

Do Women Directors Constraint Accrual Management? Malaysian Evidence

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Abstract

Women are found to be more risk averse than men (Fehr-Duda, 2006; Watson & McNaughton, 2007; Eckel & Grossman, 2008). Women are also different from men in their leadership styles and attitudes towards ethics and risks (Gul, Srinidhi & Tsui, 2007). These differences suggest that the presence of women is capable of reducing accrual management. Our empirical results show that the presence of women on the board and audit committee is not associated with accrual management. Hence, women do not appear to perform the accounting oversight role well.

Keywords: Directors, Accrual Management, Leadership, Accountancy

1. Introduction

In the US, women represented 16% of the directors in 2006 (Spencer Stuart 2006 Board Diversity Report). In a survey conducted by the Malaysian Ministry of Women, Family and Community Development in 2007, only 5% of the board members in a sample of 50 listed firms were occupied by women. Previous findings, although mixed, generally provide evidence that women's participation in top management is positively associated with firm performance (see for example Nguyen and Faff (2007) in Australia, Smith et al. (2006) in Denmark, and Erhardt et al. (2003) in the U.S).

To date, very few research has been undertaken to observe if women's participation in top management is able to mitigate accrual management. To our knowledge, only two studies were conducted to examine the association between board and audit committee characteristics, and actual earnings management practice based on reported financial figures. First is the work by Krishnan and Parsons (2008), and second, a study by Gul et al. (2007). Both studies examined American companies and provided evidence that the representation of women in top management is associated with reduced earnings management practice. However, no such study is found in other jurisdictions. To fill the missing gap, we feel that it is necessary that this study is conducted on Malaysian companies. Hence, it is the aim of this study to examine if the participation of women on the board of directors and audit committee would mitigate earnings management practice of companies in Malaysia.

2. Literature Review

It is evident that rising to the top by women is blocked by a “glass ceiling” in which aspiring women could see where they might go, but, in reality, they might not be able to be there. It is a widely accepted perception that “In any given occupation, and in any given public office, the higher the rank, prestige or influence, the smaller the proportion of women” (Hansard Society (1990, p. 2). This perception has slowly changed. In the U.S, the proportion of female directors was only 4.7% in 1987 but it rose to 13.6% in 2003 (Catalyst, 2003), and improved further to 16% in 2006 (Spencer Stuart 2006 Board Diversity Report). A similar pattern has also been observed in the UK where the proportion of female directors on UK FTSE 100 has increased from a mere 3.7% in 1995 to 8.6% in 2003 (Conyon and Mallin, 1997; Vinnicombe and Singh, 2003). Considering that these developed nations are champions in promoting gender equality, the increase in women participation on board is still not promising. Smith et al. (2006) reported, in Norway, the proportion of women directors increased from 6% in 2000 to 22% in 2003. As at end of 2007, the proportion of women directors increased to 37% (Oslo, 2007).

In Asia, evidence on women directors is very limited. This is because in the Asian culture, women are expected to play supporting roles rather than the leading role. Even Japan, a developed nation, is still very far from other developed nations with respect to the appointment of women to the boards. In 1998, only 0.2% of the board seats in Japan were occupied by women (Corporate Women Directors International, 2009).

The issue of women’s participation in top management in Malaysia emerges because the educational level of women has improved tremendously in recent years. In 2006, about 60% of students in the government-assisted universities in Malaysia were females. Evidently, in 2006, 45.8% of women aged 15 to 64 were in the workforce and they represented 35.6% of the total workforce of 10.6 million in Malaysia (Ministry of Women, Family and Community Development, 2007a). Statistics also shows that 26.1% of the working women are professionals, legislators, senior officials, managers, technicians and associate professionals. Thus, the pool of potential and qualified women who could serve on the board is large. In its 2004-2007 Achievement Report, the Ministry of Woman, Family and Community Development (MWFCDD) reported that the percentage of women appointed at the principal position levels (JUSA) in the public sector increased to 18% in 2004 and to 25% in 2007. The percentage of women elected as parliament members increased from 4.5% in 1980 to 9.6% in 2004 (MWFCDD, 2007a). The percentage of female senators increased markedly from a mere 9.5% in 1980 to 33.3% in 2004 (MWFCDD, 2007b). A survey by the MWFCDD on a sample of 50 Malaysian listed companies in 2007 reveals that the participation of women on the BODs from the year 2001 to 2005 was constant at about 10.2%. Surprisingly, the figure dwindled significantly to only 7.6% and 5.3% in 2006 and 2007, respectively. Statistics shows an increase of women’s representation on the boards of government-owned companies (GLCs), from 11% in 2005 to 14% in 2007 (Ministry of Finance, 2008).

Gul et al. (2007) describe women in top management as having “trust building roles”. Unlike men, women are believed to show greater concern for interpersonal relationship and rely on rules of fairness. The successful new generation of women leaders show that they succeed by “drawing on the skills and attitudes they developed from their shared experience as women” (Rosener, 1990, p. 119). While men adopt the “transactional” or command-and-control approach of leadership, women tend to adopt the “transformational”, interactive or the participative approach of leadership. Unlike men, women leaders are more interested in building relationships with their subordinates and they

would rather be evaluated on the basis of employee satisfaction than on the basis of financial performance (Appelbaum and Shapiro, 1993).

Surveying fund managers in the U.S., Germany, Italy, and Thailand, Beckmann and Menkhoff (2008) found that women are more risk averse, tend to be less overconfident and are more likely to shy away from competition. Using laboratory experiment with monetary incentives, Fehr-Duda (2006) found that women are risk averse than men. The finding is supported by Watson and McNaughton (2007) and Eckel and Grossman (2008). Since earnings management is associated with risks, we believe that women are less likely to be involved in earnings management. Gender socialization approach argues that men and women bring different values into their workplace that will subsequently shape their decisions and practices (Betz et al., 1989). Because men regard money and advancement as their successful factors, and see achievement as competition, Betz et al. (1989) argued that men are more likely than women to break rules or be less ethical. However, a number of empirical evidence indicates that men are more likely to engage in unethical behaviour (see for example Albaum and Peterson, 2006; and Betz et al., 1989).

Krishnan and Parsons (2008) determine if the participation of women in senior management predicts the quality of earnings. Multiple measures are used to proxy earnings quality. Gul et al. (2007) examine the association between female board membership and earnings quality. They measured earnings quality by using several measures. Both studies provide evidence that top management with female representation is associated with lower earnings management practice.

Drawing on the perspectives of leadership, ethical values and attitudes towards risks discussed above, and prior empirical evidence, we hypothesise the following:

- H₁: Boards of directors with women representation are less likely to engage in earnings management.
- H₂: Audit committees with women representation are less likely to engage in earnings management.

3. Research Methods

In view of several initiatives taken by the government with the policy on women participation and the revision of the Malaysian Code in 2007, data for the year 2008 are collected from all companies listed on the main board. To test the hypotheses, the following regression model is employed:

$$DACC = \alpha + \beta_1 WOMDIR + \beta_2 WOMAC + \sum_{i=2}^n \beta_i X + \varepsilon \quad (1)$$

Where,

DACC = Discretionary accruals,

WOMDIR = 0 if a board has no woman director and 1 if it has at least one woman director.

WOMAC = 0 if an audit committee has no woman director and 1 if it has at least one woman director and

X = a vector of control variables which include board independence (BODIND), board size (BODSIZE), board ethnicity (BODETHNIC), company size (COMSIZE), profitability (ROA), gearing (GRG) and auditor size (AUDITOR). Board independence is measured by the proportion of independent directors on the board, board size by the total number of board members, and company size by natural log of total assets. As for auditor size, a score of 1 is given if a company is audited by a Big-4 auditor, and a 0 otherwise. ROA is the ratio of net income to total assets. GRG is the ratio of total debt to total assets and gearing ratio is a measure of risk of breaching debt covenants.

Board ethnic diversity is measured using Simpson's diversity index as defined by Gibbs and Martin (1962) (cited in http://en.wikipedia.org/wiki/Diversity_index#References) for use in sociology as:

$$D = 1 - \sum_{i=1}^N p_i^2 \quad (2)$$

Where,

p = proportion of individuals or objects in a category

N = number of categories.

A score of 0 means all directors are of the same ethnic group. If there is 30% Malays, 50% Chinese and 20% Indians for example, the score will be 0.62. The highest score is not 1; it will be 0.5 if there are two ethnic groups, and 0.67 if there are 3 groups, and 0.75 if there are four groups. Earnings management is measured by the abnormal (or discretionary) accruals, which is computed using working capital accruals (also referred to as current accruals). Manipulation through working capital accruals is very attractive as it has no direct cash flow consequences and is relatively difficult to detect and easier for managers to manage (Xie, Davidson III and DaDalt, 2003). Further, managers have greater discretion over to manage current accruals than long-term accruals (Guenther, 1994; Teoh, Welch and Wong, 1998). This working definition of discretionary accruals is different from Jones' (1991) model, which used total accruals that include depreciation of fixed assets. DeFond and Jiambalvo (1994) argued that the Jones' (1991) model is more susceptible to manipulation than the non-working capital accruals. In addition, Beneish (1998) argued that the use of long-term accruals, such as depreciation, for manipulation is more transparent and economically implausible. Peasnell, Pope and Young (2000) found that the model was almost indistinguishable from the Dechow, Sloan and Sweeny (1995) modified version in detecting the levels of earnings management. Hence, total working capital accruals (WCA) are defined as the change in non-cash working capital and is computed as below:

$$WCA_{i,t} = \Delta(CA_{i,t} - CASH_{i,t}) - \Delta(CL_{i,t} - CBORR_{i,t}) \quad (3)$$

where CA is current assets, CASH is cash and cash equivalents, CL is current liabilities and CBORR is borrowings repayable in one year, all of which are scaled by lagged total assets. The total working capital accruals would then be partitioned into discretionary accruals (DACC) and nondiscretionary accruals (NDACC) and a cross-sectional ordinary least squares (OLS) regression is used to estimate the parameters (α_1 , α_2 and α_3) needed to estimate discretionary accruals and nondiscretionary accruals. The parameters (α_1 , α_2 and α_3) are estimated for each industrial sector of the Bursa Malaysia. Following Subramanyam (1996), industries which have less than six observations are excluded from the analysis.

$$WCA_{i,t}/TA_{i,t-1} = \alpha_1 + \alpha_2(1/TA_{i,t-1}) + \alpha_3(\Delta REV_{i,t}/TA_{i,t-1}) + \varepsilon_{i,t} \quad (4)$$

Where:

TA = Total assets

REV = Total sales

i and t = Firm and year

The nondiscretionary accruals (NDACC) are the predicted component of the regression while the residual of the regression represents (i.e. ε) the discretionary accruals (DACC). Thus:

$$NDACC_{i,t} = \hat{\alpha}_1 + \hat{\alpha}_2(1/TA_{i,t-1}) + \hat{\alpha}_3(\Delta REV_{i,t} - \Delta REC_{i,t}/TA_{i,t-1}) \text{ and} \quad (5)$$

$$DACC_{i,t} = WCA_{i,t}/TA_{i,t-1} - NDACC_{i,t} \quad (6)$$

The interest of this study is on accrual management, rather than its direction. Thus, consistent with prior studies (e.g. Barton, 2001; Klein, 2002), we use the absolute value of discretionary accruals as a proxy for accrual management.

4. Results

A total 855 companies were listed on the Main and Second Boards of Bursa Malaysia; however, after omitting companies with insufficient data; those designated under PN17 (i.e. classification for financially distressed firms); those under finance, REITs and closed fund sectors; those belonging to sectors that comprise of less than six companies, we ended up with 639 companies. Table 1 presents the descriptive statistics of the variables included in the study.

Table 1 Descriptive statistics (n=639)

Panel A: Continuous variables

| Variable | Min. | Max. | Mean | Std. Dev. | Skewness |
|---|---------|---------|---------|-----------|----------|
| Discretionary Accrual (DACC _{mj}) | -5.4217 | 1.56578 | -0.0961 | 0.3335 | -6.54023 |
| Discretionary Accrual (DACC _{wacc}) | -1.0755 | 1.02468 | 0.0445 | 0.9837 | 0.06975 |
| Board Independence (BODIND) | 0.11 | 0.92 | 0.4439 | 0.1207 | 0.793 |
| Board size (BODSIZE) | 3 | 17 | 7.46 | 1.858 | 0.889 |
| Ethnic Diversity (ETHNIC) | 0 | 0.76 | 0.3825 | 0.1799 | -0.653 |
| Firm Size (LnASSET) | 10.04 | 18.07 | 12.884 | 1.3438 | 0.0862 |
| Return on assets (ROA) | -0.88 | 0.74 | 0.0320 | 0.9560 | -0.643 |
| Leverage (LEV) | 0.48 | 176.81 | 4.0350 | 8.0920 | 16.161 |

Panel B: Dummy variables

| Variable | Frequency of "0" | Frequency of | Mean |
|----------|------------------|--------------|------|
|----------|------------------|--------------|------|

| | | "1" | |
|---|-----------|-----------|--------|
| Presence of female on Board (WOMBD) | 365 (57%) | 274 (43%) | 0.4288 |
| Presence of female on Audit Committee (WOMAC) | 530 (83%) | 109 (17%) | 0.1706 |
| Auditor (BIG4) | 277 (43%) | 57 (57%) | 0.57 |

Results in Panel B of Table 1 shows that 43% of the sample firms have women on their boards. The practice of appointing women to sit on the audit committee is not prevalent; only 17% firms appoint women to their audit committees and less than half of those companies with women on their boards appoint women to their audit committees (i.e. 40%). Ethnic diversity is found to be moderate as shown in panel A of Table 1 where the average score is 0.38, i.e. the majority of the boards have directors from two ethnic groups, i.e. Malay and Chinese directors dominate board memberships. Table 2 presents the results from regression analysis.

Table 2 Regression analysis results (n=639)

| Variable | Predicted sign | Coefficient | Std. error | T value | Sig. |
|---------------------|----------------|-------------|------------|---------|----------|
| Constant | ? | 1.556 | 0.425 | 3.361 | 0.000*** |
| WOMBD | - | -0.055 | 0.092 | -0.591 | 0.277 |
| WOMAC | - | -0.073 | 0.120 | -0.605 | 0.273 |
| BODIND | - | -0.005 | 0.332 | -0.016 | 0.490 |
| BODSIZE | ? | 0.016 | 0.023 | 0.712 | 0.238 |
| ETHNIC [§] | ? | 0.018 | 0.041 | 0.449 | 0.326 |
| LnASSET | + | -0.119 | 0.033 | -3.608 | 0.000*** |
| ROA [§] | - | 0.074 | 0.043 | 1.695 | 0.045** |
| LEV [§] | + | -0.157 | 0.044 | -3.559 | 0.000*** |
| BIG4 | - | -0.104 | 0.080 | -1.290 | 0.09* |
| Adj. R square | | 0.037 | | | |
| F- statistic | | 2.717 | | | |
| Sig. | | 0.004*** | | | |

* Significant at 0.10 level (one-tailed); ** Significant at 0.05 level (one-tailed), *** Significant at 0.01 level (one-tailed).

[§] normalized using the Van de Waerden formula.

The presence of women on the board and audit committee does not have any impact on accrual management. This evidence thus is not consistent with Krishnan and Parsons (2008) and Gul et al. (2007). Gul et al. (2007) find that the presence of women on the boards is associated with higher stock prices, which implies higher earnings quality. However, the findings are consistent with Abdullah and Ku-Ismail (2011) and Ku-Ismail and Abdullah (2011) where both of the studies find that women on the board are not associated with higher firm performance. Thus, the presence of women does not help in mitigating accrual management; rather their presence makes no difference in terms of accrual management.

Board independence and board ethnicity are also not associated with earnings management. Abdullah and Mohd Nasir (2004) also did not show any association between board independence and accrual management among Malaysian listed firms. Similarly, Abdul Rahman and Mohamed Ali (2006) also find that board independence and board ethnicity are not associated with earnings

management. Likewise, Hashim and Devi (2009) find that there is no significant relationship between board of directors' independence and earnings quality. In an earlier study, Abdullah (2004) also documents that board independence and firm performance are not related. Thus, taken all the evidence together, it does indicate that board independence and board ethnicity are not related to board performance, either in earnings management mitigation or improving the firm financial performance.

5. Conclusion

Our results show that the presence of women on the board is not associated with the level of accrual management. Therefore, based on the findings, women directors on the board and women on the audit committee are not able to constraint accrual management. While the evidence indicates that women on the boards and audit committees do not constraint the level of earnings management, their importance could not be ignored. As more women being appointed to the board and the audit committee, their voice will become stronger. Further, as they become more experienced as directors, they will become more effective in discharging their duties. In order to justify their appointment, women directors need to improve themselves and show a good example as a testimony of their capability. Consequently, the chances of more women being appointed to the board will increase as well. The initiative taken by the government in increasing the number of women to hold directorships in listed firms should be seen as a very important move as an attempt to break the "glass ceiling". In fact, in Norway and Spain, the appointment of women to the boards is done through law. But the initiative or enactment is not enough if women directors fail to perform their duties effectively.

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