

## Literature Review on the Association between Earnings Management and Corporate Social Responsibility

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### Abstract

This paper aims to give an overview of the existing literature on the Earnings Management (EM) and Corporate Social Responsibility (CSR) relationship in different countries. This paper reviews preceding studies concerned about EM, CSR and their relationship. Out of 23 works of literature, 11 studies found a negative relationship, 6 studies found a positive relationship, 2 studies found blended relationships in case of different situations and 4 studies found no connection between CSR and EM. Most of the results demonstrated that probably the socially responsible organizations have a negative correlation with EM practice. The types of the relationship depend on cause-effect relationship, information asymmetry, how can a company use resources, awareness on environmental issues, awareness on ethical issues, tax avoidance tendency, corporate governance practice, nature of the firm, political environment, opportunistic incentive, and stakeholder capital, manager's psychology, etc. Relationships between EM and CSR influence on earnings quality, firm performance, and firm value.

**Keywords:** Association, Corporate Social Responsibility, Earnings Management, Literature Review.

### I. Introduction

According to the (Ning, 2009) Earnings manipulation or Earnings Management (EM) is one kind of management's action taken for reporting the desired level of earnings. EM has some features such as earnings are intentionally managed by management rather than accountant, EM includes both accounting choices and real business decisions, the objective of real EM is to affect the reported earnings or income, etc. Probably EM practice is increased when asymmetric information is more; signaling theory indicates that the symmetric data among firms and shareholders can diminish through CSR related data (Almahrog *et al.*, 2018). Tandry *et al.* (2014) explained that CSR operations may be one of the stratagems to keep up the viability of the organization. CSR disclosures help to create a favorable image of the organization among investors and other stakeholders that lead to enhancing an organization's value directly or indirectly. Suteja *et al.* (2016) found that EM has an important and negative effect as the moderating variable on the association between profitability and CSR. They suggest a significant level of commitment in EM, which prompts expanded CSR exercises, corresponds to infirm profitability.

Several previous works of literature have endeavored to inquire about the connection between CSR and EM. Almahrog *et al.* (2015) reviewed the preceding paper on the association between CSR and EM and got that there are 2 standpoints. One standpoint is the negative connexion between CSR and EM. Another standpoint is the positive connexion between these 2 variables. There are no such previous articles which conduct a full and systematic review to find out how many relationships can exist between EM and CSR, which type of relationship has been found mostly and which type of procedure has been used to examine the relationship.



This paper intends to give an overview of existing literature on the association between CSR and EM. This study reviews previous literature more systematically and tries to find out how many relationships can exist between EM and CSR, which type of relationship has been found mostly and which type of procedure has been used to examine the relationship.

Different nations everywhere throughout the world, for example, Australia, Tehran, Thailand, Korea, China, Pakistan, Singapore, UK, Indonesia, USA, Spain, Nigeria, Ghana, Italy, Bangladesh, Hong Kong, India, Japan, Malaysia, Philippines and so forth led examination on the connection between EM and CSR. From the result of the past investigation, it is observed that some companies might have less involvement in EM practice when they participate in CSR activities, some firms take the help of CSR activities intentionally to conceal EM practice through impressing by CSR disclosure, some company's behavior depends on the situation. Some studies showed no relationship between EM and CSR. EM practice may also have a relationship with other factors. Academicians, policymakers, future researchers understand from this paper what types of relationship exist between EM and CSR, which type of relationship has been found mostly, causes of different types of relationship and impact of the relationship on the firm. This paper also identifies some research gaps which will be the future research area for further research.

In the rest of this paper, methods, empirical studies on the EM's, CSR relation and, lastly, conclusion are discussed.

## 2. Methodology

The method used for this paper is the literature review. Figure I shows the previous article selection framework for this paper. Approximately 41 articles are reviewed for this paper. All articles are selected randomly. 8 articles are used for EM related discussion during 2005-2018, 6 articles are used for CSR related discussion during 2001-2017, 23 articles are used for the relationship between EM and CSR related discussion during 1991-2015 and 11 articles are used for other related discussions during 2008-2018. Findings of the 23 articles about the association between EM and CSR are shown in table 2. Table I displays the information of those 23 articles (Used in table 2) in chronological order. Most studies deal with the nonfinancial firm within the country.

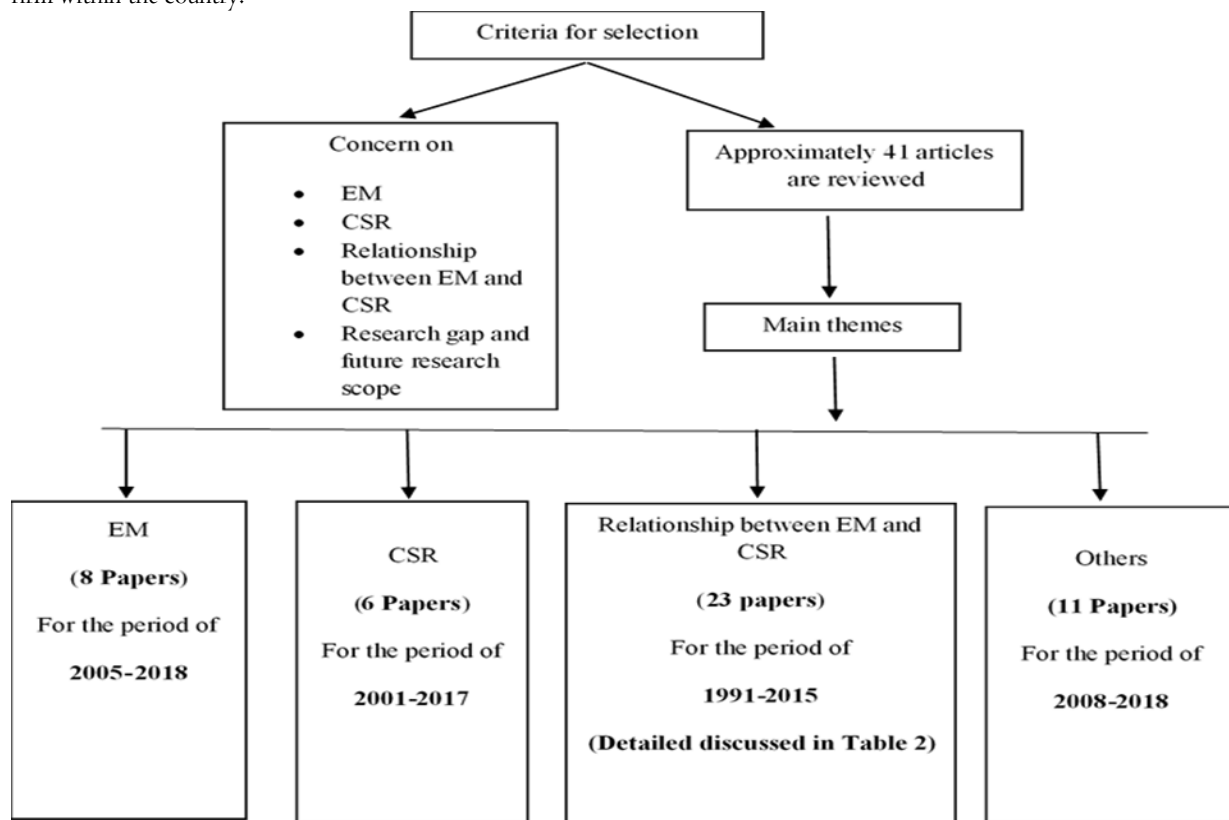


Figure I. Article selection framework

Table I. 23 Articles Information (Used in Table 2) in Chronological Order

No.	Authors	Journal	Kind of analysis		Kind of sector	
			Inter-nation	Cross-nation	Non-financial	Financial
1	(Izadinia <i>et al.</i> , 2014)	International Journal of Academic Research in Business and Social Sciences	✓		✓	
2	(Choi & Byun, 2018)	Investment Management and Financial Innovations	✓		✓	
3	(Almahrog <i>et al.</i> , 2018)	Journal of Financial Reporting and Accounting	✓		✓	
4	(Rahmawati & Dianita, 2011)	Journal of Modern Accounting and Auditing	✓		✓	
5	(Yip <i>et al.</i> , 2011)	Australasian Accounting Business and Finance Journal	✓		✓	
6	(Grougiou <i>et al.</i> , 2014)	Accounting Forum	✓			✓
7	(Mukhtaruddin <i>et al.</i> , 2014)	Net Journal of Business Management	✓		✓	
8	(Gras-Gil <i>et al.</i> , 2016)	BRQ Business Research Quarterly	✓		✓	
9	(Faisal <i>et al.</i> , 2018)	Int. J. Business Governance and Ethics	✓		✓	
10	(Cui <i>et al.</i> , 2016)	Financial Management Association Annual Conference	Not Mentioned	Not Mentioned	✓	
11	(Rahmawati <i>et al.</i> , 2014)	International Journal of Management, Economics and Social Sciences	✓		✓	
12	(Moratis & Egmond, 2018)	International Journal of Corporate Social Responsibility	✓		✓	
13	(Uyagu & Dabor, 2017)	The Romanian Economic Journal	✓		✓	
14	(Hong & Andersen, 2011)	Journal of Business Ethics	✓		✓	
15	(Prior <i>et al.</i> , 2008)	Corporate Governance: An International Review		✓	✓	
16	(Gavana <i>et al.</i> , 2017)	Sustainability	✓		✓	
17	(Cho & Chun, 2016)	Asia-Pacific Journal of Accounting & Economics	✓		✓	
18	(Kim <i>et al.</i> , 2012)	The Accounting Review	Not mentioned	Not mentioned	✓	
19	(Chih <i>et al.</i> , 2008)	Journal of Business Ethics		✓	✓	
20	(Muttakin <i>et al.</i> , 2015)	Managerial Auditing Journal	✓		✓	
21	(Scholtens & Kang, 2013)	Corporate Social Responsibility and Environmental Management		✓	✓	
22	(Liu <i>et al.</i> , 2017)	Journal of Business Research	Not mentioned	Not mentioned	✓	
23	(Amidu <i>et al.</i> , 2016)	Journal of Accounting and Taxation	✓		✓	

### 3. Empirical Studies on the Association between Earnings Management and Corporate Social Responsibility

In this section, related literature regarding EM, CSR and their relationship are reviewed. And also discussed the research gap and future research scope.

#### 3.1 Studies Regarding Earnings Management (EM)

Uyagu & Dabor (2017) interpreted EM by agency theory. EM is the method through which managers (agents) want to maximize their benefit at the detriment of the organization and investors (Principal)- it is regarded as an agency problem. As a result, wrong corporate financial information conveyed by managers (agent), shareholders make decisions based on this information, which represents agency costs generated by earnings management or manipulation. Greenfield *et al.* (2008) explained that from an ethical perspective, people should be more committed to their profession than to their achievement. When people supremely committed to their profession, they behave probably less opportunistically which probably leads to encouraging less likely taking part in EM practice. Lo (2008) explained that EM practice could be a harmony result whereby directors' report improved income for fulfilling their advantage. They also explained that EM closely related to earnings quality. Engaging a higher level of EM practice indicates that having a lower level of earning quality. Different studies use different proxies for EM such as real activities manipulation, discretionary accruals and the incidence of Accounting and Auditing Enforcement Releases (AAER), etc. (Kim *et al.*, 2012). Accrual-based and Real Activities EM (RAEM) have a usual feature which is managers use their discretionary decision and deliberately attempt to distort accounting numbers to misguide stakeholders (Chun & Cho, 2017). RAEM destroy relation with stakeholder and having a negative effect on its shareholder due to reduced firm value (Cho & Chun, 2016). Discretionary accruals are tricks to decrease or misrepresent clearness of the financial statement except involving the making difference of future cash flows (Choi & Byun, 2018).

#### 3.2 Studies Regarding Corporate Social Responsibilities (CSR)

CSR is voluntary activities that are taken by a firm to run in a socially, economically and environmentally sustainable manner (Alshannag *et al.*, 2017). Ahmadian & Khosrowpour (2017) explained that CSR is known as different terms, for example, corporate social responsiveness, corporate citizenship, strategic philanthropy, and global citizenship, etc. Sometimes spiritual capitalism is utilized conversely; actually, it depends on the company to use it. CSR covers different issues for example corporate ethics, plant closures, human rights, environment, community and employee relations (Moir, 2001). Hamidu *et al.* (2015) reviewed different literature and conclude that the features of CSR are: CSR performance is not mandatory, stakeholder management, managing external factors, alignment of economic and social responsibilities, considering values and practices and pervaded CSR actions beyond philanthropy. They explained CSR by different theories for example agency, stakeholder, and legitimacy, instrumental, institutional and Islamic CSR theory. Moir (2001) explained CSR by different theories for example stakeholder, social contracts and legitimacy theory.

#### 3.3 Studies Regarding the Association between EM and CSR

Sarbanes-Oxley Act of 2002 (SOX) contains 11 sections, was enacted as a repercussion to some major corporate blemishes such as Enron, WorldCom, etc. Cohen *et al.* (2008) found that companies that just gained necessary earnings benchmarks used more real EM and less accrual after SOX when contrasted with analogous companies before SOX. Their analysis also found that the raises in accrual-based EM in the period previous SOX were simultaneous within equity-based compensation. Anderson *et al.* (2014) separated the entire example time frame into the pre-SOX test from 1992 to 2001 and the post-SOX test from 2002 to 2009. They find 03 primary outcomes by utilizing a thorough board vector autoregressive (PVAR) approach: (1) In the pre-SOX period, CSR positively affects EM however CSR operation has no impact on EM during the post-SOX. (2) In the pre-SOX, there is no association between CSR task and financial performance (FP), but during the post-SOX period, there are bi-directional associations between them: a positive effect of CSR on FP and a negative impact of FP on CSR. (3) In both pre- and post-SOX periods, FP positively leads EM.

Several works of literature have been examined in the association between CSR and EM. Table 2 shows the articles used for the association between EM and CSR. These studies are conducted on different counties such as Australia, Tehran, Thailand, Korea, China, Pakistan, Singapore, UK, Indonesia, US, Spain, Nigeria, Ghana, Italy, Bangladesh, Hong Kong, India, Japan, Malaysia, and Philippines, etc. from the period of 1991 to 2015. Most of the studies used regression analysis for the testing relationship between EM and CSR. These articles use various types of control variables such as firm size, leverage, financial resources, market-to-book equity ratio, ROA ratio, R&D expense, advertising expense, age, equity offering, the value of CF operation, proprietorship concentration, size of the board of commissioners and institutional proprietorship, etc.

Table 2. Articles Used for the Association between the Earnings Management and Corporate Social Responsibility

No.	Author	Sample	Methodology	Findings
1	(Izadinia <i>et al.</i> , 2014)	39 listed Tehran Stock Exchange companies (2007-2012)	Measuring EM by using the modified Jones model. Measuring CSR by using a questionnaire based on the Likert scale. Testing hypothesis by regression models.	The negative correlation between EM and CSR. About 15% of CSR of the variety in the reverse factors is influenced by financial, EM and organization size. The organization's FP has a positive relation to EM.
2	(Choi & Byun, 2018)	Listed non-financial organizations of Korean Securities Market (2002-2010)	Calculating EM by the absolute value of performance-adjusted discretionary accruals, the sum of real activities manipulation, level of abnormal CF from operations, level of unusual discretionary spending and level of unusual manufacturing cost. DCSR took an estimation of 1 if the organization is positioned in the KEJI file and any case 0. Testing the relationship by OLS regression.	The significant and negative connection exists between real activities manipulation and CSR commitment.
3	(Almahrog <i>et al.</i> , 2018)	515 UK firms (2008-2010)	Measuring EM by using the modified Jones model. Measuring CSR by content analysis and disclosure index.	The more significant level of CSR will in general practice in the low extent of EM.
4	(Rahmawati & Dianita, 2011)	27 listed Indonesian Stock Exchange companies (2006-2008)	Accrual variables Jones model is used for detecting EM. Assessing CSR by an index of social disclosure. Measuring FP by ROA. Testing hypothesis by using OLS regression	CSR activities are not influenced by practicing EM. In the future, CSR operations correlated to EM engagement adversely influence the firm's FP.
5	(Yip <i>et al.</i> , 2011)	80 listed US companies from the food industry and 30 listed US companies from the oil and gas industry	Cross-sectional Jones model used for measuring discretionary accruals. Testing hypothesis by regression	CSR and EM are negatively associated with the oil & gas industry while positively associated with the food industry. Politics is a significant factor to influence the relationship between these 2 variables.
6	(Grougiou <i>et al.</i> , 2014)	116 listed commercial US banks (2003-2007)	Estimating EM by using both the LLPs and RSGLs. For CSR activities, externally-determined ratings are given by Kinder Lydenburg and Domini (KLD). Examining the association of the bi-directional variables by using simultaneous equations.	The positive connection among EM practice and CSR which implies that managers of bank oversee profit purpose to effectively expand their commitment in CSR tasks.
7	(Mukhtaruddin <i>et al.</i> , 2014)	38 Indonesian listed manufacturing companies (2010 - 2012)	Detecting EM by a modified model of Jones discretionary accruals proxy. Measuring CSR activities disclosure dependent on the ISO 26000 Guidance Standard. Calculating the firm's value by using Tobin's Q Ratio. Path analysis methods are used for	EM has an insignificant and positive effect on CSR activities disclosure. CSR disclosure has an important and favorable impact on the value of the organization. EM has an insignificantly adverse effect on the value of the organization.

				testing the effect of intervening variables.	
8	(Gras-Gil <i>et al.</i> , 2016)	100 companies (2005-2012)	Spanish	Absolute discretionary accrual value is used to measure the EM. Measuring extension of CSR activities by using the MERCO index. Using regressions analysis for testing hypothesis.	CSR practices harm EM as CSR practices tend to lead more effectively using resources.
9	(Faisal <i>et al.</i> , 2018)	479 Indonesian companies (2012 to 2013)	listed	Used RAM to calculate EM practices. Measuring CSR by content analysis. Employing two-stage least square method for testing the relationship.	CSR disclosures are negatively related to EM. CSR disclosures and EM connection can be considered as a substitute instrument.
10	(Cui <i>et al.</i> , 2016)	6,146 Firms (2006 to 2011)		Using the discretionary component of accruals as a proxy for EM. Measuring of CSR index based on the mean score of all 29-IVA. Regression analysis for testing hypothesis.	The significantly negative correlation between CSR activities and firms' EM. The opposite CSR & EM relationship is more prominent in companies with higher awareness of environmental issues, stronger stakeholder governance, and more stakeholder capital. Their results are supportive of the individualistic culture hypothesis, ethical financial transparency hypothesis, uncertainty avoidance, culture hypothesis, but not supportive of the opportunistic incentive hypothesis.
11	(Rahmawati <i>et al.</i> , 2014)	27 Indonesian manufacturing companies (2006-2008)	listed	Assessing real activity manipulation by CF operating activities. Measuring CSR by social disclosure index as a dummy variable. Testing hypothesis by OLS regression analysis.	The company engages in real manipulation has no impact on CSR actions. The higher amount of real manipulation leads to a negative influence on the association between FP and CSR.
12	(Moratis & Egmond, 2018)	5494 companies (2003-2009)	listed US	Detecting EM by using the modified Jones model. Calculating CSR by using the KLD database. Examining relationship by regression analysis.	The high natural organizations have significant levels of CSR but it is not related to EM.
13	(Uyagu & Dabor, 2017)	52 manufacturing companies (2001 -2015).	Nigerian	Measuring EM by using discretionary accrual. CSR amount expended on CSR actions for the year. Determining the relationship by OLS regression and multivariate regression analysis.	The positive correlation between CSR activities and EM.
14	(Hong & Andersen, 2011)	8,078 nonfinancial U.S. firms (1995–2005)		The quality of accruals is measured by the standard deviation of residuals. KLD database is used for measuring CSR. Measuring the relationship by regression.	More socially responsible companies have less activity-based EM practice and upper-quality accruals that ensure the reporting quality concerned about finance.
15	(Prior <i>et al.</i> , 2008)	593 organizations from 26 nations (2002-2004)		Estimating EM through discretionary accruals. Measuring CSR by Siri Pro data. Measuring corporate FP by ROA. Testing the hypothesis by regression.	The positive influence of EM exercise on CSR operations. The coalescence of CSR operations harms organization performance.



16	(Gavana <i>et al.</i> , 2017)	226 listed Italian non-financial, family, non-family companies (2006–2015)	Estimated discretionary accruals by using the modified Jones model. Measuring CSR disclosure by content analysis. Testing hypothesis by using panel regression.	Family firms, downward EM which is more prone to detaching attention from the CSR disclosure practice, compared to non-family companies
17	(Cho & Chun, 2016)	1432 Korean listed firms (2005–2010)	RAEM proxy, $COMB\_RM = AB\_CFO + AB\_PROD - AB\_EXP$ . Measured CSR by the KEJI Index. Testing hypothesis by regression analysis.	CSR is negatively and significantly related to RAEM. Good corporate governance reinforces the adverse correlation between CSR activities and RAEM.
18	(Kim <i>et al.</i> , 2012)	23,391 firm (1991 to 2009)	Computing discretionary accruals by the cross-sectional modified. Estimating the net score of CSR appraisals as qualities deduct worries in 5 social rating order of KLD evaluations datum. Testing hypothesis by using multiple regressions and logistic regression.	Socially accountable companies are less probable to (1) manipulate earnings or income, (2) to exploit real operating activities and (3) CFOs/CEOs of CSR companies are not more probable to be subject to SEC examines of GAAP nonconformity as reported in AAER.
19	(Chih <i>et al.</i> , 2008)	1,653 corporations from 46 countries (1993–2002)	EM is proxied by earnings smoothing, earnings aggressiveness, and earnings losses abstinence. Treated organizations practice CSR activities if organizations are constituents in the FTSE4Good Global Index.	Expanding in CSR exercises diminish earnings smoothing. Increase in CSR exercises increment earnings aggressiveness. Practices of CSR diminish earnings losses abstinence
20	(Muttakin <i>et al.</i> , 2015)	116 non-financial Bangladeshi firms listed on the DSE (2005-2009)	EM calculated by the level of discretionary accruals. Measuring the extent of CSR disclosures by using a checklist containing 20 items. Testing the hypothesis by using regression.	The positive relation between EM practices and CSR activities.
21	(Scholtens & Kang, 2013)	139 companies from 10 Asian countries	EM practice is proxied by earnings smoothing, earnings aggressiveness. Adopting CSR score from Asian Sustainability Rating's report. Testing the relationship by using multiple regression analysis.	Relatively better CSR performed companies are involved significantly less with EM practice.
22	(Liu <i>et al.</i> , 2017)	2369 firm (2003–2010)	Using the unusual level of manufacturing costs, discretionary spending and operating CF, as proxies for real EM. CSR is the residual value of its total strength score deduct from the total concern score. Testing the relationship by using regression analysis.	CSR is not importantly connected to either real or accrual-based EM
23	(Amidu <i>et al.</i> , 2016)	119 non-financial firms in Ghana (2010 – 2013)	Using the Jones model to calculate EM. Estimating CSR as a spurious variable that gets the estimation of one when an association connects with or embraces CSR exercises and in any case zero. Measuring	Expanding in CSR practice is related to expanding in EM. A positive and important connection has existed between EM and corporate tax avoidance.

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tax avoidance by the effective tax rate methodology. Examine relationships by logistic regression and methods of moments (GMM).

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Table 2 shows 23 studies found mixed results such as 11 studies found that negative relationships, 6 studies found a positive relationship, 2 studies found mixed relationships in case of different situations and 4 studies found no connection between EM practice and CSR activities. Most of the literature found that companies that participate in CSR functions, possibly they have little engagement EM. There is a negative association between more corporate subventions and discretionary accruals and this association is more spoken when organizations voluntarily issue CSR reports (Pyo & Lee, 2013). Some studies found that socially responsible firms had more engagement in EM. Sometimes companies engage in EM for trying to avoid tax, and then they increase CSR activities for eye washing purposes or create a positive image for stakeholders. Some studies found mixed relationships in case of different conditions such as what kinds of proxies are used for measuring EM, nature of the industry, etc. Some studies found that CSR and EM have no connection between themselves. Cause effect relationship, information asymmetry, way of using resources, awareness on environmental issues, awareness on ethical issues, tax avoidance tendency, corporate governance practice, nature of the industry, opportunistic incentive and stakeholder capital, etc. are the reasons of the different result of the relationship between EM practice and CSR. Almahrog *et al.* (2015) reviewed the previous literature. They found that the negative association of EM practice and CSR function is consistent with the theory of legitimacy, agency, and singles. And the positive correlation between EM and CSR based on stakeholder theory. EM, CSR and their relationship influence earnings quality, corporate performance and firm value. CSR disclosures increase the firm's value and EM practice decrease the firm's value. Hamza & Jarboui (2017) explained that the manager's psychology may have an important effect on his or her attitude toward practicing CSR activities and engaging EM practice. The manager's psychological characteristics may fix the connection between CSR and EM. They interpret the connection between these 2 variables from the perspective of legitimacy, agency, stakeholders' and singling theory base on the previous studies. Basuony *et al.* (2014) investigated the CSR influence on FP. The result showed that there is a significantly positive influence on CSR on company performance by using cross-sectional data. Older and larger organizations have a positive impact on FP which will tend to enhance the practice of better CSR operations. Garcia-Sanchez & Garcia-Meca (2017) interpreted that CSR operations increase the bank's income quality. FP, ethics, and reputation justify the positive impact of CSR operations on banks' income quality. The supreme level of CSR activities may provide shareholders and creditors with earnings information that permits managers to forecast future CF. Significant and negative links between CSR and earnings quality (Siueia & Wang, 2019). Tandry *et al.* (2014) found that EM practice and organization's size have an important positive impact on the value of the organization. Another finding is EM practice has a negative and important impact on the connection between organization value and CSR related disclosures.

### 3.4 Research Gap and Future Research Scope

Alongside CSR, there may be other factors that have a relation to practicing EM. Such as firm-specific factors, corporate governance (executive compensation, audit opinion), related party transactions, market liquidity, capital structure, cost of equity, information disclosure quality, etc. The future researcher can consider possible all factors that have relation in practicing EM and their findings will be more helpful for making a useful decision. From the previous literature, we find that out of 23 articles only 3 articles conducted their studies on cross countries. So, we suggest that future researchers could focus on more comparative studies in cross countries. From the previous literature, we also find that out of 23 articles only 1 article conducted their study on the financial sector. The financial sector is a strong and large sector for any country. The future researcher has the scope to work on the financial sector.

## 4. Conclusion

This study looks at the association's related articles about earnings management and corporate social responsibility. This article systematically reviews previous literature to find out how many relationship results can exist between EM & CSR, which type of relationship has been found mostly and which type of procedure has been used to evaluate the relationship. From the empirical works of literature evidence, a conclusion can be drawn that the result of the association between EM and CSR are mixed. Four types of relationships are found. Such as positive, negative, mixed relationship in case of different situations and no relationship. And we also found that most of the relationships are negative. The reason for relationship result depends on the cause-effect relationship, information asymmetry, how can firm use resources, awareness on environmental issues, awareness on ethical issues, tax avoidance tendency, corporate governance practice, nature of the industry, opportunistic incentive and stakeholder capital, manager's psychology, etc. EM and CSR relationship influence on earnings quality, firm performance, and firm value.





This paper has some limitations. This paper only emphasis on the result of the association between EM and CSR activities. Alongside CSR, there may be other factors that have a relation to practicing EM. The future researcher can consider possible all factors that have relation in practicing EM and their findings will be more helpful for making a useful decision. There are also scopes for future researchers to work on the financial sector and across countries.

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