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## Accounting Accruals and Stock Returns: Evidence from European Equity Markets

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optimism, and lower ownership concentration. In markets where minorities have legal

protection against expropriation by corporate insiders and where accrual accounting is permitted, the accrual effect based only on percent accruals is positive. Earnings opacity does not appear to exhibit a significant influence. Overall, the evidence suggests that cross-country differences in culture, equity-market setting, analysts' research output, investor protection, and ownership structure play an important role in explaining variation on the magnitude of the accrual anomaly in Europe.

## Acknowledgements

The paper has benefited from helpful comments from the participants at the EFMA (2012) annual meeting, at the EAA (2013) annual congress and at the HFAA (2013) annual conference. Helpful comments have also been received from Gikas Hardouvelis, Dimitrios Thomakos and Emmanuel Tsiritakis. I am especially indebted to Guochang Zhang (the associate editor) and one anonymous reviewer for insightful comments and suggestions on several drafts of the paper. The usual disclaimer applies.



Italy, Japan, and Switzerland. France exhibits significant raw returns and insignificant alphas, while South Korea and Thailand exhibit the opposite pattern.

<sup>4</sup>Pincus et al. (<u>2007</u>) use the anti-director index and the legal enforcement index as measures of shareholder protection and find conflicting results: investors overestimate the lower persistence of the accrual component of earnings in countries with weaker outside shareholder rights and stronger legal enforcement.

<sup>5</sup>I also perform initial data screenings for basic coding errors via the methods outlined in Ince and Porter (2006).

<sup>6</sup>All results remain qualitatively similar when I repeat the analysis using firm-level variables that are converted to local currency for all countries.

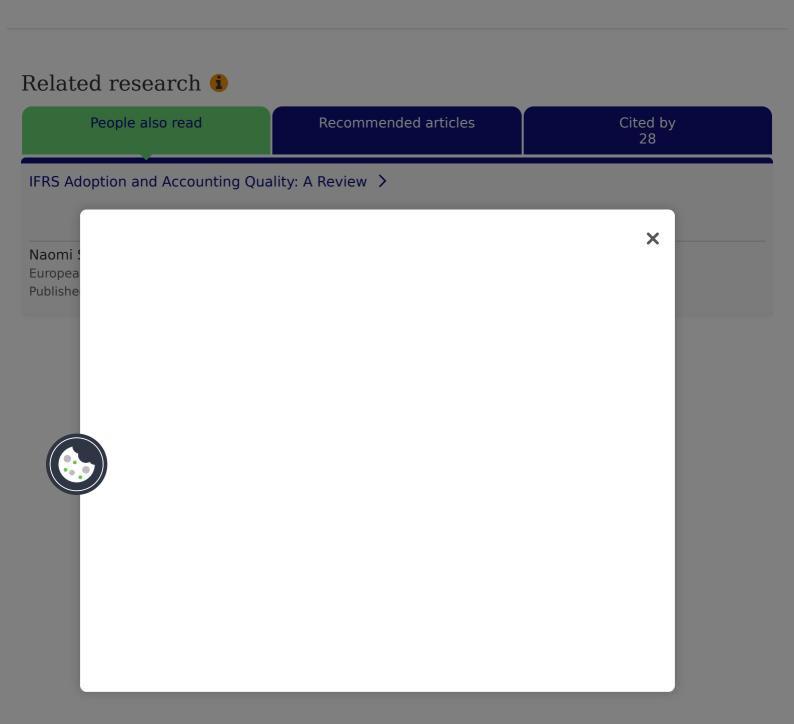
'Fama and French (2008) argue that size and book-to-market adjusted returns are almost similar to factor alphas from the Fama and French (1993) three-factor model.

<sup>8</sup>Hung's (2001) accrual intensity index is based on accounting standards associated with goodwill, equity method, depreciation, purchased intangibles, internally developed intangibles, research and development costs, interest capitalisation, lease capitalisation, allowance of the percentage of completion method, pension accounting, and accounting for other post-retirement benefits.

X <sup>9</sup>Leippol on working capital a a-French three-fa of my sample my study are not average returns are an al return of abnorm 0.06 g evidence from the urns obtained rom working <sup>10</sup>Size a riables in cash flows, regressi n et al. asset gr

(<u>forthcoming</u>) use them at the country level to examine the asset growth anomaly in an international setting.

- <sup>11</sup>Results are qualitatively similar if I instead use the Petersen (2008) estimation procedure, clustered by country.
- <sup>12</sup>I use the natural logarithm of LIQ and ACOV when I include them in the regressions as a result of the extreme variation of these characteristics (the standard deviations of LIQ and ACOV are about 436 and 453, respectively).
- <sup>13</sup>Mandatory adoption of International Financial Reporting Standards on 1 January 2005 led to changes in the accounting regimes of European Union countries. Thus, I perform sub-period regression analyses (up to 2004) for both the accrual index and the earnings opacity index and find qualitatively similar results.



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