

**Corporate Governance and Earnings Management:
Evidence from Pakistan's Listed Firms**

Submitted to

School of Business and Economics

In partial fulfillment of the requirements

For the degree of

MASTERS OF SCIENCE IN FINANCE

By

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RESEARCH COMPLETION CERTIFICATE

It is certified that the research work contained in the thesis “Corporate Governance and Earnings Management: Evidence from Pakistan’s Listed Firms” has been conducted under my supervision by Mr. MOHSIN MUMTAZ, ID, 15008096-010, of MS Finance program.

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DECLARATION

I MOHSIN MUMTAZ, ID # 15008096-010 hereby declare that the work entitled “Corporate Governance and Earnings Management: Evidence from Pakistan’s Listed Firms” is my own work and no part of this discretion has been copied from any other source except where explicit acknowledgement is made in the text.

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This thesis is my original work, and the data/material presented herein has not been used for the acquisition of any other degree from any institution.

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DEDICATION

To

My Parents and Teachers

ABSTRACT

The research employs fixed effects methodology to examine the impact of corporate governance on earnings management in non-financial firms of KSE 100 index within Pakistan from the period 2010 to 2016. Corporate governance mechanisms examined comprise board size, board meetings, audit committee independence, audit committee meetings, big 4 audit firms and managerial ownership. While earnings management is measured through discretionary accruals measured in accordance with the Modified Jones Model (1995). Results of the study indicate that larger board encourages earnings management through increased board diligence appears to have a controlling impact on profits manipulation by management. Further, we find that lower percentage of insider shareholding encourages earnings manipulation. This could stem from the overriding influence of larger block holders and institutional shareholders on the smaller shareholders for the achievement of short term profits by firm leading to earnings management. While more independent members on audit committees encourage earnings manipulation which is in line with the findings related to board size. We also find that more the board members meet, would reduce the earnings management practices. It suggests that board and audit committee members may encourage earnings manipulation from the need to protect their credibility and reputations in the markets by showing robust earnings and firm performance. This is the first study that provides glimpse of the impacts of corporate governance changes in response to the 2012 SECP Code of Corporate Governance, and we contend based our findings that there is a need for tougher legislation, and more elaborate measures with which to assess corporate governance performance within firms.

Key Words: Discretionary Accruals, Earnings Management, Corporate governance, SECP

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1. INTRODUCTION

Global corporate scandals of Enron and world com augmented the screaming for better corporate governance mechanism all over the world. Corporate governance is a system that able to converge managerial decisions with that of the shareholders and it plays an instrumental role in reducing the agency cost that arises due to the conflict of interest that exist between the principal (owner) and agent (manager). Agency problem originates naturally because of the separation between management and ownership. However, modern day business empowers manger (agent) to take decisions that would either converge with or diverge with the interest of owner. Hence managers are able to use their powers in order to achieve their personal goals at the cost of the owner (Jensen & Meckling, 1976).