



# A study of earnings-management motives in the Anglo-American and Euro-Continental accounting models: The Canadian and French cases

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## Abstract

The purpose of this paper is to investigate factors that potentially influence earnings-management policy with reference to the Anglo-American and Euro-Continental accounting models. Canada and France, respectively, belong to those different socio-economic environments. Earnings-management practices detected in those countries are expected to be affected by specific socio-economic features of the Anglo-American and the Euro-Continental environments. We explain earnings-management practices by incentives suggested in the literature to reveal which motives are prominent within each environment.

We tested our earnings-management motives (EMM) model using appropriate panel-estimation techniques over 1674 Canadian and 1470 French firm-year observations. Our results provide evidence that incentives for earnings management for French firms are specifically linked to contractual debt costs and effective tax rate. However, Canadian firms show specific incentives matched with a dynamic capital market. Issuing equity is a strong motive for earnings management in Canadian firms.

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*Keywords:* Earnings management; Discretionary accruals; Financial reporting; International accounting; Panel-estimation techniques

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doi:[10.1016/j.intacc.2006.09.004](https://doi.org/10.1016/j.intacc.2006.09.004)

## 1. Introduction

Earnings management has often been considered as the alteration of a firm's reported economic performance by insiders to either mislead some stakeholders or to influence contractual outcomes (Healy & Wahlen, 1999). In effect, a wide literature has addressed the issue of earnings management. Most studies in this area have concentrated on the Anglo-American world. These studies have tried to examine earnings management in particular contexts. They investigated incentives provided by management-compensation plans (Guidry, Leone, & Rock, 1999; Healy, 1985; Holthausen, Larker, & Sloan, 1995), debt contracts (DeAngelo, DeAngelo, & Skinner, 1994; DeFond & Jiambalvo, 1994; Healy & Palepu, 1990; Sweeney, 1994), regulatory cases (Cahan, 1992; Jones, 1991; Key, 1997), and stock price motives such as stock offering (Erickson & Wang, 1999; Shivakumar, 2000; Teoh, Welch, & Wong, 1998), avoiding decreases and losses (Burgstahler & Dichev, 1997; Burgstahler & Eames, 2003) and meeting thresholds such as analysts' and management's forecasts (Burgstahler & Eames, 1998; Degeorge, Patel, & Zeckhauser, 1999).

However, little attention has been focused on earnings-management motives in countries from the Euro-Continental accounting model. French managers operate within an accounting system which is contingent upon specific socio-economic features. Although Leuz, Nanda, and Wysocki (2003) documented international differences in earnings-management behavior for a large number of countries (including Canada and France), they did not examine specific determinants of earnings management for these countries. Considering 31 countries in their study has confined them to using broad, institutional factors to explain earnings management (outside investor rights, legal enforcement, private control benefits, etc.) as well as descriptive and aggregate measures of earnings management (median ratio of the firm level standard deviation of operating income and operation cash flow, country's Spearman correlation between the change in total accruals and the change in cash flow from operations, country's median ratio of the absolute value of total accruals and the absolute value of the cash flow from operations, etc.). Their results may suffer from an endogeneity bias (Leuz et al., 2003, p. 521). They also recognize that "theoretical relations among institutional factors are not well understood and hence difficult to disentangle" (Leuz et al., 2003, p. 526).

This paper sheds light on the importance of certain specific motives for earnings management within different socio-economic environments. We investigate specific factors which potentially influence earnings-management policy with reference to the Anglo-American and Euro-Continental accounting models. Canada and France, respectively, belong to those different socio-economic environments.

The accounting system in Canada is marked by a conceptual framework that safeguards shareholder interests. Accounting values of flexibility and professionalism prevail as in Anglo-American accounting traditions (Gray, 1988). Financial reporting is independent of the tax system. The capital market has a major role in enhancing financing through equity. Pressures from a dynamic capital market (shareholders, financial analysts, and the financial press) are prominent.

On the other hand, the accounting system in France, as in most Continental European countries, relies upon the "Plan Comptable" and codified rules that have the purpose of

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