JASF | Journal of Accounting and Strategic Finance
Vol.2 No.2 November 2019, pp. 107-116

ISSN 2614-6649 (online)
http://jasf.upnjatim.ac.id

DOES ETHICAL CONTEXT AFFECT THE ETHICALLY RELATED JUDGEMENT BY THE OBSERVERS OF EARNINGS MANAGEMENT?

Feby Astrid Kesaulya [1], Weny Putri, Khairunnisa

Accounting Department, Faculty of Business and Accounting, Universitas Katolik Musi Charitas , Jl. Bangau No.60, 9 Ilir, Kec. Ilir Tim. II, Kota Palembang, Sumatera Selatan 30114, Indonesia

DOI : https://doi.org/10.33005/jasf.v2i2.51

Received: *June 19, 2019.* ***Revised:*** *July 15, 2019.* ***Accepted:*** *September 16, 2019*

Abstract

This research aims to empirically prove that there will be a difference in ethically related judgment by the observer of earnings management, primarily when they work in the company, which has a higher ethical context or value, and they know the moral agent personally. This research used experiment 2x2 between subjects to collect data by giving each respondent different treatments and scenarios. The different treatments to the respondents are the diverse workplaces with different ethical values and whether the respondents were related to the moral agent. The sample for this research is the students of Musi Charitas Catholic University from both accounting and management majors who have been taking specific courses, e.g., Business Ethics, Business and Management, and Management Control System, so that they can figure out the organizational structure and how earnings management happen. The final sample for this research is 67 respondents from both majors. The result of this research proves that there is no different ethically related judgment from each observer in each scenario, whether they come from the company with the high or low ethical context or whether they know the moral agent personally or not. The results indicate that ethical judgment is more affected by the ethical value from each person rather than organizational culture or egocentric bias.

Keywords: *Ethical Context, Ethically Related Judgement, Earnings Management.*

How to cite (APA 6th style)
Kesaulya, F.A., Putri, W., & Khairunnisa. (2019). Does Ethical Context Affect the Ethically Related Judgement by the Observers of Earnings Management?. *Journal of Accounting and Strategic Finance*, 2 (2), 107-116.

INTRODUCTION

Merchant and Rockness (1994) state that there is one similarity between lawmakers, organizational control system designers, and professional code of ethics that is their desire to distinguish acceptable and unacceptable behavior. Sometimes this task is easy enough for them,

[1]Feby Astrid Kesaulya
Email: feby@ukmc.ac.id

but they still find difficulties when dealing with controversial things. One of the controversial things that often happens in business and accounting practices is earnings management.

Healy and Wahlen (1999) state that earnings management occurs when managers use judgment in financial reporting and in structuring transactions to make stakeholders that are not seen the company's actual economic performance or to influence contractual results that depend on reported accounting practices. This earnings management practice itself often occurs even though it is considered not to show actual and less ethical company performance (Septiari and Maruli, 2017; Rusdianto, 2018). Based on data compiled by Wardani and Santi (2018) from the online news portal Kompas and Integrity-Indonesia, one of the earnings management phenomena that have occurred is that which is carried out by PT Toshiba. The top leadership of PT Toshiba Corporation has been involved in a "systematic" scandal in the company's profit bloating of 1.2 billion US dollars for several years. Based on the results of the investigation, it was known that PT Thosiba carried out the profit inflation because it had failed to reach the profit target plus the global crisis that hit at that time. The profit markup action made CEO Hisao Tanaka decide to resign, besides the name Toshiba was also removed from the stock index and a significant decline in sales.

This research wants to investigate the manager's evaluation of earnings management practices that occur. Do these managers think that this practice is ethical when carried out by their colleagues is the question to be answered in this study. Several previous studies have tried this question, including research by Bruns and Merchant (1990), Merchant and Rockness (1994), Kaplan (2001), and Nazaruddin (2012). Merchant and Rockness (1994) who found that the acceptability of earnings management actions varied depending on the type, size, time, and purpose of the action. Kaplan (2001a) found that earnings management would be considered more ethical by shareholders if it was done for the benefit of the company while the research of Bruns and Merchant (1990) shows that managers think earnings management practices to be acceptable. Kaplan's study (2001b) also found that earnings management was considered more ethical by managers who knew earnings management practitioners.

Quite different results from some of these studies will be tested again in this study. This study focuses on evaluating a manager of other managers who perform earnings management in the context of whether the manager who assesses knows or does not know the manager who performs earnings management. This research is based on Kaplan's (2001b) study, which examines the valuation of shareholders and managers of other managers who conduct earnings management.

Kaplan (2001a) has tested the valuation of shareholders and non-shareholders on managers who perform earnings management. Therefore, this research will focus more on the judgment (ethical judgment) of a manager or internal company that tends to be more aware of things that happen in the company. Following Kaplan's (2001b) research, he believed that managers who know other managers who are earnings management actors will assume that earnings management actions are more ethical.

What distinguishes this study from previous research is the addition of ethical value factors into the organization. Elias (2004) found that CPAs working in organizations with high ethical values would better evaluate earnings management practices as unethical, and vice versa. Then in this study also will be tested whether the organization has a high ethical value and low affect the manager's judgment on ethics or not earnings management actions. It is estimated that a manager who works in an organization that upholds ethical values (high ethical values) will see earnings management actions as unethical even though the manager knows income management actors.

Epley and Caruso (2004) state that there is an egocentric bias in ethical judgments, for example, that someone who tries to make moral reasoning will conclude that a self-interested outcome is morally justified. This thing can make an ethical judgment about an action biased. Aside from the existence of egocentric biases, ethical judgments, the relationship between the observer and the moral agent influenced that action (Singer and Singer, 1997).

The concept used by Singer and Singer (1997) is the concept of the scope of justice. This concept reveals that an individual will expand his concern for righteousness (justice) to others who have the same status in the same group (inclusion attention) or to people who have different conditions that are outside the group (exclusive attention). The study conducted by Singer and Singer (1997) was carried out with experiments that manipulated the relationship between observers and moral agents, namely whether they had a good relation or not. The results of this study indicate that there are differences in ethical judgment when the observer and moral agent have a good or close relationship.

A similar result was found by Kaplan (2001b), who tested the ethical valuation of shareholders, managers from the same company who knew or did not know the manager he was going to judge. This study obtained results similar to Singer and Singer (1997) that the ethical judgment of shareholders and managers who are not familiar with managers who will be judged will be different from the ethical judgments of managers who know the manager to be assessed well.

This study wants to expand previous research by adding variable ethical context or ethical value. Hunt, Wood, and Chonko (1989) define corporate ethical values as "a collection of individual ethical values of managers and formal and informal policies in the ethics of an organization." Ethical value or ethical context itself is also seen as one of the main dimensions in an organizational culture that distinguishes one organization from another.

Research Elias (2004) proves that a professional accountant who works in organizations that have a high ethical context will view that earnings management is a less moral act, while professional accountants who work in organizations that have an ethical context will have the opposite view. The study of Shafer and Wang (2010) also found the same thing that accountants who work at companies that emphasize public service or in this context have high ethical regard so that he will view that earnings management is an unethical action. Based on the previous explanation, the hypothesis is as follows:

Based on some of the reasons above, this study also wants to examine the interaction between the observer-moral agent relationship with the ethical context of ethical judgments about earnings management. This thing is based on the belief that someone who is in an environment that has high ethical value or in other words, has an organizational culture that upholds ethics, then he will tend to care more about ethics. Besides, he will also look at certain things from an ethical perspective more objective. Whereas someone who is in an organization with a low ethical context will behave the opposite way. Therefore the following hypothesis was formulated:

H1a: When the manager knows the moral agent personally, and he is in an organization with a low ethical context, his assessment of earnings management will be different from when he was in an organization that has a high ethical context.

H1b: When the manager does not know the moral agent personally, and he is in a work environment that has a low ethical context, his assessment of earnings management will be the same as if he was in a work environment that has a high ethical context.

Based on the explanations described above, this study aims to investigate whether someone's ethical related judgment will be influenced by the ethical values of his work environment and his position as an observer of earnings management. The testing of the research hypothesis will be carried out experimentally. The experimental design used was 2x2 (observer of earnings management x ethical value of organization). Participants will be given a role as managers who know or do not know the managers of earnings management actors and are in organizational situations that have high or low ethical values.

RESEARCH METHOD

Data and Sample

Data will be obtained through experiments with a 2x2 design. Participants in this experiment are students of business and accounting faculties majoring in accounting and management at Musi Charitas Catholic University who have taken or are currently attending Business and Management courses, Management Control Systems, Business Ethics, and participants are expected to take part in this experiment voluntarily.

Overview and Task

The experiments in this study involve students of the business and accounting faculties majoring in accounting and management who have taken business ethics courses. This sample is chosen because by taking a course in business ethics, it is hoped that a greater understanding of ethical issues in this research. The experiments contained in this study follow several previous studies, including Bruns and Merchant (1990), Kaplan (2001a), Kaplan (2001b), Hunt et al. (1989), Elias (2004), Roychowdury (2006), and McMahon and Harvey (2007).

Each participant will be given three scenarios. The scenario contains a story about a division manager at PT. A and PT. B, which carries out earnings management. Each scene states that the manager who carries out earnings management will benefit personally from these actions. The instructions are given also include their role in the company as well as the ethical context in the company. As a form of response from each scenario, participants will be given four questions related to their ethical judgment. After that, the participants also had to fill in some questions about background and manipulation checks. Participants will fill out this questionnaire anonymously. Besides, they were also given an explanation in advance about the scenarios presented and what questions needed to be answered.

Operational Definition and Variable Measurement

Dependent Variable

The dependent variable in this study is the ethical assessment of earnings management. This variable will be measured based on questions that have been tested in the research of Singer and Singer (1997), Kaplan (2001a), Kaplan (2001b). The questions asked are as follows:

a. Overall, how ethical is the action taken by the manager? Participants will choose one of the scales (1) very unethical to (9) very ethical. This question is based on the research of Bruns and Merchant (1990).

b. How much will the company or division suffer financial loss or the manager's actions? Participants will choose one of the scales (1) very small, too (9) very large. This question is based on the research of Singer and Singer (1997).
c. How serious are the consequences of this manager's actions? Participants will choose one of the scales (1) not very serious until (9) very serious. This question is based on the research of Singer and Singer (1997).
d. Overall, how fair is the action taken by the manager? Participants will choose one of the scales (1) very unfair to (9) very fair. This question is based on the research of Singer and Singer (1997).

Independent Variable

There are three independent variables in this study, namely, the role of participants, earnings management activities, and the ethical context of the company. These three variables will be presented in the instrument/questionnaire provided.

a. Role of participants

Participants will be assigned a random role. There are two roles in this experiment: managers who know moral agents or managers who do not know moral agents. If participants get a role as a manager who knows the moral agent, it is assumed that he often communicates and knows the moral agent personally. If participants get the part of managers who do not know the moral agent, it is assumed that they do not know personally and rarely communicate with the moral agent.

b. Earning Management Activities

The earnings management activities in this experiment are adapted from Bruns and Merchant (1990) and have been cited by Kaplan (2001a) and Kaplan (2001b). The earnings management activity consists of three scenarios, namely accounting gain case (delaying the disclosure of costs that should have been disclosed during this period, such as research and development costs), operating gain case (delaying disclosure of individual costs), and accounting loss case (increasing the allowance for receivable losses). Participants will accept the same scenario, but the order in which they will receive this scenario will be randomized.

c. *Ethical Context*

The ethical context in this study will be presented in the form of a story about the company where participants work. PT. A has a high ethical context during PT. B the opposite. Description of the ethical context of PT. A and PT. B is based on the research of Hunt et al. (1989), which has been cited by Elias (2004). The description of the ethical context consists of several things, namely the perception of ethical action, the understanding of ethical concern, and whether the unethical act will be punished.

Experiment Design

Participants will be given a role as managers of one of the companies in the case, and the company is PT. A (high ethical context) and PT. B (low ethical context). Participants will be given the role of managers who know or do not know their colleagues who do earnings management. Participants are given the task to provide an assessment of the actions taken by managers who carry out earnings management at their respective companies.

Tabel 1. Experiment Design

Observers Conditions	*Ethical context*	
	High (PT. A)	**Low (PT.B)**
Know the Assessed Manager (*moral agent*)	Ethical judgments about earnings management	Ethical judgments about earnings management
Do not Know the Assessed Manager (*moral agent*)	Ethical judgments about earnings management	Ethical judgments about earnings management

Data Analysis Technique

For testing a hypothesis, it will be verified by a variant analysis test or ANOVA. Tanady and Munardi (2015) explained that the ANOVA test represented a parametric test error and had several requirements to use, namely:

1. Data must be normally distributed. Normally distributed data is needed to use several statistical tools, such as regression analysis, t-test, analysis of variance (ANOVA), and many more. If a practitioner does not use such special tools, however, it does not matter whether the data is typically distributed. Distribution becomes a problem only when practitioners reach a point in a project where they want to use statistical tools that usually require distributed data, and they do not have it. Nevertheless, before testing the normality of the data, the steps taken are as follows:
   a. Data Uniformity Test. In conducting research, the observed data must be uniform, where no data exceeds the control limits (Control Limit). So, if the research data is out of reach or goes beyond the control limits, then the data must be removed. If data has been removed, then re-establish the control limits. Continue to Test Data Uniformity until no data exceeds the control limits.
   b. Data Adequacy Test. After getting uniform data, the data is then tested to find out whether the research data is sufficient or not. If it is not enough, research should be conducted again so that the amount of data that want to test is normal (do not forget to re-do the Data Uniformity Test again).
   c. Data Normality Test. After the data is uniform and sufficient, it can proceed to the Data Normality Test.
2. Data variance must be the same. Variance testing is intended to test whether the data has the same variation or not.

Before conducting the analysis using the ANOVA test, make sure these conditions are met. If they do not meet, then the Kruskal Wallis Test can be used. For the initial hypothesis and the counterpoint of this test, it is usually used. Ho: $\mu 1 = \mu 2 = ... = \mu n$ and H1: one or more of the

RESULTS AND DISCUSSION

Research Data

The initially planned respondents are 80 students. After manipulation checks, 13 questionnaires cannot be used because they do not pass the manipulation checks, which consisted of questions about the role and place of work. Questionnaires that do not pass the manipulation checks are excluded from the study. Therefore, the final observation data used for testing is 67 respondents. The details are in Table 2 and Table 3.

Table 2. Research Data

Explanation	Total
Preliminary Research Data (Observation)	80
less: Questionnaire that does not pass manipulation checks	(13)
Final data (Observation)	67

Source: Data processed

Table 3. Detailed Characteristics of Respondents

Observers Conditions	*Ethical context*	
	High (PT. A)	**Low (PT.B)**
Know the Assessed Manager (*moral agent*)	20 Respondents	16 Respondents
Do not Know the Assessed Manager (*moral agent*)	13 Respondents	18 Respondents

Source: Data processed

Descriptive Statistics

From the results of descriptive statistics, it can be seen that the respondents' answers per quadrant are in the range of 61-65. In plain view, there is no difference in the average responses per quadrant, which indicates that there is no striking difference between responders who are given roles as managers who know or do not know the party being observed or managers who work in companies with high or low ethical contexts.

Table 4. Average Respondents' Answers (Per Quadrant)

Observers Conditions	*Ethical context*	
	High (PT. A)	**Low (PT.B)**
Know the Assessed Manager (*moral agent*)	65,2	61,75
Do not Know the Assessed Manager (*moral agent*)	65,31	63,44

Source: Data processed

Hypothesis Testing

Based on testing using two-way ANOVA in Table 5, the results show that the significance value of the interaction between the ethical context variable and the role or condition of the observer is higher than 0.05, which is equal to 0.702.

Table 5. The Result of Hypothesis Test

Variable	F Count	Significance	Explanation
Ethical Context	1,659	0,202	
Agent	0,191	0,664	
Ethical Context x Agent	0,148	0,702	The hypothesis is not supported

Source: Data processed

So it can be concluded that the interaction between the two variables does not influence ethical judgments about earnings management. Alternatively, it can also be said that there is no difference in ethical judgments about earnings management of an observer who is in a company with a high or low ethical context in which the observer knows or does not know the person he values. Therefore, this research hypothesis is not supported.

Discussion

This study wants to examine the interaction between the observer-moral agent relationships with the ethical context of ethical judgments about earnings management. This thing is based on the belief that someone who is in an environment that has high ethical value or in other words, has an organizational culture that upholds ethics, then he will tend to care more about ethics. Besides, he will also look at certain things from an ethical perspective more objective. Testing is done by giving different treatments and roles to respondents and see the differences in their answers.

From the results of hypothesis testing, it is found that there are no differences of opinion or ethical judgments on earnings management from observers in organizations with different ethical contexts or observers who know or do not know the moral agents who perform earnings management. The results of this study are not in line with Lasdi's (2012) research, which finds that, in general, the ethical nature of action has the most significant influence on ethical judgment and intention to intervene managers. However, the combination of the treatment of the decision to manage earnings with favorable consequences for the organization encourages a reduction in reprimand. These results are also not in line with the research of Shafer and Wang (2010) and Elias (2004), who also found that ethical context will affect one's ethical judgment.

The existence of egocentric bias in an ethical judgment issued by Epley and Caruso (2004) cannot be proven in this study. Besides, this study also cannot verify the egocentric bias of ethical judgments about actions can also be related to the relationship between observers and moral agents, as questioned by Singer and Singer in 1997. This research also cannot prove the ethical context or ethical values adopted organization can affect the ethical person in the organization. This study provides an overview of earnings management actions that are seen as something that is not done. Furthermore, this judgment is not required by the organizational characteristics or personal interests of the observer of moral agents. This thing can be judged by the ethical values that exist in each observer. If they already have high ethical values, personal closeness, or work environment may not affect the overall ethics much.

CONCLUSION

This study wants to examine the interaction between the observer-moral agent relationship with the ethical context of ethical judgments about earnings management. Testing is done by giving different treatments and roles to respondents and see the differences in their answers. From the results of hypothesis testing, it is found that there are no differences of opinion or ethical judgments on earnings management from observers in organizations with different ethical contexts or observers who know or do not know the moral agent who does earnings management.

Although this study has been conducted in a prudential manner, some of the limitations can be derived. Firstly, some questionnaires do not pass manipulation checks because respondents may not thoroughly understand the treatment given. Secondly, some questions in the questionnaire are still challenging to understand, so there is some confusion in answering them. Based on this study, suggestions that can be given to further researchers are 1) using treatments or scenarios that are easier to understand. 2) setting the place and time for distributing questionnaires should be paid more attention so that the results of filling out the questionnaire can be better.

REFERENCES

Bruns Jr., W.J., K.A. Merchant, (1990). The Dangerous Morality of Managing Earnings. *Management Accounting 72(2), pp 22-25.*

Elias, R.Z. (2004). The Impact of Corporate Ethical Values on Perceptions of Earnings Management. *Managerial Auditing Journal 19(1), pp 84-98.*

Epley, N., dan E.M. Coruso, (2004). Egocentric Ethics. *Social Justice Research 17(2): 171-187*.

Healy, P.M., dan J.M. Wahlen, (1999). A Review of the Earnings Management Literature and Its Implication for Standard Setting. *Accounting Horizon 13; pp 365-383*.

Hunt, S.D, V.R. Wood, dan L.B. Chonko, (1989). Ethical Values and Organizational Commitment in Marketing. *Journal of Marketing 53(3): 79-90.*

Kaplan, S.E. (2001a). Further Evidence on the Ethics of Managing Earnings: An Examination of the Ethically Related Judgements of Shareholder and Non-Shareholder. *Journal of Accounting and Public Policy 20, pp 27-44*.

Kaplan, S.E. (2001b). Ethically Related Judgements by Observer of Earnings Management.*Journal of Business Ethics 32(4), pp 285-298.*

Lasdi, L. (2012). Studi Eksperimen Evaluasi Etis Manajer Terhadap Manajemen Laba dan Konsekuensinya. *Jurnal Simposium Nasional Akuntansi XV, pp 1-26*.

McMahon, J. M. & Harvey, R.J. (2007). The Effect of Moral Intensity on Ethical Judgment, *Journal of Business Ethics*, 72, 335-357.

Merchant, K.A., dan J. Rockness, (1994). The Ethics of Managing Earnings: an Empirical Investigation. *Journal of Accounting and Public Policy 13, pp 79-94*.

Nazaruddin. I. (2012). Pengaruh Religiositas, Relativisme Dan Idealisme Terhadap Penalaran Moral Dan Perilaku Manajemen Laba. *Jurnal Akuntansi Dan Auditing Indonesia 16(1): 14-32*.

Roychowdury, S. (2006). Earnings Management Through Real Activities Manipulation. *Journal of Accounting and Economics 42, pp 335-370*.

Rusdianto. (2018). Pengaruh Kinerja Ekonomi, Non Ekonomi, Dan Nilai Personal Dalam Proses Pengambilan Keputusan Manajer. *Jurnal Balance 15(2): 12-34.*

Septiari, D., dan M. Maruli. (2017). Earnings Management Behaviour: The Role of Pressure on Behaviour Performance. *Asian Journal of Business and Accounting 10(2): 137-163.*

Shafer, W.E., dan Z.H. Wang, (2010). Effects of Ethical Context and Machiavellianism on Attitudes Toward Earnings Management in China. *Managerial Auditing Journal 26(5): 372-392.*

Singer, M.S., dan A.E. Singer, (1997). Observer Judgements about Moral Agents' Ethical Decisions: The Role of Scope of Justice and Moral Intensity.*Journal of Business Ethics 16(5): 473-484.*

Tannady, H., dan W.K. Munardi, (2015). Pengamatan Waktu Pelayanan Operator Pintu Tol Dengan Uji Hipotesis *Analysis of Variance* (ANOVA) (Studi Kasus: Gerbang Tol Ancol

Timur, Jakarta Utara). *Journal of Industrial Engineering & Management Systems 8(1): 26-54.*
Wardani, D.W., dan D.K. Santi, (2018). Pengaruh Tax Planning, Ukuran Perusahaan, *Corporate Social Responsibility* (CSR) Terhadap Manajemen Laba.*Jurnal Akuntansi 6(1):11-24*.