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The Impact of Agency Structure and Management Team Characteristics on Disclosure Fraud

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The study represents an integrative effort to investigate potential differences regarding both the agency environment (as represented by its monitoring and incentive structure) and the characteristics of the agents (as represented by the management team) between a sample of publicly traded firms who have committed disclosure fraud according to Rule 10b-5 of the Securities and Exchange Act of 1934 and a carefully selected pair-matched control sample of firms who have not been singled out for misleading public disclosures. Our sampling design minimizes firm differences due to size, industry type and time period as well as the identity of certain monitors. The empirical analyses indicate the importance of including both agency structure variables and individual management team characteristics in describing the fraud environment. The regression results support the view that monitoring and incentive variables are important indicators of management fraud. When firm performance moderator variables are added to the model, the significance of the model, the amount of variation explained, and classification accuracy increase. Pair-wise comparisons reveal differences for the management team characteristics involving military experience and functional background. Fraud companies are more likely to possess management teams with a higher concentration of individuals with no military experience and peripheral background (law and finance).

INTRODUCTION

Publicly traded entities that issue misleading financial disclosures are in violation of Rule 10b-5 of the Securities and Exchange Act of 1934. This type of violation constitutes a form of corporate illegal activity that has resulted in large economic losses to many of the constituencies of the reporting environment. Disclosure fraud and the ability of the auditor to detect such fraud is the focus of attention from the public, from federal and state legislators and from public and private regulatory bodies (Latham & Jacobs 2000).[1]

[1] Disclosure fraud is defined in this study in accordance with Rule 10(b)-5 of the Securities Exchange Act of 1934.