

Chapter 10

Gender Diversity and Audit Fees Across Diverse Institutional Settings

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ABSTRACT

This Study examines whether and how gender diversity at the board and top management team (TMT) level, as well as commitment to the UN's Sustainable Development Goal on Gender Equality (SDG5), influences financial reporting quality by studying the independent auditors' assessment of the risk of material misstatement. Employing a large global dataset, they find a positive relationship between board gender diversity and audit fees, which is consistent with an active monitoring role by the board. In contrast, we do not find a significant effect of TMT gender diversity, nor for the firm's commitment to the SDG Goal on Gender Equality. In addition, we find that the relationship between board gender diversity and audit fees is mainly driven by firms in countries without mandatory board gender quotas, and that the results are especially strong in settings where there is a lower perception of corruption and a greater representation of females in parliament.

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INTRODUCTION

The lack of gender diversity on corporate boards and in leadership roles has emerged as a significant issue in corporate governance in recent years (Gow, Larcker, and Watts, 2023). Regulators, politicians, and investors are increasingly urging companies to address this imbalance at the board and executive levels (Zattoni et al., 2023). For example, the 'Women on Boards' law, approved by the European Parliament in November 2022, mandates that women must comprise at least 40% of non-executive board members at large companies in the European Union by mid-2026. Additionally, major institutional investors launched a campaign in 2017 to increase board gender diversity, resulting in U.S. corporations appointing 2.5 times more female directors in 2019 compared to 2016 (Gormley et al., 2023).

These regulatory and investor pressures underscore the perceived advantages of gender diversity on corporate boards, a topic that has received increasing attention in the literature. Numerous studies examine these advantages, indicating that increased gender diversity can stimulate creative thinking and introduce novel perspectives into board discussions (e.g., Benton, 2021; Perryman, Fernando, and Tripathy, 2016). Supporting this, a 2022 survey of U.S. corporate directors revealed that gender diversity was highly valued for introducing new ways of thinking to the boardroom (PwC Report, 2022). Prior research also indicates that women, compared to men, have less tolerance for engaging in opportunism (Bernardi and Arnold, 1997; Krishnan and Parsons, 2008; Thorne, Massey, and Magnan, 2003) and place less importance on self-interest (Arlow, 1991). These characteristics enhance strategic decision-making (Perryman et al., 2016) and reduce financial misconduct (Adams and Ferreira, 2009; Chen, Crossland, and Huang, 2016; Cumming, Leung, and Rui, 2015; Post and Byron, 2015).¹

Financial reporting quality is a cornerstone of corporate governance, serving as the foundation for transparency, accountability, and oversight (Aguilera, Desender, and LópezPuertas-Lamy, 2021). Accurate and reliable financial information enables investors and other stakeholders to hold company management and boards accountable. In the contemporary business landscape, the audit function plays a critical role in ensuring the reliability and integrity of financial reporting (Aguilera et al., 2021). This study focuses on the growing importance of diversity at all organizational levels and its impact on financial reporting quality, adopting the perspective of external auditors, who are professionally trained to assess this quality. The research question we seek to address is: "How does gender diversity at various levels influence auditors' perceived risk of material misstatements?" Additionally, we explore how institutional factors shape this relationship."

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