INTERNATIONAL JOURNAL OF SOCIAL SCIENCES BULLETIN
ISSN: (E) 3007-1917 (P) 3007-1909
Volume 3, Issue 6, 2025

THE INFLUENCE OF FINANCIAL DISTRESS ON EARNING MANAGEMENT: AN INSIGHT ON PAKISTAN TEXTILE SECTOR

Shabir Khan[*1], Mansoor Rahimi[2], Fahad Siraj[3]

[*1]*CUSIT, Peshawar, Pakistan*
[2]*Hochschule, Wismar, Germany*
[3]*CUSIT, Peshawar, Pakistan*

[*1]shabirkhan9051272@gmail.com, [2]mansoorrahimi64@gmail.com, [3]contactfahad3@gmail.com

Corresponding Author: *
Shabir Khan

DOI: https://doi.org/ 10.5281/zenodo.15589655

Received	Revised	Accepted	Published
11 April, 2025	11 May, 2025	26 May, 2025	04 June, 2025

ABSTRACT

Earnings management has recently been a current Area of focus among professionals and Overseers. It has sparked significant curiosity among academic scholars throughout the world. The study aimed to examine the impact of financial distress on EM (earnings management) in the setting of Pakistan. Data was collected from a sample of 25 textile enterprises experiencing financial distress throughout 5 years from 2018 to 2022. Using Altman's Z-Score, the extent of financial Distress was calculated. Financial distress is monitored using proxies such as free cash flow, financial leverage, business size, liquidity, and profitability. Discretionary accrual (DA), a Stand-in for EM (earnings management), has been found using the Modified Jones Model. Econometrics Analytics was employed to gain insight into the impact of financial distress on earnings management. The data analysis demonstrates that profitability and EM (earnings management) have a strong positive relationship, as does the relationship between FCF (free cash flow) and EM (earning management). Financial leverage and earnings management have a negative relationship, but this relationship is not statistically significant. The Analysis of FS (firm Size) reveals that there is no statistically significant relation, suggesting that a company's size has little to no impact on EM. Liquidity has a negative influence on earning management in financially distressed corporations, though it is not statistically significant. These findings could assist lenders and investors in understanding that even enterprises in financial trouble may engage in earnings management strategies.

Keywords: *Altman's Z-Score, discretionary accruals (DAC), earnings management, financial distress, modified Jones model.*

INTRODUCTION

1.1 Background of Study

A company's financial reports are an essential source of documentation as they show how the business is doing financially at a glance. In this way, investors, creditors, and regulators are all able to see the whole picture and make informed decisions. Financial statements are often generated using the accrual method. The accrual foundation was selected because it is more rational and honest in portraying a company's true state (Rusci, 2021). By deciding to use the accrual basis, management gains some leeway in choosing an accounting technique, which means they can modify the financial statements to make as many adjustments as they want. Earning management is the art of masking financial statements, resulting in fictitious information to present a favorable financial picture. In the past, many large, well-known companies around the world used complex financial tricks to trick investors and the public. This has been linked to catastrophic fraudulent financial reporting

scandals that have rocked the world, causing shareholders to lose billions of dollars (Bin Mohamad Kamal & Binti Khazalle, 2021; Mohamed and Kassem, 2010).

Information asymmetry resulting from agency problems (Velte, 2020) often leads to earning management .regulatory loopholes in accounting standards and practices (Ghazali, 2015) can lead to opportunities for earnings management. Focusing on the signaling theory argument (Östman & Sharp, 2022) and Agency Theory argument (Xie, 2003) management may feel compelled to engage in earnings management practices in situations of financial distress to fulfill investors' expectations of financial results while protecting self-interests in the organization. Östman & Sharp, (2022) states that signaling theory proposes that corporations often utilize signals, such as earnings announcements, to communicate information to investors.

Financial distress is a critical state in which a company can't meet its obligations and its liabilities exceed its assets. Financial distress can lead corporations to manipulate their reported earnings, which can seriously affect lenders and investors. Such actions distort the reported information quality and pose a challenge for stakeholders to accurately interpret the true financial condition of the companies (Rakshit & Paul, 2020). Kliestik, (2021) Conducted a study that aims to assess if earning management is the common practice of companies in different countries their research confirms that companies do manipulate earnings, particularly in an upward direction which means that companies with financial distress conditions engage in earning management to present a better picture.so this study focus on Pakistan and whether companies in Pakistan from textile sector engage in earning management when they experience financial distress.

1.2 Problem Statement

Earnings management can compromise financial report credibility and undermine investor confidence (Bin Mohamad Kamal & Binti Khazalle, 2021). During periods of financial crisis, the practice of earnings management might provide short-term reassurance by providing a more favorable financial outlook. By doing this, the company's reputation and access to funding may be preserved and creditors and investors may be reassured. Nevertheless, over a longer period, depending on such methods might have negative consequences. It has the potential to conceal fundamental problems, undermine confidence, and attract regulatory examination. Ultimately, this can result in a worse financial situation, reduced credibility, and potentially even insolvency (Hassanpour & Ardakani, 2017). It can lead to misallocation of capital and suboptimal investment decisions. According to As noted by (Dhahran, 2008), renowned corporations such as Enron and Xerox were among the corporations whose reputations were damaged by earnings management.

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Many studies have been done on earnings management in various Fields of Pakistan and have focused on the Association of earnings management with fields such as Governance structure (Safdar A. Butt Shah, 2009), dividend policy (Shah, 2011) and the role of earnings management in Family business groups (Khan & Kamal, 2022).In this study, we aim to investigate whether companies listed in the Textile sector of the Pakistan Stock Exchange (PSX) experienced financial distress and engaged in earnings management practices to release reports that provide a better view of their financial situation.

1.3 Research Question

1) Does Free Cash Flow (FCF) influence earning management?
2) Can the financial leverage of the company influence earning management?
3) Is company size influence earning management?
4) Will the Liquidity of the Company influence earning management?
5) Does the profitability of the company influence earning management?

1.4 Objectives of Research

1) To evaluate the influence of FCF (free cash flow) on Earnings management.
2) To assess the influence of financial leverage on Earning management
3) To Analyze the influence of company size on Earning management
4) To Determine the influence of company liquidity on Earning management
5) To evaluate the influence of profitability on Earning management

1.5 Significance of the Study

Financial distress is difficult for firms, and stakeholders need precise financial data to make decisions. In financial hardship, earnings management can distort this information, misrepresenting a company's financial health. Investors need accurate financial reporting to analyze risk, make investment decisions, and assess recovery prospects. A company's ability to meet obligations is also assessed by creditors using credible financial accounts. While regulators protect market integrity, employees worry about job security and the future. Recognizing these techniques helps stakeholders evaluate financial accounts and distinguish between real issues and manipulation. This awareness prevents stakeholders from making decisions based on incorrect information and promotes transparency and accountability. Thus, understanding earnings management amid financial crises is essential to building confidence, improving decision-making, and protecting stakeholders.

1.6 Scope of the Study

In this study, we aim to investigate whether companies listed in the Textile sector of the Pakistan Stock Exchange (PSX) experienced financial distress and engaged in earnings management practices to release reports that provide a better view of their financial situation. Furthermore, we will look at any potential link between financial distress and shady practices in how companies report earnings in the PSX Textile industry from 2018 to 2022.

LITERATURE REVIEW

2.1 Theoretic framework

2.1.1 Agency Theory

Stephen A. Ross, an American economist originated agency theory. In his article, he presented the idea of the principal-agent relationship and discussed the difficulties in lining up their interests. Jensen and Meckling are credited with creating agency theory. Their paper provided a comprehensive framework for understanding agency relationships in organizations. Agency Theory is a popular organizational economics framework that examines the relationship between company principals (owners or shareholders) and agents (management or employees) (Bin Mohamad Kamal & Binti Khazalle, 2021; Ghazali, 2015). Agency Theory acknowledges that people seek self-interest and utility. The desire for personal gain, self-interest, and risk aversion influence managerial behavior (Ghazali, 2015). Earnings management in financially distressed enterprises shows the complex interaction of stakeholder interests and agency conflicts, in which managers balance short-term survival constraints with long-term sustainability, frequently at the price of stakeholder confidence and financial honesty.

2.1.2 Signaling Theory

Signaling theory, derived from economics and finance, examines how individuals and firms convey information regarding their attributes or capabilities to external entities. Signaling theory explains that good financial statements are signals or signs that the company is operating well (Ross, 1977). Company management is directly responsible for the company's operations (Baccelli, 2012). Signaling theory is employed in earnings management when corporations proactively manipulate financial statistics to convey signals to the market regarding their performance, prospects, or underlying value (Elshabasy, 2018). Managers employ strategies such as profit smoothing or understating losses to provide reassurance to creditors, investors, and other stakeholders, with the possible objective of preventing default or bankruptcy. Minimize adverse indicators that may result in a decline in stock values and harm the company's standing (Rakshit & Paul, 2020; Stephen A. Ross, 1977) Offers indications of a consistently steady and predictable trend in earnings over a while.

2.2 Empirical Literature Review

Managers distort financial statements through techniques like A.E.M, R.E.M. "Accruals earning management" Which permits a certain amount of adaptability in recognizing revenue or expenses not present in cash-based accounting. Managers can engage in various accrual earnings management techniques, for example as recording Sale or Returnable goods basis, lowering allowance for Irrecoverable debts, and avoiding or postponing asset and inventory write-offs. The utilization of an accrual basis, as opposed to cash flow, allows for the manipulation of financial information by management, making it more straightforward to overstate or understate. In comparison, accruals are less easily detectable (Chen & Liu, 2010).

Gras-Gil, (2016) study examined the correlation between the operational performance of Korean industrial businesses and their practice of earnings management. The researchers observed that Korean manufacturing businesses exercise control over their income. Their study's findings showed that company managers were driven to choose tactics that would increase profits when operating performance was unsatisfactory. The study found that US companies that were struggling financially and eventually filed for bankruptcy had purposely lowered their earnings before the actual filing. This strategy was used to make their financial situation look worse leading up to the bankruptcy. There has been a lot of research on what makes earnings management work, but not much on how earnings management works in companies that are in financial distress, especially in developing countries. That's why this study tries to find out how financial distress influences earnings management in developing nations such as Pakistan.

2.3 Free Cash Flow Association with Earnings Management

An essential control variable utilized in this research is free cash flow. FCF (free cash flow) can be calculated as the net income of the company plus depreciation and amortization of assets, minus capital expenditure. Rina Br Bukit, (2015) found out that Companies listed on the Indonesian stock market sometimes inflate their reported results, especially in industries with low capital intensity and plenty of free cash flows. This was also supported by (Dewi, 2016) that cash flow and earnings management were positively correlated for Non-monetary enterprises Registered on the (Indonesian Stock Exchange) between '2010 and 2014'.

H1: There is a positive influence of Free Cash Flow on earnings management.

2.4 Financial Leverage Association with Earnings Management

Financial leverage refers to the practice of using debt instruments like loans and bonds to finance a company's assets. Financial leverage also increases risks for shareholders, as companies must meet certain financial obligations, including interest payments and debt covenants. Violating these covenants can result in severe consequences, like having to pay higher interest rates or even facing bankruptcy (Rayan, 2008; Ross, 1977). Debt covenant violations can serve as a red flag, signaling that a company is in financial distress and unable to fulfill its financial obligations. Anagnostopoulou & Tsekrekos, (2017) have found that EM (earnings management) is profoundly affected by financial leverage. Specifically, it is more common for companies with high levels of financial debt to manipulate their real earnings rather than their accrual-based earnings.

H2: There is a positive influence of Financial Leverage on earnings management.

2.5 Firm Size Association with Earnings Management

Earnings management is impacted by the firm size (Habib, 2013). Certain studies suggest that Big companies often have solid systems of management and less informational inequality, making them Modest to engage in earnings management behavior (Donnelly, 2014). On the other hand, some argue that according to agency theory, large firms experience higher agency costs, which may create opportunities for more opportunistic practices (Elshabasy, 2018). Larger firms face more pressure from investors and analysts, which can lead to distorted reported earnings (Usman Ali Muhammad Afzal Noor, 2015).

H3: There is a positive influence of the size of a company on earnings management

2.6 Firm Liquidity Association with Earning Management

A company's liquidity is a key indicator of its financial strength and stability. Companies' liquidity can be gauged by looking at their current ratio (CR) and quick ratio (QR) (Chanchal Chatterjee, 2015). Insufficient liquidity can have serious consequences for a company's financial health leading to financial distress. When faced with liquidity challenges, companies may turn to earnings management practices as a temporary remedy. Current ratios (CR) and earnings management are positively correlated.

H4: There is a positive influence of Liquidity of the firm on Earnings Management

2.7 Firm Profitability Association with Earning Management

The profitability of the enterprises can be measured by their return on assets (ROA). Profitability, financial distress, and earnings management are interconnected. High profitability can lead to financial stability, but a decline in profitability can trigger financial distress. In such situations, management may turn to earnings management to navigate difficulties or to present a more favorable financial position to stakeholders (Fivos V. Bekiris, 2011; Marion Hutchinson, 2008; Rakshit & Paul, 2020) .

H5: There is a positive influence of the Profitability of the firm on Earnings Management

Conceptual Framework

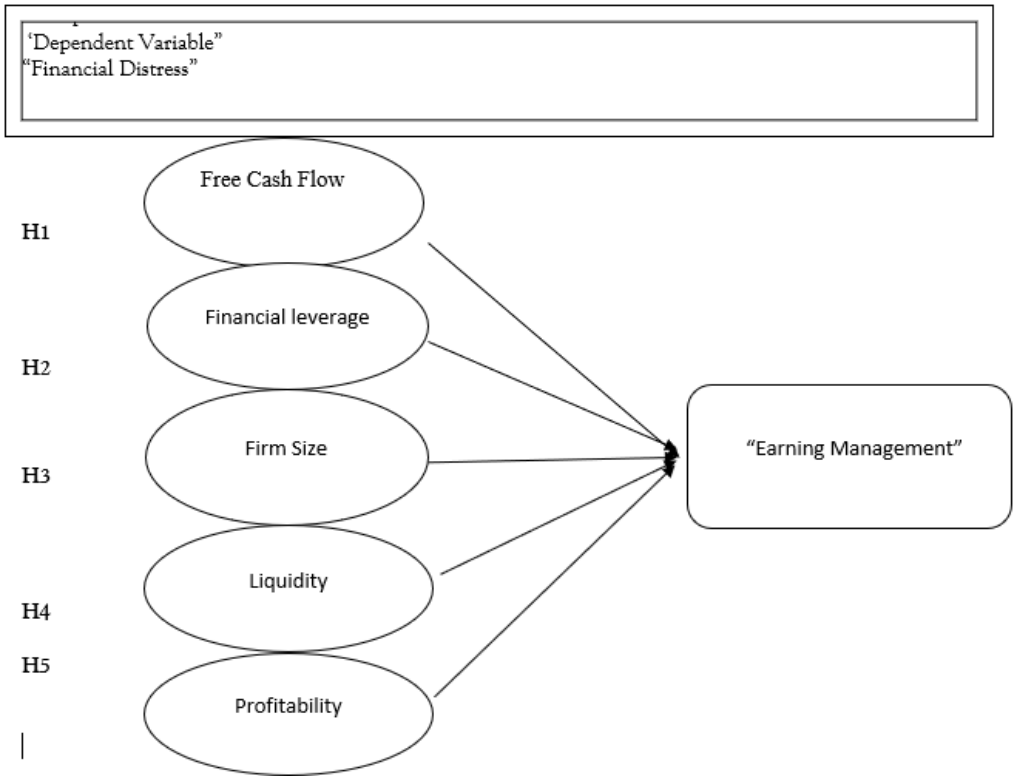

Figure 1: Conceptual Framework

RESEARCH METHODOLOGY

3.1 Research Philosophy

In this study, a positivist approach is used. The study is deductive in nature since it investigates the impact of several aspects on income management, drawing upon existing theories and literature.. This study has a quantitative nature because the variables' information is derived from the financial statements of relevant companies for a certain period.

3.2 Research Strategy

The study used methods and concepts to investigate whether a company's financial distress has an influence on its earnings management and, if so, how the two factors relate to one another in the textile industry.

3.3 Data Acquisition

The related data for this research will be gathered from diverse origins, including the PSX website,

business recorder, and respective companies' websites. The study will cover the period from 2018 to 2022.

3.4 Population and sample size

The results are backed by credible secondary sources, such as the published reports of 25 businesses listed under textile composite on the Pakistan stock exchange, and the study uses a quantitative approach. All these 25 companies are taken as population for research. In this study, we employed a random sampling technique to select companies listed on the Pakistan stock market under textile composite. The sample was drawn from the population of all companies listed on the Pakistan stock exchange, also from the population, only those companies were selected who were financially distressed and in this study, we aim to find the impact of financial distress on earning management.

3.5 Statistical Analysis:

To make sure the gathered data has a normal distribution, it will be run through extensive descriptive analysis, reliability testing, and normality assessment. Following this, a Pearson correlation test will be conducted using SPSS software to determine and evaluate potential relationships between variables while also assessing the multicollinearity effect. Once all necessary conditions for econometrics analysis have been met, the latter will be carried out to confidently and accurately evaluate the connections between financial stress and management of earnings, in keeping with the objectives of this investigation.

3.6 Earnings Management Computation

Many scholars from different parts of the world have looked into discretionary accruals because of how important they are as a metric of earnings management. a popular model for calculating discretionary accruals in the existing earnings management literature is the Adjusted (modified) Jones Model proposed by (Dechow, 1995). Consequently, this study estimates discretionary accruals, a stand-in for earnings management, using the same approach. To start, we need to estimate how much cash each company in a certain field makes in total accruals each year. Either the cash flow statement method or the balance sheet method can be used to figure out total accruals. For this study, however, the cash flow statement method was used because it is a popular one among researchers (Zafar, 2009). The process for accrual calculation for this study is;

Total accruals (TA) = NI – cash flow from operation (CFFO)

Earnings management, the part of accrual over which the manager has authority and can exert manipulation (discretionary accrual), is not proxies by total accrual. Total accrual consists of two components: discretionary and non-discretionary. To calculate discretionary accrual, the latter is deducted from the former (Safdar A. Butt Shah, 2009) using formula

Total accruals TA = DA + NDA

Non-discretionary accrual can be calculated using the Kothari model (2005):

$(NDA)= \alpha 1\ (1//Asset\ t\text{-}1) + \alpha 2\ (\Delta REV\ t - \Delta\ REC\ t\ //Asset\ t\text{-}1) + \alpha 3\ (PPP//Asset\ t\text{-}1)$

HERE;

NDA = Non-discretionary accrual of a company in the current year T

REV t= change in revenues /income of the company in the current year T

REC t = change in account receivables of a company in the current year T

PPE = property, plant, and equipment of the company in the current year T

To find non-discretionary accrual (NDA) according to the above formula, the first thing is to find **α1, α2, and α3** by using the formula;

$(TAC)/\ Asset\ t\text{-}1 = \alpha 1\ (1/Asset\ t\text{-}1) + \alpha 2\ (\Delta REV\ t - /Asset\ t\text{-}1) + \alpha 3\ (PPP/Asset\ t\text{-}1)$

3.7 Measurement of Proxy Variables for Financial Distress

3.7.1 Free Cash Flow

An integral part of the study's control variables is operational free cash flow. It denotes the surplus cash flow that a corporation has from its operations after subtracting all other operational expenses associated with the organization (Nobanee & Abraham, 2017). Mills & Bible, (2011) describe the term "free cash flow" as the excess cash flow generated by a business's operations that is not needed for investments in ventures with positive net present values. Cash flow can be measured by using (Ferdinand A Gul, 1997) model;

$$\mathbf{FCF_{it}} = \frac{\mathbf{CFO_{it}} - \mathbf{DIV_{it}}}{\mathbf{TA_{t-1}}}$$

Where FCF_{it} = free cash flow in t, CFO_{it} = Cash flow from operation in t, $DIV_{i\ =\ dividend}$ in t
$TA_{t-1\ =}$, total asset t-1

3.7.2 Financial Leverage

Financial leverage is the total amount of debt that a business has to pay back in the future and that is part of its capital structure (Rayan, 2008) To find a company's financial leverage following formula can be used;
T. Debt / T. Equity

3.7.3 Company Size

In this study, "Total Assets" will be used to figure out how big the company is, since that's how most academic studies do it (Dang, 2018)

3.7.4 Profitability

Return on assets (ROA) is a statistic used to evaluate a company's profitability.
The following formula can be used;
Net Income/ Total Asset

3.7.5 Liquidity

A company's liquidity is a key indicator of its financial strength and stability. The smooth execution of operations depends on the capacity to satisfy short-term financial obligations with current assets, such as cash and receivables, according to (Chatterjee, 2015) an assessment of a company's liquidity can be performed by examining its quick ratio (QR).
Quick ratio = (Current Asset-inventory / Current liability)

3.8 Independent Variable: Measurement of financial distress

Financial distress refers to a condition in which companies experience financial difficulties as a result of insufficient profits and cash flows. The organizations may face difficulties in sustaining their daily business operations because of cash flow issues. The leverage ratio will rise as a result of the injection of fresh capital., thus resulting in an elevated likelihood of insolvency leading to bankruptcy (Vosoughi, 2016).
The following formula can be used to assess the financial distress;
Z- Score = 1.2 * (WC /T.A) + 1.4 * (RE/T.A) + 3.3 * (EBIT/T.A) + 0.6 * (MV equity /T.L) + 1.0* (S/T.A) Where;
WC = 'Working Capital', TA = 'Total Assets', RE = 'Retained Earning', EBIT = 'Earnings before Interest and Taxes', MVE = 'Market Value of Equity', TL = 'Total Liabilities', S = 'Sales'

3.9 Econometrics Model

To test the hypotheses and to investigate the correlation between a dependent variable and several independent variables we will be using the econometrics model. The purpose of this analysis was to determine whether there was a correlation between earnings management and variables such as financial distress, free cash flow from operations, financial leverage, company size, profitability, and liquidity.
The following equation can be used;
EM = β0 +β1 (free cash flow) + β2 (Firm Financial Leverage) + β3 (company Size) + β4 (liquidity) + β5 (profitability) + €
Here,
β0 = the intercept; β1 = (free cash flow), β2 = (Firm Financial Leverage), β3= company Size), β4= (Firm liquidity), β5 = (firm profitability), € = Random error.

Result Findings and Data Analysis:

4.1 DESCRIPTIVE STATISTICS:

The study investigates the impact of several independent variables, such as FCF (Free cash flow), FL (Financial leverage), FS (Firm size), L (Liquidity), P (Profitability), and dependent variable (Earnings management). In study settings, descriptive statistics are employed to provide data about variables, including measures such as "minimum", "maximum", "mean", and SD (standard deviation) for every proxy variable used in the study. N 125 represents the number of 25 companies as a sample for five years (5*25). The descriptive data of this investigation is displayed in Table 1.

Table 1. Descriptive Statistics

	N Statistics	Minimum Statistics	Maximum Statistics	Mean Statistics	Std. Deviation Statistics	Skewness Statistics	Std. Error
EM	125	.00	.51	.0684	.10039	2.183	.217

FCF	125	1	35	12.05	10.472	.658	.217
FL	125	-.05	.02	.0017	.00545	-5.269	.217
FS	125	.00	.00	.0008	.00097	1.729	.217
Liquidity	125	1	32	11.35	6.879	1.099	.217
Profitability	125	-.11	.33	.0454	.05597	1.237	.217
Valid N	125						

Table 1 presents the findings about earnings management. Earnings management (EM) has a significantly right-skewed distribution; values fall between 0.00 and 0.51; this indicates that although most firms manage their earnings minimally, a subset of enterprises manage their earnings quite extensively. The data points are focused around values that are lower and extended towards data that is higher in values, as shown by a mean of 0.0684 and an SD (standard deviation) of 0.10039. This conclusion is supported by the skewness statistic of 2.183, which shows a clear asymmetry towards higher rates of earnings management among specific companies.

The analysis shows an average FCF (Free cash flow) value of 12.05, along with a significant variance i.e. standard deviation of 10.472. The skewness value of 0.658 suggests that the majority of enterprises have lower free cash flow (FCF), while a few organizations have much higher FCF. Firms have near-neutral levels of leverage on average, as shown by the average financial leverage of almost zero (0.0017).The distribution of financial leverage appears to be significantly skewed to the left, as shown by the negative skewness score of -5.269. This shows that most businesses have little leverage, but there are comparatively fewer examples of businesses with somewhat negative leverage. While the majority of businesses show minimal leverage, there are a few outliers with somewhat negative leverage, according to the negative skewness and the mean value being near to zero. The average growth in company size is super tiny, standing at 0.0008. That means companies in our sample only slightly got bigger on average. With a skewness of 1.729, we see most businesses are similar in size (with a few big shots here and there). The mean liquidity of firms is 11.35 with a range from 1 to 32. The positive skewness of 1.099 implies that most firms have enough liquid assets, while some outliers have significantly higher liquidity. With values ranging from -0.11 to 0.33 and a mean of 0.0454, profitability also shows up as a significant factor. The positive skewness of 1.237 shows that, most firms manage to maintain a basic level of profitability. However, some firms achieve considerably higher profitability. This could suggest that Organizations with higher profits have less Persuasion to be involved in earnings management, possibly due to reduced financial pressures or better compliance with ethical standards and regulatory requirements.

	Unstandardized Coefficients		Standardized Coefficients		
Analytical Model	**B**	**Std. Error**	**Beta**	**t**	**Sig.**
Constant	.045	.029		1.551	.124
a1	-9977.648	12863.233	-.072	-.776	.439
a2	.009	.019	.047	.510	.611
a3	-.021	.050	-.040	-.424	.673

Table 2. The coefficients a1, a2, and a3 are determined using (SPSS) program, and the coefficients valves for a1, a2, and a3 are -0.072, 0.047, and 0.040, respectively. In the computation of earning management, coefficient valves are employed to ascertain the link between different factors and their influence on EM (earning management). As all p-values are greater than 0.5 which shows that statically there is no significant impact on earning management leading to view that there is no strong evidence that these variables significantly influence earnings management.

Table 3.0 *Correlation Matrix*

	EM (Earnings management)	FCF (Free cash flow)	FL(Financial leverage)	FS (Firm size)	Liquidity	Profitability
EM(Earnings management)	1					
FCF (Free cash flow)	.546	1				
FL (Financial leverage)	.054	.130	1			
FS (Firm size)	.067	-.009	.050	1		
Liquidity	.064	-.039	-.091	-.075	1	
Profitability	.287**	.014	-.041	.169	.544**	1

Table 3.0 shows the analysis of Pearson correlation find out using SPSS software. The Pearson correlation study provides insight into the relationships between various financial variables and earnings management practices inside firms by investigating the association between financial distress and EM (earnings management). In examining the relationship between financial distress and EM (earnings management) within corporations, I came across some interesting insights. The Pearson correlation analysis showed there is a reasonable positive relation between (EM) earnings management and (FCF) Free cash flow with a correlation coefficient 0.546, which is significant at level of (0.01). The analysis further reveals that there are insignificant relationships between earnings management and other financial measures such as Financial Leverage (FL), Firm Size (FS), and Liquidity. The correlation coefficients for these factors are 0.054, 0.067, and 0.064, respectively, and are statistically insignificant. These findings suggest that these factors (variables) may not have a direct or strong Impact on EM (earnings management) techniques. If we look at small correlation between FL (financial leverage) and EM (earnings management) shows that the degree to which a company is financed by debt does not directly correlate with its tendency to be involved in EM (earnings management). This suggests that debt levels may not significantly pressure managers to alter earnings to meet debt covenants or other leverage-induced benchmarks, contrary to what might be expected. Additionally, there is a positive correlation - coefficient of 0.287 between profitability and EM (earnings management). This implies that organizations that are more profitable might also be involved in earnings management, either due to a desire to preserve the image of steady prosperity or to even out earnings over time. This may be a reflection of agency theory, which emphasizes how managers' behavior may be impacted by financial performance-related bonuses or other personal incentives, leading managers to manipulate earnings in order to obtain such rewards

Table 4.0 *Coefficients*

	Unstandardized Coefficients		Standardized Coefficients		
Analytical Model	**B**	**Std. Error**	**Beta**	**t**	**Sig.**
(Constant)	-.005	.018		-.296	.768
FCF	.005	.001	.539	7.407	.000
FL	-.207	1.345	-.011	-.154	.878
FS	1.000	7.703	.010	.130	.897
Liquidity	-.001	.001	-.095	-1.075	.285
Profitability	.590	.159	.329	3.707	.000

Dependent Variable: EM

Table 4.0 shows that free cash flow (FCF) and profitability are two key financial factors that have a considerable impact on earnings management, a process that involves purposeful manipulation of financial reporting to accomplish specific targets or improve a firm's

financial image. With a standardized coefficient (Beta) of 0.539 and a significance threshold below 0.001, our analysis shows a positive and significant association between EM (earnings management) and FCF (free cash flow). This shows that companies are more prone to manipulate earnings if they have larger free cash flows. Also, profitability, with a beta value of 0.329 and a comparable degree of statistical significance, further shows a strong positive correlation with earnings management. This suggests that there may be a greater motivation for more profitable businesses to manipulate earnings.

There is no discernible influence of Financial Leverage (FL) on the management of earnings, with a strong p-value and a beta of (-0.011), indicating that companies in financial difficulties are not compelled to manipulate their earnings due to their debt levels. Likewise, there is no apparent impact of FS on EM. Also relationship between Liquidity and EM (earning management) is negative, and non-significant. The coefficient for Liquidity (-0.095) further supports the notion that firms having more liquidity are not necessarily involved in techniques of EM (earnings management).

CONCLUSION, Limitations, Recommendation for Future Work

5.1 Conclusion

The study's objective is to Gain deep insight into how financial distress impacts EM (earnings management) in the setting of Pakistan. For analysis, data was collected from a sample of 25 textile enterprises experiencing financial distress throughout 5 years from 2018 to 2022. There are a total of 51 companies listed on a textile composite of the PSX. Among these companies, 17 have been classed as defaulters. After considering the remaining companies, a sample of 25 financially distressed corporations was selected. Using the formula of Altman's Z-Score, the extent of financial distress was calculated. The independent variable in this study is financial distress. Financial distress is monitored using proxies such as free cash flow, financial leverage, business size, liquidity, and profitability. Discretionary accrual (DA) has been found using the "Modified Jones Model". Also, the Econometrics model was employed to gain insight into the relationship between financial distress and EM (earnings management). Free cash flows, FL (financial leverage), and FS (firm size) were variables taken into consideration. Liquidity is calculated by using Quick ratio analysis, and profitability is calculated by using (ROA). The empirical analysis provides insights into the intricacies of EM (earnings management) practices inside companies, also the impact of financial indicators such as the amount of financial leverage (FL), company size (FS), free cash flow (FCF), liquidity, And Profitability. The analysis of data indicates that there is significant positive correlation between FCF (free cash flow), and profitability as well as earnings management, suggesting that companies using high levels of profitability or FCF (free cash flow) are also more inclined to employ earnings management strategies and This outcome validates the findings of various previous studies (Erna Setiany, 2021),(Aburisheh, Dahiyat, and Owais 2022),(Abubakar 2021). The data analysis also shows a negative correlation between FL (Financial Leverage), and EM (earnings Management), although it is not statistically significant. This outcome validates the findings of various previous studies of (Bin Mohamad Kamal & Binti Khazalle, 2021) and (Harry DeAngelo, Linda DeAngelo, 1994). The study of firm Size (FS) reveals that there is no statistically significant relation, suggesting that the size of a business does not have a major impact on EM. This result confirms the findings of (Aburisheh et al., 2022) and (Kalbuana, 2021). Also, the relation between Liquidity and EM is negative but non-significant.

5.3 Recommendation for Future Work

Managers distort financial statements through techniques like A.E.M (Accrual earnings manipulation), R.E.M (real earnings manipulation), and classification shift. In this study, we focus on Discretionary accrual (DA), a proxy for earnings management. Future studies can focus on real earning management in financial distress firms. Real earnings management (REM) activities involve the manipulation of financial data. For instance, managers may choose to decrease discretionary expenses such as funding R&D, paying for advertising, and also funding maintenance, or perhaps produce too much. Auditors and supervisory bodies find it more challenging to detect R.E.M practices compared to accrual-based

earnings management (Siyal, 2020). Further studies could also investigate if financially distressed organizations have a greater propensity for accrual earning management or actual earning management.

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