Expropriation Risk Through Real Earnings Management on Islamic Banking

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This study develops a model of expropriation through real earnings management (REM) in the Indonesian Islamic banking industry. The purpose of this study is to test a new model by examining the relationship between REM, bank ownership types, and performance of Islamic banks in Indonesia in the period of 2006 - 2013. This study finds that there are significant differences in REM and performance scores in banks with different ownership types. The REM and performance scores for family-owned banks and private-owned banks are relatively similar. However, Islamic banks with government as the controlling shareholder have the highest REM scores and the lowest performance scores. In contrast, foreign-owned banks have the lowest REM scores and the highest performance scores. The indications of expropriation can be seen from the magnitude of REM. A high REM can lower profitability and efficiency while increasing the risks faced by Islamic banks in Indonesia.

Keywords: Real earnings management, Islamic banking, performance

Introduction

Expropriation is the leveraging of power and control by large shareholders to maximize their welfare at the expense of minority shareholders (Méndez, 2009). Expropriation or the taking of private benefits can be done by using at least three ways as follows: 1) through the company's operation policy, such as its compensation, pension financing and bonus policies, and by withholding dividends, 2) through freezing out; that is, selling shares with a higher cash flow and lower controlling rights than regular shares to other companies, with cheaper price. 3) through the company contract policy (tunneling), using transfer prices, asset transfer from the company to the controlling shareholders under cheaper prices, and using the company's assets to guarantee loans taken (Gilson & Gordon, 2003).

There are many indications of expropriation by the controller-owners and/or management in legal cases involving Indonesian banks. For example, Bank Century's case in 2008, Bank Global's in 2005, and Bank Summa in 1992. Badan Pemeriksa Keuangan Republik Indonesia (The Audit Board of the Republic of Indonesia) (2009) ruled Bank Century as a failed bank in November 20th, 2008. Police data showed that Bank Century suffered financial loss of IDR 1.18 trillion. The financial losses were traced to have flowed to up to IDR 276.7 billion to Robert Tantular, up to IDR 248.44 billion to Anton Tantular, and up to IDR 853.971 billion to Hartawan Alui. Hartawan Alui and Robert Tantular were the sons-in-law of Sukanta Tanudjaja (Vivanews.com, 2008). The government liquidated Bank Summa in December 14th, 1992. Bank Summa failed because it channeled most of its credit to affiliated companies, which are apparently non-performing (Business Knowledges,

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2009). Bank Indonesia revoked the business permit for Bank Global in January 13th, 2005. Bank Global experienced capital adequacy issues because of fictitious credits and securities. In the end, the capital adequacy ratio (CAR) of Bank Global reached negative 39.11% (Tempo. co, 2005). Evidences point out that the collapse of several banks in the economic crisis of 1997-1998 is not only due to their weakness in utilizing best practice corporate governance, but also because their channeled credit is concentrated too highly to affiliated companies.

Expropriation can be hidden, either by using earnings management or through discretionary accruals as well as real activities. Several studies show that insiders covered the taking of private benefits through accrual earnings management (Crocker & Slemrod, 2007). Earnings management can also be done through various real activities, such as using related transactions (Carlo, 2014), cutting research and development expenses (R&D), advertising and maintenance, and delaying new projects (Graham, Harvey, & Rajgopal, 2005), through the excessive goods production, discount, sale, discretionary expenses, and administration and general expenses (Roychowdhury, 2006), through the related party transaction and excessive executives compensation (Saanoun, Riahi, & Arab 2013), through tunneling transaction (Luo, Wan, & Cai, 2012; La Porta, Lopez-de-silanes, & Shleifer, 2000; Bhaumik & Gregoriou, 2010), or through propping with an affiliated company (Jian & Wong, 2010).

The main purpose of this research is to develop an earnings management model based on the real activities in Islamic Bank. The earnings management model based on the real activities in the conventional banks have been studied by Surifah (2014), meanwhile an ERM for non-financial and non-bank companies have been done many times in several previous studies (Graham et al., 2005; Jian & Wong, 2010; Luo et al., 2012; Roychowdhury, 2006; Saanoun et al., 2013; Zang, 2012). The study of a real earnings management model for Islamic banks has not received enough attention yet in the afore-mentioned literature, yet Islamic banks have particular characteristics that differentiate them from conventional banks and non-bank industry. Therefore, this study will develop a real earnings management model for Islamic Bank.

This study is relevant not only because inattention on modeling real earnings management for Islamic banks in current literature, but also because the managing earnings through real activities is a tool most often used to hide expropriation (Bhaumik & Gregoriou, 2010; Graham et al., 2005; Jian & Wong, 2010; Johnson, La Porta, Lopez-de-silanes, & Shleifer, 2000; Kim & Sohn, 2013; Luo et al., 2012; Roychowdhury, 2006; Saanoun et al., 2013). The development of real earnings management model for Islamic banks is the original contribution of this study.

This study will examine the new model of Islamic bank's real earnings management by studying the relationships between the real earnings management, types of bank controlling interest and company performance. Therefore, other purposes of this study is to provide empirical evidence that: 1) Real earnings management in various banks differs with different controlling interest. The difference reflects the different expropriation level among the types of ownership. 2) Bank performances differ among different ownership types. Expropriation by the controller shareholders finally will influence the performance. Therefore, the performance difference can reflect the expropriation level (Achmad, Rusmin, Neilson, & Tower, 2009; Surifah, 2014). 3) giving evidence that the real earnings management influences the banks' performance.

Literature Review

Earnings management is the accounting policies or decisions set by the manager to influence the earnings figure to achieve certain purposes (Scott, 2012). Earnings management can be done by controlling various accrual accounts[2], changing selected accounting policy and real activities. Earnings management utilizes accounting policies such as the selection

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[2] Accrual is the income items and expense in the income statement that are not included in the statement of cash flow, such as amortization expense, the increase of the receivable, the increase of inventory value and the decrease of debts (Scott, 2012).

of a depreciation method, and discretionary accruals such as the amount set to cover guarantee expenses, inventory valuation, determining the particular time, and amount of extraordinary and nonrecurring expense items to recognize. Earnings management through real activities such as advertisement expenses, research and development, maintenance, the timing of fixed assets purchase and sale (Scott, 2012). Earnings management through manipulation of real activities is defined by Roychowdhury (2006) as departures from normal operational practices, motivated by managers' desire to mislead at least some stakeholders into believing certain financial reporting goals have been met in the normal course of operations. These departures do not necessarily contribute to firm value even though they enable managers to meet reporting goals.

Types of Controlling Owners and Earnings Management

Previous studies have found that certain types of controlling interests are related to earnings management. Control over the company motivates the controlling shareholders to manage earnings (Haw, Hu, Huang, & Wu, 2011). Companies held under the sway of controlling shareholders tend to have a high misclassification level on their financial statements (Sanjaya, 2011). The controlling shareholders minimise the accounting earnings to maintain the growth potential in the future (Ding, Zhang, & Zhang, 2007). Several other studies found the negative effects of different ownership types on earnings management, especially the family-ownership type. Companies controlled by a family is less aggressive in managing earnings using discretionary accruals (Atmaja, Haman, & Tanewski, 2011; Jiraporn & Dadalt, 2009; Tong, 2008). Companies with high percentage of family ownership tends to choose efficient earnings management (Siregar & Utama, 2008).

Based on the above studies, this study assumes that the various banks' ownership types will also determine the degree of earnings management practiced. The earnings management in this study was measured with the real earn-

ings management, therefore the first hypothesis (H1) in this study can be stated as follows: "there is the difference of the real earnings management among Islamic Banks with different types of controlling owners in Indonesia".

Types of Controlling Owners and Bank Performance

The previous studies found that the type of controlling shareholders are related with the use of earnings management (Atmaja et al., 2011; Ding et al., 2007; Haw et al., 2011; Jiraporn & Dadalt 2009; Sanjaya, 2011; Siregar & Utama, 2008; Tong 2008), meanwhile earnings management is often used as the tool to hide expropriation (Crocker & Slemrod, 2007; Graham et al., 2005; Luo et al., 2012; Jian & Wong 2010; Saanoun et al., 2013). Therefore it makes sense if the controlling ownership type will influence the degree of a company's performance level. This is supported by the finding of Achmad et al. (2009) that the ownership type directly influenced the financial performance of Indonesian companies in their data set. Thus, the second hypothesis (H2) of this study can be stated as follows:

H2: There is a difference in performance among Islamic banks in Indonesia with differing types of controlling ownership.

The Real Earnings Management and Bank Performance

The management decision to manage earnings is due to both the encouragement of the controlling shareholders and their own initiative, and can bring financial loss to the company as a consequence. Why is this so? This is because: 1) earnings management can lead to suboptimal investment decisions (McNichols & Stubben, 2008), 2) both the real earnings management and discretionary accruals positively influence the cost of capital (Kim & Sohn, 2012), 3) discretionary accruals that are the proxy of earnings management negatively influences company value (Abbas & Rizwan, 2007). Commercial banks managing their earnings face negative market response if they in-

Table 1. The Sample Number of Banks Each Year

Note	Year								Sum of Observation
Year	2006	2007	2008	2009	2010	2011	2012	2013	
Sum of Banks (N)	3	4	6	6	11	11	11	3	61

tentionally report decreased earnings during good periods and report increased earnings during bad periods (Abbas & Rizwan, 2007).

Based on these studies, this means that the earnings management can negatively influence the company performance. This study therefore assumes that real earnings manement has a negative effect on performance. The performance in the study is measured using three proxies in three dimensions. The three proxies used are profitability, efficiency, and risk level. Therefore, hypothesis 3 is specified as follows:

H3.a: Real earnings management has a negative effect on profitability.

H3.b: Real earnings management has a negative effect on efficiency.

H3.c: Real earnings management has a positive effect on risk level.

Data and Methodology

Data

The data used in this study is of Indonesian Islamic Banks from 2006 to 2013. We use secondary data such as financial statements and financial ratios from the Indonesian Banking Directory (Bank Indonesia, 2006-2013). The number of Islamic Banks of Indonesia were not many, so this study's population relatively small. Sample is taken for the study using purposive sampling, with the requirement that the financial statement is included in Indonesian Banking Directory (IBD). There are 11 Islamic Banks in 2013; however, only 9 banks are used in our sample because the financial statements of the other two banks are not included in IBD. Finally, we acquire 61 observed banks in the sample period of 8 years. Table 1 shows the number of banks observed each year.

Operational Definition and Variable Measurement

The study variables consist of bank per-formance, types of controlling owners, REM, ownership concentration, and size of bank. Performance is seen from 3 dimensions, and these are profitability, efficiency and risk level. Profitability is measured by return on asset (ROA), return on equity (ROE), and net interest margin (NIM). Profitability represents the Islamic Bank's ability in generating profit. The greater the profitability, the better the bank's performance is. The efficiency dimension is measured using operational efficiency ratio (OER). Operational efficiency ratio is derived from the operational expense to the operational income. The greater the OER, the less efficient the bank is. The risk level dimension is measured by the loan to deposit ratio (LDR), capital adequacy ratio (CAR), equity to total assets (ETA), non-performing loan - gross (NPL_G), and non-performing loan - net (NPL_N). The greater CAR and ETA, the lower the risk, but the greater LDR, NPL_G and NPL_N, the higher the risk. NPL is the ratio of loans that are close to default or actually defaulted to total loans. The greater the NPL, the higher the risk.

The independent variable of the type of controlling owner is measured by using dummy variable. This consists of the family-control type (D_Fam), government-control type to represent control by the government of the Republic of Indonesia (D_Gov), private-control type to represent control by private institution (D_Priv), and foreign-control type (D_Forg). The type of a bank's controlling interest is determined by which group has the largest control of the bank, based on the largest percentage of shares owned. The type of controlling ownership does not rely on just direct share ownership, but is determined by following each intermediate owner until the ultimate ownership. For example, the largest shareholder of Bank Victoria Syariah is Bank Victoria International, possessing 99.98% of the Islamic bank, but the ultimate shareholders of Bank Victoria Syariah are Susanna Tanoyo and Christien Tanoyo (Bank Indonesia, 2012). They are indirect own-

ers of Victoria Syariah Bank through Victoria International Bank. The total direct and indirect shares owned by Victoria International Bank amounts to 48.22%. Therefore, Victoria Syariah Bank is categorized as a family controlled bank.

The largest shareholder (99.99%) of Panin Syariah Bank is Bank Panin, but the ultimate owners of Bank Panin are Tijan Ananto & Muljadi Koesumo, Gunadi Gunawan, and Mu'min Ali Gunawan (Bank Indonesia, 2012). They are indirect owners of Bank Panin through PT Panin Finance Tbk., which holds 44.68% of Panin Bank's stocks. Moreover, the largest shareholders (99.99%) of bank BCA Syariah is Bank Central Asia (BCA), but the bank's ultimate owners are Robert Budi Hartono and Bambang Hartono (Bank Indonesia, 2012). As in the case of Bank Panin, Robert Budi Hartono and Bambang Hartono are the indirect owners of BCA through Farindo Investment (Mauritius) Ltd, which hold 47.15% of the BCA's stocks (Bank Indonesia, 2012). Therefore, Panin Syariah Bank and BCA Syariah as a bank is categorized as a bank that is family owned and controlled.

Real earnings management as independent variable is measured using the model of real earnings management (Roychowdhury, 2006; Surifah, 2014) that is adjusted to the business operations of the Islamic bank. On the other hand, we use ownership concentration and size of bank as our control variables. Ownership Concentration is measured by the largest share ownership, meanwhile the size is measured by log total assets.

Before discussing the expropriation model using real earnings management in Islamic Banking, we will first discuss the model of the real earnings management in the manufacturing industry and conventional banks in the following section. This is pertinent because it relates to the basic logic of the model's formation.

Real Earnings Management–Manufacturing Industry

Roychowdhury (2006) used a regression model to measure the manipulation of real activities through cash flow from operating ac-

tivities, production expenses, and discretionary expenses. The regression model used was as follows:

$$CFO_t/A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \beta_1(S_t/A_{t-1}) + \beta_2(\Delta S_t/A_{t-1}) + \epsilon_t \quad (1)$$

$$PROD_t/A_{t-1} = \alpha_0 + \alpha_1(1/A_{t-1}) + \beta_1(S_t/A_{t-1}) + \beta_2(\Delta S_t/A_{t-1}) + \beta_3(\Delta S_{t-1}/A_{t-1}) + \epsilon_t \quad (2)$$

$$DISEXP_t/A_{t-1} = \alpha_0 + \alpha1(1/A_{t-1}) + \beta(S_{t-1}/A_{t-1}) + \epsilon_t \quad (3)$$

Note:

CFO_{it}/A_{it-1} : Cash flow from operations in the year t, which is scaled with total assets in year t-1.

$\alpha_1(1/A_{t-1})$: The intercept scaled with total assets in year t-1 thus operating cash flow does not have value 0 when sales and lag sales value are 0.

$Prod_t/A_{t-1}$: Production costs in the year t scaled with total assets in year t-1.

$\Delta S_t/A_{t-1}$: Sales in the year t minus sales in year t-1 scaled with total assets in year t-1.

$DisExp_t/A_{t-1}$: Discretionary expenses in year t scaled with total assets of bank i in year t-1.

S_t/A_{t-1} : Sales in year t scaled with total assets in year t-1.

α_0 : constant.

ϵ_t : Error term in the year t.

The regression results in cash flow from normal operation, normal production cost, and normal discretionary expenses. The proxy of REM are the abnormal cash flow of the operation activities, abnormal production costs, and abnormal discretionary expenses. Therefore, the observation of the abnormal cash flow of the operation activities, abnormal production costs, and abnormal discretionary expenses each year are calculated by dividing the cash flow of the actual operation activities, actual production costs and actual discretionary expenses, with total assets previous year minus the normal cash flow of the operation activities, normal production costs, and normal discretionary expenses. The normal cash flow of the operation

activities, normal production costs, and normal discretionary expenses are calculated by using the estimation coefficient from the equations 1, 2, and 3.

The Real Earnings Management–Banking Industry

Surifah (2014) created a model of real earnings management for banking industry that is derived from Roychowdhury's model (2006), adjusted to the banking industry. The adjustment was done by: 1) replacing the sales income in manufacturing company with interest income. This is done because the primary source of revenue in manufacturing industry is sales while the primary source of revenue in the banking industry is interest income. 2) Replacing the production costs with interest expenses. The largest costs in the manufacturing industry is costs of production, while the main expenses in the banking industry is the interest expenses. 3) Replacing the discretionary expenses items in manufacturing industry with the discretionary expenses items in banking industry.

Roychowdhury (2006) defines discretionary expenses as the total amount of research and development (R&D), advertisement, sales, general and administrative (SG&A) expenses. The administration and general expenses were regarded as discretionary expenses, because it often contained certain discretionary expenditure such as staff training, maintenance, travelling, etc. Surifah (2014) defines discretionary expenses in the banking industry as the amount of advertising, research and developments, administration and general expenses, the cost of replacing production assets, and allowance for doubtful accounts.

The real earnings management of the banking industry can be estimated by using the following three equations (Surifah, 2014):

$$CFO_{it}/A_{it-1} = \alpha_0 + \alpha_1(1/A_{it-1}) + \beta_1(IR_{it}/A_{it-1}) + \beta_2(\Delta IR_{it}/A_{it-1}) + \epsilon_{it} \qquad (4)$$

$$IE_{it}/A_{it-1} = \alpha_0 + \alpha_1(1/A_{it-1}) + \beta_1(IR_{it}/A_{it-1}) + \beta_2(\Delta IR_{it}/A_{it-1}) + \beta_3(\Delta IR_{it-1}/A_{it-1}) + \epsilon_{it.} \qquad (5)$$

$$DE_{it}/A_{it-1} = \alpha_0 + \alpha_1(1/A_{it-1}) + \beta(IR_{it-1}/A_{it-1}) + \epsilon_{it.} \qquad (6)$$

Note:

CFO_{it}/A_{it-1} : Cash flow from operations of bank i, in year t, which is scaled with total assets in year t-1.

$\alpha_1(1/A_{it-1})$: Interception scaled with total assets in year t-1, thus operating cash flow does not have value 0 when interest revenue and lag interest revenue values are 0.

IR_{it}/A_{it-1} : Interest revenues of bank i, in year t scaled with total assets in year t-1.

$\Delta IR_{it}/A_{it-1}$: Interest revenue of bank i, in year t minus interest revenue of bank i in year t-1 scaled with total assets in year t-1.

IE_{it}/A_{t-1} : Interest expenses of bank i in year t scaled with total assets of bank i in year t-1.

DE_{it}/A_{it-1} : Discretionary expenses of bank i in year t scaled with total assets of bank i in year t-1.

α_0 : constant.

ϵ_{it} : Error term of bank i in year t.

The regression estimated by equations 4, 5, and 6 was done inter-company (cross-sectional) per year, as done by Roychowdhury (2006) and (Zang, 2012). The abnormal values of CFO, IE, and DE are left as is instead of transformed into their absolute values, because the positive and negative values have different meanings. Abnormal interest expenses and positive discretionary expenses meant that the interest expenses and discretionary expenses of the bank are higher than the industry's average. This indicates that the bank is less efficient. On the contrary, abnormal positive cash flow indicates that the bank has a higher cash flow compared to the industry's average. Several previous studies that tested the real earnings management also choose to not turn the variables into their absolute values (Cohen, Dey, & Lys, 2008; Gunny 2010; Hashemi & Rabiee, 2011; Roychowdhury, 2006; Surifah, 2014).

The regression results in cash flow from normal operation, normal interest expenses, and normal discretionary expenses. The proxies of REM are the abnormal cash flow of the operation activities, abnormal interest expenses, and

abnormal discretionary expenses. Therefore, the observation of the abnormal cash flow of the operation activities, abnormal interest expenses, and abnormal discretionary expenses each year are calculated by dividing the cash flow of the actual operation activities, actual interest expenses, and actual discretionary expenses, with total assets previous year minus the normal cash flow of the operation activities, normal interest expenses, and normal discretionary expenses. The normal cash flow of the operation activities, normal interest expenses and regular discretionary expenses are calculated by using the estimation coefficient from equations 4, 5, and 6 (Surifah, 2014).

In the other words, the abnormal CFO, IE, and DE are the actual CFO, IE, and DE after being deducted by the normal CFO, IE, and DE. Because normal CFO, IE, and DE could not be observed directly, they were estimated using the regression of the actual CFO, IE, and DE towards the independent variable in the equations 4, 5, and 6. Thus the abnormal CFO, IE, and DE were the error terms of those equations. The abnormal CFO, IE, and DE were the proxy of the real earnings management (REM) (Surifah, 2014).

With the model of the real earnings management of banking as above, Surifah (2014) is able to show strong indication of expropriation of family-type controlling shareholders, using real earnings management that may decrease the bank's financial performance. The real earnings management in banks controlled by family and private institution are significantly different and higher than banks controlled by government and foreign investors. Does the Islamic banking industry also display similar expropriation risk from the family owner-controller? This study began to answer the question.

The Real Earnings Management – Islamic Bank

Before discussing the real earnings management in Islamic banks, we will first discuss the main operating revenue and expenses in Islamic Banking (Bank Indonesia, 2006-2012). The main operational incomes of an Islamic bank consists of incomes from the fund disbursement and incomes from other operating sources. The incomes from fund disbursement consist of various investment and loans to non-bank third parties, income from sharia-compliant securities of Bank Indonesia and other banks in Indonesia. While incomes from non-bank third party consist of *murabahah* margin income, parallel *salam* net income, parallel *istishna* net income, *ijarah* leased income, *mudharabah* revenue sharing income, *musyarakah* revenue sharing income, and income from equity participation. In addition, incomes from Bank Indonesia consist of Bank Indonesia *wadiah* certificate (SWBI) bonuses and others. Moreover, incomes from other banks in Indonesia consist of bonuses from other Islamic bank, *mudharabah* revenue sharing income, and others. Lastly, other operating incomes consist of *mudharabah muqayyadah*, service fee, foreign exchange transaction income, loss allowances for earning assets (PPAP), and miscellaneous others.

The primary operating expense of the Islamic banking industry consists of the share of revenue for investors of unrestricted investment fund. This consists of *mudharabah* savings account, *mudharabah* time deposits, sharia short term funding facility, *mudharabah* interbank investment certificate, and others. The discretionary expenses of the Islamic banking industry consist of expense of provision for asset of possible losses, expense for estimated losses of commitment and contingencies, general and administration expense, and promotion expense.

Based on the incomes and revenue share distributed to investor of unrestricted investment fund and discretionary expenses, the real earnings management model for Islamic Bank can be made as follows:

$$CFO_{it}/A_{it-1} = \alpha_0 + \alpha_1(1/A_{it-1}) + \beta_1(OR_{it}/A_{it-1}) + \beta_2(\Delta OR_{it}/A_{it-1}) + \epsilon_{it} \qquad (7)$$

$$RSD_{it}/A_{it-1} = \alpha_0 + \alpha_1(1/A_{it-1}) + \beta_1(OR_{it}/A_{it-1}) + \beta_2(\Delta OR_{it}/A_{it-1}) + \beta_3(\Delta OR_{it-1}/A_{it-1}) + \epsilon_{it.} \qquad (8)$$

$$DE_{it}/A_{it-1} = \alpha_0 + \alpha_1(1/A_{it-1}) + \beta(OR_{it-1}/A_{it-1}) + \epsilon_{it.} \qquad (9)$$

Note:

CFO_{it}/A_{it-1}: Cash flow from operations of bank

i, in the year t, which are scaled with total assets in the year t-1.

$\alpha_1(1/A_{it-1})$: Interception scaled with total assets of bank i, in the year t-1 thus operating cash flow does not have value 0 when operating revenue and lag operating revenue value are 0.

OR_{it}/A_{it-1} : Operating revenue of bank i, in the year t, which are scaled with total assets in the year t-1.

$\Delta OR_{it}/A_{it-1}$: Operating revenue of bank i, in the year t, minus operating revenue of bank i in the year t-1 scaled with total assets in year t-1.

RSD_{it}/A_{t-1} : Revenue sharing distributed for investor of unrestricted investment fund of bank i, in the year t, which is scaled with total assets in the year t-1.

BD_{it}/A_{it-1} : Discretionary expenses of bank i, in the year t, which are scaled with total assets in the year t-1.

α_0 : constant.

ϵ_{it} : error term of bank i, in the year t.

This model of the real earnings management is derived from the real earnings management model in Roychowdhury (2006) and Surifah (2014), adjusted for the Islamic banking industry. The adjustment on Roychowdhury model (2006) is done by replacing the sale items with the operation expenses, the production cost items using revenue sharing distributed (RSD). Besides, the discretionary expenses in Roychowdhury model (2006) consist of R&D expenses, advertisement, administration and general expenses, meanwhile the discretionary expenses in this study consist of the expenses for provision for asset of possible losses, estimated losses of commitment and contingencies, general purpose and administration, and promotion.

There are only few Islamic Banks in Indonesia, therefore the regression estimation in the equation 7, 8, and 9 is used for all the firms in all the observation years. The abnormal values in CFO, operating revenue (OR), and revenue sharing distributed (RSD) are not transformed

into their absolute value like done by Cohen et al. (2008), Gunny (2010), Hashemi and Rabiee (2011), and Roychowdhury (2006).

Cash flow from normal operation normal production cost, and normal discretionary expenses are generated from the regression results. The proxies for REM are the abnormal cash flow of the operation activities, abnormal revenue sharing distributed, and abnormal discretionary expenses. Therefore, the observation of the abnormal cash flow of the operation activities, distributed abnormal revenue share, and abnormal discretionary expenses each year are calculated by dividing the cash flow of the actual operation activities, actual revenue sharing distributed, and actual discretionary expenses, with total assets previous year minus the normal cash flow of the operation activities, normal revenue sharing distributed expenses, and normal discretionary expenses. The normal cash flow of the operation activities, normal revenue sharing distributed expenses, and normal discretionary expenses are calculated by using the estimation coefficient from equations 7, 8, and 9.

In other words, the abnormal CFO, RSD, and DE are the actual CFO, RSD, and DE, deducted by the normal CFO, RSD, and DE. Because the normal CFO, RSD, and DE could not be observed directly, so they are estimated using the actual CFO, RSD, and DE regression to the independent variable in equations 7, 8, and 9. Thus the abnormal CFO, RSD, and DE are the error terms from those three equations. The abnormal CFO, RSD, and DE are the proxies of real earnings management (REM).

Analysis Technique and Research Equation Model

The Mann-Whitney test is used to test hypothesis 1 and hypothesis 2. This technique can be used to observe the difference of two independent data categories from similar population (Siegen & Castellan, 1988). The test is one of the most powerful of the nonparametric tests, and a very useful alternative to the parametric t test when the researcher wishes to avoid the t test's assumptions or when the measurement

Table 2. Descriptive Statistics of Type of Control and Ownership Percentage

Type of Controllers	N	(%)
Family	16	26
Governance	22	36
Institution	18	30
Foreign	5	8
Total N	61	100

Table 3. Descriptive Statistics of Financial Ratios, Size, and Ownership Concentration

Financial Ratios	N	Min.	Max.	Mean.	Std. Dev.
Return on assets	61	-0.059	0.069	0.014	0.018
Return on equity	61	-0.190	0.681	0.163	0.203
Net interest margin	61	-0.009	0.155	0.066	0.032
Operating efficiency ratio	61	0.347	6.077	0.984	0.729
Capital adequacy ratio	61	0.106	5.086	0.442	0.811
Loan deposits ratio	61	0.066	2.986	0.686	0.610
Non-performing loan net	61	0.000	1.083	0.068	0.222
Non-performing loan gross	61	0.000	3.900	0.087	0.497
Assets /size (billion – IDR)	61	161,649	124,754	12,581	20,820
Ownership Concentration (largest)	61	0.28	1.00	0.86	0.25

Table 4. Descriptive Statistics of Real Earnings Management (REM)

The Type of REM	N	Min	Max	Std. Dev.
REM_RSD	61	-0.044	0.068	0.022
REM_DE	61	-0.305	0.955	0.144
REM_CFO	61	-0.036	0.107	0.022

Note:
• REM is calculated by dividing all numerator in the above equations (equation 1 to 9) with total asset of previous year. Therefore the number of REM is small.
• REM_RSD: real earnings management through revenues sharing distribution, REM_DE: real earnings management through discretionary expenses; REM_CFO: real earnings management through cash flow from operation.

used in the study is weaker than interval scaling (Siegel & Castellan, 1988).

Furthermore, we use ordinary least square multiple regression to test hypotheses 3. This technique is commonly used for testing the impact of independent variable on dependent variable. Equation Model is used to test hypothesis 3 are:

$$\text{Profitability} = \alpha + \beta_1 \text{REM\_RSD} + \beta_2 \text{REM\_DE} + \beta_3 \text{REM\_CFO} + \beta_4 \text{OwnConc} + \beta_5 \text{Size} \qquad (10)$$

$$\text{Efficiency} = \alpha + \beta_1 \text{REM\_RSD} + \beta_2 \text{REM\_DE} + \beta_3 \text{REM\_CFO} + \beta_4 \text{OwnConc} + \beta_5 \text{Size} \qquad (11)$$

$$\text{Risk} = \alpha + \beta_1 \text{REM\_RSD} + \beta_2 \text{REM\_DE} + \beta_3 \text{REM\_CFO} + \beta_4 \text{OwnConc} + \beta_5 \text{Size} \qquad (12)$$

Note: REM_RSD: real earnings management through revenues sharing distribution; REM_DE: real earnings management through discretionary expenses; REM_CFO: real earnings management through cash flow from operation; OwnConc: ownership concentration; size: size of bank.

Results and Discussion

Descriptive Statistics

Table 2, 3, and 4 are descriptive statistics of data and variables we use in this study. Table 2 indicates that the Government controls 36% of the Islamic Banks in Indonesia. Private institutions and Family control 30% and 26% of the Banks successively, while foreign institutions only control 8% of them.

Table 3 shows that almost all Islamic banks are controlled by the controller owners, and all of their shares are held by large factions instead in the diffused manner by the general public. The average ownership concentration (OwnCon) is 86%, and this shows that the Islamic banking industry is very concentrated. This is in line with the previous studies which shows

that most Indonesian companies are very concentrated (Prabowo 2010; Sanjaya 2010; Surifah 2014). This result is differ from that of the spreading ownership in US and UK.

Table 4 shows that maximal REM_DE is 0.995 and minimal -0.305. It show that the distance between maximal REM_DE and minimal REM_DE the bigger than the distance between maximal and minimal REM_RSD and REM_CFO. It means that REM_DE more likely to be conceal expropriation than REM_CFO and REM_DE.

Result of H1 test: the Difference of Real Earnings Management among the Various Controller Types

Result on H1 testing shows that real earnings management through revenues sharing distribution, discretionary expense, and cash flow from operation are significantly different among the various bank controller types. The result means that there is a difference of the real earnings management among various controller types. This result is in line with some previous studies that show that controller shareholders are related to earnings management (Atmaja et al., 2011; Ding et al., 2007; Haw et al., 2011; Jiraporn and Dadalt, 2009; Sanjaya, 2011; Siregar & Utama, 2008; Tong, 2008).

The ownership categories with the highest scores in real earnings management (REM) through revenues sharing distribution, ordered from the highest to the lowest, are government controlled banks, private institution controlled banks, family controlled banks, and foreign controlled banks. The ownership categories with the highest scores in REM through discretionary expense, ordered from the highest to the lowest, are government controlled banks, followed by foreign institution controlled banks, private institution controlled banks, and family controlled banks. The ownership categories with the highest scores of REM through cash flow from operation, ordered from the highest to the lowest, are foreign controlled banks, government controlled banks, private institution controlled banks, and family controlled banks.

Real earnings management through reve-nues sharing distribution and discretionary expense show that expenses deviate from normal operational practices, thus the higher the real earnings management through revenues sharing distribution and discretionary expense, the less efficient it would be. On the contrary, real earnings management through cash flow from operations shows great deviation in the cash flow, so the higher the real earning management through cash flow from operation, the better.

The result indicates that Islamic banks controlled by the Indonesian government have the highest revenues sharing distribution and discretionary expense. On the contrary, the banks controlled by foreign investors have the lowest revenues sharing distribution for investors expense, but have the highest operating cash flow. Based on this result, it can be concluded that the foreign banks are the best in earnings management. The family-controlled banks have the lowest real earnings management through discretionary expense and cash flow from operation. This means the discretionary expenses and revenues sharing distribution for investors expenses of the family bank are relatively low compared to the other banks. The family-controlled banks also have the smallest operating cash flow compared to the other banks. The banks controlled by private institution has the second highest score in real earning management through revenues sharing distribution, third rank score in real earnings management through discretionary expense, and third rank score in real earning management through cash flow from operation. This result shows that the private institution controlled banks have the earnings management in the middle position among the other banks.

This study uses the various dimensions of the real earnings management, so it is difficult to determine which is the highest controller types who do opportunistic earnings management. Therefore, scoring needs to be done, so the controller types with the highest real earnings management score can be determined. Scoring is done by giving the score 4 for the controller types with the highest real earning management through revenues sharing distribution and discretionary expense, respectively score 3, 2, and

Table 5. The Test Result of Man Whitney U, the Differences of Real Earnings Management among the Various Bank Controller Types

REM	Controller Types	N	Mean Rank	Sign.	REM Numb	Score	Fam	Gov	Priv	Forg
REM_RSD	Fam	16	25.63		3	2	2			
	Gov.	22	38.45	0.039	1	4		4		
	Priv	18	30.39		2	3			3	
	Forg.	5	17.60		4	1				1
REM_DE	Fam	16	18.94		4	1	1			
	Gov.	22	42.18	0.001	1	4		4		
	Priv	18	27.39		3	2			2	
	Forg.	5	33.40		2	3				3
REM_CFO	Fam	16	22.69		1	4	4			
	Gov.	22	37.41	0.052	3	2		2		
	Priv	18	28.50		2	3			3	
	Forg.	5	38.40		4	1				1
	Sum of REM score:						7	10	8	5

Note: REM: Real earnings management. Fam: Family control; Gov: Government control, Priv: Private institutions control, Forg: Foreigners control. REM_RSD: real earning management from revenues sharing distribution; REM_DE: real earnings management form discretionary expense; REM_CFO: real earnings management through cash flow from operation.

1 for the lowest. On the contrary, the researcher will give score 4 for the lowest real earning management through cash flow from operation score of the controller types, and respectively score 3, 2, and 1 for the highest real earning management through cash flow from operation.

Table 5 shows the differences of real earnings management among the various bank controller types. Based on the scores of the various real earning management dimensions, we can conclude that the highest score of the real earnings management is achieved by the banks controlled by Indonesia government, while the lowest is achieved by the banks controlled by foreigners. Real earning management bank controlled by family is not significantly different from the bank controlled by government.

Why do government controlled Islamic banks seem to be the highest expropriator through real earnings management? Technically, the owners of a government-owned bank are the populace. The populaces like in the spreading share ownership are the powerless party because person per person cannot control the company. The management party, direction, and the commissioner board can expropriate, such as by determining the high salaries, bonuses, and fund distribution facility to the family or persons in their group. There had been the regulation of the maximum limit of the credit giving to the related party (Bank Indonesia, 2005), but did not regulate in detail until to what degree of blood relative relation or relation by marriage,

might also be political relation. On the contrary, the banks controlled by foreigners have the low real earnings management score; it might be because the tighter professionalism demand, better corporate governance, sophisticated technology, and better mechanism control. This result is in line with the previous studies that showed that Controllers type is associated with incentive to expropriation (Fayoumi, Abuzayed, & Alexander, 2010; Palenzuela & Mariscal, 2007) and it would be associated with higher misuse of reporting discretion and lower earnings informativeness (Fan & Wong, 2002). The controller types are significant and positively affect earnings management (Fayoumi et al., 2010).

Result of H2 test: the Performance Difference among the Various Controller Types of Islamic Bank

This study uses the various dimensions of the performance, so it is difficult to determine which is the highest controller types who have performance. Therefore, scoring needs to be done, so the controller types with the highest performance score can be determined.

Scoring is done by giving the score 4 for the controller types with the highest ROA, ROE, NIM, CAR, and ETA, respectively score 3, 2, and 1 for the lowest. On the contrary, the researcher will give score 4 for the lowest OER, LDR, NPLG, and NPLN score of the controller types, and respectively score 3, 2, and 1 for the

Table 6. The Test Result of Man Whitney U; the Difference of Performance among the Various Bank Controller Types and the Scoring

Perf.	Controller Types	N	Mean Rank	Sign.	Numb of Perf.	Scor	Fam	Gov	Priv	Forg
Profitability Dimension:										
ROA	Fam	16	24.69	0.015	4	1	1			
	Gov.	22	27.16		3	2		2		
	Priv	18	35.86		2	3			3	
	Forg.	5	50.6		1	4				4
ROE	Fam	16	19.31	0.004	4	1	1			
	Gov.	22	32.09		2	3		2		
	Priv	18	41.22		1	4			4	
	Forg.	5	26.8		3	2				3
NIM	Fam	16	23.25	0.09	4	1	1			
	Gov.	22	37.05		1	4		4		
	Priv	18	32.44		2	3			3	
	Forg.	5	24		3	2				2
					Sum of Profitability Score:		3	8	10	9
Efficiency Dimension:										
OER	Fam	16	36.56	0.035	4	1	1			
	Gov.	22	31.86		3	2		2		
	Priv	18	30.83		2	3			3	
	Forg.	5	10		1	4				4
					Sum of Efficiency Score:		1	2	3	4
Risk Dimension:										
CAR	Fam	16	45.88	0	2	3	3			
	Gov.	22	27.91		3	2		2		
	Priv	18	17.06		4	1			1	
	Forg.	5	47.2		1	4				4
LDR	Fam	16	34.31	0.029	2	3	3			
	Gov.	22	36.05		4	1		1		
	Priv	18	20.5		1	4			4	
	Forg.	5	36		3	2				2
ETA	Fam	16	47.31	0	1	4	4			
	Gov.	22	25.64		3	2		2		
	Priv	18	19.11		4	1			1	
	Forg.	5	45.2		2	3				3
NPLG	Fam	16	17.19	0	1	4	4			
	Gov.	22	41.8		4	1		1		
	Priv	18	31.39		3	2			2	
	Forg.	5	26.3		2	3				3
NPLN	Fam	16	20.28	0.005	2	3	3			
	Gov.	22	34.68		3	2		2		
	Priv	18	39.28		4	1			1	
	Forg.	5	19.3		1	4				4
					Sum of Risk Score		17	8	9	16
					Sum of Performance Score:		**21**	**18**	**22**	**29**

Note: Perf: performance. N: number of samples. Fam: Family control; Gov: Government control, Priv: Private institutions control, Forg: Foreigners control. ROA: return on assets. ROE: return on equity. NIM: net interest margin. OER: operational efficiency ratio. CAR: capital adequacy ratio. LDR: loan deposit ratio. ETA: equity to total assets. NPLG: non performing loan_gross. NPLN: non performing loan_net.

highest OER, LDR, NPLG, and NPLN.

Table 6 indicates that the highest score of profitability respectively is private institution controlled banks, followed by foreign controlled banks, government controlled banks, and family controlled banks. The highest score of efficiency respectively is foreign controlled banks, followed by private institution controlled banks, government controlled banks, and family controlled banks. The highest score of risk respectively is family controlled banks, followed by foreign controlled banks, private institution controlled banks, and government controlled banks.

Based on the score value of the various performance dimensions, it can be concluded that that the bank with the highest performance is the bank controlled by foreigners. On the contrary

Table 7. The Test Result of The effect of Real Earnings Management on Profitability

Variable	Exp. Sign.	Regression Coef.	t values	Sig.
Constant)		-10.551	-4.411	0.000***
REM_RSD	-	0.140	0.027	0.979
REM_DE	-	-2.064	-2.775	0.008***
REM_CFO	+	12.202	2.191	0.033**
OwnCon		0.875	1.816	0.075***
Lg_Assets		0.773	4.440	0.000***
F value	7.121			
Significancy	0.000			
R²	0.393			
Adjusted R²	0.338			
N	60			

Note:*, **, *** Indicate significance at the 10, 5, and 1 percent levels, respectively. REM_RSD: real earnings management from revenues sharing distribution; REM_DE: real earnings management through discretionary expense; REM_CFO: real earnings management through cash flow from operation. OwnCon: ownership concentration. Lg_assets: log of total assets.

the bank with the lowest performance score is the bank controlled by Indonesian Government. The score difference between Indonesian Government Bank and foreign banks is very high, meanwhile the score difference between the family banks and private institutions banks is very low. This study result is in line with the previous study, which found that there was the performance difference among the different controller shareholders (Achmad et al., 2009).

This result indicates that there is expropriation risk through the real earnings management related with the banks' low performance. This study result is in line with the previous study which found that the high expropriation risks was related to the low performance and firm value (Claessens, Djankov, & Lang, 2000; La Porta, et al., 2002; Zhu & Ma 2009).

Result of H3 test: the Effect of the Real Earnings Management on Performance

Hypothesis 3 tests the effect of the real earnings management on performance, which is measured by the various financial ratios. Therefore the factor analysis needs to be done to summarize or reduce the variables. The factor analysis results become 3 variables that are named profitability (profit), efficiency, and risk. Profitability variable comes from the variables ROA, ROE and NIM. The efficiency variable comes from OER, meanwhile the risk variable comes from NPLG. Not all variables can be summarized.

The Effect of the Real Earnings Management on Profitability

Table 7 shows that the real earnings management through RSD expenses does not affect the profitability level. This result is not in accordance with the prediction. The real earnings management through the discretionary expenses influences negatively and significantly the profitability. This result means that the higher the earnings management through discretionary expenses, the lower the profitability level of Islamic bank. This result is in accordance with the prediction.

The earnings management through the operation cash flow influences positively the profitability. It means that the higher the departures from normal operational practices of the positive operation cash flow are, the lower the banks' profitability level. The operation cash flow is the main source of the banks' operational, so the greater the cash flow of the banks' operation is, the business opportunities catching will be more free, and the greater the fund that can be distributed to the customers is, therefore the greater the profitability is. This result is also in accordance with the prediction.

Why didn't real earning management through revenues sharing distribution (RSD) expenses influence the profitability? It might be because the greatness of RSD expenses in the certain range was relatively determined by government, so the management party or the controller owners were difficult in taking the pri-

Table 8. The Test Result of The effect of Real Earnings Management on Efficiency

Variable	Exp. Sign.	Regression Coef.	t-value	Sig
(Constant)		9.691	6.219	0.000***
REM_RSD	+	8.733	2.451	0.018**
REM_DE	+	11.808	22.608	0.000***
REM_CFO	-	-1.049	-0.293	0.770
OwnCon		-0.536	-1.632	0.109
Lg_Aset		-0.655	-5.771	0.000***
F value	110.56			
Sign.	0.000			
R²	0.914			
Adjusted R²	0.906			
N	59			

Note:*, **, *** Indicate significance at the 10, 5, and 1 percent levels, respectively. REM_RSD: real earnings management from revenues sharing distribution; REM_DE: real earnings management through discretionary expense; REM_CFO: real earnings management through cash flow from operation. OwnCon: ownership concentration. Lg_assets: log of total assets.

Table 9. The Test Result of The effect of Real Earnings Management on Risk

Variable	Exp. Sign.	Regression Coef.	t-value	Sig.
C		-0.080	-2.053	0.045
REM_RSD	+	0.019	0.221	0.826
REM_DE	+	0.063	5.255	0.000***
REM_CFO	_	0.081	0.905	0.370
OwnCon		-0.006	-0.799	0.428
Lg_Aset		0.009	3.042	0.004***
F value	8.351			
Sign.	0.000			
R²	0.436			
Adjusted R²	0.384			
N	60			

Note:*, **, *** Indicate significance at the 10, 5, and 1 percent levels, respectively. REM_RSD: real earnings management from revenues sharing distribution; REM_DE: real earnings management through discretionary expense; REM_CFO: real earnings management through cash flow from operation. OwnCon: ownership concentration. Lg_assets: log of total assets.

vate benefits through real earning management from revenues sharing distribution. Therefore, real earning management the expenses of revenues sharing distribution does not influence the performance.

The Influence of the *Real Earnings Management* toward Efficiency

Table 8 shows that the earnings management through the revenues sharing distribution and discretionary expenses influences positively the efficiency, in accordance with the prediction. This result means that the greater real earning management from revenues sharing distribution and real earning management from discretionary expenses are, the greater OER (the operational cost per operational income) is or less efficient. REM through the operation cash flow does not influence efficiency. The control variable of ownership concentration does not

influence efficiency; meanwhile the company size influences negatively the efficiency. This result means that the greater Islamic Bank is, it will be more efficient.

The Effect of the *Real Earnings Management* On the Risk Level

Table 9 shows that the earnings management through discretionary expenses influences the risk level positively. This result is in accordance with the prediction. It means that the greater real earnings management from revenues sharing distribution, the higher NPLG or it is riskier. Real earnings management from revenues sharing distribution and real earnings management through cash flow from operation do not influence the risk level.

The control variable of ownership concentration does not influence the risk level, mean while the size of Islamic bank influences the

risk positively. This result means that the greater the bank size is, the greater NPLG is, so it will be riskier.

Based on the table 7 through 9, it can be concluded that the REM negatively affect the performance of Islamic banks in Indonesia. The REM through discretionary expenses negatively affect profitability. The earnings management through the expenses of revenues sharing distribution and discretionary expenses positively affect the OER (operational cost per operational income) is or it can be stated that it operates less efficient. The earnings management through discretionary expenses positively influences the risk level. These results are in line with previous study which states that when companies change the timing and structure of real business transactions, they deviate from normal operating practices, optimal planning and disturb the real cost of the company (Ewert & Wagenhofer, 2005). The manager will manipulate real activities to meet the earnings targets, even though it will lower the company value in the long term (Graham et al., 2005). Manipulation operating activities such as R&D, production, and capital investment leads to deviation from normal business practices and potentially degrade the performance in subsequent years. Manipulation of real activity can reduce the long-term profitability (Roychowdhury, 2006).

Conclusion

This study provides evidence that the earnings management model based on the real activities of an Islamic bank can be used to detect expropriation by controller owners. This is supported by empirical evidence, where the banks coring high in real earnings management has among the lowest performance score. The opposite is also true; the bank with the lowest score of the real earnings management has the highest performance.

This study finds evidence that there are differences of REM and performance in the various types of banks' controllers. Islamic Bank controlled by Indonesian Government has the highest REM score and the lowest performance. On the contrary, the banks controlled

by foreigners have the lowest REM score and the highest performance score. This result indicates that there is expropriation risk through the real earnings management related with the low Islamic Bank performance. REM and banks' performance controlled by family are not significantly different from the private institutions.

This study also finds that the real earnings management through discretionary expenses influences negatively and significantly the profitability. The higher the earnings management through discretionary expenses, the lower the profitability level of Islamic bank. The earnings management through the operation cash flow influences positively the profitability. It means the higher the earnings management through the operation cash flow, the higher the banks' profitability. The earnings management through the revenues sharing distributed expenses and discretionary expenses influences positively the efficiency. This result means that the greater the earnings management through the revenues sharing distributed expenses and discretionary expenses is, the greater the operational expenses per operational income are or less efficient. The earnings management through discretionary expenses influences positively the risk level. It means that the greater the earnings management through discretionary expenses is, the higher the non performing loan, thus it is riskier.

This study result can be applied by practitioners to detect the expropriation indication in Islamic Bank. Expropriation indication can be seen from the real earnings management through the expenses of the revenues sharing distributed, discretionary expenses, and operation cash flow. Based on the study findings the researchers recommended to policy makers to restrict REM and specify the rules and guidelines about corporate governance for Islamic banking.

Limitations of this study are 1) sample size is rather small, because the number of Islamic banks in Indonesia is still limited. Therefore, further study could include more data, for example: bank in Asia regional level or in world level. 2) This study only examine the expropriation indications of Islamic bank through

REM, further study can examine the expropriation indication in the Islamic bank through discretionary accruals or loan loss provision. 3) This study combines various types of revenue in Islamic banks such as *murabahah* margin income, parallel *salam* net income, and *istishna'* income into the one name of the operating revenue. Therefore, further study could test the REM on each item of income and expenses.

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