

Corporate Governance and Earnings Management: Evidence from Listed Companies in Pakistan

Dr. Abdul Lateef Kalwar

Ph.D. Department of (Public Administration), University of Karachi

Email: alkalwar70@gmail.com

Vijay Kumar

MSc Accounting Finance & Regulation, Glasgow Caledonian University, UK

Email: vijay.raheja500@gmail.com

Dr. Abdul Rasheed Kalwar

Ph.D. Department of (Public Administration), University of Karachi

Email: a.rasheedkalwar@gmail.com

ABSTRACT

This article reviews published archival evidence on the relationship between corporate governance and earnings management in companies listed in Pakistan. It does not estimate a new regression. It compares studies of the Karachi Stock Exchange and the Pakistan Stock Exchange that measure earnings management with discretionary accruals or real activity models and relate those measures to board, audit committee, and ownership variables. Board independence and financial expertise are the devices most consistently associated with lower discretionary accruals around the 2012 and 2017 governance codes, although that restraint is weaker in family companies. Board size does not restrain manipulation. Duality of the chief executive and the chair is positively associated with earnings management in some earlier evidence. Audit committee independence constrains accruals in studies of 2003 to 2012, yet the audit clauses of the 2017 code raised formal independence and expertise without producing the hypothesized restraint. Director and family shareholding is linked to higher discretionary accruals, while institutional ownership does not point in one direction. Affiliation with a family business group coincides with lower earnings management without removing the conflict between controlling owners and minority shareholders. Across these studies, earnings management in listed Pakistani companies is predominantly opportunistic.

Keywords: Corporate Governance, Earnings Management, Discretionary Accruals, Board Independence, Audit Committee, Pakistan Stock Exchange

Introduction

Corporate governance" refers to the mechanism for directing and holding the listed company accountable, while "earnings management" is the mechanism by which the reported profit can be misaligned from the underlying performance. Healy and Wahlen (1999) describe earnings management as the "use of judgment in financial

reporting and in structuring transactions to mislead investors or to shape contractual outcomes based on the reported accounting numbers. The definition holds true with a special force for Pakistan. The companies listed on the Pakistan Stock Exchange submit accounts to every bank, minority shareholder, tax authorities and securities regulator as proof of performance. Controlling families and sponsor directors typically are in close proximity in the preparation of those accounts. If judgment is exercised in accruals, provisions, in selling or in discretionary expenditures, to achieve a more favourable or consistent profit, then the public number is not simply a report, but an aide to private strategy. The focus of the present article is on the relationship between corporate governance and earnings management in the listed companies of Pakistan, which is based on only published empirical evidence and theoretical literature that provides meaning to such evidence.

The motivation to run for profit is as much an ancient motivation as any code of governance. Schipper (1989) defined earnings management as a conscious manipulation of the external financial reporting process that is done with the intent of gaining some private benefit. The intervention can be done within acceptable accounting standards! A manager can manipulate the amount of the doubtful debts, the useful life of an asset, the timing of an impairment, or the timing of revenue recognition when it is not firmly supported by cash. Any of these acts does not have to be an imaginary act. Here are some of them that will still be able to move towards a target, which benefits a manager, controlling family or lender covenant. The intervention is frequently legal in form, and is only likely to be discovered on the basis of models of unexpected accruals and of abnormal real activity, and not only based on a mere search for illegal entries. When enforcement resources are scarce, there is only so much room between what is allowed and what is informative for earnings to reside.

The first reason that one might expect governance to matter is provided by agency theory. Jensen and Meckling (1976) demonstrate that there are costs associated with the separation of decision rights from the residual claims; the residual claimant who exercises control over the firm is not responsible for the full risk of opportunistic reporting. Shareholders do not have access to all the estimates contained in the accounts. Boards, audit committees and outside owners are thus requested to oversee the agent on their behalf. With widely held companies, the classic conflict is between the professional managers and the widely dispersed shareholders. The more common battle in Pakistan is between controlling shareholder and outside minority shareholders. The controlling group can appoint the CE and control the board and still be compliant with the formal code. Devices created to be used in a distributed control system (DCS) can then be made ceremonial. That is not the slogan but an empirical question that is addressed in the article.

Governance system is more than just a list of committees. According to Shleifer and Vishny (1997), the corporate governance is a system of mechanisms by which providers of finance guarantee themselves a return on their investment. Those mechanisms involve legal protection, the makeup of the board, incentives to managers, and owners who are both invested and able to take an active role. Where there is little legal protection, the burden of private mechanisms is greater, and, under those mechanisms, they frequently fail. Earnings that are managed to achieve control,

for a related party transaction or to prevent a covenant violation are an explicit assault on the assurance outside financiers need. The Pakistani literature is valuable, because of the study of these mechanisms within a concentrated ownership setting, instead of within the textbook setting of a dispersed ownership.

The extent of earnings management is not consistent across countries, according to international evidence. Leuz, Nanda and Wysocki (2003) examine earnings management in different economies and conclude that it is more prevalent in economies with lower investor protectiveness and higher private control benefits. Their result would only serve as an indicator of the failure of a specific Pakistani Board practice and not an outright statement about all practices. It does create a preconceived idea. When outside investors do not have the means of court or disclosure or really independent directors, insiders have not only an incentive to manipulate reported profit, but the means to do so. Since early 21st century, Pakistan has improved the corporate statute and its governance code several times. Those reforms were expressed in investor protectionism. The question that later Pakistani studies have attempted to measure is whether the language has affected the accounting results.

Institutional environment influences the institutional context of firm level devices. According to La Porta et al. (2000), investor protection reduces the ability of the incumbent to expropriate outside owners, and facilitates the development of deep capital markets. The argument goes in through a straightforward route into accounting. The accountability of outside owners is more likely to curb insiders' ability to conceal performance in discretionary accruals. Formal board features can be adopted if the regulator requires them, but substance of monitoring is low where the features are being adopted by the external owners. Listed companies have been pushed by the Pakistani codes towards independent directors, audit committees and separation of leadership positions. Not changing the way a form is reported is not an adoption. The studies reviewed in this article are useful since a number of the studies examine the form and test the association with discretionary accruals or association with real activity manipulation.

The board is the internal institution which ought to ratify and keep track of the most crucial decisions of the firm. Fama and Jensen (1983) argue that outside directors, whose reputations depend on the proper exercise of decision control, are an important part of the separation between decision management and decision control. When there is a true separation, a more independent board must limit the use of financial reporting to entrenchment tools. For a nominal separation, independence as noted in an annual report may not be associated with earnings management at all, or may be correlated with more aggressive reporting when they are independent in name. The evidence from Pakistan is not unanimous on this topic, as is detailed later. Other studies report that after regulatory reform, accrual manipulation becomes constrained with the arrival of independence. Others do not see any definite correlation. The dispute itself is a statement on the extent to which formal independence is possible in a focused market.

The regulatory reaction in Pakistan has been clear. The Securities and Exchange Commission of Pakistan (2017) released the Listed Companies Code of Corporate Governance Regulations 2017, which strengthens the expectations relating to

composition of the boards, independent directors, and the presence of women on the boards and the leadership and expertise of the audit committee. The reform was continued in a later revision in 2019, but the 2017 text is the break time that recent empirical papers use in order to divide an earlier time from a later one. Discretionary accruals are not specifically referenced in the code. Its logic is still an earnings quality logic, however. A more independent, expert, and accompanied by any serious audit committee is assumed to make opportunistic reporting more difficult. The question for research is if that presumption remains after touching the accounts of the listed companies.

Literature Review

Positive accounting theory provides a rationalization for the management of earnings when a code exists. A decade of research is reviewed by Watts and Zimmerman (1990) and found that accounting decisions are driven by contractual rewards, political exposure and the costs of covenant enforcement. Reported profit is associated with bonus plans that promote positive accruals. Debt contracts stipulated on accounting ratios foster decisions that safeguard the ratios. Firms with larger and more visible firms may opt for income reducing accruals for the purpose of minimizing political cost. The inclusion of an audit committee does not affect these incentives. It is simply disputed by them. The contractual and reputational considerations as outlined by positive accounting theory are easily identifiable in Pakistan where the financial role of the banks is paramount and family honor and prestige is based on the reported success. Governance is a counterweight, not a substitute to the motive.

The first step in measuring earnings management is to try to distinguish normal accruals from abnormal ones. In a model by Jones (1991) the nondiscretionary accruals depend on the growth in revenue and on property, plant, and equipment levels; and the residual is treated as a proxy for discretion. The model was constructed around a particular investigative context but proved to be the workhorse of the larger body of literature because it provided a means for researchers to discuss unanticipated accruals instead of talking about accruals in general, which combine business fundamentals with managerial decision. This logic is carried over by subsequent Pakistani studies with changes in regressors. In practice, any restriction on earnings management is a restriction on a residual of a model of accruals. The quality of that claim cannot be better than the quality of the residual.

The most popular modification is the one that eliminates the idea that management would attempt to manipulate the revenue. Dechow, Sloan and Sweeney (1995) modify the Jones model by removing the adjustment of the change in receivables from the change in revenue when calculating discretionary accruals. Their paper also demonstrates that traditional models are not very powerful and that they can fail to correctly identify normal performance as manipulation. That's a warning that's relevant for Pakistan. There are marked differences among the listed companies with respect to their growth, leverage and profitability, and according to several Pakistani studies, the larger the discretionary accruals, the more profitable, growing and leveraged the companies. Without performance being captured by the accruals model, a governance coefficient can monitor business fundamentals, instead of monitoring. A

careful study of the Pakistani evidence therefore does not just focus on the presence of a governance coefficient but also whether the study took account of the performance, size, leverage, growth, and age of the firm.

Further refinement is made based on performance, before the discretion is inferred. When earnings performance is extreme, performance matched to discretionary accruals are better specified than the unmatched residuals as shown by Kothari, Leone and Wasley (2005). The accruals that accompany unusual profits or unusual distress situations are disproportionately likely to seem discretionary even in the face of economic, rather than opportunistic, accruals. This is what Pakistani researchers are doing, including the application of return on assets in the accruals regression. The selection of the model is not a technical trimmer. Ownership results are reported later, but Kamran and Shah test four different accrual specifications and search for results that hold up to model change. It's a serious attitude in a literature that is delicate at best.

Accrual models can't list all the ways to manage profit. Managers can also be seen as manipulating real activities, overproduction, reduction of discretionary spending, or pulling of sales forward at the expense of cash margins as shown by Roychowdhury (2006). The warning that a code can redirect the stream of earnings management without eliminating it comes from Cohen, Dey and Lys (2008) who find that the Sarbanes Oxley reforms actually led to a decrease in accrual manipulation and an increase in real manipulation. The study by Zang (2012) reveals that managers opt for the lower cost avenue. Independent directors and auditors add to the cost of accruals. The cost of real manipulation can be increased because of weak competitive conditions. Pakistani studies have therefore been able to report such a success when only discretionary accruals are measured, but not when the Cash flows are measured. The audit committee is the mechanism most closely bound up with the integrity of the accounts. The more independent the audit committee and the board, the lower the earnings management, finds Klein (2002). Xie, Davidson and DaDalt (2003) further argue that competence and frequency of occurrence are important; competence is a technical as well as a political judgment when making an opportunistic estimate. The monitoring result is not just American: Peasnell, Pope, and Young (2005) report that outside directors have the negative effect on the probability of abnormal accruals in the United Kingdom. There is a smaller number of outside directors on the boards of companies that engaged in financial statement fraud, according to Beasley (1996). Routine discretion and fraud are more extreme events, but are equally supported by the institutional claim. A board that's captured is a weak barrier to numbers that are helpful to insiders. Without knowledge, they are incomplete monitors, without independence monitors are none.

When ownership changes, outside investors' perception of earnings changes. In East Asia, controlling owners conceal the private benefits of control, resulting in less informativeness of earnings, as shown by Fan and Wong (2002). Claessens, Djankov and Lang (2000) sketch that separation in the form of pyramids and cross holdings. The market of widely held firms is more similar to the kind of market Pakistan has than it is to the former one. Wang (2006) concludes that founding family ownership may be linked with increased earnings quality but not in a linear fashion, and that entrenchment can be correlated with decreased earnings quality once the family is

shielded from challenges. It is other objects that will be direct shareholding of directors, founding family reputation and affiliation with a business group. They are not considered to be one variable in the Pakistani studies that are reviewed later, nor will they be treated as one here.

The quality of earnings is a more comprehensive concept than any one governance coefficient. Dechow, Ge, and Schrand (2010) provide a summary of proxies, determinants and consequences of earnings quality, and demonstrate that governance is one among many determinants, which includes fundamentals, accounting standards and auditor effort. It has to be broadened in a responsible manner in the reading of Pakistan. The discretionary accruals are sensitive to growth, leverage, profitability and age in nearly all local studies that incorporate those variables. Without them, it's impossible to estimate governance coefficients that will be credible. Even after they are taken into account, governance coefficients account for only a portion of the variation in reporting outcomes. The present article therefore denies two opposites. It is not saying codes are unimportant or that a bigger board or a named independent director means that earnings will be honest.

Problem Statement

Early evidence from the period immediately after the first major Pakistani code was uncomfortable for reformers. Shah, Butt, and Hassan (2009) examined listed companies for the year 2006, measured governance quality with a weighted set of attributes, and estimated discretionary accruals with a modified cross sectional Jones model. Ordinary least squares estimation indicated a positive relationship between measured governance quality and earnings management. The authors interpret the result as unconventional and suggest that companies were passing through a transition after the 2002 code, during which discretionary accruals rose as a cautious response to a new regime. A single cross section cannot identify a transition. The result remains important because it warns against the assumption that the first years of formal compliance are years of lower manipulation. Ceremony can spread faster than substance.

The disagreement across later studies is the problem that motivates this article. Iqbal, Zhang, and Jebran (2015) study 89 nonfinancial companies listed on the Karachi Stock Exchange from 2003 to 2012 and find that audit committee independence is negatively associated with discretionary accruals, while duality of the chief executive officer and the chair is positively associated with discretionary accruals. Board size and managerial ownership are not significant in their fixed effect estimates. That package of results is internally coherent with a monitoring story. It is not the same package reported by every other Pakistani study of the same decade. Board size is insignificant in more than one paper, which already weakens any simple claim that larger boards monitor better. Duality is positive in some designs and insignificant in others. Institutional ownership constrains earnings management in some studies and is positively associated with it in others. A literature in this condition does not need another slogan about good governance. It needs a disciplined comparison of what has actually been found.

The problem can be stated without ornament. Listed companies in Pakistan operate under repeated governance reforms, concentrated ownership, and active use of

accounting discretion. Published studies agree that earnings management is present and that it is often opportunistic rather than a device that improves the information in earnings. They do not agree on which governance devices restrain it. Board independence is associated with lower discretionary accruals in several studies conducted around the 2012 and 2017 codes, yet an earlier study of the Karachi Stock Exchange finds no significant association. Audit committee independence is negative in two studies of the 2003 to 2012 period, yet audit committee attributes that rose after 2017 do not show the hypothesized restraining relationships in difference in differences evidence. Insider and family ownership is linked to higher discretionary accruals in a large sample study, while affiliation with a family business group is linked to lower earnings management in a later study of group structure. Institutional investors constrain manipulation in some estimates and are positively associated with it in others. Until these disagreements are set beside one another, regulators and directors cannot tell which parts of the code are supported by Pakistani evidence and which parts are imported assumptions.

Objectives

This article pursues four objectives.

To set the Pakistani evidence inside agency theory, positive accounting theory, and the international measurement literature, so that local coefficients are read against a known standard rather than as isolated facts.

To compare published findings on board structure, including independence, size, expertise, female representation, and the combination of the chief executive and chair roles.

To compare published findings on audit committees, including independence, size, expertise, and the independence of the chair.

Research Questions

Are board characteristics of listed Pakistani companies, in particular independence, size, financial expertise, gender composition, and chief executive duality, associated with lower earnings management in the published evidence?

Are audit committee characteristics, in particular independence, size, expertise, and chair independence, associated with lower earnings management, and did those associations strengthen after the 2017 code?

Does ownership structure, in particular insider and family ownership, institutional ownership, ownership concentration, and family business group affiliation, restrain or facilitate earnings management, and is the earnings management documented in these companies opportunistic?

Methodology

The method of the article is a structured evidence review of archival studies on listed companies in Pakistan, supported by the theoretical and measurement papers required to interpret them. Studies were retained when they examined companies listed on the Karachi Stock Exchange or the Pakistan Stock Exchange, when they measured earnings management with a recognised accruals model or a recognised real activity model, and when they related that measure to at least one governance or ownership

variable. The core local studies span Shah, Butt, and Hassan (2009), Kamran and Shah (2014), Latif and Abdullah (2015), Iqbal, Zhang, and Jebran (2015), Khan, Kamal, Abbas, and Hussain (2022), Naz et al. (2023), Manan and Amin (2023), Bashir, Rashid, and Bashir (2024), Shah, Mehmood, Khan, and Popp (2024), Khan and Kamal (2024), and Khan, Khan, and Kamal (2025). Sample sizes in this set run from a single year cross section to panels of more than 300 nonfinancial companies. The review privileges results that are stated in the published abstracts and article reports, and it does not invent coefficients that those reports do not contain.

Accrual measurement in the reviewed studies follows a known family of models. The modified Jones approach of Dechow, Sloan, and Sweeney (1995) is the most common. Performance matched or performance adjusted residuals in the spirit of Kothari, Leone, and Wasley (2005) appear in studies that wish to avoid confusing profitability with discretion. Kasznik (1999) is part of the same conversation because cash flow from operations can be included so that accruals are not mistaken for cash performance, and Kamran and Shah (2014) include that specification among the four models they estimate. A study that finds the same ownership result across the Jones model, the modified Jones model, a cash flow adjustment, and a performance adjustment is more persuasive than a study that reports a single residual. This article gives more interpretive weight to results that survive that kind of check, and it says so when a result comes from one specification only.

Real activity measurement follows Roychowdhury (2006), sometimes combined with an accruals model that also attends to estimation error. Dechow and Dichev (2002) relate working capital accruals to past, present, and future cash flows, so that the residual reflects accrual estimation error and, with it, a dimension of earnings quality that is not identical to opportunistic discretion. McNichols (2002) discusses that approach and links it back to the Jones tradition. Khan, Kamal, Abbas, and Hussain (2022) estimate discretionary accruals with a McNichols style combination and estimate real activity manipulation separately. Their design is better suited to the substitution problem than a design that stops at the modified Jones residual. When this article reports that discretionary accruals declined across the years surrounding the 2017 code, the statement is tied to that study and is not treated as a market wide census conducted for the present paper.

Endogeneity is the central threat to every governance coefficient in this literature. Independent directors may be appointed by firms that already manage earnings less, in which case the negative coefficient flatters the directors. Firms that intend to manage earnings may resist a truly independent audit committee, in which case the committee coefficient is a choice rather than an effect. Difference in differences designs around the 2017 code, fixed effect panel estimators, generalised method of moment's estimation, and propensity score matching are the main responses visible in the recent Pakistani studies. None of these devices is magic. A regulatory shock helps when the shock changes board composition for reasons that are not identical to the firm specific desire to manipulate accruals. Fixed effects remove time invariant firm traits but do not remove a change in manipulation that causes a change in board structure. This article reports the estimator a study used and does not upgrade an ordinary least squares correlation into a causal claim.

There is a particular level of caution that needs to be taken with mediation design.

Manan and Amin (2023), taking the logic of Baron and Kenny (1986), investigate the hypothetical mediation role of earnings management between governance and financial performance. Their focus is on 191 nonfinancial companies with data from 2010 to 2019, and they compare their results on return on assets, and evaluate their discretion according to the Kothari approach. A mediating pattern is informative where the governance association with earnings management is non-significant, earnings management association with earnings is significant, and the governance association with earnings while controlling for the earnings management is non-significant. When those steps aren't completed, it's not informative. The mediation claim is supported for the governance variable of independence on the board and is not supported for the other governance variables they test in their results. In this article, that particular mediation is considered to be a finding of independence, not to be generalised as a picture that all governance in Pakistan adopts methods of earnings management.

The tables and figures that follow are comparative tools, rather than estimated outputs. Table 1 presents the design and the board related findings of the major Pakistani studies. The number of studies that actually tested the relationship between board independence and discretionary accruals in the figure is merely illustrative of the number that found a negative association, no association, or a positive association between board independence and discretionary accruals. Table 2 and Figure 2 perform the same function for evidence for the audit committee. Table 3 and Figure 3 do it for ownership; in this case, the figure was limited to institutional ownership, as there are equally serious studies that go in opposite directions. The number of studies are not effect sizes, they are just counts. The fact that one company has an 89 sample size as opposed to a 372 sample size does not give the 89 study the same inferential weight as the study with the 372 sample size. The figures are a map of the literature in the sense that they represent the results of a search for the literature. The sample sizes, the periods and the conflicts that a bar cannot show are present in the prose.

Board Structure and Accrual Earnings Management

The first research question is answered by setting the board studies side by side rather than by averaging them into a false consensus. Table 1 reports the sample, the period, the earnings proxy, and the board result of each major Pakistani study used in this review. The designs are not interchangeable. The earlier studies observe the Karachi Stock Exchange from 2003 to 2012, with samples of 89, 120, and 372 companies. The later studies observe the Pakistan Stock Exchange, often with more than 170 companies and, in the regulatory studies, with 323 nonfinancial companies from 2015 to 2019. A reader who treats a duality coefficient from the earlier window as a contradiction of an independence coefficient from the later window is moving too fast. The windows differ, the codes differ, and in several cases the earnings proxy differs. What can be compared is the direction of the association and the care of the design.

Table 1 Published Designs on Board Monitoring in Listed Pakistani Companies

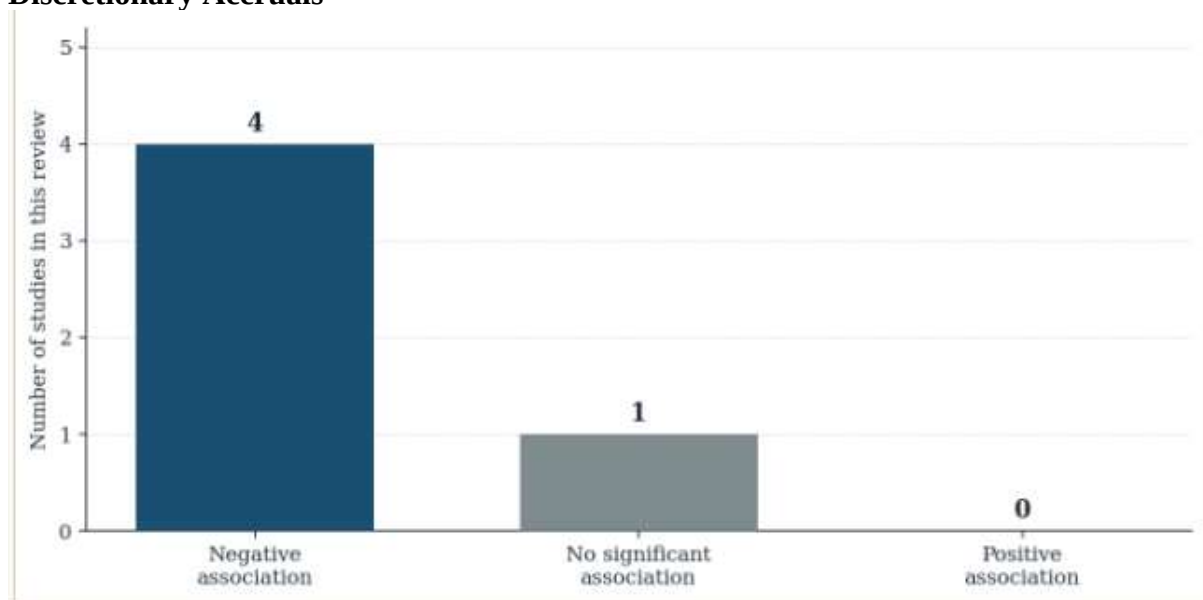
Study	Sample and period	Earnings measure	Board result
Kamran and Shah (2014)	372 listed companies, 2003 to 2010	Four accrual models	Board size is not related to discretionary accruals.
Iqbal, Zhang, and Jebran (2015)	89 nonfinancial companies, 2003 to 2012	Modified Jones model	Board size is insignificant. Chief executive and chair duality is positive.
Latif and Abdullah (2015)	120 nonfinancial companies, 2003 to 2012	Discretionary accruals	Board independence is not significant. Duality is positive.
Khan, Kamal, Abbas, and Hussain (2022)	323 nonfinancial companies, 2015 to 2019	McNichols accruals and real activities	Independence and financial expertise are negative for accruals after the 2017 code.
Naz et al. (2023)	172 companies, 2012 to 2019	Accruals and real earnings management	Independence is negative for accruals. Board size is positive for real earnings management.
Manan and Amin (2023)	191 nonfinancial companies, 2010 to 2019	Kothari discretionary accruals	Board independence reduces earnings management.

Board size is the weakest of the board variables in this literature, and the weakness is consistent enough to be believed. Iqbal, Zhang, and Jebran (2015) find no significant association between board size and discretionary accruals in fixed effect estimates for 89 nonfinancial companies. Kamran and Shah (2014), working with 372 listed companies from 2003 to 2010 and with four accrual models, likewise find no evidence that the number of directors on the board influences discretionary accruals. A large board is sometimes defended as a source of counsel and sometimes attacked as a forum that no one controls. Jensen (1993) argues that oversized boards are easier for the chief executive to capture and slower to act when performance deteriorates. Yermack (1996) finds that smaller boards are associated with higher market valuation. Neither of those international results is a finding about Pakistani accruals. They do explain why a null result on board size should not be spun into a recommendation to add seats. In the Pakistani evidence, adding directors, by itself, is not a demonstrated restraint on earnings management.

Leadership duality tells a sharper story in the earlier window and a quieter one later. Iqbal, Zhang, and Jebran (2015) find that the combination of the chief executive role and the chair role is positively associated with earnings management. Latif and Abdullah (2015), studying 120 nonfinancial companies over a similar decade, also find that chief executive duality is positively associated with earnings management. The monitoring interpretation is straightforward. A person who both manages the firm and chairs the board that is supposed to monitor management has reduced the separation between decision management and decision control. Kamran and Shah (2014) do not find a duality effect in their larger sample, so the result is not universal

even inside the earlier window. The fair conclusion is narrower than a slogan. Where duality is associated with discretionary accruals in Pakistani listed companies, the association is positive. It is not a device that the evidence credits with restraint. Board independence is the variable on which the later literature has the most to say. Figure 1 counts the studies in this review that tested independence directly. Four report a negative association with discretionary accruals, one reports no significant association, and none reports a positive association. The insignificant result is the earlier one. Latif and Abdullah (2015) expected independence to constrain earnings management and did not find a significant relationship. The negative results cluster in studies that observe the years of the amended 2012 code and the 2017 code. Khan, Kamal, Abbas, and Hussain (2022) study 323 nonfinancial companies from 2015 to 2019 and report that board independence and financially expert directors are negatively related to discretionary accruals in the period after the 2017 code and in the full period, whereas the earlier years inside their window do not show the same significant restraint. They also report that the accrual measure declined from 2015 toward 2019, and that an aggregate real activity measure declined from 0.18 in 2015 to 0.069 in 2019. Independence, in their evidence, is not a decorative compliance statistic. It lines up with lower accrual discretion once the 2017 reforms are in the data.

Figure 1: Direction of Published Findings on Board Independence and Discretionary Accruals



The family boundary qualifies that success. Khan, Kamal, Abbas, and Hussain (2022) report that the restraining association of independence and expertise is visible in smaller companies and in nonfamily companies, and that it is not visible in the same way inside family companies. Naz and colleagues (2023), using 172 Pakistan Stock Exchange companies from 2012 to 2019, similarly find that board independence has a substantial negative association with accrual earnings management, while board size has a significant positive association with abnormal discretionary expenses and with

overall real earnings management. They also report that managers in family owned companies alter reported earnings opportunistically. Taken together, these two studies support a conditional answer to the first research question. Independence and financial expertise are the board features that most reliably coincide with lower accrual manipulation in recent Pakistani evidence. That coincidence is weaker, and sometimes absent, where family control is strong. Board size does not earn a place in the restraining set, and there is some evidence that larger boards sit alongside more real activity manipulation.

Gender composition should not be forced into the same sentence as independence. Khan, Kamal, Abbas, and Hussain (2022) document that female inclusion on boards rose after the 2017 code, which is what the regulation intended. The association of female directors with discretionary accruals in that study is not negative. Khan and Kamal (2024) likewise report a positive relationship between female directors and discretionary accruals, and they report the same direction for real activity manipulation. The responsible inference is not that women director's cause manipulation. The responsible inference is that a quota style increase in female presence, if it is not matched by independence of mind and by relevant expertise, does not automatically reproduce the monitoring effect that independence and expertise display. Regulators who treat every compositional target as an earnings quality instrument will misread this evidence. The first research question is therefore answered in parts. Expertise and independence have support. Size does not. Duality is suspect in the earlier evidence. Gender targets have not been shown to constrain earnings management in the studies that measured them.

Audit Committees and Financial Expertise

The second research question concerns the committee that is supposed to look at the accounts more closely than the full board. Table 2 isolates the audit committee evidence so that it is not blurred into a general claim about governance. Two studies of the 2003 to 2012 Karachi Stock Exchange window agree with the international benchmark associated with independent audit committees. Iqbal, Zhang, and Jebran (2015) find a negative association between audit committee independence and earnings management. Latif and Abdullah (2015) find the same negative association, and they also note that discretionary accruals are negatively correlated with audit committee independence in their descriptive evidence. These are the cleanest Pakistani results in the earlier period. They say that an audit committee which is not an extension of management coincides with less accrual discretion. They do not say that every committee labelled an audit committee does so. Independence is the attribute doing the work in both studies.

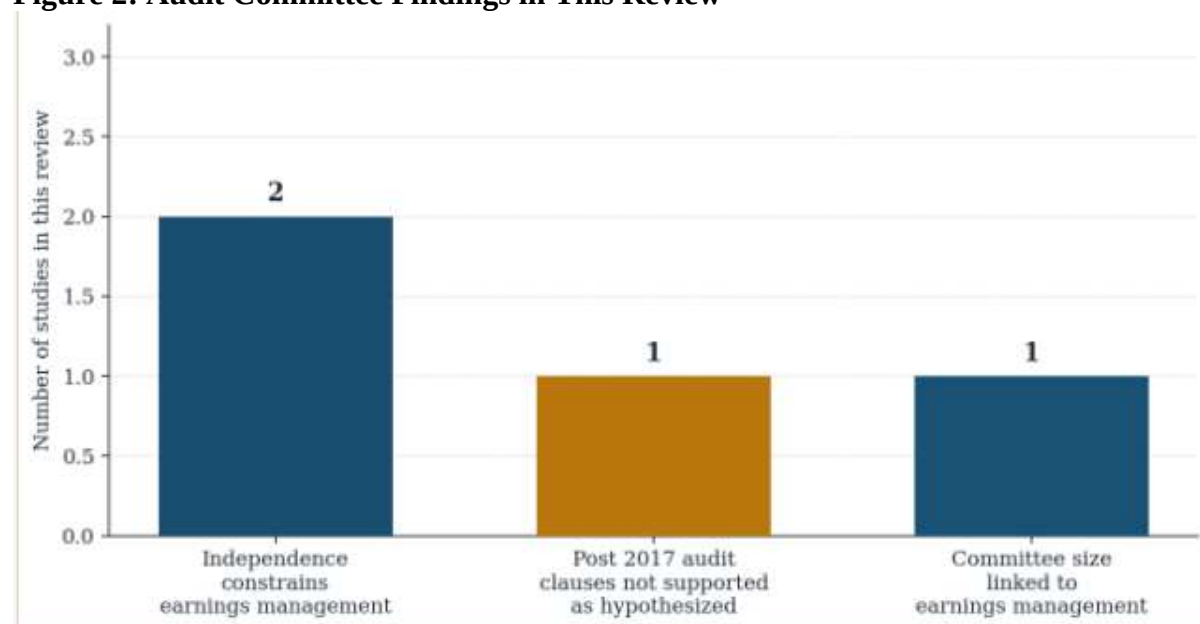
Table 2 Audit Committee Evidence from Listed Pakistani Companies

Study	Audit attribute	Published result
Iqbal, Zhang, and Jebran (2015)	Committee independence	Negative association with earnings management.
Latif and Abdullah (2015)	Committee independence	Negative association with earnings management.

Study	Audit attribute	Published result
Manan and Amin (2023)	Committee size	Relevant for earnings management. Mediation to performance is not found for this variable.
Khan and Kamal (2024)	Independence, expertise, and chair independence	These attributes rose after the 2017 code, but the hypothesised restraint did not appear.

Figure 2 summarises the pattern without pretending that every study used the same audit variable. Two studies link audit committee independence to lower earnings management. One study finds that audit committee size is a relevant governance factor for earnings management. One study of the 2017 reforms finds that audit committee attributes changed in the required direction while their relationship with earnings manipulation did not follow the hypotheses. Manan and Amin (2023) are the source of the size result. In a panel of 191 nonfinancial companies from 2010 to 2019 they treat board size, board independence, audit committee size, and ownership concentration as governance proxies, and discretionary accruals from the Kothari model as the earnings management measure. Board independence and audit committee size stand out as the governance factors that matter for earnings management. The performance result is more specific still. Earnings management mediates the path from board independence to return on assets. It does not mediate the remaining governance variables. An audit committee that is merely large, and an ownership block that is merely concentrated, are not awarded the same mediating role.

Figure 2: Audit Committee Findings in This Review



The 2017 reforms are the hardest test, because they were designed to strengthen the audit committee and not only the board. Khan and Kamal (2024) examine 323 listed companies from 2015 to 2019 with panel estimators and a difference in differences approach aimed at endogeneity. Relative to the years before the 2017 code, board and

audit committee variables increased significantly in the later years. Financial experts on the board and board independence retain a negative effect on discretionary accruals. Female directors do not. On the audit committee itself, independence, expertise, and the independence of the chair all differ between the earlier and later years, yet their relationships with earnings manipulation are not the relationships the hypotheses predicted. This is the most important negative result in the recent literature, and it should not be softened. A reform can succeed at changing the observable structure of the audit committee and still fail, inside the same sample period, to produce the accrual restraint that justified the reform. Structure is observable in the annual report. Restraint has to be earned in the residual.

Even when accruals decline, the substitution problem helps to keep the audit result of good reporting quality intact. Khan and Kamal (2024) conclude that the positive correlation between female directors and manipulation holds true for real activity as well as for accruals, as this is not just a result of one residual. Khan, Kamal, Abbas, and Hussain (2022) conclude that they did not detect a significant correlation between board independence or expert directors and real activity manipulation even when they do not facilitate accruals. In the event that the discretion of accrual goes down and the real manipulation goes up, then the code might just be switching to another channel instead of retiring the incentive. That was a channel shift that Cohen, Dey, and Lys (2008) recorded following a rather different statute. The Pakistani evidence is not yet a clean case of the same change, since some of the real activity associations are just insignificant, not yet significantly positive. This is still a warning of insignificance. Audit reform based on the notion of discretionary accruals can be considered a success when cash flow measures cannot.

The second research question is thus answered in part. Audit committee independence in the evidence appears to be the governance variable most consistently associated with a restraining effect in the 2003-2012 evidence. In the evidence period 2010–2019, the size of the audit committee, together with the independence of the audit committee, is one of the variables that affect discretionary accruals, and mediation to operating performance is limited to independence. The committees were more independent and more knowledgeable about the audit in paper in the specific test of the audit clauses in the 2017 audit, and the hypothesized restrictions on those audit attributes didn't. Independence of the audit committee chair is not as well covered as expertise on the board. An international audit committee template that is copied into a concentrated ownership market should be prepared for this partial effect and audit the results of the committee by accruals as well as the real activity, but not just the statistics on its composition.

Ownership Structure and the Character of Earnings Management

Ownership is the setting in which Pakistani earnings management either makes sense or becomes a mechanical exercise in residuals. Table 3 places the ownership findings of the main studies in one view. The dominant early result is about insiders. Kamran and Shah (2014) find that discretionary accruals increase monotonically with the ownership percentage of directors, their spouses, children, and other family members. The result survives alternative accrual models. It supports the view that managers and directors who are entrenched inside the ownership structure can influence accounting

numbers in their own interest. The same study finds that institutional investors play a significant role in constraining earnings management. It does not find that ownership concentration, chief executive duality, the size of the audit firm, or the number of board members influences discretionary accruals. Among controls, more profitable firms, growing firms, and more leveraged firms manage earnings more actively, and earnings management declines with firm age. That control pattern reappears often enough in this literature to be treated as part of the Pakistani fact, not as a nuisance to be ignored.

Table 3 Ownership Evidence from Listed Pakistani Companies

Study	Ownership measure	Published result
Kamran and Shah (2014)	Director and family stakes, institutions, concentration	Discretionary accruals rise with insider family ownership. Institutions constrain. Concentration is not significant.
Latif and Abdullah (2015)	Institutional shareholding	Positive association with earnings management.
Bashir, Rashid, and Bashir (2024)	Institutions and concentration	Institutions reduce earnings management. Concentration is related to accruals.
Shah, Mehmood, Khan, and Popp (2024)	Managerial, institutional, and family ownership	Earnings management is opportunistic. Managerial ownership is weakly tied to a more efficient form.
Khan, Khan, and Kamal (2025)	Family business group affiliation	Affiliated firms show less earnings management. Governance does not fully protect minority owners.

Institutional ownership is the point on which honest studies disagree, and Figure 3 is drawn to keep the disagreement visible. Two studies in this review, Kamran and Shah (2014) and Bashir, Rashid, and Bashir (2024), report that institutional investors restrain earnings management. Bashir and colleagues, using ordinary least squares and a modified Jones measure of discretionary accruals for companies listed on the Pakistan Stock Exchange, also find that the number of directors and ownership concentration are related to discretionary accruals, and that significant institutional investment reduces the force of concentration. One study points the other way. Latif and Abdullah (2015) find that institutional shareholding is positively associated with earnings management, even while audit committee independence is negative in the same paper. A fourth study does not find a significant role for institutional ownership in distinguishing efficient from opportunistic manipulation. The institutional investor in Pakistan is not a single economic actor. A pension fund with a monitoring mandate and a friendly financial institution sitting beside a sponsor are both capable of being coded as institutional. Until studies separate those types, the bar in Figure 3 will remain split, and it should remain split.

Figure 3: Institutional Ownership Findings in This Review

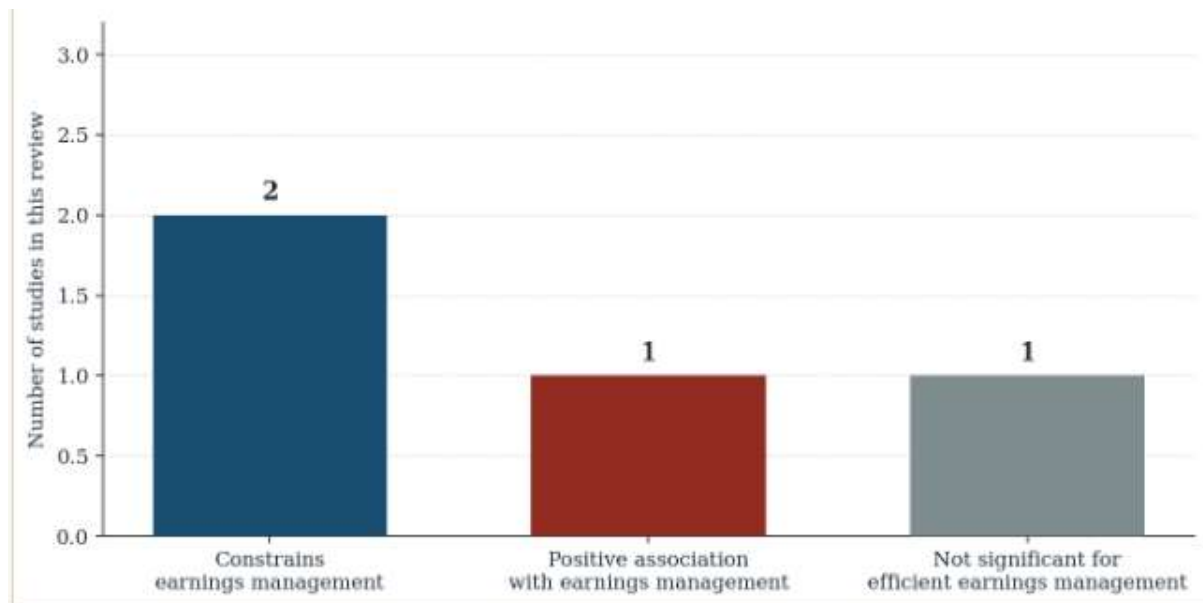
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The character of the manipulation is no longer an open compliment to management. Shah, Mehmood, Khan, and Popp (2024) study companies listed on the Pakistan Stock Exchange from 2010 to 2019, measure discretion with the modified Jones model, and judge the character of earnings management by its association with future cash flow, future discretionary income, and the future change in earnings. Feasible generalised least squares estimates indicate that earnings management in the selected companies is opportunistic. It does not improve the information in earnings about future performance. Managerial ownership has a weak but significant association with the type of earnings management, in the direction of a more efficient use of discretion where managerial ownership is high. Institutional ownership, family ownership, a larger board, an independent board, and a high ratio of independent directors on the audit committee do not show significant evidence of efficient earnings management. The monitoring variables that sometimes reduce the amount of discretion do not, in this design, convert the remaining discretion into a signal that outsiders can trust. Opportunism is the baseline. Efficiency is the exception, and a limited one.

Family business groups require a separate paragraph because they are not the same object as the personal shareholding of directors. Khan, Khan, and Kamal (2025) study 327 nonfinancial companies from 2010 to 2019, of which 187 are affiliated with family business groups and 140 are not. Earnings management is less prevalent in affiliated companies, and the association between group affiliation and earnings management is negative and significant. Governance quality is also higher in affiliated companies than in nonaffiliated companies. The authors interpret the package through the conflict between controlling principals and outside principals. Governance does not reliably stop controlling shareholders from using their position against minority shareholders, even where the accrual measure is lower than in stand-alone companies. Lower earnings management is not the same thing as safe minority shareholders. A group can report cleaner accruals and still move value through related party dealings that an accruals model will not catch. That limit should sit in front of any celebration of the negative affiliation coefficient.

International evidence stops the Pakistani split from being treated as confusion. Bushee (1998) shows that institutional investors are not one type, and that short horizon investors can press managers toward myopic cuts while dedicated institutions monitor. Cheng and Warfield (2005) link managerial equity incentives to earnings management aimed at targets. Anderson and Reeb (2003) show that founding family ownership can be a performance advantage, which leaves room for lower earnings management inside some family groups. Ali, Chen, and Radhakrishnan (2007) show that family firms differ in disclosure because the conflict with outside shareholders and the conflict with salaried managers are not the same conflict. Director shareholding, group affiliation, and family management can therefore point in different directions without any one study being careless.

The answer to the third research question has several parts. Insider ownership by directors and their families is associated with more discretionary accruals in the broadest early sample, and that result is robust to the choice among standard accrual models. Institutional ownership sometimes constrains and sometimes does not, and one careful study finds a positive association, so institutions cannot be written into the code as an automatic monitor. Ownership concentration is insignificant in the early large sample and relevant in later ordinary least squares evidence, which is too unsettled for a firm rule. Family business group affiliation coincides with lower earnings management and does not, on their own argument, solve the conflict between controlling owners and minority owners. Across these ownership forms, the character of earnings management in listed Pakistani companies is predominantly opportunistic. Governance changes the room in which opportunism operates. It has not been shown to turn opportunism into efficient signaling, except weakly where managerial ownership itself is high.

Conclusion

The arguments put forth in this article warrant a strong but limited conclusion. Relationship of corporate governance with earnings management has been found in Pakistan listed companies and it is selective. It is not an overall shine that is imposed upon any solid that have the boxes of a code. The most consistent findings in the literature on the years around the 2012 and 2017 reforms are that boards that are independent are associated with lower discretionary accruals, and that boards with better financial knowledge are associated with lower accruals. Audit committee independence is strongly negatively associated with the evidence of 2003–2012, and has a considerably less favorable association in the direct test of the 2017 audit clauses. The size of the board is often irrelevant as a limiting factor and sometimes linked to increased actual management of the board. In two studies of the earlier window, having two leaders (chief executive and chair) was a risk factor, but this was not always observed. Female representation increased due to the code mandate and the studies that examined the code did not identify a negative relationship with earnings management. A high level of discretionary accruals has been associated with insider and family shareholding in the biggest study so far. High discretionary accruals are associated with insider and family shareholding in the largest study to date. There are some designs in which institutional investors participate and others in which they do not. Familiarity with the family business groups, in which the controller is less

inclined to engage in earnings management than in nonaffiliated firms, does not eliminate the conflict between the controller and the minority. The earnings management that is left, at best on the first direct test, is opportunistic.

These results should shift discussion on how the code should be used. The Securities and Exchange Commission of Pakistan (SEC) has kept the structure of Independent Directors, Audit Committees and Expertise from the Listed Companies Code of Corporate Governance Regulations 2019. That architecture isn't a wasted effort. The most local support the architecture has is the post reform evidence on board independence and board expertise. Other evidence states that there is no correlation between compliance and outcomes. The link between audit committee independence, expertise, and chair independence and reduced manipulation does not materialize and these three variables may actually rise following a regulation. A regulator that will stop when the residual is the same will pat itself on the back during those years. Supervision after 2019 should include testing whether the accruals and real activity measures move and that movement should be subjected to a test in family controlled companies in addition to other companies. A reform that succeeds on the outside of the market has not yet made it to the heart of the family companies.

Directors and investors have a more limited lesson to learn than the typical governance seminar. The successful coefficients are not a mark of an independent director who is not well versed in finances. The financial expert is also not the monitor, if he or she is relying on the sponsor for the seat. Consult the questions that audit committees put to the management to assess them, rather than how many meetings they have in a compliance statement, in terms of whether they are asking questions about estimates, dealings with related parties or questions about the switch from accrual manipulation to real manipulation. Institutional investors who want to perform the role identified by Kamran and Shah (2014) and Bashir, Rashid and Bashir (2024) of being a restrainer must be prepared to act as monitors as opposed to silent block holders. A lower accrual residual in a family group should not be considered as a blanket guarantee by minority shareholders. There is no conflict between cleaner accruals and other channels of private benefit.

Researchers need to cease to create and publish new versions of the regression that is "exchanged" by adding another governance dummy variable to an adapted version of the Jones residual and dub it a new theory. The open-ended questions now include specific questions. Like in the 2015-2019 period, does board expertise limit accruals after 2019, or does it turn out that it was a transition effect of the 2015-2019 period that Butt, Hassan and Shah (2009) might have suspected after the 2002 code? Do family firms eliminate independence not only in the accruals but also in the real activity measures that decreased overall between 2015 and 2019? Prior to reconciling the conflicting institutional results, can institutional investors be divided into either "dedicated monitors" or "short horizon traders" in Pakistani data as the theory of "Bushee 1998" suggests? Does the reduced earnings management persists when related party transactions and control wedges are directly accounted for in family business groups? But the literature will continue to declare the importance of governance and the praxis will remain uncertain about the device that matters and in which firm.

It is a good reminder of the international standard. According to OECD (2015),

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principles include that the board is accountable, that disclosure is timely and accurate and that the rights of external owners are real. Much of that language has been codified in Pakistan. The company evidence listed includes some translation into reporting behavior. When they are real, discretionary accruals go in the right direction due to independence and expertise. Ceremony does not. The studies which can be found reveal opportunistic earnings management. The challenge for the coming decade for Pakistan's research and supervision is not to discover that governance and earnings are related. It's quite right to say that each part of the code either shows a measure of constraint on the companies that dominate the market in opportunistic reporting, or is rearranged until it does.

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