The Development of Earning Management in Indonesia: A Systematic Literature Review

Nurika Restuningdiah¹, Eka Ananta Sidharta²
Universitas Negeri Malang¹,²
Jl. Semarang No.5, Malang, 65145, Indonesia
Correspondence email: nurika.restuningdiah.fe@um.ac.id
ORCID ID: 0000-0001-8329-3993

ARTICLE INFORMATION

ABSTRACT

Management can affect the appearance of financial statements by earning management. Thus, the investors will be disturbed by earning management practice because the financial reports become incredible. There were mixed results and few systematic reviews in the research on earning management in Indonesia. Therefore, the objective of the research is to analyze the existing themes of earning management practices in Indonesia. The research method is guided by Reporting Standards for Systematic Evidence Syntheses review method to make a systematic review of the Sinta 1 and 2 databases. The research results of 23 eligible articles show four main themes in earning management in Indonesia: monitoring, management opportunities, accounting policies, and investor decision-making. The value of this research offers recommendations to future researchers to conduct more qualitative studies in earning management.

Keywords: Earning Management, Indonesia, Motive, Systematic Literature Review
INTRODUCTION

The agency problem is a conflict of interest between the agent (management) and principals (owners of capital) that often arise in various companies. Suranta and Merdistusi (2004) state that information about profit causes conflicts of interest between agents and principals because it is used to measure performance management. The separation of management and ownership functions makes management not directly feel the consequences of mistakes in business decisions because the shareholders bear the risks entirely. The attention of investors who are often only focused on profit makes them not pay attention to procedures used to generate earnings information. This condition encourages managers to manage or manipulate earnings (Beattie et al., 1994; Sandra & Kusuma, 2004; Harahap, 2004).

Schipper (as cited in Harahap, 2004) says that earnings management is an intervention with a specific purpose on the reporting process of external finance intentionally to obtain some personal gain. The practice of income smoothing is one form of earnings management. Scott (as cited in Restuningdiah, 2011) states that four patterns are carried out: management to carry out earnings management, namely taking a bath, income minimization, income maximization, and income smoothing.

Ronen and Sadan (in Suranta & Merdistusi, 2004) state that the practice of smoothing profit can be done through several dimensions: income smoothing through events that occur or recognition of an event, income smoothing through allocation over a certain period and income smoothing through classification. Furthermore, Bartov (in Suranta & Merdistusi, 2004) state that Income smoothing can be done using various accounting methods or accounting estimates, which can be used to treat transactions that result in more reported earnings approaching the targeted number rather than maximizing the current expected cash flow.

The research results of Restuningdiah (2011) stated that the internal governance mechanism (independent commissioner, audit committee, internal audit function, and Risk Management Committee) does not guarantee that there will be no income smoothing in the company. Likewise, Restuningdiah's (2010) results show that the market responds to corporate earnings information and has an income-smoothing negative influence on market response. The higher the smoothing action earnings, the lower the market reaction to company information. The research results on the factors that influence earnings management are very diverse, so mapping the research development on the factors that influence earnings management is still needed. Based on this information, we want to examine the motives of earnings management in Indonesia. Moreover, based on the phenomena and the research gaps about earning management in Indonesia, we also want to analyze the underlying earnings management in Indonesia. This study's primary purpose is to systematically review the motive of management doing earning management. This study provides some practical and significant contributions to the company, investors, the public, and policymakers. Thus, the researchers can better understand the motive of earning management.

LITERATURE REVIEW

Agency Theory

According to Jensen and Meckling (1976), an agency relationship is a contractual arrangement in which a principal authorizes an agent to act on the principal's behalf and to make decisions on the principal's behalf. The agent wants to maximize his welfare and maybe trigger a conflict of interest between the principal and the agent in this agency relationship. Thus, according to Chua et al. (as cited in Supit, Saerang, Tewal, Lengkong, & Poputra, 2019), agency problems can be solved at certain costs by using incentive compensation, monitoring, and agent signaling.
Managers in agency relationships have access to more internal company information and know it faster than external parties. Managers can manipulate financial reporting with information in order to maximize their profits. As a result, agency theory can imply information asymmetry between managers and principals. Rahmawati (2006) defines information asymmetry as when managers know more about internal information and future company prospects than shareholders and other stakeholders.

The presence of agency conflict and information asymmetry between the principal and the agent encourages managers to engage in dysfunctional behavior, specifically income smoothing. This condition can bring many advantages and disadvantages to the definition of income smoothing.

**Earning Management**
Earnings management is the self-serving intervention of management in financial reporting. Earnings management can diminish the credibility of financial reports, increase the in financial reports, and irritate users of financial reports who rely on profit figures that have been artificially inflated (Setiawati & Na’im, 2000).

Earnings management is when someone tries to get personal gain by messing with the process of reporting financial information to the outside world (Harahap, 2004). Income smoothing is a type of earnings management practice. According to Scott (2000), several factors motivate managers to manage earnings. These factors include bonus reasons (bonus scheme), long-term debt contracts (debt to a convention), political motivation, taxation motivation, change of CEO (chief executive officer), and an initial public offering.

According to Scott (2000), management uses four patterns to manage earnings: taking a bath (a pattern of earnings management in which the company’s profits in the current period become very low (even a loss) or very high (compared to profits in the previous or subsequent period); income minimization (a pattern of earnings management in which the profit in the current period’s financial statements is lower than the profit in the previous or subsequent period).

**RESEARCH METHOD**

**The Review Protocol – ROSES**
The ROSES (RepOrting standards for Systematic Evidence Syntheses) guided this systematic literature review. ROSES review protocol is designed to encourage the author to ensure they have the correct information and level of detail. First, roses start with formulating a research question. Second, explain the systematic searching strategy – identification, screening, and eligibility. Third, proceed with the quality appraisal of selected articles to ensure that quality articles are reviewed. Fourth, the research explains data abstraction and how the data is abstracted, analyzed, and validated.

**Resources**
This systematic literature review relied on articles from Sinta. Sinta is a portal indexing journal from The Ministry of Education, Culture, Research, and Technology Indonesia. Sinta provides benchmarks and analysis, identification of the research strength of each institution in Indonesia. This article used SINTA 1 (Sinta Journal Level 1 with a value (n) ranging from 85 to 100) and SINTA 2 as the primary journal database. Sinta Journal Grade 2 with a value (n) ranging from 70 to 85. Sinta consists of diverse subject areas, including financial management, economics, and accounting.
RESULTS

Systematic Literature Review Process

Identification

Four stages are involved in this systematic review process—Identification, Screening, Eligibility, and Quality Appraisal. The systematic review process began in August 2022. The first process is manually picking keywords on the title and abstract of the article in journals Sinta 1 and 2. The manual picking method is used because the “search” system in Sinta is by the journal’s name, not by the title of the article. Relying on and thesaurus, keywords similar and related to earning, management, income, and smoothing were used (Table 1). Also, after three manual screenings, the duplicated articles were removed at this stage.

Table 1. Keywords and Searching Information Strategy

<table>
<thead>
<tr>
<th>Databases</th>
<th>Keywords used (Manually Picked)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sinta 1 and 2</td>
<td>Earning, Earning Management, Income Smoothing</td>
</tr>
</tbody>
</table>

Screening

Screening is the second process where criteria are included and excluded to perform eligibility. First, a literature-type article with empirical data is selected. Second, to avoid confusion in translating, the search efforts excluded non-English and non-Bahasa Indonesia and focused only on articles published in Bahasa Indonesia and English. Third, a period of 8 years is selected (between 2015 and 2022), and an adequate period is to see the evolution of research and related publications. Fourth, Records are excluded due to needing a similar topic to earn management, such as income persistence, earning quality, earning diversification, and earning diversion. Fifth, in line with its objective which focuses on Indonesia, only articles focused on Indonesia territories are selected.

Table 2. The inclusion and exclusion criteria

<table>
<thead>
<tr>
<th>Criterion</th>
<th>Eligibility</th>
<th>Exclusion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Language</td>
<td>English and Bahasa Indonesia</td>
<td>Non-English and non-Bahasa Indonesia</td>
</tr>
<tr>
<td>Timeline</td>
<td>Between 2015-2022</td>
<td>&lt;2015</td>
</tr>
<tr>
<td>Countries and territories</td>
<td>Indonesian countries</td>
<td>Non-Indonesian countries</td>
</tr>
</tbody>
</table>

Eligibility

Eligibility is the third process where a full-text article is assessed from the title, abstract, and result. The authors manually monitored the retrieved articles to ensure the remaining article was in line with the criteria and research question. Article far from the research question is excluded. This process was done by reading the article’s title, abstract, and result. This process excluded 140 articles due to focus on another variable than motive management doing earning management, focus on review, not empirical data, the methodology section needs to be clearly defined, and the result is flexible. After all, there were only 73 articles selected.

Quality Appraisal

The last systematic review is the quality appraisal. According to Petticrew and Roberts (2006), The expert reviewers categorized each article as high, moderate, and low quality. The moderate and low-quality article is excluded. The expert focused on the articles’
methodology to determine the quality’s rank. This process ranked 36 articles as high, 22 as moderate, and 25 as low. Thus, all the remaining articles were eligible for review.

**Data Abstraction and Analysis**
The remaining articles were assessed and analyzed. The researcher read the 23 articles thoroughly, particularly in the section abstract, results, and discussions. The data abstraction is based on the research question, and then the authors use the deductive theme method in the process. Four themes were selected – monitoring, management opportunities, accounting policies, and investor decision-making. The experts were asked to evaluate five themes subjectively and agreed that the five themes were appropriate and relevant to the result of this article. Below is the flow diagram that was adapted from Shaffril, Samah, Samsuddin, and Ali’s (2019) research.
Figure 2. The Flow diagram

Formulation of Research Question

Records retrieved manually picked from Sinta 1 & 2 (n=356)

Records are excluded due to not article type with empirical data, not having similar topic with earning management such as income persistence, earning quality, earning diversification, and earning diversion, period of 8 years (since 2015), non-English and Indonesia, studies conducted in non-Indonesia (n=143)

Total records are screened (n=213)

Full-text articles assessed for eligibility (Title, abstract, and discussion screen) (n=213)

Full text article excluded due to focus on other variables than motive management doing earning management, focus on review not empirical data, the methodology section is not clearly defined, and the result is not rigid (n=140)

Articles ready for quality appraisal (n=73)

The expert reviewers categorized 23 articles as high quality, 25 articles as moderate quality, and 25 as low quality (moderate & low-quality articles excluded)

Articles ready for quality of synthesis (n=23)
Table 3. The Themes

<table>
<thead>
<tr>
<th>No</th>
<th>Author</th>
<th>Years</th>
<th>Monitoring</th>
<th>Management Opportunities</th>
<th>Accounting Policy</th>
<th>Investor decision making</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Handoko and Ahmar</td>
<td>2015</td>
<td>√</td>
<td></td>
<td>√</td>
<td>√</td>
</tr>
<tr>
<td>2</td>
<td>Cinthya and Indriani</td>
<td>2015</td>
<td>√</td>
<td>√</td>
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<td></td>
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<tr>
<td>3</td>
<td>Dwiharyadi</td>
<td>2017</td>
<td>√</td>
<td></td>
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<tr>
<td>4</td>
<td>Jasman and Amin</td>
<td>2017</td>
<td></td>
<td></td>
<td></td>
<td>√</td>
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<tr>
<td>5</td>
<td>Nurhandono and Firmansyah</td>
<td>2017</td>
<td>√</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>6</td>
<td>Machmuddah, Syafruddin, Muid, and Ulomo</td>
<td>2017</td>
<td>√</td>
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<tr>
<td>7</td>
<td>Istiqomah and Adhariani</td>
<td>2017</td>
<td>√</td>
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<td>√</td>
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<td>8</td>
<td>Firmansyah and Irawan</td>
<td>2018</td>
<td>√</td>
<td></td>
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<td>√</td>
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<tr>
<td>9</td>
<td>Abbas</td>
<td>2018</td>
<td>√</td>
<td></td>
<td>√</td>
<td>√</td>
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<tr>
<td>10</td>
<td>Yapono and Khomsatun</td>
<td>2018</td>
<td>√</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>11</td>
<td>Kusumawati</td>
<td>2019</td>
<td>√</td>
<td>√</td>
<td></td>
<td>√</td>
</tr>
<tr>
<td>12</td>
<td>Setiawan and Putra</td>
<td>2019</td>
<td>√</td>
<td></td>
<td></td>
<td>√</td>
</tr>
<tr>
<td>13</td>
<td>Astuti and Pangestu</td>
<td>2019</td>
<td>√</td>
<td>√</td>
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<tr>
<td>14</td>
<td>Panjaitan and Muslih</td>
<td>2019</td>
<td>√</td>
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<td>√</td>
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<tr>
<td>15</td>
<td>Wahyono, Novianto, and Putri</td>
<td>2019</td>
<td>√</td>
<td></td>
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<td>√</td>
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<tr>
<td>16</td>
<td>Kiswanto and Fitriani</td>
<td>2019</td>
<td></td>
<td></td>
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<td>√</td>
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<tr>
<td>17</td>
<td>Subadriyah, Sa’diyah, and Murniati</td>
<td>2020</td>
<td>√</td>
<td></td>
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<tr>
<td>18</td>
<td>Feliana and Bagus</td>
<td>2020</td>
<td></td>
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</tr>
<tr>
<td>19</td>
<td>Wijoyo and Firmansyah</td>
<td>2021</td>
<td>√</td>
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<td>√</td>
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<tr>
<td>20</td>
<td>Surbakti and Sudaryati</td>
<td>2021</td>
<td></td>
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<td>21</td>
<td>Marheni</td>
<td>2021</td>
<td>√</td>
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<tr>
<td>22</td>
<td>Nazarudin and Suseno</td>
<td>2017</td>
<td>√</td>
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</tbody>
</table>

Table 3 shows the main themes of earnings management research from 2015 to 2022. Based on the 23 existing articles, there are four main themes, namely: monitoring, management opportunities, accounting policy, and investor decision-making. The most frequently discussed of the four themes were accounting policy (33.3%) and monitoring (30.95%), followed by management opportunities (19.05%) and investor decision-making (16.67%). These results indicate that few research studies discuss the theme of investor decision-making in earnings management.

Most research related to earnings management is found in articles published in 2017 (25%) and 2019 (25%). Most of the themes raised in 2017 (50%) were monitoring, followed by accounting policy (37.5%) and investor decision-making (12.5%). The theme raised in 2019 was somewhat different from the theme raised in 2017. In 2019, the theme was dominated by management opportunities (35.71%), while the other theme was monitoring (21.43%), accounting policy (21.43%), and investor decision-making (21.43%), spread evenly.

In 2020 and 2021, the most common theme will be accounting policy (44.44%), followed by monitoring (22.22%) and management opportunities (22.22%), and investor decision-making (11.11%).
DISCUSSION

Monitoring
There are various ways to reduce earnings management, one of which is to supervise the behavior of managers. Strict and good supervision will detect earnings management from the start to mitigate it (Yapono & Siti, 2018; Wahyono et al., 2019). Furthermore, excellent and strict supervision is also an obstacle for managers in managing earnings (Marheni, 2021). Many elements are covered in excellent and strict supervision, including supervision by auditors, board of commissioners, Independent Commissioners, company size, and IFRS adoption (Astuti & Nandha, 2019; Wahyono et al., 2019; Firmansyah & Irawan, 2018; Marheni, 2021; Istiqomah & Adhariani, 2017; Cinthya & Mirna, 2015; Machmuddah, et al., 2017). In addition, companies that already have high market power are not there is an incentive to carry out earnings management.

Management Opportunities
The company’s condition is one factor that can trigger managers to carry out earnings management. These conditions are in the form of companies with high free cash flow, close to debt agreements, financial distress, and cooperative companies (family-owned) (Kusumawati, 2019; Setiawan & Putra, 2019; Subadriyah et al., 2020; Cinthya & Mirna, 2015). On the other hand, earnings management rarely occurs in large and complex companies. Thus, Astuti and Pangestu (2019) found that managers are careful in reporting financial reports to improve the company’s reputation. In addition to that, Wijoyo and Firmansyah (2021) add that managers’ motivation to carry out earning management in Indonesia is due to the opportunistic nature of managers. Therefore, management becomes opportunistic for various reasons, including wanting to maximize bonuses because of opportunistic behavior that managers already have and want to achieve targets (Panjaitan & Muslih, 2019; Wahyono et al., 2019; Subadriyah et al., 2020).

Accounting Policies
Accounting policy regulations in Indonesia are one of the management’s motives for managing earnings. IFRS accounting standards in Indonesia can provide a narrow space for management in managing earnings (Firmansyah & Irawan, 2018). Applying PSAK 50/55 is expected to reduce earnings management practices; interest income, insurance, and insurance cannot be recorded as income in advance (Nazarudin & Suseno, 2017). However, protection for investors in Indonesia is still low, and the law must be adequate (Yapono & Khomsatun, 2018). IFRS implemented in Indonesia is just a convergence and very flexible with existing company regulations (Abbas, 2018).

Various company conditions cause management to carry out earnings management, such as in the early stages of financial distress, maintaining quality in the long term, family companies that have complete financial control authority, and high environmental uncertainty (Setiawan and Putra, 2019; Feliana and Bagus, 2020; Surbakti and Sudaryati, 2021; Savitri, 2021). There are various ways to make earnings management look legitimate with existing accounting policies in Indonesia. These methods include deferring costs / increasing intangible assets so that profits can be processed by carrying out earnings management in real action, namely increasing sales at a discount, increasing production prices to reduce COGS, recognizing future income, transferring profits generated in the future to the current period, and decreased production or shifted classification thereby reducing operating profit, and operating cash flow by increasing production resulting in lower overhead costs (Marheni, 2021; Panjaitan and Muslih, 2019; Wijoyo and Firmansyah, 2021; Kusumawati, 2019).

Investor Decision Making
The last motive is the consideration of investors in making investments. There are various reasons managers carry out earnings management so that they can determine decision-making for investors, including anticipating unexpected things so that the company’s value decreases, maintaining the company’s reputation, attracting investors,
avoiding reporting losses, pursuing lower cost of equity so that the company looks attractive, and so that in the eyes of shareholders and the public, its performance looks good (Abbas, 2018; Kusumawati, 2019; Astuti and Pangestu, 2019; Kiswanto & Fitriani, 2019; Kusumawati, 2019).

There are various forms of earnings management so that investors catch company signals, including when the company’s value decreases. Thus, managers make discretionary accruals through income-decreasing patterns and play with the amount of profit. There is information asymmetry so that they can change cash flow as desired, according to the research results from (Abbas, 2018; Kusumawati, 2019; Jasman & Amin, 2017). However, the signal of earnings management is well received by investors when investors know that companies carry out earnings management through accrual transactions. Consequently, as Handoko and Ahmar (2015) said in their research, the company’s market power will decrease and vice versa. Furthermore, if managers are proven to be doing earnings management, it will cause distrust of information investors to capture as a wrong signal (Wijoyo & Firmansyah, 2021). As it is stated by Istiqomah and Adhariani (2017), investors in Indonesia react negatively to earnings management.

CONCLUSION

The results show some of the basic motives of management using earnings management. Moreover, the result informs researchers on a specific area of financial management and other area related to earning management that can become the focus of the study. The result shows that there are several motives for management doing earning management. Researchers can get insight for the following research. This study suggested several recommendations for future research. First, more studies are needed to review motive management doing earning management in Indonesia – research about earning management in Indonesia is massive but not deep and clear enough to reveal why management is doing earning management. Second, the systematic review suggests that future research should consider more earning management-related studies on regions such as Asia-Pacific, Asia-African region, and different countries. Third, future research of systematic review can use other searching techniques such as reference techniques with Scopus, WoS (Web of Science), and other search databases.

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DECLARATION OF CONFLICTING INTERESTS

The authors declared no potential conflicts of interest.

REFERENCES


