Available online at www.sciencedirect.com

ScienceDirect

Procedia Economics and Finance 28 (2015) 176 – 182

Procedia
Economics and Finance

www.elsevier.com/locate/procedia

7th INTERNATIONAL CONFERENCE ON FINANCIAL CRIMINOLOGY 2015
13-14 April 2015, Wadham College, Oxford, United Kingdom

Analysis of Earnings Management Practices and Sustainability Reporting for Corporations that offer Islamic Products & Services

Mohd Sabrun Ibrahim[a]* , Faizah Darus[b] , Haslinda Yusoff[c] , Rusnah Muhamad[d]

[a, d] *Department of Accountancy, Faculty of Business and Accountancy, University of Malaya,50603 Kuala Lumpur, Malaysia.*
[b] *Accounting Research Institute (ARI), Universiti Teknologi MARA Shah Alam,40450 Selangor, Malaysia*
[c] *Faculty of Accountancy, Universiti Teknologi MARA Puncak Alam,42300 Selangor, Malaysia.*

Abstract

Earnings management is generally viewed as unethical behaviour as it involves the use of managerial discretion of accounting numbers, which may result in the distortion of financial information provided to stakeholders. However, the engagement in socially responsible initiatives by companies demonstrates their concern for the societal well-being which goes beyond profit making. The aim of this study is to examine the earnings management practices and sustainability reporting among corporate sectors that offer Islamic products. An Islamic perspective is used to underpin the theoretical arguments for this study. This study uses longitudinal panel data analysis to examine the sustainability reporting of 16 public-listed companies in Malaysia that offer Islamic financial products for a three year period from 2011 to 2013. Content analyses on corporate annual and stand-alone reports used Global Reporting Initiatives (G3) guidelines to measure the quality of the sustainability disclosure, while the earnings management related data was obtained using the Modified Jones Model. The results of the study provide evidence that the sustainability reporting practices among companies in Malaysia that offer Islamic products are generally good over the three-year period and that financial performance improved the quality of sustainability reporting. The insignificant results between earnings management and the quality of sustainability reporting suggest that sustainability reporting is not being manipulated to cover their earnings management practices.

Peer-review under responsibility of ACCOUNTING RESEARCH INSTITUTE, UNIVERSITI TEKNOLOGI MARA

Keywords: Earnings Management; Sustainability Reporting; Islamic Perspective

* Corresponding author. Tel.: +6014-5556087
E-mail address: imsabrun@siswa.um.edu.my

2212-5671
Peer-review under responsibility of ACCOUNTING RESEARCH INSTITUTE, UNIVERSITI TEKNOLOGI MARA
doi:10.1016/S2212-5671(15)01098-9

1. Introduction

Enron could be cited as a perfect example where the company produced an annual corporate social responsibility (CSR) reporting and was actively involved in promoting environmental protection and philanthropy activities, yet is a living proof that even when a company is committed to CSR practices, it can still be "*brought down by gigantic ethical delinquencies*" (Wang, Yao, Peterson and Lee, 2008, p. 232). Prior empirical study has proven that earnings management (EM) has a direct influence over the corporate sectors reporting decisions (Francis, Nanda and Olsson, 2008). Earnings management occurs when managers used their own judgment in the financial reporting and structuring transactions to alter the financial reports (Healy and Wahlen, 1999). Jensen (2010) argues that, when managers act as agents of the stakeholders, especially when the stakeholders share the power of corporate control, the strategic behaviour of SR practices can be regarded as an entrenchment initiated as a consequence of earnings management.

Academic scholars have discovered a strong and significant correlation between CSR reporting practices and earnings management (Chih, Shen and Kang, 2008; Francis, Nanda and Olsson, 2008; Yip, Van and Cahan, 2011; Hong and Anderson, 2011; Ahmed, Islamand Hasan, 2012; Kim, Park and Wier, 2012; and Ibrahim, Yusoff and Darus, 2014) and financial performance can be an influencing factor (Callan and Thomas, 2009; Yang, Lin and Cang, 2010; Saleh, Zulkifli and Muhamad 2011; Rahmawati and Dianita, 2011; Yusoff, Mohamad and Darus, 2013 and Ibrahim, Yusoff and Darus, 2014). A review of the extant literature reveals that none of these prior studies have combined the elements of SR and EM viewed from an Islamic perspective. *Shariah* compliance is a required expectation in institutions offering Islamic financial products and services (Muhamad, Melewar and Alwi, 2012) and, hence it is expected that the overall operations of these institutions are, indeed, *Shariah* compliant (Muhamad, 2011). The aim of this study is to examine the quality of SR among companies that are offering Islamic financial products and services and to examine whether these companies that are engaged in socially responsible initiatives are constrained from acts of managing earnings. The focus on these institutions is appropriate because it is expected that institutions that embrace and practise Islamic values in their business operations would be constrained from acts of EM.

The remainder of this paper is organized as follows. Section 2 discusses the literature review and hypotheses generation. Section 3 discusses the research methodology. The research findings are reviewed in Section 4. The final section highlights the conclusion and implications of the results.

2. Literature Review and Hypotheses Generation

2.1. Islamic perspective

Shariah is defined as a system of ethics and values that has a holistic view which cover all aspects of life e.g. personal, social, political, economic, and intellectual with its unchanging bearings as well as its major means of adjusting to change deem not to be separated or isolated from Islam's basic beliefs, values, and objectives (Dusuki and Abdullah, 2007). The fundamentals in Islamic principles are `*aqidah* (creed), `*ibadah* (worship), and *akhlaq* (morality and ethics). The doctrine of *Shariah* objectives (*Maqasid al-Shariah*) and the concept of public good (*Maslahah*) were used in this study to provide the theoretical foundation for the social acts of Islamic organisations. The *Shariah* objective is primarily related to the protection of the basic human elements while the *Maslahah* deals with the levels of protection of those elements. Darus, Yusoff, A/Naim, M/Zain, Amran, Fauzi and Purwanto (2013) argues that the practices and policies of CSR of Islamic organisations should be prioritised according to their importance and urgency from the viewpoint of *Shariah*. According to them, the prioritisation of CSR will relate to the objective of *Shariah* and to ensure that the society's interests are preserved, which is also consistent with the motivation for sustainability practices. Darus et al. (2013) also is of the view that the prioritisation will help to establish guidelines for an Islamic CSR to meet the needs of Islamic organisations.

Earnings Management (EM) occurs when managers use their own judgment in financial reporting and structuring transactions to alter the financial reports (Healy and Wahlen, 1999). Accruals are the most important instruments that are being used by managers to manage earnings either to alter or to control earnings, by increasing or decreasing reported income. Managers generally used discretionary accruals to manage earnings. Therefore, in an attempt to detect EM, a multitude of studies that focus on EM used a form of discretionary accruals as dependent