DETECTION OF EARNINGS MANAGEMENT – A PROPOSED FRAMEWORK
BASED ON ACCRUALS APPROACH RESEARCH DESIGNS

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The scope of this theoretical research is to outline recommendations for improving the complex process of detection of accounts manipulation. In this respect we turned to the previous literature and assessed empirical studies in order to be able to develop a robust model for understand the process of detection for accounts manipulation and further to ease the path of detection by proposing as we stated above a theoretical framework in this respect. Since there is a constant conjecture between cause and effect we are able to assert that two direction of research can be identified and both can explain further the roots for limiting earnings management since its detection can be much easier approached: the event that can represent the root for accounts manipulation and the normal trend considered for a certain company related to the accruals level and economic trend. In the end if we know the cause we can interpret the event and combat its appearance. But when this kind of research appears, another question springs. Should we fight earnings management practices? Clikeman (2003:78) sensed that by using those practices companies are walking on a very slippery slope where minor accounting gimmicks become more and more aggressive until they create material misstatements in the financial statements. So, the recourse to such practices creates a stake that is not negligible. The users of financial statements are misled when making decisions based on manipulated accounting numbers. To a certain extent, the existence of earnings management distorts the usefulness of financial statements, and in this respect the process of detecting it can be regarded both as being important and challenging. Our proposal is not related to a technical process of detecting earnings management as typical empirical studies found in the literature and more than that we open a new stream of research based on understanding the forms of manifestation for accounts manipulation, getting to know the antecedents, the features, the possible interactions among antecedents and current features. Based on the recommendations found in the literature the eradication of manipulative processes is next to impossible but the limitation can be a reality. In this respect the researchers recommend controlling the conditions and motives that increase the likelihood of its presence and also developing stronger tools to detection.

Keywords: earnings management, accruals

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Introduction
This particular study represents the first step of a larger empirical study that will assess the credibility of the accounting information presented into the financial statements in the Romanian economic environment. Into the present study we intend to analyze the paths of detecting accounts manipulation with a scope of developing a general framework for better understanding this complex process. The existence of earnings management practices under all its forms of manifestations is possible under the aegis of various factors that work together as a whole in order to permit its appearance.
By reviewing the literature we are able to elaborate a framework that has a genesis point the influence of those factors explaining in this respect the context of appearance for manipulating behaviors. This demarche is realized as a consequence of the fact that psychology-based research indicates that learning and subsequent judgment is facilitating by knowledge frameworks and availability of examples.

**Motivation of the study**
The importance of the study is underlined by the interest of the investors and other contracting parties in assessing the possibilities of detecting unfair accounting information.

The present study presents a different view that the traditional view of detecting accounts manipulation, based on qualitative and quantitative information.

The main idea of the study was constructed based on the shortcomings evoked by the empirical studies that conducted various quantitative methods trying to assess the magnitude of accounts manipulation but didn’t explained the detection process which is a very complex process with psychological accents that put in connection always the cause and the effect. In the end if we know the cause we can interpret the event and combat its appearance. Based on the recommendations found in the literature the eradication of manipulative processes is impossible to conceit but the limitation can be a reality. In this respect the researchers recommend controlling the conditions and motives that increase the likelihood of its presence and also developing stronger tools to detection (McBarnet and Whelan 1999: 272). In detecting earnings management practices the objects of manipulation and the actions undertaken in order to achieve it also must be known. Also the magnitude of interventions that management actually makes to influence earnings is relevant for the inference of earnings management in an empirical context.

**State of the art**
The general trend found in the literature regarding earnings management manipulation is related to the fact that managers may manage net income by controlling various accruals. Accruals such as accounts receivables, inventory and accounts payable are discretionary in that they allow for some flexibility by management to control. A manager may decide to become more optimistic about warranty claims on its products its current year than in previous years to decrease the accounts payable and accrual liabilities thereby increasing reported net income. Since accruals management is less obvious and detectable than changing accounting methods that have to be explained in the financial reports by explaining every material change in the accounting treatment together with an estimation of how much difference it makes; the management make use of them more often then they use changing accounting methods for manipulating of accounts.

Accrual accounting theory is based on the idea that there is a difference between cost and expenditure versus benefits and revenue. In this context net income is seen as adjustments of the operational cash flow for transitory items resulting in net income from operations. All the adjustments involved are called accruals. Accrual accounting is considered open to manipulation, as we stated before, having the fact that comprise various subjective decisions taken in the allocation of expenditure and revenue over time. By getting to understand the magnitude of earnings management practices we should identity the objects or the main instruments used in order to perform the manipulative behavior. This demarche is very important since this step represent the roots of constructing our theoretical framework.

In the following table we summarized some instruments and objects identified in the literature, presenting in the same time the methodology used by previous researchers in order to assess the existence or the magnitude of earning management income practices. Those studies are empirical studies and the main goal was to detect earnings management practices by identifying the objects that were managed.
Table 1. Instruments and objects of earnings management practices identified in the literature and presented in chronological order with related methodology

<table>
<thead>
<tr>
<th>Authors</th>
<th>Year</th>
<th>Studies</th>
<th>Instruments/Objects</th>
<th>Methodology used</th>
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<tbody>
<tr>
<td>Moffitt J. S.</td>
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<tr>
<td>Leach R., Newsom P.</td>
<td>2007</td>
<td>Do Firms Manage their Earnings Prior to Filing for Bankruptcy?</td>
<td>Current accruals</td>
<td>Cross-sectional analyses of large samples using coarse data.</td>
</tr>
<tr>
<td></td>
<td></td>
<td>International Diversification, Ownership Structure, Legal Origin and Earnings Management: Evidence from Taiwan</td>
<td>Discretionary accruals</td>
<td></td>
</tr>
</tbody>
</table>

Source: Projection of the authors

In detecting earnings management practices the objects of manipulation and the actions undertaken in order to achieve it must be known. Also the magnitude of interventions that management actually makes to influence earnings is relevant for the inference of earnings management in an empirical context.

Methodology
By positioning our research in this large field we can say that this particular research is focused on every area of accounting field. The method applied consist in a analytical method, the most
suitable to use in this type of research according to Macdonald and Rutherford (1989:89) that asserted that when constructing a model from assumed or observed relationships, analytical methods must be used. As type of research our paper can be included in the theoretical research type which importance was underlined by Kothari (2001:106) who asserted that: “empirical research is (or should be) informed by theory, since interpretation of empirical analysis is impossible without theoretical guidance”. Ronen and Yaari (2008: 289) underlined the importance of both types of research and concluded that theoretical research benefits from empirical research having the fact that: “an analysis is conducted through modeling, which by definition admits only a few features of reality”.

A Proposed theoretical Framework for detecting earnings management

In our vision in detecting earnings management behavior is important to follow at least three directions. The first step comprised the identifying process of the most managed accruals (in order to do so the incentives for managing earnings must be assessed). In this respect the object that can be susceptible of manipulation must be known based on the company trend. Also the context in which the company activates is important. Features like: dearth of regulations; any change in accounting treatment noticed by the auditors; any new growth of profit after arrival of a new chief executive or finance director; unusual change in the trend of sales growth or profit margins; unusual increase in debtor days or stock days; large acquisitions; discrepancy between reported profits and operational cash flow that employ differences that persist for period after period. All those must be followed by the examination of the magnitude of earnings management direct effect on resource allocation decisions having the fact that earnings management may have adverse effects on resource allocation decisions by investors and creditors, with far-reaching consequences. The last step comprises the identifying process of the financial and operating characteristics of the firms that are engaged in earnings management activities based on our opinion.

The following figure may represent the starting point in shaping our proposed framework.

Figure 1. Framework for understanding earnings management detection process

Source: Projection of the authors based on Healy and Wahlen (1999) conceits
The event occurrence is related to the opportunity that can arise in different periods of time in a firm’s economic cycle. By identifying the possible incentives to manipulate accounts in order to maximize the benefits from the event occurrence, the manipulative behavior can be understood. Once examined the possible incentives and concluding regarding their existence, the detection may be closer to realize. In order to be able to detect possible earnings management practices in all its forms of manifestation, three simultaneously directions can be outlined as following.

The magnitude and frequency of the practices of earnings management in all its forms of manifestation must be assessed. If those practices are encountered to have significant levels then the detection will be a success.

The second direction is materialized in the process of finding the main incentives or motivations for using earnings management practices in all its forms of manifestation. The main questions that may arise are: “Why does practices are needed?” and “When those practices are used?”.

The motivations for using creative practices need to be compared with the existence constrain in order to assess the degree of which firms may escape regulatory and publicity sanction. A low level of constrains may induce a high level of motivations or incentives. The third direction of research is focused in detection of the main accruals used in order to employ earnings management practices and all its forms of manifestation and the main accounting policies and choices design to achieve its goals and concretization of its incentives. In this respect, Table 1 can offer some insights into the results documented by previous empirical studies.

Table 2 present our proposal.

*Figure 2. Framework for detecting earnings management process:*

Source: Projection of authors

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Conclusions and scope for future research

The transactions of a certain company can be structured in such a way that in the end reported earnings are reduced or enlarge, depending on the management intent. In this context the managerial intent is the genesis point that makes the whole mechanism of structuring transactions to be developed and old habits to change. According to the framework that we have proposed for understanding what a detection process of accounts manipulation should comprise, a logical “red thread” must be followed based on the context in which the company activate in order to assess what kind of actions can be taken and in this respect to be able to ease the process of detecting earnings management. As we stated above this study represents a first step into assessing the most suitable path to follow when judging the process of earnings management detection. Based on this framework we intend to develop an econometrical model that can simulate various detection processes in order to improve the present research designs for detecting earnings management.

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