Section 1. Introduction, Thesis, Purpose, Objective, Approach

Human capital is arguably a firm’s most precious asset though its importance can oftentimes be overlooked to a large degree due to its intangible nature and the consequent difficulty associated with expressing its value in quantitative terms. Defined in concise but precise terms, human capital refers to “the economic value of a worker’s experience and skills” (Investopedia, Kenton 2020) which can be assessed from a broad range of criteria including the employee “education, training, intelligence, health”, as well as other important attributes such as “loyalty, and punctuality”. As an emerging area of research in accounting, discourses on ‘diversity, equity, and inclusion’ continue to garner increasing attention as more people realize that employees - especially rank-and-file ones - play a critical role in determining the success of a firm in this ever more competitive, complex, and globalized market. The competitive advantages of a firm can no longer be attributed solely to cutting-edge technology and top-notch business practices as industrial leadership cannot be established or sustained without a solid employee base as the key driving force behind continual innovations in all possible forms and directions. A growing number of firms nowadays demonstrate strong commitment to promoting diversity and inclusion in the workforce, stressing that equitable treatment of employees is the key to maximizing the productivity of the human capital of their business through improvements in employee satisfaction, loyalty, and motivation. The ability to retain competent employees allows firms to put their resources to more productive use by avoiding substantial costs that will be incurred in constantly searching for and training new employees when high employee turnover constitutes a pressing problem.

The growing intensity of competition in the modern business world unfortunately has led to a rise in the prevalence of accounting and reporting-related issues. To gain an edge over their rivals and seize a greater share of the market, firms devote effort to maximizing contributions from investors in order to raise capital in sufficient amounts to sustain their ongoing endeavors in research and innovation. Firms experiencing poor performance that persistently falls below analyst expectations could have a strong tendency to manipulate the figures on their financial reports to prevent the erosion of investor trust by conveying a deceptive image of their financial and operational strength to the public. Similarly, when performance declines due to unexpected and adverse changes in external factors, firms adopt unsound accounting practices to boost their earnings and restore investor confidence. Another key force underlying firms’ incentives to temper with their accounting numbers lies in their compensation structures. In many large organizations, the compensation of executive-level employees is now increasingly stock-based, creating strong incentive for these key decision makers to resort to an upward distortion of the firm's earnings in order to augment their financial interest. The compensation of rank-and-file employees, in contrast, is usually less closely tied to the firm’s performance in the stock market. As a result, rank-and-file employees acting with integrity are likely to perceive the manipulative reporting behaviors by management as unethical and unacceptable and demand that corrective measures be implemented when they observe a notable deviation of the firm’s accounting numbers from its actual financial reality.
In this project, I aim to explore the relation between employee diversity and firms’ financial reporting quality. Specifically, I plan to focus exclusively on the ethnicity dimension of diversity, examining whether firms with a more diverse base of rank-and-file employees exhibit higher overall financial reporting quality. Existing research yields compelling evidence that employee education level can critically influence firms’ financial reporting quality. More highly educated employees demonstrate stronger ability to supply their firms with high quality information as inputs into the financial reporting process, while simultaneously being more skilled at detecting intentional misstatements by management before they turn into material reporting errors with costly consequences. Similarly, evidence also exists supporting the idea that gender diversity in the workforce can impact external reporting quality. Improvements in the female-to-male ratio of a firm’s employees is shown to be positively associated with reductions in the incidents of aggressive reporting behavior compared to when the employee base follows a more uniform gender distribution characterized by male domination. I hypothesize that ethnic diversity will affect a firm's financial reporting quality in a similar fashion as these other more extensively studied dimensions of diversity, and postulate that firms with more ethnically diverse rank-and-file employees will exhibit greater transparency and accuracy in their disclosure of key financial information compared to competitors in the same industry that attach less importance to workforce diversity.

To initiate the project, the first step will be to identify the industry or industries from which firms to be studied in this research will be selected. Analyzing and comparing firms from too broad a range of different industries could reduce the validity of the research findings and yield less valuable insights. The financial structure of firms could vary widely across industries, and the varying degree of reliance on equity financing among firms of disparate industries makes it difficult to conclusively study the employee-driven impacts on financial reporting quality, as fundamental differences can exist in management’s attitude toward earnings manipulation from firm to firm. The next steps will involve determining the sample size and designing the data collection process. I plan to keep a reasonable sample size to ensure the reliability and usefulness of the research findings. Data on workforce diversity will be obtained from the following sources: Home | US Equal Employment Opportunity Commission, US Bureau of Labor Statistics Latest Numbers, Economy & Work - Research and data from the Pew Research Center.

Research Questions
- How does employee ethnic diversity influence a firm’s financial reporting quality (in terms of completeness/transparency/accuracy in disclosure, frequency of restatements, likelihood of material misstatement, risk of fraud) ?

Section 2. Responsibility

For this individual project, I will be responsible for carrying out all aspects of the research. The process involves identifying research questions, formulating hypotheses, performing literature review, surveying relevant social contexts, developing data collection procedures, collecting and analyzing data, interpreting results, and finally evaluating the significance of the research outcomes in relation to existing literature on similar research topics.

Section 3. Timeline

Fall 2021
- Identify firms and industries to collect data on
- Develop research method, determine research sample
- Design data collection processes and procedures

Winter 2022
- Collect and analyze data
- Draw conclusions and compare to hypothesis
- Identify relation of research findings to existing research evidence

Section 4. Itemized Budget
- No budget anticipated

Section 5. References

https://doi.org/10.1016/j.jfineco.2013.02.019

https://doi.org/10.1016/j.jaccpubpol.2013.08.007.

https://doi.org/10.1016/j.jacceco.2017.06.003.

https://doi.org/10.1111/j.1467-8683.2010.00809.x.

https://doi.org/10.1016/j.emj.2021.02.005

https://doi.org/10.1016/j.jacceco.2015.06.001.

Kenton, Will. “Reading into Human Capital.” *Investopedia,* 20 Sep. 2021,