

Board Characteristics and Earnings Management: A Literature Review for gap analysis in Emerging Economies

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Abstract

Purpose: Earnings management on account of personal motivations of the management has been the subject of research in almost every country including the USA, UK and Australia. The increasing transnational transactions and changing market dynamics have necessitated research on earnings management and corporate governance in emerging economies for the interests of global stakeholders.

Design/Methodology/ Approach: It analyses academic articles indexed in EBSCO and related databases, between 2004 and 2014 and identifies the gaps in existing literature about the board characteristics and earnings management. It further illustrates how topics, theories, settings, characteristics and sources of data influence insights about board– corporate governance relationships during the time period.

Findings: The research in this domain, particularly in the context of emerging economies needs to be developed to become more paradigmatic in the light of globalization.

Originality: Although there are articles about the board characteristics and earnings management, the number of articles that examine this relationship in the context of an emerging economy like India are few. It is hoped that it will help future researchers to identify exemplars and to select suitable board characteristics for identifying earnings management behaviour in this context and to apply alternative methods to fully capture the impact of board processes and dynamics on earnings management in the light of corporate governance.

Keywords: earnings management; board characteristics; corporate governance; audit committees; emerging economies

1. INTRODUCTION

Whether firms are motivated towards wealth maximisation of all its stakeholders or selfish greed has been debated for long (Haynes, Campbell and Hitt, 2014). The incidence of corporate scams reported all across the globe including Enron, Worldcom, Xerox and Satyam have demanded stronger accountability in the duties and functioning of boards of directors at the centre of the corporate governance debate (Kiel and Nicholson, 2003; Ingley and Van Der Walt, 2005). This raises the issue of the impact of board characteristics on earnings management for effective corporate governance.

The corporations today, are run by professional managers on behalf of the owners who have to make many accounting choices for financial reporting. Sometimes, such accounting choices lead to private gains. This phenomenon finds its roots in the Agency theory and is supported by extant literature on corporate governance (Jensen and Meckling, 1976).

Prior studies have explored the association of earnings management with varied measures of board characteristics including size, independence, busyness and expertise (Peasnell et al., 2000; Klein, 2002; Xie et al., 2003; Baxter and Cotter, 2009; Jaggi et al., 2009; Kent et. al., 2010). However, most of these studies are contextualised in the USA and other developed economies. Only a few studies have explored the impact of board characteristics on earnings management practices of the firms in the context of an emerging economy. With the globalisation of equity markets across the world, the quality of reported earnings of developing economies becomes a serious concern.

A number of studies have identified that the developing economies struggle with corporate governance concerns (LaPorta et al., 2000; Sarkar & Sarkar, 2000; Rajagopalan and Zhang, 2008). India, one of the most diverse countries in the world; with over 122 languages spoken by at least 10,000 people¹, is also in the transition phase of corporate governance. It is a rapidly growing marketplace and tipped to be one of the largest economies in the world in near future². “Over the years, the business reasons drawing multinationals to India have evolved, as reflected in their increasing number from 197 in 1991 to 891 in 2012. Their revenue grew at a compound annual rate of 18%—faster than the overall economy³.”

India witnessed two major corporate scams, Satyam and Kingfisher in 2009 and 2012; resulting in the regulatory transformation in the form of new Companies Act, 2013 since the old Companies Act, 1956 for improving corporate governance. The Companies Act, 2013 mandated inclusion of at least one woman director on the board of every listed company and does not allow independent directors to receive stock-options as part of remuneration.

The corporate governance models followed by the developed economies are different than the models followed in the developing economies. *For example*, in the US, there is the Anglo-American governance model that considers the shareholders as legal owners of the companies. The corporate governance models in other developed economies like Germany and Japan identify corporations as a social institution with distinct public role and responsibility. It incorporates representation of a range of stakeholder groups. But in developing economies like India, companies witness a hybrid of outsider-dominated market-based systems of the USA and the UK, and the insider-dominated bank-based systems of Germany and Japan. India witnesses a Promoter dominated shareholders model (PDSHM) with strong control of the promoters. The majority of the private companies in India are family-owned businesses with the largest shareholder controlling more than 50% of the shares.

¹ Ojha Prasad, Nikhil., O’Keeffe, Dunigan., and Dalal Saha, Arunava. The steady rise of MNCs. (2017). Livemint, 6th August. <http://www.livemint.com/Companies/t6wKAX4HAhpl4MKwCY1IJL/The-steady-rise-of-MNCs.html> accessed 4th August, 2017

² <http://www.commisceo-global.com/country-guides/india-guide> accessed 4th August, 2017.

³ Ibid.

The present study attempts to evaluate the following research questions. Firstly, it presents a critical review of the articles exploring the role of board level characteristics in containing earnings management. Secondly, it identifies specific board characteristics that have been extensively researched for restraining earnings management in the context of emerging economies. Thirdly, it evaluates the extent of research on the association of board quality and earnings management in the context of developing economies and compares it with those from developed economies. Finally, it examines the institutional framework in India and the researches that are specific to Indian context. The study also identifies numerous research gaps that provide scope for future studies.

The rest of the paper is organised as follows: Next section describes the methodology of conducting the literature review. The following section reviews the theoretical and empirical research on earnings management along with its association with board characteristics. This section also discusses the research in the Indian context. Section 4 presents the research gap identified in the review and Section 5 concludes with Section 6 discussing the implications for future research.

2. RESEARCH METHODOLOGY

A number of studies have explored the phenomenon of earnings management through various dimensions. A few studies (Burgstahler and Dichev, 1997; Healy and Wahlen 1999; Dechow and Skinner, 2000) have outlined the conceptual framework of earnings management. Some studies laid the foundation of theoretical research on earnings management. Another category of articles initiated the empirical research in this domain. The articles on developing economies offering unique corporate governance, like India were limited.

Accordingly, the process of literature review can be divided into following steps. At the first level, an EBSCO search with earnings management and board characteristics as keywords was conducted between 2004 and 2014. The time-span of 2004 to 2014 not only covers the implications of pre and post recessionary phase of 2007-08 for earnings management and the motivational impact of earnings management. This period also highlights the change in corporate governance regulation in India after Companies Act, 2013. A global financial meltdown may lead to regulatory reforms (Goodhart *et al.*, 2013) and would provide an interesting opportunity to study the association of earnings management and board characteristics. EBSCO is one of the easily accessible databases which provides abstracts and indexing for over 3,000 scholarly journals and features full-text articles for over 1,000 of those same journals⁴. It revealed 34 journal articles within 2004 and 2014. The summary of the articles revealed from EBSCO search is presented in Table 1.

⁴ Chapter 6 Evaluation Research Design: Literature Reviews & Synthesis, Evaluating Education & Training Services: A Primer. 1st MAY, 2017.<http://charlesdennishale.org/Evaluating-Education-and-Training-Services/6-EETS-Evaluation-Research-Design-Literature-Review-Synthesis-3.0.pdf> accessed 1st May, 2017.

Table 1: Summary of articles from EBSCO search

S. No.	Author(s)	Year	Title	Context	Key Findings
1.	Sarkar, Sarkar and Sen	2008	Board of directors and opportunistic earnings management: Evidence from India	India	Effective boards reduce earnings management
2.	Roudaki	2013	Earnings management in developing countries: Iranian listed companies	Iran	High incidence of earnings management in the absence of formal corporate governance guidelines
3.	Anglin <i>et al.</i>	2013	What is the relationship between REIT governance and earnings management	USA	Effective governance mechanisms reduce earnings management by Real Estate Investment Trusts
4	Quttainah, Song and Wu	2013	Do Islamic banks employ less earnings management?	Multi-country	Islamic banks are less likely to indulge in earnings management as Shari'ah Supervisory boards effectively check such behaviour.
5	Ghosh, Marra and Moon	2010	Corporate Boards, Audit Committees, and Earnings Management: Pre- and Post-SOX evidence	USA	Board and audit committee size, activity and tenure are associated with earnings management. No evidence to suggest that overall level of earnings management declined post the adoption of SOX
6	He <i>et al.</i>	2009	What makes a board independent? Australian evidence	Australia	Board monitoring is effective when share ownership of grey directors is lower and when fixed component of independent director remuneration is higher
7	Geraldes Alves	2011	The effect of the board structure on Earnings Management: Evidence from Portugal	Portugal	Discretionary accruals are negatively associated with board composition in Portugal

8	Gonzalez and Garcia-Meca	2014	Does corporate governance influence Earnings Management in Latin American markets?	Latin America	Limited role of external directors in containing earnings management
9	Ahmed	2013	Board of director characteristics and earnings management in Malaysia	Malaysia	Directors' financial expertise is significant in constraining earnings management
10	Farrell, Yu and Zhang	2013	What are the characteristics of firms that engage in Earnings Per Share Management through share repurchases?	USA	Board independence, CEO duality and low entrenchment index reduce earnings management through share repurchases. Share ownership by CEO also constrains earnings management
11	Simpson	2013	Does investor sentiment affect earnings management?	USA	Earnings management is driven partially by the prevailing market-wide investor sentiment
12	Sharma and Kuang	2014	Voluntary Audit committee characteristics, Incentives and Aggressive Earnings Management: Evidence from New Zealand	New Zealand	Audit committees comprising of independent directors and financial expertise of independent directors reduce the likelihood of earnings management
13	Fakhfakh and Nasfi	2012	The determinants of Earnings management by the acquiring firms by the acquiring firms	France	The study identified following determinants of earnings management in the context of mergers and acquisition: relative size of operation, accounting criteria, quality of auditors of MandA and board independence
14	Chekili	2012	Impact of some governance mechanisms on Earnings management	Tunisia	Presence of external directors, board size and presence of CEO appointed by the state reduce earnings management

15	Zgarni, Halioui and Zehri	2014	Do the characteristics of board of director constrain real earnings management in emerging markets? – Evidence from the Tunisian context	Tunisia	Adoption of the Financial Security Law, 2005 has reduced real earnings management. Also document association of board size and independence with real earnings management
16	Cheng and Leung	2012	The effects of management demography on auditor choice and earnings management: Evidence from China	China	Firms managed by reputed chairpersons and chairpersons with longer tenure are associated with better quality of earnings
17	Waweru and Riru	2013	Corporate governance, firm characteristics and earnings management in an emerging economy	Kenya	Ownership structure and board composition impact earnings quality. Highly leveraged firms were also found to be associated with earnings management
18	Visvanathan	2008	Corporate governance and real earnings management	USA	Limited support for governance factors checking earnings management.
19	Rahman and Ali	2014	Board, audit committee, culture and earnings management: Malaysian evidence	Malaysia	Larger boards are ineffective monitors of management action. Director ethnicity has limited effect in mitigating earnings management
20	Kang and Kim	2012	Effect of corporate governance on real activity-based earnings management: Evidence from Korea	Korea	Aggregated measure of real activity-based earnings management decreases with increase in board size and independence
21	Marra, Mazzola and Prencipe	2011	Board monitoring and earnings management pre- and post-IFRS	Italy	Board independence and audit committee are important characteristics that reduce earnings management specially after adoption of IFRS

22	García, Barbadillo and Pérez	2012	Audit committee and internal audit and the quality of earnings: Empirical evidence from Spanish companies	Spain	Audit committee size and meeting frequency and internal audit function reduce earnings management
23	Chen, Kao and Tsao	2010	To improve investors' valuation of accounting earnings in emerging markets: Evidence from Taiwan	Taiwan	Better governance characteristics are associated with improved investor valuation of accounting earnings
24	Chen, Liao and Lu	2012	The effects of public venture capital investments on corporate governance: Evidence from IPO firms in emerging markets	Taiwan	Private venture capital backed firms indulge in lesser earnings management in Initial Public Offering financial statements
25	Voeller, Bremert and Zein	2013	Interdependencies between auditing and corporate governance- Evidence from Germany	Germany	Increased audit risk due to enhanced incentives for earnings management is reflected in higher audit fees
26	Choi <i>et al.</i>	2011	Do management EPS forecasts allow returns to reflect future earnings? Implications for the continuation of management's quarterly earnings guidance	USA	More informative disclosures allow returns to depict future earnings
27	Wagerhofer	2014	The role of revenue recognition in performance reporting	Theoretical	Evaluates revenue recognition standard of IASB (International Accounting Standards Board)
28	Durisin and Pusone	2009	Maturation of corporate governance research, 1993-	Literature Review	Substantial research on corporate governance in US. Gaps exist for cross-national studies

			2007: An assessment		
29	Hermanson and Ye	2009	Why do some accelerated filers with SOX Section 404 material weaknesses provide early warning under Section 302?	USA	Early warning of internal control deficiencies in SEC filing under Section 302 is associated with material weaknesses including lower earnings quality
30	Chan <i>et al.</i>	2013	Exploring the moderating role of growth options on the relation between board characteristics and management earnings forecasts	Australia	Board characteristics have a positive association with management earnings forecasts and such associations are accentuated for high growth option firms
31	Shaver	2005	Characteristics of corporate boards in single-industry and conglomerate media companies	USA	Reported association of board composition with various financial measures of performance specifically in media companies
32	Jiraporn and DaDalt	2009	Does founding family control affect earnings management	USA	Family controlled firms are less involved in earnings management
33	Fung, Su and Gul	2013	Investor legal protection and earnings management: A study of Chinese H-shares and Hong Kong shares	Hong Kong	Firms incorporated in China but listed on Hong Kong stock exchange have higher incidence of earnings management than Hong Kong firms, highlighting the impact of investor legal protection on financial reporting quality
34	Bedard, Coulombe and Courteau	2008	Audit committee, underpricing of IPOs and accuracy of management earnings forecasts	Canada	Audit committee independence and financial expertise decreases the level underpricing of IPO

Source: Authors' compilation

At the next level, key accounting journals were identified and searched for articles on earnings management and board characteristics for the same time period. The

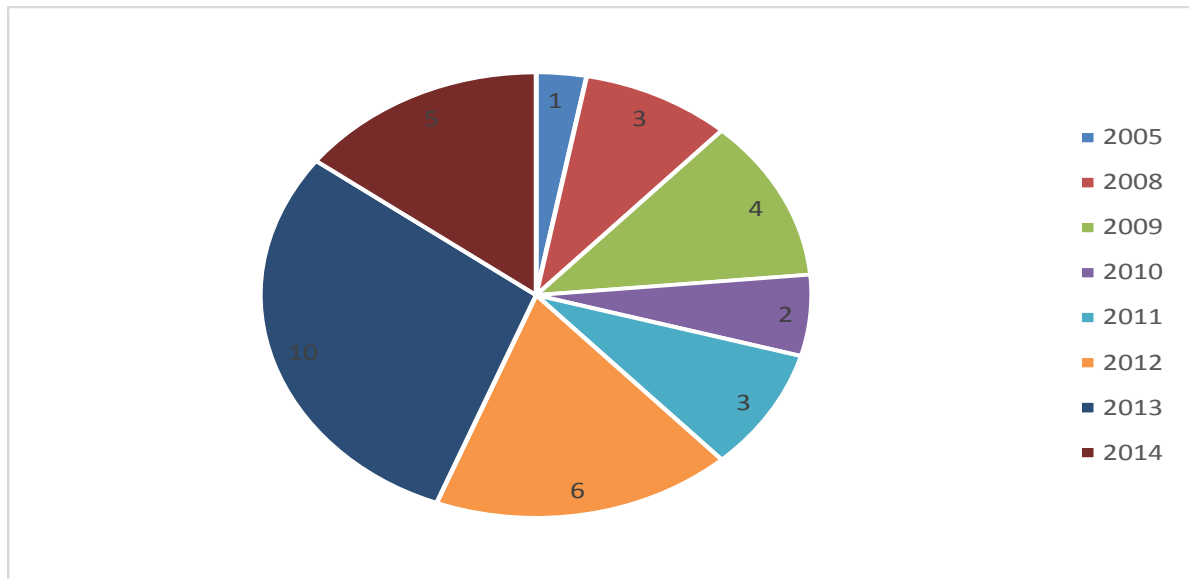
journals were identified on the basis of impact factor and cover eight significant publishers from various geographies. The list of journals is presented in Table 2.

Table 2: Key accounting journals included for review

S.No.	Journal	Publisher
1	Journal of Accounting and Economics	Elsevier
2	The Accounting Review	American Accounting Association
3	International Journal of Accounting	Elsevier
4	British Accounting Review	Elsevier
5	Accounting, Organisations and Society	Elsevier
6	Accounting Horizons	American Accounting Association
7	Auditing: A Journal of Practice and Theory	American Accounting Association
8	Journal of International Accounting Research	American Accounting Association
9	Contemporary Accounting Research	Canadian Academic Accounting Association
10	Journal of Accounting Research	Accounting Research Centre, University of Chicago, Booth School of Business
11	Abacus	Accounting Foundation, University of Sydney
12	Review of Accounting Studies	Springer
13	Journal of Business, Finance and Accounting	John Wiley and Sons
14	Management Accounting Research	Elsevier
15	European Accounting Review	European Accounting Association

Source: Authors' compilation

In order to increase the scope of the literature review, related articles were searched on other platforms like Google scholar and those articles were included for review which were significant with large citations. *Then*, we searched the references of the identified articles and reviewed articles that were cited multiple times. *Finally*, we concluded our study by discussing the changes in the trend of research caused by the impact of the board on earnings management, with a special focus on India. Figure 1 depicts the representation of articles included in this review, published from 2005-2014.

Figure 1: Representation of Articles published from 2005-2014

3 LITERATURE REVIEW

This review discusses and evaluates the board characteristics and earnings management in considerable detail. It further examines the case of India as an example of developing economy and highlights the fact that the developing economies offer unique corporate governance. It also draws attention to lack of research in this domain in the context of developing economies like India.

3.1 Earnings management: Conceptual framework

Both academia as well as industry has highlighted concerns regarding the management of reported earnings (Dechow and Skinner, 2000). The superior quality of financial reporting is associated with better performance of the corporation in the long run and value creation for all the stakeholders (Gaio and Raposo, 2011). On the other hand, studies also reveal that weak legal institutions and low earnings quality were critical factors during the East Asian financial crisis (Johnson *et al.*, 2000; Mitton, 2002).

Earnings management is defined as a strategy that is adopted by the management of a corporation to deliberately modify its earnings to match it to a predetermined target. It is found to be a 'pervasive phenomenon' (Burgstahler and Dichev, 1997). Healy and Wahlen (1999) define earnings management as a phenomenon which occurs when managers use their discretion in financial reporting with the intention of misleading various stakeholders about the company's actual performance. Earnings management is also defined as 'a purposeful intervention' by the management in the external financial reporting process, with the objective of attaining some private gain (Schipper, 1989). Thus, earnings management is a process of manipulating the reported earnings.

3.2 Theoretical research on earnings management

For increasing the confidence among the shareholders and creditors, the management prefers to report stable corporate earnings over earnings with fluctuations (Hepworth, 1953). Much later, the concept of 'agency' was developed as a theory by Ross (1973) in his seminal paper where he analysed the principal-agent relationship.

The insights on earnings management were developed with the penetration of game theoretic tools into accounting research. Lambert (1984) described real smoothing as a management strategy employed to reduce the variability in total firm value. He modelled this real income smoothing as an outcome of the principal-agent relationship between the shareholders and the management in a game-theoretic framework. Dye (1988) studied the internal and external demand for earnings management. He found that the internal demand for earnings management originates from the principal-agent relationship between owners and management of the firm while the external demand arises from the pricing needs of the capital market.

Another theory which has influenced the advancement of research in the domain of earnings management is the Stakeholder theory. It is argued that this approach of stakeholder interests contribute by extending the scope of accountability (Gary et al., 1997). According to agency and stakeholder theory, the behaviour of managers as agents should be in the interest of principal, which is either the shareholder or stakeholders. However, both these theories emerged at distinct contexts and fall short of explaining some very important facets of earnings management like why managers deviate from their ethical paths. A comprehensive theory that is specific to the context of earnings management is yet to be formulated.

3.3 Empirical research on earnings management

The managers use their judgment to modify reported earnings through accruals. These accruals can thus be classified as either discretionary or nondiscretionary. Empirical research is able to distinguish between discretionary and nondiscretionary accruals by modelling the accrual process. Normal accruals measure the changes in the fundamental performance while abnormal accruals measure distortions induced due to earnings management (McNichols and Wilson, 1988). These measures attempt to directly capture problems with the accounting measurement system. Literature suggests that if the nondiscretionary component of accruals is modelled properly, then the distortions can also be measured in the form of discretionary accruals depicting the lower quality of earnings (Jones, 1991).

Healy (1985) modelled nondiscretionary accrual (NDA) as a function of deflated long run accruals. He found that motivation to manipulate earnings work both in upward as well as downward directions. DeAngelo (1988) modelled nondiscretionary accruals in a similar manner. It differs from the previous model as in DeAngelo's model NDA is a function of previous year's accrual. Later, Beneish (1999) developed a model to find the probability of company indulging in manipulating its earnings.

There are numerous other models of accruals mentioned in the literature. These models measure the normal or nondiscretionary levels of accruals and the residuals are used as a proxy for discretionary accruals. Jones (1991) modelled accruals as a function of revenue growth. The model also takes into account depreciation as a function of the gross block. Later, Dechow et al. (1995) adjust Jones model to exclude growth in credit sales in years identified as manipulation years. Another study by Kothari et al. (2005) compared discretionary accrual of the firm-year observation with another observation from the same industry and year having a similar return on asset. Dechow and Dichev (2002) modeled accruals as a function of past, present and future cash flows. Francis et al. (2005) decomposed the standard deviation of the residual from the previous accrual models into innate and discretionary accruals measuring company's operating environment and managerial choice respectively.

3.4 Earnings management and board characteristics

The studies have employed different characteristics of the boards to test their specific impact on earnings management. This review includes those board characteristics that have been extensively explored by studies namely board size, board independence, board busyness, audit committee size and audit committee independence. Although there are other board characteristics that may be important at the firm level, (e.g., expertise and qualifications of the directors of the board, board diligence, audit committee diligence, etc.), their impact on earnings management practices has not been adequately explored. Therefore, these board characteristics have not been included in this review.

Table 3 presents a summary of the papers that evaluate impact of various board characteristics on earnings management practices. These specific characteristics and their impact are reviewed in the following sub-sections.

Table 3: Summary of articles evaluating the relationship between board characteristics and earnings management

S. No.	Subtopic	Total Papers	Publications till 2009	Publications after 2009
1	Board size	7	4	3
2	Board independence	8	5	2
3	Board busyness	6	3	3
4	Audit committee size	3	1	2
5	Audit committee independence	6	1	5

Source: Authors' compilation

3.4.1. Corporate board size and earnings management

In his seminal paper, Jensen (1993) discussed the rationale for keeping the corporate boards small. As the board size increases, it becomes difficult for directors to participate freely and objectively in board activities. Larger boards, thus, become unmanageable and fail to function effectively. Several empirical studies have reported a negative relationship between the size of the corporate boards and firm performance (Black and Kim, 2012; Cheng, 2008). These studies find that while

large boards fail to create value for their shareholders, smaller boards are able to achieve this function efficiently. It can be argued that if large boards are unable to create value for shareholders, they may also be associated with lower quality of earnings.

In the context of earnings management, literature on board size has been limited and inconclusive. Analysing the earnings management practices of Hong Kong companies, Ching, Firth, and Rui (2006) find that the firms with the larger board are engaged in earnings management practices, consistent with Jensen's (1993) view. While Ching, Firth, and Rui (2006) and Busirin et al (2016) find a negative relation between board size and quality of earnings; Xie, Davidson III, and DaDalt (2003) report the opposite.

Studies contextualised in developing economies do not find any significant association between board size and earnings management (Sarkar et al, 2008; Kapoor and Goel, 2017). Such studies evaluating the impact of board size on earnings management are based out of a distinct context and therefore have limited generalizability. There arises a need for multi-country comparison so as to ascertain whether the size of the corporate boards can affect the level of earnings management for the firm.

3.4.2. Board independence and earnings management

A number of studies have explored the relationship between board independence and earnings management. In one of pioneer studies, Klein (2002) found a negative association between abnormal accruals and board independence in the US. Similarly, Xie, Davidson III and DaDalt (2003) also reported a similar relationship between these variables. With UK data, Peasnell, Pope and Young (2005) found that in certain conditions, i.e., when the pre-managed earnings fall below previous year's reported earnings, board independence is associated with better reporting practices. In the context of Hong Kong, Jaggi, Leung, and Gul, (2009) also found a significant and negative association between board independence and earnings management. In the case of Taiwan, Chi et al (2015) found that board independence reduced earnings management among family firms. In the Indian context, however, Sarkar, Sarkar, and Sen (2008) failed to establish a significant association between board independence and accruals quality. Similarly in the context of Egypt, Khalil and Ozkan (2016) do not find association of board independence with earnings management practices.

3.4.3. Board busyness and earnings management

A recent study by Field, Lowry and Mkrtchyan (2013) found that busy boards are detrimental to large organisations. They concluded that even if busy directors might offer quality advice, they do not function as effective monitors of management. Prior studies like Core, Holthausen and Larcker (1999) and Fich and Shivdasani (2006), have also highlighted the fact that busy boards are associated with weaker profitability and lower values for the firm. In the Indian context, Sarkar, Sarkar and Sen (2008) found that companies with busy independent directors on their boards have higher incidences of earnings management. Kapoor and Goel (2017) also found a positive association between board busyness and earnings management

among large listed companies in India. However, Baatour and Hussainey (2016) do not find any significant impact of multiple directorships on earnings management in the Saudi Arabian context.

A number of studies have evaluated the monitoring effectiveness of directors with multiple directorships in various contexts. However, such stream of literature is yet to reach a level of adequacy so that its effect can be observed through policy formulation. Many countries do not have a limit on the number of directorships that any director can hold. In countries where there exists such limit, the policy framework is rarely stringent enough. For example, in the case of India the Clause 49 of Listing Agreement allows the independent director to hold a maximum of 7 directorships which is too large to have an effective role.

3.4.4. Audit committee size and earnings management

The monitoring of the financial reporting can be effectively done by the audit committees of the board. Several studies have identified the prominent role played by audit committees in monitoring mechanism and maintaining the quality of financial reporting (Davidson, Goodwin-Stewart and Kent, 2005; Kent and Stewart, 2008; Rainsbury, Bradbury, and Cahan, 2008).

Research in the context of emerging economies has been limited. Khan et al. (2013) have reported that presence of audit committee has a positive and significant impact on corporate social responsibility disclosures in Bangladesh. In the Indian context, Puri et al. (2010) have argued that the audit committees perform diverse functions in the multiple areas that include financial reporting. Similarly, Sarkar & Sarkar (2012) have highlighted the importance of audit committee independence for improving corporate governance in emerging economies. Chatterjee (2011) has stressed that an active committee is important because it indicates the commitment to the issues of interest and the efforts made to ensure adequate internal control. The present study attempts to further explore this argument particularly with respect to audit committee diligence.

The size of the audit committee might be important in restricting earnings management practices of corporations. Choi et al. (2004) argue that larger audit committees can be more effective monitors as they are more likely to include members with varied expertise to intensely monitor financial reporting practices. Similarly, Baxter and Cotter (2009) found in the context of Australian listed companies that audit committee size has a significant impact in restricting earnings management.

3.4.5. Audit committee independence and earnings management

Few studies have explored the association between independence of the audit committee and accruals quality. While Klein (2002) and Kent, Routledge and Stewart (2010) find a negative and significant association in the context of US and Australia respectively, Baxter and Cotter (2009) do not find such relationship on Australian data. Recently, Amar (2014) and Sharma and Kuang (2014) have also reported the association of audit committee independence with improved quality of financial reporting in France and New Zealand respectively. In case of India, Kapoor and Goel

(2017) also found that independent audit committees are effective in their monitoring role.

Most of the studies that evaluate the significance of audit committee independence are contextualised in developed economies like the USA, Australia and France where the regulatory framework is already developed. Future studies need to be focused on developing economies that are still undergoing transformation in policy framework.

3.5. Emerging Business Environment: The case of India

3.5.1. Earnings Management in Indian context

Among articles revealed from EBSCO search described earlier in this paper, only 9 articles were contextualised in any emerging economy. Earnings management research in the Indian context has been limited. Certain studies have documented evidence of earnings management in India but in a limited way (Sarkar, 2008; Ajit, 2013; Kaushal, 2013). Sarkar, Sarkar and Sen (2008) explored board characteristics and earnings management. They found that effective boards are successful in reducing earnings management. Goel (2014) study evaluates the implications of discretionary accruals for earnings management in the Indian corporate enterprises. His analysis indicates that there is a presence of accrual management in the units.

Further, for the period between 2004 and 2014, EBSCO search with earnings management and board characteristics as keywords revealed 34 journal articles. Out of these articles, as mentioned above only a single study Sarkar, Sarkar and Sen (2008) was conducted on Indian companies which roughly constitutes 3% of scholarly articles. Sarkar, Sarkar and Sen (2008) explored the role of board characteristics in restraining discretionary accruals. They find that it is the board quality which is important for earnings management instead of just board independence as brought forward by earlier studies.

The studies have also highlighted that the environment of business in India offers corporate governance issues which are unique and incomparable to other widely researched developed economies (Jackling and Johl, 2009). A SEBI DRG study found that average level of earnings management in India is at 2.9% of the total assets and is comparable to US, Europe and other parts of the world (Ajit, Malik and Verma, 2013). It found that smaller companies in India indulged more in earnings management than medium or large sized companies. Kaur, Sharma and Khanna (2014) detected sector-wise earnings management in India. They found that certain top performers, particularly in IT and BPO and biotechnology sectors were also indulging in discretionary manipulations of accruals. This is an important finding because these sectors are majorly servicing overseas markets.

In a different domain, Rudra and Bhattacharjee (2012) report that firms adopting international accounting standards are most likely to smooth earnings as compared to firms that do not adopt them. This questions the effectiveness of International Financial Reporting Standards (IFRS) in checking opportunistic earnings management in a developing economy.

Most of the research in the domain of earnings management has been conducted on widely held corporations in developed economies like the USA, UK and Australia.

The studies exploring earnings management practices in the Indian context are limited. However, there is empirical evidence to support that earnings management practices are prevalent in both developed and emerging economies.

3.5.2. Institutional framework in India

The Confederation of Indian Industry's Code for Desirable Corporate Governance in 1996 was one of the pioneer efforts at developing corporate governance mechanism in India. Subsequent to this code, Securities and Exchange Board of India (SEBI) formed various committees namely, Bajaj Committee (1996), Birla Committee (2000), Chandra Committee (2002) and Narayan Murthy Committee (2003), to evaluate the state of corporate governance and propose governance laws and reforms in India. The reports of these committees laid the foundation of Indian corporate governance code which culminated into the formulation of Clause 49 of Listing Agreements. The role of the corporate board as an internal mechanism for corporate governance has been adequately emphasised in Clause 49. Since the enactment of clause 49 by SEBI, it has been amended numerous times to include various facets of corporate governance under its purview.

3.5.3. Evaluating Indian Companies Act, 2013

The Companies Act, 2013, is a landmark legislation in the area of corporate governance in India. As a mechanism to improve governance in India, it mandated the inclusion of at least one woman director on the board of each listed company. Limited studies have explored the role of women directors on the board across the globe. Carter *et al.* (2010) evaluated the inclusion of women and ethnic minority directors on the board and its association with firms' financial performance. The study falls short of establishing any such association. However, they highlight that inclusion of women and ethnic minorities on the board should be evaluated on criteria other than future financial performance. Adams and Ferreira (2009) explored the behaviour of women directors on the boards and find a significant difference in behaviour of male and female directors. They also reported the association of gender composition with board effectiveness. Thiruvadi and Huang (2011) studied gender diversity of audit committees and its association with earnings management. They find that presence of women directors on the board constrains earnings management practices.

Similarly, the new act limits the remuneration of independent directors to sitting fees, reimbursement of expenses for participation in the board and other meetings and profit related commission as may be approved by the shareholders. Research exploring remuneration of independent directors has been extremely sparse. Brick *et al.* (2006) found a significant correlation between CEO and director compensation. They stressed that high director remuneration is evident of cronyism i.e., an environment of ineffective monitoring by independent directors. Chtourou, Bedard and Courteau (2001) argued against inclusion of short-term stock option in independent director remuneration. They found that such short-term stock option may create incentives that reduce the quality of independent director's monitoring over management actions. In an important study, He *et al.* (2009) found that high level of compensation for non-executive director (NED) is associated with lower earnings management. Exploring further, they disaggregated total compensation into fixed and variable components. They study found board monitoring to be effective (or

lower level of earnings management) when the fixed component of independent director is higher.

Therefore, exploration regarding the effectiveness of women directors and limited independent director remuneration as governance mechanism is required across nations.

4 DISCUSSION & RESEARCH GAP

The phenomenon of earnings management has been identified as an important area of research. In this context, the role of corporate boards in containing earnings management practices becomes crucial. Various characteristics of corporate boards have different impact on earnings management and this relationship differs across geographies and legislative framework. This stream of research is heavily focused in the context of developed economies, while there remains a need to explore the relationship of earnings management and board characteristics in developing economies like India which are in the transformation phase of formulating stringent policies to check fraudulent activities of the listed companies. It has also been documented that each country has 'its own standards, regulations and culture' (Pathak et al., 2014), and therefore there is a need to explore earnings management – board of director relationship in that specific context.

The analysis of the number of papers evaluating the relationship between board characteristics and earnings management reveals that there is a distinct evolution of literature. Majority of the studies conducted till the year 2008 focused on the specific characteristics of the board and their impact on earnings management. However, there is a clear drift in research agenda from 2009 onwards as majority of the papers in this area discuss characteristics of audit committee and their impact on earnings management practices. This analysis also suggests a drift in the stream of research towards developing economies. Later studies have also attempted to evaluate these relationships for developing economies such as India.

It needn't be stressed further that the developing economies have an increasing role in global business and therefore, the quality of reported earnings in these economies is a serious concern for all global stakeholders. Specifically in the Indian context, board quality has been studied mostly from policy and compliance perspectives. Only Sarkar, Sarkar, and Sen (2008) have explored the association of board characteristics and earnings management. However, the real impact of corporate governance crisis was experienced by corporate India after the year 2008, post-Satyam fiasco while this study was conducted much earlier (Chakrabarti *et al.*, 2011). Since its enactment, the Clause 49 of Listing Agreements by SEBI has been amended many times to include various facets of corporate governance under its purview. The Companies Act, 2013 has brought forward newer facets of governance among Indian listed companies. This highlights the importance of exploring the effectiveness of such governance mechanisms in inculcating superior management practices among Indian corporates and restraining earnings management. Therefore, there is a strong need to examine the association of board characteristics and earnings management in the context of developing economy like India.

Further, both the agency and stakeholder theory explain the phenomenon of earnings management partially. They are not able to explain the motivations behind

earnings management. So, a comprehensive theory that is specific to the context of earnings management needs to be formulated.

5 CONCLUSION

This study aims to evaluate the body of research on the association of board characteristics and earnings management, with a special focus on India. Numerous articles from various sources were identified and reviewed. It is found that the research in this context has matured in the case of developed economies, like the USA, UK, etc. However, research in the context of developing economies, for countries like India has been sparse and extremely limited.

There is empirical evidence to support that manipulation of earnings is prevalent in both developed as well as emerging economies (Bhattacharya *et al.*, 2003). Therefore, there remains a strong need of exploring the association of board level characteristics and earnings management in a developing country like India on account of its multi-nationality of operations. The corporate practices of India can be a global example for improving corporate governance in the light of new Companies Act, 2013.

Thus, it can be concluded the regulations guiding corporations in terms of governance mechanisms should be able to address country-specific issues. This necessitates the research on earnings management for board characteristics in Indian companies for setting lessons globally. Studies have proved that enforcement of board-level corporate governance reforms, without consideration of country-specific cultural and legal environment limits its effects (Machuga and Teitel, 2009).

6. IMPLICATIONS FOR FUTURE RESEARCH

This article presents a detailed review of studies that explore the association of board quality and earnings management in various contexts. The study has several scholarly implications for future research. The review was conducted using a search command for the words “earnings management” and “board characteristics” primarily on EBSCO database, supported by Google scholar. Further, we considered the time period between 2004 and 2014 for the study as this duration covers both pre- and post-global financial crisis and highlights the motivational impact of earnings management.

Firstly, the findings of the review suggest that the existing research has been concentrated in the context of developed economies. The regulatory and governance framework in developed economies is relatively stringent and mature. Firms functioning in such environment have limited freedom in terms of board characteristics. However, in case of developing economies, research in this domain has been sparse and more or less inconclusive. Future research should be contextualised in developing economies which are still in the process of formulating an exhaustive framework for corporate governance. This would be beneficial for multinational firms having stakeholders in developed as well as developing economies. This would also lead to advancement in research on policy perspectives in this domain.

Secondly, certain studies evaluate the effectiveness of board as a governance mechanism and help in developing insights about specific board characteristics that might have a role in containing earnings management. Characteristics like board size, board independence, audit committee size and audit committee independence have been extensively studied in the context of earnings management. However, there remains a need to further explore other board-level characteristics that might contribute towards superior governance mechanisms. *For example*, professional background of independent director might be explored for effective governance framework. Similar studies based out of different economies may assist in the assimilation of universal theory on the relationship between corporate governance and earnings management.

Thirdly, as discussed in the earlier sections, the researchers have employed the lens of agency theory to explore the association between specific board characteristics and earnings management. There are theories from other contexts like the stewardship theory and the resource dependence theory which may assist research on the effectiveness of board in restraining earnings management. Future research may employ multiple theoretical lenses to evaluate the role of board characteristics in producing superior quality of financial reporting. At the same time, there remains a strong need for theory development at universal level in this domain.

So, despite all previous endeavours, the debate on the impact of boards' characteristics on earnings management in the context of developing economies provides a promising and challenging research agenda for various macro and micro factors and global outreach.

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