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# CORPORATE SUSTAINABILITY DISCLOSURES AND EARNINGS MANAGEMENT AMONG LISTED FIRMS IN EAST AFRICA MEMBER STATES

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**Abstract**

*This paper empirically analyses the effect of corporate sustainability disclosures on earnings management among listed firms in the East Africa Community. The study analyzed a sample of listed firms in East Africa to examine the effect of economic, environmental, and social disclosures on earnings management. Panel data covering multiple firm-year observations were employed, and the study utilized hierarchical regression analysis to test the hypotheses. The regression results indicate that economic and environmental disclosures both have a significant positive effect on earnings management. This suggests that firms may use these disclosures strategically to manipulate financial statements and present a more favorable image to stakeholders. On the other hand, social disclosures exhibit a significant negative association* *with earnings management, implying that greater transparency in social reporting enhances corporate accountability and reduces opportunistic financial reporting practices. These findings align with previous empirical studies on the role of corporate disclosures in earnings management. These findings contribute to the growing literature on corporate disclosures and earnings management, particularly in the context of East African capital markets. The results have important implications for investors, regulators, and policymakers. Regulatory bodies should enhance disclosure standards to mitigate the risk of earnings manipulation through economic and environmental reporting. Investors should carefully evaluate firms' disclosures, recognizing their potential use as tools for earnings management. Additionally, firms should be encouraged to strengthen their social disclosures, as this has been shown to promote ethical financial reporting and corporate governance. This study extends the literature on corporate disclosures and earnings management by providing empirical evidence from a developing region. While previous research has primarily focused on developed economies, this study highlights how firms in East Africa leverage economic and environmental disclosures for earnings management. The study underscores the importance of strengthening regulatory frameworks to ensure the reliability and transparency of corporate disclosures in emerging markets*

*Keywords: Earnings Management, Corporate Sustainability Disclosures, Environmental Disclosures, Economic Disclosures and Social Disclosures*

## INTRODUCTION

Earnings management is the practice of manipulating financial statements or accounting records in order to present an untruthful depiction of a company's financial performance (Arita *et al*., 2021). Typically, the purpose of this manipulation is to delude stakeholders regarding the true financial position of the company or to accomplish specific financial objectives (Harymawan *et al*., 2018). Earnings management is a prevalent financial strategy employed by managers to attain their financial objectives and manage unfavorable circumstances (Yao & Liu, 2020). Nevertheless, the utilization of earnings management by stakeholders of financial statements may be detrimental, as it undermines the information presented's credibility and dependability (Flayyih *et al*., 2020). In addition, fraudulent financial reporting or fraud may result from earnings management, particularly when it entails the intentional manipulation of earnings through deceptive means. Managers may, for instance, manipulate accrual components of financial statements, which are more susceptible to manipulation (Christensen *et al*., 2020). Manipulating accrual components, such as the timing of expenses or revenue recognition, enables managers to exaggerate earnings artificially in order to satisfy or surpass market expectations. Such actions may lead investors and other stakeholders to form judgments predicated on inaccurate or manipulated data. The act of earnings management gives rise to ethical quandaries due to the dissemination of information that fails to precisely mirror the actual financial state of the organization (Zhou, McGee & Souissi, 202).

In reality, earnings management is a two-edged weapon. Companies may utilize it, on the one hand, to maintain consistent profit growth and project a favorable image to stakeholders. Conversely, it may also be employed to manipulate financial statements in order to deceive stakeholders about the actual economic performance of the company (Martínez-Ferrero, Banerjee & García-Sánchez, 2016). When implemented in an ethical and responsible manner, earnings management can assist businesses in reaching their financial objectives and attracting investors. It can also reduce the risk of stock price volatility and improve financial stability by mitigating earnings fluctuations. However, it can be detrimental when earnings management is employed with the intention of misleading investors and stakeholders. For example, the act of distorting earnings can result in escalated stock prices, thereby deceiving investors regarding the true worth of the company. Individuals or organizations that depend on precise financial data may incur financial losses and market instability as a consequence?

Positive earnings management, as defined by Surifah (2017), pertains to the implementation of lawful accounting practices and strategies with the intention of augmenting the transparency of financial reporting and furnishing stakeholders with a more precise depiction of the economic performance of a company. Earnings information is frequently the focus of engineering, which occurs when management strategically manipulates data to maximize their own interests or those of other stakeholders who place greater emphasis on earnings. It is executed by management, particularly those whose performance is evaluated in accordance with earnings data. Consider Savitri (2014). As a result, earnings are frequently manipulated in an effort to enhance the appearance of financial statements; this practice is referred to as "earnings management" (Indracahya and Faisol, 2017).

Managers consider the reported earnings to be an important measure for stakeholders to evaluate not only the financial success of organizations, but also executive compensation and the future viability of the firms (Graham, Harvey, & Rajgopal, 2005). Managers, thus, might have a significant motive to alter profits data in order to enhance their compensations (Xu, Taylor, & Dugan, 2007). Even while earnings manipulation might not be breaching the widely recognized accounting standards in a given context, nonetheless it might portray a deceptive picture of a firm's financial success to outsiders (Rahman & Ali, 2006).

Given the current circumstances of climate change, limited natural resources, and other socio-environmental challenges, Corporate Environmental Disclosure (CED) has gained significant importance in corporate decision-making and communication. This is supported by various studies (Albitar, Hussainey, Kolade, & Gerged, 2020; Cho & Patten, 2007; Gerged, Beddewela, & Cowton, 2020; Gerged, Matthews, & Elheddad, 2021; Lu & Abeysekera, 2017). We describe CED as the dissemination of information to external stakeholders about a corporation's environmental policies, operations and performance (Deegan, 2002). CED might entail major environmental challenges and their effects on enterprises' future financial performance, material items of expense or income, environmental regulations, and other uncertainties and hazards (Birkey, Michelon, Patten, & Sankara, 2016). These challenges are likely to attract a significant number of users, including investors, lenders, and shareholders who are worried about the economic, social, and political consequences of environmental sustainability (Gray, Javad, Power, & Sinclair, 2001; Lehman & Kuruppu, 2017). CED can also be useful in boosting company reputation, reducing the cost of financing and strengthening enterprises' negotiation power and market competitiveness (Bae, Chang, & Yi, 2018; Sarumpaet, Nelwan, & Dewi, 2017). A firm may engage in Corporate Environmental Disclosure (CED) for two main reasons. Firstly, it can be used as a means to gain legitimacy for the firm's actions. Secondly, managers may use CED opportunistically to greenwash unethical behaviors, such as earnings management. These motivations have been discussed by various researchers (Chen, Cho, & Patten, 2014; Lu & Abeysekera, 2017; Gerged, Al-Haddad, & Al-Hajri, 2020; McWilliams, Siegel, & Wright, 2006). The first theoretical perspective proposes a substantial and adverse correlation between CED and earnings manipulations, while the second one posits the reverse link (Kim, Park, & Wier, 2012).

As per Healy and Wahlen (1999), earnings management (EM) refers to the practice of managers using their discretion in financial reporting and transaction structuring to manipulate financial reports. This manipulation can be done to deceive certain stakeholders about the true economic performance of the company or to influence contractual outcomes that are dependent on reported accounting figures (Healy & Wahlen, 1999, p. 386). Prior studies have concluded many motivations for corporate engagement in EM such as avoidance of possible regulatory interference (Adiel, 1996; Collins, Shackelford, & Wahlen, 1995), meeting analysts' forecasts (Kasznik, 1999; Payne & Robb, 2000), equity offerings (Teoh, Welch, & Wong, 1998), and achieving specific contract-related objectives (Abarbanell & Lehavy, 2003). Dechow and Sloan (1991) suggest that managers use earnings management to optimize their overall CEO remuneration. However, some contend that the management of a firm appeared to be involved in actively manipulating the reported earnings in order to prevent a violation of debt covenants (DeAngelo, DeAngelo, & Skinner, 1994; DeFond & Jiambalvo, 1994; Sweeney, 1994).

 

Since the start of the 21st century, there have been several instances of financial accounting scandals, such as the FlowTex scandal in 2000, the Parmalat scandal in 2003, the AIG scandal in 2004, and more recently, the Pescanova scandal in 2013, the Toshiba scandal in 2015, and the Malaysia Development Berhad scandal in 2018 (Dessain, Meier, & Salas, 2008). The occurrence of this event has led to problems related to the way companies are governed, which in turn has influenced several significant business choices (Vijayakumaran & Vijayakumaran, 2019). Additionally, it has raised public apprehensions regarding the ethical conduct, social responsibility, and corporate governance practices of enterprises (Huynh, 2019).

The occurrence of multiple economic cycles, characterized by periods of growth followed by declines in financial markets, culminated in the global financial crisis of 2007 and 2008. This crisis, which was the most severe financial collapse in terms of corporate governance and governmental regulations, was primarily caused by failures in corporate governance (Dessain *et al*., 2008). This highlights the perils of unregulated financial markets, disregarded risk management, and inadequate governance. Corporate governance is established to address the division between ownership and management and to ensure fair distribution of benefits among different stakeholders, such as shareholders, consumers, banks, suppliers, local communities, governments, managers, and employees (Rodriguez-Fernandez, 2016).

Nainawat and Meena (2013) argue that corporate governance mechanisms are important for managing ethical decisions in accounting reporting and ensuring responsible use of organizational resources. Financial accounting principles enable managers to exercise accounting discretion in reporting their earnings. Managers typically manipulate their firm's reported earnings when there are significant disparities in benefits among shareholders (Almahrog, Marai, & Knežević, 2016). The adherence to ethical principles in accounting reporting, which is widely acknowledged as being associated with moral standards of right and wrong in human behavior, can have significant impacts on the operational success of organizations (Kantor & Weisberg, 2002).

The field of accounting ethics focuses on the principles and guidelines for making ethical decisions in relation to the creation, communication, and identification of financial data. This is closely associated with the practice of earnings management, which ultimately results in a decline in the quality of reported earnings. Furthermore, Stuebs and Sun (2015) and Crifo and Rebérioux (2016) have suggested that corporate governance considerations play a crucial role in motivating socially responsible activities undertaken by enterprises, which ultimately contribute to optimal organizational performance. Corporate governance practices play a crucial role in influencing both earnings management and socially responsible activities undertaken by firms. It is important to note that earnings management and social responsibility are closely linked to each other (Gras-Gil, Manzano, & Fernández, 2016; Gavana, Gottardo, & Moisello, 2017; Mahrani & Soewarno, 2018).

Some Listed corporations in East Africa, including NBK, Uchumi, Limuru Tea, Kakuzi, Tanzania Cigarette Company, Tanga cement company limited, BAE Security Radar Tanzania, New vision group Uganda, Equity bank Uganda, Uganda Clays Limited, Heritage Oil and Gas Ltd and CMC, have been engaging in earnings management practices. In 2018, the CMA imposed a fine of Sh113 million on former National Bank of Kenya executives for fraudulent financial reporting, as reported by Standard Media in 2018. Furthermore, the business publication from 2022 reported that the Capital Markets Authority investigated the audit company Ernst & Young for falsifying financial records of Uchumi. According to a 2022 Business Daily report, Kakuzi was accused of transferring profits overseas. The Capital Markets Authority (CMA) initiated investigations against Limuru Tea, a company controlled by Unilever, for allegedly undervaluing its 696.8-acre plantation and suspected financial misconduct. EM involves manipulating financial reporting through short-term strategies to deceive stakeholders over the company's performance or for contractual reasons, as discussed by several researchers (Healy and Wahlen 1999; Dechow et al. 1996; Xie et al. 2003; Gargouri et al. 2010; Choi et al. 2018). The practices have faced significant criticism in the literature for their potential to greatly impact a firm's long-term sustainability and diminish the trustworthiness of financial reporting (Ehsan et al., 2022).

The relationship between earnings management, socially responsible actions, corporate governance, and firm performance or success has been extensively studied and recognized as influential factors (Han, Kang, & Shin, 2016; Mahrani & Soewarno, 2018; Sheikh, Bhutta, & Sultan, 2019). Various studies have examined the connections between earnings management and corporate governance, the relationship between socially responsible behaviors and corporate governance, and the correlation between corporate social responsibility and earnings management. Several projects (Shiri, Vaghfi, Soltani, & Esmaeli, 2012; Dhu & Hbp, 2019; Essa, Kabir, & Nguyen, 2016; Latif, Bhatti, & Raheman, 2017) highlight the important role of corporate governance in ensuring the accuracy of reported earnings by minimizing agency costs. This, in turn, improves the trustworthiness and relevance of accounting information by controlling opportunistic behavior of agents.

The current literature on the conversion of CED to EM appears to have various shortcomings. Prior studies have examined the correlation between environmental disclosures and EM on a global scale. For instance, Kim *et al*. (2012), Liu, Shi, Wilson, and Wu (2017), Pyo and Lee (2013), and Sun, Salama, Hu'ssainey, and Habbash (2010) have all conducted study in this area. However, there have been limited studies investigating the relationship between CED and EM in underdeveloped countries (Gerged, Al-Haddad, & Al-Hajri, 2020).

Yip, Van Staden, and Cahan (2011) demonstrate that the link between CED and EM is a context-specific, particularly related to the governance and regulatory framework. The primary cause of the variations in the relationship between CED and EM is the diversity in governance systems among countries. Compliance with corporate governance (CG) procedures can improve the integrity of financial reports and act as a disincentive to earnings manipulation (Uadiale, 2012). Our research builds upon prior studies (e.g., Fama & Jensen, 1983; González & García-Meca, 2014; Meckling & Jensen, 1976) and specifically examines the extent to which corporate governance measures contribute to the reduction of corporate participation in emerging market activities.

## LITERATURE REVIEW

### Economic disclosure and earning management

A study by Chen and Jaggi (2000) showed that firms with better corporate governance disclosure tend to have fewer indicators of earnings management, highlighting the role of transparency in discouraging manipulative practices. Cornett, Marcus, and Tehranian conducted a similar study and concluded that quality governance disclosures are associated with less opportunistic earnings management. High-quality disclosures likely create a control mechanism that induces managers to behave in shareholders' best interests.  Rao, Tilt, and Lester found that companies providing substantial and more transparent governance disclosures have lower levels of earnings management. Their research supports the need for thorough governance disclosures to foster accountability.

Siregar and Utama (2008) investigated governance disclosure and earnings management in Indonesia. Contrary to most findings, they discovered no significant effect of governance structures and disclosure on the extent of earnings management.

Panjaitan and Suranta (2024) conducted a study to investigate the correlation between Environmental, Social Governance (ESG), and earnings management. The objective was to identify the disparity in earnings management practices between companies with ESG scores and demonstrate the variations in ESG scores among these companies.  The study population consisted of all companies that possess ESG scores, while the sample specifically included 20 publicly traded manufacturing companies that reported ESG scores.

Trisnawati & Setiawati (2016) investigated the impact of Sustainability reporting on earnings management for all organizations that took part in the Indonesian Sustainability Report Award (ISRA) in 2015. This study utilized data from companies who were listed on the

Indonesia Stock Exchange and registered for the Islamic Social Reporting Award (ISRA) in 2015.The user's text is empty. The ISRA 2015 event was attended by a total of 37 firms, which included 4 international companies and 1 non-listed company. Hence, the overall sample consists of 33 companies over the period of 2013 to 2015. The variables that are not influenced by other factors are economic disclosure, environmental disclosure, and social disclosure. The factors were assessed using the disclosure index of Sustainability reporting criteria provided by the Global Reporting Initiative (GRI) G4. The dependent variable was earnings management, which was measured by discretionary accruals. The findings indicate that all aspects of sustainability reporting have a statistically significant detrimental impact on earnings management.

Olagunju, *et al*., (2023) investigated the effects of sustainability reporting on the manipulation of financial earnings. This study utilized a causal research design. The study population consisted of all 112 non-financial enterprises quoted in Nigeria. The sample size for this study was 22 listed manufacturing firms, which were purposefully selected. The study spanned a duration of 7 years, specifically from 2015 to 2021. The data utilized for this study were obtained from the annual reports and sustainability reports of the chosen companies. The data utilized in this study were examined using descriptive statistics and panel regression analysis. In this study, sustainability reporting was assessed using the social, economic, and environmental disclosures index, while earnings management was evaluated by discretionary accrual and actual earnings. The analysis of the study found that sustainability reporting had a notable adverse impact on discretionary accruals and real profitability.

*$H_{O1}$: Economic disclosure has significant effect on Earnings Management*

**Environmental disclosure and earning management**

A study by Cho and Patten (2007) examined the association between environmental performance, environmental disclosure, and economic performance. They found that poor environmental performers compared to good ones were more likely to manage their earnings and increase their level of environmental disclosures to offset negative public perceptions. Clarkson, Li, Richardson & Vasvari (2008) found that higher levels of corporate environmental disclosure correlate with decreased levels of earnings management activities. Their study suggested that transparent environmental reporting can constrain earnings management.

De Villiers, Naiker & Van (2011) Staden explored the relationship and found that companies with poor environmental performance practice had more earnings management. They concluded that these companies use delegitimation and legitimation strategies to distract stakeholders from their poor environmental performance. Luo, Zhang, & Zhang, (2025). found that firms with more carbon emissions (poor environmental behavior) had higher levels of earnings management, and these firms tended to disclose more about their environmental activities.

Gerged *et al*. (2023) investigated the potential moderating effect of internal corporate governance (CG) mechanisms on the association between an emerging economy firm's earnings management (EM) practice and its level of corporate environmental disclosure (CED). The study examined 500 firm-year observations spanning 100 Jordanian listed firms from 2010 to 2014. It found that although there is a negative correlation between CED and earnings manipulations, the associations between CG arrangements and EM are variable, potentially resulting in either a decrease or an increase in earnings manipulations in Jordan. Additionally, the CED-EM nexus was moderated by certain CG structures, including managerial and institutional ownership structures, board size, and institutional ownership.

Shang and Chi (2023) analyzed the financial implications of enterprise environmental information disclosure (EID) from the standpoint of earnings management (EM), which serves as an external indicator of the 'ethical behaviour' and 'opportunistic motivations' of EID, using a sample of listed companies in China's most polluting industries from 2009 to 2020. Internal management competency and operating environment volatility were also taken into account. Among the findings was the following: EID can restrain EM and support EID's "ethical behaviour" motivation. The impact of 'hard disclosure' on environmental matters is more conspicuous in comparison to'soft disclosure' of such information. Increased environmental uncertainty undermines the EM governance function of EID, whereas heightened management competence can strengthen this mechanism. EID inhibits EM in mature enterprises, state-owned entities, regions with low public environmental concern, and western locations.

As stated by Almubarak *et al*. (2023), companies persistently encountered a significant ethical dilemma in the form of earnings management. In order to protect themselves from stakeholders, management that engages in earnings manipulation may implement environmental, social, and governance (ESG) initiatives. Participation in ESG initiatives is occasionally perceived as a form of managerial impropriety and an attempt to obscure manipulative strategies. Consequently, the primary objective of the research was to examine the correlation between levels of earnings management and ESG disclosure within the context of publicly traded corporations in Saudi Arabia. The research examined the impact that financial distress had on the aforementioned correlation. 304 observations per company year were utilised to compile the data from 2014 to 2021. ESG disclosure had a positive and statistically significant impact on earnings management, according to the findings. Additionally, this effect was significant and positively influenced by financial distress.

 

Gerged *et al*. (2020) examined the relationship between earnings management (EM) and corporate environmental disclosure (CED) in Kuwait, an emerging market within the Gulf Cooperation Council (GCC). The study examined the CED-EM nexus utilising panel data from companies listed on the Kuwaiti stock exchange between 2010 and 2014. A fixed-effects model was implemented for this purpose. Further estimations of a two-stage least-squares model and a generalised method of moments model were performed in order to mitigate any apprehensions pertaining to endogeneity issues. The results indicated the existence of a significant and negative correlation between CED and EM. Further, finding revealed that managers who prioritise environmental responsibility were less inclined to implement EM practices in Kuwait.

Shahwan and Esra'a (2021) investigated the potential moderating effect of earnings management on the relationship between the disclosure of social and environmental costs and financial performance. The objective of this study was achieved through the utilisation of primary data obtained from the Amman Stock Exchange and a quantitative research approach. A questionnaire was utilised to gather data from a representative sample of 127 companies for the study. The findings of the research indicated that the disclosure of social and environmental costs had a substantial and positive effect on the financial performance of the companies.

Brahmana *et al*. (2018) found that corporate environmental disclosure significantly affect earnings management. A correlation between CED and EM was investigated in the study. 238 publicly traded companies across three distinct sectors—construction, technology, and trading—were the primary sources of attention. From 2008 to 2014, the research was carried out. Based on the findings, CED had a significant and positive impact on the EM.

Panjaitan and Suranta (2024) conducted a study to investigate the relationship between Environmental, Social Governance (ESG), and earnings management. The objective was to identify variations in earnings management amongst companies with ESG scores and demonstrate the disparities in ESG scores among these companies. The hypotheses were examined using SPSS 24. The study's findings suggest that organisations with a high score effectively reduce risk by applying earnings management.

*$H_{O2}$: Environmental disclosure has significant effect on Earnings Management*

### Social disclosure and earnings management

Empirical research has looked into the potential relationship between social disclosure and earnings management. These studies generally probe whether companies might manipulate earnings and concurrently increase social disclosure as a means of mitigating negative perceptions. Maas & Rosendaal, (2016) investigate this relationship and found that firms tend to increase their voluntary social disclosures when they have managed their earnings. These firms leverage increased social disclosure as a strategy for masking their earnings management activities and maintaining a positive public image.

A study by Prado-Lorenzo and Garcia-Sanchez (2011) suggested that social disclosure is used as a tool to legitimize earnings management practices. In their research, they found that companies with higher levels of corporate social responsibility disclosure also had higher levels of discretionary accruals.

Sun, Salama, Hussainey and Habbash . (2010). found that companies with higher earnings management tend to provide greater social disclosure. The authors suggest that such companies use social disclosure as a way to divert stakeholder attention away from their earnings manipulation activities.

Roychowdhury and Watts (2007) didn't find any significant relationship between social disclosure and earnings management, emphasizing the need to consider other firm-specific factors that could impact the relationship. Overall, empirical literature provides mixed findings.

Ningsih *et al*. (2023) posit that the act of earnings manipulation is frequently linked to the fabrication of public data presented in sustainability reports. Consequently, the objective of this research was to investigate the correlation between sustainability social reporting practices and earnings management within the Indonesian context. During the period 2010–2021, the study utilised 408 firm-year observations from publicly traded companies in Indonesia to examine the hypothesis. Standard error estimates were incorporated into the fixed effect regression analyses. The authors determined the degree to which earnings management impacts sustainability reporting practices by analysing the financial statements and sustainability reports of their respective companies during a specified time period.

Pakawaru and colleagues (2021) the link between corporate social responsibility (CSR) and earnings management remains a source of contention. Several prior research have found that CSR is a factor in earnings management. Others, on the other hand, demonstrated the opposite. As a result, the study sought to evaluate the impact of CSR disclosure on earnings management, as well as the impact of earnings management on CSR disclosure. This research was carried out with mining businesses listed on the Indonesia Stock Exchange (IDX) between 2016 and 2019. Multiple linear regression analysis was used to analyse the research data. Financial statements, annual reports, and sustainability reports were used to collect the data. According to the findings, there was a positive association between CSR disclosure and earnings management. This study also revealed that the CSR disclosure and earnings management relationship model is recursive.

According to Faisal *et al*. (2018), the association between corporate social responsibility disclosure (CSRD) and earnings management (EM) is inconclusive. The study looked at the relationship between CSRD and EM. The sample for this study was 479 annual reports from publicly traded Indonesian companies. The two-stage least squares (2SLS) approach was used to test the connection between CSRD and EM. The data suggested that organisations with a high CSRD are less likely to control earnings. Furthermore, the findings revealed that the interaction between CSRD and EM can be seen as a substitution mechanism.

Christina and Alexander (2019, February) investigated the impact of corporate governance and CSR disclosure on earnings management practice. Corporate governance is measured by the board of directors, the independent board of directors, and institutional ownership. The study's population comprised of 94 non-financial enterprises that were listed on the Indonesia Stock Exchange between 2014 and 2016. Purposive sampling was performed, and multiple regression was used to test the hypothesis. The study found that corporate governance has no effect on earnings management and that corporate social reporting has a negative impact on earnings management.

Borralho *et al*. (2022) posited that organisations might disclose corporate social responsibility (CSR) initiatives on purpose to offset the scrutiny of stakeholders regarding atypical reporting practices and to mitigate for earnings management. Nevertheless, the manner in which CSR dimensions contribute to these practices can vary, and the extent to which these impacts are influenced can be contingent upon particular business contexts. This research examined the distinct impact of environmental, social, and governance (ESG) disclosure elements on earnings management in family-owned businesses as opposed to non-family businesses. For the analysis, data pertaining to listed companies in France and Spain from 2009 to 2018 were utilised, given that both of these code law nations have concentrated ownership. The results demonstrated that not all ESG dimensions are equally essential for reducing earnings management and that the family or non-family status of a company influences the relationship between ESG disclosure and earnings management.

In their study, Laksmi and Kamila (2018) examined the impact of earnings management and sound corporate governance on the disclosure of corporate social responsibility (CSR) for seventeen state-owned companies that were listed on the Indonesia Stock Exchange between 2013 and 2015. The researchers followed the guidelines set forth by the Global Reporting Initiative (GRI). This research utilized secondary data and employs the purposive sampling technique. The findings of the study suggest that there are notable positive impacts of state ownership, audit committee membership, and managerial ownership on the disclosure of corporate social responsibility in Indonesian state-owned enterprises.

*$H_{O3}$: Social disclosure has significant effect on Earnings Management*

## RESEARCH DESIGN

This study employed both the longitudinal and explanatory research design and the target population for this study was all listed firms in the East Africa Community. The firms are listed across four securities and stock exchanges comprising of the Nairobi Securities Exchange, Uganda Securities Exchange, Dar es Salaam Stock Exchange and the Rwanda Stock Exchange. The selection of the firm was based on three criteria: First the firm should have operated throughout the study period. Second, availability of complete data. Third, cross-listed firms were only considered from their country of incorporation, where consolidated reports were used. Data of this research was secondary in nature and it was extracted from the firm's audited annual reports that were downloaded from firms' websites and the African Financials. Our final sample was 672 firm-year observations representing 65 firms over the period between 2013-2023.

### Measurement of variables

The following section presents the measurement of the variables of the study which are earnings management as the dependent variable and economic disclosure, environmental disclosure, social disclosure as independent variables.

Table 1: Measurement of variables

| Variable | Category | Symbol | Measurement | Source |
|---|---|---|---|---|
| Earnings Management | Dependent Variable | EM | modified Jones model | Dechow *et al.,* 1995 |
| Economic disclosure | Independent variable | ECON | CSD index | GRI4 |
| Environmental disclosure | Independent variable | ENVI | CSD index | GRI4 |
| Social disclosure | Independent variable | SOCI | CSD index | GRI4 |
| Firm size | Control variable | FS | Natural logarithm of total assets. | Raimo *et al*., 2020; Al-Najjar and Kilincarslan (2016). |
| Leverage | Control variable | LEV | Ratio of the book value of debt over the book value of equity. | Raimo *et al*., 2020; Al-Najjar and Kilincarslan (2016). |
| Firm age | Control Variable | FA | current year's log minus the incorporation year. | (Loderer & Waelchli, 2010). |
| Firm performance | Control variable | ROA | Net income divided by net assets. | Al-Najjar and Kilincarslan (2016). |

### Regression models

Drawing on previous literature, this study employed the modified Jones model proposed by Dechow et al. (1995) to estimate discretionary accruals as a measure of earnings management (EM) behavior. Prior research extensively uses abnormal accruals as a proxy for earnings manipulation (Jones, 1991; Dechow et al., 1995; Defond & Subramanyam, 1998; Kasznik, 1999). Consistent with earlier studies (Carmo et al., 2016; Chen et al., 2011; Houqe et al., 2017; Karjalainen, 2011; Orazalin & Akhmetzhanov, 2019), this study utilizes the modified Jones model to estimate EM. The study applied the following regression model to estimate the relationship between corporate sustainability disclosures and earnings management.

Model 1. Testing the effect of the control variables on Earnings Management.

$$EM_{it} = \beta_0 + \beta_1 FS_{it} + \beta_2 LEV_{it} + \beta_3 FA_{it} + \beta_4 ROA_{it} + \varepsilon_{it}$$

Model 2. Testing the effect of independent variable on Earnings Management.

$$EM_{it} = \beta_0 + C + \beta_1 ECON_{it} + \beta_2 ENVI_{it} + \beta_3 SOCI_{it} + \varepsilon_{it}$$

## ANALYSIS AND RESULTS

### Descriptive Statistics

The descriptive statistics for the untransformed data are presented in Table II. The mean value of earnings management is 0.0316329, which indicates that, on average, firms slightly engage in earnings manipulation. However, the standard deviation of 0.3376265 signifies a notable variation among firms. The minimum value is -1.015912, and the maximum is 0.976693, showing that while some firms significantly underreport earnings, others overreport them, leading to a wide range of practices in earnings management. The firm age variable, measured in its logarithmic form, has a mean of 1.470013. This suggests that the firms in the dataset are relatively well-established on average. The standard deviation of 0.384888 reflects moderate variability in the age of the firms. The minimum value of 0 represents newly established firms, while the maximum value of 2.103804 indicates the presence of older firms in the sample. The spread of values highlights the inclusion of both new and long-standing firms, providing a broad perspective on the age distribution within the dataset. The firm size variable, also measured logarithmically, has a mean of 7.767341. This suggests that the firms in the sample tend to be relatively large. The standard deviation of 1.647555 indicates significant variability in firm sizes. The minimum value of 4.04914 and the maximum value of 12.96864 demonstrate a wide range of firm sizes, from smaller to very large firms. This considerable range suggests that the dataset encompasses firms of various sizes, which can provide insights into how firm size affects other variables such as performance and leverage. With a mean of 0.0713753, firm performance on average is slightly positive. The standard deviation of 0.3483157 shows moderate variability among firms. The performance ranges from a minimum of -8.18046 to a maximum of 0.7726612, indicating that while some firms experience significant negative performance, others perform quite well, contributing to a broad performance spectrum. The mean firm leverage is 2.315173, indicating that on average, firms have a moderate level of debt. However, the high standard deviation of 5.951875 points to significant variability in leverage levels among firms. The minimum value of -25.90048 suggests some firms have net cash positions, while the maximum value of 96.61061 indicates that some firms are highly leveraged, resulting in a wide range of leverage ratios. The mean score for economic disclosures is 0.3557289, showing that firms, on average, disclose a moderate amount of economic information. The standard deviation of 0.2385377 suggests there is variability in the extent of these disclosures. With a range from 0 to 0.9230769, it is evident that some firms do not disclose any economic information, while others disclose extensively, highlighting diverse disclosure practices. The mean value for environmental disclosures is 0.1473339, indicating that environmental information disclosure is relatively low among firms. The standard deviation of 0.1795663 reflects moderate variability in disclosure levels. The minimum value is 0, and the maximum value is 0.859375, showing that while some firms do not engage in environmental disclosures, others provide significant information, reflecting a range of environmental transparency. The mean score for social disclosures is 0.2547552, suggesting that firms tend to disclose a low amount of social information. The standard deviation of 0.196816 indicates moderate variability in these disclosures. The range from 0 to 0.8 signifies that some firms do not engage in social disclosures at all, while others disclose extensively, indicating a wide range of practices.

Table 2: Descriptive statistics

| Variable | Obs | Mean | Std. Dev. | Min | Max |
|---|---|---|---|---|---|
| EM | 715 | .0316329 | .3376265 | -1.015912 | .976693 |
| FA | 715 | 1.470013 | .384888 | 0 | 2.103804 |
| FS | 715 | 7.767341 | 1.647555 | 4.04914 | 12.96864 |
| FP | 715 | .0713753 | .3483157 | -8.18046 | .7726612 |
| FL | 715 | 2.315173 | 5.951875 | -25.90048 | 96.61061 |
| ECO | 715 | .3557289 | .2385377 | 0 | .9230769 |
| ENVI | 715 | .1473339 | .1795663 | 0 | .859375 |
| SOCI | 715 | .2547552 | .196816 | 0 | .8 |

**Correlation results**

The pairwise correlation coefficients for the study variables are presented in table III. The positive correlation between earnings management and firm age ($r = 0.2410$, $*p < 0.05$) suggests a moderate positive relationship. This indicates that older firms tend to engage more in earnings management practices, and this result is statistically significant at the 5% level. There is a very strong positive correlation between earnings management and firm size (r = 0.9308, *p < 0.05). This significant relationship suggests that larger firms are more likely to engage in earnings management, with the result being highly statistically significant at the 5% level. The correlation between earnings management and firm performance is moderately positive (r = 0.2979, *p < 0.05), indicating that better-performing firms are somewhat more likely to engage in earnings management, and this relationship is statistically significant at the 5% level. The correlation between earnings management and firm leverage is very weak (r = 0.0323), and not statistically significant. This suggests that the level of debt in a firm has little to no relationship with its earnings management practices. The correlation between earnings management and economic disclosures (GRI) is positive (r = 0.1085, *p < 0.05), indicating that firms with more economic disclosures tend to have slightly higher earnings management. This relationship is statistically significant at the 5% level, though the effect size is small. There is a positive correlation between earnings management and environmental disclosures (GRI) (r = 0.1469, *p < 0.05), suggesting that firms with higher levels of environmental disclosures are more likely to engage in earnings management. This relationship is statistically significant at the 5% level. The correlation between earnings management and social disclosures (GRI) is also positive (r = 0.0878, *p < 0.05), but weak. This suggests that while there is a slight positive relationship between social disclosures and earnings management, the effect is minimal and statistically significant at the 5% level.

Table 3: Correlation results

| | EM | FA | FS | FP | FL | ECO | ENVI | SOCI |
|---|---|---|---|---|---|---|---|---|
| EM | 1.0000 | | | | | | | |
| FA | 0.2410* | 1.0000 | | | | | | |
| FS | 0.9308* | 0.0163 | 1.0000 | | | | | |
| FP | 0.2979* | 0.5705* | 0.0408 | 1.0000 | | | | |
| FL | 0.0323 | 0.0044 | 0.0520 | 0.0009 | 1.0000 | | | |
| ECO | 0.1085* | 0.2229* | -0.0422 | 0.2855* | 0.0028 | 1.0000 | | |
| ENVI | 0.1469* | 0.2394* | -0.0098 | 0.4041* | 0.0018 | 0.5067* | 1.0000 | |
| SOCI | 0.0878* | 0.1628* | -0.0327 | 0.3235* | 0.0027 | 0.7772* | 0.6985* | 1.0000 |

**Regression results**

In this paper, three hypotheses were evaluated. The first three hypotheses tested the effect of corporate sustainability disclosures on earnings management. The results for the direct effect are presented in table IV. The model generates R-squared of 0.9499 for the evaluation carried in on above, wald $chi^2$ = 16408.89, while the Prob > $chi^2$= 0.000. The regression results in the table 4 indicate that economic disclosures have a significant positive effect on earnings management ($\beta1 = 0.0818$, $\rho<0.05$). Consequently, H01 is rejected. This implies that a unit increase in economic disclosures leads to a 0.0818 unit increase in earnings management. The findings align with prior studies by Leuz and Wysocki (2016), Salem et al. (2021), and Yuan, Li, Xu, and Shang (2022), which similarly found a positive association between economic disclosures and earnings management. However, the results suggest that economic disclosures may create opportunities for management to manipulate earnings to present the company in a favorable light. Management might use economic disclosures strategically to influence investor perceptions, thereby masking the true financial performance of the firm.

The results further indicate a significant positive association between environmental disclosures and earnings management ($\beta2 = 0.0661$, $\rho<0.05$); therefore, H02 is rejected. This finding is consistent with previous empirical studies, including Flammer (2013), Sun, Salama, Hussainey, and Habbash (2010), as well as Christofi, Christofi, and Sisaye (2012). The regression results suggest that a unit increase in environmental disclosures results in a 0.0661 unit increase in earnings management. This outcome highlights the monitoring role played by external stakeholders in ensuring corporate transparency. However, it also implies that firms may engage in earnings management to align their financial performance with the positive environmental image they project. By manipulating earnings, companies can create a perception of financial stability and profitability that supports their claims of being environmentally responsible, thereby enhancing their reputation and potentially attracting environmentally conscious investors (Wedari, Jubb, & Moradi-Motlagh, 2021).

Meanwhile, the regression results in the table 4 reveal that social disclosures have a negative and significant effect on earnings management ($\beta3 = -0.084$, $\rho<0.05$). As a result, H03 is rejected. These findings are supported by prior empirical research conducted by Hess (2008), Muttakin, Khan, and Azim (2015), as well as Choi, Lee, and Park (2013). From the analysis, a unit increase in social disclosures leads to a 0.084 decrease in earnings management. Social disclosures typically encompass information on labor practices, community engagement, human rights, and social equity. When companies provide comprehensive social disclosures, they commit to higher standards of ethical behavior and corporate governance, which discourages earnings manipulation. Transparent social reporting requires firms to align their financial reporting with their ethical and social commitments, reducing the likelihood of deceptive financial practices (Dhaliwal, Li, Tsang, & Yang, 2011). By ensuring transparency in social matters, companies enhance stakeholder trust and reduce the incentives for engaging in opportunistic financial reporting.

Table 4: Random effect regression results

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Random-effects GLS regression | Number of obs | = | 585 | | | | |
| Group variable: companyid | Number of groups | = | 65 | | | | |
| R-sq: within = 0.9717 | Obs per group: min | = | 9 | | | | |
| between = 0.8722 | Avg | = | 9.0 | | | | |
| overall = 0.9499 | Max | = | 9 | | | | |
| | Wald $chi^2(10)$ | = | 16408.89 | | | | |
| corr(u_i, X) = 0 (assumed) | Prob > $chi^2$ | = | 0.0000 | | | | |
| EM | Coef. | | Std. Err. | z | P>z | [95% Conf. | Interval] |
| FA | .0451153 | | .0103188 | 4.37 | 0.000 | .0248907 | .0653398 |
| FS | .9625128 | | .0077882 | 123.59 | 0.000 | .9472483 | .9777773 |
| FP | .2256339 | | .0151174 | 14.93 | 0.000 | .1960044 | .2552634 |
| FL | -.018542 | | .0076961 | -2.41 | 0.016 | -.033626 | -.003458 |
| ECO | .0818228 | | .0233831 | 3.50 | 0.000 | .0359929 | .1276528 |
| ENVI | .066122 | | .0192427 | 3.44 | 0.001 | .028407 | .103837 |
| SOCI | -.0843455 | | .0264211 | -3.19 | 0.001 | -.1361299 | -.0325612 |
| _cons | .0038229 | | .016574 | 0.23 | 0.818 | -.0286615 | .0363073 |
| sigma_u | .10958684 | | | | | | |
| sigma_e | .17184802 | | | | | | |
| Rho | .2890944 | | (fraction of variance due to u_i) | | | | |

## CONCLUSION AND RECOMMENDATIONS

Analyzing a sample of listed firms in East Africa over a specific period, this study aimed to examine the impact of economic, environmental, and social disclosures on earnings management. The findings indicate that economic and environmental disclosures have a significant positive effect on earnings management, while social disclosures exhibit a negative association with earnings management. These results suggest that firms may leverage economic and environmental disclosures to manipulate earnings, presenting a more favorable financial position to stakeholders. Conversely, social disclosures appear to enhance transparency and corporate accountability, reducing the likelihood of earnings manipulation.

The study's findings contribute to the literature by demonstrating that economic and environmental disclosures, despite their intended purpose of enhancing transparency, can serve as tools for earnings management. This highlights the need for more stringent regulatory oversight to ensure that such disclosures accurately reflect a firm’s financial reality rather than being used opportunistically. Furthermore, the negative relationship between social disclosures and earnings management suggests that firms engaging in socially responsible activities are more likely to adhere to ethical financial reporting practices. This aligns with prior research emphasizing the role of corporate social responsibility in strengthening governance mechanisms.

Based on these findings, several recommendations emerge. Policymakers and regulatory bodies should enhance disclosure standards to minimize the potential for earnings manipulation through economic and environmental reporting. Stricter monitoring and enforcement mechanisms should be implemented to ensure that disclosed information is reliable and not misleading. Additionally, firms should be encouraged to integrate social disclosures into their reporting frameworks, as these have been shown to reduce earnings management and promote ethical financial practices. Investors and stakeholders should exercise due diligence when assessing financial reports, recognizing that economic and environmental disclosures may be strategically used to influence perceptions of a company's financial health.

Future research should explore additional factors that may moderate or mediate the relationship between disclosures and earnings management, such as corporate governance structures or firm-specific characteristics. Additionally, studies could investigate the effectiveness of regulatory interventions aimed at curbing opportunistic earnings management through disclosures. By addressing these issues, future research can further contribute to understanding how firms balance transparency with financial reporting incentives.

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