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# **The Beauty and the Beast of earning management in Indonesia**

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## **Abstract**

Earnings management is controversial for the business and accounting worlds. This research prioritized the concept of understanding of earnings management patterns carried out by companies in Indonesia for eleven years (2008-2018). This research was conducted using a descriptive quantitative method with 1,023 data analysis of 93 selected company samples from a total of 676 companies on the Indonesia Stock Exchange. This study concludes that three types of ratio scales can be used in interpreting a pattern of earnings management in all companies in Indonesia, as measured by discretionary accruals.

**Keywords:** Earning management; Finance accounting; Discretionary accruals.

# La bella y la bestia de la gestión de ingresos en Indonesia

## Resumen

La gestión de ingresos es controvertida para el mundo empresarial y contable. Esta investigación priorizó el concepto de comprensión de los patrones de gestión de ganancias llevados a cabo por empresas en Indonesia durante once años (2008-2018). Esta investigación se realizó utilizando un método cuantitativo descriptivo con 1,023 análisis de datos de 93 muestras de compañías seleccionadas de un total de 676 compañías en la Bolsa de Indonesia. Este estudio concluye que se pueden usar tres tipos de escalas de proporción para interpretar un patrón de gestión de ganancias en todas las empresas en Indonesia, medido por las acumulaciones discrecionales.

**Palabras clave:** Gestión de ingresos; Contabilidad financiera; Acumulaciones discrecionales.

## 1. INTRODUCTION

Earnings management is a unique art of number alteration in a company's financial statement. Most of the managers conducted activities like this to improve his financial performance statements. Behind the stunning financial statement performance, however, lie the underlying problems of a financial report because the report does not reflect the actual conditions of the company. Thus, earnings management is perceivable from two different points of view. A good earnings management practice does not bring any mishap to anyone and has a certain limitation. Earnings management, which will lead to

a decline or bankruptcy of a business, is considered the worst earnings management practice.

The practice of earnings management is understandable from Positive Accounting Theory (PAT) and Agency Theory (JENSEN and MECKLING, 1976; FAMA, 1980; WATT and ZIMMERMAN, 1986). Famous PAT hypotheses capable of serving as a base for accepting earnings management are Bonus Plan Hypothesis. The Debt to Equity Hypothesis (Debt Covenant Hypothesis), and the Political Cost Hypothesis (Size Hypothesis) (WATTS and ZIMMERMAN, 1986; HEALY, 1985; JONES, 1991). Agency Theory applies when each individual (principal and agent) is motivated by their interest, inciting a conflict of interest (JENSEN and MCKLING, 1976; FAMA, 1980).

Practicing earnings management is intended to achieve particular objectives and benefits during external financial reporting (HEALY, 1985; SCHIPPER, 1989; WATT and ZIMMERMAN, 1986). Techniques of earnings management are taking a bath, income minimization, income maximization, income smoothing, and Timing Revenue and Expenses Recognition (HEALY, 1985; JONES, 1991; SCOTT, 2003). Some accountants believe that earnings management is a process that interferes with a financial statement with the objective of misleading stakeholders or parties of interest who have a concern about the company's performance and conditions. Thus, this concept addresses earnings management as fraud. However, some people seeing earnings management from another point of view, believing that earnings management practiced by a company manager is not a fraud, because it still operates using accounting methods and procedures that are publicly acceptable and recognized (DECHOW and SKINNER, 2000; MYERS and SKINNER, 1999).

SCOTT (2009) classified earnings management into two, efficient, and opportunistic. Efficient earnings management is carried out to improve profitability and convey private information that is unavailable to the public and intended only for particular parties. Opportunistic earnings management, on the other hand, is conducted by a manager for his interest. Earnings management is practiced in several steps. First, management organizes and estimates accountings data. This step is intended to estimate which post (account) will receive addition or subtraction to adjust to the company's earnings statements. Second, management can perform this by altering the accounting method or shifting the period of financial statement calculation. This process may benefit the company and is not a prohibition, but it may turn the information within the financial statements to be biased and untransparent.

The number of earnings management cases in Indonesia does not seem to drop each year. The following are some cases of earnings management: PT Karina Utama Tbk, established on 20 June 1997, manipulated its 2008 financial statements and also its audited 2009 financial statements. PT Garda Tujuh Buana Tbk (GTBO) was also proven to falsify its 2012 company financial statements which were misleading. In May 2015, Toshiba Company announced that it was investigating an internal accounting scandal and had to revise its earnings for the last three years. A thorough investigation revealed that Toshiba had found it hard to generate profit since 2008 global crisis. This crisis hit Toshiba and led Toshiba to conduct an accounting fraud.

Toshiba employed several methods to manipulate profits that did not reflect reality.

An earnings statement manipulation took place in 2016. The actor behind the manipulation was PT. Hanson International Tbk (MYRX). The manipulation came into light due to the investigation of another case, a violation of Financial Accounting Standards no. 44 on Accounting for Real Estate Activities by the same company. PT Bank Bukopin Tbk has revised its 2015, 2016, and 2017 financial statements, led the Financial Services Authority (OJK) to commence an investigation based on an allegation of financial statement manipulations. PT Garuda Indonesia (Persero) Tbk was also found to manipulate its 2018 earnings statement. This case was revealed in 2019 following an examination of its financial statements by The Audit Board of Indonesia (BPK). The same BPK also discovered PT Asuransi Jiwasraya (AJS), in 2006, manipulated its financial statement manipulation through window dressing. Only in early 2020, this case was exposed.

## **2. METHODOLOGY**

The research belongs to quantitative comparative (casual comparative research) in which this type of research is conducted descriptively to find out answers fundamentally about the factors that cause or trigger the appearance of a particular phenomenon (earnings management: the beauty and the beast). Therefore, this research used hypothesis testing. An extended period of eleven years was spent on the descriptive research of this study. Quantitative methods are methods that try to understand through positivist, a rationalistic inquiry

from the outside, and functionalist perspectives (BURREL & MORGAN, 1979; GUBA & LINCOLN, 1982; GUBA, 1990).

The population was companies listed on the Indonesia Stock Exchange during 2008-2018. The companies were never unlisted during that period. In this study, there are 676 companies from the Indonesian Stock Exchange administered as the population. The sampling technique used was non-probability sampling, with judgment sampling or purposive sampling. Thus the sample was chosen based on particular conditions and specific characteristics so that it could be assessed based on scientific considerations, such as 1) Samples were public companies listed in the Indonesia Stock Exchange from 2008 through 2018, 2) Sample had data of their 2008-2018 financial statements which served as useful information for this study, 3) Sample was never delisted during 2008-2018.

Discretionary accruals were used in this research to measure the earnings management. The outcome value was obtained by calculating the values of the companies' earnings management practices from 2008 – 2018. The formula is presented in the following (JONES, 1991; DECHOW et al., 1995):

$$1. \quad \mathbf{TAC}_{it} = \mathbf{EXBT}_{it} - \mathbf{OCF}_{it}$$

Notes:

- $\mathbf{TAC}_{it}$  : Total Accruals of a company  $i$  in period  $t$
- $\mathbf{EXBT}_{it}$  : Earning Before Extraordinary Item of a company  $i$  in period  $t$
- $\mathbf{OCF}_{it}$  : Operating Cash Flow company  $i$  in period  $t$



The regression equation above is used to calculate the company's total accruals. NDAC is calculated by applying the coefficients as follows:

$$2. \frac{TAC_{it}}{TA_{it-1}} = \alpha_1(\frac{1}{TA_{it-1}}) + \alpha_2 \frac{[(\alpha REV_{it} - \alpha REC_{it})]}{TA_{it-1}} + \alpha_3 \frac{(PPE_{it})}{TA_{it-1}}$$

$$3. \frac{NDAC_{it}}{TA_{it-1}} = \alpha_1(\frac{1}{TA_{it-1}}) + \alpha_2 \frac{[(\alpha REV_{it} - \alpha REC_{it})]}{TA_{it-1}} + \alpha_3 \frac{(PPE_{it})}{TA_{it-1}}$$

$$4. \frac{DAC_{it}}{TA_{it-1}} = \frac{(TAC_{it})}{TA_{it-1}} - \frac{NDAC_{it}}{TA_{it-1}}$$

Note:

- $TA_{it-1}$  : Total Assets of a company  $i$  in period  $t$
- $REV_{it}$  : Total Revenue of company  $i$  in period  $t$
- $REC_{it}$  : Total Receivable of a company  $i$  in period  $t$
- $PPE_{it}$  : Total Fixed Assets (gross) of a company  $i$  in period  $t$

The value of earnings management obtained would be analyzed based on the company's annual financial statement.

No.	Variable	Variable Information	Data Source
1.	$TAC_t$	Total Accruals company (i) in period (t)	Ratio
2.	$EXBT_t$	Earnings Before Extraordinary Item company (i) in period (t)	Osiris
3.	$OCF_t$	Operating Cash Flow company (i) in period (t)	Osiris
4.	$NDAC_t$	Non-Discretionary Accruals company (i) in period (t)	Ratio
5.	$TA_{t-1}$	Total Assets of the company (i) in period (t)	Osiris
6.	$REV_t$	Total Revenue company (i) in period (t)	Osiris
7.	$REC_t$	Total Receivable company (i) in period (t)	Osiris
8.	$PPE_t$	Fixed Asset Value of the company (i) in period (t)	Osiris
9.	$DAC_t$	Discretionary Accruals company (i) in period (t)	Ratio

Table 1: Mapping of Research Variable Measurement

All companies would be observed in terms of their industry, earnings management patterns, and the "momentum" of the earnings management. Thus, the moment and pattern observed would be associated with the hypothesis and also the earnings management's other points of view, no matter whether they were "good" or "bad." The sustainability of the companies, based on their existence in the Indonesia Stock Exchange for eleven years (2008-2018), would also be under observation. It is to strengthen the pattern of earnings management allegedly carried out by companies in Indonesia for the sustainability of the company.

### **3. RESULTS and DISCUSSION**

Data already in had would then be classified based on criteria. The 583 companies out of 676 total companies did not meet the criteria and were removed from the list of research observations. Such non-fulfillment of criteria was mostly due to the difference of various industry criteria, leading to the availability of required data. It inevitably affects the accounting standards widely used by companies. Such finding thus supports the urgent call to all companies of various industries to adopt the same standards applied in all countries, for example, international accounting standards which will prove useful to uniform financial statements. Thus it is understandable why several modern countries try to implement financial statement standardization when they find that particular financial data is beneficial for various parties and economic development between countries.

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
DAC	1023	-54.71652	.29590	-1.4446933	2.99750778
Valid N (listwise)	1023				

Source: IBM SPSS, 2020.

Table 2: Result of descriptive statistics test

Data processing on earnings management practices of 93 selected companies in Indonesia in eleven years (2008-2018) resulted in 1,023 pieces of data. This descriptive statistics test concluded that the minimum earnings management value obtained was -54.71652. This value becomes an indication that some companies in Indonesia still practiced earnings management. Such earnings management practices took place in 2010, the same year, the global economic recovery cycle occurred. Consequently, domestic economic performance in 2010 continued to improve. Inflation until mid-2010 was also under control. In the second semester of 2010, however, the intensity experienced a supply disruption, especially of food, which brought considerable pressure on inflation, triggering a higher value of inflation than 2010 inflation target. Several companies were affected by this condition, driving them to conduct an earnings management. There is another assumption that stated that most company profits were still in the form of receivables, which in turn caused the operational cash flow drop and pseudo-profit (earnings which are still not classified due to their cash inflows).

The maximum value of earnings management, on the other hand, is 0.29590. This outcome shows that there were still companies in Indonesia that did not resort to earnings management. Thus, these results provide hope and confidence for domestic and foreign investors

that the presented company's financial statements are not "always" manipulated through the practice of earnings management. This evidence also encourages foreign investors to cast their doubts over investing in Indonesia. Although some companies in Indonesia conduct earnings management, there are still many other companies that do not perform it.

For eleven years (2008-2018), this study also classified the values of earnings management based on the types of industries those companies belong to. There are as many as 93 companies divided into eight (8) industry types in this study, namely, i) the telecommunications industry covers three (3) companies; ii) the mining and oil industries: sixteen (16) companies; iii) the paper industry: four (4) companies; iv) the textile industry: two (2) companies; v) property, real estate, and contractor industries: eleven (11) companies; vi) food and beverage manufacturing industry: seven (7) companies; vii) plantation manufacturing industry: five (5) companies, and viii) retail and other manufacturing industries: forty-five (45) companies. The classification and its discussion are presented in the following.

No.	Stock Code	Year										
		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
1	TLKM	-0.666	-0.663	-0.689	-0.692	-0.693	-0.649	-0.633	-0.617	-0.648	-0.647	-0.635
2	ISAT	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000
3	EXCL	-0.339	-0.502	-0.642	-0.587	-0.592	-0.529	-0.370	-0.390	-0.390	-0.407	-0.399

Source: Data Processing Result, 2020.

Table 3: Earnings Management (DAC) in Telecommunication Industry Company

Table 3 presents three selected telecommunication industry companies that met the data sample criteria. The values of earnings management (discretionary accruals) calculated show that there are two discretionary accruals (DAC) categories, namely  $DAC = 0$  and  $DAC < 0$ .  $DAC \text{ value} = 0$  means that the company does not conduct earnings management, and its financial statements are reliable. The company prepared its financial statements following applicable standards and conditions honestly and openly.  $DAC \text{ value} < 0$  indicates that investors must be meticulously careful with the minus figures. A value lower than -1 means the company is indicated to employ earnings management by lowering profits. If the value of earnings management (DAC) is only slightly lower than -0, it does not fully indicate that the company practices earnings management. Thus, in general, there is no strong indication that telecommunication companies in Indonesia employ earnings management.

No.	Stock Code	Year										
		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
1	PGAS	-0.501	-0.629	-0.617	-0.632	-0.660	-0.696	-0.572	-0.473	-0.430	-0.437	-0.488
2	ADRO	-0.866	-0.394	-0.562	-0.453	-0.377	-0.397	-0.412	-0.476	-0.418	-0.460	-0.473
3	INDY	-2.129	-2.788	-4.497	-5.110	-6.827	-7.723	-8.587	-12.318	-16.849	-8.652	-8.691
4	ANTM	-0.936	-0.876	-0.710	-0.681	-0.530	-0.517	-0.428	-0.347	-0.304	-0.421	-0.758
5	ITMG	-1.345	-1.259	-1.531	-1.509	-1.636	-1.643	-1.483	-1.349	-1.131	-1.244	-1.392
6	AKRA	-1.480	-1.477	-1.032	-1.257	-0.983	-0.766	-0.884	-0.903	-0.888	-1.157	-1.061
7	PTBA	-1.551	-1.109	-1.398	-1.634	-1.703	-1.913	-1.512	-1.170	-0.819	-0.834	-0.975
8	MEDC	-0.650	-0.328	-0.409	-0.442	-0.415	-0.353	-0.282	-0.217	-0.175	-0.191	-0.249
9	GEMS	-0.465	-0.228	-0.898	-0.380	-0.484	-0.572	-0.634	-0.482	-0.407	-0.245	-0.217
10	TBMS	-0.030	-0.027	-0.024	-0.025	-0.025	-0.037	-0.040	-0.054	-0.060	-0.057	-0.055
11	ELSA	-0.767	-0.870	-1.145	-1.075	-1.113	-0.941	-0.992	-0.858	-0.865	-1.027	-1.172
12	ENRG	-0.441	-0.370	-0.586	-0.722	-1.181	-1.589	-1.890	-1.835	-2.557	-4.479	-5.435

13	MYOH	-0.142	-0.104	-0.385	-0.207	-1.154	-0.351	-0.322	-0.207	-0.141	-0.181	-0.221
14	DOID	-0.104	-0.049	-0.047	-0.037	-4.460	-6.771	-9.304	-11.974	-11.389	-11.440	-10.737
15	INCO	-0.491	-0.378	-0.381	-0.361	-0.335	-0.274	-0.322	-0.300	-0.317	-0.427	-0.505
16	KKGI	-4.177	-2.066	-4.678	-4.543	-0.531	-0.833	-0.976	-1.066	-1.426	-6.740	-6.833

Table 4: Earnings Management (DAC) in the Mining and Oil Industry Company

Source: Data Processing Result, 2020.

Table 4 shows 16 mining and oil industry companies that met the criteria for the sample data. The values of earnings management (discretionary accruals) obtained show that there appears to be one category of discretionary accruals (DAC), namely  $DAC < 0$ . If the DAC value is  $< 0$ , then investors must be aware and careful about the minus figure that results from the computation. If the result is than -1, then there is an indication that a particular company performed earnings management by lowering profits. However, if the value of earnings management (DAC) is only slightly above -0, then the score does not sufficiently indicate that the company practiced earnings management. So, in general, there are mining and oil companies in Indonesia that still practice earnings management. These results trigger new allegations about how effective the applicable regulations on earnings management in the mining and oil industry in Indonesia are so far.

No.	Stock Code	Year										
		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
1	INKP	-0.535	-0.555	-0.734	-0.959	-0.829	-0.952	-0.916	-0.799	-0.929	-0.875	-0.687
2	TKIM	-0.293	-0.327	-0.244	-0.263	-0.288	-0.376	-0.319	-0.350	-0.444	-0.587	-0.528
3	FASW	-0.814	-0.745	-0.754	-0.836	-0.716	-0.873	-0.980	-0.712	-0.687	-0.786	-0.909

Source: Data Processing Result, 2020.

Table 5: Earnings Management (DAC) in Paper Industry  
Company

Four paper industry companies that met the data sample criteria are listed in Table 5. Earnings management value (discretionary accruals) resulted from the computation shows that there is one discretionary accruals category (DAC), the one with  $DAC < 0$ . If the DAC score is lower than 0, investors need to pay attention to the figures carefully. A figure lower than -1 means that the particular company has a strong indication of practicing earnings management through lowering its profit. An earnings management (DAC) value slightly lower than -0; on the other hand, signals that the company in question is not firmly indicated to have practiced earnings management. Three (3) companies have a 2008-2018 DAC of -0, so it is fair to assume that those companies belonging to the paper industry did not practice earnings management.

No.	Stock Code	Year										
		2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
1	INAF	-	-	-	-	-	-	-	-	-	-	-
		8.832	9.238	11.184	10.636	12.973	13.634	13.666	13.147	12.399	13.424	14.512
2	CNT	-	-	-0.792	-1.115	-0.914	-1.005	-0.273	-1.031	-0.833	-0.689	-0.870
	X	0.873	0.717									

Source: Data Processing Result, 2020.

Table 6: Earnings Management (DAC) in Textile Industry  
Companie

#### 4. CONCLUSION

Data on financial statements in this research only included an annual financial statement that had been audited by external auditors.

It will be interesting to follow up on this research by emphasizing the role of external auditors in lowering earnings management practices in Indonesia or foreign countries. It is difficult to decide whether earnings management practices are legal or not. Creative methods are employing different accounting techniques for financial statement composition, which make financial statements look better and more reasonable. However, this statement seems to adjust the practices of earnings management. Several companies have succeeded in making it appear acceptable through certain conditions, accruals, adjustments that lower the values, revenue recognition, and deferral. On the other hand, the motive of practicing earning management appears only to meet targets on budgets/incentives and market income expectations or income smoothing to show an ever-increasing trend. Thus, it was concluded that earnings management would turn out to be a fraud when the company provides a material misstatement on purpose.

Scholars doing previous researchers are still debating theories on earnings management practice. However, the empirical conclusions from processed data should drive the government and accounting standard board to firmly apply the regulations of the ratio of the earnings management (discretionary accruals), so there is clear guidance on the legal protection for the parties involved. The progress of a country can be analyzed from its economy, which is governed by the number of regulations. When there are too many regulations, and they do not work, the functions of the regulator are questioned.

The researchers also offered some recommendations to the government, standard board, and the next researchers. Financial



statement composers are expected not to practice earnings management (discretionary accruals) and provide financial information that genuinely reflects the conditions of the company, thus achieving the qualitative characteristics of the accounting information. Investors and potential investors alike, creditors, government, and other stakeholders should be more cautious and meticulous when analyzing the earning power of the company, and should not solely rely on the earnings indicators in the company's financial statements. The government must start to affirm and regulate the scale of the ratio of earnings management (discretionary accruals) in the composition of financial statements of a company or other business entity in order to increase supervision and narrow gaps for management to stop the managements from practicing earnings management. Academic community and researchers should continue to perform more, which will be more useful in revealing other philosophical aspects related to earnings management.

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