Chapter 12
Corporate Governance and Properties of Accounting Numbers in Brazil

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ABSTRACT

This chapter analyzes 30 variables of the boards of directors (BDs) and oversight boards (OBs) of 325 Brazilian companies from 2011 to 2015, including examination of 19,487 resumés of their members. With support from factor analysis, the authors performed empirical tests considering the relations between the underlying factors of BDs and the properties of Brazilian accounting numbers, controlling for ownership structure, differences in corporate governance levels, issuance of ADRs, type of auditor, presence of an OB, size, and leverage. Factors like age, board interlocking, and variable compensation arrangements are the main characteristics associated with the variations in the accounting information properties of the firms analyzed. On the other hand, characteristics such as gender diversity, existence of a controlling shareholder chairing the board, board independence, and other characteristics considered relevant in the international literature tended to lose strength when the spectrum of variables analyzed increased.

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INTRODUCTION

Many properties can be attributed to accounting information. Besides being essentially informative, various other characteristics are considered important, such as relevance, conservatism, timeliness and persistence of earnings (Lopes & Walker, 2008). According to Dechow *et al.* (2010), six factors are responsible for determining the quality of accounting numbers: i) firm characteristics; ii) accounting practices; iii) corporate governance mechanisms; iv) auditing; v) capital market incentives; and vi) other external factors.

This study examines the corporate governance mechanisms – mainly operating through two specific bodies, the board of directors (BD) and oversight board (OB)[1] – and their influences on the properties of accounting numbers, especially profits. The authors analyzed the influence of BDs and OBs (when established) of listed Brazilian companies regarding the properties of their accounting numbers.

Studies of governance tend to report inconsistent coefficients due to the limited number of variables to represent its quality (Dechow *et al.*, 2010). To resolve this type of problem, also common in studies related to Corporate Governance, the authors analyzed a broad set of characteristics of the two boards, by factor analysis (FA) and the construction of indexes derived from that technique. The use of FA aims to extract constructs that better reflect, in non-correlated form, most of the variance of the original data, besides permitting discerning a robust relation between the environment of the boards and the quality of the accounting information disclosed, considering the possible effect of reverse causaltity between the various characteristics analyzed.

The general hypotheses of this chapter is that the board of directors and oversight board, through their monitoring of management, influence the quality of the information disclosed at various levels, depending on the structure in which each board operates and the compensation paid to the members. It is possible that better monitoring of executives will reduce the manipulation of results to benefit managers and increase the earnings persistence.

According to Martinez (2010), the tolerance for earnings management can be explained by the profile of the board of directors. Du, Jian & Lai (2017) identified that the presence of foreigners on the boards of directors tended to mitigate earnings management. In this respect, Gul, Srinidhi & Tsui (2007) identified that firms with female directors tended to manage earnings less and had higher quality of accruals.

In turn, Klein (2002) supplies evidence that the independence of boards is responsible for increasing the levels of monitoring of accounting processes. In this respect, it is possible that other characteristics, such as education, age and specific knowledge of directors, influence the quality of monitoring of managers to the point of preventing, for instance, an undesirable reputation in the market, as well as manipulation of results for purposes unknown to the shareholders.

Aspects like the frequency of meetings and size of boards can increase the monitoring power of directors, and consequently the quality of accounting information. A larger board is seen as being more capable of preserving the interests of shareholders, since it has more resources (Zahra & Pearce, 1989), a greater range of experiences to share (Xie *et al*., 2003) and greater expertise (Zahra & Pearce, 1989; Rahman & Ali, 2006). On the other hand, larger boards tend to take longer to reach decisions and are more likely to resist innovations (Jensen, 1993).

Another relevant point is whether the presence of an oversight board has an effect on the numbers disclosed by firms. Since this is a body inexistent in most other countries in the world, few studies have examined this theme in Brazil, making it an attractive research target.