

Have New Economy Firms Ushered in a New Era of Earnings Management?

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The emergence of the Internet has led to new standards of product customization, variety, convenience, timeliness, and overall productivity. Clearly, the Internet has been good for economic growth. Simultaneously, new standards of ethics and company building may have also emerged as the basis for the primary building code of many Internet firms in the 90's.

Our thesis is that the emergence of the New Economy has also lead to the emergence of more aggressive accounting practices.¹ Further, it is our view that aggressive accounting practices are themselves a form of earnings management. Despite the increased vigilance by the SEC in monitoring such activity, prevalence of aggressive accounting in the New Economy appears undeniable. The increased use of pro forma reporting was but one example of aggressive accounting in financial reporting.

BACKGROUND

New Economy firms as used in this paper are broadly defined as Internet-based companies (IBC), which are firms that do a majority of their business over the Internet or serve the Internet industry as a majority of their business. Old Economy firms, non-Internet-based companies (NIBC), are those that conduct business primarily face to face or over the phone. Our contention is that IBCs have been more aggressive than their Old Economy counterparts in managing their accounting numbers.

During the last fifty years, accounting researchers have produced a plethora of articles on the various forms of earnings management (EM). Although the methodology to detect it is

¹ See Bitner and Crawford, "Unabashed Artful Dodgers of the New Economy," *Strategic Finance*, September 2002.