

A BRIEF MAPPING OF EARNINGS MANAGEMENT'S DRIVERS AND RESTRAINTS

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Abstract: *Earnings management is a financial reporting phenomenon which allows managers to present their financial reports for organisational or their personal benefits. It occurs when managers use their discretion in financial reporting to meet some predetermined target. High profile scams like Enron, WorldCom, and Satyam have raised a question mark on the veracity of financial statements. The present paper describes the earnings management concept and tries to provide a comprehensive synthesis of past studies regarding the drivers of earnings management and impact of corporate governance variables on earnings management practices. Research studies around a quarter of a century commencing from the year 1991 through 2016 published in national and international journals have been revisited to shed light on the earnings management behaviour of corporate sector across the world. The review reveals that the extent and type of earnings management depend on company's specific circumstances and unique managerial drivers. Motives related to capital market, management compensation contracts, external contracts and regulatory & political costs encourage the managers to manage corporate earnings. In addition, the result shows that good corporate governance significantly reduces the level of earnings management which plays a restraining role against earnings management and enhances the reliability of financial reporting. The paper provides novice researchers a bird's eye view of earnings management concept and the related issues. It also helps them to explore new ideas related to earnings management and provide insights to curb malpractices.*

Keywords: *Earnings Management, Earnings Management Drivers, Corporate Governance Characteristics*

JEL Classification: *M41, G34, M10*

INTRODUCTION

Earnings, the “bottom line” of income statement, reflect the health and financial soundness of a company. Earnings are the crucial component of the company's annual reports as they reflect the extent to which the value addition has been made in a particular financial year. They demonstrate the stability of earnings and the growth of the business organisation. In fact, the present value of a company's stock depends upon its future earnings projections. Companies with poor earnings projections would have depressed market prices in comparison to others with good earnings forecasts (Rahman, Moniruzzaman, & Sharif, 2013). Keeping in mind the importance of earnings, managers want to exhibit rosy financial position to various stakeholders. For accomplishing this, they manipulate the accounting figures in financial reports using the flexibility given by Generally Accepted Accounting Principles (GAAP). Such practices are known

as earnings management. It is a strategy used by managers to achieve the predetermined target. It is an intentional act which is based on managerial judgement. Poor accounting quality encourages the management to indulge into earnings management practices (Barth, Landsman, & Lang, 2008). Due to agency problem and information asymmetry, the interest of managers and shareholders are inevitably not aligned (Alves, 2012). Therefore, managers try to maximise their utility at the expense of other stakeholders through opportunistically managing the earnings.

Earnings management practices are commonly used by managers across the world but public gets to know the effect only when a big accounting fraud comes into picture (Gakhar, 2013). Satyam Computer Services Ltd. is the real life example of the biggest auditing fraud in Indian corporate history which took place in Jan, 2009. This case is often referred to as “India's Enron” (Enron was a US-based company which was suffered with a similar accounting fraud)

Satyam Computer Services Ltd. (contrary to its name which means 'truth' in Sanskrit) manipulated its income statements and cash flows for more than seven years. The balance sheet of the company contained fictitious cash and bank balances of Rs. 5040 crore. The unveiling of the scam leads to a fall in stock prices of Satyam from its highest level of Rs. 800 to Rs. 11.50 on Jan 10, 2009. Mr. Raju wrote in his confession statement "It was like riding a tiger, not knowing how to get off without being eaten" (The Economist, 2009). The main reason of this fraud is that auditors were not compliant their duties independently because they were under the owner's influence. This has raised a question mark on 'true and fair' view of financial statements.

Enron, WorldCom, Parmalat are popular accounting scandals at international level. Such fraud cases not only cause heavy financial loss, but also erode the investors' confidence on capital market. An alarming rise in number of frauds has raised the attention of regulators and auditors to understand the drivers behind earnings management. Excessive earnings management provides a red signal to the stakeholders of a company to enhance monitoring and surveillance. Mangala and Kumari (2015) found that red flag is a chief mechanism to avoid fraud. Forensic accounting has developed as a new tool for fraud detection and prevention. Strong investor protection, legal enforcement, security laws, high quality accounting system, good corporate governance are prominent tools for reducing the level of earnings management and increases the quality of accounting information. Good corporate governance structure would help to reduce the agency problems. When governance quality is low, chances of engaging in opportunistic earnings management is high (Dechow, Sloan, & Sweeney, 1996). Sarbanes-Oxley Act (SOX), an act passed by U.S. Congress in 2002, is the important regulatory intervention to protect investors from the possibility of fraudulent accounting activities by corporations. Fang (2009) found that level of earnings management reduced after the implementation of Sarbanes-Oxley Act.

The present review paper aims to determine what earnings management is, why the companies get involved in it, and how to control it. For accomplishing this objective, the present paper provides an in-depth understanding of the concept of earnings management. It also aims to investigate various aspects such as incentives or drivers behind earnings management and impact of corporate governance variables on earnings management through review of literature. Data have been used in this paper is secondary in nature. Research studies published in various national or international journals, newspaper article during the period of 1991 to 2016 have been used in order to conduct a detailed review.

The layout of the remaining paper is as follows. Second section describes the concept of earnings management.

Third and fourth sections provide extensive review of past studies on the drivers of earnings management and impact of corporate governance variables on earnings management respectively. Fifth and sixth sections include implication and conclusion the study and provide directions for future research.

EARNINGS MANAGEMENT: CONCEPT

Earnings management is transformation of accounting numbers to fulfill the predetermined managerial motives by taking the advantage of existing rules and regulations. In other words, it is an art of manipulating books of accounts in a creative way by managers either to maintain steady earnings growth or to avoid reporting red flags that may indicate presence of something fishy. Healy and Wahlen (1999) define "earnings management occurs when managers use judgement in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company or to influence contractual outcomes that depend on reported accounting numbers". For managing earnings, two methods could be used by managers: accrual earnings management and real earnings management. In accrual based earnings management, a manager can alter the level of accruals to achieve the desired level of earnings through their own judgement in financial reporting (Healy and Wahlen, 1999). For example, provisions for doubtful accounts, provisions for obsolete inventories, and variation in the useful economic life of depreciated long-term assets. In real earnings management, a manager can change operating decisions in order to structure the transactions. For example, to reduce discretionary expenses like research and development expenditures, overproducing to report lower cost of goods sold, to offer price discounts for temporarily increase sale, etc. (Roychowdhury, 2006).

To better understand the concept of earnings management, there is a need to distinguish between earnings management and accounting fraud. Earnings management refers to earnings manipulation through exercising the discretion permitted by accounting standards and/or structuring the transaction in such a way that firm value is not affected negatively. Dechow and Skinner (2000) categorised it into three parts as conservative accounting, neutral earnings, and aggressive accounting. Under conservative accounting, a manager uses some accounting discretion like overly aggressive recognition of provisions or reserves and delaying sales etc. Neutral earnings results from neutral business operations and lastly aggressive techniques like understatement of provisions & reserves and postponing research & development or advertising expenses are comes under aggressive accounting. Fraudulent accounting refers to earnings manipulation by violating accounting standards and/or structuring the transactions as to decline expected

value of the firms. Aggressive accounting techniques are not essentially fraudulent accounting. It might be a beginning of a slippery slope. In other words, when earnings manipulation within limits of GAAP, is called earnings management and when earnings manipulation violates limits it becomes fraud (Yaping, 2005). Where earnings management ends, accounting fraud begins.

Earnings management has two perspectives: opportunistic and informational perspective. Opportunistic perspective indicates that managers use information asymmetry between insiders and outsiders to influence contractual outcomes to maximise their utility. This unreliable reported information mislead the investors, and the informational perspective states that managers reveal the private information about the firm's future cash flow to investors or information users which enhance their ability to estimate firm's future performance (Hamdi and Zarai, 2013). Earnings can be managed either upward or downward depending upon the manager's objective such as to smooth fluctuations in earnings and to meet the analysts' earnings projections.

The popular earnings management methods like aggressive revenue recognition, aggressive capitalisation, accounting choice method, misrepresenting cash flows, big bath accounting and cookie jars reserve etc. are adopted by companies to manipulate earnings. Accrual accounting plays an important role in earnings management. As compared to cash system, accrual accounting offers a lot of opportunities to managers to determine firms' earnings according to their discretion (Gakhar, 2013). Accounting earnings of a firm consists of cash from operations and total accruals. Total accruals are the sum of discretionary accrual and non-discretionary accruals. Discretionary accruals are non-obligatory in nature and based upon manager's choice alone whereas non-discretionary accruals are obligatory in nature as it derived from normal business operations or past accounting transactions. Hence, discretionary accruals are employed as instrument of earnings management and it is used as a measure of earnings management. In India, SEBI DRG Study (2013) revealed that average discretionary accrual (proxy for earnings management) is 2.9 percent of total assets (around 1 to 5 percent of total assets in Europe, UK and elsewhere in the world). As compared to large and medium sized firms, small sized companies are more involved in earnings management (10.6% of total assets) and on the basis of Industry classification, mining and constructions companies score over other counterparts in earnings management. In addition, Kumari and Pattanayak (2015) found the presence of earnings management practices in Indian banking sector.

EARNINGS MANAGEMENT: DRIVERS

Empirical evidences have identified varied drivers or motives behind earnings management like stock market

motives, signaling / concealing private information, political cost, personal interest, internal motives, management compensation motives, lending contracts and regulatory motives. Generally, earnings management drivers or motives mainly segregated into four categories, namely, capital market drivers, management compensation contract drivers, external contracts drivers, and regulatory & political costs drivers.

Capital Market Motives

Managers used earnings management practices to manipulate accounting information in financial reports in order to achieve the objective of improved short-term stock price performance. In other words, stock prices are sensitive to earnings benchmarks that help the investors to evaluate the company's position in the market. Therefore, managers try to boost short-term stock price by managing reported earnings. Most of the studies have been conducted at the time of specific corporate events such as Initial Public Offers (IPOs), seasoned equity offerings and management buyout. Teoh, Welch, and Wong (1998a) and Ahorany, Lin, and Loeb (1993) found that IPO firms are involved in income increasing earnings management activities than non-IPO firms and revealed poor earnings and stock performance in subsequent years. Recently, Maheshwari and Agrawal (2015) found that graded IPOs exhibit lower earnings management as compared to non-graded. Further, earnings management is lower in highest graded IPOs than low graded IPOs among graded IPOs. Rangan (1998) and Teoh, Welch, and Wong (1998b) concluded that firms upward their earnings around seasoned equity offerings to increase the value of share in the capital market and decline earnings in upcoming years due to the reversal of discretionary accruals. An Indian study also supports this conclusion that firms which are close to the equity offerings inflate their earnings temporarily (Rao & Dandale, 2008).

Conversely, Perry and Williams (1994) found significant evidence that managers are indulged into understatement of earnings prior to the announcement year of management buyout. But De Angelo (1986) did not find significant evidence of understatement of earnings before the management buyout. Another driver for companies to participate in earnings management is to meet the expectations of stock market analysts because investors often make decisions on the basis of expectations of stock market analysts.

Management Compensation Contract Motives

Healy (1985) and Holthausen, Larcker, and Sloan (1995) found that managers are involved in manipulating accruals to manage earnings in either upward or downward direction in order to maximise their compensation as management bonus are normally tied to the firm's earnings. When the

level of earnings reached at cap on bonus awards, managers are indulged into income decreasing earnings management or defer current earnings to the next period because no additional bonus is paid after this. The extra earnings will be saved for future to earn bonus. Conversely, when earnings are below the minimum level to receive a bonus, managers tend to involve in income increasing earnings management. In other words, an earnings-based bonus plan encourages the managers to make fine-tuning in accounting statements to enhance their compensation.

Zhang (2009) found that, on average, long tenured CEOs report earnings less aggressively as compared to short tenured CEOs. Furthermore, CEOs with long tenure have incentive to inflate their earnings at the beginning of their term to build their reputation, after creating reputation they report less aggressively in order to protect their reputation, except for the last year before their departure. Because a higher last year earnings gives them short-term benefits such as higher current period compensation and higher pension annuity. Conversely, Hu, Hao, Liu, and Yao (2015) found that inverted U-shaped relationship between manager's tenure and earnings management in context of China. The result argued that in initial stage of managerial position, managers are conservative in managing earnings and after few years they become aggressive in managing earnings. Once they reach at peak level of earnings management, they will become conservative again and manage earnings less aggressively except the last year. Dechow and Sloan (1991) found that CEOs in final years of their service spend less on research and development expenditures in order to increase reported earnings, because their retirement benefits are based on compensation received in final years.

External Contracts Motives

External contracts include debt contracts, supplying contracts, dividend covenant etc. For regulating the firms' activities, lenders often impose some financial limits such as to maintain specified level of reported accounting figures and ratios that ensure them about the repayment of firms' borrowings. Therefore, firms who have high portion of debt in their capital structure have an incentive to alter accounting data by earnings management in order to avoid the breaching of their covenant. Dechow et al. (1996) concluded that managers performed earnings management practices to avoid debt covenant restrictions and to raise financing from external sources at low cost. Similarly, Defond and Jiambalvo (1994) examined a sample of 94 debt covenant violation firms and found that sample firms used accruals to accelerate earnings before the covenant violation year. Recently, an Indian study, Nagar and Sen (2016) revealed that financially distressed firms have the incentive to influence managers to use different techniques of earnings management as varies from different situation.

Regulatory and Political Costs Motives

Industries related to banking, insurance and utility sectors are scrutinised on the basis of regulations in terms of accounting figures and ratios to confirm companies' obedience with industry-specific and anti-trust regulations. Banks which are proximate to minimum capital requirements have the incentive to use income increasing earnings management to avoid breach of regulatory requirements. If requirements are not fulfilled, regulatory interventions such as restrictions on dividend and management dismissal are imposed. Jones (1991) found that managers are involved in income decreasing earnings management in order to get relief on import which is to be provided by United State ITC (International Trade Commission). Under political cost motivation, firms make adjustment within financial data in order to reduce political costs and taxation. Managers are indulging into income decreasing earnings management to avoid political scrutiny. Noronha, Zeng, & Vinten (2008) found that private companies are engaged in earnings management practices for tax expense savings. Narayanaswamy (2013) concluded that political connected firms which have audited by Big Four firms have lower earnings quality than non-connected firms in context of India.

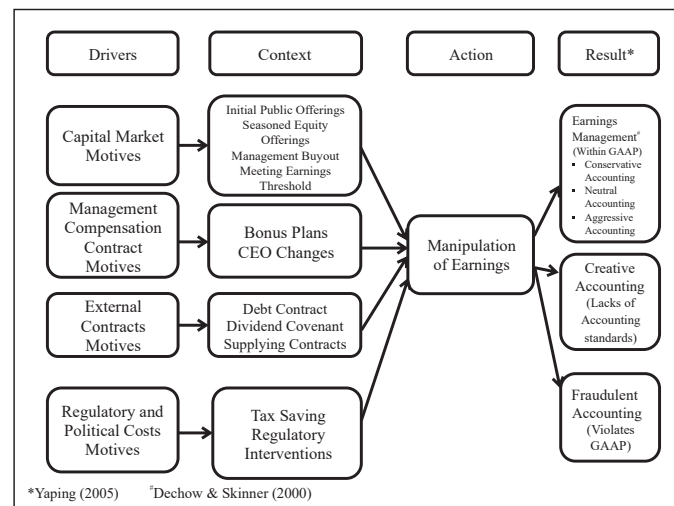


Fig. 1: Conceptual Framework of Earnings Management

Fig. 1 expounds the drivers to manipulate earnings by considering various contexts by which managers stimulates to compliance their personal judgement which results in earnings management, creative accounting and fraudulent accounting practices.

IMPACT OF CORPORATE GOVERNANCE ON EARNINGS MANAGEMENT

The primary objective of corporate governance is to reduce agency problems because opportunistic earnings management rotates around agency problems. Corporate governance

mechanisms include board characteristics, audit committee characteristics and ownership structure. When governance quality is low, chances of engaging in opportunistic earnings management is high (Dechow et al., 1996).

Table 1: Empirical Work Depicting Influence of Corporate Governance Characteristics on Earnings Management

Corporate Governance Characteristics	Negative Relation(-)	Positive Relation(+)
Board Characteristics		
Independent directors in board	Beasley (1996, U.S), Chtourou, Bedard, and Courteau (2001, U.S), Klein (2002, U.S), Xie, Davidson, and Dadalt (2003, U.S), Niu (2006, Canada), Ebrahim (2007, U.S), Roodposhti and Chashmi (2010, Iran), Jaiswall and Banerjee (2012, India), Fodio, Ibikunle, and Oba (2013, Nigeria), Uwuigbe, Peter, and Anjolaoluwa (2014, Nigeria), Iraya, Mwangi, and Muchoki (2015, Kenya)	
Board size	Chtourou et al. (2001, U.S), Xie et al. (2003, U.S), Bradbury, Mak, and Tan (2006, Singapore and Malaysia), Jaiswall & Banerjee (2012, India), Fodio et al. (2013, Nigeria), Uwuigbe et al. (2014, Nigeria), Iraya et al. (2015, Kenya)	Rahman & Ali (2006, Malaysia), Fauzi & Sanusi (2015, Indonesia),
Board meetings (board diligence)	Xie et al. (2003, U.S), Sarkar, Sarkar, and Sen (2008, India), Jaiswall & Banerjee (2012, India), Gonza'lez & Garci'a-Meca (2014, Latin America), Abbadi, Hijazi, and Al-Rahahleh (2016, Jordan)	
Multiple directorships	Chtourou et al. (2001, U.S), Rajpal (2012, India)	Beasley (1996, U.S), Sarkar et al. (2008, India)
CEO duality		Dechow et al. (1996, U.S), Klein (2002, U.S), Sarkar et al. (2008, India), Murhadi (2009, Indonesia), Roodposhti & Chashmi (2010, Iran), Gulzar & Wang (2011, China), Uwuigbe et al. (2014, Nigeria), Iraya et al. (2015, Kenya)
Audit Committee Characteristics		
Independent directors in audit committee	Chtourou et al. (2001, U.S), Klein (2002, U.S), Bradbury et al. (2006, Singapore and Malaysia), Ebrahim (2007, U.S), Alzoubi (2016, Jordan)	Fodio et al. (2013, Nigeria)
Existence of audit committee	Dechow et al. (1996, U.S), Piot & Janin (2007, France), Abbadi et al. (2016, Jordan)	
Audit committee meetings	Xie et al. (2003, U.S), Ebrahim (2007, U.S),	
Audit committee financial expertise	Chtourou et al. (2001,U.S), Xie et al. (2003,U.S), Agrawal & Chadha (2005,U.S)	
Audit quality (Big firms)	Becker, DeFond, Jambalvo, and Subramanyam (1998, U.S), Lapsley & Lee (2007, Singapore), Rusmin (2010, Singapore), Jaiswall & Banerjee (2012, India), Alzoubi (2016, Jordan)	
Ownership Structure		
Managerial ownership	Niu (2006, Canada), Ebrahim (2007, U.S), Alves (2012, Portugal), Fauzi & Sanusi (2015, Indonesia)	Dechow et al. (1996, U.S), Isenmila & Elijah (2012, Nigeria), Gonza'lez & Garci'a-Meca (2014, Latin America)
Ownership concentration	Murhadi (2009, Indonesia), Iqbal & Strong (2010, UK), Gulzar & Wang (2011,China), Alves (2012, Potugal)	Zhong et al. (2007, U.S), Sarkar et al. (2008, India), Isenmila & Elijah (2012, Nigeria), Gonza'lez & Garci'a-Meca (2014, Latin America)
Institutional ownership	Ebrahim (2007, U.S), Shah, Zafar, and Durrani (2009, Pakistan), Njah & Jarboui (2013, France), Fauzi & Sanusi (2015, Indonesia), Ajay & Madhumathi (2015, India)	

Board Characteristics

Board of directors is the main decision making body of any firm and the quality of financial reporting is affected by its characteristics such as board composition, size, meetings, number of directorships, CEO duality etc. Independent directors in board are the effective variable in reducing earnings management. In India, Clause 49 of listing agreement requires that one-third directors are independent in the board. Several studies, as shown in Table 1, found that there is negative relationship between independent directors in board and earnings management. Also, Beasley (1996) conducted a comparative study by using 75 fraud and 75 non-fraud firms and found that involvement of outside directors in board reduces the probability of financial statement fraud because outside directors have more able to monitor management and efficiently perform their oversight functions.

Board size is another significant influencing variable that may have an effect on earnings management. An optimum numbers of board members should be in whole board which ensures that they are enough members to efficiently perform their functions and discharge their responsibilities. Excessive and deficiency both could be an obstacle in better supervision. There have been different perspectives on the role of board size and earnings management. Some studies concludes that as board size increases, possibilities of earnings management decreases because a larger board includes more experienced and expertise members that creates a synergy. Conversely, Rahman & Ali (2006) argued that larger board seemed to be ineffective in discharging their oversight duties relative to smaller board because board members have lack of knowledge about company affairs consequently management starts dominance over board matters. In addition, Fauzi and Sanusi (2015) found that smaller board helps to fix their accountability and reduces the opportunities of free riding by individual directors.

Most of the studies found that board meetings help the directors to identify and resolve the potential issues related to a firm by regular discussion. Chtourou et al. (2001) found that multiple directorships reduce the earnings management practices. Also, Rajpal (2012) argued that busyness (hold the position of chairmanship in other companies) of independent directors adversely affects their capability to reduce earnings management. The results also suggest that when independent directors hold multiple directorships, they become more able to constrain earnings management due to their diverse experience. Conversely, Beasley (1996) and Sarkar et al. (2008) argued that when outside directors hold directorship in other companies, they distract from their monitoring responsibility thereby chances of financial statement fraud increases.

CEO duality becomes more problematic issue when the interest of shareholders is different from the interest of CEO. Table 1 shows that companies with duality variable allows greater managerial discretion and gives more power to CEO over board matters which results in easily manipulation of firm's earnings.

Audit Committee Characteristics

The audit committee provides a continuous communication channel between the board of the directors, internal auditors, external auditors and relevant authorities. In financial reporting, audit committee performs their activities for monitor the business activities and enhance the credibility of financial statements. Chtourou et al. (2001), Klein (2002), and Alzoubi (2016) found that earnings management is lower when independent directors involved in audit committee. Dechow et al. (1996) and Piot and Janin (2007) found that existence of audit committee curbs earnings management. Another important variable is audit committee meetings that reduce the potential problems in financial reporting. Active audit committee proxied by the numbers of committee meetings significantly negative associated with the level of earnings management (Xie et al. 2003; Ebrahim, 2007).

Chtourou et al. (2001); Xie et al. (2003) and Agrawal & Chadha (2005) reported that financial expertise members in audit committee reduces the chances of earnings management because they are able to understand, interpret and analyse the financial statements. Also, they can give better accounting and financial advice to the board. Becker et al. (1998) found that companies with non-big six auditors have higher discretionary accruals than companies with big six auditors. In the same vein, Lee (2007), Rusmin (2010), Jaiswall & Banerjee (2012), and Alzoubi (2016) also found that big audit firms are more capable to constrain earnings management. Because the reputation of these firms is very good in the market, having large clients and internationally recognised by their brand names, so they have more induced to maintain good quality audit reports.

Ownership Structure

Ownership structure is considered as an important monitoring mechanism to reduce earnings management. As Table 1 shows that several studies found that as managerial ownership increases, the scope of earnings management practices decreases due to the alignment of interest hypothesis. This statement recommends that when managers obtained a significant portion of equity in a firm, they play an efficient monitoring role and want to report actual accounting information. This explanation is consistent with the higher ownership concentration. On the contrary, some studies found that earnings management increases as managerial ownership increases. Higher stock ownership gives considerable power

to managers to attain their own objectives without any fear of punishment. In this case, the objective of managers is to increase the share price and increase their personal wealth. Overall, the results explained that earnings management is reduced by managerial ownership at certain level but after crossing this limit earnings management increases as managerial ownership increases.

Another variable of ownership structure is ownership concentration. As shown in above table, some studies found that ownership concentration (block holder ownership) reduces the scope of opportunistic earnings management. According to agency theory perspective, small shareholders have discretion to sell their shares if they are not satisfied with the performance of managers, whereas large shareholders are interested into monitoring function because they want to protect their investment. However, they focused on long-term view rather than short-term view. So, they do not put pressure on management to meet short-term expectations. This may reduce the agency cost and make sure a better quality of accounting information of a company. On the other hand, a number of studies argued that as ownership concentration increases, earnings management level also increases. Ownership concentration generates a conflict between the interest of minority and majority shareholders. Sometimes large block holders use their control rights to make private benefits and expropriate minority shareholders. It explains private benefit hypothesis. Consequently, they may encourage the management to engage in earnings management.

Institutional ownership is an important governance mechanism in emerging and developed countries. A numbers of studies (Ebrahim, 2007; Shah et al., 2009; Njah & Jarboui, 2013; Fauzi & Sanusi, 2015) concluded that institutional ownership is negatively associated with earnings management. Recently, Ajay and Madhumathi (2015) found that institutional investors with substantial investment in firms have an ability to efficiently monitor the managers. There is a negative relationship found between earnings management and institutional ownership for larger and matured firms. Foreign institutional ownership also has a negative association with earnings management.

After reviewing the relevant literature, it can be clearly stated that corporate governance practices are effective monitoring tool for mitigating earnings management. As the objective of governance mechanism is to align the interest between shareholders and managers which is the main cause of earnings management. It brings real transparency, accountability and truthfulness into accounting system.

IMPLICATIONS OF THE STUDY

The present paper gives the better understanding of the concept of earnings management which will help the various

stakeholders like regulators, investors, auditors, practitioners, academicians, researchers, standard setters et. to try to restrict the opportunistic behaviour of managers. This paper offers a valuable insight about the corporate governance variables on earnings management which are playing effective role in reducing the scope of earnings management at present time. A comprehensive view about earnings management helps the auditors to understand whether it is a red signal before occurring fraud or only for informative purpose to enhance investor's ability of predicting firm performance. Therefore, a conceptual base built up in the paper might help the auditors, regulators in developing a better understanding of earnings management and its possible causes, thus inducing them to take suitable measure to reduce information asymmetry and improve the functioning of capital market and protects the interest of small and minority shareholders.

It provides background for further and experimental research in the context of earnings management which is helpful to give answers for many questions such as why, when, how earnings management occurred and what are the factors that limit the earnings management.

CONCLUSION

Earnings management can be defined as the designing of earnings to fulfill the requirement of business situations. It can be either ethical or unethical, based on the intention of management. There is a need to revise accounting standards and auditor's role that would help to increase the transparency and reliability of financial statements which protect the interest of investors and increase the value of firm. Furthermore, standard setters and accounting policy makers need to examine the scope of abusive manipulation and tries to reduce the ambiguity and subjectivity in accounting standards. If accounting standards have fewer opportunities, less the potential of earnings manipulation. At last, it may be said that earnings management is an emerging area in research which allow accounting and management researchers to develop and explore new ideas and provide a clear definition to decide whether it is good or bad.

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