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Earnings management in the financial sector: A systematic review through the fraud diamond and Hofstede's cultural dimensions

Sophia Wattimena[1*], Maya Malinda[2], Surya Setyawan[3]

[1,2]*Doctoral Program in Science Management, Faculty of Digital Business and Law, Maranatha Christian University, Indonesia.*
[3]*Faculty of Digital Business and Law, Maranatha Christian University, Indonesia.*

Corresponding author: Sophia Wattimena (*Email: siw5057@gmail.com*)

Abstract

Earnings management in the financial sector remains a critical issue due to its potential to mislead regulators, investors, and other stakeholders about the true financial condition and stability of financial institutions. This study examines earnings management practices in the financial sector by exploring their underlying causes, cultural influences, and commonly used tools. This study uses a Systematic Literature Review approach, with 41 selected articles based on specific inclusion criteria. The selected articles were subjected to bibliometric and descriptive analysis. The findings confirm that the elements of the fraud diamond theory are significant determinants of earnings management. Analyzed through the lens of Hofstede's cultural dimensions, deeper cultural traits such as short-term orientation and high masculinity are found to further reinforce earnings management practices. Moreover, loan loss provisions seem to be the most common tool used for earnings management in the financial sector. This research offers insights into the implications and determinants of earnings management and how culture correlates with fraud theory. By recognizing how cultural values shape managerial behavior, more effective detection and prevention strategies for earnings manipulation can be developed.

Keywords: Earnings management, Fraud diamond, Hofstede cultural dimensions, Regulatory framework, Systematic literature review.

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1. Introduction

The financial sector plays a central role in the stability and development of an economy, as it facilitates the efficient allocation of resources, mobilizes savings, and provides the infrastructure necessary for investment and economic growth. This central role in the economy makes it all the more important for the financial sector to remain stable and transparent. However, the financial sector has higher complexity compared to other sectors. For example, the central role of information is highly uncertain in banks compared to industrial firms, due to the increased complexity of banking activities [1]. Not only the business itself, but also the regulatory frameworks and accounting practices are often tighter and more complex for financial sectors. This heightened complexity has also facilitated a range of unethical practices, including earnings management and financial misreporting, which may be harder to detect and regulate. Few examples of the reasons firms engage in earnings management are to enhance the appearance of financial statements before public securities offerings, to boost executive compensation, and to secure job security [2]. However, when manipulation becomes excessive, financial statements lose their reliability, making it difficult for decision-makers to accurately assess the firm's financial position and performance [3].

By integrating the fraud diamond and Hofstede [4] cultural dimensions, it examines both internal drivers of fraud and societal values that shape these conditions. The fraud diamond theory by Wolfe and Dana [5] which identifies four key conditions that typically drive fraud: pressure, opportunity, rationalization, and capability. This perspective highlights how individual motivations and situational factors interact to shape fraudulent actions, making it a valuable tool for analyzing earnings manipulation within organizations. At the same time, Gray [6] highlights culture's role in shaping social systems and behaviors, while Yamen et al. [7] argue that accounting choices often stem more from cultural values than from formal governance. Thus, examining national cultural dimensions can offer deeper insights into fraud, especially where cultural norms override regulation [8].

2. Theoretical Framework

2.1. Agency Theory

According to Jensen and Meckling [9] agency theory arises from the relationship between principals (shareholders) and agents (management). Agency theory thus provides a foundational explanation for why earnings management occurs by explaining that the interaction between principals and agents is prone to agency conflicts, as the differing interests of stakeholders and management can lead to actions that may not align with the best interests of the principals. The incentive for earnings manipulation is often rooted in shareholder manager conflicts, where managers may favor compensation schemes tied to volatile earnings [10].

2.2. Earnings Management

Earnings management refers to the intentional actions taken by company executives to manipulate financial reporting and structure transactions in a way that misrepresents the firm's actual economic performance or influences contractual outcomes [2]. According to Ardiany et al. [11] this occurs when managers use discretion in reporting and executing financial transactions to alter financial statements with the intent to mislead stakeholders, thus affecting the results of contracts relying on reported accounting figures. The excessive manipulation could result in a lower quality of financial statements, evident by its lower reliability, making it difficult for decision makers to accurately assess the firm's financial position and performance [3].

2.3. Fraud Theory

The fraud theory was initiated by Cressey [12] by presenting that pressure, opportunity, and rationalization are triggering fraud, known as the fraud triangle theory. Opportunity is the perceived weakness in the control system of the organization that makes it easier for fraudsters to escape without being caught. Pressure can emanate internally or externally; some examples are political, social, or financial pressures. For the third element of the fraud triangle, rationalization, is the justification and excuses formulated by *fraudsters* to neutralize the sense of wrongdoing, effectively stripping the immoral conduct of its criminality [13]. The fraud triangle theory was then developed by Wolfe and Dana [5] who stated that to enable fraud being conducted, a person needs the capabilities? This capability could come in the form of the fraudster's position, their intellect, confidence in their act, and their belief that it will succeed [5]. The fraud triangle theory is also refined by Muhsin and Nurkhin [14] by adding competence and arrogance as the fourth and fifth component resulting in the fraud pentagon theory.

This literature review adopts the fraud diamond theory as its conceptual framework. While alternative models such as the fraud pentagon or fraud hexagon offer additional elements, the four core factors of the fraud diamond broadly capture the essential drivers found across these models. This rationale is also supported by Avortri and Agbanyo [15] who argued that the additional elements proposed in the fraud pentagon are already embedded within the rationalization component of the fraud diamond.

2.4. Hofstede's Cultural Dimensions

Criminal acts like fraud cannot be fully separated from the social context of the offenders [8]. Such behavior is often shaped by the surrounding norms, pressures, values, and institutional environments. Hofstede [4] developed Hofstede's cultural model as a framework to understand the diversity of cultures in different countries, which comprises six dimensions:

a) power distance index, acceptance of unequal power distribution,

b) individualism, preference for individualism over collectivism,
c) masculinity, how assertive or modest a society is,
d) uncertainty avoidance, degree of tolerance for uncertainty,
e) long-term orientation, long-term versus short-term goals,
f) indulgence, the allowance to fulfil basic human desires.

The dimensions of national culture offer valuable insights for shaping fraud theories that incorporate cultural influences in understanding the motivations or pressures, opportunities, and rationalizations behind fraud [8]. While direct literature on the influence of national culture on earnings management remains limited, many of these determinants form recurring motivations or rationales that can be interpreted as cultural manifestations, which reflect patterns in societal norms and values.

3. Methodology

This study employs a systematic literature review (SLR) method. Generally, the selection of literature involves four main phases: identification, screening, eligibility assessment, and inclusion in the final review sample (see Figure 1). This study uses the Scopus database as the primary source due to its extensive coverage and the high quality of its indexed publications [16]. No limitations were imposed on the publication period to ensure a comprehensive review of all relevant studies. The initial phase of the database search, conducted within the “Article title, abstract, keywords” fields, involved defining keywords aligned with the research topic. The selected keywords encompassed “culture,” “institution,” “organization,” and “determinant,” along with terms associated with financial statement fraud: "financial statement fraud," "financial report fraud," "earnings management," "fraudulent reporting," "accounting fraud," "financial misstatement," "earnings manipulation," and “earnings quality.” To further refine the scope of the search, the terms bank and insurance were used to focus the results within the financial sector.

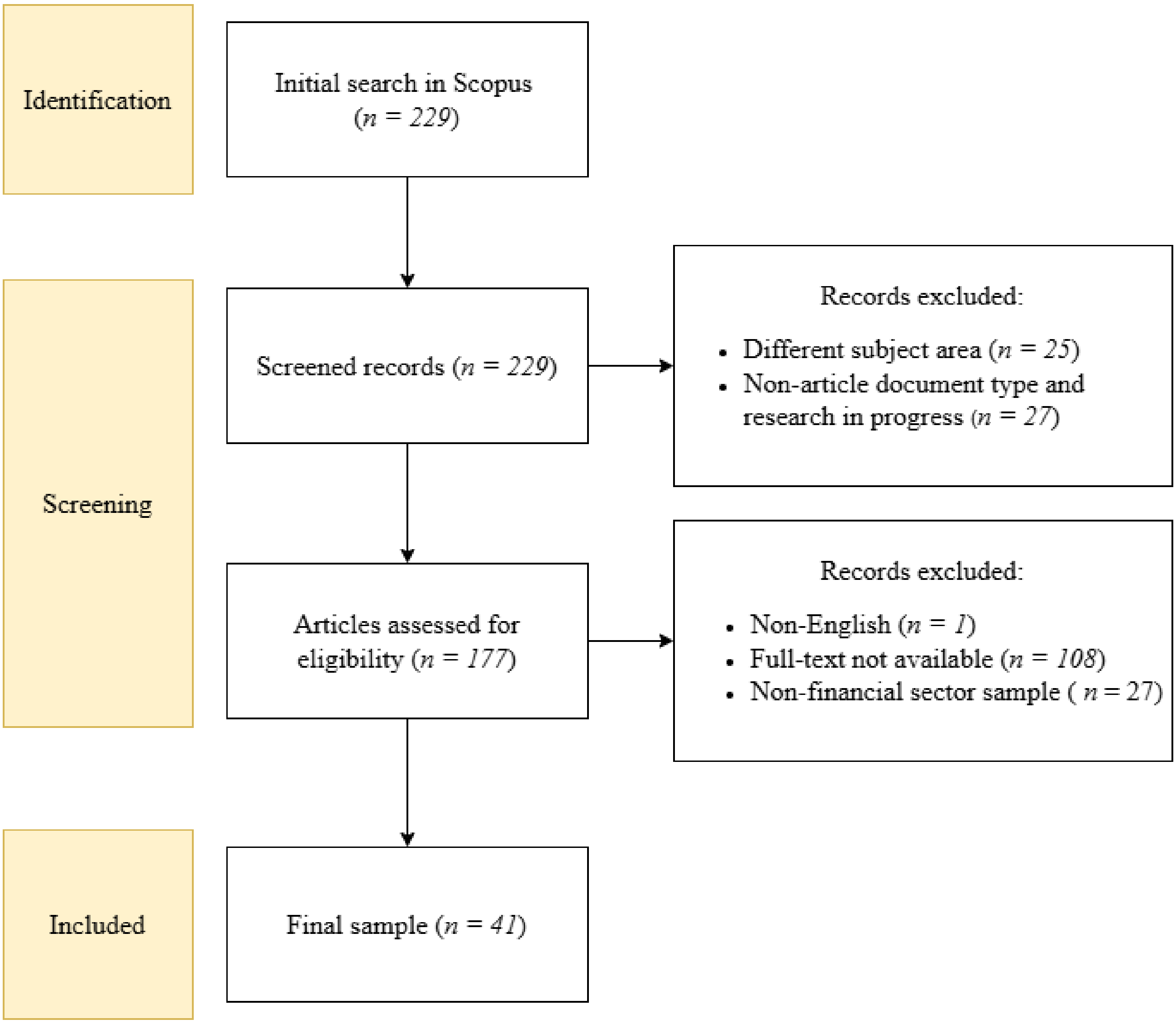

Figure 1.
Sample Selection Strategy.

Initial search resulted in 229 articles published between 2005 and 2024. The selection was then refined based on the inclusion of two subject areas: "business, management, and accounting" and "economics, econometrics, and finance." Additional filtering was applied by limiting the document types to "article" and "final," excluding results from other sources such as books and articles that are still in the press stage. From the refined search, 156 articles were retrieved. Following another screening process, non-English and full-text articles that are unavailable were excluded. Finally, 41 articles published between 2012 and 2024 were selected for further detailed review. After finalizing the sample, a bibliometric and descriptive analysis of the literature was performed.

4. Literature Overview

Most of literature in the final selection is conducted using quantitative method with a sample of banks. Out of the 41 selected articles, there is one identified article that is a systematic literature review, authored by Biswas et al. [17] with the title of "Antecedents and Consequences of Earnings Management: A Systematic Review of the Banking Sector in Developed and Developing Countries". The primary objective of the review by Biswas et al. [17] was to summarize the diverse causes and consequences of earnings management. Notably, it highlights variations in earnings management causes and consequences among developed, emerging, and cross-country research. In contrast, our review focuses more deeply on the **reasons** behind earnings management, using the Fraud Diamond and Hofstede's cultural dimensions.

4.1. Year of Publication

Although this review did not impose a specific time restriction, the earliest article included was published in 2012. The year 2022 recorded the highest number of publications, with a total of seven articles. Notably, the majority of the selected literature was published from 2018 onward.

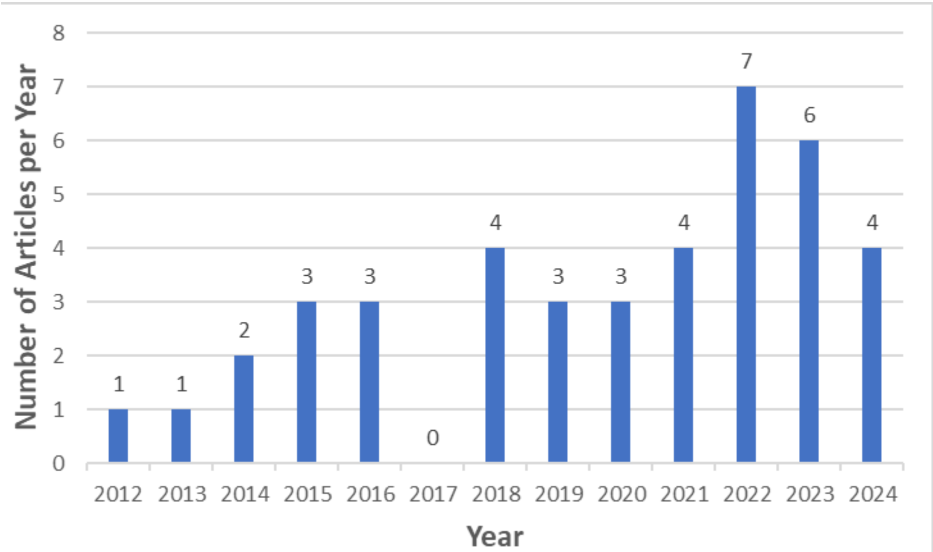

Figure 2.
Number of publications per year.

4.2. Journal Source

The reviewed articles were published across various academic journals. A few journals featured more than one article, with the *Journal of Banking and Finance* being the most frequently represented, with four articles. The rest were distributed among a diverse set of other journals.

Table 1.
Journals with more than one articles identified.

Journal	Number of Articles
Journal of Banking and Finance	4
Australasian Accounting, Business and Finance Journal	2
Journal of Asian Finance, Economics and Business	2
Journal of Financial Reporting and Accounting	2

5. Literature Review

Our literature review categorizes the causes of earnings management into several thematic groups to provide a clearer understanding of the underlying drivers behind such practices. This literature review is structured into three thematic subsections: the determinants of earnings management, instruments for managing reported earnings, and the effect of regulations and accounting standards on earnings management. This categorization is intended to facilitate a systematic examination of the literature by distinguishing between the underlying motivations, the methods, and the institutional influences that shape earnings management practices.

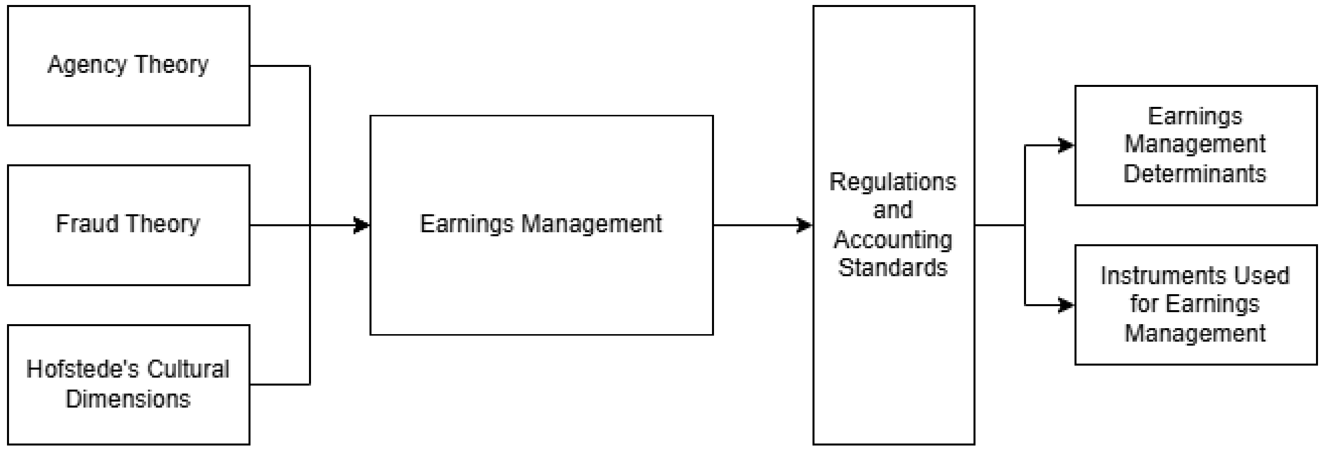

Figure 3.
Conceptual Framework.

5.1. Determinants of Earning Management in the Financial Sector

The determinants were further categorized into thematically similar topics, beginning with internal factors such as ownership structure and extending outward to aspects of firm operations, reflecting a progression from the organizational internally to more externally influenced elements.

5.1.1. Ownership Structure

Director ownership negatively affects earnings manipulation, as founded by Alqirem et al. [18] and Rizani et al. [19] directors with ownership are more likely to act in the company's long-term interest, avoid riskier financial practices, and have lesser incentives for earnings management as they have already received bonuses [18]. Foreign ownership also has a negative impact, as foreign investors typically demand higher transparency and stronger governance, which helps deter earnings manipulation [20]. Similarly, institutional ownership is also related to lower earnings manipulation, as investors possess the capacity to better monitor and influence management's behavior [19]. Although, another research found that higher institutional ownership tends to lower earnings quality, which could be due to short-term managerial behavior [21]. Not only could ownership type affect earnings manipulation, but ownership concentration is also positively associated with earnings manipulation [18]. Fewer shareholders holding significant control may pressure management to manipulate earnings for personal gain, with limited oversight from minority shareholders [18]. Also, the use of loan loss provisions (LLPs) to smooth income is significantly reduced among banks with a major shareholder [22]. The relationship between dividends and earnings management is also researched by Haq et al. [10] who found that higher dividend payments are also associated with reduced earnings management due to lesser control over earnings. Regarding listing status, evidence suggests it is largely insignificant, as both listed and unlisted firms engage in earnings management practices [23].

5.1.2. Management Structure

Board structure also plays a critical role in shaping earnings management behavior. A larger board size is associated with lower earnings management [24]. Not only its size, but also board members who possess expertise in economic matters, including accounting and finance, are associated with lower earnings management [24]. Additionally, directors' attendance rate has been found to be negatively associated with earnings management, as this could be a sign of effective oversight by the management [11]. However, in a dual board system, the roles of independent commissioners and the size of the commissioners' board are found to be insignificant in controlling earnings management [25]. In the insurance industry, earnings management may occur through more specialized mechanisms involving the role of actuaries. Actuaries with additional officer positions tend to manage reserves to achieve higher firm value, which is linked to both tax shielding motives and earnings management incentives, unlike actuaries without an officer position who may adopt a longer-term perspective [26].

5.1.3. Auditing

Higher quality audits help reduce earnings manipulation and promote a more transparent financial disclosure [27]. The establishment of the Audit Committee fosters an environment that supports the broader application of professional skepticism by external auditors, thereby enhancing audit quality [28]. Larger audit committees can help minimize earnings management; this could be due to more effective audits that better identify errors and misstatements [25]. In this regard, many researchers found that firms audited by the Big Four auditing firms tend to have lower earnings management [29]. The effect of higher quality audits of the Big Four is also present in Islamic banking [30]. This could be explained by their extensive audit knowledge and experience, where Big Four auditors are well-equipped with superior financial expertise to detect earnings management and promote higher earnings quality [31]. While strong governance mechanisms such as high-quality audits and well-structured audit committees can reduce earnings management, certain conditions may still undermine audit effectiveness. For example, an auditor who is economically dependent on a client becomes more vulnerable to pressure from the client's management [28]. Audit quality may tend to decline when the engagement extends beyond the sixth year of audit [28].

5.1.4. Firm Characteristics

Some studies also focus on firm-specific characteristics as key determinants in analyzing their impact on earnings manipulation. Bank size has a negative relationship [32]. Banks with better performance and higher growth potential are less likely to be associated with earnings management [29]. However, another research has found higher growth to be associated with lower earnings quality [21]. Low liquidity banks also tend to do earnings management, since liquidity needs influence managers' estimation of LLPs [29, 33]. In addition to liquidity, operational efficiency has also been identified as a factor, where operational efficiency is negatively associated with earnings management [33]. Higher levels of bank diversification through non-interest sources are also positively correlated with earnings management, possibly due to lower bank stability [10]. Income smoothing is not significantly affected by insolvency risk, bank capital buffers, and syndicated loan issuance [34]. Positive earnings, substantial earnings, and losses have an insignificant effect on the extent of income smoothing by banks [34]. Some research argues that the earnings management strategy is associated with the firm’s life cycle, with the growth stage being the phase most closely linked to the use of earnings management strategies [35].

5.1.5. Firm Operations

Increased bank competition has a positive effect on earnings management [36, 37]. Some research has found that banks engaging in earnings management practices are also more likely to be actively involved in CSR activities [38]. This could be explained by the perception that low accounting earnings are a serious threat, prompting companies to adopt CSR initiatives as a defensive strategy. Similarly, companies involved in sustainability practices are also more likely to manage earnings [27]. Although some research finds this link of CSR towards earnings management to be insignificant [38].

5.2. Instruments for Managing Reported Earnings

The financial sector is inherently complex [1]. Thus, the financial sector has various instruments that can be used to manage earnings. Several recurring tools have been identified in the literature, such as using provisions and a special case of using hidden reserves.

5.2.1. Loan Loss Provisions

Earnings management in the financial sector is typically examined using proxies tailored to the business models of each sub-industry, particularly banking and insurance. Loan loss provisions are the most commonly used instruments for earnings management in banks. Loan loss provisions represent the funds that banks are required to allocate as a safeguard against anticipated credit losses within their loan portfolios [39]. For example, setting aside higher provisions even during periods of strong earnings may indicate that bank managers are anticipating potential economic downturns [40]. There are some studies that argue LLP is not associated with income smoothing and mostly fluctuates with the business cycle [41]. Nevertheless, other evidence indicates that banks do engage in earnings smoothing through LLPs, as banks tend to reduce LLP when earnings are low and overstate LLP when earnings are high to smooth reported performance [33].

Research on earnings management in the banking sector frequently employs discretionary loan loss provisions (DLLP) as a proxy, as seen in studies by Valdiansyah and Murwaningsari [33] and Wong et al. [42]. DLLP refers to management-driven accounting policies that reflect intentional manipulation rather than responses to underlying economic conditions [33]. A widely cited reference in this context is Cornett et al. [43], which defines earnings management as the difference between realized securities gains/losses (RSGL) and discretionary loan loss provisions, since the RSGL increases earnings and the DLLP decreases them. High levels of earnings management are characterized by lower DLLP and higher RSGL, used to inflate reported income [43]. However, some research found that the LLP model is ineffective in detecting financial statement fraud [41]. This may be due to the complicated estimation of LLP, which uses assumptions, methodologies, and other unobservable factors that bank managers consider when determining the appropriate LLP amounts [44].

5.2.2. Earnings Management in the Insurance Sector

Research on earnings management in the insurance sector remains limited, likely due to its distinct regulations and accounting practices. However, some studies exist. One found a positive relationship between net premiums written (NPW) and net technical reserves (NTR), suggesting income smoothing [3]. Another used loss reserve errors, which are the differences between initial estimates and actual losses occurring 5–20 years later [26].

5.2.3. Special Case: Banking Hidden Reserves

There are also other forms of earnings management in banks, such as hidden reserves. Bornemann et al. [45] find that German banks use hidden reserves, the so-called 340f reserves in the German Commercial Code, to manage earnings. These 340f reserves are created by undervaluing loans and other securities, but the 340f reserves are not required to be directly associated with the risks of the assets [45]. Advocates for the use of hidden 340f reserves argue that they are suitable for addressing bank-specific risks to not raising concerns among less-informed depositors [46]. Such fluctuations might otherwise raise concerns about the financial health of individual banks or the stability of the entire banking system [45]. However, it’s unclear if this practice still prevails under current regulations. Updated research is needed to confirm its current relevance.

5.3. Effect of Regulations and Accounting Standards on Earnings Management

Lastly, we examined the effects of regulations and accounting standards on *earnings management*. This section is further organized into thematic areas, beginning with the legal and institutional environment and concluding with findings on accounting standards.

5.3.1. Legal and Institutional Environment

Research by Kanagaretnam et al. [47] found that stronger legal, extra-legal, and political environments are associated with higher earnings quality, enhancing the ability to predict future cash flows and an effective loan loss provision. This strong institutional setting is also found to constrain income-increasing earnings management, but it appears to have no significant effect on income-decreasing earnings management [47]. This stronger "rule of law" seems to reduce income smoothing due to stronger legal enforcement, which discourages such practices [3]. Insiders often have stronger incentives to conceal the true performance of the firm, especially in environments with weak external governance [48]. Additionally, auditors tend to exercise greater professional care when operating in environments where the risk of punishment is higher [28]. However, another research by Ozili [34] found that the rule of law has an insignificant effect on income smoothing. Interestingly, income smoothing is also more persistent in regional blocs with stronger banking regulations, such as the European Union [36]. As for the political environment, banks in politically unstable countries are more likely to engage in earnings management, largely due to weaker monitoring systems [29]. In politically unstable countries, firms that are more transparent could provide the government with the necessary information and justification to seize the firm's assets, thus incentivizing firms to hide their true profits [47].

Stronger investor protection regulations are also linked to improved earnings quality [10]. Protection of minority shareholders' rights mitigates income smoothing [49]. This is because countries with better investor protection have higher transparency in their financial reports to avoid the risk of litigation arising from concealing important information. Hence, stronger investor protection should act as an effective deterrent against earnings management [50]. The level of perceived corruption is not significantly towards income smoothing, which might be because the Corruption Perceptions Index (CPI) only captures perceived corruption and does not measure actual corruption [49]. However, earnings quality improves when there is greater control over corruption [21].

Additional regulations in Islamic banking include the Sharia Supervisory Board (SSB), which is responsible for providing consultation, supervision, and assessing the ethical conduct of bank management in accordance with Islamic principles [51]. However, there is no evidence of the difference of earnings management practice between Islamic banks with and without SSB [52]. When comparing Islamic banks with SSB, a larger board size and an SSB board with additional accounting and auditing skills have been found to constrain earnings management [52]. Islamic law and ethical standards, which lead to higher audit quality and lower earnings management [53, 54]. Another additional regulation is the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), which exhibits a negative relationship with earnings management [54]. Despite the presence of additional regulatory Islamic banking, the empirical evidence remains mixed. On the contrary, some research has found that earnings management behaviors between Islamic and conventional banks do not differ significantly [23]. Conversely, other researchers have found that Islamic banks have a higher tendency toward earnings management [55].

5.3.2. Policy

Tightening of macroprudential policies plays a key role in improving earnings quality and curbing earnings management [10]. Basel-compliant banks tend to be more resilient, as banks with higher capital can absorb higher risk exposures [56]. Another example is the stricter accounting policies implemented by the Securities Exchange Commission (SEC) for public banks. Notably, this has prompted privately-held banks to engage in higher earnings management [40]. Similar dynamics are observed in the insurance industry, where findings by Gaganis et al. [3] indicate that stricter regulations regarding technical provisions and stronger supervisory powers significantly constrain income smoothing practices.

5.3.3. Accounting Standard

Accounting policy reforms have produced mixed results in curbing earnings management. For example, during the amendment of IAS 39, it was successful in limiting income smoothing via securities gains and losses following the 2009 financial crisis [57]. Although another research found that these new IFRS policies following the 2008 crisis has been insignificant [58]. This suggests that either banks shifted to other accounting items for income smoothing or that stricter regulations constrained their ability to manipulate profits. Ozili [57]. Ozili [34] found that the introduction of the newer IFRS 9 was successful in reducing earnings management. However, in general, higher disclosure requirements related to technical provisions seem to have a positive effect on earnings management by potentially encouraging firms to disclose more during favorable periods, thus enabling smoother financial outcomes [3].

Comparing IFRS and GAAP, Ashraf et al. [23] found no significant difference in earnings management between banks applying FASB's GAAP and those using IFRS. However, they argued that the enhanced disclosure requirements under IFRS may help reduce earnings management [23]. This argument is supported by another research, where conditional conservatism practiced under the IASB framework could minimize issues arising from information asymmetry related to loan risk [59]. In the end, both the FASB and IASB models are more conservative than the incurred loss approach, though each reflects a distinct form of conservatism [59]. Similarly, the adoption of additional accounting standards for Islamic banks is positively associated with financial performance and accounting conservatism, while exhibiting a negative relationship with earnings management [54].

Islamic banks introduce an additional layer of regulatory and ethical considerations, as Islamic banking tends to adopt more conservative accounting policies [30]. This could be due to the additional Islamic law and ethical standards, which leads to lower earnings management [53, 54]. Another regulatory influence is the AAOIFI standard, which is found to have a negative relationship with earnings management [54].

6. Discussion

This section discusses the findings of the reviewed literature through the lens of fraud diamond theory and Hofstede's cultural dimensions, highlighting the underlying motivations and contextual factors that shape earnings management practices in the financial sector.

6.1. Fraud Theory

The discussion section is organized into four parts, each addressing one of the elements of the Fraud Diamond theory: pressure, opportunity, rationalization, and capability.

6.1.1. Pressure

High expectations during economic downturns can pressure bank management to maintain strong financial performance despite rising credit risks. Increased market pressure from new competitors could also exert pressure on banks to engage in income smoothing [36]. Supervisors may also expect banks to build reserves proactively. Setting aside higher provisions during periods of strong earnings may reflect this anticipation, but it can also lead to discretionary adjustments [40]. This creates pressure to manage reserves strategically, blurring the line between prudence and earnings management.

6.1.2. Opportunity

Stricter regulations regarding technical provisions and stronger supervisory powers significantly constrain income smoothing practices [3]. Furthermore, firms in politically unstable countries are more likely to engage in earnings management due to weaker monitoring systems [29]. In contrast, heightened scrutiny and stricter regulations significantly constrained firms' ability to manipulate profits [57]. However, some regulatory requirements, such as disclosures, could be exploited during favorable periods for income smoothing practices [3]. Another example of regulatory control that created opportunities for *earnings management* is the use of Section 340f reserves by German banks, which effectively functioned as hidden reserves [45].

6.1.3. Rationalization

Ozili and Outa [49] found that banks used income smoothing to lower high earnings pre-financial crisis and during the financial crisis but not in the post-financial crisis period. Financial crises provide bank managers with extra motivation to smooth income as a strategy to survive during times of crisis; even the presence of Big Four auditors during the crisis period was unable to constrain the extent of income smoothing [60]. From a fraud theory perspective, this behavior may reflect an instance of *rationalization*, wherein managers justified the use of income smoothing during crisis years as a necessary measure to stabilize financial results or meet stakeholder expectations. Another factor influencing earnings management is political instability. In such countries, firms that are more transparent may face a risk of expropriation by corrupt politicians, as this transparency provides the government with information and justification to seize the firm's assets, thus incentivizing firms to conceal their profits [47].

6.1.4. Capability

Capable board members can act as deterrents to fraud and are a crucial mechanism for reducing the risk of financial misconduct within an organization. Research by Dang [24] shows that board members who possess expertise in accounting and finance are better equipped to understand accounting policies and financial statements. This capability strengthens their ability to detect and prevent manipulative financial practices. Similarly, institutional ownership is also related to lower earnings manipulation, as they possess the capacity to better monitor and influence management's behavior [19]. Skilled auditors from the Big Four auditing firms tend to have lower earnings management [29]. This could be explained by their extensive audit knowledge and experience to detect earnings management and promote higher earnings quality [25, 30, 31].

6.2. Hofstede's Cultural Dimensions

While fraud theories explain the necessary conditions for fraud to occur, cultural factors provide a deeper understanding of why fraud actually happens. Cultural factors are divided into six dimensions, as defined by Hofstede [4].

6.2.1. Individualism

Individualistic cultures place a high emphasis on personal achievement, self-direction, individual goals, and performance [61]. In general, some research argues that the more collectivist a society is, the lower its level of corruption tends to be [62]. Another example of how individualism affects governance is where foreign ownership has a negative impact on earnings management [20]. This may be because foreign investors are less likely to share collective ties with local management, thereby reducing informal loyalties. As a result, foreign owners typically demand greater transparency and stronger governance practices, which in turn help deter earnings manipulation [20]. In contrast, audit quality tends to decline when the engagement extends beyond the sixth year of audit [28]. The prolonged auditor-client relationship could create a sense of loyalty or mutual understanding, similar to a collectivist society. Such cultural traits may reduce professional skepticism and lead to greater tolerance of aggressive or questionable accounting practices, including potential earnings management. However, Kanagaretnam et al. [1] found banks operating in high individualism societies are more inclined to engage in earnings smoothing.

6.2.2. Masculinity

The demand for financial or career achievement in a masculine society could create pressures for fraud Guritno et al. [62]. Luu et al. [63] found that U.S. banks with a competitive culture have a higher tendency for earnings management. Similarly, increased bank competition has a positive effect on earnings management [37]. These examples are similar to a *masculine* cultural orientation, where earnings management can be viewed as a reflection of a desire to maintain or enhance the perceived success or strength of the bank.

6.2.3. Power Distance

Power distance is defined as the degree to which less powerful members of organizations and institutions accept and expect an unequal distribution of power [4]. Societies with a higher power distance index tend to show greater acceptance of authority and prioritize conformity over independence and innovation [61]. High power distance can create a feeling of being overlooked in key organizational decisions, which may make it easier for potential wrongdoers to rationalize dishonest behavior [8]. Research on this dimension shows societies characterized by high power distance are more inclined to engage in earnings smoothing [1]. This is high power distance reflected in lesser protection for minority shareholders, which has also been found to increase income smoothing [49]. This relationship exists because countries with stronger investor protections tend to exhibit higher financial reporting transparency, reducing the risk of litigation that may arise from concealing material information [49].

6.2.4. Uncertainty Avoidance

Research on the uncertainty avoidance dimension of culture is abundant, as it is closely linked to the development of regulations and the quality of institutional frameworks. Cultures with high uncertainty avoidance seek to reduce ambiguity by enforcing strict behavioral norms, establishing comprehensive laws and regulations, discouraging unconventional views, and upholding a belief in absolute truths [4].

Research by Kanagaretnam et al. [47] found a stronger legal, extra-legal, and political environment is associated with higher earnings quality. This stronger "rule of law" seems to reduce income smoothing practices due to stronger legal enforcement [3]. However, another research by Ozili [34] found that the rule of law has an insignificant effect on income smoothing. Interestingly, income smoothing is also more persistent in regional blocs with stronger banking regulations, such as the European Union [36]. Changes in stricter accounting policies also produce mixed results. Some research on accounting changes has found it discourages banks from income smoothing [57]. This discouragement may suggest stricter regulations significantly constrained their ability to manipulate profits, but could also be a sign that banks have shifted to other accounting items for income smoothing [57]. Moreover, higher disclosure requirements related to technical provisions seem to have a positive effect on earnings management by potentially encouraging firms to disclose more during favorable periods [3].

It can be concluded that higher uncertainty avoidance, which is often reflected in stricter regulatory environments, shows mixed results in relation to earnings management. One possible explanation is that, in the absence of clear rules, certain manipulative practices may not have been classified as violations. In some cases, individuals or organizations violate those laws because they view laws as excessively complex public systems, which could cause insubordination and lead to financial crime [16]. This aligns with how existing literature approaches the issue, as studies tend to compare the strength or strictness of regulatory environments across countries, rather than comparing the presence with the absence of regulation.

6.2.5. Long-term Orientation

Individuals in cultures with strong long-term orientations are generally more committed to organizational values and less prone to succumbing to short-term pressures or incentives [8]. The fear of reputational loss from opportunistic financial reporting imposes a self-regulatory discipline on managers [47]. When managers are aware that misreporting may damage their personal or the institution's reputation, they are less likely to engage in earnings manipulation [47]. This reputational concern also extends to ownership structures, particularly foreign investors, who have been shown to play a significant role in constraining earnings management practices [18]. Their influence may derive from a heightened sensitivity to reputational risk and a strategic need to maintain trust across multiple markets. Moreover, foreign investors often adopt a long-term investment perspective, favoring sustainable financial outcomes over short-term manipulation. Similarly, auditors tend to exercise greater professional care when operating in environments where the risk of punishment is higher, resulting in higher-quality audits [28]. This implies that in long-term orientation settings, the *pressure* aspect of *fraud* may be naturally lower, suggesting that anti-*fraud* strategies in such cultures should concentrate more on mitigating *opportunity* and addressing *rationalization* [8].

6.2.6. Indulgence

Our findings on the indulgence dimension of culture are limited, partly because many of its aspects overlap or can be interpreted through other dimensions such as long-term orientation or individualism. Akhter and Azad [55] found that higher levels of national religiosity act as a constraint on managerial decisions, exerting downward pressure on earnings management practices. Religious adherence and moral accountability constraints function as complementary mechanisms to statutory auditing, enhancing ethical behavior and reinforcing the effectiveness of formal audit processes [30]. The deterrence effect of religiosity on earnings quality is more pronounced during recessions and turbulent periods, and also in countries where religion is a significant element of national identity [21].

7. Conclusion

This research finds that elements of fraud theory and Hofstede's cultural dimensions are evident in various fraudulent activities. Opportunity and capability consistently influence earnings management. Auditing limits opportunity, while auditor capability is key to detection and prevention. Though regulations aim to restrict manipulation, they can sometimes be exploited instead. Thus, anti-fraud measures must be carefully designed, as poorly crafted controls may create new loopholes [3]. While capability can be a determining aspect in earnings management practices, it can also serve as a deterrent when present in the right individuals. For instance, capable directors with adequate accounting skills and auditors with high expertise can significantly reduce the likelihood of manipulation [24, 29]. Balancing these aspects is critical for effective fraud prevention and maintaining financial transparency.

Beyond institutional and professional factors, cultural values also shape how earnings management is perceived and practiced across different contexts. Hofstede's cultural dimensions, in the form of individualism, power distance, and long-term orientation, appear to be most strongly associated with earnings management. A large body of research suggests that higher levels of individualism are correlated with increased corruption, which may foster a more permissive environment for earnings manipulation. Power distance, on the other hand, is often interpreted as a reflection of inequality in authority and influence; higher power distance tends to be associated with weaker protection for minority shareholders, thereby increasing the likelihood of earnings management. Lastly, long-term orientation is frequently linked to stronger self-regulation, driven by the belief that the long-term consequences of earnings manipulation outweigh any short-term financial gains.

While fraud theories like the fraud diamond explain the necessary conditions for fraud, these conditions may be influenced by cultural context. In some cultures, norms and values may increase the likelihood that pressure, opportunity, rationalization, or capability lead to earnings management. This view aligns with the findings by Yamen et al. [7], who also argue that accounting choices are more deeply rooted in cultural values than in formal governance structures or regulatory frameworks. In other cultures, even when those factors are present, cultural values may discourage fraud. This suggests that culture can either trigger or suppress the mechanisms described in fraud theories.

This research highlights key implications for financial sector stakeholders. Regulators, auditors, and governance bodies must consider how culture shapes fraud risks. Auditors should incorporate cultural indicators into risk assessments, as some traits may increase manipulation pressures. Evidence also shows auditors can both limit and enable earnings management. Regulators can enhance policy effectiveness by integrating cultural dimensions. Auditors should include cultural red flags in training and models, while boards must understand how cultural values influence internal controls and ethics. However, cultural dimensions may not fully capture the complexity of diverse institutions. Using Hofstede's and the fraud diamond frameworks offers structure but may oversimplify behavior. Future research should explore how culture interacts with fraud conditions and why some individuals refrain from fraud despite opportunity.

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