

## ACCRUAL EARNINGS MANAGEMENT, REAL EARNINGS MANAGEMENT, AND COST OF DEBT: DOES CAPITAL STRUCTURE MATTER?



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### Abstract

This study looks at how accrual and real earnings management affect the cost of debt. This study also considers capital structure as a moderating variable. This quantitative study draws on data from the financial statements of manufacturing businesses listed on the IDX from 2016 to 2020. The research data was gathered from [www.idnfinancial.com](http://www.idnfinancial.com). Purposive sampling is employed in this study, with a sample size of 565 observations. Multiple linear regression analysis was employed to evaluate hypotheses with panel data. According to this study, accrual earnings management is unrelated to the cost of debt. Meanwhile, real earnings management correlates favorably with the cost of debt. The moderating influence of capital structure is often missing or minor in the link between real earnings management and the cost of debt. This research enriches the knowledge discussing the hazards of earnings management performed by managers in organizations with specific debt levels.

### INTRODUCTION

Company plans for funding operational activities typically involve a combination of equity and debt (Brigham & Houston, 2019). This funding initiative increases both the cost of debt and the cost of equity (Brigham & Houston, 2019). Funding decisions substantially impact the company's ability to conduct its operational activities and affect the associated risks (Fajaria, 2018). Companies prioritize internal sources of money and only turn to external borrowing when internal finances are insufficient (Goenawan & Wasistha, 2019). However, not all company needs for funds can be satisfied from internal sources, so companies may need to outsource those funds from external sources such as debt.

Using debt as an alternative funding source for businesses brings tax benefits (Sánchez-Ballesta & Yagüe, 2023). The interest expense the company bears is tax deductible, which can reduce the tax the company should

pay (Meiriasari, 2017). Heightened debt consumption exacerbates inequality information between managers and shareholders, as managers are more accountable to creditors than shareholders (Firmansyah, Fauzi, et al., 2020). Thus, the company's debt must be limited to minimize this asymmetry. On the other hand, investors expect more transparency from managers when providing company financial information. The existence of asymmetric information between managers and shareholders results in shareholders' lack of confidence in the manager's performance. The increasing use of debt can reduce investor confidence (Firmansyah, Utami, et al., 2020). Companies with higher debt will likely distribute less dividends to shareholders (Prasetyo & Riduan, 2015). Debt management can influence investors' perceptions of managers' performance, which is less aligned with investors' interests.

The cost of debt illustrates the risk that a firm must carry since creditors intend a greater rate of return to compensate for the company's possible losses in the future. The case of overexerting debt occurred to PT Garuda Indonesia Tbk. In 2021, its debt exceeded its total assets, so PT Garuda Indonesia Tbk experienced negative equity (Uly, 2021). This condition results in companies like PT Garuda Indonesia Tbk bearing a greater risk of bankruptcy due to substantial interest expenses, worsened by their inability to deduct them from their taxable income. According to the Indonesian Tax Law (PMK-169/PMK.010/2015), a company with negative equity may not deduct all its interest expenses from its taxable income. This has been one of the government measures against thin capitalization. This condition will put a company in serious cash constraints due to ballooning interest liability to creditors and higher tax liability to the government. Although most companies are less likely to experience these two adverse situations simultaneously, this shows that managers' debt policies must be carefully made.

High corporate cost of debt can disrupt the company's going concern in the future. The high cost of debt results from creditors' lack of confidence in providing company loans (Valta, 2012). On the other hand, debt funding is easier for companies to procure than equity funding and high costs of debt are usually provided to companies with easier terms (Valta, 2012). Creditors impose a higher cost of debt on companies to compensate for any potential inability to repay the loans in the future (S. Chen et al., 2018). Different from equity investors, through debt instruments, creditors secure a right of preemption to company profits (through installments including interest payments and any other payments as agreed upon) and even assets should the company ever be liquidated (Fachrudin, 2021). Asymmetric information may lead managers to make decisions independently by increasing debt usage in the company's capital structure. Obtaining loans is seen as easier but comes with a greater cost of debt (Yulianto et al., 2021). As a result, shareholders, as the true company owners, have difficulty scrutinizing and controlling the manager's policies. Thus, the investigation of the cost of debt needs to be conducted further.

Several prior studies have investigated the cost of debt, such as competitive product markets (Valta, 2012), greenhouse gas emissions (Maaloul, 2018), carbon emissions (Kumar, 2018), capital control (Andreasen et al., 2019), religiosity (H. Chen, 2016), capital structure (Daffa et al., 2022; S. L. Wardani & Ruslim, 2020), corporate opacity (Ma, 2017). The previous studies also examined the cost of debt with accrual earnings management (Firmansyah, Fauzi, et al., 2020; Hanawijaya, 2020; Le et al., 2021; Orazalin & Akhmetzhanov, 2019; Thu et al., 2018; Xiaoxia & Minghui, 2023), real earnings management (Khuong et al., 2021; J. H. Kim, 2020; Liu, 2022a, 2022b; Xiaoxia & Minghui, 2023), and policy risk (Bradley et al., 2016). Furthermore, in previous studies, corporate governance (Hashim, 2016) and tax avoidance (Hutabarat & Firmansyah, 2022; Kovermann, 2018) also examined the cost of debt.

This study examines how accrual and real earnings management impact the cost of debt. Company risks resulting from the cost of debt are usually caused by certain managers' discretion, such as the discretion to manipulate the numbers in the financial statements. This activity is called earnings management, which managers may carry out using accrual or real earnings management (Roychowdhury, 2006). Financial accounting standards allow managers to select certain accounting procedures (Scott, 2015). Using discretionary rules to impact accounting profitability, on the other hand, permits managers to make accounting record judgments that may not represent actual conditions. Although management discretion can be applied within the confines of accounting rules, its usage may attempt to distort financial reports to deceive stakeholders about actual business performance or influence contracts relying on accounting data. (Camfferman & Wielhouwer, 2019). However, earnings management operations, which were previously mostly carried out utilizing accrual earnings management, are now simpler to identify by tax authorities, auditors, and capital market regulatory agencies (Cohen & Zarowin, 2010; Zang, 2012). Therefore, some alternatives allow managers to manage earnings through real activities.

Studying these two forms of earnings management aims to determine whether one has a greater influence on firm risk from the creditor's point of view. Several previous studies investigating accrual earnings management have been conducted internationally. Beiruth et al. (2021) and Le et al. (2021) found that accrual earnings

management positively affects the cost of debt. These findings imply that discretionary accrual policies carried out by managers can increase risk from a creditor's perspective. Orazalin & Akhmetzhanov (2019) concluded that Accrual earnings management adversely impacts the cost of debt. Accrual earnings management can potentially decrease business risk, as suggested by this discovery. Thu et al. (2018) and Xiaoxia & Minghui (2023) concluded that accrual earnings management does not affect the cost of debt. Meanwhile, investigations of accrual earnings management's effect on the cost of debt are rarely carried out in Indonesia. Firmansyah, Fauzi, et al. (2020) and Hanawijaya (2020) found that Accrual earnings management does not impact the cost of debt. It is crucial to examine how accrual earnings management impacts the cost of debt due to the variance in the prior test results.

This study also examines real earnings management concerning the cost of debt, a practice not commonly explored in Indonesia. Kim & Sohn (2013) stated that, after controlling for accrual earnings management effects in U.S. firms, the cost of equity capital increases with the level of real earnings management. Khuong et al. (2021), J. H. Kim (2020), Xiaoxia & Minghui (2023) concluded that real earnings management positively impacts the cost of debt. This discovery indicates that engaging in real earnings management practices raises the firm's risk level as perceived by creditors. Liu (2022a) found that real earnings management negatively affected the cost of debt in banking companies in China. Real earnings management is considered an efficient activity that decreases firm risk from a creditor perspective. Liu (2022b) also found that real earnings management does not affect South Africa's cost of debt. It implies that real earnings management is unrelated to the company risk creditors offer. Previous research showing inconsistent outcomes motivates a re-examination of this association.

In addition, this research is different from other research, such as Xiaoxia & Minghui (2023), which only tested the cost of debt with accrual earnings management and real earnings management. This research expands previous studies by including capital structure as a moderating variable. According to agency theory, managers can utilize their discretion as agents in making certain decisions for the company. These policies include making decisions on company funding from external sources. Companies will prefer funding from debt rather than shares. Even though it has a greater potential risk, debt funding is easier for managers to obtain compared to equity funding. Daffa et al. (2022) and Wardani & Ruslim (2020) found that capital structure positively affects the cost of debt. Companies with higher debt bear higher costs of debt. Creditors consider that companies with greater debt may experience financial distress or bankruptcy. Creditors will require a higher interest rate on debt to offset any indication of risk associated with the company.

This study explores the risks creditors face due to managers' accounting policy decisions from the creditor's standpoint. The manager's policy decisions are reflected in earnings management. This study categorizes earnings management actions into accrual and real earnings management to analyze risky strategies. Testing for both is still infrequently conducted at both the international level and in Indonesia. Furthermore, the positioning of the capital structure indicates that earnings management actions will be riskier when a company has a higher proportion of debt than equity. This research can enhance the existing financial accounting research on business risk internationally, specifically in Indonesia. Additionally, this research is anticipated to benefit the Capital Market Supervisory Authority in overseeing or formulating rules concerning earnings management actions associated with safeguarding the interests of investors and creditors.

The agency theory states that managers possess more complete information than shareholders (Scott, 2015). Managers may exploit these conditions to cultivate policies, allowing them to procure personal benefits, including manipulating financial reports (Scott, 2015). Managers are the real parties given the authority to manage capital obtained from investors and creditors (principals), which should bind them to the principal's interests. However, the principal's negligence and the lack of scrutiny of managers' actions often drive opportunistic managers to put their interests ahead of those of principals.

The financial information submitted by the company to creditors may not all receive a positive response, considering that the information may not fully reflect the company's actual financial condition. Creditors' lack of confidence results in creditors assuming that the company may possess higher risk than reported. Hence, creditors may price this uncertainty by demanding higher interest rates on the company's loan (Suhendi & Firmansyah, 2022). Managers' earnings management attempts may result in biased financial statement data.

Investors and creditors often use information regarding a company's profitability to determine the rate of return on capital that will be handed over (Brigham & Houston, 2019). Poor earnings quality due to interference from various management discretions may raise uncertainty in decision-making by investors and creditors (Scott, 2015). Companies will have to bear higher capital costs because they are considered riskier (Prakosa et al., 2022). Accrual-based earnings management is one of the most common ways managers manipulate financial data for personal advantage (Scott, 2015). It uses discretionary accruals to exploit managers' misuse of judgment inside the GAAP framework, resulting in low-quality reported results. The degree of discretionary accruals is commonly used to indicate earnings quality. Increasing discretionary accruals lowers earnings

quality and deteriorates the information environment. Managerial discretion, such as employing discretionary accruals and previously managed earnings, has dramatically raised corporate risk (Firmansyah & Suhanda, 2021; Prakosa et al., 2022). In this case, financial statements lose their relevance and increase uncertainty.

In this regard, Beiruth et al. (2021) and Le et al. (2021) found that accrual earnings management positively affects the cost of debt. Low earnings quality leads to higher risk as the accounting information provided by the company becomes less useful for predicting future cash flow returns and the company's financial stability. Bankruptcy is a significant issue in high-risk companies.

Separating control between managers (agents) and investors (principals) may lead to a conflict of interest (Jensen & Meckling, 1976). Managers have more knowledge about how the organization operates, which they may utilize to optimize their welfare. One method is to conduct earnings management. The goal is to receive incentives and satisfy analysts' expectations so that they may push share prices higher (Persakis & Iatridis, 2015). Earnings management causes earnings in financial statements to be of poor quality, thereby increasing information asymmetry between managers and users of financial statements (Prakosa et al., 2022). The impact is that users of financial statements can face uncertainty in estimating firm value (Limarwati et al., 2023). As a result, investors and creditors consider companies with high asymmetric information riskier and, therefore, require compensation in the form of higher capital costs.

Managers can use asymmetric information in agency partnerships to their advantage. A high amount of asymmetric information will encourage management to utilize their judgment to control earnings (Scott, 2015). Earnings management may also be carried out with real activities because the company considers that accrual earnings management can be detected by several parties, such as auditors, tax authorities and capital market authorities (Zang, 2012), likewise with creditors who are concerned with the condition of the company's financial statements.

Khuong et al. (2021), J. H. Kim (2020), Xiaoxia & Minghui (2023) concluded that real earnings management has a positive effect on the cost of debt. Creditors believe managers undertake real earnings management operations with complete knowledge compared to creditors. As a result, creditors will give a greater rate of return to compensate for the risk caused by creditors not having complete information about the company's status.

A company's capital structure relates to how much it has funded its business operations through external resources (Brigham & Houston, 2019). Meanwhile, according to Hsu & Jang (2008), capital structure measures the extent to which a business uses liabilities relative to equity. The company's capital structure is related to conditions that arise because the company uses assets and funding sources that give rise to fixed expenses in the form of interest costs from debt (Bui et al., 2023). Capital structure is a company's funding needs that occur when the company uses funding sources that provide fixed charges to increase shareholder returns (Suleman & Sumani, 2021).

Capital structure is a crucial component of management strategy since altering it will impact the company's financial risk (Hsu & Jang, 2008). Maintaining an optimal capital structure is crucial because investors and creditors view a company with a high debt-to-equity ratio as more risky (O. M. Wardani & Subowo, 2020). The capital structure ratio shows a company's financial risk since enterprises with significant financial leverage face a higher cost of capital (El-Deeb, 2019). This financial risk arises from signals that the company's financial performance is insufficient to fund its total operations, necessitating the use of debt instruments to get additional funding. The ideal capital structure is a collection of trade-offs between the advantages of taking out debt and the expenses associated with the risk of bankruptcy (O. M. Wardani & Subowo, 2020).

Debt creates more risk; hence, a capital structure with high debt presumably has higher risk (Vozlyublennai, 2013). According to the agency theory, a company's capital structure with a larger usage of debt must be aligned with the interests of its shareholders. The debt or finance policy guarantees that the company's debt-to-capital ratio is optimal, improving cash flow and maximizing financial efficiency and effectiveness in operational operations. However, capital structure is like a two-edged sword. Companies use higher debt to get returns expected to exceed the cost of funds to increase shareholder returns. However, financial leverage also increases the risk of returns so that it can increase potential losses for shareholders and profits. Daffa et al. (2022) and Wardani & Ruslim (2020) found that capital structure positively affects the cost of debt.

Besides policies in choosing external funding, managers can also choose certain accounting policies in financial reporting (Roychowdhury et al., 2019). Accrual earnings management allows managers to use their discretion to influence the statistics in financial statements (Haykal, 2018). Accrual earnings management is often done after the quarter. Meanwhile, real earnings management continues throughout the year. Accrual and real earnings management can enhance knowledge asymmetry, especially between managers and creditors (Prakosa et al., 2022). Earnings information might be skewed for creditors in measuring firm success when managers undertake stronger earnings management through accrual and actual operations (Prakosa et al., 2022). Creditors levy a greater cost of debt as a result of these factors. Furthermore, significant debt in a

company's capital structure might enhance the risk of financial hardship in the future (Firmansyah, Fauzi, et al., 2020). Earnings management measures carried out by managers in organizations with progressively high levels of debt might enhance asymmetric information because managers constantly try to maintain a specific level of earnings to draw the attention of creditors and conceal the company's weaknesses. This study has four hypotheses as follows. H1 Accrual earnings management is strongly correlated with the cost of debt, H2 Real earnings management is strongly correlated with the cost of debt, H3 capital structure reinforces the positive relationship between accrual earnings management and the cost of debt, H4 capital structure reinforces the positive relationship between real earnings management and the cost of debt.

## METHODS

The research, conducted in 2021, is based on secondary data extracted from financial statements of manufacturing companies listed on the Indonesia Stock Exchange between 2016 and 2020. The research data was obtained from [www.idx.co.id](http://www.idx.co.id). The sample requirements for this research are as follows:

Table 1. Research Sample

Criteria	Number
Indonesian manufacturing listed companies as of July 2021	195
Manufacturing sector companies listed after January 1, 2015	-59
Companies that fail to provide comprehensive annual financial statements	-15
Companies with incomplete data for the years 2016 to 2020	-8
Quantity of companies available for research	113
Duration of research	5
Total sample	565

This study's dependent variable is the cost of debt. To determine the cost of debt, divide the company's annual interest expense by the average total interest-bearing debt. This proxy is used following Juwita & Julia (2021).

$$\text{COD} = \frac{\text{Interest Expense}}{\text{Average interest-bearing debt of the company}}$$

This research's independent variables are accrual and real earnings management. According to Ferdiawan & Firmansyah (2017), who also used this proxy in research in Indonesia, companies that carry out earnings management have low cash flow from operations (CFO) and/or discretionary expenses so that the abnormal value of both is multiplied by minus one (-1) and/or costs production is extraordinarily high, so it needs to be combined. Similar calculations were carried out by Cohen & Zarowin (2010), Francis et al. (2014), and Lee & Chung (2019). The first stage to obtain abnormal CFO is derived from this formula in this industry for each year:

$$\frac{\text{CFO}_{it}}{\text{Assets}_{i,t-1}} = \beta_1 \frac{1}{\text{Assets}_{i,t-1}} + \beta_2 \frac{\text{Sales}_{it}}{\text{Assets}_{i,t-1}} + \beta_3 \frac{\Delta \text{Sales}_{it}}{\text{Assets}_{i,t-1}} + \varepsilon_{it}$$

$\varepsilon_{it}$  is residual the equation, suggesting that abnormal CFO. In the second stage, to obtain abnormal production costs (ABNPROD), the formula is as follows in this industry for each year:

$$\frac{\text{Prod}_{it}}{\text{Assets}_{i,t-1}} = \beta_1 \frac{1}{\text{Assets}_{i,t-1}} + \beta_2 \frac{\text{Sales}_{it}}{\text{Assets}_{i,t-1}} + \beta_3 \frac{\Delta \text{Sales}_{it}}{\text{Assets}_{i,t-1}} + \beta_4 \frac{\Delta \text{Sales}_{i,t-1}}{\text{Assets}_{i,t-1}} + \varepsilon_{it}$$

Prod represents the company's production expenses (cost of goods sold + inventory adjustments).  $\varepsilon_{it}$  is residual the equation, suggesting that ABNPROD. The formula for the three states to obtain abnormal discretionary expense (DiscExp) is as follows for each year in this industry.

$$\frac{\text{DiscExp}_{it}}{\text{Assets}_{i,t-1}} = \beta_1 \frac{1}{\text{Assets}_{i,t-1}} + \beta_2 \frac{\text{Sales}_{it}}{\text{Assets}_{i,t-1}} + \varepsilon_{it}$$

DiscExp is total discretionary expenses (advertising, research, development, and general and administrative expenses),  $\epsilon_{it}$  is residual the equation, suggesting that abnormal DiscExpReal earnings management is the sum of the three based on past studies (Cohen et al., 2008; Prakosa et al., 2022) that is  $REM = AbnCFO + AbnPROD + AbnDiscExp$ .  $ABNCFO$  is abnormal operating cash flow (multiplied by minus 1),  $ABNPROD$  is abnormal production cost, and  $ABNDISCEXP$  is abnormal discretionary expenses (multiplied by minus 1).

Furthermore, accrual earnings management is measured by discretionary accrual as Kothari et al. (2005). Prakosa et al. (2022) also employed this model, which employs the absolute value of the residual computed without regard for whether the residual is positive or negative. It will become earnings management data utilized in the research model by doing cross-sectional regression on the following model each year for each industry.

$$\frac{TACC_{it}}{Assets_{i,t-1}} = \beta_0 + \beta_1 \left( \frac{1}{Assets_{i,t-1}} \right) + \beta_2 \frac{(\Delta REV_{it} - \Delta REC_{it})}{Assets_{i,t-1}} + \beta_3 ROA_{i,t-1} + \beta_4 \left( \frac{PPE_{it}}{Assets_{i,t-1}} \right) + \epsilon_{it}$$

TACC is total accrual, resulting from net income minus cash flow operation,  $\epsilon_{it}$  is the residual of the equation, which is the value of discretionary accruals. Furthermore, the proxy for capital structure in this research is the debt ratio following Kimsen et al. (2019) and Winda & Nariman (2021), which is measured using the following formula:

$$Debt\ Ratio\ (REV) = \frac{Total\ Liabilities}{Total\ Assets}$$

This study used the natural logarithm of total assets as an indicator of firm size following Geno et al. (2022) and Pamungkas et al. (2021):

$$SIZE = \ln (Total\ Assets)$$

This study employs return on assets (ROA) as a proxy to measure profitability (Lisda & Anthony, 2023; Pamungkas et al., 2021).

$$ROA = \frac{Net\ Income}{Total\ Assets}$$

This research's net profit margin proxy follows the research of Firmansyah, Sihombing, et al. (2020) and Prakosa et al. (2022).

$$NPM = \frac{Net\ Income\ After\ Tax}{Total\ Sales}$$

This study's hypothesis is tested using multiple linear regression analysis with panel data. Model 1 tests hypotheses 1 and 2, whereas Model 2 tests hypotheses 3 and 4.

$$COD_{it} = \beta_0 + \beta_1 AEM + \beta_2 REM_{it} + \beta_3 SIZE + \beta_4 ROA_{it} + \beta_5 NPM_{it} + \epsilon_{it} \dots\dots\dots(1)$$

$$COD_{it} = \beta_0 + \beta_1 AEM + \beta_2 REM_{it} + \beta_3 LEV_{it} + \beta_4 AEM * LEV_{it} + \beta_5 REM * LEV_{it} + \beta_6 SIZE_{it} + \beta_7 ROA_{it} + \beta_8 NPM_{it} + \epsilon_{it} \dots\dots\dots(2)$$

## RESULTS

The descriptive statistics for the variables in this investigation are as follows:

Table 2. Descriptive statistics

Variable	Mean	Med.	Max.	Min.	Std. Dev.	Obs
COD	0.095	0.066	9.107	0.000	0.400	565
AEM	0.070	0.050	1.346	7.79E-05	0.107	565
REM	-0.239	-0.152	0.673	-2.097	0.371	565
LEV	0.536	0.466	5.168	8.43E-07	0.550	565
ROA	0.057	0.060	0.480	-2.216	0.167	565
SIZE	28.704	28.490	33.494	25.216	1.617	565
NPM	0.526	0.466	5.168	0.065	0.533	565

Source: data processed

The descriptive statistical data in Table 2 shows that the average cost of debt for manufacturing businesses in Indonesia is quite low. Although some companies have a very high cost of debt, the high cost of debt is in line with the high leverage value. Generally, manufacturing companies have high leverage, but this condition does not make manufacturing companies more risky. However, with leverage and a high cost of debt, the company has corporate risks that will endanger it. Based on the comparison of information in Table 2, manufacturing companies in Indonesia use accrual earnings management more than real earnings management. However, accrual earnings management actions carried out by manufacturing companies in Indonesia can still be said to be relatively low. Accrual earnings management actions in Indonesia are still relatively easy to carry out, so many managers in manufacturing companies still carry out these actions. Apart from that, Indonesia's lack of strict regulations on discretionary policies encourages companies to still practice accrual earnings management compared to real earnings management.

After running the Chow, Lagrange multiplier, and Hausman tests, the fixed effect model best fits models 1 and 2. Here is a summary of the results from the hypothesis test.

Table 3. Hypothesis Test Results Summary

Variable	Coeff.	T-Stat.	Prob.		Coeff.	T-Stat.	Prob.	
C	0.161	0.832	0.203		0.222	1.249	0.106	
AEM	-0.002	-0.060	0.476		0.042	0.795	0.213	
REM	0.065	4.212	0.000	***	0.031	1.509	0.066	*
ROA	-0.119	-3.176	0.001	***	-0.124	-3.686	0.000	***
SIZE	-0.001	-0.158	0.437		-0.003	-0.553	0.290	
NPM	-0.022	-1.037	0.150		-0.015	-0.716	0.237	
LEV					-0.009	-0.436	0.331	
AEM*LEV					-0.015	-0.175	0.430	
REM*LEV					0.043	0.878	0.190	
R2	0.586				0.692			
Adj. R2	0.477				0.609			
F-stat.	5.402				8.333			
Prob(F-stat.)	0.000				0.000			

According to Table 3, the findings of model 1 indicate that accrual earnings management does not substantially impact the cost of debt due to the probability value of 0.476, which is less than 0.1. The test results align with those of model 2, showing a probability value of 0.213. Meanwhile, the results of testing real earnings management in model 1 show that it has a significantly positive effect on the cost of debt with a value of Prob. of 0.000, smaller than the 1% significance level. The results of this test are consistent with the test in model 2, with a value of Prob. of 0.066, smaller than the 10% significance level. Furthermore, the interaction between AEM and LEV and REM and LEV does not significantly affect the cost of debt because of the value of Prob., below the 10% significance level.

## DISCUSSION

The hypothesis test result suggests that accrual earnings management is not associated with the cost of debt. The results of this test are in line with Firmansyah, Fauzi, et al. (2020), Hanawijaya (2020), Thu et al. (2018), and Xiaoxia & Minghui (2023). Regardless of the information shared between managers and shareholders or between managers and creditors, creditors believe that accrual earnings management is a widespread technique managers use. Managers have more comprehensive knowledge about the statistics in financial reports. Creditors do not view earnings management initiatives as dangerous since they are unrelated to risk from the creditor's perspective. Creditors' returns are strongly linked to cash flow, but accrual earnings management has no immediate cash flow effects. Creditors will not be too eager to raise interest rates on accrual earnings management practices (Fauzi & Firmansyah, 2023).

Creditors value a company's ability to meet its commitments over managers' accrual earnings management, negatively impacting decision-making. The capacity to achieve high performance suggests that the firm is in a lower-risk position (Rajapathirana & Hui, 2018). Companies with higher levels of profitability provide greater assurance to creditors since they feel the firm will be able to meet its future commitments, as opposed to companies with poor operating performance.

The second hypothesis test in this study indicates a positive relationship between real earnings management and the cost of debt. This research is in line with the findings of Khuong et al. (2021), J. H. Kim (2020), and Xiaoxia & Minghui (2023). Creditors are expected to be more familiar with accrual earnings management activities than real earnings management. This type of earnings management carried out by manufacturing companies is considered an activity more easily recognized by creditors than real activities. In this regard, managers continue to exploit information asymmetry by continuing to manage real earnings. However, unlike accrual earnings management, real earnings management directly impacts company cash flow and, in some cases, accruals (Prakosa et al., 2022). Creditors will be greatly concerned because the company's capacity to fulfill its contractual obligations relies heavily on its cash flow. Therefore, creditors are more eager to raise interest rates on real earnings management practices.

Financial statements do not explicitly capture real activities (Zang, 2012). Creditors consider that real activity actions can increase information asymmetry in the information conveyed by managers to creditors. Real earnings management actions can increase creditors' concerns regarding the profits generated by the company. Creditors consider that real earnings management action results in increasingly biased earnings information, so that these actions can increase the risk from the creditor's perspective.

Testing the third hypothesis suggests that capital structure does not strengthen the positive association between accrual earnings management and the cost of debt. Managers do not enhance the perceived risk for creditors by engaging in earnings management in companies with higher debt levels in their capital structure. Creditors consider that manufacturing companies in Indonesia with high debt levels do not put the company in a risky condition. Creditors believe that managers in companies with high debt can still perform well. Under the current tax regulation framework, companies can benefit from higher debt if they deduct interest expenses from their taxable income, resulting in tax savings (Ricca et al., 2021). These tax savings may improve the companies' cash flow and help them meet their contractual obligation to creditors.

Managers at manufacturing enterprises devise techniques to keep their businesses running even when heavily in debt. Furthermore, larger debt levels do not alter creditors' perceptions of accrual earnings management actions carried out by managers since accrual earnings management has no direct influence on cash flow. Thus, accrual earnings management in enterprises with significant debt does not influence rising risk from the creditor's point of view.

The fourth hypothesis testing indicates that capital structure does not enhance the favorable relationship between real earnings management and the cost of debt. Debt levels are unlikely to impact a company's real earnings management, as the methods used are unrelated to the company's debt structure. The change in real earnings management intensity is not responsive to the change in the amount of debt the company acquires. As a result, creditors do not pay attention to the company's high- or low-debt condition. Higher debt composition does not result in increased risk from the creditor's perspective (Tayem, 2023). Creditors view real earnings management actions as the primary cause of concern, deeming them risky irrespective of the company's debt magnitude.

## CONCLUSIONS

Hypothesis testing results show that accrual earnings management does not affect the cost of debt. However, real earnings management has a beneficial impact. Creditors see and expect accrual earnings management as a standard managerial activity without directly impacting cash flow. Meanwhile, real earnings management activities impact the company's cash flow and ability to pay, thus jeopardizing the creditor's contractual claim to the company's revenue. Another result is that capital structure does not improve the impact of accrual and real earnings management on loan cost. Creditors' opinions of these two earnings management styles are independent of the company's high or low level of debt in its capital structure. The theoretical implications of the results of this research indicate that asymmetric information carried out by managers and creditors is not evident from accrual earnings management activities, but it occurs in the context of real earnings management activities. It may differ between managers and shareholders.

This study's weaknesses stem from the fact that accrual earnings management does not distinguish between upward and downward earnings management, hence utilizing accrual earnings management biases measuring the cost of debt. As a result, future studies may distinguish between the forms of accrual earnings management to assess their impact on the cost of debt. More research might be conducted with non-manufacturing firms to achieve more thorough test findings. This study suggests that the Capital Market Supervisory Authority enhances the inspection of listed businesses' earnings management procedures, either accrual or real earnings management, to improve earnings quality information so investors or creditors can use it to make educated judgments.



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