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EARNING MAHAGEMENT FROM THE PERSPECTIVE OF INSAN KAMIL

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ABSTRACT

This article aims to analyze earnings management actions from the perspective of Insan Kamil, characterized as an ideal and perfect human figure. In the portrayal of Insan Kamil, there exist strength, insight, deeds, and wisdom. The interpretative method is employed to analyze earnings management actions ontologically, epistemologically, and axiologically. From an ontological standpoint, earnings management is regarded as a science that can be observed and measured based on empirical evidence. In the epistemological context, Insan Kamil is considered to have a profound understanding of ethical and moral values, such as honesty, integrity, transparency, and adherence to professional ethical standards. Earnings management practices involving manipulation or concealment of information are viewed as violations of these values. Axiologically, earnings management actions may be considered as a potential failure to align rationality with moral values, unless such practices do not violate principles of morality and ethics.

Keywords: *Earning Management, Insan Kamil, Ontological, Epistemological, Axiological*

ABSTRAK

Artikel ini bertujuan untuk menganalisis tindakan manajemen laba dari sudut pandang Insan Kamil, yang dicirikan sebagai tokoh manusia ideal dan sempurna. Dalam penggambaran Insan Kamil, terdapat kekuatan, wawasan, perbuatan, dan kebijaksanaan. Metode interpretatif digunakan untuk menganalisis tindakan manajemen laba secara ontologis, epistemologis, dan aksiologis. Dari sudut pandang ontologis, manajemen laba dianggap sebagai ilmu yang dapat diamati dan diukur berdasarkan bukti empiris. Dalam konteks epistemologis, Insan Kamil dianggap memiliki pemahaman mendalam tentang nilai-nilai etika dan moral, seperti kejujuran, integritas, transparansi, dan ketaatan terhadap standar etika profesional. Praktik manajemen laba yang melibatkan manipulasi atau menyembunyian informasi dianggap sebagai pelanggaran terhadap nilai-nilai ini. Secara aksiologis, tindakan manajemen laba dapat dianggap sebagai kegagalan potensial untuk menyalurkan rasionalitas dengan nilai-nilai moral, kecuali praktik tersebut tidak melanggar prinsip-prinsip moral dan etika.

Kata Kunci: *Manajemen Laba, Insan Kamil, Ontologis, Epistemologis, Aksiologis*



Introduction

These days, there is an increasing number of actions taken by a business entity or company to enhance its performance image in the eyes of the public. In fact, this is a common practice that has been carried out for many years. Companies listed on the stock exchange have an obligation to present their annual performance reports to all interested parties or stakeholders. Stakeholders will view, scrutinize, and analyze the company's financial statements to assist them in making financial decisions. A financial report is highly valuable to stakeholders; therefore, the figures in it should ideally reflect the true condition of a company. The practice of earnings management that has evolved over the past few decades, carried out by company management, is a strategy used to manipulate the figures in the company's financial statements to generate positive financial performance information regarding their business activities and financial position. Internal and external pressures on the company make management eager to meet profit expectations, leading them to engage in earnings management practices more than ever before. An effective earnings management strategy can create a misleading view of the company's financial performance in the long run. (Beneish, 2001) mentions that earnings management can be viewed from two different perspectives: opportunistic earnings management and informative earnings management. Opportunistic earnings management aims to mislead investors, while informative earnings management seeks to manipulate information to present a positive image of the organization. Therefore, it is challenging to draw conclusive conclusions about earnings management because it has been interpreted differently in previous research depending on the context (Callao et al., 2014). Financial scandals and the collapse of reputable companies due to financial reporting fraud have made earnings management a central issue for stakeholders who still heavily rely on accounting information (Callao et al., 2014). Practices like these are misleading and report inaccurate results to users. Therefore, in organizations that implement earnings management, organizational ethics are questionable.

Actions of earnings management that impact short-term financial reports often do not provide true economic benefits to the company. Such practices can harm the company in the long run, as noted by (Merchant & Rockness, 1994). A survey by (Bruns & Merchant, 1990) among Harvard Business Review readers revealed that actions related to short-term income could be a source of misinterpretation, manipulation, or deliberate fraud. With financial scandals such as Enron and WorldCom in 2001, business ethics gained global attention (Giacomino et al., 2006). Company failures are not only caused by accounting and auditing issues but also by personal factors such as integrity and ethics. Individuals with poor ethical values can sometimes trigger significant losses for a company.

Ethics is related to making good and moral decisions. In the concept of ethics, there is consideration of what should and should not be done, what is obligatory and not obligatory, and what one should or should not become. Adam Smith, an English moral philosopher, spoke about ethics as a way of life for corporate gain. According to the Ethics Resource Center, Washington DC, companies dedicated to doing the right thing, with a written commitment to social responsibility, consistently act in a way that is more profitable than those that do not. If a company acts ethically and responsibly, it may not make us rich and successful immediately, but it will undoubtedly pave the best way for success. Ethics + competence = success is the winning equation. It is the ethics equation for corporate gain. On the other hand, companies that continuously strive to test ethical excellence will inevitably exceed limits. Shortcuts, fraud, and unethical practices test ethical excellence and never yield long-term results. In the long run, society and organizations always suffer if they live without ethics and moral principles.

Despite various initiatives, many countries, including highly religious ones, still face significant challenges in overcoming corruption and ethical issues. The accounting profession, in some countries, has shown unethical behavior in several cases (Liyanapathirana, 2021). (Goel & Misra, 2020) attribute this unethical behavior to a lack of ethics in the decision-making process. This ongoing criticism has prompted ethics research to investigate factors influencing the decision-making of professionals, including accountants. Although many factors influence ethical decision-making, a comprehensive understanding of what drives ethical decision-making by accountants is still incomplete (Liyanapathirana, 2021). Ethical decision-making is an "individual struggle." Individuals, including accountants, are influenced by the culture around them, including religion and corruption. However, it is important to note that business ethics vary depending on the country, culture, and tradition (Ananthram & Chan, 2016).

Religion provides an ethical foundation for individuals. (Dobrin, 2004) provides a comprehensive definition of religion as a "set of beliefs and/or institutions." Reviewing existing literature, the relationship between religiosity and ethical decision-making has been explored in various contexts but has yielded diverse results.

The concept of "insan kamil" is an important concept in Sufism. Sufism is an Islamic movement that teaches the purification of the soul, the clarification of morals, the development of the physical and spiritual aspects, and the attainment of eternal happiness. Sufism emphasizes spiritual experience, introspection, and a deep search for the Almighty. Muhammad Iqbal, a Muslim philosopher from Pakistan, introduced the concept of "insan kamil." In Iqbal's view, "insan kamil" is a believer who possesses strength, insight, deeds, and wisdom within. "Insan kamil" is someone with high moral and spiritual qualities, known

for attributes such as love, compassion, humility, wisdom, and justice. They are also believed to have a deep understanding of the essence of existence and the essence of Allah. These noble qualities are manifested at their highest level in the character of Prophet Muhammad.

This article aims to analyze the concept of earnings management from the perspective of "insan kamil." It is motivated by the numerous major financial scandals in business and finance history, leading to ethical and moral questions related to earnings management practices, such as how companies report profits, conceal losses, or manage financial information. This article analyzes the concept of earnings management from the perspective of "insan kamil" by Muhammad Iqbal based on the ontological, epistemological, and axiological aspects.

Religion plays a role in guiding individuals in determining what is right and wrong. A comprehensive definition of religion by (Dobrin, 2004) describes religion as "a set of beliefs and/or institutions, behaviors, and emotions that bind humans to something beyond themselves and cultivate humility and gratitude within its followers. Religion performs three main functions: (1) providing an understanding of ultimate truth; (2) offering a method of becoming spiritual; and (3) providing moral guidance. Incentive-based ethical theories, as expressed by (Ananthram & Chan, 2016), state that desired character traits (referred to as incentives) can be instilled in individuals to facilitate ethical decision-making. Ethical virtues are defined as "core beliefs inherent in and intrinsic to individual behavior." Virtues reflect values, traditions, and cultural narratives in the communities where they arise. Ethical decision-making is interpreted as a psychological process involving four steps: awareness, judgment, intention, and behavior. Three types of outcomes related to ethical decision-making are unethical behavior, routine ethical behavior, and extraordinary ethical behavior.

Insan Kamil (*Perfect Human*)

"Khudi" is a Persian word, a diminutive form of the word "khuda," meaning God; literally, khudi means selfhood translated as ego, self as an individual or individuality. In Iqbal's thought, derived from Abdul Wahhab Azzam's quote, the concept of "khudi" is an enlightening point of consciousness that illuminates the thoughts, feelings, and desires of humans in a mysterious way, organizing various unlimited potentials inherent in human nature. This is called khudi, the ego, or the mind, which is clearly visible in human actions but remains a hidden reality. Thus, the essence of human life is the individual (khudi). From a metaphysical perspective, Iqbal expresses that the term "ego" refers to an entity that cannot be defined with the word "I," which is the root of the uniqueness inherent in each individual. In the ethical context, the word "ego" refers to self-belief, self-esteem, autonomy, self-preservation efforts, self-confidence, and self-affirmation. The ethical view of this ego

forms the basis of the concept of insan kamil according to Iqbal, as Iqbal believes that through self-realization, one can improve their personal morality and move towards the greatness bestowed by God. Muhammad Iqbal's thoughts on Insan Kamil are:

1. Insan Kamil is an ideal human, a truly perfect human being.
2. Insan Kamil according to Iqbal is none other than the true believer, who possesses strength, insight, deeds, and wisdom. These noble qualities are most clearly reflected in the character of the Prophet Muhammad.
3. Insan Kamil, in Iqbal's view, is a true believer who is a moral being, endowed with spiritual and religious abilities. To cultivate strength within themselves, true believers constantly absorb and internalize divine morality.

Earnings Management

Earnings management is a practice that has existed in the business world for years. It involves managerial actions in financial reporting and transaction structuring to modify financial reports with the aim of deceiving some stakeholders about the economic performance of the company or influencing contracts that depend on reported accounting figures (Healy et al., 1998). Although (Barton et al., 2010) acknowledges that there are common and legitimate forms of earnings management that do not violate GAAP, there is still ambiguity in determining when earnings management is considered ethical or unethical.

Unethical earnings management involves concealing actual operational performance through the creation of false accounting entries or broad estimates beyond reasonable limits. Conversely, ethical earnings management involves reasonable actions, is a proper practice, and is part of running a well-managed business while providing value to shareholders. It is a sign of skills and excellence sought and valued by the market, as noted by (Barton et al., 2010).

In many companies, the focus on short-term profits often seems to overshadow concerns for ethical values (Verschoor & Murphy, 2002). Companies employ various methods, including "big bath" costs and upholding materiality principles and revenue recognition, to influence income results. Discretionary spending allowed by GAAP can also be used by managers to increase or decrease earnings by a certain percentage (Durfee, 2006). Such practices can reduce the quality of earnings and financial reporting and mislead financial statement users.

Managers have various ways to manage earnings, including in the selection of accounting policies, assessments, timing, or operational decisions. (Belkaoui, 2005) also argues that earnings management aims to influence short-term stock performance and produce profit reports in line with Wall Street expectations rather than reflecting financial reality.

Earnings management activities can be based on accounting methods or operational methods. For example, in accounting methods, managers may unreasonably adjust reserve amounts to influence earnings. On the other hand, when a manager arranges future discretionary spending to increase current earnings, this can be considered an example of operationally based earnings management (Kaplan, 2001). Any form of earnings management is deemed unethical if its purpose is to deliberately provide a false representation of the entity's financial position with the goal of enhancing managerial compensation. However, (Barton et al., 2010) argue that public perception is more nuanced, and earnings management is considered ethical if its methods are in line with GAAP and its purpose is not for the personal benefit of managers but fair to other stakeholders.

The first years of the twenty-first century have witnessed upheavals in the international business community, especially through a number of scandals, such as fake transactions (AIG, Kmart, and Xerox), GAAP non-compliance in revenue recognition (Halliburton), mergers (Tyco), off-balance-sheet charges (Enron), and errors in the classification of operating cash flows (WorldCom). These scandals not only violate investor protection laws but also violate prevailing social norms (Barton et al., 2010). Moreover, managerial actions are often related to the incentives they receive. The relationship between accounting accruals and incentives provided to managers in revenue-related bonus plans has been proven (Deegan, 2009). Managers also tend to decrease earnings when profits are in extreme conditions or to inflate earnings when their performance is poor, or to increase earnings by suppressing reserves (Merchant & Rockness, 1994). Although (Merchant & Rockness, 1994) acknowledge that not all earnings management actions are illegal and most are managerial prerogatives, this perspective raises questions about whether such actions are morally right. Despite the existence of a code of ethics that should prevent earnings management actions, individuals involved can still carry out these actions, ultimately considered socially unacceptable.

Method

Literature analysis and interpretative qualitative study are employed to describe an individual as an "insan kamil" (perfect human) from the perspective of Muhammad Iqbal, a philosopher born in Pakistan, and to analyze the concept of earnings management in the context of "insan kamil" from the aspects of ontology, epistemology, and axiology. The writing comprehension provides a metaphorical understanding (Ricoeur, 1981). One type of narrative investigation (requesting stories) involves the researcher using written narratives about social actions to drive social change (Chaidali & Jones, 2017) through manual content analysis.

Result and Discussion

Efforts to connect science with religion in the Islamic world took place in the 1970s to the early 1990s with the emergence of new dynamics related to the relationship between Islam and science (Cuk & Wijaya, 2006). They stated that both science and religion arise from the same human spirit, which is to survive in life.

Ontological Aspect, The ontological aspect refers to the assumptions and perspectives of humans towards a certain reality. Ontological assumptions shape how we perceive and study research objects (Saunders et al., 2007). In the perspective of Insan Kamil, knowledge holds a truth value that is relative depending on human reasoning and the perspective from which they view it. In his view, scientific knowledge encompasses three aspects. First, Spiritual Knowledge (Religion and Sharia): This type of knowledge is related to beliefs, teachings, and spiritual practices associated with religion. Religions have rules, ethics, and values that underlie the beliefs and actions of their followers. Spiritual knowledge includes an understanding of religious beliefs, rituals, morality, and views on a higher reality. Second, Rational Knowledge (Science): This is knowledge that focuses on understanding the physical world and the universe through scientific methods. Science uses logical approaches, observation, measurement, experimentation, and analysis to explain natural phenomena and develop theories based on empirical evidence. Rational knowledge helps us understand and explain natural phenomena and develop technology. Third, Metaphysical Knowledge (Tariqat, Haqiqat, and Ma'rifat of Sufism): This type of knowledge is related to the understanding of metaphysical or spiritual dimensions that go beyond physical reality. In the context of Sufism, a mystical stream in Islam, metaphysical knowledge includes an understanding of the relationship between humans and God, the search for the meaning of life, and profound spiritual experiences. It involves practices such as reconstruction, introspection, and seeking a deeper understanding of the essence of existence.

In the perspective of Insan Kamil, earnings management is considered a form of science that can be observed, measured, and analyzed to explain existing phenomena based on empirical evidence. Earnings management, as a form of science, is viewed as a subject that can be researched and scientifically analyzed. This means that earnings management practices can be studied, described, and explained using applicable scientific methods. Earnings management practices can be observed in the actual actions of companies or individuals. This includes changes in financial reporting, selected accounting policies, or changes in financial behavior that may indicate efforts in earnings management and various measurement methods and indicators used to identify earnings management practices.

This includes analyzing the differences between actual earnings and reported earnings or using specific financial ratios.

Epistemological Aspect, Epistemology concerns assumptions about knowledge, what is acceptable, valid and legitimate knowledge, and how we can communicate knowledge to others (Burrell & Morgan, 1979). The persona of *Insan Kamil* refers to an individual who has reached a level of perfection in spiritual, moral, and intellectual aspects. This person has a profound understanding of ethical and moral values, including honesty, integrity, transparency, and adherence to professional ethical standards. In Islam, the Quran and Hadith serve as guidance for ethics and morality. They contain teachings about honesty, integrity, justice, and responsibilities that must be followed in all aspects of life, including in the profession of accounting. The persona of *Insan Kamil* uses their reasoning to understand and apply the principles of accounting ethics. They think critically, consider the consequences of their actions, and ensure that they adhere to mandated ethics. Intuition within them can be interpreted as a deep understanding and sharp insight related to ethical principles. *Insan Kamil* may have sensitivity to actions that violate ethics, even if these actions cannot be proven through scientific methods. The persona of *Insan Kamil* has the ability to cultivate a sense of truth and justice in their soul. They can sense truth and justice and use their reasoning to make decisions that are right and ethical.

The perspective of an *Insan Kamil* on earnings management practices is influenced by the ethical values, moral principles, and religious principles they adhere to. They would view earnings management practices involving manipulation or concealment of information as a violation of these values. Bankruptcies of well-known companies such as Enron, WorldCom, Xerox, and A Hold Royal, etc., demonstrate accountants' ability to manipulate financial figures, resulting in a misinterpretation of financial information (Shawar & Qaisar, 2015). This is considered inconsistent with religious teachings. Earnings management practices aimed at hiding information or harming others may not align with these values. Violation is a form of tarnishing or contaminating the purity of human beings. Purity comes from the divine light of God within humans. Purity resides within humans, and its existence is inseparable from the mission and responsibility that God has bestowed upon each soul.

Axiological Aspect, *Insan Kamil* views knowledgeable individuals as capable of balancing and harmonizing both intellectual knowledge (mind) and inner knowledge (feelings), guided by values and the righteousness (humanity) prevailing in society. This ability enables them to provide holistic awareness of human attitudes and behaviors. Earnings management actions can be considered a potential failure in aligning intellect and moral values. Practices of earnings management involving financial information manipulation with the intention to deceive stakeholders are regarded as a failure in aligning intellect and moral values. This

is because such actions contradict moral and ethical principles, such as honesty, justice, and integrity. However, it is essential to note that not all earnings management practices are automatically considered a failure in aligning intellect and moral values. Some earnings management practices may have valid business reasons, such as maximizing tax efficiency or managing profit volatility, without violating moral principles. As long as these practices stay within the bounds of applicable laws and ethics, their alignment with intellect and moral values may not be an issue.

Conclusion

Insan Kamil represents an ideal form of human, someone truly perfect as a human being, possessing strength, insight, actions, and wisdom. Their entire life is lived with enthusiasm and creativity in accordance with the will of God. Ontologically, in the perspective of Insan Kamil, earnings management is seen as a scientific form that can be observed, measured, and analyzed to explain phenomena based on empirical evidence. As a research subject, earnings management practices are considered study able and explainable using scientific methods, evident through real actions of companies or individuals. Consistent with this, the epistemological aspect explains that the figure of Insan Kamil is someone who has a deep understanding of ethical and moral values, including honesty, integrity, transparency, and adherence to professional ethical standards. Regarding earnings management practices, they view those involving manipulation or concealment of information as violations of these values. Ultimately, in the axiological aspect, earnings management actions can be considered a potential failure in aligning intellect and moral values. As long as earnings management practices do not violate moral and ethical principles, their alignment with intellect and moral values may not be an issue.

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