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Motives and techniques of earnings management used in a global environment

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Introduction

Earnings management represents a complex and compound phenomenon in the global environment. This phenomenon belongs to the integral and fundamental part of companies' business finance. Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial statements due to deceiving certain partners concerning the company's economic performance. It represents a selection of accounting policies made by the manager affecting revenues as well as the achievement of the positive performance of companies. Earnings management occurs in a global environment in many companies that are motivated to manage their profits to create the impression of a prosperous company in the business world in the eyes of third parties. Earnings management practices can exacerbate information asymmetry between stakeholders such as creditors, suppliers and investors, and the focal firm. Different motives lead managers to use different techniques, which in a global business environment can be classified according to two types of earnings management. There is real earnings management which represents the activity where managers try to influence reported earnings through actions that substantially change the underlying cash flows thereby influencing reported earnings and accrual-based earnings management which operates within the accounting norms choices that try to obscure the true performance of companies.

Research background: From a research perspective, it is very important to point out motives and used techniques of earnings management because it allows better identify the factors that drive the decision to practice earnings management. Motives of earnings management can be organized thematically into contractual obligations, asset pricing, or influencing external parties which are carried out through the use of various earnings management techniques.

Purpose of the presentation: The presentation aims to identify all possible motives leading to the practice of earnings management in companies in a global environment and to point out the individual techniques of earnings management, which are used to realize the individual motives.

Methods: From a research perspective, it is very important to point out motives and used techniques of earnings management because it allows better identify the factors that drive the decision to practice earnings management. Motives of earnings management can be organized thematically into contractual obligations, asset pricing, or influencing external parties which are carried out through the use of various earnings management techniques. In the presentation is used the method of description and the method of classification of technical terms are used to specify in more detail the motives and techniques of earnings management used in the global environment.

Earnings management motives

- *Compensation contract*
- *Debt covenant*
- *Political costs*
- *Providing information to investors*
- *Manager reputation*

Real earnings management techniques

- *Big Bet on the Future*
- *Flushing investing portfolio*
- *Throw out a problem child*
- *Shrink the ship*
- *Other real earnings management techniques*
    - delaying sales,
    - accelerating R&D or advertising expenditures,
    - postponing R&D or advertising expenditures,
    - sale/leaseback and asset exchange technique.

Accrual-based earnings management techniques

- *Cookie Jar Reserve*
  - ✓ *Specific example of Cookie Jar Reserve:*
    - ***Return of goods***
    - ***Amortization of inventories***
    - ***Warranty expense***
- *Big Bath*
- *Accounting change*
  - ***Volunteering for a new accounting standard***
  - ***Expense recognition rule***
- *Operating and non-operating earnings*

- *Other accrual-based earnings management techniques*
  - recording sales before they are realizable,
  - recording fictitious sales,
  - overstating inventory by recording fictitious inventory,
  - early retirement of debt,
  - amortization, depreciation, and depletion,
  - change in accounting methods,
  - backdating sales invoices,
  - overly aggressive recognition of provisions or reserves,
  - overvaluation of acquired in-process R&D in purchase acquisitions,
  - overstatement of restructuring charges and assets write-offs,
  - understatement of provisions for bad debts,
  - drawing down provisions or reserves in an overly aggressive manner.

Conclusion

In a global environment, there are strong motives for managers to practice earnings management. These motives include better pricing of securities, beating analysts' expectations, avoid negative earnings, show better performance than past, better compensation of managers, tax evasion, external finance attraction, concealment of poor performance, favourite contracts from suppliers, customers, lenders, and employees and avoiding technical default on debts covenants. Another dimension of earnings management is the stress level of managers builds up due to expectations of better performance by stakeholders. Within real earnings management, the most frequently used techniques for earnings management are big bet on the future, flushing investment portfolio, throw out and shrink the ship. In addition to these techniques, delaying sales, accelerating R&D or advertising expenditures, postponing R&D or advertising expenditures, sale/leaseback, and asset exchange techniques are also used for earnings management. Accrual-based earnings management uses techniques such as cookie jar reserve, with specific examples being the return of goods, amortization of inventories, and warranty expense. Other techniques are a big bath, accounting change, and operating and non-operating earnings. Accrual-based earnings management also uses other earnings management techniques such as recording sales before they are realizable, recording fictitious sales, overstating inventory by recording fictitious inventory, early retirement of debt, amortization, depreciation, and depletion, change in accounting methods, backdating sales invoices, overly aggressive recognition of provisions or reserves, overvaluation of acquired in-process R&D in purchase acquisitions, overstatement of restructuring charges and assets write-offs, understatement of provisions for bad debts, drawing down provisions or reserves in an overly aggressive manner.

Thank you for your attention