

## **CEO Optimism, Accounting Conservatism and Earnings Management of Listed Manufacturing Firms: Evidence from Asian Emerging Economies**

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It is pertinent to understand how CEO optimism and accounting conservatism influence earnings management to verify the reliability and accuracy of financial reporting. The motivation behind this research comes from the possible implications for financial transparency, regulatory oversight, and investor trust while focusing on the usefulness of corporate governance. The research explores the influence of CEO optimism and accounting conservatism on earnings management within Asian emerging economies, analyzing data from listed manufacturing firms between 2010 and 2022. The study finds a negative correlation between accounting conservatism and earnings management while CEO optimism positively correlates with earnings management. These findings imply that conditional conservatism diminishes the possibility for management to inflate earnings. However, CEO optimism increases the likelihood of a firm's earnings management. This research ought to offer a thorough understanding of accounting conservatism and CEO optimism and the effect that these factors have on earnings management from the context of Asian emerging economies.

**Keywords:** CEO optimism; accounting conservatism; earnings management; Asian emerging economies

**JEL:** G30, M41

Earlier research shows that the standard and effectiveness of financial reporting factual information influence the success of the firm (Hunjra et al., 2020; Hunjra et al., 2022). The management of a firm's earnings can make valuation and investment choices more difficult. We investigate whether or not conditional conservatism places constraints on earnings management (Aliahmadi, 2023; Boulhaga et al., 2023). Conservatism is a term used to describe an approach to financial reporting that minimizes the value of assets and revenue. An accountant's conservatism is the tendency to require more confirmation to acknowledge profit (positive earnings news) than to recognize losses (Basu, 1997; Alves, 2023). Conservatism is summarized by the phrase "expect no gains, but loss", which means that management detects 'bad news' in declared earnings sooner than 'good news' (Rickett et al., 2016). Further, accounting conservatism improves the accuracy of financial reporting information and reduces informational asymmetries, agency conflicts, and management's opportunistic choices (Asri, 2017).

Conditional conservatism has the potential to increase the market value of the firm, which in turn increases the capacity to get low-cost financing from outside sources (Guay & Verrecchia, 2018). Earnings management denotes to the intentional manipulation of accounting records by management in order to achieve specific earnings goals (Ruch & Taylor, 2015). Conservatism may lead to improve earning quality and decreases information asymmetry (Abdou et al., 2021). Conservative accounting is employed to ensure that firms do not exaggerate their earnings and the users of their financial reports can trust the information in these statements as they do not lead to overvaluation (Lev & Ohlson, 1982). However, conservative approach in accounting and earnings management have same outcomes as both show bias in preparing financial statement. The difference is that earnings management represents subjective choice made by individuals, conservatism arises from the established accounting standards.

In addition, conditional conservatism paves the way for the supervisory function of the business, which gives firms who adopt conditional conservatism an advantage in the managerial function of their businesses. Conditional conservatism makes it more difficult to control earnings since it necessitates greater evidence of gains than losses, therefore, it demands that firms recognize expenses and losses when they are certain while controlling the ability to manage earnings with aggressive profit recognition procedures. However, Ball and Shivakumar (2005) maintain that based on past studies, firms possibly manage earnings even though there are restrictions on accruals-based management imposed by conservative reporting standards. Although a loss on that investment is recognized through conservatism, the fund managers aim to avoid making an investment decision that involves a project with a negative net present value wherever possible before making the decision. After the investment project has been completed, a more accurate appraisal of the management's performance can be made using conservative financial accounts.

An important empirical characteristic of corporate finance theory is the firm investment decision misconception (Salehi et al., 2020; Hunjra et al., 2021). In recent years, a new field of study known as behavioural finance has emerged as a credible and relevant explanation of corporate decision-making that is still in its infancy (Mohamed et al., 2020). Managerial overconfidence and a positive outlook are two of the most resounding behavioural findings in corporate settings. Overconfident people in behavioral finance are those who are over-optimistic. A person's predisposition to have unreasonably optimistic views about what the future holds is the concept of optimism (Weinstein, 1980). Managers, in particular, are more prone than the average person to show signs of optimism (Landier & Thesmar, 2009). Overconfident managers have tendency to overstate the potential returns on firms' investments (e.g., Malmendier & Tate, 2005; Lin et al., 2005; Huang-Meier, Lambertides, & Steeley, 2016; Campbell et al., 2011; Alves, 2023). These board members believe that the value of their firms' stock is artificially low because investors are underestimating the potential for future growth or the cash flows from ongoing initiatives. CEOs with overconfidence are keen to take risky decisions which may include manipulation of financial reporting to show more favorable picture of company (Schrand & Zechman, 2012).

Previous research argues that conditional conservatism minimizes the incentives and possibilities for managing profits by requiring more evidence of gain than loss before recognizing any benefit. This restricts earnings management by prompting the rapid reporting of losses, such as through impairments and write-offs. Studies have shown that conditional conservatism is somewhat a matter of judgment because it is dependent on several accounting decisions (Lawrence et al., 2013). This indicates that there is far more nuance and complexity to the connections between accrual earnings management and conditional conservatism. Therefore, it is an intriguing area of study whether businesses may control earnings through accruals, achieve or exceed earnings objectives, and still adhere to their conservative reporting practices. Recent research in the field of accounting has connected overconfidence of managers to several factors, including the accuracy of earnings forecasts (Hilary & Hsu 2011), income smoothing, and the credibility of financial statements (Ahmed & Duellman, 2013).

Our research contributes to this latter school of thought by delving into the link between overconfident management and earnings manipulation. Managerial confidence is related to conservative accounting practices (Ahmed & Duellman, 2013). To be conservative in accounting means to expect no gains and plan for every possible loss. To put it another way, if negative news has more influence in earnings compared to good news, then it stands to reason that this rule favors the latter (Basu, 1997). Overconfident CEOs are more inclined to speed up recognizing gain which is at odds with conservative accounting (Ahmed & Duellman, 2013). They discovered that self-assured chief executive officers are less likely to utilize cautious accounting methods than their counterparts (Malmendier et al., 2011; Campbell et al., 2011). Current study expands this debate by investigating the role of CEO optimism in earnings management.

The study outlines the theoretical underpinnings of conservatism and optimism in financial decision-making and reporting, illustrating how these factors potentially influence earnings manipulation. Firms in Asian emerging economies have distinctive market features and attributes with uncertain economy (Sumiyana, 2020). The financial sector faces many challenges to survive in competitive global business situation (Zhang et al., 2024). Previously, the studies examined the link between accounting conservatism and managerial optimism individually. This examination adds to the literature covering the aspects of conditional conservatism managerial optimism and earnings management from Asian emerging economies. As CEOs are more overconfident in developing economies and they manage earnings in these economies confidently because of having little competition as compared to developed nations (Sumiyana et al., 2023). Further, CEOs in these economies accomplish their responsibilities boldly due to unique organizational structure and closed access to leadership position. Therefore, it will be interesting to investigate how CEOs in Asian emerging economies contribute to manage earnings.<sup>4</sup>

Further, previous researches have not comprehensively examined the complex relationship between the conservative accounting, CEO optimism and earnings management, mainly in developing countries. This disparity highlights the need of conducting a comprehensive analysis to better understand how these factors are important to determine earnings management. We select manufacturing sector in our study because in competitive business environment worldwide, this sector faces financial hurdles to earn better revenue mainly in emerging economies (Mehmood et al., 2019). Further, managers in emerging countries also face challenges to manage earnings and financial aspects ineffectively (Khan et al., 2020). Understanding the pivotal significance of CEO optimistic behavior and accounting conservatism, this study fills the gap by considering the effects of both factors on earnings management. Our outcomes suggest that accounting conservatism negatively while managerial optimism positively relate to earnings management. The study is helpful for policymakers, regulators and investors. This examination ought to deliver investors a complete grasp of conditional conservatism and managerial optimism and how those factors affect the firm's adaptability to manage its earnings.

The following is a brief overview of the paper's structure: Second, we give an understanding of the related literature. In the third section, the data and methods are given. Sections 4 and 5 summarize and discuss the paper's results and conclusions.

### **Review of Literature and Hypotheses Development**

The present section comprehensively discusses previous studies on accounting conservatism, managerial optimism, and their effects on financial reporting and earnings management. Two different manifestations of conservatism have been identified by the aforementioned Beaver and Ryan (2005) and Ball and Shivakumar (2005). First, accounting can be conservative in the sense that it is ex-ante or unaffected by external factors such as news. Accounting conservatism may depend on managerial ability because managers with high abilities follow accounting conservatism as it is beneficial for stakeholders and firms (Haider et al., 2021). Unrecognized goodwill arises because of the conservative assessment and recognition criteria used for assets and liabilities at their beginning, which results in an ongoing underestimate of net assets. Unconditionally cautious procedures include the rapid expensing of some intangibles like R&D or the accelerated depreciation of P&E. This is because economic losses are recognized into accounting earnings at a sooner and more complete rate than gains due to the stricter verification standards for recognizing losses. This prudence is called the asymmetric timely nature of earnings, as described by Basu (1997). Some situations that call for a conditional conservative approach include the valuation of inventory at a lesser cost or market and the accounting for fixed-asset impairments. Thus, the essential aspects of conditional conservatism are the prompt acknowledgement of economic losses by businesses that will become evident shortly and the imposition of a sticker assessment for the recognition of advantages.

There is a lack of empirical data in the literature on the subject matter, and earlier analytical research offers inconsistent conclusions. One school of thought holds that conditional conservatism is a cause of failure when it comes to managing a business's profits. This can be understood because both conservatism and conditional conservatism reduce managerial opportunities to inflate earnings, thereby reducing the earnings management as suggested by Chen et al., (2007). Moreover, conservative accounting, as advocated by Chen et al., (2007), makes it such that low-profit figures are less indicative of inadequate performance, making earnings management less desirable. These studies assert that conservatism diminishes the probability of managing earnings consistent with the research demonstrating that higher conservatism is favorable and economically beneficial for improving firm performance. Earlier studies indicate that enterprises implementing conditional conservatism in their financial statements reporting benefit in terms of better credit conditions (Lara et al., 2016), with cheaper costs on equity funds (Kim et al., 2013; Li, 2015). The firms that stray from their historically conservative reporting policies to meet or surpass a profit target would no longer reap these benefits or would reap them to a much lesser extent. Conservative policies have been shown to minimize debt expenses, while Ahmed et al. (2002) offer similar justifications. A new stream of analytical research, on the other hand, gives contradictory reasoning and suggests that conservatism might boost revenue management.

Bertomeu et al., (2017) describe that managers increase pay-for-performance contracts to maintain their payment level when conservatism decreases current profitability. The marginal value of profit management will increase as a result of these more stringent contracts. Consistent with this view, Caskey and Laux (2017) indicate that conservatism encourages board scrutiny of the executive team. The value of limiting accounting information to prevent board scrutiny has consequently increased in light of the current climate. Furthermore, Al Ani and Chong (2021) asserted that companies that are more conditionally cautious can manage their earnings more effectively because they can afford larger impairments and contingencies. This may indicate that their financial statements are less manipulated. Previous studies have shown that an inflated balance sheet can act as a barrier to future profit

management and that aggressive accounting actions add up to the balance sheet. Conditionally conservative organizations may absorb impairments and provisions to rein in earnings, but doing so might cost the company the stated conditional conservatism benefits. In light of the above studies, the following hypothetical statement is developed.

*H1: Conditional conservatism has a significant impact on earnings management.*

Overconfident managers have an optimistic perspective on future risk and returns, and they also overestimate the quality of the information on which they are basing their projections of future business earnings and cash flows. Moreover, firms can reduce risk with effective governance and control processes (Rehman & Ishak, 2022). Some COEs with overconfidence can manage earnings due to their self-belief (Sumiyana et al., 2023). However, any mismanagement practice on governance side and administrative failure may lead to unfavorable financial outcomes (Shah et al., 2019). Effective leadership requires an appropriate amount of self-confidence, but misrepresenting one's ability can result in costly errors (Rajabalizadeh, 2023). In contrast, overconfident CEOs may be helpful in reducing the risk by underestimating possible challenges (Sutrisno et al., 2023). Executives who are too optimistic may inflate their reported earnings for the present quarter by reinvesting funds from future periods. Overconfidence on the part of managers can induce profit smoothing by causing them to overestimate the reliability of future cash flows (Bouwman, 2014). Further, overconfident CEOs being considered as powerful individuals employ more earnings management (Kouaib, 2023). Corporate governance procedures play a crucial part in preventing actual earning management.

Schrand and Zechman (2012) document that executive overconfidence affects the actions of financial reporting. Further, they find that overconfidence increases the chance of fraud in financial statement fraud that needs to be monitored by internal and external governance. To a similar extent, Presley and Abbott (2013) and Ngo and Nguyen (2022) conclude that executive overconfidence is significantly related to financial restatements. The impact of management confidence on profit smoothing and earnings surprise was then studied by Bouwman (2014). Moreover, Bzeouch et al. (2024) describe that overconfident CEOs have behavioral biases and they have adverse effect on earnings quality. They uncovered a positive and statistically significant link between smoothing of earnings and inflated confidence levels among company executives. In reality, he demonstrated that optimistic managers had better predictable financial outcomes and fewer profit shocks than directors who were more pessimistic.

*H2: Managerial optimism has a significant impact on earnings management.*

## Method

The present study evaluates the effects of accounting conservatism and CEO optimism on earnings management. We selected the top 20 listed manufacturing firms based on market capitalization in the country's leading stock exchange which gives a total sample of 200 manufacturing firms from 10 Asian emerging economies<sup>1</sup>. We have excluded firms with missing data of more than 3 consecutive years. Therefore, we reached the final sample of 114 listed manufacturing companies. Financial institutions are omitted from the study due to the wide range of practices in which accounts are handled. Non-financial manufacturing companies listed on the stock exchanges of respective countries from 2010 to 2022 are taken as simple of the study. The data was taken from the annual reports of these companies. The variables of concern in the study are accounting conservatism, CEO optimism and earnings management. However, board independence, board size, audit committee activity, audit committee size, leverage, firm size, tangibility, and profitability are firm level control variables. A variable description is given in Table 1.

**Table 1**  
*Measurement of variables*

Variable	Abbr.	Measurement of Variables	References
Earnings Management	EM	Earnings management is measured with the discretionary accruals method calculated using the modified Jones (1991) model.	Hunjra et al. (2022) and Lara et al. (2020)
Accounting Conservatism	AC	Accruals are measured as (net income minus cash flows from operations) divided by the average total asset	Givoly & Hayn (2000) and Wibawa & Wardhani (2018)
CEO Optimism	CEO_O	A value of one if CEOs are rated as optimistic and a value of zero otherwise	Lin et al., (2005)
Board Size	BSZ	Total board members	Jabeen and Ali (2017) and Fariha et al., (2022)
Board Independence	BIND	Ratio of independent directors	Fariha et al., (2022)
Audit Committee Size	ACM	Audit committee members	Mawardi et al., (2022)

<sup>1</sup> China, India, Indonesia, Lebanon, Malaysia, Pakistan, Philippines, Thailand, Turkey and Vietnam

Audit Committee Activity	ACA	Audit committee meetings per year	Mawardi et al., (2022)
Firm Size	FS	FS is the natural logarithm of the average total assets	Hunjra et al., (2021)
Leverage	LEV	Debt to total assets ratio	Mehmood et al., (2019)
Profitability	ROA	Net income/Total assets	Mehmood et al., (2019)
Tangibility	TAN	Annual percentage in total assets	Lu-Andrews and Yu-Thompson (2015)

We employ the regression model for testing study hypotheses as follow.

$$(EM)_{i,t} = \alpha_{i,t} + \beta_1(AC)_{i,t} + \beta_2(CEO\_O)_{i,t} + \beta_3(BSZ)_{i,t} + \beta_4(BIND)_{i,t} + \beta_5(ACM)_{i,t} + \beta_6(ACA)_{i,t} + \beta_3(FS)_{i,t} + \beta_4(LEV)_{i,t} + \beta_5(ROA)_{i,t} + \beta_6(TAN)_{i,t} + \epsilon_{i,t} \dots\dots\dots(1)$$

Where EM is firm earnings management, CEO\_O serves as a proxy for CEO optimism and AC is accounting conservatism. AC and CEO\_O are independent variables. The control variables of the study include BSZ describing board size, BIND showing board independence, ACM is audit committee size, AQ indicating audit quality, FS representing firm size, LEV denoting leverage, ROA representing profitability and TAN denoting tangibility.

Our study utilizes discretionary accruals (DA) as an indicator of earning management. Estimation of DA is employed with the help of cross-sectional modified Jones (1991) model.

$$\frac{TACit}{TAS\ t-1} = \alpha_0 + \alpha_1 \frac{1}{TAS\ t-1} + \alpha_2 \frac{(\Delta REVit - \Delta RECit)}{TAS\ t-1} + \alpha_3 \frac{PPEit}{TAS\ t-1} + \epsilon t \quad (2)$$

In equation 2, TACit stands for total accruals in the year t (calculated as net income minus cash flow from operations); TAS $t-1$  denotes total assets for the year t-1. REV  $it$  is the revenue difference between year's  $t-1$  and  $t$ , and RECit is the receivables difference between year's  $t-1$  and  $t$ . PPEit denotes property, plant, and equipment of a firm in a year;  $\alpha_1$ ,  $\alpha_2$  and  $\alpha_3$  are approximated coefficients;  $\alpha_0$  is the constant and  $\epsilon$  is the error term. The coefficients are measured with the help of ordinary least squares. Moreover, non-discretionary accruals (NDAit) are determined by applying the following formula and putting the estimation method into equation 3:

$$\frac{NDAit}{TAS\ t-1} = \alpha_0 + \alpha_1 \frac{1}{TAS\ t-1} + \alpha_2 \frac{(\Delta REVit - \Delta RECit)}{TAS\ t-1} + \alpha_3 \frac{PPEit}{TAS\ t-1} \quad (3)$$

Then, we calculate DA (DAit) using the formula DAit = TACit - NDA it. The study employs the magnitude of DA to show proxy for EM, as suggested by Leuz et al. (2003). Table 1 lists descriptions of relevant variables.

We apply descriptive statistics to show the summary of the data, while correlation test to verify multicollinearity in the data. Panel regression method is utilized in the particular research to investigate the relationship between accounting conservatism, CEO optimism and earnings management. The main models of panel regression consist of fixed effect and random effect. As we get significant p-value from the Hausman test, we select fixed-effect model. Further we use the dynamic panel model to ensure the reliability of findings, while applying generalized method of moments (GMM) for analysis. González (2013) states that the GMM is utilized to deal with the autoregressive attributes of the dependent variable and the endogeneity related issues.

**Results**

Table 2 presents the results of descriptive statistics. The average value of earnings management is 11.634 with a standard deviation of 1.063 indicating that about 11 percent of firms in Asian emerging economies are engaged in earnings management practices. Accounting conservatism and CEO optimism have mean values of 0.110 and 0.543 suggesting that 11 % of sample firms follow accounting conservatism however, about half of the firms have overconfident CEOs. Also, the average values of the control variable show little variations in the data. It can be inferred from the facts presented in the aforementioned table that the data is normal, that the estimated variables do not exhibit any extreme values, and that the data follows a normal distribution. Furthermore, multicollinearity is assessed with variance inflation factor (VIF) in our study. The variance inflation factor (VIF) quantifies the degree to which multicollinearity has inflated a predicted coefficient. Measures how well each predictor variable in a model explains other explanatory variables. The acceptable values for VIF range between 1 to 5 (Nguyen et al., 2021), and some researchers suggest 1 to 10 as an acceptable range for VIF (Kim & Zhang, 2016). Considering that the values of the VIF are lower than 5, we can conclude that there is no need for concern regarding multicollinearity in the model.

**Table 2**  
*Statistical summary*

Variables	Mean	Median	SD	Maximum	Minimum	VIF
EM	11.634	10.917	1.063	20.560	1.231	---
AC	0.110	0.091	0.607	-0.371	0.128	1.31
CEO_O	0.543	0.706	0.440	1	0	1.27
BSZ	7.539	6.938	0.810	15	6	1.35
BIND	0.183	0.1715	0.938	0.627	0.053	1.41
ACM	4.183	4.083	0.816	5	3	1.37
ACA	6.153	5.495	0.795	10	3	1.42
FS	10.48	10.03	0.304	14.202	6.029	1.82
LEV	0.235	0.243	0.133	0.435	0.067	1.69
ROA	8.742	7.924	1.051	16.623	2.048	1.01
TAN	7.029	6.582	1.365	11.254	2.820	1.56

Note: EM is earnings management which is the dependent variable, AC and CEO\_O represent accounting conservatism and CEO optimism. BSZ, BIND, ACM, and ACA represent board size, board independence, audit committee size, and audit committee meetings, while FS, LEV, ROA and TAN denote firm size, leverage, profitability and tangibility.

Table 3 represents the level of correlation among explanatory variables of the study. However, the study results indicate that there is not a significant link between the independent variables, which ensures that there is not a problem of multicollinearity in our data.

**Table 3**  
Correlation analysis

	EM	AC	CEO_O	BSZ	BIND	ACM	ACA	FS	LEV	ROA	TAN
EM	1										
AC	-0.084	1									
CEO_O	0.043	-0.081	1								
BSZ	-0.106	0.085	0.058	1							
BIND	-0.092	0.078	-0.183	0.063	1						
ACM	-0.159	0.145	0.072	-0.124	0.084	1					
ACA	-0.082	-0.216	-0.173	0.192	0.137	0.237	1				
FS	0.057	-0.018	0.021	0.077	0.142	0.071		1			
LEV	-0.021	0.051	0.049	-0.098	0.058	-0.084	0.082		1		
ROA	-0.071	0.102	0.024	0.142	-0.068	0.132	0.143	0.058	-0.073	1	
TAN	0.123	0.063	0.044	0.152	0.091	0.081	0.094	0.069	-0.082	0.086	1

Note: EM is earnings management which is the dependent variable, AC and CEO\_O represent accounting conservatism and CEO optimism. BSZ, BIND, ACM, and ACA represent board size, board independence, audit committee size, and audit committee meetings, while FS, LEV, ROA and TAN denote firm size, leverage, profitability and tangibility.

It is possible to use the redundancy of the fixed effects likelihood test to determine which model the common effect or the fixed effect is preferable. The P-value serves as the criterion for inclusion in this study. The common effect model will be rejected if the likelihood test is substantial. The P-value is significant, hence the common effect hypothesis is ruled out in this case. As a way to help researchers choose between the two methods known as fixed effects and random effects, Hausman (1978) developed a test. This test shows us if the discrepancy between the fixed effect and random effect estimation methods is significant or not. According to the Hausman test, a fixed-effects model should be utilized to get consistent and efficient results.

**Table 4**  
*Results of Fixed Effect Estimation*

Variables	Model I	Model II	Model III
AC	-1.247** (-2.163)	---	-1.319** (-2.395)
CEO_O	---	1.075*** (3.967)	1.195*** (4.686)
BSZ	-0.405*** (-5.391)	-0.075** (-2.424)	-0.063*** (-4.239)
BIND	-0.138** (-2.295)	-0.215* (-1.763)	-0.037** (-2.375)

ACM	-0.192** (-2.235)	-0.234* (-1.835)	-0.375* (-1.752)
ACA	-0.424* (-1.819)	-0.215* (-1.717)	-0.063** (-2.275)
FS	0.219*** (4.638)	0.439** (2.536)	0.839*** (3.163)
LEV	-1.385** (2.035)	1.183** (2.162)	-1.262** (2.075)
ROA	-0.089*** (-4.465)	0.173*** (3.836)	-0.146** (-2.063)
TAN	0.075*** (4.263)	0.008*** (3.533)	0.114*** (3.235)
C	1.695** (2.422)	-1.295** (-2.085)	-2.245*** (-3.053)
Country Fixed Effect	Yes	Yes	Yes
Year Fixed Effect	Yes	Yes	Yes
R-squared	0.572	0.586	0.583
Adj. R-squared	0.566	0.562	0.547
F-statistic	12.578	10.231	11.514
Prob. (F-statistic)	0.000	0.000	0.000
Likelihood Test ( <i>P</i> -value)	0.000	0.000	0.000
Hausman Test ( <i>P</i> -value)	0.000	0.000	0.000

Note: EM is earnings management which is the dependent variable, AC and CEO\_O represent accounting conservatism and CEO optimism. BSZ, BIND, ACM, and ACA represent board size, board independence, audit committee size, and audit committee meetings, while FS, LEV, ROA and TAN denote firm size, leverage, profitability and tangibility. The independent variable in Model I is accounting conservatism (AC) and in Model II, CEO optimism is the independent variable. However, Model III is estimated using both independent variables. \* denotes  $p < 0.10$ , \*\* denotes  $p < 0.05$  and \*\*\* represents  $p < 0.01$ .

The results of the analysis reveal that accounting/conditional conservatism is negatively related to firms' earnings management. This can be understood because conservatism reduces incentives for earnings management by increasing the costs associated with doing so (Chen et al., 2007), and conditional conservatism limits managerial opportunities to inflate earnings by imposing stricter requirements for the recognition of good news (Gao, 2013). Further, the findings suggest a positive relationship between CEO optimism and earnings management. It suggests that a more confident CEO is more involved in earnings management. Schrand and Zechman (2012) concluded that executive overconfidence has an impact on the behaviour of financial reporting. They concluded that enhanced internal and external governance mechanisms do not ameliorate the effect of overconfidence in increasing the likelihood of financial statement fraud. Furthermore, Presley and Abbott (2013) discovered that CEO overconfidence is highly connected to financial restatements (Bouwman, 2014). Among corporate governance and audit characteristics variables, all have significant and negative effects on earnings management. It shows that board members fulfil their monitoring responsibilities to avoid any opportunistic behaviour which may also include earnings management (Epps & Ismail, 2009). Results relating to audit committee size and meetings are in line with the study of Bryce et al. (2015). Among other firm specific control variables, firm size and tangibility are significantly and positively related to earnings management. Leverage and ROA are negatively related to firm management aligned with the studies of Givoly and Hayn (2000) and Wibawa and Wardhani (2018).

**Table 5**  
*Robustness test*

Variables	Model I	Model II	Model III
L1	0.049*** (-3.312)	0.081*** (3.485)	0.316*** (-4.051)
L2	-0.412** (2.392)	0.898*** (3.411)	-0.515*** (-4.392)
AC	-1.284*** (-3.031)	---	-1.415** (-2.412)
CEO_O	---	1.015*** (3.833)	1.174*** (3.595)
BSZ	<b>-0.052**</b> (-2.431)	-0.175** (-2.319)	-0.073*** (-4.639)
BIND	<b>-0.345*</b> (-1.283)	-0.053* (-1.722)	-0.183** (-2.395)
ACM	<b>-0.535*</b> (-1.718)	-0.034* (-1.886)	-0.395* (-1.821)
ACA	<b>-0.362*</b> (-1.796)	-0.795* (-1.834)	-0.038** (-2.296)
FS	0.245*** (3.305)	0.415** (2.395)	0.595*** (3.015)

LEV	-1.441** (-2.179)	1.217* (1.734)	-1.312** (2.041)
ROA	-0.195*** (-3.063)	0.146*** (3.794)	-0.168** (-2.245)
TAN	0.087*** (3.351)	0.074*** (3.494)	0.114*** (4.018)
C	1.295** (2.057)	1.442*** (3.165)	1.458*** (3.072)
Sargan ( <i>P-value</i> )	5.675 (0.147)	8.735 (0.117)	7.695 (0.138)
AR <sub>1</sub> ( <i>P-value</i> )	0.032	0.021	0.031
AR <sub>2</sub> ( <i>P-value</i> )	0.411	0.396	0.374
Country Fixed Effect	Yes	Yes	Yes
Firm Fixed Effect	Yes	Yes	Yes
Year Fixed Effect	Yes	Yes	Yes

*Note:* EM is earnings management which is the dependent variable, AC and CEO\_O represent accounting conservatism and CEO optimism. BSZ, BIND, ACM, and ACA represent board size, board independence, audit committee size, and audit committee meetings, while FS, LEV, ROA and TAN denote firm size, leverage, profitability and tangibility. The independent variable in Model I is accounting conservatism (AC) and in Model II, CEO optimism is the independent variable. However, Model III is estimated using both independent variables. \* denotes  $p < 0.10$ , \*\* denotes  $p < 0.05$  and \*\*\* represents  $p < 0.01$ .

Results for robustness with dynamic panel estimates are described in Table 5. It is necessary to do the Sargan test to determine the authenticity of an instrument. Because the Sargan test results are so insignificant, the techniques used in this analysis can be verified. It is also possible to apply the Arellano–Bond test to verify the existence of autocorrelation. Further, Arellano–Bond first-order autocorrelation (AR1) is statistically significant, but AR2 is insignificant, implying that there is no autocorrelation. We find very similar results with GMM estimation as in our main hypothesis tests with fixed effect estimation.

## Conclusion

The purpose of this analysis is to provide a clear indication that conditional conservatism has a detrimental impact on earnings management in an Asian context. The investigation is focused on the impact of accounting conservatism and CEO optimism on earnings management. The research concludes that accounting conservatism plays a crucial role in curbing earnings management in Asian emerging economies. The findings of our study indicate that conditional conservatism lowers the earnings management by the firms emphasizing the importance of conservative financial reporting practices. Meanwhile, CEO optimism emerges as a factor that can potentially increase the likelihood of earnings manipulation. The outcomes of the study suggest that firms with a high conditional conservatism are less likely to involve earnings manipulations as compared to firms not involved in conditional conservatism.

The research on the effect that accounting conservatism and management optimism on earnings management can indicate an incredible breakthrough in the comprehension of its significance of it for executives, managers and investors. Therefore, the findings of the study provides various policy implications. The outcomes of this research are advantageous for financial managers and accountants in that conservatism helps in arranging financing sources while investing. This finding is important because it shows that conservatism helps in limiting earnings management by firms. Policymakers can employ regulations to encourage the adoption of conservative accounting practices and standards. An effective approach to accomplish this objective is to enforce a requirement for firms to use conservative accounting practices in their financial reporting. Further, policymakers should give importance to improving the disclosure and transparency needs of financial statements. This further certifies that stakeholders are well aware of any conservative approach employed by the firms, which ultimately minimizes the chances of manipulation. Outcomes provide practical implications for regulators in a way that regulators may provide guidelines regarding conservative accounting rules. This in turn leads to standardize the implementation of conservatism in different firms.

Findings propose that practitioners may adopt conservative accounting methods and rules in their working. This contains precautions in recognition of revenues, valuation of assets, and estimating liabilities. By applying these practices, the likelihood of earning management may be reduces. Overconfident managers tend to exaggerate the benefits of their investments and underestimate the costs. We anticipate that overconfident CEOs would declare lower estimates for future losses, boosting present profitability. Our findings add to the expanding body of work on overconfidence and accounting policy by demonstrating a connection between managerial confidence and earnings manipulation. Positive impact of CEO optimism on earnings management suggests that regulators can consider



improving the disclosure standards on the assessment of CEO optimism and its effect on financial reporting. Further, regulators need to enhance their monitoring the firms where CEO optimism is an important issue. They can improve audit quality with more frequent assessment of financial reporting. Moreover, Practitioners and policymakers need to emphasize the moral issues related to managing earnings that arises due to CEO optimism.

Our study is a comprehensive analysis covering manufacturing sector of Asian emerging economies. However, certain aspects need to be focused in future. First, future research may enhance the dataset while taking sample from outside Asian emerging economies with focus of non-manufacturing firms. Second, future research may consider additional control variables such as corporate governance indicators, market competition intensity, and macroeconomic conditions, to refine the analysis and capture more nuanced effects. Third, in future, research could consider composite index or employ mixed methods to measure CEO optimism. These methods can include qualitative assessments, text analysis of communications, or behavioral measures. Fourth, quality of external audit can be taken as mediator or moderator in the same analysis is a good insight for future study. Lastly, the future research could conduct longitudinal studies to observe changes over time. Additionally, cross-sectional analysis can be interesting for future study while comparing different economic settings.

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