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Earnings Management Cosmetics and Tricks: An Exploratory Study

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Abstract: This study aims to explore some new causes, motivational factors behind manipulation of earnings management and its controlling measures through qualitative research methods in Pakistani context. Traditionally, many studies have been carried out in this field by using quantitative version. To break the saturation and to explore and identify more versions related to earnings management, qualitative approach has been followed in this study. Data were collected through semi-structured interviews from auditors, credit analysts, investors and academicians of accounting and analyzed using NVivo 10, software. Many quantitative studies have been conducted regarding the causes of earnings management; however, this novel study provides in-depth motivation behind earnings management, responsible entities for such manipulations and remedial actions in practical life by conducting interviews with most relevant bodies dealing with accounting statements. This study, in addition to traditional factors, has singled out the role of government and auditors, the attitude of managers and owners as the new entities responsible for earnings management. Reporting quality can be improved by having proper check and balance from government level, from the Security and Exchange Commission of Pakistan (SECP) and from auditors. Government and SECP can check whether the rules and regulations set for the companies are being implemented properly, and auditors can check whether companies are presenting their true picture to the outsiders. Additionally, the involvement of managers on the board should be reduced. Small sample size, time consuming semi-structured interviews, limited number of interviewees' groups, non-availability of the experienced respondents and financial constraints in a qualitative study are a few leading limitations. The limitations may include the extent of the researchers' bias, lack of comfort level for some respondents with the audio recording, but the authors have tried to maintain these limitations at the minimum possible level. Empirical studies can be conducted to scientifically investigate the extent of the relationship between these new entities and earnings management with more recommendations for stakeholders in the corporate sector in Pakistan and the economies with similar characteristics.

Keywords: financial statements, real activities manipulation, earnings management, agency problems, Pakistan.

盈余管理化妆品和技巧：一项探索性研究

摘要: 本研究旨在通过巴基斯坦背景下的定性研究方法，探讨盈余管理操纵背后的一些新原因、动机因素及其控制措施。传统上，许多研究都是通过使用定量版本在该领域进行的。为了打破饱和并探索和识别与盈余管理相关的更多版本，本研究采用了定性方法。数据是通过审计员、信用分析师、投资者和会计院士的半结构化访谈收集的，并使用 NVivo 10 软件进行了分析。关于盈余管理的原因，已经进行了许多定量研究；然而，这项新颖的研究通过与大多数处理会计报表的相关机构进行访谈，提供了盈余管理背后的深入动机、此类操纵的责任实体和实际生活中的补救行动。这项研究，除了传统因素外，还特别指出了政府和审计师的作用、管理者和所有者的态度，作为负责盈余管理的新实体。通过政府层面、巴基斯坦证

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券交易委员会(证券交易委员会)和审计师的适当检查和平衡，可以提高报告质量。政府和证券交易委员会可以检查为公司制定的规章制度是否得到正确执行，审计师可以检查公司是否向外界展示了真实情况。此外，应减少管理人员在董事会中的参与。样本量小、半结构化访谈耗时、受访者群体数量有限、经验丰富的受访者不可用以及定性研究中的财务限制是一些主要限制。这些限制可能包括研究人员的偏见程度、一些受访者对录音缺乏舒适感，但作者试图将这些限制保持在尽可能低的水平。可以进行实证研究，以科学地调查这些新实体与盈余管理之间关系的程度，并为巴基斯坦和具有类似特征的经济体的企业部门的利益相关者提供更多建议。

关键词: 财务报表，实际活动操纵，盈余管理，代理问题，巴基斯坦.

1. Introduction

The goal of these businesses is to grow and outperform their competitors in the corporate world. Business companies desire to earn more profits, which portrays the financial soundness (in terms of high earnings per share, smooth dividend policies and efficient performance), health and strength of the companies to the investors. To achieve their goals, they may apply different tactics that can be ethical and unethical and illegal. The unethical tactics are known as earnings management [1]. Earnings management, a commonly used practice, occurs when managers' judgment is involved in financial reporting and they alter transactions in financial reports as well. Such practices mislead stakeholders about the financial position and performance of the companies and change the influence of those outcomes that directly depend on accounting numbers [2].

Earnings management is of two types that are accrual based and real earnings management. The former refers to the changes in accounting methods and manipulation in reporting time for earnings, for example, bad debt expenses and manipulating the reporting time of assets and has no long run effect on the total earnings [1]. However, later includes manipulating R&D expenses, advertisement expenses, sales and production, and can be more dangerous for the company [3]-[4]. Researchers argued that companies commonly use real earnings management tactics rather than accrual earnings management to earn high profits, attracting more investors and portraying positive signals in the market.

Earnings management is an important issue of developing and developed economies [5]. Companies manipulate their financial statements to achieve targeted goals, to improve their performance and value [1]. However, the advantages associated with achievements provide them with benefits only in the short run [1]. Many studies find a negative relationship between earnings management and a company's performance [6]-[8]. From these studies, it can be inferred that the companies enjoy short-term benefits from earnings management but ultimately, they end up with huge losses. This decreases earnings and increases the cost of capital. The cases of Enron and WorldCom have been widely discussed in earnings management. Due to the involvement in harmful practices, they made good profits in the short run but ended up with huge losses. In 2000, Enron's share price was traded at $83.13 and after eleven months their share prices fell to $0.26 [9]. Some Malaysian companies also suffered failures because of inaccurate recordings [10].

Transparent reporting helps in improved performance and it also saves companies from huge losses but practically, companies are motivated toward earnings management because of which they face problems. It is the responsibility of managers to work to better the company so that the company's performance can be improved, positive value can be added and profits can be generated. But mostly managers are the persons who are directly or indirectly involved in such illegal activities. Thus, instead of getting profits, companies ultimately fail with huge losses [11].

As earnings management is illegal, resulting in huge losses to the well-established organizations by affecting their financial soundness, reputation, profitability and company's operation so there is a need to take different actions at the company and the government level. There should be a proper audit committee and independent board size for this purpose. Management's involvement in the board must be minimum and there should be proper check and balance. Policies must be properly implemented so that such illegal and unethical activities can be reasonably controlled and prudently management.

The central point of this study is to explore the causes and motivations for earnings management in the first place, exploring the responsible entities for such activities and offering some remedial actions for these regular practices. This investigation was important for several reasons. First, every company wants to make a profit, which is sustainable eventually, but because of industrial pressure and many other reasons, they play some games and get involved in unethical tricks for the short run benefits. These short run gains may be hazardous and cause bankruptcy eventually. Secondly, every investor wants to invest in some profitable companies but because of unethical tactics and games played by the businesses, investors end up with no other options but huge losses. Similarly, credit analysts sometimes approve a huge number of loans as a bail-out package for the companies, by keeping the element of trust in mind, in addition to the financial soundness of their financial reports, liquidity and profitability of the companies. Later on, these analysts understand the tricks played by the companies. As a result, bad debts are faced. Keeping this as a background, this study explores some new insights about earnings management.

A better understanding of the role of financial statements and reasons for the manipulating different financial statement items such as current assets, fixed assets, sales and net income is the help devise some important recommendations of this study. Furthermore, an understanding and evaluation of the factors responsible for earning management, such as stock price, tax shield, bank loans, motivating investment, stable earnings and dividend payments also develops the theme of this study. The study explores some controlling measures to view the true picture of a company for all stakeholders.

Considering earnings management as a serious issue leading to the failure of the companies, this study recommends some measures to resolve it. Based on the severity of the problems, the following research questions are addressed in this study:

RQ1: What is the role and importance of financial statements and which of the financial statement-related items out of current assets, fixed assets, sales and net income are manipulated?

RQ2: What factors are responsible for earnings management out of increasing stock prices, tax shield, bank loans, motivating investment, stable earnings and dividend payment?

RQ3: Who is responsible for such tactics?

RQ4: What controlling measures should be taken and by whom?

Many studies have been conducted on the quantitative version related to earnings management even it is reached at saturation, but there are conflicting results. To identify and explore a new version of earnings management, this study uses a qualitative approach by conducting semi structured interviews for investigating these factors as a qualitative study provides a detailed understanding of the phenomenon [12]-[13] and its main causes in search of new possible dimensions of the earnings management, including some measures to control this habitual practice that eventually leads the companies to failure.

Section 2 develops a theoretical framework from an extensive literature review by focusing on the importance of financial statements and the financial statement's items which are manipulated the most; causes and motivation for earnings management and responsible entities for earnings management and controlling measures. Methods with research design and data collection techniques are explained in Section 3 followed by the findings of the study and discussion. The last section concludes this study with an illustration of certain limitations and recommendations for future research.

2. Literature Review

2.1. Importance of Financial Statement

Financial statements are important because they provide a detailed view of the companies to the stakeholders. Companies' sales, earnings per share, expenses and dividend policies with financial reports provide a clear picture. Financial statements are a channel through which internal stakeholders of the companies can easily communicate with their external counterparts. These statements connect the company's managers, board of directors, shareholders, auditors and investors. If financial statements are not presented in a clear way or if they fail to bridge the gap between the internal and external parties, agency problems can arise [10]. Such problems may lead to the clashes between the internal and external stakeholders. There will be more chances of investment if the reports are presented in a clear way. Researchers reveal that the high quality of financial reporting information is important because it motivates capital providers and other stakeholders to make investment [10]. Furthermore, they find an overall enhancement of market efficiency through the preparedness of financial statements with integrity. Additionally, stakeholders provide credit and other resources because of the favorable performance of the executives and financial reports [14].

2.2. Manipulation of Financial Statement Items

As financial statements are related to the financial soundness of the companies so companies try to portray a good image to the investors and other stakeholders by using different tactics. As observed in [1], the company's earnings depict the financial strength and the wealth of shareholders. More earnings shown in the financial statements motivate more investors to invest. Some other tactics used by the companies can be the manipulation in terms of sales or other assets. Price cutting strategy by the companies may increase their sales for a specific period. Similarly, the production of a large amount of inventory reveals enhanced reporting assets or earnings of the companies [15]-[16]. These tricks ultimately lead to the failure of the companies, so manipulation should be avoided and the interests of both shareholders and managers should be kept in mind before making any decision about the companies.

2.3. Earnings Management and Agency Problems

According to [10] manipulated financial figures can create some agency problems because such reports fail to bridge the gap between internal and external parties and stakeholders. Furthermore, depending on the organization's objectives, agency problems vary from one organization to another. The reason behind this variation is the difference in the extent of manipulation. The literature has discussed asymmetric earnings management across different companies, such as family-owned companies and non-family businesses revealed by [17]. According to [17] family-owned companies are less motivated for earnings management as they target long-term survival rather than short-term profits. Similarly, according to [18] public family companies are more intended toward manipulation due which agency problems are more dominated in public family companies. However, the private family companies are less motivated toward manipulating activities due which agency problems are comparatively less severe [19]. However, some studies have provided contradictory results, saying that earnings management is less dominated in public companies, as compared to private companies [20]-[21].

As a conclusion, manipulation is everywhere, but the extent of manipulation is different across different organizations and sectors, as each organization has its targeted objectives. Some organizations are less intended toward manipulation and hence there are few agency problems for them. Some other companies are motivated toward manipulations and are confronted with agency problems. As most companies are involved in earnings management so there is a need to investigate the main factors that motivate companies for such unethical manipulation activities and some control measures to reduce agency problems caused by such manipulation. Motivation toward manipulation is one of the company's internal objectives that varies across companies according to their type and nature of business.

2.4. Causes and Motivation for Earnings Management

One of the main reasons for manipulating the financial statements is to meet the financial targets and to get some managerial incentives [5]. If there are chances for managers to get more incentives because of high-powered executive compensation structures, they will get motivated to manipulate their earnings. Achieving the earning targets and incentives can be the reason for earnings management [1], [22]. Additionally, the companies, which are unable to meet analysts' expectations, also manipulate some figures in their financial reports to meet forecasts to prevent a decline in their share price. [23] examined three earnings thresholds for manipulating their earnings that include analysts' forecasts, prior period earnings and zero earnings. To protect themselves and keep themselves save from penalties, managers manipulate earnings. Motivation to get high incentives and emphasis on safeguards from penalties can lead managers to divert from the interests of the business, which ultimately creates agency problems. Furthermore, managers can adopt manipulating activities because of market pressures on them [2]. Companies can also be involved in such harmful activities to portray a positive and healthier image of these companies [24].

Regular and smooth payment of dividends by the companies also attracts more investors. Paying the dividends, companies hide their weaknesses from the external bodies. In this way, the companies get involved in some manipulating activities related to the earnings management [3]. The companies may also use demand for financing, particularly equity financing [25] as a source of manipulations in terms of earning management. By comparing public and private listed companies, [26] argued that public companies listed in unprotected industries are more involved in earnings management. Because of the less protection, they want to achieve their desired goals at any cost and fall in unethical activities known as earnings management.

The inclusion of top managers on board can result in divergent interests that ultimately cause agency problems. Moreover, because of weak control on mangers, companies will be involved in some kinds of fraud and manipulation, which decrease the reliability of financial statements. This manipulation and fraud then prove disastrous in the long run [21].

2.5. Responsible Entities for Earnings Management

The literature has revealed many entities as responsible for earnings management. One of the major entities is the audit team. Auditors guarantee the reliability of financial statements and certify its quality [27]. They are responsible for a detailed overview of the financial statements prepared by the business. Qualified reports are prepared for the companies only after conducting a detailed audit, which involves earnings management. According to [4], auditors are responsible for accrual-based manipulation but they are irresponsible for manipulation of real activities. Managers are also involved in manipulation for achieving their targeted goals [5], [22], [28].

2.6. Controlling Measures for Earnings Management

Every country has some rules and regulations for reporting the financial activities. But the rules alone are not enough to control the tricks played by the businesses. There must be some sort of monitoring and enforcement to control such illegal and unethical activities [10]. Similar measures are also suggested by other researchers saying that effective monitoring and solid examination by analysts can reduce the earnings management [29], [30]. Three ways of monitoring were discussed in [29], such as (i) providing information not only to the current shareholders but to the potential shareholders as well, (ii) reviewing complex footnotes in the financial statements and (iii) tracking the managerial behavior and irregularities or clutter in financial statements on a regular basis. Internal monitoring may result in lower control due to pressure from the internal bodies, but if analysts play the role of external monitor, earnings management can be controlled.

Transparency in the financial statements is another measure for controlling the earnings management [3]. This is possible only if the board is independent [10], [31]. Transparent financial reports may reduce the information asymmetry, which results in lower agency costs and useful policy implications [3].

Generally, powerful entities are involved in the manipulation of the reports against which no actions are taken. Minority shareholders know about such manipulation and are the best people to stop such activities, but they are helpless due to less power. Another measure for controlling earnings management is to provide rights for minority shareholders so that they can raise a voice against unethical activities performed by the majority shareholders [10]. Enhanced accountability of auditors is needed to improve the financial reporting because auditors are the guarantors for the reliability of the financial reports [10], [32]. The board must be independent as it results in lower manipulation activities [21], [33]-[35]. The other controlling measures identified in the literature include independent and large size of audit committee [27], [33], [35], gender diversity and management ownership percentage [35]. Earning management can be controlled by adding more female employees to the board [36].

International Financial Reporting Standard (IFRS) are the commonly used reporting standards that ensure timely reporting of all entries and transactions with accurate. Adopting IFRS can result in less earnings management, timely reporting, more companies' value and improved accounting comparability [37]. As such, standards can decrease earnings management. In this way, more focus can be on the adaptation of international accounting standards.

The purpose of this qualitative research is to explore more dimensions associated with earnings management than what have been traditionally the focus of numerous empirical studies in case of Pakistan, in addition to the causes and motivations toward unethical practices and some controlling measures for such activities.

3. Research Methods

3.1. Research Approach

Qualitative research methodology has been employed in this study to an in-depth understanding and information about phenomena of interest [4] as an interpretive technique [12], [38]. The purpose is to highlight the detailed perspective rather than getting brief and to the point views about the phenomena of interest [5]. In-depth semi-structured interviews are considered an appropriate technique for primary data collection [13], [39] to explore the main causes of earnings management, responsible entities for such manipulations and further to explore some controlling measures for earnings management. For conducting the interviews, division of qualitative research interviews proposed in [38]'s was used, and research questions were defined; then interview guide was prepared; participants were recruited and interviews were carried out. The interview guide, adapted from [11] was used for this purpose. This interview guide contained five sections and eleven items in total. The first section was related to the general questions about the importance of financial statements, followed by the items on the manipulation of financial statements. The starting question was a general discussion, as it is considered best to start with some general questions so that the interviewer feels comfortable answering [6]. The sequence of the questions was from general to specific [4]. The interview guide was followed by the causes and motivations, responsible entities and remedial actions for earnings management. Some probing questions were also made part of the interview guide. The questions of the interview were open ended as the main purpose was to explore different viewpoints regarding earnings management. The interview was concluded by providing the opportunity to give the interviewee about his/ her opinion and to encourage discussion about the topic as it is a useful practice [6].

3.2. Data Collection

Data were collected from users of financial statements, who were divided into four groups as auditors, credit analysts and investors of the companies (public and private companies) listed in Karachi Stock Exchange (KSE). Academicians who teach accounting were also included in the sample. In total, 16 interviews were conducted from all groups, including auditors (five), credit analysts (four), investors (four) and lecturers/professors (three). Each group seemed deeply involved in the usage of financial statement. External auditors have authority to evaluate the company's financial statement and to highlight any fraud or earning management. They are the best source to provide information about the objectives of the study. Credit analysts use financial statements to know about the credit history of the company. After detailed analysis, they decide whether a company can to pay its obligation or not. Furthermore, they decide whether loans should be set for the company or not. As they are involved in deep analysis, they can provide real and actual doings of the companies regarding earnings management. Investors are the people who invest in the company by looking at financial statements of the company. If they find that company is making good profits, it is paying regular dividends, it has lots of assets to cover their liabilities, then they prefer to invest in such companies. Adding investors in the sample highlight some of their experiences regarding losses and negative feelings just because of earning management. Finally, lecturers or professors of accounting have up to date knowledge and information about such practices as they are involved in different studies that are being carried out to deal such issues. Therefore, they can also provide better and up-to-date information about the results of some relevant researches about earning management techniques, its causes and suggestions to handle such issues.

3.3. Sample Size

Sixteen semi-structured interviews were conducted, because of small sample requirement in qualitative research [13], to get first-hand information about the scenario. The period for conducting one semi-structured interview was 20 minutes on the average. The interviews were conducted by visiting places that were most feasible and convenient for the interviewee such as offices of the auditors, lecturers/professors, credit divisions of banks and stock exchange. The interview started with a brief discussion about the topic. Each interview was recorded by obtaining a permission of the interviewee, which was then verbatim transcribed and prepared for the analysis. Interviewees were assured that their name and information would be kept confidential and will be used only for research purpose. Table 1 provides complete information about the respondents (for example, gender, age, qualification, total years of experience and type of organization).

Table 1 Attribute details of respondents

Cases	Gender	Age	Qualification	Experience	The type of Organization	Group
1: Auditor 1	Female	20-30	CA/ACCA	6-10	Public	Auditor
2: Auditor 2	Male	20-30	CA/ACCA	1-5	Public	Auditor
3: Auditor 3	Male	20-30	CA/ACCA	1-5	Public	Auditor
4: Auditor 4	Male	20-30	CA/ACCA	1-5	Public	Auditor
5: Auditor 5	Female	20-30	CA/ACCA	1-5	Public	Auditor
6: Credit Analyst 1	Female	30-40	M. Phil	6-10	Public	Credit analyst
7: Credit Analyst 2	Male	30-40	CA/ACCA	6-10	Private	Credit analyst
8: Credit Analyst 3	Male	40 & above	Master	10-15	Public	Credit analyst
9: Credit Analyst 4	Female	20-30	Master	1-5	Public	Credit analyst
10: Investor 1	Male	20-30	M. Phil	1-5	Private	Investor
11: Investor 3	Male	20-30	M. Phil	6-10	Public	Investor
12: Investor 4	Male	20-30	Bachelor	6-10	Public	Investor
13: Investor 5	Male	20-30	Intermediate	6-10	Public	Investor
14: Lecturer 1	Male	20-30	PhD	6-10	Public	Lecturer/Professor
15: Lecturer 2	Male	30-40	PhD	6-10	Private	Lecturer/Professor
16: Lecturer 3	Male	20-30	PhD	6-10	Private	Lecturer/Professor

3.4. Coding Structure

Before analyzing data from transcribed interviews, some codes were generated on the basis of literature. The NVivo 10 software was used for this purpose. Initially, all level codes were based on literature (first, second and third order codes such as parent, child and grandchild nodes) but later on minor changes were made in child and grandchild nodes on the basis of interview results. After modification, some child and grandchild nodes were added and some of them were removed. Finally, total number of parent nodes used for analysis was five such as the importance of financial statement, items of manipulation, causes and motivations, responsible entities and controlling measures.

The number of interviewees from all groups who commented on an issue was recorded and the total number of references that these sources made to each issue were also noted. Each interview considered a single source. For interpretation, the relationship between sources and references was analyzed. If the sources and references for an issue were equal it shows that each interviewee/source has discussed the issue once. But if there is a difference between sources and references (large number of references as compared to the sources) it shows that an issue was discussed by a source more than once. Additionally, it was noted whether the issue was highlighted by a single respondent multiple times or it was discussed by the multiple respondents. If the issue was discussed in a flow by a single source, it was considered a single reference. But if the flow was missing then it was recorded as a new reference. Based on coding, it was tried to present the view of all respondents rather than focusing on answers of some particular interviewees (Figure 1). These codes were helpful in identifying the main causes of earnings management, responsible entities and top suggestions and remedial actions to control earnings management practices. The findings from the detailed analysis of all interviews are presented below.

4. Results

Respondents presented their views about different issues like importance of financial statement and items of manipulation in financial statements. They highlighted some causes and motivations for individual's involvement in earnings management. Furthermore, they discussed which bodies were responsible for such unethical activities and finally they presented some suggestions for controlling these illegal activities. Table 2 provides detailed information on how many respondents have focused on a specific issue (number of responses on a particular issue were considered as sources) and how many references were made from each source (number of times an issue discussed was considered as a new reference).

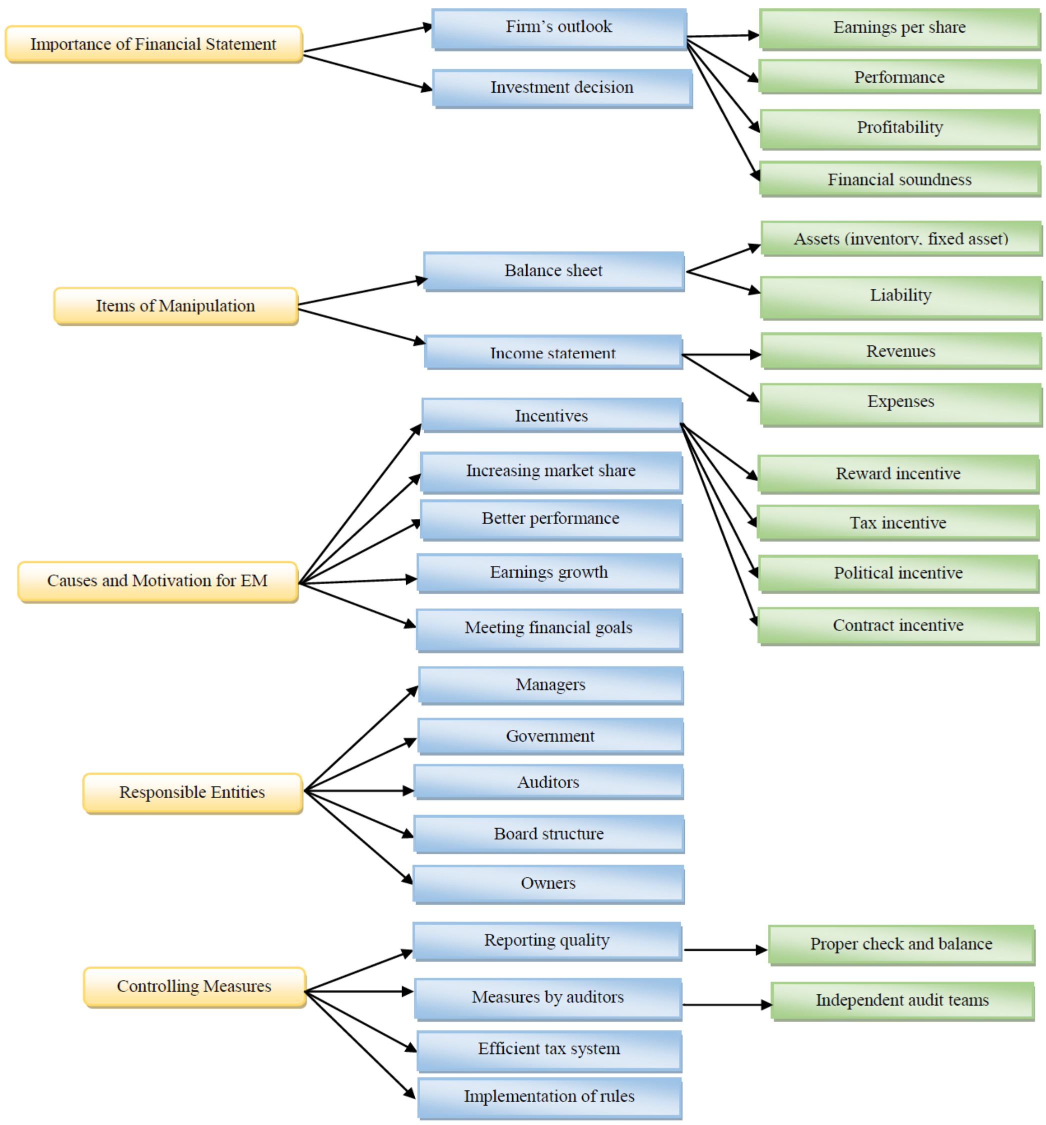

Fig. 1 Coding structure of qualitative research

Table 2 Sources and references for nodes

Nodes	Child Nodes	Auditor		Credit analyst		Investor		Lecturer/Professor		Total	
		Sources	Ref.	Sources	Ref.	Sources	Ref.	Sources	Ref.	Sources	Ref.
Importance of financial statement	Company's outlook	5	5	4	3	4	5	3	3	16	16
	Investment decisions	3	3	1	1	2	2	1	2	7	8
Items of manipulation	Balance sheet items	3	5	3	4	1	2	1	3	8	14
	Income statement	3	7	2	3	3	3	2	6	10	19
Motivations	Incentives	5	9	4	10	4	6	3	13	16	38
	Contract incentives	2	2	1	1	1	1	1	2	5	6
	Political incentives	0	0	1	1	1	1	1	2	3	4
	Reward incentives	2	4	1	1	2	2	1	1	6	8
	Tax incentives	2	3	3	7	3	3	3	8	11	21
	Increasing share prices	2	3	2	4	4	4	3	4	11	15
	Better performance	1	1	1	1	3	5	2	2	7	9
	Earnings growth	1	1	3	3	2	4	0	0	6	8
	Meeting financial goals	1	1	1	1	1	1	0	0	3	3

Continuation of Table 2

Responsible entities	Managers	3	4	3	4	3	3	1	1	10	12
	Government	1	1	3	3	1	1	2	3	7	8
	Auditors	0	0	2	2	1	1	1	1	4	4
	Board structure	2	2	1	1	2	2	0	0	5	5
	Owners	0	0	2	2	1	1	2	2	5	5
Controlling measures	Improving reporting quality of	5	8	4	6	2	4	3	4	14	22
	Decrease involvement of managers	1	1	0	0	0	0	0	0	1	1
	Proper check and balance	5	7	3	5	2	4	3	4	13	20
	Measures by audit teams	1	2	2	4	3	4	2	2	8	12
	Independent teams	1	1	1	1	2	2	2	2	6	6
	Efficient tax system	0	0	2	2	0	0	1	1	3	3
	Implementation of the rules	0	0	0	0	1	1	1	2	2	3

These responses were helpful in identifying the reasons for the importance of financial statements and the most manipulated items in financial statements. Furthermore, results provided information about the main causes of earnings management, main bodies that are responsible for earnings management and some of the suggestion for controlling such actions.

4.1. Importance of Financial Statement

Table 2 also helps provide an outline about the views of all four groups on the basis of their responses. By comparing these groups, we can see that all respondents reported that financial statements are important because of many reasons. Two of the reasons of importance were more prominent such as 'financial statements provide the overall company's outlook in the form of earnings per share, performance and profitability'. A second reason for the importance discussed was a set of reports providing detailed information about investment decision making. From Table 2, it can be analyzed that all respondents (16 out of 16) agreed on the point that financial statements are important because they provide the company's outlook. However, only seven of 16 respondents reported that financial statements help in investment decision making which includes three auditors, one credit analyst, two investors and a lecturer/professor.

The interview results, presented in Table 3 (data in the form of quotations), also provide evidence about the importance of the financial statement. As shown in Table 3, auditors and credit analysts reported that financial statements are important as they provide an overall picture of the company as they communicate about the profitability of the companies, their financial performance and the business activities of the companies. The views of academicians and investors singled out statements as a source of information about the financial worth and soundness of the companies. Furthermore, some respondents from different groups claimed that financial statements also help investors in investment decision making as company's financial position and soundness matters a lot (P14-Lecturer/ Professor, Table 3). According to the respondents, investors should consider underlining these factors before investing in a particular company. According to the auditor (P3) risk-averse investors always look into the financial figures; investors, after detailed analysis, decide whether investment will result in profits or not and after satisfactory analysis they decide about undertaking investment in a particular company.

Table 3 Representative supporting data for second order codes

Parent Node	Child Node	Quotations
Importance of Financial Statements	Company's outlook	• By using financial statements, we can analyze the profitability, performance and financial position of a company (P3-Auditor). • Financial statements show the worth of business and various activities of the business (P9-Credit Analyst). • Financial statements provide basic information about the financial position and financial worth of the business. All stakeholders can get information about the company by financial statements which are the only mean of providing information. Without financial statements, one cannot get the information about the company (P16-Lecturer/ Professor).
	Investment Decision	• Financial statements provide idea about the level of the business so investors think about the business level before making investment in a particular company (P12-Investor). • These statements are helpful for the shareholders as they look at the financial soundness, financial health and past performance of the companies before making investment decisions (P13-Investor). • Investment decisions are also made on the basis of the company's position. If its position is strong, investors will be attracted to invest in it. The strength of a company's financial position is measured on the basis of annual reports (P14-Lecturer/ Professor).
Items of Manipulation	Balance Sheet Items	• In the balance sheet, there is an account for reserves which are manipulated the most (P14-Lecturer/ Professor).

		• In balance sheets, companies manipulate more in fixed asset (P8-Credit Analyst). • Mostly, balance sheet items are manipulated. Liabilities are manipulated more. Other items like current assets (receivables, stock and cash) and current liabilities (payables) are also manipulated. Fixed assets cannot be manipulated (P9-Credit Analyst).
	Income Statement	• The majority of the manipulations are in the head of revenues. Organizations want to show high profits. Most of the time, financial position is measured by the revenue figure so they manipulate it so that they can show high financial position (P1-Auditor). • Companies manipulate their earnings most. They manage their percentages by manipulating earnings (P2-Auditor). • Some companies manipulate in sales, some in expenses or revenues (P12-Investor).
Causes and Motivations	Incentives	• Management's concerns, owner's commissions, laws and regulations are the main reasons for earnings management (P1-Auditor). • Basically, they manipulate earnings for tax saving purposes (P2-Auditor). • They also manipulate data to achieve stated targets and to achieve their personal objectives like bonuses and commissions, etc. (P7-Credit Analyst).
	Increasing Share price	• If the basic goal of the manipulation is to increase the share price, they will definitely go for manipulation. Such manipulation can increase the earnings per share and ultimately have a positive impact on the stock price (P7-Credit Analyst). • Stock or share prices are not linked to the income statement of the company. In most of the cases, investors do not consider the annual reports of the company for the share prices (P14-Lecturer/ Professor). • A reason of manipulation is to increase the stock price (P12-Investor).
	Better Performance	• Board performance and board appraisal can also be the possible reasons for the manipulation (P11-Investor). • To show a better financial position, companies might show high earnings (P15-Lecturer/ Professor). • To increase their funds and to satisfy shareholders and investors; companies show better financial position and performance (P16-Lecturer/ Professor).
	Earnings Growth	• Earnings management can directly affect a company's progress, its financial growth and health (P10-Investor). • A company never shows its true picture. The reason behind these is to save taxes and to increase its market value and to compete with its competitors and to earn high profits with a low budget and to improve their track record (P9-Credit Analyst). • They manipulate their accounts to show their business more profitable (P8-Credit Analyst).
	Meeting Financial Goals/Targets	• Public companies are more involved in earnings management. They manipulate their figures as they want to achieve target goals (P12-Investor). • They also manipulate data to achieve stated targets and to achieve their personal objectives like bonuses and commissions etc (P7-Credit Analyst). • Companies rely on some targets saying that if you achieve this much profit, you will be paid with some bonuses or compensations (P1-Auditor).
Responsible Entities	Managers	• Management of the companies is one of the responsible bodies as they have the main responsibility to present financial statements (P11-Investor). • The management of the companies is one of the responsible bodies as they want to work for their own benefits. They want to do businesses for themselves and to get some personal benefits (P12-Investor). • Management of the company is one of the responsible bodies as they have the main responsibility. They are insiders and have complete information about the financial soundness of these companies. So, it is their responsibility to provide a true picture to the investor as investors trust them (P13-Investor).
	Government	• Government is also responsible for earning management. The reason behind is that either they do not have rules and regulations to control earning management or they have rules and policies but there is no check and balance on the application (P14-Lecturer). • Apart from that government is responsible for improper check and implementation of laws (P13-Investor). • To some extent government is also responsible as there is no proper check and balance on the implementation of laws and regulations (P6, P7-Credit Analyst).
	Auditors	• The persons who are working inside the companies are more responsible, which includes the accounts department and internal auditors. They are more responsible for manipulating record (P9-Credit Analyst). • Additionally, auditors are not performing their duties well as they are not checking the records properly (P11-Investor). • Auditors are also involved in the manipulation (P8-Credit Analyst).
	Board	• Top management and board of directors are more responsible as their objective is to achieve some ratios and targets so they manipulate data (P1-Auditor). • It depends on the company's interest or the interest of the owners and board of directors. They can show a true picture and they can manipulate their financial reports too (P12-Investor). • And eventually, board is responsible for manipulations. But board comes at the end

		(P4-Auditor).
	Owners	• Owners and management are responsible because owners are directly affected by the company's profits and losses. These instruments are dealt by management. Owners hire managers because they might not be financial experts (P8-Credit Analyst). • It depends on the company's interest or the interest of the owners and board of directors. They can show a true picture and they can manipulate their financial reports too (P12-Investor). • Owners of the companies are one of the responsible bodies as they set targets and employees must achieve those targets (P15-Lecturer/ Professor).
Controlling Measures	Improving Reporting Quality (Check & Balance)	• The first action is that a proper accounting system should be developed in medium as well as small level (P6-Credit Analyst). • If there is proper control and check and balance then we can say that chances for earnings management will be low (P7-Credit Analyst). • Public companies are more involved in earnings management. They manipulate their figures as they want to achieve target goals and there is no proper check and balance in the reports. However, private sector manipulates data less as they are under proper check so they cannot manipulate even if they want to do so (P12-Investor).
	Measures by Audit Teams (Independent Teams)	• In Pakistan, mostly businesses are family owned but there is no check and balance on these companies. No auditors are there to highlight the frauds and the mistakes they make. Proper check and balance should be maintained and auditors must be independent (P14-Lecturer/ Professor). • The main role is of audit teams. There should be something like surprise visits and surprise audits (P9-Credit Analyst). • Audit committee must take some actions to control earnings management by conducting strict audits, plus auditors must be independent (P11-Investor).
	Efficient Tax System	• Tax officers should be honest. There must be a proper tax system. Secondly, the tax system must be equitable (P8-Credit Analyst). • To control earning management it is necessary to collect taxes from every individual and to distribute wealth properly (P14-Lecturer/ Professor). • Another way is that government should provide special benefits to tax payers as provided in foreign countries (P6-Credit Analyst).
	Implementation of Rules	• As there is no check and balance, there are relaxed rules and the government is not controlling companies for managing their earnings and there is no accountability so companies are motivated towards earning management (P14-Lecturer/ Professor). • Policies, rules and regulations must be followed only in that case manipulation can be controlled (P12-Investor). • Rules and regulations should be formed by the government and if there are some rules (in fact there are rules but) they must be applied (P14-Lecturer/ Professor).

4.2. Manipulation of Financial Statement Items

Most of the respondents agreed that companies manipulate their statements. They presented a list of items which can be manipulated in the financial statements. According to Table 3, two major statements that are manipulated the most include the balance sheet and income statement. Most of the auditors (three out of five) and credit analysts (three out of four) argued that balance sheet items are manipulated the most. However, only one investor and a lecturer/professor talked about manipulation in balance sheet items. The results of Table 3 depict that there are contradictory views about the manipulating items in the balance sheet. Likewise, some respondents are of the belief that receivables cannot be manipulated, while others claim that the dominating manipulated item is *receivables*. Similar views have been noted about fixed assets and other items as well (P8). A contrary view (P9) about the fixed assets has also been noted (Table 3). However, most of them (three auditors, three credit analysts, one investor and a lecturer/ professor) agreed upon manipulation of items on the balance sheet. Based on these responses, it can be concluded that current assets and liabilities, retained earnings, reserves and depreciation expenses are manipulated the most in the balance sheet.

Some respondents also highlighted manipulation in the income statement items. Revenues and expenses are manipulated the most (Table 3). As shown in Table 2, total number of references for manipulating income statement items is 19 and ten out of 16 respondents (three auditors, two credit analysts, three investors and two academicians) pointed out expenses and revenues as the most manipulated items. However, a contrary view of a lecturer was noted. According to him, companies do not involve in manipulation, rather they play with data and by using different accounting standards they present figures in financial reports. In this way, using different standards is not the fraud but it is actually the make-over that companies apply on their financial statements.

Financial statements are the makeup. Companies use different accounting standards to prepare their statements. Manipulation is something else. There are two different terms: playing with the data and fraud. Companies play with the data to present them in financial statements but they are not involved in fraud (P15-Lecturer).

4.3. Causes and Motivation for Earnings Management

From Table 2 and Table 3 many reasons can be known as to the companies' involvement in earnings management. The findings reveal that companies manipulate their statements in order to get incentives in terms of contract, reward (bonuses, commission etc.), taxes or some other political incentives. Out of these, tax incentives were the most reported reason for manipulation. Tax savings are one of the reasons for manipulating financial statements. This argument is supported by the references shown in Table 2. This argument is supported by 21 references; eleven out of 16 respondents (two auditors, three credit analysts, three investors and three lecturers).

A positive relationship between earnings management and share price is supported by ten respondents (two auditors, two credit analysts, four investors and two academicians). However, according to a reference [lecturer/ professor (P14)], share prices are not linked to the income statement of the company, rather companies manipulate financial figures to get personal incentives and to pay lower taxes but increasing share price is not the cause of manipulation. Bearing all views in mind, increasing market share can be considered the second main reason and motivation for earnings management.

Other reasons for manipulating financial statements, besides increasing market share, have also been revealed. Most of the investors (three out of four) and academicians (two out three) reported that improvement in the company's performance can be a reason for manipulation of financial statements. Company's performance is deemed better due to the good performance of board and availability of large amount of funds. Within these objectives, companies manipulate figures. However, only a single auditor and a credit analyst found it to be an important cause of manipulation. Additionally, credit analysts and investors reveal the high earnings growth of companies as a reason for manipulating statements. The growth of earnings rises with good financial health of the companies (P10). Meeting financial targets and getting funds and financing from banks are the other reasons highlighted in Table 2 and Table 3, for the earning management manipulation. Top level management and owners set some targets that are not SMART and not easily achievable, resulting into manipulating of accounting figures (P1, P7 and P12).

4.4. Responsible Entities for Earnings Management

Many reasons for the manipulation of earning management have been singled out and discussed so far. It is imperative to know the responsible persons for such manipulations. The results presented in Table 3 reveal findings in this connection. Managers have been the most responsible entity for manipulating the accounting figures. As shown in table 2, there are twelve references for management entity and ten of 16 respondents (three auditors, three credit analysts, three investors and a lecturer/ professor) assign responsibility of manipulation of the financial figures to the management. Managers are the insiders; they know about the entire situation and have more knowledge as compared to the external stakeholders of companies. The findings reveal asymmetric information to the outsiders and managers provides an opportunity to the managers for manipulation of financial statements in order for their personal benefits. The results given in Table 2 also reveal government being responsible for earnings management [seven out of 16 respondents (an auditor, three credit analysts, an investor and two academicians)]. There are eight references concerning the responsibility of government for manipulating the earnings and their management. Government being the authority but not taking any actions against manipulation whereby companies are motivated toward earnings management (Table 3). Credit analysts, investors, and lecturers/professors, in minority assume auditors as responsible for manipulations in the balance sheets (Table 2). According to them, auditors do not perform their duties well and do not take a keen interest in auditing. While two of five auditors, one credit analyst and two investors assume board structure as responsible for manipulating their financial statement. In the presence of a large number of managers in the board independent decision is not possible. They follow the direction provided by the managers, which results in endorsing manipulation of financial figures. However, two credit analysts, an investor and two academicians cited that owners are responsible for earnings management. They are the parties that set targets which are not smart and cannot be easily achieved. As a result, managers and subordinates are left with no other option but manipulation of financial figures (Table 3).

4.5. Controlling Measures for Earnings Management

All of the respondents cited companies' involvement in earnings management and an increasing trend of overestimating/underestimating financial statements for personal benefits. Some measures have been singled out to control manipulating activities of earning management. Table 3 provides some measures for controlling earnings management. Almost all respondents (14 out of 16) consider improvement in the reporting quality inevitable in order to control earnings management. For improving the reporting quality, proper check and balance has been the most cited suggestion. As shown in Table 2, there are 20 references for this particular measure and 13 of 16 respondents (all auditors, three credit analysts, two investors and all academicians) argue in favor of this controlling measure.

More measures have also been suggested to control earnings management with predominantly the role of auditors. Table 2 shows that eight of 16 respondents (one auditor, two credit analysts, three investors and two academicians) considered it as an important measure. The number of references (twelve references) present in Table 2 also verify its importance. Table 3 provides the respondents' views, which clarifies that independent audit team is very crucial for eliminating or at least reducing such illegal activities. Further, they reported that auditors must follow strict policies and should report complaints about such companies so that higher authorities can penalize them and can take strict actions against them. Additionally, auditors must keep their visits surprise so that the actual situation of the companies can be reported (Table 3).

Very few respondents, including two credit analysts and a lecturer/professor, talked about proper tax collection system with emphasis on the honest tax officers (Table 3). Further, taxes should be equally distributed so that nobody manipulates reports for their personal benefits and self-interest. However, none of the investor and auditor talked about this particular issue.

An investor and a lecturer/professor focused that rules are there but are not being implemented. Therefore, there is need to properly implement the rules and regulation rather than making new rules or policies to control earnings management. And only an auditor viewed about decrease involvement of managers in the board. However, none of the respondents, except the auditors, discussed this as a controlling measure.

Apart from that, one respondent (P15-Lecturer/Professor) reported that every individual is also responsible for earnings management as everybody thinks about their own benefits rather than thinking about collective benefits leading to agency problems. To avoid such problems, everyone must take some steps and actions should be taken at the individual level, company level and then at the country level.

5. Discussion

As indicated previously, financial statements are an important source of detailed information about the business companies. Many quantitative studies were conducted regarding causes of earnings management; however, this study provides in-depth motivations behind earnings management, responsible entities for such manipulations and remedial actions in practical life by conducting interviews of most relevant bodies that deals in accounting statements. This study, in addition to traditional factors, has singled out the role of government and auditors, the attitude of managers and owners as the new entities which are responsible for earnings management. Different groups like auditors, credit analysts, investors and academicians being the experts of financial statements and can make prudent decisions and useful analysis by looking at financial statements. For example, auditors and investors, aligned with the results of [14], can decide about the financial soundness, performance and credibility of the companies by looking at their financial statements. Similarly, credit analysts can look at the financial figures of the companies before providing them with large amount of loans. [40] also supported this view. Most of the time, investors also rely on the financial statements as these statements help in investment decision making. They look at the financial figures and try to invest in those companies where they can get regular dividends, high earnings per share and some other benefits. Similar findings were presented in [10].

Earnings management is a practice widely used by the companies. Companies manipulate their financial figures for many reasons but the items that they manipulate the most, include the balance sheet and income statement items. [16] also suggested the same results. The question arises as to which items of balance sheet or/and income statement they manipulate the most. Being consistent with [20], the current study finds that it entirely depends on the objectives of the businesses to decide as to which type of manipulation would be beneficial for them and after complete analysis, they manipulate figures of financial statements. They may manipulate their current assets, such as inventory or fixed asset or they can go for manipulation of their revenues and expenses.

Depending on the objectives, companies can understate or overstate their financial statements. One of the main reasons for understating or overstating the accounting figures is to follow some incentives and tax saving has been the most important among these incentives. This finding is consistent with [14]. Apart from tax savings, companies also intend towards earnings management for personal benefits like bonuses, commission and other benefits. Different studies have also proved this fact. For example, [22] find performance-based compensations as the main cause of motivation towards earnings management. [5] also supported similar findings. Secondly, companies motivate towards earnings management in order to increase their market share. Market share is the key to show better performance as it is the cause of attraction towards a particular company. As suggested by studies, investors are motivated for investing in a company only if it has high value for market share [11], [33]. Consistent with the literature, some other reasons for motivation towards earnings management are to show better performance and to present a better image in the market [24], to achieve financial targets and to protect themselves from market pressure [2] and last but not the least for high earnings growth.

There are number of entities that are responsible for earnings management but managers of the companies can be considered as an important and responsible entity. Managers are the insiders and being the key persons, they have detailed information about the daily operations of the companies. Also, they usually contain more information as compared to the other insiders and outsiders (asymmetrical information). It is responsibility of the managers to highlight and then stop such illegal activities. But rather than stopping others from manipulating items they usually are involved in such activities. These results are aligned with existing literature [3], [11]. Government is another responsible body for earnings management. Government is the main body of any country and it is the duty of government to take actions against companies which are involved in earnings management. But unfortunately, government does not take actions against companies and shows negligence. It has made some rules and regulations for the companies but there is no strict policy for implementation of these rules and their compliance to the companies. No support is found from literature for this finding. Apart from the discussed bodies, auditors can also play role in motivating companies towards earnings management. They have the authority to report against companies for such unethical and illegal activities but they sometimes failed to do so because of high pressures from top authorities and sometimes they willingly do not take interest in reporting actual figures for some personal benefits which are attached in reporting fake performance of the companies. [31] proved the fact that high pressures do not let them move further and they fail to report true picture. However; no support is found for fake reporting in order to get some personal benefits. Other responsible entities are ‘board’ and ‘owners’. Because of high involvement of managers in the boards, the board members are not able to take independent decision because they have to follow the directions provided by the managers. Similar results were presented by [34]. As far as owners are concern, they are also the cause of motivating employees and some managers to manipulate figures. They are the persons who set high targets for employees of the companies without thinking that those targets are unachievable. If goals are not SMART it will automatically motivate employees to manipulate in order to get benefits and to stay in the business. This fact was also proved by [33].

6. Conclusions

As there are many causes for earnings management and most of the companies are involved in these activities that severely need to be controlled. Foremost remedial action for controlling earnings management suggested by this study is improving reporting quality of the financial statement. Many researchers have suggested this as an important measure for controlling earnings management. Reporting quality can be improved by having proper check and balance. This check and balance can be from government level, from Security and Exchange Commission of Pakistan (SECP) and from auditors. High authorities have tendency to control such activities through proper check and balance. Government and SECP can check whether the rules and regulations set for the companies are being implemented properly or not and auditors can check whether companies are presenting their true picture to the outsiders or not. Another important measure is to form independent audit teams who can make fair decision about the company’s position without having pressure from higher authorities. Additionally, the involvement of managers in the board should be reduced. The independence of auditor committee and board has also been suggested by many researchers. This kind of independence will ultimately cause less agency problems. One measure can improve the tax collection system. Every individual should be bound to pay his/ her tax without considering his/ her status. Because it is a general practice that rich persons or parties are free from taxes and all taxes are being paid by the middle- or lower-class individuals. After tax collection, it must be equally distributed as the purpose of collecting tax is to provide benefits to the have-nots in the society. Moreover, some facilities should also be provided to the tax payers by the government for their motivation to willingly paying taxes.

7. Limitations and Future Research

Small sample size, time consuming semi-structured interviews, limited number of groups of interviewees, non-availability of the experienced respondents and financial constraints in a qualitative study are a few leading limitations. Therefore, results of the study cannot be generalized.

The limitations may include researcher’s bias to an extent, lack of comfort level for some of the respondents with the audio recording. Efforts were made to overcome such limitations by takings notes and transcribing the recorded verbatim while analyzing the results. Future studies can include more groups to get some new insights regarding causes and controlling measures for earnings management. Subject to financial and time constraints, number of interviews can be extended for an in-depth understanding of the phenomena related to the earnings management.

Findings, in terms of contribution of the current study, have singled out government and auditors as entities, in addition to managers and owners which are responsible for earnings management. Empirical studies can be conducted in search of more scientific reasons associated with these new entities which are responsible for earnings management and the reasons behind supporting the earnings management. The studies can also be extended over different sectors of the economy of Pakistan for deep understanding of earnings management as multiple sectoral comparison was beyond the scope of this study.

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Appendix

Interview Guide

A. General

1. Do you think accounting financial statements are important?
2. Why financial statements are so important?
3. How do you perceive the earnings figure in the income statement?
4. Is there a relation between a company's earnings and its stock price?

B. Causes and Motivations

5. Do you think publicly listed companies or private companies on the Karachi Stock Exchange use earnings management?
6. If yes:

a) What would be the rough estimate of the percentage of public and private companies using earning management techniques?

b) What are some factors that motivate companies to use it?

C. Responsibility

7. Who do you think is responsible for applying earnings management?
8. What items do you think are being used to manage earnings?
9. Is there a difference across different sectors regarding the probable application of earnings

management?

management?

D. Remedial Actions

10. What actions do you think should be taken, and by whom, to reduce the probability of earnings management?

E. Further Questions

11. Anything else you would like to share about earnings management?