IJCRT.ORG ISSN : 2320-2882

INTERNATIONAL JOURNAL OF CREATIVE RESEARCH THOUGHTS (IJCRT)

An International Open Access, Peer-reviewed, Refereed Journal

Perspective Towards Earnings Management Practices in India

Shaily Nihalani, Abhay Kesharwani
Undergraduate student, Symbiosis Centre for Management Studies,
Pune, India

Executive Summary

Accounting and Finance takes up a major sector as contributors to our economy. Financial positions are one of the key indicators to judge the performance of a company. Earnings management as a concept focuses upon enabling these companies to manipulate their financial position to put a better picture towards every individual and institution connected to them. There currently exists lesser-known clarity regarding the meaning and application of earnings management along with lack of transparency with the potential investors. There have been incidents wherein these practices have been out resulting in harsh consequences to these companies and their goodwill. This research paper highlights the same situation and throws light upon the level of understanding individuals have regarding the meaning, techniques, benefits, and usage of earnings management to put a better picture out there.

Keywords: Earnings, management, practices, ethical, accounting

1. Introduction

The most important query addressed via the means of this paper is whether equity-primarily based total reimbursement executives govern earnings. In addition, the paper also studies the function of the governance device in curtailing such wealth-pushed opportunistic behavior. The use of equity-related reimbursement has been dramatically elevated during the last many years to hyperlink the managers' non-public incentives with shareholders' interests.

1.1 The Beginning of Earnings Management

Jensen and Murphy (1990b) imply that CEOs are not that motivated to maximize shareholders' fee because of their low possession stakes of their corporations. These effects hastened Indian corporations toward growing adoption of fairness-connected repayment that ended in a widespread boom in executives' holdings of fairness throughout the duration of 1990s. This good-sized boom in fairness-connected repayment and inventory possession is evidenced through Hall and Murphy who record that normal inventory and choice holdings of S&P 500 executives accelerated from $eleven million in 2002 to greater than $31 million through 1999.

After the 1997 Asian financial crisis, the research on earnings management gained special momentum. The Real concern in this regard is that the collapse of the giant occurred in 2002. The collapse of the energy giant Enron exposed the devastating consequences of ignoring profit management. The 2008 global recession further demonstrated the importance of understanding for profit management and its consequences. Due to bad corporate governance practices, 4,444 developing countries must pay more attention to it. India has become a popular destination for foreign investors, which is one of the main reasons why this study is particularly important to India.

1.2 Involvement of Higher Executives

Executives are given variable reimbursement and incentives both thru the regular go with the drift of reimbursement objects which includes salary, bonus, alternatives, and different additives, or thru modifications of their portfolio and alternatives. The great majority of an ordinary CEO's incentives to boom inventory fee result from modifications withinside the cost of his inventory and alternatives portfolio that isn't always with the aid of using go with the drift reimbursement. Equity incentives can be described as "the incentives created with the aid of using fairness securities that encourage managers to boost the inventory fee".

There are contradicting viewpoints concerning fairness reimbursement. On the one hand, in step with the business enterprise principle, fairness reimbursement is taken into consideration as a vital device in aligning executives' incentives with shareholders' pastimes via granting the government a possession stake withinside the company. Supporters of fairness-related reimbursement declare that fairness incentives are wished additives of a government reimbursement scheme that is probably powerful in linking the government's private blessings with shareholders' hobby in a manner that minimizes the hazard of destructive consequences. On the opposite hand, the managerial strength principle considers fairness primarily based on total reimbursement as a manner via which executives can get extra reimbursement without inflicting public anger or what managerial strength theorists call "outrage constraint". The enormous of many poor phenomena which might be associated with fairness reimbursement inclusive of at – the cash options, alternative repricing, reload options, limited inventory in place of options, and executives' freedom to unwind their fairness incentives means that this sort of pay might also additionally cause undesired movements inclusive of income manipulation.

1.3 Viewpoint of company shareholders

Also, regulators and the economic press have raised many issues that fairness-related repayment gives additional motivation to book their private economic blessings through manipulating the accounting consequences. The cap potential to control income comes from the discretion that accounting requirements and the organization GAAP provide to managers while recording the adjustments in company price that are not meditated at once in present-day coin flows. The hole among the company's coins float and the stated earnings is blanketed through the accrual's element of earnings **Bergstresser & Philippon, 2006**. From this perspective, income control may be described because of the practical intervention withinside the outside economic reporting process, with the motive of acquiring a few non-public gains. Some latest research declares that fairness-related repayment gives motivation for executives to govern accounting consequences for private blessings. Despite the significance of this issue, there may be the handiest of a constrained range of empirical research that investigated the connection between fairness incentives and income control. Almost all of that research used Indian facts and the maximum of them used a cross-sectional econometric approach. Therefore, this examination contributes to the literature by analyzing the connection among executives' fairness incentives and income control through the usage of the Indian penal facts set. Firstly, **Conyon and Murphy (2010)** report that the Indian repayment stage and sensitivity decrease. Secondly, CEO duality continues to be a characteristic that offers energy for the Indian company governance system. Moreover, the Indian non-govt administrators get decreased remuneration and shareholdings in comparison to their counterparts, which can also additionally bring about much fewer economic incentives for monitoring. In addition to compelling quoted agencies to put up an in-depth file on administrators' repayment of their annual file, extra unique, this law states that agencies need to preserve a shareholder vote at the administrators' remuneration file at every fashionable meeting, that is called "say on pay".

1.4 Kothari Model

Moreover, opposite to the most of preceding analysis that used the best overall discretionary accruals generated through the changed Jones Model, this consider used the newest discretionary accruals generated through the performance adjusted version as advanced through Kothari et al. (2005). In addition, this looks at used overall accruals generated through the changed Jones version withinside the sensitivity analysis. Kothari et al. (2005) contend that the standard accruals, as measured through every Jones and altered Jones fashions, may also to boot cause extreme size mistakes in ordinary accruals whereas those fashions do not currently manage for the earlier overall performance of the company. Therefore, Kothari et al. (2005) advise a version that consists of associate degree intercept and manage for the firm's overall performance the utilization of the lag of going back on property (ROA) to reduce the tough heteroskedasticity and miss-specification problems with the Jones and altered Jones fashions in scheming accruals. They advise together with the return on the property of the preceding year (ROA) as an additional regression to the cross-sectional changed Jones version. Moreover, Guenther (2014) and Becker, Defond, Jiambalvo, and Subramanyam (2018) advise that management has extra discretion over newest accruals than over long-time amount accruals. Also, Sloan (2016) reviews that a most of the versions in overall discretionary accruals is pushed through newest discretionary accruals. The quality of economic speech in distinctive industries has delivered intensive contests to consumers and regulators, deed humans with many areas for manipulation.

Earnings management is the result of these complexities in money disclosures. Earning management is usually stated because of the deliberate manipulation of to attain a planned goal. numerous accounting techniques, appreciate cookie jars, financial gain smoothing, window decorating, etc., are wont to amendment accounting figures.

Healey and Whalen (2019) gave a definition most frequently cited in revenue management. The definition given by Healey & Whalen is: "The management of earnings occurs when managers use financial reports and judgments in structured transactions to change financial reports, in order to mislead some interested parties to understand the basic performance of economic companies or affect contract results. It depends on the reported accounting figures. "

According to Roychowdhury (2006)", because managers hope to mislead them by leading at least companies' stakeholders, the manipulation of actual activities deviates from normal Business practices. It is believed that certain financial report goals have been achieved during the normal operation of. "

1.5 Involvement of SEBI

SEBI took oversight measures specifically to make stronger regulatory requirements and for this reason, made non-stop enhancements in company governance practices. Article forty-nine must see that in 2006. Research on earnings control could be very critical to regulators. Accurate information can lessen facts asymmetry withinside the capital market, thereby substantially decreasing the fee of capital. Similarly, information on the significance of the prevalence of profit control can assist shield the pastimes of the shareholders.

SEBI performed one of the critical research on profits control in India's environment. SEBI DRG (2013) talked about that in India, the common sales control of non-economic organizations accounted for 2.9% of the full belongings of those organizations.

2. Literature Review

2.1 Introduction to topic

Earnings management has been known as a technique used by companies manipulating or abusing their financial statements. When it comes to distribution of earnings of a company, excess of it is usually used to responsibly get distributed to others as dividends. The funds are otherwise used to invest in other opportunities that might get the company higher returns. Earnings without a doubt stands to be the most important aspect to determine the capacity and performance of a company and is kept in mind by those potentially interested in investing. This as a method of management, only aims at the context of providing the audience a smooth sense of income. **Keisuke Nitta (2006)** in their study described how making such defensive decisions can result in an increase in the shareholders' value due to the manipulations conducted.

Cheng and Leung (2010) in their studies enlightened upon the concept of insider information. This involves the aspect whether the directors or the managers who are the decision makers use it as an advantage to position their firms on a higher level than it is currently in. This practice of earnings management is directed towards portraying a relatively strong image within the potential interested audience while reflecting upon their activities as efficient. This announcement of growth and development indications turn the mindsets of investors to a higher extent helping them increase the company's overall valuations.

A company's decision-making body involves various positions such as the board of directors, Chief Executive Officer, managerial ownership who look after the size, tenure, audit and policies of the company. These characteristics do not directly but indirectly influence upon the decision making of using earnings management practices or not. The audit committee here plays an essential role in being the ones who use their technical skills to moderate upon the manipulations required to be made. The audit committee requires an addition to their working policies irrespective of them outsourcing these services or not. **Nugroho, B. Y., & Eko, P. U. (2012)**

2.2 Corporate Governance

It is the management who takes up the call of using earnings management by using all their discretionary powers. This practice has been on the lower end since there exists a strict system of accountability and transparency of the internal associates of a company along with the external authorities. The practice has gradually increased since the past years with the positive impact it creates on the profitability index of a company. The level of profitability and goodwill created directly increases the chances of an increment in the compensation of these management authorities. Usage of aggressive earnings management is considered purely cosmetic to be used for such purposes. Once there lacks the impact of earnings management in the profitability, there is a direct decline in the vanishment of such compensations. Hence to use this as a beneficial factor, the quality of reports provided while estimating the earnings lack in responsibly acting upon the governance set for corporate standards. ***Tehranian, H., Cornett, M. M., Marcus, A. J., & Saunders, A. (2006)***

2.3 Detection

A company's financial statement without a doubt acts as a significant factor contributing to allowing the external sources to get insights into the company. The practice of earnings management acts as a manipulative factor which hampers the quality of earnings as it puts a false picture in front of others. There lies great importance in understanding a system to detect such practices. Manipulation of such a statement stands to be one of the biggest frauds that can be taken up by the decision makers that has its own limitations aligned with its place. It stands great relevance for the users of these financial statements to understand all the aspects of risks associated with companies using such practices. **Shahzad, A. (2016)**

2.4 India's Situation

India has had a long history of companies involving themselves in manipulating their financial statements. The main reason that has resulted in this situation is the evident lack of strong and strict corporate governing policies to investigate upon such issues. There exists a security exchange commission who have also been inefficient when it comes to identifying such practices and schemes. The independence given to such authority highly lacks the provision for amendments. Examples have already been successful in hampering the level of confidence present in the investors. The relation between the policies and regulations along with the likelihood of companies have provided evidence to identify the misstatement of financial performances in numerous ways.

3. OBJECTIVES OF THE STUDY

The objectives of conducting this research are as follows:

- Testing the level of literacy amongst individuals regarding the concept of earnings management.
- Distinguishing between perspectives regarding it being an ethical or an unethical practice.
- Understanding the level of transparency existing in the system for companies using earnings management.

4. RESEARCH METHODOLOGY

The research design will be structured to get real-time data for understanding the entire current foundational data in depth. The research will be conducted by means of surveying the eligible respondents, primarily focusing on those who have either surface or in-depth knowledge about Earnings Management. A primary list of questions was developed covering all the aspects of our research, such as meaning of earnings management, techniques they are aware of, their views regarding it being ethical, importance and relevance of transparency and application of the practice and knowledge about companies practicing it. A mixture of both quantitative and qualitative data was collected by this survey process, using an online primary medium and data was collected with a sample size of 205 respondents.

The present study is quantitative and exploratory in nature, giving the researchers the flexibility under various categories to analyze and conclude. *Exploratory research* seeks to generate a hypothesis by examining the dataset collected and looking for potential relations between variables. The major advantage of choosing exploratory research as the paper's research type is that it is easier to make new discoveries due to the less stringent methodological restrictions. The research is descriptive and non-scientific, in the sense that it does not seek to develop any novel techniques or procedures, rather it seeks to develop knowledge, based on information that is already available in the public domain and the data set. This research problem is a problem that has not been researched intensively for this age group and country before.

5. DATA ANALYSIS

The online survey consisting of multiple choice and open-ended questions was filled out by 205 individuals working as supervisors, co-workers, businessmen and students. Upon analysis of the data, we were able to find out the following:

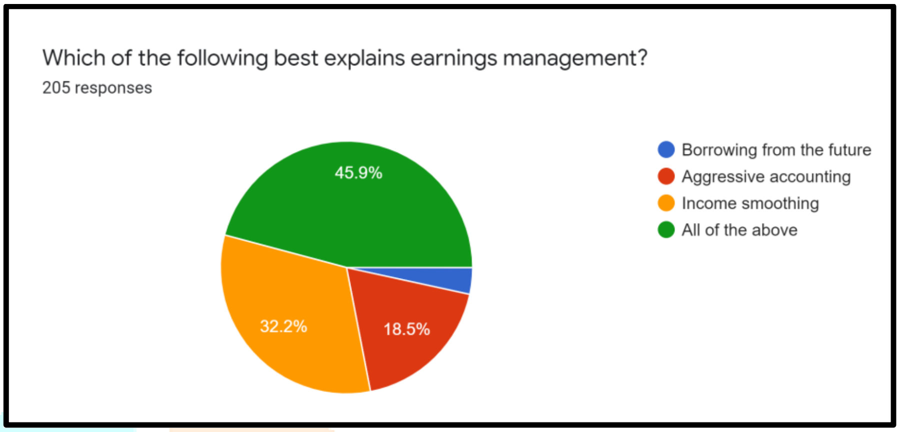

Illustration 1: Graphical representation of statements best explaining the meaning of earnings management.

Respondents were asked about their understanding regarding the concept of Earnings Management. Close to half of the respondents choose all the options to bring the correct explanation to the concept. Approximately 65% of them selected the meaning of earnings management partially correct not being aware about the other aspects. Approximately only half of the entire sample size was able to understand the meaning of this concept from the borrowing from the future perspective application which includes using future reserves into borrowing in present.

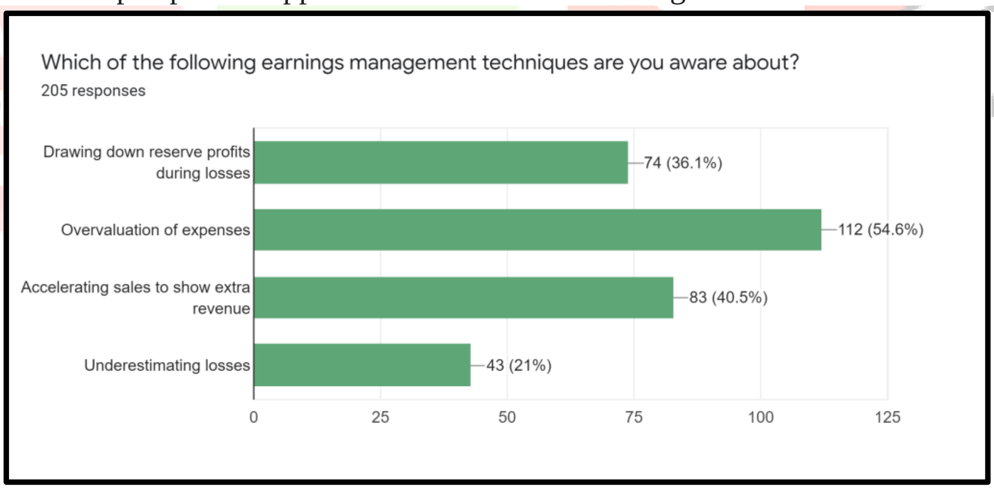

Illustration 2: Graphical representation of techniques used for earnings management

Earnings management involves numerous techniques which can be used to manipulate the accounting and financial position of a company. Majority of the respondents rightly had knowledge about companies overvaluing the expenses to influence their performance. 36-40% of them also were aware about the usage of reserves during losses and acceleration of sales in order to put up a brighter side of the earnings and profit in a given financial year.

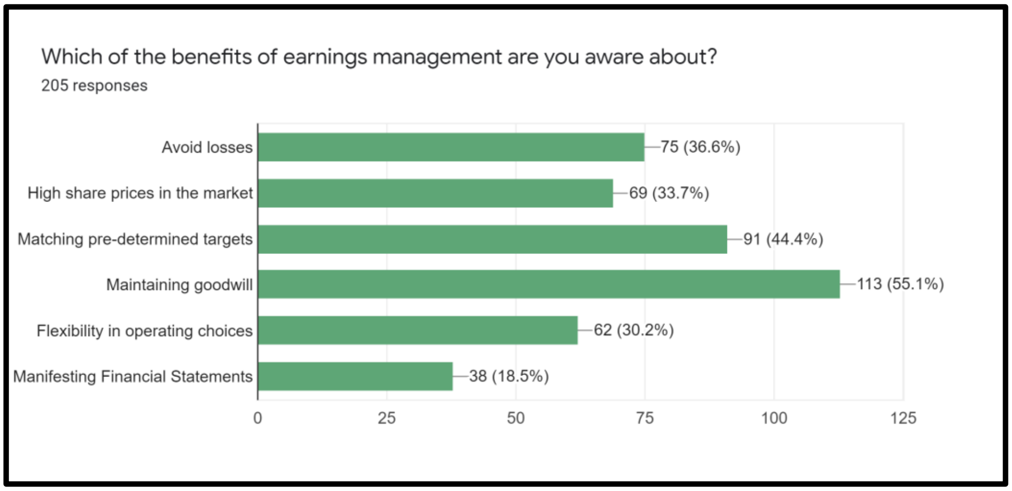

Illustration 3: Graphical representation of awareness regarding benefits of earnings management

Companies have numerous objectives in their mind while practicing earnings management. In our test, we asked the respondents to choose the benefits of earnings management they are aware of. With majority of 55% response, most of them knew that companies follow this practice to maintain their goodwill in the market to be at par with their competitors, it being the most influential intangible asset. 44.4% of the respondents also understood that the companies apply these techniques to be at par with the targets they have set for that particular financial year. Manifesting financial statements was the least known benefit known only to 18.5% of the respondents.

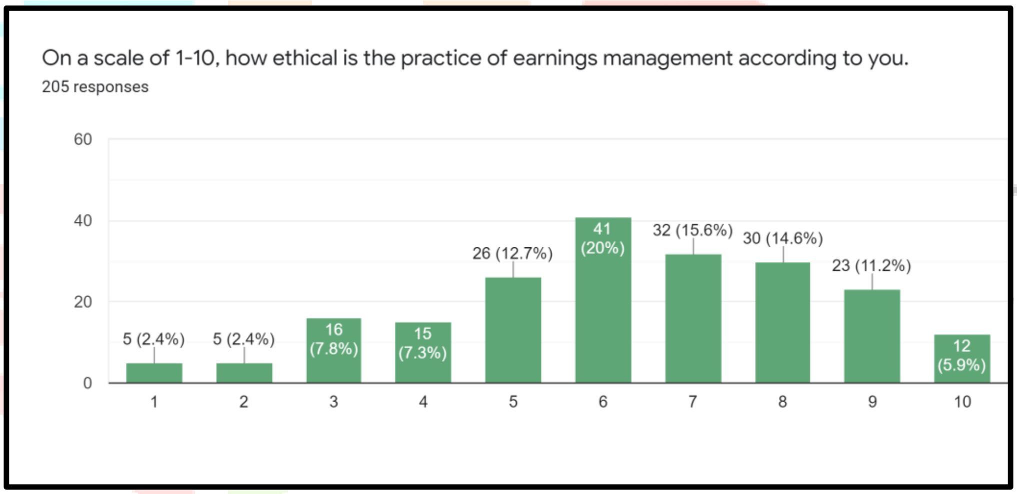

Illustration 4: Graphical representation of opinion regarding earnings management being ethical or unethical.

Ethical practices taken up by companies are what helps them build on their goodwill. Earnings management involves using an abusive technique of manipulating the financial statements of a company. We asked our respondents whether they find the practice of earnings management to be ethical or not. The range of all the responses show that most of the score selected lies in 6-8.

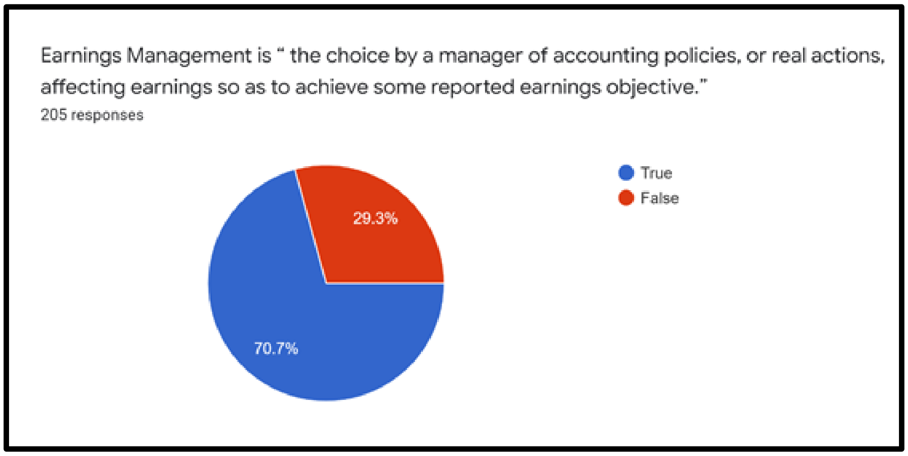

Illustration 5: Graphical representation of earnings management being a choice by a manager.

Managers are supposed to be the key decision makers in choosing the right practices for the betterment for their organization. Earnings management is one such practice which is taken up by them. 70.7% of the respondents have a belief that it is true that earnings management is the choice by a manager to affect earnings to achieve some reported earnings objective. 29.3% were not inclined towards it as they feel managers do not do it intentionally but there are other factors too. While the majority seemed to portray an inclination towards the managers manipulating finances to achieve earnings objectives, the existing workforce seemed to have a different outlook about it.

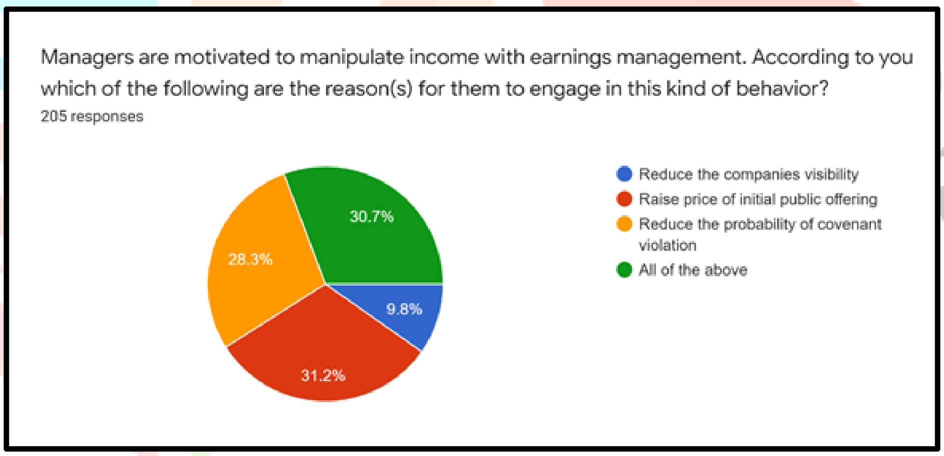

Illustration 6: Graphical representation of reasons behind engagement in earnings management.

Making a decision of using earnings management techniques is a critical one as it has various risks and consequences associated with it. When asked the reasons that could engage the managers to manipulate income with earnings management, 31.2% responded that managers do it raise price of initial public offering, 28.3% respondents selected reduce the probability of covenant violation, 9.8% selected that manager did it to reduce the company's visibility and remarkably 30.7% respondents chose all the above. From this question it can clearly be seen that the people are clearly aware about who managers get motivated to manipulate income with earnings management.

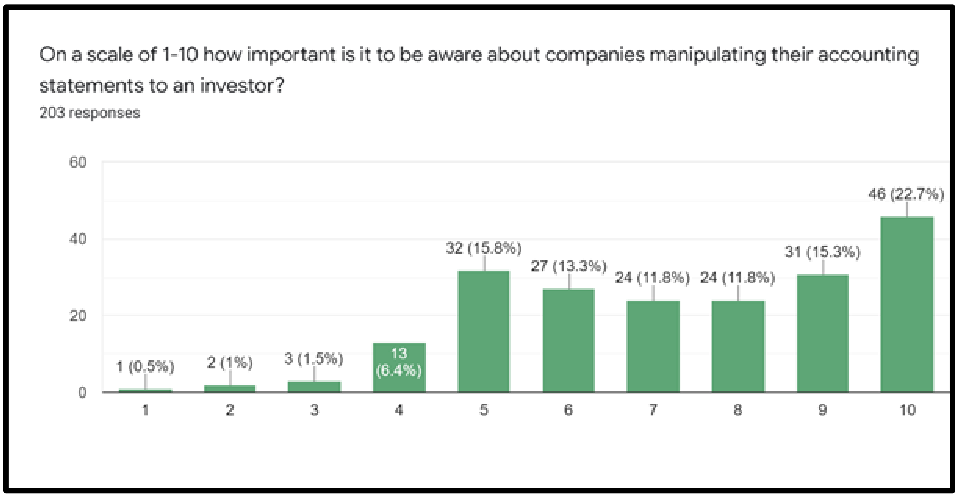

Illustration 7: Graphical representation of the importance of being aware about companies indulging in earnings management.

Consumers, investors, and official authorities often tend to look up the financial statements of a company to invest their interests and resources. It is of high importance to understand what the respondents think about the relevance of awareness regarding these practices. From this question one could actually figure out how aware people are when it comes to earnings management. With 46 people that is 22.7% chose 10 that is the max range one could choose; this shows that most of the individuals are aware about how companies manipulate accounting statements in front of investors. 15.8% also chose 5 on the scale which shows some of the people still consider that some companies do it and some necessarily do not.

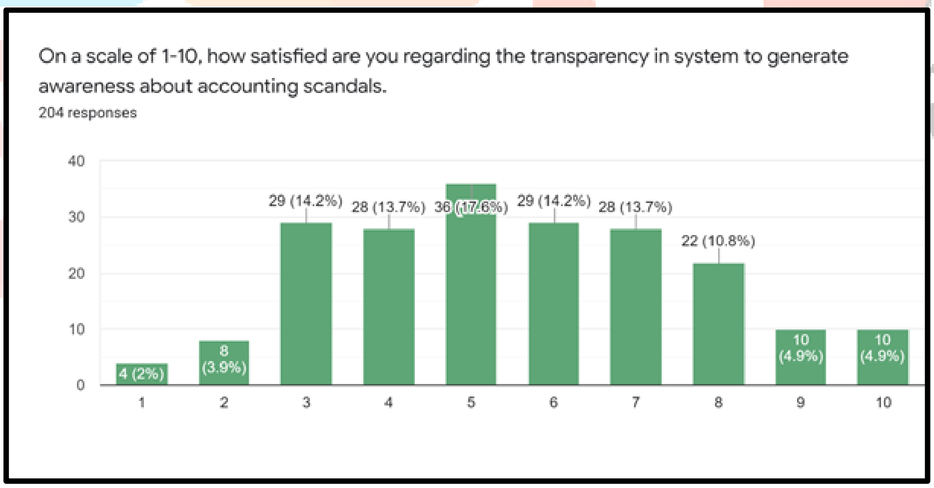

Illustration 8: Graphical representation of satisfaction regarding the transparency of earning management practices in the country.

Companies which use earning management practices often try to manipulate the information which reaches out to others and prevent others from being aware. Due to this there is absence of transparency in the economy with minimum awareness regarding the companies that have used earnings management. Regarding the transparency in the system to generate awareness about accounting scandals, the majority of people choose from 3 to 8 which shows how people are not clear about suitable ranking to be given on the scale. 17.6% responded to 5 on the scale, this showed people felt there is transparency in the system but at the same time had an opinion that it can be better.

The last question in the test was to check the transparency maintained by the companies who have had incidents of applying earnings management practices. Satyam computer services was chosen 80 times (39%) being the most popular amongst all of them. 36.6% chose Enron, 33.7% chose American international group, 32.2% chose Xerox and I feel Xerox was also in the news recently so people could recollect about it, 23.9% chose Worldcom. 24.9% of the people chose none of the above which clearly shows that they are unaware about the scandals that take place in earnings management as these big companies tend to hide and pressurize to not let these scandals go public in fear of negative publicity.

6. FINDINGS

Manipulation of companies accounting, and financial statements is a very subjective concept when it comes to ethical practices. The world and India to be specific has noticed incidents of companies following such techniques to verify their market share. Other studies conducted on this topic previously have witnessed upon the investigation of discretionary accruals. Unlike these, what remains an untouched aspect is to understand if people of this country are aware about the existence of such practices. This study focused upon understanding the level of literacy amongst individuals to interpret and state upon the usefulness of such information to make wise decisions and choices may it be as consumers, investors, institutions or as a system in this economy.

Earnings management has been a buzz word recently, but empirical studies in India have not been to a great extent. A typical scenario which builds upon the implementation of earnings management techniques is a brief history of growth and goodwill by a company. Once in case of uncertainty for the company to continue earning the same value, they get instigated towards using such practices to overestimate their performance. Whether these are harmful or because of industry trends, we cannot comment on that. But the extreme values have been surprising.

The research conducted by us was primarily focused upon understanding whether or not individuals realize the influence of earnings management in the companies they trust the most. Majority of the respondents surveyed during the research were partially known to the concept before. They had partial information rather than having a clear-cut idea to distinguish between the consequences of such techniques.

From the search it was observed that there still exists a sense of doubt within individuals regarding the technical understanding of such a subject. Earnings management stands a great relevance to be taken up as a point of discussion openly may it be in our education system, our business world or in generic agendas. With this improvement and alertness in the minds of potential investors, there will be more efficiency when it comes to building a relationship with the company.

The corporate governance practices of these industries need to be studied. Most important contribution of this study is the presence of earnings management on such a massive scale. Even though many stringent norms have been laid down, the corporates are still engaging in earning management which is a serious concern. The patterns of earnings management at FMCG and MNCs sector need special attention because of unusual trends in these sectors. Hence this research releases the relevance to investigate such aspects and create a new system of accountability and transparency within the economy to make it an impactful factor.

From a perspective of detectors, this research helped understand that the respondents have a patchy perspective when it comes to finding earnings management to be ethical or not. Considering a situation to be ethical or unethical is very subjective as it differs from person to person. Distorting and misleading users of such financial information is a significant ethical concern in spite of this major chunk of respondents found the concept to be ethical. This suggests the lack of in depth thought process and consequences that occur due to negligence of publicity of companies using it.

7. CONCLUSION and SCOPE

Earnings management stands a great chance in defining the imbursement of ethical practices by companies to create a level of trust and credibility towards their quality of performance. This research provided an overview towards existence of knowledge but partial towards the dynamic dimensions of earnings management may it be meaning, techniques or implementation without knowledge. There exists a great scope of experts in this field to target such a lesser known issue and address the same to concerned investors while enabling them to learn more. Earnings management is subject to concerns of only those who act as professionals in this accounting field. Irrespective of this, it should be noted that such practitioners should be brought out to public notice and adequate reforms need to be framed while auditing, investigating, and code of conduct of such companies. There have been examples of companies using earnings management in the past and absence of an accountability system encourages others to continue such practices. An aspect of this research can further be explored by understanding the existence of a legal framework around this concept.

8. REFERENCES

- Agrawal, A., & Chadha, S. (2005). Corporate governance and accounting scandals. The Journal of Law and Economics, 48(2), 371-406.
- Baber, W. R., & Fairfield, P. M. 1991, „The Effect of Concern about Reported Income on Discretionary Spending Decisions: The Case of Research and Development", Accounting Review, vol.66, no.4, pp.818-829.
- Ball, R., & Shivakumar, L. 2008, „Earnings Quality at Initial Public Offerings", Journal of Accounting and Economics, vol.45, no. 2-3, pp. 324-349.
- Beaver, W., & Engel, E. E. 1996, „Discretionary Behaviour With Respect to Allowances for Loan Losses and the Behaviour of Security Prices", Journal of Accounting and Economics, vol.22, no.1-3, pp.177-206
- Beneish, M. D. (2001). Earnings management: A perspective. Managerial Finance.
- Dechow, P. M., and Skinner, D. J. 2000, „Earnings Management: Reconciling the Views of Accounting Academics, Practitioners, and Regulators", Accounting Horizons, vol.14, no. 2, pp.235-250.
- Dechow, P. M., Hutton, A. P., Kim, J. H., & Sloan, R. G. (2012). Detecting earnings management: A new approach. Journal of accounting research, 50(2), 275-334.
- Dechow, P. M., Sloan, R. G., & Sweeney, A. P. (1995). Detecting earnings management. Accounting review, 193-225.
- Degeorge, F., J.M. Patell, and R. Zeckhauser, 1999, „Earnings management to exceed thresholds", Journal of Business, vol. 72, no.1, pp. 1-33.
- Degeorge, F., J.M. Patell, and R. Zeckhauser, 2009, „Earnings management to exceed thresholds", Journal of Business, vol. 72, no.1, pp. 1-33.
- Gaver, J., Gaver, K. M., and Austin, J. R. 1995, „Additional Evidence on Bonus Plans and Income Management", Journal of Accounting and Economics, vol.19, no. 1, pp.3-28
- Guidry, F., J. Leone, A., & Rock, S. 1999, „Earnings-based Bonus Plans and Earnings Management by Business-unit managers", Journal of Accounting and Economics, vol.26. no.1-3, pp.113-142
- Hagerman, R., & Zmijewsik, M. 1979, „Some Economic Determinants of Accounting Policy Choice".

- Hagerman, R., & Zmijewski, M. 1979, „Some Economic Determinants of Accounting Policy Choice‟, Journal of Accounting and Economics, vol. 1, no. 2, pp.141-161.
- Haider, J., Ali, A., & Sadiq, T. (2012). Earning management and dividend policy: Empirical evidence from Pakistani listed companies. European Journal of Business and Management, 4(1), 83-90
- Healy, P. M. 1985, „The Effect of Bonus Schemes on Accounting Decisions‟, Journal of Accounting and Economics, vol.7, no.1-3, pp. 85-107.
- Kasznik, R., 1999, „On the association between voluntary disclosure and earnings management‟. Journal of Accounting Research, vol. 37, no.1, pp. 57-81.
- McNichols, M. 2000, „Research Design Issues in Earnings Management Studies‟, Journal of Accounting and Public Policy, vol.19, no.4-5, pp.313- 345.
- Nugroho, B. Y., & Eko, P. U. (2012). Board characteristics and earning management. BISNIS & BIROKRASI: Jurnal Ilmu Administrasi Dan Organisasi, 18(1)
- Peasnell, K. V., P.F. Pope, and S. Young, 2000. „Detecting earnings management using cross-sectional abnormal accruals models‟. Accounting & Business Research, vol. 30, no.4, pp. 313-326.
- Petroni, K. R. 1992, „Optimistic Reporting in the Property- casualty Insurance Industry‟, Journal of Accounting and Economics, vol.15, no.4, pp.485-508.
- Ronen, J., & Yaari, V. (2015). Earnings management: Implications and controversies (pp. 274-360). Routledge.
- Roychowdhury, S. (2006). Earnings management through real activities manipulation. Journal of accounting and economics, 42(3), 335-370.
- Shahzad, A. (2016). Detecting earning management and earning manipulation in BRIC countries; a panel data analysis for post global financial crisis period. International Journal of Accounting Research, 4(1), 1-10.
- Tehranian, H., Cornett, M. M., Marcus, A. J., & Saunders, A. (2006). Earnings management, corporate governance, and true financial performance. Corporate Governance, and True Financial Performance (January 2006)