Managers Opportunistic Behavior and Discretionary Accrual: An Evidence of Indonesian Manufacturing Firm

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Abstract. This study aims to analyze and re-examine the impact of managers' opportunistic behavior in detecting discretionary accruals. In a variety of literature found managers have a very strong interest in managing accruals. This study examines how managers manage accruals to get direct benefits for managers by relying on the subjectivity and flexibility of accounting standards. Taking samples of Indonesian manufacturing companies from 2006-2016 to companies that issued financial reports continued. The findings prove that managers do the discretionary accrual in the preparation of financial statements. The bonus scheme is found to have a positive effect and the number of shares outstanding has a negative effect on accrual discretion. The audit quality variable was found to have a negative effect on the existence of discretionary accrual. The results of this study prove that there is a non-linear relationship between discretionary accrual with the income reported in the financial statements, the owner can suppress and have the ability to monitor the operation of the company so that managers find it difficult to do discretionary accrual when referring to the manager's own motives and interests.

Keywords: Discretionary accrual · Opportunistic · Bonus scheme · Number of shares and audit quality

1 Introduction

The use of discretionary accruals is still one of the tools used by accounting researchers in testing earnings management in financial statements. Various other literature mentioned by [1] explains that managerial opportunistic behavior is driven by three factors: there is room for opportunistic behavior, incentives for managers to engage in opportunistic behavior, and managers' propensity for opportunism. This motive arises because Opportunism refers to a lack of openness or honesty in transactions, to include self-interest with deception. Previous studies have used various variables to measure managers' opportunistic motives in conducting discretionary accrual such as ownership structure, debt, and size, audit fees [4], contract and managerial ownership [5], compensation [6], and IPO process [7].

The selection of accrual methods becomes very important for researchers to study, users of financial statements, the compilers of accounting standards [8]. Accrual changes that occur, can be considered as abnormal accrual. This change is the result of...
Excessive management discretion and if at the same time management also has an incentive / motive for discretionary accruals, accrual changes that occur are considered as a form of earnings manipulation by management. Managers prefer to use abnormal accruals and in real earnings management, this is mostly done in developing countries that do not yet have strong regulations and weak law enforcement.

The practice of dealing with accruals by managers is not fully realized by investors in analyzing financial statements. For investors, positive discretionary accrual ends to mislead and influence their business decisions [10]. For example, investors cannot detect engineered profits at the time of the initial offering coupled with an information gap between the company and potential investors at the time of the initial offering, increasing the opportunity for companies to increase profits and not be detected by the market. The motivation of managers to do discretionary accruals is mainly to maintain job security, managers will do income smoothing. Managers will tend to manage the company's revenue so as not to report a decline in the value of profits or avoid a decline in reported earnings levels. They are involved in earnings management when the company's profits increase or when the company is financially healthy. The manager's motives can change, resulting in company owners not being able to fully believe in the financial statements submitted by the manager [13]. Other indications, sometimes management may be involved in determining the board of commissioners and independent commissioners.

Now day, there are still many different and inconsistent research results in concluding the causes of the discretionary accrual in the financial statements. High dividend policy, hiding weak performance, launching new products, weak corporate governance and capital market motivation. Opportunistic manager motives arise when managers want to get incentives to meet certain targets in company earnings. Discretionary accrual made by accountants for various interests and purposes needs to be reviewed ethically [15]. Professional accountants must review the decision that will be made by considering who influenced his decision and how it will affect himself. This is a big problem in the accounting profession, financial ethics needs to be addressed. When managers and accountants change financial information, then the motive is referred to as a form of manipulation and violates ethics [16]. Ethics is not only limited to the rules (standards) but also to a value system that is mutually beneficial and fair.

In this paper, we would like to reexamine managers' opportunistic motives in conducting discretionary accruals on the Indonesian capital market. Dissent between academics and practitioners and regulators. Academics claim that discretionary accrual has revealed all activities and consider that discretionary accrual is good and not bad. While practitioners assume that discretionary accrual will cause problems that can have an impact everywhere. This is the reason why this motive needs to be reviewed and analyzed to find solutions for investors' comfort and protection in investing in the capital market.

2 Literature Review and Hypotheses Development

2.1 Bonuses Scheme and Discretionary Accrual

Manager opportunistic behavior also arises when large shareholders tend to ignore and sacrifice the interests of minority shareholders [18]. Research largely leads to evidence
of a pattern of earnings management that increases earnings or income increasing and carries out the big bath accounting or income decreasing when performance or earnings are low [6] all of which aim to maximize bonus receipt (the bonus plan hypothesis). Discretionary accruals that are opportunistic are conducted to increase their own wealth in an effort to strengthen their position in conveying good financial performance information [19].

Managers make accrual discretions to maximize their bonus payment plans [20], this is also in accordance with Healy's findings [6]. Bonuses relate to manager performance, so senior managers who approach retirement tend to have higher levels of discretionary accrual [21]. Bergstresser & Philippon, [22] states that managers also use discretionary accrual to manipulate reported earnings in companies where all profits and compensation of managers are based on the value of shares and stock options. An increase in bonuses for managers, also increases the discretionary accrual made by managers in the company [4]. Based on the above literature, it can be seen how bonuses affect managers' decisions in determining accrual policies, especially because of the manager's personal interests. Therefore, the hypotheses developed are as follows:

**H1:** There is a significant positive association between managers' bonuses and discretionary accruals.

### 2.2 Number of Shares and Discretionary Accrual

The number of shares outstanding is the quantity of shares circulating in the capital market that can be transacted whether sold or bought by investors, the number of shares outstanding in the community is intended to attract investors to invest in these shares. Issuers do not sell all the shares they have, when the company will sell shares to the public, they will offer a number of shares held for sale. The number of shares outstanding is an important factor that will be considered by investors in the decision to invest in a company. The number of shares offered to investors in accordance with OJK regulations is 7.5% of the total shares. This proves that there is very little public share ownership in the Indonesian capital market.

Managers carry out opportunistic discretionary accruals aimed at their own interests and not the interests of shareholders [24]. The gap in incentives between managers and shareholders can cause managers to use accounting policies to manage company earnings. supervision carried out by shareholders can reduce the degree of discretionary accrual [25]. Conversely ownership and control are separate in the management of the company, can encourage managers to do the discretionary accrual in financial reporting, but this practice can be prevented by implementing good governance [26]. Publicly traded companies in Indonesia are mostly family owned [27], thus allowing them to control management well. As owners, they will take a large role to control the company so that there is no conflict between deviated investors and managers who get incentives to manage the company well [28]. Based on the explanation above, we formulated the hypothesis as follows:

**H2:** There is a significant negative association between number of share and discretionary accrual.
2.3 Audit Quality and Discretionary Accrual

Asymmetric information often occurs between managers and stakeholders, managers have an incentive to change and choose accrual policies in an effort to meet various interests, especially incentives, debt, and capital markets. Company managers have a high role in the process of determining and selecting accrual models in financial reporting, they will also provide input to the amount of accruals made in the financial statements [29]. Another literature states that to eliminate doubts about what is reported by managers, it requires other parties such as accounting experts (auditors and audit committees) to be able to control the accrual accounting process at the company. At the moment the good audit quality is at big 4, namely a public accounting firm with an office in America. De Fond (1993) states that large auditor office sizes are more independent in determining and reporting audit results to clients, so that many large companies request audit services to the big 4 auditors [5].

However, in another study Humayun Kabir [31] who discovered the fact that public accounting firms in Bangladesh affiliated with Big 4 did not have a positive influence on the quality of audits conducted on their clients. They tend to compromise with clients, in fact auditors who tend to compromise with clients will produce poor quality audits, although this can also happen to Big 4 firms [32]. Based on the explanation above, the hypothesis is formulated as follows:

H3: There is a significant negative association between audit quality and discretionary accruals.

3 Data, Variables and Methodology

3.1 Data

This study uses cross section data, on Indonesian manufacturing companies by taking companies that report data for 11 consecutive years. The population and sample in this study were 171 manufacturing companies listed on the Indonesia Stock Exchange (IDX) from 2006 to 2016, which have and report complete financial reports and are published in the Indonesian Capital Market Directory (ICMD).

<table>
<thead>
<tr>
<th>No</th>
<th>Manufacturing Sector</th>
<th>Number of companies from 2006-2016</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Basic Material</td>
<td>45</td>
<td>0.28</td>
</tr>
<tr>
<td>2</td>
<td>Consumer Goods</td>
<td>74</td>
<td>0.42</td>
</tr>
<tr>
<td>3</td>
<td>Health Care</td>
<td>9</td>
<td>0.04</td>
</tr>
<tr>
<td>4</td>
<td>Industrial</td>
<td>39</td>
<td>0.23</td>
</tr>
<tr>
<td>5</td>
<td>Oil &amp; Gas</td>
<td>4</td>
<td>0.01</td>
</tr>
<tr>
<td></td>
<td>Total</td>
<td>171</td>
<td>100%</td>
</tr>
</tbody>
</table>
3.2 Variables Measurement

3.2.1 Discretionary Accruals Measure

Dechow et al (1995) tested various alternative accrual models and they stated that the modified Jones model was the best model for testing earnings management. The calculation is done by separating the non-discretionary accruals (the reasonable level of accrual earnings) and the discretionary accrual (the level of abnormal accrual earnings). Total accruals are the amount of discretionary accruals and non-accrual accruals. The accrual component imposed by accounting regulators in adjusting a company's cash flow is non-discretionary accruals.

\[
DA_{it} = TA_{it} - \left( \alpha_0^* + \alpha_1^* \left( \frac{1}{A_{t-1}} \right) + \alpha_2^* (\Delta REV_t - \Delta REC_t) + \alpha_3^* (PPE_t) \right)
\]

\(DA\) : Discretionary accrual is the difference between total accruals and the fitted non-discretionary accruals

\(TA\) : Total accruals, defined as the earnings before extraordinary items (NI) – operating cash flows (CFO).

\(A\) : Total assets.

\(\Delta REV\) : Change in revenues.

\(\Delta REC\) : Change of accounts receivable

\(PPE\) : The gross value of fixed assets

4 Methodology

By using unbalance panel data from 171 manufacturing companies, this study uses Covarian Analysis (Ancova) in regression analysis and the Generalize Least Square (GLS) Model. In this study includes analysis using descriptive statistics and correlation analysis. Hypothesis testing is done using general least square (GLS). Descriptive statistics and correlation analysis are used to describe the variables in this study.

\[
DA_{i,t} = \alpha_0 + \alpha_1 SB_{i,t} + \alpha_2 NoSh_{i,t} + \alpha_3 KA_{i,t} + \varepsilon_{i,t}
\]

\(DA_{i,t}\) = Discretionary Accrual i,t

\(SB_{i,t}\) = Bonuses scheme i,t

\(NoSh_{i,t}\) = Number of Share i,t

\(KA\) = Audit quality

\(\varepsilon_{i,t}\) = Error term i,t
5 Discussion of Results

5.1 Descriptive Analysis

Before discussing statistical data, we will first pay attention to descriptive data by describing the variables in the following table. The analytical tool used is the mean, standard deviation, minimum and maximum as presented. Based on Table 2, it can be seen the discretionary accrual variable from the total N sample of 1879 manufacturing companies. Statistical results show that the average value for the discretionary accrual variable is -0.09996 with a standard deviation of 6.462458. SD value is very high compared to the average value which means a large deviation from the number of observations studied. Herawaty [33] found the average earnings management was -0.013005 and the standard deviation of 0.2404, which means that the average company in the study sample tended to use a decreasing income strategy. Average discretionary accrual was also obtained by -0.008 and standard deviation of 0.095 [34] while finding an average discretionary accrual of -0.0028 with a standard deviation of 0.1049. Research conducted on companies in Malaysia found an average discretionary accrual in earnings management of 0.033 [36] greater than the average practice in Indonesia.

<table>
<thead>
<tr>
<th></th>
<th>N</th>
<th>Mean</th>
<th>Maximum</th>
<th>Minimum</th>
<th>Std. Dev.</th>
</tr>
</thead>
<tbody>
<tr>
<td>DA</td>
<td>1879</td>
<td>-0.09996</td>
<td>54.48708</td>
<td>-274.246</td>
<td>6.462458</td>
</tr>
<tr>
<td>BS</td>
<td>1879</td>
<td>3.118066</td>
<td>3865.341</td>
<td>-197.865</td>
<td>90.67291</td>
</tr>
<tr>
<td>NOS</td>
<td>1879</td>
<td>4435164</td>
<td>97021700</td>
<td>0</td>
<td>9594168</td>
</tr>
<tr>
<td>KA</td>
<td>1879</td>
<td>0.538052</td>
<td>1</td>
<td>0</td>
<td>0.498683</td>
</tr>
</tbody>
</table>

Source: Appendix (data processed, 2018)

DA = Discretionary accrual, BS (bonus scheme), Nosh (number of shares) AQ (audit quality).

The average value of the bonus scheme variable is 3.118066, with a standard deviation of 90.67291. Bonus schemes are improved by managers in an effort to increase income, not to reduce income [37]. The average value of the total outstanding shares is 4,435,164 shares, with a standard deviation of 9,594,168 shares. Concentrated share ownership results in many public companies that are performing well, but have a small number of outstanding shares. As a result, the profitability obtained by the company does not spread to general shareholders. The average value of audit quality is 0.54 with a standard deviation of 0.49. Manufacturing companies in Indonesia have a maximum audit quality value of 1 and a minimum value of 0. Audit quality is measured using the size of a public accounting firm. The public accounting firm that is generally considered for quality assurance and experience is known as the big four. The greater the size of the public accounting firm, the more pressing the existence of discretionary accrual practices in public companies [38].
5.2 Selecting the Panel Data Model

Using the chow test and Hausman test, it shows that all the test models above have a calculated F value greater than the F table. So that it can be concluded that the panel data model selection is the Fixed Effect Model, because H0 is rejected and accepts H1. Based on the table below the Hausman Test output found all probability values of 0.00000. This value is the p value of the hausman test. P value of 0.000 is less than 0.05 then all models accept H1 which means the best method to use is the fixed effect model.

5.3 Regression Results

Based on Table 3 opportunistic models obtained Adjusted R Square value of 0.1261. When using R Square of 0.2065. Because the use of variables is more than two, the value used is Adjusted R Square. This shows that 12.61% Variable Discretionary accrual can be explained by variable bonus schemes, the number of shares outstanding, and audit quality. The remaining 87.39% is influenced by other variables not explained by this research model.

<table>
<thead>
<tr>
<th>Variable</th>
<th>Coefficient</th>
<th>t-Statistic</th>
</tr>
</thead>
<tbody>
<tr>
<td>C</td>
<td>-0.12616</td>
<td>-4.5995</td>
</tr>
<tr>
<td>BS</td>
<td>9.36E-05</td>
<td>0.459816</td>
</tr>
<tr>
<td>NOS</td>
<td>-5.97E-10</td>
<td>-0.73329</td>
</tr>
<tr>
<td>KA</td>
<td>0.03884</td>
<td>-2.97772***</td>
</tr>
</tbody>
</table>

Based on Table 3, the partial independent variable will be tested. Testing partially independent variables that have a positive effect is a bonus scheme (not significant). The audit quality variable has a negative and significant effect, while the variable number of shares outstanding has a negative and significant effect on Indonesian manufacturing companies. Based on the table above, it can be seen that the regression model coefficient is formed:

\[ Y = -0.0814 + 0.000169 \times BS_{x1} - 0.000000000145 \times NoS_{x2} - 0.02333 \times QA_{x3} + \varepsilon \]

Previous research has seen a non-linear relationship between discretionary accrual and income reported in the financial statements. This relationship shows the position of income and discretionary accrual into a system that is not fixed, easy to change, difficult to control, and difficult to predict. Much of the literature does provide evidence of an empirical relationship between executive compensation packages and
their incentives to manipulate earnings (Balboa et al, 2013). This non-linear relationship is also caused by conflicts between management and outsiders. Healy [6] found an association of profit-based bonus schemes with the practice of discretionary accrual to maximize their personal incentives. Shuto, (2008) found how discretionary accrual affects bonus planning on managers in Japan. Managers use discretionary accrual to increase their compensation, although there is a relationship that varies between bonuses and accrual concepts according to company variations. In this study it was found that bonuses have a positive effect on accrual discretion, according to positive accounting theory, bonus policies are heavily influenced by accounting decisions [20].

Executives are expected (and encouraged) to use their talents and skills to achieve better levels of compensation payments, but in practice they can also use their accrual discretionary policies to artificially manipulate reported performance measures. In the perspective of income smoothing hypothesis that managers and controlling owners have an incentive to manage reported earnings to cover the actual performance of the company and reduce the possibility of outside intervention [41].

When the company will sell shares to the public, they will offer a number of shares held for sale. The number of shares outstanding is an important factor that will be considered by investors in the decision to invest in a company. The number of shares offered to investors in accordance with OJK regulations is 7.5% of the total shares. Investors will tend to choose liquid stocks, relying on information from financial statements investors will consider the ownership aspects and the number of outstanding shares held by the public. Investors will assess the accuracy of estimated earnings by considering the number of shares outstanding and by the ownership structure [42].

The results of this study indicate that there is a negative and significant relationship between the number of shares outstanding with the discretionary accrual in Indonesian manufacturing companies. This is in line with research conducted by [5] who found a negative relationship between various company shareholdings and discretionary accrual in public companies in Australia. A positive relationship is found when a high level of managerial ownership is associated with accrual discretion, this condition results in a bid ask spread as an indication of stock price liquidity [43]. When managers who are also part of the controlling shareholders have more power they can take actions or policies that more or only benefit them but also disadvantage minority shareholders. This phenomenon is often called the managerial entrenchment hypothesis. Research conducted by [44] in countries that embrace civil law place more emphasis on predictable laws and trust in legislation to regulate self-interest behavior. Laws in the civil law system are made by legislators [27]. This is an incentive for controlling shareholders to creatively regulate unfair transactions so that they are in accordance with the contents of the law. The value obtained by Indonesia reflects the very weak protection of non-controlling shareholders. This is an incentive for controlling shareholders to expropriate non-controlling shareholders.

Audit quality is very decisive in public accountability, the case of the collapse of Enron and WorldCom, in America is one of the results of errors in reporting public finances that are detrimental to investors. The American government reacted immediately by issuing regulations, one of the most well-known of these regulations was the Sarbanes-Oxley Act (SOX) 2002 [46]. Another literature conveys that accounting experts (auditors and audit committees) are indispensable in controlling the accrual accounting process in the company.
The monitoring process at Indonesian manufacturing companies has been going well. Providing incentives to managers as a part of the contract, gives managers the responsibility to work for shareholders. Audits conducted by independent parties require a cost (monitoring cost). Jensen & Meckling stated that auditors are parties who bridge the interests of shareholders and managers. This finding supports the agency theory, whereby the role of the auditor can reduce conflicts of interest between management and owners (shareholders).

External auditors examine financial statements independently, professionally for the relevance and reliability of the presentation of a company's financial statements in accordance with the standards issued by the government. The control mechanism can be carried out by an auditor to the client so that management presents information in the financial statements free from cheating practices. This activity can be carried out well if the auditor conducts his work with quality audits [37].

6 Conclusion

The managers of Indonesian companies are opportunistic to achieve predetermined profit targets, they use the accrual policy in planning manager bonuses. This finding supports agency theory and does not support positive accounting theory where managers tend to use changes in earnings in accrual discretion. Public ownership proxies by the number of shares outstanding was found to have a significant insignificant effect on accrual discretion. The average ownership of Indonesian public companies is owned by block holders. The number of shares outstanding is very small when compared to shares owned by institutions, in general the shares of many public companies are owned by families. Discretionary accrual can be suppressed when majority ownership is in the company. Audit quality is also very decisive in limiting opportunistic managers in making accounting decisions. This is evident, in companies audited by reputable public accountants who are able to suppress earnings management practices. The results of this study support the agency and stewardship theory. Where the owner can suppress and have the ability to monitor the operation of the company so that managers find it difficult to do discretionary accrual if it refers to the motives and interests of the manager itself.

Limitations of this study, only using a sample of manufacturing companies and using empirical data comparison analysis and previous research so that it may not reflect the true motives of the opportunistic motives of managers in doing discretionary accrual on public companies in Indonesia.

References


