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Effects of Asset Growth, Profitability, Leverage, and Accounts Receivable Growth on Earnings Management

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ABSTRACT

Asset growth, profitability, leverage, and accounts receivable growth are thought to affect company's earnings management. The research method used in this research is explanatory method. The population of this study consists of 187 companies in the manufacturing sector listed on the Indonesia Stock Exchange during the 2017-2019 period. The sampling technique used in this research is nonprobability sampling technique with purposive sampling method, resulting in sample size of 105 companies. The analytical method used in this research is panel data regression analysis with a significance level of 5%. Data analysis uses E-views 10 program. The results showed that profitability and accounts receivable growth had an effect on earnings management, while asset and leverage growth had no effect on earnings management.

Keywords
Earnings management, asset growth, profitability, leverage, accounts receivable growth

Introduction

According to Nuryaman (2010), management behaviour to manage earnings according to their wishes is known as earnings management. Earnings management practices have two main characteristics, namely efficient and opportunistic. Publicly listed companies (go public) have a higher probability of earnings management than companies that don't Publicly listed. This is because publicly listed companies (go public) are required to increase the value of their performance from year to year to meet market demands and attract new investors (Rachmasari, 2015). According to (Rezaee, 2002), fraudulent financial statements (financial statement fraud) closely related to the earnings manipulation by management. Intense business competition may change business behaviour towards unfair competition which is a form of economic crime. Such situation allows for a large number of violations and irregularities which can ultimately lead to losses and fraud (Bunga Indah Bayunitri, 2019). The fact that fraud is usually hidden can make it even more difficult to detect. However, fraud can be identified through events or conditions that indicate incentives or pressure to commit fraud or conditions that provide opportunities for fraud (the fraud factors) (IAPI, 2013).

Research on the effect of profitability and leverage has been conducted by Kusumah et al. (2020), Permatasari and Kusumah (2017), Rachmasari (2015) and Pagalung (2011). While, research on the growth of accounts receivable and earnings management has been researched by Sweeney (1998) and Rahardjo (2014).

The theme of this study is "Earning management is expected to be influenced by growth in assets, profitability, leverage and growth in accounts receivable".

Literature Review

According to Hery (2017, hal. 50), earnings management can be interpreted as an accounting tricks where flexibility in the preparation of financial statements is used or utilized by managers who are trying to meet certain profit targets, Likewise, according to Sulistyanto (2014).

Discretionary accruals can be controlled or determined by management by choosing certain policy in terms of selecting the accounting method and estimate to be used (Sulistyanto, 2014). Non-discretionary accruals cannot be influenced by accounting policies determined by management. Management does not have the flexibility to control the amount, accrual profit is recognized fairly.

Earnings management is measured by discretionary accruals which are calculated by setting aside total accruals and non-discretionary accruals. This is because discretionary accruals are an abnormal level of accruals that comes from management's policy to engineer company's earnings as they wish (Norbarani, 2012). Jones (1991) describes the steps used in the calculation of discretionary accruals which are then referred to as The Modified Jones Model.

The ratio of changes in total assets is calculated by the following formula (C. J. Skousen, 2009):

$$ACHANGE = \frac{\text{Total Asset (t)} - Total\ Asset\ (t-1)}{\text{Total Asset}\,(\text{t}-1)}$$

The concept of profitability uses theory of Kasmir (2016) and Irham (2013). Leverage is a measure of the funds provided by the owner compared to those provided by creditors. Debt financing affects the company because it has fixed expenses. Failure to pay interest causes financial difficulties that lead to bankruptcy. On the other hand, the use of debt provides tax deductions that are beneficial for shareholders (Kamaludin, 2011). Excessive use of debt will be unsafe because the company will fall into the extreme leverage category (Fahmi, 2011; Darsono, 2005).

$$Leverage = \frac{\text{Liability}}{\text{Total Asset}}$$

The concept of accounts receivable growth of Sweeney (1998) and Skousen (2009):

$$Receivable\ growth = \frac{Account\ Receivable\ (t)}{Sales\ (t)} - \frac{Account\ Receivable\ (t-1)}{Sales\ (t-1)}$$

Accounts receivable is an accrual account, which is recorded at the time of the transaction and not based on the company's cash flow. The recording of receivables is also affected by management's accounting estimate, i.e. the estimation of bad debts. The estimation of bad debts can affect the amount of bad debts expense in the income statement, which in turn will affect the amount of profit as well. Therefore, account receivables can be an opportunity for earnings management actions.

The hypothesis is as follows:
Hypothesis 1: Asset growth affects earnings management.
Hypothesis 2: Profitability affects earnings management.
Hypothesis 3: Leverage affects earnings management.
Hypothesis 4: Accounts receivable growth affects earnings management.

Methodology

This research uses explanatory; it is a research aiming to study the causality relationship between variables which explain a particular phenomenon. For that reason, in this explanatory research the researchers try to explain or verify the relationship or influence between variables (Zulganef, 2018).

Secondary data is a source of data obtained indirectly by the data collectors, secondary data functions to support primary data needs such as books, literature and other resources that related to and support this research, for example through third parties or through documents (Sugiyono, 2017).

The research population is a collection of individuals who have the same characteristics that serve as a source of research information (Edison, 2018). Population is the total collection of elements from which the collection will be made to conclusions (Nuryaman & Christina, 2015).

Sampling based on purposive sampling technique was carried out based on assumptions and criteria that illustrate that the research population is specific and population characteristics and criteria are based on the provisions of an institution (Edison, 2018) so that 105 companies were obtained.

The analysis model uses panel data analysis, is a combination of time series data and cross section data (Basuki & Pratowo, 2017). Time series data namely data based on observations made at different times and cross section data is data collected at a certain time (Ghozali & Ratmono, 2013). The collected data is processed using e-views data processing software 10.

Results and Discussion

Descriptive Analysis of Earnings Management Variables

The decrease is seen from the average discretionary accruals of the companies amounted of 0.001212069 in 2017 decreased to 0.000572161 in 2018, and to -0.000024734 in 2019. In 2017, there were 79 companies with discretionary accruals value below average and 26 companies with discretionary accruals value above average. In 2018, there were 67 companies with discretionary accruals value below average and 38 companies with discretionary accruals value above average. In 2019, there are 43 companies with discretionary accruals value below average and 62 companies with discretionary accruals value above average.

Descriptive Analysis of Asset Growth

The decrease can be seen from the average ratio of changes in the company's assets in 2017 of 0.15141, decreasing to 0.08683 in 2018, and of 0.05188 in 2019. In 2017, there were 78 companies with asset change ratios below the average and 27 companies with above average. In 2018, there were 60 companies with asset change ratios below the average and 45 companies with above average asset change ratios. In 2019, there were 56 companies with asset change ratios below average and 49 companies with asset change ratio above the average.

Descriptive Analysis of Profitability Variable

The average profitability value of the manufacturing companies in 2017 was 2.10%, in 2018 it was 8.75%, and in 2019 it was 7.20%. In this study, manufacturing companies with profitability value above the average in 2017 was 58%, in 2018 it was 42%, in 2019 it was 33%, while companies that had a profitability value below the average were 42% in 2017, 58% in 2018, and 67% in 2019.

Descriptive Analysis of Leverage Variable

The increase can be seen from the leverage of the company in 2017 of 0.47402, increased to 0.48823 in 2018, and to 0.49049 in 2019. In 2017, there were 62 companies with liabilities to total assets ratio below the average and 43 companies with above the average. In 2018, there were 58 companies with a leverage and 47 above average. In 2019, there were 57 companies with leverage is below the average and 48 companies with above the average.

Descriptive Analysis of Accounts Receivable Growth Variable

The company's accounts receivable in 2017 of 0.03042, increased to 3.64021 in 2018, and to 3.76660 in 2019. In 2017, there were 80 companies with a change in account receivables ratio below the average and 25 companies with a change in accounts receivable ratio above the average. In 2018 and 2019, there were 104 companies with a ratio of changes in accounts receivable below the average and only 1 company with a ratio of changes in accounts receivable above average.

Effect of Asset Growth, Profitability, Leverage, and Accounts Receivable Growth on Earnings Management

Effect of asset growth on earnings management

T test on the asset growth variable shows a significance value of 0.1946> 0.05 (level of significance) explaining that earnings management are not affected by asset growth. H_1 is rejected, earnings management are not affected by asset growth. It means that the percentage of change in total assets does not necessarily indicate earnings management. In this study, the ratio of changes in total assets of the majority of companies has decreased. When management faces pressure related to financial stability, management remains cautious and avoids negative views from the public so that the companies remains have positive image among the public, especially investors. A significant assets change will draw public attention and any information about the company will spread quickly (Solechan, 2009). Nasution and Setiawan (2007) also stated that large companies are more careful in their financial reporting, so that the reported financial conditions are more accurate. Thus, the pressure faced by management actually makes management more prudent and reduces earnings management practices.

Earnings management is influenced by profitability

The t test results on the profitability variable show a significance value of 0.0326 <0.05 (level of significance) explaining that earnings management is influenced by profitability. The H_2 is accepted. Profitability affects earnings management. That is, *profitability* indicates the occurrence of earnings management.

Effects of leverage on earnings management

The t test on the asset growth variable show a significance value of 0.2795 > 0.05 (significance level), explaining that earnings management is not influenced by asset growth, H_3 is rejected. Management will work hard to improve company performance with the aim of obtaining the expected benefits which in turn can solve the company's liability problems. Management can also issue new shares to gain more capital from new investors (Susianti & Yasa, 2015). In this study, some companies chose to use deposits as their credit collateral. Debtors can use bank deposits as collateral to get debt without requiring a long time, high costs, and complicated procedures, with minimal requirements (Tigor Angkup Hamonangan Sirait, 2009). Thus, earnings management is not the only solution that management can undertake in fulfilling company obligations.

Effects of account receivable growth on earnings management

The t test on the account receivable growth variable show a significance value of 0.0000 < 0.05 (significance level), explaining that account receivable growth has no effect on earnings management, H_4 is accepted. That is, accounts receivable growth which is measured using the ratio of changes in accounts receivable indicates the occurrence of earnings management. In this study, most companies experienced an increase in accounts receivable. The increase in the accounts receivables occurred in line with the decrease in the estimated bad debts. Management has an authority to determine the estimated amount of bad debts or to eliminate the estimate for bad debts as they assume it as not necessary.

The risk factors that will occur in the assessment of accounts receivable carry a greater risk of misstatement for companies that determine uncollectible accounts with estimates. The risk of misstatement of estimated bad debts increases when the accounts receivable is presented based on management's estimates for a specific purpose. Management may capitalize accounts receivables to commit fraud through accrual earnings management practices (Umarsono, 2016).

Conclusion

Earnings management is influenced by profitability and accounts receivable growth, meaning that profitability and growth of accounts receivable will be used to carry out earnings management. Meanwhile, earnings management is not influenced by asset growth, this is presumably because high asset growth will make management more careful and reduce earnings management practices. Earning management is also not influenced by leverage, it is suspected that earnings management is not the only solution that management will take in fulfilling company obligations.

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