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External Auditors, Audit Committees and Earnings Management in France

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accounting conservatism is consistent with the lower litigation risk offered by the French Civil Code (vs. the US Common Law system), which is likely to eliminate the deep pockets incentive for investors.

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Notes

1. See, for example, [Becker et al. \(1998\)](#), [Lambert and Larcker \(1987\)](#), [Kim et al. \(2002\)](#).

2. The evidence presented here demonstrates a stronger relationship between earnings and stock prices than in the US market.

3. It is important to note that the mandate to audit financial statements is not mandatory in all countries. In some countries, companies are not required to have their financial statements audited.

4. The focus of this paper is on the relationship between earnings and stock prices.



5. The methodology used for estimating abnormal accruals does not apply to financial companies.
6. Some authors (Peasnell et al., [2000b](#), Xie et al., [2003](#)) posit that only the short-term component of accruals can actually be manipulated, and as such keep only these in their model. We prefer considering also the long-term component of accruals, because of the importance placed on provisions for risks and charges in the French accounting system. The indirect formula, based on balance sheet and income statement items, is preferred given that cash flow statements are not systematically supplied in the French Diane database at the time of our study. The items used in this formula are the ones prescribed by the French accounting format, replicated in Diane. English translations of these items are recommended by the authors so that the reader may be able to appreciate the equivalent in an Anglo-Saxon accounting system.
7. Long-term deferred expenses constitute amortisable entries in French financial statements; as such, they are added to the amortisable fixed assets.
8. If this coefficient is expected to be positive for industries where companies have a structural need for working capital, it should be negative for industries in which companies post a surplus in working capital.
9. The initial 102 listed companies were classified into 54 industries. Of the resulting 162 industries, 102 observations were used to estimate the model.
10. The audit opinion. The audit opinions in the audit reports of the companies are classified into three categories: unqualified, qualified, and disallowed.
11. Early adoption. The early adopters of listed companies are Mazars & BDO, Gendrot & Guérin, and BDO. The audit reports of these companies are fairly close to the standard.
12. We have used a sample of 100% of the observations, which severely limits the power of statistical tests.



13. The question of the shareholder linkage is not addressed in detail in the Viénot Reports of 1995 and 1999. The Bouton Report ([2002](#), p. 10) stipulates that 'Beyond a threshold of 10% in capital or in voting rights, it is suitable that the board, based on the report of the nomination committee, should systematically inquire into the independent qualification, taking into account the capital structure of the company and the potential for conflicts of interest.' By default, all the directors who hold more than 10% of the capital or voting rights are not considered to be independent; the same applies to the representatives of other companies that pass one of these thresholds.

14. The results reported are potentially biased by the arbitrary dichotomy used. It is also possible that the relation between a high tenure and a loss in audit quality is not linear. Furthermore, considering only the tenure of the leading auditor inevitably causes a loss of information. In order to integrate the joint-auditorship, these tests were replicated with the average tenure of co-auditors, and the results were insignificant.

15. Given the strong contingency between the presence of an audit committee ($AC = 1$) and the presence of a committee independent in majority ($ACInd50 = 1$), hypotheses H3 and H4 are tested separately.

16. This control variable is included only when abnormal accruals are derived from the Jones Model. The control for cash flows is endogenous when the CFO Model is used.

17. Regressions on audit quality are significant.

18. See studies on the detection of earnings management.

19. The regression coefficients have been tested by regressions on audit quality.



As a whole, the results are not likely to be biased.

20. T. Brédart is derived from the business process.

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