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Real Earnings Management and Audit Quality: Pre- and Post-IFRS

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Abstract

International Financial Reporting Standards (IFRS) have been adopted by Saudi Arabia (KSA) in 2017. The adoption of IFRS in KSA has changed the way companies report their financial statements, and there have been concerns about the quality of financial reporting: relevance and faithful representation. The objective of this paper is to analyze the impact of applying IFRS by Saudi listed firms on real earnings management (REM) and to examine the role of audit quality in reducing REM. Using the model developed by Roychowdhury (2006) to detect real earnings management, the paper compares the magnitude of REM between two sub-periods: Pre-IFRS (2014-2016) and Post-IFRS (2017-2019). Main results indicate that the adoption of IFRS in KSA had a positive impact on earnings quality by reducing the level of REM. Moreover, firms with higher audit quality exhibit lower levels of real earnings management after the transition to IFRS. Overall, applying IFRS improved the reliability of financial reporting by reducing the level of REM, leading to higher earnings quality for firms in KSA.

Keywords: Real earnings management, IFRS, KSA, Audit quality