Effect the Real Earnings Management on The Earning Quality (Study on Companies Registered in Islamic Capital Market (DES) And Non DES In Indonesia Stock Exchange, 2008 – 2012)

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Abstract: This study is aimed to test and provide empirical evidence of the effect of real earnings management on earnings quality in DES and Non DES firms. The study used a research sample of 990 companies listed on the Indonesia Stock Exchange in 2008-2012. This study uses Earnings Distribution Analysis (EDA) as a method of real earnings management. The results showed that the real earning management with the method of sales manipulation, overproduction, and Discretionary Expense had no effect on earnings quality at DES companies. The same case also work for Non DES companies, where the real earning management by the method of sales manipulation and overproduction does not affect the earnings quality, while Discretionary Expense affect the eranings quality.

Keywords: Real earnings management, earning quality, sales manipulation, overproduction, and Discretionary Expense.

Introduction

In relation to financial statements, earnings management becomes an interesting discussion with regard to delivery of information related to earnings. Earnings management can be categorized as unethical behavior in submitting accounting number, so that it can provide financial informationthat less relevant to stakeholders (Obid and Demikha, 2011). Earnings management is carried out with the aim of obtaining reasonable earnings quality and meeting shareholder expectationsas well as meeting the requirements set by the party authorized by the regulator (Francis et al., 2008). Its has something in common with increasing earnings which is represented by accrual quality (Lo, 2008).

Gunny (2005) shows that there are three categories of earnings management, namely fraud of accounting, accrual earnings management, and manipulation of real earnings. The development of empirical research on earnings manipulation shows that real earnings management is more than accruals. Gunny (2005), Graham et al. (2005), Roychowdhury (2006), Zang (2006), and Cohen et al. (2008) found that agents had begun to avoid accrual earning management toward real methods after the Sarbanes-Oxley Act (SOX).

The implementation of IFRS convergence in Indonesia in Financial Accounting Standards began in 2008, while the first target of implementing IFRS adoption could be done in 2012 (Supratin & Tresnaningsih, 2013). According to Chen et al. (2010), the implementation of IFRS has an impact on improving accounting quality, reducing earnings management activities, lower amount of accrual discretion, absolute value, and a tendency to higher accrual quality. In practice, stock trading on the Indonesia Stock Exchange (IDX) includes companies listed in the Islamic Capital Market (DES) and Non DES. Yuliana and Alim's research (2017) there are differences in real earnings manipulation measures between companies listed in conventional capital markets compared to DES

Research on real Earnings management was carried out by Roychowdhury (2006) and Gunny (2010) by identifying companies that manipulate real earnings using the Earnings Distribution Analysis (EDA) technique. This study answers the problem regarding the effect of real earnings management on earnings quality in DES and Non DES companieson the Indonesia Stock Exchange from 2008 to 2012.

Literature Review

Agency theory

This theory was first proposed by Jensen and Meckling (1976) who stated that agency theory is a theory of the inequality of interests between the owner (principal) and management (agent). Agency theory is based on the contractual relationship between shareholders or owners and management or managers. Managers have the authority to manage the company and make decisions in managing the company.
The relationship between agents and principals will cause problems if there is information asymmetry. Scott (1997) states that if more information will be obtained by parties involved in the business than outsiders, it can be said to be asymmetric. This can be in the form of differences in agents and stakeholders in receiving information, and it is impossible for principals to directly observe the efforts of agents. This causes agents to do disfunctional behavior.
One of the disfunctional behaviors carried out by agents is the manipulated financial reports in order that they are in line with the expectations of the principal. Data manipulation in these financial reports can be like earning management.

Signaling Theory

Signal theory is based on the understanding that there is an inequality of information received by each party. Therefore signal theory is closely related to information asymmetry. Signal theory describes how companies should provide signals to users of financial statements. These signals illustrate what management has done in managing the company to provide the best information to stakeholders. This information shows that the company is better than other companies. Signaling according to Brigham and Houston (2001) is an act of management to provide signals for interested parties about the potential of the company they manage.
The purpose of this information is to motivate earnings management. According to Agmarina (2011), there are two objectives that motivate company management to carry out earnings management, namely opportunistic goals and information purposes for investors. The purpose of this information is to provide prosperity signals to investors. Armando and Farahmita (2012) state that real earnings management is not something opportunist, but rather functions as signaling.

Earnings management

Roychowdhury (2006) states that earnings management can be done by means of pure accrual manipulation or by manipulating real activities. Earnings management with pure accrual manipulation is a manipulation of earnings with discretionary accruals that have no direct effect on cash flows. Accrual earnings management is carried out at the end of the period when the manager knows the Earnings before it is engineered so that they can find out how much manipulation is needed to achieve the Earnings target. Basically, the manipulation of accrual earnings is limited by GAAP and this manipulation can be

detected by auditors, investors or government agencies so that it can have an impact on share prices and even lead to bankruptcy or legal cases.
Earnings management through real transactions is defined as an act of manipulation that deviates from real business practices and is carried out with the main objective of meeting earnings expectations (Roychowdhury, 2006; Cohen, 2008). Zang (2008) provides empirical evidence that real earnings management is carried out before accrual-based earnings management.
According to (Roychowdhury, 2006) real earnings management can be done in three ways, namely:

1. Sales manipulation
   Sales manipulation is an attempt to temporarily increase sales within a certain period by offering overproduct price discounts or providing more lenient credit terms. This strategy can increase sales volume and Earnings for the current period, assuming positive margins. However, discounting rates and more lenient credit terms will reduce the current period's cash flow.
2. Decrease in Discretionary Expense
   Discretionary expenses can be reduced or even eliminated without having an impact on profits. Companies can reduce the burden of research or advertising. This increases current profits, but can decrease profits and cash flow in future periods.
3. Overproduction
   In order to increase profit, manager will reduce the company's fixed cost by increasing production so as to reduce the cost of other items sold.

Earnings Quality

The definition of earnings quality according to Amilin (2008) can be determined by referring to the value which indicates how much Earnings can generate cash. Meanwhile, according to Grahita (2001), quality accounting earnings can be defined as Earningss that have a little perceived noise in them, and can reflect the company's actual financial performance. Earnings in accounting can be interpreted as the difference between realized revenue from company transactions that occurred during one period and the costs associated with that income (Chariri, 2005).

Islamic Capital Market (DES)

Sharia shares are securities in the form of shares that do not conflict with Islamic principles. In terms of the definition of Islamic shares, it refers to the regulations governing shares such as the OJK. Sharia shares in Indonesia are regulated based on POJK Number 35 / POJK.04 / 2017 and POJK Number 17 / POJK.04 / 2015.

Hypothesis Development

The Effect of Real Earnings management with Sales Manipulation Method on Earnings Quality
Roychowdhury's research (2006) explains that many companies are starting to switch from manipulation through accruals to manipulation through real activities. This happens because the manipulation of earnings through accruals will be more easily detected by auditors and regulators so that the risks faced will be much greater. Cohen and Zarowin (2010) provide empirical evidence that companies carry out sales management in order to increase reported earnings by providing discounts and soft credit terms. Based on the above explanation, the following hypothesis is proposed:
H1: Real Earnings management using sales management has a significant effect on earnings quality in both DES and Non DES companies

The Effect of Real Earnings management with Overproduction Methods on Earnings Quality

Graham et.al. (2005) stated that companies switch to managing earnings management by using the real activity method. Although this technique is more expensive, it tends to be more difficult to detect. Real Earnings management through overproduction is done by overproduction. Company managers produce more goods than market demand. Managers assess that large-scale production can reduce the fixed cost per unit and lower production costs so that the cost of goods sold is smaller. The small cost of goods sold results in high operating margins and lower operating cash flow than normal sales levels. Therefore, it can increase the company's operating Earnings (Handayani, 2014). Based on the explanation above, the following hypothesis is proposed:

H2: Real Earnings management using overproduction has a significant effect on earnings quality in both DES and Non DES firms.

The Effect of Real Earnings management with Discretionary Expenses Method on Earnings Quality

Real earnings management through discretionary cost reduction is commonly done by managers by reducing discretionary costs. Companies can reduce Discretionary Expense to increase company Earningss. This is done by managers, when these expenses have not been converted into revenue and Earnings. If discretionary expenses are in the form of cash, the reduction in Discretionary Expense will have an impact on cash outflows so that it will have a positive impact on abnormal operating cash flows and possibly in future periods, causing low cash flows (Roychowdhury, 2006).

Cohen and Zarowin (2010) provide empirical evidence that companies reduce Discretionary Expense ahead of implementing SEO to increase Earningss. A reduction in Discretionary Expense incurs negative abnormal Discretionary Expense. Based on the explanation above, the following hypothesis is proposed:

H3: Manipulation of real earnings using discretionary expenses has a significant effect on earnings quality in both DES and Non DES companies.

Methods

This research is quantitative. Sampling in this study using purposive sampling method on companies that are on the IDX in the 2008-2012 observation year to test the hypotheses mentioned above. Researchers select a sample of companies to be studied based on the following criteria:

1. Companies listed on the BEI from 2008-2012 which are List of Sharia (DES) and Non-DES Securities.
2. The sample companies are companies that manipulate real earnings which are calculated using the Earnings Distribution Analysis (EDA) technique.

Research on real earnings management using Earnings Distribution Analysis (EDA) as a study has been conducted by Roychowdhury (2006), Gunny (2010), Lee (2011), Zhang (2014), and Yuliana and Alim (2017). According to (Roychowdhury, 2006) that there are three ways of earning magement, namely:

Sales manipulation

Abonormal cost of good sold is the difference between cost of good sold and normal cash flow which is calculated using the regression coefficient estimation of each sample. The regression equation is as follows:

$$COGS\ it\ /\ Ai,\ t\text{-}1 = \alpha\ 0 + \alpha\ 1\ (1\ /\ Ai,\ t\text{-}1) + \alpha\ 2\ (Sit\ /\ Ai,\ t\text{-}1) + \varepsilon\ it$$

By using the regression coefficient above, the normal value of cost of good sold can be calculated using the formula:

$$NCOGS\ it = \alpha\ 0 + \alpha\ 1\ (1\ /\ Ai, t\text{-}1) + \alpha\ 2\ (Sit\ /\ Ai, t\text{-}1) + \varepsilon\ it$$

Then the abnormal cost of good sold can be calculated as follows:

$$ACOGS\ it = COGS\ /\ Ai, t\text{-}1 - NCOGS\ it$$

Information:
ACOGS it = abnormal cost of good sold by company i in period t
NCOGS it = normal cost of good sold by company i in period t
COGS it = cost of good sold company i in period t
Ai, t-1 = total assets of company i in period t
S it = sales of company i in period t

Abnormal Discretionary Expense

Abonormal discretionary expense is the difference between actual discretionary expense and normal discretionary expense, which is calculated using the estimated regression coefficient from each sample. Discretionary expenses include R&D, selling, advertising, and general administrations expenses. If the R&D load and advertising aren't present, it can be calculated as zero. The regression equation is as follows:

$$DISEXP\ it\ /\ Ai, t\text{-}1 = \alpha\ 0 + \alpha\ 1\ (1\ /\ Ai, t\text{-}1) + \alpha\ 2\ (Sit\ /\ Ai, t\text{-}1) + \alpha\ 3\ (\Delta Sit\ /\ Ai, t\text{-}1) + \varepsilon\ it$$

The regression coefficient of actual discretionary expense above is entered into the equation below, to get the normal value of discretionary expense:

$$NDISEXP\ it = \alpha\ 0 + \alpha\ 1\ (1\ /\ Ai, t\text{-}1) + \alpha\ 2\ (Sit\ /\ Ai, t\text{-}1) + \alpha\ 3\ (\Delta Sit\ /\ Ai, t\text{-}1) + \varepsilon\ it$$

Furthermore, abnormal discretionary expense (ADISEXP) can be calculated as follows:

$$ADISEXP\ it = DISEXP\ it\ /\ Ai, t\text{-}1 - NDISEXP\ it$$

Information:
NDISEXP it = normal discretionary expense for company i in period t
DISEXP it = discretionary expenses company i in period t
Ai, t-1 = total assets of company i in period t
S it = sales of company i in period t

Overproduction

Overproduction occurs because the difference between the actual production cost and normal production is then calculated using the estimated regression coefficient from each sample. The regression equation is as follows:

$$PROD\ it\ /\ Ai, t\text{-}1 = \alpha\ 0 + \alpha\ 1\ (1\ /\ Ai, t\text{-}1) + \alpha\ 2\ (Sit\ /\ Ai, t\text{-}1) + \alpha\ 3\ (\Delta Sit\ /\ Ai, t\text{-}1) + \varepsilon\ it$$

$$PROD\ it = COGSit + \Delta INV\ it$$

The regression coefficient of the actual production cost above is entered into the equation below, to get the normal value of production cost:

$$NPROD\ it = \alpha\ 0 + \alpha\ 1\ (1\ /\ Ai, t\text{-}1) + \alpha\ 2\ (Sit\ /\ Ai, t\text{-}1) + \alpha\ 3\ (\Delta Sit\ /\ Ai, t\text{-}1) + \varepsilon\ it$$

Then the abnormal cost of good sold can be calculated as follows:

$$PROD\ it = PROD\ it\ /\ Ai, t\text{-}1 + NPROD\ it$$

Information:
APROD it = abnormal production cost company i in period t
NPROD it = normal production cost of company i in period t
PROD it = production cost company i in period t
Ai, t-1 = total assets of company i in period t
S it = sales of company i in period t
∆S it = the difference in sales of company i in period t

The dependent variable in this study is earnings quality (y) which is proxied following the Mc Nichol (2002) model as follows:

$$\Delta \boldsymbol{WC_{i,t}} = \emptyset_0 + \emptyset_1[\boldsymbol{CF_{i,t-1}}] + \emptyset_2[\boldsymbol{CF_{i,t}}] + \emptyset_3[\boldsymbol{CF_{i,t+1}}] + \emptyset_4 \Delta \boldsymbol{SALES_{i,t}} + \emptyset_5 \boldsymbol{PPE_{i,t}} + \emptyset \boldsymbol{\varepsilon_{i,t}}$$

$\Delta WC_{i,t}$ = Changes in capital presented in the company's operating cash flow i in year t, measured by increase in liabilities plus increase in inventories plus decrease's liabilities plus decrease's accrued tax plus increase or decrease in assets (liabilities), divided by total assets.
$CF_{i,t-1}$ = cash flow from operating in the past period from the company i in year t
$CF_{i,t}$ = cash flow from operating in the current period from the company i in year t
$CF_{i,t+1}$ = cash flow from operating in future periods of the company i in year t
$\Delta SALES_{i,t}$ = current period sales minus past period sales from the company i in year t
$PPE_{i,t}$ = fixed assets in the current period of the company i in year t
$\emptyset\varepsilon_{i,t}$ = error in the current period from company i in year t

The research model is as follows:
Y= α + β1X1 + β2X2 + β3X3 + DA + e

Where :
Y = earnings quality
α = constant
β 1X1 = Sales manipulation
β 2X2 = dicretionary expenditures
β 3X3 = overproduction
e = standard error

Findings

The sample used in this research were 990 companies listed on the BEI with the 2008 to 2012 observation years consisting of 631 companies - years in the DES)and 359 companies - years not included in DES (Non DES). as described on table:

Table 1 List of Samples

Sample List	**amount**
The company is included DES	631
Companies that are not included in DES (Non DES)	359
Total	**990**

Table 2 Descriptive Statistics

	N	Range	Minimum	Maximum	Mean	Std. Deviation
DES company						
MLR_PJ	631	159.342	-0.72915	0.86427	0.01989	0.00556
MLR_Prod	631	27,60554	-802.179	1.958.375	-0.10265	0.04985
MLR_BD	631	6,78516	-0.32809	645.707	0.02210	0.01244
Q.Acc	631	20,9261	-18,92775	1,99835	-0.07071	0.04596
Valid N (listwise)	631					
Non DES company						
MLR_PJ	359	1,92421	-0.65217	127.205	-0.01131	0.16858
MLR_Prod	359	18.627.326	-53,06626	133,20701	0.06077	7,79519
MLR_BD	359	1.627.669	-0.73142	15,54528	0.06173	1,1705
Q.Acc	359	3,65083	-1,93572	1,71511	0.12123	0.63017
Valid N (listwise)	359					

DES companies with real Earnings management with the lowest over-selling method are PT. CTRA in 2009 and the highest was PT. IMAS in 2008. Real Earnings management with the lowest overproduction method is PT. MLIA in 2009 and the highest was PT. DLTA 2009. Real Earnings management with the lowest discretionary cost method is PT. ANTM 2010 and real Earnings management with the highest discretionary cost method. PT. IMAS in 2008. The lowest Earnings quality for DES companies is PT. AALI in 2009 while the highest was PT. JECC 2012.

In Non DES companies, the practice of real Earnings management with the lowest over-selling method occurs at PT. TBLA in 2009 and the highest at PT. STTP in 2011. The lowest real Earnings management using the method of production at Non DES companies occurred at PT. TMPO in 2010 and the highest was PT. SIMA 2009. The Real earning management using the lowest discretionary cost method is PT. PBRX in 2010 and real Earnings management with the highest discretionary cost method. PT. STTP in 2011. The lowest earnings quality at Non DES companies occurred at PT. TRUB in 2009, while the lowest Earnings quality occurred at PT. TRUB in 2010.

Table 3 Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
DES company	(Constant)	-.065	.047		-1,394	.164
	MLR_PJ	-.518	.344	-.063	-1,508	.132
	MLR_Prod	-.011	.037	-.012	-289	.773
	MLR_BD	.156	.153	.042	1,017	.310
Non DES company	(Constant)	.118	.033		3,537	.000
	MLR_PJ	.044	.241	.012	.184	.854
	MLR_Prod	-3	.004	-.035	-646	.519
	MLR_BD	.062	.035	.116	1,777	.076

The test results show that the independent variables MLR_PJ (X1) and MLR_Prod (X2) have no partial effect on the dependent variable earnings quality (Y), both DES and Non DES companies. The MLR_BD variable (X3) has no effect on earnings quality (Y) at DES companies, but on the contrary it affects Non DES companies with a sig value of 0.076 which is smaller than the significance level of 0.10

Sales Manipulation on Earnings Quality

The results of H1 testing which stated that sales manipulation had a significant effect on earnings quality in both DES and Non DES companies was rejected. The test results show that the regression coefficient for sales manipulation is -0.518 and the t-value is -1.394 and the p value is 0.164 in DES, this value is not significant with a significance value of 0.10 which indicates that sales manipulation has no significant effect on earnings quality.

The same is the case with Non DES companies where the test results show the regression coefficient for sales manipulation is 0.044 and the t value is 0.184 and the p value is 0.854. This value is not significant with a significance value of 0.10 which indicates that sales manipulation has no significant effect on earnings quality.

The test results show that the Real earning managements from sales activities, both companies listed in DES and Non-Des, does not affect the quality of earnings. In contrast to research Firmansyah and Irawan (2018) say that the unsuccessful adoption of IFRS in Indonesia can reduce both accrual and real earnings management. This occurs because the Real earning managements from sales activities is difficult to read. According to Scott (2003) there are two ways to understand earnings manipulation, namely earnings manipulation. Earning management is considered opportunistic management or seen as a strategy to protect managers and the company. Protecting oneself is meant to achieve benefits for all parties and anticipate unexpected events.

Overproduction on Earnings Quality

H2 test results which state that overproduction has a significant effect on earnings quality in DES and Non DES companies is rejected. The test results show the regression coefficient for overproduction is -0.011 and the t-value is -0.289 and the p value is 0.773 at DES, this value is not significant with a significance value of 0.10 which indicates that overproduction has no significant effect on earnings quality. Similar to Non DES companies, the test results show the regression coefficient for overproduction is -0.003 and the t-value is -0.646 and the p value is 0.519. This value is not significant with a significance value of 0.10 which indicates that sales manipulation has no significant effect on earnings quality.

Overproduction is carried out to reduce the fixed cost per unit and lower cost of goods sold. Overproduction that is carried out will have an impact on the large amount of inventory from production, but overproduction will be an efficient strategy if the company also makes sales. So that overproduction accompanied by abnormal sales is considered an efficient business strategy.

The view of earnings management can be regarded as not an opportunist act as expressed by Armando and Farahmita (2012) state that earnings management through real activities is not opportunistic earnings management, but rather functions as signaling. In relation to signaling motivation, company management practices earnings management to provide prosperity signals to investors.

Discretionary Expense on Earnings Quality

The results of the H3 test which state that Discretionary Expense have a significant effect on earnings quality at DES companies are rejected, while Discretionary Expense have a significant effect on earnings quality in Non-DES companies. The test results show that the regression coefficient for Discretionary Expense is 0.156, the t value is 1.017 and the

p value is 0.310 at DES, this value is not significant with a significance value of 0.10 which indicates that Discretionary Expense have no significant effect on earnings quality. In contrast to the Non DES companies where the test results show the regression coefficient for Discretionary Expense is 0.062 and the t value is 1.777 and the p value is 0.076. This value is smaller than the significance value of 0.

The results of this study are in line with the research of Yuliana and Alim (2017) which shows that there are differences in real earnings management actions between companies listed on the conventional capital market compared to DES. The research also shows that DES is more appropriate in responding to real earnings manipulation than conventional capital markets.

A decrease in Discretionary Expense can reduce the reported expenses so that reducing Discretionary Expense such as R&D, advertising, and general administration costs increases Earningss and makes cash flow in the current period greater, but is likely to cause lower cash flows in the next period (Roychowdhury, 2006). The reduction in Discretionary Expense in the current year will be the cost in the following year which has an impact on the Earnings in the following year will be smaller.

Delays in Discretionary Expense can provide information asymmetry to users of financial statements. The reduction in discretionary expense is due to the opportunistic nature of management in the current year. The goal is to present a greater Earnings value in the current year.

Conclusion

The results of the study provide empirical evidence that Earnings management, which is proxied by oversales and production manipulation, does not have a significant effect on earnings quality for both DES and Non DES companies and for Discretionary Expense for DES companies does not affect earnings management. The pattern of real earnings management is still difficult to read, where the impact of real Earnings management is not immediately visible in the year of observation. Overproduction accompanied by abnormal sales is used as an efficient strategy to increase Earningss, departing from an understanding of Earnings management which considers Earnings management as business strategy to protect the company.

This study also provides empirical evidence that Discretionary Expense for Non DES companies have an effect on earnings quality. The reduction in Discretionary Expense in the current year makes a bigger Earnings in the current year, but will be the cost in the following year which has an impact on the Earnings in the following year will be smaller.

Based on the research results, the target discussion and conclusions for further research are:

1. Adding control variables in research that are determinants of earnings management
2. It is suggested that further researchers are expected to look for other data sources besides the Indonesia Stock Exchange

It is recommended for further researchers to expand the research sample, so that the next research sample can vary with the sample selection criteria.

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