



The effect of earnings manipulation based on real activities to the performance of Indonesian SOEs

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ABSTRACT

The aim of this research is to examine the effect of real earnings manipulation (REM) on the performance of state-owned enterprises (SOEs) in Indonesia. This research was conducted at a state-owned company listed on the Indonesia Stock Exchange (IDX) in 2013-2017. Data obtained from financial reports and annual reports issued by IDX and the Web of each SOEs. Data also comes from the Indonesian Capital Market Directory. The research variables consist of a dependent variable, which is financial performance, and an independent variable that is REM. Financial performance is proxy by net profit margin (NPM) and returns on equity (ROE). Earnings manipulation is proxy by Roychowdhury's model. The type of ownership is used as a control variable of this research. Generally, the least square regression model is used to test the relationship between earnings manipulation and SOEs performance. This research shows that earnings manipulation based on real activities through production costs negatively affects the performance of Indonesian SOEs, government ownership negatively effects on NPM whereas public ownership has a positive effect on performance, as measured by ROE. Improper government policies can reduce the performance and significant disadvantages of SOEs.

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Introduction

This research examines the effect of real earnings manipulation (REM) on state-owned enterprises (SOEs) performance in Indonesia. Earnings management can be opportunistic and efficient. Opportunistic earnings management is connoted as earnings manipulation. Therefore in this paper, the terms manipulation and earnings management are similar to opportunistic earnings management. This research was motivated by SOEs' performance which continues to be in the spotlight. Major cases such as the PLN case which lost 53 trillion in the first quarter 2020, the Jiwa Sraya Case (2019), and the improper financial statement Case of PT Garuda Indonesia (2018), as well as 24 SOEs losers (2017), raise big questions. Why do SOEs suffer losses, even though they enjoy many facilities from the Government of Indonesia?

Private companies similar to SOEs, without facilities from the Government of the Republic of Indonesia, can still survive. Are these losses related to the manipulation of real activities? Is there a government policy (political policy) also affecting the decline in performance or even related to the cases of large SOEs in Indonesia? Big cases of SOEs in 2018-2019 are the cases of PT Jiwasraya and PT Garuda. The Jiwasraya case is related to defaults on customer funds, which mature around Rp 12.4 trillion (Kompas.com, 2019). Garuda Indonesia Airline Company is entangled in several cases. First, the case of improper financial statements in 2018. This case is related to a cooperative transaction providing in-flight connectivity services with PT Mahata Aero Teknologi, which is a long-term receivable from income accounts. The revenue recognition succeeded in turning the loss in 2017 into a net profit of US \$ 809 thousand in 2018. Second, the bribery case of procurement of aircraft and aircraft engines of Airbus SAS and Rolls Royce PLC which ensnared former Garuda Director Emirsyah Satar. A bribe was given to the Emir by Rolls Royce in the procurement of 50 Airbus A330-300 aircraft engines for Garuda Indonesia several years ago. The incident caused the Emir to be arrested because he was determined to be a criminal suspect in money laundering (Cnnindonesia, 2019).

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The bribery case of aircraft procurement is a form of manipulation based on real activities, which is manipulating the price of aircraft engines not under the actual price. These results in high aircraft costs, which impact on depreciation costs, will also be high, and operational costs and production costs are also high. High production costs will affect the high selling prices so they cannot compete. The case of receivables for cooperation transactions in the provision of connectivity services in flight with PT Mahata Aero Technology that has been recognized as revenue is a form of real activities manipulation with discretionary. If it is a long-term receivable, income should be recognized in proportion to the cash received. This manipulation can turn a company that was a loss into a profit. Also, many Indonesian SOEs suffered losses. In 2017 as many as 24 SOEs reported losses so that Indonesia lost IDR 5.8 trillion in 2017 (Indonesia.news, 2017). The following are 4 other SOEs cases that have lost:

1. PT Krakatau steel, for example, loses due to high debt burden and Government regulations. Short-term debt increased by 17.38% compared to before 2018. Government regulations that exempt import tariffs for imported steel from China, through Minister of Trade Regulation No. 22 of 2018, caused PT Krakatau steel to be unable to compete. Government permission for the establishment of a steel company from China in Kendal district, Central Java, with an investment of 2.54 billion US dollars, plans to become the largest factory in Asia, which will operate 2019 or 2020, causing PT Krakatau steel to sink even worse. Besides, the Corruption alleged bribery project for the procurement of goods and equipment of the Krakatau Steel Directorate of Technology and Production was worth Rp24 billion and Rp2.4 billion (CNBC.Indonesia, 2019).
2. Bulog loses money due to government policies on the BPNT (non-world food aid) program. Poor people are given vouchers and they can buy directly from the market, not through Bulog anymore. As a result, the supply of Bulog procurement both from imports and domestic is stored in the warehouse too long and can rot (Bisnis.Tempo, 2019).
3. Indofarma loses due to a large amount of the third party receivable. Indofarma provides medicines to hospitals that work with BPJS, but the Government does not immediately pay BPJS debt to hospitals. This is what hinders the payment of hospital debt to Indofarma so that Indofarma's receivables from hospitals become bigger (Katadata.co.id, 2019).
4. The factoring case of PT Pengembangan Armada Niaga Nasional (PT PANN). PT KII's Managing Director Eka Wahyu Kasih sells accounts receivable to PT PANN for invoicing against PT Indonesia Power. The receivables do not meet the requirements to be forwarded. This case is detrimental to state finances amounting to Rp55 billion. Corruption of financing, debt transfer, operation, and bailout by PT PANN. PT Meranti Maritime, which has the potential to cause losses to the state of US \$ 27 million or equivalent to Rp 1.3 trillion (Independensi.com, 2019).

The purpose of this research is to find empirical evidence that real earnings manipulation (REM) affects SOE performance. This research is important because to maximize the self-interest of agents (expropriation) by management it can be covered and carried out using REM, which will ultimately affect performance, as happened in the case of Garuda Airlines.

The following sections of this paper on the organization as follows. The second part is a literature review and hypotheses development. The third part is research methods. The fourth part is analysis and discussion, and the fifth part is the conclusions and implications

Literature Review

Conceptual Background and Hypotheses Development

Earnings management is an accounting policy or action chosen by managers to influence earnings, to achieve certain goals (Scott, 2012). Opportunistic earnings management is also called earnings manipulation. Therefore, when referring to earnings management, it connotes earnings manipulation. Earnings management is a conscious action taken by managers to achieve certain goals, still within the framework of accounting procedures. Management has access to information that cannot be accessed by others. If managers tend to send information on the true value of a business unit using earnings management, then that is acceptable. However, it is very concerning, when earnings management is used to present information that deviates from the actual performance of a company (Ghyasi, 2017). Earnings management can be in the form of accrual or real earnings management. Accrual earnings management occurs when management manipulates reported earnings by exploiting accounting policies but is still based on generally accepted accounting principles. Conversely, real earnings manipulation is related to management's efforts to change reported earnings by adjusting the time and scale of business activities. According to Chen & Tsai (2010) earnings manipulation can be classified into 2 types, namely production/distribution manipulation and discretionary accrual manipulation (Chen & Tsai, 2010).

Earnings management can also be done by non-profit organizations. Jegers (2013) found that nonprofits prefer to disclose organizational results without profit (zero profit). However, this does not imply any form of manipulation. This result can be obtained by planning organizational activities wisely so that profits are zero. This is similar to real earnings management, by rescheduling transactions, so earnings are near zero. Larger non-profit organizations tend to manipulate profits more to achieve near-zero profit levels (Jegers, 2013). Real earnings management can affect several things, which in turn will reduce the company's performance. Bereskin et al. found that R&D cuts related to earnings management lead to fewer patents, less influential patent output, and lower innovation efficiency compared to not cutting R&D. Thus real earnings management can hamper the company's technological progress (Bereskin, Po, & Rotenberg, 2018). A manager who is interested in increasing current period earnings can cut R&D

investment and employee training programs, which have economic consequences not only in the short term but in the long term (Gunny, 2010). Earnings management practices based on discretionary accounting negatively affect the company's image (Ariza, 2016). Declining corporate image can be bad for the company. Real earnings management has a negative influence on future performance (Badru & Raji, 2016). These results indicate that companies involved in opportunistic earnings management strategies have smaller operating performance and lower value relevance of accounting information (Mostafa, 2017). Earnings management through CFO has a negative and significant effect on earnings per share (Abner & Ferrer, 2018). This research assumes that profit manipulation based on real activities negatively affects company performance. So the research hypothesis is

H1: Real earnings manipulation negatively affects performance.

Research and Methodology

This research was conducted at a state-owned company listed on the Indonesia Stock Exchange (IDX). Research data in the form of secondary data from financial statements and annual reports issued by the IDX. Data also comes from the Indonesian Capital Market Directory (ICMD). The research variables consist of: the dependent variable of financial performance and the independent variable is the manipulation of real earnings. This research control variable is the type of ownership, which is divided into 3, government ownership (Gov), private institutions (Priv), and public ownership (Public). The performance is an indicator of the success of company management. Financial performance is defined as an indicator of a company's ability to generate profits. Financial performance in this research was measured using indicators of net profit margin (NPM) and return on equity (ROE) financial indicators. NPM can be obtained from net income divided by net sales. This ratio is used to measure the company's ability to generate net income from net sales generated.

Earnings Manipulation Based on Real Activity or opportunistic earnings management is more connoted to earnings manipulation. Therefore, earnings manipulation based on real activities is measured using earnings management based on real activities of the Roychowdhury model (Roychowdhury, 2006). Earnings manipulation based on real activities consists of: earnings manipulation based on real activities through cash flow from operation (REM_CFO), production costs (REM_Prod), and discretionary costs (REM_DISCR). The analysis technique to test the hypothesis using generally least squares multiple regressions. The study population includes all SOEs listed on the Indonesia Stock Exchange (IDX). Purposive sampling method, with the criteria: annual report data available on the IDX and/or on the Web of each SOE, did not stop operating during the observation year, from 2013 to 2017, and did not conduct business combinations during the observation period. Based on these criteria, the number of SOEs that became the study sample was 20 companies, for 5 years of observation, so the total sample was 100 observations.

SOEs listed on the IDX consist of various industries, both financial and non-financial. Each industry is very diverse and has its characteristics, but also has many similarities, especially in terms of reporting formats and disclosure of annual reports and financial reports. For example, similarities in financial statements, namely income statements, statements of financial position, statements of cash flows, as well as similarities in performance ratios such as ROA, ROE, and NPM. Therefore, this research processing is not distinguished between industries.

Results and Discussion

Univariate analysis

Descriptive statistics indicate the minimum, maximum, average, and standard deviation of the variables studied. The highest ROE is 134% and the lowest is minus 40.65, and the average is 16.2%. The highest NPM was 49.4%, the lowest was minus 56.6%, and the average was 8.30%. Judging from the average ROE, SOE's performance is quite good because it is still above the bank interest rate. The average net profit margin (NPM) of 8.33% shows that the performance of SOEs is still worrying because the NPM only takes into account the cost of products or services. If administrative costs and other indirect costs are taken into account, it will result in a lower net profit. Both ROE and NPM have a fairly large minimum minus value. This shows that the performance of SOEs overall is not good, because this means that some SOEs suffered severe losses. The SOEs that have suffered losses in an observation year are Indofarma, Krakatau Steel, Aneka Tambang, and Garuda Indonesia. The average percentage of ownership of the Government of the Republic of Indonesia (Gov.) is 67.9%. This percentage of ownership is following RI Law No. 19 of 2003 concerning SOEs (UU._RI._No.19, 2003). The average percentage owned by the public is 28.9%, and that owned by private institutions (Priv) is 1.7%. Descriptive statistics of research variables can be seen in table 1.

Table 1: Descriptive Statistics

<u>Variable</u>	<u>Minimum</u>	<u>Maximum</u>	<u>Mean</u>	<u>Std. Dev.</u>
ROE	-.406	1.342	.162	.205
NPM	-.566	.494	.083	.123
REM_CFO	-9.815	96.544	.000	10.203
REM_PROD	-10.021	96.470	.000	10.199
REM_DISCR	-5.919	103.729	.000	10.578
Gov	.000	1.000	.679	.164
PRIV	.000	.650	.017	.070
Public	.000	.985	.289	.179

Bivariate analysis

Table 2 shows the results of the correlation test between variables is low, with a maximum of 0.692. This means that there is no multicollinearity because it is still below 95%.

Table 2: Pearson Correlation Test

	ROE	NPM	REM_CFO	REM_PROD	REM_DISCR	Gov	PRIV
NPM	.260**						
REM_CFO	-.151	-.068					
REM_PROD	-.194	-.041	.486**				
REM_DISCR	-.204*	-.070	.692**	.458**			
Gov	-.189	-.157	.167	-.018	.130		
PRIV	-.048	-.045	-.031	-.026	.008	-.365**	
Public	.201*	.154	-.168	-.084	-.151	-.494**	.079

** , * : Correlation is significant at the 0.01 and 0.05 level respectively (2-tailed).

Effect of REM on performance

Based on statistical tests in table 3 shows that earnings management based on production activities (REM_Prod) negatively affect performance, both measured by NPM and ROE. This result remains consistent after being controlled by variables of government ownership, ownership of private institutions, and public ownership. These results indicate that real earnings management which results in high production costs will adversely affect performance. This result is supported by the phenomenon of practice that exists in several Indonesian SOEs. For example, **first**, the case of mark up the purchase of aircraft and aircraft engines at PT Garuda will cause a high cost of goods, then the selling price will be high, unable to compete, and ultimately lose. The loss is trying to be covered by recognizing income from a transaction that is not yet income, thus raising the case of PT Garuda's unfair financial statements in 2018. **Second**, the case of PT Krakatau Steel, which has a high debt burden, causes high production costs, high product selling prices, unable to compete with iron and steel products from China, and ultimately losers. The decision to owe PT Krakatau Steel with high-interest costs is also a decision of the company's real activities, which harm performance. Third, the case of factoring in PT PANN is also a decision based on the real activities of the company which cost the country 55 billion.

Statistical test results show that REM_CFO has a significant positive effect on performance both measured by NPM and ROE. This result remains consistent after being controlled by variables of government ownership, ownership of private institutions, and public ownership. This means that real earnings management which results in high operating cash flow will have a positive effect on performance. Cash flow statements are reports that are difficult to manipulate and are not influenced by accounting policies and procedures. Therefore companies that have high abnormal cash flows will have high performance. Companies that can manage their cash flow high are good financial companies so that it has a positive effect on performance. Discretionary REM does not affect performance. This could mean that management is not very interested in managing accounting profit figures using accounting methods and procedures. They are more interested in managing profits by using real activities. Managing profits using accounting methods and procedures will be reversed in subsequent periods. For example, the double-declining balance depreciation method will impose high depreciation costs in the early years but will be reversed in the final years, so that depreciation costs will be lower. Therefore, earnings management through discretionary is not effective for the controlling party to carry out the expropriation of the company's assets for personal or group interests.

$$NPM_{it} = \alpha_{it} + \beta_1 REM_CFO_{it} + \beta_2 REM_PROD_{it} + \beta_3 REM_DISCR_{it} + \varepsilon_{it} \dots\dots\dots (1)$$

$$NPM_{it} = \alpha_{it} + \beta_1 REM_CFO_{it} + \beta_2 REM_PROD_{it} + \beta_3 REM_DISCR_{it} + \beta_4 GOV_{it} + \beta_5 Priv_{it} + \beta_6 Public_{it} + \varepsilon_{it} \dots\dots\dots (2)$$

Table 3: Regression Analysis

Variable	Model 1		Model 2			
	Coefficient	t-Statistic	Coefficient	t-Statistic		
C	0.083271	***	61.14892	0.132166	***	4.158287
REM_CFO	0.038771	***	5.588844	0.042027	**	2.415640
REM_PROD	-0.040668	***	-5.566899	-0.046408	***	-2.512005
REM_DISCR	0.001249		0.819577	0.003521		1.539257
GOV				-0.087216	**	-2.144062
PRIV				-0.113930		-1.243243
PUBLIC				-0.008587		-0.288513
Adj. R²	0.323745			0.054921		
F Stat.	1.675565	**		1.958853	*	

Government ownership negatively affects NPM with a significance level of 5%, this means that the higher the percentage of government ownership, the lower the NPM. Public ownership has a positive effect on performance, as measured by ROE. This means that the higher the public ownership, the higher the ROE. Ownership of private institutions does not affect NPM or ROE. Government ownership negatively affects NPM, possibly due to widespread corruption cases and decisions that are more influenced by political or regulatory factors that can harm SOEs. For example, the corruption case at PT Berdikari and PT PANN accounts. Some regulations that are detrimental to SOEs, for example, PT Krakatau Steel are losing money because government regulations free import tariffs on imported steel from China, through Minister of Trade Regulation No. 22 of 2018. PT Aneka Tambang lost due to the government's policy on the prohibition of raw mineral exports which began entering into force in early 2014. Bulog loses money because the government policy on the BPNT (non-world food aid) program, in the form of vouchers that are used by the poor to buy directly from the market, is no longer through Bulog. As a result, Bulog's rice stocks can rot. Indofarma lost money because the Government did not immediately pay the BPJS debt to the hospital. Furthermore, the hospital cannot afford to pay for Indofarma. PT Pos Indonesia is losing money because the Government's non-cash social assistance policy has not been sent since 2016 through Pos Indonesia's financial services, but is now being done by banks. PT PLN lost 53 trillion in the first quarter of 2020, due to the high debt burden to foreign investors based on the US \$ exchange rate so that when the rupiah weakened against the dollar, there was a foreign exchange loss that was quite high. The high debt burden by PLN is also with the approval of the controlling party, namely the government.

$$ROE_{it} = \alpha_{it} + \beta_1 REM_CFO_{it} + \beta_2 REM_PROD_{it} + \beta_3 REM_DISCR_{it} + \varepsilon_{it} \dots\dots\dots (3)$$

$$ROE_{it} = \alpha_{it} + \beta_1 REM_CFO_{it} + \beta_2 REM_PROD_{it} + \beta_3 REM_DISCR_{it} + \beta_4 GOV_{it} + \beta_5 Priv_{it} + \beta_6 Public_{it} + \varepsilon_{it} \dots\dots\dots (4)$$

Table 4: Regression Analysis

Variable	Model 3		Model 4	
	Coefficient	t-Statistic	Coefficient	t-Statistic
C	0.162041	*** 18.76328	0.098482	1.194525
REM_CFO	0.166541	*** 3.179378	0.108735	** 2.075677
REM_PROD	-0.167761	*** -3.152887	-0.106574	** -2.011573
REM_DISCR	-0.001675	-0.383543	-0.004418	-0.982403
GOV			0.032679	0.297171
PRIV			-0.163052	-0.962462
PUBLIC			0.151997	*** 2.843528
Adj. R ²	0.394256		0.377216	
F Statistic	3.928875	***	3.398542	***

Based on these findings it can be concluded that the low performance of SOEs could be due to the management carrying out management (manipulation) of profits based on real activities through production costs or because of government policies that impact on the poor performance of Indonesian SOEs.

Conclusions

Based on the findings of this research it can be concluded that profit manipulation based on real activities through production costs (including operational costs) negatively affects the performance of Indonesian SOEs. This finding is supported by the phenomenon of practice that occurs in SOEs, namely the rise of corruption and various Government policies that are not in favor of SOEs. For example, Corruption factoring at PT PANN, Mark up the purchase of aircraft engines at PT Garuda Indonesia, PT Berdikari corruption case related to the procurement of urea fertilizer tablets, and Jiwasurya's default case.

Inappropriate government policies further exacerbated the condition of Indonesian SOEs, for example, PT PLN's loss in the first quarter of 2020, amounting to 53 trillion due to high debt burden to foreigners and due to foreign exchange differences due to the weakening of the rupiah. PT Krakatau Steel is losing money because the Government is waiving import tariffs on imported steel from China. PT Aneka Tambang suffered a loss because of the government's policy on the prohibition of the export of raw minerals which came into force in early 2014. Bulog lost money because the BPNT program in the form of vouchers was used by the poor to buy rice, not through Bulog. Indofarma lost money because the hospital was unable to pay the debt to Indofarma, as a result of the Government not immediately paying BPJS debt to the hospital. PT Pos Indonesia losers' non-cash social assistance is no longer sent



through Pos Indonesia. Government ownership negatively affects NPM with a significance level of 5%, this means that the higher the percentage of government ownership, the lower the NPM. Public ownership has a positive effect on performance, as measured by ROE. This means that the higher the public ownership, the higher the ROE. Ownership of private institutions does not affect NPM or ROE.

This research has theoretical implications that can prove that profit manipulation using production costs negatively affects performance. Neither the management nor the controlling SOE uses real earnings manipulation through operating and discretionary cash flows. The implications of this research practice are as follows: 1) the high number of corruption cases in SOEs, indicating that SOE Corporate Governance has not been running as it should; and 2) the poor performance of BUMNs is more influenced by various political policies of the Government, which do not favor the sustainability of the BUMN itself. Limitation of this research is not yet linked to the existing political connections to the commissioners and directors of Indonesian SOEs. Future studies will be more interesting if it includes these variables.

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