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Earnings management strategies in Brazil: Determinant costs and temporal sequence

Estrategias de Gestión de Ingresos en Brasil: Costos Determinantes y Secuencia Temporal

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Abstract

This paper describes a study that analyses earnings management strategies involving accounting choices or real activities in Brazil. An analysis is conducted of the relationships between earnings management strategies their determinant costs and of the temporal sequence in which these management strategies are applied. The results of empirical tests indicate that adoption of management strategies is dependent on their relative costs. There is a temporal relationship between the two types of strategies for manipulation of year-end results, with real activities preceding accounting choices. It was also observed that the level of manipulation by accruals (real activities) reduced (increased) after adoption of the IFRS in Brazil.

Keywords: Earnings management; Real activities management; Manipulation by real activities; IFRS
JEL classification: M4; M41; M1

Resumen

Este artículo describe un estudio que analiza las estrategias de manipuladoras de resultados que implican decisiones de contabilidad o actividades reales en Brasil. Se realiza un análisis de las relaciones entre las

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estrategias manipuladoras de resultados y los costos determinantes de la secuencia temporal en la que se aplican estas estrategias de manejo. Los resultados de las pruebas empíricas indican que la adopción de estrategias manipuladoras depende de sus costos relativos. Existe una relación temporal entre los dos tipos de estrategias para la manipulación de los resultados de fin de año, con actividades reales anteriores opciones de contabilidad. También se observó que el nivel de manipulación por parte de las acumulaciones (actividades reales) reducción (aumento) después de la adopción de las IFRS en Brasil.

Palabras clave: Gestión de los ingresos; La gestión de las actividades de bienes; Manipulación por parte de las actividades reales; IFRS
Códigos JEL: M4; M41; M1

Introduction

The international business literature has recently begun to produce a growing number of studies of the phenomenon of real activities management, and this is particularly true of North America. Interest intensified after a series of financial scandals in large corporations, such as Enron, resulted in the United States passing the "Sarbanes-Oxley Act" (SOX) in July of 2002. Among other provisions, the SOX stipulates more restrictive accounting standards, with the objective of limiting management's discretion with relation to disclosure of transactions that have an effect on the company's results. Some studies, such as one by Cohen and Zarowin (2008), found that some managers reacted by trading off accruals-based management against real activities after the SOX was passed. Brazil is going through a process of convergence with International Accounting Standards and since 2010 a large proportion of companies have been obliged to publish financial statements in accordance with the International Financial Reporting Standards (IFRS). Little is currently known about the impact that adoption of the IFRS has had on earnings management by companies on the Brazilian capital markets and less still is known about each of the two strategies for manipulation of results – accruals-based management and real activities management (Medeiros Cupertino, Lopo Martinez, & da Costa, 2016).

In view of this gap, the subjects that this article will discuss are identification of manipulation by real activities, the impact of real activities management on future performance and the trade-off between manipulation by accruals and by real activities, with reference to the Brazilian setting (Lopo Martinez, 2013).

The overall objective chosen for this study was to identify whether earnings management through real activities (specifically, earnings management through manipulation of sales, discretionary expenses and costs of production) has an impact on the results reported in the financial statements. This general study design can be refined to allow investigation of the interrelationships between real activities and accruals when used for earnings management. This is an important step in the analysis for two reasons. Fields, Lys, and Vincent (2001) point out that investigations centered on just one of the two forms of manipulation will not capture the entire effect of earnings management activities and, therefore, can only report partial rather than conclusive results.

Zang (2012) points out that analysis of management strategies in conjunction makes it possible to identify the economic implications of accounting choices. Specifically, it becomes possible to verify whether the costs of accruals-based manipulation impact on the choice to employ