

An Assessment of the Efficacy of Corporate Governance in Regulating Earnings Manipulation

Zain Jawad

Department of Management Sciences International Islamic University, Islamabad [at-
zain8956@gmail.com](mailto:zain8956@gmail.com)

Zolain khan

Department of Management Sciences International Islamic University, Islamabad [at-
khanzolain@gmail.com](mailto:khanzolain@gmail.com)

Abstract

The primary objective of annual reports is to provide an accurate evaluation of a company's financial condition; yet, managers may experience pressure to manipulate data in order to achieve or surpass projections. Diverse incentives can manifest in several forms, including as bond covenants, stock prices, and incentives specifically designed for management. This study examines three specific elements of corporate governance and their ability to reduce the use of profit manipulation strategies. This group encompasses the characteristics of the board of directors, audit committee, and ownership structure. The researchers examined data from 120 non-banking companies registered on the Karachi Stock Exchange between 2003 and 2012. The study found a negative association between the autonomy of the audit committee and the manipulation of earnings. Nevertheless, the presence of a dual CEO who simultaneously holds shares in the company on behalf of institutional investors is strongly correlated with the act of artificially inflating outcomes. Organizations experiencing rapid growth and those with moderate growth have distinct requirements regarding the effectiveness of governance structures in regulating profit management strategies.

Introduction

Under the International Financial Reporting Standards (IFRS), firm managers possess a greater degree of flexibility in selecting from a range of different accounting techniques. These behaviours can exert various impacts on a company's declared profitability. Managers have a tendency, as per Islam, Ali, and Ahmad (2011), to favour accounting judgements that result in financial benefits for themselves. González and García-Meca (2014) discovered that inadequate governance indicators can give rise to opportunistic conduct, resulting in diminished quality of profits and reduced investor trust in financial reporting. Earnings management refers to the strategic manipulation of accounting processes to create financial reports that present an excessively favourable depiction of an organization's business activities and financial condition. Earnings management encompasses alterations in the projected quantity of impaired assets, the level of bad debts written off, the reported amount of inventories, the anticipated useful life of long-term assets, and the predicted expenses of post-employment benefits and warranties (McKee, 2005). Prior research has demonstrated that strong governance is essential for overseeing managerial activities.

This is because it helps to decrease agency costs by matching the interests of management and ownership. Multiple studies have been conducted to assess the influence of corporate governance on the manipulation of earnings. These studies have discovered that strong governance can successfully deter managers from participating in earnings manipulation practices. The investigations conducted by Jiang, Lee, and Anandarajan (2008), Dimitropoulos and Asteriou (2010), Alzoubi and Selamat (2012), and González and García-Meca (2014) are included. The impetus for this investigation arises from two separate origins. Commencing with the initial point, investment or capital holds utmost importance for a burgeoning economy such as Pakistan, which exhibits a domestic saving rate of merely 13.5% of GDP. This is inadequate to guarantee an annual economic growth rate of at least 7-8 percent. Pakistan exemplifies a rising economy. Another point is that the investing environment in the country is unattractive, as enterprises engaged in profits manipulation are more prone to disseminating misleading information in the market. Consequently, investors are compelled to make choices about sales or acquisitions that lead to financial losses, ultimately eroding their confidence. Companies must cultivate an enticing investment environment and exemplary governance, enhance overall transparency, and eradicate information asymmetry to attract additional capital and bolster investor confidence. This enhances the likelihood of investors engaging in the company. Considering this, the primary objective of the study is to evaluate the effectiveness of corporate governance measures in restricting earnings manipulation. In order to achieve this, we will examine eight mechanisms of this nature, which will be categorised into three groups: (i) the characteristics of the board committee, (ii) the attributes of the audit committee, and (iii) the structure of ownership. Our second objective is to ascertain if there is a differentiation between high-growth and low-growth firms regarding the impact of corporate governance on limits in managing earnings. This builds upon the thesis made by Bowen, Rajgopal, and Venkatachalam (2008) that high-growth companies are punished by the market when they experience negative earnings surprises. This situation suggests that there is a compelling need for high-growth companies to exceed profit projections, either to maintain funding or to avoid incurring larger capital expenses. In addition, Cohen, Krishnamoorthy, and Wright (2004) propose that the influence of governance models differs depending on a company's capacity for growth. This study contributes to the existing body of literature in multiple ways. To begin with, this study expands the limited research undertaken in Pakistan on the correlation between corporate governance and earnings management. It provides a comprehensive and detailed depiction of this relationship. Furthermore, it conducts an examination of actual data regarding variations in growth within this correlation, a task that has not been previously undertaken. The theories we provide are grounded in the extensive literature review outlined in Section 2 of this study. Section 3 provides an analysis of the factors, sample, and data sources utilised. Furthermore, it provides a detailed account of the study's methodology and the econometric model that will be assessed. The fourth portion presents the empirical findings, while the fifth section provides the study's conclusion.

Literature Review

Earnings management, as defined by Healy and Wahlen (1999), refers to the strategic utilisation of managerial discretion in arranging transactions in order to influence financial reporting. This might be done either to deceive stakeholders on the company's performance or to benefit from an accounting-driven contractual outcome. Consequently, managers have the liberty to create their own economic predictions, which are then included in the financial reports of the organisation. This category encompasses the residual value and projected lifespan of durable assets, deferred tax liabilities, asset depreciation, uncollectible debt expenses, and post-employment perks. The choice of appropriate inventory costing accounting methods, such as last-in-first-out (LIFO), first-in-first-out (FIFO), and average cost, is influenced by the discretion of managers. These attributes can significantly influence accounting results in various economic contexts. Moreover, certain attributes like accelerated depreciation or the straight-line method can impact the process of documenting transactions. According to Waweru and Riro (2013), managers should use discretion when it comes to managing working capital. This includes making decisions about receivables policy, scheduling inventory purchases, and determining inventory levels. These considerations have an impact on both net revenues and cost allocations. Earnings management involves the strategic manipulation of accounting decisions to either inflate or deflate reported income. For instance, in certain situations, shareholders and managers may mutually decide that manipulating results is advantageous and select for accounting strategies that lead to a reduction in income, thereby evading costs associated with political or regulatory matters (Peasnell, Pope, & Young, 2005). Moral hazard occurs when there is a divergence between the interests of shareholders and management. Almlia (2009) asserts that agency theory is a crucial concept for comprehending the motivations associated with financial reporting. Agency theory posits that managers, when confronted with information imbalances, will opt for a series of choices that optimise their own utility. Corporate governance, in its most comprehensive definition, encompasses the regulations, guidelines, or legislation that oversee the strategic management of a firm. These measures are designed to uphold accountability, transparency, and fairness in the organization's dealings with all parties involved. After a number of well-known instances of corporate corruption (such as Standard & Poor's in 2003), most of which were connected to manipulating earnings, the idea of corporate governance gained significant attention. Corporate governance is supported by several concepts such as the agency theory, stakeholder theory, and stewardship theory. Among these, agency theory has emerged as the most influential. According to this concept, managers will only pursue strategies that benefit themselves and will not take action to improve shareholder value unless there is a proper governance framework in place to protect shareholder interests (Jensen & Meckling, 1976). Corporate governance regulations advocate for the principles of boardroom autonomy and equitable distribution of authority. These standards additionally aim to uphold shareholder rights, acknowledge the significance of transparency and disclosure, and safeguard such rights. Jiang et al. (2008) found that better levels of corporate governance are linked to reduced discretionary accruals, which are sometimes referred to as earnings management, and improved profitability. They contend that the

implementation of corporate governance is essential for enhancing financial reporting. Additionally, they assert that there is a positive correlation between elevated levels of corporate governance and superior earnings quality. The board of directors is the primary governing body of any organisation, and its composition significantly influences the accuracy and quality of the reported outcomes. Dimitropoulos and Asteriou (2010) demonstrated a favourable correlation between the informativeness of annual accounting earnings and the presence of independent directors on the board of directors. Alzoubi and Selamat (2012) argue that a board consisting mainly of external directors is more suitable for the task of overseeing and supervising the administration of a company. Consequently, the inherent conflict of interest that arises within every organisation, known as the agency problem, is diminished, leading to an enhancement in the standard of financial reporting. Based on the current body of literature, our initial hypothesis (H1) posits that there is an inverse correlation between board independence and earnings management. According to Jensen (1993), CEO duality, where the CEO also holds the position of board chairperson, enables corporate management to function in a more adaptable environment. This is due to the CEO's authority to regulate the information accessibility of other directors. Davidson, Jiraporn, Kim, and Nemec (2004) found that CEO duality enhances the CEO's influence on the perception created by the company's financial reporting. This leads to a greater concentration of authority in the role of the CEO, as well as an increase in management autonomy. Our second hypothesis (H2) suggests that there is a positive correlation between CEO dualism and earnings management. Furthermore, the dimensions of the board have a substantial influence on its capacity to supervise. According to Jensen (1993), a smaller board is more appropriate for overseeing and regulating the CEO's behaviour. This is because a larger board may prioritise etiquette, thereby causing a diversion of attention from their monitoring duties. In their study, Abbott, Parker, and Peters (2004) discovered that boards with fewer members have a higher level of efficient communication and a reduced number of misconceptions. In addition, smaller boards exhibit greater sensitivity to factors that impact investor confidence, especially in the realm of financial reporting, and are thus less inclined to engage in earnings manipulation. Now, let's consider our third hypothesis (H3), which states that there is a direct correlation between the size of the board and the practice of profit management. Board meetings offer a platform to deliberate on matters pertaining to the organisation. Chen, Firth, Gao, and Rui (2006) found that conducting regular board meetings decreases the probability of fraudulent activities. The directors' regular meetings facilitate the identification and resolution of possible challenges. Considering this, we anticipate a detrimental correlation between board meetings and profits manipulation. Our fourth hypothesis (H4) posits a negative correlation between the number of board meetings and earnings management. In order to fulfil their supervisory responsibilities, audit committees must maintain their independence. The research conducted by Klein (2002) demonstrates a clear inverse relationship between the independence of audit committees and the practice of earnings management. In 2012, Alzoubi and Selamat released a study, along with Mansor and Che-Ahmad. In their study, Ahmad-Zaluki and Osman (2013) determined that audit

committees with a larger size and greater independence exhibited superior performance as oversight boards. According on the research findings, we suggest the following fifth and sixth hypotheses:

- Hypothesis 5: There is a negative correlation between the size of the audit committee and earnings management.
- Hypothesis 6 posits a negative correlation between the autonomy of the audit committee and the manipulation of earnings.

As ownership structure is a powerful tool for governance, one of our objectives is to assess how insider and institutional shareholding affects earnings management. Cornett, Marcus, Saunders, and Tehranian (2006) suggest that insider shareholders may engage in earnings manipulation to enhance the company's perceived performance and their own personal wealth. Presumably, this strategy is employed to entice potential investors and divest existing shareholdings. Beneish and Vargus (2002) found a positive association between periods of inflated profitability and an increase in insider selling of shares. Managers who are concerned about maintaining their ownership position in the company become more attentive to its actual performance. Managers may engage in earnings management if they are driven by political or regulatory consequences. For instance, according to Klein (2002), managers who are under tax-oriented reporting regimes are motivated to manipulate employees' profits. The study project's seventh hypothesis (H7) posits a positive correlation between insider ownership and earnings management. Hartzell and Starks (2003) established that institutional investors have the power to prevent management from engaging in self-serving activities. This conclusion suggests that there should be a detrimental correlation between management and earnings management. Nonetheless, there exists an additional set of evidence indicating that institutional investors are "transient investors" that prioritise short-term profits and exert influence on management to achieve sustained higher profitability (Bushee, 1998). Cornett et al. (2006) demonstrate that in order to achieve these profit goals, management may engage in earnings manipulation. The eighth hypothesis (H8) suggests a direct correlation between earnings management and institutional ownership, indicating that higher levels of institutional ownership are likely to be associated with more earnings management. The aforementioned conclusion is derived from an ongoing discourse.

Methodology

The sample consists of 120 non-financial companies that were listed on the Karachi Stock Exchange (KSE) between 2003 to 2012. The sample only consisted of companies that had data available for a minimum of three years. Exclusion of any other companies was observed. The ownership structure details were derived exclusively from the shareholding patterns disclosed in the financial filings of the companies. The data on the board of directors' size, the audit committee's size, and the number of dual CEOs was acquired from the company profiles. We acquired knowledge on the members of the audit committee and the autonomy of the board

through the statement of compliance provided by each company. The director's report was employed in every instance to gather information regarding board sessions. Ultimately, the share values were acquired from the KSE website. Accruals in accounting are based on the principle that expenses and expenditures, as well as benefits and revenues, should be treated as separate entities. Net income can be considered as an alteration to operational cash flow due to temporary elements called accruals (Abed, Al- Attar, & Suwaidan, 2012). Dechow, Sloan, and Sweeney (1996) contended that accruals exhibit a higher level of responsiveness to managerial choice compared to cash flows. Peasnell et al. (2005) and Islam et al. (2011) commonly employ discretionary accruals as an indicator of earnings management. Discretionary accruals refer to the discrepancy between the sum of total accruals and the accruals that are not subject to discretion. Accruals in accounting are based on the principle that expenses and expenditures, as well as benefits and revenues, should be treated as separate entities. Net income can be considered as an alteration to operational cash flow due to temporary elements called accruals (Abed, Al- Attar, & Suwaidan, 2012). Dechow, Sloan, and Sweeney (1996) contended that accruals exhibit a higher level of responsiveness to managerial choice compared to cash flows. Peasnell et al. (2005) and Islam et al. (2011) are two studies that commonly employ discretionary accruals as a substitute for earnings management. Discretionary accruals refer to the discrepancy between the overall accruals and the accruals that are not subject to discretion. The objective of this study is to examine the influence of eight different corporate governance systems on limitations imposed on earnings management. The control factors being investigated include leverage, CEO remuneration, and business size. In order to ascertain the correlation between accountability approaches and earnings management, we construct the subsequent regression model: The term "IBOARD" denotes the level of autonomy possessed by a board, as quantified by the presence of independent directors. The binary variable referred to as CEO duality takes on a value of 1 when the CEO simultaneously holds the position of board chairman, and 0 otherwise. The SBOARD ratio quantifies the dimensions of a board by assessing the number of board directors it comprises. It denotes the logarithm to the base e of the total number of board meetings conducted throughout the year. The acronym SAC refers to the quantity of individuals serving on an audit committee. The independence of the audit committee is demonstrated by the Independent Audit Committee (IAC), which is decided by the proportion of nonexecutive directors that are members of the committee. Insider ownership, or POI, is determined by computing the percentage of a company's equity held by its directors and managers. POINST is the acronym used to refer to institutional ownership. Based on the proportion of ownership held by institutional investors. The book value of debt is apportioned based on the company's market value, determined by summing long-term debt, short-term debt, and the equity's market value. Subsequently, leverage is determined by dividing this numerical number by the market capitalization of the company. The acronym COMP represents the CEO pay, specifically the natural logarithm of the total remuneration awarded to the CEO throughout the year. The company's size, denoted by the abbreviation LASSET, is determined by computing the natural logarithm of its total assets.

Result and Discussion

Table 1 displays the estimation outcomes for the cross-sectional, modified, and enhanced versions of the Jones model. While the coefficients in each scenario are statistically significant and exhibit consistent signs, the models vary in their capacity to accurately account for the data. The improved Jones model yields an R-squared value of 24.74 percent, which is markedly superior to the values obtained from the previous two models. Given this information, we have chosen to utilise the augmented Jones model, where equations 3.1 and 3.2 are used to calculate the distinction between nondiscretionary and discretionary accruals. According to the data presented in Table 2, the mean value of discretionary accruals is very near to zero. This occurs because discretionary accruals are eventually reversed and ultimately converge to an average value of zero. The minimum value of independent board members is zero, whereas the average proportion is 0.22. The sample companies have a maximum of fourteen members and a minimum of six. Insiders have the ability to possess as much as 98% of the shares, whereas board and executive members typically have influence over an average of 18% of the entire company. Institutional shareholdings vary from 0% to 97%. Approximately 0.8% of audit committee members come from external sources.

Table 1

t-statistics				
Jones model (1)	Modified Jones model (2)		Augmented Jones model (3)	
ΔREV_{it} 0.0956*** (7.3283)	ΔREV_{it} - 0.0789*** (6.0833)		ΔREV_{it} - 0.0258* (2.8579)	
ΔREC_{it}	ΔREC_{it}		ΔREC_{it}	
$Assets_{it-1}$	$Assets_{it-1}$		$Assets_{it-1}$	
PPE_{it} - 0.0589*** (-4.1883)	PPE_{it} - 0.0576*** (-4.1789)		PPE_{it} -0.0490** (-3.4572)	
-	-		CFROA 0.6298*** (14.5121)	
-	-		BM 0.0055* (2.8907)	
Constant 0.0281** (2.3871)	Constant 0.0367*** (3.7654)		Constant - 0.0347*** (-3.8564)	
R-squared 0.0680	R-squared 0.0498		R-squared 0.2445	
F-test 26.33***	F-test 19.12***		F-test 58.05***	

Table 2 Descriptive Statistics

	DA	IBOARD	SBOARD	MBOARD	SAC	IAC	POI	POINST	LEV	COMP	LASSET
Mean	0.00	0.23	8.28	1.78	3.56	0.80	0.19	0.24	0.49	8.04	15.28
Standard error	0.02	0.02	0.07	0.02	0.04	0.02	0.02	0.02	0.02	0.11	0.07
Median	-0.02	0.14	9.00	1.66	4.00	0.56	0.07	0.18	0.49	8.81	15.47
Range	1.64	0.94	9.00	3.56	5.00	2.00	0.99	0.98	0.98	12.25	10.75
Minimum	-0.87	0.00	7.00	0.40	3.00	0.00	0.00	0.00	0.00	0.00	8.86
Maximum	0.79	0.94	15.00	3.57	7.00	2.00	0.99	0.98	0.98	12.56	19.56

The correlation matrix of Table 3 indicates a negative correlation between discretionary accruals and the independence of the audit committee and board meetings. A recent finding indicates a weak correlation between discretionary accruals, insider shareholdings, and board independence. Empirical evidence demonstrates a positive association between discretionary accruals and CEO duality, institutional shareholding, and CEO pay. There is a positive correlation between board independence and firm size, indicating that larger companies prioritise board independence more. The organisation necessitates the inclusion of more board members, who are commonly selected from external sources. There is a significant correlation between the size of the audit committee and the size of the company, indicating a strong link. There is a shown unfavourable association between insider ownership and audit committee independence.

Table 3: Correlation Analysis

Variable	DA	IBOARD	CEO	SBOARD	MBOARD	SAC	IAC	POI	POINST	LEV	COMP	LASSET
DA	2.00											
IBOARD	-0.02	2.00										
CEO	0.20	-0.04	2.00									
SBOARD	-0.02	0.21	-0.27	2.00								
MBOAR	-0.13	-0.02	-0.09	0.02	2.00							
D												
SAC	0.04	0.22	-0.19	0.45	0.03	2.00						
IAC	-0.17	0.14	-0.23	0.25	-0.03	0.13	2.00					
POI	-0.05	-0.21	0.21	-0.22	-0.03	-0.21	-0.21	2.00				
POINST	0.18	0.19	0.12	0.07	-0.08	0.09	0.02	-0.27	2.00			
LEV	0.00	-0.13	0.17	-0.16	-0.05	-0.18	-0.06	0.24	-0.15	2.00		

COMP	0.12	0.08	-0.14	0.28	-0.04	0.19	-0.02	-0.26	0.05	-0.24	2.00	
LASSET	-0.13	0.12	-0.21	0.33	0.33	0.36	0.28	-0.16	0.02	-0.16	0.26	2.00

Table 4 displays the complete regression results of the sample. In order to assess our hypothesis, we employed panel regression. A regression analysis is performed on all the independent and control variables in column 1, with the dependent variable (discretionary accruals) serving as the predictor. Columns 2-4 of the regression analysis focus on the board characteristics, audit committee characteristics, and ownership structure as identified features for discretionary accruals. Contrary to our initial belief that having an independent board would lead to a decrease in earnings manipulation, our research indicates that there is no substantial correlation between board independence and the use of discretionary accruals. From this, we deduce that the null hypothesis is not valid. The second hypothesis is supported as there is a positive correlation between the presence of two CEOs and discretionary accruals. The concentration of authority in a single location diminishes the CEO's ability to effectively monitor. This is due to the perception of management that the CEO possesses greater discretion as a consequence of the consolidation of power. The magnitude and regularity of board meetings can serve as indicators of the board's level of engagement in mitigating profit manipulation. Belonging to us. Nevertheless, the findings indicate that neither of the variables exerts a substantial influence on the proportion of discretionary accruals employed. Therefore, we can deduce that the third and fourth hypotheses are false. We posit that a larger committee is more effective in safeguarding the accuracy and honesty of disclosed financial performance. Consequently, we contend that the magnitude of the audit committee has an adverse influence on the manipulation of earnings. Nevertheless, the results indicate that there is no substantial correlation between the size of the audit committee and earnings management. Therefore, we can infer that the fifth hypothesis is not substantiated.

The analysis indicates that there is a negative correlation between the utilisation of discretionary accruals and the independence of the audit committee, hence confirming the sixth hypothesis. By incorporating external members, the committee can enhance its supervision capabilities, hence reducing the probability of financial fraud and the collapse of the organisation. From the data shown in the first and fourth columns of Table 4, we have determined that the seventh hypothesis is not substantiated. This is due to the lack of a positive effect of insider shareholding on earnings management. Based on the results, which demonstrate a clear correlation between the utilisation of discretionary accruals and institutional shareholding, we are prepared to endorse the eighth hypothesis. The studies conducted by Bushee (1998), Matsumoto (2002), Koh (2003), and Cornett et al. (2006) all demonstrate a positive correlation between institutional shareholding and income-increasing discretionary accruals. Consequently, this conclusion aligns with their respective findings. Matsumoto (2002) states that institutional investors encourage managers to engage in earnings management as a means to prevent unexpectedly low earnings and instead achieve more consistent profitability. Contrary to the third point, the study reveals that earnings management is not connected to leverage or CEO

remuneration. However, the results indicate a negative correlation between company size and the utilisation of discretionary accruals. This study supports the idea that big businesses are more closely examined and so less inclined to engage in profit manipulation. Based on the data presented in Table 4, namely in columns 1–4, it can be observed that both the independent and control variables have similar and significant associations with earnings management. The second objective of the study is to ascertain whether there is a distinction in corporate governance involvement between high-growth and low-growth firms when it comes to overseeing the management of earnings. To accomplish this, we categorise the data into two distinct groups: high-growth and low-growth enterprises. Mitton (2002) defines high-growth enterprises as corporations with a BM ratio below the median, while low-growth organisations are those with a BM ratio above the median. Table 5 presents a clear set of regression estimates for businesses characterised by high and low growth rates. The findings demonstrate that the obstacles posed by governance structures to the manipulation of earnings vary significantly across high-growth and low-growth firms. The presence of a dual CEO in high-growth firms is favourably correlated with profitability management. CEO duality in major organisations indicates that the CEO holds authority over a substantial amount of information due to the higher scale of their activities, accounting records, and the likelihood of greater diversity. The results suggest that the utilisation of discretionary accruals is less probable in both rapidly expanding and slowly expanding businesses, irrespective of the independence of the audit committee. External members of the audit committee are independent from the company's management, enabling them to have more control over managerial decision-making. Low-growth businesses exhibit a negative correlation between the frequency of board meetings and the extent of earnings management. In such enterprises, a board that is more engaged is likely to have a significant impact on supervising management. Although the overall regression analysis of the entire sample data (Table 4) indicates a favourable correlation between institutional holdings and earnings management, the specific regression results present a contrasting view. Based on the data shown in Table 5, there is no correlation observed between institutional shareholding and earnings management in high-growth businesses. Only institutional investors with short-term investment strategies can persuade managers to engage in earnings manipulation for companies with moderate growth rates.

Conclusion

The primary objective of this study was to ascertain the influence of corporate governance on earnings manipulation. We have opted to calculate discretionary accruals using the third alternative, which relies on the relative predictive abilities of the Jones, modified Jones, and augmented Jones models. Based on the findings, it is evident that the independence of the audit committee serves as an effective tool for corporate governance, successfully regulating behaviours related to profit management. In addition, the CEO's simultaneous position and increased institutional equity involvement help to the advancement of these efforts. Moreover, we determine that the effectiveness of corporate governance systems varies among firms with high

and low growth rates. These findings have significant ramifications for the strategies commonly used to restrict profit manipulation. Specifically, the existence of two chief executive officers is only linked to earnings management in high-growth businesses in a positive manner. CEOs who have the dual role of board chair of a company may engage extensively in profit management to maintain the company's attractiveness. However, this does not apply to low-growth enterprises. In low-growth organisations, institutional shareholding is the only factor that has a positive correlation with earnings management. However, in high-growth corporations, this relationship is not significant. Research has demonstrated a detrimental correlation between earnings management and the independence of audit committees, which applies to firms with both high and low growth rates. Considering this, it is extremely probable that an autonomous audit committee would serve as an efficient mechanism for overseeing corporate governance, guaranteeing the impartiality of financial reporting. Based on these findings, it is recommended that the board establish processes to guarantee their access to a diverse array of information as a first measure. Additionally, the audit committee is accountable for ensuring that the company's financial statements adhere to financial reporting standards. One suggestion is for the board of directors to establish an internal audit function to evaluate the company's risk management, internal auditing, and governance effectiveness, and thereafter communicate the results to the audit committee. Potential future research could explore additional governance characteristics, such as the age and qualifications of board members and the CEO, the size of the compensation committee, board meeting attendance rates, and the knowledge and expertise of board and audit committee members. One potential research field could be to evaluate if the effectiveness of corporate governance procedures has increased following the release of the Securities and Exchange Commission of Pakistan's new corporate governance regulation in 2012. After the implementation of the new code, enhancements were achieved. To summarise, previous studies have asserted that insider and institutional ownership play a role in profit manipulation. However, our examination yielded little substantiation for this notion. Therefore, it is crucial to examine additional factors, such as the correlation between corporate governance attributes and insider ownership, when considering the presence of long-term institutional investors on the board of directors.

References

- Abbott, L. J., Parker, S., & Peters, G. F. (2004). Audit committee characteristics and restatements. *Auditing: Journal of Practice and Theory*, 23(1), 69–89.
- Abed, S., Al-Attar, A., & Suwaidan, M. (2012). Corporate governance and earnings management: Jordanian evidence. *International Business Research*, 5(1), 216–225.
- Almilia, L. S. (2009). Determining factors of Internet financial reporting in Indonesia. *Accounting and Taxation*, 1(1), 87–99.

- Alzoubi, E. S. S., & Selamat, M. H. (2012). The effectiveness of corporate governance mechanisms on constraining earning management: Literature review and proposed framework. *International Journal of Global Business*, 5(1), 17–35.
- Bartov, E., Gul, F. A., & Tsui, J. S. L. (2000). Discretionary accruals models and audit qualifications. *Journal of Accounting and Economics*, 30(3), 421–452.
- Beneish, M. D., & Vargus, M. E. (2002). Insider trading, earnings quality, and accrual mispricing. *The Accounting Review*, 77(4), 755–791.
- Bowen, R. M., Rajgopal, S., & Venkatachalam, M. (2008). Accounting discretion, corporate governance, and firm performance. *Contemporary Accounting Research*, 25(2), 351–405.
- Bushee, B. (1998). The influence of institutional investors on myopic R&D investment behavior. *The Accounting Review*, 73(3), 305–333.
- Chen, G., Firth, M., Gao, D. N., & Rui, O. M. (2006). Ownership structure, corporate governance, and fraud: Evidence from China. *Journal of Corporate Finance*, 12(3), 424–448.
- Cohen, D. A., Dey, A., & Lys, T. Z. (2004). Trends in earnings management and informativeness of earnings announcements in the pre- and post- Sarbanes Oxley periods. Unpublished manuscript. Retrieved from (<http://apps.olin.wustl.edu/jfi/pdf/CohenDeyLys.pdf>).
- Cohen, J. R., Krishnamoorthy, G., & Wright, A. (2004). The corporate governance mosaic and financial reporting quality. *Journal of Accounting Literature*, 23, 87–152.
- Cornett, M. M., Marcus, A. J., Saunders, A., & Tehranian, H. (2006). Earnings management, corporate governance, and true financial performance. Unpublished manuscript. Retrieved from (http://www.researchgate.net/profile/Hassan_Tehrani/publication/228238263_Earnings_Management_Corporate_Governance_and_True_Financial_Performance/links/0c960535f9236ee94f000000.pdf).
- Davidson, W. N., Jiraporn, P., Kim, Y. S., & Nemec, C. (2004). Earnings management following duality-creating successions: Ethnostatistics, impression management, and agency theory. *Academy of Management Journal*, 47(2), 267–275.
- Dechow, P., Sloan, R., & Sweeney, A. (1996). Causes and consequences of earnings manipulation: An analysis of firms subject to enforcement actions by the SEC. *Contemporary Accounting Research*, 13(1), 1–36.
- DeFond, M. L., & Jiambalvo, J. (1994). Debt covenant violation and manipulation of accruals. *Journal of Accounting and Economics*, 17(1–2), 145–176.
- Dimitropoulos, P. E., & Asteriou, D. (2010). The effect of board composition on the informativeness and quality of annual earnings: Empirical evidence from Greece. *Research in International Business and Finance*, 24(2), 190–205.
- González, J. S., & García-Meca, E. (2014). Does corporate governance influence earnings management in Latin American markets? *Journal of Business Ethics*, 121(3), 419–440.
- Hartzell, J. C., & Starks, L. T. (2003). Institutional investors and executive compensation. *Journal of Finance*, 58(6), 2351–2374.

- Healy, P. M., & Wahlen, J. M. (1999). A review of the earnings management literature and its implications for standard setting. *Accounting Horizons*, 13(4), 365–383.
- Hribar, P., & Collins, D. W. (2002). Errors in estimating accruals: Implications for empirical research. *Journal of Accounting Research*, 40(1), 105–134.
- Islam, M. A., Ali, R., & Ahmad, Z. (2011). Is modified Jones model effective in detecting earnings management? Evidence from a developing economy. *International Journal of Economics and Finance*, 3(2), 116–125.
- Jensen, M. C. (1993). The modern industrial revolution, exit, and the failure of internal control systems. *Journal of Finance*, 48(3), 831–880.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), 305–360.
- Jiang, W., Lee, P., & Anandarajan, A. (2008). The association between corporate governance and earnings quality: Further evidence using the GOV-score. *Advances in Accounting*, 24(2), 191–201.
- Klein, A. (2002). Audit committee, board of director characteristics, and earnings management. *Journal of Accounting and Economics*, 33(3), 375–400.
- Koh, P.-S. (2003). On the association between institutional ownership and aggressive corporate earnings management in Australia. *British Accounting Review*, 35(2), 105–128.
- Mansor, N., Che-Ahmad, A., Ahmad-Zaluki, N. A., & Osman, A. H. (2013). Corporate governance and earnings management: A study on the Malaysian family- and nonfamily-owned PLCs. *Procedia Economics and Finance*, 7, 221–229.
- Matsumoto, D. A. (2002). Management's incentives to avoid negative earnings surprises. *The Accounting Review*, 77(3), 483–514.
- McKee, T. E. (2005). *Earnings management: An executive perspective*. Mason, OH: Thomson.
- McNichols, M. F. (2000). Research design issues in earnings management studies. *Journal of Accounting and Public Policy*, 19(4–5), 313–345.