

Is the Covid-19 Pandemic Affecting Income Quality?

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ABSTRACT

This study aims to empirically examine the impact of the COVID-19 pandemic on the quality of earnings reported by companies in the restaurant, hotel, and tourism sub-sector in Indonesia. This research is quantitative research with the data analysis technique of paired sample t-test. The research period is before and during the COVID-19 pandemic, namely 2019-2020. Earnings quality in this study is operationalized by discretionary accruals calculated using the model of Kothari et al. (2015). This study reveals no significant difference in earnings quality between before and during the COVID-19 pandemic. However, the mean earnings quality before the Covid-19 pandemic was higher than during the Covid-19 pandemic. This research contributes to providing empirical evidence on earnings quality during crises such as the COVID-19 pandemic. The results of this study also contribute practically to regulators in formulating policies related to financial statements during situations.

Keyword : Covid-19 Pandemic, Earnings Quality, Hotel, Indonesia, Restaurant, Tourism

1. INTRODUCTION

In December 2019, a new type of virus was confirmed to have spread in Wuhan, Hubei Province, China, called coronavirus 2, and the disease caused by the virus is called coronavirus disease 2019 (COVID-19) Zu et al (2020). The virus then spread throughout the world, so that the World Health Organization (WHO) declared that a COVID-19 pandemic had occurred. This situation has forced some countries to take a lockdown policy by limiting people's activities outside the home. The results showed that the lockdown policies adopted by some countries significantly suppressed the spread of the COVID-19 virus Bonardi et al (2020); Lau et al (2020); Pachetti et al (2020). However, other researches results reveal that the lockdown policy has hurt the economy Atalan (2020); Ozili & Arun (2020); Susilawati et al (2020).

The economic sector that has most negatively impacted the COVID-19 pandemic is the restaurant, hotel, and tourism industry Faber et al (2020); Jiang & Wen (2020); Muzakki (2020). The initial impact felt by the restaurant, hotel, and tourism industries was a decrease in cash flow due to the closure of business activities due to the lockdown policy Hall et al (2020). This situation

resulted in a significant drop in revenues and destroyed long-standing supply chains Nicola et al (2020). The long-term impact of the COVID-19 pandemic situation for restaurants, hotels, and tourism is decreased consumer demand due to changes in future needs related to health protocols. In addition, the decrease in operating capacity due to the social distancing rules that have been imposed has resulted in a reduction of long-term profitability and threatens business continuity Filimonau et al (2020); Gössling et al (2021).

The economic turbulence situation faced due to the COVID-19 pandemic and current market uncertainty affect investor confidence in the company's financial performance KPMG (2020). During the Covid-19 pandemic, many companies, including hotels, were forced to go out of business or even manipulate reported earnings to maintain investor confidence and fulfill debt agreements with creditors Albitar et al (2020). This statement is also expressed by Ayers et al. (2006) and Filip & Raffournier (2014) that when there is a dramatic change in the economic climate, companies are motivated to manipulate earnings by increasing profits to avoid reporting losses, declining profits, or negative earnings

surprises. This situation requires auditors to increase analytical procedures to improve audit quality to detect misstatements or fraud Rose et al (2020). On the other hand, social restrictions during the COVID-19 pandemic forced auditors to carry out their work in a different way than before, such as via virtual meetings and email, which added costs and time KPMG (2020).

Albitar et al. (2020) concluded that the COVID-19 pandemic impacted audit quality. Meanwhile, audit quality determines the quality of earnings reported by the company because the better the audit quality, the smaller the earnings management by the company, and the quality of earnings will increase Becker et al (1998); ElMoatasem Abdelghany (2005); Lo (2008). Persakis & Iatridis (2015a, 2015b) reveal that the financial crisis that occurred in 2008 impacted audit quality and earnings quality. Another study by Filip & Raffournier (2014) showed that earnings management declined significantly during the financial crisis in 2008-2009 due to high market tolerance for poor economic performance at that time. However, Susak (2020) reveals that delays in submitting financial reporting due to the COVID-19 pandemic can be associated with earnings management activities. Companies may transfer profits from the previous period to when the current financial performance declines.

Based on the description of the phenomenon and the results of previous research studies, this study focuses on analyzing the impact of the COVID-19 pandemic on the quality of company profits, especially for companies engaged in the restaurant, hotel, and tourism sectors which are quite affected by the current pandemic situation. This research was conducted in Indonesia, considering that Indonesia is one of the world's tourist destinations. According to Susilawati et al. (2020), one of the economic sectors that have been significantly affected by the COVID-19 pandemic in Indonesia is the restaurant, tourism, and hospitality sector. In addition, data from the Ministry of Finance of the Republic of Indonesia shows that the COVID-19 pandemic resulted in Indonesia's economic growth being minus 3.49% in the third quarter of 2020.

On the other hand, empirical evidence related to this issue is still rare. Therefore, this study aims to analyze the impact of the COVID-19 pandemic on the profit quality of the hotel, restaurant, and tourism companies in Indonesia.

2. RESEARCH METHOD

This research is verification research using quantitative data. This research data is secondary data in financial statement data of restaurant, hotel, and tourism companies listed on the Indonesia Stock Exchange. The research period covers 2019 (before the COVID-19 pandemic) and 2020 (during the COVID-19 pandemic). The research data analysis method is the paired sample t-test which aims to test whether there is a significant difference between earnings quality before the COVID-19 pandemic and during the COVID-19 pandemic.

Earnings quality in this study is proxied by the value of discretionary accruals, where discretionary accruals reflect the low quality of earnings. This is due to the modification of the numbers in the financial statements by management to manipulate profit figures. Discretionary accruals in this study were calculated using the Kothari et al (2005) model, which is a refinement of the Jones model modified by Dechow et al. (1995). According to Kothari et al. (2005), including the element of return on assets (ROA) in the calculation of discretionary accruals will minimize specification errors so that they will be able to measure earnings management more accurately. In addition, the use of the discretionary accrual model can provide additional control over the earnings management proxy, namely ROA, so that it has a more substantial predictive power..

3. RESULTS AND DISCUSSION

Table 1 below shows that the average discretionary accruals in the period before the COVID-19 pandemic occurred, namely in 2019, was 0.2658. This figure is higher than the average discretionary accruals in the period when the COVID-19 pandemic occurred, namely 2020, which was 0.2975. Meanwhile, the standard deviation value shows that the diversity of discretionary accruals is greater during the

COVID-19 pandemic than before the COVID-19 pandemic. Table 1 below also indicates a difference in the average discretionary accruals before and during the COVID-19 pandemic, 0.03167.

This result means that earnings quality during the COVID-19 pandemic is worse than before the COVID-19 pandemic. These results align with the findings Aljawaheri et al (2021); Jordan et al., (2021); Usheva & Vagner (2021); Xiao & Xi (2021). However, Table 1 below shows no significant difference between the average discretionary accruals before the COVID-19 pandemic and during the COVID-19 pandemic. These results mean no significant difference in quality between the period before and during the COVID-19 pandemic.

The results of this study reveal that there is no significant difference between earnings quality before the COVID-19 pandemic and during the COVID-19 pandemic. However, the results of this study indicate that the quality of earnings before the COVID-19 pandemic is higher than the quality of earnings during the COVID-19 pandemic. These results mean that crises such as the COVID-19 pandemic can motivate management to lower earnings quality to show good financial performance to investors, creditors, and other stakeholders.

According to Susak (2020), regulatory changes related to the deadline for submitting financial reports due to the COVID-19 pandemic provide opportunities for company management in Croatia to carry out earnings management. Meanwhile, Xiao & Xi (2021) revealed that companies in China that experience financial difficulties during crises such as the COVID-19 pandemic are more likely to adopt earnings management techniques to avoid government supervision. Jordan et al. (2021) stated that when the company's performance weakens, management will message stakeholders that they are making improvements through manipulating profit figures. In addition, Aljawaheri et al. (2021) reveal that companies tend to manipulate earnings to minimize profit fluctuations to obtain positive perceptions from investors regarding the company's financial performance. According to

Usheva & Vagner (2021), earnings management is a tool to prevent bankruptcy during the COVID-19 pandemic. The results of this study also verify positive accounting theory. Based on the debt hypothesis, the demand for debt covenants motivates management to manipulate financial statements. In the COVID-19 pandemic situation, many companies are at credit risk. As a result, they are compelled to manipulate financial statements to prevent companies from going bankrupt. Therefore, the crisis of the COVID-19 pandemic opens up opportunities for management to reduce earnings quality.

Meanwhile, the lockdown policy due to the COVID-19 pandemic has restricted auditors from examining financial statements when the policy is in effect, such as not doing fieldwork. This condition results in a decrease in audit quality, which impacts not detecting material misstatements in the audited financial statements (Albitar et al., 2020). As a result, the quality of reported earnings is low.

4. CONCLUSION

This study indicates no significant difference between the earnings quality of the hotel, restaurant, and tourism sub-sector companies before the COVID-19 pandemic and during the COVID-19 pandemic. However, this study found that the average profit quality of the hotel, restaurant, and tourism sub-sector companies decreased during the COVID-19 pandemic. This result means that the COVID-19 pandemic has adversely affected the quality of financial reporting. Management tends to be motivated to carry out earnings management to show good company performance even in a crisis. This study has several limitations, so readers must interpret the results with caution. First, the research sample is relatively small because most of the financial report data for 2020 was not yet available. Second, this study does not consider other factors that can affect earnings quality but only focuses on the financial statements period. Therefore, further research is expected to expand the research period and consider other factors that also affect the quality of earnings during the COVID-19 pandemic, such as investor protection

or government policies in dealing with the pandemic situation.

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