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A Literature Review on the Aspects Influencing Earnings Management and its Implications for the Capital Market

Ana Khaerunnisa[1], Lilis Karfina AR[2], Syarifuddin Rasyid[3], Darmawati[4]

Department of Accounting, Universitas Hasanuddin, Indonesia

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Correspondence:
Ana Khaerunnisa
Anakhaerunnisa700@gmail.com

ABSTRACT

Earnings management is a practice that affects a company's financial statements and the capital market as a whole, influenced by internal factors such as accounting policies and ownership structure, as well as external factors such as government policies and capital market liberalization. This study aims to examine the various factors that influence earnings management and its impact on the capital market. The method used is*Systematic Literature Review* (SLR) by analyzing relevant literature published between 2018 and 2024. The results show that better internal controls, such as audit quality and board quality, can reduce unhealthy earnings management practices, while external factors such as economic crises, corporate social responsibility (CSR), and the influence of open capital markets also have a significant impact on earnings management. Although this study provides important insights into earnings management practices, it has limitations as it relies solely on existing literature without direct empirical data from specific companies or capital markets. Furthermore, this study does not consider new factors such as the impact of technology or recent regulatory changes that influence earnings management practices. This study suggests that regulators and companies need to take steps to improve financial reporting transparency and reduce earnings management practices that are detrimental to the capital market

Introduction

Earnings management is a significant phenomenon in the financial world, affecting both a company's financial statements and the capital market as a whole. This practice is often influenced by various factors related to both internal and external factors of the company. These include accounting policies, the company's ownership structure, and cultural and institutional factors that shape how the company manages its financial statements. Earnings management is typically carried out to achieve specific objectives, such as meeting profit targets, influencing stock prices, or manipulating market perceptions of the company's performance (Soeprajitno et al., 2025).

In the context of capital markets, capital market liberalization is a crucial aspect that has a significant impact on earnings management practices. Opening capital markets to foreign investors can increase transparency and reduce information uncertainty, which in turn can reduce the incentives for companies to manipulate their earnings. Research shows that as capital markets become more open and integrated with global markets, companies tend to reduce earnings management practices. This is due to stricter oversight and increased trust from foreign investors who demand more accurate and reliable financial reports. (Mos, 2025)

Furthermore, oversight from financial analysts is another important aspect that can reduce earnings management practices, as this increased oversight encourages companies to present more accurate financial reports (Zhang, 2025)

Cultural and institutional factors also play a significant role in shaping earnings management behavior. In countries with better governance systems, such as those with strong financial regulations, earnings management tends to be lower. Conversely, in environments with weaker oversight, earnings management practices are more common, especially in companies with high levels of managerial ownership (Xu et al., 2026).

On the other hand, government policies are also a crucial factor influencing earnings management. For example, economic policies implemented during an economic crisis or pandemic, such as those seen during the COVID-19 pandemic, demonstrate how government policies can influence managers' decisions regarding earnings management. These policies can increase or decrease a company's incentive to manipulate earnings, depending on the level of uncertainty the company faces in responding to the policy. (Soeprajitno et al., 2025)

This research aims to explore various aspects that influence earnings management and its impact on the capital market. By examining the influence of aspects such as capital market liberalization, government policy, organizational culture, and external oversight from analysts and investors, this study is expected to provide deeper insights into how these aspects shape earnings management practices and how they affect capital market transparency and efficiency. Ultimately, this study aims to provide recommendations on steps that regulators and companies can take to reduce earnings management practices that are detrimental to the market.

Method

This research uses the Systematic Literature Review (SLR) approach, the first step in searching for literature using*Systematic Literature Review*The (SLR) methodology involves selecting articles that meet the criteria relevant to the research topic. The literature search related to capital markets used the keywords "earnings management, capital market" or "impact on earnings management."

In this study, the literature search uses the Scopus database as a reputable international database to support the credibility of this study by utilizing websites and*equipment*from *Watase Uake*. Several filters are used to limit the search for relevant literature. First, this SLR method only uses articles and other articles such as*book chapter*, *conference*, *process*, and so on will not be included. Second, only articles published within the 7 months are selected. The last year, 2018-2024. This timeframe was chosen to ensure that articles continue to be updated and current issues are kept abreast of rapid developments and increasingly open-minded society. The article search was based on articles that had*Journal Ranking*(*Quartile*1 to 4) which indicates high publication quality based on indexes such as*SCImago Journal Rankings*(SJR). Based on the results of searching for articles in the Scopus database via*Watase Uake*The website yielded 282 articles relevant to the search keywords. The following is an overview of research identified using the PRISMA database method.

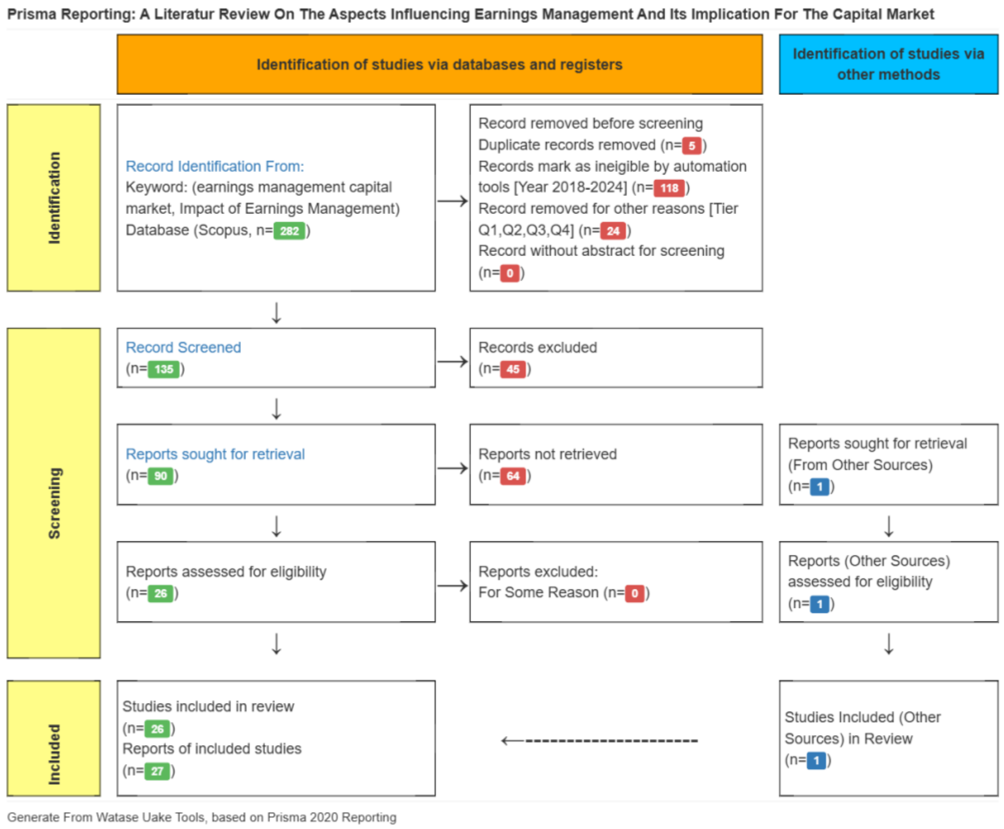

Figure 1. PRISM
Sources: Watase Uake, 2024

Using two keywords, a total of 282 studies were obtained. Five studies were then excluded by the tool due to detected duplicates from multiple keyword applications. Furthermore, 118 studies were excluded because they did not meet the publication year limit, which was before 2018. Furthermore, 24 other studies were excluded because the journals they were published in were not identified in the rankings.

After the identification process was carried out, a total of 135 articles were obtained, and from this stage screening will be carried out to prepare the article extraction process which is the most important step in the Systematic Literature Review study.

The collected research data will be curated according to a predetermined method, then summarized narratively based on the research findings. After the curation process and grouping based on the inclusion criteria and methods used, the researcher will compile a description of the research in tabular form. This table will contain information about the researcher, year of publication, journal publisher, article title, and a summary of the research findings. This summary will be used to analyze the research methods, processes, and findings in more detail based on the full-text articles reviewed. After conducting an in-depth review, the researcher will analyze the similarities and differences between each journal, which will then be summarized in a research synthesis conclusion and will be discussed further

Results and Discussion

A total of 24 articles were selected as primary literature, out of which 27 were previously found in the PRISMA data, but 3 were excluded because they were not in Indonesian or English. Table 1 presents several previous studies on aspects influencing earnings management and their implications for the capital market.

Table 1 Previous research used as literature review material

No	Writer	Title	Journal
1	Oz	The impact of terrorist attacks and mass shootings on earnings management	The British Accounting Review
2	Dang, And Khanh	The Impact of Covid-19 on Earnings Management Empirical Evidence from Vietnam	Sage Open
3	Aqabna, et al.	Firm Performance, Corporate Social Responsibility and the Impact of Earnings Management during COVID-19: Evidence from MENA Region	Sustainability
4	Liu and Niu	The impact of capital market opening on earnings management Empirical evidence based on Land-Port Connection	Finance Research Letters
5	Le and Nguyen	The impact of board characteristics and ownership structure on earnings management Evidence from a frontier market	Cogent Business & Management
6	Rocha et al.	Workforce and earnings management Evidence in the Brazilian capital market	Revista Contabilidade & Finance
7	Aburisheh et al.	Impact of cash flow on earnings management in Jordan	Cogent Business & Management
8	Munoz et al	Impacts of Earnings Management and Institutional-financial Development on Capital Structure Choice in Latin-American Markets	Emerging Markets Finance and Trade
9	Ding et al	The impact of climate risk on earnings management International evidence	Journal of Accounting and Public Policy
10	Alam et al.	The impact of corporate governance and agency effect on earnings management - A test of the dual banking system	Research in International Business and Finance
11	Kaldoski et al.	Capital market pressure, real earnings management, and institutional ownership stability - Evidence from Poland	International Review of Financial Analysis
12	Velte	Environmental performance, carbon performance and earnings management Empirical evidence for the European capital market	Corporate Social Responsibility and Environmental Management

13	Hao et al.	The impact of the Chinese stimulus program on earnings management	International Journal of Accounting & Information Management
14	Sundvik	The impact of principles-based vs rules-based accounting standards on reporting quality and earnings management	Journal of Applied Accounting Research
15	Habbash and Haddad	The impact of corporate social responsibility on earnings management practices evidence from Saudi Arabia	Social Responsibility Journal
16	Hooghiemstra et al.	Strangers on the board The impact of board internationalization on earnings management of Nordic firms	International Business Review
17	Saona et al	BOARD OF DIRECTOR S GENDER DIVERSITY AND ITS IMPACT ON EARNINGS MANAGEMENT AN EMPIRICAL ANALYSIS FOR SELECT EUROPEAN FIRMS	Technological and Economic Development of Economy
18	Lazzem and Jilani	The impact of leverage on accrual-based earnings management The case of listed French firms	Research in International Business and Finance
19	Mindzak and Zeng	the impact of pyramid ownership on earnings management	Asian Review of Accounting
20	Marchini et al.	The impact of related party transactions on earnings management some insights from the Italian context	Journal of Management and Governance
21	Capalbo et al.	The Impact of CEO Narcissism on Earnings Management	Abacus
22	Bajra and conez.	The Impact of Corporate Governance Quality on Earnings Management Evidence from European Companies Cross-listed in the US	Australian Accounting Review
23	Popli et al.	Avoiding the risk of de-legitimation Impact of internationalization on earnings management of emerging market firms	Finance Research Letters

Source: Data processed by researchers, 2025

The research results in the table above illustrate the aspects that influence earnings management and its implications for the capital market. Research (Bajra & Cadez, 2018) found that the quality of the internal audit function and the quality of the board of directors are associated with a reduction in earnings management incidents. This suggests that stronger internal oversight can reduce the practice of financial statement manipulation, which has implications for increasing market confidence in a company's financial statements. Furthermore, improved internal audit quality indicates a reduction in unhealthy earnings management practices in a company's financial statements.

(Capalbo et al., 2018) examined the influence of CEO narcissism on earnings management and found that CEOs with higher levels of narcissism tended to engage in earnings management more frequently. This was due to their desire to maintain a strong self-image and gain recognition through better-looking financial reports. These findings suggest that CEO personal characteristics can have a significant impact on corporate accounting decisions and reported earnings manipulation.

The COVID-19 pandemic has impacted earnings management in Vietnamese companies. Companies impacted by the economic crisis are more likely to use real earnings management (REM) techniques to maintain financial stability and attract investors. This suggests that in crisis situations, companies are more likely to engage in earnings manipulation practices to maintain market confidence and ensure operational continuity (Dang & Khanh Dung, 2024)

(Habbash & Haddad, 2020) found a positive relationship between CSR practices and earnings management in Saudi companies. Companies actively engaging in CSR activities were more likely to engage in earnings management practices to conceal irregularities in financial reporting and project a positive image of their social commitment, despite indications of earnings manipulation behind these CSR actions. This finding suggests that CSR can be used as a tool to divert attention from corporate earnings management practices.

(Hao et al., 2019) examined the impact of the economic stimulus provided by the Chinese government in 2008 on earnings management practices in companies receiving stimulus funds. The results showed that companies receiving stimulus funds were more likely to engage in downward accrual management to improve future earnings, suggesting that government policies can influence managerial practices in companies receiving stimulus funds.

(Velte, 2021) found that environmental performance is negatively related to accrual-based earnings management (ACC), meaning that companies with higher environmental performance tend to engage in less earnings manipulation through accruals. However, this study also suggests a positive relationship between carbon performance and real earnings management (REM), with companies potentially shifting from ACC to REM as part of their environmental strategy, which is often seen as greenwashing. This shift highlights a strategic move by companies to conceal their earnings manipulation activities, making them less detectable by stakeholders. The implication of these findings is that while improved environmental performance can enhance transparency in financial reporting, it could also signal increased engagement in more covert forms of earnings management, impacting the overall quality of financial disclosures in the capital markets.

(Sundvik, 2019) conducted a study to explore whether principles-based versus rules-based accounting standards affect financial reporting quality and earnings management strategies. The results showed that principles-based standards are associated with improved reporting quality, reflected in a decrease in the accumulation of abnormal earnings and a lower incidence of financial misconduct. On the other hand, rules-based standards tend to encourage higher use of real earnings management, which can further damage the company's long-term value. Thus, these findings suggest that principles-based accounting standards can improve reporting quality but potentially increase accrual-based earnings management, while rules-based standards tend to shift earnings management strategies to more expensive forms that affect the company's operating cash flow.

(Saona et al., 2019) found that gender diversity on boards of directors is negatively associated with the level of earnings management in companies. This finding suggests that more gender-diverse boards tend to reduce opportunistic managerial practices, including earnings manipulation. Companies with more women on boards of directors tend to adopt more cautious and conservative decisions, which results in improved financial reporting quality and a decrease in earnings management incidents. This study also shows that the existence of women's quota policies in several European countries contributes to reducing earnings management practices, in line with regulations that support gender equality in decision-making positions.

Pressure from labor unions and labor bargaining power can influence managers' decisions in managing profits. Research shows that the higher the labor intensity in a company, the greater the tendency to manage profits conservatively, by reducing reported earnings (earnings smoothing). These findings suggest that FT can act as a deterrent to accrual-based earnings management, as companies seek to maintain good relations with workers and unions to avoid higher demands. This research also shows that companies with more organized workforces are more likely to engage in activity-based earnings management, by substituting accrual practices to manage their financial reporting results (Rocha et al., 2022).

Internationalization increases external oversight of firms, which in turn reduces their propensity to engage in earnings management. More internationalized firms face greater pressure from host country stakeholders, which encourages them to reduce earnings manipulation to avoid delegitimization. This finding supports the hypothesis that external monitoring plays a substitute role for internal oversight mechanisms in controlling earnings management practices. Therefore, the higher the level of internationalization of firms, the lower their propensity to engage in accrual- and real-based earnings management, in order to maintain legitimacy among international stakeholders and increase financial reporting transparency (Popli et al., 2022).

(Oz, 2024) examined the impact of terrorist attacks and mass shootings on accrual-based and real earnings management in firms located in the affected areas. The results showed that firms located close to terrorist attacks experienced a significant decrease in both accrual-based and real earnings management. This decrease was associated with an increased risk perception resulting from the event, which led to managers' use of the availability heuristic. The increased salience of these traumatic events led managers to be more conservative in their earnings management, avoiding the greater risks associated with financial statement manipulation. Therefore, these results support the hypothesis that the salience of major events, such as terrorist attacks, can influence managers' financial decisions, including earnings management, by worsening risk assessments and encouraging managers to reduce earnings manipulation.

The accumulation of discretionary earnings is positively associated with decreased leverage and increased debt maturity. These findings suggest that accounting manipulation activities are more profitable for managers seeking to strengthen their position within the company and avoid external scrutiny, while increased institutional and financial development in a country facilitates debt issuance and longer debt maturities. However, despite the positive influence of institutional and financial development, these factors do not mitigate the impact of accounting manipulation practices. earnings management on funding structure policies. IFRS adoption serves as an effective control to reduce the impact of earnings management on capital structure and increase transparency in corporate financial reporting(Muñoz Mendoza et al., 2022).

Companies affiliated with pyramidal groups tend to engage in less accrual-based earnings management and less real earnings management than non-pyramidal companies. Further research shows that the deviation between control rights and cash flow rights of controlling shareholders in pyramidal-affiliated companies is positively related to real earnings management practices. This finding indicates that pyramidal ownership structures can influence how companies manage earnings, particularly in the context of intra-group transactions, which encourage higher earnings management practices (Popli et al., 2022) if carried out outside of internal financing. However, internal financing is negatively related to real earnings management. This research provides evidence that pyramidal ownership structures and earnings management are interrelated and can influence a company's financial decisions and financial reporting.

Related party transactions are more frequently used for earnings manipulation than other types of transactions. The results show that parent companies with less control over their subsidiaries are more likely to engage in earnings management compared to companies with greater control. Furthermore, this study also shows that the quality of related party transaction disclosures is related to the decision to engage in earnings management, with lower quality disclosures often associated with higher levels of earnings management. This research supports agency theory, which suggests that related party transactions can be used opportunistically for personal gain, particularly in concentrated ownership structures (Marchini et al., 2018).

(Liu & Niu, 2023) examined the impact of capital market transparency mechanisms on earnings management practices in companies listed on the A-share stock market in China, particularly those involved in the “Land-Port Connection” mechanism between the China and Hong Kong stock markets. This study shows that capital market transparency mechanisms can significantly restrain earnings management behavior in companies listed on the Shanghai and Shenzhen stock markets. This study identified information asymmetry as a potential constraint limiting earnings management practices, with more foreign investors entering the market through this mechanism, reducing the information asymmetry between companies and stakeholders. These results suggest that capital market transparency mechanisms strengthen oversight of managerial behavior and increase transparency in corporate financial disclosures.

A larger board size tends to reduce accrual-based earnings management, although some studies suggest that excessively large boards can increase bureaucracy and conflicts of interest, which in turn increase earnings management. Furthermore, higher ownership concentration is associated with increased accrual-based earnings management, while high managerial ownership can reduce negative earnings management. This study also found that state ownership is associated with reduced accrual-based earnings management, suggesting the influence of greater stability and control on corporate earnings management(Le & Nguyen, 2023).

Significant increases in leverage encourage managers to engage in earnings manipulation, aiming to avoid violating debt covenants. This finding supports the hypothesis that leverage provides incentives for managers to manage earnings to meet debt contractual requirements and enhances the firm's bargaining power in debt negotiations. The results also indicate that firms with increased leverage are more likely to engage in accrual-based earnings management compared to firms with consistently high levels of leverage (Lazzem & Jilani, 2018).

Institutional investors with stable ownership play a significant role in reducing real earnings management practices, particularly in companies under capital market pressure to meet short-term earnings targets. This study also found that companies with dual-class ownership structures tend to exhibit no significant relationship between stable institutional ownership and real earnings management, given that consolidated managers in these companies are better protected from external market pressures. Furthermore, these findings suggest that long-term institutional investors, such as pension funds and investment funds, can reduce real earnings management activities, demonstrating their important role in external monitoring mechanisms in emerging markets (Kałdoński et al., 2020).

The presence of non-Nordic foreign directors on boards is associated with increased levels of accrual-based earnings management. This study identified that language factors and the level of accounting knowledge of foreign directors contribute to increased earnings management, as the resulting communication barriers can reduce the effectiveness of board oversight. Therefore, more international boards tend to be less effective in monitoring managerial practices, which has implications for increased earnings manipulation, particularly related to income-increasing earnings management (Hooghiemstra et al., 2019).

(Ding et al., 2021) examined the effect of climate risk on accrual-based and real earnings management in companies operating in 64 countries between 2005 and 2016. This study found that higher climate risk is associated with increased earnings management practices, both accrual-based and real, as managers seek to protect their firm performance and performance-based compensation from the negative impacts of extreme weather events. Furthermore, the quality of a country's public governance plays a significant moderating role, with countries with better public governance tending to exhibit higher levels of earnings management as exposure to climate risk increases. These findings provide important insights for policymakers to strengthen climate risk disclosures in companies exposed to such risks.

Research results (Aqabna et al., 2023) show that ESG scores have a positive impact on return on assets (ROA) even after the COVID-19 pandemic. This study also shows that CSR has a minimal positive effect on corporate financial performance. However, these findings indicate that CSR and EM are interconnected, as managers may engage in earnings management to enhance their company's reputation through CSR activities, which in turn can affect company performance. This dynamic demonstrates how CSR initiatives can be used strategically to reduce scrutiny and potentially conceal financial irregularities through earnings manipulation.

From the article (Alam et al., 2020), it can be concluded that the quality of corporate governance, such as the size of the board of directors and the division of duties between the CEO and the chairman of the board, influences the level of earnings management (EM). In conventional banks, board size negatively affects EM, while in Islamic banks, the separation of the roles of the CEO and the chairman of the board contributes to reducing EM. In addition, the interconnectedness of the Shariah Supervisory Board (SSB) also plays a significant role in reducing EM, despite the potential for conflicts of interest if SSB members hold positions at other banks. These findings reinforce that internal controls through board structure and Shariah supervision can help limit opportunistic behavior in earnings management practices, although challenges remain regarding more effective implementation in the Islamic banking sector.

(Aburisheh et al., 2022) examined the impact of operating cash flow and free cash flow on earnings management in industrial companies listed on the Amman Stock Exchange from 2011 to 2020. The study found that free cash flow and operating cash flow significantly influenced earnings management practices, with managers using more free cash to manipulate earnings to meet their objectives. This finding suggests that cash flow Free management can create a conflict of interest between managers and shareholders, which encourages managers to use earnings management for personal gain. However, company size as a control variable has no effect on earnings management.

Conclusion

Earnings management is influenced by various factors originating from company characteristics, governance policies, and external conditions faced by the company. Aspects such as the quality of internal oversight, CEO characteristics, economic conditions, and corporate social responsibility (CSR) have a significant impact on earnings management practices. Research by Bajra and Cadez (2017) shows that stronger oversight, such as internal audit quality and board of directors, can reduce unhealthy earnings management practices, increase financial transparency, and strengthen market confidence in the company's financial statements. Conversely, Capalbo et al. (2017) show that CEOs with high levels of narcissism are more likely to engage in earnings manipulation to maintain their self-image, indicating the importance of managers' personal characteristics in influencing accounting decisions.

The COVID-19 pandemic also played a significant role, with research by Dang and Khanh (2024) showing that companies impacted by the crisis were more likely to use real earnings management (REM) to maintain operational continuity and attract investors. Furthermore, research by Habbash and Haddad (2019) revealed that companies active in CSR often engage in earnings management practices to create a positive image that can mask discrepancies in financial statements. Environmental performance is also a factor influencing earnings management, with Velte (2020) showing that companies with better environmental performance are more likely to reduce accrual-based earnings management practices, although better carbon performance can encourage real earnings management (REM) practices, often as a form of greenwashing.

Meanwhile, Sundvik (2019) examined the effect of principles-based and rules-based accounting standards on earnings management practices, showing that principles-based standards can improve reporting quality but also potentially increase accrual-based earnings management. Regarding gender diversity on boards of directors, Saona et al.'s (2019) research shows that more gender-diverse boards tend to be more cautious in managerial decisions, reducing opportunistic earnings management practices. Another important aspect is ownership and workforce structure. Rocha et al.'s (2022) research found that companies with more organized workforces tend to reduce accrual-based earnings management, while board internationalization, As found by Popli et al. (2022), it can increase external oversight and reduce earnings manipulation practices.

Leverage and ownership structure also show a significant relationship with earnings management. Lazzem and Jilani (2018) show that higher leverage increases the propensity to engage in earnings manipulation, while Kałdoński et al. (2020) reveal that institutional investors with stable ownership play a significant role in reducing actual earnings management. Overall, these findings suggest that earnings management is influenced by internal factors, such as company policies, ownership structure, and manager characteristics, as well as external factors, such as market conditions, regulations, and economic influences. The implications of these findings are important for understanding how companies can maintain the integrity of their financial reporting, particularly amid market pressures and a dynamic economic environment.

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