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Financial Reporting Quality on Dividend Payout Policy During Pandemic COVID-19

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Abstract

The COVID-19 pandemic disrupted the Indonesian business cycle and operations, leading to a stock market decline and reduced average dividend distribution as well as profitability, especially for manufacturing companies. This study investigates the pandemic's influence on financial reporting quality in Indonesia and its relationship to dividend payout policy. We collected 455 observations from IDX-listed manufacturing companies (2016-2021) and processed them using descriptive statistics and logit regression with three models in Stata. Consistent with the outcome view, the logit regression results suggest that financial reporting quality is affected by the COVID-19 pandemic. Additionally, the three models unanimously display that financial reporting quality has a significant effect on dividend policy. RM1 shows a negative relationship, aligning with financial reporting quality's impact on mitigating free cash flow problems. Contrarywise, the third model, RM2 identifies a positive and significant relationship consequent to enhancing the company's image and shareholder satisfaction.

Keywords: Financial Reporting Quality, Dividend Payout Policy, Covid-19 Pandemic, Real Earnings Management, Manufacturing.

1. Introduction

At the beginning of January 2020, the Covid-19 outbreak was stated as a Public Health Emergency of International Concern (PHEIC) by the World Health Organization's (WHO) Emergency Committee (EC) (WHO, 2020). Many countries around the world experienced economic turbulence due to the pandemic, including Indonesia. According to the National Statistics Agency, Indonesia's Gross Domestic Product (GDP) experienced a 2.07% (year-on-year) decline in 2020 (Badan Pusat Statistik, 2020). The economic decline is mainly caused by large-scale social restriction (PSBB – Pembatasan Sosial Berskala Besar) policy that was issued by the government as a response to the Covid-19 outbreak. People were afraid to go out of their house due to the massive and vast spread of the Covid-19 virus and infections, resulting in less offline activities including transactions (Indah & Rokhim, 2023).

The restrictions have disrupted the country's business cycle and money circulation. A noticeable number of companies had to lay off and readjust employee salaries and wages. Gross domestic product and purchasing power decreased, unemployment rate spiked (World Bank, 2021). Manufacturing companies, which contribute to over 18% of the nation's GDP, took one of the greatest hits, reaching as low as 27.5 in its Purchasing Manager Index (PMI) in April 2020 (CNBC, 2020). The average profitability decreased sharply during the first year of Covid-19 pandemic as shown in Figure 1.

The challenging period of uncertainty drives investors to carefully examine the company's finances, yet the average payment of dividends (Figure 2) dropped only in year 2020 and managed to bounce back in the year 2021. One of the accounts linked to a company's financial health that is reviewed by investors is dividend policy (Pinto & Rastogi, 2019). Kim et al. (2021), in their studies, contended that financially struggling firms could utilize dividend policy to spread a favorable signal to the investors and market. The change of dividend policy can be driven by many factors, one of which is financial reporting quality (FRQ). The outputs of studies incorporating US firms as sample by Koo et al. (2017) and using international firms as sample by Trinh et al. (2022) reveal a positive relationship between FRQ toward dividend policy. The higher the firm's FRQ as it can mitigate the free cash flow problem and financial constraints, the higher the dividend payout (Koo et al., 2017). Financial reporting quality itself determines the degree of accuracy in capturing a firm's performance, productivity and economic reality at the end of the period (CFA, n.d.). It can be represented by the level of earnings management done within the company, to ensure the financial statements report an excessively positive outcome. In addition, by using discretionary accrual value to measure financial reporting quality, it was found that household equipment sector experienced the lowest FRQ (value of earnings management = 3.055) during first quarter of 2019 and footwear sector had the highest FRQ during first quarter of 2020 (value of earnings management = 0.0841) (Azizah, 2021), the starting time of the pandemic in Indonesia.

These two FRQ value showed an increase from first quarter of 2019 to 2020 which illustrate an interesting phenomenon to scrutinize further whether manufacturing firms' FRQ certainly inclined.

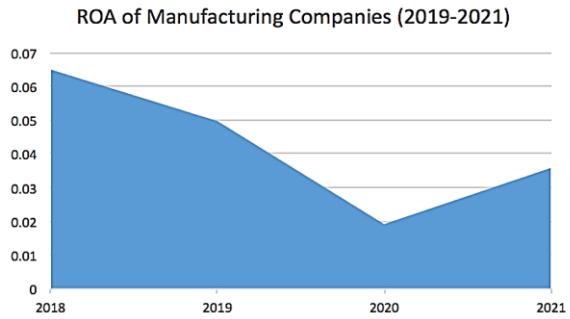

Figure 1. Manufacturing companies profitability
Source: IDX (2020)

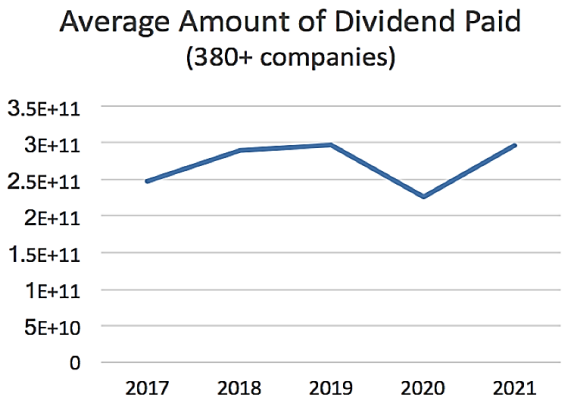

Figure 2. Average amount of dividend paid
Source: IDX (2020)

The process of earnings management affects a company's income and financial reporting quality (Shuli, 2011). Due to the information asymmetry, high earnings management gives rise to low quality of financial reporting, particularly to minimize negative effects of crises (Trombetta and Imperatore, 2014), including financial crisis of 2008 (Eng et al., 2019). Additionally, Carletti et al. (2020) and Hsu & Liao (2022) suggest that financial pressure and risk of uncertainty especially during crises engenders higher information asymmetry. Meanwhile to discuss the dividend payout policy during crisis, Ali (2020) who studied firms in European countries found that despite of high proportion of dividend cuts and omissions during the economic turbulence due to the pandemic but the majority of firms able to either maintain or increase dividends during 2015-2020. This is happening in accordance of dividend signaling theory, firms may do so in order to pursue stable dividend payout and signal their financial prospects during the crisis. Ntantamis et al. (2022) and Krieger et al. (2021) found the opposite that more countries experienced widespread dividend cuts or did share repurchase during the pandemic period. So, the effect on dividend policy during the period of a crisis/pandemic is still inconclusive.

This paper examines 1) how FRQ concern with earnings management practices has affected dividend policy in Indonesia in period of Covid-19 pandemic, 2) whether the pandemic is also affecting the dividend payout policy. The study intends to utilize the data from Indonesian manufacturing firms listed on Stock Exchange of Indonesia (IDX) from 2016 through 2021, except for banking and other financial institutions. To our knowledge, many previous studies (Koo et al., 2017; Hoang, 2021; Chen et al., 2011; Trinh et al., 2022) focus on accrual earnings management (AEM) as the measure of FRQ instead of real earnings management (REM). One of the few researches using REM applied in Indonesian manufacturing firms is one by Putra et al. (2021) to know how the managerial ability's effect on earnings management to family-owned and non-family owned firms. Another advantage point by using REM is less likely to come under audit or regulatory scrutiny compared to AEM (Cohen & Zarowin, 2010). Hence, this research is filling the gap of the effect of Covid-19 research in the developing country which may exhibit different results as it has particular capital market environments and corporate behavior. Moreover, the number of studies in developing countries is still few (Razzaque et al., 2016; Türegün, 2020; Chen et al., 2011; Hoang, 2021; Kusuma & Semuel, 2019), not many employ REM as earning management and relate EM or FRQ to dividend payout policy analysis during the pandemic in Indonesia (Hariadi & Kristanto, 2022; Putra et al., 2021; Muljono & Sung Suk, 2018; Indah & Rokhim, 2023).

This study offers beneficial suggestions about the practice of earnings management before and during pandemic in Indonesia which may support and facilitate investors' decision-making towards their portfolios. Second, this research will significantly contribute to existing literature about the financial reporting quality (earnings management) and firm dividend payout policy throughout the pandemic in a developing country. The rest of this article is managed as follows, Section 2 reviews previous literature and research in the field, also develops hypotheses. Section 3 explains the methods and data used. Section 4 presents the results and discussion, finally Section 5 is the conclusion.

2. Literature Review

2.1. Financial Reporting Quality

There have been several definitions of quality of financial reporting from previous studies. Albarqi and Herath (2017) stated the accuracy of the disclosed information in a firm's financial statements could be

applied to judge the quality of its financial reporting. Further, financial reporting quality could be measured based on its relevance, reliability, comparability, understandability, timeliness, and faithful representation. Whereas Koo et al. (2017) defined quality of financial reporting as "the informativeness of financial reports about the firm's underlying economics". On the other hand, Trinh et al. (2022) described financial reporting quality as transparency's level of presented information about the business operations. Thus, the quality of financial reporting is the degree of transparency, relevance, reliability, and informativeness of the operations and management within a company.

From companies with high financial reporting quality, shareholders could see a more accurate depiction of a firm's sales, costs, capital, and cash flow in the financial report. Therefore, it is a significant tool for shareholders to determine their actions and decisions towards a certain company. Whereas companies with low financial reporting quality do not display a true representation of the company's productivity and financial performance. A low financial reporting quality is mainly caused by the practice of altering financial reports to maintain investors' confidence towards the company. Research by Kothari et al. (2016) stated that managers frequently hold negative news from the market to prevent a decline in stock price, but promptly share positive news with investors. This will result in an information asymmetry, namely adverse selection, between the company and investors. According to previous studies, higher quality financial reporting can minimize the risk of information asymmetry and improve investment efficiency as it provides investors with more details on the company's financial information (Biddle et al., 2009; Chen et al., 2011).

To present a consistent and stable financial performance, a company could do earnings management. Although the action may help in creating great numbers and "smooth" operation impression, earnings management does not increase financial reporting quality. Healy and Wahlen (1998) explain earnings management as a device for managers to amend financial reports by organizing transactions. This is done to give shareholders the wrong impression regarding the firms' true economic accomplishment or to change contractual results that depend on the reported numbers in financial statements. There are two general methods in earnings management (EM), those are accrual-based earnings management (AEM) and real earnings management (REM). Some articles applied one or two methods of EM to be used in easing the influences of the financial crisis incurred in the past year : Trombetta and Imperatore (2014) used data of US firms listed in New York Stock Exchange to know the EM practice and the analysis resulted in higher EM as the crisis climbed to its peak during the period 1996-2011; Türegün (2020) who studied the EM practices using AEM in Turkey and compare the behavior before and after global financial crisis in 2008 found that there was declined manipulation level of income throughout the crisis due to decreasing incentives for managers in accelerating the earnings as the market's acceptance of the firm's low accomplishment; Bugshan et al. (2020) investigated the earnings management for Gulf Cooperation Council (GCC) countries during the oil prices crisis in the mid-2014 using both methods of EM, AEM and REM and concluded that firms used REM more in substitute of AEM during the crisis despite the high cost to adopt it.

Similarly, Eng et al. (2019) and Rahman et al. (2022) posited the companies incline to do more REM throughout a financial crisis period. Due to first, using REM is less likely to come under audit or regulatory scrutiny compared to AEM because REM involves discounting product price, overproducing products to reduce cost and cutting the spending on R&D or advertising expenditures (Cohen & Zarowin, 2010; Roychowdhury, 2006). Second, managers cannot rely alone in AEM to achieve the earnings target, and unlike AEM that is conducted at the end of quarter or fiscal year, REM is taking place along the year. Then, using REM to make up for any deficit would not be possible because there would not be enough time for manipulating real activities perfectly (Cohen & Zarowin, 2010; Roychowdhury, 2006). In analyzing and determining the quality of financial reporting applying REM, there are three standardized REM indicators including the abnormal cash flows from operations (AbCFO), the abnormal discretionary expenses (AbDISEX), and the abnormal production costs (AbPROD) (Li et al, 2020; Cheng et al, 2013; Rahman et al., 2022; Razzaque et al., 2016; Putra et al., 2021; Bugshan et al., 2020). The higher the real earnings management points to poorer quality of financial reporting (Roychowdhury, 2006).

2.2. Dividend Payout Policy

Dividend payout policy is a policy made through a process done among shareholders to organize and structure a company's profit into distributable dividends (Pinto et al., 2019). Dividend payout policy is constantly reevaluated to adapt to changes and ensure the company's long-term well-being. It is an essential part of the company's finances as it represents financial and investment health and prospects (Pinto et al., 2019). Therefore, companies with a higher dividend payout may drive the demands of their stocks as investors seek healthy companies with a good return on investment. Trinh et al. (2022) suggest that companies take several considerations such as the present and future earnings

to impose a consistent dividend payout policy. In addition, as reported by Fama and French (2001) that firm's size, profitability and investment opportunities are the three factors affecting shareholders' decision in determining dividend payout policy.

There are several ways to distribute dividends, such as through cash, shares, bonds, and so on. While there are many types, companies mostly distribute cash dividends that come from their Free Cash Flow (FCF) (Jensen, 1986). This is the most common method for a company to share their profit and make the stock more desirable for investors. According to Jensen (1986), FCF is total available cash obtained after being deducted by expenses and capital expenditures to fund projects with a positive net present value or pay dividends. That being said, companies do not always pay the full amount of their FCF as dividends.

Although there are companies that pay dividends at a constant rate, many companies decide each year based on a set of criteria, such as their near plan and goals. Allocating the perfect percentage into dividends and reinvestment may become a problem when a company has a substantial amount of FCF. In addition, dividend policy can be a pointer to lessen the information asymmetry between stakeholders and managers (Nguyen and Bui, 2019). When a company's reporting quality is high, it displays more detailed internal activities done by managers such as the projects the company is investing on, recent goals, and so on. Transparency and closely monitored managerial activities prevent underpayment of dividends, and over-allocation of available cash from being reinvested back into the company for projects including non-valuable ones, besides it also boosts investor's confidence in the fairness of the market (La Porta et al. 2000; Fung 2014).

Similarly, it encourages more efficiency and effectiveness in utilizing the FCF as well as discourages value-destroying activities. Biddle et al. (2009) posited that companies can ease the process of doing so if the financial report enables value-adding projects to be made. Hence, when the reporting quality is high and transparent, companies have the incentive to create a better dividend payout policy to satisfy their shareholders and a positive image for the company. Koo et al. (2017) employed a sample of US public companies from 1994 to 2011 excluding financial and utility firms to contend a positive relation between quality of financial reporting on dividend payout policy of firms significantly. Besides, similar results were found by Hoang (2021) who studied in several Asian countries and Trinh et al. (2022) in their research across 123 countries. They deduced that high-quality of financial reporting improves a firm's dividend payout policy.

The majority of managers are hesitant to send a negative signal by reducing dividends since the market typically reacts negatively to dividend omissions or cuts. Nevertheless, in times of crisis, reducing or omitting dividends may provide firms with additional cash and the flexibility to deal with unpredictability. This phenomenon proven by Krieger et al. (2021) who examined 14,000 data of dividend-paying US firms that firms were three to five times more likely to cut or omi t divdends duing the seond quarer of 2020 than in any other quarter. Same findings found by Ntantamis and Zhou (2022) that examined firms in G-7 countries, in particular of firms located in UK, Italy, Germany and France that experienced a dividends cut while US and Canada reduce cash payouts further through share repurchases. Therefore based on previous premises, the researchers hypothesized as follows:

H_1: Quality of financial reporting relates to dividend payout policy.

H_2: Pandemic is affecting the dividend payout policy.

3. Methods

3.1. Population and Sampling

This paper collected data from financial and annual reports available in Bloomberg and Indonesia Stock Exchange (IDX). The data used in this research consists of all IDX listed manufacturing companies from 2016-2021, grouped based on Global Industry Classification Standards (GICS). This paper excludes companies with incomplete information for calculation from the research sample. In total, the paper included 153 companies across 6 industries, excluding 60 companies with 48 companies that went public after 2016; 3 companies that have negative common equity; and 9 companies that were suspended during the years used in this research. A total of 608 firm-year data is collected in this study and each industry was made sure to have at least eight observations or companies to maintain the sample representativeness (Cohen et al., 2010).

3.2. Data Analysis

First, we calculate the aggregate measurements of REM (RM_{t-1}, $RM1_{t-1}$, $RM2_{t-1}$) for determining Financial Reporting Quality and continue to use Panel Logit Regression clustered in industry. Along with calculating correlation test for all variables by using the Pearson Test to make sure there is no multicollinearity problem, $r < 0.8$ (Gujarati and Porter, 2020). To lessen the effect of potential outliers, all continuous variables are winsorized at 1% and 99% levels.

3.3. Model Specification

Following earlier studies (Rahman et al., 2022; Razzaque et al., 2016; Li et al, 2020; Cheng et al., 2013;

Putra et al., 2021; Bugshan et al., 2020), quality of financial reporting is assessed using real earnings management (REM) by deducting the normal level of cash flows from operations (CFO), discretionary expenses (DISEX), and production costs (AbPROD) by actual level to get the abnormal level of CFO (-AbCFO), abnormal level of DISEX (-AbDISEX), and abnormal level of PROD (AbPROD). First, the normal CFO, PROD and DISEX have to be calculated using the formulas as the followings:

$$\frac{CFOjt}{Assetjt-1} = \alpha 2\left(\frac{SALEjt}{Assetjt-1}\right) + \alpha 3\left(\frac{\triangle SALEjt}{Assetjt-1}\right) + \varepsilon jt \quad (1)$$

$$\text{CFO}_{jt} = \frac{CFO}{Total\ Asset} \quad (2)$$

$$\text{Asset}_{jt} = \frac{1}{\text{Pr}evious\ Total\ Asset} \quad (3)$$

$$\text{SALE}_{jt} = \frac{Revenue}{\text{Pr}evious\ Total\ Asset} \quad (4)$$

$$\frac{DISEXjt}{Assetjt-1} = \alpha 1\left(\frac{1}{Assetjt-1}\right) + \alpha 2\left(\frac{SALEjt}{Assetjt-1}\right) + \alpha 3\left(\frac{\triangle SALEjt}{Assetjt-1}\right) + \varepsilon jt \quad (5)$$

$$\text{DISEX}_{jt} = \frac{(Adv\ Expense + SG\&A + R\&D)}{Previous\ Total\ Asset} \quad (6)$$

$$\frac{PRODjt}{Assetjt-1} = \alpha 1\left(\frac{1}{Assetjt-1}\right) + \alpha 2\left(\frac{SALEjt}{Assetjt-1}\right) + \alpha 3\left(\frac{\triangle SALEjt}{Assetjt-1}\right) + \alpha 4\left(\frac{(\triangle SALEjt-1)}{Assetjt-1}\right) + \varepsilon jt \quad (7)$$

$$\text{PROD}_{jt} = \frac{(COGS + Changes\ of\ Inventory)}{Previous\ Total\ Asset} \quad (8)$$

Cash flows from operation are calculated as a percentage of the previous year of total assets. Discretionary expense consists of selling, general and administrative (SG&A) expense, advertising expense, and research and development (R&D) expense scaled by previous year of total asset. Production cost is a measure of the cost of goods sold and inventory changes during the period scaled by previous year of total asset. Then we can get three aggregate measurements of RM, RM1 and RM2 (Rahman et al., 2022; Razzaque et al., 2016; Li et al, 2020; Cheng et al., 2013; Putra et al., 2021; Bugshan et al., 2020) as follows:

$$\text{RM1} = \text{Ab CFO} \times (-1) + \text{Ab DISEX} \times (-1) \quad (9)$$

$$\text{RM2} = \text{Ab DISEX} \times (-1) + \text{Ab PROD} \quad (10)$$

$$\text{RM} = \text{RM1} + \text{RM2} \quad (11)$$

Positive abnormal PROD (AbPROD), negative abnormal CFO (AbCFO) and negative abnormal DISEX (AbDISEX) are leading to higher income within REM. Therefore, increasing value of RM1 or RM2 suggest increasing value of REM, meaning less quality of financial reporting (Li et al., 2020). Continuing to test hypotheses, based on Trinh et al. (2022), Koo et al. (2017) and Hoang (2021), we can have the following model:

$$DIV_{jt} = \beta_0 + \beta_1 FRQ_{jt-1} + \beta_2 DIV_{jt-1} + \beta_3 PrePost + Control\ Variables + \varepsilon_{jt} \quad (12)$$

DIV_{jt} and DIV_{jt-1} are used as indicators of a firm j's dividend payments made during the year (t) and the year (t-1) as dummy variables indicating no dividend payment (=0) or with dividend payment (=1). While FRQjt-1 represents the firm's financial reporting quality j (using RM_{t-1} or RM1_{t-1} or RM2_{t-1}) during the previous year (t-1). PrePost is a dummy variable (0 or 1) used in this research to assign the variables into a certain time. In this case, pre-pandemic is during the year (=0) 2018-2019 while post-pandemic (which represents during pandemic) is during the year 2020-2021 (=1). Then, Logit regressions are applied to test the model (12). In addition, control variables (Trinh et al., 2022; Hoang, 2021; Koo et al., 2017) are summarized in Table 1.

Table 1. Control variables

Variable	Formula	Description
ROA	(Net Income available to common shareholders + Interest Expense + Net Deferred Taxes)/Total Assets	Return on Assets (ROA) is a ratio commonly used to calculate a company's profitability
Tobin's Q	(Total Assets + Market Capitalization - Common Equity)/Total Assets	Tobin's Q is a ratio used to weigh investment opportunities of a company
Invest	Capital Expenditures/Total Assets	Invest describes the company's spending (e.g. for expansions) as a percentage or ratio to the total asset to measure investment opportunities to measure growth opportunities
Size	Log (Market Capitalization)	A measurement of the firm's size
Age	Log (Age of Initial Public Offering)	Firm age counted from the first date of initial public offering
Debt	Total Debts/Total Assets	Debt is a leverage ratio that calculates how much debt a company possess compared to the assets
CFO	Cash Flow from Operation/Total Assets	Cash flow from operating activities to total assets is an efficiency ratio that measures the amount of cash a company generates from the assets they own
TET	Common Equity/Total Assets	Total equity turnover (TET) is a ratio that showcase the company's ability to generate revenue and ensure the worthiness of holding the company's equity
Cash (Cash Holding)	Cash and Cash Equivalent/Total Assets	Cash to total assets calculates the portion of a firm's assets held in cash or marketable securities

Source: Trinh et al., 2022; Hoang, 2021; Koo et al., 2017

4. Results

Exhibited in Table 2 is descriptive statistics of 608 firm-year data from the period of 2016-2021. The mean value of Divjt is 0.0195 (1.95%), which means most companies are on the lower end of the scale in terms of dividend payment. While, the data of control variables are mostly clustered around the mean, shown from the low standard deviation which falls below 1. Nevertheless, several control variables' observations such as TobinsQ, investment (Invest), size of the firm (Size), length of firm's being publicly listed (Age) and cash flow from operations (CFO) look more spread out, which can be seen from the high standard deviation. Related to this, the difference of minimum and maximum values of these variables are comparatively higher.

The correlation in Table 3 also displays that Divjt is correlated with several variables, and every control variable's correlation is below the 0.8 (Gujarati and Porter, 2020) with Divjt-1, ROA and TobinsQ being the most strongly correlated. So, we can conclude that there is no multicollinearity problem with all variables in this study.

Table 2. Descriptive statistics

Variable	Mean	Std. dev.	Min	Max
Divjt	0.0195	0.0643	0.0000	0.9986
ROA	0.0424	0.1136	-1.014495	0.9213
TobinsQ	1.4978	1.2536	0.1824	7.5320
Invest	0.0342	0.0372	0.0000	0.2192
Size	12.0574	1.3069	6.8730	14.2066
Age	21.3554	9.9878	1.3025	39.8740
Debt	0.2483	0.2047	0.0000	0.8820
CFO	0.0734	0.0903	-0.1511	0.4198
Divjt1	0.0186	0.0528	0.0000	0.4444
TET	0.4910	0.2880	-1.898849	1.2678
Cash	0.0800	0.1179	-0.151089	0.9655

Div_{jt} : Dividend payout in year t; Div_{jt-1} : Dividend payout in year (t-1)

By using logit regression for processing firm's data during the period of 2016-2021, Table 4 reports the mean coefficients across 608 industry-years, clustered by firms and p-value from robust standard errors to avoid heteroscedasticity problem. The table also exhibits -0.1146, -1.8117 and 0.1184 coefficient of RM_{t-1}, $RM1_{t-1}$ and $RM2_{t-1}$ along with the p-value below 0.05. It means that there is a significant relationship between earnings management towards companies' financial reporting quality. Some control variables, which are previous year dividend payout (Div_{jt-1}), profitability (ROA), growth opportunities (Invest), leverage (Debt) and total equity turnover (TET), PrePost are statistically significant across all models. The explanatory and 0.5645 is quite high and shows an excellent fit to predict the outcome (McFadden, 1979).

Table 4. Regression results

	Model 1 Div_{jt}	Model 2 Div_{jt}	Model 3 Div_{jt}
RM_{t-1}	-0.115**		
	(0.0434)		
$RM1_{t-1}$		-1.812***	
		(0.320)	
$RM2_{t-1}$			0.118*
			(0.0600)
Div_{jt-1}	4.496***	4.528***	4.488***
	(0.215)	(0.204)	(0.221)
ROA	4.871*	4.806*	4.903*
	(2.058)	(2.084)	(2.053)
TobinsQ	-0.118	-0.140	-0.115
	(0.243)	(0.227)	(0.245)
Size	0.183	0.184*	0.167
	(0.118)	(0.0904)	(0.114)
Age	0.0211	0.0199	0.0212
	(0.0170)	(0.0179)	(0.0172)
Debt	0.243	0.401	0.196
	(1.033)	(1.113)	(0.986)
Invest	6.567**	6.349**	6.575**
	(2.061)	(2.211)	(2.065)
CFO	1.062	0.644	0.989
	(2.300)	(2.310)	(2.288)
TET	1.074*	1.209*	1.017*
	(0.477)	(0.518)	(0.439)
Cash	1.395	1.254	1.401
	(1.209)	(1.178)	(1.187)
PrePost	-0.746**	-0.607*	-0.734**
	(0.249)	(0.255)	(0.244)
Intercept	-5.777**	-6.125***	-5.543**
N	608	608	608
Industry	Yes	Yes	Yes
Year	Yes	Yes	Yes
Pseudo R^2	0.5653	0.5645	0.5683

$RM1_{t-1}$: previous year RM1; $RM2_{t-1}$: previous year RM2; ***; Other variables are defined in Table 1; * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$

Table 3. Correlation test

	Div_{jt}	ROA	TobinsQ	Invest	Size	CFO	Divjt1	TET
ROA	0.4787							
TobinsQ	0.4591	0.2677						
Invest	0.0137	0.0102	0.0148					
Size	0.2416	0.1801	0.2784	0.1237				
Age	0.1596	0.1023	0.0196	0.0122	-0.0459			
Debt	-0.2044	-0.0819	-0.0826	-0.0062	-0.0178			
CFO	-0.0016	-0.0035	-0.0054	-0.6947	-0.0205			
Div_{jt-1}	0.7400	0.3540	0.5741	0.0158	0.2984	-0.0019		
TET	0.0896	0.0534	0.0022	0.0173	0.0649	0.0036	0.1041	
Cash	0.1343	0.0892	0.0330	0.0275	-0.0457	-0.0033	0.1240	0.2592

Variables are defined in Table 1

5. Discussion

Corresponding to the results discussed in the earlier section, all models support a significant relationship between FRQ and dividend payout policy. Hence, hypothesis H1 is accepted. Based on the results shown in Table 4, two findings answer the first hypothesis. The first and second model (RM and RM1) exhibits a significant and negative relationship with dividend payout ($p<0.01$). That means FRQ influences the dividend policy of firms during Covid-19 and the negative coefficient of RM and RM1 can be interpreted that when the financial reporting quality is higher, then the dividend paid is less. Further, the average RM pre-pandemic is 0.3121 and during pandemic is lowered to 0.1492 meaning that manufacturing firms have lower FRQ during pandemic. However, the payment of dividend during pandemic period is higher due to the fact that during financial crisis the dividend cuts probably serve as an indicator of future decreases in the efficacy and profitability of corporations (Krieger et al., 2021) and most firms certainly do not prefer this to happen. This statement is aligned with the substitute view, one of the perspectives about how financial reporting quality relates to dividend payout policy by easing free cash flow problems (Bøhren et al. 2012; La Porta et al. 2000; John et al. 2015; Hoang, 2021).

To conclude, despite of the lower FRQ during pandemic as it is expected due to higher earnings management, in particular Real Earnings Management (REM), Indonesian firms are not willing to give bad signaling to the market about the decline in their performance (Krieger et al., 2021)

On the contrary, these findings are not aligned with the previous study by Trinh et al. (2021), and Koo et al. (2017) who discovered a positive significant relationship that is following the outcome view (competing perspective of the substitute view). Dividends are paid to build the company's reputation and promote the managers (Wu, 2018); however by having high financial reporting quality, it eliminates the need to establish signaling for future earnings by disbursing dividends. Therefore, a negative association between dividend payout and financial reporting quality can be derived due to less urgency to disburse dividends to create a reputation when the reporting quality is high. It is common in countries with low investor protection (Koo et al., 2017; La Porta, 2000). In addition, the quality of financial reporting serves as a way to monitor and incentivize managers to invest in value-increasing projects (Jensen, 1986) and also to mitigate underinvestment (Biddle et al. 2009; Chen et al. 2011) which will lead to decreasing amount of cash available to pay dividends.

To put it another way, high-quality financial reporting reduces overpaid dividend payments (Koo et al., 2017), which the managers would use to invest in positive NPV investment projects known as the manager's quiet life attitude. This fact is supported by the result of the growth opportunities (Invest) variable that displays a significant ($p<0.01$) positive coefficient, which posits that the higher growth opportunities (measured by capital expenses divided by total assets), the higher the dividend payout of firms and prevent the dividend overpayment (John et al. 2015). Nonetheless, this study aligned with Hoang (2021) that found in support of the substitute view and reducing manager's quiet life attitude in relation to dividend overpayment across 4 different countries such as Chinese, Indian, South Korean and Taiwan by increasing the financial reporting quality.

Interestingly, the results reveal a significant and positive relationship between RM2, as another proxy of financial reporting quality and dividend payout (0.1184 coefficient). This result is aligned with the outcome view and previous study by Trinh et al. (2021), and Koo et al. (2017).

To answer the second hypothesis (referred to Table 4) can be seen from variable PrePost and it exhibits clearly that in each model (Model 1-3), there is significant relationship that can be posited that firms during pandemic are paying the dividend payout differently compared to pre-pandemic period in Indonesia and this result is aligned with previous research (Ntantamis et al., 2022; Krieger et al., 2021). Last, the control variables exhibit a significant relationship toward dividend payout, and those are the previous year of dividend payout, profitability, size, growth opportunities, and total equity turnover that are aligned with past studies (Fama and French, 2001; Hoang, 2021; Koo et al., 2017; Trinh et al., 2022).

5.1. Managerial Implications

The research findings will help the stakeholders know corporate behaviors related to their earnings management throughout the Covid-19 pandemic shock within a country with weak investor protection and assess firms' quality of financial reporting concerning discretionary expenses and operating cash flow before making investment decisions to add portfolios. Albeit the pandemic is no longer happening, this study can be beneficial for corporations to know the magnitudes of applying REM during similar financial crisis and can anticipate the effect toward the dividend policy they will make in the future.

Next, the authorities can impose higher incentives for firms that improve financial reporting quality while strengthening the investor protection law.

5.2. Limitations

Nevertheless, the researchers did not control for unobservable heterogeneity in the study, so the results could be driven by the omitted-variable bias, that become the limitations of this research. The unobserved variables may relate to the firm's governance, the social and institutional context of the capital market.

5.3. Future Research

The measurement of financial reporting quality in this study is using earnings management particularly REM, for the future research another type of financial reporting quality measurement such as the measurement of specific elements of financial report or qualitative characteristics of information (Dănescu & Stejerean, 2022) can be utilized instead.

6. Conclusions

In accordance with the underlying theories about heavy REM practice as the proxy of financial reporting quality in developed countries during a pandemic or financial crisis, this study found a relationship between financial reporting quality and dividend payout policy in the case of Indonesian manufacturing firms that cover 608 firm-year from the period of 2016-2021 (before and during the pandemic). The result is in line with the previous studies (Bøhren et al. 2012; La Porta et al. 2000; John et al. 2015; Hoang, 2021).

When using the aggregate of three abnormal expenses as a proxy to measure FRQ, it manages to know the relationship between quality of financial reporting toward dividend payout policy alongside supporting both the substitute and outcome theory, which reveals negative and positive relationship between the two. It approves the perspective of managers who are kept away from the need to establish signaling for future earnings by disbursing dividends when the financial reporting quality is high. Further, the result is in line with the theory of foregoing manager's quiet life behavior by intensifying financial reporting quality that leads to no excessive payment of dividends. The positive result supports the outcome perspective that is aligned with previous research conducted by Trinh et al. (2021) and Koo et al. (2017). The reason is due to the incentive of Indonesian firms to prioritize shareholder satisfaction and cultivate a positive corporate image through higher dividend payment. Besides, this study also reveals the affect of the pandemic toward the changes in the policy of dividend payout as hypothesized.

This study manages to contribute to existing literature related to a new perspective of financial reporting quality (or earning management) in the manufacturing industry during a pandemic in a developing country and in favor of the substitute and outcome view about quality of financial reporting toward firm dividend payout policy.

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