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# Ze współpracy z zagranicą

## Debates and studies on earnings management: a geographical perspective

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## Introduction

Earnings management is a very complex and compound phenomenon in the light of many years of investigation. Since then numerous books and articles have been written and conferences held on the concept of earnings management. The subject of earnings management in accounting literature grew in popularity, especially during the last decade of the 20th century. It has almost become a tradition, particularly in the popular and business press, to discuss the subject of accounting manipulation. No doubt, earnings management is presented day-to-day in many of the companies which hypothesized the majority of the studies. However, there is no consensus related to the concept of earnings management.

Numerous papers have investigated, theoretically and empirically, different hypotheses related to earnings management. Some researchers aimed simply to provide evidence on earnings management; others assume that earnings management has been found in connection with many aspects of the company, such as its role in companies' problems, financial markets, information asymmetry and agency theory, among others. As a consequence, an ongoing debate on the concept of earnings management is still present in the accounting and finance literature. This article contributes to this debate.

Due to the wide variety and the complexity of the issue of earnings management, our objective is to clarify and explain the question of earnings management and support new insights into the key aspects of this issue by conducting a brief literature review from a geographical perspective. We describe in detail the concept of earnings management and ongoing debates on the issue, and we present the existing literature from different countries. Our investigation covers the period of 1985 to 2011 based on journals, conferences, congresses, and other publications, such as: PhD theses, Master's theses, and some working papers.

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The remainder of this article is structured as follows. Firstly, we describe the nature of earnings management and the possible ways of manipulating financial information. We present different debates related to earnings management, such as manipulation by real activities or by accounting practice; manipulation within the accounting norms or outside the accounting norms; or the opportunistic or informative perspective of earnings management.

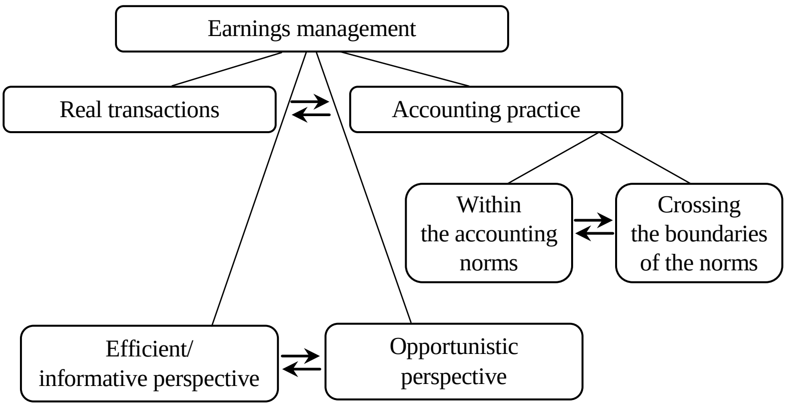
Secondly, taking into consideration the nature of the manipulation, we present our definition of earnings management, presenting the key elements of this definition. This section will discuss the prior definition suggesting differences between the authors' points of view and their implications of the perception of earnings management.

And finally, having defined the concept of earnings management, we focus on the investigation of earnings management made to date from a geographical perspective.

## 1. The phenomenon of earnings management

Manipulation of accounting information is a central problem for financial experts. A lack of transparency may lead to misunderstandings when taking decisions by the managers. This in turn may lead to a loss of trust and, in effect, a decrease in business negotiations. However, it is difficult to define earnings management because different authors define it in different ways. So, there are different debates on the concept of earnings management, see Figure 1.

**Figure 1.** Ongoing debates on earnings management




Source: the author.

Firstly, there is a great discussion about the differences between ***real earnings management*** (in other words, affecting cash flows) and ***accounting practices management.*** Real earnings management occurs when managers undertake actions that deviate from the best practice to increase reported earnings (see, for example, McNichols, 2000). Roychowdhury (2006) defines real activities manipulation as departures from normal operational practices, motivated by managers' desire to mislead at least some stakeholders into believing certain financial reporting goals have been met in the normal course of operations. Ball and Shivakumar (2006) state that managers are willing to engage in real earnings management that is costly to the firm because such actions are harder to detect; with the uncertainty inherent in business environments, there is no benchmark to determine what should have been done in any particular situation.

An example of a proper management operating decision would be whether or not to implement a special discount or incentive program to increase sales near the end of a quarter when revenue targets are not being met. Other examples of operating decisions would be whether to invest in new equipment or hire additional employees.

Following the literature on real manipulation, such as the papers of Gunny (2005), Graham *et al.* (2005), and Roychowdhury (2006) among others, we find the following transactions as real earnings activities:
– cutting R&D expenditures,
– cutting selling,
– general and administrative expenditures,
– overproducing inventory to reduce the cost of goods sold,
– selling fixed assets with a market value greater than book value to report a gain,
– price discounts.

From all the above possible activities, the literature underlines that most of the evidence on real activities management centers on the opportunistic reduction of R&D expenditures to reduce reported expenses.

The contrast group is accounting practice management. Accounting practice involves management that try to „obscure" or „mask" true economic performance (Dechow, Skinner, 2000). An example of an accounting choice would be whether a company should be a voluntary early adopter of a new accounting standard or wait until the adoption of the new accounting standard is required of all companies. Within the techniques of accruals-based accounting, bases on a broad range of studies such as those from Dechow and Skinner (2000), Amat *et al.* (2003), Vander Bauwhede and Willekens (2003) and McKee (2005) among others, we divided them into two main groups: accounting practices within the accounting norms, and techniques which cross the boundaries of the accounting norms. In the group of accounting choices within the accounting norms we observe different types of managerial choices, such as:
– overly aggressive recognition of provisions or reserves;
– overvaluation of acquired-in-process R&D (Research and Development) in purchase acquisitions;
– overstatement of restructuring charges and assets write-offs;
– understatement of the provisions for bad debts;
– drawing down provisions or reserves in an overly aggressive manner;
– estimation of future obligations (called the „cookie jar reserve");

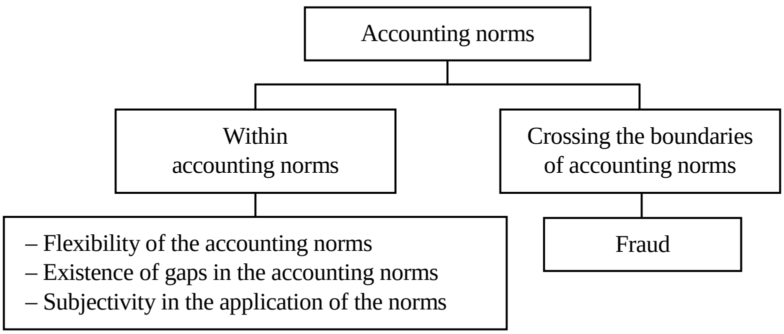
– „big bath" technique: it is used in the belief that if you must report bad news, e.g. a loss from substantial restructuring, it is better to report it all at once and get it out of the way;
– change in accounting criteria;
– amortization, depreciation, and depletion;
– operating versus non-operating income;
– early retirement of debt.

In the second group of accruals techniques of manipulation we call „techniques which violate accounting norms", we have four different types of managerial choices:
– recording sales before they are „realizable";
– recording fictitious sales;
– backdating sales invoices;
– overstating inventory by recording fictitious inventory.

Amat *et al.* (2003) point out that accounting regulations allow that the same transaction may be accounted for in different ways, for example, the criteria for asset valuing, the accounting for revenues and expenses, depreciation and provisions, research and development, and foreign currency operations, among others. This allows the use of a more conservative or less conservative accounting approach according to specific interests.

Focusing on the earnings management by accounting practice, we find a second debate: ***manipulation without violating accounting rules***, or ***crossing the boundaries of the rules***, which may even be fraud, see Figure 2. Here we have the question: do managers manipulate earnings within the accounting norms, or crossing the existing standards and principles?

**Figure 2.** Opportunity for earnings management




Source: the author.

A large number of studies found that managers can exercise discretion through the choice of accounting methods or polices, see for example, Watts and Zimmerman (1978), Hagerman and Zmijewski (1979), Holthausen (1981), Bowen *et al.* (1981), Skinner (1993), Christie and Zimmerman (1994), Teoh *et al.* (1998), Nelson *et al.* (2002), among others.

Accounting standards did play an important part in the behavior of managers (García Osma, Gill de Albornoz, 2005), and managers use the flexibility and possibilities of selecting different alternatives to opt for the particular one which may secure some benefits. So, do rigid rules provide limited accounting options and restrict the scope for subjectivity judgments, and do they constrain the ability of managers to manage earnings? More flexible rules may provide greater scope for choice and involve a higher degree of implicit subjectivity in the application of criteria, and they may allow managers a wide field in which to exercise their discretion (Jeanjean, Stolowy, 2008). They may use different accounting standards in their own interest in the absence of effective control mechanisms. So, the more flexible the rules are, the higher the possibility of earnings management practices is. Those accounting practices are carried out by management with the purposeful intent of manipulating the resulting figures to their advantage (Callao, Jarne, 2010). So the decrease of the scope for alternative choices of accounting methods can reduce the possibility of earnings management. Moreover, the existence of gaps in the accounting standards favours the possibility of managing earnings. In presence of these gaps, managers' opportunistic incentives generate the possibility for earnings management (Gao, 2011).

On the other hand, abuse of judgment and crossing the boundaries of the accounting norms can also be found in the possibility of managing earnings, and this can transform into the fraudulent behavior. When fraudulent reporting occurs, it is frequently perpetrated at levels of management above those for which internal control systems are designed to be effective. It often involves using the financial statements to create an illusion that the entity is healthier and more prosperous than it actually is.

This illusion is sometimes accomplished by masking economic realities through intentional misapplication of accounting principles (see for example, Conner 1986 and Fischer, Rosenzweig, 1995). Taking into consideration the abovementioned details, we may define fraud as accounting practices which are clearly meant to deceive, mislead or hide some financial information, and always taking into consideration crossing and not respecting the established accounting norms (see for example, Rocco, 1998; Dechow, Skinner, 2000; Mulford and Comiskey, 2002). As we can see, the main difference between fraud and non-fraudulent activity comes from following or breaking the accounting rules.

And finally, we centre on the third debate found in the literature: do managers manipulate earnings only to prepare financial reports which are more effective in conveying information to the users, or do they manipulate earnings to obtain some benefits and objectives, meaning serving the needs and expectations of the managers? The literature calls these two types of earnings management ***efficient earnings management*** (in other words, to improve earnings informativeness in communicating private information) and ***opportunistic earnings management*** (in other words, management reports earnings opportunistically to maximize their utility) (Scott, 2000).

The opportunistic behavior perspective holds that managers take the opportunity to manage earnings in order to maximize their own utilities at the expense of the contracting parties and stakeholders (Watts, Zimmerman, 1986). They use their discretion to maximize their utility, thereby managing earnings (Subramanyam, 1996). As Healy and Wahlen (1999) state, the purposes of opportunistic earnings management is that managers use judgment in financial reporting and in non-routine transactions to modify financial reports and attempt to mislead some shareholders about the viewpoint of the company or to affect the results of the accounting-based contract that depend on reported accounting numbers.

Moreover, the perspective of opportunistic behavior takes the view that managers use information asymmetry between outsiders and insiders to improve their benefits in dealing with compensation contracts. In this way, investors are thereby misled by the unreliable information reported (Sun, Rath, 2008). Furthermore, the opportunistic perspective illustrates managers' desire to affect wealth transfer between related contracting parties and themselves. And it is related to the Positive Accounting Theory, which states that owners expect managers to exercise discretion toward their personal gain and take this into consideration when they offer managers compensation plans. When the value of management compensation includes the expected managerial discretions, the compensation contracts drive up managerial expectation and thus increase the level of discretions themselves (Sun, Rath, 2008).

By contrast, the informative perspective proposes that managers exercise discretion in order to communicate inside information to outside investors to help investors predict and form expectations regarding the firm's future performance (Holthausen, Leftwich, 1983). Managers use their discretion to communicate private information about the firm's profitability, which is yet to be reflected in the historical cost-based earnings (Subramanyam, 1996). The purposes of efficient earnings management is that managers want to communicate private information to investors, to improve the informational content to earnings and promote communication between managers, shareholders and the public (Jiraporn *et al.*, 2008).

A wide number of academic studies have argued that earnings management may be beneficial because it potentially enhances the information value of earnings. For example, studies of Holtahusen (1990) and Healy and Palepu (1993) argue that managers exercise discretion over earnings to enhance earnings' information by allowing communication of private information. Moreover, Subramanyam (1996) hypothesizes that this managerial discretion improves the ability of earnings to reflect economic value. As a result, the stock market may rate the discretionary accruals. In the same study, Subramanyam (1996) also tests if current-period discretionary accruals help predict future cash flows, earnings, and dividends. It is expected that accruals should help predict cash flow if discretionary accruals increase the information content for current earnings-related future performance. He finds evidence consistent with this hypothesis, suggesting that discretionary accruals do add informational content to earnings.

The existence of these two competing perspectives (that earnings management can be viewed as either opportunistic or beneficial) forms an important dichotomy in examining the debates surrounding this research field.

Once shown the notion and perception of the manipulation, it is necessary to consider a key question: what is earnings management? The general aspects of this concept are very similar in the various definitions found in the literature. However, we may detect some discrepancies within the wide scope of definitions on earnings management, for example, if earnings management is a manipulation within accounting norms, or crossing the boundaries of accounting rules, or earnings management is efficient or opportunistic, by real manipulation or by accounting policies.

Authors contrast different aspects and characteristics of earnings management and use a wide range of expressions to describe the same phenomenon. Providing a complete list of the definitions encountered in the literature is beyond the scope of our work as there is no single description of earnings management. Within the definitions found in the literature we may stress some of the important elements, such as:

– it is a purposeful action of the managers, indicating the deliberate and conscious activity of the managers (following the definition of Schipper, 1989);
– it is an ongoing process (related to the previous one), it means the continuing activity of the managers (Mulford, Comiskey, 1996);
– it deals with the external aspects of the data, always regarding the reporting data of the firms (Healy, Wahlen, 1998);
– it is a manipulation of the financial data of the company (GAAP definition);
– it reaches targets to achieve the objectives and particular goals of the managers (Park, Shin, 2004);
– it uses the flexibility of choosing accounting treatments and the subjectivity of the managers by the selecting the norms which are helpful to achieve planned results, opting within the possibilities of the standards (Fields *et al.*, 2001);
– it can result in misleading information; the presented information can pretend to hide or even fake some of the information (Roychowdhury, 2006).

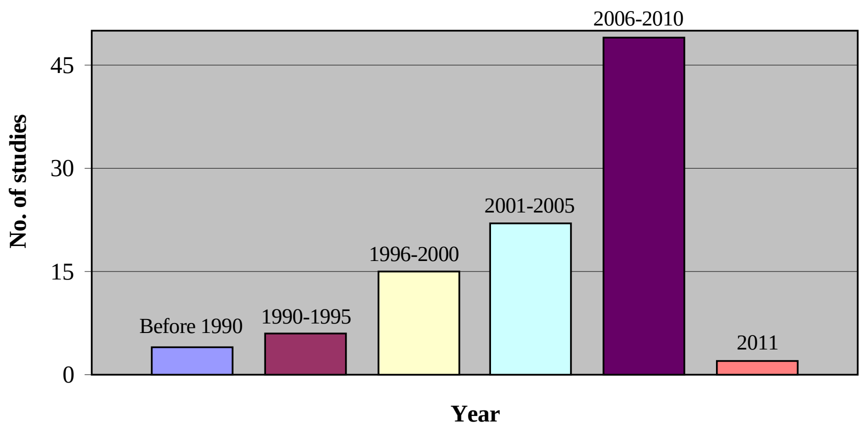
Among the different definitions, we clearly observe the evolution of the concept of earnings management. We finally obtain our definition of earnings management, which includes these different facets of earnings management:

**Earnings management is a purposeful intervention in external financial reporting, to reach earnings targets, by varying the accounting practices; however, it is an action which takes place without violating accounting regulations, and by taking benefits from the possibility of making certain choices in the policy and accounting system. This action can, but won't necessarily, mislead stakeholders into believing certain financial information**.

## 2. Earnings management around the world

The investigation on earnings management began in the U.S. and it has increased with time. Table 1 shows details on the studies on earnings management from the U.S. Between 2006 and 2010 we observe the intensification of the studies, reaching 49 studies on earnings management based on the U.S. samples. The total number of investigations based on the sample from the U.S. is 98 studies, see Figure 3.

**Figure 3.** Number of studies from the U.S.




* This research identified 195 articles testing for earnings management using proxies for discretionary behavior. To characterize the research designs applied in our study, research for the 1985 to 2011 period was conducted based on journals, conferences, congresses and other publications, such as: PhD Theses, Master's theses, and some working papers. For details see Appendix 1.1 which provides a reference for each of these articles.

Source: the author.

**Table 1.** U.S. studies on earnings management

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Healy (1985) | U.S. | 250 | Investigates the effect of bonus schemes on accounting decisions. |
| DeAngelo (1986) | U.S. | 64 | Investigates the accounting decisions made by the managers of the American Stock Exchange. |
| Jones (1991) | U.S. | 31 | Tests earnings management during import relief. |
| DeFond and Jiambalvo (1994) | U.S. | 94 | Examines the abnormal accruals of companies that reported debt covenant violations. |
| Dechow, Sloan and Sweeney (1995) | U.S. | 1000 | Evaluates alternative accrual-based models for detecting earnings management. |
| Burgstahler and Dichev (1997) | U.S. | 64,466 (observations) | Provides evidence that firms manage reported earnings to avoid earnings. |
| Key (1997) | U.S. | 47 | Tests political costs theory by examining the cable television industry. |
| Rangan (1998) | U.S. | 712 | Investigates whether earnings management around the time of the offering can explain a portion of the poor performance. |
| Healy (1999) | U.S. | 179 | The effect of earnings management on bonus awards. |
| Xie, Davidson and DaDalt (2003) | U.S. | 110 | Examines the role of the board of directors, the audit committee, and the executive committee in preventing earnings management. |

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Klein (2002) | U.S. | 692 | Examines whether the magnitude of abnormal accruals is related to audit committee independence. |
| Richardson, Tuna and Wu (2002) | U.S. | 225 | Examines the usefulness of accounting information in predicting earnings management. |
| Larcker and Richardson (2003) | U.S. | 5,815 | Examines the relation between the fees paid to auditors for audit and non-audit services and the choice of accrual measures for a large sample of firms. |
| Das and Zhang (2003) | U.S. | 103,944 firm-quarter observations | Provides evidence that firms manipulate earnings so that they can round-up and report one more cent of earnings per share. |
| Dechow, Richardson and Tuna (2003) | U.S. | 48 | Investigates whether boosting of discretionary accruals to report a small profit is a reasonable explanation for this „kink”. |
| Louis (2004) | U.S. | 1,280 | Examines the market’s efficiency in processing manipulated accounting reports. |
| Guan *et al.* (2005) | U.S. | 172 | Examines the discretionary accounting choices made by CEOs facing forced dismissal. |
| Kothari, Leone and Wasley (2005) | U.S. | 250 samples of 100 firms | Examines the specification and power of tests based on performance-matched discretionary accruals, and make comparisons with tests using traditional discretionary accrual measures. |
| Bergstresser and Philippon (2006) | U.S. | 4,671 | Evidence that the use of discretionary accruals to manipulate reported earnings is more pronounced at firms where the CEO’s potential total compensation is more closely tied to the value of stock and option holdings. |
| Roychowdhury (2006) | U.S. | 21,758 firm-years | Managers are manipulating real activities to avoid reporting annual losses. |
| Petrovits (2006) | U.S. | 323 | Examines the strategic use of corporate philanthropy programs to achieve financial reporting objectives. |
| Lang, Raedy and Wilson (2006) | U.S. | 698 | Non-U.S. firms’ earnings exhibit more evidence of smoothing, greater tendency to manage towards a target, lower association with share price and less timely recognition of losses. |
| Koh (2007) | U.S. | 16,641 | Examines the association between institutional investor type and firms’ discretionary earnings management strategies in two mutually exclusive settings – firms that (do not) use accruals to meet/beat earnings targets. |
| Jacob and Jorgensen (2007) | U.S. | 22,015 | Examines if earnings management is a tool to avoid earnings decreases and losses. |
| Ye (2007) | U.S. | total number of observations is 75,348 | Shows that unexpected accruals based on the proposed model evince less bias and higher power in testing earnings management compared to those based on the existing models. |

**Table 1.** U.S. studies on earnings management (continued)

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Byard, Hossain and Mitra (2007) | U.S. | 29 | Examines earnings management by U.S.-based oil companies in the period immediately after the impact of hurricanes Katrina and Rita. |
| Chi and Gupta (2009) | U.S. | 91,742 firm-year observations | Examines the agency costs of overvalued equity. |
| Duh, Lee and Lin (2009) | U.S. | 55 | Examines whether the reversal of a previously recognized impairment loss provides an opportunity for earnings management and whether such behavior is associated with managers' incentives. |
| Zhang and Gimeno (2010) | U.S. | 124 | Examines the effect of pressure felt by management to meet or beat analysts' earnings forecasts on firms' behavior in oligopolistic output competition. |

Source: the author.

The investigation appeared in Europe at the end of 90s. It suggests that Europe is a follower of the U.S. investigators. See Table 2, the summary of studies on earnings management in Europe.

We want to point out that research on earnings management in Europe has been done in detail in Western European countries; however, some new emerging countries are still unexplored. Nevertheless, earnings management in Eastern Europe is still ongoing. We find only some of the studies based on the sample from Eastern European countries, and most of them are theoretical studies. It is obvious that the process of transformation, the process of globalization and fundamental changes in the economic and societal structures have taken place in less developed and developing countries, like Poland, Hungary, or other countries from the East of Europe. Consequently, further investigation of Eastern Europe is needed (investigations on the companies' behavior).

**Table 2.** European studies on earnings management

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Konings, Labro and Roodhooft (1998) | Belgium | 175 | Examines the hypothesis that in firms with strong trade unions, management manipulates reported earnings downward, compared to firms without trade union activity. |
| Vander Bauwhede and Willekens (2003) | Belgium | Review of empirical evidence | Discusses the empirical evidence on earnings management practices by Belgian companies. Also the review on the influence of the larger boards and Big6 auditors on earnings management. |
| Lybaert, Jans and Orens (2005) | Belgium | 10,418 | Examines whether Belgian companies manage their earnings by focusing on their policy of provisions during the period 1997–2002. Concerning |

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| | | | the technique of income smoothing, some proof has been found that companies engage in income smoothing by increasing or decreasing the provisions. |
| Kasanen, Kinnunen and Niskanen (1996) | Finland | 37 | Finds that predicted and actual earnings management are in the same direction, and the reported earnings depend on the dividend-based target earnings |
| Kallunki and Martikainen (1999) | Finland | 509 | Investigates the adjustment process of the earnings management of a firm to industry-wide targets also in Finland, where accounting and tax legislation provide extensive possibilities for firms to manage their earnings. |
| Kinnunen *et al.* (2000) | Finland | 37 | Measures earnings management and expected dividend increases around seasoned share issues. |
| Sundgren (2007) | Finland | 99 public and 99 private | The paper studies earnings management in public and private companies and whether earnings management is a function of a company's leverage using a matched sample with public and private Finnish companies. |
| Jeanjean 2000 | France | 1383 firm-years | Investigates the role of independent directors to monitor earnings management. Using a latent variable approach to assess earnings management, he shows that external monitoring of the CEO (big six or five auditor, significant stockholder, percentage of independent board members) constrain the manager to engage in opportunistic income increasing decisions. |
| Cormier and Martinez (2006) | France | 118 | Investigates managers' motivations to engage in earnings management through purposeful interventions in the setting of discretionary accruals, in the context of initial public offerings. |
| Burghof and Johannsen (2006) | Germany | 850 | Examines whether market participants differently assess the information uncertainty associated with earnings management depending on the degree of income smoothing. Further hypothesis tests demonstrate that within a high income smoothing sub-sample, the differences in the degree of information uncertainty between high and low earnings management firm years are about half the size compared to a low income smoothing sub-sample. |
| Böcking *et al.* (2011) | Germany | 599 | Contributes to the discussion of standardized Europe-wide enforcement mechanisms by assessing the German enforcement system. |
| Caramanis and Lennox (2008) | Greece | 633 | Test the effect of audit efforts on earnings management using a unique database of hours worked by auditors. |

**Table 2.** European studies on earnings management (continued)

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Markarian, Pozza and Prencipe (2008) | Italy | 130 | Examines whether companies' decisions to capitalize R&D (research and design) costs are affected by earnings-management motivations. |
| Roosenbooma, Van der Gootb and Mertens (2003) | Netherlands | 64 | Investigates the pattern of discretionary current accruals over time and examines the impact of earnings management on the long-run stock price performance of IPOs. |
| Kempen (2010) | Netherlands | 77 public and 3,105 private | Investigates the use of earnings management in public and private companies. |
| Kamela-Sowinska (2003) | Poland | Based on the one company | Description of the case of Enron. |
| Prusak (2003) | Poland | Theoretical research | Treating the problem of the distortion of financial statements. Explaining the situation of the occurrence of accounting scandals. The role of the investor and the board in the companies in order to control. |
| Tokarski and Tokarski (2007) | Poland | Theoretical research | Treating the topic of creative accounting. |
| Wiercińska (2008) | Poland | Theoretical research | The issue of terminology connected with accounting frauds, which were committed by famous companies such as Enron, Worldcom etc., is brought up in the article. The author tries to explain the main differences between such terms as creative, aggressive and fraudulent accounting, which are often wrongly, and interchangeably used. |
| Tokarski (2009) | Poland | Theoretical research – mentioned the wide range of companies which use creative accounting | Balance policy is not only the art of making what is possible, but also the art of making it according to the law. Examples of these occurrences are known as: creative accounting, window dressing, incomes smoothing, or off balance sheet financing. The aim of the article is to show that financial statements can be an imperfect source of information about the financial situation of the enterprise and possible the negative consequences for potential users. |
| Gierusz (2010) | Poland | Theoretical research | The bankruptcy of Enron in December 2001, which shook the American economy and world public opinion, marked the beginning of a fierce discussion on the creative accounting. The purpose of this article is to attempt to define these issues. |
| Jackowicz and Kozłowski (2010) | Poland | 382 banks from 11 different countries | The article examines the importance of thresholds of profitability in the operation of commercial banks originating from the countries of Central and Eastern Europe. The authors assume that the threshold is important, when banks take management actions. The results of these actions are |

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| | | | characteristic discontinuities in distributions profitability measures around the threshold. |
| Wójtowicz (2010) | Poland | Theoretical research | This monograph is an attempt at a comprehensive look at the issue of the phenomenon known in the English-language literature as earnings management. The study presents the terminology on earnings management. In this paper the author proposes that earnings management be translated into Polish as „shaping the financial result”. |
| Matis (2010) | Romania | 101 | Intended to be a first step in an attempt at measuring the earnings management using an econometric model valid for the Romanian specificities by trying to establish the level of significance of three acknowledged econometric models: Jones (1991), Dechow *et al*. (1995) and Kasznik (1999) in the Romanian economic environment. Given the above mentioned premise, the study was conducted using Romanian listed companies. |
| Anandarajan, Hasan Lozano-Vivas (2003) | Spain[1] | 970 observations of which 490 are commercial bank observations and 480 are savings banks observations | Examines the relative importance of key factors affecting the loan loss provisions decisions of Spanish depository institutions. Among others, they focus on the role of organizational structure. They specifically examine if and how loan loss provisions are used prior to and after the implementation of capital adequacy regulations in the Spanish depository industry in 1992. |
| Gill-de-Albornoza and Illueca (2005) | Spain | 114 | Analyzes the effect of price regulation on the accounting policy of Spanish electricity companies. |
| García Osma and Gill de Albornoz Noguer (2007) | Spain | 155 firm-year observations | Tests whether corporate governance mechanisms promoted by best practice codes are effective in constraining earnings manipulation. |
| Arnedo, Lizarraga and Sánchez (2007) | Spain | 7,428 firm-year observations | Analyzes the difference in earnings quality between public and private firms. |
| Mora and Sabater (2008) | Spain | 281 | They analyze total and discretionary accruals around the time of labor negotiations. The „political costs” hypothesis predicts that labor bargaining creates incentives to reduce accounting earnings in order to avoid salary demands. |
| Yagüe, Gómez-Sala and Poveda-Fuentes (2009) | Spain | 45 | Examines the use of stock split announcements as signals of a firm’s earnings performance. |

[1] We have analysed in more profundity the Spanish market (papers published in English as well as in Spanish), which is why we have a wide sample of studies from Spain.

**Table 2.** European studies on earnings management (continued)

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| García Osma and Guillamón-Saorín (2009) | Spain | 106 | They study the association between corporate governance and impression management in annual results press releases. Press releases constitute a timely vehicle to communicate a firm's performance to third parties that can be manipulated to distort readers' perceptions of corporate achievements. |
| Rodríguez-Pérez and van Hemmen (2010) | Spain | 192 | They use panel-estimation techniques to calculate discretionary accruals and to produce a better understanding of the nature of the relation between debt and earnings management. Consistent with the transparency hypothesis (which suggests that diversification increases the complexity of firms' activities and reduces their transparency to outsiders). |
| Peasnell, Pope and Young (1999) | United Kingdom | 837 | Examines specification and power issues in relation to cross-sectional models used to estimate abnormal accruals based on a sample of UK companies. |
| Iatridis and Kadorinis (2009) | United Kingdom | 239 | Focuses on the investigation of motives for, and characteristics of, UK firms that engage in earnings management activities. |
| Pina, Arcas and Martí (2009) | United Kingdom | 67 | Research whether public sector managers apply accounting numbers – earnings-management. They seek to learn about the motivations of public sector managers to manipulate accounting numbers and how managers are managing accounting numbers. |

Source: the author.

And finally, the investigation in oriental countries appears much later (at the beginning of 21st century), see Table 3. In recent years we have observed a „boom" of investigations based on the sample from Asia. From 2006 to 2010 we observed 23 research investigations. The total number of studies from Asia is 34.

**Table 3.** Asian studies on earnings management

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Razzaque, Rahman and Salat (2006) | Bangladesh | 14 | Evaluates the earnings management in the textile sector. |
| Lee and Xue (2004) | China | 329 | Examines the earnings management of loss-firms during 1995-2000 in the Chinese capital market. |
| Lau (2004) | China | 736 | Shows that using average earning per share to set the Initial Public Offering pricing may be an additional incentive for earnings management. The research also investigates whether the forecasted EPS disclosed in the prospectus or public announcement can be realized under different regulations. |

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Yu, Du and Sun (2006) | China | 5,921 observations | Examines whether Chinese firms manipulate their earnings to meet the regulatory requirements. |
| Lin (2006) | China | 112 | Investigates whether foreign investment enterprises in China alter their corporate reporting behavior in response to a known schedule of tax-rate increases. The context of this investigation is a tax-incentive scheme that allows firms to pay taxes at a reduced rate for a limited period of time, and then at a higher rate when this period expires. |
| Liu and Lu (2007) | China | 5,977 firm-year observations | Indicates that Chinese firms indeed heavily engaged in earnings management to meet the rights issue. |
| Chen, Lee and Li (2008) | China | 4,437 firm-year observations | Examines how local governments in China help listed firms in earnings management to circumvent central government's regulation. |
| Shen, Coakley and Instefjord (2008) | China | 506 | Examines the under-pricing and long-term performance of Chinese initial public offerings issued during the 1998-2003 period in the accrual context. While issuers use income-increasing discretionary accruals to inflate earnings prior to IPOs, sentiment investors do not price discretionary accruals correctly but extrapolate past histories of managed earnings too far into the future. |
| Kao, Wu and Yang (2009) | China | 366 | Examines whether government regulatory initiatives in China involving initial public offerings may have contributed to opportunistic behaviors by the issuer. |
| Lo, Wong and Firth (2010) | China | 266 | Investigates whether good governance structures help constrain management's opportunistic behaviors (in the form of transfer pricing manipulations) in one of the world's most dynamic economies. |
| Aharony, Wang and Yuan (2010) | China | 185 | Shows that related-party sales of goods and services could be used opportunistically to manage earnings upwards in the pre-IPO period. They also provide evidence that such behavior may be motivated by the prospect of tunneling opportunities in the post-IPO period, i.e. exploiting economic resources from minority shareholders for the benefit of the parent company. |
| Jaggi and Leung (2007) | Hong Kong | 770 firm-year observations | Examines whether the establishment of audit committees by Hong Kong firms would constrain earnings management, especially in firms with family-dominated corporate boards. |
| Jaggi, Leung and Gul (2009) | Hong Kong | 633 | Investigates family control, board independence and earnings management |
| Siregar and Utama (2008) | Indonesia | 144 | Investigates whether companies listed on the Jakarta Stock Exchange conduct efficient or opportunistic earnings management and examines the effect of ownership structure, firm size, and corporate-governance practices on it. |

**Table 3.** Asian studies on earnings management (continued)

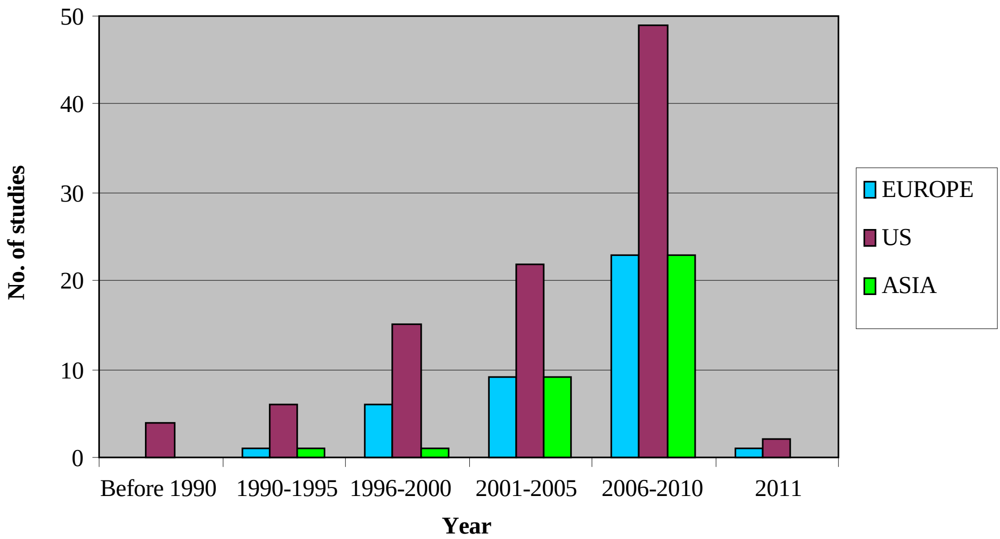
| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Aflatooni and Nikbakht (1990) | Iran | 2458 firm-years | Using the Tucker-Zarowin statistic of income smoothing, they find that firms with higher income smoothing rankings exhibit lower long-run return and abnormal return. |
| Darrough, Pourjalali and Saudagaran (1998) | Japan | 1440 | Examines choices of accounting accruals using a large sample of Japanese companies, which operate in an environment that is generally regarded as being rather different from the United States. |
| Otogawa (2002) | Japan | 828 | Investigates earnings management surrounding initial public offerings using Japanese firms that went public in the over-the-counter market between 1990 and 1999. |
| Shuto (2007) | Japan | 16,368 firm-year observations | Investigates the relation between discretionary accounting choices and executive compensation. |
| Agarwal (2007) | Japan | 78 | Measures earnings management behaviors in different economic environments. |
| Yoon and Miller (2002) | Korea | 663 | Explores the relationship between the operating performances of industrial firms and the behavior of discretionary accruals. |
| Kim and Yi (2005) | Korea | 63,386 firm-year observations | Using a large sample of both publicly traded and privately held firms in Korea, investigate whether, and how, the deviation of controlling shareholders' control from ownership, business group affiliation, and listing status differently affect the extent of earnings management. |
| Johl, Jubb and Houghton (2003) | Malaysia | 596 firm observations | Assumes that evidence regarding audit quality can be derived from the level of earnings management reflected in reported abnormal or discretionary accruals. Given this assumption, audit quality is examined in the context of the 1997 Asian financial crisis using data from Malaysia. Examining audit quality in its association with earnings management across differential macroeconomic periods provides insights that may be otherwise masked. |
| Saleh, Iskandar and Rahmat (2005) | Malaysia | 559 | Assesses the effectiveness of some board characteristics to monitor management behavior with respect to their incentives to manage earnings. |
| Rahman, Dowds and Cahan (2005) | Malaysia | 99 | Studies the differences between the earnings management practices of the Muslim-managed firms and the non-Muslim-managed firms listed on the Kuala Lumpur Stock Exchange in Malaysia. |
| Ahmad-Zaluki (2008) | Malaysia | 254 | Investigates the operating performance and the existence of earnings management. |

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Bukit, Takiah and Iskandar (2009) | Malaysia | 155 | Examines whether high surplus free cash flow is related to earnings management. This study hypothesizes that managers of high surplus free cash flow companies have an incentive to engage in earnings management. |
| Ali Shah *et al.* (2009) | Pakistan | 654 | Observes the relationship between Board Composition and earnings management. |
| Duh, Lee and Lin (2009) | Taiwan | 55 | Examines whether the reversal of a previously recognized impairment loss provides an opportunity for earnings management, and whether such behavior is associated with managers' incentives. They also examine whether a corporate-governance mechanism can mitigate this behavior. |

Source: the author.

Figure 4 shows the studies based on Europe, the U.S., and Asia. It presents the number of studies along the years.

**Figure 4.** Number of studies from the Europe, the U.S. and Asia*




* This research identified 203 articles testing for earnings management using proxies for discretionary behavior. To characterize the research designs applied in our study, research for the 1985 to 2011 period was conducted based on journals, conferences, congresses, and other publications, such as: PhD Theses, Master's theses and some working papers.

Source: the author.

We have not included in the previous graphic studies from South America, Africa or Australia, as we have observed a very small number of studies from these regions, see details on these studies in the Table 4.

**Table 4.** Details on studies on earnings management in North and South America and Australia

**Panel A.** North and South American studies on earnings management

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Park and Shin (2004) | Canada | 539 | Investigates the role of the board by investigating the effect of board composition on the practice of earnings management in Canada. They find that earnings are managed upward to avoid reporting losses and earnings declines. |
| Martinez (2005) | Brazil | Theoretical | Presents empirical evidence that Brazilian public companies practice earnings management as a response to capital market incentives. |
| Feres de Almeida *et al.* (2005) | Brazil | 156 | Investigates earnings management activities of Brazilian firms, after the Enron and WorldCom accounting scandals, which brought new attention to the quality of financial accounting reports produced by listed corporations. |
| Lopes, Tukamoto and Galdi (2006) | Brazil | 1026 observations | Investigates the impact of cross listing and of adjustments to U.S. GAAP on the earnings management practices of Brazilian firms. The institutional environment in Brazil is characterized by poor investor protection and uninformative accounting numbers. In this environment firms with better prospects could try to opt out of the country's poor institutional environment and to commit themselves to superior governance systems by cross-listing in the U.S. |

**Panel B.** Australian studies on earnings management

| Author (year) | Country | Number of companies | Objective of the study |
|---|---|---|---|
| Koh (2003) | Australia | 836 | Examines the association between institutional ownership and Australian firms' aggressive earnings management strategies. |
| Habib and Hossain (2008) | Australia | 738 | Examines whether managers manage earnings to 'just meet or beat' analyst forecasts in Australia. Previous Australian studies on benchmark-beating have focused on loss avoidance and small earnings increases as benchmarks. |

Source: the author.

## Conclusions

As we may see, ongoing debates are observed on the topic of earnings management, such as: real or accruals manipulation; efficient or opportunistic perspective on earnings management; manipulation within accounting rules or crossing the boundaries of accounting principles.

There is currently no consensus on the concept of earnings management. Each author, depending on his position on the above statements or research scope, specifies and details the definition of the concept stressing the aspects which he tackles in the investigation.

A short revision of the recent studies on earnings management indicates the existence of manipulation in the accounting numbers in companies. Moreover, in the light of corporate scandals (such as: Enron, WorldCom, Tico) there is no doubt that the credibility of present financial reporting is being questioned. Even more, a study executed by PricewaterhouseCoopers (DiPiazza, Eccles, 2002) reveals that only 20% of the analysts, investors and executives consider that information prepared under the present accounting norms is very useful to know the true image of a company.

We may conclude that the practice of earnings management is a phenomenon which was presented in the past and are still observed at present in the companies' environment. However, the research on earnings management has progressed over the last twenty five years. We observe a major intensification of studies between 2006 and 2010. Moreover, in the previous five years (2001–2005) the tendency to improve on the research into earnings management was also observed. Moreover, U.S. studies still persist as a leader in this topic. Almost 50% of all studies done within our sample period are from the U.S.

Taking into consideration all the debates presented above, and the fields of research observed during last twenty five years, we may still observe possible lines of investigations. As we mentioned earlier, most of the studies from Eastern Europe are rather theoretical studies. So we think it could be interesting to carry out a study on earnings management in these countries, after globalization and the fundamental changes in their economic and society, to know if earnings management exists and what the possible motivations for it are.

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**Summary**
Earnings management has received considerable attention in the accounting literature. However some aspects and environments are still unexplored. We present the debates on this subject: real transactions or accounting practices, respecting the rules or crossing the boundaries, efficient or opportunistic earnings management. Based on diligent investigation of more than two hundred papers, we present the evolution of the earnings management concept and present our own definition. Finally, we conduct a literature review on earnings management from a geographical perspective.

**Keywords:** earnings management, accounting, literature review, geographical perspective.

**Streszczenie**
**Dyskusja na temat zarządzania zyskiem: perspektywa geograficzna**
Zarządzanie zyskiem (*earnings management*) od dłuższego czasu jest przedmiotem studiów literaturowych z zakresu rachunkowości. Prowadzone na ten temat bardzo liczne badania wykazują, że niektóre aspekty zarządzania zyskiem wciąż pozostają nie do końca wyjaśnione. W niniejszym artykule autorzy przedstawiają dyskusję na temat zarządzania zyskiem. Poruszają w nim kilka zagadnień. Po pierwsze, czy kształtowanie zysków dotyczy decyzji z zakresu działalności operacyjnej, czy może decyzji z zakresu rachunkowości (praktyki rachunkowości). Po drugie, czy zarządzanie zyskiem ma na celu prezentację zdarzeń gospodarczych w sposób sprzeczny z zasadami rachunkowości, czy też może w ramach jej przepisów. I wreszcie po trzecie, czy zarządzanie zyskiem wiąże się z efektywnym funkcjonowaniem przedsiębiorstwa, czy tylko z oportunistycznym dostosowaniem do istniejących warunków. Na podstawie systematycznej i starannej analizy ponad dwustu artykułów autorzy przedstawiają również ewolucję terminu zarządzania zyskiem i prezentują własną jego definicję. Ponadto dokonują szerokiego przeglądu literatury z perspektywy geograficznej.

**Słowa kluczowe:** zarządzanie zyskiem, rachunkowość, przegląd literatury, perspektywa geograficzna.