



## THE IMPACT OF EARNINGS FORECASTS IN EUROPEAN NATIONS

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### ABSTRACT

*This study provides empirical evidence regarding the credibility of management forecasts of earnings during differing economic cycles, namely, economic expansion, and economic contraction for a sample of firms from nine European countries. Past research on earnings forecasts assess the forecast over time periods which do not consider the effects of the economic cycle on the forecast. In addition, these studies focus almost entirely on U.S. firm forecasts. This study is the first to attempt to assess any possible distinction between U.S. and European firm forecasts. Bias results indicate that during periods of economic expansion and contraction, European managers exert greater downwards earnings management on the forecast (relative to actual earnings) Information content results indicate the presence of information content in management forecasts during both economic expansion and contraction periods. European firms' forecasts tend to exhibit a positive enhancing signal to users during both times of economic expansion and economic contraction.*

**KEYWORDS:** *Accounting, Forecasts, Security Markets*

### INTRODUCTION

Discussions between the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) continue. Although FASB and IASB continue to move away from full convergence (Fitch Ratings Report, July 2014), there are areas where convergence continues on track. New revenue recognition standards, which converge with International Financial Accounting Standards (IFRS), are scheduled to take effect for accounting periods beginning on or after January 1, 2017, with early application permitted (Fitch Rating Report, July 2014). For many companies, the new rules will affect the timing of revenue recognition, and have the potential to make earnings less consistent over time. Some speculate that this new approach to revenue recognition may even affect the composition and release of voluntary earnings reports (Fogarty and Rogers, 2014).

Although U.S. Generally Accepted Accounting Principles (GAAP) may not be in line for full convergence with IFRS, we see the U.S. taking small steps that bring the two much closer. As this happens, there is also renewed focus on the importance of earnings forecasts, i.e., what they contain, how often they are released, and if European

IFRS-based voluntary earnings releases contain similar information content as shown in U.S. forecasts from prior literature.

Because of the global economy in which American companies operate, and American investors invest, managers and investors alike are facing uncertainty and risk. A way of minimizing this risk is through voluntary forecast information. Since U.S. public companies are required to release earnings performance data within 45 days after their year-end, this data is old and often times not as meaningful as forward-looking information. European firms also follow a similar release timeframe. It therefore behooves investors to search out forecast information to enhance the decision-making process. The purpose of this study is to assess the European voluntary earnings release environment. This becomes a significant issue as globalization and alignment between U.S. and European firms takes place through convergence of GAAP and IFRS.

### LITERATURE REVIEW

There are many similarities in the economic conditions in which European and U.S. firms operate. All countries included in this study have developed economies and a high degree of economic



interdependence. So there is broad homogeneity between economic and social conditions in which the firms conduct business.

The justification for this type of research is, first and foremost, the importance of earnings forecasts to securities market practices. Forecasts are essentially produced for market participants. UK, German and Dutch studies have found that forecasts of earnings per share (EPS) are an important factor in share appraisal methods (Arnold and Moizer, 1984; Vergossen, 1993; and Pike, 1993). In many cases EPS forecasts are a crucial component of stock selection models. Further evidence of the value of EPS forecasts is the amount of time and effort dedicated to producing such forecasts by commercially oriented analysts and brokers (Capstaff, 1995).

In their analysis of U.S. consensus forecasts from 1974-1991, Dreman and Berry (1995) argued that average forecast errors are too large for investors to rely on their predictions, and only a small percentage of forecasts fall within a range considered acceptable to investors. Brown (1996) countered this interpretation by citing the overwhelming evidence that forecasts almost always provide the best available estimates when they are quarterly point forecasts. Therefore, forecasts might be used to devise profitable trading strategies by investors.

Accounting practices also affect the forecast information available. Rees (1998) reports a comparison of seven accounting measurement issues across fourteen European countries. In only two pairs, Sweden and Norway, and Ireland and the UK, do countries use the same practices across the full set. It is apparent that even after the completion of the European Union (EU) harmonization effort, substantive differences in disclosure and measurement practices still exist within EU countries (a major reason why FASB is reluctant to commit to full convergence). Alford (1993) finds that only Ireland, the Netherlands and the UK have accounting systems which are relatively free from the influence of taxation. In other European countries, managers have an incentive to manage earnings downward to minimize taxes.

The quality of disclosure in accounting statements can be expected to affect forecast accuracy. This has been demonstrated with regard to segment reporting (Baldwin, 1984; Hopwood, 1982), while Lang and Lundholm (1996) provide evidence that forecasts are more accurate for firms with more

informative disclosure policies. Saudagaran and Biddle (2002) provide a ranking of effectiveness and rank the top nine European countries with the highest quality of disclosure. Basau (2006) confirms that forecasts emanating from these countries possess fewer forecast errors than other European countries with less informative financial disclosure. These nine countries are used as the basis for assessing European earnings forecasts and they are listed in Table 1 below.

Table 1: List of European Countries Contained in the Study

Country
1. Belgium
2. France
3. Germany
4. Ireland
5. Italy
6. Netherlands
7. Spain
8. Switzerland
9. United Kingdom

Table 1 lists the European countries with the highest degree of disclosure information as determined by Saudagaran and Biddle (2002)

Some extant research concludes that earnings forecasts may be less beneficial during unsettled economic periods (Miller, 2009), and as a result fewer may be issued during such periods. Other literature concludes that earnings forecasts help to cut through the fog of economic uncertainty (Anilowski et al, 2010) and are encouraged to assist users particularly during such periods. An analysis of the Institutional Brokers Estimate System (IBES) and Worldscope Data was made for the years 2003-2012 in an attempt to determine the number of quarterly forecasts recorded during this timeframe, which includes both periods of economic expansion (2003-2007), and periods of economic contraction (2008-2012). Results are shown in Table 2.

Table 2: Quarterly Firm Point Forecasts by Sample Group

Year	European Firm Forecasts
2003	318
2004	314
2005	389
2006	362



2007	371
2008	328
2009	340
2010	337
2011	352
2012	361

Table 2 indicates the numbers of quarterly earnings forecasts made by European firms from 2003 through 2012, as reported by IBES and Worldscope Data..

As can be seen from Table 2, there appears to be no discernible drop-off in the number of voluntary earnings forecasts during the economic crisis of 2008-2012, versus the economic expansion period of 2003-2007. Having demonstrated this, the next step is to ascertain whether or not there are any inherent differences in the quality of the earnings forecast with respect to bias and information content during economic downturn periods (2008-2012) and economic growth periods (2003-2007).

Prior research in the study of U.S. voluntary earnings forecasts finds that managers release information that is unbiased relative to subsequently revealed earnings and that tends to contain more bad news than good news (Baginski et al, 1994; Frankel, 1995). Such releases are also found to contain information content (Patell, 1976; Waymire, 1984; Pownell and Waymire, 1989). Although forecast release is costly, credible disclosure will occur if sufficient incentives exist. These incentives include bringing investor/manager expectations in line (Ajinkya and Gift, 1984), removing the need for expensive sources of additional information (Diamond, 1985), reducing the cost of capital to the firm (Diamond and Verrechia, 1987), and reducing potential lawsuits (Lees, 1981).

All of the aforementioned empirical studies have common characteristics, they assess voluntary earnings forecasts irrespective of economic climate (i.e., during both economic expansions and contractions), and they assess only U.S. firm forecasts. The research questions addressed in this study are: What characteristics do firms' voluntary earnings forecasts for selected European countries possess, and; Do these characteristics change with the economic environment? These questions link earnings management to voluntary disclosures of earnings. For several years researchers have found that some degree of earnings management may exist in mandatory earnings disclosures. I argue that

incentives leading to earnings management may manifest in voluntary disclosures as well. If the potential exists for voluntary disclosures to be managed, then to what extent do investors rely upon the forecast information, and how does this information content affect forecasts for European firms?

In addressing these research questions, I rely upon literature that indicates potential earnings management during periods with differing incentive structures. DeAngelo (1986) shows that managers have incentives during management buyouts to manage earnings downward in attempt to reduce buyout compensation. Collins and DeAngelo (1990) indicate that earnings management occurs during proxy contests, and market reaction to earnings during these contests is different than during non-contest periods. DeAngelo (1990) finds that managers have incentives during merger activities to manage earnings upward so as to convey to current stockholders that the potential merger will not adversely affect their investment. Perry and Williams (1994) find that management of accounting earnings occurs in the year preceding "going private" buyouts. Stunda (1996) finds that managers exert greater upward earnings management during mergers and acquisitions. And Stunda (2003) finds greater earnings management when a firm is under Chapter 11 protection.

This study assesses any differences that economic environment may have on management forecast credibility of European firms. It also assesses any effects that may be present in information content on the voluntary forecast of these firms during changing economic periods. In accomplishing this, the presence of earnings forecast management is tested by using bias measures along with the market reaction to the forecasts. The study focus is on firm forecasts during a period of relative economic expansion (2003-2007) versus firm forecasts during a period of relative economic contraction (2008-2012). Based upon statistical analysis, conclusions are reached that identify whether or not economic environment is a factor that has the potential for influencing European voluntary earnings forecasts. The results have implications for both U.S. and European investors and potential investors alike.



**HYPOTHESES DEVELOPMENT**

**Hypotheses about bias of management forecast**

As previously noted, most past studies of voluntary earnings forecasts do not find evidence of bias in such disclosures. These studies of management forecasts must be considered along with the earnings management literature. For instance, voluntary disclosures facilitate additional information to the investor at a lower acquisition cost. However, if only partial communication flows from management to investors and acquiring full information is costly, there exists asymmetric information and the potential for earnings management of the forecast.

If the same degree of earnings management (whether positive or negative) exists in both the forecast of earnings and actual earnings, the expectation is that there would be no difference in forecast error. If, however, the ability to perform earnings management is anticipated but not realized, some difference of forecast error would be present. If greater upward earnings management of the forecast occurs (or less actual earnings management), a negative forecast error should exist. If greater downward earnings management of the forecast occurs (or less actual earnings management), a positive forecast error should result. Thus, the first hypothesis tests for the existence of forecast error. The null hypothesis tested is:

*H1: Average management forecast error ( actual EPS – management forecast of EPS) for European firms equals zero for firms regardless of economic environment.*

**Test of hypotheses 1**

The management forecasts of earnings must be related to actual earnings in order to determine if bias exists. McNichols (1989) analyzes bias through the determination of forecast error. Stated in statistical form, the hypothesis is represented in Equation 1 as follows:

$$\sum_{i=1}^n fe_i = 0 \tag{1}$$

This equation describes how forecast error is determined:

Where:  $fe_i$  = forecast error of firm i (forecast error = actual eps – management forecast of

eps), deflated by the firm’s stock price 180 days prior to the forecast.

In order to test hypothesis 1 firm forecasts included in the combined study samples (i.e., both economic expansion and economic contraction) were analyzed. Statistical analysis is performed on the samples in order to determine if the average forecast error is zero. McNichols (1989) and DeAngelo (1988) conduct a t-test on their respective samples in addition to a Wilcoxon signed rank test. Lehmann (1975) reports that the Wilcoxon tests has an efficiency of about 95% relative to a t-test for data that are normally distributed, and that the Wilcoxon test can be more efficient than the t-test for non-normal distributions. Therefore, this analysis consists of performing a t-test and a Wilcoxon signed rank test on the average cross-sectional differences between actual earnings per share and the management forecast of earnings per share.

Introducing a firm-specific control (i.e., a forecast for the same firm during economic expansion versus economic contraction) allows a test of the relative forecast error in both economic environments. If firms display the same degree of earnings management in both periods, the expectation is that there will be no difference in forecast error. If, however, there exist different incentives to manage earnings (either upward or downward) during times of economic fluctuation, then a positive or negative forecast error would result. Stated in null form:

*H2: The average forecast error for European firms is not significantly different during periods of economic expansion and economic contraction.*

**Test of hypothesis 2**

The second hypothesis introduces firm-specific and time-specific controls, namely, they assess potential bias of the management forecast by the two study periods, those made during economic expansion, and those made during economic contraction for the same firms. This permits a test of the relative forecast error in these two respective periods. Stated in statistical form the hypothesis is represented in Equation 2 as follows:

$$\sum fe_i = \sum fe_i \tag{2}$$



*η expansion*

This equation reflects the hypothesis that in null form suggests that forecast errors in expansion periods are equal to forecast errors in contraction periods.

**Hypothesis about information content of accounting earnings and management forecasts**

If mandatory disclosures of earnings contain some degree of earnings management, then voluntary disclosures may possess the potential for such earnings management as well. Investors may react to managed earnings in one of two ways; they may discount the information as additional noise, or they may view this information as enhancing the properties of the signal (i.e., in terms of amount or variance). Research during the past two decades has shown that accounting earnings possesses information content. Current literature finds that the information content of earnings announcements is different during non-routine periods (i.e. stock proxy contests, mergers and acquisitions, buyouts, Chapter 11 proceedings, etc.).

If investors interpret managed earnings forecasts as just additional noise, the market would

$$CAR_{it} = a + b_1UE_{it} + b_2UEE_{it} + b_3UEC_{it} + b_4MBit + b_5Bit + b_6MV_{it} + eit \quad (3)$$

Where:  $CAR_{it}$  = Cumulative abnormal return forecast  $i$ , time  $t$

$a$  = Intercept term

$UE_{it}$  = Unexpected earnings for forecast  $i$ , time  $t$

$UEE_{it}$  = Unexpected earnings for forecast  $i$ , time  $t$  during economic expansion

$UEC_{it}$  = Unexpected earnings for forecast  $i$ , time  $t$  during economic contraction

$MBit$  = Market to book value of equity as proxy for growth and persistence

$Bit$  = Market model slope coefficient as proxy for systematic risk

$MV_{it}$  = Market value of equity as proxy for firm size

$eit$  = error term for forecast  $i$ , time  $t$

This equation indicates the regression model that is used to assess the information content of the earnings forecasts for both expansion and contraction study periods. In addition to assessing those two specific periods, (i.e.,  $b_2$  and  $b_3$  variables), an assessment is also made for total forecast samples ( $b_1$  variable), and other variables that have shown significance in prior studies such as growth, risk and size ( $b_4, b_5, b_6$  variables).

In the above model, the coefficient  $a$  measures the intercept. The coefficient  $b_1$  is the earnings response coefficient (ERC) for all firms during both periods of economic expansion and contraction. The coefficient  $b_2$  represents the incremental ERC for firm forecasts made during periods of economic expansion. The coefficient  $b_3$  represents the incremental ERC for firm forecasts made during periods of economic contraction. The

discount this information. If, however, investors view the managed earnings forecast as a positive (or negative) signal from management, the market would not discount the information. The expectation for information content of management forecasts in varying economic environments would revolve around these two notions. These alternative notions suggest the following null hypothesis:

*H3: The information content of management forecasts during periods of economic expansion is not significantly different from the information content of management forecasts during periods of economic contractions for European firms.*

**Test of hypothesis 3**

The purpose of this test is to assess the relative information content of management earnings forecasts during periods of economic expansions and economic contractions. The following model in Equation 3 is used to evaluate information content:

coefficients  $b_4, b_5,$  and  $b_6$  are contributions to the ERC for all firms in the sample. To investigate the effects of the information content of management forecasts on ERC, there must be some control for variables shown by prior studies to be determinants of ERC. For this reason, the variables represented by coefficients  $b_4, b_5$  and  $b_6$  are included in the study.

Unexpected earnings ( $UE_i$ ) is measured as the difference between the management earnings forecast ( $MF_i$ ) and the security market participants'



expectations for earnings proxied by consensus analyst following as per Investment Brokers Estimate Service (IBES) ( $EX_i$ ). The unexpected earnings are scaled by the firm's stock price ( $P_i$ ) 180 days prior to the forecast. This is illustrated in Equation 4:

$$(4) \quad UE_i = \frac{(MF_i - EX_i)}{P_i}$$

This equation is used to assess unexpected earnings. Unexpected earnings is measured as the difference between the management forecast of earnings and the expected earnings level as determined by consensus analyst following per Investment Brokers Estimate Service. This value is then deflated by the firm's stock price 180 days prior to the forecast.

For each disclosure sample, an abnormal return (ARit) is generated for event days -1, 0, and +1, where day 0 is defined as the date of the forecast disclosure identified by Worldscope. The market model is utilized along with the equally-weighted market index and regression parameters are estimated between days -290 and -91. Abnormal returns are then summed to calculate a cumulative abnormal return (CARit). Hypothesis 3 is tested by examining the coefficients associated with unexpected earnings during economic expansion ( $b_2$ ) and economic contraction ( $b_3$ ).

## DATA AND METHODOLOGY

The sample consists of quarterly management forecast point estimates made during two sample periods, 2003-2007 (representing economic expansion), and 2008-2012 (representing economic contraction). The sample met the following criteria: 1) The management earnings forecast was recorded by Worldscope. 2) Security price data was available from AMADEUS database. 3) Earnings data was available from Compustat Global. 4) Analyst forecast information was available on the Institutional Brokers Estimate System (IBES). 5) The samples consist of firms which made at least one management earnings forecast in each sample period. Table 3 provides details on the samples

Table 3: Study Samples by Sample Period

Economic Expansion Study Period	
Year	Number of European firm

forecasts	
2003	188
2004	175
2005	190
2006	184
2007	<u>192</u>
<b>Total</b>	<b>929</b>
Economic Contraction Study Period	
Year	Number of European firm forecasts
2008	199
2009	188
2010	194
2011	187
2012	<u>192</u>
<b>Total</b>	<b>960</b>

Table 3 reflects the two study periods that are evaluated in this study. Years 2003-2007 reflect the years of economic expansion. Years 2008-2012 reflect the years of economic contraction. Forecasts reflect the firms selected in the sample after removing those eliminated for insufficient data as enumerated above. The information was obtained from Worldscope.

## RESULTS

### Hypothesis 1 results

The test of hypothesis 1 was conducted on the combined two samples (i.e., forecasts made during periods of economic expansion, and forecasts made during periods of economic contraction), a total of 1,889 firm forecasts. Table 4 contains the results of this test.



Table 4: Average Management Forecast Error Deflated by Firm’s Stock Price 180 Days Prior to Forecast

Model: $\sum \frac{fe_i}{n} = 0$						
n Forecasts	Mean	Medium	Minimum	Maximum	Standard Deviation	(t-statistic)
1,889	0.03	0.02***	-0.138	0.322	0.0021	(2.27)**
** Significant at the .05 level (two-sided test).						
*** Significant at the .01 level using the non-parametric sign-rank test.						
fe <sub>i</sub> = forecast error of firm i (actual eps – management forecast of eps)						
n = sample of 1,889 firm forecasts during 2003-2012						

Table 4 assesses the bias of voluntary earnings forecasts for all quarterly forecasts included in both samples. That is, forecasts from the expansion study period, and forecasts from the contraction study period. This analysis is made to determine a baseline measurement of all forecasts in this study to ensure that results are comparable with prior studies that assess forecast bias.

Table 4 indicates that the mean forecast error is 0.03 with a p-value of .05. Using the distribution-free rank test, significance is observed at the .01 level. These results are consistent with the preponderance of extant earnings forecast literature that indicates that management forecasts tend to reflect more bad news in the forecast relative to actual earnings. As a result, Hypothesis 1, which states that average management forecast error equals zero regardless of economic environment, is overturned since the forecasts in the sample, on average, exhibit downward bias of the management forecast.

**Hypothesis 2 results**

Tests of hypothesis 2 was conducted on two samples; one sample including firm forecasts between 2003-2007 (economic expansion), and the other sample including firm forecasts between 2008-2012 (economic contraction). Table 5 contains the results of this test.

Table 5: Average Management Forecast Error Deflated by Firm’s Stock Price 180 Days Prior to Forecast

Model: $\sum \frac{fe_i}{n} = \sum$					
fe <sub>i</sub>					expansion
n contraction		n			
Panel A- management forecasts during economic expansion (2003-2007)					
n forecasts	Mean	Medium	Minimum	Maximum	
Standard Deviation	(t-statistic)				
929	0.04***	0.02	-0.022	0.051	
0.0029	(2.24)**				

** Significant at the .05 level (two-sided test).					
*** Significant at the .01 level using the non-parametric sign-rank test.					
fe <sub>i</sub> = forecast error of firm i (actual eps – management forecast of eps)					
Panel B- management forecasts during economic contraction (2008-2012)					
n forecasts	Mean	Medium	Minimum	Maximum	
Standard Deviation	(t-statistic)				
960	0.03***	0.02	-0.019	0.048	
0.0018	(2.27)**				
** Significant at the .05 level (two-sided test).					
*** Significant at the .01 level using the non-parametric sign-rank test.					
fe <sub>i</sub> = forecast error of firm i (actual eps – management forecast of eps)					
n= 929 firm forecasts during expansion periods and 960 firm forecasts during contraction periods					

Table 5 Panel A reflects forecasts of European firms during expansion periods (2003-2007). Panel B reflects forecasts of European firms during economic contraction (2008-2012).

Panel A of Table 5 indicates results for the economic expansion sample of firm forecasts of earnings per share. Mean forecast error is .04 with a p-value of .05. The distribution-free rank test is significant at the .01 level. As seen with hypotheses 1, these results are consistent with prior earnings forecast literature which indicates that management forecasts tend to reflect more bad news in the forecast relative to actual earnings. Panel B of Table 5



provides results for the economic contraction sample of firm forecasts of earnings per share. Mean forecast error is observed to be .03 with a p-value of .05. The distribution-free rank test provides significance at the .01 level. For European firms forecasts, there appears to be no significant difference between forecasts released during either economic upturns or downturns, both reflect bad news content. Hypothesis 2 which states that there is no significant difference in forecast error between these two sample periods can, therefore, not be overturned.

**Hypothesis 3 results**

Hypothesis 3 tested information content of management forecasts during periods of economic expansion and economic contraction. Table 6 reports the results of this test. As indicated in Table 6, The coefficient representing the overall ERC for all firm forecasts in both study periods (b<sub>1</sub>) has a value of 0.10 with a p-value of .01. Similar to U.S. firms, this is consistent with prior management forecast literature regarding information content. The coefficient representing the incremental ERC for firm forecasts during economic expansions (b<sub>2</sub>) has a value of 0.15 with a p-value .01. The coefficient representing the incremental ERC for firm forecasts during economic contractions (b<sub>3</sub>) has a value of 0.08 with a p value of .01. All other control variables are not significant at conventional levels. These findings indicate that, for European firms, not only do forecasts contain information content, but the information content is a positive enhancing signal in both economic expansion and economic contraction periods. Hypothesis 3, therefore, cannot be overturned.

In addition, whenever a set of multiple regression variables are employed, there is a probability of the presence of multicollinearity within the set of independent variables which may be problematic from an interpretive prospective. To assess the presence of multicollinearity, the Variance Inflation Factor (VIF) was utilized. Values of VIF exceeding 10 are often regarded as indicating multicollinearity. In the test of hypothesis 3 a VIF of 2.1 was observed. Results indicate the non-presence of significant multicollinearity.

Table 6: Test of Information Content of Management Forecasts

Model:  $CAR_{it} = a + b_1UE_{it} + b_2UEE_{it} + b_3UEC_{it} + b_4MBit + b_5Bit + b_6MV_{it} + e_{it}$

Where:  $CAR_{it}$  = Cumulative abnormal return forecast i, time t  
 a = Intercept term  
 $UE_{it}$  = Unexpected earnings for forecast i, time t  
 $UEE_{it}$  = Unexpected earnings for forecast i, time t during economic expansion  
 $UEC_{it}$  = Unexpected earnings for forecast i, time t during economic contraction  
 $MBit$  = Market to book value of equity as proxy for growth and persistence  
 $Bit$  = Market model slope coefficient as proxy for systematic risk  
 $MV_{it}$  = Market value of equity as proxy for firm size  
 $e_{it}$  = error term for forecast i, time t

		Coefficients			(t-	
statistics)		a	b1	b2	b3	b4
b5	b6			Adjusted R <sup>2</sup>		
0.11	0.10	0.15	0.08		0.08	
0.09	0.10	0.223				
(.93)	(2.41)***	(2.38)***	(2.39)***		(0.27)	
(0.19)	(0.31)					

\*\*\*Significant at the .01 level (two-sided test)  
 b<sub>1</sub>, b<sub>4</sub>, b<sub>5</sub> and b<sub>6</sub> sample = 1,889 firm forecasts  
 b<sub>2</sub> sample = 929 firm forecasts  
 b<sub>3</sub> sample = 960 firm forecasts

Table 6 reflects the results of the assessment of information content through the running of the above regression formula. This includes the total forecast sample (b<sub>1</sub> variable), the economic expansion forecast sample (b<sub>2</sub> variable), and the economic contraction forecast sample (b<sub>3</sub> variable). Other variables assessed in the model (b<sub>4</sub>, b<sub>5</sub>, b<sub>6</sub>) are variables shown in previous studies to provide some level of significance in the model.

**CONCLUSIONS**

This study provides empirical evidence regarding the credibility of management forecasts of earnings during differing economic cycles, namely, economic expansion, and economic contraction for a sample of firms from nine European countries. Past



research on earnings forecasts assesses the forecast over time periods which do not consider the effects of the economic cycle on the forecast. In addition, these studies focus almost entirely on U.S. firm forecasts. This study is the first to attempt to assess any possible distinction between U.S. firm forecasts and European firm forecasts, in addition to assessing the effect of economic expansion and contraction periods.

Earnings forecasts for European firms were broken into two sample periods; an expansion period (2003-2007), and a contraction period (2008-2012). Firms that issued forecasts in both of these sample periods were evaluated. The evaluation consisted on conducting a study of bias for all firms in both periods combined to assess if results are comparable to previous studies. In addition, a study of bias was conducted for each sample separately to assess any differences between expansion and contraction samples. Lastly, a regression analysis was made for each sample period in order to assess any differences in information content of the earnings forecasts between the two periods.

Bias results indicate that during periods of economic expansion and contraction, managers exert greater downwards earnings management on the forecast (relative to actual earnings). This is consistent with prior management forecast literature. Information content results indicate the presence of information content in management forecasts during both economic expansion and contraction periods. European firms forecasts tend to exhibit a positive enhancing signal to users during both times of economic expansion and economic contraction.

As U.S. GAAP aligns more closely with IFRS standards over time, the analysis of U.S. and European firms becomes more critical from the perspective of global management and investment. The findings of this study have significant implications for managers and investors with current or potential international holdings.

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