THE ANALYSIS OF INFORMATION ASYMMETRY, PROFITABILITY, AND DEFERRED TAX EXPENSE ON INTEGRATED EARNING MANAGEMENT

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ABSTRACT

Previous studies examining earnings management from accruals and real perspective. These model can`t describe the earning management practices completely. It needed the integrated model for measuring earning management.. The purpose of this study is to analysis the information asymmetry, profitability and deferred tax on integrated earning. It proxies with real and accruals earnings management. Real earnings management are measured by abnormal cash flow of operation, abnormal production cost, and abnormal discretionary expenses. On the contrary, accruals earnings management are measured by short and long term discretionary accruals. The sample are 188 companies listed in JII and 254 companies listed in LQ 45 during 2004-2013 period. Descriptive qualitative used to measure the mean value of these proxies, then the integrated earning management measured by ranking of them. The results showed that information asymmetry has an effect significantly on earning management in JII and LQ 45 index. It has negative significantly on earning management in both indexs. In the future, researcher will continue this model by looking for the relationship earning management with relevance of accounting information and the explore another proxies of earning management.

Key words: Integrated earning management, real and accruals earning management

Introduction

Managers as corporate managers have more aware of internal information and prospects of the company in the future than the owners (shareholders). The gap of information will trigger a condition called as asymmetric information It can provide an opportunity for managers to manage the earnings in order to mislead the owner (shareholder) of the company's economic performance.

Agency theory assumed the agent and the principal have different personal interests. Principal motivated held to improve the life of his contract with the increasing profitability. Agent motivated to maximize the economic needs and psychological, in terms of obtaining an investment, loan, contract or compensation. According to Jensen and Meckling (1976), if principal and agent include individuals seeking to maximize their utility, it is believed that the agent will not always act in the best interest of the principal. Besides they have limited information about the company and agent performance. Agent has more information about the self capacity, work environment and the company as a whole. The gap information between agent and principal is called information asymmetry. Conflict of interests and information asymmetry makes the agent tried to exploit the situation by hiding some information from the principal. Agent will select information that benefit himself. The existence of information asymmetry will encourage managers to present information that is not true, especially if the information relates to the measurement of the managers performance. Richardson (1998) argues that there is a systematic relationship between the asymmetry of information with the level of earnings management. Earnings management is the financial numbers were made through creative accounting as a result of flexibility practices principles issued by GAAP (General Accepted Accounting Principal). Meanwhile, earnings management is the act of reporting profit that is manipulated for the benefit of the company's management or accounting methods. Earnings management can be done by controlling the accrual transactions or transactions that do not affect cash flow (Scott, 2006).

Research on earnings management with various earnings management models in the Indonesian capital market both in the Islamic and conventional indexes has been done by (Wiyadi et al.2011, 2012). Generally, previous studies (Boediono (2005);

Kusumawati, et.al, (2005); Veronica and Bakhtiar (2005); Rahmawati, et.al, (2006); Nasution and Setiawan (2007); Ujiyantho and Pramuko (2007); Herawaty (2008) , Sasongko and Fauziah (2011), Wiyadi and Prasnowo (2011), Trisnawati and Nugroho (2011), are measuring earnings management used accruals aggregate approach. This approach separated total accruals into non-discretionary component and discretionary accruals (accruals components are in management or policy managers to intervene in the financial reporting process). This models frequently used is the modified Jones

Further models were developed to perform separation of components of discretionary accruals into short-term discretionary accruals component and long-term discretionary accruals. The separation is expected to clarify the role of each of the components of discretionary accruals to measure earnings management (Sasongko and Purbasari, 2012; Wiyadi and Safitri, 2012; Subekti, et al 2010 ;).

The accrual earnings management measurement model is considered by some researchers still have not been able to reveal the full of the earnings management practices because the model ignores the relationship between cash flow transactions and accruals (Dechow et al. 1995, Kothari et al., 2005, Subekti, et al. 2010). Accounting research drawing conclusions about the earnings management only based on accrual adjustment alone may be invalid (Roychowdhury, 2006). Furthermore, Trisnawati and Suhestiningsih (2012) measured earnings management based on real activity. Survey Graham, Harvey and Rajgopal (2005) found the evidence that top management as respondents are much more willing to engage in real earnings management*)* rather than accruals management to achieve earnings targets

The integrated management model introduced by Leuz, Nanda and Wysocki (2003). This model is a combination of the values of smoothing earnings and reported earnings discretion (discretionary accruals) and real earnings management. Later, this model adopted by Habib (2004). Subekti, Kee and Ahmad (2008) also conduct an integrated approach to earnings management by performing factor analysis to determine the value of earnings management. Trisnawati et al (2012) conducted a study of earnings management by integrated approach with an average approach. They refer Baharudin and Satyanugraha (2008). Real earnings management is measured by abnormal operating cash flow, abnormal production costs, and abnormal discretionary expenses (Suhestiningsih and Trisnawati, 2012). While accrual earnings management is measured by *short-term discretionary accruals* and *discretionary long term accruals* (Wiyadi and Safitri, 2012; Sasongko and Purbasari, 2012). Integrated measurements provide a more accurate model to measure earnings management in the Indonesian capital market (Trisnawati et al, 2012).
This research is to analysis the effect of the information asymmetry, profitability and deferred tax on integrated earning. While the measurement of earnings management using integrated earnings management refers Leuz, Nanda and Wysocki (2003). Habib (2004) Subekti, et.al (2010) and Trisnawati et al (2012). The following sections describe the literature review and hyphotesis, research method, the research findings and finally come up with conclusions, suggestions and limitation of this study.

Literature Review and Hypotheses

Earnings Management

Scott (2006: 344) defines earnings management as follows *"Given that managers can choose accounting policies from a set (for example, GAAP), it is natural to expect that they will choose policies so as to maximize their own utility or the market value of the firm".* From this definition, the earnings management is an accounting policy cheesed by the manager from accounting standards that can maximize their utility or the enterprise market value.

Schipper (1989) defines earnings management as an intervention with the specific purpose of external financial reporting process deliberately to gain some personal advantage. Fischer and Rosenzweig (1995) defines earnings management as an act of a manager by presenting a report that raise (lower) profit for the period of the business unit that became his responsibility, without causing an increase (decrease) the economic profitability of such units in the long run. Meanwhile, Healy and Wahlen (1999), earnings management occurs when managers use considerations (judgment) in financial reporting and the preparation of transactions to alter financial reports, in order to manipulate the size (magnitude) of income to some stakeholders about the economic performance of the company or to influence the outcome agreement (contract) which depends on the accounting figures reported.

Healy and Wahlen (1999), states that the definition of earnings management contains several aspects. The first, intervention of earnings management from financial reporting can be done with the use of judgment, for example judgment needed in estimating the number of economic events in the future to show in the financial statements, such as the estimated economic life and residual value of fixed assets, the responsibility for pensions, deferred taxes, losses receivables and a decrease in asset values. Besides, the manager has the option of accounting methods, such as the depreciation method and cost method. Secondly, the purpose of earnings management to mislead stakeholders about the economic performance of companies. This is occurs when management has access to information that it is not accessible by outsiders. Earnings management is intervening process of external financial reporting in order to make benefit themselves. Earnings management is one factor to reduce the credibility of financial reporting, it increases the bias in the financial statements and can interfere the trust of financial statements users because the profit rate was engineered as a number of profit without engineering .

There are various motivations in performing earnings management practices. by managers. Scott (2003) suggested various motivations for doing earning management, namely:

a. Bonus Plan Hypothesis
Managers will act opportunistically to maximize current income to obtain personal benefit. Managers have information previously reported net income in the financial statements, while outsiders do not have it. The manager will seek to regulate the

net profit so that they can maximize their bonuses based compensation plans of the company. There are two approaches that can be taken by a manager in controlling earnings, namely: control accruals, which includes revenue and expenses in the calculation of income that do not affect cash flows and the change in accounting policy.

b. Debt Covenant

Corporate managers who violate the agreement of debt will be using accounting methods that can increase profits (Rahmawati et al, 2006). This is done to maintain their reputation in view of external parties, the debt agreement is an agreement to protect creditors of the actions of managers like dividends high, additional loans, or let the working capital is below a predetermined level, and this increases the risk to the lender who will lend to the company. It is also mentioned in the positive accounting theory, that the debt covenants is one of motivation by managers for doing earning management.

c.Political Motivation

Political aspects can not be separated from the company, especially large enterprises and strategic industries, because of its activity involves the lives of many people. Some political motivations that drive the company did earning management by reducing profits, among others, (a) to reduce the cost of political and supervision of the government, (b) to obtain the facility of government, for example, subsidies, protection from overseas competitors, and (c) to minimize the demands of the union.

d.Taxation Motivation

Income tax is one of the motivations why companies present information net income in the financial statements that are smaller than the actual. Government imposes high taxes on companies and this will reduce the company's profit. For example, for supplies, the company will choose the LIFO accounting method, which resulted in lower net income compared to most other methods.

e.Substitution CEO

The change of CEO is one of the motivation did earnings management. CEO who are nearing the end of the assignment or retirement will be pursuing a strategy to maximize profits to increase bonuses. Meanwhile, the CEO of the less managed to improve the company's performance will tend to maximize profits in order to prevent or cancel the recording.

f. Initial Public Offering (IPO).

Companies will go public that do not have a market price make the problem. It's problem is how to set the value of shares to be offered. Therefore, for bargaining, the financial information contained in the prospectus is a source of very useful information. In analytical, information such as the net profit can be divided as a signal to investors about the "value" of the company. So, this raises the possibility that the management company that being go public conduct earnings management to obtain a higher price on the shares.

Asymmetry information

The existence of information asymmetry is considered as a cause of earnings management. Richardson (1998) argues that there is a systematic relationship between the asymmetry information with the level of earnings management. The existence of information asymmetry will encourage managers to present information that is not true, especially if the information relates to the measurement of the performance of managers. Management flexibility for managing earnings could be reduced by providing more quality information to outsiders. The quality of financial statements will reflect the level of earnings management. Some researchers Yangseon Kim, Caixing Liu and Ghon Rhee (2003) in Rahmawati et al (2006), found that the asymmetry of information can affect earnings management. Agency theory implies the existence of information asymmetry between managers as agents and owner information asymmetry arises when managers more aware of the internal information and the company's prospects in the future compared to shareholders and other *stakeholders.* If related to earnings management, earnings management can perform manipulation because they have better information and interest to give a positive signal to the market. Then the hypothesis can be derived the following.

$H1_{a:}$ information asymmetry has effect on earnings management in the LQ-45

$H1_{b:}$ information asymmetry has effect on earnings management in the JII

Deferred tax

In the tax calculation, for getting profit companies, it must use the cash basis, whereby revenues and expenses are recorded on a cash basis. As a result there are differences between the accounting profit which calculated on a accrual basis (earnings in the financial statements for external parties) with a taxable income which calculated on cash basis. The differences between the accounting income and taxable income can be an indicator of earnings management, so the users of the financial statements should be aware about it. The definition of deferred taxes under SFAS No. 46 is the amount of income tax for the current period as a result of deductible temporary differences and the rest of the compensation for losses. Scott (2006) stated that one of the motivations managers did earning management is the motivation of taxation. Various cases of accounting fraud that have occurred is to manipulate earnings by earnings management that the manager in particular has the interests of the company. Earnings desired by management course high profit after tax. Earnings management activity is detected in the book-tax differences, can be done by raising the net deferred tax liability (ie net of deferred tax liabilities minus net of deferred tax assets), and lead to higher deferred tax expense This is consistent with the theory proposed by Watts and Zimmerman (1986, 1990) that the reason for savings or deferral of taxes (deferred tax) through the tendency of companies to reduce reported earnings is one of the three hypotheses in relation to the positive accounting theory, namely the Political Cost Hypothesis . So the deferred tax can affect the motivation of earnings management as tax savings. Hamzah (2008) states that the effect of deferred tax expense in detecting earnings management at the time to avoid reporting a profit decline. While the research conducted by Widyastuti,et.al.(2007) showed that the deferred tax expense negatively affect earnings management. So the hypothesis can be stated the following.

$H2_{a:}$ deferred tax has effect on earnings management in the LQ-45
$H3_{b:}$ deferred tax has effect on earnings management in the JII

Profitability

Profitability is the company's ability to generate profit The greater the profitability, the greater the ability of management to manage the company's assets to generate earnings. It affects investors for earnings forecast and predict risk in their investments which have an impact on investor trust against the company. Related with the management motivation to perform earnings management, companies that have high profitability will tend to manage their the profit (Widyastuti .2007). Her result stated that the profitability have positive effect on earnings management significantly. On the basis of these explanations, the third hypothesis in this study can be formulated as follows.

$H3_{a:}$ Profitability has effect on earnings management in the LQ-45
$H3_{b:}$ profitability has effect on earnings management in the JII

Research Method

The population is manufactured companies which listed in JII and LQ 45 index. Sample selected by *purposive sampling* with criteria manufacturing companies listed in Indonesian capital market which published financial statement completely during 2004-2013 periods. Data used secondary data and got from PRPM (Pusat Referensi Pasar Modal), BEI UNS and www.idx.co.id . For computing asymmetry informastions, it got from www.yahoo finance Total sample is 254 companies which listing in LQ 45 index and 188 companies which listing in JJI index. Completely, the process for selecting sample can be explained by the following table

Table 1: Selected Sample

SAMPLE IN LQ 45 INDEX	
Total listed companies in LQ-45 during 2004-2013 periods	450
The number of companies that do not publish financial statements	(80)
Number of non-manufacturing companies (industry, banking, etc.)	(68)
The number of companies which their financial statements are not complete	(42)
Total sample	260
Outliers	(6)
Total data available for analysis	**254**
SAMPLE IN JII INDEX	
Total listed companies in JII during 2004-2013 periods	300
The number of companies that do not publish financial statements	(60)
The number of companies which their financial statements are not complete	(39)
Total sample	201
Outliers	(13)
Total data available for analysis	**188**

Variable

Dependent variable in this study is earning management as measured by **integrated earnings management** (the average value of each proxy is *Short term discretionary accruals and discretionary long term accruals, abnormal cash flow operations (CFO), abnormal production costs (PROD)* , and *abnormal discretionary expenses (DISCR)* Measurement of real earnings management refers to Roychowdhury (2006). Measurement accrual earnings management refers to Kothari et al (2005) and the idea of an integrated measurement of earnings management refers Baharudin and Satyanugraha (2008). Measurement of each proxy is:

a. Abnormal Cash Flow Operation (*Abnormal CFO)*

$$CFO_t / A_{t-1} = \alpha_0 + \alpha_1(1/\log.A_{t-1}) + \beta_1(S_t/A_{t-1}) + \beta_2 (\Delta S_t/A_{t-1}) + \varepsilon_t$$

b. *Abnormal Production Costs*

$$PRODt / A_{t-1} = \alpha_0 + \alpha_1(1/Log.\ A_{t-1}) + \beta_1(S_t/A_{t-1}) + \beta_2 (\Delta S_t/A_{t-1}) + \beta_3 (\Delta S_{t-1}/ A_{t-1}) + \varepsilon_t$$

c. *Abnormal Discretionary Expenses*

$$DISC_t/ A_{t-1} = \alpha_0 + \alpha_1(1/Log.\ A_{t-1}) + \beta (\Delta S_{t-1}/A_{t-1}) + \varepsilon_t$$

d. ***Short Term Discretionary Accrual***

$$STDA = STACC_{i,t} /TA_{i,t-1} -[\beta_1(1/Log.TA_{i,t-1}) + \beta_2(\Delta REV\ i,t - \Delta REC\ i,t / TA_{i,t-1}) + \beta_3(INC\ i,t / TA_{i,t-1})] + \varepsilon_t$$

e. ***Long Term Discretionary Accrual***

$$LTDA = LTACC_{i,t} /TA_{i,t-1} -[\beta_1(1/Log.TA_{i,t-1}) + \beta_2(PPE_{i,t}/ TA_{i,t-1}) + \beta_3(INT\ i,t / TA_{i,t-1}) + \beta_4(INC\ i,t / TA_{i,t-1})] + \varepsilon_t$$

Qualitative descriptive analysis performed to calculate the amount of abnormal CFO, abnormal PROD, abnormal DISCR, STDA and LTDA and to express the degree of *earnings* management in each proxy for each sub-group sample (JII and LQ45) during the period 2004-2013. Ranking made to the value AGGREGATE EARNINGS MANAGEMENT by calculating the average value of the four proxies of aggregate earnings management (AGGR).

Independent variables in this study are:

1. Asymmetry Information

Asymmetry information is a situation where the manager has access to information on the prospects of a company that is not owned by the parties outside the company. Asymmetry information in this study is measured by relative bid-ask spread, which can be expressed as follows (Rahmawati, et al. 2006):

SPREAD = ($ask_{i,t}$– $bid_{i,t}$)/{($ask_{i,t}$+ $bid_{i,t}$)/2} x 100%...........

Explanation :

α_0	= konstanta
$Ask_{i,t}$	= ask price (highest price) of stocks i on t days period
$Bid_{i,t}$	= bid price (lowest price) of stocks i on t days period

2. Profitability

Profitability is measured by return on assets (ROA). Profitability is an indicator of the management performance in managing the company's assets . It indicated by the profit produced by the company (Sudarmadji and Sularto, 2007). The formula is: **earning after tax/total assets**

3.Deferred tax expense

Deferred tax expense resulting from the difference between deferred tax assets with deferred tax liabilities. (Sudarmadji and Sularto, 2007)

Analysis Method

Multiple Regression used to analysis data. Regression models were developed to test the hypotheses that have been formulated are:

$$INTGR = \alpha + \beta 1AI + \beta 2PROFIT + \beta 3TAX + e$$

Result and Discussion

The regression analysis used to test the hypotheses. Before, we test analysis assumption such as normality, multicollinearity and heteroskedasticity. The analysis showed if data has normal distribution (Kolmogorov smirnov test). There are no multicollinearity between independent variables (tolerance value more than 0,10 and *variance inflation factor*-VIF less than 10), and no heteroskedasticity (prob vale more than 0.05 with glejser test). The all of analysis will be showed in table 2 and table 3

Table 2. Regression analysis-LQ 45

Variables	B	t value	Sig	Conclusion
constant	172,173	15,077	0,000	
AI	57,515	4,195	0,000*	H1 supported
PROFIT	3,504	1,096	0,274	H2 not supported
TAX	3,004E-006	0,624	0,533	H3 not supported
F = 6.037 sig=0.001				*Model fit*
R ^{2} =0.26				

Based on this analysis, asymmetry information has an effect on earning management, but the other variables such as profitability and deferred tax have not significantly affected earning management with integrated models

Table 3.Regression Analysis- JII

Variables	B	t value	Sig	Conclusion
constant	62,432	6,041	0,000	
AI	49,291	4,120	0,000*	H1 supported
PROFIT	6,040	0,291	0,772	H2 not supported
TAX	4,824E-006	1,168	0,244	H3 not supported
F =6.019				*Model fit*
R ^{2} =0.29				

There are the same results with LQ 45 index. Based on this analysis, asymmetry information has an effect on earning management, but the other variables such as profitability and deferred tax have not significantly affected earning management.

Discussion

1. **Asymmetry information**

Results of hypothesis testing in LQ 45 and JII indicate that information asymmetry has positive effect on earnings management (t value=4.195; t value=4.120). The test results supported the hypothesis and consistent by previous studies which conducted by Rahmawati, et al. (2006). It means that higher information asymmetry or the higher gap information to shareholders, it opportunities for the manager to manage earnings. This occurs because the manager has better information than the company owners or shareholders. Therefore, the manager is obliged to provide information about the condition of the company to the owner. The information given can be made through the company's financial statements. But sometimes, they received information submitted does not match the actual conditions of the company. Asymmetry between the management *(agent)* with the owner *(principal)* provide an opportunity for managers to act opportunistic, such as maximize the personal profit by earnings management.

To minimize the occurrence of earnings management by management, the company needs to implement the mechanisms of good corporate governance for he company's control and management system. This mechanism is done to ensure that investors get their rights in accordance with the company's financial reporting. Corporate governance is an effort made by all parties to direct and control the enterprise in order to achieve a balance between the strength and authority of the company (Sutedi, 2011). Fundamental principles of corporate governance that need to be considered for the implementation of the practice of good corporate governance. There are transparency (transparency), accountability (accountability), justice (fairness), and responsibility (responsibility). by implementation of GCG expected to be a tool to give confidence to investors that they would receive the returns they invest. GCG is expected to reduce the information asymmetry between investors and management, so it can reduce earnings management practices.

2. Profitability

Results of the data analysis based on LQ45 and JII index, it shows that is no effect ROA on earnings management, so the value of net profit after interest and tax have no effect on earnings management The greater the profitability, the greater the ability of management to manage the company's assets to generate earnings. It affects investors in predicting risk in investment earnings and thus have an impact on investor trust in the company. The higher the level of profitability of the company, the management will not tend to perform earnings management because companies which have high profit, will be interested by the public spotlight. So the company is likely trying to prevent acts with reducing the company credibility. The result shows that profits do not affect earnings management to perform by because it would endanger the company reputation. The results are consistent with research conducted by Wardani 2014.

3, Deferred tax

Results of the analysis for deferred tax variable shows that it has not effect on earnings management, so the difference value between the deferred tax assets with deferred tax debt is not affecting earnings management . This occurs because the value of deferred tax expense which is owned by their respective companies. This situation indicates the amount of tax borne by the company. This situation prompted the company to get additional funds to solve those obligations. Management will be hesitate or afraid to take advantage of tax-deferred cash flow, therefore the agent turned their attention to a wide range of other policy for doing earning management. The result is consistent with research conducted by Zamrudah (2009) which found that no effect of deferred tax expense in earnings management to avoid decreasing profit and avoid reporting to losses both in the growing stage (growth) and mature.

Conclusion

The main focus of this study is to examine the opportunistic management behavior. It looked from the relationship between asymmetry information and earning management. The results supported the objective because there is positive effect significantly asymmetry information to earning management. The other variables such as profitability and deferred tax have not effected on earning management. It means that the higher gap information to shareholders (asymmetry information), it opportunities for the manager to manage earnings. This occurs because the manager has better information than the company owners or shareholders. Therefore, the manager is obliged to provide information about the condition of the company to the owner. The information given can be made through the company's financial statements. But sometimes, they received information submitted does not match the actual conditions of the company. Asymmetry between the management *(agent)* with the owner *(principal)* provide an opportunity for managers to act opportunistic, such as maximize the personal profit by earnings management.

Limitations

This study has some limitations and suggestions for the future research, it can be described follows:

1. The research used manufacturing company as the sample, so the results of this study can not be generalized to the type of other companies such as banking, transportation insurance and others
2. The study found the asymmetry information affected to earning management, so the future research can be added with another control variables such as company size, leverage, tax evasion and other variables which have affected in earning management.
3. Future studies could use another proxies for profitability such as ROE, ROI, NPM deferred tax proxies and the compare their results with using different proxy.

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