

DO INTERNALLY MANAGED REITS MANAGE EARNINGS MORE THAN EXTERNALLY MANAGED REITS?

Oluwaseun Damilola Ajayi*¹, Omokolade Akinsomi²

¹ Department of Real Estate, School of the Built Environment, London Metropolitan University, 166-220 Holloway Rd, London N7 8DB, United Kingdom; e-mail: o.ajayi@londonmet.ac.uk, ORCID: 0000-0001-9129-4056

² School of Construction Economics and Management, University of the Witwatersrand, 1 Jan Smuts Ave, Braamfontein, Johannesburg, 2017, South Africa; e-mail: kola.kinsomi@wits.ac.za, ORCID: 0000-0002-0745-043X

* Corresponding author

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ABSTRACT

The purpose of the paper was to provide an empirical examination of earnings management among internally and externally managed REITs. The empirical accounting literature claims that internal management of a firm does not constrain earnings management, while others argue in favor of internal management for firms. Using a sample of listed South African REITs for the 2013 - 2021 time period, we examine the relationship between management structures and earnings management. We do not find any aggressive practice in internally managed REITs during the study period. The study's findings imply that good corporate governance is a critical safeguard for stakeholders in exceptional circumstances when REITs have special incentives to manage earnings; as a result, it is suggested that REITs' corporate governance is important, despite being overlooked in some circumstances. Specific to South African REITs, policymakers as well as nominating committees of the board of directors may wish to take note that financial competence is an important quality of external directors in order to effectively curb earnings management. This is the first study to investigate financial sheet manipulation among REITs management structures in an emerging market.

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1. Introduction

The perceived manipulation of financial sheets in the real estate investment trust sector is a topical issue. Zhu, Ong, and Yeo (2010) opined that Real Estate Investment Trust (REITs) managers engage in activities such as earnings management; they argued that this tends to be a possibility because of the heavy reliance on finance from external sources in funding their investments and expansions. In a similar vein, Adams, Hayunga and Rasmussen (2017) recently corroborated this by stating that there appears to be a possibility of REITs engaging in financial sheet manipulations owing to the fact that such firms needed to file their financial statements with their respective regulatory bodies. The real estate industry has made considerable progress in securitizing it. However, real estate investment trusts (REITs) in emerging markets face challenges due to the limited availability of data. This

scarcity prevents corporate and individual investors from acquiring comprehensive insights into the investment risks associated with these assets. Such constraints on information availability directly contribute to investment risk because decisions made under such circumstances are susceptible to irrationality stemming from bounded rationality. (Marzuki & Newell, 2020; Zhu et al., 2010). These market microstructure distinctions include dividend pay-out obligations and restrictions on property investment. REITs cannot support investment activities through internally generated profits, which is undesirable for them (Deng & Ong, 2018). The REIT sector is perceived as more transparent than other businesses because of its rigorous regulatory requirements, physical assets, and highly predictable income flow (Schrand, et al., 2021; Olanrele, et al., 2015; Newell & Osmadi, 2009; Morri & Beretta, 2008).

Existing literature (Zhu et al., 2010; Deng & Ong, 2014) noted that the perceived transparency within the REITs sector ought to ameliorate potential engagement in earnings management; yet, there are also wide reports of investor concerns with respect to low dividend yields in emerging markets (Toumeh et al., 2020; Corredor et al., 2015); the aforementioned studies reveal a tendency among REITs managers to manipulate financial statements in favor of external financing sources. This prompts the following consideration: Could such actions stem from opportunism? Opportunism, characterized by self-interest, raises concerns about the integrity and transparency of financial reporting. Investigating the motives behind managerial behavior is crucial for understanding corporate governance and regulatory compliance in the REITs sector. Therefore, exploring the potentially opportunistic nature of managers' actions is vital to comprehending financial decision-making dynamics. In addition, the dividend yields of REITs in emerging (especially African) markets do not appear to have performed comparatively well with their counterparts in developed markets (Ajayi & Akinsomi, 2022; Erol & Tirtiroglu, 2011).

Earnings management is an economic act used by managers to conceal the financial performance of their companies. Various strategies, such as delaying revenue recognition, boosting or reducing discretionary spending, and disposing of assets can influence the earnings of REITs. The study predicts that in times of increased SEO activities of REITs, they will engage in microstructure-induced earnings management practices to reduce the cost of capital. Therefore, the study asks the following research question: Do Internally Managed REITs Manage Earnings more than Externally Managed REITs around Secondary Equity Offerings? This is the question that the study aims to address. If earnings management techniques in the REITs sector are significantly curtailed or perhaps eliminated, policymakers will do well to encourage businesses to seek debt funds, implying that buyers will benefit in two distinct ways: their dividend yields will increase and management will be less likely to deceive them. REITs that engage in financial manipulation to generate cash flow, those with frequent share price announcements (SEOs), and those with inactive corporate governance structures and high levels of leverage have been identified as indicative of perceived earnings management (Cohen & Zarowin, 2010; Ghosh & Sirmans, 2006). Moreover, most issuers tend to deplete their cash reserves within

a year of not receiving the offer revenue from the SEO (DeAngelo et al., 2010). Ling and Wu (2013) discovered that a firm's cost of equity is lower prior to SEO filing when liquidity risk increases. Similar to all REITs, there is a larger amount of liquidity risk for REITs than for common stocks, and thus REITs' desire to manage their liquidity risk is stronger (Deng & Ong, 2018). Moreover, earlier studies find that firms sell expensive shares through earnings manipulation (the behavioral hypothesis). In view of recent studies indicating that SEO companies frequently engage in legitimate earnings management (Kothari et al., 2016; Deng & Ong, 2014), it can be reasonably anticipated that the negative consequences of these practices on post-SEO firm performance will be more pronounced than initially believed. This finding aligns with prior research suggesting that post-SEO firm performance is often inferior to manipulated post-SEO firm performance (Cohen & Zarowin 2010; Rangan 1998).

Earnings management efforts over accrual-based manipulation are favored among REIT managers for a major reason, i.e. the fact that REIT managers are also limited by the dual performance measurement by net income and money from operations prior to enhancing their compensation by actions like mergers and acquisitions (Deng and Ong, 2018). Because REITs with low operating cash flow are less likely to seek external funding, their motivation to control net operating income is greater than for other companies. In terms of REIT exposure to SEO timing, the study has just begun to focus on SEO timings in connection to the degree of earnings management. In light of South Africa's recent financial scandals¹ (Holtzblatt et al., 2020; Jooste, 2011), this study contributes to investigating possible instances of earnings manipulation among REITs on the Johannesburg Stock Exchange. These incidents call into doubt the competency and ethics of firm managers which, in turn, drives investors and future investors to question the financial statements that they receive. Cases like these elicit concerns not only about the aptitude and ethical fiber of corporate executives, but also about the dependability of financial records furnished to shareholders and potential shareholders. For instance, the South African Institute of Chartered Accountants started an inquiry on November 2, 2017 to investigate the conduct of a handful of troubled accountants and managers. Examining REITs in this paper intends to expand the understanding of the prevalence and

¹ fraudulent financial reporting; Corporate malfeasance; Audit Scandals

degree of earnings management activities in South African REITs. Regulators like the International Accounting Standards Board (IASB) and the South African Institute of Chartered Accountants (SAICA) are also concerned with earnings quality, as financial reports reflect the outcome of, *inter alia*, the standard-setting process (Schipper & Vincent, 2003). Of interest is the specific relationship between management structures of REITs and instances of earnings management in the South African market. When ownership and management are separated, the study may expect alternative decisions including differing degrees of earnings management to emerge (Ambrose & Linneman, 2001). Based on the pioneering evidence of Jensen and Meckling (1976), the study assumes that REITs, like other firms, are vulnerable to earnings management. Several scholars have examined the influence of REIT ownership/management structures on REIT performance to the exclusion of earnings management.

According to Omokhomion, Egbu, and Robinson (2018), REITs have two basic types of management structures: internal and external. Managers who work for a REIT but are governed by REIT authorities have control over the structure. REITs use people in various roles, including asset management, acquisition, and advising. The study also noted that REITs with external management have a more marked control and ownership split. An intermediary asset management firm engaged in REIT manages day-to-day property management, as well as financial and operational duties. As a result, the REIT firm pays a variety of fees to managers; it is possible to charge a flat fee or an incentive fee, both of which are based on the percentage of the fund's assets under management (AUM). Ooi (2009), for instance, documented that compensation paid to externally managed REITs managers must be scrutinized due to the underwhelming performance of these firms in the United States and the looming global financial crisis. REITs have historically behaved like mutual funds in the United States (US), with the exception of their ability to trade. They were required to engage advisers who served as managers, select properties, and implement investment plans that are inherent in managing earnings on behalf of them. In contrast to other passive investments, such as bonds and shares, property investments necessitate the employment of property managers, which is why numerous REITs noticed inefficiencies and conflicts of interest among

advisors/REIT managers and shareholders in the late 1980s (Wei et al. 1995; Ambrose & Linneman, 2001). REITs were permitted to engage in self-advisory and management activities following a modification of the legislation in 1986. REITs grew rapidly in the 1990s, sparking several academic studies on the organizational management structure of REITs and its effect on REIT performance. Despite the argument that REITs are internally rather than externally managed, several REIT regimes have embraced externally managed structures since the US first implemented them. Most REITs, particularly in Asia, have an externally managed structure, either by default or as a necessity, indicating that externally managed REITs have certain advantages. Because of the increasing use of REITs as a form of indirect property market investment and their increasing appetite for expansion (mergers and acquisitions), among other reasons, it is critical to examine how their management style, structure, and corporate governance influence the degree of earnings management around SEOs.

It is possible to assume that individuals assigned to prepare financial statements have conflicting interests (Ronen & Yaari, 2008; Burgstahler et al., 2006), which increases the likelihood that financial statements are incomplete and inaccurate. The statistical models presented in this paper use data obtained from the Stock Exchange News Service (SENS) and IRESS Expert database to examine if there are financial sheet manipulations around SEOs and the degree of earnings management (if any) around the different management structures of real estate investment trusts (REITs) listed on the Johannesburg Stock Exchange. This study contributes to the literature on REITs in two ways. First, it provides novel evidence of the earnings management behavior of different management structures around SEOs in the REITs sector. Second, it extends this line of inquiry to the emerging REIT market. Also, because the legislative requirement of a 90% dividend payout is often considered to lessen agency problems and hence minimize earnings management activities in REITs, the study of earnings management in REITs is extremely significant; according to Boshoff and Bredell (2013), the new tax treatment allows an SA REIT to deduct all distributions made to shareholders as a cost. Consequently, if all distributable earnings are distributed to shareholders, they are not taxed. The SA REIT is exempt from the Capital Gains Tax (CGT) on property transactions. SA REIT shareholders are not

required to pay any Security Transfer Tax (STC) when purchasing or selling REIT shares. Investors receive gross payments that are not subject to 15% dividend tax. However, dividends were included in their taxable income. This allows investors to use debt efficiently to fund the acquisition of their REIT investments on a pre-tax basis. If the investment in an SA REIT is part of a pension, provident, or preservation fund, no tax is payable; however, foreign shareholders of an SA REIT must pay 15% of their dividends, or the double tax agreement may apply; all in all, REITs listing requirements limit the debt to gross asset value for SA REITs. The insights presented aims to decrease the probability of dishonest behaviors by REITs' managers, who appear to frequently deceive investors.

The relationship between the organizational structure of real estate investment trusts (REITs) and manipulation of earnings and losses in emerging markets had not been previously examined. Existing studies are likely to be limited in their scope. Addressing this relationship would significantly contribute to our understanding of the broader implications of REITs, not only in South Africa but also in other contexts. Further research in this direction holds promise for enriching academic discourse and more informed decision making. This study contributes to literature in several ways. First, our findings contribute to the body of knowledge in the field of finance that examines market performance by highlighting the significance of strong corporate governance as a safeguard for stakeholders. In light of this, it is claimed that REIT corporate governance is crucial, but neglected in some instances. We think REIT investors are aware of earnings management and its impact, and that their monitoring and disclosure duties require earnings manipulation to be conducted in a manner compatible with the interests of shareholders. Second, our research contributes to accounting and finance literature by examining the connection between stock price movements and earnings management. In contrast to previous research, we provide evidence that domestically managed REITs do not engage in aggressive earnings management. In conclusion, we contribute to the real estate literature by addressing the ongoing debate on whether equity securitization of real estate portfolios through the REIT structure adds value by facilitating the processing of information concerning portfolio management investment decisions. These results should be of interest to both investors and governments, who hope that real estate capital

markets work as efficiently as possible. The remainder of this paper is organized as follows. The following section presents the data sources and testable hypotheses; this is inherent with "Measuring Financial Results Manipulation" which describes ways to quantify prevalence and the degree of financial manipulation. The subsequent section "Empirical Results" summarizes and interprets the empirical findings from univariate and multivariate regression analyses. The last section is referred to as the "Discussion."

2. Data Sources and Hypotheses

The study analyzed 476 SEOs issued by 34 REIT firms (depending on data availability) from January 1, 2013, to December 31, 2021. The number of SEOs was obtained from the Stock Exchange News Service of the (SENs). The study did not uncover consistent data on SEOs for 2020 and 2021; hence, it began the study period in 2013 and ended in 2019, which was inspired by the evolution of the REITs regime in South Africa. For the purposes of this study, the sample comprised all types of REITs. Financial ratios and stock accounting data were obtained from the IRESS Expert database. The 34 SAREITs were further classified into internally managed and externally managed enterprises (using information gathered from SENs) for comparison to examine the degree of earnings management around SEOs. There were 29 domestically managed REITs and five externally managed REITs. The study first evaluates earnings management using its discretionary accruals proxy and then tests the hypotheses using multivariate and univariate ordinary least squares (OLS) specifications. We apply OLS regressions as one of the relevant models to capture a long time series. Moreover, the OLS-based Jones model is favored for identifying simulated earnings management (Höglund, 2013; and Ambrose & Bian, 2010). Morri et al. (2020) noted that the OLS model is best suited to investigate whether there is a significant relationship between excess dividends and a small set of covariates, including the samples of ratios used in this study (free cash flow, size, and ROA). As a result, this study used an alternative proxy for discretionary accruals.

2.1. Measuring Earnings Management in Financial Statements: The Discretionary Accruals Phenomenon

Extant studies (Jones 1991; Defond & Jiambalvo 1994; Teoh 1998; Rangan 1998, Zhu et al. (2010); Cohen & Zarowin (2010); Ghazali et al., (2015); Jackson (2018))

have measured earnings management using discretionary accruals. Jackson (2018), for instance, opined that discretionary accruals are widely used in literature. This study documents how the use of basic econometrics explains discretionary accrual estimation. Interestingly, the study criticized the proxy as a measure, noting that many researchers often do not consider the underlying econometric nature of the same proxy or how it is interpreted. Rangan (1998) also documented that earnings management is best measured using discretionary accruals, noting that discretionary accruals are most effective in the quarter during which stock prices are announced, and in the following quarter. Furthermore, discretionary accruals are measured by the total accruals. To generate the non-discretionary accruals component, we adopt a model to categorize the discretionary and non-discretionary components. Such models include the Jones Model, Modified Jones Model, M-score Model, to Industry Model. Motivated by prior real estate studies, the Modified Jones Model is used in this study (Liang & Dong, 2018; Anglin et al., 2013; An et al., 2011; Islam et al., 2011; Zhu et al., 2010). Recently, this has been observed to be the most widely used approach for detecting instances of earnings management or manipulation. The assumption in the Jones model and the cross-sectional Jones model is that any variations in revenue are nondiscretionary. Managers can use credit sales to control revenue. Dechow et al. (1995) adjusted the Jones model by subtracting the variance of receivables (ΔREC); hence, this study adopted the modified Jones model proposed by Dechow et al. (1995), which is commonly used in earnings management studies to estimate discretionary accruals (Peasnell et al., 2005; Frankel et al., 2002; Haw et al., 2004; Rahman & Ali, 2006). The modified Jones model regresses total accruals (TACC) for three variables: the change in revenues (ΔRev); the change in receivables (ΔRec) and the level of gross property, plant and equipment (PPE).

Discretionary Accruals:

$$TACC_{it} = \alpha_0(1/A_{it-1}) + \alpha_1(\Delta REV_{it} - \Delta REC_{it}/A_{it-1}) + \alpha_2(PPE_{it}/A_{it-1}) + \epsilon_{it} \quad (1)$$

where:

$TACC_{it}$ - the sum of total accruals in year t ,

A_{it-1} - the sum of assets in year $t-1$,

ΔREV_{it} - the change in revenues between years t and $t-1$,

ΔREC_{it} - the change in receivables between years t and $t-1$,

PPE_{it} - the sum of the property, plant & equipment in year t ,

ϵ_{it} - statistical error.

$$DA0 = \alpha_0 + \alpha_1 * DE - \alpha_2 * DY - \alpha_3 * FSIZE - \alpha_4 * MTB + \alpha_5 * ROA + \alpha_6 * FCF + \alpha_7 * ManagementStructure \quad (2)$$

The independent variables are time-varying covariates.

2.2. Control Variables

This study focuses on previous studies that used variables to control for earnings management, which is in line with the investigation of the incidence of earnings management within the different management structures of REITs in South Africa. Based on this, this study employs the variables that explain the earnings management of REITS (due to the availability of data) in Table 1. Analysts and investors use the debt-to-equity ratio (LEVERAGE) to determine how much debt a company has in relation to the equity it possesses or shareholders own. A firm has a wide range of financial requirements to effectively execute its activities (Matsuura, 2008). Most accounting choice research has examined the debt-to-equity ratio as a proxy for how close a firm is to breaching its covenant obligations. This study reveals that, when the ratio is high, managers are more likely to choose accounting practices that increase earnings. Duke and Hunt (1990) implied that, for more than 60% of the limits on retained earnings, working capital, and net tangible assets, the debt-to-equity ratio is a suitable proxy for the presence or absence of debt covenant constraints. The higher the debt-to-equity ratio, the more likely it is that business activity will raise income, and hence, a positive correlation. Dividend Yield (DY) is expressed as the financial ratio (dividend/price), which indicates how much a firm pays out in dividends per year in relation to the stock price, and is calculated as a percentage (Christie, 1990; Chen et al., 1990; Asquith & Mullins Jr, 1986; Ong et al., 2011; Elliott et al., 2009); dividends are a way for a corporation to return profits to its owners. This is a method for returning cash or assets to shareholders as well as a strategy for paying funds to shareholders (Jensen, 1986). Free cash flow can be distributed to shareholders via dividends.

Managers may be motivated to manipulate earnings and maintain dividend hikes in this scenario (Barkhordar & Tehrani, 2016). Firm Size (SIZE) Syed Zulfiqar et al. (2010) claim that dividends can be utilized as a feature to forecast income. These scholars further argue that if a corporation reduces its

shareholder dividend, this can be seen as a solution to alleviate the firm's difficult situations. Ultimately, this is an example of earnings management. The relationship between firm size and earnings management has been studied using agency theory (Barton and Simko (2002); Ali et al. (2015)). Financial analysts have high expectations from large firms and thus often engage in earnings management to meet these expectations (Turegun, 2016). Conversely, research by Kim (2003) and Swastika (2013) opined that same large firms possess adequate organizational controls. Furthermore, the scholars noted that large firms are frequently audited by one of the big accounting firms, reducing the likelihood of engaging in financial reporting manipulation. Several prior studies have found conflicting results regarding the relationship between the amount of leverage a firm has and its size. The market-to-book value ratio (MTB) is also believed to be linked to firms' incentives to control earnings. To compensate for their greater sensitivity to earnings swings, firms with low market-to-book value ratios stand to gain more from earnings management, and thus, have higher incentives to manage earnings (Skinner & Sloan, 2002). Return on assets (ROA) measures how much a firm may make from its assets while still making a loss (Yuliana & Trisnawati, 2015). Indeed, it is possible that a decline in earnings will make a company less appealing to investors. Firms that generate many returns are more motivated to make money-driven decisions to maintain or even enhance their profits each year (Wiyadi et al., 2015). Free cash flow (FCF) and earnings management have a positive relationship. According to Jaggi and Gul (2006), FCF and earnings management are positively related. The management of firms with high FCF manipulates earnings upward to post strong results and maintain job security. The findings of Chung et al. (2005a) are supported by those of the aforementioned studies. Firms with high FCF use discretionary accruals to cover negative net present value (NPV) projects (Bukit & Iskandar, 2009).

Table 1

Model Specification - Earnings Management and Financial Ratios/Control Variables

<i>Dependent Variable</i>	
DA (Earnings Management Proxy/Measure)	Earnings Management: Discretionary accruals are often used to measure the dependent variable, EM. The Jones Model calculates discretionary accruals. The Jones model (1991) is a widely used model for measuring earnings management.
<i>Independent variables (Firm Level)</i>	
DE	Debt/Equity ratio: Book value of total liabilities divided by book value of equity,

	computed by using data from the year preceding the SEO announcement
DY	Dividend yield: The financial ratio (dividend/price) which indicates how much a firm pays out in dividends per year in relation to the stock price, and calculated as a percentage
FSIZE	Firm Value: The value at which the shares of a company's stock is estimated
MTB	Market to Book value Ratio: The measure is used to equate a company's available net assets to the price at which the stock is sold
ROA	Return on Assets: Net income divided by book value of assets, computed by using data from the year preceding the SEO announcement
FCF	Free Cash Flow: calculated as sales revenue - (operating costs + taxes) - required investments in operating capital.
MANAGEMENT STRUCTURE	Internal and External Management: Internally managed REITs hire their own personnel, analysts, managers, and executives to handle the firm's assets as opposed to externally managed REITs. Internally Managed – Dummy Variable 1 Externally Managed – Dummy Variable 0

Source: own study.

3. Empirical Results

3.1. Basic research premises

This study estimates the degree of earnings management using discretionary accruals (modified Jones model) between internally and externally managed REITs during the study period. The chapter begins by providing descriptive statistics, followed by trend analysis, correlation, and Ordinary Least Squares (OLS) regression.

3.1.1. REITs SEOs by year, and management type

The distribution of the REITs is shown in table below. The time-series of SEOs and management structures are presented in the following table below (Table 2) (i.e., internally managed versus externally managed REITs). There was an overall increase in the number of businesses issuing SEOs during the study period. The year 2014 saw the highest number of observations, with 179 SEO concerns. In South Africa, this can be traced back to the implementation of the REITs system (2013). A noticeable decrease in SEOs was observed during the years encompassing the Covid-19 outbreak. According to Hsu et al. (2021) and Halling et al. (2020), the initial phase of the pandemic saw a significant decline in stock prices across multiple industries of publicly traded companies, which can be attributed to investors' rational projections of the

adverse effects of the pandemic on businesses. Furthermore, as a result of the spread of Covid-19, both IPOs and SEOs were excluded from robustness testing.

Table 2

Distribution of REITs SEOs by year and Management Type		
SEO Year	Internally Managed	Total
Externally Managed		
Distribution by Year and Management type		
2013	18	44
2014	56	179
2015	26	77
2016	17	65
2017	47	111
2018	20	51
2019	13	55
Total	202	590

Source: own study.

3.1.2. Summary Statistics

Table 3 presents a mean comparison of all variables for internally managed REITs compared to those managed externally. The findings demonstrate that the mean value for Discretionary Accruals (DA) in externally managed REITs (9.5, standard deviation=1.7) is somewhat higher than the mean value for DA in internally managed REITs (9.74, standard deviation=2.6). When comparing FIRMSIZE in externally managed REITs with that in internally managed REITs, the former was 1.9 times larger/higher. "FIRMSIZE" denotes the natural logarithm of the total assets of firm *i* in 2010. The calculation of "FIRMSIZE" involves adding the market value of all long-term debt, debt in current liabilities, and the liquidating value of preferred stock (Anglin et al., 2013). In terms of corporate capital, leverage, also known as the debt-equity ratio, measures the proportional contributions of creditors, shareholders,

and owners to the total amount of capital utilized in the firm (Ambrose & Bian, 2010). LEVERAGE levels in externally managed REITs (0.84, standard deviation = 0.77) were much lower than those in internally managed REITs (6.2, standard deviation = 36). The DIVIDEND YIELD, also known as the financial ratio, is a measure of how much dividends a company pays out every year in proportion to the price of its shares. It is expressed as a percentage of the stock price.

The DIVIDEND YIELD in externally managed REITs (14.1; standard deviation = 37.2) was greater than that in internally managed REITs (9.8; standard deviation = 10.4). Regarding RETURN ON ASSETS (ROA), the findings demonstrate that the ROA in externally managed REITs (5.9 percent; SD=7.1) was somewhat lower than that in internally managed ones (6.1 percent; SD=6.1); nevertheless, this difference is minor. Furthermore, the descriptive data reveal that TOTAL ASSETS in externally managed REITs were marginally lower (6.7; SD=10.6) than those in internally managed REITs (7.6; SD=8.3). In externally managed REITs, the mean MARKET TO BOOK VALUE RATIO (0.87) was 15 times lower than the mean MARKET TO BOOK VALUE RATIO in internally managed REITs (13.5; SD=132). When comparing internally managed REITs to externally managed REITs, the FREE CASH FLOW (FCF) was 1.3 times greater in internally managed REITs (243,363; SD>100) than in their externally managed counterparts. The findings also reveal that the mean value of discretionary accruals in internally managed REITs is less than the values inherent in externally managed REITs; interestingly, South African externally managed REITs manage their earnings more than their counterparts do.

Table 3

Summary Statistics for Internally and Externally Managed REITs in a matched sample						
Variable	Externally Managed REITs			Internally Managed REITs		
	Obs.	Mean	Std. Dev.	Obs.	Mean	Std. Dev.
Panel A: Earnings Management Proxy/Measure						
DA	388	9.497	1.701	202	9.743	2.58
Panel B: Control Variables						
Firm Size ('000s)	388	7,160,000	13,100,000	202	13,400,000	17,900,000
Leverage (Debt/Equity)	388	1	1	202	6	36
Dividend Yield	388	14	37	202	10	10
Return on Assets	388	6	7	202	6	7
Free Cash Flow (FCF)	388	185,573	324,806	202	243,363	432,678
Market to Book Value	388	1	0	202	13	132
Panel C: DA Variables						
Current Liabilities	388	1,446,728	2,927,914	202	2,200,729	2,461,585
Current Assets	388	1,446,728	2,927,914	202	2,200,729	2,461,585
Amortization	388	-	-	202	-	-
Total Assets	388	7	11	202	8	8

Receivables	388	205,051	348,358	202	554,271	846,787
PPE	388	199,770	713,585	202	1,044,047	4,447,983
Depreciation	388	9,519	28,892	202	3,759	12,152
Revenue	388	471,276	630,805	202	1,161,108	2,919,826

NOTE: The above presents summary statistics for internal and external REITs in a matched sample. Using Mean and Standard Deviation values, discretionary accruals in internally managed REITs are less than the values inherent in externally managed REITs; interestingly, South African externally managed REITs manage their earnings more than their counterparts do.

Source: own study.

3.1.3. Overall Discretionary Accruals (2013 - 2019, all REITs)

Table 4 indicates that the average discretionary values between 2013 and 2019 (although 2020 and 2021 were excluded because of inconsistent data) in this sample were negative. For each percentile, we computed a 95% confidence interval around the mean discretionary accruals (DA). The results reveal that the null hypothesis of zero DA is rejected at the 0.05 level for percentiles representing lower and higher earnings levels (type I error). Surprisingly, the results show that aggressive earnings management (Discretionary Accruals) practices in externally managed REITs are relatively higher than those in internally managed REITs, although negative. Therefore, the null hypothesis is rejected. This prediction is, therefore, inconsistent with the extant literature, which has established that external managers on a firm's board appear to restrain earnings management activities (Klein, 2002; Peasnell et al., 2000, 2005, 2006; Benkel et al., 2006; Benkraiem, 2011). To comprehend the uniqueness of the findings, it is reasonable to assume that earnings management is motivated by the desire to postpone or minimize the release of negative news to investors (Peasnell, et al., 2005).

Another possible reason is that the negative discretionary accruals discovered in this study are due to poor financial performance and distress among internally and externally managed REITs. This study

observes that, as a result of financial distress and the inability to express a going concern modification (GCM), issuing firms can manipulate their stock prices by managing earnings, and the market appears to extrapolate earnings growth associated with negative discretionary accruals and thus overvalue the issuing firm (Yuanwei, 2009; Ajona, et al., 2008). Prior REIT-specific research (Dempsey et al., 2012; and Ambrose & Bian, 2010) offer an equally compelling justification for boosting earnings management activities among financially distressed firms. Dechow et al. (1995) show that discretionary accruals are skewed in organizations with exceptional performance.

3.1.4. The Augmented Dickey-Fuller (ADF) Unit Roots Test

All the test statistics, except DEBT/EQUITY RATIO (LEVERAGE), DIVIDEND YIELD, and REVENUE, are greater than the critical value, with a corresponding Mackinnon p-value greater than the recommended 5%; hence, we conclude that there is a presence of unit roots. By implication, the presence of a unit root in a series implies that there is more than one trend in the series. This justifies the need to transform data into natural logarithms. The data series for LEVERAGE, DIVIDEND YIELD, and REVENUE are stationary (they do not have unit roots, as the p-value is significant at the 5% level). The results of the Augmented Dickey-Fuller test for all the variables are shown in Table 5.

Table 4

Overall Discretionary Accruals (2013 - 2019, all REITs)						
Discretionary accruals (DA)						
Percentiles		Smallest				
1%	-69	-68.98				
5%	-65.9	-65.94				
10%	-65.6	-65.60		Obs	22	
25%	-63.4	-64.54		Sum of Wgt.	22	
50%	-55.2			Mean	-55.70	
				Std. Dev.	7.66	
		Largest				
75%	-51.1	-47.83				
90%	-44.6	-44.61		Variance	58.66	
95%	-43.4	-43.42		Skewness	0.01	
99%	-42.6	-42.57		Kurtosis	2.04	
Variable	Obs	Mean	Std. Dev.	Min	Max	
DA_internally managed REITs	8	-53.06	9.09	-65.60	-42.57	
DA_externally managed REITs	13	-56.95	6.79	-68.98	-47.83	

Source: own study.

Table 5

The Augmented Dickey-Fuller (ADF) Unit Roots Test

Interpolated Dickey-Fuller Unit Root Test		Statistic	1% Critical value	5% Critical value	10% Critical value	MacKinnon p- value for Z(t)	Unit root	Stationarity
<i>Panel A: Control Variables</i>								
ROA	Z(t)	-0.81	-3.75	-3	-2.63	0.8162	No	No
Dividend Yield	Z(t)	-10.106	-3.75	-3	-2.63	*0.000	No	Yes
Free Cash Flow	Z(t)	-3.315	-3.75	-3	-2.63	*0.0142	No	Yes
MBVR	Z(t)	-2.26	-3.75	-3	-2.63	0.1851	Yes	No
FSIZE	Z(t)	-0.781	-3.75	-3	-2.63	0.8246	Yes	No
Leverage	Z(t)	-0.86	-3.75	-3	-2.63	0.1720	Yes	No
<i>Panel B: DA Variables</i>								
TL	Z(t)	-0.05	-3.75	-3	-2.63	0.9542	Yes	No
TR	Z(t)	-0.452	-3.75	-3	-2.63	0.9011	Yes	No
DEP	Z(t)	-1.342	-3.75	-3	-2.63	0.567	No	No
REV	Z(t)	-3.416	-3.75	-3	-2.63	*0.0104	No	Yes
CASH	Z(t)	-0.818	-3.75	-3	-2.63	0.8138	No	No
TA	Z(t)	-0.669	-3.75	-3	-2.63	0.8546	No	No

NOTE: (*) denotes statistical significance at the 5% level. The significance level indicates the probability that the observed test statistic will occur if the null hypothesis of the unit root is true. A p-value below 0.05 suggests rejection of the null hypothesis, indicating evidence of stationarity in the data.

Source: own study.

3.1.5. Pearson's Correlation

In Table 6, there are strong positive correlations between DIVIDEND YIELD and discretionary accruals (Earnings Management) in both domestic ($r=0.80$, $p0.05$) and externally managed REITs ($r=0.985$). An increase in DIVIDEND YIELD would almost certainly results in an increase in Earnings Management. In accordance with He (2017), this study reveals that previous studies (Lintner, 1956; Skinner & Soltes, 2011) found that paying dividends does not preclude firms from committing accounting fraud, implying that dividend-paying firms may not always operate in the best interests of their shareholders. Consistent with Susanto et al. (2017), Agustia (2013), Amertha et al. (2014), and Yogi and Damayanthi (2016), FREE CASH FLOW (FCF) is significantly negatively associated with Earnings Management ($r=-0.36$, $p0.05$), with a weak effect in internally managed REITs and a twofold effect on externally managed REITs ($r=-0.729$). A reduction in FREE CASH FLOW (FCF) would generally be expected to lead to a decline in shareholder earnings, unless it is utilized to enhance shareholder earnings through a profitable investment. If the company's management fails to use this opportunity to benefit the company's owner, investors will likely conclude that the company's management is ineffective, ultimately resulting in a state of stagnant growth (Jensen, 1986). For internally managed REITs, firm size (firm value) is highly correlated with Earnings Management (EM); however, this is not the case for externally managed

REITs. In this sample, DIVIDEND YIELD, LEVERAGE (debt/equity), and RETURN in ASSETS (ROA) were not associated with EM.

Table 6

	Pearson's Correlation		
	Internally Managed REITs	Externally Managed REITs	Full Sample REITs
	DA_In	DA_In	DA_1n
Discretionary Accruals	1	1	1
Dividend Yield	0.8042*	0.9852*	0.8319*
Leverage_1	-0.1584	-0.2699	-0.1851
Return on Assets	-0.2266	-0.6385	-0.4734
Market Book Value	-0.1298	-0.1418	-0.1305
Free Cash Flow	-0.3616	-0.7295*	-0.5619*
Firm Size	-0.7536*	0.0809	0.0439

NOTE: (*) denotes statistical significance at the 5% level. The correlation coefficient measures the strength and direction of the linear relationship between the two variables. Positive correlations indicate that as one variable increases, the other tends to increase, whereas negative correlations indicate that as one variable increases, the other tends to decrease.

Source: own study.

3.1.6. REITs management structures and Earnings Management: Multivariate OLS regression

Table 7 presents the results of the OLS regression to test the association between REITs management structures and Earnings Management. The dependent variable was estimated using the cross-sectional modified Jones model (1991). The two proxies for

management structure include a DUMMY variable for internally managed REITs (1) and externally managed REITs (0). Although Gras-Gil et al. (2016) provide contrary evidence, we corroborate these findings with those of Arun et al. (2015), wherein Firm SIZE is found to be negatively associated with earnings management. The negative FIRM SIZE coefficient term indicates the change in Discretionary Accruals (DA) for a unit change in Firm Size; that is, if firm value rises by one unit, earnings management decreases by -3.2. The results are significant at the 10% level ($\alpha=-3.21$, $p=0.1$), implying a negative relationship between FIRM SIZE and earnings management. While there is no agreement in the literature regarding the effect of FIRM SIZE on earnings management, these findings imply that aggressive earnings management practices are not dependent on a firm/REIT being large, because of close scrutiny by investors. In contrast to Alhadab and Al-Own (2017), Bhojraj et al. (2009), and Taylor and Xu (2010), we find that the positive RETURN ON ASSETS (ROA) coefficient term indicates the change in discretionary accruals (DA) for a unit change in ROA; that is, if the ROA values rise by one unit, then earnings management increase by 4.4 times ($\alpha=4.4$, $p<0.05$). The results are significant at the 5% level, implying a significant relationship between ROA and earnings management.

As ROA is a key performance indicator of firm performance, these findings are consistent with extant studies (Lee et al., 2006; Dechow et al., 1995; El Sood, 2012), thus suggesting that REITs managers of internal and external management classifications use earnings management to understate the current period reported earnings in an attempt to reduce the current market price of the firm's common stock or adopt stock options plans that will ultimately increase share prices and, consequently, firm value (Alves, 2012). The negative market value coefficient term indicates the change in discretionary accruals (DA) for a unit change in market values; that is, if market values rise by one unit, earnings management decreases by -2.34 ($p=0.06$). Thus, the relationship between market values and discretionary accruals appears to be inverse, as discretionary accruals tend to decrease with increasing market value. The magnitude of this decrease is indicated by the negative coefficient (-

2.34), suggesting a negative association between market value and discretionary accruals. This finding implies that higher market values are associated with lower earnings management levels, as indicated by the negative coefficients. Therefore, the results indicate that changes in market value are associated with corresponding changes in discretionary accruals. The results are significant at the 10% level, implying weak evidence of a relationship between market-to-book value and earnings management. Our study uncovered a unique insight that high free cash flow (FCF) and low growth potential in real estate investment trusts (REITs) are associated with poor long-term profitability, as reported in earlier research (Bukit, 2015; Nekhili, 2015; Astami et al., 2017). To conceal the impending poor performance of these new investments, corporate executives turn to negative accruals to reduce the current year's earnings and smoothen earnings when these investments have a negative effect. Surprisingly, these results indicate lower levels of earnings management in internally managed REITs than in externally managed ones; dividend yield and debt equity ratios were also not significant predictors of earnings management.

We believe that there is no widespread or aggressive earnings management practice among internally managed REITs in South Africa; however, these findings are not consistent with the literature on the subject (Epps & Ismail, 2009; Xie et al., 2003; Beekes et al., 2004; Chen et al., 2007). We believe that these findings are one-of-a-kind because of the rising popularity of REITs in South Africa and their reputation as an interesting investment option for investors in Africa, with a current market size of approximately \$400 billion. In addition, these results are based on the fact that the administration of South African REITs is handled by organizations that adhere to stringent governance standards and are performance-driven and entrepreneurial (de Klerk, 2019; Moloi & Akinsomi, 2019). This finding suggests that they focus on getting the most out of their property investments in the long term. They improved the transparency and accountability of the real estate industry by implementing sound governance practices.

Table 7

Do internally managed REITs manage earnings more than externally managed REITs: Multivariate OLS Regression												
Internally Managed REITs						Externally Managed REITs						
	Coef.	Std. Err.	z	P>z	[95% Conf. Interval]		Coef.	Std.Err.	z	P>z	[95% Conf. Interval]	
DA												
1.Internal	1.306	3.661	0.36	0.722	-5.88178	8.494011	2.113	2.892	0.51	0.521	-4.1134	7.71839
Firm Size	-3.213	1.665	-1.93	**0.054	-6.47721	0.051	-3.021	2.510	-1.71	**0.161	-5.02191	0.0021
MBVR	-2.342	1.243	-1.88	**0.06	-4.77939	0.09481	-3.910	1.031	-1.54	**0.75	-4.01831	0.071027
Dividend Yield	0.721	0.7182	1	0.315	-0.68629	2.129007	0.810	0.8210	1	0.741	-0.51089	1.920281
Debt/Equity_1	0.677	0.843	0.8	0.421	-0.97436	2.330233	0.319	0.310	0.65	0.682	-0.85105	2.829102
Return on Assets	4.499	1.835	2.45	*0.014	0.901663	8.096469	4.103	1.720	2.01	*0.003	0.75631	7.038293
Free Cash Flow_1	0.137	0.460	0.3	0.764	-0.76388	1.039834	0.201	0.501	0.41	0.620	-0.82184	1.070291
Constant	48.069	37.607	1.28	0.201	-25.639	121.7784	43.012	33.103	1.31	0.318	-23.019	117.0128

NOTE: R-squared= 0.9970; Prob > chi2= 0.0000. **Significant at 5% level *Significant at 10% level. Property, plant, and equipment (PPE) were excluded because of collinearity. This table presents the results of a multivariate ordinary least squares (OLS) regression analysis comparing internally managed REITs to externally managed REITs. The coefficients represent the estimated effect of each independent variable on the dependent variable. The standard error indicates the precision of the coefficient estimate, whereas the z-value and p-value tests indicate the statistical significance of the coefficient. The confidence interval provides the range within which the true coefficient is likely to decrease. Our note also provides information on the overall goodness-of-fit of the regression model and significance levels of the coefficients.

Source: own study.

4. Discussion

Earlier research has documented large discretionary accruals accompanying seasoned stock issues, without considering the management structure of issuing REITs. We propose that information asymmetry concerns are more severe in an externally managed REIT. As a result, earnings management is more aggressive in an externally managed REIT than in an internally managed one in the same industry. Using a sample of 34 South African real estate investment trusts (REITs) that issued seasoned equity between 2013 and 2020, we investigate the difference in discretionary accruals between internally and externally managed REITs in South Africa. When comparing externally managed REITs to internally managed REITs, we find that the former have higher discretionary accruals. Even after adjusting for elements that have been demonstrated to be associated with a firm's discretionary accrual, these findings are not consistent across commonly used measures of earnings management. In this study, it is hypothesized that the composition of a REIT board with external directors influences earnings management practices in South Africa (Marrakchi Chtourou, et al., 2001; Shah, et al., 2009; Uadiale, 2012; Abbad, et al., 2016). SEOs are the subject of this investigation, which demonstrates how accrual management can be utilized to achieve financial objectives. To "achieve these objectives," manipulating earnings to increase profits is standard practice. Previous studies have reached varying conclusions in various settings. Accruals decline with

external management, but external management has no statistically significant effect on earnings manipulation, as Kim and Yoon (2008a) and Mazumder (2016) demonstrate. Additionally, scholars assert that externally managed firms, particularly those with a high and stable proportion of foreign capital in their capital structure, engage in less profit management than their internally managed counterparts (Mohd-Sanusi, & Hermawan, 2017 and Guo et al., 2015).

Shayan-Nia et al. (2017) state that they can limit upward earnings management owing to discretionary expenditure, but not due to the work cycle. According to Guo et al. (2015), firms with external management also lower earnings manipulation in firms listed in Japan through net cash. On the other hand, Udawatte (2020) cites information asymmetry between domestic and foreign investors as one reason why firm managers are more inclined to manage earnings. For the first time in South Africa, we find evidence that financial sheet manipulation is associated with the extent of external management of REITs, indicating that the board of directors does not benefit significantly from external directors in monitoring a firm's earnings management, which is consistent with Park and Shin (2004). According to a few reasonable variables, the external management of real estate investment trusts (REITs) was inefficient in regulating earnings management in South Africa throughout the SEO period. Owing to a lack of financial acumen and access to critical information, external directors may be unable to identify and

correct earnings management in most cases. External directors may also be disinterested because of their lack of financial interest in the firm over which they reside. In addition, if there are many powerful shareholder CEOs, it may be difficult for them to properly oversee earnings management.

In addition to having several practical implications, this research should be of particular interest to the relevant securities exchange regulatory body in South Africa, which is currently engaged in an anti-earnings management campaign, and the Accounting Standards Board (ASB), which has proposed changes to its standard-setting process to shift away from a rule-based approach to a principles-based standards setting. The findings of this study imply that good corporate governance is a critical safeguard for stakeholders in exceptional circumstances when REITs have special incentives to manage earnings. As a result, it is suggested that REIT corporate governance is important despite being overlooked in some circumstances. It is possible that reducing accounting discretion may increase the informativeness of earnings because it will confine earnings management and encourage the comparability of outcomes among REITs (Fishman & Hagerty 1990). Specific to South African real estate investment trusts, policymakers and nominating committees of the board of directors may wish to take note that financial competence is an important quality of external directors to effectively oversee earnings management. Future studies could include alternative earnings management measures (beyond total accruals, as in this study).

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