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Is the earnings management ethical practices or an economic justification for corporate management in the Iraqi environment? : Literature review

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Abstract:- *A number of joint-stock companies listed in the Iraq Stock Exchange have been exposed to bankruptcy and great losses, especially in the banking sector, which is one of the most important and largest sectors in the market, which prompted the Central Bank to place guardianship over a group of banks that practiced fraudulent activities represented in earnings management. This study aims to evaluate the literature review in the Iraqi environment to clarify whether earnings management is a bad ethical practice or an economic justification for corporate management. Therefore, the Iraqi studies were selected for the period 2011-2021, and through our analysis of literature review, we concluded that the practices of earnings management are unethical practices aimed at the management's attempt to achieve economic benefits, violating the instructions of the accounting system and the directives of the supervisory body for joint stock companies, taking advantage of this flexibility in the application of accounting principles and the absence of the authority of international financial accounting standards and financial reporting standards during that period. Although there is a lot of controversy about whether the practice should be accepted for economic reasons that management justifies as a necessary good practice to address economic fluctuations rather than a bad one, the second aspect about earnings management is that it is a bad ethical practice, whereby earnings management reduces the quality of financial reporting. Nevertheless, this study found the existence of earnings management practices in companies through an academic discussion of literature reviews that extended from the year 2011-2021 in the Iraqi environment.*

Keyword: *Earnings Management, Ethical, economical.*

1. Introduction

Several instances of severe accounting manipulation have occurred which has led to the collapse of many major companies such as Enron, Parmalat, Refco, and WorldCom in the past few years, whose earnings management does not need additional comment due to the damage to the economy. However, this study analyzes both the causes and drivers of management, so it is not surprising that market participants, legislators, regulators, and academics are concerned about the need to control financial reporting violations, as earnings management is a common term in today's business world. Nevertheless, earnings management is an accounting treatment that managers use at their discretion to manage or smooth earnings in financial reports as a kind of business reporting "language". In general, earnings management is engaged deliberately to achieve a specific goal or objective; this objective is either to maximize the wealth of the shareholders or the benefits of the managers. This prejudgment of earnings management is only good or bad practice for companies and shareholders, and without a doubt, earnings management is a "financial game" between managers and investors that does not reflect the true economic performance of the company. Managers attempt to smooth earnings as a strategy to build market credibility and to achieve positive growth in the company's share price (Graham et al., 2005). Nevertheless, this money game is wisely used to supplement the company's rewards from investors or shareholders in terms of rising stock prices, which can provide a bright opportunity for the company for the good management of shareholder wealth. This is a way that earnings management benefits the company. However, earnings management is also reflected as a short-term strategy that benefits the managers and not the company in the long run. Earnings management is observed as an opportunistic measure to the detriment of shareholders. This indicates that earnings management can be good or bad for companies and shareholders, or an opportunistic opportunity for managers to reflect the company's performance well and thus maximize their rewards. Thus, management action to participate in earnings management can be good or bad earnings management. However, some studies have consistently stated that earnings management is not good for the company while other studies have documented that earnings management is not harmful to the company (Roychowdhury, 2006; Rezaei & Roshani, 2012). This is reflected in the existence of a double aspect of earnings management, that is, it can be either good or bad for the company and the shareholders.

2. Literature review:

Study of (Al-Hussaini, 2011) showed insights of researchers and scholars related to these titles. The research contains a sample consisted of (115) companies recorded in a number of Arab stock markets and (Jones model, Modified Jones and Industry model) were applied to measure the earning management. As well as the research modeled the variables of governance which related to company's performance, ownership structure, returns, rewards of management board and the ability of company's announcement. In addition to the adoption of CAPM model to measure systematic risk which affect the companies. The retrospective modeled between earnings management, governance and risk were modeled. The research covered the period between (2002-2004) and reached to construct a model of measuring the exchange relation between earnings management, governance and risk, and invite the Arab countries and their companies to follow suit the countries which established the governance rules, to declare play and maneuver cases.

Study of (al-Mashhadani & al-Fatlawi.2012) aims to show the effect of corporate governance in limiting the practices in earnings management as some companies practice earnings management through the interference in the measuring and accounting disclosure taking into consideration the flexibility in the accounting standards to choose between the methods and policies of the accounting alternatives. The used Junes amended sample to measure the earnings management an also used developed Indications promoted by The China Securities Regulatory Commission (CSRE) were used to measure the level of corporate governance in 42 companies listed in Amman (SE) and 20 companies listed in Iraqi (SE) and from all different economic sectors for the period 2006-2009, the search concluded a group of conclusions and recommendations The researchers recommended that it is vital to Issue laws and legislations concerned with corporate governance and a guide of the obligatory rules to be practiced by the Iraqi companies due to its impact on reducing the earnings management implementations.

study of (AL-Timemi & Flayyih, 2013) Use Benford's law to detect the companies that practiced earnings management in a sample of listed companies in the Iraqi stock exchange , The sample consisted of (61) companies from the (87) companies Listed on the market for the year 2010 , the study concluded that there are a number of companies that practiced earnings management, he net profit reported in the annual financial statements of the companies listed in the financial markets, is considered one of the Sources of information relied upon by users of accounting information in making their investment decisions. At the same time be relied upon in calculating the bonus (Incentives) granted to management, therefore the management of companies to manipulate those numbers in order to increase those bonuses associated to earnings, This practices are called earnings management practices. The manipulation in the figures of earnings by management will mislead the users of financial statements who depend on reported earnings in their decisions. Because it did not honestly reflect the operational results of the companies, therefore are resorting to Benford's Law is use to identify the companies that might be manage their earnings management, Where is this law is conceded one of the monitoring tools that have been used to detect the risk of earnings management, we Use Benford's law to detect the companies that practiced earnings management in a sample of listed companies in the Iraqi stock exchange, The sample consisted of (61) companies from the (87) companies Listed on the market for the year 2010, We concluded that there are a number of companies that practiced earnings management.

Study of (Adnan, 2015) focus on study of The quality audit and how enhancing confidence in financial statements and thus its users to make appropriate decisions in reducing the earnings that impact the financial statements The research problem that arises is whether quality Auditing possess any role in discovering Management Earring? The conclusion resulted a significant relationship between quality Auditing and the reduction of Earrings and its effect on financial statement users.

The purpose of (Hadi & Mustafa 2016) Study of fine out methods Which Forensic Accounting could help in solving problems of The Earnings Management practices, in order to overcome the accounting scandals like the collapse of the big companies in USA. Which can the forensic accounts are enable the forensic Accountant by its practitioner experience such as skills knowledge, abilities and beside that mechanism like internal and External Auditing Roles, information Technology, corporate Governance, standards and codes Development.

Study of (Jassim, 2018) aims to explain the concept of earning management , forms , motivations and implications of earnings management practices and the importance of detecting this practices by the external auditor through the use one of the effective methods is modified Jones model on sample of Iraqi private banks to see the application of those banks to management earning , Where most of the studies indicated that the strongest between the models used in the detection of management earning and explain motivation of that the practices and effects it.

Study of (Ahmed, 2019) aimed to reveal the relationship between the practices of earnings management and Audit quality standards in a sample of companies listed in the Iraqi Stock Exchange, Using the questionnaire for a sample of (25) auditors at audit offices , the study provided some recommendations the companies of the research sample rationalize the practice of earning management because of its negative effects on the economic development and on all parties involved in the company even if it achieved temporary benefit to one of the parties.

Study of (Ali, 2019) aims determine the effect of profits management in the market value of shares of Iraqi private banks, which are listed in the Iraqi Stock Exchange, via using some selected indicators that denote the practices of profits management. To achieve this objective, the research relied on (Miller) model to determine the practices of profits management in three listed banking firms. The conclusions of the research are Adopting the profits management policy by the economic unit have an impact on the prices of traded shares in Iraqi Stock Exchange. This was proved through analysis, which showed the effect of profits management on the market value of shares. The profits management policy adopted by the economic units have influenced the investment decisions taken by those units.

Study of (Flayyih et al., 2020) examining a set of literature review for the period from 2017 to 2019. The study concluded that there is great agreement among most researchers that earnings management methods are used to mislead shareholders and users of financial statements, thus it can be said that it is a set of activities, means, and procedures taken by the company's management, which aims to maximize the benefits of management and achieve some benefits, regardless of their legitimacy, through the use and exploitation of flexibility in accounting standards or departure from them.

Study of (Salih & Flayyih, 2020) aims to measure the impact of the quality of auditing in reducing the risks of the external audit profession in the Iraqi environment, the research provided a knowledge framework for the concept of the quality of auditing and the risks of external auditing based on the descriptive analytical approach, by preparing a questionnaire prepared for this matter. A random sample was selected, including a group of specialists in accounting and auditing aspects and university professors and auditors with higher degrees in this field, and the conclusion that was reached is that the quality of the audit has had an impact on reducing the risk of the external audit profession.

Study of (Salem & Abdullah. 2021) show role of corporate governance to limit earnings management according to theory of agency by using governance technics whether internal or external, also many corporate managements attempt to exploit powers given for it to show positive aspects about management of those corporates, and good appearance in front of the owners through manipulation of profits because result of the selection specific financial and accounting policies show the financial position of the corporate in the short term exploiting the flexibility in accounting standards to choose a particular method of accounting treatment and disclosure in the financial statements. To limit these actions, the owners should follow several technics to reduce conflicts of interest between managers and owners, the manipulation of financial and accounting policies, and the persistence of using these policies.

3. Display and analysis of the results of literature review:

Through our study of the most important literature reviews that dealt with earnings management in the Iraqi environment, which varied between the use of mathematical scales or those that were in the form of a questionnaire for the period from (2011-2021), it was found that many of them reached a conclusion that there are practices in earnings management, such as the study (Al-Hussaini, 2011), which reached to build a model to measure the exchange relationship between earnings management, governance and risk. The study of (al-Mashhadani & Al-Fatlawi, 2012; AL-Timemi & Flayyih, 2013; Ahmed, 2019) found that there are many companies that practice earnings management (Adnan, 2015; Salih & Flyyih, 2020). The study concluded that there is an important relationship between audit quality and the reduction of earnings management and its impact on earnings management, and the study (Hadi & Mustafa 2016) found that forensic accounting can help in solving the problems of earnings management practices, and as the study (Albanaa & Neamah. 2018) indicated that there is an impact of the behavior of earnings management on changes in the credit rating of each of the Iraqi banks individually and collectively, and as the study (Jassim, 2018) indicated to the types of models and the most powerful in the disclosure of earnings management and indicated the motives behind these practices and their impact, and as shown by the study (Salem & Abdullah. 2021) the role of corporate governance in reducing earnings management according to the agency theory using governance techniques, whether internal or external.

4. Conclusion

The study concluded, through a literary review of previous studies, the existence of earnings management for Iraqi companies by clarifying the goal or purpose of earnings management as a business strategy according to the management's goals. In addition, the practice of managing opportunistic earnings by managers leads to negative results for the company's performance, which is likely to reduce the value of companies (in the short or long term) and the wealth of their shareholders. Essentially, it is a measure taken by managers to mislead shareholders. Nevertheless, it is important for managers with entrepreneurial skills to care deeply about the requirements of companies and shareholders and not engage in earnings management practices. Furthermore, there is a relationship between professional ethics and earnings management, as a strong sense of morality will reduce and limit earnings management. However, flexibility in accounting principles allows managers the opportunity to manipulate earnings, and management compensation is one of the most important incentives for managing earnings. Managers may use the timing of transactions, discretionary accruals, and bad debt expenses to manage earnings to increase the share price and obtain gains from stock options. Therefore, the literature review of previous studies must discourage earnings management because financial reports are supposed to reflect the actual performance of the company.

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