Insurers' Earnings Management: Review and Suggestions

The important lesson from Enron and Samsung Biologics accounting scandals is that both firms committed a fraudulent earnings management. Accounting discretion by managers is a critical issue not only in the accounting industry but also in the insurance industry. In general, firms manage their earnings using accruals and/or real activity. This report compares the basics of these two methods and further introduces the insurers' unique earnings management technique. Insurance companies have a direct earnings management measure called loss reserves. Loss reserves are defined as the estimated liabilities for unpaid claims. With three aspects of this measure: direction, magnitude, and volatility, insurers have various incentives to over or under-estimate loss reserves. For example, income smoothing, financial weakness, big bath, tax, insolvency, leverage, external monitoring, executive compensation, corporate governance, dividends and cost of capital in the capital market. This report throughly examines each motivations with a comprehensive literature. Furthermore, the recent adoption of accounting regulation, IFRS 17(International Financial Reporting System), may affect insurers' earnings management behaviour. Necessary discussions are followed by future research areas to explore.