ISBN: 978-605-307-685-8

Earnings Management to Exceed Earnings Benchmarks Conditioned on Revenue Surprises: Testing by Multinomial Logit Model

Dong Hyun Son[1]

ABSTRACT

The objective of this paper is to examine whether revenue surprises can affect management's incentive to manipulate their reported earnings to meet or exceed analysts' earnings forecasts. More specifically, this paper tests whether managers would be more likely to manage earnings upward to achieve market expectations of earnings depending on the signal of revenue surprises. Our empirical analysis using the multinomial logit model shows that managers have the higher likelihood of earnings management to have positive earnings surprises under positive revenue surprises. More importantly, our further analysis considering all possible situations (R+E+, R+E-, R-E+, R-E-) provides evidence that firms have the strongest incentives to increase their earnings to meet or beat analysts' earnings forecasts when they have negative unexpected revenue. These results are consistent with prior research that the major purpose of aligning earnings with market expectations is to avoid asymmetrical negative market responses associated with missing the expected earnings.

Keywords: Earnings Management; Analysts' Earnings Forecasts; Revenue Surprises; Earnings Surprises; Multinomial Logit Model

[1] Hankuk University of Foreign Studies

DOI: 10.19275/RSEPCONFERENCES101