# Financial statements and accounting quality: theories and methods to detect earnings management

Alessandro Mura e Viviana Ecca

**Aims of the course:**

This course is a research seminar, designed for PhD students that aim at carrying out their research in the field of Accounting. As a pre-requisite, participants must have solid expertise in financial accounting and valuation.

The purpose of the course is to provide a critical review of the current state-of-the-art of research on earnings management. After focusing on the definition and meaning of the key elements of financial statements as identified by the IASB's Conceptual Framework for Financial Reporting, to understand where the use of discretion and judgment may become critical, students will develop a sound understanding and appreciation of the theories that explain the risks and benefits for firms to manipulate accounting data. Moreover, they will learn different techniques to detect either accrual or real earnings manipulation, becoming aware of their main strengths and weaknesses. Students will also gain some insight into how evidence of earnings management from different methodologies can complement and reinforce each other. Additionally, students will engage in the replication of the sample and models of an existing study using Stata and available database, to familiarize with the operating aspects of archival research in the field of earnings management.

During the course, particular emphasis will be given on the crucial activity of developing an interesting research question on earnings management and a coherent research design. A critical review of existing studies to be searched within top journals of the field (Journal of Accounting and Economics, Journal of Accounting Research, The Accounting Review, Review of Accounting Studies, Contemporary Accounting Research, European Accounting Review, Accounting and Business Research, Accounting in Europe, Abacus, etc.) will play this role. At the end of the course, students should be able to autonomously present a research idea for their topic and a proposal on how to tackle the chosen research question. Students are also required to explain why their research question is relevant and interesting.

**Learning outcomes and competences:**

After completing this course, students are expected to have an essential view of earnings management both in theory and practice and to be encouraged to perform further accounting research in this field. More specifically, students will be able to:

- identify accounting items where discretion and judgment are particularly critical when preparing financial statements;
- understand the implications of theories that explain the costs and benefits for firms engaging in earnings management practice;
- critically evaluate the strengths and weaknesses of alternative earnings management techniques;
- familiarize with basic earnings management models using STATA;

- be aware of the challenges and difficulties of finding an interesting research question and a coherent feasible research design in the field of earnings management.

**Assessment methods:**

Students are required to prepare an essay (about 1,000 words) where they carry out a critical review of the literature on a selected topic in the field of earnings management.

**Course content:**

**Lecture 1 Elements of Financial Statements (IASB's Conceptual framework) and the role of accounting numbers (**3 hrs Mura Alessandro)

1. Users and Qualitative characteristics of financial statements
2. Definition of Assets, Liabilities, Equity, Income and Expenses
3. Statement of financial position, Statement of profit or loss and other comprehensive income, Cash flow statement, Notes
4. The role of accruals
5. Implications of accounting choices on the information content/usefulness of earnings

**Lecture 2, 3 Earnings management: theories and quantitative methods** (6 hrs Ecca Viviana)

1. Theories on earnings management
2. Accrual based earnings management and Real earnings management
3. Alternative approaches to detect accrual-based earnings management
4. Alternative approaches to detect real earnings management

**Lecture 4 - Critical analysis of an earnings management research article** (3 hrs Mura)

1. Identifying the read thread that links the sections of an earnings management paper: Abstract, Introduction, Literature review, Hypothesis development, Research design, Results, Interpretation and Conclusion
2. Replicating the methodology of an existing study with Stata and public database (Orbis, Aida).

**Lecture schedule**

- 17/09/26 (h 09.00-12.00) Lecture 1
- 24/09/26 (h 09.00-12.00) Lecture 2
- 08/10/26 (h 09.00-12.00) Lecture 3
- 09/10/26 (h 09.00-12.00) Lecture 4

**Required Reading:**

- Burgstahler D., Dichev I., (1997) Earnings management to avoid earnings decreases and losses, Journal of Accounting and Economics, 24 (1), 99-126
- Dechow P., Sloan R. and Sweeney A. (1995), Detecting Earnings Management, The Accounting Review, 70, 2, 193-225
- Dechow P., Ge W. and Schrand C. (2010), Understanding earnings quality: A review of the proxies, their determinants and their consequences. Journal of Accounting and Economics, 50, 344-401.
- Ohlson J, (2010) On successful research, European Accounting Review, (2), 1, 7-26
- Roychowdhury, S. (2006). Earnings management through real activities manipulation. Journal of accounting and economics, 42(3), 335-370.
- Walker, M (2013). How far can we trust earnings numbers? What research tells us about earnings management. Accounting and Business Research, 43(4), 445-481

- Zang, A. Y. (2012). Evidence on the trade-off between real activities manipulation and accrual-based earnings management. The accounting review, 87(2), 675-70.
- IASB, Conceptual framework for financial reporting (March 2018).

Further Reading:

- Ball R., Shivakumar L. (2006), The Role of Accruals in Asymmetrically Timely Gain and Loss Recognition, Journal of Accounting Research, 44(2): 207-242
- Dechow P., Hutton A. P, Kim J.H.K, Sloan R. (2012), Detecting Earnings Management: A New Approach, Journal of Accounting Research,
  50 (2): 275-334.
- Dichev, I. D., Graham, J. R., Harvey, C. R., & Rajgopal, S. (2013). Earnings quality: Evidence from the field. Journal of accounting and economics, 56(2-3), 1-33.