

Earnings Management

Hasil Penelitian Manajemen Laba di 34 Negara

Sumber: Bhattacharya, *et al.* (2003, p.670)

Earnings Aggressiveness**Loss Avoidance****Earnings Smoothing****Overall Earning Opacity
(Earnings Management)**

Least, 1

Portugal
Belgium
The Netherlands
Germany
Switzerland
United States
Denmark

Brazil
Mexico
Australia
United States
Norway
Ireland
Denmark

Turkey
United States
Brazil
Norway
Mexico
Canada
Australia

United States
Norway
Portugal
Brazil
Belgium
Mexico
Canada

2

France
Spain
Finland
Austria
Canada
Thailand
Norway

France
United Kingdom
Belgium
Sweden
Portugal
Canada
Hong Kong

Taiwan
Spain
France
Thailand
Sweden
United Kingdom
India

France
Australia
Spain
United Kingdom
Denmark
Switzerland
Sweden

3

Italy
United Kingdom
Pakistan
Ireland
Australia
Sweden
Singapore

The Netherlands
South Africa
Austria
Singapore
South Korea
Malaysia
Germany

Hong Kong
Portugal
Indonesia
Malaysia
Switzerland
Finland
Singapore

Germany
The Netherlands
Finland
Austria
Thailand
Ireland
Hong Kong

4

Taiwan
Chile
Japan
South Africa
Brazil
Mexico
Hong Kong

Italy
Spain
Switzerland
Japan
Finland
Pakistan
Chile

Belgium
South Africa
Austria
Germany
Ireland
Pakistan
Denmark

Singapore
Taiwan
Turkey
South Africa
Malaysia
Italy
Pakistan

Most, 5

Malaysia
South Korea
Indonesia
India
Greece
Turkey

Greece
Turkey
Taiwan
Thailand
India
Indonesia

Chile
Greece
Japan
The Netherlands
Italy
South Korea

Japan
Chile
India
Indonesia
South Korea
Greece

What is Earnings Management ?

- *“...a purposeful intervention in the external financial reporting process, with the intent of obtaining some private gain*
(Schipper, 1989: “Commentary Earnings Management”, *Accounting Horizon*).
- *“Earnings management occurs when managers use judgment in financial reporting and in structuring transactions to alter financial reports to either mislead some stakeholders about the underlying economic performance of the company, or to influence contractual outcomes that depend on reported accounting numbers”*
(Healy dan Wahlen, 1999: “A Review of the Earnings Management”, *Accounting Horizon*)
- *Given that managers can choose accounting policies from a set of policies (for example, GAAP), it is natural to expect that they will choose policies so as to maximize their own utility and/or the market value of the firm. This is called earnings management*
(Scott, 2003, “Financial Accounting Theory” , Third Edition)

Distinction between Earnings Management and Fraud

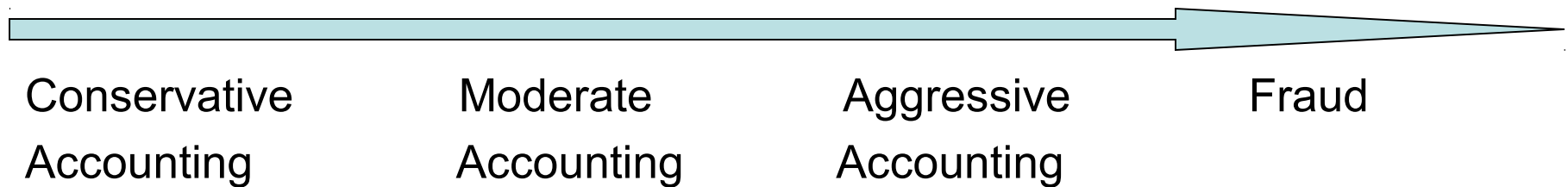
Fraudulent Financial Reporting

“the intentional, deliberate, misstatement or omission of material facts or accounting data, which is misleading and, when considered with all the information made available, would cause the reader to change or alter his or her judgment or decision”

(Definisi *financial fraud* oleh *National Association of Certified Fraud Examiners*, 1993).

The Distinction between Earnings Management and Fraud

- Earnings management includes the whole spectrum, from conservative accounting through fraud, a huge range for accounting judgment, given the incentives of management.



- The objective of accounting information is to explain financial and economic reality, including both performance and the financial position of company. The chief financial officer (CFO) develops a perspective on what this economic reality is and how it should be reported.

With this approach, earnings management is the planning and control of the accounting and reporting system to meet the personal objective of management

Accounting Choices

“Real” Cash Flow Choices

Within GAAP

“Conservative”
Accounting

Overly aggressive recognition of provisions or reserve
Overvaluation of acquired in-process R&D in purchase acquisition
Overstatement of restructuring charges and asset write-offs

Delaying sales
Accelerating R&D or Advertising expenditures

“Neutral”
Earnings

Earnings that result from a neutral operation of the process

“Aggressive”
Accounting

Understatement of the provision for bad debts
Drawing down provisions or reserves in an overly aggressive manner

Accelerating sales
Postponing R&D or Advertising expenditures

Violate GAAP

“Fraudulent”
Accounting

Recording sales before they are “realizable”
Recording fictitious sales
Backdating sales invoices
Overstating inventory by recording fictitious inventory

Motivations For Earnings Management

● Capital Market Motivations

The widespread use of accounting information by investors and financial analysts to help value stocks can create an incentive for managers to manipulate earnings in attempt to influence stock price performance (include meeting analysts expectation, or maximizing proceed from initial share issues).

● Contracting Motivations

Accounting data are used to help monitor and regulate the contracts between the firm and its many stakeholders (lending contracts, or management compensation contracts)

● Regulatory Motivations

The effects of two forms of regulation : industry specific regulation and anti trust regulation. Accounting standard setters have demonstrated an interest in earnings management to circumvent industry regulation (banking, utility industries). Standard setters may also be interested in earnings management for anti-trust purposes.

Other Motivations For Earnings Management

● Taxation Motivations

Income taxation is perhaps the most obvious motivation for earnings management (firms use LIFO for tax purposes). However, taxation authorities tend to impose their own accounting rules for calculation of taxation income, thereby reducing firms' room to maneuver.

● Changes of CEO

CEOs of poorly performing firms may income-maximize to prevent or postpone being fired.

Alternatively, CEOs may take a bath so as to increase the probability of positive future earnings. This motivation also applies to new CEOs, especially if large write-offs can be blamed on the previous CEO.

Earnings Management Techniques

- ➡ The most common of earnings management techniques involves simply using the flexibility that exists in GAAP (include changing depreciation method, changing the useful lives and the estimates of salvage value for depreciation, determining the allowance for uncollectible accounts receivable, estimating the stage of completion of percentage-of-completion contract, etc)
- ➡ Abusive earnings management (Levitt, 1998) include big bath charges, creative acquisition accounting, cookie jar reserves, materiality, and revenue recognition.
- ➡ Earnings management techniques (Giroux, 2004) include:
 - Aggressive revenue recognition (recognizing revenues early in the operating cycle),
 - Capitalizing rather than expensing operating cost,
 - Allocating costs over longer period (increasing the estimated useful lives of fixed assets)

Is Earnings Management Good or Bad ?

➡ Contracting Perspective (Scott, 2003)

Good earnings management.

Under "efficient contracting", it is desirable to give managers some ability to manage earnings in the face of incomplete and rigid contracts (bonus, debt covenant, & political). Thus, we would expect some earnings management to persist for efficient contract.

In "a financial reporting context, earnings management can be a device to convey inside information to the market, enabling share price to better reflect the firm's future prospects.

Bad earnings management.

From contracting perspective, this can result from opportunistic manager behavior. Example, the tendency of managers to use earnings management to maximize their bonuses (Healy, 1985), debt covenant violations (Dechow, *et al.*, 1996).

In a financial reporting context, earnings management can be used to increase reported net income in the short run for raising new share capital. Example: speeding up revenue recognition, lengthening the useful life of assets, etc.

Is Earnings Management Good or Bad?

➡ **CEO Perspective** (Mulford & Comiskey, 2002, p.82)

Good earnings management as reasonable and proper practices that are part of operating a well-managed business and delivering value to shareholders

Bad earnings management, that is, improper earnings management, is intervening to hide real operating performance by creating artificial accounting entries or stretching estimates beyond a point of reasonableness.

➡ **Abusive earnings management** (Levitt, 1998)

“Abuses such as earnings management occur when people exploit flexibility in accounting. Trickery is employed to obscure actual financial volatility. This, in turn, mask the true consequences of management’s decisions.

Earnings Management Environment

➡ Corporate Governance

The governance structure includes the board of directors, the functions of the committees, the interaction of the board with management, and auditing.

➡ Auditing

The external auditors must have the ability to discover significant discrepancies with GAAP (competence) and willingness to report the discrepancies to the audit committee or other relevant bodies (independence)

➡ Accounting regulation and Standard Setting

Securities and Exchange Commission (SEC) is responsible for regulating the entire equity capital market structure.

➡ Earnings restatement

An earnings restatement is the revision of public financial information that was previously reported. It represents real evidence of past earnings manipulation.

How to Detect Earnings Management

Analysis of earnings management often focuses on management's use of discretionary accruals.

Discretionary Accruals Model :

- Healy Model (1985)

Tests for earnings management by comparing mean total accruals (scaled by lagged total assets) across the earnings management partitioning variable.

$$NDA_t = \frac{\sum_t TA_t}{T}$$

Discretionary Accruals Model

➡ DeAngelo Model (1986)

Tests earnings management by computing first differences in total accruals, and by assuming that the first differences have an expected value of zero under the null hypothesis of no earnings management.

$$NDA_T = TA_{T-1}$$

➡ Jones Model (1991)

The model attempts to control for the effect of changes in a firm's economic circumstances on nondiscretionary accruals.

$$NDA_T = \alpha_1 (1/A_{T-1}) + \alpha_2 (\Delta REV_T) + \alpha_3 (PPE_T)$$

Kasus : PT Indofarma

- PT Indofarma merupakan perusahaan milik negara (BUMN) di bidang farmasi.
- Tahun 2002, manajemen melakukan *mark-up* atas laba yang dilaporkan.

Triwulan 1 : perseroan meraih laba hanya Rp.6,62 Miliar,
dilaporkan laba sebesar Rp.15,92 Miliar

Triwulan 2 : perseroan rugi Rp.12,62 Miliar, dilaporkan laba
Rp45,31 Miliar

Triwulan 3 : perseroan rugi Rp.1,41 M, dilaporkan laba
Rp88,57 Miliar

Faktor-faktor Penyebab Kesalahan (Mark-up)

- Tidak akuratnya data tentang stok produksi di 29 cabang milik perusahaan, yaitu PT Indofarma Global Medika, mengakibatkan selisih Rp.57,16M
- Nilai barang dalam proses *overstated*, disajikan pada laporan keuangan 2001, akibatnya HPP *understated* & laba bersih mengalami *overstated*.
Tidak akuratnya perhitungan HPP, manajemen mengira masih ada margin laba yang cukup besar sehingga meningkatkan diskon dari 27% sampai triwulan III menjadi 43% di triwulan IV.
- Tahun 2002 perusahaan merugi karena adanya tekanan beban pokok penjualan yang meningkat 70% selama 2,5 tahun terakhir.

Tindakan Bapepam

- PT Indofarma dikenakan denda Rp.500juta
- Direksi lama PT Indofarma dikenakan denda Rp.1 Miliar
- Partner KAP Hadori Tuanakotta & Mustofa (HTM) didenda Rp.100 juta, karena dinyatakan tidak berhasil mengatasi risiko audit dalam mendeteksi adanya penggelembungan laba yang dilakukan oleh kliennya.