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Audit Committees and Quarterly Earnings Management

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Abstract

Regulators have frequently expressed concerns about corporate earnings management. Audit committees are expected to monitor managers' financial reporting, including attempts to manipulate earnings numbers. The extant literature has focused on managers' incentives to manipulate *annual* earnings numbers. However, managers also have incentives to manage *quarterly* earnings, due to, for example, pressures to meet quarterly analyst forecasts. We test the association between audit committee characteristics and measures of quarterly earnings management. Using a sample of 896 firm-year observations for the years 1996–2000, we report three findings. First, quarterly earnings management is lower for firms whose audit committee directors have greater governance expertise. Second, the extent of stock ownership by audit committee directors is positively associated with quarterly earnings management. Third, the average tenure of audit committee directors is negatively associated with quarterly earnings management.

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