Editorial

Corporate governance and earnings quality

This issue presents a forum on corporate governance and earnings quality. Corporate governance received worldwide attention following colossal corporate collapses around 2001. Subsequently, many countries around the world issued both hard and soft regulations. Regulators around the world not only issued "comply or explain" type governance codes but also enacted new legislation with the aim to protect investors. Naturally, researchers are interested to investigate whether the various corporate governance measures, whether legislated or not, mitigate agency costs in any way.

One of the indirect measures of agency costs is the quality of financial reporting, specifically, the quality of earnings. Earnings quality is high when earnings management (EM; or manipulation) is low and vice versa. Because financial statements are declarations by management and the financial statements, directly or indirectly, and reflect management's economic incentives, measuring earnings quality and the quality of financial reporting indirectly provides evidence of the prevalence of practices consistent with high agency costs.

In the first paper, Richard Kent, Pamela Kent, James Routledge and Jenny Stewart investigate whether Australian best practice recommendations for corporate governance is equally effective for all listed companies, regardless of their size and whether corporate governance choices made by the companies are consistent with their operating environment. Using cluster analysis, Kent *et al.* find that larger companies tend to exhibit higher levels of adoption of best practice recommendations than smaller companies. Further, independence of the audit committee is crucial for preserving the quality of earnings. Overall, Kent *et al.* conclude that for smaller firms, effective governance is possible without implementing all of the best practice recommendations. Hence, for smaller companies, the Australian Securities Exchange (ASX) corporate governance guidelines should remain as *best practice* rather than mandatory requirements.

In the second paper, Effiezal Aswadi Abdul Wahab, Marziana Madah Mrzuki and Hasnah Haron examine whether earnings conservatism increased in Malaysian listed companies following the Malaysian Code of Corporate Governance (MCCG) reform in 2007. The authors do a pre- and post-reform analysis. They measure conservatism using asymmetric loss recognition (Basu, 1997) and accruals-based conservatism models (Ball and Shivakumar, 2005). Abdul Wahab *et al.* conclude that earnings conservatism improved following the MCCG 2007. They also note that it is not the expertise of the board of directors, rather expertise and independence of the audit committee members that enhance the conservatism of earnings. The importance of the audit committee's independence in preserving earnings quality has been highlighted in Kent *et al.*'s study as well.

The third paper is a cross-country study. Using top-indexed companies in Australia, Malaysia, Pakistan and The Philippines, Qaiser Yasser and Mamun Abdullah find that chief executive officer (CEO) duality is not associated with firm performance and earnings quality. However, surprisingly, female CEOs are associated with lower firm performance in Malaysia, The Philippines and Pakistan, but not in Australia. On the other hand, large firms in Australia have higher quality of earnings. One of the plausible

Accounting Research Journal
Vol. 29 No. 4, 2016
pp. 370-371
© Emerald Group Publishing Limited
1030-9616
DOI 10.1108/ARJ-08-2016-0105

explanations for these mixed results would be the differences in institutional settings and managerial incentives across these four countries. Corporate governance regulation, investor protection, level of economic development, accounting standards and their enforcement vastly differ across these four countries. In a cross-country study, it is very important to account for these important factors before any valid conclusions can be made. Also, the evidence that female CEOs under-perform in all of the sample countries, except Australia, raises the question whether female CEOs still face "the glass ceiling" in developing counties or is it because of a "competency gap".

The next paper is authored by Ebraheem Saleem Salem Alzoubi. He uses the Jordanian setting in exploring whether disclosure quality (DQ) affects EM. DQ is measured via a disclosure index, and EM is estimated using a cross-sectional version of the modified Jones model (Dechow, Sloan and Sweeney, 1995). Alzoubi finds a weak negative association between DQ and EM. He rightly identifies that all accruals-based measures of EM inherently suffer from the plausible misclassification error.

The fifth and final paper in the forum is again a cross-country study. It addresses the relation between EM and corporate reputation and whether this relation is moderated in family firms. The authors, Jennifer Martínez-Ferrero, Lázaro Rodrigues-Ariza and Manuel Bermejo-Sánchez, use multiple measures of EM (both accounting-based and real) and analyse a sample of 1,169 firms over the period 2006-2010. Martínez-Ferrero *et al.* find that EM practices negatively affect corporate reputation. However, the negative effect of EM on corporate reputation is ameliorated in family-controlled firms.

In sum, the five papers published in this issue enhance our understanding of the inter-relations between corporate governance and earnings quality/EM. The papers span over both single-country setting and cross-country setting. We hope readers find them informative.

Reza Monem
Griffith University, Queensland, Australia