

# FROM MORALE TO METRICS: THE INFLUENCE OF WORKFORCE ENGAGEMENT ON FINANCIAL REPORTING CHOICES

Ayishat Omar \*

\* Department of Accounting and Finance, Rohrer College of Business, Rowan University, Glassboro, USA  
Contact details: Department of Accounting and Finance, Rohrer College of Business, Rowan University, 201 Mullica Hill Road, Glassboro, NJ 08021, USA



## Abstract

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This study investigates the relationship between employee engagement and discretionary accruals, offering a stakeholder-oriented perspective on earnings management. Using panel data from U.S. public firms (2017–2024) and the Drucker Institute’s employee engagement and development score, the study estimates regression models to assess whether engagement influences revenue reporting discretion. Results show that higher employee engagement is associated with lower discretionary accruals, indicating that engagement functions as a governance mechanism that promotes transparency rather than opportunistic reporting. The effect is stronger in consumer-facing industries, where reputational visibility and stakeholder scrutiny are greatest, but it is not moderated by firm growth. These findings extend stakeholder theory by demonstrating that non-financial performance indicators can shape financial reporting behavior and highlight the contextual nature of reputational pressures. Practical implications include the need for regulators, auditors, and investors to consider engagement metrics as indicators of reporting quality. Future research should examine interactions with other stakeholder attributes and institutional contexts.

**Keywords:** Employee Engagement, Discretionary Accruals, Stakeholder Theory, Financial Reporting Transparency, Reputational Pressure

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## 1. INTRODUCTION

Revenue recognition remains a central concern in financial reporting due to its significant impact on earnings quality and the discretion it affords managers (Hinson et al., 2024). Despite the implementation of the Accounting Standards Codification standard No. 606 (ASC 606), which introduced a standardized framework for revenue reporting, managerial judgment continues to play a substantial role, making revenue recognition a frequent subject of SEC comment letters and regulatory scrutiny (Giedt, 2018; Stubben, 2010).

This discretion allows managers to exercise latitude in timing and measurement, and prior literature has linked aggressive reporting to factors such as governance quality, compensation incentives, and capital market pressure (Dechow et al., 2010; Jiang et al., 2010; Hinson et al., 2024). However, less attention has been given to how stakeholder-related organizational dynamics, particularly employee engagement, shape financial reporting behavior (Budd & Bhava, 2019; Edmans et al., 2023; Harrison & Bosse, 2013).

Employee engagement reflects the degree to which employees are committed to organizational

goals, feel supported by leadership, and perceive strong opportunities for development (Budd & Bhawe, 2019). High engagement is generally associated with stronger firm performance, better customer outcomes, and competitive advantage because it enhances internal cohesion and operational efficiency (Edmans, 2011; Edmans et al., 2023). Yet, engagement also contributes to organizational identity and reputational expectations. Firms celebrated for strong employee cultures may face internal pressure to maintain narratives of continual excellence, particularly when performance temporarily weakens or competitive conditions shift. In such settings, reputational capital may function not only as a source of value but also as a source of performance pressure (Ashforth & Mael, 1989; Gond et al., 2017; Rao, 1994).

This dynamic raises a central question:

*RQ: Does strong employee engagement discipline management and reduce opportunistic reporting, or does it heighten pressure to sustain performance narratives, increasing reliance on discretionary reporting techniques?*

Stakeholder theory emphasizes that firms operate within networks of interdependent actors whose expectations shape managerial decisions (Freeman, 1984; Harrison & Bosse, 2013). When employees are central to a firm's identity, managers may be motivated to avoid outcomes that disrupt perceptions of organizational strength and stability, particularly during periods of weaker performance (Ravasi & Schultz, 2006). These dynamics suggest two competing mechanisms. Employee engagement may function as an internal governance mechanism that reinforces transparency and ethical reporting norms. Alternatively, strong engagement and the reputational expectations it generates may intensify pressure to preserve images of success, increasing incentives for earnings management. This tension motivates our hypotheses, which examine whether employee engagement constrains aggressive revenue recognition and whether this effect varies by industry visibility.

Using the Drucker Institute's employee engagement and development index merged with Compustat data for U.S. public firms from 2017 to 2024, we examine the association between engagement and discretionary accruals, commonly used to detect earnings management. Contrary to concerns that engagement might increase pressure for performance continuity, we find that higher employee engagement is associated with lower discretionary accruals, suggesting that engagement functions as a governance mechanism that promotes transparency rather than opportunistic reporting. This effect is stronger in consumer-facing industries, where organizational identity and employee-customer interactions are highly visible. Conversely, growth expectations do not significantly moderate the relationship, indicating that external market pressures play a lesser role compared to internal cultural dynamics.

This study contributes to research on financial reporting and stakeholder governance. First, it extends earnings management literature by introducing employee engagement, a non-financial, stakeholder-oriented metric, as a determinant of reporting behavior. Second, it reinforces the assumption that employee-centric cultures can strengthen reporting integrity, while highlighting

that this effect is context-dependent. Third, the findings inform environmental, social, and governance (ESG) and human capital reporting debates, demonstrating that engagement metrics may serve as indicators of governance strength and reporting quality.

For regulators, auditors, and investors, these results suggest that strong employee cultures should be interpreted as positive signals of transparency rather than risk factors. For managers, the findings underscore the importance of maintaining robust internal controls to ensure that cultural reputation objectives continue to align with accurate financial reporting.

The remainder of the paper proceeds as follows. Section 2 reviews relevant literature and develops hypotheses. Section 3 describes data and research design. Section 4 presents results, and Section 5 discusses implications. Section 6 concludes the research.

## 2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

Revenue recognition plays a critical role in shaping reported firm performance because it directly influences earnings, firm valuation, and managerial accountability (Hinson et al., 2024). Although ASC 606 introduced a principles-based framework designed to increase comparability and reflect the economic substance of transactions, implementation continues to rely heavily on managerial judgment. Managers decide how to identify performance obligations, estimate variable consideration, assess collectibility, and determine whether revenue should be recognized at a point in time or over time (Badger et al., 2025). This flexibility, while theoretically intended to align reporting with underlying economics, also preserves opportunities for aggressive recognition practices, including channel stuffing, bill-and-hold arrangements, and premature revenue booking (Dechow et al., 1995; Stubben, 2010; Yassin et al., 2024).

Empirical evidence following ASC 606 confirms substantial heterogeneity in reporting outcomes, with some firms exhibiting increased reliance on discretionary accruals where managerial performance incentives are strong (Burnett et al., 2021; Hinson et al., 2024). This is consistent with research showing that compensation sensitivity in high-growth firms can amplify earnings management incentives (Kwon et al., 2022). As a result, research on revenue-based earnings management continues to employ accrual-based estimation models and industry-adjusted discretionary revenue metrics to detect opportunistic behavior (Kothari et al., 2005; Burnett et al., 2021).

Historically, this literature attributes variation in aggressive reporting primarily to internal drivers, including executive compensation structures, board monitoring strength, ownership incentives, and auditor oversight (Bartov et al., 2002; Hales et al., 2025; Nguyen et al., 2024; Rajpurohit & Rijwani, 2024). For example, ownership structure and governance composition have been shown to affect earnings management in initial public offerings (Burdeos, 2021). However, an increasingly influential stream of research suggests that managerial discretion is also shaped by external relational and institutional pressures (Ricapito, 2024). Firms operate within

a landscape of stakeholders whose expectations influence how performance is communicated (Miles, 2017). In this context, reputational concerns, legitimacy maintenance, and public visibility can either discipline reporting practices or create pressure to sustain a particular performance narrative (Jing & Ng, 2024). For example, Gunawan et al. (2026) show that firms facing heightened public reputation sensitivity are more likely to engage in real earnings management to avoid earnings disappointments. von Berlepsch et al. (2024) further document a surge in research linking reputation management to financial reporting choices, reflecting the growing relevance of intangible assets in contemporary markets.

Stakeholder theory provides a foundational lens for understanding how firms navigate complex relational environments. It posits that organizations are not merely accountable to shareholders but are embedded within a network of interdependent constituencies, including customers, employees, investors, suppliers, regulators, and communities, whose trust and approval are essential for long-term viability (Freeman, 1984; Donaldson & Preston, 1995). These stakeholders exert both direct and indirect influence on managerial decision-making, shaping how firms communicate performance, allocate resources, and respond to strategic challenges. In this context, financial reporting becomes not only a technical exercise but a relational act, where transparency, credibility, and consistency are critical to sustaining legitimacy.

Reputational capital theory complements this view by emphasizing the strategic value of perceived reliability and competence. When firms consistently signal ethical behavior, operational excellence, and financial stability, they accumulate reputational capital — an intangible asset that enhances access to financing, attracts talent, strengthens customer loyalty, and buffers against crises (Fombrun & Shanley, 1990; Rindova et al., 2010; Velte, 2024). However, reputation is inherently fragile and path-dependent. It is built incrementally through repeated interactions but can be undermined swiftly by perceived inconsistencies or failures. As such, reputation functions not only as a resource but also as a constraint, imposing expectations that may limit managerial flexibility (Rindova et al., 2010).

Firms that cultivate strong identity-based reputations, such as those emphasizing innovation, social responsibility, or employee empowerment, face particularly acute pressures. These reputations are often embedded in brand narratives, stakeholder relationships, and internal culture, making them difficult to recalibrate without risking dissonance or backlash (Bhargava & Bedi, 2022; Brammer et al., 2014). When performance falters, managers may struggle to reconcile actual outcomes with the aspirational image the firm has projected (Dadanlar et al., 2024; Liang et al., 2018). This tension can lead to impression management behaviors, including selective disclosure, earnings smoothing, or strategic use of accounting discretion to preserve continuity (Gioia et al., 2010; Love & Kraatz, 2009). In such cases, the desire to maintain reputational coherence may override normative reporting standards, especially when stakeholder scrutiny is high or when firms operate in industries where public perception is tightly coupled with financial credibility.

Employee engagement and development represent one such domain of identity-based reputation. The Drucker Institute conceptualizes employee engagement as the degree to which organizations invest in internal development, foster collaborative culture, empower employees, and support meaningful work-based relationships (Drucker Institute, n.d.). High engagement is associated with lower turnover, higher productivity, greater innovation, stronger customer satisfaction, and improved financial performance (Ahmed et al., 2020). Firms that cultivate engaged workforces often publicize these cultural strengths, embedding them into brand identity and value propositions. In these organizations, employees themselves become strategic assets whose morale and commitment are central to performance continuity.

However, this internal strength can also lead to elevated expectations. When employees are positioned as a core element of the firm's identity, management may become reluctant to allow financial results that suggest deterioration, instability, or the weakening of the organizational culture. Studies in organizational identity show that firms are particularly likely to engage in impression-management behaviors when changes in performance threaten internal self-concepts or external reputation narratives (Gioia et al., 2010). In accounting contexts, prior literature has speculated that high-engagement firms might rely on discretionary accruals to maintain continuity (Graham et al., 2022). However, emerging evidence, including this study, suggests the opposite: engagement functions as a governance mechanism that reduces aggressive reporting, reinforcing transparency rather than opportunism.

This incentive is expected to be especially strong in consumer-facing industries, where brand reputation and service experience are closely tied to perceived internal culture. Prior research shows that stakeholder reactions to firm performance are more immediate and behaviorally consequential in industries where customers directly interact with the firm's output (Noh et al., 2025; Datta et al., 2013). Firms in these sectors frequently market their employee culture as part of their brand identity — examples include hospitality chains emphasizing empowerment, technology firms highlighting innovation culture, and retailers promoting frontline service quality. Consequently, a decline in reported financial performance in such firms may be interpreted as signaling weakening workforce cohesion or strategic clarity, heightening incentives to preserve stable earnings trajectories.

In parallel, a growing body of research calls for greater integration of non-financial performance indicators, such as customer satisfaction, employee engagement, and sustainability metrics, into accounting research and practice (Burnett et al., 2021). These indicators offer early signals of organizational health and integrity, complementing traditional financial metrics and providing a more holistic view of firm performance (Ghanbarpour et al., 2024; Ittner & Larcker, 1998; Said et al., 2003). Their inclusion reflects broader shifts within the accounting profession and regulatory discourse toward stakeholder-oriented reporting frameworks (Appleton et al., 2023; Burnett et al., 2021). In this context, employee engagement emerges not only as a cultural asset but also as a governance mechanism that can influence financial reporting behavior.

Although employee engagement is widely recognized as a key intangible resource that strengthens organizational identity and enhances firm reputation, prior work has not examined whether firms with high employee engagement face performance continuity pressures that influence earnings management behavior. Existing studies treat engagement primarily as a source of operational efficiency or cultural strength but do not consider its potential to create reputational performance expectations that managers seek to uphold through discretionary reporting. This represents a critical omission in the literature, as engagement-driven reputational pressures may uniquely shape financial reporting choices in ways not captured by traditional governance or incentive-based explanations. This study fills that gap by testing whether firms with stronger employee engagement and development exhibit lower levels of aggressive revenue recognition and whether this relationship is amplified in consumer-facing industries, where organizational reputation is more visible and socially embedded.

While employee engagement is theorized to reduce opportunism by fostering intrinsic motivation and ethical norms (Edmans, 2011), its role in financial reporting may depend on reputational visibility. Firms that embed engagement into their identity often publicize cultural strength as part of their brand, creating expectations of consistent excellence (Ashforth & Mael, 1989; Fombrun & Shanley, 1990). In consumer-facing industries, where employee culture is highly visible and closely tied to customer experience, these expectations are amplified (Noh et al., 2025). Prior research on organizational identity suggests that when performance signals threaten internal or external narratives, managers may resort to impression management behaviors, including accounting discretion, to maintain continuity (Gioia et al., 2010). Taken together, theory and evidence imply that engagement can function as a governance mechanism that discourages aggressive reporting, with stronger effects in contexts of high reputational visibility. This leads to the following hypotheses:

*H1: Firms with higher employee engagement and development exhibit lower levels of aggressive revenue recognition.*

*H2: The negative association between employee engagement and aggressive revenue recognition is stronger in consumer-facing industries, where reputational expectations and stakeholder visibility are more salient.*

### 3. RESEARCH METHODOLOGY

#### 3.1. Data sources and sample selection

The primary data source for employee engagement and development is the Drucker Institute's holistic company rankings, which report annual standardized, continuous index scores for five dimensions of corporate effectiveness — customer satisfaction, employee engagement and development, innovation, social responsibility, and financial strength — each built from multiple indicators. An overall ordinal ranking is then derived from the aggregate of these five index scores (Drucker Institute, n.d.). These rankings and indices are widely used in stakeholder and ESG research because they

provide a comprehensive and consistent framework for assessing corporate performance (Ghanbarpour et al., 2024). The focal variable in this study — employee engagement and development (*EED*) — is the index score for the employee engagement dimension, which reflects practices related to workforce development, empowerment, and organizational culture. This study uses *EED* scores from 2017 to 2024, merged with firm-level financial data from Compustat for the same period. The initial merged dataset includes 1,997 firm-year observations. After excluding observations with missing Compustat variables or insufficient information to compute discretionary accruals, the final sample consists of approximately 848 firm-year observations across 209 publicly traded U.S. firms.

#### 3.2. Variables

To examine the relationship between *EED* and aggressive revenue recognition (*RevAgg*), this study employs the following variables. The dependent variable is discretionary accruals (*DISC*), which serve as a proxy for aggressive revenue recognition. Specifically, discretionary accruals are estimated using the modified Jones model (Dechow et al., 1995). To mitigate the influence of extreme values, the resulting accruals are winsorized at the 1st and 99th percentiles, consistent with standard practice in earnings management research. As a robustness check, the study also computes abnormal receivables scaled by sales (*ABNRECT*), following Stubben (2010), where elevated abnormal receivables may indicate premature revenue recognition.

The key independent variable is employee engagement and development (*EED*), measured using the Drucker Institute's holistic company rankings. The *EED* score, scaled from 0 to 100, is lagged by one year to reduce concerns regarding reverse causality. The Drucker rankings evaluate U.S. public companies across five dimensions of corporate effectiveness: customer satisfaction, employee engagement and development, innovation, social responsibility, and financial strength (Wartzman & Tang, 2019). The *EED* dimension reflects firms' investments in internal career development, leadership quality, workplace culture, learning systems, and employee empowerment. The index draws on multiple third-party and proprietary data sources, including Glassdoor employee feedback, LinkedIn workforce analytics, company disclosures, and organizational culture benchmarks (Ghanbarpour et al., 2024). The measure is standardized and updated annually, allowing for consistent comparisons across firms and over time. Higher values indicate stronger engagement and development practices, which may influence managerial discretion in financial reporting by shaping organizational identity, reputational considerations, and performance expectations (Edmans, 2011).

To assess whether the relationship between *EED* and earnings management varies across industries, we include a moderator for consumer-facing sectors. Firms operating in industries where customers directly experience products or services — such as retail, hospitality, consumer goods, and consumer services — are coded as 1; all others are coded as 0. This classification follows AbuRaya et al. (2023) and allows us to evaluate whether reputational pressure is more salient in sectors with direct customer interaction.

The study also includes several firm-level controls to account for financial characteristics and governance incentives. Firm size is measured as the natural logarithm of total assets. Profitability is captured by return on assets (ROA). The market-to-book (MTB) ratio proxies for growth expectations, while *Leverage* (total debt to total assets) captures financial risk and potential pressure to manage earnings. A binary *Loss* indicator accounts for firms reporting net losses, which may face heightened incentives to manipulate earnings (Dechow et al., 1995; Kothari et al., 2005). The models incorporate industry and year fixed effects (FE) to address unobserved heterogeneity and macroeconomic trends that may influence accounting practices.

$$RevAgg_{it} = \beta_0 + \beta_1 EED_{it-1} + \beta_2 Controls_{it} + \gamma_i + \delta_t + \varepsilon_{it} \quad (1)$$

where,

- $RevAgg_{it}$  is the proxy for aggressive revenue recognition for firm  $i$  in year  $t$ ;
- $EED_{it-1}$  is the lagged employee engagement and development score;
- $Controls_{it}$  includes the control variables listed above;

$$RevAgg_{it} = \beta_0 + \beta_1 EED_{it-1} + \beta_2 Consumer_i + \beta_3 (EED_{it-1} * Consumer_i) + \beta_4 Controls_{it} + \gamma_i + \delta_t + \varepsilon_{it} \quad (2)$$

where,  $Consumer_i$  is a binary indicator equal to 1 for firms in consumer-facing industries (e.g., retail, hospitality, consumer goods), and 0 otherwise. This model tests whether the association between  $EED$  and aggressive revenue recognition is stronger in sectors where customer perceptions and reputational visibility are more salient.

$$RevAgg_{it} = \beta_0 + \beta_1 EED_{it-1} + \beta_2 MTB_{it} + \beta_3 (EED_{it-1} * MTB_{it}) + \beta_4 Controls_{it} + \gamma_i + \delta_t + \varepsilon_{it} \quad (3)$$

where,  $MTB_{it}$  is the market-to-book ratio for firm  $i$  in year  $t$ , and the interaction term captures whether the effect of  $EED$  on aggressive revenue recognition varies under different levels of market valuation pressure. This model is exploratory, and its results are interpreted with caution.

## 4. RESULTS

### 4.1. Descriptive statistics and correlation

Table 1 presents descriptive statistics for the key variables used in the analysis. The dependent variable, discretionary accruals ( $DISC$ ), has a mean of -0.0038 and a standard deviation of 0.042. The mean being centered near zero is expected, as discretionary accruals are calculated as the residuals from the modified Jones model, which by construction produces residuals that average to

To further explore contextual factors, the study estimates an exploratory interaction model between  $EED$  and the  $MTB$  ratio. The  $MTB$  ratio serves as a proxy for market expectations and growth pressure, as firms with higher market valuations face greater demands to maintain performance and meet investor expectations (Graham et al., 2005). These pressures may heighten incentives for earnings management (Barton & Simko, 2002). Thus, this analysis assesses whether investor-driven performance pressure moderates the relationship between  $EED$  and aggressive revenue recognition ( $RevAgg$ ).

To test  $H1$ , whether firms with higher  $EED$  engage more aggressively in revenue recognition, the study estimates the following regression model:

•  $\gamma_i$  and  $\delta_t$  represent the firm and year FE, respectively.

Lagging  $EED$  mitigates reverse causality concerns.

To test  $H2$ , the study includes the consumer-facing industry moderator:

In addition to the models specified for  $H1$  and  $H2$ , the study estimates an exploratory interaction model to assess whether market expectations moderate the relationship between  $EED$  and aggressive revenue recognition. Specifically, we interact the lagged  $EED$  score with the  $MTB$ , which serves as a proxy for growth pressure and investor expectations. The model is specified as follows:

zero in each estimation year (Dechow et al., 1995). The employee engagement and development ( $EED$ ) index has substantial cross-sectional variation (Mean = 58.36; Standard deviation (SD) = 7.33; Range = 26.30 to 82.00), reflecting meaningful differences in workforce-related practices across firms.

The financial control variables display expected patterns. Firms report an average size (log of assets,  $Firm\ size$ ) of 10.17 and an average  $ROA$  of 9.1%, while approximately 5.7% of observations report a net loss.  $Leverage$  averages 0.31, and  $MTB$  ratios are positively skewed, indicating a mix of growth-oriented and mature firms in the sample. These descriptive patterns are consistent with prior research on discretionary accruals and stakeholder-related firm characteristics (Ittner & Larcker, 1998; Burnett et al., 2021), suggesting that the sample reflects typical variation in financial reporting and organizational performance attributes.

**Table 1.** Descriptive statistics of the main sample

Variable	N	Mean	Std dev.	Minimum	Q1	Median	Q3	Maximum
<i>DISC</i>	848	-0.0038	0.0424	-0.1573	-0.0257	-0.0020	0.0199	0.1393
<i>EED</i>	848	58.3550	7.3279	26.3000	53.9000	57.9000	62.7500	82.0000
<i>Firm size</i>	848	10.1680	1.1836	7.5438	9.2674	10.0871	11.0687	14.6309
<i>ROA</i>	848	0.0913	0.0776	-0.3595	0.0442	0.0833	0.1306	0.6530
<i>Loss</i>	848	0.0566	0.2312	0.0000	0.0000	0.0000	0.0000	1.0000
<i>MTB</i>	848	10.9167	12.3951	1.0252	3.1681	5.5881	13.3592	63.1006
<i>Leverage</i>	848	0.3074	0.1464	0.0172	0.2051	0.2994	0.4114	0.6801

Note: To reduce the impact of potential outliers, the continuous variables are winsorized at the 1% and 99% levels.

Table 2 reports Pearson correlation coefficients among the study variables. Notably, *EED* is negatively correlated with discretionary accruals ( $r = -0.166, p < 0.001$ ), suggesting that, in a bivariate context, higher employee engagement is associated with lower levels of earnings management. This finding aligns with prior research suggesting that engaged employees may foster ethical cultures and reduce opportunistic behavior (Budd & Bhav, 2019; Edmans et al., 2023).

Other patterns are consistent with prior literature. *DISC* is negatively correlated with *Loss* ( $r = -0.148, p < 0.001$ ), indicating that firms reporting losses tend to exhibit more income-decreasing accruals. This pattern is consistent with the “big bath” explanation, where managers take larger write-offs in loss years to reset performance benchmarks and improve future earnings comparisons (Healy, 1985). *DISC* is also negatively correlated with *MTB* ( $r = -0.156, p < 0.001$ ) and

*Leverage* ( $r = -0.073, p < 0.05$ ), suggesting lower discretionary accruals among high-growth and more heavily financed firms.

*Firm size* shows a small positive correlation with discretionary accruals ( $r = 0.087, p < 0.05$ ). Prior research offers competing mechanisms: larger firms often exhibit better accrual quality (predicting lower abnormal accruals) due to monitoring and systems (Dechow & Dichev, 2002; Francis et al., 2005), yet size also brings greater operational complexity and more opportunities for discretion (consistent with political-cost and complexity arguments) (Watts & Zimmerman, 1990). Accordingly, we treat size as a key control in the multivariate analyses.

These correlations generally align with prior research on discretionary accruals and firm characteristics (Dechow et al., 2010; Kothari et al., 2005; Edmans, 2011), suggesting that the sample reflects typical patterns observed in earnings management studies.

Table 2. Pearson correlation result

Variable	1	2	3	4	5	6	7
1) <i>DISC</i>	1						
2) <i>EED</i>	-0.1661***	1					
3) <i>Firm size</i>	0.0874**	0.1481***	1				
4) <i>ROA</i>	0.0293	0.2633***	-0.0993***	1			
5) <i>Loss</i>	-0.1484***	-0.0717**	-0.0423	-0.4789	1		
6) <i>MTB</i>	-0.1560***	0.1769***	-0.1320***	0.3202	-0.0271	1	
7) <i>Leverage</i>	-0.0732**	-0.2016***	0.0013	-0.0956	0.0978***	0.3363***	1

Note: \*\*\*, \*\*, and \* denote significance at the 1%, 5%, and 10% levels, respectively. The definitions of variables are provided in the Appendix.

#### 4.2. Regression results

Table 3 presents the baseline regression results examining the association between employee engagement and discretionary accruals. *EED* is negatively and significantly associated with discretionary accruals ( $\beta = -0.0012, t = -5.46, p < 0.001$ ), consistent with the prediction that higher engagement is associated with stronger ethical norms and, therefore, lower use of income-increasing accruals. This finding aligns with the earlier correlation evidence and remains robust after controlling for firm size, performance, growth opportunities, leverage, and firm and year FE.

Among the control variables, *Firm size* is positively and significantly associated with discretionary accruals ( $\beta = 0.0037, t = 3.00$ ), suggesting that larger firms may possess greater operational complexity that enables greater reporting discretion. *Loss* is negatively associated with discretionary accruals ( $\beta = -0.0231, t = -3.30$ ), consistent with firms reporting losses engaging in income-decreasing accruals, indicative of “big bath” behavior in loss years. *MTB* is also negatively significant ( $\beta = -0.0004, t = -2.83$ ), indicating that firms with higher growth expectations employ fewer income-increasing accruals, potentially to maintain credibility with capital markets and avoid jeopardizing valuation premiums. *ROA* and leverage do not exhibit statistically significant effects in this model.

The model explains approximately 7.8% of the variation in discretionary accruals (Adjusted  $R^2 = 0.0775$ ), and the F-statistic confirms overall model significance ( $F = 12.86, p < 0.0001$ ).

Table 3. Baseline regression results: Employee engagement and discretionary accruals

Variable	Predicted sign	Estimated coefficient	t-value
<b>Dependent variable = DISC</b>			
<i>EED</i>	-	-0.0012***	-5.46
<i>Firm size</i>	+/-	0.0037***	3.00
<i>ROA</i>	+	0.0335	1.46
<i>Loss</i>	-	-0.0231***	-3.30
<i>MTB</i>	+/-	-0.0004***	-2.83
<i>Leverage</i>	+	-0.0168	-1.55
Firm FE		Yes	
Year FE		Yes	
Adjusted $R^2$		0.0775	
F-statistic (p-value)		12.86 (< 0.0001)	
N		848	

Note: The table reports the results of the baseline regression for the fiscal years 2017 to 2024. Industry and year-FE are included but not tabulated. \*\*\*, \*\*, and \* denote significance at the 1%, 5%, and 10% levels, respectively. Variables are defined in the Appendix.

Table 4 reports the results of the moderated regression examining whether the relationship between employee engagement and discretionary accruals varies across consumer-facing industries. Consistent with expectations, *EED* remains negatively and significantly associated with discretionary accruals ( $\beta = -0.0007, t = -2.79, p < 0.01$ ), reinforcing that higher engagement reduces income-increasing reporting behavior.

The interaction term between *EED* and the consumer-facing industry indicator is negative and significant ( $\beta = -0.0013, t = -3.13, p < 0.01$ ), indicating that the inverse relationship between engagement and discretionary accruals is stronger in consumer-facing firms. This supports the hypothesis that reputational visibility heightens the disciplining effect of internal engagement culture on financial reporting choices.

The consumer-facing industry indicator itself is positive and significant ( $\beta = 0.0819$ ,  $t = 3.31$ ), suggesting that, on average, firms in consumer-oriented sectors exhibit higher baseline discretionary accruals, possibly due to stronger incentives to manage market perceptions of brand performance. The control variables retain similar signs and significance levels to the baseline specification. Model fit improves modestly (Adjusted  $R^2 = 0.0883$ ;  $F = 11.25$ ,  $p < 0.0001$ ), indicating incremental explanatory value from the interaction effect.

**Table 4.** Moderation by the consumer-facing industry

Variable	Predicted sign	Estimated coefficient	t-value
<b>Dependent variable = DISC</b>			
EED	-	-0.0007***	-2.79
Consumer	+	0.0819***	3.31
EED * Consumer	-	-0.0013***	-3.13
Firm size	+/-	0.0038***	3.13
ROA	+	0.0335	1.47
Loss	-	-0.0223***	-3.20
MTB	+/-	-0.0004***	-3.07
Leverage	+	-0.0156	-1.44
Firm FE		Yes	
Year FE		Yes	
Adjusted R <sup>2</sup>		0.0883	
F-statistic (p-value)		11.25 (<0.0001)	
N		848	

Note: The table reports the results of the regression for the fiscal years 2017 to 2024. Industry and year-FE are included but not tabulated. \*\*\*, \*\*, and \* denote significance at the 1%, 5%, and 10% levels, respectively. Variables are defined in the Appendix.

Table 5 presents the exploratory moderation analysis assessing whether firm growth moderates the association between employee engagement and discretionary accruals. Consistent with prior models, EED remains negatively and significantly associated with discretionary accruals ( $\beta = -0.0012$ ,  $t = -5.57$ ,  $p < 0.001$ ), reinforcing that higher engagement is associated with lower use of income-increasing accruals.

**Table 5.** Moderation by firm growth

Variable	Predicted sign	Estimated coefficient	t-value
<b>Dependent variable = DISC</b>			
EED		-0.0012***	-5.57
Growth		-0.0678*	-1.68
EED * Growth		0.0003	0.52
Firm size	+/-	0.0041***	3.40
ROA	+	0.0404*	1.81
Loss	-	-0.0248***	-3.55
MTB	+/-	-0.0371***	-3.79
Leverage	+	-0.0156	-1.44
Firm FE		Yes	
Year FE		Yes	
Adjusted R <sup>2</sup>		0.1031	
F-statistic (p-value)		14.86 (<0.0001)	
N		845	

Note: The table reports the results of the regression for the fiscal years 2017 to 2024. Industry and year-FE are included but not tabulated. \*\*\*, \*\*, and \* denote significance at the 1%, 5%, and 10% levels, respectively. Variables are defined in the Appendix.

The interaction term between EED and firm growth is not statistically significant ( $\beta = 0.0003$ ,  $t = 0.52$ ), indicating that growth orientation does not meaningfully alter the relationship between

engagement and discretionary accruals. This suggests that the ethical or cultural mechanisms linking engagement to reporting choices are not contingent on growth pressure, at least within this sample.

Firm growth itself is marginally negative ( $\beta = -0.0678$ ,  $t = -1.68$ ,  $p < 0.10$ ), suggesting that expanding firms may exhibit slightly lower discretionary accruals, potentially due to increased transparency during investment or expansion phases. The control variables behave as in prior models, with firm size and MTB ratio remaining significant. This model explains approximately 10.3% of the variation in discretionary accruals (Adjusted  $R^2 = 0.1031$ ,  $F = 14.86$ ,  $p < 0.0001$ ).

Across all models, the negative association between employee engagement and discretionary accruals is consistent and statistically significant, even after controlling for firm characteristics and FE. This indicates that firms with higher engagement scores tend to use fewer income-increasing accruals, reinforcing the idea that engagement operates as a governance mechanism promoting reporting integrity. The magnitude of the coefficient suggests that this effect is economically meaningful, not just statistically significant.

Interaction analyses reveal that this effect is amplified in consumer-facing industries, where reputational visibility is high, and stakeholder expectations are more salient. In these contexts, engagement appears to exert stronger disciplinary influence on managerial discretion, likely because firms are more motivated to maintain credibility with customers and employees. Conversely, the absence of moderation by firm growth suggests that reputational pressures, rather than expansion opportunities, drive this relationship.

Taken together, these findings underscore the role of employee engagement as both a cultural and governance factor, particularly in industries where reputation is central. They contribute to emerging literature on the intersection of stakeholder theory, organizational identity, and earnings management (Ashforth & Mael, 1989; Harrison & Bosse, 2013).

### 4.3. Additional analyses

To assess the robustness of our findings, the study re-estimated the models using alternative measures of aggressive financial reporting, including abnormal total accruals (Jones, 1991; Dechow et al., 1995) and performance-matched abnormal accruals (Kothari et al., 2005). These specifications employed the same set of controls and FE as the main models. In untabulated results, the coefficient on employee engagement remained negative but was not statistically significant across these alternative measures. This suggests that the observed relationship is more pronounced in the context of revenue-based accruals than in broader accrual metrics, consistent with prior research highlighting revenue recognition as a key area of managerial discretion under ASC 606 (Stubben, 2010). While these null results do not contradict the main findings, they underscore the importance of construct specificity in measuring earnings management.

## 5. DISCUSSION OF THE RESULTS

This study advances understanding of how stakeholder-oriented practices influence financial reporting behavior by examining employee engagement and development. Prior research has primarily attributed earnings management to financial incentives, governance structures, and market pressure (Dechow et al., 2010; Kim et al., 2014; Badertscher et al., 2019), while stakeholder governance studies often assume that reputational capital uniformly constrains opportunistic reporting (Appleton et al., 2023). Our findings contribute to this view by demonstrating that employee engagement can shape reporting incentives in distinctive and context-dependent ways.

Across all specifications, employee engagement is negatively associated with discretionary accruals, indicating that firms investing in workforce development tend to adopt more conservative reporting practices. This effect is stronger in consumer-facing industries, where reputational visibility is high, and employee culture is more closely tied to brand identity. These patterns align with stakeholder theory (Freeman, 1984; Miles, 2017) and research emphasizing the role of reputational scrutiny in constraining managerial discretion (Deephouse, 2000; Love & Kraatz, 2009). By contrast, firm growth does not moderate the engagement-accrual relationship, suggesting that external reputational exposure, rather than internal performance dynamics, is the primary contextual factor shaping the influence of engagement on reporting practices.

These results qualify prior arguments that reputational capital may create performance pressure that increases the likelihood of aggressive reporting (Rindova et al., 2005). Our evidence suggests instead that engagement may function as an internal governance mechanism, reinforcing ethical norms and discouraging opportunism even under heightened public visibility. This contributes to the earnings management literature by introducing a stakeholder-driven, cultural factor into models typically dominated by financial and governance variables. It also extends stakeholder governance research by illustrating that reputational assets can mitigate, rather than exacerbate, reporting risk when coupled with strong internal cultural alignment.

Overall, the findings underscore the contextual nature of reputational pressures and highlight the value of integrating non-financial indicators into empirical accounting research. In doing so, this study responds to calls for broader performance frameworks attentive to stakeholder-relevant organizational attributes (Ittner & Larcker,

1998; Burnett et al., 2021) and offers implications for regulators, investors, and boards seeking to understand how cultural conditions within firms shape financial reporting transparency.

## 6. CONCLUSION

This study investigates the relationship between employee engagement and discretionary accruals, offering a stakeholder-oriented perspective on earnings management. Using firm-level panel data with controls for financial characteristics and FE, we find that higher employee engagement is consistently associated with lower discretionary accruals. This relationship is stronger in consumer-facing industries, where reputational visibility and stakeholder scrutiny are heightened, but is not moderated by firm growth. These findings suggest that employee engagement can operate as an internal governance mechanism that promotes conservative reporting, while also demonstrating that its effects are context-dependent.

This study contributes to earnings management research by highlighting a non-financial, stakeholder-driven determinant of reporting behavior — an area that has received limited empirical attention. Integrating employee engagement into models of financial reporting discretion extends stakeholder theory and shows that reputational attributes can mitigate, rather than intensify, reporting risk when coupled with strong internal cultural alignment. The results have practical implications for regulators, auditors, and investors, suggesting that engagement metrics may serve as indicators of reporting integrity rather than mere performance signals.

Several limitations should be acknowledged. First, while the Drucker Institute's engagement index is comprehensive, it may not capture all dimensions of workforce culture or managerial behavior. Second, discretionary accruals reflect only one form of earnings management and do not capture real activities manipulation. Third, unobserved factors such as governance quality or managerial risk preferences may still influence reporting decisions despite the use of FE.

Future work could examine how employee engagement interacts with other stakeholder-related attributes — such as customer experience or ESG performance — to shape reporting choices. Comparative studies across institutional environments could assess whether regulatory or cultural contexts condition these effects. Finally, qualitative or mixed-method research could illuminate the internal decision-making processes through which engagement shapes financial reporting behavior, offering deeper insight into the mechanisms identified in this study.

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## APPENDIX. VARIABLE DESCRIPTION

<i>Variable</i>	<i>Description</i>
<i>EED</i>	Employee engagement and development score
$EED_{it-1}$	Lag of employee engagement and development score
<i>RevAqq<sub>it</sub></i>	Proxy for aggressive revenue recognition for firm <i>i</i> in year <i>t</i>
<i>DISC</i>	Discretionary accruals using the modified Jones model
<i>ABNRECT</i>	Abnormal receivables scaled by sales
<i>Firm size</i>	Measured as the natural logarithm of total assets
<i>ROA</i>	Return on assets, measure of profitability
<i>MTB</i>	Market-to-book ratio, proxy for growth expectations
<i>Leverage</i>	Total debt to total assets to capture financial risk
<i>Loss</i>	Binary indicator accounts for firms reporting net losses, set equal to 1 if net income < 0, and 0 otherwise
<i>Consumer</i>	Binary indicator equal to 1 for firms in consumer-facing industries (e.g., retail, hospitality, consumer goods) and 0 otherwise
$EED_{it-1} * Consumer_i$	Interaction of $EED_{it-1}$ * $Consumer_i$
$EED_{it-1} * MTB_{it}$	Interaction of $EED_{it-1}$ * $MTB_{it}$
$\gamma_i$	Firm FE
$\delta_t$	Year FE