ACCRUAL EARNINGS MANAGEMENT, REAL EARNINGS MANAGEMENT, FIRM VALUE

YULIUS KURNIA SUSANTO

ABSTRACT

The purpose of the research is to provide empirical evidence about the influence of accrual earnings management and real earnings management on firm value. Sample of this research are 162 non financial companies listed in Indonesia Stock Exchange during the research period 2012 until 2015, thus totaled 648 data. Sample selection method used was purposive sampling. Data were analyzed using multiple regression method. The empirical evidence of the research indicated that accrual earnings management has positive and significantly influence to firm value. While, real earnings management has negative and significantly influence to firm value. Ease in detecting accrual earnings management can make investors to judge whether a company is worth it or not. Meanwhile, the difficulty in detecting earnings management from real activity makes investors not dare to speculate to invest in the company.

Keywords: Firm value, accrual earnings management, real earnings management, cash flow of operation, discretionary expense, production cost

Jel Classification: G3, M4

INTRODUCTION

Earnings is important for companies, especially companies that have been listed on a stock exchange. Company management is responsible for the company's performance to shareholders. Company performance is usually reflected by the earnings. Earnings becomes so important that earnings is so span to manipulation by management. Earnings management is probably the most disturbing issue of the use of accrual accounting in financial statements (Subramanyam, 2014).

The use of assumptions and estimates in accrual accounting leads to company management being able to retrieve important information and experience to improve accounting usage. There are two forms of earnings management: to change accounting methods that are real, and to change accounting and policy estimates that change accounting calculations that are forms of hidden earnings management (Subramanyam, 2014). Earnings management can harm shareholders due to financial statement information that is inconsistent with reality and may make decision making for shareholders improper with firm performance. The occurrence of earnings management due to differences in interests between managers (agent) and shareholders (principal). Differences of interests resulting from the desire of managers or shareholders to maximize the welfare of each.

Some earlier earnings manipulation research has focused on accrual-based earnings manipulation techniques, whereas earnings manipulation based on accrual activity may have been abandoned. So it becomes important to understand how the company performs earnings management through manipulation of activities other than earnings-based accrual (Sari, 2015). Real earnings management is a manipulation done by company management through the company's operational activities that directly impact the company's cash flow (Sun & Lan, 2014).

In 2002 there was a case of earnings management in Indonesia in an open company involving the manipulation of financial statements by PT Indofarma Tbk. Earnings management is done by allocating cost of goods sold on the value of inventory in the process so that the cost of goods sold becomes smaller. This can be said as real earnings management because management manipulates the cost of goods sold. Based on the description above the practice of earnings management using the allocation of cost of goods sold is a way of doing real earnings management (Roychowdhury, 2006). Real-based earnings management practices at this point need to be done research. Especially in Indonesia that has not done much research on real-based earnings management. There is a possibility that many real earnings management practices are occurring in public companies located in Indonesia such as PT Indofarma Tbk.

Failure to understand the financial statements resulted in some companies experiencing mismanagement errors either undervalued or overvalued as the case of Enron, Worldcom, Kimia Farma and Toshiba. This raises questions about transparency, information disclosure and accounting roles in generating relevant and reliable financial information. The Toshiba case that emerged in April 2015 indicates that the company's financial condition is different from an independent committee's report, that earnings are exaggerated to $ 1.2 billion over five years. This has led to distrust of shareholders and Toshiba's share price down 20% since April 2015.

Every company has a goal to earn profits as an effort to maintain business continuity. Earnings that are defined as the excess of between income and costs within a certain time period cannot be separated from management performance. Earnings become one measure of the success of management in operating the company. Therefore, the management company is always willing to display earnings in the financial statements. One of the alternatives undertaken by company management is to take earnings management.

Earnings management is an engineering of financial statements through opportunistic actions of managers in maximizing their desires. By increasing this earnings, it will reflect good company performance through the manipulation of financial statements that ultimately make the earnings information contained becomes irrelevant. Earnings management can be categorized into two things, namely real earnings management and accrual earnings management. This is based on the direct or indirect effect on cash flow. Real earnings management is to manipulate earnings through operational activities that directly affect cash flow. While accrual earnings management is the manipulation of earnings management through estimation and accounting methods that have no direct impact on cash flow (Sun & Lan, 2014). The purpose of the study is to obtain empirical evidence that accrual earnings management can increase firm value; real earnings management can lower firm value. The remainder of this paper is organised as follows. First, literature review including hypothesis development. Second, the research method is discussed. Third, the research result and discussion, and Final, the research conclusions.

Agency Theory

Concept of agency is a contract in which the principal uses the management company (agent) as a manager or provide some decision-making authority to the management company (Jensen & Meckling, 1976). However, with the wishes of both parties on the welfare of each may cause management of the company will not always act in accordance with the wishes of shareholders. Agency theory provides a framework for knowing the contacts between shareholders and the management and predicting the adjustment of economic standards (Godfrey et al., 2010).

Conditions that led to the management of the company have an opportunity for better information from shareholders and the existence of differences in interests between shareholders and management that encourage manipulation. Differences of interests resulting from the desire of the management or shareholders to maximize the welfare of each (Jensen & Meckling, 1976).

Accrual Earnings Management

Earnings management is a deliberate process of corporate management intervention in the process of determining earnings, usually to meet corporate management goal. Scott (2012) divides the understanding of earnings management into two ways: first, earnings management as an opportunistic behavior of management to maximize its utility in the face of compensation contracts, debt contracts and political costs. Earnings management in this case is called Oportunistic Earnings Management. Second, earnings management as an efficient contracting perspective (Efficient Earnings Management). Management companies gain flexibility to protect themselves and companies in anticipation of unforeseen events.

The absence of rules that prohibit for the management to make earnings management, financial accounting standards enable the company's management to determine accounting policies and methods as well as accrual based accounting so as to open the opportunity for management to make earnings management. The motivation of management to make earnings management is motivation bonus, debt motivation, political motivation, taxation motivation, change of directors, motivation of stock sale (Watts & Zimmerman, 1986).

Scott (2012) suggests forms of earnings management such as taking a bath, income minimization, income maximization, income smoothing. Setiawan (2009) suggests earnings management techniques can be done with three techniques, namely (1) take advantage of opportunities to make accounting estimates. The manner in which the firm's management to influence earnings through judgment on accounting estimates is, among other things, estimated uncollectible receivables, estimated depreciation periods of fixed assets or amortization of intangible assets; (2) Changing the accounting method, by changing the accounting method used to record a transaction. For example by changing the depreciation method; (3) Shift the cost or income period. Examples of periodic cost or revenue engineering include speeding up or delaying expenses for research or promotion development until the next accounting period, speeding up or delaying delivery of products to customers.

One way earnings management uses the accrual approach. Accrual is the difference between operating cash flow and net income. The financial statements are prepared using the accrual approach. Accrual earnings management can be seen from discretionary accrual. Earnings management can be done as the company is growing until the company approaches bankruptcy (Hayn, 1995). Companies that are growing often report high earnings to meet investor expectations (Susanto et al., 2017). Research on accrual earnings management often uses modified Jones models to measure earnings management over other models (Dechow & Dichev, 2002).

Real Earnings Management

Real earnings management is a manipulation performed by company management through the company's operational activities that directly impact the company's cash flow (Sun & Lan, 2014). Roychowdhury (2006) says that earnings management through manipulation of real activity is the shifting of earnings management from normal operating practice to practice in order to get the desired earnings target. This is motivated by the desire of the company's management to deceive some shareholders into believing in financial statements made on the basis of normal operations. Real earnings management can reduce the value of a company because doing earnings management in the period concerned can have a negative effect on future cash flows (Roychowdhury, 2006).

Management (agents) prefer to manipulate earnings through real activities rather than accrual activities. The shift from accrual earnings management to real earnings management according to Roychowdhury (2006) is due to (1) accrual manipulation is likely to attract auditor's attention compared to real manipulation, such as change of method used by company; (2) Relying on accrual manipulation alone can carry risks. Realized loss-earning or deficit end-of-year earnings can make it difficult for company management to manipulate accruals after the end of the fiscal period. If the reported earnings falls from the target then the accrual-based strategy used becomes weak. This means that management will no longer be able to achieve the desired target, and if the desired target is not achieved then the manager is considered not to have a good performance or the opportunity to get a bonus. Therefore, manipulation through real activity is a safe way to achieve earnings targets because it can be done throughout the company's operating period so that the probability of reaching the target can be enlarged.

Roychowdhury (2006) found evidence that company management performs real earnings management through 3 approaches first, sales manipulation is an attempt to temporarily increase sales in a certain period by offering excessive product price discounts or providing credit terms which is lighter. This strategy can increase the sales volume and earnings of the current period, assuming a positive margin. However, giving discounted rates and lighter credit terms will reduce the cash flows of the current period resulting in abnormal cash flows.

Second, the reduction of discretionary expenditures, the company can reduce discretionary expenditures such as research and development expenses, advertising, and sales, administrations, and general especially in periods where such expenditures do not directly lead to revenue and earnings. This strategy can improve the cash flow and cash flows of the current period but with the risk of reducing future cash flows. Reducing discretionary loads causes unusually low discretionary loads.

Third, overproduction, excess production to reduce the cost of goods purchases, company management can produce more than necessary with the assumption that higher production levels will cause fixed costs per unit of product lower. This strategy can reduce the cost of goods sold (cost of goods sold) and increase operating earnings. However, sales in the same period can not cover costs incurred from overproduction and the overhead cost of goods being manufactured resulting in cash flow from operations being lower than normal sales rates.

Accrual Earnings Management and Firm Value

Easily predictable earnings management is the accrual earnings management. When management performs earnings management then the firm value will go down. Earnings information from accrual earnings management is questioned by investors so that the value of the firm falls as investors do not believe in management performance (Ferdawati, 2009). This is supported by Herawaty (2008), Anggraini (2011), Gill et al. (2013) which states that the accrual earnings management has a negative effect on the firm value. Management that have more information than shareholders are more likely to be selfish (opportunistic behavior). This enables the management to provide a positive signal about the company's financial condition for its shareholders and stakeholders. Positive signals are accounting earnings that are the result of earnings management. Accounting earnings is one measure of corporate performance that gets major attention from shareholders and stakeholders because they use earnings to evaluate the performance of company management. Earnings management may result in the earnings being presented does not reflect the actual financial state of the company.

The financial statements provide information to stakeholders and stakeholders. The information is used by the principal whether the management company has been managing the company in accordance with the principal objectives, namely increasing the firm value. Accrual earnings management is easier to detect than real earnings management. This can be seen from reported earnings as the company is growing. The ease of investors in detecting accrual earnings management can make investors to judge whether a company is worth it or not. Based on these explanations can be proposed hypothesis:
H_1 Accrual earnings management can increase the firm value

Real Earnings Management and Firm Value

Liu and Tsai (2015), Young et al. (2015) states that there is a positive relationship between firm value and real earnings management. While research Sun and Lan (2014) states that firm value is negatively related to real earnings management. Difficulty in detecting earnings management from real activity makes investors not dare to speculate to invest in the company. Real earnings management can reduce the value of the firm because it gives a negative effect on future cash flows (Roychowdhury, 2006). Based on these explanations can be proposed hypothesis:
H_2 Real earnings management can lower the firm value.

RESEARCH METHODS

Based on non-financial companies listed on the Indonesia Stock Exchange in the period 2011 to 2015. The sample used in this study as many as 162 non-financial companies selected by using purposive sampling method (Sekaran & Bougie, 2013). Based on sample selection criteria, then the data obtained are as follows:

Table 1: Sample Selection

No	Sample Criteria	Company	Data
1	Non-financial companies that are consistently listed in the Indonesia Stock Exchange from 2011 to 2015 and not delisted during the study period.	360	1440
2	Non-financial companies that do not issue their financial statements as of December 31.	(11)	(44)

3	Non-financial companies that do not present their financial statements in Rupiah.	(72)	(288)
4	Non-financial companies that do not earn net income.	(115)	(460)
	Total data used as sample	162	648

Company value is measured using market to book, which is the ratio between the value or the market price of shares with the book value of the company (Sarwendhi & Samekto, 2014). The scale of this variable is the ratio and measurement scale referring to Sun and Lan (2014) calculated from the divided between market value of common equity and book value of common equity. According to Darusman and Prastetiono (2012) market value of common equity is seen from market capitalization. Market capitalization is calculated from the stock price times the number of outstanding shares. The book value of common equity is derived from the difference between total assets and liabilities. Accrual earnings management is measured using the following modeled Jones modes:

$TAt /At\text{-}1 = (\alpha 1/At\text{-}1) + \beta 1t ((\Delta REVt - \Delta RECt)/At\text{-}1) + \beta 2t (PPEt/At\text{-}1) + vt$ (1)

Where TA*t* total accruals (Net Income – Cash Flow of Operation), A*t*-1 total assets (t-1), ΔREV*t* change in net operating revenues, ΔREC*t* change in net receivables, PPE*t* gross property, plant and equipment, *α* constant, *β*1*t*, *β*2*t* industry-specific estimates of the coefficients, v*t* error term (discretionary or abnormal accruals).

Real earnings management is proxied with abnormal cash flow of operation activities, abnormal discretionary expense activities and abnormal production cost activities. Real earnings management regression model as measured by the residual value of 3 regression models derived from the research Sun and Lan (2014), Susanto and Pradipta (2016) as follows:

1. Abnormal cash flow of operation activities

$CFO_t/A_{t-1} = a_0(1/A_{t-1}) + a_1(S_t/A_{t-1}) + a_2(\Delta S_t/A_{t-1}) + \epsilon_1$ (2)

The value of abnormal cash flow of operation is low due to sales manipulation so that if high the value of abnormal cash flow of operation indicates low real earnings management.

2. Abnormal discretionary expense activities

$DISX_t/A_{t-1} = a_0(1/A_{t-1}) + a_1(S_{t-1}/A_{t-1}) + \epsilon_2$ (3)

The reduction of discretionary loads will decrease the value of the abnormal discretionary expense so that if a high abnormal discretionary expense indicates low real earnings management.

3. Abnormal production cost activities

$PROD_t/A_{t-1} = a_0(1/A_{t-1}) + a_1(S_t/A_{t-1}) + a_2(\Delta S_t/A_{t-1}) + a_3(\Delta S_{t-1}/A_{t-1}) + \epsilon_3$ (4)

Excessive production leads to high abnormal production cost so that if high abnormal production cost value indicates high real earnings management.

Where CFO_t cash flow of operation firm i year t, $DISX_t$ discretionary expenses (total advertising expenses, research and development expenses, and sales, general and administrative expenses) firm i year t, $PROD_t$ production cost (total cost of goods sold and inventory changes) firm i year t, S_t sales firm i year t, S_{t-1} sales firm i year t-1, ΔS_t change of sales firm i year t compared to sales year t-1, ΔS_{t-1} change of sales firm i year t-1 compared to sales year t-2, α estimates of the coefficients , ϵ *error* (ϵ_1 abnormal cash flow of operation, ϵ_2 abnormal discretionary expense, ϵ_3 abnormal production cost).

To test the hypothesis using multiple regression analysis as follows

$FV = b_0 + b_1AEM + b_2REM + e$ (5)

$FV = b_0 + b_1AEM + b_2AbsCFO + b_3AbsDISX + b_4AbsPROD + e$ (6)

Where FV firm value, AEM accrual earnings management, REM real earnings management, AbsCFO Abnormal CFO, AbsDISX Abnormal discretionary expense, AbsPROD abnormal production cost, error term.

RESEARCH RESULT

Test results of descriptive statistics and hypothesis testing can be seen in the following table 2 and 3:

Table 2: Descriptive Statistics

Variabel	Minimum	Maksimum	Mean	Std. Deviation
FV	-41,077900	246,459700	3,052124	10,878600
DAC	-0,445682	0,593655	-6,1679E-18	0,097024
Ab_CFO	-0,632442	0,557113	4,9515E-17	0,126004
Ab_DISX	-0,512142	0,964195	2,2204E-16	0,170051
Ab_PROD	-1,798215	2,316768	1,5173E-15	0,287348

Table 3: Hypothesis Testing

Variabel	Expected Sign	B	t	Sig.
Konstanta		3,052		
DAC	+	37,935	5,226	0,000
Ab_CFO	-	45,567	7,146	0,000
Ab_DISX	-	9,555	3,127	0,002
Ab_PROD	-	-0,177	-0,083	0,934

$F_{4,643}$ 30,114976 Sig. 0,000 Adj. R^2 0,152542

The effect of earning accrual management has a significant value of 0.000 less than 0.05 then H_1 is accepted, it means that the accrual earnings management has a positive effect on firm value. The result consistent with Susanto and Christiawan (2016) found that earnings management had positive significant affect to firm value. Users of financial statements are aware of the accrual earnings management and easy in detecting accrual earnings management seen from the financial statements mainly related to the use of accounting methods. The ease in detecting accrual earnings management can make investors to judge whether a company is worth it or not. The deviations made on the accrual earnings management are still within the limits set by the financial accounting standards such as the use of depreciation methods and the write-off of account receivables. This makes investors feel safe to invest and increase the firm value.

The effect of real earnings management as measured by abnormal cash flow of operation and abnormal discretionary expense activities loads has a significance value of 0.000 less than 0.05 then H_2 is accepted, meaning real earnings management negatively affects firm value. Users of financial statements, especially investors are increasingly aware of the earnings management of real activities that are difficult to detect. Difficulty in detecting earnings management from real activity makes investors not dare to speculate to invest in the company and decrease the firm value.

CONCLUSIONS

Research conclusion is accrual earnings management have positive effect to firm value, real earnings management have negative effect to firm value. This result is in line with Sun and Lan's (2014) stating firm value is negatively related to real earnings management. Ease in detecting accrual earnings management can make investors to judge whether a company is worth it or not. Meanwhile, the difficulty in detecting earnings management from real activity makes investors not dare to speculate to invest in the company. This study has limitations that need to be considered for the next research, that is, the research uses only the research period from 2011 to 2015. For further research use a longer period. There are many other variables that can influence corporate value such as earnings response coefficients and accounting conservatism. The management behavior (opportunistic) to make earnings management of each country is different because the culture of each country is different. Because of financial accounting standards enable the company's management to determine accounting policies and methods of each country is different. The different of financial accounting standards can be used as development of future research for other country.

References

Anggraini, L. (2011). Analisis Dampak Discretionary Accruals terhadap Nilai Perusahaan yang dimoderasi dengan Penerapan Good Corporate Governance (GCG). *Jurnal Aplikasi Bisnis*, 1(2), 84-96.

Darusman, Dery & Prasetiono. (2012). Analisa pengaruh firm value, book to market ratio, price earning ratio, dan momentum terhadap return portopolio saham. *Diponegoro Journal Of Accounting*, 1(1), 1-14.

Dechow, P. M. & Dichev, I. D. (2002). The quality of accruals and earnings: The role of accrual estimation errors. *Accounting Review*, 77(4), 35–59.

Ferdawati. (2009). Pengaruh Manajemen Laba Real terhadap Nilai Perusahaan. *Jurnal Akuntansi dan Manajemen*, 4(1), Juni, 59-74.

Gill, A., N. Biger, H.S. Mand. (2013). Earnings Management, Firm Performance, and the Value of Indian Manufacturing Firms. *International Research Journal of Finance and Economics*, 116, 120-132.

Godfrey, Jayne., Allan Hodgson, Ann Tarca, Jane Hamilton & Scott Holmes. (2010). *Accounting theory*. Australia: John Wiley & Sons.

Hayn, Carla. (1995). The Information content of losses. *Journal of Accounting & Economics*, 20, 125-153.

Herawaty, Vinola. (2008). Peran Praktek Corporate Governance Sebagai Moderating Variable dari Pengaruh Earnings Management Terhadap Nilai Perusahaan. *Jurnal Akuntansi dan Keuangan*, 10(2), November, 97-108.

Jensen, Michael C. & William H. Meckling. (1976). Theory of the Firms: Managerial Behavior, Agency Cost and Ownership Structure. Journal of *Financial Economics,* 3(4), 305-360.

Liu, Jo Lan & Ching Chieh Tsai. (2015). Board Member Characteristics and Ownership Structure Impacts on Real Earning Management: Evidence From Taiwan. *Accounting and Finance Research,* 4(4), 84-96.

Roychowdhury, S. (2006). Earnings management through real activities manipulation. *Journal of Accounting and Economics*, 42, 335-370.

Sari, Gustin Padwa. (2015). Manipulasi Laba Riil: Upaya Untuk Menghindari Kerugian. *AKUISISI,* 11(2), 35-43.

Sarwendhi, Rezza Arlinda & Agus Samekto. (2014). The effect of market-to-book, asset structure, and earning after tax on the level of leverage in non-financial companies listed in indonesia stock exchange 2007-2012. *The Indonesian Accounting Review*, 4(2), 149-156.

Scott, William R. (2012). *Financial accounting theory*, edisi 6. Pearson Prentice Hall. USA.

Sekaran, Uma & Roger Bougie. (2013). *Research Method for Business: A Skill Building Approach*, Edisi 6. New York: John Wiley.

Setiawan, Teguh. (2009). Analisis Pengaruh Mekanisme *Good Corporate Governance* Terhadap Praktek Manajemen Laba Pada Perusahaan Manufaktur Yang Terdaftar Di Bursa Efek Indonesia Periode 2005-2007. *Jurnal Akuntansi Kontemporer*, 1(2), Juli.

Subramanyam, K.R. (2014). *Financial statement analysis United States*: McGraw-Hill Education.

Sun, Jerry & George Lan. (2014). Independent Audit Committee Characteristics and Real Earnings Management. *Managerial Auditing Journal,* 29(2), 153-172.

Susanto, Sherly & Y.J. Christiawan. (2016). Pengaruh Earnings Management terhadpa Firm Value. *Business Accounting Review*, 4(1), Januari, 205-216.

Susanto, Yulius K. & Arya Pradipta. (2016). Corporate Governance and Real Earnings Management. *International Journal of Business, Economics and Law*, 9(1), April, 17-23.

Susanto, Yulius K., Arya Pradipta, & Indra Arifin Djashan. (2017). Free Cash Flow and Earnings Management: Board of Commissioner, Board Independence and Audit Quality. *Corporate Ownership & Control*, 14(4-1), 284-288

Watts, Ross L. & Jerold L. Zimmermand. (1986). *Positive accounting theory*. Prenctice-Hall. New Jersey.

Young, Chaur-Shiuh., Yueh-Ju Lin, Fei-Liang Chien & Chia-Hui Chen. (2015). CEO Succession, Investor Expectations, and Real Earnings Management. *Asian Journal of Finance & Accounting,* 7(2), 120-137.

YULIUS KURNIA SUSANTO
Trisakti School of Management
yulius@tsm.ac.id