

## **The Impact of Leverage on Real Earnings Management: Evidence from the Manufacturing Sector Companies in Sri Lanka**

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The amount of money a 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. Despite that fact, management has some autonomy in deciding what financial information will be made available and when it will be released. Considering about the earnings this provides an incentive to managers to determine earnings in different time periods. 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 study the association between Leverage and Real Earnings Management activities. It hypothesized that there is an inverse association between Leverage and Real Earnings Management. Although the several researches have been done with earning management, it is hard to find the effect of Leverage on Real Earnings Management in Sri Lankan context. This study uses Abnormal Cash Flow from operation, Abnormal Production Cost, and Abnormal Discretionary Expenses model developed by Roy Chowdhury, 2006 as proxy for Real Earnings Management. Research was conducted using the sample of twenty five firm-quarter observations of the manufacturing companies listed in Colombo Stock Exchange, for the period of 2009/2010 to 2014/2015 using a panel data analysis. In accordance with the hypothesis developed it is anticipated that the Leverage will have inverse association with Real Earnings Management. Consequently it will be observed that,

manufacturing companies listed in CSE are manipulating activities via real earnings management.

**Keywords:** *Accruals Earnings Management, Real Earnings Management, Abnormal Cash Flows from Operations, Abnormal Production Costs, Abnormal Discretionary Expenses*