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THE ROLE OF REAL EARNINGS MANAGEMENT IN THE VALUE RELEVANCE OF ACCOUNTING INFORMATION IN INDONESIA

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ABSTRACT

Purpose- One feature that should be integrated in financial statements to be relevant to decision-makers is the relevance of the information to the users. When the value and usefulness of accounting information used to gauge business financial performance are undermined by earnings management methods, problems arise. As a result, the information presented may deceive financial statement users about the corporation's financial performance. Because IFRS demands managerial judgment in the accounting process by definition, its adoption may even increase the chance for real earnings management (REM). This study aims to examine the impact of REM to the value relevance of accounting information before and after IFRS adoption.

Methodology- The population was manufacturing companies listed on the IDX, with samples 230 firm year observations consists of one hundred fifteen firms year before adoption of IFRS and one hundred fifteen firms year after IFRS adoption. this study used firms' abnormal levels of cash flows, production costs, and discretionary expenditures as proxies for real earnings management. Using a price model and panel data, the main result confirms that real-based earnings management has an impact on the value relevance of earnings and book value of equity before IFRS adoption, but has no effect after IFRS adoption.

Findings- The findings revealed that prior to the adoption of IFRS, real earnings management was employed by companies that had higher earnings value relevance and lower equity book value relevance than companies that did not apply earnings management. After the adoption of IFRS, there is no significant effect of real earnings management on the value relevance of earnings and equity book value.

Conclusion- The results show that investors believe that earnings are a signal from managers with the implementation of real earnings management prior to the adoption of IFRS, but after the adoption IFRS, they may not be able to do so.

Keywords: Real earnings management, value relevance, accounting information, earnings, equity book value,
JEL Codes: M40, M41, M49

1. INTRODUCTION

Financial reports serve the useful purpose of giving a general overview of an entity's financial position, overall performance, and changes for various users in making financial decisions with the necessary awareness to help, for example, the achievement of the company to come (IASB, 2018) and to propose the financial status of the current company to shareholders and the public (Krause & Tse, 2016). .

Accounting is employed in financial reports as a tool to recapitulate all company transactions for recognition, measurement, and dissemination, which is important since it incorporates relevance and reliability (Tahat & Alhadab, 2017). These are the features that underpin accounting numbers in the IASB Conceptual Framework (FASB) for Financial Reporting.

The capital market necessitates appropriate accounting data that may be used to make effective and efficient judgments (Chen et al., 2016). Increasing capital market investment has an impact on capital market strength and economic growth. Accounting figures are used by investors to determine stock prices, and firms that provide high-quality information benefit from cheaper capital expenditures (Balagobei, 2017). Numerous studies have been conducted to examine the value and relevance of accounting information, including financial reports, which was carried out, among other things, by examining the correlation between accounting information and stock prices or stock returns (Sutopo et al., 2018). There are compelling arguments in the value relevance literature for adopting profit as the key measure of financial information (Mirza et al., 2020).

In order to be used as the main tool for making decisions, financial reports must be of high calibre (Ernawati & Aryani, 2019). The expansion of worldwide commerce involves the use of universal accounting standards. In response to the requirements of this standard, the International Accounting Standards Board (IASB) published International Financial Reporting Standards (IFRS). The total implementation of IFRS in Indonesia began in 2012. This attracted a large number of academics to conduct studies on the overall impact of IFRS adoption on the company's financial reporting process.

Many developing countries have inefficient and immature capital markets (Black & Nakao, 2017). The condition of the Indonesian Stock Exchange has not proven that there is the required level of efficiency in the capital market (Natapura, 2009), on the other hand there is concentrated ownership (Black & Nakao, 2017), weak institutions (Alshyoukh & Manaf, 2018), or a lack of compliance with implementing regulations (Outa, 2011) . The literature notes that there are differences between developing countries and developed countries in highlighting the effect of IFRS adoption. In developing countries, there are findings that high quality standards will help these countries improve the quality of their financial reporting (Ismail et al., 2013).

In general, widely accepted accounting rules provide managers some leeway in deciding which accounting technique to apply for their organization. Managers are presumed to want to make decisions on the best accounting technique for the firm, resulting in earnings management (Healy & Wahlen, 1999). Investors seldom use manipulated data when making judgments, therefore their reaction to the data is no longer reflected in the company's stock price (Chandrapala, 2013).

Earnings management may be accomplished in a variety of ways. According to the literature, one of the most prevalent techniques is to manage accruals using accounting judgments. This is referred to as accrual-based earning management. Companies frequently engage in real-earnings management to misappropriate earnings in addition to the accrual earnings management (Dechow & Skinner, 2000). Roychowdhury (2006) devised an empirical method for escribing actual earnings management. The findings show that managers avoid reporting losses by performing real-earnings management.

The earnings management phenomenon that occurs in Indonesia in the financial reports of Garuda Indonesia, PLN, and Pertamina has the same pattern, namely the recognition of earnings that is larger than it is. The Management manages earnings by recognizing unearned income on receivables from related parties from each of the company's transaction partners. The distinction is that the debtor in the case of Garuda Indonesia is a private corporation. Meanwhile, in the case of the PLN and Pertamina, the government is obligated to pay the loan.

Based on the many incidents of earnings management, it can be inferred that management frequently manipulates financial reports to make them seem good to outside parties. corporations with modest earnings are designed to be larger in order to appear larger to outside parties, whereas corporations with huge profits are designed to be smaller in order to reduce the tax burden. Earnings management efforts all have one goal: to make financial reports seem good in the eyes of the public, particularly investors.

Previous research has indicated that the combined outcomes of the earnings management and value relevance connection Earnings management has been identified as an issue that impacts earnings quality (e.g., Klann and Beuren 2018); value relevance (Callao, Cimini, and Jarne 2016; Shan 2015); and business value (Azaria & Muslichah, 2021). As a result, while evaluating organizations, market participants will move from earnings to book value (Marquardt & Wiedman, 2004). It has been established through prior research that earnings management decreases the relevance of earnings value (Mostafa 2017; Altintas, et al., 2017) laba, and the relevance of book value (Habib, 2004), but Oraby (2017) demonstrates that earnings management is irrelevant since it has no effect on stock prices.

By investigating the value and usefulness of accounting data under IFRS standards in Indonesia, a developing stock market, this study attempts to provide evidence of the unintended consequences of IFRS adoption, which is important, given the scarcity of information accessible to developing country investors, such an investigation is worth considering. Although there are many studies on the value relevance of accounting information in developed markets, value relevance studies in developing countries are rarely documented (Dosamantes, 2013). This research contributes to body of knowledge by providing empirical information regarding the usefulness and significance of accounting data in Indonesia as a developing country, both before and after the implementation of IFRS.

Based on the description above, research is needed on the effect of earnings management on the relevance of earnings and book value of equity before and after the implementation of IFRS in Indonesia. While the results of this study are as follows: first, prior to IFRS adoption, companies that applied real earnings management had higher earnings value relevance and a lower book value of equity value relevance compared after IFRS adoption. Second, There is no effect of real earnings management on the value relevance of earnings and the book value of equity.

2. LITERATURE REVIEW

2.1. Value Relevance of Accounting Information

The value of accounting information is relevant because of the net surplus hypothesis, which asserts that the company's worth is represented in the accounting figures in the financial statements (Feltham & Ohlson, 1995). Accounting data, which include financial reports, might influence user investment and credit decisions (Krause & Tse, 2016; Comiran, Fedyk, & Ha, 2018). Accounting information is significant when it can explain stock values, such as earnings or book value. According to the net surplus theory, the profit-equity connection can explain a company's market value. Profit, according to this so-called net surplus relationship, is the decisive element in changes in equity transactions such as dividend payments and equity investments. Stock prices may be assessed by earnings and decided by equity as a result of this connection. Furthermore, the theory generates a measuring technique that demonstrates that a company's market value may be stated using financial components such as balance sheets and income statements.

2.2. IFRS Adoption in Indonesia

IFRS convergence was the one of the outcomes reached by the Indonesian authorities at the G20 Forum meeting in Washington, DC on November 15, 2008. In Indonesia, the IFRS convergence process is complete adoption, selective adoption with interlude, and adoption with amandemen to accommodate for the country's unique characteristics. As a result, Indonesia eventually accepted IFRS as its nearest accounting standard and made minimal changes to Indonesian regulations and the corporate environment.

The terraced IFRS convergence technique has introduced different tiers to the IFRS convergence program. The first spans the extended period from 2007 to 2012. The primary goal of this part is to reconcile IFRS with Indonesian accounting requirements. In general, Indonesian accounting rules in 2012 were the same as those in effect on January 1, 2009. Meanwhile, from January 1, 2015, PSAK utilized in Indonesia will converge with IFRS in general, which went into force on January 1, 2014, minimizing the gap between the two standards from three years on January 1, 2012 to one year on January 1, 2015. This is Indonesia's pledge to serving as Southeast Asia's single G20 member.

Many studies have been conducted to determine if a transition from GAAP to IFRS would result in an increase in accounting quality by taking into account the normative, positive repercussions of IFRS. However, past research' findings have not proven conclusive. Although several studies have documented an increase in the value and relevance of accounting information (Suadiye 2012; Isaboke & Chen 2019; Erin, Olojede, & Ogundele 2017; Bhatia and Mulenga 2019), there are other findings that show a limited increase in value relevance (e.g., García et al. 2017; Kadri, Aziz, & Ibrahim 2010) while other studies show no increase (e.g., Filip and Raffournier 2013 or even negative results (Negakis, 2013). Many reasons have been proposed to explain the inconsistent results. According to Ball and Shivakumar (2006), there are too many different components in a corporation that lead IFRS to lack clarity and quality of information. According to Pelucio-Grecco et al. (2014), other crucial elements, such as country-specific characteristics, demonstrate that research on IFRS adoption is scarce, particularly throughout the convergence phase. In the accounting literature, the focus is mostly on accruals and earnings in terms of the impact of earnings management strategies on accounting numbers (Boujelben et al., 2020).

2.3. Opportunistic and Informational Real Earnings Management

One of the primary distinctions between accrual earnings management and real earnings management is that the former has no influence on cash-based accounting information, such as that of the CFO, because it happens as a result of accounting technique modifications that directly affect accrual-based data. Nonetheless, the latter has a significant impact on the CFO because, according to Roychowdhury (2006), real earnings management represents managerial efforts that are distinct from routine operational tasks. According to Zang (2012), Cohen & Zarowin (2010), and Andreas (2017), enterprises that choose to control their results through real earnings management are more likely to disclose negative cash flows from operations. According to Ho, et al. (2015), whereas accrual-based earnings management declined with IFRS adoption, businesses were more likely to create real earnings management. As a result, it is predicted that real earnings management may increase the risk of changes in the relevance and trustworthiness of the CFO's current value as one of the most essential pieces of information for decision making by some of the most important consumers of financial statements.

Earnings has been implied as a primary measure in accounting and investigated as a "summary" of a firm's activities, capable of summarizing a firm's past and present accomplishments and serving as an input to forecasting future performance, primarily sought as a measure of value, a predictive tool, and a measure of assessing investment opportunities (Leal et al., 2017).. Previous empirical study on financial data for economic decision making has concentrated on earnings, book value of equity, dividends, accruals, and cash flows.

The empirical question is whether earnings or book value can be used to determine firm value. The main source of earnings dominance, according to the financial reporting conceptual framework developed by the IASB, is accrual-based income, which is the main financial data for estimating the future cash flows of a business, assisting investors in making sound economic decisions (IASB, 2018).

Earnings management causes a company's earnings rate to become substantially more unpredictable (Marquardt & Wiedman, 2004). The present literature highlights that the value of earnings becomes less relevant as investors become more reliant on the book value of equities and other financial information (Dedman, et al. 2017; Mirza, et al. 2018). As a result, for a better understanding of the value and relevance of financial information for making wise economic decisions about investments, taking into account the book value of equity and other financial information is crucial (Mirza et al., 2020).

Because earlier research on effect of earnings management on the quality of reported accounting numbers has generally focused on the influence of accrual earnings management strategies on earnings-based evidence, The main objective of this study is to close this gap by investigating whether real earnings management causes changes in investors' preferences in investing, shifting from earnings valuation to book value. According to the preceding debate, the company's involvement in profits manipulation has diminished its effectiveness in making economic judgments.

3. RESEARCH METHOD

3.1. Population and Sample

The population in this research comprises manufacturing companies that were registered on the Indonesia Stock Exchange (IDX) between 2007 and 2016. Manufacturing businesses were chosen because, being the largest category of enterprises on the IDX, they exhibit similar accrual characteristics. Because IFRS went into effect on January 1, 2012, the testing period began five years before and after that date, resulting in the 2007-2016 research period. The sample strategy utilized was basic random sampling because the population's members are homogeneous.

From 2007 to 2016, data was gathered from the Indonesian Stock Exchange (IDX) database. The end of each company's fiscal year was determined, and the data was divided into five-year periods before and after the implementation of IFRS. Because IFRS was fully implemented on January 1, 2012, the financial statements for the inaugural period of IFRS standard adoption are reports generated for the 12 fiscal months ending December 31, 2012.

For this study, financial reports from the IDX were combined with notes from the Indonesian Capital Market Directory (ICMD), while information on publication dates, financial reports, and stock prices were sourced from PT Indonesian Capital Market Electronic Library (ICaMEL). Using a random sample approach, the patterns acquired include 115 observations prior to IFRS implementation and 115 observations after IFRS adoption from manufacturing businesses listed on the Jakarta Stock Exchange (IDX).

3.2. Variable Measurement

3.2.1. Real Earnings Management

Following Roychowdhury (2006), this study used firms' abnormal levels of cash flows, production costs, and discretionary expenditures as proxies for real earnings management. Specifically, the normal level of cash flows, production costs, and discretionary expenditures are modeled as follows:

$$CFO_{it}/A_{it-1} = \alpha_0 + \alpha_1(1/A_{it-1}) + \beta_1(S_{it}/A_{it-1}) + \beta_2(\Delta S_{it}/A_{it-1}) + \epsilon_{it} \quad (1)$$

$$PROD_{it}/A_{it-1} = \alpha_0 + \alpha_1(1/A_{it-1}) + \beta_1(S_{it}/A_{it-1}) + \beta_2(\Delta S_{it}/A_{t-1}) + \beta_3(\Delta S_{it-1}/A_{it-1}) + \epsilon_{it} \quad (2)$$

$DISEXP_{it}/A_{it-1} = \alpha_0 + \alpha_1(1/A_{it-1}) + \beta(S_{it-1}/A_{it-1}) + \epsilon_{it}$ (3)

Where:

CFO_{it} : operating cash flows adjusted for extraordinary items and discontinued operations of firm i in year t
A_{it-1} : total assets of firm i in year t–1
S_{it} : total sales revenue of firm i in year t
ΔS_{it} : change in sales revenue of firm i in year t
$PROD_{it}$: production costs offirm i in year t, defined as the sum of cost of goods sold and the change in inventories
$DISXP_{it}$: discretionary expenditures of firm i in year t, defined as the sum of advertising expenses, research and development expenses, and selling, general, and administration expenses.
ε_{it} : other relevant information firm i during year t

For each firm-year, the cross-sectional regressions of models (1) to(3) were estimated. The abnormal CFO, abnormal PROD, and abnormal DISX were computed as the difference between the actual values and the normal levels estimated from models (1) to (3). There were three continuous variables created, i.e. AB_CFO, AB_PROD, and AB_DISX, to measure the extentof abnormal operating cash flows, abnormal production costs, and abnormal discretionary expenditures, respectively.

To obtain consistent estimations across different measures so that a higher value of each measure indicates the extent of the real earnings management, the abnormal CFO and abnormal DISX were multiplied by negative one (-1): AB_CFO = (–1)*abnormal CFO and AB_DISX = (–1)*abnormal DISX. AB_PROD is defined as the abnormal PROD. An aggregate measure, AB_REM, was also operated to capture the total effects of the real earnings management. AB_REM is defined as AB_CFO + AB_PROD + AB_DISX. Similar to the accrual-based earnings management, a value of 1 (one) was assigned to REM if AB_REM waspositive, and zero for otherwise.

3.2.2. Value Relevance

The model was frequently utilized in the literature (for example, Burgstahler & Dichev, 1997). In accordance with these research, the model is as follows:

$P_i = \alpha_0 + a_1\ EPS_{it} + \alpha_2\ BV_{i,t} + \alpha_3\ REM_{it} + \alpha_4\ REM_{it} \times EPS_{it} + \alpha_5\ REM_{it} \times BV_{i,t} + \varepsilon_{it}$ (4)

Where:

P_{it} : share price firm i during year t
EPS_{it} : earnings per share firm i during year t
$BVPS_{it}$: book value of equity firm i during year t
REM_{it} : real earnings management firm i during year t
ε_{it} : other relevant information firm i during year t

Ohlson's model was expanded to investigate the impact of real-based earnings management (REM) on the relevance of earnings and book values before and after the implementation of IFRS. The equation shows the regression model used to observe this impact. In the context of real-based earnings management, the slope coefficient a4 expresses the value relevance of earnings. Similarly, the slope coefficient a5 denotes the importance of book value in the context of real-based earnings management. It is projected that a4 is negative, suggesting that the value of earnings is less relevant in companies that practice real earnings management. On the other hand, a5 is expected to be positive, indicating greater value relevance to the book value of equity as the market shifts its confidence from earnings to the book value of equity.

3. FINDINGS AND DISCUSSION

Table 1 shows the sample distribution based on the manufacturing industry sub-sector classified in the Indonesia Capital Market Directory (ICMD), with a total sample of 230 samples.

Table 1: Sampling Framework

Sub Sektor	Jumlah Perusahaan	Jumlah Perusahaan- Tahun
Stone, clay, glass, concrete products	1	10
Electronic	1	20
Automotive & similar products	5	40
Apparel & other textile products	2	20

Adhesives	2	20
Pharmacy	3	30
Paper & similar products	1	10
Cement	1	10
Metals & similar products	3	30
Textiles & mills	1	10
Plastic	1	10
Consumer goods	1	10
Tobacco	1	10
Total	23	230

Table 2 presents the results of the descriptive statistical tests of the main research variables, which consist of stock log prices, earnings, book value of equity, and real earnings management.

Table 2: Descriptive Statistics

	Minimum		**Maxsimum**		**Mean**		**Standard Deviation**	
Variable	Pre IFRS	Post IFRS	Pre IFRS	Post IFRS	Pre IFRS	Post IFRS	Pre IFRS	Post IFRS
LOGPRICE	1.673	2.021	4.99	5.301	2.850	3	0.651	0.662
EPS	-253	-2394	10.320	8.019	505.38	409.94	1345	1264
BV	-2242	-2372	22.062	26.012	2119	2747.02	3537	5074
REM	0.00	0.000	1.000	1.000	0.574	0.513	0.497	0.502

Before and after IFRS adoption, the mean real earnings management (REM) values were 0.574 and 0.513, respectively, suggesting that 57.4% and 51.3% of firm-years produced positive real earnings (real earnings management by growing earnings). The average log stock price after IFRS implementation is 3.00, up from 2.850 before IFRS adoption, suggesting that the average stock price after IFRS adoption is higher than before IFRS adoption.. The average EPS was 505 before and 410 after IFRS introduction, showing that the typical business enjoyed greater positive profits per share before than after IFRS adoption. The average book value is 2119 and 2747, respectively, indicating that the average book value after IFRS implementation is larger than the average book value before IFRS adoption.

Table 3 shows the findings of several regressions which attempt to look at the influence of real earnings management on earnings relevance and book value of equity before and after IFRS implementation.

Table 3: Results of tests H1, H2, and H3

Variable	**Before IFRS Adoption**	**After IFRS Adoption**
C	2.57	2.8445
	(0.0000)	(0.0000)
EPS	-0,0003	1.2×10^{-4}
	(-2.18)	(2.0308)**
BV	0,00023	5.8×10^{-5}
	(4.22483)***	(3.7831)***
REM	0.02111	-0.1456
	(0.171632)	(-1.3797)
REM x EPS	5.59×10^{-4}	9.33×10^{-6}
	(1.82507)*	(0.50)
REM x BV	-1.79×10^{-4}	9.6×10^{-6}
	(-2.1511)**	(0.25)
F_stat	17.2116	22.15
	(0.0000)	(0.0000)
Adj R^2	0.4156	0.48
N	115	115

Prior to the implementation of IFRS, there was a positive and substantial interaction between REM and EPS on stock prices at a 10% level, with a coefficient of 5.59 x 10^{-4}, and a negative interaction between REM and BV on stock prices at a 5% level, with a coefficient of -1.79 x 10^{-4}. This suggests that prior to the implementation of IFRS, firms that used real earnings management had higher earnings value relevance and lower equity book value relevance than companies that did not use real earnings management. This demonstrates that prior to the adoption of IFRS, real earnings management led investors to believe that the measure of earnings was more reliable than the book value of equity or that earnings information was information or signals from managers.

After the adoption of IFRS, the relationship between REM x EPS and stock price is not significant as well as the relationship between REM x BV and stock price, with coefficients of 9.33 x 10^{-6} and 9.6 x 10^{-6}, respectively.This indicates that after adopting IFRS, organizations who practice real earnings management do not see a change in the relevance of the value of earnings, and the book value of equity as well. These findings suggest that, following the introduction of IFRS, the market may be unable to discern between opportunistic real earnings management and genuinely beneficial information.

4. CONCLUSION

This study focuses on whether real earnings management affects the relevance of the value of earnings and the book value of equity both before and after the implementation of IFRS. The data reveal that prior to IFRS adoption, companies that applied real earnings management had higher earnings value relevance and a lower book value of equity relevance compared after IFRS adoption. There is no effect of real earnings management on the significance of earnings and the book value of equity after the implementation of IFRS. This demonstrates that prior to the adoption of IFRS, with the implementation of real earnings management, investors assumed that earnings were a signal from managers; however, after the adoption period, with the implementation of real earnings management, investors may be unable to distinguish whether earnings are managed opportunistically or informationally. As a limitation of this study, only two forms of accounting information are are utilized namely earnings and book value of equity to evaluate stock prices, and only the price model is used in the valuation model. In the future, valuation models should employ the return model together with other accounting data like as cash flow and dividends .

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