The impact of corporate governance on earnings management in emerging economies: the Greek evidence

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Abstract: This study tries to investigate the impact of corporate governance mechanism effects on decisions that may manipulate earnings in Greek listed firms. To do so, the board of directors and the audit committee were taken into account, together with the total accruals of 46 Greek listed firms for the years 2011–2015. For the analysis, three research hypotheses have been made to investigate where the independent members do not use earnings management tactics and if financially healthy firms try these tactics. The main finding of the study is that firms with a strong and independent board of directors combined with an active audit committee, together with financial soundness and the presence of a large audit firm, are deterred from practices related earnings management.

Keywords: corporate governance; earnings management; discretionary accruals; accrual method.

Introduction

Nowadays, it is essential for listed firms to compose corporate governance statements, so that they are legitimate. As Cadez and Guilding (2008) denotes, corporate statements, including the corporate governance statements, are often released with deviations due to the firm’s management, risk factors, legal gaps and external factors. This all means that, under some circumstances, where goals are not being met, firms use earnings management (Bedard and Johnstone, 2004; Bajra and Cadez, 2017). Lin et al. (2011) notes that earnings management is the managerial action by which revenues and profits are either increased or decreased through aggressive accounting tactics.

Earnings management is the key factor of managers to lure stakeholders by using their power over accounting standards, with or without restriction, to affect corporate outcomes that depend on reported accounting numbers (Healy and Wahlen, 1999; Xie et al., 2003; Katmon and Al Farooque, 2017). Agency theory (Jensen and Meckling, 1976) and signalling theory referred as information asymmetry (Spence, 1973), indicate that there are many situations that motivate managers to involve inappropriate earnings management, such as changing corporate depreciation policy, estimations, provisions of bad debt, etc., to maximise their bonus, decrease the cost of debt, etc. (Katmon and Al Farooque, 2017).

Although, sometimes managers tend to manipulate earnings for their own benefit, stakeholders are being protected in a way by the corporate governance system (Bajra and Cadez, 2017). According to this system, there are several protection mechanisms to prevent fraud against stakeholders, among them the board of directors and the audit committee of the firm. The protection mechanisms of corporate governance system on earnings management are examined by several studies (Klein, 2002; Xie et al., 2003; Engel et al., 2010; Lin and Hwang, 2010).
The impact of corporate governance on earnings management

In the end of past century, there have been several accounting scandals in both sides of Atlantic (e.g., Enron, Parmalat, etc.), due to weaknesses in corporate governance systems (Bajra and Cadez, 2017). For that reason, changes in regulation policies have been made, to stricter requirements in internal controls and financial reporting methods (Schipper and Vincent, 2003; Schipper, 2005; Patterson et al., 2007; Grein and Tate, 2011). The European Union introduced the 8th Company Law Directive, to strengthen the role of board of directors and the audit committee and nowadays all the EU member-states (among them Greece) have taken the above directive into their national law.

As many studies note, there are several different internal and external mechanisms used, to protect shareholders’ rights, over earnings management. Literature argues that the quality of corporate governance practice in an enterprise may prevent earnings management. A strong example is the primary role of the board of directors, who may monitor the companies’ management on behalf of shareholders (Corbett et al., 2008; Katmon and Al Farooque, 2017).

Several studies have investigated the relationship between the disclosure quality and earnings management (Lapointe-Antunes et al., 2006; Jo and Kim, 2007; Iatridis and Kadorinis, 2009), till now research failed to consider the effect that corporate governance practice that used from an enterprise have on the earnings management (Xie et al., 2003; Chang and Sun, 2009; Kent et al., 2010; Katmon and Al Farooque, 2017).

2 Literature review

Earnings management is the managerial activity that manipulates the reported earnings through the influence that managers have on the financial reporting process (Bajra and Cadez, 2017). Managers tend to manipulate earnings by discretionary accruals (Dechow et al., 1995). Although corporate conditions, as business cycle and growth, create the accrual profits, discretionary accruals identify management choices (Bajra and Cadez, 2017). As literature notes, the protective mechanism to reduce the manipulation of earnings by managers is corporate governance (Beasley and Salterio, 2001; Raghunandan et al., 2001; Cohen et al., 2002; Moyes et al., 2006; Doyle et al., 2007; Engel et al., 2010; Brown et al., 2014).

Board members usually work in order to defend not only the stakeholders’ interests, but their own as well. Xie et al. (2003) note that nowadays board monitoring is affected from the composition of the board itself and of the structure of the board’s subcommittees. Vance (1983) remarks that there are four board subcommittees that have great influence on firm’s activity and these are the audit, the executive, the compensation, and the nomination committee, while Kesner (1988) contends that is the most important decisions are taken at the committee level.

Board composition may be unrelated to a firm’s performance, as Klein (1998) notes, but the structure of the subcommittees referred to accounting and finance have impact on firm’s performance (Xie et al., 2003). Davidson et al. (1998) found that outside directors may be more important members of committees as the influence positive on firm’s best practices. The outside directors are better to handle agency issues, such as audit
committee, while inside directors may use their firm’s knowledge on committees that focus on specific issues, such as finance committee. It is essential to note that a subcommittee includes some members of the board, but it influences topics that are discussed by the entire board members.

One of the most important subcommittee, that may have a direct role on earnings management and to control that practice, is the audit committee. This committee has the duty to monitor the firm’s performance and financial performing. Xie et al. (2003), note that an active, well-structured, and well-functioning audit committee may prevent earnings management tactics. Of course, an audit committee that have outside members and mostly independent tends to be more effective on monitoring. The members of audit committee should have corporate and financial backgrounds, so that to understand earnings management. If an audit committee be composed by independent outside members with economic background, earnings management will be less likely happen. Xie et al. (2003), note that audit committees should be active to monitor earnings management. An audit committee that meets few times per year leads managers to manipulate earnings.

On the other hand, the board size and the board meetings may be related to firm’s performance (Xie et al., 2003). Yermack (1996) and Eisenberg et al. (1998), note that smaller board size lead to better firm performance. This is because, in a way, a smaller board may be more functional, free from bureaucracy. It should be noticed that if a larger board may have independent directors with economic background, that also might prevent from manipulate earnings.

3 Sample – empirical analysis

For this study, a sample composed of non-financial firms listed on the Athens Stock Exchange was selected covering the period between the fiscal years 2011 and 2015. Financial companies were excluded from this study and because their accounting standards and financial reports are different from non-financial firms (as suggested by previous studies). The financial data received from ICAP database, which provides historical financial data for Greek public and private firms.

In Table 1, the sample of the study is given.

<table>
<thead>
<tr>
<th>Fiscal year</th>
<th>2011</th>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public non-financial firms on Athens Stock Exchange</td>
<td>197</td>
<td>197</td>
<td>197</td>
<td>193</td>
<td>188</td>
</tr>
<tr>
<td>LESS: two digit SIC industries with fewer than 15 companies per year</td>
<td>(146)</td>
<td>(146)</td>
<td>(146)</td>
<td>(142)</td>
<td>(137)</td>
</tr>
<tr>
<td>LESS: firms with missing/invalid data (accounting or corporate governance)</td>
<td>(5)</td>
<td>(5)</td>
<td>(5)</td>
<td>(5)</td>
<td>(5)</td>
</tr>
<tr>
<td>Final sample</td>
<td>46</td>
<td>46</td>
<td>46</td>
<td>46</td>
<td>46</td>
</tr>
</tbody>
</table>
From the total sample all the firms with missing data (values) were excluded. As Roychowdhury (2006) denotes firms which operate in share classes with fewer than 15 firms per fiscal year, were excluded from further analysis. The final sample consist of 46 firms of which 23 are activate as wholesale and retail trade and the rest as other professional, scientific, and technical activities.

4 Earnings management estimation

Prior literature has used different methodologies to discover earnings manipulation and to measure their impact on the reliability of financial statements. The methodological approach of this study is based on the modified Jones’ regression model (Jones, 1991), which uses the discretionary component of total accruals (TA) as a measure of the reliability of financial statements.

Usually TA at the time t for firm i (TA


) are expressed as the difference between accounting earnings before extraordinary items and operating cash flows; we adopted the balance sheet approach, thus the ICAP’s database does not include the operating cash flow as a variable.

Equation 1: the balance sheet approach for total accruals

\[ TA_{it} = \Delta Current\ Assets_{it} + \Delta Cash_{it} + \Delta Current\ Liabilities_{it} + Depreciation\ and\ Amortisation\ Expenses_{it} \] (1)

where:

- \( TA_{it} \) = total accruals for firm \( i \) in the year \( t \).
- \( \Delta Current\ Assets_{it} \) = changes in current assets for firm \( i \) between year \( t \) and \( t-1 \).
- \( \Delta Cash_{it} \) = changes in cash for firm \( i \) between year \( t \) and \( t-1 \).
- \( \Delta Current\ Liabilities_{it} \) = changes in current liabilities for firm \( i \) between year \( t \) and \( t-1 \).
- Depreciation and amortisation \( Expenses_{it} \) = depreciation and amortisation expenses for firm \( i \) between year \( t \).

TA may expressed as discretionary (DA) and non-discretionary (NDA) component as follows:

Equation 2: total accruals as discretionary and non-discretionary parts

\[ TA_{it} = DA_{it} + NDA_{it} \] (2)

According Jones (1991) the discretionary accruals (\( DA_{it} \)) can be expressed in the following terms:

Equation 3: total accruals according Jones (1991)

\[ DA_{it} = \frac{TA_{it}}{A_{it-1}} = a1 \left( \frac{1}{A_{it-1}} \right) + a2 \left( \frac{\Delta REV_{it}}{A_{it-1}} \right) + a3 \left( \frac{PPE_{it}}{A_{it-1}} \right) + e_{it} \] (3)
where

\[
\begin{align*}
TA_{it} & \quad \text{total accruals for firm } i \text{ in the year } t \\
A_{it} & \quad \text{total assets for firm } i \text{ in the year } t \\
\Delta \text{REV}_{it} & \quad \text{changes in revenues for firm } i \text{ between year } t \text{ and } t-1 \\
PPE_{it} & \quad \text{gross property, plant and equipment for firm } i \text{ in the year } t \\
\epsilon_{it} & \quad \text{error term of the equation.}
\end{align*}
\]

5 Hypothesis development

According Grose et al. (2014), Greek firms appear to represent a corporate governance model like the Anglo-Saxon model, separating the role of Chairman of Board and that of the CEO, as well as the audit committees (no duality). However, the model applied to Greece, has characteristics of the traditional European-continental model (e.g., family members running firms and participating on Boards). Greek firms have a surprisingly low degree of CEO-chairman of board duality. Women have a place in companies’ boards, while the average size of boards is eight members, which is above the threshold set for ideal practices. All the above underlines the fact that Greek firms gradually adopt corporate governance’s best practices in their operations.

Non-executive members of boards in Greek firms are the 50% of the total board members whereas the required ratio by the law is one in three members (33.33%). On the other hand, the independent members are on average no more than two, which represents the minimum requirement. Greek firms tend not to release a lot of information on frequency of board meetings, on the remuneration packages of members of boards and top management officials or on internal audit organisation and practices.

According to the literature, large firms are more likely to manage their earnings to meet the expectations of analysts (Safari et al., 2016; Myers et al., 2007; Barton and Simko, 2002). On the other hand, indebted firms have a stronger incentive to manage their earnings to present themselves as more attractive borrowers to lenders (Degeorge et al., 1999; Burgstahler and Dichev, 1997).

When the financial statements are audited by one of the big four audit firms a negative relationship with earnings management practices is expected. The big four are the four largest professional services networks in the world, offering audit, assurance services, taxation, management consulting, advisory, actuarial, corporate finance and legal services. The four largest auditing firms of the world are Ernst & Young, Deloitte & Touche, KPMG and PriceWaterhouseCoopers. They have grand experience and expertise in auditing financial statements, especially compared to other, smaller auditing firms and are considered as more independent (Francis et al., 1999; Tsipouriou and Spathis, 2012; Van Tendeloo and Vanstraelen, 2008; Maijoor and Vanstraelen, 2006; Carlin and Finch, 2015).

Profitable firms are less likely to engage in earnings management practices than non-profitable firms. Our sample under the influence of financial crisis is primarily non-profitable for the period 2011 to 2015. But most firms report positive EBITD, probably to meet the analysts’ expectations.
On the other hand, firms which are composed by big and strong Board of Directions with the presence of several independent members are expected to have negative correlation with earnings management practices. The same assumptions are expected to exist for firms with strongly liquidity or firms which the audit committee meets and intervenes regularly (more than one meeting per year).

Summarising all the above our study leads to the following research questions:

**H1** The presence on the board of several independent members negatively affects to the adoption of earnings management practices.

**H2** The proper functioning of the audit committee in combination with the presence of an independent auditor negatively affects to the adoption of earnings management practices.

**H3** There is an inverse relationship between a firm’s financial health and the likelihood of adopting earnings management practices.

### 6 Model specification

The model specified below is proposed to test the hypotheses. The model includes several control variables that have been identified as important determinants of earnings management according previous researches (Bajra and Cadez, 2017; Prencipe and Bar-Yosef, 2011; Xie et al., 2003):

\[
EM_{it} = b_0 + b_1 SIZE_{it} + b_2 AUDITOR_{it} + b_3 LEV_{it} + b_4 EBITDA_{it} + b_5 BOARDSIZE_{it} \\
+ b_6 INDIP\_BM_{it} + b_7 QUICKRATIO_{it} + b_8 AudComMeet_{it}
\]

where

- **EM** earnings management (discretionary accruals)
- **SIZE** natural log of total assets
- **AUDITOR** an indicator that a firm have been audited by a Big4 auditor by one (1) and zero in other case
- **LEV** ratio of total liabilities to total assets
- **EBITDA** an indicator that a firm have positive EBITDA by zero and one if it is negative
- **BOARDSIZE** an indicator (dummy variable) that a firm’s Board have less of seven members by zero and 1 if it have over seven members
- **INDIP\_BM** the percentage of the independent members of the board of directors
- **QUICKRATIO** ratio of (current assets – inventories) to current liabilities
- **AudComMeet** an indicator that a firm’s audit committee have one or zero annual meetings by zero.
7 Results

7.1 Descriptive statistics

The data were analysed using the STATA software package (v.14). Data was screened for missing values. For those missing values a hand-collected from the annual financial reports were made. Finally, variables with missing data were excluded from the analysis. In addition, we exclude also the extreme values for the basic variables of the models we used (1st and 99th percentile observations). Table 2 presents descriptive statistics of the sampled data. Our sample consists of 230 observations from 46 listed Greek firms for the period 2011 to 2015.

Table 2 Descriptive statistics

<table>
<thead>
<tr>
<th>Variable</th>
<th>Obs</th>
<th>Mean</th>
<th>Std. Dev.</th>
<th>Min</th>
<th>Max</th>
</tr>
</thead>
<tbody>
<tr>
<td>EM</td>
<td>230</td>
<td>.0530592</td>
<td>.0911008</td>
<td>.0000314</td>
<td>1.0392</td>
</tr>
<tr>
<td>AUDITOR</td>
<td>230</td>
<td>.326087</td>
<td>.469802</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>SIZE</td>
<td>230</td>
<td>17.97587</td>
<td>1.284625</td>
<td>15.25708</td>
<td>21.54265</td>
</tr>
<tr>
<td>LEV</td>
<td>230</td>
<td>.544064</td>
<td>.5591486</td>
<td>.0068324</td>
<td>5.734333</td>
</tr>
<tr>
<td>INDIPMB</td>
<td>230</td>
<td>.3337891</td>
<td>.1129397</td>
<td>.0909091</td>
<td>.8</td>
</tr>
<tr>
<td>EBITDA</td>
<td>230</td>
<td>.4043478</td>
<td>.4918358</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>BOARDSIZE</td>
<td>230</td>
<td>.4478261</td>
<td>.498355</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>QuickRatio</td>
<td>230</td>
<td>1.863686</td>
<td>.895238</td>
<td>.0009462</td>
<td>3.37656</td>
</tr>
<tr>
<td>AudComMeet</td>
<td>230</td>
<td>.5304348</td>
<td>.5001614</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>board size</td>
<td>230</td>
<td>7.821739</td>
<td>1.914882</td>
<td>5</td>
<td>14</td>
</tr>
<tr>
<td>Board_Meetings</td>
<td>229</td>
<td>12.82096</td>
<td>19.13246</td>
<td>0</td>
<td>88</td>
</tr>
<tr>
<td>Independent board members</td>
<td>230</td>
<td>2.53913</td>
<td>.88448</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>Audit_committee size</td>
<td>230</td>
<td>3.021739</td>
<td>.27159</td>
<td>0</td>
<td>4</td>
</tr>
<tr>
<td>Audit committee independent meetings</td>
<td>230</td>
<td>2.256522</td>
<td>2.427881</td>
<td>0</td>
<td>18</td>
</tr>
<tr>
<td>Audit committee independent members</td>
<td>230</td>
<td>1.813043</td>
<td>.689791</td>
<td>0</td>
<td>4</td>
</tr>
</tbody>
</table>

Of the sample, 57.83% of the firms are audited from a non-big four auditor; on the other hand, the 42.17% of the sample are audited from a big four auditor. The firms of the sample have an average of discretionary accruals (earnings management) of 0.0530 (in absolute values) high enough to show that the earnings manipulation in Greece is very strong. About 60% of the sample report positive EBITDA. Finally, 45% of the sample has big board (over the seven members).
Table 3
Spearman correlation matrix

<table>
<thead>
<tr>
<th></th>
<th>EM</th>
<th>AUDITOR</th>
<th>SIZE</th>
<th>LEV</th>
<th>INDPMB</th>
<th>EBITDA</th>
<th>BOARDSIZE</th>
<th>QuickRatio</th>
<th>AudComMeet</th>
</tr>
</thead>
<tbody>
<tr>
<td>EM</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AUDITOR</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIZE</td>
<td>0.4179*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>LEV</td>
<td>0.1439*</td>
<td>-0.3350*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>INDPMB</td>
<td>0.1212</td>
<td>-0.3269*</td>
<td>0.3376*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>EBITDA</td>
<td>0.2472*</td>
<td>0.1762*</td>
<td>-0.2638*</td>
<td>-0.2264*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>BOARDSIZE</td>
<td>-0.1224</td>
<td>0.2778*</td>
<td>0.3852*</td>
<td>-0.4201*</td>
<td>-0.1951*</td>
<td>0.1264</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>QuickRatio</td>
<td>-0.1885*</td>
<td>-0.4201*</td>
<td>-0.1951*</td>
<td>0.1264</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>AudComMeet</td>
<td>0.2327*</td>
<td>0.1452*</td>
<td>0.1452*</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Notes: The values highlighted with star are significant for 95%, the other values are significant for 90% and the missing values are significant for less of 90%. EM = earnings management (discretionary accruals), SIZE = natural log of total assets, AUDITOR = an indicator that a firm have been audited by a big four auditor by one (1) and zero in other case, LEV = ratio of total liabilities to total assets, EBITDA = an indicator that a firm have positive EBITDA by zero and one if it is negative, BOARDSIZE = an indicator (dummy variable) that a firm’s board have less of seven members by zero and one if it have over seven members, INDP_MB = the percentage of the independent members of the board of directors, QUICKRATIO = ratio of (current assets – inventories) to current liabilities, AudComMeet = an indicator that a firm’s audit committee have one or zero annual meetings by zero.
In Table 3, is presented the Spearman rank correlation matrix. We easily notice that beyond the variables SIZE and AUDITOR, no other variable is strongly correlated. On the other hand, usually large companies choose large auditing firms to audit their reported financial statements.

7.2 The regression analysis

In order to test the model a panel data analysis is used. To detect which model fits better to our data we use the Hausman test. For the above analysis, the null and the alternative hypotheses are:

H₀  The random effect model is appropriate for our model.
Hₐ  The fixed effect model is appropriate for our model.

The result of the Hausman test gave us the following results.

<table>
<thead>
<tr>
<th></th>
<th>Coefficients (b)</th>
<th>Coefficients (B)</th>
<th>Difference</th>
<th>S.E.</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fixed</td>
<td>Random</td>
<td></td>
<td></td>
</tr>
<tr>
<td>AUDITOR</td>
<td>-0.5865990</td>
<td>-0.0377741</td>
<td>-0.0208858</td>
<td>0.0130914</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.0871326</td>
<td>0.0149089</td>
<td>0.0722237</td>
<td>0.0428164</td>
</tr>
<tr>
<td>LEV</td>
<td>0.0761871</td>
<td>0.0300147</td>
<td>0.0461724</td>
<td>0.0234093</td>
</tr>
<tr>
<td>INDIPMB</td>
<td>-0.4060512</td>
<td>-0.1239023</td>
<td>-0.2821489</td>
<td>0.0697493</td>
</tr>
<tr>
<td>EBITDA</td>
<td>0.0063449</td>
<td>0.0201377</td>
<td>-0.1379290</td>
<td>0.0154008</td>
</tr>
<tr>
<td>BOARDSIZE</td>
<td>-0.0298260</td>
<td>-0.0218372</td>
<td>-0.0079888</td>
<td>0.0169362</td>
</tr>
<tr>
<td>QuickRatio</td>
<td>-0.0360098</td>
<td>-0.0173783</td>
<td>-0.0186315</td>
<td>0.0077840</td>
</tr>
<tr>
<td>AudComMeet</td>
<td>-0.0570496</td>
<td>0.0084692</td>
<td>-0.0655188</td>
<td>0.0346121</td>
</tr>
</tbody>
</table>

Note: Chi²(8) = 38.77, Prob > chi² = 0.0000.

The probability value it is very low (less than 0.05), therefore we reject the null hypothesis and we accept the alternative one. This means that the fixed effect model fits better to our data.

We tested our model using the fixed effect model and the results are shown in Table 5. The presence of a big four auditor, the low liquidity, the existence of a large board with several independent members and the proper functions of an active audit committee show a negative correlation in adopting earnings management practices. On the other hand, big firms, of firms with negative EBITDA or financially distressed firms (high leverage) are more likely to adopt earnings management practices, probably to meet the expectations of analysts.
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Table 5  Regression analysis

<table>
<thead>
<tr>
<th>EM</th>
<th>Coef.</th>
<th>Std. err.</th>
<th>T</th>
<th>P &gt; t</th>
</tr>
</thead>
<tbody>
<tr>
<td>AUDITOR</td>
<td>-0.0586599</td>
<td>0.0206819</td>
<td>-2.84</td>
<td>0.005</td>
</tr>
<tr>
<td>SIZE</td>
<td>0.0871326</td>
<td>0.0434712</td>
<td>2.00</td>
<td>0.047</td>
</tr>
<tr>
<td>LEV</td>
<td>0.0761871</td>
<td>0.0276425</td>
<td>2.76</td>
<td>0.006</td>
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<td>INDIPMB</td>
<td>-0.4060512</td>
<td>0.0963881</td>
<td>-4.21</td>
<td>0.000</td>
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<tr>
<td>EBITDA</td>
<td>0.0063449</td>
<td>0.0207914</td>
<td>0.31</td>
<td>0.761</td>
</tr>
<tr>
<td>BOARDSIZE</td>
<td>-0.029826</td>
<td>0.0225832</td>
<td>-1.32</td>
<td>0.188</td>
</tr>
<tr>
<td>QuickRatio</td>
<td>-0.0360098</td>
<td>0.0113682</td>
<td>-3.17</td>
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<tr>
<td>AudComMeet</td>
<td>-0.0570496</td>
<td>0.0376045</td>
<td>-1.52</td>
<td>0.131</td>
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<td>cons</td>
<td>-1.308743</td>
<td>0.8007875</td>
<td>-1.63</td>
<td>0.104</td>
</tr>
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</table>

F-stat = 7.09  P = 0.000

Fixed-effects (within) regression Number of obs = 230
Group variable: firm_id  Number of groups = 46
R-sq:
    Within = 0.2438
    Between = 0.0431
    Overall = 0.0576

Notes: EM = earnings management (discretionary accruals), SIZE = natural log of total assets, AUDITOR = an indicator that a firm have been audited by a big four auditor by one (1) and zero in other case, LEV = ratio of total liabilities to total assets, EBITDA = an indicator that a firm have positive EBITDA by zero when EBITA is positive and one if it is negative, BOARDSIZE = an indicator (dummy variable) that a firm’s board have less of seven members by zero and one if it have over seven members, INDIP_MB = the percentage of the independent members of the Board of directors, QUICKRATIO = ratio of (current assets – inventories) to current liabilities, AudComMeet = an indicator that a firm’s audit committee have one or zero annual meetings by zero.

8 Conclusions

This study examined the impact of how corporate governance mechanisms (such as audit committee and board size) affect decisions on whether to adopt earnings management practices from firms. In Greece, most firms are family owned with characteristics that do not match exactly to the rest of the Western world. Although prior studies are focused on public US or EU firms which have many common features, our study focuses on the characteristics of family-owned firms, active in an emerging economy following the transition from a severe economic crisis.
The main finding of the study is that companies with a strong and independent board of directors combined with an active audit committee, together with financial soundness and the presence of a large audit firm are deterred from practices related to earnings management. In that way, those firms ensuring their reputation and credibility in the market.

On the other hand, financially distressed firms or firms with big size are more likely to adopt earnings management practices to improve their financial status in the market.

Like any other study, this study is subject to limitations. In addition to general limitations of archive-based research, the major limitation concerns measurement of the variables. Discretionary accruals are only a proxy for earnings management and no perfect measure or estimate of earnings management exists. Another limitation is that we do not have a clear picture of the work, the quality and the reliability of internal control or the quality of the board as well as their educational level and professional experience.

These limitations, also pertinent to other studies, should however not preclude further research concerning corporate governance quality and earnings management. Furthermore, we suggest as an investigation for future analysis, the effects of several other corporate governance mechanisms simultaneously owing to their potential interactive effects.

References


The impact of corporate governance on earnings management


