

Female directors help to boost earnings quality

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Prof. Judy Tsui, PolyU's Vice President (International and Executive Education), Director of the Graduate School of Business and Chair Professor of Accounting, Prof. Ferdinand A. Gul, Chair Professor of Accounting and Corporate Governance, and Prof. Bin Srinidhi of the City University of Hong Kong, have co-conducted a research project entitled "Female Directors and Earnings Quality".

Drawing on a sample of US listed firms from 2011-2007, the researchers tested the relationship between female participation in corporate boards and earnings quality. They employed two measures of earnings quality. Their first measure is discretionary accruals quality which is the estimation error in accruals after controlling for current, past, and future cash flows, sales and long-term assets, and operating cycle and volatility in sales. Their second measure of earning quality is the propensity of firms to beat earnings benchmarks by a small amount. When a firm's unmanaged earnings are just shy of earnings benchmarks such as prior-year earnings or analyst-forecasted earnings, managers have an incentive to manipulate earnings to meet/beat those benchmarks. These small increases (over the prior year's earnings) and surprises (over analysts' forecasts) constitute earnings management that is unrelated to firm performance. The researchers also conducted additional tests using performance-adjusted discretionary current accruals.

The results of this research project reveal that female directors are willing to tackle tough issues that are often considered unpalatable by all-male boards. Female board participation is also found to lead to more

effective board communication with investors. The presence of female directors in monitor positions on audit and corporate governance committees also makes for more transparent reporting and earnings quality. There is evidence that boards with female directors promote greater vigilance over financial reporting, exhibit greater independence of thought and ensure a more rigorous monitoring process.

The study reveals a positive relationship between female participation in corporate boards and earnings quality. After controlling for endogeneity, firm-level board governance, and other known firm and industry characteristics, the study finds significantly higher earnings quality in firms with female board participation.

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