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Today's News

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Are Hiring Practices Biased in Favor of Earnings Management?

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***Summary:** Recruitment and promotion practices at many companies tend to favor financial executives who are predisposed to manipulate reported earnings , according to a recently published academic study. The study also offered little hope for fixing the problem through rulemaking or revisions to U.S. GAAP. The most productive solution may be to work with companies to reorient their hiring and promotion practices, although the study does not say how to do this.*

Recruitment and promotion practices at many companies tend to favor financial executives who are predisposed to manipulate reported earnings , according to three academics from the University of South Carolina who were scheduled to present the findings at the **American Accounting Association's annual meeting in Chicago on August 11, 2015.**

“The job candidate whose personality characteristics signal a predisposition to manage earnings is much more likely to be hired in for-profit public companies,” according to a paper titled *Earnings Management and Employee Selection* by Ling Harris, Scott Jackson, and Joel Owens. The researchers also found that recruiters tend to screen out job candidates who may be more reluctant to massage reported earnings .

Some Wall Street analysts and regulators consider earnings management, the tendency to misrepresent a company's financial results and boost the stock price, to be a common problem. The practice is blamed for contributing to investor mistrust in public company financial statements.

The academics acknowledge that their findings may not be conclusive, in part because of the small number of respondents for the two scenarios they tested — filling an opening for a senior accounting manager and hiring a candidate for a vacant financial reporting position. Some 59 professionals of 2,500 contacted in business accounting jobs responded to the question about the vacancy for the senior manager, and 99 recruiters took part in the survey for the open financial reporting position.

The researchers also said the design of their questions may steer some of the respondents to favor the job candidates predisposed to earnings management, but they also said that the study tried to mimic real-world behavior. In addition, the follow-up questions they included in the tests tended to reinforce the initial findings.

“The results are disturbing,” said Thomas King, a member of Financial Executives International and the Institute of Management Accountants. “I care a lot about financial reporting. Financial reporting helps people distinguish effective from ineffective companies, and earnings management means that employees do things to mislead users of financial statements.”

The study also offered little hope for fixing the problem through rulemaking or revisions to U.S. GAAP.

“The selection process in firms may populate accounting positions with individuals who are predisposed to manage earnings,” the study said. “No amount of regulation may significantly curtail earnings management under such circumstances.”

From the study’s perspective, the most productive solution may be to work with companies to reorient their hiring and promotion practices, although the study does not say how to do this.