Abstract

Using a sample of 127 companies that initially listed their stocks on Taiwan Stock Exchange during the 1986-1992 period, this study examines earnings management of IPO firms. By examining earnings, cash flows and the discretionary accruals six years prior to and four years after IPO, the study finds that the IPO firms do engage in earnings management. First, the time series patterns of earnings and cash flows demonstrate a steady upward trend for the pre-IPO years and a downward trend for the post-IPO years. Discrepancy in the time series patterns of earnings and cash flows reveals two types of earnings management—real earnings management and pure accounting manipulations. Second, based on two accrual-based models for detecting earnings management, the time series of estimated discretionary accruals further supports the earnings management hypothesis. Finally, analysis of four individual accrual items suggests that the IPO firms engage in earnings management on a portfolio basis—engaging in income-increasing earnings management to boost reported earnings through some accruals. (e.g., bad debt and R&D expenditure) and income-decreasing earnings management possibly for tax reason through other accruals (e.g., depreciation).

Keywords: Initial Public Offerings, Earnings Management, Accounting Manipulations, Accruals.