Do Analysts and Auditors Use Information in Accruals?

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Companies with high accruals tend to experience future earnings problems, research has shown. Despite this, company news of high accruals does not appear to affect the company’s stock price. In this paper, we seek to explain this phenomenon.

We begin by directly examining the published opinions of two types of professional investor intermediaries — sell-side analysts and independent auditors — to see if they provide investors with information concerning the future earnings problems experienced by firms with high accruals.

We show that sell-side analysts’ earnings forecasts do not incorporate the predictable future earnings declines associated with high accruals. We also find no evidence that independent auditors signal the future earnings problems associated with high accruals through either their audit opinions or through auditor changes.

Overall, our evidence indicates that analysts and auditors do not alert investors to the future earnings problems associated with high accruals, thus shedding some light on why investors do not appear to anticipate these problems.