EARNINGS MANAGEMENT: OPPORTUNISTIC BEHAVIOR VS EXTERNAL MONITORING MECHANISMS

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ABSTRACT

The objective of study is to provide the influence of opportunistic behavior versus external monitoring mechanisms on earnings management. Opportunistic behaviors are bonus motivation and free cash flow. While, external monitoring mechanisms are leverage, company size, and sales growth. This research used 194 non-financial companies which listed in Indonesia Stock Exchange in 2016 until 2018, selected by purposive sampling method and used multiple regression as a method of analysis data. The result of study showed that bonus motivation, free cash flow, leverage, company size and sales growth had an effect to earnings management. The effect of bonus motivation on earnings management is significant and positive. The effect of leverage on earnings management is significant and positive. This shows that the monitoring from external parties (like creditors) is very low, resulting in opportunistic behavior to do earnings management. Bonus motivation is one of the opportunistic behavior of management to do earnings management.

Keywords: Bonus motivation, free cash flow, leverage, company size, earnings management

INTRODUCTION

Earnings management is an intervention carried out by management in determining profit for personal gain (Subramanyam, 2014). However, Kusumawardhani (2012) explains that earnings management is not always detrimental if it is carried out within the corridor of opportunity. Earnings management also does not manipulate financial statements because there are options to use several methods and do not violate the provisions. One of the methods used to oversee companies and impose limits on management behavior is corporate governance.

In February 2015 the Indonesia Stock Exchange (IDX) found misstatements in the financial statements of PT Inovisi Infracom Tbk for September 2014. The Indonesia Stock Exchange asked the company to revise eight items in its financial statements including the value of fixed assets and earnings per share. The Indonesia Stock Exchange also stated that the company's management misstated items of cash payments to employees and net receipts (payments) of related party debts in the cash flow statement. The company also recognizes earnings per share based on profit for the period which should be using profit for the period attributable to owners of the parent. This practice makes the company's net income per share appear bigger than it should be (Suhendra, 2015).

This research is a development of Wimelda and Chandra (2018). Prior research using opportunistic behavior consisting of bonus motivation and free cash flow, as well as external monitoring mechanisms consisting of leverage and company size, the difference in research is the addition of sales growth from Linasmi (2017) as a form of monitoring from outside parties because investors want the company to grow. The research motivation is that research on earnings management provides inconsistent results related to opportunistic behavior and external monitoring mechanisms. The objective of study is to provide empirical that opportunistic behavior (bonus motivation and free cash flow) and external monitoring mechanisms (leverage, company size, and sales growth) on earnings management.

Bonus Motivation

Bonus motivation has a positive influence on earnings management (Wimelda and Chandra, 2018). When management report profitability, this can act as an incentive for management to take earnings management and show the company's future profitability (Ghazali, Shafie, & Sanusi, 2015). This opinion is supported by Amertha, Ulupui, & Putri (2014), Yuliana and Trisnawati (2015), and Arifin and Destriana (2016) which state that bonus motivation or what is known as profitability has a positive effect on earnings management. The hypothesis proposed is:
H_1: Bonus motivation affects earnings management.

Free Cash Flow

Free cash flow has a positive effect on earnings management. The manager will try to put a high cash flow value under his control so as to encourage him to do earnings management (Cardoso, Martinez, & Teixeira, 2014). Other research states that free cash flow has a negative effect on earnings management (Wimelda and Chandra, 2018). Companies that have sufficient free cash flow have more confidence in their financial performance, and are therefore less likely to take earnings management. This opinion is supported by Yogi and Damayanthi (2016), Susanto and Bosta (2018) and Ghazali, Shafie, & Sanusi (2015) which states that free cash flow has a negative effect on earnings management. The hypothesis proposed is:
H_2: Free cash flow affects earnings management.

Leverage

Leverage has a negative effect on earnings management (Yuliana and Trisnawati, 2015). The low leverage is due to the company's high earnings management. This opinion is supported by Aygun, Suleyman Ic, & Sayim (2014), Guna and Herawaty (2010), Santoso and Pudjolaksono (2013), Sari and Asyik (2013), and Susanto (2013) who state that leverage has a negative effect on earnings management

Leverage has a positive effect on earnings management (Wimelda and Chandra, 2018). When the company has a high leverage, management is more likely to engage in earnings management to reduce the company's risk to investors. This opinion is supported by Susanto, Pirzada, & Adrianne (2019), Arifin and Destriana (2016), Prastiti and Meiranto (2013), Kusumaningtyas (2012), Sosiawan (2012), and Bassiouny, Soliman, & Ragab (2016) which state that leverage has a positive influence on earnings management. The hypothesis proposed is:
H_3: Leverage affects earnings management.

Company size

Company size has a positive influence on earnings management (Lidiawati and Asyik, 2016). This is because large companies avoid drastic increases in profits in order to avoid high tax burdens and a drastic decline in profits in order to avoid a decrease in firm value. This opinion is supported by Amertha, Ulupui, & Putri (2014), Ali et al. (2015), Jatiningrum, Hamid, & Popoola (2016), Susanto (2016), Yuliana and Trisnawati (2015), Kusumaningtyas (2012), and Zeptian and Rohman (2013) which state that company size has a positive influence on earnings management.

Company size has a negative influence on earnings management (Jao and Pagalung, 2011). This is because large companies will be more careful in carrying out earnings management because they are more concerned about the environment outside the company, in that case, the company will report their condition more accurately. Large companies are also better resourced to develop and create robust and sophisticated internal control and governance mechanisms. This opinion is supported by Susanto et al. (2019), Susanto (2016), Abbadi, Hijazi, & Rahahleh (2016), Purwanti and Rahardjo (2012), Jesus and Emma (2013), Swastika (2013), Ahmad, Anjun, & Azeem (2014), Debnath (2017) and Firnanti (2017) which state that company size has a negative influence on earnings management. The hypothesis proposed is
H_4: Company size affects earnings management.

Sales Growth

Sales growth has a positive influence on earnings management (Heidarpoor, Rafiee, & Rafiee, 2014). This means that the increasing sales growth will affect earnings management that are getting bigger. This opinion is supported by Gonzalez and Meca (2014) and Llukani (2013) which state that sales growth has a positive influence on earnings management. The hypothesis proposed is:
H_5: Sales growth affects earnings management.

METHOD

The research objects taken for this study came from non-financial companies listed on the Indonesia Stock Exchange in 2016-2018. The results of sampling are presented in the following table:

Table 1: Sampling result

No.	Criteria	Firm	Data
1.	Non-financial companies consistently listed on the Indonesia Stock Exchange during the 2015-2018	419	1257
2.	Non-financial companies that do not use rupiah currency.	(84)	(252)
4.	Non-financial companies that did not publish their financial statements for the financial year ended December 31.	(3)	(9)
5.	Non-financial companies that do not make a profit.	(117)	(351)
6.	Non-financial companies that do not have institutional ownership.	(21)	(63)
	Total Sample	194	582

Source: data proces

Earnings management is measured using absolute discretionary accruals and applying the modified jones model, as follows:

$$\frac{TAC_{it}}{A_{it-1}} = \beta_0 \frac{1}{A_{it-1}} + \beta_1 \frac{\Delta REV_{it} - \Delta REC_{it}}{A_{it-1}} + \beta_2 \frac{PPE_{it}}{A_{it-1}} + \epsilon_{it} \quad (1)$$

Where: TAC_{it} Total Accruals year t, $NI_{it} – CFO_{it}$, NI_{it} net income year t, CFO_{it} operating cash flow year t, A_{it-1} Total asset year t-1, ΔREV_{it} changes in revenue, ΔREC_{it} changes in account receivable, PPE_{it} gross property, plant, and equipment year t, εit discretionary accruals. Bonus motivation is measured by the ratio of net income before tax to the company's total assets (Nurdiniah & Herlina, 2015). Free cash flow is measured by the difference between operating cash flow and investment cash flow, the results are scaled total assets. Leverage measurement uses the Debt to Assets. Company size is measured using the natural logarithm of total assets (Wimelda & Chandra, 2018). Sales growth is measured by the change in current sales divided by the previous year's sales (Linasmi, 2017). The multiple regression equation model used in this study is as follows:

$$EM = \alpha + \beta_1 ROA + \beta_2 FCF + \beta_3 LEV + \beta_4 FS + \beta_5 SG + \varepsilon \qquad (2)$$

Where: EM earnings management, α constant, β_1-β_5 coefficient, ROA bonus motivation, FCF free cash flow, LEV leverage, FS company size, SG sales growth, ε error

RESULT AND DISCUSION

The t test results are shown in the following table:

Table 2: Result of t-test

Variable	B	Sig.
(Constant)	0.129	0.005
ROA	0.092	0.004***
FCF	- 0.058	0.005***
LEV	0.044	0.000***
FS	- 0.003	0.045**
SG	0.032	0.003***

Dependent variable: Earnings management
** Sig<5% ***Sig<1%
source: statistic output

The results of the t test above indicate that the bonus motivation (ROA) has a coefficient (B) of 0.092 and a significance value of 0.004. It can be concluded that H1 is accepted, meaning that bonus motivation has an influence on earnings management. The coefficient (B) of 0.092 indicates that bonus motivation has a positive effect on earnings management. The results of the research are consistent with Amertha, Ulupui, & Putri (2014), Yuliana and Trisnawati (2015), and Arifin and Destriana (2016). The opportunistic behavior of managers encourages earnings management. This behavior can be seen from the management reporting earnings to get a bonus.

The results of the t test above indicate that free cash flow (FCF) has a coefficient (B) of -0.058 and a significance value of 0.005. It can be concluded that H_2 is accepted, meaning that free cash flow (FCF) has effect on earnings management. The coefficient (B) of -0.058 indicates that free cash flow has a negative effect on earnings management. The results of the research are consistent with Wimelda and Chandra (2018), Yogi and Damayanthi (2016), Susanto and Bosta (2018) and Ghazali, Shafie, & Sanusi (2015). Companies that have sufficient free cash flow have more confidence in their financial performance, therefore are less likely to take earnings management (Wimelda & Chandra, 2018).

The t test results show that leverage (LEV) has a coefficient value (B) of 0.044 and a significance value of 0.000. It can be concluded that H_3 is accepted, meaning that leverage has an influence on earnings management. The coefficient (B) of 0.044 indicates that leverage has a positive effect on earnings management. This shows the weakness of the creditor's monitoring of management to carry out earnings management. The results of the research are consistent with Susanto, Pirzada, & Adrianne (2019), Wimelda and Chandra (2018), Arifin and Destriana (2016), and Bassiouny, Soliman, & Ragab (2016).

The t test results show that the company size (FS) has a coefficient value (B) - 0.003 and a significance value of 0.045. It can be concluded that H_4 is accepted, meaning that company size has an influence on earnings management. The coefficient (B) of -0.003 indicates that company size has a negative influence on earnings management. The results of the research are consistent with Firnanti (2017), Debnath (2017), Susanto (2016) and Abbadi, Hijazi, & Rahahleh (2016). This is because large companies will be more careful in carrying out earnings management because they will report their condition more accurately. Large companies also have better resources to develop and create robust and sophisticated internal control and governance mechanisms (Jao & Pagalung, 2011).

The results of the t test above indicate that sales growth (SG) has a coefficient (B) of 0.032 and a significance value of 0.003. It can be concluded that H_5 is accepted, meaning that sales growth has effect on earnings management. The coefficient (B) of 0.032 indicates that sales growth has a positive influence on earnings management. The results of the research are consistent with Heidarpoor, Rafiee, & Rafiee (2014), Gonzalez and Meca (2014) and Llukani (2013). This shows that the greater the sales growth of a company, the higher the probability of earnings management. If the company has a high sales growth, company management can use it to get a bigger bonus because of it, management may take earnings management. The higher the sales growth, the greater the income the company earns so that the tax the company must pay will be even greater. Companies carry out their earnings management by reducing earnings to reduce the tax burden that must be paid (Yunietha & Palupi, 2017).

CONCLUSION

This study proves empirically that bonus motivation, free cash flow, leverage, company size, and sales growth have effect on earnings management. The influence of bonus motivation and leverage on earnings management is significant and positive. This suggests that opportunistic behavior (bonus motivation) triggers earnings management. Meanwhile, the external monitoring (creditors) is weak to suppress earnings management. The research implication is that investors focus on bonuses received by management as an indication of earnings management. Suggestions for further research are to use data from ASEAN countries to see a comparison of the opportunistic behavior of each country as well as differences in external monitoring mechanisms to earnings management. In addition to adding the audit committee as moderating (Susanto, 2016).

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