

Allowance for uncollectible accounts as a tool for earnings management: Evidence from South Korea

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Purpose

This study aims to verify the circumstances under which managing the allowance for uncollectible accounts is used as a tool of earnings management.

Design/methodology/approach

The authors investigate whether bad debt expense, which is an income statement counterpart of allowance for uncollectible accounts, is adjusted downward when pre-managed earnings is slightly above zero earnings, prior year's earnings or analysts' forecasts.

Findings

The findings of this study show that firms manage bad debt expense downward to avoid losses, sustain the prior year's earnings and meet or beat analysts' forecasts. The authors also find that the understatement of bad debt expense to meet earnings benchmarks is pronounced for firms with high tax costs.

Social implications

Standard setters and auditors can gain a better understanding in detail of the practices and methods of managing earnings via the allowance for uncollectible accounts.

Originality/value

This study is the first to examine earnings management via the allowance for uncollectible accounts in non-financial Korean firms. In addition, the findings provide the evidence that firms prefer to use the allowance for uncollectible accounts as a strategic tool to meet benchmarks, especially when their tax costs are high.

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