IFRS-style accounting enable managers to switch from the outright fraud into subtle means of earnings management. Lippens (2010) doubted the effectiveness of IFRS in monitoring earnings management; instead he found an increase in earnings management after the mandatory adoption of IFRS. Elbannan (2010) concluded that the implementation of IFRS was not able to lower earning management; in fact, it increased earning management. Bruggeman et al (2013) noted that IFRS had limited effect on financial reporting.

On the other hand, some studies provided evidence showing that IFRS adoption can neither lower earnings management nor increase its use; in fact, its adoption leads to the replacement of one form of earnings management with the other. Particularly, Ferentinou and Anagnostopoulou (2014) and Ho et al (2015) found evidence on a statistically significant shift from accrual-based earnings management to real earning management after the adoption of IFRS, indicating that firms are substituting the discretionary accruals by turning into real activities manipulation. Similarly, Ipino and Parbonetti (2017) confirmed this trade-off between the forms of earning management after the adoption of IFRS.

From another point of view, Capkun et al (2016) showed that the effectiveness of IFRS in lowering earnings management is related to whether the latter is early voluntary adopted or adopted after becoming mandatory. Precisely, the early voluntary adopters showed increased transparency as they are motivated to attract side capital, while firms that adopted IFRS after it became mandatory showed increase in earnings management after this adoption as they lacked incentives for transparency.

2.5 Conclusion

Mergers and acquisitions are one of the most vital corporate strategies that have long been a topic of interest for researchers and economists for its considerable aspects in coping with the market changes and surviving the fierce competition. Moreover, the motives of acquisitions are classified into two groups of theories; the first group referred to as "value maximizing theories" and focuses on motives to maximize shareholders value emphasizing on the potential benefits of acquisitions. The second group of theories referred to as "non-value maximizing theories" that explain motives for managerial self-interest rather than shareholder's wealth maximization. Furthermore, there are additional theories that do not belong to the above mentioned groups.

Business literature has also shed light on acquirer's market performance at the three stages of acquisition and showed mixed results. Studies that show positive market performance in the preannouncement period suggests that this favorable market performance reflects the view that bidders enjoy positive market performance before

the acquisition announcement. However, other studies show negative market performance in the preannouncement period. Considerable studies have found positive returns around or on the announcement date reflecting shareholders' positive attitude towards the bids, whereas others found negative performance signaling that market's perception that the bidder overpaid to win the bid affects the return. Similarly for the post announcement period, good performance reflects that market participants were correct in their assessment of the acquisition process, while studies that found negative performance in this period suggested that bidders overpaid to win the bid.

Research has also investigated two critical topics that do affect acquirer's market performance. Starting with the method of payment, empirical research suggested that acquisitions could be financed through the exchange of cash, stocks, or both; and provided evidence that cash acquirers tend to outperform stock acquirers. In addition to the financing method, the target's attitude towards the bid has also proven to affect the performance of bidders depending on whether the acquisition is friendly or hostile.

Extensive prior research tried to examine the existence of earnings management prior acquisition, several studies provided robust evidence confirming the use of earnings management by both acquirers and targets, others conversely showed that acquirers and targets do not manipulate their earnings prior to acquisition. In addition, the determinant factors; evidence; and motives of earnings management were analyzed to further explain this strategy in relation to its measures. The real-based earnings management was discussed briefly in this chapter while the focus of the study is on one favored and vital instrument that is accrual-based measure of earnings management.

Earnings management might be motivated by managerial empire building goals. In response to these market pressures, a series of consistently accounting standards were required, particularly IFRS was adopted in numerous countries to enhance quality and content of financial reports and accordingly affecting capital markets, contractibility, the auditors and above all eliminating earnings management. A stream of literature focused on providing insight into whether the introduction of IFRS is an effective solution to the above mentioned debates. Several researches

revealed that this act has eliminated some of investor's concerns about the quality of financial reports provided by firms adopting IFRS; others showed that IFRS did not succeed in enhancing transparency.

3 Chapter Three: Methodology

3.1 Introduction

Chapter three explains the methodology utilized in serving the objective of this research which is investigating whether the Canadian acquiring firms tend to manipulate earnings in the accounting year immediately preceding the execution of the acquisition process through engaging in accrual-based earnings management before and after the adoption of International Financial Reporting Standards (IFRS) in 2010. This chapter starts by highlighting the philosophical approach of this research in section two. Section three discusses the reasoning approach of this thesis. Research Strategy is discussed in section four. Section five introduces the development of the research hypotheses. Research methods and procedures are explained in section six. Statistical tests used to test the results are introduced in section seven. Data sources are identified in section eight. Samples procedures are explained in section nine. Section ten concludes.

3.2 Philosophical Dimension

The manner by which a researcher approaches the development of knowledge is referred to the philosophy of research. Generally, there are two basic debatable assumptions in the research philosophy; these are titled epistemology and ontology. Epistemology is mainly concerned with the ways to seek knowledge taking into account the limits of inquiry, validity and nature. Two extreme positions in this philosophical debate are positivism and interpretivism. For positivism, the aim of any research is achieved by using scientific methods and the focus is on observable phenomena that are studied objectively and apart from internal reality of researchers (Denscombe, 1998). Remenyi et al (1998) also defined a positivist as a researcher who assumes him/herself as an objective analyst who comes up with law-like findings that can be generalized and look like laws produced by neutral and physical sciences. Moreover, positivism is associated with empiricism, in other words, positivists are prioritizing empirical knowledge over other forms of knowledge (Ritchie, 2013). Phenomenology, on the other hand, assumes that the world is not objective; yet a function of personal perception in which reality is believed to be socially constructed by humans and this social phenomenon is too complex to be

restricted by law-like generalizations, accordingly, interpritivists would not give great importance for the generalizations of the findings. Furthermore, researchers who follow this approach focus on understanding deeply the details of the studied subject to understand its reality, that is, interpretivists calls for understanding the subjective rather than the objective reality of a certain situation through interpreting actions and motives of research participants (Saunders et al, 2011). This paper approaches its research questions with a positivist philosophical position since the aim of the study is to detect the variation in earning management prior to acquisitions announcement and after the enactment of IFRS in Canada in 2010, by analyzing ratios describing accruals. In light of this aim, observed data that is recorded in trusted data base will be used (ratios of listed firms in TSX) confirming the positivist epistemological stand.

Ontology is the second debatable assumption in the research philosophy, it is concerned with the nature of reality, basically, with the nature of existence of things; whether they take place inside or outside the human's brain (Burrell and Morgan, 1979). In fact, ontological stands fall on a continuum of two extremes: objective realism and solipsism. Objective realism resembles the position of reality that is independent of human beliefs; in other words, realists believe that the world has existed prior to the existence of humans and thus, knowledge about reality can be achieved through measurement rather than human's conscious and beliefs. On the contrary, solipsism is the subjective ontological position. This philosophical stand assumes that reality has no existence signaling that human's mind fully shape the humans' world (Holden and Lynch, 2004). Since the aim of the study is to detect the variation in earning management prior to acquisitions announcement and after the enactment of IFRS in Canada in 2010, it is assumed that the market reaction to acquisitions announcements is perceived as an external reality that could be studied through measurable proxies based on observable data that exists independently outside the human's brain. This assumption of the existence of external reality that is independent of human's mind makes this research approaches its research questions based on objective realism.

3.3 Reasoning Approach

In general, the research approach describes the way the researcher involves a certain theory to be used in the study, knowing that this research may or may not be obviously stated in the research. The two broad methods to the area of reasoning approach are referred to deductive and inductive approaches. According to Valijarvi and Tarsoly (2015), deductive reasoning starts from one or more general premises to reach a specific and narrow conclusion, in other words, deductive reasoning starts by a theory that is relevant to the topic of interest and then this theory is narrowed into more specific and explicit hypothesis, for this reason it is also called "top-down" approach and dominant in business research. In the same context, Robson (1993) divided the deductive research approach into five steps:

- Step one states that the researcher start by deducing the hypothesis from a relevant theory.
- Step two includes determining measured variables and a subsequent relationship between those variables to operationalize the hypothesis.
- Step three involves testing the hypothesis.
- Step four involves examining the results to know if they confirm the theory or additional modifications are needed.
- Step five involves revising the theory and adjusting the required adjustments if necessary.

On the other hand, researchers may also adopt inductive form of reasoning or what is also known as theory building approach or "bottom-up" approach that works the other way. It starts with specific observation to scope broader theories and generalization, meaning that theories are built on the collected data focusing on the contextual issues and this data collected is usually qualitative data (Smith and Kim, 1994). Moreover, inductive approach is usually more open-ended and exploratory in nature.

In this research, a deductive form of reasoning is adopted. Since this research aims at detecting firms' readiness to manipulate earnings upon acquisitions and pre and post

IFRS, agency theory is considered as the directorial theory for such a study as agents have certain motivations in manipulating company's financial data. Particularly, this research will start by examining the techniques used by agents to manipulate earnings prior to acquisition decisions and then narrow down to discuss the role of IFRS in enhancing accounting reports and mitigating agents' activities. These theories will be narrowed down even further to address explicit statistically tested hypotheses. Generalization is a building block of the deductive approach where an acceptable sample is required to achieve accurate results in order to generalize the findings; accordingly this research is conducted on a considerable sample of Canadian firms that are engaged in the acquisition process.

3.4 Research Strategy

In every research there is a plan that should be followed to handle the research questions and provide accurate answers; this plan is usually known as the research strategy that should be chosen based on the research aim and objectives (Saunders et al, 2011). Archival research strategy will be adopted in this research. According to Pearce-Moses (2005), this strategy is an approach of seeking out and extracting evidence from original archival records, this is the case in this study in which previous data of acquiring firms will be extracted, observed and analyzed. Furthermore, archival research analyzes data resulting from business decisions (Maines and Wahlen, 2006), which also applies in this thesis as the previous data of discretionary accruals of firms engaged in acquisition decisions will be analyzed.

Moreover, since the study will examine the difference between mean accruals as a proxy of earning management at two periods, a longitudinal design is employed in which testing the data will be conducted in the pre and post IFRS implementation, confirming the ability of longitudinal studies in examining the change or development of the studied subject.

It is worth mentioning that this study could be also considered as an exploratory study since the use of earnings management by the participants of the acquisition process is assessed in a new legal environment. This fact is a key characteristic of this type of studies referring to the definition of Robson (2002) stating that the

exploratory study involves discovering what is happening to assess a phenomenon in a new insight.

3.5 Hypotheses Development

As discussed in chapter two, some of the most important top-management decisions are whether to engage in an acquisition process to invest the firm's resources or whether to agree on a bidder's offer to sell the firm. Various motives stand behind these critical decisions, for instance, the prospects of growth is the basic underlying reason for the acquisition decision to be taken by firms given that the target firm merged with the acquiring firm together can provide benefits for shareholders that independent firms could not provide on their own. In addition, the acquisition of a firm by another one can be desirable to confront the fierce foreign competition by empowering the involved enterprise. Besides understanding the motives of acquisition, the evaluation of the quality of such decision is also crucial. As Roll (1986) emphasized, economists usually do not give much importance on examining the evidence of individual decision making. In fact it is vital to understand the behavior of individual managers in case of an important corporate event such as a takeover where the individual decisions do matter.

In general, an external financial advisor is hired to estimate the acquirers and targets value. These valuations are performed during the discussion of the acquisition process before reaching an agreement. The fair evaluation of the takeover bid is performed by the relative multiples on earnings, capital, deposits and total assets. Extensive studies showed that both, the acquirer and the target, have strong incentives to manipulate earnings. Erickson and Wang (1999) for instance, showed that the acquiring firm tends to increase their accounting earnings prior to acquisition announcement in an attempt to increase the market price of its share. Likewise, the target firm's existing shareholders prefer higher prices to prevent earnings dilution. Erickson and Wang (1999) also argued that the costs associated with earnings management are high for both parties in the acquisition process; particularly target firm's management could hire expert advisors and auditors that are usually professional at detecting earnings management techniques. However, the cost of detection may be high whereby pushing target firms to demand higher exchange ratio. In the same context, Watts and Zimmerman (1990) emphasized that when the

cost of manipulating earnings is lower than the cost of undoing earnings management, earnings management could occur. Furthermore, it is worth mentioning that since it is costly and difficult to suspect earnings management, the management team of both participants in the acquisition agreement should rationally anticipate that the other party would manage their pre-acquisition earnings to their advantage.

Conducting an earnings management study, and similar to Louis (2004), Botsani and Meeks (2008), and Murtini and Lusiana (2016), this study will use accruals as a proxy for earning management in the Canadian context to investigate whether firms listed in the Toronto Stock Exchange (TSX) tend to manipulate earnings in the accounting year immediately preceding the bid announcement leading to the formulation of the first hypothesis:

H_1: Canadian successful acquirers engage in accrual-based earnings management in the accounting year immediately preceding the acquisition offer.

However, this hypothesis is considered broad and general as it cannot fully capture the performance of Canadian acquirers, thus this investigation should further take into account the characteristics of acquisitions. Empirical research shed light thoroughly on acquirer's earnings management considering whether the latter is a stock acquirer or cash acquirer and came out with controversial results. Erickson and Wang (1999) noted that as a response of the anticipated market behavior of discounting firms' stock price at the announcement of stock swap, managers tend to manipulate earnings upward to raise the market price. Their findings were consistent with those presented by Loughran and Vijh (1997), Easterwood (1998), Rau and Vermaelen (1998) and Botsari and Meeks (2008) postulating that acquiring firms aggressively use discretionary accruals to manipulate reports by overstating their earnings prior to stock acquisition announcements. Erickson and Wang (1999) showed that unlike stock acquisitions, cash acquirers do not rely on earnings management activities. Whereas Pungaliya and Vijh (2009) underlined that insignificant difference occurs between discretionary accruals of cash and stock acquisitions. Given this reasoning, it is hypothesized that:

H_{1a}: Canadian successful stock acquirers engage in accrual-based earnings management in the accounting year immediately preceding the acquisition offer.

H_{1b}: Canadian successful cash acquirers do not engage in accrual-based earnings management in the accounting year immediately preceding the acquisition offer.

H_{1c}: The magnitude of accrual-based earnings management in the accounting year immediately preceding the acquisition announcement is larger for successful stock acquirers than for successful cash acquirers.

As previously discussed in chapter two, IFRS was developed as a response to the market pressure to enhance the quality of financial reporting, boost investor's confidence and increase transparency in stock markets. Several prior researches focused on providing insight into whether the introduction of IFRS can limit earnings management, or instead, it allows a higher degree of earnings management. For instance, Barth et al (2006) found that the introduction of IFRS succeeded in improving accounting quality by reducing earnings management, similarly, Ball (2006) showed that IFRS promises more transparency in terms of reducing agency costs, asymmetric information and increasing efficiency of stock markets and thus reducing earning management practices. Moreover, Liu et al (2011) revealed that the new substantially IFRS-convergent accounting standards were associated with a significant reduction in earnings management. Consistent results were found by Aubert and Grudnitski (2012); they noted a decline in the magnitude of earnings manipulation among European countries after the enforcement of IFRS. Likewise, Rohaeni and Aryati (2012), Palea (2013), and Ismail and Adibah (2013), pointed out the positive effects of IFRS adoption as it can improve the quality of accounting information and consequently decline earning management.

However, some researchers suggested that the more principles-based IFRS might permit higher degree of earnings management. Van Tendeloo and Vanstraelen (2005) recorded an increase in the magnitude of discretionary accruals and thus earnings management upon the introduction of IFRS. In his turn, Selling (2007) reported that the IFRS-style accounting enable managers to switch from the outright

fraud into subtle means of earnings management. Lippens (2010) doubted the effectiveness of IFRS in monitoring earnings management; instead he found an increase in earnings management after the mandatory adoption of IFRS and Elbannan (2010) concluded that the implementation of IFRS was not able to lower earning management; in fact it increased earning management. Bruggeman et al (2013) noted that IFRS had limited effect on financial reporting,

Thus, in order to detect the presence of significant change in acquirers' earning management after the implementation of IFRS in this study of the Canadian acquirers, the difference between mean (median) accruals pre IFRS and mean (median) accruals post IFRS for both stock and cash bids should be analyzed leading to the formulation of the following hypotheses:

H_{2a}: There is a significant difference of accrual-based earning management by successful stock bidders before and after the adoption of IFRS.

H_{2b}: There is no significant difference of accrual-based earning management by successful cash bidders before and after the adoption of IFRS.

3.6 Research Method

Among the various discretionary accrual models, the Jones and the modified-jones models perform the best (Dechow et al, 1995). As previously discussed, the cross-sectional estimation of the Jones model takes the following form:

$$\frac{TA_{ijt}}{A_{ijt-1}} = a_{0jt}\left(\frac{1}{A_{ij,t-1}}\right) + a_{1jt}\left(\frac{\Delta REV_{ijt}}{A_{ijt-1}}\right) + a_{2jt}\left(\frac{PPE_{ijt}}{A_{ijt-1}}\right) + \varepsilon_{ijt}$$

Where:

TA_{ijt} = Total accruals for firm *i* in portfolio *j* for year *t*,

ΔREV_{ijt} = Change in revenue (total sales) for firm *i* in portfolio *j* for year *t*,

PPE_{ijt} = property, plant and equipment for firm *i* in portfolio *j* for year *t*,

A_{ijt-1} = beginning of period total assets for firm *i* in portfolio *j* for year *t*,

εijt = error term for firm i in portfolio j for year t,

i = 1,. . ., N firm index,

j = 1,. . ., J estimation portfolio index,

t = 1,. . ., t year index

Many researchers including Dechow et al (1995), Young (1999) and Fields et al (2001) explored the drawbacks and limitations of the Standard-Jones and the modified-Jones models. Furthermore, Kothari et al (2005) showed that the above mentioned models for estimating discretionary accruals are biased; recommending the need for adjusting the discretionary accruals by the average discretionary accruals matched on prior year's return on assets (ROA). Kothari et al's (2005) recommendation rise from the tendency of previous models to reject the null hypothesis of no earnings management when performance associates the event, in other words, they suggest that the model should include performance-adjusted discretionary accruals to prevent unreliable inferences. For these reasons, this research will estimate a model that is close to the Jones and modified-Jones models, except that it includes a performance measure in the accruals regression (ROA) that compares the effectiveness of performance.

Thus, following Erickson and Wang (1999) and Ferentinou and Anagnostopoulou (2014), the existence of accrual-based earnings management will be tested by examining discretionary total accruals and differentiating them from non-discretionary accruals through employing the cross-sectional version of the Jones model (Jones, 1991) adjusted by Kothari et al (2005) modifications. This study will calculate discretionary total accruals in two-step process. The estimation of non-discretionary accruals based on cash flow approach of the total accrual model is the first step that takes the following form:

$$\frac{TAC_{ij,t}}{TA_{ij,t-1}} = a_0 + a_1\left(\frac{1}{TA_{ij,t-1}}\right) + a_2\left(\frac{\Delta REV_{ij,t}}{TA_{ij,t-1}}\right) + a_3\left(\frac{PPE_{ij,t}}{TA_{ij,t-1}}\right) + a_4\left(ROA_{ij,t}\right) + \varepsilon_{ij,t}$$

Where:

$TAC_{ij,t}$: Total accruals for firm i in industry j for year t;

$TA_{ij,t-1}$: total assets for a firm I in industry j for year t-1;

$\Delta REV_{ij,t}$: The change in revenues for a firm i in industry j for year t;

$PPE_{ij,t}$: Gross property plant and equipment for firm I in industry j for year t.

$ROA_{ij,t}$: Return on asset for a firm i in industry j for year t;

$\varepsilon_{ij,t}$: Residual term for a firm i in industry j for year t

All variables in the above equation, except $ROA_{ij,t}$, are scaled by lagged total assets ($TA_{ij,t-1}$) to reduce heteroskedasticity. The estimation of coefficients a_0, a_1, a_2, a_3 *and* a_4 for industry and year combination is based on the Acquirer Primary SIC industry classification to prevent excluding any industry-year portfolios with few observations and hence allow for more efficient estimation of the OLS regression parameters. In addition, the above equation allows for a true constant term for several reasons, for instance, discretionary accrual measures based on models without a constant term are less symmetric giving a less clear-cut power of the test comparisons. Moreover, the constant term provides additional control to reduce heteroskedasticity.

The second step in this process is to estimate the discretionary accruals which particularly measures earnings management. It is computed as the difference between Total accruals and non-discretionary accruals.

Total Accruals are calculated from the cash flow statement following Botsari and Meeks (2008) knowing that the Balance sheet approach can misrepresent accruals especially around events such as mergers and acquisitions (Hribar and Collins, 2001). Thus, total accruals are defined as the difference between net income before extraordinary items and cash flow from operations:

NI (Worldscope yearly data item WC04001) – CFO (Worldscope yearly data items WC04201 + WC04831).

The estimates of $a_0, a_1, a_2, a_3 and\ a_4$ are used to calculate normal or non-discretionary total accruals, and hence the non-discretionary total accruals take the following form:

$$NTAC_{ij,t} = \hat{a}_0 + \hat{a}_1\left(\frac{1}{TA_{ij,t-1}}\right) + \hat{a}_2\left(\frac{\Delta REV_{ij,t} - \Delta REC_{ij,t}}{TA_{ij,t-1}}\right) + \hat{a}_3\left(\frac{PPE_{ij,t}}{TA_{ij,t-1}}\right) + \hat{a}_4\left(ROA_{ij,t}\right)$$

A noteworthy issue to mention in the above model is the deduction of the change in accounts receivables from the change in revenues. This is based on Dechow et al (1995) argument that Jones model will remove part of the managed earnings from the discretionary accruals; and thus in response for this limitation, he proposed a modified version that is identical to the previous one with the exception that the change in revenues must be reduced by the change in accounts receivables to take into account any possible accounting discretion arising from sales (DeFond and Jiambalvo, 1994).

Consequently, the estimated abnormal or discretionary accruals are computed as the difference between total accruals and normal or non-discretionary accruals:

$$DAC_{ij,t} = \frac{TAC_{ij,t}}{TA_{ij,t-1}} - NTAC_{ij,t}$$

Earnings management is thus measured using discretionary accruals (DAC) that is calculated by subtracting nondiscretionary accruals (NTAC) from total accruals (TAC).

Hence, when discretionary accrual's value is zero, earnings management is not detected and the firm's total accruals in year t are normal. A positive value indicates that the firm manages its earnings upward as the total accruals exceed their normal levels. And finally, a negative value reveals that a downward earning management is observed as the firm's actual accruals are below the expected ones.

Following Louis' (2004) reasoning that acquirers rely on earnings before interest, taxes, depreciation and amortization in managing their earnings showing that managers tend to manage their current accruals to manipulate earnings, this study

will use the cash flow-based current discretionary accruals as another proxy measure for earnings management for comparison reasons and as a robustness check.

The following cross-sectional regression model is estimated for each industry similar to the above model except that the PPE variable will be excluded:

$$\frac{CAC_{ij,t}}{TA_{ij,t-1}} = a_0 + a_1\left(\frac{1}{TA_{ij,t-1}}\right) + a_2\left(\frac{\Delta REV_{ij,t}}{TA_{ij,t-1}}\right) + a_3\left(ROA_{ij,t}\right) + \varepsilon_{ij,t}$$

Where:

$CAC_{ij,t}$: The current accruals for firm i in industry j for year t;

$TA_{ij,t-1}$: total assets for a firm I in industry *j* for year t-1;

$\Delta REV_{ij,t}$: The change in revenues for a firm i in industry j for year t;

$ROA_{ij,t}$: Return on asset for a firm i in industry j for year t;

$\varepsilon_{ij,t}$: Residual term for a firm i in industry j for year t

Current accruals are calculated from the cash flow approach as the difference between net income before extraordinary items and cash flow from operations excluding depreciation and amortization (D&A):

NI (Worldscope yearly data item *WC04001*) – CFO (WorldScope yearly data items *WC04201* + *WC04831*) – D&A (Worldscope yearly data item *WC04051*).

The estimates of $a_0, a_1, a_2 and\ a_3$ are used to calculate normal or non-discretionary current accruals, and hence the non-discretionary current accruals take the following form:

$$NCAC_{ij,t} = \hat{a}_0 + \hat{a}_1\left(\frac{1}{TA_{ij,t-1}}\right) + \hat{a}_2\left(\frac{\Delta REV_{ij,t} - \Delta REC_{ij,t}}{TA_{ij,t-1}}\right) + \hat{a}_3\left(ROA_{ij,t}\right)$$

Consequently, the estimated abnormal or discretionary accruals are computed as the difference between current accruals and normal or non-discretionary accruals:

$$DCAC_{ij,t} = \frac{CAC_{ij,t}}{TA_{ij,t-1}} - NCAC_{ij,t}$$

Earnings management is thus measured using discretionary accruals (DA) that is calculated by subtracting nondiscretionary accruals (NDA) from current accruals (CA).

After calculating discretionary accruals for pre-IFRS and post-IFRS periods, statistical tests will be conducted to detect if there is a change in the mean discretionary accruals on the pre and post periods. Therefore, to test the previously stated hypotheses; both parametric and non-parametric tests will be utilized after analyzing the data's descriptive statistics in an attempt to increase the robustness of the results.

3.7 Parametric and Non-Parametric Significance Tests

Testing the statistical significance of the mean discretionary accruals is usually done using t-tests. Assuming a cross-sectional independence in the estimated discretionary accruals of the selected samples, the t-test in this research is estimated by dividing the equal-weighted sample mean discretionary accruals by an estimate of its standard error.

The test statistic is:

$$\overline{DA}/(\frac{s(DA)}{\sqrt{N}}) \sim t_{N-1}$$

Where the mean discretionary accrual for the sample ($\overline{DA}$) is:

$$\overline{DA} = \frac{1}{N}\sum_{i=1}^{N} DA_{it}$$

And the estimated standard deviation of the $\overline{DA}$ (s(DA)) is:

$$s(DA) = \sqrt{\sum_{i=1}^{N} (DA_{it} - \overline{DA})^2 / N - 1}$$

DA_{it}: is the discretionary accrual for the firm *i* in year *t*.

N: is the sample size.

In general, t-tests assume that discretionary accruals are normally distributed. Thus, when ignoring this assumption, the risk that the sampling distribution of the t-test differs from the actual distribution is more likely to increase which could lead to incorrect inferences. In fact, to avoid such problem, researchers have more tendencies to use non-parametric tests even when parametric test assumptions are met since the non-parametric tests could also act as a robustness measure. This could enhance the validity of the statistical inferences. Wilcoxon rank test is an example of nonparametric tests that will be used as a robustness check for the results of the statistics tests.

3.8 Data Sources

After presenting the general plan of the study in the research strategy section, this section explains the data collection tools and analysis techniques; introducing the tactics of the research. First step in collecting secondary data is obtaining a sample of Canadian acquisition announcements from Thomson Reuters Eikon. Thomson Reuters Eikon is a data analytics platform that provides access to the broadest data sets across asset classes, sectors and geographies (Thomson Reuters, 2017). Second step in the data collection process requires obtaining the necessary financial data for acquirers on Thomson Reuters DataStream to estimate the annual proxies for accrual-based earnings management in the year immediately prior to the acquisition announcement. The acquisition year is determined similar to Iqbal et al (2009). For instance, if an acquiring firm has a December 31 year-end, the accounting information for the financial year 2012 is assumed to be available by March 31st, 2013. Furthermore, if a firm announces an acquisition between April 1st, 2012 and March 1st, 2013, accounting information for year 2011 are used as the data for the pre-acquisition year.

All the available and collected data are cleaned, organized and prepared for statistical analysis.

3.9 Samples Procedures

The focus of this study is on the Canadian acquirers' earnings management by taking into account the adoption of IFRS in 2010. The initial sample is composed of 57,337 Canadian acquirers; it is limited to 40,581 excluding non-Canadian targets. To be included in the final sample, each acquisition announcement deal has to meet the following criteria:

- This research limits its scope to studying acquirers and targets that are publicly listed companies and traded on the Toronto Stock Exchange (TSX), excluding private and government owned companies. The mentioned procedure insures that both acquirers and targets are subject to same laws and regulations (such as IFRS) and minimizing the presence of information asymmetry between them. This limits the sample count to 9,082 Acquirers.
- This study is concerned with bids that have taken place between the 1st of January 2005 and the 31st of December 2015. Applying this condition reduces the sample count to 945 Acquirers. Therefore, this study:
- Investigates the deals that were successfully completed between Canadian acquirers and domestic targets excluding rumors, ceased rumors and withdrawn bids. This limits the sample count to 748 Acquirers.
- Excludes all acquisitions that include either an acquirer or a target from the financial sector since acquisitions in this sector require unique procedures and accounting requirements that are different from other sectors. This automatically reduces the sample count to 583 acquirers.
- Focuses on the deals that are financed either by cash or by stock offering. This further reduces the sample to 390 acquirers.
- Excludes stock repurchases from the sample; such deals take place when the acquirer and the target is the same and might bias the results. The sample is reduced to 387 acquirers.
- Excludes acquirers whose stocks are listed in foreign exchanges limiting the sample to 337 acquirers.

- Excludes acquirers that did not have DataStream codes. The missing DataStream codes reduce the sample to 285 acquirers.

- Excludes acquisitions by same firm that are in adjacent fiscal year and keep only the first acquisition to prevent confounding multiple transactions reducing the sample to 279.

- Excludes acquirers that did not have necessary financial data on DataStream. Consequently, this leads to a sample of 105 acquirers that meet the sampling criteria and have available data.

- Finally, in addition to the exclusion of observations due to unavailable data, few observations are deleted to mitigate the effects of outliers. The mean plus/minus 3 Standard deviation rule is used to check the distribution of variables in the study and exclude extreme values.

The detailed sample selection procedure is illustrated in Table 3.1.

Table 3.1: Sampling Procedures

Description	count
Initial Sample: public acquirer/target between 01/01/2005 to 31/12/2015	945
EXCLUDE:	
Unsuccessful deals[a]	197
Aquirer/target from the financial sector	165
Deals whose method of payment are neither pure cash nor pure stock[b]	193
Share Repurchases[c]	3
Acquirers listed in foreign exchanges	50
Missing DataStream Codes	52
Acquisition by same acquirer in adjacent years[d]	6
Observations with unavailable data	174
Outliers[e]	10
Final Sample	95

a Unsuccessful deals include rumors, discontinued rumors and withdrawn deals

b We include only acquisitions that use one financing method for clearer results

c Deals in which both the acquirer and the target are the same

d Results when multiple acquisitions by same acquirer in same year are included in the final sample are qualitatively the same.

e In addition to the unavailable data, few observations for some control variables are deleted to mitigate the effects of outliers. The mean plus/minus 3 Standard deviation rule is used to check the distribution of these variables and exclude extreme values.

Table 3.2: Distribution of Sample Acquirers across Industries and Years of the Bids

Panel A: Distribution of sample acquirers by year & method of payment

Year	Stock Bids		Cash Bids		All Bids	
	Freq.	%	Freq.	%	Freq.	%
2005	3	4%	2	9.5%	5	5%
2006	5	7%	2	9.5%	7	7%
2007	7	9%	6	29%	13	14%
2008	6	8%	2	9.5%	8	8%
2009	13	18%	1	5%	14	15%
2010	4	6%	0	0%	4	4%
2011	7	9%	3	14%	10	11%
2012	5	7%	3	14%	8	8%
2013	7	9%	2	9.5%	9	10%
2014	7	9%	0	0%	7	7%
2015	10	14%	0	0%	10	11%
Total	74	100%	21	100%	95	100%

Panel B: Distribution of sample acquirers by industry

Industry	Stock		Cash Bids		All Bids	
	Freq.	%	Freq.	%	Freq.	%
Copper & Silver Ores	11	15%	1	5%	12	13%
Crude Petroleum And Natural Gas	9	12%	6	28.5%	15	16%
Gold Ores	34	46%	6	28.5%	40	42%
Uranium-Radium-Vanadium Ores	8	11%	0	0%	8	8%
Others	12	16%	8	38%	20	21%
Total	74	100%	21	100%	95	100%

Table 3.2 reports the distribution of the final sample comprising of 95 bids. Panel A presents the distribution of the overall sample of acquirers by year and by the method of payment. It shows that year 2009 has witnessed the highest number of acquisitions among the study years, with a total of 14 bids compromising 15% of the entire sample of bidders. On the other hand, year 2010 witnessed the lowest number of acquisitions among the selected years, with a total of 4 bids compromising about 4% of the entire sample of bidders.

Moreover, when the entire sample is classified according to the consideration structure, panel A of table 3.2 shows that the highest count of stock acquisitions is in year 2009 with 13 bids compromising 18% of the entire stock financed acquisitions. Whereas the highest count of cash acquisitions was in 2007 with 6 bids compromising 29% of the entire cash financed bids.

Panel B of this table reveals how the sample is distributed across a total range of five industry sectors. These sectors are classified according to the acquirer primary SIC. It can be inferred from this panel that the highest percentage of acquirers is for bids that operate in the Gold Ores industry (42%), whereas Uranium-Radium-Vanadium Ores has the least contribution of the sample with 8%.

Table3.3: Relationship between Method of Payment and Period (before and after IFRS 2010)

	Pre-IFRS Bids		Post-IFRS Bids		All Bids	
	Freq.	%	Freq.	%	Freq.	%
Cash Bids	13	28%	8	17%	21	22%
Stock Bids	34	72%	40	83%	74	78%
Total	47	100%	48	100%	95	100%

Table 3.3 demonstrates the relationship between method of payment and the study period in which it provides comparative display of the two financing methods between the two studied periods (Pre- and Post- IFRS). Looking at the entire studied period, it is noticeable that stock bids dominate 78% of the sample while cash bids compromise only 22% of it. When the sample is divided to pre and post IFRS sub

samples, table 3.3 also shows that 47 bids have been announced prior to the IFRS enactment of which 72% are stock bids and 28% are cash bids. The remaining 48 bids have been announced after the IFRS enactment of which 78% are stock bids and 22% are cash bids. In both periods, stock bids had markedly higher proportions than cash bids.

3.10 Conclusion

This chapter explains the proposed methodology of the research. It begins by discussing the philosophical dimension followed, in which the research question of this study is approached from a positivist philosophical stand as it relies on empirical observations to reach meaningful results. This research also adopts a deductive approach as it starts with a general theory, particularly, the agency theory and narrows this theory into explicit hypotheses. Moreover, archival research strategy is applied where previous data of acquiring firms will be extracted and analyzed. Accordingly, the cross-sectional version of the Jones model (Jones, 1991) adjusted by Kothari et al (2005) modifications is employed to estimate discretionary accruals as a proxy for earnings management.

Furthermore, in order to test the statistical significance of the results, both parametric (t-test) and non-parametric (Wilcoxon test) are used. These procedures are applied on a sample of 95 Canadian acquirers where cash acquisitions compromise 22% of the sample and stock acquisitions compromise 78% of it. When the sample is partitioned to pre- and post- IFRS sub samples, 47 bids have been announced before the enactment of IFRS and 48 bids after it. Announcement dates and accounting data are obtained from DataStream and Thomson Reuters Eikon.

4 Chapter 4: Results

4.1 Introduction

This chapter presents the empirical results of this research. Section two provides descriptive statistics for discretionary total accruals (DAC) and discretionary current accruals (DCAC) variables. Section three reports the results, explains the significance of DAC and DCAC and compares it with previous research findings. Empirical results and their relevance to the research hypotheses are discussed in section four. Section five concludes.

4.2 Analysis Framework

In order to reach conclusions on the observations of this research, it was essential to explain the descriptive statistics and apply inferential tests on the outputs resulted from the cross-sectional model. In other words, after implementing the cross-sectional estimation of the Jones model adjusted by Kothari et al (2005) modifications; and finding the discretionary current and total accruals, the following paragraphs will present the descriptive statistics of the research output. In addition, parametric and non-parametric tests are used to detect the statistical significance of the mean and median discretionary accruals. Particularly, one-sample t-tests are performed to test hypotheses H_{1a} and H_{1b} postulating if Canadian cash and stock acquirers engage in accrual-based earnings management prior to acquisition announcements based on the significance of the mean and median DAC. Independent sample tests and Wilcoxon rank test are performed to test hypotheses H_{1c}, H_{2a}, and H_{2b} by detecting the mean and median differences between stock and cash acquirers, pre-post IFRS mean difference for stock acquirers, and pre-post IFRS mean difference for cash ones.

4.3 Descriptive Statistics

This section will explain the descriptive statistics of the research output. Particularly, the mean, number of observations, standard deviation, median, minimum, maximum, kurtosis and skewness are all reported for both discretionary total accruals and discretionary current accruals. The results are presented in table

4.1 for the entire sample which covers all bids and sub samples of cash bids, stock bids, pre-IFRS bids and post-IFRS bids.

For the entire sample constituting of 95 observations, table 4.1 of panel A shows that the means for DAC and DCAC are 1.5% and 3.3% respectively with a standard deviation of 8.5% and 13.6% each. The minimum and maximum values of DAC registered -23% and 26.3% respectively, while -40.2% and 34.9% for DCAC. In addition, for both DAC and DCAC measures, skewness values fall between $\pm$ 1 and kurtosis values fall between $\pm$ 3, representing a normal distribution.

Moreover, for the sub sample constituting of 74 stock acquirers, panel B shows that the means for DAC and DCAC are 1.7% and 2.4% respectively, with a standard deviation of 8.7% and 14.2% each. The minimum and maximum DAC values are -23% and 26.3% respectively and -40.2% and 34.9% for DCAC, indicating that the highest and lowest values of the aggregate sample are reported by stock acquirers.

Table 4.1: Descriptive Statistics
This table presents the descriptive statistics of the study sample over five panels. It presents the mean, number of observations, standard deviation, median, minimum, maximum, skewness and kurtosis figures for the entire sample, stock bids, cash bids, pre-IFRS bids and post-IFRS bids.

Panel A: Entire Sample

	Mean	N	SD	Median	Min	Max	Kurtosis	Skewness
DAC	0.015	95	0.085	0.017	-0.23	0.263	0.918	-0.451
DCAC	0.033	95	0.136	0.048	-0.402	0.349	1.706	-0.899

Panel B: Stock Bids

	Mean	N	SD	Median	Min	Max	Kurtosis	Skewness
DAC	0.017	74	0.087	0.014	-0.23	0.263	0.982	-0.344
DCAC	0.024	74	0.142	0.043	-0.402	0.349	1.635	-0.860

Panel C: Cash Bids

	Mean	N	SD	Median	Min	Max	Kurtosis	Skewness
DAC	0.008	21	0.078	0.032	-0.172	0.11	0.655	-1.148
DCAC	0.061	21	0.108	0.093	-0.160	0.242	-0.024	-0.686

Panel D: Pre-IFRS Subsample

	Mean	N	SD	Median	Min	Max	Kurtosis	Skewness
DAC	0.037	47	0.071	0.036	-0.156	0.263	2.040	0.239
DCAC	0.061	47	0.111	0.064	-0.160	0.349	0.568	0.298

Panel E: Post-IFRS Subsample

	Mean	N	SD	Median	Min	Max	Kurtosis	Skewness
DAC	-0.006	48	0.092	0.006	-0.220	0.158	-0.106	-0.519
DCAC	0.005	48	0.153	0.024	-0.402	0.243	0.867	-1.142

Furthermore, panel C presents 21 bids reported for cash acquirers with means of 0.8% for DAC and 6.1% for DCAC. The standard deviation of the discretionary total accruals is 7.8% and that of discretionary current accruals is 10.8%. The minimum and maximum values of DAC are -17.2% and 11% respectively, and those of DCAC are -16% and 34.9% respectively. Regarding the skewness and kurtosis, all values indicate normality except the skewness of DAC which is -1.148 indicating a slight negatively skewed distribution.

Panel D shows that pre-IFRS subsample constituting of 47 bids witness a 3.7%mean DAC and 6.1% mean DCAC with standard deviation of 7.1% and 11.1% respectively. The minimum values of DAC and DCAC are -15.6% and -16%, while the maximum values are the highest values reported by the entire sample (26.3% and 34.9%). Skewness values again lie between ±1 and kurtosis values fall between ±3 confirming normality.

Finally, the post-IFRS subsample constituting of 48 bids reported in panel E shows the lowest mean values of -0.6% and 0.5% for DAC and DCAC respectively. The minimum value of the entire sample is detected in the post-IFRS subsample (-23% for DAC and -40.2% for DCAC). The skewness and kurtosis values indicate a normal distribution, except for the skewness of DCAC which indicated a slight negatively skewed distribution.

4.4 Empirical Results

This section presents a detailed presentation of the results.

4.4.1 Results of DAC for the Entire Sample, Stock and Cash subsamples, and Pre and Post periods

4.4.1.1 Reporting the Results

As shown in table 4.2, the mean and median values for both total and current accruals for the entire sample, for stock and cash bidders separately, and pre and post periods. This section will report the results of total accruals only, leaving current accruals to be analyzed in the robustness checks section.

Starting with the entire sample, both the mean discretionary total accruals of 0.015 and the median estimate of 0.017 presented in table 4.2 panel A are statistically significant at 5% and 1% levels respectively. These numbers could indicate that Canadian acquirers, in general, do manage their earnings upward prior to the acquisition announcements. In fact, these findings are consistent with those of a considerable number of studies. For instance, Ferentinou and Anagnostopoulou (2014) found that both the mean discretionary accruals of 0.0834 and the median estimate of 0.0387 are significant at 1% level, demonstrating positive earnings management by Greek firms. Likewise, Kassamany et al (2017) reported mean accruals of 0.019 and median estimate of 0.018, both statistically significant and indicating upward earnings management by the entire sample of UK acquirers.

For the stock acquirers, table 4.2 panel A shows a mean discretionary total accruals of 0.017 and a median estimate of 0.014, both statistically different from zero and significant at 5% level. These numbers could reveal that for the stock financed acquisition; Canadian acquirers tend to upward their earnings through manipulating discretionary accruals in the accounting year immediately preceding the acquisition

announcement. Their actions can be explained through their tendency to boost their own stock price as a response of the anticipated market behavior of discounting firms' stock price at the announcement of stock swap (Erickson and Wang, 1999). Moreover, these findings are consistent with the findings of Botsari and Meeks (2008), who reported a mean discretionary accruals of 0.0353 significant at 5% level for 41 UK publicly traded companies undertaking share swap M&A during the period 1997-2001. Consistently, Kassamany et al (2017) reported mean discretionary accruals significant at 10% level for 75 UK publicly traded companies undertaking stock acquisition during the period 1990-2009. A stream of previous research reported consistent results such as Loughran and Vijh (1997), Easterwood (1998), Rau and Vermaelen (1998), Erickson and Wang (1999) and Louis (2004) postulating that acquiring firms aggressively use discretionary accruals to manipulate reports by overstating their earnings prior to stock acquisition announcements.

Regarding cash acquirers, panel A of table 4.2 shows positive mean discretionary total accruals of 0.008 and a positive median estimate of 0.032, however, these results are not statistically significant. Therefore, it does not appear that cash acquirers rely extensively on managing their earnings prior to the cash financed acquisition announcement. Widespread previous research found consistent results that are in line with the findings of this study, for instance, Erickson and Wang (1999) showed that unlike stock acquisitions, cash acquirers do not rely on earnings management activities. In addition, Louis (2004) reported insignificant mean discretionary accruals of 0.055 (with a p-value = 0.595) immediately prior to the merger announcement of the publicly traded U.S. cash acquirers during the period 1992-2000. Similarly, Kassamany et al (2017) reported insignificant mean discretionary accruals of 0.012 (with a p-value = 0.193) indicating low levels of earnings management detected by cash acquirers, since the latter lack the motivation to influence their share value before completing the bid.

It is obvious from the reported results that there is a difference between the stock financed abnormal accruals and the cash financed ones. However, when comparing stock and cash bids, we find that although both the mean and median discretionary total accruals are positive, they are insignificant, in which the mean difference registered 0.009 (with a p-value = 0.663) and the median difference calculated using the Wilcoxon Rank Sum test registered 0.018 (with a p-value = 0.993). These

findings appear to be inconsistent with those of Erickson and Wang (1999), Louis (2004), Botsari and Meeks (2008) and Kassamany et al (2017). Yet, the insignificance of the results are supported by the findings reported by Pungaliya and Vijh (2009), in which they documented insignificant difference between discretionary accruals of cash and stock acquisitions for a sample composed of 1,719 cash acquirers and 895 stock acquirers during 1989-2005 period. Similarly, Hamza and Lakhal (2010) found strong evidence that bidder firms manipulate earnings either downwards or upwards, regardless of the method of payment in France between 1998 and 2008.

As previously shown, acquirers, in general, manage earnings through manipulating their discretionary total accruals prior to the announcement of the acquisition decision. This can also be noticed when dividing the sample into the pre and post-IFRS subsamples. For instance, table 4.2 panel B shows that acquirers of the pre-IFRS subsample report mean and median discretionary total accruals of 0.037 and 0.036 respectively, both statistically significant at 1% level. This could indicate the occurrence of earnings management by acquirers immediately prior to acquisition announcements and in periods before the implementation of IFRS.

In the post-IFRS period, results could reveal that no earnings management is detected since the mean and median discretionary total accruals registered small values of -0.006 and 0.006 respectively, both are statistically insignificant. These results provide strong evidence of a substantial decrease in discretionary total accruals for the period after IFRS enactment as compared to those before it. Subsequently this could prove IFRS's ability to increase transparency through reducing accrual-based earnings management.

The pre-post mean and median discretionary total accruals difference are also tested for significance. Table 4.2 panel B shows that the mean pre-post difference of discretionary total accruals is 0.043 significant at 5% level. Similarly, the median pre-post difference of discretionary total accruals is 0.030 significant at 5% level. These results confirm that IFRS enforcement could succeed in declining the magnitude of earnings management among Canadian acquirers.

The findings of this research are consistent with several previous studies, for instance, Ferentinou and Anagnostopoulou (2014) also found a significant decline in

the use of accrual-based earnings management in the post-IFRS period as compared to the pre one in Greece. Likewise, Ho et al (2015) provided reinforcing evidence that the extent of accrual-based earnings management measured using discretionary total accruals is lessened after IFRS adoption in China.

Table 4.2: Accrual-Based Earnings Management Proxies derived from the Cross-Sectional Modified-Jones Model based on the Cash Flow (CF) Approach.

This table shows accrual-based earnings management measures for the acquirers prior to the deal's announcement dates. The results are based on parametric (t-tests for the means) and non-parametric (Wilcoxon Rank Sum test for the medians). Abnormal Total Accruals (DAC) and Abnormal Current Accruals (DCAC) based on Cash Flow (CF) approach are calculated for all, stock, and cash bids in Panel A, while Panel B reveals DAC and DCAC values for the Pre- and Post-IFRS subsamples. P-values are given in parentheses and significant results are marked in bold. ***, **, *denote one-tailed significance at 1%, 5%, and 10% level respectively.

Panel A: Abnormal Total and Current Accruals results for the entire sample, stock and cash bids.

	All Bids		Stock Bids		Cash Bids		Difference Stock-Cash	
	Mean	Median	Mean	Median	Mean	Median	Mean	Median
DAC	**0.015****	**0.017*****	**0.017****	**0.014****	0.008	0.032	0.009	-0.018
P-Value	(0.042)	(0.009)	(0.046)	(0.020)	(0.322)	(0.130)	(0.663)	(0.993)
No. of Obs.	95		74		21			
DCAC	**0.033****	**0.048*****	**0.024***	**0.043*****	**0.061*****	**0.093****	-0.037	-0.05
P-Value	(0.011)	(0.001)	(0.072)	(0.009)	(0.009)	(0.012)	(0.278)	(0.233)
No. of Obs.	95		74		21			

Panel B: Abnormal Total and Current Accruals results for the pre and post-IFRS subsamples.

	Pre-IFRS Bids		Post-IFRS Bids		Difference Pre-Post	
	Mean	Median	Mean	Median	Mean	Median
DAC	**0.037*****	**0.036*****	-0.006	0.006	**0.043****	**0.030****
P-Value	(0.001)	(0.001)	(0.334)	(0.119)	(0.014)	(0.031)
No. of Obs.	47		48			
DCAC	**0.061*****	**0.064*****	0.005	0.024	**0.056****	0.040
P-Value	(0.000)	(0.001)	(0.410)	(0.500)	(0.045)	(0.203)
No. of Obs.	47		48			

4.4.1.2 Robustness Checks

According to Louis' (2004), acquirers rely on earnings before interest, taxes, depreciation and amortization in managing their earnings and thus managers tend to manage their current accruals to manipulate earnings. Hence, following Louis' (2004) reasoning, this study also used the cash flow-based current discretionary accruals as another proxy measure for earnings management for comparison reasons and as a robustness check.

It is worth mentioning that results are very similar when the robustness checks are applied. Particularly, when the discretionary current accruals are used instead of the discretionary total accruals in the cross-sectional version of the Jones model (Jones, 1991) adjusted by Kothari et al (2005) modifications, findings are very close to those obtained by discretionary total accruals. Table 4.2 panel A shows that Canadian acquirers, in general, reports mean discretionary current accruals of 0.033 significant at 5% level and median estimate of 0.048 significant at 1% level. This could also confirm that Canadian acquirers rely on earnings management prior to the announcement of an acquisition agreement. Consistency in results is also evident in stock subsample, where the mean discretionary current accruals of 0.024 significant at 10% level and the median estimate of 0.043 significant at 5% level, both could reinforce the fact that stock acquirers tend to manage their earnings upward immediately prior to the acquisition announcement. Unfortunately, table 4.2 panel A shows significant positive mean and median estimates of discretionary current accruals for cash acquirers (0.061 and 0.093 respectively), inconsistent with discretionary total accruals' mean and median values. According to Botsari and Meeks (2008), an explanation that could be associated to this difference in results between discretionary total and current accruals is the treatment of depreciation. Specifically, when the measure is current accruals, depreciation and amortization variable is excluded from total accruals one and hence it will cause this difference. Moreover, the opaque nature of current accruals and its inclusion of judgmental items such as provisions for doubtful debts, warranties and inventory obsolescence which prior research has shown are used to manage earnings; can also lead to an increase in values as compared to total accruals.

A noteworthy issue to mention is that the above explanation created a difference for cash acquirers only, this can be related to the small sample considered (21 cash acquirers) which made the presence or absence of any small number effective.

Furthermore, the stock-cash difference is still insignificant when discretionary current accruals are used instead of discretionary total accruals.

Concerning the pre-and post-IFRS subsamples, results do not show any considerable difference when robustness checks are applied. It is worth mentioning that in the pre-IFRS period, the discretionary current accruals and total accruals yield the same statistically significant level (0.001). Moreover, in the post-IFRS period, table 4.2 panel B shows that when the discretionary current accruals are used instead of the discretionary total accruals, acquirers report mean values of 0.005 (insignificant). In fact, these values were very close to the ones reported by the discretionary total accruals (-0.006 insignificant). There is also no difference in the values and the significance level of the pre-post mean differential between the two proxies.

Excluding 2008

In addition to using discretionary current accruals for comparison reasons and as a robustness check, excluding 2008 acquisitions, which are the years of the earnings management prior to the announcement offer, is also conducted following Ipino and Parbonetti (2017) to verify the robustness of the results.

The main reason behind excluding the observations of the crises year is because in such periods; managers are motivated to engage in income-increasing earnings management to compensate for the exhibited lower earnings and to avoid a large decline in the firm's stock price (Ahmad-Zaluki et al, 2011). Thus, earnings reported in such transitionary periods are less useful for predictions. Accordingly, and based on the above argument, it was of huge importance to exclude 2008 observations and assure that accruals reported in the 2008 global financial crises did not bias the final results of the total sample.

Consequently, all of the above analysis is replicated after excluding 2008 and hence the sample is reduced to 87 acquirers. After running the model and the descriptive statistics of the new research output, the results remain unchanged.

4.4.2 Pre- and Post- IFRS values of DACs for Stock and Cash Acquirers

4.4.2.1 Reporting the Results

Table 4.3 presents, on a more specific level, the acquirers' mean and median total and current abnormal accruals for pre and post-IFRS periods, after splitting the sample into stock and cash acquirers. Results in table 4.3 panel A show that the mean total abnormal accruals for stock bids in the pre-IFRS period is 0.045 significant at 1% level, however, its median estimate is positive (0.041) but insignificant. These results could indicate the use of earnings management by stock acquirers in the pre-IFRS period. Whereas in the post-IFRS period, stock acquirers do not show any clue of the presence of earnings management since both the mean and median estimates of discretionary total accruals are insignificant (-0.006 and -0.001 respectively). It is obvious from the reported results that there exist a substantial decline in the mean and median abnormal total accruals in the post-IFRS period as compared to the pre-IFRS one, pointing out to the decline in the use of earnings management by stock acquirers. Table 4.3 panel A shows that the mean and median abnormal total accruals difference of pre and post-IFRS subsamples was 0.051 and 0.042, both significant at 1% and 5% levels respectively as expected.

For cash acquirers, table 4.3 panel A shows insignificant mean and median discretionary total accruals values (0.015 and 0.036 respectively) in the pre-IFRS period, this could indicate that cash acquirers do not use earnings management closely before acquisition announcements. The post-IFRS bids show an insignificant mean discretionary total accruals of -0.003 (with p-value = 0.415) but a significant median estimate of 0.024. These confusing results for the post-IFRS group can be settled by testing the significance of the pre-post difference, the latter reveals insignificant mean and median abnormal total accruals values of 0.018 and 0.012, indicating no difference between the two periods for cash acquirers.

In comparing the difference between stock and cash bidders in the pre-IFRS and Post-IFRS periods, table 4.3 panel B shows that stock bidders have positively higher income increasing accruals, yet insignificant only in the pre-IFRS period. Regarding the post IFRS period, the difference between the stock and cash bidders is negative indicating that cash acquirers have higher income increasing accruals than stock

acquirers. The magnitude of positive accrual-based earnings management by stock bidders compared to cash bidders is lower in the post-IFRS period than in the pre-IFRS one although the values in both periods are insignificant.

Table 4.3: Accrual-based Earnings Management Proxies derived from the Cross-Sectional Modified-Jones Model based on the Cash Flow (CF) Approach for the Pre- and Post-IFRS Bids with the Method of Payment

This table presents accrual-based earnings management measures for the acquirers in the year prior to the deal's announcement date. The results are based on parametric (t-tests for the means) and non-parametric (Wilcoxon signed-ranks test for the medians) tests. P-values are given in parentheses and significant results are marked in bold. ***, **, * denote one-tailed significance at 1%, 5%, and 10% level respectively

Panel A: Abnormal Total and Current Accruals results for the pre and post-IFRS subsamples with the method of payment

	Stock Bids						Cash Bids					
	Pre-IFRS Bids		Post-IFRS Bids		Difference Pre-Post		Pre-IFRS Bids		Post-IFRS Bids		Difference Pre-Post	
	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median	Mean	Median
DAC	**0.045*** **	0.041	-0.006	-0.001	**0.051*** **	**0.042** **	0.015	0.036	-0.003	**0.024*** **	0.018	0.012
P-Value	(0.000)	(0.337)	(0.337)	(0.415)	(0.010)	(0.025)	(0.254)	(0.140)	(0.465)	(0.001)	(0.634)	(0.595)
No. of Obs.	34		40				13		8			
DCAC	**0.072*** **	**0.063** **	-0.016	0.003	**0.088*** **	**0.06** **	0.031	0.073	**0.109*** **	**0.118*** **	-0.078	-0.045
P-Value	(0.001)	(0.009)	(0.262)	(0.405)	(0.007)	(0.037)	(0.167)	(0.173)	(0.004)	(0.001)	(0.111)	(0.140)
No. of Obs.	34		40				13		8			

Panel B: Difference Between Stock and Cash Abnormal Total and Current Accruals results for the pre and post-IFRS subsamples

	Difference between Stock and Cash Bids			
	Pre-IFRS Bids		Post-IFRS Bids	
	Mean	Median	Mean	Median
DAC	0.030	0.005	-0.004	-0.0243
P-Value	(0.190)	(0.536)	(0.919)	(0.615)
DCAC	0.041	-0.01	**-0.125** **	**-0.115** **
P-Value	(0.269)	(0.476)	(0.033)	(0.028)

4.4.2.2 Robustness Checks

Table 4.3 panel A reveals significant positive mean abnormal accruals in the pre-IFRS period for stock bids (0.072 significant at 1% level) when using the discretionary current accruals. Similarly in the post-IFRS period, using discretionary current accruals resulted insignificant mean and median estimates consistent with the findings of discretionary total accruals. Consistency in results is also evident for the stock pre and post-IFRS abnormal current accrual difference figures whereby both mean and median estimates are significant at 1% and 5% levels respectively.

After applying the robustness check for the pre-IFRS group of cash bids, insignificant mean and median estimates are reported similar to the corresponding results reported by discretionary total accruals. For the post-IFRS period, cash acquirers reported significant mean and median discretionary current accruals, inconsistent with discretionary total accruals. Same reasoning as that presented in section 4.3.1.2 for results of table 4.2 panel A for cash acquirers is also applied for the justification of this group's results. For the cash bids pre-post accrual differential, insignificant mean and median discretionary current accruals are reported, consistent with discretionary total accruals findings.

For panel B of table 4.3, the difference between stock and cash bids for the pre-IFRS group do not exhibit a serious change, both mean and median discretionary current accruals were insignificant, consistent with mean and median abnormal total accruals. This is not the case in the post-IFRS group, where significant mean and median estimates are reported when abnormal current accruals are used, unlike abnormal total accruals findings. This is not surprisingly reached, however it can be justified from the previous reported results for cash bids in the post-IFRS period.

4.5 Discussion of the Results

After reporting the results in the previous section, this section discusses and relates them to the hypotheses developed in chapter three as well as to the findings of previous studies. Starting with the aggregate level, it has been observed that the discretionary accruals of the Canadian acquirers are positive and significant; this could indicate that Canadian successful acquirers engage in accrual-based earnings management prior to acquisition announcements. Moreover, after splitting the sample into two subsamples, stock and cash, stock acquirers have shown significant positive discretionary accruals. This empirical evidence supports for hypothesis $H_{1a,}$ and thus it could be inferred that Canadian stock acquirers engage in accrual-based earnings management. In this context, previous research such as Erickson and Wang (1999), Botsari and Meeks (2008), and Kassamany et al (2017) reported consistent results proposing that stock acquiring firms aggressively used discretionary accruals to manipulate reports and thus engage in earnings management.

Regarding cash acquirers, results in the previous section reported insignificant mean and median accruals. These findings are in support of hypothesis H_{1b} and the findings of Erickson and Wang (1999), Louis (2004) and Kassamany et al (2017) confirming the low levels of earnings management detected by cash acquirers. More precisely, mean accruals reported for the stock-cash difference was positive, however insignificant, therefore there is no strong evidence that the magnitude of accrual-based earnings management immediately prior to the acquisition announcement is larger for successful stock acquirers than for cash ones. This leads to a partial support for hypothesis H_{1c} but appear consistent with the findings of Pungaliya and Vijh (2009) and Hamza and Lakhal (2010).

The second hypothesis to be tested in this study is centered on the effect of IFRS on earnings management for both stock and cash acquirers. Stock acquirers have shown a decline in mean accruals (insignificant values) in the post-IFRS period after it was significantly positive in the pre-IFRS period. Moreover, the mean and median accruals difference of pre and post-IFRS subsamples are significant, showing that there is a significant difference of accrual-based earnings management by successful stock acquirers before and after the adoption of IFRS and hence supporting hypothesis H_{2a}. These results are in line with findings in other contexts such as Barth

(2006), Liu et al (2011), Aubert and Grudnitski (2012), Ferentinou and Anagnostopoulou (2014) and Ho et al (2015), they all agreed on the fact that the extent of accrual-based earnings management is lessened after the adoption of IFRS. For cash bids, the reported results show that there is no significant pre-post mean (median) discretionary accruals difference, and hence supports hypothesis H_{2b}.

4.6 Conclusion

This chapter reported and explained the empirical findings of this research based on detailed univariate analysis. It also analyzes and discusses the results by comparing them with previous research. The descriptive statistics reported values for mean, number of observations, standard deviation, median, minimum, maximum, kurtosis and skewness for the entire sample and for sub samples of cash bids, stock bids, pre-IFRS bids and post-IFRS bids.

Results have supported hypotheses H_{1a} and H_{1b} that Canadian successful stock acquirers engage in accruals-based earnings management immediately prior to acquisition while Canadian cash ones do not engage in accrual-based earnings management. However, there is no sufficient evidence to support H_{1c} that the magnitude of accrual-based earnings management prior to the acquisition announcement is larger for successful stock acquirers than for successful cash acquirers. In other words, empirical results show that mean accruals reported for the stock-cash difference is positive, but this difference is not statistically significant, therefore it can be deduced that H_{1c} is partially accepted.

Hypotheses H_{2a} and H_{2b} that there is a significant difference of accrual-based earning management by successful stock bidders before and after the adoption of IFRS while no significant difference of accrual-based earning management by successful cash bidders before and after the adoption of IFRS, were also supported by the findings of this research.

5 Chapter 5: Conclusion

5.1 Introduction

This research aims to study Canadian acquiring firms' tendency to engage in accrual-based earnings management prior to the acquisition announcement in pre- versus post-IFRS comparative approach. This final chapter is a summary chapter in which it recaps the results and provides an avenue for future research. Section two reviews the findings and compares them with the findings of previous studies. Section three discusses the validity of results. The limitations of the study are mentioned in section four. Section five sheds the light on the theoretical and practical implications of this research. Section six opens a window for future research.

5.2 Summary of the Findings

This study investigates accrual-based earnings management for a sample of 95 Canadian acquiring firms from five different industries over the period 2005-2015 in two stages. In the first stage, tests are conducted on the entire sample of Canadian bidders and for the stock and cash subsamples over the entire period (2005-2015). However, in the second stage, tests are conducted over two separate periods, the pre- and post-IFRS periods, for both stock and cash acquirers.

Results reported in the first stage show that Canadian acquirers engage in accrual-based earnings management immediately prior to acquisition announcement. This finding is consistent with several studies that also find acquiring firms before acquisitions rely on earnings management (Ferentinou and Anagnostopoulou, 2014; and Kassamany et al, 2017). This is also the case for stock acquirers in which results show that Canadian stock acquirers rely on accrual-based earnings management prior to acquisition consistent with Erickson and Wang (1999), Louis (2004), Botsari and Meeks (2008) and Kassamany et al (2017). Regarding cash acquirers, reported results show that they do not rely on accrual-based earnings management prior to acquisition. This is also consistent with the findings of a number of studies such as Erickson and Wang (1999), Louis (2004) and Kassamany et al (2017).

Results reported in the second stage after splitting the period into pre- and post-IFRS show a significant decline in the level of accrual-based earnings management by

stock acquirers after the passage of IFRS. This finding could be explained by the enhanced governance environment associated with the enactment of IFRS. Moreover, cash acquirers did not witness any significant change in the level of accrual-based earnings management after the passage of IFRS, this stability could be explained by the initial nature of this type of acquirers who lack the motivation to influence their share value before completing the bid and hence does not engage in earnings management activities.

The summary of findings associated with the tested hypotheses is illustrated in Table 5.1.

Table 5.1: Summary of Findings

Hypothesis	Theory	Statistical Test	Empirical Results	Findings
H_{1a}: Canadian successful stock acquirers engage in accrual-based earnings management in the accounting year prior to acquisition.	Agency Theory	One-Sample parametric and non-parametric Tests	Significant	Supported
H_{1b}: Canadian successful cash acquirers do not engage in accrual-based earnings management in the accounting year prior to acquisition.	Agency Theory	One-Sample parametric and non-parametric Tests	Significant	Supported
H_{1c}: The magnitude of accrual-based earnings management in the accounting year prior to the acquisition announcement is larger for successful stock acquirers than for successful cash acquirers.	Agency Theory	Independent Samples parametric and non-parametric Tests	Insignificant	Partially Supported
H_{2a}: There is a significant difference of accrual-based earning management by successful stock bidders before and after the adoption of IFRS.	Agency Theory	Independent Samples parametric and non-parametric Tests	Significant	Supported
H_{2b}: There is no significant difference of accrual-based earning management by successful cash bidders before and after the adoption of IFRS.	Agency Theory	Independent Samples parametric and non-parametric Tests	Significant	Supported

5.3 Validity

One of the most essential indicators used in assessing the quality and understanding the criteria for good research is validity of results. Validity is a general term that mainly includes four different forms: external validity, construct validity, internal validity and conclusion validity (Trochim, 2008). Thus, this section will examine the forms of validity that are applicable in this research.

Starting with the construct validity that basically assesses the degree to which the programs or measures used reflect the concepts and theories of the study (Trochim, 2008), in more explicit terms, the credibility of the adopted proxies is an important issue in Business research. Given that the study aims at investigating whether the Canadian acquiring firms tend to manipulate earnings prior to the execution of the acquisition process, the variable of interest in this case is accruals as they present a favored instrument for manipulating reported earnings due to their low cost (Peasnell, 1998). It follows that the cross-sectional version of the Jones model (Jones, 1991) adjusted by Kothari et al (2005) modifications was adopted among various other proposed discretionary accrual models as it is considered a widely well-known earnings management model that is used by considerable number of influential studies such as Botsari and Meeks (2008), Ferentinou and Anagnostopoulou (2014), and Kassamany et al (2017). The wide usage of accruals as a proxy by researchers and its ability to reflect the earnings management activities of Canadian acquirers around acquisition announcements is considered as strong evidence of its validity. There are also other similar proxies for earnings management that are used in similar researches, yet they have not been as widely studied as accrual-based earnings management.

On the other hand, conclusion validity is another form that is relevant to this research topic. Conclusion validity refers to the degree to which the conclusions reached from the study are reasonable. In fact, as mentioned earlier in this thesis, in the first stage of analysis, where the study is conducted on the entire sample of Canadian bidders and for the stock and cash subsamples over the entire period (2005-2015), the results are consistent with the results of other distinguished studies such as Erickson and Wang (1999), Louis (2004), Botsari and Meeks (2008), Ferentinou and

Anagnostopoulou (2014), and Kassamany et al (2017). This consistency in results is considered as evidence on validity of conclusions reached by this study. Moreover, in the second stage of analysis, where tests are conducted over two separate periods, the pre- and post-IFRS periods, for both stock and cash acquirers, the reported declined earnings management activities are considered complementary to previous research that has reported increased corporate governance and enhanced transparency in terms of reducing earnings management practices in the post-IFRS period (Barth, 2006; Liu et al, 2011; Aubert and Grudnitski, 2012; Ferentinou and Anagnostopoulou, 2014; and Ho et al, 2015). This fact can also be considered as evidence on validity of conclusions reached. Nevertheless, to assure the validity of conclusions, this study also used the cash flow-based current discretionary accruals as another proxy measure for earnings management for comparison reasons and as a robustness check for the results.

5.4 Limitations of the Research

Despite the substantial efforts utilized to achieve a valuable study with robust results that could contribute to the existing body of research, this study has faced some limitations as with all research. First, this research focuses on a specific setting in a specific market, in other words, the study centers on acquisition events regardless of any other corporate setting. In addition, the empirical investigation of this study focus on accrual-based earnings management of Canadian acquiring firms prior to acquisition announcements after the transitioning of new corporate governance regime brought by IFRS. Therefore, it is clear that the results associated with this study might not be generalized to other corporate events and other countries.

Moreover, the sample studied in this research included disproportionate numbers of stock acquirers to cash acquirers. For instance, the number of stock acquirers is 74, while the number of cash acquirers is 21 only. Besides, the size of the sample became small because of the deletion of many observations due to the implementation of several criteria and the missing data from DataStream.

5.5 Theoretical and Practical Implications

The results of the study pose substantial theoretical and practical implications. As previously mentioned, acquisitions are increasing tremendously nowadays and the use of earnings management is extending in parallel, from here comes the need to

extend the debate further and examine variables that can reflect the quality of accounting information to detect earnings management. Thus, on the theoretical level, the evidence of the existence of earnings management prior to acquisition and the ability of IFRS to mitigate it could pave the way for future research that aims at investigating a causal effect relationship between the implementation of IFRS that represent the cause, and the change in the use of earnings management that represent the effect.

Moreover, on the practical level, the findings of this study might have favorable implications on the professional fields. In fact, as empirical results of this research have shown that IFRS would contribute to mitigating earning management activities, this provides evidence on the effectiveness and influence of IFRS in curbing acquirers misbehavior and controlling financial institutions. Consequently, the findings in this research will be of interest to regulators and policy makers.

Investors might also benefit from the results of the study; market participants will no longer have fears of manager's intentions to manipulate earnings. Accordingly, investors will make more efficient investment decisions, as their trust in the financial system is enhanced due to the fact of the firms' commitment to the IFRS guidelines.

5.6 Suggestions for Future Research

After reviewing the theoretical and practical implications posed by the results of this research, it is important to shed light on other avenues that could be opened for further research that elaborates on the idea of this study. For instance, given that this study is limited only to using accrual-based measures of earnings management, it would be worth to also study real-based earnings management practices to contribute to earnings management research in the Canadian acquisition context. In other words, three proxies should be derived to measure real earnings management activities that are abnormal cash from operations (*A_CFO*), abnormal discretionary expenses (*A_DISX*) and abnormal production costs (*A_PROD*). To estimate the abnormal values of these proxies, the normal levels of cash from operations, discretionary expenses, and production costs are calculated by implementing the models developed by Dechow *et al.* (1998) and as followed in Roychowdhury (2006).

Furthermore, a comprehensive study can consider a multivariate analysis to further examine the use of both accrual and real-based earnings management in acquisitions financed by stock compared to those financed by cash. In more explicit terms, earnings management could be regressed on a dummy variable that represents the passage of IFRS, in addition to other determinants of earnings management to be also included in the regression to test their significance such as firm's size, leverage, and market-to-book value of the acquirer.

Another avenue for future research is to investigate targets' tendency to engage in earnings management activities prior to acquisition announcement. Moreover, similar studies could be conducted to explore the same scenario of analysis when bidding firms acquire private targets especially that different levels of information asymmetry may exist. Researchers can also examine accrual and real-based earnings management for other Canadian corporate events such as seasoned equity offerings (SEOs) and initial public offerings (IPOs).

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