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Earnings Management and Ownership Structure in Brazil: the Moderating Role of Auditing

Jonas Silva , Verônica de Fátima Santana

FECAP University Center, Brazil

Abstract

This study investigates the relationship between ownership structure and earnings management in publicly traded companies in Brazil, with special focus on the impact of managerial ownership. Additionally, it analyzes the moderating role of external auditors, examining both auditor reputation (Big Four firms) and the length of the client-auditor relationship (tenure). The research addresses a gap in the Brazilian literature, as previous studies have examined ownership structure and audit quality in isolation, without investigating their interactive effects. Using a fixed effects panel model for 145 companies listed on Brasil, Bolsa, Balcão (B3) between 2010 and 2022, with 777 firm-year observations, the results indicate a positive and significant relationship between executive directors' ownership and the magnitude of earnings management, measured through discretionary accruals using the Kothari, Leone, and Wasley (2005) model. This finding supports the management entrenchment hypothesis, suggesting that managers with greater equity participation engage in opportunistic accounting practices. However, this relationship is significantly attenuated when the company is audited by a Big Four firm and when there is a longer audit relationship duration, indicating that audit quality serves as an effective governance mechanism. Furthermore, board ownership demonstrates a negative association with earnings management, evidencing an additional monitoring function. The findings reinforce the importance of audit quality as an essential corporate governance mechanism to mitigate opportunistic behaviors in emerging markets with concentrated ownership structures, providing relevant insights for regulators, investors, and standard setters.

Keywords: Earnings Management, Managerial Ownership, Audit Quality, Agency Theory, Corporate Governance