CREATIVE ACCOUNTING: VIEWED FROM RISK AND SHARIA COMPLIANCE PERSPECTIVE

Muhammad Noor[1], Sopian[2]
[1,2]Polytechnic of State Finance STAN
muhammadnoor.91@gmail.com[1], sopian@pknstan.ac.id

ABSTRACT

Purpose: A company with a corporate form resulting from the industrial revolution rises a principal and agent relationship. The separation between the company's owner and the people who run the company makes accounting needs more crucial. However, accounting which is a solution for communication between owners and management is often exploited by managers through creative accounting, also known as earnings management. This study aims to determine the effect of firm risk, tax risk, and sharia compliance on earnings management.

Design/methodology/approach: The research was conducted on manufacturing sector companies listed on Indonesia Stock Exchange (IDX) in 2016-2019. Using the purposive sampling method, the number of samples used is 69 companies with 276 observations. The hypothesis examination used in this research is the multiple linear regression analysis of pooled data.

Findings: The result shows that firm risk from the perspective of debtholders has a positive effect on earnings management. As for firm risk from equity holders' perspective, tax risk, and sharia compliance has no effect on earnings management.

Research limitations: First, this study only measures earnings management with proxy discretionary accruals from the modified Jones model. Second, this study measures firm risk (equity holder) with the total risk proxy. The proxy describes the risks faced by the company both systematically and non-systemically. To see which of the two risks affects earnings management more, further research can simultaneously use systematic risk and idiosyncratic risk proxies. Third, the study was conducted in the period before the covid 19 pandemic in Indonesia.

Practical implications: Companies with high leverage tend to carry out earnings management so that creditors must be more aware of the company's financial statements. On the other hand, as an independent party that tests a company's financial statements, auditors can be more aware of companies with high leverage because they tend to use earnings management. It requires more vigilance when conducting audits of related companies.

Originality: There are still several inconsistencies in the results in previous studies regarding the effect of firm risk from the debtholder perspective on

earnings management. Research that discusses the effect of firm risk from the equity holder side on earnings management is quite diverse. The research on the effect of sharia compliance, which is more specific than the level of religiosity, and tax risk on earnings management has never been done. All of these make this research the first study of its kind.

Keywords: earnings management, firm risk, tax risk, sharia compliance.

1. INTRODUCTION

Since the start of the industrial revolution, the definition of a company has shifted significantly. The industrial revolution brought many new things in the business world, one of which was the form of the corporation. Today, company owners can be interpreted as owners of capital. In the case of a public company, shareholders are often very far from where the company's activities are running. For the company's day-to-day operations to continue under these conditions, the owners of capital appoint certain parties as representatives, namely the company's board of directors.

The separation of shareholders from the companies they own makes the need for reporting on the board of directors' performance very important. Accounting is present as a bridge between the two parties. Through accounting reports, the board of directors conveys the version that has been carried out during a period to the owners of the company. Accounting, which is a communication solution between company owners and management, does not come without problems. It is not uncommon for company management to cover operational deficiencies by manipulating records, either by taking advantage of the flexibility gaps in accounting provisions or committing fraud, also known as creative accounting.

Creative accounting is nothing new. It has existed since the emergence of accounting science (Umobong & Ironkwe, 2017). Diana and Beattrice (2010) mention that this has been going on for 500 years and Luca Paciolo has described this practice in his book De Arithmetica. Marino (1993) further mentions that the history of creative accounting appeared during Phillip II's reign in the Kingdom of Spanish Naples. At that time, the rationalization of mathematical calculations was used to reduce the interest rate on the royal debt from the original 9% to only 3.3%. Mathematical illusions are steps taken to overcome the kingdom's economic conditions related to deficit financing, projected income, and interest rates.

Mutuc et al. (2019) state that creative accounting occurs when management uses their judgment to prepare financial statements and make transactions that alter financial statements. Jones (2010) explained further about five strategies that can be used by company managers related to creative accounting. The strategy is to control the company's revenue, cut

various expenses, increase the value of the company's assets, reduce the company's liabilities, and increase the company's operating cash flow.

The widespread adoption of earnings management has given rise to a number of major scandals around the world. Several accounting scandals that occurred in Australia after 1980 were described by Carnegie and O'Connell (2012), namely the case of Adelaide Steamship (Adsteam), One.Tel, and the biggest one was the collapse of HIH Insurance. Creative accounting problems are also rife in the Asian continent. Chen et al. (2012) described various accounting scandals in China, including the Great Wall Fund Raising in 1993 and Zhengzhou Baiwen in 2000. Still from the East Asia region, Suda (2012) describes several accounting scandals in Japan after the 1980s involving Yaohan Japan, Nikko Cordial, and Kanebo. Not only in the Pacific region, but creative accounting has also shocked the Indian Ocean region. Banerjee (2012) describes some cases that occurred in India. One of the most exceptional cases is Satyam Computer Service Ltd. that happened in 2009.

Excessive earnings management also occurs in many countries in Europe. Two big cases in the blue continent are Parmalat in Italy and Polly Peck in the United Kingdom. Melis (2012) mentions that Parmalat represents the most important and most spectacular case in Italy. The Parmalat case covers various techniques, from creative accounting to false accounting. Difficulties in detecting the problems occur because Parmalat utilizes many related parties with very complicated corporate schemes. In the United Kingdom, Gwilliam and Jackson (2012) illustrate Polly Peck's growth rate as a meteoric rise which recorded an increase in profit before tax from 9 million pounds in 1982 to 161 million pounds in 1989. Although there is still no bright spot, Polly Peck's success which finally dimmed is thought to be due to the company's accounting policies regarding transactions using foreign exchange, asset revaluation, and management's interpretation.

Two of the largest creative accounting cases in the world occurred in the United States. Mulford and Comiskey (2012) mention that these two companies, Enron Corp. and WorldCom, are famous for the wrong reasons. Enron, which in 2000 was ranked seventh in the Fortune 500, suddenly faced bankruptcy and went into liquidation in 2001. That is due to the disclosure of management practices that use special purpose vehicles to hide debt and create phantom income. Just a few months later, the WorldCom case came to the attention of the American public. The scheme used by WorldCom management is the capitalization of expenses by using operating expenses for leasing telecommunications lines from other companies, which are reported as capital expenditures and added to the company's balance sheet as fixed assets.

In Indonesia, several cases related to creative accounting have been revealed. One of the most exceptional cases in the practice of earnings

management is PT Garuda Indonesia which recognizes revenue from PT Mahata Aero Teknologi prematurely (Hartomo, 2019). The latest case involving one of the state-owned enterprises, Jiwasraya, involved the management of financial statements with the window-dressing method (Irene, 2020).

The exploitation of earnings management in the preparation of financial statements can also affect the development of sustainability accounting. Lamberton (2005) mentions three indicators that underlie the concept of sustainability accounting, economic, environmental, and social. Earnings management practices will be able to affect all aspects of the economic indicators. As for social indicators, earnings management has a close relationship with the category of society.

The board of directors' decision to carry out the earnings management strategy without paying attention to ethics has proven detrimental to shareholders, creditors, and the company itself. The presentation of the original accounting profit becomes so crucial because of the rapid growth of domestic and international investors. In the equity market, the development of individual investors is also increasing in the debt market. Referring to the release of OJK data, the number of lender accounts registered with a number of peer-to-peer lending in the country grew by 186% since December 2018. The high growth of investors and lenders makes the need for financial statements increasingly important.

The tendency of a company to carry out earnings management has encouraged tests using many factors and variables by several previous researchers. These studies include discussing the variables that affect the company in carrying out earnings management practices in the form of good corporate governance (Kordlouie & Sheikhbeglo, 2012; Wibawa et al., 2020; Mutuc et al., 2019; Jao & Pagalung, 2011; Asitalia & Trisnawati, 2017; Mahiswari & Nugroho, 2014), deferred tax expense (Phillips et al., 2003; Nurhanifah & Jaya, 2014; Trisnawati et al., 2015; Ifada & Wulandari, 2015; Wibawa et al., 2020), deferred tax asset (Utami et al., 2018; Yahya & Wahyuningsih, 2019; Wibawa et al., 2020), tax planning (Ifada & Wulandari, 2015; Trisanti, 2019; Dwianika & Wisnantiasri, 2019), leverage (Sosiawan, 2012; Suhartanto, 2015; Dwianika & Wisnantiasri, 2019; Religiosa & Surjandari, 2021; Jao & Pagalung, 2011; Tala & Karamoy, 2017; Asitalia & Trisnawati, 2017; Mahiswari & Nugroho, 2014), company size (Sosiawan, 2012; Suhartanto, 2015; Trisanti, 2019; Jao & Pagalung, 2011; Mahiswari & Nugroho, 2014), profitability (Trisnawati et al., 2015; Suhartanto, 2015; Tala & Karamoy, 2017), litigation risk (Kirana et al., 2016), firm risk (Suhartanto, 2015; Pradnyani & Astika, 2019; Religiosa & Surjandari, 2021), and religiosity (Kanagaretnam et al., 2015).

One of the factors that influence the company's actions in carrying out earnings management practices is leverage. Leverage, which is the use of debt in the capital structure, can bring the company to default risk. This

bankruptcy risk is the risk of the company from the perspective of the debtholder. Sosiawan (2012) has previously researched the effect of leverage on earnings management with the results that leverage has a positive effect on earnings management. In contrast to the results of this study, Suhartanto (2015) found that leverage has no effect on earnings management practices.

An indicator of the existence of earnings management in a company that has also been studied previously is the firm risk. Suhartanto (2015) proves that the firm business risk influences earnings management. In addition, Religiosa and Surjandari (2021) examined the effect of corporate risk in the banking sector and obtained results indicating that corporate risk has a significant effect on earnings management practices.

In terms of taxation, previous research has discussed several factors and their relation to earnings management. Wibawa et al. (2020), who researched mining companies on the IDX for the 2016-2019 period, concluded that deferred tax expense aligns with earnings management activities. In contrast to the previous opinion, Nurhanifah & Jaya (2014), Trisnawati et al. (2015), and Ifada and Wulandari (2015) write that deferred tax expense has no effect on earnings management practices. As for the deferred tax asset variable, Utami et al. (2018) and Yahya and Wahyuningsih (2019) indicate that there is no effect of deferred tax assets on earnings management. Wibawa et al. (2020) state that the regression test results show that deferred tax assets have a positive effect on earnings management.

Further research related to taxes revolves around tax planning variables. Ifada and Wulandari (2015), in their study, indicate that tax planning has no significant effect on improving earnings management practices. It is contrary to Dwianika and Wisnantiasri's (2019) research, which states that tax planning has an effect on earnings management. Trisanti (2019) reinforces this result, who concludes that tax planning moderates the effect of firm size on earnings management practices. Based on this explanation, it can be seen that the research on taxation factors on earnings management that has been carried out is deferred tax expense, deferred tax assets, and tax planning. There is still no correspondence regarding tax risk research on earning management practices.

Another factor that is also related to earnings management but rarely gets the attention of researchers is the level of religiosity. Kanagaretnam et al. (2015) previously researched religiosity and earnings management in the international banking industry. In line with the hypothesis, the results of the analysis show that religiosity has a negative effect on earnings management, whether it is aimed at avoiding losses or just meeting the company's revenue targets.

From the explanation above, it can be seen that there are still several inconsistencies in the results in previous studies regarding the effect of firm

risk from debtholder perspective on earnings management. Research that discusses the effect of firm risk from equity holder side on earnings management is quite diverse. The research on the effect of sharia compliance, which is more specific than the level of religiosity, and tax risk on earnings management has never been done. It makes the variables very interesting to study.

The purpose of this study was to determine the effect of firm risk (debtholder and equity holder), tax risk, and sharia compliance on earnings management. The research is expected to be used by investors in determining the investment decisions to be made. In addition, the study is expected to be useful for the government, especially the Financial Services Authority (OJK) and the Directorate General of Taxes (DJP), to provide a basis for indications of companies conducting creative accounting to mislead investors and avoid taxes.

2. LITERATURE REVIEW AND HYPOTHESIS

2.1. POSITIF ACCOUNTING THEORY

Modern positive accounting research began to develop in the 1960s when Ball and Brown (1968), Beaver (1968), and other researchers introduced the use of empirical financial methods in financial accounting. (Watts & Zimmerman, 1990). Positive accounting theory developed from several thoughts, one of which was the thought of Ball and Brown (1968) about how one can explain the predictive ability of a proposition based on assumptions without adequate verification. Accounting that does not have a sufficient theoretical framework that is comprehensive causes the development of differences in practice in the field (Ball & Brown, 1968).

Watts and Zimmerman (1986) mention three positive accounting theory hypotheses: the bonus plan hypothesis, the debt covenant hypothesis, and the political cost hypothesis. The bonus plan hypothesis explains the tendency of companies to choose accounting procedures that can increase current period profits so that management gets bonuses from the company. The debt covenant hypothesis sees management's efforts to implement accounting policies that maintain the company's debt ratio at a safe level to avoid imposing penalties from creditors. The political cost hypothesis describes management's intention to carry out earnings management practices to minimize political costs.

2.2. AGENCY THEORY

Agency relations are one of the oldest and most common codified methods of social interaction. It can be said that an agency relationship exists between two or more parties, one party acts as an agent and the

other party acts as a principal (Ross, 1973). Eisenhardt (1989) concludes that agency theory offers a unique view of information systems, outcome uncertainty, incentives, and risk.

Jensen and Meckling (1976) argue that an agency relationship is a contract entered into by the company's owner involving other parties (agents) to carry out several functions on their behalf. Agency theory demonstrates that the emergence of various conflicts between the owner (principal) and management (agent) gives rise to agency costs, costs that exist to reduce friction (Morris, 1987). On the other hand, Umobong and Ironkwe (2017) argue that agency relationships require delegation of decision-making authority from the owner to the agent.

2.3. EARNINGS MANAGEMENT

Also known as creative accounting, earnings management is a purposeful intervention in the financial reporting process to external parties. Management is motivated to carry out creative accounting due to pressure to meet the company's financial expectations (Mutuc et al., 2019). Healy and Wahlen (1999) argue that earnings management occurs when managers use financial reporting and transaction preparation judgment to modify financial statements.

Sosiawan (2012) states that earnings management adds to the bias in financial statements and can interfere with users of financial statements who believe that the engineered profit figure is an unengineered profit figure. Earnings management itself is a step in reporting manipulated profits for the benefit of company management (Trisnawati et al., 2015).

Based on the definition described above, earnings management is a practice used by company management in utilizing the flexibility of accounting rules in preparing financial statements. This flexibility is exploited to meet the needs of management with various objectives that often conflict with the expectations of the company's owners.

2.4. FIRM RISK

Pradnyani and Astika (2019) state that firm risk is a condition with some possibilities that cause a company's performance to be lower than what the company expects due to uncertain conditions in the future. Financial leverage is the use of debt as a source of funding at the company's expected rate of return (Firmansyah et al., 2021). In terms of debtholders, the use of financial leverage is one of the risks faced by the company. Raningsih and Putra (2015) mention that a high level of leverage ratio reflects that the company has a high risk, especially for the inability to pay off its debts so that investors judge it as not good.

Bhattacharya et al. (2019) state that from an investor's perspective, there are two stakeholders, namely debtholders and equity holders. From

the perspective of equity holders, firm risk can be measured using total risk and idiosyncratic risk (Chakraborty et al., 2019). Further mentioned by Bhattacharya et al. (2019) that the company's risk from the equity holder side contains two risks, namely systematic risk and idiosyncratic risk.

Based on these definitions, firm risk can be interpreted as the possibility of circumstances that bring the company to unexpected conditions. This risk is closely related to the company's capital structure, considering that funding using debt or equity has a negative potential for company performance. Excessive use of debt will lead to default risk, while market and company conditions can affect the volatility of company value.

2.5. TAX RISK

Tax risk is defined as all tax-related risks and uncertainties related to the company's operating, investing, and financing decisions. These uncertainties include tax reporting related to the company's original condition, audit risk by tax authorities, and financial accounting related to income tax payments (Hutchens & Rego, 2013). Guenther et al. (2013) stated that tax risk is the uncertainty associated with future corporate tax payments. Therefore, tax risk has a different view from tax avoidance and tax aggressiveness.

Firmansyah and Muliana (2018) state that the tax risk faced by companies is caused by various company policies used to respond to tax regulations. This response is not always in line with applicable regulations. One example of tax risk faced by a company is the imposition of tax sanctions by the tax authorities if the company is found to have deviated from taxes, such as not reporting part of the sales proceeds or passively increasing deductible expenses (Wardani & Putriane, 2020).

Referring to several definitions that have been described previously, tax risk can be interpreted as all risks faced by companies in connection with fluctuations in corporate tax payments. This risk can be caused by fluctuations in the company's cash flow, changes in tax rules, or company internal policies.

2.6. SHARIA COMPLIANCE

Based on Islamic finance theory, companies that comply with sharia provisions are subject to several restrictions to maintain their compliance status (Alnori & Alqahtani, 2019). Naz et al. (2017) state that the principles of Islamic finance are derived from sharia, Islamic law, a law based on the hadith/Sunnah of the Prophet Muhammad PBUH and the Quran, which directs all aspects of the individual and social life of Muslims.

Companies in issuing sharia securities must meet the provisions that have been set. Becoming a company that has sharia securities has the consequence that the company's activities will continue to be monitored by

the Sharia Board (Tanno & Putri, 2019). Sharia compliance plays an essential role in ensuring that all company activities align with sharia principles (Zakiah M, 2017).

Based on the explanation above, the definition of sharia compliance in this study is conformity with sharia principles that have been determined by the National Sharia Council of the Indonesian Ulema Council (DSN-MUI) concerning the principles of brotherhood (ukhuwah), justice (‘adalah), balance, and universal (syumuliyah). Compliance with sharia provisions in the Indonesia Stock Exchange is reflected in the inclusion or absence of issuers in the Indonesian Sharia Stock Index (ISSI) list.

2.7. HYPOTHESIS DEVELOPMENT

An agency relationship exists between two or more parties, one party acts as an agent and the other party acts as a principal (Ross, 1973). In running the company, management is always faced with risk. From investors’ perspective, firm risk can be divided into debt holders and equity holders (Chakraborty et al., 2019). The use of debt in the company’s capital structure reflects the risk from the perspective of the debtholder. Watts and Zimmerman (1990) state that in the debt covenant hypothesis, companies with a high debt to equity ratio (DER) are predicted to be more likely to use accounting provisions that increase company profits. This is because the higher the DER of a company, the thinner the distance between the company and the limitations in the debt agreement (Kalay, 1982).

The company also encounters risk from the perspective of the equity holder, namely the overall market conditions and events involving the company’s management can bring risks that must be borne by the corporation. These various risks can create severe fluctuations in the profitability and price of the company’s shares which are generally the basis for calculating bonuses for the board of directors. The bonus program hypothesis states that managers lured by bonuses are more likely to use various accounting methods that can boost company profits in the related period (Watts & Zimmerman, 1990).

A large firm risk will result in management tending to carry out earnings management. It is in line with the results of research by Pradnyani and Astika (2019), Suhartanto (2015), and Religiosa and Surjandari (2021). Therefore, the first and second hypotheses proposed in this study are:
H_1: Firm risk (debtholder) has a positive effect on earnings management
H_2: Firm risk (equity holder) has a positive effect on earnings management.

Agency theory offers a unique view of information systems, outcome uncertainty, incentives, and risk (Eisenhardt, 1989). It can be said that an agency relationship exists between two or more parties, one party acts as an agent and the other acts as a principal (Ross, 1973). One of the hypotheses in Positive Accounting Theory proposed by Watts and Zimmerman (1986) is

the political cost hypothesis. In this hypothesis, it is illustrated that management has the intention to carry out earnings management practices to minimize political costs, one of which is the tax burden.

Referring to the previous study, research on taxation factors on earnings management revolves around deferred tax expense, deferred tax assets, and tax planning. There is still no research on the effect of tax risk on earnings management. However, several researchers have studied the effect of tax risk on firm risk, as previously mentioned that Pradnyani and Astika (2019), Religiosa and Surjandari (2021), and Suhartanto (2015) found that firm risk influences management decisions in carrying out earnings management practices. In that study, Guenther et al. (2013) and Hutchens and Rego (2015) agree that tax risk has a positive effect on company risk. Therefore, the third hypothesis proposed in this study is:

H_3: Tax risk has a positive effect on earnings management.

An agency relationship is a contract entered into by company owners involving other parties (agents) to carry out several functions on their behalf (Jensen & Meckling, 1976). The existence of two different parties in one entity can trigger different interests. This difference in interest is in line with the opinion of Trisnawati et al. (2015) which states that company owners are motivated to maintain an increase in living standards by increasing company profitability while managers are motivated to maximize economic and psychological needs in the form of obtaining investment, debt, job security, or compensation.

Companies on the Indonesia Stock Exchange can be divided into sharia complaints and non-sharia complaint companies. Ahmed (2009) mentions several specific provisions in sharia provisions, including funding, investment, operations, and risk management practices. Companies that do not follow sharia provisions are not subject to these restrictions. Sharia provisions, which are also aspects of religiosity, are the foundation of morals and ethics (Kanagaretnam et al., 2015).

Management in companies that tend to be religious and comply with sharia provisions can have better morals. Actions that prioritize morals and ethics will further reduce friction between principals and agents, decreasing earnings management practices. This opinion is in line with the research results of Kanagaretnam et al. (2015). Although Hamdi and Zarai (2012) state that Islamic banks still tend to carry out earnings management, there is no statistical evidence of account manipulation that leads to the avoidance of revenue declines. Based on this, the fourth hypothesis proposed in this study is:

H_4: Sharia compliance has a negative effect on earnings management.

3. RESEARCH METHODOLOGY

This research uses quantitative methods. The research was conducted using a descriptive study. The type of data used in this study is

secondary data. The data to be processed is pooled data. The population used in this study are companies in the manufacturing sector, including basic industry and chemicals, miscellaneous industry, and consumer goods industry.

Based on the population, the next step is to determine the sample. The sampling technique that will be used is non-probability sampling. Determination of a non-random sample requires that there are criteria that an item must meet in the population. There are four criteria used in determining the sample in this study. The first is manufacturing companies listed on IDX since 2012. The second is the company presenting complete annual financial reports for the 2012-2019 period. The third is the company having a positive net profit during the 2016-2019 period and successfully reversing losses in the beginning becomes profit at the end of the research period. And the fourth is the annual financial statements ending in December.

3.2.1. Dependent Variable

The dependent variable in this study is earnings management. The proxy used to measure earnings management in this study is discretionary accruals from the modified-Jones model. Discretionary accrual was chosen because previous studies suggest that this model gives the best results (Kothari et al., 2005).

Wibawa et al. (2020) describe the calculation of this proxy as follows:

$$EM = \mathrm{DTA}$$

$$DTA = \frac{TACC_{it}}{TA_{i(t-1)}} - NDA$$

Explanation:
EM : Earnings management
DTA : Discretionary accruals
TACC : Total accruals
NDA : Non-discretionary accruals
Total accruals are calculated using the following proxy:

$$TACC_{it} = NI_{it} - CFO_{it}$$

Explanation:
$TACC_{it}$: total accruals of company i in period t
NI_{it} : net profit of company i in period t
CFO_{it} : cash flow operation of company i period t
The accrual value is calculated based on the residuals from the simple linear regression equation using the following equation:

$$\frac{TACC_{it}}{TA_{i(t-1)}} = \beta_1\left(\frac{1}{TA_{i(t-1)}}\right) + \beta_2\left(\frac{\Delta REV_{it}}{TA_{i(t-1)}}\right) + \beta_3\left(\frac{PPE_{it}}{TA_{i(t-1)}}\right) + \varepsilon_{it}$$

Explanation:
$TA_{i(t-1)}$: total asset of company i period t-1

ΔREV_{it} : revenue of company i period t minus period t-1
PPE_{it} : value of fixed assets less accumulated depreciation of company i in period t
β : fitted coefficient obtained from the regression results in the calculation of total accruals
The value of non-discretionary accruals (NDA) is calculated using the following equation:

$$NDA_{it} = \beta_1\left(\frac{1}{TA_{i(t-1)}}\right) + \beta_2\left(\frac{\Delta REV_{it} - \Delta REC_{it}}{TA_{i(t-1)}}\right) + \beta_3\left(\frac{PPE_{it}}{TA_{i(t-1)}}\right)$$

Explanation:
NDA_{it} : non-discretionary accruals of company i period t
ΔREC_{it} : total receivables of company i period t minus period t-1

3.2.2. INDEPENDENT VARIABLE

This study has four independent variables: firm risk (debtholder), firm risk (equity holder), tax risk, and sharia compliance. In terms of debtholders, leverage reflects the risks faced by the company. Leverage is measured by using the debt ratio. The leverage proxy in this study follows the model used by Titman et al. (2011), Firmansyah et al. (2021), and Pradnyani and Astika (2019),

$$LEV_{it} = Total\ Debt_{it}/Total\ Asset_{it}$$

In this study, firm risk (equity holder) is measured by using total risk. The measurement of total risk follows the model used by Guenther et al. (2013), Firmansyah and Muliana (2018), and Parendra et al. (2020),
$TRISK_{it}$ = annual standard deviation of monthly stock return of company i period t
Which:

$$Stock\ Return = \frac{P_t - P_{t-1}}{P_{t-1}}$$

Explanation:
P_t : Share price of company i period t
P_{t-1} : Share price of company i period t-1

The proxy used to measure tax risk in this study is the volatility of cash ETR. Cash ETR volatility is calculated based on the standard deviation of a company's cash ETR as used by Firmansyah and Muliana (2018), Guenther et al. (2013), and Hutchens and Rego (2015),

$CETR_VOL_{it}$ = five-year standard deviation of annual cash ETR of company i year t

Which:

$$Cash\ ETR = \sum_{t=t-4}^{5} \frac{Cash\ Tax\ Paid_{it}}{Pretax\ Income_{it}}$$

Explanation:

Cash Tax Paid$_{it}$: Total tax payment of company i from year t-4 to t
Pretax Income$_{it}$: Profit before tax of company i from years t-4 to t

Sharia compliance in this study is measured using a dummy variable. The use of dummy variables follows the model used by Alnori and Alqahtani (2019) and Tanno and Putri (2019),

$SHARIA_{it}$ = Dummy variable with a value of 1 if the company complies with sharia provisions and a value of 0 if otherwise

Explanation: The value of 1 in dummy variable is given to companies listed in the Indonesian Sharia Stock Index (ISSI)

In this study, two control variables are used, namely profitability and firm size. Profitability is one of the crucial parameters in measuring the achievement of company goals (Noor et al., 2020). The proxy used in measuring profitability in this study follows Firmansyah et al. (2021) and Mondayri et al. (2020),

$$ROA_{it} = \frac{Pretax\ Income_{it}}{Total\ Asset_{it}}$$

Company size shows how big the company is regarding total assets owned (Januardi & Afrianto, 2017). The proxy used in this study refers to Firmansyah et al. (2021), Mondayri et al. (2020), and Parendra et al. (2020),

$$SIZE_{it} = Log(Total\ Asset)_{it}$$

Explanation:
Log (total Asset)$_{it}$: Natural logarithm of total assets of company i year t

Based on these variables, the model used in this study is as follows:

$$EM_{it} = \alpha_0 + \beta_1 LEV_{it} + \beta_2 TRISK_{it} + \beta_3 CETR_VOL_{it} + \beta_4 SHARIA_{it} + \beta_5 ROA_{it} + \beta_6 SIZE_{it} + \varepsilon_{it}$$

Explanation:

EM_{it} : Earnings management of company i period t
LEV_{it} : Leverage of company i period t
$TRISK_{it}$: Total risk of company i period t
$CETR_VOL_{it}$: Cash ETR volatility of company i period t
$SHARIA_{it}$: Sharia compliance of company i period t
ROA_{it} : Profitability of company i period t
$SIZE_{it}$: Company size of company i period t
α_0 : Constant
ε_{it} : Error

4. RESULTS

4.1. Sample and Descriptive Statistics

The data used in this study are financial statement data of manufacturing sector companies that meet the following criteria:

Table 1 Research Sample

Criteria	Total	Measure
Manufacturing companies listed on IDX at 2019	185	Company
The company has not registered since 2012	(59)	Company
Companies with incomplete financial statements	(3)	Company
Companies with a financial period that does not end in December	(3)	Company
Companies that experience losses at the end of the period and the entire study period	(39)	Company
Outlier	(12)	Company
Total sample	69	Company
Research period	4	Year
Total observation	276	Observation

Source: processed data

The results of descriptive statistic analysis for all variables used in this study are presented in Table 2.

Table 2 Descriptive Statistics

Variable	Mean	Median	Maximum	Minimum	Std. Dev.
EM	0.001833	0.001650	0.035890	-0.026447	0.007198
LEV	0.403214	0.378094	0.999261	0.066532	0.179780
TRISK	0.339163	0.269961	1.126638	0.000000	0.218600
CETR_VOL	0.140564	0.068026	1.212866	0.001968	0.184878
SHARIA	0.836957	1.000000	1.000000	0.000000	0.370076
ROA	0.081452	0.070105	0.400191	-0.180379	0.081205
SIZE	28.88534	28.55451	33.49453	25.79571	1.706455

Source: processed data

4.2. Regression Results

Hypothesis testing was carried out using the random effect model presented in Table 3.

Table 3 Hypothesis Test Result

Variable	Prediction	Coeff.	t-Stat	Prob.	
LEV	+	0.006249	2.200012	0.0143	**
TRISK	+	0.002444	1.193702	0.1168	
CETR_VOL	+	-0.001229	-0.477641	0.3166	
SHARIA	-	0.001038	0.832578	0.2029	
ROA		0.019451	3.000710	0.0014	***
SIZE		-0.000152	-0.532559	0.2974	
C		0.000592	0.071523	0.4715	

R^2	0.051603
Adj. R^2	0.030450
F-stat.	2.439438
Prob(F-stat.)	0.025887
*** Level of Sig 1%, ** Level of Sig 5%, * Level of Sig 10%	

Source: processed data

4.3. Discussion

4.3.1. Effect of Firm Risk (*Debtholder*) on Earnings Management

The results of research that have been carried out show that firm risk (debtholder) has a positive effect on earnings management. This result is in line with Pradnyani and Astika (2019), which states that firm risk as proxied by leverage has a positive effect on earnings management.

One of the hypotheses proposed by Watts and Zimmerman (1986) is the debt covenant hypothesis. This hypothesis looks at management's efforts to implement accounting policies that maintain the company's debt ratio at a safe level to avoid imposing penalties by creditors. Failure to maintain this debt ratio can lead to default risk for the company. To avoid this, companies tend to take advantage of loopholes in accounting rules that can be exploited to increase company profits.

Companies that use debt in their funding structure place creditors as one of the principals in the company. Management as a representative of the principal should also act in the interests of creditors. However, management who acts as a representative of the company's owner can have different preferences. This misalignment of interests can be seen in agency theory.

Leverage in the form of the use of debt in the company's funding structure provides excellent benefits for management as a multiplier. However, if the debt borne has exceeded the optimal limit, the company will have difficulty paying it off, which can lead to bankruptcy in extreme conditions. The risk of default needs to be anticipated by creditors by using debt covenants. Violation of the debt agreement can cause the company to be categorized as default.

However, corporate steps taken by managers can still take the company beyond the determined limits. This condition makes earnings management practices a promising option. Accounting rules that allow companies to use management discretion in recording methods make company directors try only to practice the favorable conditions, not the ideal provisions based on conservatism. It is reflected in the results of research showing that companies with high leverage use more earnings management strategies in preparing financial statements.

4.3.2. Effect of Firm Risk (Equity Holder) on Earnings Management

Based on the study results, it is known that the firm risk (equity holder) has no effect on earnings management. This result is in line with Suhartanto's (2015) research, which concludes that changes in stock prices have no significant effect on earnings management.

From equity holders' perspective, firm risk is reflected in total risk, which is the fluctuation of monthly returns received by shareholders during a period. Highly volatile returns reflect the magnitude of the risk faced by the company's owners. To avoid this, principals set up many provisions and targets that must be achieved by management. The achievement of the targets that have been formulated will make the directors get rewards. This scenario is the first hypothesis Watts and Zimmerman (1986) proposed in positive accounting theory, the bonus plan hypothesis.

The stock return, which illustrates investors' interest, is influenced by macroeconomic conditions and the company's internal conditions. However, the only thing that can be controlled by management is the conditions that occur internally. If macroeconomic conditions do not support operations, management can compensate for this by presenting a brilliant company performance. The easiest thing for management to do is present financial statements, mainly company profits, which are growing positively.

To ensure that the company's conditions are presented satisfactorily, management needs to make some adjustments. These adjustments are carried out at management's discretion by taking advantage of exploitable accounting loopholes. However, the results of this study show something different. Stock returns' fluctuations are not a factor that encourages companies to take advantage of massive earnings management practices. It is probably due to the low level of use of earnings management in the manufacturing sector. Previous descriptive statistics have shown that the average company performs earnings management intending to increase income in a deficient range. This condition causes the rise and fall of a company's stock price does not affect the manager's decision to use earnings management related to the preparation of financial statements.

4.3.3. Effect of Tax Risk on Earnings Management

The results of research that have been carried out show that tax risk has no effect on earnings management. This result indicates that a company's cash ETR volatilities are not a factor the board of directors considers in preparing financial statements' earnings management practices.

Tax payments are transactions involving external parties with high authority (government). This phenomenon is closely related to the third hypothesis in the positive accounting theory proposed by Watts and Zimmerman (1986), the political cost hypothesis. The hypothesis describes management's intention to carry out earnings management practices to

minimize political costs, such as subsidies and tax payments, which the company will bear.

The volatility of cash ETR, the number of tax payments compared to profit before tax in one period, shows how the company faces much tax risk. Changes in the value of the tax deposit will invite the attention of the tax officers. Special attention by tax officers will increase the risk faced by the company. Tax risk can then have an impact on uncertainty in the company's operational activities. These uncertainties include tax reporting related to the company's original condition, audit risk by tax authorities, and financial accounting related to income tax payments (Hutchens & Rego, 2013).

Referring to descriptive statistics in Table 2, the average cash ETR volatility of manufacturing sector companies is only 14.06%. This low volatility puts the company in a less risky position to be examined by the tax authorities, considering that the company's income tax payments are not volatile. It makes tax risk not a factor considered by managers in making decisions regarding the use of earnings management. This condition is further supported by the low practice of earnings management in manufacturing sector companies which shows that only a few companies carry out massive earnings management in the preparation of financial statements.

4.3.4. Effect of Sharia Compliance on Earnings Management

Based on the study results, it is known that sharia compliance has no effect on earnings management. This condition indicates that whether or not a company is included in ISSI is not a factor influencing the board of directors to use earnings management.

The relationship between investors and companies can be explained using agency theory. The existence of two interrelated parties, the principal and the agent, will create a conflict of interest. This difference can be seen from the motivation of both parties. The company's owner is motivated to maintain an increase in the standard of living by increasing the company's profitability. At the same time, the manager is motivated to maximize economic and psychological needs by obtaining investment, debt, job security, or compensation (Trisnawati et al., 2015).

The relationship between sharia compliance and earnings management can be estimated from the selection criteria for sharia shares compiled by the Financial Services Authority (OJK). One of these criteria is the provision of financial ratios that issuers must meet, which is that total interest-based debt compared to total assets does not exceed 45%. Suppose this criterion is compared with the composition of company funding that has been presented in table 2. In that case, it can be seen that the average company in the manufacturing sector only has 40% of DER. With this debt-to-asset ratio, the average company in the manufacturing sector does not need to adjust financial data using earnings management to remain included

in the ISSI, which means the company can continue to have more investor coverage. This condition causes sharia compliance does not affect the manager's decision in conducting earnings management.

5. CONCLUSION

This study concludes that the firm risk from the debtholders' perspective has a positive effect on earnings management. Leverage has a multiplier effect which in optimal conditions will boost operating income. However, the use of excessive leverage has the potential to bring the company to default. The potential for bankruptcy can occur if the company passes the agreed limits in the debt covenant. From the perspective of equity holders, firm risk has no effect on earnings management. Stock returns describe how much risk the company faces, both idiosyncratic risk caused by corporate actions and systematic risk influenced by macroeconomic conditions. Of the two risks, idiosyncratic risk is a risk that the company's internal parties can control. However, fluctuations in changes in company stock prices in the manufacturing sector are relatively low. Supported by low earnings management practices, this makes a company's stock return fluctuations not a consideration for managers to take advantage of earnings management strategies.

Tax risk has no effect on earnings management. The low volatility of cash ETR in manufacturing companies makes this variable not a significant consideration for managers in determining the company's operational and business strategy. This low volatility of cash ETR puts the company in a less risky position to be examined by the tax authorities. Finally, sharia compliance has no effect on earnings management. One of the criteria for sharia compliance is providing financial ratios that issuers must meet. Suppose this criterion is compared with the composition of the company's funding. In that case, it can be seen that the average manufacturing company has a DAR lower than the criteria, so there is no need to adjust financial data using earnings management to remain included in ISSI.

This study only measures earnings management with proxy discretionary accruals from the modified Jones model. To get results from the other side, further research can measure earnings management from the perspective of real earnings management. In addition, to produce a more comprehensive measurement of earnings management, it can be considered to use the integrated model developed by Habib (2004). This study measures firm risk (equity holder) with the total risk proxy. The proxy describes the risks faced by the company both systematically and non-systemically. To see which of the two risks affects earnings management more, further research can simultaneously use systematic risk and idiosyncratic risk proxies.

This research has implications for several parties, namely creditors and auditors. Companies with high leverage tend to carry out earnings management so that creditors must be more aware of the company's financial statements. On the other hand, as an independent party that tests the company's financial statements, the auditor can be more aware of companies with high leverage because they tend to use earnings management. It requires more vigilance when conducting audits of related companies.

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