The Influence of Earnings Volatility on the Association among Leverage and Real Earnings Management

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ABSTRACT

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The association between leverage (LEV) and Real Earnings Management (REM), as well as how the volatility of earnings affects this relationship, are examined in this paper. The study sample comprises all non-financial companies listed on the Pakistan Stock Exchange from 2004 to 2018. Due to the endogeneity issue between the variables and the two-step system Generalized Method of Moment (SYS-GMM) dynamic panel estimator, business risk will be used as an interaction term in the hypothetical model to examine the association between LEV and REM. The model will be further elaborated using agency theory and positive accounting theory. After examining the connection between LEV and REM, the study will examine how business risk affects earnings volatility for the Pakistan Stock Exchange.

INTRODUCTION

The research study examines into how cash flow volatility influences the link between LEV and REM. For the three categories of abnormal cash flows, abnormal discretionary expenditure, abnormal production, and LEV as short-term debt, long-term debt, and total debt, we apply REM. Managers are less inclined to make use of REM when cash flow is volatile. The influence of cash flow volatility on the previously demonstrated relationship is also investigated in this study.

Keeping the same context in mind, the managers use window dressing within the bounds of GAAP by changing real transactions, accruals, and occasionally stock prices. Earnings management is described as a fraudulent activity in the definition. However, it becomes legal if the manager uses earnings management practices within bounds and without deviating from GAAP standards. Utilizing earnings management does not constitute fraud. Nevertheless, it needs to be addressed due to managers' opportunistic behavior. To intentionally mislead investors and financial institutions about the value of firm, managers employ in opportunistic earnings management (Healy & Wahlen, 1999). According to Rezaei and Roshan (2012), the manager uses opportunistic earnings management to deceive the shareholders. Therefore, managers employ earnings management within the bounds of accounting principles, but it is still viewed negatively.
Additionally, managers use the idea of earnings management to deceive shareholders and investors for a brief period by creating an artificial map. Using REM for a brief period, managers can manipulate a firm's management of its earnings by using an artificial map. REM appears to be a helpful solution that is appealing now, but it causes many problems down the road. The financial reports are manipulated by managers who show a better side of the financial performance that will soon perform worse. When managers purposefully make operational decisions with some real cash flow concerns, they are engaging in REM, which modifies reported earnings. Managers use earnings management to demonstrate short-term benefits like bonuses, raises, and promotions to further their interests. They move or eagerly anticipate the next job opportunity while receiving their benefits and putting the company in the worst possible situation. All changes here affect stockholders and investors who rely on financial statements and indicators. Additionally, these changes make it impossible for financial institutions to obtain loans or avoid defaulting on previous loan agreements.

Additionally, most studies demonstrated the financial portrayal managers use to win over financial trust and security brokers. Based on the financial LEV, the manager represented the financial statements. Financial LEV is a source of funding for businesses in terms of debt and equity. The company's financial performance, which they demonstrated to investors and financial institutions, determines the source of funding. The source of funds collection in terms of debt and equity can change depending on the firm's performance. The manager used earnings management in financial statements to guarantee businesses' financial performance to financial institutions and investors. The significance of debt and equity sourcing draws attention to the hierarchy that distinguishes the firms' criteria for choosing debt and equity. The agency theory also affects management and ownership because they must either distribute ownership through debt financing or maintain the same ownership through the issuance of equity financing.

The core ratio of the debt-to-equity structure is also determined by other factors in addition to the debt and equity structure in the form of LEV. By taking into account the short- or long-term benefits, the manager may also raise or lower the level of LEV. If the financing strategy is more volatile, the firm must be aware of future benefits and risks because the level of LEV upsurges the bankruptcy cost of firm. In light of the increased LEV, the manager applies REM to minimize debt contract violations and decrease reported expenses on the income statement. Managers may minimize R&D spending to reduce expenses on the income statement for a certain time (Dechow & Skinner, 2000). The interaction between LEV and REM is also influenced by cash flow volatility. Managers utilize REM as a result of the volatility in the company's cash flows that influences LEV. A form of business risk is cash flow volatility.

Generally, a company's financial market bond and stock price can easily impact its performance. The company's operating cash flows are often impacted by its poor operational performance, which increases the likelihood of bankruptcy rather than stable cash flows. Creditors' perception of a high return on debt due to the possibility of bankruptcy lowers a company's value by raising the cost of debt. The firm's business risk increases due to the high debt’s cost. Therefore, volatility steers managers' decisions to manipulate real earnings to deceive shareholders and financial institutions. On the base of financial statements prepared by
managers based on their financial benefits and, ultimately, the company's business risk, shareholders and financial institutions invest in the opportunity.

Continuing with the same perspective, business risk is the potential market uncertainty brought on by changes in earnings, cash flows, and returns. Market LEV results from high business risk caused by fluctuating equity prices (Welch, 2004). This market's LEV is extremely susceptible to changes in equity prices. Financial institutions typically demand a high-risk premium for financing with high risk. These companies have a high cost of capital, which causes market investors to undervalue new equity offerings. They also run the risk of seeing their earnings and investments decline. Their ability to repay the loan is reduced, raising the risk of default. As a result, businesses with high levels of business risk may pay a high price for financial distress and bankruptcy.

Additionally, the desire to influence how the financial market views a firm's business risk is among the most important drivers of earnings management. Indeed, increased earnings management may be linked to a higher level of business risk. Consequently, business risk is a factor in the management of earnings that may be increased or decreased. Regardless of the category, there is an optimistic relation between earnings management and risk, which tends to lower risk (Neffati et al., 2011). Similarly Karimi and Naserinasab (2023) studied that hypothetical results are significantly positive between LEV and REM. The business risk may affect how LEV and earnings management are managed. Additionally, Hassan et al. (2022) found that financial LEV is significantly positive related to earnings management.

**LITERATURE REVIEW**

**Earnings Management and Leverage**

The most crucial aspect of accounting and Finance is earnings management, including its present and past components. REM is a specific aspect of earnings management that utilizes managerial opportunism as a strategic approach. When managers purposefully make operational choices with real cash flow repercussions, they engage in REM, which modifies reported earnings. For instance, a business may provide customers with price breaks and more accommodating credit terms to temporarily increase sales revenues. Also, managers may reduce research and development costs to lower income-statement expenses (Dechow & Skinner, 2000). Real activity-based earnings management refers to managerial decisions that differ from standard business procedures and involve cash flow manipulations (Cohen & Zarowin, 2010). These explanations have one thing in common: purposeful real activities-based earnings management, which has practical ramifications for cash flow.

The manager continues this and takes advantage of REM. The financial institutions and investors supply the manager with the money they need for operations and future investments. In this situation, the manager must use REM to inspire financial institutions and investors. The manager employs REM by making operational choices that impact the cash flows statement of the company. In addition to regular production and discretionary expenses, the manager also uses increases or decreases in these costs to demonstrate how the income statement is
misrepresented. Therefore, it is still necessary to establish the connection between REM, LEV, and the cash flow volatility’s impact of in this relation.

Different findings are presented within the empirical past studies on REM and LEV. According to DeAngelo et al. (1994), managers practice earnings management to give loan providers a positive impression of the company while lessening the obligations associated with debt contracts. Mohrman (1996), who contends that firms through greater LEV are projected to embrace accounting practices that increase current income to avoid debt covenant violations, also supports this point of view. On the other side Naz and Sheikh (2023) studied the effects of capital structure of on earnings management and found capital structure significantly negative affects REM. On the other side Al-Duais et al. (2022) found that ownership structure significantly affect REM.

Additionally, Sercu et al. (2006) studied an optimistic relation between LEV and earnings management and hypothesized that earnings management is closely related to bank credit because banks are less forgiving of financial stress than suppliers. In contrast to trade credit, the company director focuses more on earnings management to evade any issues with the loans of bank. Similar findings were made by Rodríguez-Pérez and Van Hemmen (2010), discovered that rising debt encourages the managers to fudge their earnings. These bank loans and trade credits put the banks in trouble, unstable the capital structure, and make it very difficult for the companies to repay the loans. Therefore, high LEV also increases the risk of default, and CEOs use REM to fake success.

The researchers also discovered a favorable connection between LEV and REM (Alzoubi, 2016; Beatty & Weber, 2003; Becker et al., 1998; DeAngelo et al., 1994; DeFond & Jiambalvo, 1994; Dichev & Skinner, 2002; Fung & Goodwin, 2013; Jaggi & Lee, 2002; Jha, 2013; Kim et al., 2010; Lazzem & Jilani, 2018; Sweeney, 1994; Zamri et al., 2013). Likewise, (Anagnostopoulou & Tsekrekos, 2017) and (Chen et al., 2015) found the positive relation among LEV and earnings management. (Doukakis, 2014; Kim et al., 2020) support the arguments of positive association between earnings management and LEV and found that high LEVd firm tend to use REM. According to Kalgo et al. (2019), high LEV levels consistently result in higher agency costs and increase the companies' use of REM. To evade default on debt agreements, manager uses REM by presenting the financial statements for LEVd firms.

Following this logic, it was discovered that there is positive correlation between increased levels of earnings management among high levels of LEV (Ho et al., 2015; Kuo et al., 2014; Waweru & Riro, 2013). According to Christiana et al. (2020), managers are motivated to use earnings management for high-LEV firms. The manager is motivated to present the financial statement mapping to shareholders and financial institutions to win over the trust of lenders, attract new investments, or keep existing contracts. Mamatzakis et al. (2023) found financial crisis are positively affect REM.

Furthermore, Kim et al. (2010) explored into the level of earnings management and the cost of capital . According to this perspective, a country's institutional environment affects how REM and capital costs vary, and financial institutions charge higher premiums for capital costs in developed and mature debt markets. Additionally, using 2SLS regression, Tulcanaza-Prieto et
al. (2020) examine how LEV and REM are handled in suspicious and non-suspicious firms and the findings of the study differ. According to the results, LEV and REM were significantly positively correlated for suspicious firms, and vice versa for non-suspicious firms. Due to the manager's seasonal nature, these results are stronger in the year's second half.

Christiningrum (2020) looked into how debt affected earnings quality simultaneously and discovered that debt level significantly positively impacts REM. LEV is employed to calculate the debt level for fictitious results, and REM is used to calculate earnings quality. Like previous study, Tonye and Sokiri (2020) used the OLS method to study the effect of financial LEV on accruals earnings management for the Nigerian Stock Exchange (NSE). They discovered that it had a positive effect. Total LEV, however, significantly worsens REM techniques.

Other researchers, on the other hand, offer evidence in favor of the control hypothesis and revealed a negative association among LEV and earnings management, i.e., that increased LEV is associated with reduced earnings management (Daniel et al., 2008; Jelinek, 2007; Jensen, 1986; Wasimullah & Abbas, 2010). According to the same opinion, for Malaysian firms, there is a negative association among LEV and earnings management (Nejad et al., 2012; Zamri et al., 2013). Similarly, according to Ishartati et al. (2022), LEV results in decreases earnings management techniques. In addition to that Mamatzakis et al. (2023) also studied the same and found the negative relation between financial crisis and REM. This occurs in developing nations where the rule of law is weak, and businesses don't properly implement governance codes.

Due to the swaying actions of financial institutions and their knowledge, the rising pattern of LEV noticeably reduces earnings management Mardianto and Chintia (2022). According to Romadani and Aryani (2021) modified John model, LEV similarly harms earnings management. Similarly, LEV significantly reduces shareholders' wealth and practices for managing earnings (Aditama et al., 2018). Similarly, Grabiński and Wójtowicz (2022) studied the impact of religiosity on earnings management and found that manager are engaged to use earnings management in more LEVd firms. Therefore, these warning signs indicate that financial institutions and some investors are knowledgeable about accounting standards and professionals. In this regard, the manager can’t use REM because of the professionalism of the financial institutions.

Yahaya (2022), on the contrary, demonstrates the beneficial connection among REM and LEV. In keeping with the positive accounting theory, Hussain et al. (2022) found that total LEV favors REM. Similarly, Sukoco and Ratmono (2022) look into the beneficial connection between REM and LEV. The lower likelihood of being discovered is the cause of the positive association between REM and LEV. The financial statements are restored to their actual position once the manager achieves his desired result.

Draief and Chouaya (2022) research supports this by demonstrating that managers are prospective to employ REM with increasing LEV to meet earnings targets due to the scrutiny of finance providers and the low likelihood of being caught. A company with a pattern of increasing LEV faces a high capital cost and risk. The manager uses REM to avoid these scenarios and maintain the trust of financial institutions and investors. Awuye and Aubert
(2022) also show how REM and LEV have a positive association. Contrarily, LEV level and changes to LEV have a different impact on REM, according to an analysis by Tran (2022). LEV has a negative but insignificant impact on REM. Similarly, Tijjani et al. (2023) also studied the association between LEV and REM and found negative relation.

**H1. A firm’s financial leverage LEV effect real-based earnings management of Pakistan listed firms.**

**Earnings Volatility and Rem**

Volatilities can potentially impact a company's earnings in terms of volatility significantly. The shareholders, who are the company's true owners, prefer stability to uncertainty. The management still wants to change these volatilities and the earnings and cash flows in a financial statement for their short-term goals. The reason for the earnings management is these variations in the financial statements. The managers use these earnings management to satisfy internal stakeholders’ and financial institutions' requirements.

On contrary, these earnings management techniques can be reduced if internal oversight is strict and financial institutions continue to observe professionally. Therefore, the internal owners and financial institutions providing the company's financing are most interested in the business operations. The extensive literature discusses the problematic association between earnings volatility and earnings management.

Additionally, market shortcomings can create a situation where businesses are exposed to financial price volatility-related economic risk. These fluctuations of financial price include commodity prices, rates of interest, rates of foreign exchange, equity prices, and other price volatilities. Since they result in cash flow volatility, underinvestment cost of earnings Froot et al. (1993), risk aversion on the part of management, financial distress and bankruptcy Smith and Stulz (1985), and asymmetric information DeMarzo and Duffie (1995), these risks are very sensitive and expensive. As a result, if volatility is expensive, managers create incentives to reduce risk by managing earnings volatility.

Recent research has shown that risk-takers are further motivated to engage in REM (Billings et al., 2020; Hassan et al., 2022). Furthermore, according to Vali Nia et al. (2022), REM has a significant impact on financial and business risk. To maintain the trust of investors and financial institutions, the managers, aware of the fluctuations in the financial statements, work to stabilize the financial statements using REM. Further indication of the beneficial effects of earnings volatility on earnings management is provided by Phua et al. (2021). When there is earnings volatility, the manager tries to make up for it by using earnings management to keep the trust of investors and financial institutions.

Additionally, Deng and Ong (2018) investigated the likelihood that earnings management would be used to manipulate financial statements before equity offerings in real estate business trust investments with high volatility risk. Additionally, when REM is used, there is more irrational trading. Volatility risk arises when the price fluctuates, which eventually causes the company's entire structure to default. At this point, the company uses REM to stabilize the risk fluctuations that eventually cause the stock to decline after rearranging the financial statements.
On the other hand, managers are prohibited from using earnings management in cases of earnings volatility due to the strict guidelines set by investors and financial institutions.

Following these justifications, Kazemian et al. (2018) employ regression analysis and find that the level of earnings management by managers through financial distress risk, LEV, and cash flows is unaffected by the company’s compliance with Sharia or not. Financial institutions and individual investors are more concerned with the financial statement with in-depth observations when default or distress risk is prevalent. In that case, the business chooses earnings management over refraining from using it.

**H2: Earnings volatility positively effects real-based earnings management.**

LEV and earnings volatility positively impact real-based earnings, so the manager reaps the rewards based on financial statement strategies. Investors and financial institutions continue to have faith in the manager based on these financial statements and asymmetries. These financial institutions are the ones who provide the debt, and they keep a close eye on the activities based on the financial statements to ensure that the principal and interest payments are made. The manager will use REM to ensure that the financial institutions will receive their interest and principal back in the event of high earnings volatility. The debt will be provided once the financial institutions have confirmed they will provide the debt or extend the loan's term.

The intensity of LEV is determined by debt; the higher the debt, the higher the LEV and, consequently, the greater the firm’s risk for. Managers are pressured to practice REM due to high-risk level and earnings volatility. The manager uses REM to keep investors’ trust and financial institutions. The manager will reevaluate these financial statements based on actual performance that mistrusts the financial market once they assure investors and financial institutes' confidence and the desired benefit.

According to the literature and the same context, real-based earnings management is positively impacted by LEV, and real-based earnings management is positively impacted by earnings volatility. Additionally, it shows a markedly favorable relationship with real-based earnings management when earnings volatility is used as an interaction term between LEV. Additionally, since real-based earnings management is difficult for auditors to identify, the manager uses more REM as LEV increases. Earnings volatility is a term used to describe the interaction between LEV and real-based earnings management. According to the findings, business risk, as measured by earnings volatility, exhibits a strong positive relationship with real-based earnings management when used as an interaction term with LEV.

**H3. Business risk is a significantly positively factor that moderates the association between accrual-based earnings management and LEV.**
DATA AND METHODOLOGY

Research Design and Data Collection

This section describes the sample that serves as a representation of the model that is used to test hypotheses and measure variables.

The Pakistan Stock Exchange's listed non-financial firms from 2004 to 2018 comprise the study sample; there were 6825 observations overall. To reduce potential bias, firms with missing values have been excluded from the non-financial sector and the empirical analysis (Frank & Goyal, 2009; Keefe & Yaghoubi, 2016; Strebulaev & Yang, 2013) will exclude the financial and insurance sectors and some data from the sample data with missing values. Because of capital reserve requirements that skew their capital structure, the financial sector will be excluded from the study. These firms' capital structure and financial characteristics differ from those of non-financial firms. The businesses must adhere to and satisfy the regulatory requirements set forth by the central bank about minimum capital requirements (Ariff et al., 2008).

Empirical Model

The divergence in real transactions that occurs during routine business operations is covered by REM (Roychowdhury, 2006). Additionally, he suggests a link between debt on the balance sheet the company and management of rising real earnings. Higher positive REM correlates with high debt levels and changes. Kim et al. (2012) demonstrate how businesses manage real earnings to stay within debt covenants. As a result, LEV positively impacts earnings management because rising LEV leads to greater REM. More REM results from increased LEV to avoid debt contracts, which is the cause of the rise in real earnings.

In general, managing risk and real earnings is associated with positive outcomes. According to Li et al. (2019), the auditor should raise its fees in the future in line with any perceived increases in business risk by REM. As resultant, the equation identifies risk as the moderating and controlling variables, LEV as the independent variable, and real-based earnings management as the dependent variable.

\[
REM_t = \beta_0 + \beta_1 REM_{t-1} + \beta_2 \text{LEV}_t + \beta_3 \text{risk}_t + \beta_4 \text{LEV}_t \times \text{risk}_t + \beta_5 \text{Control Variables}_t + \epsilon_t
\]

The study follows Roychowdhury (2006) to determine the extent of real transaction manipulations in the context of earnings management based on real transactions. The analysis utilizes cross-sectional regression analysis for each industry and year to estimate abnormal operating cash flows (TEMOCF), abnormal discretionary expenses (TEMDISX), and abnormal cost of productions (TEMPROD). Initially, we establish expected standard metrics for operating cash flows, production costs, and discretionary expenditure. The cross-sectional regression model is employed to estimate the normal measurements of operational cash flows, a linear function of sales, and the change in sales for each industry and year.

\[
\frac{CFO_t}{A_{t-1}} = \beta_0 + \beta_1 \left( \frac{1}{A_{t-1}} \right) + \beta_2 \left( \frac{Sales_t}{A_{t-1}} \right) + \beta_3 \left( \frac{\Delta Sales_t}{A_{t-1}} \right) + \epsilon_t
\]
Where \( CFO_{it} \) the operating cash flows of firm; \( sales_{it} \) = the sales revenue of the firm; \( \Delta Sales_{it} \) = the change in sales revenue of firm; \( TA_{it-1} \) = the total assets of firm. The measure for abnormal cash flows from operations (TEMOCF) is derived by deducting the normal cash flows from operations from the actual cash flows from operations. The cross-sectional regression model is employed to determine the normal measure of operating cash flow for each industry and year. The model considers the linear association between operating cash flow and variables such as sales and the change in sales.

According to Roychowdhury (2006), there is a potential mapping problems when attempting to depict discretionary expenses as a linear function of contemporaneous sales.

In order to mitigate this issue, we employ a linear model to represent discretionary expenses as a function of lagged sales, as demonstrated by the subsequent cross-sectional regression equation for each specific industry and year.

\[
\frac{DISEXP_{it}}{A_{it-1}} = \beta_0 + \beta_1 \left( \frac{1}{A_{it-1}} \right) + \beta_2 \left( \frac{\Delta Sales_{it}}{A_{it-1}} \right) + \epsilon_{it} \tag{7}
\]

Where \( DISEXP_{it} \) = the discretionary expenses of firm, and \( \Delta Sales_{it} \) = the change in sales revenue of firm. The measure of abnormal discretionary expenses (TEMDISX) is calculated by subtracting the normal level of discretionary expenses, as determined in Equation (9), from the actual discretionary expenses. In keeping with the findings of Roychowdhury (2006), we begin by formulating a model that represents the normal cost of goods sold as a function of a linear equation, with contemporaneous sales on the cost of goods sold.

\[
\frac{COGS_{it}}{A_{it-1}} = \beta_0 + \beta_1 \left( \frac{1}{A_{it-1}} \right) + \beta_2 \left( \frac{Sales_{it}}{A_{it-1}} \right) + \epsilon_{it} \tag{8}
\]

Where \( COGS_{it} \) = the cost of goods sold of firm, and other variables are as defined previously. Next, we estimate the model of normal inventory growth as a linear function of contemporaneous sales and lagged change in sales:

\[
\frac{\Delta INV_{it}}{A_{it-1}} = \beta_0 + \beta_1 \left( \frac{1}{A_{it-1}} \right) + \beta_2 \left( \frac{Sales_{it}}{A_{it-1}} \right) + \beta_3 \left( \frac{\Delta Sales_{it}}{A_{it-1}} \right) + \beta_4 \left( \frac{\Delta Sales_{it-1}}{A_{it-1}} \right) + \epsilon_{it} \tag{9}
\]

Where \( \Delta INV_{it} \) = The change in inventory of firm, and other variables are as defined previously. Because production costs are the sum of the cost of goods sold and inventory growth, the normal production costs function can be estimated by the following industry-year regression:

\[
\frac{PROD_{it}}{A_{it-1}} = \beta_0 + \beta_1 \left( \frac{1}{A_{it-1}} \right) + \beta_2 \left( \frac{Sales_{it}}{A_{it-1}} \right) + \beta_3 \left( \frac{\Delta Sales_{it}}{A_{it-1}} \right) + \beta_4 \left( \frac{\Delta Sales_{it-1}}{A_{it-1}} \right) + \epsilon_{it} \tag{10}
\]
RESULT AND DISCUSSION

Real Based Earnings Management and Leverage. Role Of Business Risk

The abnormal cash flows, discretionary expenses, and production in this study section are added to create real-based earnings management. Market and book LEV are two distinct metrics (short-term, long-term, and total debts). Business risk is the variation in earnings as expressed by the earnings standard deviation. The study determined the association between business risk and the practices used by Pakistani firms to manage their real-based earnings. The lag-dependent variable is added as an independent variable to create a dynamic model. The results of this relationship are shown in Table 4.10. The dynamic panel model is indicated by the lagged dependent variable being significant in every column.

The real-based earnings management strategies used by firms listed on the PSX have significantly improved, as indicated by the positive coefficient of LEV. According to Djalil et al. (2017), REM practices are more prominent in highly levered companies and these are supported by Karimi and Naserinasab (2023). Higher earnings management practices would result from increased LEV (Chen et al., 2015). Managers take advantage of REM to use accounting window dressings. Christiningrum (2020) discovered consistent findings that as debt levels rise, managers of businesses tend to use unusual cash flows, discretionary spending, and production. Similarly Mamatzakis et al. (2023) LEV positively influence the REM. Managers conceal the users by manipulating the financial statement at its initial position. Similarly, Elsheikh et al. (2022) found the positive influence of LEV on earnings management.

Additionally, the findings indicated a favorable correlation between REM and earnings volatility. (Amir et al., 2007; Chambers et al., 2002; Dichev & Tang, 2009; Kothari et al., 2002; Pandit et al., 2011) continue investigating the association between firm involvement in research and development activity and earnings volatility. Similarly, (Al-Duais et al., 2022; Hassan et al., 2022) showed the significant association between ownership structure and REM. Therefore, the managers will use REM if business risks like earnings volatility increase.

According to the interaction term between earnings volatility and LEV, the real-based earnings management practices in panels A and B significantly declined. According to the findings, rising earnings volatility lowers LEV, enabling managers to scale back real-based earnings management techniques.

However, panels C and D it has a favorable relationship with real earning management. It demonstrates how lower earnings and a reduced ability to pay debt obligations affect firms. They prefer less LEV in these circumstances. Managers were under pressure to manipulate the financial statements due to the decline in earnings, investments, and LEV. Shareholders and financial institutions are more focused on a company's profits. Due to this circumstance, managers of businesses indicate to employ real-based earnings management techniques and disclose profits in financial statements.
### Table 1: REM and Leverage with Cash Flows Volatility

<table>
<thead>
<tr>
<th>Variables</th>
<th>Panel A</th>
<th>Panel B</th>
<th>Panel C</th>
<th>Panel D</th>
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</tbody>
</table>
CONCLUSION AND POLICY IMPLICATION

The earnings volatility positively influences the association among leverage and REM. When the company is facing high volatility then there is high pressure and incentive on management to use REM in order to make the financial statement more smoot and to meet financial expectations. Similarly, leverage also make this relationship stronger by highlighting the potential repercussions of missing earnings targets. As a result, the companies operating in high volatile environment with high leverage are likely to use REM in order to present a steady and consistent financial performance. The association among earnings volatility, leverage and REM highlights the importance of financial responsibility and disclosure to minimize the risk involved with such operations. In order to maintain the integrity of financial reporting to protect the interest of all stakeholders like investors and regulators, must be attentive to ensure the true disclosure of financial activities of the company. Apart from the implication on stakeholders, the study also has some limitations that must be addressed here.

The earnings volatility positively influences the association between LEV and REM. When the company is facing high volatility then there is high pressure and incentive on management to use REM in order to make the financial statement more smoot and to meet financial expectations. Similarly, LEV also make this relationship stronger by highlighting the potential repercussions of missing earnings targets. As a result, the companies operating in high volatile environment with high LEV are likely to use REM in order to present a steady and consistent financial performance. The association between earnings volatility, LEV and REM highlights the importance of financial responsibility and disclosure to minimize the risk involved with such operations. In order to maintain the integrity of financial reporting to protect the interest of all stakeholders like investors and regulators, must be attentive to ensure the true disclosure of financial activities of the company. So, all the concerned stakeholders can use this information in their policy implementations like, to enhance disclosure and transparency, strengthen corporate governance, adjust compensation structures, improve debt management strategies, enhance risk management framework, engage with stakeholders, regulator measures, educational initiatives.
There is a common conflict between the researchers that claimed the policy implications. This article has an important policy implication regarding the firm’s usage of real earnings management while using leverage. The article highlights the importance of leverage and real earnings management in the presence of business risk as earnings volatility. In the past literature more of the studies were related to leverage impact on real earnings management while this study added the earnings volatility and how earnings volatility moderate this relationship. The study is so important for the stakeholders specially for the shareholders and Government to check that either the firm’s management is using the financial mapping of the statement or not. The stakeholders must aware with the financial statements earnings management in order to check the managements activities either they are molding the financial statement.

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