



Earnings Management, Firm Location, and Financial Reporting Choice: An Analysis of Fair Value Reporting for Investment Property in an Emerging Market

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Background

- Investment property
 - Real estate for the purpose of rental income and/or capital appreciation
 - Fixed assets are traditionally accounted for at cost, with depreciation over time
 - Under the new IFRS's IAS 40, an option of **fair value reporting** for investment properties
 - Fair value of properties reflected on balance sheet
 - Changes in fair values reflected in net income

Background

- Fair value reporting
 - Becoming common with IFRS adoption
 - Traditionally used only for financial assets (i.e., most liquidly traded)
 - Now extended to property, plant & equipment (IAS 16) and investment properties (IAS 40)
 - Proponents claim fair values provide relevant information
 - Opponents think properties are unique, non-exchange-traded and are subject to appraisal bias

Background

- So far, fair value reporting for investment properties seems to be well-received in developed markets
 - Firms that chose FV reduce agency cost and information asymmetry (Muller et al. 2011)
 - Improved disclosure on FV reporting (Edelstein et al. 2012)
 - FV adoption is negatively related to managerial opportunism (Quagli and Avallone 2010)

Motivation

- Financial reporting quality is more dependent on local preparers' perspectives than the quality of standards (Ball et al. 2003)
- IFRS may not be as effective across all countries (Leuz et al. 2003)
- Important differences between developed and emerging markets
 - Financial reporting environment (law and governance), real estate market efficiency across and within countries

Objectives

- What if fair value reporting is implemented in an emerging market?
- We examine firms' decision to adopt fair value reporting for investment property in the emerging market of China
 - With weakness in its financial reporting environment, is financial reporting decision influenced by **earnings management**?
 - With its real estate market in infancy, is fair value reporting for investment property influenced by **location**?
 - Is fair value reporting used to achieve **earnings goals**?

Why China?

- China is BIG!
 - Chinese Accounting Standards (CAS) 3 is drafted based on IAS 40
 - No other large emerging country has developed equivalency to IAS 40 to-date
 - Interesting corporate culture (Morck et al. 2000) and institutional environment (Li et al. 2008) to examine earnings management
 - Significant regional disparity in real estate development within a single country

Summary of Findings

- Collectively, our findings contrast sharply to findings in developed markets
 - Firms that adopt fair value reporting are those with **history of significant earnings management**
 - Fair value option is particularly attractive for earnings management firms in **less developed** regions
 - FV firms subsequently use changes in fair value to **smooth earnings** as well as to meet **earnings benchmarks**

Literature Review

- Relevance and reliability of fair values
 - Fair values are related to market value (Easton et al. 1993; Aboody et al. 1999)
 - Could be subject to managerial discretion (Dietrich et al. 2001; Danbolt and Rees 2008)
- Effectiveness of IAS 40
 - Overall improvement on fair value reporting (Quagli and Avallone 2010; Muller et al. 2011; Edelstein et al. 2012)

Literature Review

- Effectiveness of IFRS in China
 - Overall improvement in earnings quality (Liu et al. 2011)
 - Significant increase in value relevance in **less developed** regions (Lee et al. 2013)
 - Earnings management in **mandatory** FV reporting for trading securities and restructured debts (He et al. 2012)

Literature Review

- Location on financial and investment decisions
 - Investment: Rural versus urban firms on external financing, trading, cost of debt, agency cost, corporate transparency (Loughran and Schultz 2005; 2006; Francis et al. 2008; John et al. 2011; Cai and Tian 2009)
 - Financial reporting: U.S rural firms have higher earnings persistence (Urcan 2007); Further U.S.-listed foreign firms have more readable financial statements (Lundholm et al. 2014)

Hypothesis 1

- Managers could adopt FV to provide more relevant information as in developed markets
 - Legal and corporate reporting environment in China is improving
 - Some regions in China are as developed as other major

H₁: The likelihood of reporting fair values for investment properties in an emerging market is positively associated with firms' earnings management motive.

- Managers could adopt FV to facilitate earnings management
 - After all, China has lower transparency and lower credibility in its capital market
 - Real estate appraisal quality lower (Chinese CA Network 2011) and transactions not transparent (Wang and Wang 2012)

Research Design 1

$$ACCR_{it} = b_0 + b_1CFO_{i,t-1} + b_2CFO_{i,t} + b_3CFO_{i,t+1} + b_4\Delta REV_{it} + b_5PPE_{it} + e_{it} \quad (1)$$

- Earnings management motive
 - Measure EM by square root of mean discretionary accruals from Dechow and Dichev (2002)
 - Data from 2001-2005 prior to the implementation of CAS 3 in 2007
 - Rationales: EM tends to be static (i.e., once a bad firm, always a bad firm!); EM tends to reverse (Barton and Simko 2002)

Research Design 1

$$FV_{it} = b_0 + b_1EM_i + b_2SIZE_{it} + b_3LEV_{it} + b_4CFO_{it} + b_5PPE_{it} + b_6RETURN_{it} + b_7LOSS_{it} + b_8BIG4_{it} + b_9CHAIR_CEO_{it} + b_{10}DOM_{it} + b_{11}STATE_{it} + e_{it} \quad (2)$$

- Logistic regression framework
 - FV equals to one if the firm switched to FV
 - Fundamental controls: Size, leverage, cash flows, return, loss firm, PP&E
 - Governance controls: CEO duality, dominant shareholdings
 - Chinese control: state-owned

Hypothesis 2

- Location affects the likelihood for FV adoption
 - Differences in regional Chinese real estate markets and quality of appraisal
 - Earnings management motive could be dependent on manipulative opportunities

H₂: Firms with properties located in less developed regions have a stronger association between the choice of fair value accounting for investment property and their earnings management motive.

Research Design 2

$$FV_{it} = b_0 + b_1EM_i + b_2HQ_{it} + b_3EM_i \times HQ_{it} + b_4SIZE_{it} + b_5LEV_{it} + b_6CFO_{it} + b_7PPE_{it} + b_8RETURN_{it} + b_9LOSS_{it} + b_{10}BIG4_{it} + b_{11}CHAIR_CEO_{it} + b_{12}DOM_{it} + b_{13}STATE_{it} + e_{it} \quad (3)$$

- We use firm headquarter to proxy location
 - HQ1 = 1 if firms are located in Yangtze River Delta, Pearl River Delta, Beijing-Tian Jing District
 - HQ2 = 0-7 index (GDP, stock trading, distance to exchanges, residential consumption, urban population, number of financial experts, number of real estate experts)

Hypothesis 3

- If FV is adopted by firms with earnings management motive, they should be using the new discretion to achieve earnings goals
 - Earnings smoothing (Trueman and Titman 1988)
 - Earnings benchmarks (Degeorge et al. 1999; Dechow et al. 2003)

H3: Firms that have adopted fair value reporting for investment properties are more likely to engage in earnings management post-CAS 3 compared with firm using the cost model.

Research Design 3

$$FVGL_{it} = b_0 + b_1 \Delta Earnings_{it} + b_2 \times \%IP_{it} + e \quad (4)$$

- FVGL is fair value gains or losses from investment properties
- Change in earnings is exclusive of FVGL
- %IP is percentage of investment property to total assets

$$Suspect_{it} = b_0 + b_1 FV_{it} + b_3 SIZE_{it} + b_4 LEV_{it} + b_5 MB_{it} + b_6 CFO_{it} + e_{it} \quad (5)$$

- Suspect is an indicator variable for firms that just beat zero earnings or earnings change

Sample Selection

- China Center of Economic Research (CCER) 2007-2009
 - CAS effective 2007 and no FV adoption in 2010
 - Financial data from CCER
 - Hand-collection on FV choice and related IP information
 - Macro-data from China's statistics yearbook
- Final sample of 1,545 firm-year observations from 577 firms
 - Only **21** out of **577** firms (3.6%) adopted FV!

Sample Selection

Table 1 Sample Selection

Initial sample of firm-year observations reported in CCER database for year 2007-2009	6,340
Less: firms without investment property	(2,940)
Less: firms in financial industries	(1,395)
Less: IPOs	(112)
Less: firm observations with no financial records before 2006	(300)
Less: firm observations with missing control variables	<u>(18)</u>
Less: subsequent firm-year observations for fair value adopters	(30)
Final sample of firm-year observations	<u>1,545</u>

Descriptive Statistics

Table 2

Panel A: Descriptive Statistics for Main Analysis

Variables	N	Mean	Median	Std Dev	1st quartile	3rd quartile
<i>FV</i>	1545	0.0136	0.0000	0.1158	0.0000	0.0000
<i>EM</i>	1545	0.2217	0.2004	0.1043	0.1479	0.2752
<i>HQ1</i>	1545	0.5197	1.0000	0.4998	0.0000	1.0000
<i>HQ2</i>	1545	4.0848	6.0000	3.0155	0.0000	7.0000
<i>SIZE</i>	1545	22.1140	21.9905	1.0536	21.3979	22.7160
<i>LEV</i>	1545	0.5800	0.3722	0.6319	0.1930	0.7160
<i>CFO</i>	1545	0.0356	0.0281	0.1105	-0.0002	0.0735
<i>PPE</i>	1545	0.2319	0.2072	0.1763	0.0897	0.3330
<i>RETURN</i>	1545	0.9298	1.0275	1.3840	-0.5402	1.7143
<i>LOSS</i>	1545	0.1256	0.0000	0.3315	0.0000	0.0000
<i>BIG4</i>	1545	0.0699	0.0000	0.2551	0.0000	0.0000
<i>CHAIR_CEO</i>	1545	0.1405	0.0000	0.3476	0.0000	0.0000
<i>DOM</i>	1545	0.4485	0.0000	0.4975	0.0000	1.0000
<i>STATE</i>	1545	0.6861	1.0000	0.4642	0.0000	1.0000

Descriptive Statistics

Panel B: Descriptive Statistics: FV Adoption Firms vs. Non-adoption Firms

Variables	N	FV=1			FV=0			Difference		
		Mean	Median	Std Dev	N	Mean	Median	Std Dev	Mean	P Value
<i>EM</i>	21	0.2751	0.2484	0.1279	1524	0.2209	0.2002	0.1038	0.0542***	(0.0090)
<i>HQ1</i>	21	0.4286	0.0000	0.5071	1524	0.5210	1.0000	0.4997	-0.0924	(0.2001)
<i>HQ2</i>	21	3.3462	3.0000	3.2034	1524	4.0932	6.0000	3.0131	-0.6170	(0.1760)
<i>SIZE</i>	21	22.1407	22.2332	1.1163	1524	22.1136	21.9902	1.0531	0.0271	(0.4534)
<i>LEV</i>	21	0.6859	0.3329	0.7443	1524	0.5786	0.3722	0.6303	0.1073	(0.2198)
<i>CFO</i>	21	-0.0192	0.0059	0.1192	1524	0.0364	0.0286	0.1103	-0.0556**	(0.0110)
<i>PPE</i>	21	0.1558	0.1127	0.1762	1524	0.2329	0.2079	0.1761	-0.0771**	(0.0232)
<i>RETURN</i>	21	1.7162	1.6797	1.5256	1524	0.9190	1.0201	1.3794	0.7972***	(0.0044)
<i>LOSS</i>	21	0.0952	0.0000	0.3008	1524	0.1260	0.0000	0.3319	-0.0308	(0.3365)
<i>BIG4</i>	21	0.0476	0.0000	0.2182	1524	0.0702	0.0000	0.2556	-0.0226	(0.3435)
<i>CHAIR_CEO</i>	21	0.1428	0.0000	0.3586	1524	0.1404	0.0000	0.3475	0.0024	(0.5127)
<i>DOM</i>	21	0.4286	0.0000	0.5071	1524	0.4488	0.0000	0.4975	-0.0202	(0.4266)
<i>STATE</i>	21	0.3809	0.0000	0.4976	1524	0.6903	1.0000	0.4625	-0.3094***	(0.0012)

Descriptive Statistics

Panel C: Pearson Correlations

	FV	EM	HQ1	HQ2	SIZE	LEV	CFO	PPE	RETURN	LOSS	BIG4	CHAIR_CEO	DOM	STATE
<i>FV</i>	1													
<i>EM</i>	0.0412*	1												
<i>HQ1</i>	0.0021	-0.0295	1											
<i>HQ2</i>	-0.0083	-0.0324	0.9135***	1										
<i>SIZE</i>	0.0075	-0.1578***	0.0837***	0.09***	1									
<i>LEV</i>	0.0538**	-0.0208	-0.0388	-0.0448*	-0.1652***	1								
<i>CFO</i>	-0.0363	-0.0731***	-0.0512**	-0.0578**	0.0604**	0.1433***	1							
<i>PPE</i>	-0.0638**	-0.1098***	-0.243***	-0.2742***	0.0485*	0.0202	0.2459***	1						
<i>RETURN</i>	0.071***	0.0210	-0.021	-0.0289	0.3562***	-0.3288***	-0.0309	-0.0109	1					
<i>LOSS</i>	-0.0274	0.075***	-0.0084	-0.0172	-0.1485***	0.0305	-0.0329	0.0403	0.0652***	1				
<i>BIG4</i>	-0.0053	-0.0883***	0.0993***	0.104***	0.3244***	0.1225***	0.1372***	0.0961***	-0.0361	-0.0098	1			
<i>CHAIR_CEO</i>	0.0066	0.0471	0.0922	0.0937	-0.1056	-0.0868	-0.0069	-0.0056	0.0085	0.0305	-0.0699	1		
<i>DOM</i>	-0.0129	0.0055	0.0383	0.0396	0.2699***	0.0376	-0.0019	0.0009	-0.0224	-0.0641***	0.1452***	-0.0993***	1	
<i>STATE</i>	-0.0777***	-0.0635**	-0.0394	-0.0378	0.2112***	0.0843***	0.0919***	0.1365***	-0.0066	-0.0226	0.1276***	-0.2006***	0.1534***	1

Differences in Mean Absolute Discretionary Accruals

Table 3 Univariate Test of Differences in Absolute Discretionary Accruals

	<u>All firms</u>		<i>HQ1 = 1</i> (firms in developed regions)		<i>HQ1 = 0</i> (firms in less developed regions)	
	Obs.	Obs.	Obs.	Obs.	Obs.	Obs.
<i>FV = 1</i> (fair value firms)	0.084	101	0.043	45	0.116	56
<i>FV = 0</i> (cost model firms)	0.065	2491	0.068	1299	0.062	1192
Differences	0.019	2592	-0.025	1344	0.054	1248
t-value	1.42		3.65 ^{***}		2.48 ^{**}	

Earnings Management on FV Choice

Table 4 Logistic Regression Analysis of Fair Value Choice and Earnings Management

Variables	(1) <i>FV</i>	(2) <i>FV</i>	(3) <i>FV</i>
<i>EM</i>	3.856*** (0.006)	2.626* (0.051)	3.859** (0.023)
<i>SIZE</i>		0.218 (0.416)	0.088 (0.768)
<i>LEV</i>		0.476 (0.163)	0.762*** (0.007)
<i>CFO</i>		-3.584** (0.032)	-3.612** (0.029)
<i>PPE</i>		-1.455 (0.465)	-3.226 (0.163)
<i>RETURN</i>		0.364 (0.177)	0.437 (0.324)
<i>LOSS</i>		-0.516 (0.516)	-0.500 (0.575)
<i>BIG4</i>		-0.091 (0.931)	-0.085 (0.931)
<i>CHAIR_CEO</i>		-0.211 (0.749)	-0.101 (0.884)
<i>DOM</i>		-0.043 (0.929)	-0.067 (0.883)
<i>STATE</i>		-1.261** (0.012)	-1.358*** (0.009)
<i>Constant</i>	-7.829* (0.068)	-8.914 (0.134)	-7.070 (0.297)
Year Fixed Effect	NO	NO	YES
Industry Fixed Effect	NO	NO	YES
Pseudo R ²	0.022	0.068	0.123
Observations	1,545	1,545	1,545

Earnings Management & Location on FV Choice

Table 5 Logistic Regression Analysis of Fair Value Choice, Earnings Management and Firm Location

Variables	(1) <i>FV (HQ = HQ1)</i>	(2) <i>FV (HQ = HQ2)</i>
<i>EM</i>	7.651*** (0.001)	8.752*** (0.001)
<i>HQ</i>	1.708* (0.091)	0.256 (0.162)
<i>EM × HQ</i>	-8.147*** (0.006)	-1.319*** (0.010)
<i>SIZE</i>	0.114 (0.710)	0.105 (0.736)
<i>LEV</i>	0.813*** (0.003)	0.816*** (0.003)
<i>CFO</i>	-3.922** (0.018)	-3.736** (0.024)
<i>PPE</i>	-3.375 (0.140)	-3.780* (0.091)
<i>RETURN</i>	0.374 (0.344)	0.394 (0.337)
<i>LOSS</i>	-0.383 (0.658)	-0.258 (0.760)
<i>BIG4</i>	-0.221 (0.832)	-0.215 (0.839)
<i>CHAIR_CEO</i>	-0.081 (0.908)	-0.049 (0.944)
<i>DOM</i>	0.028 (0.953)	0.010 (0.984)
<i>STATE</i>	-1.353** (0.012)	-1.368** (0.010)
<i>Constant</i>	-8.683 (0.221)	-8.628 (0.232)
Year Fixed Effect	YES	YES
Industry Fixed Effect	YES	YES
Pseudo R ²	0.182	0.186
Observations	1,545	1,545

Post-Adoption Earnings Management – Earnings Smoothing

Table 6

Panel A: Post-Adoption Earning Manipulation Test - Earnings Smoothing

Variables	(1) <i>FVGL</i>	(2) <i>FVGL(HQ = HQ1)</i>	(3) <i>FVGL (HQ = HQ2)</i>
<i>Constant</i>	0.009*** (0.000)	0.008*** (0.007)	0.008** (0.021)
$\Delta Earnings$	-0.109*** (0.005)	-0.120** (0.010)	-0.154*** (0.001)
<i>HQ</i>		-0.002 (0.724)	-0.000 (0.872)
$\Delta Earnings \times HQ$		0.061 (0.350)	0.023** (0.039)
<i>%IP</i>	0.015** (0.014)	0.016** (0.011)	0.018*** (0.004)
Adjusted R ²	0.275	0.294	0.333
Observations	51	51	51

Post-Adoption Earnings Management – Meet or Beat Quarterly Earnings

Table 6

Panel B: Post-Adoption Earning Manipulation Test - Meet or Beat Zero Earnings Threshold

Variables	Zero Earnings Threshold		
	(1) All firms	(2) Excluding <i>FVGL</i> loss	(3) Excluding <i>FVGL</i> gain
<i>FV</i>	0.410** (0.030)	0.475*** (0.000)	-0.130 (0.748)
<i>SIZE</i>	-0.154*** (0.000)	-0.157*** (0.000)	-0.156*** (0.000)
<i>LEV</i>	-0.010 (0.919)	-0.014 (0.891)	-0.013 (0.901)
<i>MB</i>	-0.162*** (0.000)	-0.163*** (0.000)	-0.160*** (0.000)
<i>CFO</i>	-4.287*** (0.000)	-4.309*** (0.000)	-4.272*** (0.000)
<i>Constant</i>	2.092** (0.031)	2.162** (0.026)	2.200** (0.024)
Industry Fixed Effect	YES	YES	YES
Year Fixed Effect	YES	YES	YES
Pseudo R ²	0.029	0.0184	0.028
Observations	7673	7641	7453

Post-Adoption Earnings Management – Meet or Beat Quarterly Earnings Change

Table 6

Panel C: Post-Adoption Earning Manipulation Test - Meet or Beat Zero Earnings Change Threshold

Variables	Zero Earnings Change Threshold		
	(1) All firms	(2) Excluding <i>FVGL</i> loss	(3) Excluding <i>FVGL</i> gain
<i>FV</i>	0.737*** (0.000)	0.784*** (0.000)	0.403 (0.370)
<i>SIZE</i>	-0.097* (0.082)	-0.099* (0.073)	-0.112** (0.033)
<i>LEV</i>	-0.069 (0.538)	-0.075 (0.508)	-0.033 (0.756)
<i>MB</i>	-0.161* (0.083)	-0.159* (0.077)	-0.157* (0.054)
<i>CFO</i>	-3.270*** (0.002)	-3.237*** (0.002)	-3.225*** (0.001)
<i>Constant</i>	0.727 (0.031)	0.774 (0.570)	1.043 (0.416)
Industry Fixed Effect	YES	YES	YES
Year Fixed Effect	YES	YES	YES
Pseudo R ²	0.026	0.026	0.022
Observations	7673	7641	7453

Robustness Analysis

- The number of FV firms is low
 - Penalized likelihood method for rare event
 - Matched sample by SIC and year
- The impact of property locations
 - Differences of headquarter and property locations
 - We check and find most firms (74%) have most investment properties (>75%) located near HQ
 - We create IPLOC with hand-collected 448 firm-year observations
- Alternative proxies for EM
 - Modified Jones model

Matched Sample

Table 7 Logistic Regression Analysis of Fair Value Choice and Earnings Management on Matched Sample

Variables	(1) <i>FV</i>	(2) <i>FV</i>	(3) <i>FV</i>
<i>EM</i>	8.375*** (0.000)	10.654*** (0.000)	12.524*** (0.000)
<i>SIZE</i>	0.260 (0.361)	0.415 (0.361)	0.322 (0.710)
<i>LEV</i>		1.794*** (0.009)	2.618*** (0.001)
<i>CFO</i>		-2.268 (0.517)	-4.784 (0.335)
<i>PPE</i>		-2.864* (0.087)	-4.357** (0.041)
<i>RETURN</i>		0.441 (0.442)	0.799 (0.663)
<i>LOSS</i>		-1.175* (0.095)	-1.657** (0.013)
<i>BIG4</i>		-1.694 (0.291)	-2.446 (0.215)
<i>CHAIR_CEO</i>		0.803 (0.313)	1.022 (0.258)
<i>DOM</i>		0.152 (0.825)	0.231 (0.749)
<i>STATE</i>		-0.495 (0.373)	-0.767 (0.241)
<i>Constant</i>	-9.332 (0.148)	-13.456 (0.203)	-12.181 (0.524)
Year Fixed Effect	NO	NO	YES
Firm Fixed Effect	NO	NO	YES
Pseudo R ²	0.097	0.243	0.303
Observations	126	126	126

Investment Property Location

Table 8

Panel A: Logistic Regression Analysis of Fair Value Choice and Investment Property Locations (Comparing the Effect of *IPLOC* and *HQ*)

Variables	(1) <i>FV</i>	(2) <i>FV (HQ = HQ1)</i>	(3) <i>FV (HQ = HQ2)</i>
<i>EM</i>	16.636*** (0.001)	8.029*** (0.007)	14.781*** (0.000)
<i>IPLOC</i>	0.689*** (0.007)		
<i>EM</i> × <i>IPLOC</i>	-3.202*** (0.000)		
<i>HQ</i>		2.526** (0.039)	0.648** (0.012)
<i>EM</i> × <i>HQ</i>		-12.696*** (0.004)	-3.035*** (0.001)
<i>SIZE</i>	0.057 (0.914)	0.050 (0.923)	0.024 (0.963)
<i>LEV</i>	0.542 (0.357)	0.588 (0.240)	0.613 (0.232)
<i>CFO</i>	-3.331 (0.219)	-3.637 (0.163)	-3.237 (0.209)
<i>PPE</i>	-5.402** (0.045)	-5.342** (0.049)	-5.329* (0.050)
<i>RETURN</i>	0.324 (0.110)	0.272 (0.194)	0.363 (0.100)
<i>LOSS</i>	-1.043 (0.221)	-0.843 (0.290)	-0.555 (0.486)
<i>BIG4</i>	-10.891*** (0.000)	-11.069*** (0.000)	-10.734*** (0.000)
<i>CHAIR_CEO</i>	-0.114 (0.912)	-0.096 (0.922)	-0.186 (0.853)
<i>DOM</i>	-0.295 (0.658)	-0.058 (0.922)	-0.145 (0.820)
<i>STATE</i>	-1.179 (0.201)	-0.816 (0.322)	-0.862 (0.300)
<i>Constant</i>	-9.756 (0.441)	-7.477 (0.518)	-8.833 (0.443)
Industry Fixed Effect	YES	YES	YES
Year Fixed Effect	YES	YES	YES
Pseudo R ²	0.279	0.238	0.258
Observations	448	448	448

Investment Property Location

Panel B: Logistic Regression Analysis of Fair Value Choice and Investment Property Locations (Including both *IPLOC* and *HQ*)

Variables	(1) <i>FV (HQ = HQ1)</i>	(2) <i>FV (HQ = HQ2)</i>
<i>EM</i>	17.899*** (0.001)	19.366*** (0.000)
<i>IPLOC</i>	0.736** (0.041)	0.582 (0.235)
<i>EM</i> × <i>IPLOC</i>	-3.143*** (0.005)	-2.609* (0.070)
<i>HQ</i>	0.307 (0.841)	0.242 (0.604)
<i>EM</i> × <i>HQ</i>	-3.908 (0.443)	-1.262 (0.373)
<i>SIZE</i>	0.129 (0.816)	0.096 (0.869)
<i>LEV</i>	0.581 (0.296)	0.576 (0.302)
<i>CFO</i>	-3.351 (0.195)	-3.278 (0.226)
<i>PPE</i>	-5.478** (0.047)	-5.495* (0.058)
<i>RETURN</i>	0.349 (0.111)	0.380* (0.091)
<i>LOSS</i>	-1.148 (0.182)	-0.932 (0.251)
<i>BIG4</i>	-12.054*** (0.000)	-11.813*** (0.000)
<i>CHAIR_CEO</i>	-0.051 (0.960)	-0.151 (0.885)
<i>DOM</i>	-0.221 (0.737)	-0.235 (0.744)
<i>STATE</i>	-1.030 (0.276)	-1.013 (0.273)
<i>Constant</i>	-11.911 (0.376)	-11.520 (0.405)
Industry Fixed Effect	YES	YES
Year Fixed Effect	YES	YES
Pseudo R ²	0.287	0.288
Observations	448	448

Alternative EM Proxy

Table 9 Logistic Regression Analysis of Fair Value Choice, Earnings Management and Firm Location (with Alternative Measure of Discretionary Accruals)

Variables	(1) <i>FV</i>	(2) <i>FV (HQ = HQ1)</i>	(3) <i>FV (HQ = HQ2)</i>
<i>EM</i>	3.859** (0.023)	7.651*** (0.001)	8.752*** (0.001)
<i>HQ</i>		1.708* (0.091)	0.256 (0.162)
<i>EM×HQ</i>		-8.147*** (0.006)	-1.319*** (0.010)
<i>SIZE</i>	0.088 (0.768)	0.114 (0.710)	0.105 (0.736)
<i>LEV</i>	0.762*** (0.007)	0.813*** (0.003)	0.816*** (0.003)
<i>CFO</i>	-3.612** (0.029)	-3.922** (0.018)	-3.736** (0.024)
<i>PPE</i>	-3.226 (0.163)	-3.375 (0.140)	-3.780* (0.091)
<i>RETURN</i>	0.437 (0.324)	0.374 (0.344)	0.394 (0.337)
<i>LOSS</i>	-0.500 (0.575)	-0.383 (0.658)	-0.258 (0.760)
<i>BIG4</i>	-0.085 (0.931)	-0.221 (0.832)	-0.215 (0.839)
<i>CHAIR_CEO</i>	-0.101 (0.884)	-0.081 (0.908)	-0.049 (0.944)
<i>DOM</i>	-0.067 (0.883)	0.028 (0.953)	0.010 (0.984)
<i>STATE</i>	-1.358*** (0.009)	-1.353** (0.012)	-1.368** (0.010)
<i>Constant</i>	-7.070 (0.297)	-8.683 (0.221)	-8.628 (0.232)
Industry Fixed Effect	YES	YES	YES
Year Fixed Effect	YES	YES	YES
Pseudo R ²	0.157	0.183	0.186
Observations	1545	1545	1545

Concluding Remarks

- We show that FV adoption for investment property is used for earnings management purpose
 - Yet, not all firms adopt/abuse the FV option
 - Only firms with the (1) greatest EM motive and (2) opportunities exercise the FV option
 - These firms have significant history of EM and are located in less developed regions
 - FV firms are associated with more subsequent earnings smoothing and manipulation

Concluding Remarks

- Policy Implication: Is IFRS implemented ‘too soon too fast’ in an emerging market such as China?
 - Yes and no
 - Chinese firms have varied purposes in adopting the FV option for investment properties
- One critical determining factor is financial reporting decision could be essentially location-driven!
 - Novel evidence that location matters for financial reporting