

Implementation of Recording Earnings Management and Accounting During the Covid-19 Pandemic for Various Companies in Indonesia

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Abstract

The Covid-19 pandemic has caused changes in various things in the world to continue to adapt so as not to fall and be left behind. This includes the company's ability to adapt during the pandemic, especially recording earnings management and accounting. This research will be carried out using a descriptive qualitative approach. The data earning obtained for this study comes from various previous studies that are still related to a recording of earnings management and accounting by companies during the pandemic as secondary data. The results of this study indicate that there is a vital role that accounting has in being able to reduce the negative impacts generated by the COVID-19 pandemic. Although basically accounting cannot be blamed for the adverse effects caused by the pandemic, if viewed through social science, then accounting can be considered a failure to help reduce these adverse effects.

Keywords: Covid-19 Pandemic, Big-Bath Earnings Management, Profit Smoothing, Loss Avoidance, and Fair Value Accounting.

A. INTRODUCTION

This study will explore the accounting record practices adopted by businesses and companies in Indonesia during the Coronavirus pandemic and other standard procedures during other volatile financial periods, such as the Market Collapse in 2007-2008 or the DotCom Bubble in the early 2000s. The Coronavirus (COVID19) pandemic was first reported in Wuhan, China, on December 31, 2019.

The pandemic of Coronavirus (COVID-19) has created significant uncertainty for businesses in the real estate and finance sectors. On Saturday, March 14, 2020, the Indonesian government proclaimed the coronavirus pandemic a national disaster, and the country has entered a time of non-natural disaster emergency. This has harmed the performance of businesses worldwide through demand and supply shocks caused in part by government-imposed lockdowns or Large-Scale Social Restrictions (PSBB) in a number of countries and cities (Israhadi, 2020), resulting in cash flow problems for many businesses and a deterioration of their balance sheets, including Indonesia.

By examining these accounting recording approaches, this study will demonstrate how they result in considerable improvements to cash flow statements, income statements, and balance sheets. Shareholder confidence, and company reputation, among other factors, motivate managers to change financial information through the methods explored in this study (Murphy et al., 2020).

This research demonstrates that managers have an incentive to employ accounting strategies in order to improve their companies' financial performance during a pandemic, such as that caused by the coronavirus (COVID-19). In comparison to other fields of accounting scholarship, there is scholarship devoted to the role of accounting in times of crisis. According to (Laux, C., & Leuz, 2010), (Arnold, 2009), and (Bezemer, 2010), certain financial reporting accounting processes exacerbated the 2008 global financial crisis. However, no proof of a pandemic exists. No research has been conducted on accounting amid pandemic, which is the subject of this study.

In Indonesia, the coronavirus pandemic (Covid 19) has not shown a declining trend. The government has started injecting vaccines hoping that Indonesia will recover soon. However, the company's prolonged liquidity conditions could cause permanent damage to the reputation and trust of investors. Various accounting techniques can hide such damage from a company's financial statements. Because such techniques can conceal information and potentially mislead shareholders, studying their use and impact during such exceptional circumstances is crucial.

Agency theory, which was first introduced by Jensen & Meckling (1976), is a theory that underlies the contractual relationship between the owner of the company (the principal) and the management who runs the company (the agent). The principal, in this case, delegates authority to management to carry out business operations aimed at achieving company goals for the welfare of the shareholders. According to Scott, the essence of agency theory is contract design that aligns the interests of business owners (shareholders) and managers in order to minimize agency conflicts (Parker et al., 2018).

In agency theory, managers must provide detailed and relevant information to shareholders related to the company's condition regarding the financial situation and the state of the company's business operations. One of this information can be provided through reliable, relevant, and timely financial reports to be used as the basis for the decision-making process by shareholders.

Auditors must verify that financial statements are presented properly and in accordance with widely accepted accounting principles in order to ensure transparency and relevance. Auditors are strongly needed to provide an opinion on the financial statements that are correctly audited. Therefore, the auditor must consider various factors, one of which is the inherent risk arising from using complex estimates by management. If the client uses complex estimates in its financial statements, the auditor must plan the audit and perform very detailed substantive

tests to ensure the reasonableness of the forecast. This is done in order to mitigate conflicts of interest between managers and stockholders (Rustam et al., 2013).

Agency conflicts that arise today are no longer limited to principals and agents or commonly called 'type I' agency conflicts. However, it has developed into an agency conflict between the majority and minority shareholders, commonly known as the 'Type II' agency conflict. This agency conflict arises in companies whose ownership structure is concentrated, for example, the ownership structure of companies in Indonesia (Panda & Leepsa, 2017).

According to Khan et al. (2015), the majority of family-owned and controlled businesses rarely experience 'type I' agency conflicts, but frequently experience 'type II' agency conflicts. This is because families frequently have significant incentives to seize wealth from minority owners and promote their own interests at the expense of non-controlling shareholders (Faccio & Lang, 2002; Villalonga & Amit, 2006). For example, one way is by increasing the value of assets (revaluation) to look healthy even though the company's condition is not the case.

Earnings management is defined more inconsistently by experts. Schipper (1989) defines earnings management as a conscious, intentional participation in the external financial reporting process with the intent of generating personal gain. Scott defines earnings management as a manager's accounting policy designed to accomplish a certain goal. Earnings management is also defined as "the ability to unilaterally increase or decrease reported net income" (Copeland, 1968). This indicates that earnings management is an endeavor on the part of management to maximize or decrease profits, including income smoothing in accordance with management's preferences.

Sugiri, in Widyaningdyah (2001), separates the term "earnings management" into two parts, namely: Earnings management is limited to the choosing of accounting processes in this instance. Earnings management is characterized in this restricted sense as managers' activity in determining the amount of profit by "playing" with the discretionary accruals component. Earnings management is the manager's activity to enhance and decrease the unit's currently reported profit without affecting the unit's long-term economic performance.

Sugiri defines earnings management technically, whilst Surifah discusses the effect of earnings management on the credibility of financial accounts. (Widyaningdyah, 2001). Surifah in Widyaningdyah (2001) asserts that earnings management can degrade the credibility of financial statements when they are used to make decisions. This is because earnings management is a subset of financial statement engineering, a technique for communicating between managers and the company's external stakeholders.

Setiawati & Na'im also support this opinion in Muliati (2011), which states that earnings management can erode the credibility of financial statements, enhance their bias, and cause financial statement consumers to believe that the modified results are the same as the original profit statistics.

Based on the opinion of Sugiri & Surifah, earnings management is stated in an opportunistic perspective. In general, earnings management is commonly expressed in an opportunistic viewpoint rather than an efficiency perspective. The efficiency perspective states that managers choose accounting policies to provide better information about future cash flows and minimize agency costs due to conflicts of interest between stakeholders and managers (Jiambalvo, 1996). Others say that earnings management is equally improper behavior because it reduces the trustworthiness of financial statement information (Asyik, 2007). Investors may not receive accurate information about earnings to evaluate the return and risk of their portfolio (Asyik, 2007).

Based on some of these definitions, it can be said that the purpose of earnings management, in general, is management intervention on external financial statements by utilizing the flexibility of accounting standards to increase or decrease profits for certain parties, to mislead investors in making decisions.

Previous research has shown that economic disasters cause companies to change their financial reporting to reduce the impact on these financial statements. A study on the Greek crisis concludes that the economic downturn caused a surge in the ABC system (activity-based costing) and unconventional recording methods. The study also confirms that conventional accounting, as happened in the Greek Financial Crisis, shows a drastic decline in financial performance during difficult times. Thus, it can be expected that unconventional accounting will return to popularity after the pandemic.

Huizinga & Laeven (2012) demonstrate that banks' balance sheets during the global financial crisis provide an erroneous impression of their financial health. They observed that banks exaggerated the value of their fixed assets and capital ratios during the US mortgage crisis. Additionally, tangible estate-related assets on bank balance sheets, particularly those of large banks, are overpriced. In comparison, banks with large exposure to mortgage-backed securities retain lower loan loss reserves, whereas failing banks use accounting discretion to inflate their financial statements through the classification of mortgage-backed securities.

Pozen notes that during the 2007-2008 global financial crisis, many analysts blamed 'fair value' or 'mark to market' accounting rules for requiring banks to record distressed assets at the prices at which they sold them on the open market for nearly nothing, and that recording distressed assets at their fair value at the time pushed the financial institution toward bankruptcy (Menicucci & Paolucci, 2016). Arnold (2009) asserted that accounting practices contributed significantly to the global financial crisis and subsequent proposed recapitalization of financial institutions, as well as to

the restoration of the global financial system's stability (Peterson, & Arun, 2018), implying that systemic banks manipulate estimated loan loss provisions in order to smooth profits during a recession. Additionally, they observed that global systemic institutions in Europe employed income smoothing following the crisis, although income smoothing was popular among non-systemic banks before to the crisis.

Reviewing other research on accounting practices during the 2007 Market Crash, it can be argued that principles like 'fair value' and 'matching principle' lead banks to bankruptcy as they force these institutions to report the actual value of the assets they will sell in the market. At that time, due to high uncertainty, the value of real estate assets practically fell drastically. This is the rationale behind adopting concealment practices that can help maintain shareholder trust and corporate value. In addition, previous research has shown that, during the crisis, financial practices began to become more complex, and companies began to use more financial statement footmarks to embed information, which may not be easily understood by shareholders in general (Magnan, 2009).

The research mentioned above can be used to build this research. Using studies of past financial crises, this study attempts to understand, and to some extent, predict the use of unconventional accounting in the current global economic downturn.

B. LITERATURE REVIEW

General Condition of the Company during the Covid-19 Pandemic

The COVID-19 outbreak that has hit the world, including Indonesia, has caused the government to impose Large-Scale Social Restrictions (PSBB). The PSBB is an effort to prevent the transmission of COVID-19, and as a result of the PSBB, many companies have to go out of business close temporarily. The wheels of the economy will undoubtedly stop, resulting in increased poverty. A sign of the impact of the COVID-19 pandemic on the company is work from home or even termination of employment. The performance of financial factors is a fundamental determinant in influencing the company's income. Companies are currently being tested whether they can survive in this situation, or because of many other considerations, the company will slowly stop operating.

During this pandemic, companies that run their economic wheels have experienced many structural changes in all lines, including the efficiency of everything from finance/budget to the quantity of labor, marketing strategies, and the organization's structure. Human resources are the most priority component in the organization because they have a role as a driver. But what happens when many companies experience bankruptcy and falter because the many costs that have been incurred are not balanced with those found by the company (Greiner, 1998).

Large and small business actors can survive facing global crisis conditions by utilizing existing technological advances. Maybe this can be done for substantial office matters, but what about operations that require labor as usual? This is not a big problem for companies that have invested in technology-based operations. But it will be a crucial problem for companies that remain and still use workers in most of their operations.

C. METHOD

This study will use a descriptive qualitative approach as the method. The data obtained came from various studies of previous scientific articles that still have a relationship with this research. The collected research data will be analyzed, and then conclusions will be drawn. Through descriptive qualitative methods, it is hoped that the recording practices carried out by companies in earnings management and accounting can be explored.

D. RESULT AND DISCUSSION

Economic players will avoid economic activity requiring interaction during a pandemic, much more so if the pandemic is linked with many communicable diseases. Financial markets will become more volatile as investors become risk averse and seek for safer havens in the face of fear and uncertainty. Enterprises will face difficulty obtaining equity, and private equity investment will reduce; supply will be impacted as production declines; operating costs will increase; and profitability will decline, resulting in poor corporate performance. Businesses can use the following accounting techniques in financial reporting to offset the pandemic's detrimental impact on performance in these scenarios.

Fair Value Financial Reporting

Fair value financial reporting, in the context of balance sheet obligations, refers to the practice of documenting the worth of assets and liabilities at the market price at which market participants transact. Fair value changes are represented in the income and expense columns of the income statement. Market value is another method of valuation that is based on valuing assets and liabilities in respect to their current market prices.

Businesses with big liabilities or substantial securities obligations may have a motivation to revalue their weaknesses at fair value using current market values or the closest equivalent that would minimize the amount owed and the company's overall risk during a pandemic. This is true if the liability contract contains an option for fair value measurement.

Historically, fair value accounting has been associated with financial disasters. Previous study has proven that proper value accounting contributed, albeit indirectly, to the 2008 financial crisis. While some experts, such as Laux and Leuz (2010), concede that fair value accounting contributed to the financial crisis, others, like as Véron (2008), argue that proper value accounting is being used as a scapegoat for the financial catastrophe. If under the fair value measurement option, the market valuation method will allow companies to reduce the size of their liability, revaluing it at a lower amount. Firms and institutions with large debt obligations, or other forms of liability, are incentivized to shift to market prices, causing them to pay lower amounts of the responsibility. However, this can force companies to reassess their assets, resulting in a smaller asset base. Although this may decrease the company's market value, such a reduction in assets will not be remarkable but will be seen by other leveraged companies (Barman, 2020).

However, previous research had also identified that companies that used market value to record financial information before the market crash faced severe liquidity conditions, and some even went bankrupt. When institutions record their assets at market value during a downturn, the asset value drops drastically to nothing. Thus, the benefits of Market Value to a company during a financial crisis are debatable. Still, it can be argued that borrowers benefit most when the value of their debt declines as the market value falls.

While the effect of fair value accounting on the pandemic is unknown empirically, one plausible prediction is that when assets and liabilities are valued at market prices, debtors prosper and creditors suffer during the pandemic.

Big-Bath Accounting, Bailout Funds, and Stimulus Packages

Big-bath accounting is a cost-cutting approach in which significant accounting write-offs are performed on current period earnings in order to reduce assets, resulting in future cost savings (Hope & Wang, 2018).

The Center for Accounting Studies Unpad (CAS Unpad) has held a Focus Group Discussion for the lecturers of the Accounting Department FEB Unpad on Sunday, March 29, 2019, and was attended by 16 lecturers. According to the Focus Group Discussion, companies are not allowed to carry out any earnings management practices or make false representations due to the Coronavirus or Covid 19 pandemic. Suppose some companies experience a drastic decline in sales at the beginning of 2020. In that case, the company must include its financial condition in the first interim financial report of 2020.

In countries where financial and nonfinancial companies received stimulus packages or bailouts during the pandemic, companies may have a higher incentive to participate in Big-bath earnings management in order to take advantage of

government support and the fact that the market will not penalize companies for bad performance during the epidemic.

When a business employs Big Bath accounting, it refers to the process of adjusting future fiscal year costs to the current fiscal year. This will reduce assets and profits in the current year for the company and allow them to make their future results look better. A government that provides the stimulus and bailout packages for a distressed industry will most likely demonstrate the profound use of Big Bath accounting as an attempt to hide surplus assets and corporate earnings. When the country has recovered from the situation, these assets and revenues can be deferred for subsequent years.

During a global pandemic, where company financial reports are already bad, the use of the Big Bath technique can make company performance results look worse than they are. This will create room for deferred earnings for subsequent financial years, allowing the company to reduce costs and increase its profits in the future.

While auditors can detect Big-bath practices in businesses, businesses can defend these practices by claiming that the decision to write off large fees in a pandemic year was made due to the pandemic's negative effect on business activity and that the resulting decline in profits would be offset by the company's use of the government stimulus package. This hypothesis is bolstered by prior studies highlighting the importance of incentives for Big-bath behavior in low-performing organizations.

Extensive Income Smoothing and Loss Avoidance Accounting

In the absence of stimulus packages or bailouts during the epidemic, businesses will attempt to maintain their competitiveness by utilizing accounting procedures that enable them to declare constant earnings, indicating that they are not failing in comparison to their competitors. Accounting procedures such as income smoothing and loss avoidance are two examples of accounting techniques that can be used for this aim. Smoothing income requires limiting or eliminating variations in earnings over time, ensuring that reported earnings are neither overly high nor excessively low. Businesses may maximize revenue streams during a pandemic by postponing research and development (R&D) spending or by reducing personnel costs.

On the other hand, firms can avoid reporting losses during an epidemic by deferring high costs to a future year or by recognizing future gains in a pandemic year. For example, during a pandemic year, businesses may postpone the procurement of technology machinery, equipment, software, or hardware, instead making bulk purchases on credit and recognizing future cash flows.

Profit-Leveling and Loss-Aversive Recording

Suppose the company cannot receive the funds from the government necessary for the company's survival. In that case, the company can still realize a good quarter by

using unconventional accounting methods. This method allows the company to record higher average profits, even in bad years.

These methods include Profit Leveling and Loss-Aversive Recording. Profit Leveling, or Income Smoothing, includes maintaining a certain level of profitability each year, which has very volatile profits, and ensuring that profits don't drop. This can be achieved by delaying payments or by reducing the workforce. In addition, the Loss Aversive technique also includes delaying payments to creditors or reporting future income in the current fiscal year.

Loose Accounting Rules During a Pandemic

To avoid corporate insolvency and poor performance during the epidemic, it may be necessary to relax accounting norms or provide management additional financial reporting freedom. However, lax accounting procedures during a pandemic might result in accounting statistics being manipulated, reducing the trustworthiness of accounting information. Laux & Leuz (2010) explain how permissive accounting regulations, such as fair value measurement standards, result in manipulation and a reduction in the trustworthiness of accounting information as a result of a lack of transparency surrounding asset pricing.

Despite the fact that governments frequently pressure accounting standard-setters to relax accounting standards in the event of a pandemic, the counter-argument is that accounting rules should not be loosened in the event of a pandemic because businesses can fairly anticipate such accounting regulations (Laux & Leuz, 2010).

Financial Assistance Package

While financial reporting liberalization allows companies to have better financial reporting during financial crises, it will also decrease transparency as companies can use the above-mentioned tactics to hide their poor performance or manifest themselves as a weaker party. It has also been demonstrated that liberal accounting laws lead to manipulative reporting. Therefore, the government should implement regulations that allow companies to be flexible while not giving them the freedom to be misreported. It is widespread for companies to try to hide their performance in a financial crisis and embody a better version of their statement. Therefore, accounting laws and practices should not be relaxed or liberalized during this pandemic.

E. CONCLUSION

Accounting practices have a significant impact on how much a corporation is affected by a recession and extreme situations such as 2020. Additionally, accounting can either assist a business in surviving or contribute to its demise. In summary, this study's discussion demonstrates that many accounting procedures can be employed to

mitigate the pandemic's negative influence on a company's financial statements. During a pandemic, businesses might employ a variety of tactics, incorporating fair value accounting, income smoothing, loss aversion, and management of large-bath earnings. As a result, accounting can play a significant role in reducing the impact of the pandemic on business performance. The study's findings are relevant to the current discussion regarding accounting's utility to society. While accounting, like social science, cannot be blamed for the pandemic's adverse effects on businesses, accounting can be blamed for failing to assist businesses in mitigating the pandemic's adverse effects on financial performance when managers are not permitted to exercise significant accounting discretion to mitigate the pandemic's adverse effects on their balance sheets. As the pandemic worsens, more basic questions about accounting's role in society, particularly in minimizing the negative impact of a crisis or pandemic on firms, will be raised.

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