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Earning Management and Financial Performance in Real Estate Company in Indonesia

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ABSTRACT

Earning management is a practice by the management to convince the stakeholders and to maintain firm reputation by modified or manipulate financial statement. This practice brings positive and negative impact to firm performance. Although, earning management allegedly made by the managers to enhance financial reporting strategies and provide positive opinion of the business, this practice would reduce the quality of financial statement. Such reasons as financial distress and high competition are name of few that the management manipulate financial statement. In addition to this, the study examines the effect of earnings management towards return on asset and market value in the company in Indonesia. Quantitative method used to measure variable of study and the data was taken from real estate and property company that listed in Indonesian stock exchange. The study finds that two indicators of earning management namely, total accrual (balance sheet approach and cash flow approach) has significant effect on return on asset and market value. In addition to this, neither increase and decrease on balance sheet approach and cash flow approach give the effect on firm performance Thus, practice on earning management play roles to the firm performance. In addition to this, the study provides the insight of earning management practice in the company as the contribution of study

Keywords: Earning Management, Balance sheet approach, Cash flow approach and Firm Performance

INTRODUCTION

Financial statement is valuable source for stakeholders to find the ability of the company to survive in the business competitive. In addition, the management responsible to provide the financial statement and responsible to maintain good company reputation to stakeholders. In order to maintain good company reputation, the company performance should be positive. In addition, management do their best to bring positive effect to the company [2]. Including use the method that able to modify the financial statement. Accounting accrual basis is the method that gives the management flexibility to adjust accounting recognition, Thus, the management able to modify the financial statement according to their need.

The management is highly given authorization, control and manage the company's resource to improve the firm performance [1]. It is not new things that managers have a tendency to take actions to make financial statements look good for investors especially shows the profitability

in the financial statement. by showing profitability of the firm, thus, effect to their annually bonus and compensation [3]. Adjust or manipulate the financial statement by the management is named as earning management [4]. Earning management is common practice by the management in the organization and it is a popular issue in the business practice [5]. Some earning management issues practice shows that the practice gives negative impact to the company. Case like Enron Corporation, Sunbeam Corporation, Dell Computer, Sinar Mas group and Garuda Indonesia shows that earning management practice leads to firm reputation [3]. Earning management does not relate to the action of manipulating accounting data and information, instead the selection accounting method in order to obtain the benefits such as to regulate desire profit and, selecting accounting method that suit to the firm business is permissible in the accounting regulation [3], although, there is the weaknesses of that method that use by the management to manipulate accounting recognition that channel to profit and loss reporting.

The common factor the management practice earning management is financial distress and high competition. Financial distress refers to the disability of a company to meet its debt or other obligations. It may derive from poor cash flow and unprofitability which may to lead bankruptcy and liquidation. In addition to this, the management attempt to avoid financial loss by practicing earning management. it is in line with Sun (2011) that the company carries out earning management an attempt to meet the projected sales of analysis and avoid the loss. Moreover, the management will gain trust from stakeholder and earn annually incentive [6]. High competition on the other hand, creates pressure on the company to compete to show the best quality and performance and it is a challenge for stakeholders for assessing whether financial information reliable as results of management manipulation. Such practice earning management as control of the income, by adjustment business activities that channel to profitability. In addition, accrual earning management adjust immediately in the financial statement without any improvement in the business activities [7]. As the earning management practice is the issue that effect to the firm performance therefore, the study aims to identify earning management practice that led to firm performance within the scope of a sample of real estate and property companies listed on Bursa Effect Jakarta, Indonesia. In addition to this, research question arises what is the affect earning management to firm performance? By study the effect of earning management to firm performance, it will gain deep understanding affect earning management on the firm performance and how earning management commonly practice by the management and effect to firm performance especially in real estate and property companies.

THEORETICAL FRAMEWORK & HYPOTHESIS DEVELOPMENT

The management have opportunities to exploit earning that effect to the quality and reliability of financial statement. The strain from bad performance and/or difficult financial condition is the condition that the management improvise the firm performance. For instance, high financial distress makes the management to adjust the firm revenue thus avoid bankruptcy [8]. It is in line with Duncan (2001) that the management modify revenue recognition that impact to unsustainable profit and/or refuse to report declining profits that impact to firm reputation. Meanwhile, Aman et.al., (2006) stated that the factor that management improvise firm earning is debt contract, political cost, internal finance and equity ownership. The management believes by control outcomes will prevent company losses. It is dress window to show to the public that company able to survive in business competitive while hide the current firm condition [9]. The

relationship between the management and shareholders explains in the agency theory. The agency problem arises when management reporting does not meet the shareholders interest. In order to minimize agency problem, the management engage in earning management to show better performance of the company [10]. It is also reduced the agency cost. Earning management can be measured by using indicator namely, total accrual balance sheet approach and total accrual cash flow approach. Accrual is the instrument of earning management which define as the difference between the reported income and the cash flow. that is, they represent the cumulative effect derived from introducing the accrual basis in the conventional accounting model. Hence results the following expression of the total or observed accruals (TAC) for company i in period t:

TACit = Income it – Cash Flow it

However, the accounting standards of many countries does not require companies to report consistently the Cash Flows Statement [6], precluding the TAC calculation (refer red to as cash flow statement approach). Thus, several researchers usually calculate TAC indirectly, using information available in other financial statements (referred to as balance sheet approach) [11]. Literally, account in Balance Sheet such as, other receivable, prepaid expenditure, short term loan, long term payable and other non-current liabilities are name of few that susceptible be manipulated. Overevaluation of assets and under deposition of liabilities are common practice of manipulation in Balance sheet [11]. One of the reasons for managing earnings is to give corporate board positive news in a given time by showing good performance [2]. Management is unwilling to disclose profit below analyst estimates because the price of market share could have a bad effect [5]. In fact, managers appear to manipulate revenues to mislead creditors, raise equity values and reduce debt charges. Because revenue-management strategies are typically taken to promote top management interests, these activities are performed at the detriment of other parties that have effect to the market value of the company. If, there is reason for the practice of earnings management that are related to management incentives in the form of stock options or price-based rewards, it may partially discourage management from managing profits. In addition to this, the earning management effect to return of asset and market value. An auditor independent allows the management to make economic decisions using reliable accounting data including earning management practice. However, the management of company reduce the earning control while their financial reporting is audited by the big four audit firm. The big four auditor firm provides right and logical method of auditing content misstatement that led improve audit quality. Furthermore, the auditor size effect to earning management practice in the company [12]. On the other hand, financial leverage is indicator of financial stability and the combination of liabilities and equity ownership can be calculated. Financial leverage is the warning that management has to adjust the current and potential cash flow [13]. Thus, the hypothesis is:

H1: Total accrual balance sheet approach has positive relationship with ROA and, auditor size and financial leverage associate with Total accrual balance sheet approach and ROA

H2: Total accrual balance sheet approach has positive relationship with market value and auditor size and financial leverage associate with Total accrual balance sheet approach and market value

According to Leonardi (2012), The ability of a company to finance its operations depends on the company's cash. If the company's operating cash is fulfilled, it indicates good firm's financial

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performance. It finds in the cash flow statement, that if return on asset is high, then, it assumes the firm is operated effectively. It attracts the investor to invest in the company as a promising of higher return of asset will lead to higher profit. It provokes that manager to act accordance with success criteria opportunistically by rise the earning and/or reduce the profit. The reasons for managing earning are to give board of director positive information by showing good financial performance. Furthermore, the management unwilling to disclose the profit and loss statement that contradicted with the financial analyst that may impact to firm stock price in the market [5]. As the auditor allows the management to make economic decision using reliable accounting data however, the management would not do many earning management practice if their financial statement is audited by big four company. Therefore, size audit firm effect on earning management practice in the company [12]. Financial leverage is indicator to show financial stability of the firm. By having good financial leverage, it gains trust from the stakeholders [13]. Thus, the hypothesis is:

H3: Total accrual cash flow has positive relationship with ROA and, auditor size and financial leverage associate with Total accrual cash flow and ROA

H4: Total accrual cash flow has positive relationship with market value and, auditor size and financial leverage associate with Total accrual cash flow and Market value

The conceptual framework of the study:

$$“Y_1 = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + e”$$

$$“Y_2 = \alpha + \beta_1X_1 + \beta_2X_2 + \beta_3X_3 + e”$$

Where, Y_1 is return on asset, Y_2 is Market value, α is constant, $\beta_{1\text{-}4\ is}$ regression coefficient, X_1 is total accrual balance sheet approach, X_2 total accrual cash flow approach, X_3 auditor size, X_4 financial leverage and e error.

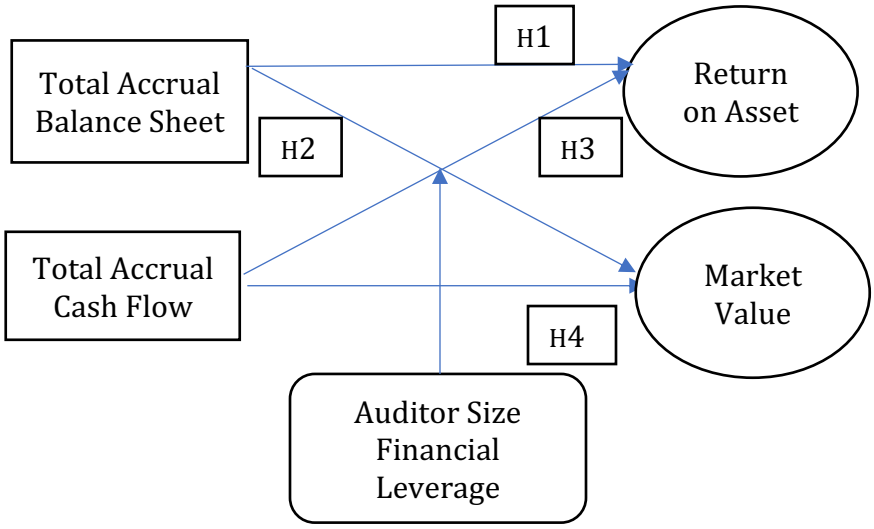


Figure 1: Conceptual Framework

RESEARCH METHOD

The study uses quantitative method by using secondary data. The method the study consists of sampling procedure and data collection, measurement variable and data analysis

SAMPLING PROCEDURE & DATA COLLECTION

The population of the study is all Indonesian real estate and property listed in Indonesian Stock Exchange (IDX) which consist of 88 listed real estate and property that listed in IDX. The sampling method is purposive sampling. Due to not all real estate company not completely present financial statement on 2016-2019 and have negative return on asset during the period 2016-2019. Therefore, only 22 real estate companies are selected as sample of the study. Data is collected from real estate and property company that listed in Indonesian Stock Exchange (IDX). IDX provides financial statement and annual report from 2016-2019

MEASUREMENT OF THE VARIABLE

The variables of study were measured using formula that are well established. There are two independent variables i.e., total accrual balance sheet and total accrual cash flow, two dependent variables i.e., return on asset and market value and two control variables i.e., auditor size and financial leverage. the measurement of the variable for total accrual balance sheet and total accrual cash flow approach are adopted from Jones Model (1991). Profitability is determined by return on asset that calculated based on EBIT / Total asset while, market value is calculated by market value of equity. Auditor size is determined by big four audit firm company. Financial leverage is determined by DER (Debt to equity ratio). There are measurements of the variables:

- The formula of total accrual balance sheet
  $TACC\text{-}Bi,t = \Delta CAi,t - \Delta Cashi,t - \Delta CLi,t + \Delta DCi,t$
- The formula of total accrual cash flow
  $TAab = NIab - CFOab$
- The formula of return on asset
  $ROA = EBIT / Total\ Assets\ x\ 100\%$
- The formula of market value
  Market value of equity: Stock Price x Number of Outstanding Shares

RESULT ANALYSIS

Descriptive Statistic

Descriptive statistic explains average, highest, lowest and deviation value for all the variables from 2016 until 2019. Table 1. shows that the value of average ROA (Y1) is 0,493 and it is closed to value of standard deviation which is 0,480 which mean data variance from ROA is minimal. Meanwhile, value of the market value (Y2) is 0.345 and the value of standard deviation is 0.467 thus, it shows data variance is minimal (million-rupiah per unit). It is similar with Total Accrual Balance sheet which value is 0.973 and the value of standard deviation is 0.997 and shows data variance also minimal (million-rupiah per unit). Furthermore, the average of Total accrual cash flow (X2) is -0.455 with standard deviation is 0.109. it shows data variance is minimal. Auditor size with average value is 0.36 and the standard deviation is 0.48 shows less data variance and financial leverage with average value 0.791 and standard deviation 0.665 also shows less data variance. To conclude, all the variables of the study less data variance and able to proceed to another test i.e., classical assumption test.

Table 1. Statistical Descriptive

Variable	Min	Max	Mean	Standard Deviation	N
Return on Asset (Y1)	0,001	0,309	0,493	0,480	88
Market value (Y2)	0,198	0,202	0,345	0,467	88
Total Accrual Balance Sheet (X1)	- 0,166	0,423	0,973	0,997	88
Total Accrual Cash flow (X2)	-0,770	0,221	-0,455	0,109	88
Auditor Size (X3)	0	0,10	0,36	0,484	88
Financial Leverage (X4)	0,002	0,625	0,791	0,665	88

Classical assumption test

The classical assumption test consists of normality test, multicollinearity test and heteroscedasticity test. the classical assumption test aims to ensure that data free from error therefore, avoid misstatement [14]. The results find the data does not diverse and it distributes normally. Furthermore, no multicollinearity and heteroscedasticity occur as a result of the testing.

Hypothesis testing

The study uses SPSS 25 to examine the hypothesis of the study. the hypothesis is tested to find the relationship among the variables of the study [14]. Table 2 shows the result of testing the hypothesis H1 and H3. The result shows that coefficient regression of total accrual balance sheet is 0.0812 with p-value 0.02. It implies that if total accrual balance sheet increases 1 million rupiah, then ROA will decrease 0.0812%. Meanwhile, the coefficient regression of total accrual cash flow is 0.014 with p-value 0.02. It also implies that if total accrual cash flow increases 1 million rupiah them ROA will decrease 0.014%. On the other hand, coefficient regression of auditor size is 2.04 with p-value 0.06. It shows that if auditor size increase 1 point e.g., quality of the audit, then ROA will increase 2.04%. Coefficient regression of financial leverage is 0.08 with p-value 0.31. it shows if financial leverage increase 1 rupiah, ROA will increase 0.08%. Based on the result, it shows two independent variables i.e., total accrual balance sheet and total accrual cash flow have negative relationship with ROA and two control variables i.e., auditor size and financial leverage support independent variables that lead to ROA.

Table 2. The Relationship Earning Management (X1, X2) with ROA (Y1)

Variable	Coefficient regression	p-value
Total accrual balance sheet (X1)	0,0812	0,02
Total accrual cash flow (X2)	0,0142	0,02
Auditor Size	2.04	0,06
Financial Leverage	0,08	0,31
R-Squared 0.132 **Adjusted R-Square 0.090** **F-statistic 3.155, Sig = 0.018**		

Significant level *(0,1) **(0,05) *(0,01)**

Table 3 show the result of testing the hypothesis of H2 and H4. The result shows that coefficient regression of total accrual balance sheet is (0.20) with p-value 0.02. It implies that if total accrual balance sheet increases 1 million-rupiah, market value will decrease 0.20 rupiah. Meanwhile, coefficient regression of total accrual cash flow is 0.08 with p-value 0.00. It shows that if total accrual cash flow increases 1 million then market value decreases 0.088 rupiah. On

the other hand, coefficient regression auditor size is (0.42) with p-value 0.68. it ensures that while auditor size increase their audit quality, the market value will be 0.42 rupiah. Coefficient regression of Financial Leverage is (0.21) with p-value 0,76. It shows that if financial leverage increase 1 rupiah, then market value (stock) will decrease 0.21 rupiah. Based on the result, it shows two independent variables i.e., total accrual balance sheet and total accrual cash flow have relationship with market value and two control variables i.e., auditor size and financial leverage support independent variables that lead to market value.

Table 3. The Relationship Earning Management (X1, X2) with Market Value (Y2)

Variable	Coefficient regression	p-value
Total accrual balance sheet (X1)	**(0,20)**	**0,02**
Total accrual cash flow (X2)	**(0,08)**	**
Auditor Size	**(0,42)**	**0,68**
Financial Leverage	**(0,21)**	**0,76**
R-Squared 0.201 Adjusted R-Square 0.163 F-statistic 5.234, Sig = 0.001		

Significant level *(0,1) **(0,05) *(0,01)**

DISCUSSION

Total accrual balance sheet and ROA and Market

Based on the result of the study explain that the Total Accruals Balance Sheet (X1) has a significant on negative effect on Return on Assets (Y1) which mean, if the Total Accruals Balance Sheet (X1) decreases, the Return on Assets (Y1) will increase. According to Natarsyah and Ma'ruf (2006), the financial ratio that is often used is ROA as an indicator of a company's earnings power, which reflects management's performance and often used by potential investor. The finding of the study is in line with Zahdjuki et.al (2018) that earning management has negative impact on the ROA. According to Zahdjuki et.al (2018), once the managers able to move effectively in managing company assets, the profit potential of the company will be higher, but high profits do not necessarily trigger earnings management. Fluctuating inter-period earnings are not a benchmark for the companies. Management's focus is on long-term indicators. If the company profitable therefore, it will impact to the level of achievement of earnings, thus the managers do not have to do earnings management practice.

Meanwhile, total accrual balance sheet approach also has negative impact to market value. This is because balance sheet accounts are linked to various form of fraud**.** overvaluations of assets or under depositions of liabilities were the most commonly found fraudulent acts in balance sheets [15] One of the reasons do earning management is to give the board positive view of good company performance. Furthermore, company performance is the parameter that effect on company share price in the market, Thus, the management unwilling to disclose profit below the estimation that made by analyst**.** As the company performance effect to share price in the market, the mangers do manipulate income and balance sheet components to sustain and or optimize the company share price for current and subsequent years [16]

Auditor size and financial leverage are influenced on earning management practice. If total accrual balance sheet decrease, the auditor size and financial leverage increase. Management decrease earning control if the financial statement audited by big four audit firms. This is

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because, they perform good quality assurance on the audit reporting. Meanwhile, financial leverage is indicator of financial stability with include the combination of liabilities and the ownership. The liabilities ratio and the total asset ratio were employed to show the independent financial aid from another company.

Total accrual cash flow and ROA and Market

The result shows that Total Accruals Cash Flow has negative effect on ROA. This means, if the Total Accruals Cash Flow decrease, the Return on Assets increase and vice versa. It is supported by Herni Susanto (2008), while financial performance that proxy by ROA improve, less earning management practice will be. This is because financial performance has met the stakeholder expectation. Based on the finding of study, it indicates, the management choose accounting method for their own purpose and benefit, not to provide real company performance information.

Meanwhile, Total Accruals Cash Flow has negative effect on Market Value, which mean if the Total Accruals Cash Flow decrease, the Market Value increase. According to Andreas (2017), Sales management is one of earning management technique that affect to cash flow. If the management will to boost the sales, the management will give discount and credit terms to the customers thus, lead to the revenue and income. However, it will impact to the cash flow. Cash in reduce as result of discount of the products and credit sales [2]. Because revenue and income increase therefore, lead to the company share price. The market finds that high demand of the company product and sold in the market. In addition, it shows the management able to sell the products.

On the other hand, auditor size and financial leverage play role on the earning management practice in the real estate company. For instance, if total accrual balance sheet decrease, auditor size and financial leverage increase. Management less earning management practice, if the financial reporting audited by big four auditor firm. It shows, the largest auditor firm, the credible audited of the financial statement. they i.e., big four audit firm have to maintain their reputation by providing good audit quality. Meanwhile, financial leverage is indicator of financial stability and the combination of liabilities and equity ownership. In addition, in the financial leverage liabilities ratio and the total asset ratio were employed to show the investment from the investor. Financial leveraging is the warning that management has to adjust the current and potential cash flow and also one of component of wealth control.

CONCLUSION

Earning management is a practice that conducted by the management by selecting accounting method to meet their expectations and also gain the investor trust. There are two indicators of earning management in the study namely, total accrual balance sheet and total accrual cash flow and the study use these indicators to measure effect on firm performance especially in real estate and property company. The study finds that total accrual balance sheet has negative impact on return on asset (ROA). It indicates that while total balance sheet decrease, it does not mean ROA would increase instead its opposite i.e., ROA would decrease. It is similar vein with finding of total accrual cash flow to ROA. The results shows that total accrual cash flow has negative impact on ROA. It indicates that once there is good rate of return therefore it gives positive effect to firm performance. Another finding of study show that total accrual balance sheet has negative impact to market value. It implies that while total accrual balance sheet

decrease, stock valuation would increase. In addition to this, stock valuation would react according to balance sheet statement. On the other hand, there is similar result that total accrual cash flow has negative impact to market value. It indicates while total accrual cash flow decrease, thus, stock demand is increased. This is because, the firm with high free cash flow, the management tend not do earning management practice. The management assume that without earning management practice, the firm able to increase the share price in the market and investor sees that the firm has free cash to distribute the dividend. As the result of study finds that both total accrual balance sheet and total accrual cash flow have negative impact to firm performance, it indicates that the management does not motivate to take earning management practice if firm performance meet their expectation The result of study does not represent to all companies in Indonesia since sample of the study real estate and property company only that stated in Indonesian Stock Exchange (IDX). It is not adequately described the phenomena of the company in the same year of the period. On the other hand, the study uses two financial variables in earning management only since there is another financial variable in earning management. By adopting another financial variable in earning management, therefore it gives another angel or view of earning management practice in the company. The length of study only four years thus, it is not enough sufficient to measure earning management since the business lack to define the true state of control business activities. In addition to this, the study provide recommendation that need to put the instrument for real estate & property company therefore, it able to define the characteristic of real estate & property company. Perhaps by define the characteristic would find different earning management practice will be. Meanwhile, use another variable in the study such as, tax aggressiveness, corporate governance and corporate value would give other views of earning management practice that led to firm performance.

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