Summary of Paper: How Board Monitoring and Mandated Clawbacks Shape Managers' Use of Discretion: Experimental Evidence

What is this Study About?

This study investigates how two governance mechanisms—board monitoring (internal) and mandated clawbacks (external regulations)—jointly influence how managers use discretion (and the type of discretion they use: financial versus operational) to manage earnings.

What are the major findings of the study?

Using an experiment with 127 experienced MBA students acting as CEOs, the study finds that when board monitoring is weak, mandated clawbacks push managers to favor operational actions (like cutting advertising) instead of accounting tactics (like adjusting warranty accruals) to hit short-term earnings goals. However, when board monitoring is strong, managers do not shift their behavior in response to clawbacks—strong boards already limit opportunistic tactics.

Why is the study important?

The research reveals that internal governance strength (i.e., an engaged board) can be more effective than rules alone in curbing earnings management. For CPAs, analysts, and regulators, this highlights the importance of assessing board effectiveness alongside compliance with external regulations like SOX and Dodd-Frank.

What is the impact on professional practice and society at large?

The findings suggest that mandated clawbacks can have unintended consequences—if boards are weak, managers may simply shift from accounting manipulation to real operational cuts that can harm long-term competitiveness. For shareholders, this could mean unsustainable profits and reduced future value. Thus, practitioners and policymakers should prioritize building a culture of accountability within firms, not just rely on legal rules.

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