

## Future Employees' Rating on Earnings Management Actions

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### ABSTRACT

Earnings manipulation, financial fraud, and other financial criminal cases involve the process of alteration of financial report that can mislead it. This had led to losses amounting to millions of ringgit to the company. Since the management of the company controls the business operations and activities, there is a need to investigate the future managers on the earnings management actions. Therefore, this study investigates the business and accounting students' perceptions of the morality of specific earnings management actions. In addition, the study also examines the differences in the perception based on gender and course. 172 from 280 self-administered questionnaires were received and analyzed. It is found that only one out of 18 actions were viewed as "questionable actions", where the respondents would rather feel uncomfortable for not saying anything to the person involved in the action. On the other hand, 17 actions were considered as "minor violation", where the respondent will warn the person not to involve in the action again. In addition, the study also found that there is a significant difference on the mean ethicality of the eighteen earnings management actions between male and female students. In fact, the analysis shows that females are stricter than males in four actions out of 18 earnings management actions, where the difference is statistically significant. On the other hand, there is no significant difference in the mean ethicality of the eighteen earnings management actions between business and accounting students.

**KEYWORDS:** Short-Term Earnings Management, Business and Accounting Students, Gender, Course.

### INTRODUCTION

Ethics is the core business management of a company. Most of the organizations have their own ethical code, but many of the employees and management failed to comply with it. Nowadays, employees and management face greater pressure to ensure that their business and personal targets are achievable, no matter what it takes. Problems will occur, especially when the employees and management are unable to justify their ethical values and its implication. This is where many employees and management intentionally or unintentionally committed fraud.

Fraud deals with manipulations and deceptions. Greed and personal financial pressure are the most common factor of committing fraud in Malaysia. From January 2006 to December 2008, RM63.93 million losses were reported due to fraud in Malaysia. However, 53% of the respondents in the survey were unsure of the actual losses incurred [1]. Thus, the actual total losses might be higher than the amount reported. In year 2011, 44% of the respondent from Malaysia had reported frauds in their organization as compared to 28% in the year 2009. Asset misappropriation, accounting fraud and bribery, and corruption are the highest types of fraud worldwide. Most of the accounting fraud involves the manipulation of financial statements [2].

One of the issues that are commonly being discussed under fraud is earnings management. Earnings management is the manipulation of financial reports "to either mislead some stakeholders about the underlying economic events of the company or to influence contractual outcomes that depend on reported accounting numbers" [3]. It involves the selection of accounting estimates that may give benefits to the organization, but ignores the right of the other stakeholders [4].

Prior research found that managers, accountants and investment analysts in East Asian were seem to be more secretive on their perception of few ethical situations. They were less willing to rank the situation as completely unethical, as compared to respondents from United Kingdom/United States (UK/US). Thus, there are significant differences in the perception of accounting and operational manipulation in an organization [5]. Meanwhile, a study on 249 undergraduate business students and business manager found that five out of twenty earnings management practices were rated as a serious violation, ten as minor violation, four practices as questionable practices and one action as an ethical practice. The study also found that females have a stricter view on twenty earnings management actions, but only three actions were found significant [6].

On the other hand, undergraduates in accounting and business program rated thirteen practices as minor violation, five practices as questionable practice, while the remaining as serious violation. Besides, only two practices were significantly

differs, where the females were stricter [7]. 583 certified public accountants, who are registered with the American Institute of Certified Public Accountants strongly agreed that corporate ethical values have a strong impact on the earnings management ethics. They are stricter in rating the earnings management actions as unethical. In fact, the male public accountant possesses higher ethical values compared to the female public accountant [8].

Most of the fraud cases are not due to the lack of technical knowledge in accounting. As a preventive action, most universities teach business ethics education, which is part of the requirement for accounting and business graduates. Although there are some debate on the impact of the course in the ethical decision making of the future employees, but at least it may open the young graduates' view on the ethical issues that they may face in their workplace. Thus, this study is conducted to examine the differences in the perception based on gender. In addition, the study also investigates the business and accounting students' perceptions of the morality of specific earnings management actions.

## DATA AND METHODOLOGY

About 280 self-administered questionnaires were distributed to the business and accounting undergraduate students in a public university in Malaysia. However, only 172 were considered valid responses, which is 61.4% of the total questionnaires distributed. The study analyses 18 earnings management actions, which is commonly being used in prior studies [4]. The subjects responded using a 5-point Likert scale where 1 was "totally ethical" and 5 was "totally unethical". Later, the study will conduct the independent sample t-test to investigate the difference on the mean ethicality of the eighteen earnings management actions based on gender and course.

## RESULTS AND DISCUSSION

Table 1: Demographic data

		No. respondents	Percentage (%)
<b>Gender</b>	Male	47	27.3
	Female	125	72.7
<b>Course</b>	Business	89	51.7
	Accounting	83	48.3

Table 1 shows the demographic data of the respondents. 72.7% of the respondents are female students, while the remaining are the male students. Most of the respondents are majoring business administration, while 83 respondents are majoring in accounting. In addition, the study also conducted the reliability test. In this study, the Cronbach alpha coefficient for 18 items is 0.855, which is above 0.7. Thus, the scale is considered as reliable [9].

Table 2 tabulates the rating of earnings management actions. None of the respondents rated the actions as totally unethical or serious violation. About 17 actions are ranked as minor violation. Most respondents agree that the person who involved in these 17 earnings management actions must be reminded not to involve in the action again. The action of deferring supplies expense by delaying recording invoice is considered as the highest rank, with the mean of 3.26.

On the other hand, only working overtime for budget target is considered as questionable action. The respondent will be silent on the action, although they feel uncomfortable with it. This finding is similar to the study on East Asian managers, accountants and investment analysts. Most of them prefer to keep quiet or become lenient in their rating of ethical action [5].

Table 2: Rating of earnings management actions

Ethical Categories	Description	Mean	Standard Deviation
<b>Totally unethical (4.5-5)</b>	None		
<b>Serious violation (3.5-4.5)</b>	None		
<b>Minor violation (2.5-3.5)</b>	Defer supplies expense by delaying recording invoice	3.26	0.922
	Request deferred billing from supplier, RM500000	3.24	0.971
	Bury scrap costs in "other expenses". No income effect	3.17	0.962
	Accelerate delivery to customers by 42 days	3.10	1.049
	Prepay expenses to reduce income by RM60,000	3.04	1.011
	Increase reserve for obsolescence; reduce income RM700000	3.04	0.951
	Request deferred billing from supplier, RM300000	3.03	0.948
	Defer expenses to meet annual budget	2.95	0.993
	Defer expenses to meet quarterly budget	2.93	1.006
	Accelerate delivery to customers by 28 days	2.90	0.909
	Reduce reserve for obsolescence to meet budget target	2.85	1.013
	More liberal credit terms to reach budget target	2.85	0.909
	Accelerate delivery to customers by 14 days	2.84	0.850

	Reduce reserve for obsolescence to continue work	2.78	0.976
	Accelerate delivery to customers by 3 days	2.71	0.929
	Sell excess assets to reach budget target	2.71	1.069
	Paint ahead of schedule	2.64	1.064
<b>Questionable actions (1.5-2.5)</b>	Work overtime to reach budget target	2.48	1.017
<b>Ethical actions (0.00-1.5)</b>	None		

### Gender Difference

Later, the study conducted the independent sample t-test to examine the differences in the perception based on gender. Table 3 indicates that there is a significant difference in mean ethicality of the eighteen earnings management actions for male ( $M = 2.758$ ,  $SD = 0.542$ ) and females ( $M = 2.980$ ,  $SD = 0.506$ ;  $t(120) = -2.511$ ,  $p = 0.013$ ). The same findings were found in prior literatures [6], where there is a significant difference on the mean ethicality of the eighteen earnings management actions between male and female students.

Table 3: Independent sample t-test result (gender)

Gender	N	Mean	Std. Deviation	T	Sig. (2-tailed)
Male	47	2.758	0.542	-2.511	0.013*
Female	125	2.980	0.506		

The mean score for male respondents were lower compared to the female respondents. This indicated that the male respondents were more tolerated in their ethical judgments. However, it should also be highlighted that the toleration may lead to more involvements in the unethical behavior [10, 11]. Prior research also found that females have better ethical reasoning ability compared to males [12], and are more conservative and unbiased than men in making ethical decisions [13]. This is where the females are more concern on the financial rewards that they might get if they make ethical decisions [14].

Table 4 shows the detail mean score and significant level for each action. Out of 18 earnings management actions, 4 actions were significantly different, where the females are stricter than males. The actions are deferring expenses to meet annual budget, reducing reserve for obsolescence to continue work, reducing reserve for obsolescence to meet the budget target and burying scrap costs in "other expenses".

Table 4: Mean score by gender and significant level for each action

Action	Mean Score		Sig.
	Male	Female	
Paint ahead of schedule	2.91	2.54	0.070
Defer expenses to meet quarterly budget	2.79	2.98	0.301
Defer expenses to meet annual budget	2.64	3.06	0.012*
Defer supplies expense by delaying recording invoice	3.11	3.32	0.176
More liberal credit terms to reach budget target	2.64	2.94	0.055
Work overtime to reach budget target	2.36	2.53	0.341
Sell excess assets to reach budget target	2.43	2.82	0.052
Prepay expenses to reduce income by RM60000	2.98	3.06	0.652
Increase reserve for obsolescence; reduce income RM700000	2.83	3.12	0.074
Reduce reserve for obsolescence to continue work	2.28	2.98	0.000*
Reduce reserve for obsolescence to meet budget target	2.38	3.03	0.001*
Bury scrap costs in "other expenses". No income effect	2.83	3.30	0.004*
Request deferred billing from supplier, RM30000	2.94	3.07	0.459
Request deferred billing from supplier, RM500000	3.15	3.27	0.460
Accelerate delivery to customers by 3 days	2.57	2.76	0.244
Accelerate delivery to customers by 14 days	2.94	2.80	0.350
Accelerate delivery to customers by 28 days	2.81	2.94	0.454
Accelerate delivery to customers by 42 days	3.06	3.12	0.755

### Course Difference

The study also conducted the independent sample t-test to examine the differences in the perception based on the courses. Table 5 indicates that there is a no significant difference in mean ethicality of the eighteen earnings management actions for business students ( $M = 2.952$ ,  $SD = 0.450$ ) and accounting students ( $M = 2.884$ ,  $SD = 0.595$ ;  $t(152) = 0.846$ ,  $p = 0.399$ ). The same findings were found in prior literatures [6], where there is no significant difference on the mean ethicality of the eighteen earnings management actions between business and accounting students.

Table 5: Independent sample t-test result (course)

Gender	N	Mean	Std. Deviation	t	Sig. (2-tailed)
Business	89	2.952	0.450	0.846	0.399
Accounting	83	2.884	0.595		

Table 6 tabulates the detail mean score and significant level for each action. Out of 18 earnings management actions, only one action were significantly different, where the business students are stricter than accounting students. The action is accelerating delivery to customers by 3 days.

Table 6: Mean score by course and significant level for each action

Action	Mean Score		Sig.
	Business	Accounting	
Paint ahead of schedule	2.67	2.60	0.660
Defer expenses to meet quarterly budget	3.02	2.83	0.217
Defer expenses to meet annual budget	3.00	2.89	0.476
Defer supplies expense by delaying recording invoice	3.29	3.23	0.654
More liberal credit terms to reach budget target	2.91	2.80	0.409
Work overtime to reach budget target	2.58	2.37	0.175
Sell excess assets to reach budget target	2.62	2.81	0.247
Prepay expenses to reduce income by RM600000	3.04	3.04	0.955
Increase reserve for obsolescence; reduce income RM700000	3.11	2.96	0.308
Reduce reserve for obsolescence to continue work	2.84	2.75	0.423
Reduce reserve for obsolescence to meet budget target	2.89	2.82	0.660
Bury scrap costs in "other expenses". No income effect	3.18	3.16	0.875
Request deferred billing from supplier, RM30000	3.03	3.04	0.987
Request deferred billing from supplier, RM500000	3.17	3.31	0.333
Accelerate delivery to customers by 3 days	2.85	2.55	0.034*
Accelerate delivery to customers by 14 days	2.92	2.75	0.179
Accelerate delivery to customers by 28 days	2.87	2.94	0.594
Accelerate delivery to customers by 42 days	3.12	3.08	0.809

## CONCLUSION

The study investigates the business and accounting students' perceptions on the morality of specific earnings management actions. It is found that the respondents are willing to warn those who involved in 17 earnings management actions, not to involve in the same action again. However, the respondents prefer to be silent on if they encounter a situation where the person works overtime to reach the budget target.

In addition, the study also examines the differences in the perception based on gender. The study found that there is a significant difference in mean ethicality of the eighteen earnings management actions for male ( $M = 2.758$ ) and females ( $M = 2.980$ ). Further analysis found that the females are stricter than males in four actions out of 18 earnings management actions, where the difference is statistically significant. On the other hand, the study found that there is no significant difference on the earnings management actions between business and accounting students.

The findings of this study have certain implication for the academia. Most of the universities integrate business ethics as their curriculum, but still further emphasis should be given on the importance of whistle blowing. As the finding shows that the respondents prefer to just warn the person who involved in the actions only, without reporting it to higher authority, there is an issue of reason the respondents refuse to be a whistle blower. They might feel fear to report the action, as they are unsure of the consequences of their action.

This study consists of few limitations. First, the study only investigated the perceptions of students in a university in East coast Malaysia. Thus, the result may not represent the whole population of business and accounting undergraduate students in Malaysia. Second, the earnings management actions that are applied in this study are used in few prior literatures. Therefore, other earnings management actions applied in another study are beyond the scope of this study.

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