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The relevance of legal requirements in the going public process: the discretionary decision of adopting an audit committee

Leticia Castaño, José E. Farinós and Ana M. Ibañez
Department of Corporate Finance, Universitat de València, Valencia, Spain

Abstract

Purpose – We study the role of having an audit committee (AC) as a signal of firm quality and as a monitoring device of the information quality contained in the listing prospectus.

Design/methodology/approach – Ordinary Least Squares regressions are used to examine the association between the presence of an audit committee and (1) the initial return (IR), and (2) the earnings forecast error in the listing prospectus in a sample of 55 Real Estate Investment Trusts that went public on the BME Growth market during 2013–2022. Heckman two-step estimation procedure to correct for endogeneity and bootstrap are used for robustness.

Findings – We show that IR and earnings forecasts are significantly affected by the presence of AC. The IR is higher and the earnings forecast included in the prospectus are of higher quality in firms with AC.

Practical implications – Our research provides (1) managers with new tools when deciding on their corporate governance structure in the listing process, (2) specific evidence for regulators on the role played by ACs in the process of going public, which may be useful in the context of the ongoing regulatory changes regarding admission processes in Europe, and (3) society with a sign that AC can enhance investor and public confidence in financial markets and foster a more stable and transparent investment environment.

Originality/value – The adoption of an AC is voluntary in this market, so this discretionary decision provides an exceptional opportunity to conduct such an analysis. Additionally, this issue has not been previously analysed in Europe.

Keywords Corporate governance, Audit committee, Going public, Initial return, Earnings forecast, Real estate

Paper type Research paper

1. Introduction

European companies are highly dependent on self-financing and bank financing. One of the alternatives to this dependence is the possibility of equity financing in the stock markets.

JEL Classification — G12, G23, G34, M40

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Nevertheless, some of the main challenges that companies encounter in accessing capital markets are the regulatory requirements that hinder firms accessing the European stock markets and the initial and subsequent incorporation costs. These costs extend beyond mere financial considerations and encompass a range of other factors, including the need for enhanced transparency, governance, and increased management complexity. The European Union (EU), aware that firms require a favourable environment to be able to meet their financing needs through capital markets, is engaged in a debate on how to make these markets more accessible to companies without neglecting the necessary safeguards for investors (ESMA, 2024). Simplifying some of the incorporation requirements would reduce the costs that companies have to bear, providing them with incentives and making securities markets more attractive. Conversely, transparency and investor protection are essential for maintaining market security and confidence. From our point of view, the study of the process of requirement simplification is mandatory in order to evaluate its consequences on companies, investors and markets.

In this context, the aim of this research is to assess whether the constitution of an audit committee (AC), a rather costly requirement for companies, is beneficial for the incorporation of a company on the stock market by analysing the efficacy of having an AC as a signal of company quality and as a monitoring mechanism for the accuracy of information presented in the prospectus during the listing process. BME Growth for Real Estate Investment Trusts (REITs) is a good case study to evaluate this because the adoption of an AC is not mandatory, and this discretionary decision provides us with an exceptional opportunity to conduct such an analysis, which is not possible in most markets where this figure is mandatory [1].

The AC is a subcommittee of the board of directors that has the potential to play an important supervisory role, especially regarding the quality of information (financial and non-financial). Some of its primary responsibilities include overseeing the financial reporting process, ensuring the accuracy of financial statements, and compliance with laws and regulations, overseeing the external audit process, and monitoring the company's internal controls. The academic literature has devoted considerable attention to examining the role and effectiveness played by the AC covering areas such as intellectual capital efficiency (Waseem *et al.*, 2022), financial reporting reliability (Jaggi, 2023), long-term performance in equity markets (Kao *et al.*, 2024), earnings management (Zadeh *et al.*, 2023) and financial reporting quality (Dilshad *et al.*, 2023), as well as their impact on the initial public offerings (IPO) process. These last two issues are the focus of our research. Specifically, we study whether the presence of an AC has a significant effect on how investors perceive the quality of the firm that goes public in the BME Growth market for the admissions made on this market during the period from November 2013 to December 2022. Investigating the role of the AC in the going public process is crucial to understanding effectiveness in an environment where promoting transparency and protecting the interests of investors and other stakeholders is critical, while encouraging companies to go public by reducing their costs.

In the context of the current European debate referred above, this study aims to fill the gap in the literature on the effectiveness of the existence of an AC as a sign of the quality of the company and as a tool to control the quality of the information contained in the prospectus in a European market where its existence is not mandatory. To our knowledge, the effectiveness of the existence or not of an AC in the context of going public process had only been studied in Canada, US, Taiwan and Australia (Bédard *et al.*, 2008; Ettredge *et al.*, 2021; Kao and Chen, 2020; She, 2020; respectively). Moreover, our study provides new evidence since our results are different from those obtained so far in the aforementioned markets where either there is no relationship (Bédard *et al.*, 2008; Ettredge *et al.*, 2021; She, 2020) or the relationship between the existence of an AC and the initial return is negative (Kao and Chen, 2020).

The paper is organised as follows. Section 2 describes the audit committee and the characteristics of BME Growth. Sections 3 and 4 describe the theoretical framework and

literature review and hypotheses, respectively. The sample and the methodology used are described in section 5. The results obtained are shown in section 6. Section 7 concludes and Section 8 discuss implications and future research.

2. The audit committees and the characteristics of BME growth

Regarding the AC, during the 1970s a number of measures were implemented in the US to encourage listed companies to set up an AC. In Europe, however, large companies did not set up ACs until the 1990s, following the publication of different codes of good corporate governance. Over time, various institutional and professional organisations have advocated the creation of ACs, especially in listed companies. In Spain, the 1998 Olivencia Code proposed the voluntary creation of ACs for listed companies and identified as essential missions the review of the internal control system, the evaluation of the company's accounting verification system and the guarantee of the independence of the external auditor. The Olivencia Code had an enormous influence on the governance system of Spanish companies, since a significant number of large listed companies adopted the recommendation to create an AC. But it was with the Financial System Reform Law in 2002 that listed companies were obliged to establish an AC from 2003 onwards. However, this obligation applied to companies listed on an official secondary market (or regulated market) and, therefore, did not include companies incorporated in a Multilateral Trading Facility (MTF) such as BME Growth. It was with Law 22/2015 when a modification was included on this regard and catalogued the companies traded on BME Growth (then called *Mercado Alternativo Bursátil* -MAB- for growing companies) as companies of public interest having, therefore, the obligation to constitute an AC. However, Law 22/2015 left REITs traded on BME Growth out of this obligation. Therefore, the decision to have an AC is therefore at the REIT's discretion. That is why this is a good case of study on the effectiveness of the existence of an AC as a sign of the quality of the company and as an instrument for monitoring the quality of the information contained in the prospectus.

BME Growth has a flexible regulation in terms of admission, information and trading requirements, without foregoing an adequate level of transparency (Castaño *et al.*, 2023). One relevant feature is that all REITs have been incorporated by direct listing, that is, without an IPO. The initial admission price (reference price) is determined by the board of directors, considering an independent valuation, unless a private placement of shares occurs before listing for trading. In that case the reference price is derived from that placement.

3. Theoretical framework

The role and effectiveness of AC in the going public process have been analysed from a variety of angles, mostly including the information asymmetry, agency problem and signalling theory. It is worth noting that most of this literature refers to the quality of the AC rather than its presence, as its presence is mandatory.

The going public process is characterised by the existence of information asymmetry between firms and investors, as companies possess privileged insights into their future cash flows that prospective investors do not have. Thus, the greater the level of information asymmetry surrounding an IPO, the greater the underpricing, measured as the increase in the price of the shares at the initial time of listing (Ritter and Welch, 2002). Previous seminal studies show that these problems could be mitigated by transparent financial disclosure (Hughes, 1986). Since one of the main functions of an AC is to enhance the quality of financial information, by improving the quality of financial reports, an AC mitigates the information asymmetry between investors and issuers. Previous studies such as Bédard *et al.* (2008) and Venkataraman *et al.* (2008) find that an AC enhances the quality of financial reporting to mitigate information asymmetry, thereby improving IPO pricing efficiency.

Agency theory has also been related in the literature with the role and effectiveness of ACs in the going public process. This theoretical perspective posits the presence of agency issues between underwriters and issuers, resulting in underpricing as underwriters may deliberately undervalue IPOs to minimise their marketing efforts (see seminal work by Baron (1982)), consequently leading to an allocation of IPO shares that does not favour the issuers (Liu and Ritter, 2010). Given that the AC assumes the supervisory role of the board of directors concerning financial reporting, thereby enhancing the quality of financial disclosures, it potentially diminishes the bargaining power of underwriters. Consequently, the firm's performance could also be elucidated through the lens of agency theory (Kao and Chen, 2020). Previous seminal studies also show that these problems could be mitigated by transparent financial disclosure (Hughes, 1986), which minimises agency problems by reducing information asymmetry between management and shareholders. Additionally, this author also identifies management forecasts in a going public prospectus as a possible signal of the quality of the company. Karamanou and Vafeas (2005), in line with agency theory, find that corporate governance with an effective monitoring role increases the accuracy of management forecasts.

Finally, signalling theories state that the issuer or its managers attempt to communicate to investors the quality of their firm by choosing from a set of signals. These signals may include the proportion of shares held by shareholders with executive positions or sponsor (Saengchote and Charoenpanich, 2021), the reputation of the specialist agent (as investors may infer that an offering is of higher quality and/or less speculative if it is supported by a reputable agent (Paulus *et al.*, 2021)), the level of leverage (Brobert, 2016) or the board of directors structure (Filatotchev and Bishop, 2002), among others. The AC has the potential to play an important oversight role, especially with regard to the quality of information (financial and non-financial) communicated to the markets through the prospectus in the specific case of going public. Its creation and features can be used by existing shareholders as credible signals of the quality of their company and the quality of the information it provides. If the signal is effective, it would condition the price behaviour on the first day of trading, showing less underpricing. Furthermore, under the underlying hypothesis that the AC has a positive effect on the quality of financial information, as previous evidence shows (Bédard *et al.*, 2004; Klein, 2002), the AC provides a credible signal to build and maintain shareholders' confidence in the transparency and reliability of the financial information contained in the going public prospectus, thus validating the signalling theory.

4. Literature review and hypotheses

Next, we have divided the literature review and hypotheses into the analysis of the effect of the AC on (1) the price behaviour of the first trading day and (2) the quality of the earnings forecasts disclosed in the listing prospectus for the first year after listing [2]. As we discuss below, these specific issues have not been previously analysed in Europe, thus our review refers to non-European markets. Instead, some research has been conducted in Europe on the relationship between various aspects of corporate governance and the issues analysed in this study (Saona *et al.*, 2020; Teti and Montefusco, 2022).

4.1 Audit committee and the initial return when going public

Several studies have analysed the relationship between the AC and its characteristics and the initial return when going public.

Bédard *et al.* (2008) analyse a sample of 246 IPOs in the Canadian province of Quebec to determine if the establishment (voluntary in that market) and characteristics of the AC can be used as a signal by issuing companies to reduce the underpricing associated with IPOs. While

they do not find that the establishment of an AC at the time of the going public has a significant effect on underpricing, they do find that the level of IPO underpricing decreases significantly when its members are independent and have expertise in financial matters. Subsequently, Kao and Chen (2020) examine the effect of a pre-IPO AC on IPO pricing in 316 IPOs issued in Taiwan from 2007 to 2015. They find a significant negative relationship between the existence of an AC and the IPO underpricing and provide evidence on the presence of an AC to reduce agency problems between issuers and underwriters. She (2020), using a sample of 21 firms that made an IPO in Australian Securities Exchange (ASX) between 2008 and 2010, reported that the relationship between AC and the initial return is not statistically significant. In addition, Ettredge *et al.* (2021) demonstrate that the presence of an AC is not associated with the underpricing of IPOs with a newly established AC in a sample of 587 IPOs issued in the US during the period 2000–2010.

As pointed out before, this literature focus on IPOs, which involve soliciting new funds or investors to the market. Nonetheless, in our case of study, the fact that REITs go public through a direct listing, rather than by an IPO, changes the perspective from which to look at the market reaction on the first day of trading. It should be noted that in this market, the price taken as the initial admission price does not come from a book-building route, but rather it is determined by the REIT's board of directors based on the valuation of the company. In this sense, we associate the initial performance with higher market demand rather than higher underpricing. Thus, in a context where AC is voluntary, existing shareholders may utilise the presence of an AC as a mechanism in the company's quality signalling strategy (Castaño *et al.*, 2023). Because of the limited knowledge that investors have about companies that go public, they must place substantial reliance on the prospectus produced by the new issuer. The presence of an AC helps to ensure that the information communicated prior to the flotation is credible and that the company's management will continue to provide quality information even after the listing fostering the demand of shares on the first day of trading.

We, therefore, formulate the following hypothesis:

H1. The presence of an audit committee is positively associated with the initial return.

4.2 Audit committee and earnings forecast error in the listing prospectus

Previous evidence shows that ACs are positively associated with financial reporting quality (Bédard *et al.*, 2004; Klein, 2002). Although there is a relevant literature analysing how various variables influence the quality of management earnings forecasts included in the prospectus, the literature studying the effect of having (or not) an AC on the mentioned quality is scarce. Bédard *et al.* (2008) analyse the effect of having an AC on the quality of management earnings forecasts included in the prospectus for a sample of 246 IPOs in Quebec, where ACs are not mandatory and firms can voluntarily incorporate an earnings forecast in their prospectus. They do not find that the AC presence has an effect on management forecast precision.

Some authors examine the relationship between certain characteristics of the AC and the accuracy in earnings forecasting. Ahmad-Zaluki and Wan-Hussin (2010), in a sample of 235 IPOs in Malaysia that took place between 1999 and 2006, find that companies with a higher percentage of non-executive directors in the AC and a larger AC size exhibit greater accuracy in forecasts. Ben Ahmed *et al.* (2021) analyse the effect of the size of the AC on the accuracy of earnings forecasts in 33 companies that have gone public in Tunisia between 2011 and 2015. Their results reveal that firms with a suitably sized AC have a significant level of earnings forecast accuracy.

Finally, several studies analyse the relationship between the age and size of the issuer, the level of leverage, the size and independence of the board of directors, the quality of auditor, among others, and the earnings forecast error in the going public prospectus (Ammer and Ahmad-Zaluki, 2017; Bédard *et al.*, 2004; Chen *et al.*, 2020; Karim *et al.*, 2013; Mnif, 2010).

Following Bédard *et al.* (2008), we use the accuracy and bias of the earnings forecast for the first year after flotation included in the listing prospectus as a measure of the quality of the disclosed information. Given the role of the AC as a supervisor of the financial reporting preparation process, we expect that the presence of an AC in the REIT's governance structure will result in higher quality earnings forecast and, therefore, we hypothesise the following:

H2. The presence of an audit committee is associated with a lower error in the earnings forecast included in the prospectus.

5. Methodology

Our initial sample consists of all the REITs listed in BME Growth since the creation of the particular segment for REITs on 15 February 2013 until 31 December 2022. Over this period, there have been 100 admissions. For the initial return analysis, we have discarded those companies that have not traded on the first day or have only done so through block trading (bilateral trading), as the latter is not considered as an official closing price and, therefore, it is not representative of market behaviour (47 firms removed). Additionally, we have removed two companies from the sample because they are considered outliers with respect to the initial-day return (IR), as they could distort the results [3]. Thus, the final sample consists of 51 observations (listed companies). For the analysis of the earnings forecasts error, we have discarded those companies that have not included forecasts in their prospectus. As a result, the sample has been reduced to 55 observations (listed companies).

Data on market admissions, financial information and other information about the REITs were hand-collected from the Informational Document on Admission to the Market (IDAM), financial information and the relevant facts available on the BME Growth website. Specifically, to build the database, the IDAMs were read one by one, extracting from them all the data needed to calculate the variables defined in Table A1, except for one variable that refers to stock market data. Stock market data was obtained from the Bolsas y Mercados Españoles Group and from the Thomson Reuters Datastream database. To calculate the earnings forecast error, it was also necessary to review the first post-listing audited annual accounts of all the companies analysed, one by one.

Regarding the methodology for analysing the relationship between the AC and the initial return when going public, we have measured the initial return of REITs going public *(IR_i)* by the return on the first trading day, obtained as the relative difference between the closing price of REIT i on the first day of trading (P_{ic}) and the reference price (P_{ir}) as shown in expression (1).

$$IR_i = (P_{ic} - P_{ir})/P_{ir} \tag{1}$$

To isolate the effect of the committee on IR, we control for other variables that previous literature has shown as related to the initial return of REITs when going public (Castaño *et al.*, 2023). We test the hypothesis with the cross-sectional regression model defined in expression (2). The control variables are shown in Table A1.

$$IR_i = \alpha + \gamma AUDITCOM_i + \sum_{j=1}^{m} \beta_j X_{ij} + \varepsilon_i\,, \tag{2}$$

where IR_i is the Initial-day Return of company i calculated from expression (1), AUDITCOM is a dummy variable that takes value 1 if REIT i has an audit committee prior to the listing and zero otherwise and X_{ij} are the control variables defined in Table A1. The natural logarithms of the variables SIZE (LNSIZE), AGE (LNAGE) and DEBT (LN (1+DEBT)) have been used to minimise the influence of extreme values on expression (2) and expression (4) defined below.

Table 1 offers a summary statistics for the variables used in the IR sample, both for the full sample and by splitting the sample into the REITs that have an AC and those that have not.

We find a mean (median) IR of 1.58% (1%) for the full sample. Our results are in line with those obtained by Castaño *et al.* (2023) and within the wide range of IRs reported in previously REIT studies, as shown in the aforementioned study. When we split the sample by AC, we find that the average IR of the subsample with AC (2.49%) is higher than the sample without AC and we also see that REITs with AC are much larger and older than those without AC.

With regard to the methodology employed for the analysis of the relationship between the AC and the earnings forecast error in the listing prospectus, it is worth mentioning that the traditional measures used to assess the quality of financial reporting involve examining discretionary accrual levels in accounting statements and abnormal market returns linked to accounting information disclosures (Kao and Chen, 2020; Klein, 2002). Nevertheless, these measures are challenging to implement for companies with limited prior financial information and no history of share trading. Therefore, following Bédard *et al.* (2008), we calculate the earnings forecast error (EFE_i) by comparing the expected earnings declared in the prospectus ($FORECAST_i$) with its realisation contained in the first annual report after the listing ($ACTUAL_i$), as in expression (3).

$$EFE_i = \left(\frac{FORECAST_i - ACTUAL_i}{|FORECAST_i|}\right)100. \tag{3}$$

The signed earnings forecast error (EFE) in expression (3) measures *Bias*, while the absolute value of the EFE measures *Accuracy*. By examining the sign of the mean of earnings forecast bias (positive or negative), we can conclude whether the firm is optimistic or conservative (pessimistic) about its earnings forecast (i.e. whether the earnings are overestimated or underestimated).

Similarly, to test hypothesis H2 we analyse the relationship between earnings forecast error and the existence of an audit committee (AUDITCOM) through expression (4).

	Full sample					With AC			Without AC		
	N	Mean	Min	Median	Max	*N*	Mean	Median	*N*	Mean	Median
IR (%)	51	1.58	−4.34	1.00	7.69	8	2.49	1.71	43	1.41	1.00
Size (million €)	51	148.04	5.91	57.18	1,838.56	8	463.68	226.90	43	89.32	50.00
Age (years)	51	4.31	0.19	2.17	42.27	8	11.60	5.31	43	2.95	2.14
Auditor	51	0.586	0.05	0.63	1.00	8	0.49	0.55	43	0.60	0.63
Executives (%)	51	23.02	0.00	7.14	98.72	8	20.79	3.83	43	23.43	7.88
IGBMRET (%)	51	−1.96	−15.42	−0.26	5.98	8	−0.59	−0.56	43	−2.21	−0.26
DEBT (%)	51	31.27	0.00	33.93	79.14	8	32.24	35.23	43	31.09	33.93

Dummy variables	*N*	Num. Dummy 0	Num. Dummy 1
AUDITCOMIT	51	43	8
Property	51	38	13
Management	51	42	9
Reference price	41	16	25
PPP	51	30	21
Standard	51	9	42

Note(s): The variables are described in Table A1
Source(s): Table by authors

Table 1. Summary statistics of the IR sample for the variables. Full sample and segmentation of the sample according to whether or not there was AC

$$ERROR_i = \alpha + \gamma AUDITCOM_i + \sum_{j=1}^{m} \beta_j X_{ij} + \varepsilon_i, \quad (4)$$

where $ERROR_i$ stands for EFE and | EFE |. The control variables used are identical to those in expression (2), except for the IGBMRET and REFERENCE PRICE variables, as it was not appropriate to include it.

Regression models (2) and (4) have been estimated by cross-sectional Ordinary Least Squares (OLS), applying the methodology proposed by White to obtain a robust estimation of the parameters in the presence of heteroscedasticity. Additionally, we have used the bootstrap procedure (Fox, 2008) as we have a small sample size. For the same reason, we considered appropriate not to include more than 7 explanatory variables in the same model. To analyse the absence of multicollinearity among the regressors, we have used the Variance Inflation Factor (VIF). Finally, we check the possibility of endogeneity caused by selection bias through the two-step estimation procedure of Heckman (1979) [4].

Table 2 offers summary statistics for both the full sample and splitting it into the REITs that have an AC and those that have not. Examining the sign of the mean of the earnings forecast bias (EFE) for the full sample we can conclude that firms are optimistic about their future earnings in line with the findings of the main literature (Chen *et al.*, 2020). By splitting the sample, we observe that the same happens in the case of REITs without AC as the mean is positive. However, in the case of REITs with AC the opposite happens, as the negative sign of the mean indicates that the earnings forecast is pessimistic (or less optimistic) and future earnings are underestimated. Regarding the earnings forecast accuracy (| EFE |), it is lower for the REITs that have an AC and, therefore, the quality of the forecasts is higher in these REITs.

6. Results

6.1 Audit committee and the initial return when going public

The results obtained for the seven regression models (see expression (2)) are shown in Table 3. We find that our variable of interest AUDITCOM is positive and statistically significant in all

	Full sample					With AC			Without AC		
	N	Mean	Min	Median	Max	*N*	Mean	Median	*N*	Mean	Median
EFE (bias) (%)	55	9.86	−54.58	0.00	34.04	3	−2.26	−0.45	52	10.56	0.00
| EFE | (accuracy) (%)	55	19.10	0.00	5.21	100.00	3	3.41	1.72	52	20.01	5.31
Size (million €)	55	59.53	7.04	28.80	329.43	3	147.07	152.69	52	54.48	28.09
Age (years)	55	2.90	0.19	1.91	31.49	3	1.63	2.08	52	2.97	1.91
Auditor	55	0.57	0.04	0.31	1.00	3	0.45	0.31	52	0.58	0.31
Executives (%)	55	25.82	0.00	8.53	93.4	3	4.80	7.14	52	27.04	10.05
DEBT (%)	55	29.09	0.00	18.97	134.26	3	15.46	12.08	52	29.87	20.38

Dummy variables	*N*	Num. Dummy 0	Num. Dummy 1
AUDITCOMIT	55	52	3
Property	55	43	12
Management	55	52	3
PPP	55	27	28
Standard	55	7	48

Note(s): The variables are described in Table A1
Source(s): Table by authors

Table 2. Summary statistics of the earnings forecast error sample for the variables. Full sample and segmentation of the sample according to whether or not there was a AC

	M1	M2	M3	M4	M5	M6	M7
Intercept	0.022	0.008	0.023	***0.030[b]	*0.021[c]	0.021	0.025
AUDITCOM	**0.025[b]	*0.018[c]	*0.025[c]	**0.023[c]	**0.021[c]	*0.025[c]	**0.023[c]
LNSIZE	−0.005		−0.005	−0.003	−0.003	−0.005	−0.004
LNAGE				−0.070			
LNDEBT		*−0.034		−0.021	−0.022		−0.029
Auditor			−0.002				
Executives	**−0.001[b]	*−0.002[c]	*−0.001[c]			**−0.001[c]	**−0.001[b]
IGBMRET				*0.112[c]			
Property						0.001	
Management					−0.008		
Reference price	**0.011[b]	*0.010[c]	**0.011[c]	**0.012[c]	*0.011[b]	**0.011[b]	**0.012[b]
PPP	**0.017[b]	***0.020[a]	**0.016[b]	*0.013[c]	**0.016[b]	**0.016[b]	***0.018[a]
Standard	0.006	0.010	0.006			0.006	0.006
N[(a)]	41	41	41	41	41	41	41
Adjusted R^2	0.202	0.214	0.178	0.222	0.153	0.178	0.231
F-test statistic	***5.20	**2.78	***4.83	**3.12	**3.07	***4.45	**4.16
VIF	[1.06–1.99]	[1.07–1.20]	[1.08–2.01]	[1.17–1.68]	[1.10–1.64]	[1.10–2.16]	[1.11–2.10]

Note(s): Multiple linear regression models estimated by cross-sectional OLS. Dependent variable is the initial-day return. Heteroscedasticity has been corrected using White's methodology
The variables are described in Table A1
VIF: Variance Inflation Factor. Maximum-minimum values are reported
***, **, * significant at the 1%, 5 and 10% levels, respectively
[a, b, c] significant at the 1%, 5 and 10% levels, respectively, using the bootstrap methodology
[(a)] 10 observations have been lost out of the initial 51 since there are firms that do not perform an initial valuation of the company and therefore the REFERENCE PRICE variable has no value (see Section 2 for more information)
Source(s): Table by authors

Table 3.
OLS regression models of AC and IR

the models. That is, the IR for those firms that have an AC is significantly higher than those that do not have one, accepting our first hypothesis H1. Thus, investors show more interest in and demand for the shares of companies with an AC, leading to an increase in the price on the first day of trading. These results suggest that companies with an AC provide greater guarantee and confidence in the financial information published, both in the issue prospectus and in the information to be published in the future. Our evidence is consistent with a context in which the going public takes place without an IPO and it is related with the signalling theory.

Our results are contrary to some studies, such as those by Bédard *et al.* (2008), Ettredge *et al.* (2021), and She (2020) who show that either there is no relationship between the existence of an AC and the initial return, or that the relationship between the two variables is negative, as in Kao and Chen (2020). It should be noted that in these studies the procedure of going public is an IPO and primarily rely on the theories of information asymmetry and agency theory.

Regarding the control variables, Table 3 shows that variables EXECUTIVES, PPP and REFERENCE PRICE have a significant relationship with the IR. These results are consistent with those of Castaño *et al.* (2023) and are explained by certain signalling theories related to capital structure, investor sentiment, and market peculiarities.

6.2 Audit committee and earnings forecast error in the listing prospectus

Table 4 presents the results on the relationship between our variable of interest (AUDITCOM) and the quality of managers' forecasts for the first post-listing annual earnings included in the prospectus (see expression (4)), so testing H2.

	M1		M2		M3		M4	
	Bias	Accuracy	Bias	Accuracy	Bias	Accuracy	Bias	Accuracy
Intercept	**52.20[a]	***51.13[a]	***46.99[a]	***46.11[a]	***53.67[b]	***54.42[b]	35.56	**51.39[b]
AUDITCOM	***−25.92[a]	***−26.74[b]	**−28.26[a]	*−26.69[b]	*−18.13[c]	*−20.45	**−22.59[b]	**−21.60[b]
LNSIZE							0.97	−2.15
LNAGE	**−10.26[b]	*−7.10[c]	**−10.23[b]	*−8.13[c]	**−10.53[b]	*−7.44		
LNDEBT	**−52.43[b]	***−53.82[b]	**−51.65[b]	***−51.16[b]	**−53.45[b]	***−55.50[a]	**−50.22[b]	**−51.53[b]
Auditor	***−34.44[b]	**−24.07[b]	**−36.87[b]	**−23.12[b]	***−39.64[a]	**−27.19[b]	***−32.60[a]	*−20.93[b]
Executives			−0.03	0.07				
Property			20.38	17.77				
Management					*−25.65	*−23.46		
PPP	−5.61	−0.05						
Standard							35.56	0.44
N	55	55	55	55	55	55	55	55
Adjusted R^2	0.188	0.149	0.236	0.169	0.209	0.189	0.128	0.120
F-test statistic	**2.44	**2.30	**2.53	*1.94	**2.52	*2.07	*2.10	*2.06
VIF	[1.02–1.28]	[1.02–1.28]	[1.02–1.28]	[1.02–1.28]	[1.04–1.23]	[1.04–1.23]	[1.09–1.21]	[1.09–1.21]

Note(s): Multiple linear regression models estimated by cross-sectional OLS. Dependent variable is the Earnings Forecast Error (ERROR). Bias regressions use the signed EFE as dependent variable. Accuracy regressions use the absolute value of EFE as dependent variable. Heteroscedasticity has been corrected using White's methodology

The variables are described in Table A1

VIF: Variance Inflation Factor. Maximum-minimum values are reported

***, **, * significant at the 1%, 5 and 10% levels, respectively

[a, b, c] significant at the 1%, 5 and 10% levels, respectively, using the bootstrap methodology

Source(s): Table by authors

Table 4.
OLS regression models of AC and earnings forecast error

Our results suggest that the presence of an AC has an effect on the quality of the earnings forecast in the first year after listing, as we find a significant negative sign for the variable AUDITCOM for all the models. This negative sign indicates that in REITs with an AC the earnings forecast error (Accuracy) is lower. In the case of the earnings forecast bias (Bias), it indicates that in REITs with an AC the earnings forecast is less optimistic. Therefore, our results support the second hypothesis (H2) and suggest that the quality signalled by the company through the establishment of the AC at the initial stage is subsequently ensured by the fulfilment of the forecasts. Our results differ from those by Bédard *et al.* (2008) as they suggest that the presence of an AC do not to have any effect on either earnings forecast accuracy or bias.

We find among the control variables that the level of leverage (LNDEBT) of the REITs influences the earnings forecast error. That is, companies with higher leverage will be subject to greater supervision and monitoring, which should result in more accurate forecasts and a lower forecast error as in Mnif (2010). By contrast, Ben Ahmed *et al.* (2021) and Karim *et al.* (2013) found that this variable was not significant.

On the other hand, we observe that the variable AUDITOR is negative and statistically significant in all the models. Thus, REITs with a more prestigious auditor have more conservative forecasts and are related to a higher accuracy of earnings forecasts. These results are in line with those obtained by Ahmad-Zaluki and Wan-Hussin (2010), Ammer and Ahmad-Zaluki (2017), Ben Ahmed *et al.* (2021), Chen *et al.* (2020) and Karim *et al.* (2013). However, they are contrary to the evidence provided by Bédard *et al.* (2008) and Mnif (2010), as they found that this variable is not significant.

As for the age of the issuing firm (LNAGE), the negative and statistically significant sign of the variable suggests that younger firms (with a short or non-prior operating history and probably more difficult to forecast their earnings) are related to a higher earnings forecast error as in Chen *et al.* (2020), but not consistent with the findings of Ahmad-Zaluki and Wan-Hussin (2010), Ammer and Ahmad-Zaluki (2017), Bédard *et al.* (2008), Ben Ahmed *et al.* (2021) and Mnif (2010), where this variable was not significant.

Regarding the MANAGEMENT variable, its sign shows that internal management is negatively related to earnings forecast error. This variable is significant at 10% and is not significant using the bootstrap methodology.

Finally, we do not find the variables SIZE and EXECUTIVES to have statistical significance.

7. Conclusions and discussion

This study analyses the effectiveness of the existence of an AC as a sign of the quality of the company in the going public process, which is currently the subject of intense debate at the EU regarding regulatory changes to simplify the admission process. We focus on the European market BME Growth because of the adoption of an AC is voluntary for these firms, a fact that provides a unique opportunity to analyse its effectiveness as it is a discretionary decision of the companies and not a legal requirement. Specifically, we analyse the REIT admissions on BME Growth during the period from November 2013 to December 2022.

Our results suggest that the discretionary decision of REITs to have an AC is not neutral in the direct listing process given that we find that (1) REITs with an AC have a higher initial return (suggesting a greater demand for shares), and that (2) earnings forecasts contained in their prospectuses for the first year after listing are of higher quality than in those cases where there is not an AC. Our findings suggest that the AC serves as a reliable signal of the company's quality and the information provided in the prospectus, which plays a fundamental role in establishing and upholding investors' trust in the reliability of these financial disclosures.

In a context in which the European Union is studying several measures aimed at promoting the use of stock exchanges as a source of financing for companies, including regulatory changes to relax the requirements demanded to companies for their incorporation on the stock exchanges, this study fills the gap in the literature on the role of ACs in the going public process in a European market where the existence of an AC is not mandatory by showing evidence of their important role in this process. To our knowledge, the impact of the existence or absence of an AC in the context of the going public process has only been studied in non-European counties. Our study provides new evidence with results that differs from that obtained in other markets in a field where the evidence is inconclusive.

8. Implications and future research

Our research has several implications. For practitioners, companies considering its listing on a stock market can use the findings of this study to make more informed decisions about their corporate governance structure. Knowing that an AC can improve the quality of information in their prospectuses and increase the IR on their shares, companies may choose to establish an AC despite the additional costs. They can also use this decision as part of their strategy to attract potential investors by highlighting their commitment with transparency and good governance. This issue is relevant in an increasingly competitive environment where financing is key for companies, and listing on the stock market is an option for companies to carry out their investments. Additionally, our research provides specific evidence for regulators on the role played by the companies' audit committee in the process of going public, an important feature in the current European Union debate on the benefits of encouraging companies to go public. Regulators should be aware, before making decisions on rules changes, that having an AC, for example, positively affects the quality of certain information in the going public prospectus. For researchers, it contributes to enriching the scarce literature on this topic, whose results are inconclusive, studying a European emerging market with specific rules for determining the initial price when going public and where neither new funds nor new investors are sought. Studies such as ours highlight the importance of market design (microstructure) in the functioning of markets. For society, the study demonstrates that the AC plays an important role in the going public process. The implementation of ACs can contribute to the stability and transparency of financial markets, which benefits the economy as a whole. A higher level of confidence in financial markets can attract more investments and investors, not only institutional but also retail, thereby fostering economic growth. Nevertheless, we are aware that our study is subject to the prevalent constraint observed in emerging markets, namely, the small size of the sample.

Future research would extend the study to the analysis of seasoned equity offerings (SEOs) once the quality of the companies has been discovered. Likewise, an analysis of how the decision of establish (or not) an AC affects the performance of BME Growth REITs over the long term would complete the information necessary to have a broader view of the role played by these committees.

Notes

1. From the establishment of the market until October 2020 this market was called *Mercado Alternativo Bursátil* (MAB).
2. Additionally we have analysed whether the first annual report released by the REIT after listing has a greater effect on the prices of companies without an AC, assuming that the effect on prices will be driven by the earnings surprise. The results of our event study show that the stock market does not react to the earnings announcement, and there is no difference in behaviour between REITs with an AC and those without one. For the sake of brevity, results are not shown but they can be obtained from the authors on request.

3. Extreme values have been considered as being those that exceed three times the standard deviation of the IR_i mean.
4. The results are consistent with those obtained using OLS, not finding selection bias. For the sake of brevity, results are not shown but they are available from the authors upon request.

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Appendix

Variable	Definition
AUDITCOM	Dummy variable that equals to one if the REIT has an AC prior to the listing and zero otherwise
Size	Market capitalisation on the listing day, in millions of euros
Age	Age of the issuing company from the constitution date to the listing day
Auditor	Ranking of the auditor based on the number of listings in which the agent has participated
Executives	Percentage of shares retained by shareholders in executive positions according to IDAM information
DEBT	Total debt to total assets ratio (both from the latest annual audited accounts or interim financial information subject to a limited review by its auditor, published in the IDAM)
IGBMRET	Buy-and-hold return of the Madrid Stock Exchange General Index (IGBM) computed 30 days prior to the listing
Property	Dummy variable equal to one if the property strategy followed by the REIT is diversified and zero if the property strategy followed is specialised
Management	Dummy variable equal to one if the management of the company is internal and zero if the management is external
Reference price	Dummy variable equal to one if the reference price determined by the board of directors of the REIT is equal to or less than the equilibrium price determined by the appraiser and zero otherwise
PPP	Dummy variable equal to one if the REIT has performed a private placement of shares (up to six months) before going public and zero otherwise
Standard	Dummy variable equal to one if the accounting standard used in the financial information is the national accounting standard and zero if it is the International Financial Reporting Standards

Table A1. Definition of variables[(a)]

Note(s): [(a)] For more details see Castaño *et al.* (2023)
Source(s): Table by authors

Corresponding author
Leticia Castaño can be contacted at: leticia.castano@uv.es