

# Impacts of Board Characteristics and Ownership Structure on Discretionary Accruals: Evidence from Thai Listed Companies

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## Abstract

This research aimed to analyze the impact of board characteristics and ownership structure on discretionary accruals (or unconditional accounting conservatism). Board characteristics comprised board size, board independence, board meeting and board leadership and ownership structure comprised highest percentage of shareholders and percentage of institutional investors. The dependent variable was discretionary accruals. The secondary data were collected from listed companies on the Stock Exchange of Thailand during 2016-2018 excluding finance companies and restructuring companies. There were 702 data with 234 companies for data analysis in the study. The relationship between independent variables and dependent variables were analyzed using multiple regression analysis. The research results showed that there were significant impacts of board size, board independence and board leadership on discretionary accruals (or unconditional accounting conservatism). Board size and board leadership provided significant positive impacts on discretionary accruals; whereas board independence showed a negative impact on discretionary accruals.

**Keywords:** Board Characteristics, Ownership Structure, Discretionary Accruals, Unconditional Accounting Conservatism

## I. Introduction

Investors pay more attention to financial information when making investment decisions. While executives prioritize management returns and measure performance as well as figures shown in the statement of financial position are used to communicate firms' image in term of total asset figures. Furthermore, groups related to firm are stockholders and stakeholders such as investors, government agencies and employees. They usually employ financial reports to respond to their objectives although they have different aims. As a result, the accounting information must be quality, comprehensive, reliable, timely and comparable according to financial reporting standards. However, the figures appearing in the financial statements can be employed based on the accounting policy that is suitable for the context of the company itself. This is the reason that the company executives select the accounting policy as a tool to calculate profit numbers. Actually, accounting conservatism is an accounting policy to warn a company to recognize low revenue and high liability to ensure the minimum financial position or low risk for a firm; however, executives' consideration is a major factor impacting on accounting conservatism without the contradiction of financial reporting standards. This is an intervention into the accounting process to distort the numbers of financial items in the financial statements, resulting the misunderstanding in the financial statements. The users employing financial statements may make wrong decision due to low quality of accounting information. Actually, generally accepted accounting standards allow company executives to employ approximate discretion and discretionary accruals in term of accrual basis. This could open up a loophole providing company executives with an opportunity to decorate and misrepresent accounting information. A kind of tool that executives commonly used in accounting numbers management is the estimation of accounting figures

using discretionary accruals (Strobl, 2013). As a result, shareholders may have a higher risk and the company may have higher cost of capital. Botosan, Plumlee, and Xie (2004) and Gray, Koh, And Tong (2009) found that financial information with high quality and transparency can reduce business capital. While Bhattacharya, Daouk, and Welker (2003) pointed those companies having financial figure decorations tend to have higher costs of investments. The problems about using an accrual basis for estimating accounting figures under the discretion of management have been a critical issue and attracted the attention of academics and researchers around the world in trying to find tools to reduce that problem.

Therefore, they attempt to create mechanisms to protect investors, that is corporate governance (CG) mechanisms to monitor, control and oversee the profit management that negatively affects the quality of financial reports (Jaggi & Tsui, 2007). At present, the corporate governance mechanism is very important to all organizations in the developing countries, especially business units because it can create creditworthiness in financial reports. However, the effectiveness of the corporate governance mechanism, which plays a role in managing profits, depends on various factors such as the nature of the shareholder structure, the board characteristics, motivation, firm culture, society and politics of each country. The corporate governance is expected to reduce the problem about the distortion of financial information by executives (Abed, Al-Attar, & Suwaidan, 2012; Ali Shah, Butt, & Hasan, 2009; Banko, Frye, Banko, Frye, Wang, & Whyte,(2013). Nevertheless, in Thailand, the effectiveness of corporate governance is not yet clear. Regardless of the good corporate governance in term of the shareholder structure, the board of directors will be able to use the discretionary accruals principle to reduce the problem in estimating accounting figures under the management's discretion or not. For this reason, this research aimed to study the

impact of board of director characteristics and ownership structure on discretionary accruals: evidence from Thai listed companies

## II. LITERATURE REVIEW

### 1. Board of director characteristics and ownership structure

Corporate governance (CG) enhances transparency of financial information, whether it is the nature of the shareholder structure, board of directors and other factors. Corporate governance is an audit system ensuring that an entity is accountable and acts to respond to business goal and to the interests of shareholders (Solomon cited in Brennan & Solomon, 2008). The organization for economic co-operation and development (OECD) (2004) mentioned that corporate governance is a system that involves business management, board of directors, shareholders and other stakeholders allowing the business to achieve the firm objectives and continuously monitor the performance of the business. Corporate governance is a system that creates the administrative structure and control processes in creating business transparency and corporate sustainability to increase corporate value and shareholders' wealth over the long term. Corporate governance can also motivate executives and the board, who act on behalf of shareholders, to work for the firms' benefits.

In regard of a number of board directors, corporate governance concept expects that higher number of board of directors leads to high accounting conservatism base on conservatism concept. Many researcher found the findings differently. Salihi & Jibril (2015) found that the higher number of the board of directors, the higher profit quality by profit managers would be. However, the study of Fodio et al. (2013) and Bala & Kumai. (2015) found a statistically significant negative effect of the board of directors on profit quality. It was found that the greater the number of

the board of directors, the lower the yield balance and profit-to-quality management would be due to accounting conservatism in term of discretionary accruals.

For a number of independent board, corporate governance concept expects that higher number of independent board leads to high accounting conservatism base on conservatism concept also. However, discretionary accrual should decrease because of the protection of shareowners from independent board as shown in many studies. Omoye & Eriki (2014) and Yasser & Mamun (2015) stated that the proportion of the independent directors of the board directors plays an important role for shareholders. It is considered a governing mechanism to protect shareholders and help reduce conflicts between shareholders and management (or agency conflict). Meiryani & Syaifullah, (2015).found that the higher the proportion of independent directors of the company, the more effective it was in monitoring and overseeing the meeting of the board of directors. It is considered that independent directors play their role to solve problems for the company and make the quality of accounting figures in line with the principles of accounting conservatism.

Regarding board meeting, corporate governance concept expects that higher number of board meetings leads to high accounting conservatism base on conservatism concept also. The number of board meetings is one of the measurement of the business transparency. Lipton & Lorsch (1992) said that the number of meetings reflected the monitoring management team to improve work efficiency, especially the accounting figures. Thus the number of the boards meetings reflected the principle of accounting conservatism in term of discretionary accruals involved. The relationship of board independence, board size, the number of meetings on accounting conservatism in term of discretionary accruals was positively correlated. For example, a UK company used a

measure of discretionary accruals with the impact of the number of the board Jensen (1993).

The findings about the relationship between accounting conservatism and CEO duality showed differently from country to country. For example, Daghani, O., Zouhayer, M., and Mbarek, KBH (2016) found that if the chairman of the board and the CEO are the same person, it may affect the business because he or she is the only one person who has the full power to make decisions. However, this it requires creating a balance of power between the board of directors and the management team due to causing the lack of independence of the performance and control abilities of the committee. This is in line with the study of Pi, L. and Timme, S. G. (1993). It was found that the success tendency of a company might be higher if the chairman of the board and the CEO are the different person.

In regard to the ownership structure, Mita and cready (2005) and Teshima and shuto (2008) found that the percentage of institutional shareholders was inversely correlated with the accounting conservatism. This implied that institutional shareholders preferred more actual business transactions recording on accounting system for actual performance to accrual basis. While Balsam, bartov and Marquardt (2002) showed that institutional shareholders perceived the profitability of an entity better than general shareholders.

## 2. Discretionary accruals

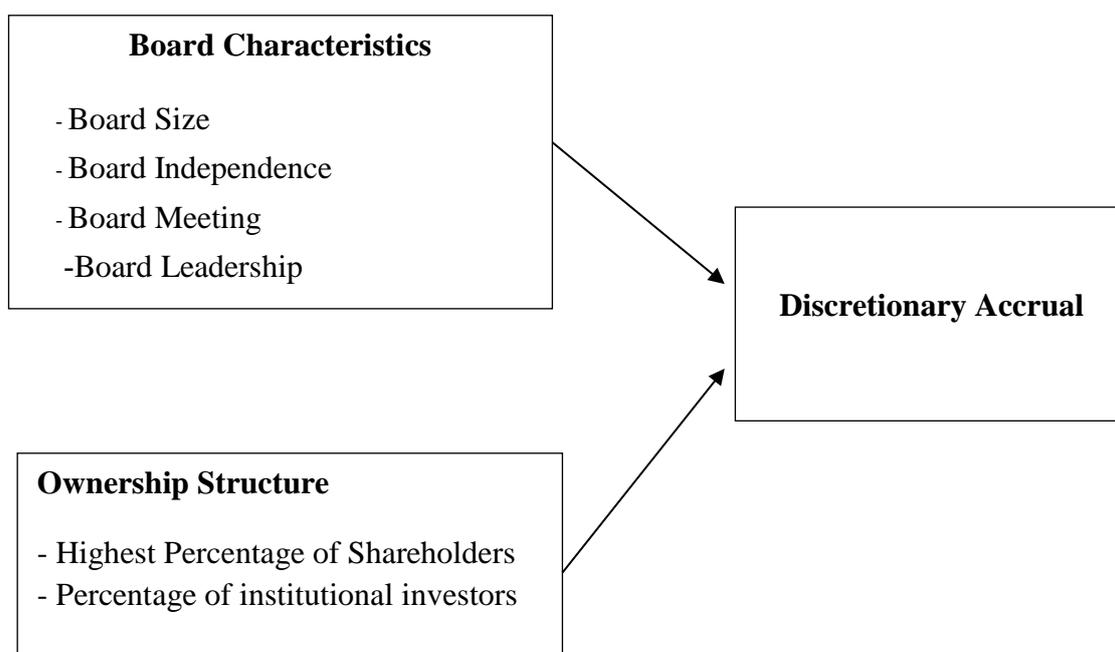
Actually, accounting conservatism can be divided into two types which are conditional conservatism and unconditional conservatism. However, discretionary accruals and unconditional conservatism accounting have a very close relationship. Accounting conservatism is accounting policy based on conservatism principle, which allows managers to employ their judgment to estimate some financial information, affecting

on accounting record. Thus, it is an opportunity for managers to distort financial information by accrual basis or discretionary accruals.

Unconditional accounting conservatism term used as a representative of earning quality in term of the difference between accounting profits and operating cash flow as a component of the accrual profits. Thus, the zero accrual profits implied the high earning quality because accounting profits and operating cash flows profits are the same. In the other word, the accrual profits represents low earning quality. Thus, accounting accrual basis is a tools impacting on business earning quality. Schipper and Vincent, (2003) defined conservatism accounting as the use of discretion under uncertainty in order to make the financial statements reliable so that the figures of the assets or income should not report too high, while the liabilities or expenses should not report too low called the principle of conservatism. Givoly and Hayn (2000) mentioned that unconditional accounting conservatism reflects from the different between accounting profits based on accounting accrual and operating cash flows profits, implying low earning quality. Further, Watts (2003a) defined unconditional accounting conservatism an inequality in the perception of profit and loss. Beaver and Ryan (2005) defined that under unconditional conservatism, the book value of net assets would be understated. The nature of the accounting operation depends on events or news, but based on accounting practices. This is in line with Ahmed et al. (2002) who mentioned that profitable companies tend to exercise greater unconditional accounting conservatism by measuring total assets representing the profit of company sizes (Kohansal et al 2017, Beaver and Ryan 2005, Gassen et al. 2006 and Iatridis 2011) with no relevant conditions to audit financial reports.

Then, researchers aimed to examine impact of board of director characteristics and ownership structure on accounting conservatism in terms of discretionary accruals. Finally, this study proposed the hypotheses stating that there are significant impacts of board of director characteristics and

ownership structure on discretionary accruals. The research framework of the conceptual model is shown in Figure 1.



**Figure 1: Conceptual Model**

### III. DATA AND METHODOLOGY

The data were collected from listed companies on the Stock Exchange of Thailand during 2016-2018 excluding financial companies, real estate mutual fund companies and restructuring companies as these companies were quite different from others. Finally, there were 702 data with 234 companies in the study. The secondary data were collected from SET Market Analysis and Reporting Tool or SETSMART in term of annual basis. Statistical tools were

descriptive statistics, Pearson’s correlation and multiple regression analysis. The multiple regression were implemented to study the impact of board characteristics and ownership structure on discretionary accruals.

All the variables were defined as shown in Table 1 below.

Table 1 Definitions of independent and dependent variables.

Variables	Definitions
<b>Independent variable</b>	
1. Board Size (BS)	The number of directors.
2. Board Independence (BI)	The number of independent directors.
3. Board Meeting (BM)	The board meeting per year.
4. Board Leadership (BL)	The same person served as both CEO and chairperson. (1,0)
5. Highest Percentage of Shareholders ( HPS)	The highest percentage of shareholding.
6. Percentage of institutional investors ( PII)	The proportion of institutional investors.
<b>Dependent variable</b>	
1. Discretionary Accruals ( DIS-ACC)	Net income minus operating cash flows divided by total assets.

#### IV. RESEARCH RESULTS

The first stage was descriptive analysis as shown in Table 2.

Table 2 Descriptive analysis.

	Minimum	Maximum	Mean	Std. Deviation
Board Size	5	21	10.33	2.54
Board Independence	3	12	4.15	1.28
Board Meeting	3	21	7.39	3.31
Board Leadership	0	1	0.48	0.50
Discretionary Accruals	-0.24	0.37	0.03	0.08
Highest Percentage of Shareholders	4.78	98.48	34.26	18.17
Percentage of institutional investors	0.00	98.66	23.37	25.01

Table 2 describes means, standard deviations, minimums and maximums of each variables. For the board characteristics, the results shows that mean of the number of board size (BS) was 10.33. The mean of the number of board independence (BI) was 4.15. The mean of the number of board meeting (BM) and board leadership were 7.39 and 0.48, respectively. In regard to ownership structure, the mean of the highest percentage of

shareholders (HPS) was 34.26%. The mean of the percentage of institutional investors (PII) was 23.37%. Finally, the mean of discretionary accruals (DIS- ACC) mean was 0.03.

The study examined the relationship among variables by employing pearson correlation. The results are shown in Table 3.

Table 3 Correlation coefficient between variable

	BS	BI	BM	BL	HPS	PII	CIS-ACC
BS	1						
BI	.578**	1					
BM	.096*	.225**	1				
B L	-.006	.157**	.013	1			
HPS	.093*	.062	-.023	.093*	1		
PII	.225**	.170**	.118**	-.097*	.210**	1	
DIS-ACC	.095*	.037	.037	.149**	.676**	-.025	1

Note: \*\*5% significance level, \*\*\*1% significance level

Table 3 shows correlation coefficients between variables. The findings shows that the percentage of institutional investors provides the significant relationship with board size of 0.225, board independent of 0.170, board meetings 0.118, board leadership - 0.097 and the highest percentage of shareholders of 0.210. In addition, it was found that the significant correlation coefficients were

board leadership and discretionary accruals of 0.149. Importantly, there was no correlation coefficients above 0.80 in the study.

Finally, multiple regression was employed to study the impact of corporate governance factors on discretionary conservatism. The results are shown in Table 4.

Table 4 Multiple regression

Model	Unstandardized Coefficients		Standardized Coefficients		t	p
	Beta		Beta			
(Constant)		-0.012			-0.753	0.452
BS		0.003		0.108	2.406	0.016*
BI		-0.006		-0.092	-1.969	0.050
BM		0.001		0.028	0.736	0.462
BL		0.022		0.133	3.595	0.000**
HPS		0.000		0.065	1.755	0.080
PII		0.000		0.012	0.300	0.764
2.Indcd		0.031		0.120	2.622	0.009
3.Indcd		0.008		0.031	0.703	0.482
4.Indcd		0.037		0.170	3.624	0.000
5.Indcd		-0.001		-0.005	-0.096	0.923
6.Indcd		0.001		0.003	0.059	0.953
7.Indcd		-0.056		-0.222	-4.940	0.000
R <sup>2</sup>		0.149				
Adjusted R Square		0.134				
F-statistic		10.018***				

a Dependent Variable: Discretionary accrual (DIS-ACC)

Table 4 shows the significant of F-statistic, implying the fitness of the model. Explanatory power was 14.9%, meaning all independent

variables were able to explain dependent variables of 14.9%. The finding shows that board size significantly positively correlated with

discretionary accruals at 0.016 at 5% significance level. While, board leadership provided a significant correlation to discretionary accruals at 1% significance level.

## V. CONCLUSION

From multiple regression testing, it was found that the board size and discretionary accruals were positively correlated with standardized coefficient of 0.108 at the 5% level. It means that the big size of the board led to accounting conservatism in term of discretionary accruals. This is in line with Xie, Davidson; DaDalt (2003); Haniffa, Fairuzana (2006); Bradbury, Mak & Tan (2006). They demonstrated that the size of the board led to unconditional accounting conservatism. A large number of the board will be able to control the management of the organization leading to more conservatism principle through profit accrual. The size of the board has an influence on discretionary accruals showing influence on providing annual accounting profit data.

The results of the study of board leadership had a statistically significant positive

correlation with discretionary accruals with the standardized coefficient 0.133 at the 5% level. It means that high board leadership led to more unconditional conservatism in term of discretionary accruals. If the CEO and the board director are the same person, it leads to full power to manage profits. In addition, if the both positions are not clearly separated, the monitoring efficiency decreases towards the discretionary accruals principle. This is consistent with Eng & Mak, (2003); Krishnan & Vivanathan (2008); Lim (2011) who indicated that board leadership played a role in unconditional accounting conservatism in term of discretionary accruals, leading to high accounting accruals and lower earning quality.

Therefore, board size and the board leadership are company tools to employ discretionary accruals through accounting conservatism or accounting policy.

Future research can be further developed by adding or modifying study variables, sampling groups, or modifying study or comparison variables to confirm the information and benefit investors.

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