6.6. Conclusions

This paper investigates the effects of a temporarily increased level of oversight on a firm’s level of income-increasing RAM. Using hand-collected quarterly data for a sample of IFRS reporting firms from German censured during an IFRS enforcement investigation, we examine a firm’s RAM behavior during pending IFRS enforcement investigations.

We provide evidence that firms censured for erroneous IFRS financial reporting use income-increasing RAM, especially overproduction, during pending enforcement investigations. Supporting this result, we show that firms use income-decreasing AEM in the same period. Additionally, we examine whether the level of internal and external oversight, appeasement incentives, and managers’ individual moral incentives moderate the magnitude of the RAM reaction. Overall, we find higher levels of RAM in case of weak internal (external) oversight, a higher error severity, and if the CEO or CFO in charge still belongs to the firms.

These results can be attributed to two distinct effects. First, due to the direct attendance of an enforcement authority, firms' possibilities to use AEM are constrained leading to higher relative costs of AEM. Beyond that, being in a defendant position, an affected manager has incentives to confess to opportunistic behavior and to prevent adverse effects. Further, appeasement incentives are more pronounced in case of severe misstatements. These effects foster more conservative accounting practices and lead to higher levels of RAM.

Our study contributes to the understanding of potential unintended consequences of IFRS enforcement investigations. We show that not only the existence but also the direct attendance of an enforcement authority has an influence on firms’ corporate behavior. Contrary to the intention of the regulator, the direct attendance of enforcement authorities does not only influence a firm’s accounting practices but also operating decisions. Thus, these results are of particular interest for regulators in evaluating the net-benefits of regulatory changes.
Nonetheless, at least the following caveats remain. First, our results rely on the assumption of a sequential nature of AEM and RAM, as proposed by Zang (2012). However, this relation is not yet fully understood. Thus, future research is necessary to examine the sequential and causal relationship between AEM and RAM. Further, in contrast to other countries, the German setting enables us to precisely identify the interval of pending enforcement. However, while this setting comprises a large set of error findings, the number of observations is comparably small in contrast to, e.g., enforcement studies using US data. Last, immanent for all single country studies, it is unclear whether these results are entirely transferable to other countries or enforcement authorities.