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Motive Behind Earnings Management Practices in Public Property and Real Estate Companies

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Abstract

This study examined the antecedents and consequence variables of earnings management. This study explained the motive of earnings management practices by public property and real estate companies in Indonesia: opportunistic or efficient. Based on developing the hypotheses, the theory was an agency, positive accounting, and signaling theories. This study was explanatory research, which aims to explain the causal relationship between variables through hypothesis testing. This research's data were financial statements of public companies in Indonesia's property and real estate sector (2014-2018) with some criteria. There are 60 firm-years data used in the analysis. Hypothesis testing uses multiple linear regression two-stage. The first stage of testing examined the influence of earnings management factors, followed by the second stage of testing to reviewed the consequences of earnings management practices. The results showed debt and independent commissioners affect earnings management. Management performs more dominant earnings management because of opportunistic interests than maintaining market value and its shareholders' interests. The implication of this research was to provide a comprehensive discourse on the motives for earnings management behavior in Indonesia.
Keywords: Earnings Management, Efficient Motive, Opportunistic

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INTRODUCTION

Management has information asymmetry so that it can indirectly increase firm value through earnings management. Investors can misjudge companies due to limitations and the inability to observe the financial reporting process. As a result, earnings management measures are often seen as an attempt to deceive shareholders and investors.

Earnings management research is generally based on agency, positive accounting, and signaling theory. Agency theory refers to the emergence of a manager's self-interest priority rather than maximizing the principal (Agustia, 2013). The agency relationship can be in the form of a relationship between management and shareholders or management and creditors.

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Investors, commissioners, and creditors can carry out the monitoring mechanism. If supervision is carried out effectively can suppress management's negative incentives to undertake earnings engineering. The variables derived from the agency cost concept is the size of the commissioner board and independent commissioners as a form of shareholder supervision.

Positive accounting theory proposes two hypotheses. These hypotheses are the political cost and the debt covenant hypothesis. The political cost hypothesis assumes that companies getting closer to the emergence of political costs have an incentive to perform earnings management. Political costs are usually proxied by firm size. Larger companies tend to be more sensitive to political costs. Large companies become public attention compared to small companies (Rusmin, 2014). The debt covenant hypothesis predicts that companies close to the covenant threshold will choose an opportunistic accounting method. Management can be restricted from taking specific strategic actions if it exceeds the requirements required by creditors. This variable's significance on earnings management indicates management's desire to avoid political costs and debt covenants (Ekaterina, 2010; Saksessia & Firmansyah, 2020).

Signaling theory assumes asymmetric information that causes the average investor to underestimate the stocks of all companies. This situation is very detrimental to the good company so that it is motivated to convince investors or potential investors about the company (Moratis, 2018; Spinos, 2013). Managers can convey company prospects with signals based on the manager's understanding of the company. Earnings management practices are signals that corporate managers are giving investors.

Based on these three theories, this study examined the variable size of the board of commissioners and independent commissioners' existence as a representation from the agency perspective, firm size, and debt as a representation from a positive accounting perspective. The effect of earnings management on firm value as a representation from a signaling perspective. This study explains the phenomenon of earnings management practices by public property and real estate companies in Indonesia.

Previous earnings management studies have shown inconsistencies in results and the direction of relationships. Some researchers find a positive influence between firm size and earnings management for political costs (Amertha, Ulupui, & Putri, 2014; C. Chen, Weng, & Fan, 2016; Nalarreason, T., & Mardiati, 2019; Swastika, 2013). Some other researchers find a negative effect (Rusmin, 2014; Wahidahwati, 2012). Other researchers failed to find the influence of firm size variable (Laily, 2017; Sebastian & Handojo, 2019).

The high debt ratio encourages creditors to closely monitor the company (Ekaterina, 2010; Zamri, Rahman, & Isa, 2013). Contrary to this statement, other researcher proved that the effect of the debt variable was positive (Chou, Lin, Chan, & Chang, 2011; Kim, Lee, & Keun Yoo, 2020; Y. Liu, Ning, & Wallace N., 2010; Nalarreason et al., 2019). They gave an example of incentive management to convey information that can reduce risk perceptions in companies with high debt ratios.

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The effect of board size on earnings management also remains a contradiction. The greater the commissioners' board, the higher the likelihood that management will apply earnings management (X. Chen, Cheng, & Wang, 2015; Mahrani & Soewarno, 2018; Sebastian & Handojo, 2019). Many board members worsen coordination not to be significant (Idris, Abu Siam, & Nassar, 2018; Shaique, Guo, Shaikh, Khan, & Usman, 2017).

Recent empirical research examined the effect of earnings management on firm value. Consistency results have not shown an effect. The market provides exceptional value for companies that practice earnings management because they are considered more stable (Abbas, 2018; Dang, Nguyen, & Tran, 2020; Susanto, 2018). Different results are shown by the other researchers (T. Chen, 2016; Gottardo & Moisello, 2019; Savitri, Andreas, Syahza, Gumanti, & Abdullah, 2020; Yorke, Amidu, & Agyemin-Boateng, 2016). Their study found a negative effect on earnings management.

This study was conducted using an agency theory framework, positive accounting, and signaling simultaneously in contrast to previous studies. This test's implication would provide a comprehensive discourse on the supported of this theory in explaining earnings management behavior in Indonesia. Previous studies generally used a single approach and did not conduct joint testing.

Earnings management can be seen from the positive and negative sides, depending on the motivation that drives management to carry out this practice. This motivation can be seen as the manager's opportunistic motivation and efficiency motivation. The positive significance of the variable firm size and debt influence showed its response to political costs and debt covenants. The significance of firm value indicates the choice of management to signal company personal information. The commissioner board's size and independent commissioners' negative effect showed an attempt to hide company information.

The political cost hypothesis discusses the proximity of companies to political interests. Political costs suggest that firm size is an incentive for managers to exercise earnings management to avoid government inquiry and excessive public concern. The debt covenant hypothesis showed the manager's action to prevent technical default due to debt covenant violations (Spiceland, Yang, & Zhang, 2016).

Agency theory states that the firm can be represented as a contract between the principal and the agent entrusted with managing these resources. Efforts to maximize each party's utility lead to conflicts of interest between the principal and the agent. This conflict is known as agency conflict (An, Li, & Yu, 2016; Shiri, Vaghfi, Soltani, & Esmaeli, 2012; Yang, Tan, & Ding, 2017). Agents are required to maximize the principal's wealth. In contrast, the agent also has an interest in maximizing his welfare.

Earnings management is a management action that can be classified as accounting engineering (Shubita, 2020). To suppress these engineering actions, the principal must pay agency costs such as commissioners and independent commissioners' appointments.

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Agency cost is considered as a mechanism that can suppress earnings management practices.

From the perspective of signaling theory, earnings management is a signal for investors. Managers have information about the company's prospects. Management is motivated to signal information to outsiders so that the share price can be corrected to its actual value. Earnings management practices affect the firm value, as reflected by its share price.

As a signal, earnings management provides investors information to predict future earnings based on the current year's earnings. In other words, reported earnings in time series have persistence. Earnings management practice made earnings a useful predictor of future company performance (Ustman, Subekti, & Ghofar, 2016).

Firm Size and Earnings Management

Firm size is a measure that showed the boundaries of an organization that is being formed. The political cost hypothesis stated that large firms tend to pay more considerable political costs. Large companies are assumed to have more contractual ties. Each of these contracts has a level of commitment to the company and has implications for political costs.

Larger companies receive more attention from analysts and are better recognized than others. Managers manage earnings to avoid negative impacts that may occur. Some researchers have found that large companies are more likely to practice earnings management. The motivation is to prevent government interference, protect the reputation, and maintain earnings according to analysts and market expectations.

Differences in firm size can lead to differences in company characteristics or policies. The firm size can be an essential factor influencing management's motivation in managing earnings. This size is related to the intensity of supervision and public reputation. Previous research found that firm size on earnings management was positive (Amertha et al., 2014; Y. Chen, Wang, Zhang, & You, 2018; Nalarreason et al., 2019; Shu, Chiang, & Lin, 2012; Swastika, 2013). Based on the theory and empirical findings above, the first hypothesis (H1) predicted firm size positively influences earnings management tendencies.

Debt and Earnings Management

Sources of company funding apart from investors can also be obtained from debt. The debt covenant hypothesis stated that the closer the company is to the covenant limit, the management will manipulate the financial statements. Debt becomes an incentive for management to perform earnings management.

A high debt ratio increases the company's risk. This ratio level causes creditors to implement a control mechanism by imposing covenants. Company managers choose accounting procedures that shift future incomes to the current period. This tight monitoring is done if there are covenants related to net income. The reported increase in net income

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reduces the occurrence of technical defaults. In general, a covenant with a high debt ratio limits strategic decisions. When the company is close to bankruptcy, the company can manage earnings. Previous empirical research showed indications of the effect of debt on earnings management (Chou et al., 2011; Kim et al., 2020; Y. Liu et al., 2010; Nalarreason et al., 2019; Tonye & Seth Sokiri, 2020; Tulcanaza-Prieto, Lee, & Koo, 2020). Based on the theory and empirical findings above, the second hypothesis (H2) predicted debt positively influences earnings management tendencies.

Board of Commissioners Size and Earnings Management

The size of the commissioner board refers to the number of commissioners of a company. The number of commissioners is a crucial factor in board effectiveness. Previous studies have not shown consistency in the direction and significance of the effect of board size. The bigger the work effectiveness will decrease.

The size of the commissioner board has an impact on supervision. The more the commissioners' board is expected, the members' ability to supervise company operations will be more intensive due to the comprehensive experience and expertise. The board of commissioners is considered effective at reducing agency costs between shareholders and managers. The board of commissioners is responsible for minimizing conflicts of interest between management and shareholders by monitoring management actions against the company. A board's existence affected the quality of financial statements and suppressed earnings engineering by management (Kankanamage, 2016; J. Liu, Harris, & Omar, 2013; Savitri et al., 2020). Based on the theory and empirical findings above, the third hypothesis (H3) predicted the number of commissioner boards negatively influences earnings management tendencies.

Independent Commissioner

A company is required to have at least one independent commissioner. Independent board members are assumed to have contributed to monitoring and can keep aligning interests of the company.

The need for independent commissioners is based on the need to maintain the credibility of the financial statement. Several previous studies have shown that effective corporate governance, financial statements' reliability, and company performance increase with independent commissioners' presence. Companies that have external boards of commissioners are less likely to commit fraud.

An independent commissioner is a member of the board with the competence to work objectively. The absence of a relationship with the company makes objectively monitor the management. Better supervision reduced management's motivation to perform earnings management (Amin, Djuminah, & Suhardjanto, 2017; Busirin, Azmi, & Zakaria, 2015; X. Chen et al., 2015; J. Liu et al., 2013; Uwuigbe, Sunday, & Oyeniyi, 2014). The

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fourth hypothesis (H4) proposed independent commissioner has a negative influence on earnings management tendencies.

Firm Value and Earnings Management

Firm value is the value provided by the market for company performance. The share price above book value indicates market appreciation, and the share price below book value shows market depreciation. Earnings management is an effort to reduce perceived risk. This risk is related to bankruptcy, cost of borrowing, and the company's prospects in generating future profits. This risk affects market perceptions of firm value.

Company managers practice earnings management because they maintain long-term share prices. Managing earnings reduces the possibility of bankruptcy that reflects a company's financial risk. Investors pay a premium for companies that practice earnings management. Managers were motivated to maintained firm value by performing earnings management (Abbas, 2018; Dang et al., 2020; Susanto, 2018). Based on the empirical findings, the fifth hypothesis (H5) suspected that earnings management positively influences firm value.

RESEARCH METHOD

This study was explanatory research, which aims to explain the causal relationship between variables through hypothesis testing. This research's data are a financial statement of public companies in Indonesia's property and real estate sector (2014-2018). The data sources were obtained by the Indonesian Capital Market Directory and the company's audited financial statement. This study uses a sample of the property and real estate sectors to control industrial sector controls that may impact earnings management.

This population was public property and real estate companies in Indonesia whose data can be accessed and available with specific criteria. The research sample was part of the population that the selection was made using a purposive sampling method according to the specified criteria. The criteria used are companies are public property and real estate companies in Indonesia listed on the IDX in 2014-2018, publishing the complete annual report for 2014-2018, and reporting complete data related to the variables used.

Operational Definition of variables

Each variable was measured using one measure. Firm size used the natural log of total assets as an indicator measurement. Debt used ratio of debt to assets. The size of the board of commissioners used the number of commissioners. The number of independent commissioners measured independent commissioners' presence, and firm value uses price to book value measurement. The modified Jones estimated earnings management. This model can detect earnings management more effectively when compared to other models.

To test the antecedents of earning management, the econometric equation used was as follows:

$$EMit = \alpha + \beta 1\ \mathrm{FSit} + \beta 2\ \mathrm{DEBTit} + \beta 3\ \mathrm{SOCBit} + \beta 4\ \mathrm{ICOMit} + \mathrm{e} \qquad (1)$$

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With EM is earnings management, FS is firm size, DEBT is a firm's debt, SOCB is the size of commissioner board, ICOM is the independent commissioner, i is company i, and t is a period.

To test the consequences of earnings management, the econometric equation was as follows:

$$FVit = \alpha + \beta 5 \, \text{EMit} + \text{e} \qquad (2)$$

with,
FV is a firm value.

RESULTS AND DISCUSSION

This study used secondary data in annual reports of property and real estate public sector companies for 2014-2018. The data obtained are as follows:

Table 1. Research Sample

Data	Amount
Population of property and real estate companies 2014-2018	55
The companies did not consistently present variable items	(17)
Incomplete data	(24)
Number of companies	14
Number of firm-year samples (5 years)	70

Source: processed data, 2020

Result

The processed data was obtained from the company's audited financial statements for the 2014-2018 period and was matched with data from the Indonesian Capital Market Directory for the same period. Descriptive analysis of all variables showed the results as in table 2.

Tabel 2. Descriptive statistics

	Minimum	Maximum	Mean	Std. Dev.
FIRM SIZE	21.90	31.17	26.65	2.880
DEBT	0.03	0.64	0.37	0.177
SOBC	2	9	4.480	1.850
INCOM	0.00	0.67	0.258	0.190
EM	0.001	0.065	0.003	0.0084
FV	-0.47	7.970	1.264	1.251

a. Dependent variable: EM
Source: Processed data, 2020

Hypothesis testing used multiple linear regression in two stages. The first stage analysis was used to examine the effect of the antecedent earnings management variable. The results of multiple linear regression analysis could be seen in table 3.

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Table 3. Opportunistic Motive Test Results

	Unstandardized Coefficients		Standardized Coefficients	T	Sig.
	B	Std. Error	Beta		
(Constant)	0.021	0.024		0.892	0.376
FS	-0.001	0.001	-0.137	-0.862	0.392
DEBT	0.002	0.001	0.479	20.789	0.007**
SOCB	0.001	0.005	0.024	0.199	0.843
INCOM	-0.003	0.001	-0.353	-20.418	0.018**

a. Dependent variable: EM

Source: Processed data, 2020

Based on table 3, it could be seen that the size of the influence of each independent variable on the dependent variable:

a. The effect of FS on EM had a probability (α) of 0.392. Firm size does not affect earnings management. Hypothesis 1 was rejected.
b. The effect of DEBT on EM had a probability level (α) of 0.007. Debt has a significant positive effect on earnings management. Hypothesis 2 was accepted. The effect of SOCB on EM had a probability (α) of 0.165. The size of the commissioner board does not affect earnings management. Hypothesis 3 was rejected.
d. The effect of INCOM on EM showed the probability level (α) was 0.018. Independent commissioners had a significant negative effect on earnings management. Hypothesis 4 was accepted.

Table 4. Efficient Motive Testing Results

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
(Constant)	1.723	0.359		4.801	0.000
EM	-5.547	35.155	-0.019	-0.158	0.875

a. Dependent variable: FV

Source: Processed data, 2020

Regression second stage tested the consequences of earnings management practices with the dependent variable on the firm value shown in table 4. The probability of the EM effect on FV (α) was 0.875. This statistic value means that earnings management did not affect firm value. Hypothesis 5 was rejected

Discussion

This study examined the factors that influence earnings management and the consequences of earnings management on firm value. The resulting test showed that the firm size and the commissioner board's size do not affect earnings management. Debt and independent

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commissioners affected earnings management. The tendency of earnings management had no impact on firm value.

Firm Size

The test result showed that firm size does not affect earnings management tendencies. The firm size did not have an impact on the company's motivation to practice earnings management. This result was in line with previous studies (Laily, 2017; Sebastian & Handojo, 2019; Widya & Sandra, 2016).

This result indicated that there are no political costs to public property and real estate companies in Indonesia. The company had the same beliefs regarding its corporate reputation. The public would respond more sensitively to events involving corporate financial statements. Earnings management actions were often viewed as misleading information to the public. Public companies had a reputation risk when managing their reported earnings. The firm's value could decrease and lead to higher costs.

Public property and real estate companies generally have adequate internal control systems. An efficient internal control system will help monitor the presentation and disclosure of inaccurate financial statements. Qualified auditors must audit both large and small public companies. Public accounting firms have many experienced auditors who can help correct misstatements of earnings.

This result differed from other studies (Amertha et al., 2014; Nalarreason et al., 2019). They found a positive influence between firm size and earnings management.

Debt

Another factor that was the focus of this research was debt. The result of this study indicated that debt has a positive effect on earnings management. The second hypothesis, which stated that debt affects the tendency of earnings management, was accepted. This result supported previous studies (Kim et al., 2020; Y. Liu et al., 2010; Tonye & Seth Sokiri, 2020).

This result reinforced the conclusion that the higher the debt ratio, the higher its tendency to practice earnings management. High debt-ratio increased company risk. Company managers chose to do earnings management to avoid covenants that limit the company. The choice of accounting policy was consistent with the opportunistic motive for avoiding covenants.

f the cost of bankruptcy is expensive, then the firm value of earnings management is higher than those that do not manage their earnings. The risk of default on the debt will be directly proportional to the loan amount. The more debt a company has, the higher the probability of failure. Creditors want assurance that the company can generate profits in the future. To fulfill this, management is encouraged to change reported earnings.

Earnings management enables managers to reduce earnings volatility, thereby reducing the possibility of bankruptcy. Management has the opportunity to get a loan with

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low interest. The decrease in the cost of capital is related to the perceived risk of creditors. The higher the risk faced, the higher the cost of debt.

Analysis of data on changes in the debt to assets ratio showed that the more significant the ratio's change, the more likely the company would practice earnings management. This showed that earnings management practices are more motivated by relationships with creditors than other shareholders. Companies that need additional funds from creditors tend to manage earnings to reduce creditor risk and get additional funding.

The result of this study contradicted other research (Amertha et al., 2014; Ekaterina, 2010; Zamri et al., 2013). Zamri et al. (2013) stated debt was associated with a more credible demand for financial statement data. The higher the risk of the company, the creditors wanted a more reliable financial report. They could do close monitoring. The higher the proportion of debt, the more motivated management will be to practice earnings management to minimize this risk.

Board of Commissioners Size

The size of the commissioner board did not have a significant effect on earnings management trends. Hypothesis four stated that there was an effect of board size on earnings management tend to be rejected. This result consistent with other studies (Laily, 2017; Nuryana & Surjandari, 2019).

The following analysis could explain the test result in this study. The board of commissioner size was not a dominant element of commissioner effectiveness. The larger the board size would have communication and coordination difficulties. The argument was based on the plurality of individual board abilities.

In addition to the number of members, board effectiveness was influenced by its composition, characteristics, and structure (Hermawan, 2011; Rossi, 2014). The effect of board members on earnings management might not be as significant as other variables' effects. This opinion followed a statement that the board of commissioners' role was determined by its composition and structure (Holtz & Sarlo Neto, 2014). The commissioner board's size could affect earnings engineering is supported by the existence of good board composition and structure.

The study result was inconsistent with other research (Kankanamage, 2016; Mahrani & Soewarno, 2018; Savitri et al., 2020). Maharani and Soewarno (2018) found a positive influence between board size and earnings management. A large board of commissioners would reduce the effectiveness of monitoring because coordination becomes more difficult. The bigger the board of commissioners would limit earnings management practices.

Independent Commissioner

The results of testing the coefficient of table 3 showed that there was a negative effect of independent commissioners on earnings management tendencies. The fourth hypothesis,

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which stated that independent commissioners affect earnings management, was rejected. This result indicates that a large number of independent commissioners reduced earnings management. Several empirical studies found the same results (Busirin et al., 2015; X. Chen et al., 2015; Uwuigbe et al., 2014).

Independent commissioners had a positive contribution to monitoring responsibilities. The more the number of independent commissioners was expected to represent the interests of shareholders better.

The number of independent commissioners was directly proportional to the ability to limit earnings management. The more independent board members were expected to represent the interests of public shareholders better. Independent commissioners played an important role when ownership was relatively spread out. Independent commissioners were considered to have the ability to act in the best interests of the company.

An independent commissioner was a member of the board with the competence to work objectively. The monitoring function was more effective when the member independent with companies. Better monitoring would reduce management's motivation to perform earnings management.

This result differed from previous research (Mohd Fadzilah, 2017; Shaique et al., 2017). They found independent commissioners drive earnings management. An independent commissioner had a positive influence on managing the firm's earnings.

Earnings Management and Firm Value

The test result in table 3 showed that earnings management's tendency has no significant effect on firm value. Based on these results, the fifth hypothesis stated that earnings management tendencies affected the firm value and were rejected. There was no influence on earnings management tendencies and firm value. Earnings management did not influence the market to give a particular value to the company.

The result of this study could be analyzed as follows. First, earnings management could not be detected by those who use financial statement information, so the market did not overreact. Because it could not detect earnings management behavior, the market did not react to what management does.

Second, the market could detect earnings management but did not react to this practice because investors relied more on other company variables such as asset size to value the company.

Several studies showed that earnings management was not a predictor of firm value (Savitri et al., 2020; Yorke et al., 2016). Yorke et al. (2016) examined the effect of earnings management on firm value. Their results showed that the market ignores real earnings management and accounting earnings management. Furthermore, his research results showed that the market could detect earnings management behavior, but the market ignores it. The market did not identify earnings management practices as something to be worried about.

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Savitri et al. (2020) demonstrated empirical evidence that earnings management through real earnings management and accounting does not significantly affect investors' motivation to invest in Indonesia's public manufacturing companies. The market does not use earnings management by the company as a consideration for investment decisions. The market had not responded in more detail to company earnings information.

This finding was inconsistent with other studies (Abbas, 2018; T. Chen, 2016; Dang et al., 2020; Gottardo & Moisello, 2019; Sayari, Mraihi, Finet, & Omri, 2013). Gottardo and Moisello (2019) concluded a decline in the firm value because management implements earnings management. Abbas (2018) and Dang et al. (2020) found that earnings management can improve earnings quality and firm value.

Motivation Earnings Management

This study examined public companies' management incentives in the property and real estate sector to conduct earnings management. An understanding of the encouragement is crucial because it is related to whether earnings management is an act that is detrimental or benefits users of financial statements. Earnings management can be harmful if opportunistic management desires drive it. Earnings management will benefit if these actions offer a signaling effect on the company's prospects for users.

The test results showed that the variables associated with earnings management are debt and independent commissioners. The significance of these variables' influence indicated that opportunistic management motives more drove earnings management. Earnings management was not identified as an efficiency motive because it has no impact on firm value.

The variable derived from the concept of agency theory: the independent commissioner, showed the effect predicted. Likewise, debt as a translation of the debt covenant hypothesis showed a significant impact. Management performs more dominant earnings management because of opportunistic interests than maintaining market value and its shareholders' interests.

CONCLUSION

There are five hypotheses tested. Agency theory and positive accounting theory were each represented by two variables. One variable represented the signaling theory. The overall conclusions showed that debt and independent commissioners are predictors of earnings management practices. Firm size and the number of boards of commissioners were not the reasons for earnings management practice.

This study provides a theoretical contribution to the application of agency, accounting, and signals theories in explaining earnings management motives in property and real estate public companies in the Indonesia Stock Exchange. Theories that can explain management practices are agency theory and positive accounting theory. The

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failure of signaling theory explains that the dominant motive of managers was opportunistic.

Companies that are in the population were not classified as their respective financial conditions. Companies that experience financial pressure and are healthy naturally have different motivations and accounting policies. The measurement of corporate accounting policies needs to separate between healthy companies and companies under financial pressure. Further research can classify the state of the company to determine differences in earnings management motivation.

Earnings management was considered a constant phenomenon. The company was supposed to practice earnings management from year to year with the same motivation. Future research suggests using event studies to examine the earnings management motive.

These results contributed to the formulation of policies. The regulator can establish regulation to improve corporate governance quality through independent commissioners and commissioners' competency requirements.

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