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Women on corporate boards foster better financial reporting, study finds

When Ligand Pharmaceuticals, a small California biotech, announced on November 5 that it was restating its financial statements for 2011 and the first two quarters of 2012, it caused scarcely a ripple on Wall Street. After all, not only is the company's market capitalization a mere several hundred million dollars, but restatements are not all that uncommon in small, high-tech companies. But even those attending to the announcement probably missed another feature about the restating company that runs true to form: its board of directors is all male. What does the absence of women on the board have to do with the company's financial probity? In Ligand's case perhaps nothing at all -- but as a general matter quite a bit, according to research to appear next month in a leading accounting journal.

The study in the December issue of the **American Accounting Association journal *Accounting Horizons*** finds that female presence on a company board reduces the chance of financial restatements by close to 40%. Restatements are necessitated by serious misrepresentations, whether through error or fraud, in corporate financial reports.

In the words of the study, by Lawrence J. Abbott of the University of Wisconsin-Milwaukee, Susan Parker of Santa Clara University, and Theresa Presley of Kansas State University, "the presence of at least one woman on an otherwise male board is associated with a likelihood of restatement that is 62% of the likelihood without the gender diversity."

In fact, a woman's board presence, they find, does more on behalf of financial integrity than such tried-and-true measures as requiring the board's audit committee to consist entirely of independent directors, one of them with financial expertise, and mandating that it meet at least four times annually. The study finds those measures in combination to reduce the likelihood of restatements by about 20%, about half the effect achieved by having a woman director.

What accounts for this effect? While the study doesn't provide a definitive answer, the authors surmise that it has to do with the ample measure of independence that diversity confers upon corporate boards. This can be of particular value in cases where "a CEO or CFO justifies a financial reporting decision by suggesting that he or she is in a more knowledgeable position regarding the potential recognizability of this transaction. In this scenario, gender diversity can potentially affect the outcome by generating more questioning of the status quo, greater acknowledgment and legitimization of opposition and third-party viewpoints (including those of the audit committee, auditor, or internal audit director) and a slower, more deliberative and collaborative decision-making process...heightening the monitoring effectiveness that may [otherwise] be diminished by groupthink."

As to how gender diversity among directors might influence a firm's financial reporting, the authors envision board meetings where "the details of significant accounting estimates and accruals, auditor's comments as to the aggressiveness or conservatism of financial reporting, and even individual items, such as particularly large sales wins or losses, may be described. A more diverse, less cohesive board may be more likely to question assumptions and inquire as

to the comparability of accounting with industry practice, resulting in more in-depth discussion and slower decision-making."

The authors also cite experiments in which gender differences tended to prevent escalation of commitment by groups. As the study notes, "Given that many restatements start out on a small basis, but grow as a result of an escalation of commitment to a particular reporting philosophy or standard (particularly with respect to the recognition and collectability of future revenues), it seems reasonable that a board with at least one female director may be more proactive in its governance duties and display a more conservative financial reporting philosophy."

The study's findings derive from a comparison of companies that had to issue financial restatements with a control group of similar firms with no such reporting problem. The restatement sample consisted of 540 firms in total, with each of the restating firms matched with a control company on the basis of market capitalization, industry, and the ranking of the firm that performed its auditing.

In all, about 27% of the restating companies had at least one woman on their boards, compared with about 40% of the firms in the control group, a more than 50% higher prevalence in the controls than in the restatement sample.

On average, assets of restating firms amounted to less than two percent of the mean for companies in the Fortune 500, leading the study's authors to observe that smaller firms "are less likely [than the 500] to have a female board presence and are less apt to feel public pressure to establish a female board presence, due to their lack of visibility." They go on to add that this lack of external pressure "reduces the chance that female board presence is a form of tokenism, with no real costs or benefits. By minimizing the likelihood of tokenism, we believe our test setting provides an ideal environment to investigate the impact of female board presence on the governance role of boards."

Entitled "Female Board Presence and the Likelihood of Financial Restatement," the study is in the December issue of ***Accounting Horizons***, published quarterly by the **American Accounting Association**, a worldwide organization devoted to excellence in accounting education, research, and practice. Other journals published by the AAA and its specialty sections include *The Accounting Review, Issues in Accounting Education, Behavioral Research in Accounting, Journal of Management Accounting Research*

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