CEO TENURE AND EARNING MANAGEMENT (Empirical Study on Manufacturing Companies Listed on the Indonesian Stock Exchange)

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Abstract

The action raises earnings management accounting reporting scandal in the business world. Research on management of profit made by the CEO at the beginning of the year working period and at the end of his tenure is comprehensive regarding the CEO incentive to undertake earnings management. Several previous studies have focused on the accrual-based earnings management techniques. But in this study earnings management is also measured by the real earnings management to get more comprehensive results. This study predicts that the CEO in the early years of operation will increase the earnings management earnings (income-increasing) which can be explained by the theory of career concerns.
Keywords: Accrual earnings management, real earnings management, the CEO of the early, late CEO, career concern theory

Introduction

The company is said to have a good performance when generating large profits and stock prices are high (Adiasih and Kusuma, 2011). When the CEO of serving stakeholders expect the company's performance is increasing from year to year, it sort of is what drives the main director to present the company's financial statements as possible. Scott (2000) states in general management compensation awarded based on two measurements of the management performance corporate profits and stock prices. Based on these two measurements is the case then the era of the relationship between compensation Executif Chief Officer (CEO) and earnings management. Research on management of profit made by the CEO at the beginning of the year working period and at the end of his tenure is comprehensive regarding the CEO incentive to undertake earnings management. Davidson et al. (2007) and Kalyta (2009) found that CEO at the end of his tenure will perform earnings management increase profits when retiring CEO was based on the company's performance. Several previous studies have focused on the accrual-based earnings management techniques. But in this study earnings management is also measured by the real earnings management to get more comprehensive results.

Right Issue

Earnings management actions cause scandal in business accounting reporting, including Enron, Merck, World Com and other companies in the United States (Cornett, et al. 2006). The same thing happened in Indonesia, namely earnings management conducted by PT Garuda Indonesia Tbk (GIAA) to the financial statements in 2018. In those statements, PT Garuda Indonesia (Persero) Tbk posted net income of USD809,85 thousand or equivalent Rp11,33 billion (assuming an exchange rate of Rp14,000 per US dollar). This figure rose sharply compared to 2017 a loss USD216,5 million. However, these financial statements polemical, because two commissioners Garuda Indonesia namely Tanjung and Dony Chairal Oskaria (currently not served), consider the financial statements of 2018 Garuda Indonesia is not in accordance with Statement of Financial Accounting Standards (SFAS). Financial statement manipulation case also happened in PT Kimia Farma Tbk. Based on the results of Bapepam (Capital Market Supervisory Agency, 2002), obtained evidence that there are misstatements in the financial statements of PT Kimia Farma Tbk, Former directors of PT Kimia Farma Tbk. has proved to have violated in the case of suspected inflation (mark-up) net profit in the financial statements of the state-owned company for the financial year 2001. The same case also happened in PT. Indofarma Tbk. Based on the results of inspection by Bapepam to PT. Indofarma Tbk. (Capital Market Supervisory Agency, 2004). Previous research predicts that the new CEO would do to lower earnings management earnings (income-decreasing), which can be explained by the big bath theory (Murphy and Zimmerman 1993; Wells 2002; Adiasih and Kusuma 2011; Bornemann et al. 2015). However, this study predicts that the CEO in the early years of operation will increase the earnings management earnings (income-increasing) which can be explained by the theory of career concerns. To test whether the CEO at the beginning of his tenure will perform earnings management that increase profitability, the study did not consider the transition to avoid lowering the earnings management earnings (taking a bath). Thus, this study contributes to closing the gap in the research literature.

Literature Review

Agency Theory

Conflicts of interest between agent and principal in achieving the prosperity that pleases called agency problem (agency problem). The agency problem may occur due to the asymmetry of information between owners and managers. This information asymmetry occurs when managers have the company's internal information that is relatively more and get relative information faster than external parties, such as investors and creditors. These conditions provide an opportunity for managers to use the information learned to manipulate financial reporting in an effort to maximize their own welfare (Richardson, 1998). As a rational man, the agent put his interests (without taking into account the interests of the principal), for example, by manipulation of the income statement.

Career Concern

Managerial labor market may trigger the CEO to perform their best performance since the labor market performance of the company's managerial using renew belief in the ability of the CEO and to determine the salary opportunities in the future (Gibbons and Murphy 1992). Because of concerns over his career, the new CEO served as likely to make a profit to secure a management position (Bornemann et al. 2015) and to revise the perception of market participants on the ability of the CEO (Holmstrom 1999).

Earning Management

Earnings management financial statements prepared for the purpose of providing information on the company's financial position, performance and changes in financial position that is useful to financial statement users in making economic decisions (IAS, 2009). Based on this statement can be described that the financial report is a communication tool that is used as a liaison between the parties that have an interest in the company. The financial statements as well as a tool for managers to take responsibility for the management of the resources entrusted to them (Adiasih and Kusuma, 2011).

Discretionary Accrual

*Discretionary accrual*is a way to decrease or increase the earnings reporting difficult to detect through the manipulation of accounting policies relating to accruals, such as raising the cost of amortization or depreciation, recorded a great obligation to the price cuts, and record inventory obsolete. While accrual itself are all events that are operational in a year that does not affect the cash flow. In other words, the difference between the total accrual of income to cash flows from operating activities of the company. Total accruals are divided into two parts, namely the accrual that is naturally present in the financial statements referred to non-discretionary accruals and accrual is part of the data manipulation is called discretionary accrual accounting.

Earnings Management Through Real Activities

According to Roychowdhury (2006) earnings management is generally done in two ways: accrual earnings management and real earnings management. Several previous studies have focused on the accrual-based earnings management techniques. However, empirical evidence suggests that there is a shift in the way in which the management to manage earnings. Cohen and Zarowin (2008) states that the manager has shifted away from accrual earnings management leading to earnings management through real activities after the period of the Sarbanes Oxley Act (SOX).

Work Period (Tenure) Chief Executive Officer (CEO)

*tenure*CEOs are intended in this research is the life of the Chief Executive Officer (CEO). CEO tenure in Indonesia itself based on the policy of each company. As CEO or president of the company on average 3-5 years, if there is no one thing that causes premature CEO dismissed as an example: the CEO of poor performance led to CEO was dismissed early by the company. This study tries to analyze the presence or absence of earnings management beginning or the end of the tenure of CEO tenure CEO.

Effect of CEO Tenure in Early Years Of Work Period Accrual and Real Earnings Management

CEO Early Years and Profit Management CEO in the early years of operation will try harder to show the best performance because of concerns about his career. Reputation CEO essence is the assessment of the ability of market participants and CEO, but it is not easy to directly measure the ability of the CEO. Therefore, the length of the CEO office is one measure of the ability of the CEO (Milbourn, 2003).

H1: CEO would be more aggressive use of earnings management by discretionary accrual proxy that increase profitability in the early years of operation than in the coming years tenure.

H2: CEO would be more aggressive use proxies of earnings management with abnormal discretionary expenses that increase profitability in the early years of operation than in the coming years tenure.

Effect of CEO at Year-End Work Period Accrual Of Earnings Management and Real

CEOs are nearing the end of retirement will try to increase profit in order to increase the compensation, pension funds (Kalyta 2009; Davidson et al. 2007). The lower the risk will be borne by the CEOs nearing retirement may be detected using aggressive earnings management (Zhang 2009). Furthermore, Reitenga and Tearney (2003) found that CEOs earning management that increase profitability at the approach end of retirement in order to increase the probability served as a board of directors when the CEO retired. Based on the foregoing, the hypothesis is:

H3: CEO at the end of his tenure will be more aggressive use of earnings management by discretionary accrual proxy to increase profits.

H4: CEO at the end of his tenure will be more aggressive use proxies of earnings management with abnormal discretionary expenses to increase profit.

Discussion

Ali and Zhang (2015) argued that the CEO will have more incentive to manage earnings that increase profitability (income-increasing) in the early years of operation of the in coming years tenure. Research on management of profit made by the CEO at the beginning of the year working period and at the end of his tenure is comprehensive regarding the CEO incentive to undertake earnings management. Davidson et al. (2007) and Kalyta (2009) found that CEO at the end of his tenure will perform earnings management increase profits when retiring CEO was based on the company's performance. Several previous studies have focused on the accrual-based earnings management techniques. But in this study earnings management is also measured by the real earnings management to get more comprehensive results.

Conclution

Previous research predicts that the new CEO would do to lower earnings management earnings (income-decreasing), which can be explained by the big bath theory (Murphy and Zimmerman 1993; Wells 2002; Adiasih and Kusuma 2011; Bornemann et al. 2015). However, this study predicts that the CEO in the early years of operation will increase the earnings management earnings (income-increasing) which can be explained by the theory of career concerns. To test whether the CEO at the beginning of his tenure will perform earnings management that increase profitability, the study did not consider the transition to avoid lowering the earnings management earnings (taking a bath). Thus, this study contributes to closing the gap in the research literature.

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