

ACCOUNTING FLEXIBILITY, REAL EARNINGS MANAGEMENT, AND AUDIT QUALITY: EVIDENCE FROM INDONESIAN LISTED FIRMS

Indah Masri

ABSTRACT

The aim of the research is to examine the effect of accounting flexibility, which is the limitation of the company to manage as a substitution relationship of Accrual Earnings Management (AEM) to Real Earning Management (REM). The research also explores the role of quality audits as moderation effect on the relationship of accounting flexibility and real earnings management in public company listed on the Indonesia Stock Exchange during period 2010 to 2013, with the observation of 213 companies, 852 firm-year. Results of the study showed that the accounting flexibility negatively affects to real earnings management, that is with the lower accounting flexibility, the company tends to shift to real earnings management, this confirms the existence of a substitution relationship for accounting flexibility between Accrual Earnings Management (AEM) to Real Earnings Management (REM). When moderated by the audit quality the result show reinforces negative relationship accounting flexibility with real earning management, because the higher the quality of the audit company will be limited to discretionary accrual accounting, causing the lower accounting flexibility.

Key words: Accounting flexibility, real earnings management, accrual earnings management, audit quality.

Introduction

Based on literature research there is a lot of strong evidence that management involved in doing earnings management. One of the ways to manage revenue is to manipulate accrual without any direct consequences from cash flow such as suspending asset deletion, reducing the provision of allowance, etc. In addition to accrual manipulation, managers also have incentives to manipulate the real activities for one year running to meet specific profit targets (Roychowdhury, 2006).

In the result of his research Graham et al. (2005) showed that manager prefers to manage the revenue through real activities over economic decision rather than accrual accounting. His research showed that 80% survey participants took the economic actions such as reducing discretionary spending expense on R&D, advertising, and maintenance to meet specific profit targets. According to Roychowdhury (2006), although Real Earning Management (REM) can reduce the company values, manager prefers to manage the profit through real activities such as practices that do not attract the attention of auditors or supervision of regulator. Moreover, the research of Barton and Simko (2002) stated that accounting options are accumulated on the balance sheet through net assets level, which in part is earning management level in accounting (accounting accrual) that has been done in the previous period. The result showed decreasing optimistically bias earning if the net asset on the balance sheet was overstated. Barton and Simko's research indicated that there were companies' limitations to increasing accrual and companies which high accruals limitation tend to do fewer accruals earnings management. The company which has a limitation to do accruals earnings management will have an incentive to change their method to do earnings management through a real activity which called real earning management. In some research, companies' limitation to do accruals earnings management is called accounting flexibility.

After Barton and Simko (2002), there were several types of research which have been done about testing accounting flexibility. Wang and D'Souza (2006) used NOA/sales proxy which also has been used in Barton and Simko (2002) as a proxy to determine accounting flexibility. Their result indicates that company with less accounting flexibility tends to cut expenses to research and development division. Xu and Yang (2013) measured abnormal value net operation asset to sales (AbNOA) as a proxy to measure limitation level in accruals management within current period. In this case, it can be used as a proxy to determine accounting flexibility. Xu and Yang (2013) studied the relationships between accounting flexibility and companies tendency to do earnings management through accruals and real business activity using logit model. Their research result indicates that the company which has less accounting flexibility tend to use real earnings management through stock buyback.

According to that explanation, this research is about the relationship between accruals earning management, real earnings management, and accounting flexibility. When a company has limitation to do accruals, there is an incentive to do real earnings management, this indicates the substitute relationship from accounting flexibility to accrual earning management to real earnings management. This research is studying the accounting flexibility which is accruals limitation in earnings management which showed in balance sheet through abnormal net operating asset as substitution from accrual earning management to real earning management.

Audit quality in some researches which used as a proxy to indicate an error on finance report. In some previous research, there was a relationship between earnings management and audit quality. Those research studied about the influence of audit quality to

manager incentive to manipulate income data report. Audit as a valuable monitoring to the company so that it can lower agency cost with debt holder and stockholders (Jensen and Meckling, 1976; Watts and Zimmerman, 1983). The audited value can be determined by checking whether it can reduce error data of accounting report.

According to review from previous research by Kinney and Martin (1994), it can be concluded that audit result can decrease positive bias from net income and net asset pre-audit. Hirst (1994) found in his research that auditor will sensitive to earnings management and tend to concentrate on the managerial incentive to excess data report. This result is the as Becker et al (1998) and Chung et al (2005), they indicate that high audit quality tends to limit discretionary accruals which have been done by management. Cohen et al (2008) and Zamri (2013) said that companies which audited by Big 4 has an excellent name and show perfect audit quality, tend to use less accrual earning management and use more real earning management. According to the research result above, this research is determining the audit quality role in the relationship between accounting flexibility and real earning management.

This research has two objectives. First is determining the influence of accounting flexibility as company limitation to do accrual earnings management as substitution from accrual earning management (AEM) to real earnings management (REM). Second is to see the influence between audit quality and the relationship between accounting flexibility and real earning management. Accounting flexibility measurement in this research is using the abnormal net operating asset. This proxy is developed from Xu and Yang (2013) measurement. Otherwise real earning management measurement in this research using three real earnings management measurement which developer by Roychowdhury (2006).

There were several research which already tested about accounting flexibility with real earning management in economics decision such as accounting flexibility with cut R&D cost (Wang and D'souza, 2006), or accounting flexibility with repurchase stock (Xu and Yang, 2013). According to the literature review, there is no research which studies about the relationship between accounting flexibility and real earning management to Roychowdhury (2006) measurement. In the other side, this research is also studying about the influence of audit quality to the relationship between accounting flexibility with real earning management. Better audit quality will decrease earnings management behavior so that audit quality role will give an improvement in this research.

Literature Review

A. Conceptual Theory and Previous Research

1. Earnings Management

Earnings management is an intervention by the management to maximize or minimize the profits in accordance with the volition of managers. In Scott (2015) states that dividing the understanding of earnings management into two: 1) as opportunistic earnings management, which is the behavior of management to maximize its utility in facing contract compensation, debt contract, and political cost. 2) as efficient earnings management, which is manager and company flexibility in anticipating unexpected events for the benefit of parties involved in the contract, for example by making income smoothing. Many earnings management practices can be performed by managers, both accrual manipulations of accounting records that have no impact on cash flows (Dechow et al., 1998, and Khotari et al., 2005) nor through real activities manipulation (Roychowdhury, 2006) which impact on cash flow such as reductions in expenditures on research and development.

2. Accounting flexibility

From many research results, it can be defined that accounting flexibility is company limitation to increase accruals, and company with high limitation level to accruals tend to do accrual earnings management. Barton and Simko (2002) used the beginning balance of operational net asset is relative to sales (NOA) as a proxy to bias in measuring and standard acknowledgment. Barton and Simko (2002) declared that articulation between the income statement and the balance sheet is accruals which showed on income and net asset. So that, income optimism bias show net asset which measured and recorded temporary with it value is more than neutral and standard application. The manager often gives assumption to acknowledgment and measurement in one period decrease their ability to make the same assumption in the next period. If the manager wants to stay in regulator and accountant professional guidance. So that manager ability to optimist income bias will decrease as far as a net asset is exaggerated.

Accounting flexibility measurement used in many research as accruals limitation proxy in earnings management. Wang and D'souza (2006) which used NOA/sales proxy to measure accounting flexibility as well as Barton and Simko (2002) research. Their research result indicates that company with low accounting flexibility tend to cut cost for R&D.

According to Defond (2002), he said that net normal operational asset (NOA) for the company may be influenced by industries and other factors which unrelated to earnings management. So that Xu and Yang (2013) determined abnormal net operational asset to sales (AbNOA) as a proxy to determine accounting flexibility. Xu and Yang (2013) developed expectation models to predict normal NOA level as following:

$$\text{Log NOA}_{i,t} = a_1 + a_2 \log \text{Sales}_{i,t} + a_3 \text{LifeCycle}_{i,t} + a_4 \text{CapInt}_{i,t-1} + \sum_{j=1}^4 Q_j + \varepsilon_{i,t}$$

Where:

Log NOA _{i,t}	=Log ending balance of net operational asset in quartal t
Log Sales _{i,t}	=Log from total sales in four quartal (Dechow et.al, 1998)
LifeCycle _{i,t}	=Variable dummy. Variable dummy is equal to 0 (zero) if the company need more and strong financing (CFF>CFO and CFF>CFI) and equal to 1 (one) if the company doesn't need more and strong financing (for all other situation) (Liu, 2008). CFF= cash from financing activities; CFO=cash from operating activities; CFI=cash from investment activity.
CapInt _{i,t-1}	=Capital intensity in quartal t-1, measured as total PPE/total employee (Abowd, et al, 1999)

The equation above determines log net operational asset as log function from sales, company life cycle, and capital intensity. This is based on the following research:

- Dechow et al. (1998) show that working capital which needed in the operation is a linear function from sales.
- Liu (2008) develop company life cycle measurement based on company funding intensity. Liu (2008) show that managerial operational decision in different capital investment in the growing company, developed company, and decrease company. For several amounts of sales, growing company tend to make more investment than the developed company and decreasing company which lead to high positive accruals for growing company and negative accruals for decreasing company.
- Abowd et al (1999) who develop capital intensity measurement, he describes some variation in company input production combined from labor and capital point of view. Dupuy and Grip (2006) said that substitution between capital and labor allows the company to make several amounts of sales with different input combination factors.

Model is estimated with quartal data, so dummy variable used to represent quartal is added to the model to control seasonal effect potential. This model is also estimated using year and industry to control operation asset variation in quartal and industry for all company. Abnormal NOA obtained from residual expectation model. It is predicted that abnormal NOA size shows how far balance sheet is exaggerated and can function as a proxy for accounting flexibility.

Xu and Yang (2013) research which tested the relationship between accounting flexibility and companies tendency to do earnings management through accruals and real business activity using logit model. Their research result indicates that company which has lower accounting flexibility (which is a company who has high limitation to increase accruals) will tend to use real earnings management through stock buyback.

B. Hypothesis Development

1. The relationship between accounting flexibility and real earning management

Other than accrual manipulation, managers also have the incentive to manipulate real activity within current year to fulfill less income targets (Roychowdhury, 2006). Graham et al (2005) said that manager prefers to manage income with real activity for economic decision better than accrual accounting. On the other hand, Roychowdhury (2006) said that although real earning management (REM) can decrease company value, manager prefers to do earnings management with real activity such as practices that are less likely to attract the attention of the auditor or the supervisory of the regulator. Barton and Simko (2002) research said that accounting choice accumulated on balance sheet with net asset level and some of it is accounting accrual earnings management level which has been done in previous period. Barton and Simko (2002) research result indicates that there is company limitation to increase accruals, and company with high accrual limitation tend to do earnings management through accrual. Xu and Yang (2013) studied the relationship between accounting flexibility and companies tendency to do accrual earnings management and real business activity using logit model. Their research result said that company which has low accounting flexibility will have more tendencies to do real earnings management with the stock buyback. The company which has limitation to do accrual earnings management will have the incentive to change their method to real activity earnings management, which also called real earning management. Company limitation to do accrual earnings management is called accounting flexibility. In this case, there is negative accounting flexibility with real earning management. So that in this research, the hypothesis is:

H1 : *Company which has less accounting flexibility tend to do real earnings management.*

2. The influence of moderation audit quality to the relationship between accounting flexibility and real earning management.

In the previous research, there is some relationship between earnings management and audit quality and studying about the influence of audit quality and manager incentive to do data manipulation in the income report. In Hirst (1994) research, it was found that the auditor will be sensitive to earnings management and tend to concentrate on the managerial incentive for excess income report. Better auditor quality tends to reduce earnings management for income increasing as an evidence to show that manager prefers to overstate that understate earning (Kinney and Martin, 1994). That result is the same as Becker et al. (1998) and Chung et al. (2005) research. It also indicates that higher quality of audit will restrict discretionary accrual which has been done by management. Zamri et al (2013) and Cohen et al. (2008) shows that companies which audited by the Big 4 well-known audit company and higher audit quality, tend to do less accruals earning management and more using real earning management. This research is identifying the influence of audit quality to the relationship between accounting flexibility and real earning management. Better audit quality will decrease earnings management behavior. With better audit quality will cause manager

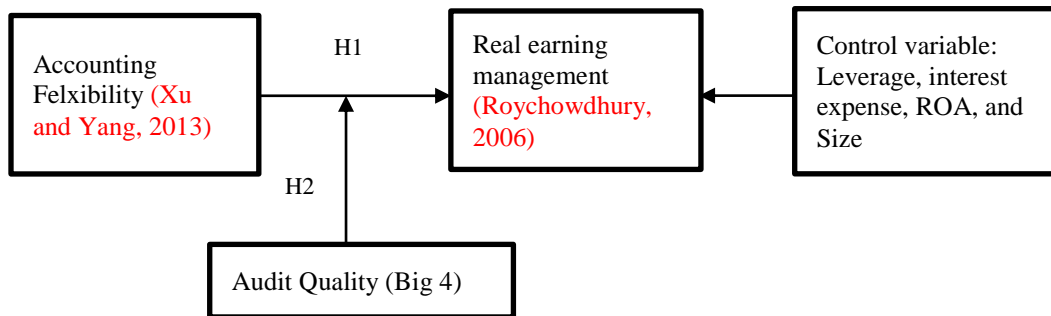
limitation to do earnings management discretionary so that it will lower accounting flexibility level and shift to real earning management. Therefore, the second hypothesis is:

H2 : *Audit quality moderation will strengthen the negative relationship between accounting flexibility and real earning management.*

C. Research Framework

Based on the development of hypotheses in this study on the relationship between accounting flexibility and real earnings management, as well as the role of audit quality in the relationship, the research framework developed in this study is as follows:

Figure 1: Research Framework



Research Method

A. Type and Data Source

Data type which used in this research is annual finance report and annual company report from 2010 to 2013. The data source is Indonesia stock exchange on their website www.idx.co.id and also DataStream.

B. Sample and Population

Population describes as the whole element which identified in this research. Population in this research is all the IDX listed industry from 2010 to 2013. The reason to use all the industry is to study the influence of accounting flexibility to real earning management in every different industry. To control every data used in this research, dummy industry and dummy year for every industry sector were used. The samples in this research chosen by some criteria such as:

1. Eliminate observation with negative sales value where total asset value is zero or vanish,
2. Exclude finance institution and utility industry because these industries have accounting rule, operation characteristics, and different debt funding,
3. The similarity accountancy report which ends on December 31st
4. The company who has relevant data with variable measurement.

C. Definition of Operation Variable Measurement

1. Dependent variable

This research is using real earning management (REM) proxy which developed by Roychowdhury (2006). Those proxies estimated normal business activity level which is shown on cash flow operation, production cost, and discretionary expenditure. Residual from each model used as REM proxy. As well as the previous research (Cohen and Zarowin, 2010; Zang, 2012; Ge and Kim, 2014). This research is also used the model to construct REM measurement consist of three models, such as:

- a. Estimating normal cash flow operation.

$$CFO_t/Assets_{t-1} = \alpha_0 1/Assets_{t-1} + \alpha_1 Sales_t/Assets_{t-1} + \alpha_2 \Delta Sales_t/Assets_{t-1} + \epsilon_t \text{ ---- (1)}$$

CFO is cash flow operation activity. The asset is a total asset. Sales are net sales, and $\Delta Sales$ is year-end sales change level compared with the beginning year.
- b. Estimating normal cost production level.

$$Prod_t/Assets_{t-1} = \alpha_0 1/Assets_{t-1} + \alpha_1 Sales_t/Assets_{t-1} + \alpha_2 \Delta Sales_t/Assets_{t-1} + \alpha_3 \Delta Sales_{t-1}/Assets_{t-1} + \epsilon_t \text{ ----- (2)}$$

Prod is the sum of COGS and inventory changes.
- c. Estimating normal discretionary cost level.

$$\text{DisExp}_t/\text{Assets}_{t-1} = \alpha_0 1/\text{Assets}_{t-1} + \alpha_1 \text{Sales}_{t-1}/\text{Assets}_{t-1} + \varepsilon_t \text{-----} (3)$$

DisExp is the discretionary cost to measure from the sum of advertising costs, R & D costs, sales costs, and general and administrative costs.

Every model in this research is analyzed by cross-sectional regression analysis with the addition of industrial dummy and year dummy as a control. Residual from regression result warms up in abnormal level from real earning management activity. From those residual result, residual from the model was multiplied by identified Ab_CFO and ab_DisExp with -1 so that the higher value shows a higher probability to make a real decision in order to increase the revenue (Cohen and Zarowin, 2010; Zang, 2012; Ge and Kim, 2014). Whereas, for another residual result from ab_Prod which haven't multiplied with -1 because higher production cost is an indication of excess to reduce the cost of goods sold. To capture the effect from earnings management through those three activities at the comprehensive level, we create whole REM proxy by summarizing standardization Ab_CFO, Ab_Prod, and Ab_Dexp.

2. Independent variable

To identify accounting flexibility, this research using Xu and Yang (2013) measurement. This measurement developed from normal net operating asset level (NOA) as following:

$$\text{Log NOA}_{i,t} = a_1 + a_2 \log \text{Sales}_{i,t} + a_3 \text{LifeCycle}_{i,t} + a_4 \text{CapInt}_{i,t-1} + \varepsilon_{i,t}$$

Where:

- Log NOA : Log net operational asset ending balance in period t
NOA according to measurement by Barton and Simko (2002) is shareholder equity – Cash – Marketable securities + total debt.
- Log Sales_t : Log from total sales in period t (Dechow et al, 1998)
- Life cycle_t : Dummy variable is equal to 0 if the company need strong funding (CFF > CFO and CFF > CFI) and equal to 1 if the company don't need strong funding (Liu, 2008); CFF= cash from financing activities; CFO = cash from operational activities; CFI=cash from investment activity.
- CapInt_{t-1} : Capital intensity in t-1, measured as total PPE / number of employee (Abowd et al, 1999)

Those models estimated with yearly data so that dummy variable year is added to the model to multiplied yearly effect potential. Besides that, this model is also estimated using industry data so that industry dummy variable is added to the model to control industry effect potential. Abnormal NOA is determined from residual expectation model. It is also estimated that NOA abnormal level indicates accounting flexibility.

3. Moderator variable

To identify audit quality, this research is using dummy variable Big 4. Big 4 is 1 for the company audited by Big 4 and 0 for vice versa. Public accounting firm which owned by the biggest parent auditor 4 is KPMG, Ernst and Young, Deloitte, and PWC. It is estimated that well-known Public Accounting Firm will have higher audit quality.

4. Control variable

This research using several control variables. According to some literature, there are some variables that influence real earning management as follows:

- a. Leverage. Leverage is the total amount of debt scale by a total asset firm i in year t. based on Zamri et al (2013) research, leverage has a negative relationship with real earning management. Leverage impact to earning management have two different points of views. On the other hand, the previous research determined that higher leverage company will prefer to do earnings management (Dichev and Skinner, 2002; Beatty and Weber, 2003). In Beatty and Weber (2003) research, it was found that company will tend to do accruals to increase profit to avoid the company from breach of the debt agreement. On the other hand, Jensen (1986) research shows that debt will reduce manager opportunistic behavior. In conclusion, leverage has a positive or negative relationship with earnings management.
- b. IntExp. IntExp is net interest cost to short-term debt and long-term debt of firm i in year t. in Jensen (1986) research, it was told that higher interest cost can control opportunistic behavior, which has a negative relationship with earnings management.
- c. ROA t-1. ROA t-1 is previous year income before tax scale by a total asset of firm i in the t-1 year. In Kothari et al (2005) and Jiraporn et al (2007) research, they found that there was a negative relationship between earnings management and ROA.
- d. Size. Size is logarithm from company asset. Gu et al (2005) and Aini et al (2006) found that asset can influence accrual discretionary. Higher company size will make the higher possibility for the company to do earnings management. In this case, it has a positive relationship with earnings management.
- e. Ind and Year. Ind and Year are controlled variable for industry and year.

D. Research Model and Hypothesis Formulation.

In this research, there are two research models to examine the first and second hypothesis. To examine the first hypothesis to

influence the accounting flexibility with real earning management. To examine the second hypothesis about the influence of moderation audit quality over accounting flexibility and real earning management. Therefore, this research has models like following:

Model 1 for first Hypothesis

$$REM_{it} = \beta_0 + \beta_1 AbNOA_{it} + \beta_2 Auditor_{it} + \beta_3 Leverage_{it} + \beta_4 IntExp_{it} + \beta_5 ROA_{it-1} + \beta_6 Size_{it} + \beta Ind + \beta Year_t + \varepsilon_{it}$$

Model 2 for second hypothesis

$$REM_{it} = \beta_0 + \beta_1 AbNOA_{it} + \beta_2 AbNOA_{it} * Auditor_{it} + \beta_3 Auditor_{it} + \beta_4 Leverage_{it} + \beta_5 IntExp_{it} + \beta_6 ROA_{it-1} + \beta_7 Size_{it} + \beta Ind + \beta Year_t + \varepsilon_{it}$$

Where:

- REM : *Real earning management*, summary of AbCFO, AbProd, and AbDisExp (Roychowdhury, 2006; Ge and Kim, 2014),
- AbNOA : Abnormal Net Operating Asset, accounting flexibility measurement (Xu and Yang, 2013),
- Auditor : Auditor quality, dummy variable 1 for Big 4, and 0 vice versa,
- Leverage : Total of debt scale by total asset firm i in year t,
- IntExp : Net interest cost on short-term debt and long-term debt of firm i in year t,
- ROA_{t-1} : Previous year income before tax scale by total asset of firm i in year t-1,
- Size : Company asset logarithm,
- Ind : Dummy for industry by firm i in year t(1 if observation within sample industry, and 0 vice versa),
- Year : Dummy for firm i in year t(1 if observation within year from sample, 0 vice versa)
- ε : Error from firm i in year t

E. Analysis Technic

This research using quantitative descriptive analytic technic and regression analysis over data pool panel balance to study the influence of accounting flexibility to real earning management.

F. Step Analysis

Eviews 8 is used to do analytic in this research. The step to analyzed is:

1. Doing descriptive statistic examination.
To give a description about data spread such as mean, median, maximum, minimum, and standard deviation.
2. Doing hypothesis examination.
Identifying the influence of accounting flexibility as an independent variable to real earning management to examine the first hypothesis. Identifying the influence of moderation audit quality to the relationship between accounting flexibility and real earning management to examine the second hypothesis.

Result and Discussion

A. General Information and Research Sample.

Samples in this research are all public company which has been listed in Indonesia Stock Exchange from 2010 to 2013. Finance report consists of yearly finance report and company yearly report from IDX website, www.idx.co.id. Besides that, there are also data samples from company financial report provided by Data Stream.

From the end of period 2013, there were 503 IDX listed companies with nine industrial sectors. This research excludes finance and insurance industrial sectors which consist of 84 companies. It also excludes utility industrial sector which consists of 51 companies. Moreover, this research using pool panel balance data. So that the company which doesn't have completes finance report from 2010 to 2013 was excluded from the samples. It consists of 81 companies. After variable measurement was checked, there were 61 companies which must be excluded because they don't have complete data for variables measurement in this research. After the data is collected from all variables measurement, 13 companies were excluded from the sample as outliers. Outlier data must be excluded from the sample in order to get perfect research result. In the end, the final data result in this research is 213 companies or 852 firm-years.

Table 1: Research sample selection

	Observation Summary
Initial sample	Year
IDX-listed Industry public company from 2010 to 2013	503
Finance industrial sector (8)	(84)
Utility industrial sector (7)	(51)
Company which do not have the finance report from 2010 to 2013	(81)
Company which do not have complete data for variable measurement	(61)
Outlier data company	(13)
Final company sample	213
Final firm-year sample (four years)	852

B. Descriptive Statistics Analysis

Descriptive statistic measurement in this research was intended to simplify the observation through means, maximum, minimum, and standard deviation measurement. The data were processed were 213 companies listed in IDX from 2010 to 2013 and 852 firm-years. Descriptive statistic from variables which used in this research presented in table 2.

Table 2 present descriptive statistic variables in this research from 213 companies in four years. Table 2 describes mean, median, maximum, minimum, and standard deviation value. Minimum value describes the lowest value from the variables. Mean value describes value data range from all data summary and divided by the amount of the data. Median describe the middle value. Maximum value describes the highest value from the variables. Standard deviation describes the deviation from mean which square-rooted in the variable.

REM has higher median value than the mean value. This indicates less real earning management practice. Otherwise, AbNOA has higher mean value than the median value. This indicates that accounting flexibility is higher in this research samples. For another variable indicates higher means value than median value except for size.

Table 2: Statistic description

	Mean	Median	Maximum	Minimum	Std. Dev.	Observations
REM	0.08236	0.36803	10.49903	-11.98905	2.19368	852
ABNOA	-0.00417	-0.00676	0.97953	-0.85032	0.23851	852
LOGNOA	0.01859	-0.05219	1.82008	-0.86602	0.37633	852
AUD	0.43662	0.00000	1.00000	0.00000	0.49626	852
LEV	0.51080	0.49702	2.82963	0.01185	0.25854	852
INTEXP	0.08240	0.07226	0.30312	0.00301	0.05459	852
ROA	0.10184	0.08688	0.60386	-0.88068	0.11378	852
SIZE	9.29723	9.30725	11.32532	7.05203	0.71370	852

C. Research Hypothesis Examination

The first hypothesis in this research is studying the influence of accounting flexibility to real earning management. Accounting flexibility is predicted will have negative influence to REM, where the lower the flexibility of accounting for accruals earnings management then the company will prefer to REM so that REM value becomes higher. Table 3 shows regression model 1 to test the first hypothesis. P-value F-statistic indicated significant result on 1% level. Adjusted R square value is 23%. This means independent variables have significant improvements in the dependent variable (real earning management). To examine the first hypothesis, AbNOA value shows negative significant value on 5% so that the first hypothesis is accepted.

Table 3: The first hypothesis result

Method: pool panel balance

$$REM_{it} = \beta_0 + \beta_1 AbNOA_{it} + \beta_2 Auditor_{it} + \beta_3 Leverage_{it} + \beta_4 IntExp_{it} + \beta_5 ROA_{it-1} + \beta_6 Size_{it} + \beta Ind + \beta Year_t + \epsilon_{it}$$

Variable	Prediction	Test Result		Note
		Coefficient	Probability	
Constanta		-2.48417	0.03670	
ABNOA	-	-0.68730	0.0281**	H1 is accepted
AUD	-	-0.48649	.0002***	Same as previous research
LEV	+/-	0.78287	0.0042***	Same as previous research
INTEXP	-	-3.54031	0.0057***	Same as previous research
ROA	-	-8.26898	0.0000***	Same as previous research
SIZE	+	0.34627	0.0047***	Same as previous research
Dummy Industry				Include
Dummy Year				Include
Adj R2				0.228787
F-Statistic				16.53379
p value (F-Stat)				0.0000***

* significant on 10%; ** significant on 5%; *** significant on 1%

As predicted before and from the previous research result, it is described that the company which has less accounting flexibility has limitation to do accruals earnings management. They tend to do earnings management with real activity. This result indicates that accounting flexibility show the substitution relationship between accruals earning management and real earning management. Audit quality shows negative significant at 1% level. This result shows a similar result with previous research which stated that higher audit quality will decrease management opportunistic so that it will have a negative impact on earnings management.

For all control variables show significant result and predicted direction as well as the previous research. Leverage control variable indicates positive significant at 1% level. In the previous research, it was two different result of leverage impact on earnings management. In this research result, the relationship between leverage and REM show positive result as well as Dichev and Skinner (2002) and Beatty and Webber (2003) research. The company which has higher leverage tend to prefer to do earnings management. Interest expense shows the negative significant result on 1% level as well as Jensen (1986) research. It shows that higher interest can control opportunistic behavior so that it has a negative relationship with earnings management. ROA describe negative significant result on 1% level as well as Kothari et al (2005) and Jiraporn et al. (2007) research. It shows that there was a negative relationship between EM and ROA. Size describe positive significant result on 1% level as well as Gu et al (2005) and Aini et al. (2006) research. It proves that asset can influence accrual discretionary. Higher size of the company will make the higher possibility for the company to do earnings management so that it has a positive relationship with earnings management.

Tabel 4: test result for the second hypothesis

Method: Pool Panel Balance

$$REM_{it} = \beta_0 + \beta_1 AbNOA_{it} + \beta_2 AbNOA_{it} * Auditor_{it} + \beta_3 Auditor_{it} + \beta_4 Leverage_{it} + \beta_5 IntExp_{it} + \beta_6 ROA_{it-1} + \beta_7 Size_{it} + \beta Ind + \beta Year_t + \epsilon_{it}$$

Variable	Prediction	Test Result		Note
		Coefficient	Probability	
Constanta		-3.56583	0.0029	
ABNOA	-	0.07921	0.8191**	
ABNOA*AUD	>-	-3.05899	0.0000***	H2 is accepted. Similar as prediction direction
AUD	-	-0.56565	.0003***	Same as previous research
LEV	+/-	0.83490	0.002***	Same as previous research
INTEXP	-	-3.19193	0.0117***	Same as previous research
ROA	-	-8.03299	0.0000***	Same as previous research
SIZE	+	0.44296	0.0003***	Same as previous research
Dummy Industry				Include
Dummy Year				Include
Adj R2				0.250048
F-Statistic				17.40028
p value (F-Stat)				0.0000***

* significant on 10%; ** significant on 5%; *** significant on 1%

Second hypothesis study about the influence of moderating audit quality to the relationship between accounting flexibility and REM. It was predicted that audit quality will increase the negative influence to the relationship of accounting flexibility and real earning management. Table 4 shows the model 2 regression result to test the second hypothesis. P-value F-statistic value shows the significant result on 1% level and adjusted R square value is 25%. It means that independent variable has a significant influence on the dependent variable (real earning management). Moderation audit quality with accounting flexibility which measured by ABNOA proxy describes negative significant result on 1% level. According to ABNOA value without moderation and ABNOA value with moderation, audit quality in this research model which describe the second hypothesis is accepted. It is clear that the audit quality can increase the negative relationship between accounting flexibility and REM. Higher audit quality will make the company has more limitation to do accruals discretionary (Becker et al, 1998; Chung et al, 2005; Zamri et al, 2013; Cohen et al, 2008). This limitation will make the company do more real earning management. In this case, better audit quality will decrease accounting flexibility to do accruals accounting. All the control variable in this research model 2 show significant result on 1% and 5% level with prediction direction is the same as the previous research and consistent with research model 1.

Conclusion

This research studying about the influence of accounting flexibility to real earning management in the Indonesia stock exchange public listed company from 2010 to 2013 which has 213 company and 852 observations firm-year. This research result shows a similar result with the first hypothesis. The first hypothesis was a company which has less accounting flexibility will tend to prefer increasing real earning management. There is a negative relationship between accounting flexibility and real earning management. Therefore, accounting flexibility can be used as a substitution to accrual earning management (AEM) to real earnings management (REM).

The second hypothesis indicates that audit quality moderation increases the negative relationship between accounting flexibility and REM so that the second hypothesis is accepted. With the better quality audit, the company tends to do less accruals discretionary. In this case, better audit quality can make less accounting flexibility to do accrual accounting. This will make the company do real earning management. This result will make those relationships more negative and significant.

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Authors:

Indah Masri
University of Pancasila
Email: indahmasri@univpancasila.ac.id