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First-Time Adoption of IFRS, Managerial Incentives and Value-Relevance: Some French Evidence

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Abstract

This paper investigates whether and how managerial incentives influence the decision to elect optional exemptions when first adopting International Financial Reporting Standards (IFRS). It also examines the value-relevance of the mandatory and optional equity adjustments that must be recognized as a result of the first-time adoption of IFRS. Both questions are addressed in the context of the mandatory adoption of IFRS by French firms in 2005. Three major findings emerge from our analyses. First, managerial incentives influence the decision to strategically elect one or more optional exemptions at the transition date. Second, mandatory equity adjustments are more valued than French GAAP equity, suggesting that the first-time adoption of IFRS by French firms is perceived as a signal of an increase in the quality of their financial statements. Third, the value-relevance of optional IFRS equity adjustments depends on whether they result in the disclosure of new information.

**First-Time Adoption of IFRS, Managerial Incentives
and Value-Relevance: Some French Evidence**

1.   Introduction

This paper investigates whether and how managerial incentives influence the decision

to elect optional exemptions when first adopting International Financial Reporting

Standards (IFRS). It also examines the value-relevance of the mandatory and optional

equity adjustments that must be recognized as a result of the first-time adoption of IFRS.

Both questions are addressed in the context of the mandatory adoption of IFRS by French

firms in 2005. Firms listed on European stock exchanges are required to use IFRS in their

consolidated accounts since January 1, 2005 to comply with Regulation Act EC

1606/2002. The European Union (EU) Parliament mandated the adoption of IFRS to

improve the integration of capital markets within Europe, and between Europe and the

rest of the world. However, widespread adoption of IFRS also resulted in a fundamental

change in European firms' financial reporting since they previously followed a variety of

country-specific generally accepted accounting principles (GAAP) that sometimes

differed drastically from IFRS (Soderstrom and Sun, 2007).[1]

Firms that adopt IFRS for the first time must comply with IFRS 1 – First-Time

Adoption of IFRS. IFRS 1 generally requires first-time adopters to apply the version of

IFRS effective at the reporting date retrospectively. Therefore, the first IFRS financial

statements are presented as if the entity had always presented financial statements in

accordance with IFRS. IFRS 1 contains mandatory exceptions to the general rule of

retrospective application in areas where the effect of the change in accounting policies

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[1] Prior to 2005, most European countries were reporting under a version of the 4th Directive incorporated in individual countries' legislation.

cannot be measured with sufficient reliability. IFRS 1 also provides a number of optional exemptions to the general principle of retrospective application in areas where the costs of applying IFRS retrospectively may exceed the benefits to financial statement users, or where retrospective application may be impracticable. First-time adopters can elect to use one or more of these exemptions.

We choose to focus on the first-time adoption of IFRS for two reasons. First, the cumulative effect of the mandatory and optional changes in accounting policies resulting from the first-time adoption of IFRS is charged to equity. Equity is used in the calculation of several key ratios such as return on equity, leverage, and price to book value. It is also a key determinant of firm value. As such, the choices made at the first-time adoption of IFRS can have significant financial and strategic implications. Second, the choices made at the first-time adoption of IFRS determine the accounting policies that will be used to prepare future IFRS financial statements. By electing to use one or more optional exemptions, managers can benefit from a fresh start by revaluing assets and liabilities. Furthermore, they establish the benchmark against which their performance will be assessed in the future.

We study the first-time adoption of IFRS by French firms because French GAAP was shown to be among the most divergent from IFRS (Ding, Hope, Jeanjean and Stolowy, 2007). The implementation of IFRS in Europe, and in France in particular, introduces many changes in the traditional continental accounting practices. Hung and Subrananyam (2007) argue that "there is an urgent need for managers and investors to understand the implications of IAS adoption. This is especially true in European countries with stakeholder-oriented accounting systems (such as Germany and France), as IAS is

heavily influenced by the shareholder-oriented Anglo-Saxon accounting model, whereas

local standards in many European countries have a greater contracting orientation and are

driven by tax-book conformity considerations" (p. 624). Thus, the first-time adoption of

IFRS is likely to have a significant impact on French firms' financial statements. In

addition, a survey published in 2005 by Mazars shows that French firms are the most

likely in Europe (more than 60% compared to 40% for the rest of Europe) to believe that

the adoption of IFRS increases the margin for interpretation.[2] Hence, we expect reporting

incentives to influence French firms' decisions to elect one or more optional exemptions

when first adopting IFRS.

We classify sample firms based on their portfolio of exemption choices to examine

whether and how managerial incentives influence the decision to elect optional

exemptions when first adopting IFRS. Our analysis of the information disclosed in the

annual reports on the impact of the optional exemption choices on equity leads us to

distinguish between firms that only choose exemptions with a negative impact on equity

and other firms. We expect firms that report equity-increasing mandatory adjustments

and firms with higher book values and higher earnings multiples to be more likely to elect

optional exemptions that have a negative impact on equity at transition date, and firms

with higher leverage to be less likely to elect such exemptions. Our results are consistent

with our expectations. We also find that French firms cross-listed on a non-European

stock exchange are less likely to elect optional exemptions with a negative impact on

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[2] The survey was conducted in 2005 on 556 European firms from twelve countries. It shows the firms were technically ready to adopt IFRS, even though they were not convinced IFRS would improve the comparability and transparency of financial statements. The survey shows that French firms were less prepared than their counterparts in other European countries. It also demonstrates they were the most sceptical about IFRS: 25% of French firms vs. 50% of firms from other countries believed IFRS would improve the transparency of financial statements; 37% of French firms vs. 63% of firms from other countries believed IFRS would improve the comparability of financial statements from different countries.

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equity at the transition date, but that larger firms are more likely to choose such exemptions.

To test for the value-relevance of the mandatory and optional equity adjustments that must be recognized as a result of the first-time adoption of IFRS, we alter our basic valuation model to separate the cumulative effect of all mandatory adjustments and the individual effect of each optional exemption from the book value of equity. Consistent with prior research, we expect the first-time adoption of IFRS by French firms to be perceived as a signal of an increase in the quality of their financial statements. As such, we expect mandatory and optional IFRS equity adjustments to be more valued than French GAAP equity. Furthermore, we expect the value-relevance of optional IFRS equity adjustments to be influenced by whether they result in the disclosure of new information regarding capital assets, employee benefits, cumulative translation differences, financial assets, and business combinations. Consistent with our expectation, results show that mandatory IFRS adjustments are more valued than French GAAP equity and that optional equity adjustments that result in the disclosure of new information are generally valued.

Our study contributes to the accounting literature in at least three ways. We contribute to the literature on the determinants of mandatory accounting changes by studying factors affecting the decision to simultaneously elect up to five optional exemptions when first adopting a new set of GAAP, IFRS, rather than focusing on individual changes within a specific set of accounting standards. We contribute to the literature related to the determinants and consequences of IFRS adoption by examining the causes and consequences of the individual exemption choices made at the transition date, rather than

considering the adoption per se as the choice. Finally, we contribute to the literature on the valuation effects of mandatory IFRS adoption by investigating the value relevance of equity adjustments at the transition date rather than focusing on the value relevance of earnings and equity as reported in the first IFRS financial statements. We also distinguish between mandatory and optional equity adjustments.

Standard setters and regulators are interested in understanding managers' reporting choices to determine how the discretion afforded by accounting standards may be exploited. The EU Parliament mandated the adoption of IFRS by all European listed firms to enhance the comparability, consistency and transparency of their financial statements. One of the stated objectives of IFRS 1 is to ensure that the information provided in the first IFRS financial statements is transparent for users and consistent with all prior years. By showing that optional exemption choices are associated with managerial incentives and that the potential for managerial opportunism seems to reduce the perceived reliability and value-relevance of optional equity adjustments, our results provide insight into the potential costs and benefits of the mandatory adoption of IFRS and IFRS 1. They indicate that the EU Parliament and the International Accounting Standards Board (IASB) have not been entirely successful in enforcing increased transparency.

The remainder of the paper is organized as follows. Section 2 provides background information on the first-time adoption of IFRS and reviews the related literature. Section 3 presents the research hypotheses. Section 4 discusses the methodology. Section 5 presents the results. Finally, Section 6 concludes and discusses the implications of the study.

2.   Background

2.1   First-Time Adoption of IFRS

IFRS 1 – First-Time Adoption of IFRS specifies the requirements that an entity must follow when it first adopts IFRS as the basis for preparing its general-purpose financial statements. The IASB issued IFRS 1 in June 2003, superseding SIC 8 – First-Time Application of IAS as the Primary Basis of Accounting. The standard is effective for first-time IFRS financial statements for periods beginning on or after January 1, 2004. The objectives of IFRS 1 are to ease the transition to IFRS globally and to create comparability over time for an individual entity and between different entities adopting IFRS for the first time at a given date (Deloitte, 2004).

An entity's first-time IFRS financial statements are the first annual financial statements in which it states compliance with IFRS in an explicit and unreserved statement. IFRS 1 generally requires first-time adopters to apply the version of IFRS effective at the reporting date (i.e. the balance sheet date) retrospectively. The specific transitional provisions of the individual standards do not apply to first-time adopters.

A first-time adopter is required to prepare an opening balance sheet in accordance with IFRS 1 at the date of transition. This opening IFRS balance sheet serves as the starting point for the entity's accounting under IFRS (Epstein, 2006). The same accounting policies must be applied in the opening IFRS balance sheet and all periods presented in the first IFRS financial statements. The date of transition to IFRS is defined as "the beginning of the earliest period for which an entity presents full comparative information under IFRS in its first IFRS financial statements" (IASC, 2003). IFRS 1 requires first-time adopters to present at least one year of comparative financial statement

information. The EU Parliament has the same requirement. Therefore, French (and other European) firms first adopting IFRS in 2005 for calendar year financial statements report in accordance with the following timetable:

- January 1, 2004 – Transition date

- December 31, 2004 – French GAAP financial statements

- December 31, 2005 – First IFRS financial statements with comparative IFRS information

According to Sections 13 to 25 of IFRS 1, first-time adopters should apply four rules when preparing the opening IFRS balance sheet: 1) recognize all assets and liabilities whose recognition is required under IFRS; 2) derecognize items as assets or liabilities if IFRS does not permit such recognition; 3) reclassify items recognized under previous GAAP as one type of asset, liability or component of equity as a different type of asset, liability or component of equity under IFRS; and 4) measure all recognized assets and liabilities according to principles set forth in IFRS. If the transition to IFRS results in a change in accounting policies, the effect of the change is recognized directly in equity in the IFRS opening balance sheet.

Sections 26 to 34 of IFRS 1 contain four mandatory exceptions to the general rule of retrospective application in areas where the effect of the change in accounting policies cannot be measured with sufficient reliability (e.g. retrospective application would require judgments by management about past conditions after the outcome of a particular transaction is already known). IFRS 1 also provides a number of optional exemptions to the general principle of retrospective application in areas where the costs of applying IFRS retrospectively may exceed the benefits to financial statement users, or where

retrospective application may be impracticable. First-time adopters can elect to use one or more exemptions.

2.2 Optional Exemptions

The set of standards to be applied by first-time adopters in 2005, also called the stable platform, provides for ten optional exemptions to the general principle of retrospective application.[3] First-time adopters' ability to use one or more exemptions first depends on the differences between IFRS and the predecessor national GAAP.[4] The most significant differences between French GAAP and IFRS follow. First, the recognition of defined benefit plans is optional. Second, the temporal method is used to translate the financial statements of integrated foreign operations. Third, financial assets are valued at the lower of cost or market. Fourth, business combinations can be accounted for using either the pooling or the purchase method.[5] In addition, firms that did not revalue their capital assets under French GAAP can choose to revalue their capital assets upwards. We focus on the five optional exemptions that relate to these differences and choices.

2.2.1 Fair Value or Revaluation as Deemed Cost

IAS 16 – Property, Plant and Equipment allows firms to choose between the cost model and the revaluation model for the measurement of their capital assets after

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[3] The exemptions are: 1) business combinations; 2) fair value or revaluation as deemed cost; 3) employee benefits; 4) cumulative translation differences; 5) compound financial instruments; 6) assets and liabilities of subsidiaries, associates and joint ventures; 7) designation of previously recognized financial instruments; 8) share-based payment transactions; 9) insurance contracts; and 10) decommissioning liabilities included in the cost of property, plant and equipment.
[4] Readers interested in knowing more about French accounting can refer to Chapter 5 of Walton, Haller and Raffournier (2003).
[5] French GAAP also do not require the recognition of share-based payment transactions. However, whether or not French firms use the optional exemption offered by IFRS 1 has no impact on equity at the transition date because the decrease in retained earnings coming from the recognition of the compensation expense is offset by the increase in the stock options equity account. The use of the optional exemption also has no impact on future net income because the options to which it applies have already vested. Thus, we do not consider this exemption.

recognition. IFRS 1 allows first-time adopters to measure capital assets at fair value at the date of transition to IFRS and to use that fair value as its deemed cost at that date. Revaluations are credited to equity and amortized with the asset. First-time adopters that revalued one or more categories of capital assets under previous GAAP (such as French GAAP) are allowed to use these values as deemed cost at the transition date.[6] First-time adopters that choose to use the exemption do not have to use the revaluation model in future periods. The revaluation typically increases transition date equity and reduces future net income.

2.2.2   Employee Benefits

IAS 19 – Employee Benefits requires firms to measure the compensation cost associated with employees' benefits and to recognize that cost over the employees' respective service periods (Epstein, 2006). Cumulative actuarial gains and losses are recognized in accordance with the corridor approach. IFRS 1 allows firms to calculate the net pension obligation[7] at the transition date without consideration of the corridor approach, and to eliminate unrecognized actuarial gains and losses by charging them to equity in the opening IFRS balance sheet. By so doing, first-time adopters avoid having to amortize these gains and losses to future net income. This is especially beneficial to firms with actuarial losses because they avoid future decreases in net income by eliminating the need to amortize the unrecognized losses in excess of the corridor.

2.2.3   Cumulative Translation Differences

IAS 21 – The Effects of Changes in Foreign Exchange Rates prescribes the use of the current rate method to translate the financial statements of foreign subsidiaries. IFRS 1

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[6] However, they are rarely practiced.
[7] Present value of pension obligation minus fair value of pension plan assets.

allows first-time adopters to calculate the cumulative translation difference prospectively instead of retrospectively and to set the cumulative translation difference calculated in accordance with previous GAAP to zero. Only translation differences that arose after the date of transition to IFRS will be recognized in future net income if the foreign operation is subsequently sold. Again, this is especially beneficial to firms with cumulative translation losses because they can avoid future decreases in net income by electing to use the optional exemption.

2.2.4 Designation of Previously Recognized Financial Instruments

IAS 39 – Financial Instruments: Recognition and Measurement requires firms to designate financial assets as "at fair value through profit or loss" or as "available-for-sale" when they are initially recognized. IFRS 1 allows first-time adopters to designate previously recognized financial assets as "as at fair value through profit or loss" or as "available-for-sale" at the transition date. For instruments previously carried at the lower of cost or market, the revaluation increases equity at the transition date. It also decreases future net income because a portion of the unrealized gain on the financial asset has recognized directly in equity at the transition date.

2.2.5 Business Combinations

IFRS 3 – Business Combinations requires the use of the purchase method for all business combinations. Retrospective application of IFRS 3 may be difficult, if not impossible, for past business combinations. Thus, IFRS 1 allows first-time adopters to account for a business combination prior to the transition date in accordance with previously followed GAAP rather than with IFRS 3. First-time adopters that elect to account for past business combinations in accordance with IFRS 1 do not have to

reclassify them (i.e. pooling of interests method can be maintained); they do not have to remeasure original fair values determined at the time of the business combination; and they do not have to adjust the carrying amount of goodwill recognized under previous GAAP.[8] Firms that choose to apply IFRS 3 retrospectively need to restate goodwill at the amount before any amortization. The impact of the change in accounting policy on equity at the transition date is therefore likely to be positive. Furthermore, future net income is likely to increase in all cases because goodwill will not be amortized after the transition date. Table 1 summarizes the optional exemptions.

{Insert Table 1 here}

2.3   Relationship to Prior Research

A large number of empirical studies investigate the determinants and consequences of voluntary adoption of IFRS. It is difficult, if not impossible, to apply the evidence from voluntary adoption of IFRS to its mandatory adoption for two reasons. First, voluntary adopters are unlikely to suffer negative net consequences from the adoption of IFRS because they have the choice to keep using local GAAP if the costs of IFRS reporting exceed the benefits. Second, the adoption can only be seen as a potential signal to the market if it results from a choice (i.e. not all firms have to comply with IFRS) (Daske, Hail, Leuz and Verdi, 2008). Therefore, we focus on studies that examine the mandatory adoption of IFRS. Because these studies are typically in working paper format, their findings should be viewed as preliminary (Daske, Hail, Leuz and Verdi, 2008).

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[8] First-time adopters that choose to apply IFRS 3 retroactively must have obtained the information necessary to apply IFRS 3 at the date of the business combination. They must apply IFRS 3 to all business combinations subsequent to the date of the earliest business combination accounted for in accordance with IFRS 3 and earlier than the transition date.

2.3.1 Earnings Management and Mandatory IFRS Adoption

A first group of studies examine accounting quality changes in connection with mandatory IFRS adoption. Capkun, Cazavan-Jeny, Jeanjean and Weiss (2008) investigate whether European firms use the discretion afforded by IFRS to manage earnings during the mandatory transition to IFRS. Their sample includes 1,722 firms from European countries where adoption of IFRS was mandatory in 2005. They test for the presence of earnings management and find that managers use the transition period to increase their reported earnings and return on assets (ROA), and to avoid reporting losses. Earnings management in the transition period is present in all countries, with the highest levels in Poland, France and Italy.

Christensen, Lee and Walker (2008) examine changes in earnings management and timely loss recognition during IFRS adoption for a sample of German firms, focusing on earnings smoothing and managing towards small positive earnings. The authors compare German firms that voluntarily adopt IFRS before 2005 (the voluntary adopters) to German firms that are forced to comply as of 2005 (the resisters). This allows them to test whether accounting quality improves when firms are forced to comply with what is generally perceived as higher quality accounting standards. Consistent with prior literature, they find that voluntary adoption of IFRS is associated with decreased earnings management and more timely loss recognition. However, they find no evidence of accounting quality improvements for firms that are forced to adopt IFRS. This leads them to conclude that the adoption of IFRS does not necessarily lead to higher quality accounting and that the flexibility offered by IFRS might render it ineffective in restricting earnings management.

Thus, the evidence to date suggests the presence of earnings management during the mandatory transition to IFRS. However, it does not provide insights into the accounting choices used to manage earnings, or the reporting incentives that drive such choices. As such, our study contributes to this stream of literature in at least three ways. First, we focus on a specific set of accounting choices, the portfolio of optional exemptions chosen by French firms, and their impact on equity rather than looking at the overall impact of the mandatory adoption of IFRS on ROA or earnings. It is important to look at the impact of the choices made on equity because IFRS 1 requires the effect of the changes in accounting policies resulting from the mandatory adoption of IFRS to be charged to equity, not earnings. Second, we identify reporting incentives likely to affect the portfolio of optional exemptions chosen by French firms rather than only testing for the presence of earnings management. Finally, we consider the impact of the optional exemptions chosen by French firms on both transition-date equity and future earnings rather than only looking at the current impact on earnings. It is important to do so because managers are not likely to ignore the impact on future earnings of the choices made when first adopting IFRS.

2.3.2 Value-Relevance and Mandatory IFRS Adoption

A second group of studies uses the first set of financial statements released by European firms under IFRS to examine the valuation effects of mandatory IFRS adoption. Horton and Serafeim (2007) examine the value relevance of the earnings and equity IFRS adjustments for a sample of UK first-time adopters. Their results indicate that the earnings reconciliation adjustment is value relevant and has incremental price relevance over and above the UK GAAP numbers. In contrast, the equity adjustment does

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not seem to be value relevant. The authors attribute this result to the fact that IFRS and UK earnings are very different and highly variable, whereas IFRS and UK equity appear to be very similar.

Capkun, Cazavan-Jeny, Jeanjean and Weiss (2008) examine the value-relevance of earnings and book values under local GAAP and IFRS for a sample of 1,528 first-time adopters across Europe. They decompose earnings and the book value of equity under IFRS into earnings and the book value of equity under local GAAP and the IFRS earnings and equity adjustments. They conduct the valuation analysis using market value four months after the transition date and and then repeat the analysis with market value four months after the 2005 fiscal year-end. Similar to Horton and Serafeim (2007), their results indicate that the earnings reconciliation adjustment is value relevant and has incremental price relevance over and above local GAAP. While the book value of equity under local GAAP is value-relevant, the equity reconciliation adjustments do not seem to be. The authors do not offer any potential explanation for this result. However, descriptive statistics indicate that earnings under local GAAP and IFRS are very different whereas local GAAP and IFRS equity appear to be quite similar.

The effect of any change in accounting policies from the first-time adoption of IFRS has to be recognized directly in equity at transition date. Thus, we investigate the value relevance of equity adjustments at transition date rather than focusing on the value relevance of earnings and equity as reported in the first IFRS financial statements. We also distinguish between mandatory and optional equity adjustments. Overall, we expect this unique approach will help us to better assess the valuation consequences of first-time adoption per se.

3. Hypotheses Development

3.1 Determinants of Optional Exemptions

French firms have the opportunity to exercise discretion when first applying IFRS because 1) IFRS 1 offers optional exemptions to the general principle of retrospective application; and 2) they can elect to use one or more exemptions. Given this opportunity, we consider three incentives for French firms to strategically elect one or more optional exemptions.

3.1.1 Offsetting Mandatory Adjustments

Optional exemptions can provide an opportunity for French firms to mitigate the impact of the mandatory equity adjustments that need to be recognized because of the first-time adoption of IFRS. The mandatory adoption of IFRS in France and the rest of Europe is often referred to as an accounting revolution (e.g. KPMG, 2006). However, Marchal, Boukari and Cayssials (2007) show that the absolute effect of the first-time adoption of IFRS on equity is less than 5% for 45% of listed French firms. Similarly, Cazavan-Jeny and Jeanjean (2007) find an average decrease in equity at transition date of only 3.5%. Both papers attribute the relatively small net impact on equity to the offsetting of equity-increasing and equity-decreasing changes in accounting policies as a result of the first-time adoption of IFRS. Cazavan-Jeny and Jeanjean (2007) further show that the impact on equity at the transition date of the optional exemptions that French firms choose to apply tends to be positive (negative) when the mandatory adjustments have a negative (positive) effect. This suggests that the observed offsetting of equity-increasing

and equity-decreasing changes in accounting policies is partly attributable to the strategic use of the optional exemptions[9]. Hence, our first research hypothesis:

H_1: *Firms are likely to choose optional exemptions that have a net negative (positive) impact on equity at the transition date to offset the positive (negative) net impact of mandatory adjustments.*

3.1.2 Trade-Off between Current Impact on Equity and Future Impact on Net Income

Most optional exemption choices made at the transition date will have an opposite impact on future net income. French firms must therefore consider the impact of optional exemptions on equity at transition date and future net income when first adopting IFRS.[10] According to Karleff (2003), the retroactive method has the potential to mute the impact of and attention paid to negative events because they are buried in the past and do not appear on the income statement. Hence, there is a perceived benefit to reporting negative events directly in equity. Optional exemptions with a negative impact on equity may also lead to an increase in future net income. A higher earnings multiple can provide an incentive for French firms to strategically elect these exemptions since they would then

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[9] It is important to test H_1 to answer our research question even though Cazavan-Jeny and Jeanjean have already investigated this effect because offsetting the effect of mandatory adjustments is likely to be one of the most significant reporting incentives when it comes to the optional exemptions offered by IFRS 1. Cazavan-Jeny and Jeanjean's analysis is mostly univariate. They also test H_1 by regressing the impact of mandatory adjustments to equity on the impact of the optional exemptions on equity, thereby treating each optional exemption as an individual choice. In contrast, we classify sample firms based on their portfolio of exemption choices. Our paper also provides a more extensive examination of the first-time adoption of IFRS by French firms as it considers both the causes and consequences of such adoption.

[10] Beatty and Weber (2006) examine SFAS 142 adoption decisions, focusing on the trade-off between recording certain current goodwill impairment charges below the line and uncertain future impairment charges included in income from continuing operations. They show that firms whose future above-the-line goodwill impairment losses are expected to be more highly capitalized by the market are more likely to record adoption write-offs, and record relatively larger charges when adopting SFAS 142. As such, their evidence suggests that firms also consider the impact of their accounting choices on future periods when making those choices.

also benefit from an increase in future share price. Hence, our second research hypothesis:

H_2:   *Firms with higher book values and higher earnings multiples are more likely to elect optional exemptions that have a net negative impact on equity at the transition date.*

3.1.3   Leverage

Debt financing generates incentives for the exercise of accounting discretion because lenders extensively rely on financial statements for the evaluation of a firm's financial standing and credit rating, and set debt covenants that need to be met to avoid debt contract violations (Watts and Zimmerman, 1990). Thus, firms that need the continuous support of their lenders are more likely to make accounting choices that enhance their profitability and reduce their leverage (DeFond and Jiambalvo, 1994). Marchal, Boukari and Cayssials (2007) show that the first-time adoption of IFRS increases leverage by more than 10% for 45% of surveyed French firms, and by more than 20% for 28% of these same firms. Mandatory adjustments such as the recognition of variable interest entities and the revaluation of hedged liabilities are the most significant sources of increases in leverage at the transition date. This can create an incentive for firms with higher leverage to choose not to implement optional exemptions that have a net negative impact on equity at the transition date to avoid further increases in leverage. As such, our third research hypothesis:

H_3:   *Firms with higher leverage are less likely to elect optional exemptions that have a net negative impact on equity at the transition date.*

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3.2   Valuation of IFRS Adjustments

It is generally believed that investors tend to place little importance on catch-up adjustments to reflect the cumulative effect of using an accounting policy for the first time (Ciesielski, 2004). Further, the retroactive method has the potential to mute the impact and attention paid to negative events because they are buried in the past and do not appear on the income statement (Karleff, 2003). In addition, frequent restatements may cause public concern over the reliability of financial statements (Eldridge, 2004). At the same time, prior research suggests that the adoption of IFRS, be it voluntary or mandatory, is perceived as a signal of an increase in the quality of accounting information, thereby increasing its association with stock prices and stock returns (e.g. Morais and Curto, 2007; Bellas, Toludas and Papadatos, 2007; Barth, Landsman and Lang, 2008).

Consistent with prior research, we expect the first-time adoption of IFRS by French firms to be perceived as a signal of an increase in the quality of the financial statements. As such, we expect mandatory and optional IFRS equity adjustments to be valued more than French GAAP equity. However, the value-relevance of optional IFRS equity adjustments is likely to be influenced by whether they result in the disclosure of new information regarding capital assets, employee benefits, cumulative translation differences, financial assets, and business combinations. Thus, we expect the option to set cumulative translation differences to zero not to be valued since this decision only leads to the reclassification of an amount already known to retained earnings. Hence, our fourth and fifth research hypotheses:

H₄: *Mandatory IFRS equity adjustments are valued more than French GAAP equity.*

H_{5a}:   *Revaluations as deemed cost are valued.*

H_{5b}:   *Cumulative actuarial gains or losses are valued.*

H_{5c}:   *Cumulative translation differences are not valued.*

H_{5d}:   *Revaluations of financial assets are valued.*

H_{5e}:   *Retrospective application of IFRS 3 is valued.*

4.   Methodology

4.1   Sample and Data

The sample selection procedure is summarized in Table 2. Sample firms were drawn from the Société des Bourses Françaises Index (SBF 120) as at December 31, 2005. To enter the sample, firms must be first-time adopters of IFRS in their 2005 financial statements. Three firms were excluded because they are reporting in US GAAP. Three firms were excluded because they were already using IFRS before 2005 (i.e. they are not first-time adopters). Finally, seven firms were excluded because they have been delisted. This results in a sample of 107 firms. Financial data was obtained from Worldscope. Information on the optional exemption choices was hand collected from the annual reports. One firm was lost because of missing data, for a final sample of 106 firms. The final sample represents 67% of the French stock market capitalization at the end of 2005.

{Insert Table 2 here}

4.2 Models and Variables

4.2.1 Determinants of Optional Exemptions

The following probit regression model is used to examine the determinants of French firms' decisions to use one or more optional exemptions when first adopting IFRS:

$$OPTEXEMP_i = \beta_0 + \beta_1 MANDADJUST_i + \beta_2 TRADEOFF_i + \beta_3 LEVERAGE_i + \beta_4 FLIST_i + \beta_5 SIZE_i + \varepsilon_i \qquad (1)$$

Where:

OPTEXEMP	=	1 if the firm elects to use only the optional exemptions with a negative impact on equity at the transition date; 0 otherwise
MANDADJUST	=	1 if the sum of the mandatory equity adjustments at the transition date is positive; 0 otherwise
TRADEOFF	=	1 if the firm's equity before optional exemptions and earnings multiple are higher than the sample median; 0 otherwise
LEVERAGE	=	Long-term debt under French GAAP at the end of 2004 divided by total assets under French GAAP at the end of 2004
FLIST	=	1 if the firm is cross-listed on a non-European stock exchange; 0 otherwise
SIZE	=	Natural logarithm of lagged total assets

We code the impact of each of the five optional exemptions on equity at the transition date to develop our dependent variable. Three variables are included in the model to proxy for incentives to strategically elect one or more optional exemptions (*MANDADJUST, TRADEOFF, LEVERAGE). MANDADJUST* differentiates between firms with net positive and net negative mandatory adjustments. If firms use the optional exemptions to offset the impact of mandatory adjustments, then *MANDADJUST* will be positively related to *OPTEXEMP*. *TRADEOFF* distinguishes between firms with equity before IFRS adjustments higher than the sample median and an earnings multiple higher than the sample median, and others. The earnings multiple is derived from the Capital

Asset Pricing Model. We calculate the expected return using the risk free rate of the European Central Bank for 2005 (3%) and the return on the SBF 120 for that same year. The earnings multiple is calculated as 1 over the expected return. Consistent with H_2, we expect *TRADEOFF* to be positively related to *OPTEXEMP*. *LEVERAGE* is calculated using French GAAP data to exclude the impact of the optional exemptions. If firms with higher leverage avoid optional exemptions with a negative impact on equity to prevent further increases in leverage, then *LEVERAGE* will be negatively related to *OPTEXEMP*.

Finally, two control variables are included in the model (*FLIST*, *SIZE*). French firms that list on foreign stock exchanges increase their reliance on international investors for financing and valuation. Foreign listing also results in increased analyst following and monitoring of managers' accounting decisions. As such, it could influence their choice of optional exemptions. In the context of positive accounting theory, firm size is posited to proxy for political costs faced by a firm (Watts and Zimmerman, 1978). A consistent result across many positive accounting studies is the influence of size in the determination of a firm's accounting policies (Watts and Zimmerman, 1990). Again, this suggests that firm size could influence French firms' choices of optional exemptions. However, we do not make any directional prediction for *FLIST* and *SIZE*. [11]

4.2.2   Valuation of IFRS Adjustments

The following ordinary least squares regression model is used to examine the value-relevance of IFRS adjustments for French firms that adopt IFRS for the first time:

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[11]Executive compensation could be considered a potential incentive for French firms to strategically elect one or more exemptions. When we add CEO compensation (salary + bonus) as an independent variable in the determinants model, the coefficient is not significant and our other results remain unchanged.

$$MTB_i = \beta_0 + \beta_1 INEQUITY_i + \beta_2 ADJBV_i + \beta_3 MANDIFRS_i + \beta_4 REVAL_i + \beta_5 EBEN_i +$$

$$\beta_6 TRANSDIFF_i + \beta_7 FININSTR_i + \beta_8 BUSCOMREM_i + \beta_9 RESEPS_i + \varepsilon_i \qquad (2)$$

Where:

MTB	=	Closing share price three months after the end of the adoption year divided by book value of equity per share the end of t-1
INEQUITY	=	1/ book value of equity per share at the end of t-1
ADJBV	=	Book value per share minus the cumulative effect of the mandatory and optional IFRS adjustments per share divided by book value of equity per share at the end of t-1
MANDIFRS	=	Cumulative effect of the mandatory IFRS adjustments per share divided by book value of equity per share at the end of t-1
REVAL	=	Effect of revaluation as deemed cost exemption per share divided by book value of equity per share at the end of t-1
EBEN	=	Effect of employee benefits exemption per share divided by book value of equity per share at the end of t-1
TRANSDIFF	=	Effect of cumulative translation difference exemption per share divided by book value of equity per share at the end of t-1
FININSTR	=	Effect of designation of previously recognized financial instruments exemption per share divided by book value of equity per share at the end of t-1
BUSCOMREM	=	Effect of retrospective application of IFRS 3 per share divided by book value of equity per share at the end of t-1
RESEPS	=	Residual earnings per share for the adoption year divided by book value of equity per share at the end of t-1

Our model is based on Amir and Lev (1996) and Collins, Pincus and Xie (1999). However, previous research by Brown, Lo, and Lys (1999) argues that there is a problem with an omitted correlated variable, the scale factor, in this model. Therefore, similar to Lang, Raedy, and Yetman (2003) and Barth, Landsman, and Lang (2008), we scale all variables by book value per share at the end of t-1. We calculate Cook's D statistic and exclude all observations with D > 1. The regression is then re-estimated with the coefficient tests being based on White's t-statistics. This approach is similar to Aboody, Barth and Kasznik (2004). The valuation model is altered to separate the cumulative effect of mandatory adjustments and the individual effect of each optional exemption

from the book value of equity. Thus, *ADJBV* captures the book value of equity under French GAAP. Consistent with prior research, we expect *ADJBV* to be positively related to share price. We also expect mandatory IFRS adjustments (*MANDIFRS*) to be positively related to share price. We use a test of equality of coefficients to test for H_4. Consistent with H_{5a}, H_{5b} and H_{5d}, we expect *REVAL*, *EBEN* and *FININSTR* to be positively related to share price. Consistent with H_{5c}, we expect the coefficient on *TRANSDIFF* not to be significantly related to share price. Finally, consistent with prior research, we expect *RESEPS* to be positively associated with share price. Residual earnings per share are calculated using a fixed cost of capital of 9% (the risk-free rate of the European Central Bank for 2005 (3%) plus a risk premium of 6%) for all sample firms. This approach is similar to the one used by Bernard (1995) and Ball, Kothari and Robin (2000).

4.   Results

4.1   Descriptive Statistics

Table 3 summarizes the classification procedure used to code the dependent variable in Model 1. Our analysis of the disclosures related to the impact of the optional exemptions in the annual report reveals that: 1) 21 firms revalued their capital assets upwards; 2) 80 firms charged unrecognized actuarial losses to equity; 3) 83 firms transfered cumulative translation losses to retained earnings; 4) 50 firms revalued their financial assets upwards; and 5) 7 firms applied IFRS 3 retrospectively to all their business combinations. None of our sample firms revalued their capital assets or financial assets downwards, or reported unrecognized actuarial gains. Only 4 firms showed cumulative translation gains.

Based on these statistics, we consider that two of the optional exemptions have a negative impact on equity (employee benefits and cumulative translation differences) and three have a positive impact on equity (fair value or revaluation as deemed cost, the designation of previously recognized financial instruments, and business combinations). We then classify sample firms based on their portfolio of exemption choices. We distinguish between firms that choose only exemptions with a negative impact on equity (42 firms), and others (64 firms). Our dependent variable is coded accordingly.

Among the 42 firms that only chose optional exemptions with a negative impact on equity, 4 firms only chose to use the exemption related to employee benefits, 10 firms only chose to use the exemption related to cumulative translation differences and 28 firms chose to use both exemptions. Among the 64 other firms, 8 firms chose to revalue their capital assets upwards, 36 firms chose to designate previously recognized financial instruments and 2 firms chose to apply IFRS 3 retrospectively. Five firms chose to both designate previously recognized financial instruments and apply IFRS 3 retrospectively. Finally, 13 firms chose to both revalue their capital assets upwards and designate previously recognized financial instruments.

{Insert Table 3 here}

Table 4 presents mean and median values for the variables included in the regression models for firms that elect optional exemptions with a negative impact on equity at transition date (N = 42), other firms (N = 64) and all sample firms (N = 106). We use tests of differences in means and medians to compare the behaviour of the two groups and provide univariate evidence to support our research hypotheses. Consistent with H_1, a higher proportion of firms that elected optional exemptions with a negative

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impact on equity at the transition date report mandatory equity adjustments with a positive impact on equity, and the difference in means is significant ($p < 0.077$). Consistent with H_2, a higher proportion of firms that chose optional exemptions with a negative impact on equity at transition date have higher than median book values and earnings multiples, and the differences in means and medians are significant ($p < 0.012$ and $p < 0.020$). Finally, consistent with H_3, firms that elect for optional exemptions with a negative impact on equity at the transition date have lower leverage and the difference in means is significant ($p < 0.021$).

Firms that elect exemptions with a negative impact on equity at the transition date report higher cumulative translation losses on average ($p < 0.014$), but lower revaluations of capital assets ($p < 0.056$ and $p < 0.018$) and financial assets ($p < 0.173$ and $p < 0.002$), a finding that is consistent with the criteria used to classify sample firms in the first place. They are less likely to be cross-listed on a non-European stock exchange ($p < 0.002$ and $p < 0.003$), are larger ($p < 0.025$), have a lower share price ($p < 0.040$ and $p < 0.017$), report higher equity under French GAAP ($p < 0.006$ and $p < 0.011$), and are more profitable ($p < 0.050$).

The net impact of the first-time adoption of IFRS on equity at the transition date is relatively small on average (€0.46 per share as compared to equity under French GAAP of €24.46 per share) (untabulated). This suggests that the effect of mandatory IFRS equity adjustments is offset by the use of optional exemptions, a finding that is consistent with the results of Marchal, Boukari and Cayssials (2007) and Cazavan-Jeny and Jeanjean (2007). It also provides univariate support for H_1.

{Insert Table 4 here}

Table 5 presents Pearson correlations between the variables included in the regression models. In Panel A, it can be observed that *OPTEXEMP* is positively correlated with *TRADEOFF* (ρ = 0.219) and negatively correlated with *LEVERAGE* (ρ = -0.203). The latter results are consistent with H_2 and H_3. *OPTEXEMP* is also negatively correlated with *FLIST* (ρ = -0.286). In Panel B, none of the correlations between *PRICE*, *REVAL*, *EBEN*, *TRANSDIFF, FINISTR* and *BUSCOMREM* is significant. Overall, however, the univariate evidence is largely consistent with our predictions.

{Insert Table 5 here}

4.2 Determinants of Optional Exemptions

Table 6 presents the result of the binary probit regression examining the determinants of French firms' decisions to elect one or more optional exemptions when first adopting IFRS. The model is significant (p < 0.000) with a pseudo R^2 of 26.8%. Consistent with H_1, the coefficient on *MANDADJUST* is positive and significant (0.782; p < 0.05). This suggests that French firms use optional exemptions to offset the impact of mandatory IFRS equity adjustments on equity at transition date. The coefficient on *TRADEOFF* is also positive and significant (0.701; p < 0.01). Consistent with H_2, this indicates that firms with higher book values and higher earnings multiples are more likely to elect optional exemptions that have a negative impact on equity at the transition date. Thus, French firms seem to consider the impact of optional exemptions on equity at the transition date and future net income when first adopting IFRS. Consistent with H_3, the coefficient on *LEVERAGE* is negative and significant (-3.518; p < 0.01). This shows that firms with higher leverage are less likely to elect optional exemptions with a negative impact on equity at the transition date, potentially to avoid further increases in leverage

from the first-time adoption of IFRS. The coefficient on *FLIST* is negative and significant

(-1.932; p < 0.01), suggesting that French firms cross-listed on a non-European stock

exchange are less likely to elect optional exemptions with a negative impact on equity at

the transition date. Finally, the coefficient on *SIZE* is positive and significant (0.315; p <

0.01). This indicates that larger firms are more likely to choose optional exemptions with

a negative impact on equity at the transition date.

{Insert Table 6 here}

4.3   Valuation of IFRS Adjustments

Table 7 presents the results of the ordinary least squares regression examining the

value-relevance of IFRS equity adjustments for French firms that adopt IFRS for the first

time. The model is significant (p < 0.000) with an R^2 of 47.8%. Consistent with our

expectations, *ADJBV* (1.587; p < 0.01) and *RESEPS* (11.092; p < 0.01) are positively

associated with share price, and the associations are significant. Mandatory IFRS

adjustments per share (*MANDIFRS*) are also positively associated with share price and

the association is significant (1.745; p < 0.01). Consistent with H_4, the test of equality of

coefficients between *ADJBV* and *MANDIFRS* is not significant (*ADJBV – MANDIFRS* =

0; F = 0.95; p < 0.33). This suggests that mandatory IFRS adjustments per share contain

significantly more information content than French GAAP equity, and that the first-time

adoption of IFRS by French firms is perceived as a signal of an increase in the quality of

the financial statements.

Consistent with H_{5a}, *REVAL* is positive and marginally significant (1.575; p <

0.10). This indicates that investors incorporate the new information on the fair value of

capital assets into their valuation assessments. Consistent with H_{5b}, *EBEN* is positive and

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significant (2.244; p < 0.01). This indicates that investors incorporate the new

information on the value of the net pension obligation into their valuation assessments

(i.e. actuarial gains valued positively and actuarial losses valued negatively). Consistent

with H$_{5e}$, *BUSCOMREM* is positive and significant (2.731; p < 0.01). This indicates that

investors incorporate the new information on prior business combinations into their

valuation assessments. Contrary to our expectation, *FININSTR* is negative and not

significant (-23.761; p> 0.10). Nevertheless, our evidence suggests that investors do not

question the reliability of the measurement of the fair value of capital assets, the pension

obligation, and the new information on prior business combinations, perhaps as a

reflection of the fact that they are based on expert reports. Finally, H$_{5c}$ is supported as

TRANSDIFF is negative but not significant (-1.422; p > 0.10). The decision to reset

cumulative translation losses to zero does not have any impact on equity. It only leads to

the reclassification of an amount already known to retained earnings.

<div align="center">{Insert Table 7 here}</div>

4.4   Sensitivity Analyses

　　　We conduct supplementary tests to provide additional support for our results.

First, we exclude sixteen financial firms from our sample and repeat our analyses.

Financial firms are subject to specific regulation that may influence their accounting

choices. Furthermore, their leverage ratio is likely to differ from that of industrial firms.

Results (untabulated) are not affected by the exclusion of financial firms. Second, we add

controls for growth (Tobin's Q) and industry and repeat our analyses. Results

(untabulated) remain unchanged. Finally, we repeat our valuation analysis by running

separate regressions for each optional exemption. Results (untabulated) are not affected.

5. Conclusion

This paper investigates whether and how managerial incentives influence the decision to elect optional exemptions when first adopting International Financial Reporting Standards (IFRS). It also examines the value-relevance of the mandatory and optional equity adjustments that need to be recognized in connection with the first-time adoption of IFRS. Both questions are addressed in the context of the mandatory adoption of IFRS by French firms in 2005. Three major findings emerge from our analyses. First, managerial incentives influence the decision to strategically elect one or more optional exemption choices at the transition date. Second, mandatory equity adjustments are more valued than French GAAP equity, suggesting that the first-time adoption of IFRS by French firms is perceived as a signal of an increase in the quality of the financial statements. Third, the value-relevance of optional IFRS equity adjustments depends on whether they result in the disclosure of new information regarding capital assets, employee benefits, cumulative translation differences, financial assets, and business combinations.

We contribute to the literature on the determinants of mandatory accounting changes by studying factors affecting the decision to simultaneously elect up to five optional exemptions when first adopting a new set of GAAP, IFRS, rather than focusing on individual changes within a specific set of accounting standards. We contribute to the literature related to the determinants and consequences of IFRS adoption by examining the causes and consequences of the individual exemption choices made at the transition date, rather than considering the adoption per se as the choice. Finally, we contribute to the literature on the valuation effects of mandatory IFRS adoption by investigating the

value relevance of equity adjustments at transition date rather than focusing on the value relevance of earnings and equity as reported in the first IFRS financial statements. We also distinguish between mandatory and optional equity adjustments.

Our results must be interpreted with caution for a number of reasons. First, the power of our empirical analyses is limited because of the small size of our sample. Second, our analysis is restricted to French firms and does not include firms from other European countries. Third, our analysis of the determinants of the optional exemption choices is based on the observed portfolio of choices made by French firms. Overall, this could reduce the external validity of our results and create a self selection bias. In addition, the exclusion of delisted companies could introduce a survival bias. Finally, pricing mechanisms and the information environment differ across firms and countries. Value relevance studies using stock price as a parsimonious measure to capture all public information in the market, such as ours, may suffer from a correlated omitted variable problem because stock prices may incorporate information in a different manner across firms (Soderstrom and Sun, 2007).

Future research may be needed to compare how the managerial incentives that influence the decision to elect optional exemptions differ across countries that mandatorily adopt IFRS. It would also be interesting to investigate whether the value-relevance of mandatory and optional equity adjustments is influenced by country-specific factors.

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Table 1
Optional Exemptions

	Optional Exemption
Fair Value or Revaluation as Deemed Cost	Choice to measure individual items of property, plant and equipment at fair value at the date of transition to IFRS and to use that fair value as its deemed cost at that date. First-time adopters that choose to use the exemption do not have to use the revaluation model in future periods.
Employee Benefits	Choice to calculate the net pension obligation at the transition date without consideration of the corridor approach. First-time adopters can eliminate unrecognized actuarial gains and losses by charging them to equity in the opening IFRS balance sheet.
Cumulative Translation Differences	Choice not to calculate the cumulative translation difference retrospectively and to set the cumulative translation difference calculated in accordance with previous GAAP to zero. Only translation differences that arose after the date of transition to IFRS are recognized in future net income if the foreign operation is subsequently disposed of.
Designation of Previously Recognized Financial Instruments	Choice to designate previously recognized financial assets as "as at fair value through profit or loss" or as "available-for-sale" at the transition date.
Business Combinations	Choice not to account for a business combination prior to the transition date in accordance with IFRS 3. First-time adopters that elect to account for past business combinations in accordance with IFRS 1 do not have to reclassify them (i.e. pooling of interests method can be maintained); they do not have to remeasure original fair values determined at the time of the business combination; and they do not have to adjust the carrying amount of goodwill recognized under previous GAAP.

Table 2
Sample Selection[1]

French firms included in the SBF 120 at December 31, 2005	120
(-) firms reporting in US GAAP	(3)
(-) foreign firms already reporting in IFRS before 2005 because they were not subject to French GAAP	(3)
(-) firms that were delisted	(7)
First-time adopters of IFRS for 2005 financial statements listed on the SBF 120	107
(-) firms with incomplete financial data	(1)
Final sample	**106**

(1) This table summarizes the sample selection procedure.

Table 3
Classification Procedure[1]

Negative Impact on Equity (n = 42)		Other (n = 64)	
Employee benefits only	4	Fair value or revaluation as deemed cost	8
Cumulative translation differences only	10	Designation of previously recognized financial instruments	36
Both	28	Retrospective application of IFRS 3	2
		Fair value or revaluation as deemed cost **and** designation of previously recognized financial instruments	13
		Designation of previously recognized financial instruments **and** retrospective application of IFRS 3	5
Total	42	Total	64

(1) This table summarizes the classification procedure used to code the dependent variable.

Table 4
Descriptive Statistics[1]

Variable [2]	Negative (N: 42)		Other (N: 64)		Both (N: 106)		Test of differences	
	Mean	**Median**	**Mean**	**Median**	**Mean**	**Median**	**Means** $P > \lvert t \rvert$	**Medians** $P > \lvert X \rvert$
MANDADJUST	0.79	1	0.66	1	0.71	1	0.077	0.256
TRADEOFF	0.40	0	0.20	0	0.28	0	0.012	0.020
LEVERAGE	0.12	0.12	0.18	0.15	0.16	0.14	0.021	0.112
FLIST	0.07	0	0.32	0	0.21	0	0.002	0.003
SIZE	23.19	22.85	22.37	22.49	22.66	22.53	0.025	0.233
PRICE	92.63	64.35	54.42	42.79	69.69	45.83	0.040	0.017
ADJBV	39.80	22.61	15.63	13.43	24.73	16.06	0.006	0.011
RESEPS	1.70	0.94	0.68	0.74	1.08	0.62	0.050	0.112
MANDIFRS	6.93	0.84	3.95	0.35	5.05	0.61	0.248	0.254
REVAL	0.00	0	0.42	0	0.26	0	0.056	0.018
EBEN	-1.50	-0.22	-0.92	-0.09	-1.14	-0.11	0.184	0.682
TRANSDIFF	-1.76	0	-0.43	0	-0.96	0	0.014	0.362
FININSTR	0.00	0	0.21	0	0.13	0	0.173	0.002
BUSCOMREM	0.00	0	0.39	0	0.23	0	0.480	0.061
TOTAL OPTIONAL EXEMPTIONS	-3.39	-1.05	-0.12	-0.12	-1.36	-0.42	0.003	0.017

(1) This table presents mean and median values for the variables included in the regression models. Sample firms are divided among those that elect for optional exemptions with a negative impact on equity at transition date (N= 42) and others (N = 64). Tests of differences in means and medians are used to compare the two groups. Mean and median values are also reported for the full sample (N = 106).

(2) Variable definitions:

MANDADJUST	=	1 if the sum of the mandatory equity adjustments at transition date is positive; 0 otherwise
TRADEOFF	=	1 if the firm's equity before optional exemptions and earnings multiple are higher than the sample median; 0 otherwise
LEVERAGE	=	Long-term debt under French GAAP at the end of 2004 divided by total assets under French GAAP at the end of 2004
FLIST	=	1 if the firm is cross-listed on a non-European stock exchange; 0 otherwise
SIZE	=	Natural logarithm of lagged total assets
PRICE	=	Closing share price three months after the end of the adoption year
ADJBV	=	Book value per share minus the cumulative effect of the mandatory and optional IFRS adjustments per share
RESEPS	=	Residual earnings per share for the adoption year
MANDIFRS	=	Cumulative effect of the mandatory IFRS adjustments per share
REVAL	=	Effect of revaluation as deemed cost exemption per share
EBEN	=	Effect of employee benefits exemption per share
TRANSDIFF	=	Effect of cumulative translation difference exemption per share
BUSCOMREM	=	Effect of retrospective application of IFRS 3 per share
FININSTR	=	Effect of designation of previously recognized financial instruments exemption per share

Table 5
Correlations[1]

Panel A – Determinants of Optional Exemptions

	Variable[2]	(1)	(2)	(3)	(4)	(5)	(6)
(1)	OPTEXEMP	1.000	0.139	0.219*	-0.203*	-0.286*	0.191
(2)	MANDADJUST		1.000	-0.001	0.048	0.021	-0.060
(3)	TRADEOFF			1.000	0.129	-0.083	0.072
(4)	LEVERAGE				1.000	0.058	0.073
(5)	FLIST					1.000	0.336*
(6)	SIZE						1.000

Panel B – Valuation of IFRS Adjustments

	Variable[2]	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
(1)	PRICE	1.000	0.123	0.107	0.011	0.055	-0.181	0.006	0.021	0.213*
(2)	ADJBV		1.000	-0.544*	-0.095	-0.245*	-0.264*	-0.163	-0.025	0.096
(3)	MANDIFRS			1.000	*0.235	-0.132	-0.230*	0.555*	-0.168	0.177
(4)	REVAL				1.000	0.026	0.092	0.472*	-0.032	0.015
(5)	EBEN					1.000	0.067	0.028	0.041	-0.016
(6)	TRANSDIFF						1.000	0.065	0.038	0.053
(7)	FININSTR							1.000	-0.016	0.027
(8)	BUSCOMREM								1.000	-0.033
(9)	RESEPS									1.000

(1) This table presents pairwise correlations between variables included in the regression models. * denotes significance at the 5% level.

(2) Variable definitions:

OPTEXEMP	=	1 if the firm elects to only use the optional exemptions with a negative impact on equity at transition date; 0 otherwise
MANDADJUST	=	1 if the sum of the mandatory equity adjustments at transition date is positive; 0 otherwise
TRADEOFF	=	1 if the firm's equity before optional exemptions and earnings multiple are higher than the sample median; 0 otherwise
LEVERAGE	=	Long-term debt under French GAAP at the end of 2004 divided by total assets under French GAAP at the end of 2004
FLIST	=	1 if the firm is cross-listed on a non-European stock exchange; 0 otherwise
SIZE	=	Natural logarithm of lagged total assets
PRICE	=	Closing share price three months after the end of the adoption year
ADJBV	=	Book value per share minus the cumulative effect of the mandatory and optional IFRS adjustments per share
RESEPS	=	Residual earnings per share for the adoption year
MANDIFRS	=	Cumulative effect of the mandatory IFRS adjustments per share
REVAL	=	Effect of revaluation as deemed cost exemption per share
EBEN	=	Effect of employee benefits exemption per share
TRANSDIFF	=	Effect of cumulative translation difference exemption per share
BUSCOMREM	=	Effect of retrospective application of IFRS 3 per share
FININSTR	=	Effect of designation of previously recognized financial instruments exemption per share

Table 6
Determinants of Optional Exemptions[1]

Variable[2]	Predicted Sign	Coefficient
MANDADJUST	+	0.782**
TRADEOFF	+	0.701***
LEVERAGE	-	-3.581***
FLIST	?	-1.932***
SIZE	?	0.315***
Wald Chi2		28.07
(p-value)		(0.000)
Pseudo R^2		26.8%

*: $p < 0.10$; **: $p < 0.05$; ***: $p < 0.01$. One-tailed if directional prediction, two-tailed otherwise.

(1) This table presents the results of the binary probit regression examining the determinants of French firms' decision to use one or more optional exemptions when first adopting IFRS. Parameter estimates are based on the following model: $OPTEXEMP_i = \beta_0 + \beta_1 MANDADJUST_i + \beta_2 TRADEOFF_i + \beta_3 LEVERAGE_i + \beta_4 FLIST_i + \beta_5 SIZE_i + \varepsilon_i$

(2) Variable definitions:

OPTEXEMP	=	1 if the firm elects to only use the optional exemptions with a negative impact on equity at transition date; 0 otherwise
MANDADJUST	=	1 if the sum of the mandatory equity adjustments at transition date is positive; 0 otherwise
TRADEOFF	=	1 if the firm's equity before optional exemptions and earnings multiple are higher than the sample median; 0 otherwise
LEVERAGE	=	Long-term debt under French GAAP at the end of 2004 divided by total assets under French GAAP at the end of 2004
FLIST	=	1 if the firm is cross-listed on a non-European stock exchange; 0 otherwise
SIZE	=	Natural logarithm of lagged total assets

Table 7
Valuation of IFRS Adjustments[1]

Variable[2]	Predicted Sign	Coefficient
INEQUITY	+	7.236***
ADJBV	+	1.587***
MANDIFRS	+	1.745***
REVAL	+	1.575*
EBEN	+	2.244***
TRANSDIFF	-	-1.422
FININSTR	+	-23.761
BUSCOMREM	+	2.731***
RESEPS	+	11.092***
F statistic		19.37
(p-value)		(0.000)
R^2		47.8%
Test of equality of coefficients ($\beta_2 = \beta_3$)		
F statistic		0.95
(p-value)		(0.330)

*: $p < 0.10$; **: $p < 0.05$; ***: $p < 0.01$. One-tailed if directional prediction, two-tailed otherwise.

(1) This table presents the results of the ordinary least squares regression model examining the value-relevance of IFRS adjustments for French firms that first adopt IFRS. Parameter estimates are based on the following model: $MTB_i = \beta_0 + \beta_1 INEQUITY_i + \beta_2 ADJBV_i + \beta_3 MANDIFRS_i + \beta_4 REVAL_i + \beta_5 EBEN_i + \beta_6 TRANSDIFF_i + \beta_7 FININSTR_i + \beta_8 BUSCOMREM_i + \beta_9 RESEPS_i + \varepsilon_i$

(2) Variable definitions:

MTB	=	Closing share price three months after the end of the adoption year divided by book value of equity per share at the end of t-1
INEQUITY	=	1 / book value of equity per share at the end of t-1
ADJBV	=	Book value per share minus the cumulative effect of the mandatory and optional IFRS adjustments per share divided by book value of equity per share at the end of t-1
MANDIFRS	=	Cumulative effect of the mandatory IFRS adjustments per share divided by book value of equity per share at the end of t-1
REVAL	=	Effect of revaluation as deemed cost exemption per share divided by book value of equity per share at the end of t-1
EBEN	=	Effect of employee benefits exemption per share divided by book value of equity per share at the end of t-1
TRANSDIFF	=	Effect of cumulative translation difference exemption per share divided by book value of equity per share at the end of t-1
FININSTR	=	Effect of designation of previously recognized financial instruments exemption per share divided by book value of equity per share at the end of t-1
BUSCOMREM	=	Effect of retrospective application of IFRS 3 per share divided by book value of equity per share at the end of t-1
RESEPS	=	Residual earnings per share for the adoption year divided by book value of equity per share at the end of t-1