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## The Longitudinal Study of Earnings Management: Analysis on Companies Financial Abilities

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### Abstract

The aim of this paper is to provide empirical evidences of the relationships between the financial abilities towards in the financial statement to the earnings management level (EM) among of public sector companies on Bursa Malaysia from year 2001 until 2012. Primarily, the initial samples comprised 375 selected public listed companies with 4500 firm-years observation. From the samples, those companies who have not implied with the earnings management activities was excluded as a sample of the study. Thus, the final sample of this study was comprises 3971 firm-years observation. The study was adopted the Kothari Model as a measurement model for earnings management level in the business organization. Meanwhile, the findings of this study indicated significant relationships between earnings ability (EAB), financial structure's ability (FSAB), debt repaying ability (DRAB) and non-financial factors (NFF) towards the earnings management level (EM) in the business organization. Therefore, these evidences can be used as new financial mechanisms to potential and existing stakeholders in order to assist them for any decision making purposes.

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## 1. Introduction

This study will examine the financial abilities which might influence the earnings management level among of public listed companies on Bursa Malaysia from year 2001 until 2012. Therefore, this study was produced some useful input to potential stakeholders which rely the financial information disclosed by the business organization. This issue was very important to be discussed since the financial information disclosed by the business organization is based on the estimation calculation. These practices were allowed by the General Acceptable Accounting Practices (GAAP) and it has been applied to most listed companies on Bursa Malaysia. However, this provision would be manipulated by the irresponsible business organization due to several motives in their business organization. These strategies were commonly known as earnings management activities strategies or cooking the books activities, (Albrecht, Albrecht, & Zimbelman, 2012). In other words, there are possible fraudulent activities could be derived from an aggressive earnings management strategies employed in the capital market. Therefore, it's very crucial to the existing and potential stakeholders to understand on how financial abilities that was contributed to the earnings management level in the business organization. Thus, by working on this concerned the current investigation was aimed to investigate the possible relationships could be exist between the financial abilities towards the earnings management level in the business organization.

## 2. Issues of the study

An existing and potential stakeholders usually concern with the issues of the profitability financial information disclosed by the business organizations towards the capital market players. However, the reliability issues of the financial information disclosed was not seriously concern by illiterate financial people during decision process was being made, (Sun, Salama, Hussainey, & Habbash, 2010). This also was contributed of the existing and potential stakeholders which are more interested with the profit and income figures that were disclosed in the financial report of the business organization. However, due to the increasing complexity of the business organizations activities nowadays, the accounting standard was provided some of leniency for the managers to manage their financial transaction, (Nurunnabi, 2014). Furthermore, with the accounting provision provided to the managers, there are possibilities of the aggressive earnings management activities were being employed by the business organization. Thus, these activities were being disclosed in the financial reports.

Consequently, the users of the financial reports usually were not aware with earnings manipulation activities that were employed by the managers to their financial information transactions, (Tsipouridou & Spathis, 2012). In the other words, the potential and the existing stakeholders usually will rely with the information disclosed in the financial report in relation to make some decision with their investment activities. Therefore, the reliability of financial information disclosed was been critically debated by the academic scholars regarding the impacts to the stakeholders, (Blanco, García Lara, & Tribó, 2014). It's because there are many issues related to the reliability of financial information which has been reported by the business organization. One of the close related issues with the reliability financial information is the factors of occurrence of earnings management activities, (Richardson, Sloan, Soliman, & Tuna, 2005). By having unclear mechanism in accessing earnings management activities, it is considered these activities will lead to any potential losses towards the potential and existing stakeholders' decisions. Therefore, this study has provided some empirical evidence on how the financial abilities influence the earnings management activities among of business organization.

## 3. Earnings Management

Earnings management can be define as strategies by the managers in the business organization to manipulate the earnings level within the business organization activities, (Grougiou, Leventis, Dedoulis, & Owusu-Ansah, 2014). These strategies were applied by the managers in the business organization in order to conceal unfavourable financial position in the eye of the existing and potential stakeholders. According to (Filip & Raffournier, 2014), during the financial distress in the business organization the managers will tend to manipulate their earnings position within the business organization in order to avoid loss of confidence among of their potential and existing stakeholders. Another reasons behind the application earnings management activities is due to complexity of business transaction involved in the capital market, (Cormier, Houle, & Ledoux, 2013). Therefore, these strategies were allowed by the General Accepted Accounting Principle or GAAP in the accounting standards in order to meet the global environments of business transaction in the capital market itself.

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