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Audit Committee Financial Expertise, Competing Corporate Governance Mechanisms, and Earnings Management

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Abstract

A prime objective of the Sarbanes-Oxley Act and recent changes to stock exchange listing standards is to improve the quality of financial reporting. We examine the associations between audit committee financial expertise and alternate corporate governance mechanisms and earnings management. We find that both accounting and certain types of non-accounting financial expertise reduce earnings management for firms with weak alternate corporate governance mechanisms, but that independent audit committee members with financial expertise are most effective in mitigating earnings management. Importantly we find that alternate corporate governance mechanisms are an effective substitute for audit committee financial expertise in constraining earnings management. Finally, we find either no association or a positive association between financial expertise and real earnings management. Our results suggest that alternate governance approaches are equally effective in improving the quality of financial reporting, and that firms should have the flexibility to design the particular set of governance mechanisms that best fit their unique situations.

Keywords: earnings management, real earnings management, corporate governance, Sarbanes-Oxley**JEL Classification:** G34, M41[Suggested Citation](#) >[Show Contact Information](#) >

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