COSMETIC EARNINGS MANAGEMENT AND INITIAL PUBLIC OFFERING: EVIDENCE FROM INDONESIA

ABSTRACT

Objectives
The primary purpose of this empirical study is to assess whether managers of Initial Public Offering (IPO) firms in Indonesia conduct Cosmetic Earnings Management (CEM) prior to going public.

Method
The method used in this study is hypothesis testing. To fulfill the objectives, investigations are conducted on newly listed companies in the Indonesian Stock Exchange (IDX) for 19 years from 1990 to 2008 using their respective prospectuses. The total sample consists of 303 newly listed companies’ latest net income prior to their IPOs, obtained from their respective prospectuses. To analyze the data for occurrence of CEM, Benford’s (1938) Law is used as a benchmark to compare the observed frequency for each number x in various places of earnings numbers, to the expected occurrence of the number as predicted by Benford’s (1938) Law. In addition, a normally distributed Z-statistic is used to perform a significance test of the observed deviations from the expected proportions.

Results and Conclusions
The results of this research shows that there is no statistically significant evidence of managerial efforts to round earnings numbers and that the occurrence of numbers in the next place of key reference points in income numbers conform to the expected distribution. Furthermore, the findings of this research find only weak evidence that the managerial effort to round earnings may be negatively associated with the distance between earnings before manipulation and the reference points.

Keywords
Initial Public Offering (IPO), Cosmetic Earnings Management (CEM), Benford’s Law, Prospectus