

The Impact of Leverage on Real Earnings Management: Evidence from Listed Manufacturing Companies in Colombo Stock Exchange

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Abstract

The amount of money that company has earned during a given period, usually a quarter or year, as reported based on appropriate accounting standards. Accounting earnings help to quantify the company's profitability, but investors should consider not just earnings quantity, but also earnings quality, in evaluating a company's accounting earnings. For recent years studies were done with regard to the accruals earnings management. Due to the high scrutiny of the lenders and the tendency to detect by the auditors, concepts have been changed to make economic sacrifices rather than manipulating accounting figures, by managing earnings through real activities such as practices that are less likely to draw auditor or regulatory scrutiny. The primary aim of this study is to examine the impact of Leverage on Real Earnings Management activities. The study was conducted using the sample of twenty five manufacturing companies' listed in Colombo Stock Exchange with a firm-quarter observations for the period of 2009/2010 to 2014/2015 using a panel data analysis. The analysis is done based on the model developed by Roy Chowdhury in 2006. The results indicated that manufacturing companies are having abnormal cash flows and production cost in their operations and there is a significant positive association between the leverage and the real earnings management in the manufacturing companies listed in Colombo Stock Exchange, Which in turn could effects the earnings quality of the companies.

Key Words: *Abnormal Cash Flows from Operations, Abnormal Production Costs, Abnormal Discretionary Expenses, Accruals, Earnings Management, Colombo Stock Exchange, Real Earnings Management*