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NON-FINANCIAL COMPANIES: EARNINGS MANAGEMENT AND THE FACTORS THAT INFLUENCED

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Abstract

This research examines how various factors such as independent commissioners, audit committees, institutional ownership, firm size, leverage, firm age, and audit quality impact earnings management. Data for this study was collected from 94 non-financial companies listed on the Indonesia Stock Exchange between 2017 and 2019, totaling 278 data points. Purposive sampling was used to gather sample data for analysis. The findings of the study indicated that company age and audit quality have a significant influence on earnings management, whereas independent commissioners, audit committees, audit committee independence, institutional ownership, company size, and leverage do not affect earnings management.

Keywords: *Audit Committees, Audit Quality, Company Age, Leverage, Earnings Management*

1. INTRODUCTION

In this modern era, financial reports can reflect how a company is performing, so business people in Indonesia must be able to increase the competitiveness of their companies so they can compete with other business people in Indonesia. Nurdiniah and Herlina (2015) stated that companies need financial reports to determine whether there is progress or setbacks in their business. Financial reports include all a company's financial information in the form of reports in one accounting period. Investors often use financial reports as a reference for investing in the company.

In its implementation, financial report information is often manipulated, one of which is profit and loss report information. This activity is known as earnings management because investors assess a company's performance based on the profit the company earns. Alexander and Hengky (2017) explain that earnings management is the task of business managers and involves deliberate manipulation of financial reports within the limits permitted by generally accepted principles to mislead users of information in the interests of managers. Companies in various countries, including Indonesia, often practice earnings management. In 2019, PT Garuda Indonesia Tbk (GIIA) revised its 2018 financial report, namely that the condition of the financial report, which was originally good, became bad by recognizing receivables as income. That causes companies that should have made a loss to turn into a profit. Due to this incident, the IDX, OJK, and BPK re-audited the financial reports. From the results of the audit, PK and OJK determined that there were misstatements in Garuda Indonesia's 2018 financial reports, so the company had to resubmit its financial reports and was fined IDR 100

million. Apart from that, the IDX also sanctioned the company in the form of a written warning III and a fine of IDR 250 million.

The current research is a development of previous research conducted by Mardjono et al. (2020). This research has additional independent variables: audit quality, institutional ownership, company age, and leverage. This research aims to determine whether there is an influence between independent commissioners, audit committees, audit committee independence, company size, institutional ownership, company age, leverage, and audit quality on earnings management.

2. LITERATURE REVIEW

2.1. Agency Theory

Jensen and Meckling (1976) argue that agency theory is the concept that illustrates the connection between the proprietor (referred to as the principal) and the executives (known as the agent) when it comes to decision-making. Eisenhardt (1989) states that agency problems occur because:

1. Differences in goals between owners and management.
2. Differences in risk-taking behavior between owners and management.

Conflicts may arise due to disparities in interests between the principal and the agent, leading to additional costs in resolving them. These costs are called agency costs. Godfrey et.al. (2010) explain that agency costs are divided into three, namely:

1. Monitoring costs,
2. Bonding costs, and
3. Residual costs.

2.2. Earning Management

Yateno and Gustin (2016) explain that earnings management deliberately uses the freedom of accounting choices but is still within GAAP limits to obtain the desired profit. Earnings management happens when managers alter financial reports to reflect their preferences during the preparation of financial transactions.

Subramanyam (2014) said there are three typical strategies in carrying out earnings management, namely:

1. The manager increases income over the current period, which is called increasing income,
2. Managers create an artificially inflated profit margin by decreasing the current period's earnings substantially,
3. Managers minimize fluctuations in revenue by engaging in income smoothing techniques, commonly referred to as income smoothing.

2.3. Independent Commissioner and Earning Management

Independent commissioners are individuals in the board of commissioners who do not have any connections with other parties within the organization, such as fellow commissioners, directors, or major shareholders, that could compromise their autonomy. Arifin and Destriana (2016) believe that the possibility of earnings management will be greater if the proportion of independent specialists is higher in a company.

The level of the company's independent committee members is fundamental. It influences the company's earnings management as much as possible, and the company's profits are greatly impacted by the influence of independent committee members.
Ha_1: Independent commissioners influence earnings management.

2.4. Audit Committee and Earning Management

The earnings management process can be significantly impacted by the presence of an audit committee. Various audit committees may be involved, increasing oversight on financial activities and reporting. The main role of the audit committee is to oversee the process of financial reporting and to keep an eye on managers' potential profit manipulation (Alves, 2013).

The responsibilities of the audit committee revolve around examining financial report data. Auditors act as a control system to minimize information discrepancies and enhance the trustworthiness of the company's financial statements (Becker et al., 1998)
Ha_2: There is an effect on profit management from the audit committee.

2.5. Audit Committee Independence and Earning Management

The audit committee serves as a key support system for the board of commissioners in overseeing financial reports and accounting practices established by management. It acts as a structured channel of communication between the board, internal controls, and external auditors in order to enhance the trustworthiness of the financial reports being audited (Chandrasegaram et al., 2013). Having an independent audit committee can enhance the accuracy and transparency of financial statements (Hundal, 2013). One of the characteristics that each audit committee member must have to improve their independent monitoring function is independence to ensure higher quality financial reporting.
Ha_3: Audit committee independence influences earnings management.

2.6. Institutional Ownership and Earnings Management

Institutional ownership refers to the control and possession of establishments like banks, insurance firms, investment companies, and similar entities. Institutional ownership is significant because it can increase the best control over manager behavior. Arifin and Destriana (2016) stated that stakeholders, especially institutional investors, can scrutinize managers' behavior in taking opportunities to manage profits. In general, an institution has a financial analyst to monitor management performance to make it even better.
Ha_4: Institutional ownership influences earnings management

2.7. Company Age and Earnings Management

Company age states that a company continues to exist and can compete in a country's economy. Bassiony et al. (2016) stated that compared to new companies, companies with longer operating hours have lower earnings management because old companies may want to avoid a bad public reputation.

That is because companies that have been around for a long time have a reputation to maintain and the capability to minimize costs and increase production quality based on

their experience to generate profits. For this reason, companies that have been around longer will not implement earnings management.
Ha_5: Company age influences earnings management

2.8. Leverage and Earnings Management

Leverage ratio measures the proportion of a company's assets that are funded through borrowing. Companies that rely heavily on debt for financing often work to boost their profits in order to cover the high interest costs. Zamria et al. (2013) and Wibisana and Ratnaningsih (2014) researched how company leverage affects manager actions. The research results succeeded in obtaining evidence that leverage influences earnings management actions.

Syamsudin (2013) said that the the leverage ratio indicates the amount of borrowed funds utilized by the company for various operational endeavors. It is determined through the debt-to-asset ratio, which gauges the extent to which the company's assets are supported by debt and the impact of debt on asset financing (Hery, 2016).
Ha_6: Leverage influences earnings management

2.9. Company Size and Earnings Management

Company size can be defined by its scale and scope. The internal control system of a company is influenced by its size; larger companies typically have more stringent internal controls in place to ensure the accuracy of financial information shared with the public (Rahmani & Akbar, 2013). Large companies tend to avoid earnings management because of the possible effect of encouraging the public.

Susanto et al. (2019) and Anastasia (2016) expressed the same opinion that larger companies usually do not practice earnings management compared to smaller companies. Larger companies providing their financial reports are more careful because external parties pay much attention to the company. On the other hand, smaller companies usually want to show that the company's condition is always stable and sound so that investors invest their capital.
Ha_7: Company size influences earnings management

2.10. Audit Quality and Earnings Management

Guna and Herawaty (2010) argue that the quality of Big Four audits is able to prevent earnings management by managers because auditors in Big Four accounting firms have carried out various kinds of training, procedures, and audit programs that are more accurate than non-big Four accounting firms.
Ha_8: Audit quality influences earnings management.

3. RESEARCH METHODS

Mardjono et al. (2020) chose to focus on manufacturing companies listed on the IDX for their study, however, this research specifically looked at non-financial companies within the same index. A purposive sampling method was employed, collecting a total of 278 data points. The detailed sampling process can be found in Table 1.

Table 1. Sample Selection Procedure

No.	Sample Selection Criteria	Number of Companies	Number of Data
1.	Non-financial businesses that were continuously included on the Indonesia Stock Exchange from 2016 to 2019.	435	1305
2.	Non-financial companies that did not report complete financial reports during the 2016-2019 period.	(28)	(84)
3.	Businesses without any institutional investors between 2016 and 2019.	(5)	(15)
4.	Companies that present financial reports that continue after December 31 for 2016-2019.	(3)	(9)
5.	Companies that did not release rupiah-denominated financial statements between 2016 and 2019.	(77)	(231)
6.	Companies that did not have positive profits during 2017-2019.	(126)	(378)
7.	Companies that did not have non-executive directors during the 2016-2019 period.	(102)	(306)
	Number of companies sampled:	94	282

Source: Sample selection results

Earnings management involves management's involvement in external financial reporting to serve its own interests. This practice can undermine the reliability of financial statements. Earnings manipulation introduces a distortion in financial reports and may confuse users who rely on accurate profit figures (Setiawan & Na'im, 2000). The modified Jones Model method is used in this study to analyze variables related to earnings manipulation through discretionary accruals. This measurement was taken from previous research, namely Mardjono et al. (2020). To measure earnings management, use the formula:

$$TAC_{it} = N_{it} - CFO_{it}$$

The calculation of Total Accrual (TA) is determined through the utilization of the Ordinary Least Square (OLS) regression equation incorporating the specified formula:

$$TAC_{it}/A_{it-1} = \beta1\ (1/A_{it-1}) + \beta2\ (\Delta REV_t/A_{it-1}) + \beta3\ (PPE_t/A_{it-1}) + e$$

The formula below can be utilized to calculate the Non-Discretionary value Accruals (NDA) through the coefficients regression mentioned previously:

$$NDA_{it} = \beta1\ (1/A_{it-1}) + \beta2\ (\Delta REV_t / A_{it-1} - \Delta REC_t/A_{it-1}) + \beta3\ (PPE_t / A_{it-1})$$

Discretionary Accruals (DA) can be calculated with the formula:

$$DA_{it} = TA_{it} / A_{it-1} – NDA_{it}$$

Information:
TAit = Total Accruals in year t.
Nit = Net income in year t.
CFOit = Cash flow from operating activities in year t.
DA = Discretionary accruals
NDA = Non-discretionary accruals
NDAit = Non-discretionary accruals company j in year t
Ait-1 = Total assets of company j on in year t-1.
ΔREV_t = Change in income (sales) company j between year t with year t-1
ΔREC_t = Change in accounts receivable company j between year t and year t-1
PPE_t = Gross properties, plants, and equipment of company j in year t
β1,β2,β3 = Company specific parameter

In this research, a substitute measure was employed to assess the variable known as the independent commissioner (IC) from research by Mardjono et al. (2020) as follows:

$$IC = \frac{\text{Number of Independent Commissioners}}{\text{Number of All Members of the Board of Commissioners}}$$

The audit committee outlined in regulation Number 55/POJK.04/2015 is a committee tasked with supporting the board of commissioners in carrying out their responsibilities and functions. In this research, the audit committee (AC) is calculated using the following proxy (Mardjono et al.,2020):

$$AC = \text{Number of Audit}$$

Lee and Mande (2015) state that one way to look at audit committee independence is as a percentage that compares the number of non-executive directors to the number of current independent audit committee members. According to Mardjono et al. (2020) measure audit committee independence using the following proxies:

$$IC = \frac{\text{Number of Independent Commissioners}}{\text{Number of All Members of the Board of Commissioners}}$$

Nabela (2012) explains institutional ownership, which refers to shares owned by an institution at the end of the year and is measured in percentage form. In this research, the percentage of institutional ownership (IO) is measured using a proxy by Arifin and Destriana (2016):

$$IO = \frac{\text{Number of Institutional Share Ownership}}{\text{Number of Shares Outstanding}} \times 100\%$$

Bassiony et al. (2016) say that companies that operate longer will have lower earnings management compared to new companies because old companies may want to avoid a bad public reputation. In this research, we determine the age of a company (CA) by utilizing the following substitute by Yunietha, and Palupi (2017):

CA = Current Year – The year the company was

Alexander and Hengky (2017) and (Siahaan et al., 2023) said that to determine the amount needed to finance a company, you can use Leverage (LEV). Almalita (2017) mentioned that companies can utilize leverage to boost shareholder earnings by employing fixed-cost assets and funding sources. Based on the journal Arifin and Destriana (2016) leverage ratio calculation:

$$LEV = \frac{\text{Total Debts}}{\text{Total Assets}}$$

The size of a company correlates with its internal control mechanisms. As a company grows in size, it will need to have more robust internal controls in place to ensure the accuracy of the information being provided to them (Rahmani & Akbar, 2013). Based on Mardjono et al. (2020), the company size calculation is as follows:

CS = Log natural of total

The act of auditing involves gathering information and examining evidence to determine how closely the information aligns with established criteria. (Alexander & Hengky, (2017). According to Arifin and Destriana (2016), to measure audit quality

AQ = Dummy variables, 1 if auditors is a Big 4; 0

(AQ), the following proxies are used:

This research involved conducting hypothesis testing through the use of a multiple regression analysis equation model to examine the impact of the independent variables,

independent commissioner (IC), audit committee (AC), audit committee independence (ACI), institutional ownership (IO), company age (CA), leverage (LEV), company size (CS) and audit quality (AQ) on the dependent variable earnings management (DA). The

$$DA = \alpha + \beta 1IC + \beta 2AC + \beta 3ACI + \beta 4IO + \beta 5CA + \beta 6LEV + \beta 7CS + \beta 8AQ + \varepsilon$$

regression model used in this research is:

Information:
DA = Earnings Management
α = Constant
β1- β8 = Independent variable coefficient
IC = Independent Commissioner
AC = Audit Committee
ACI = Audit Committee Independence
IO = Institutional Ownership
CA = Company age
LEV = Leverage
CS = Company Size
AQ = Audit Quality
ε = Error

4. RESULTS AND DISCUSSION

This study includes a statistical table that describes the independent and dependent variables. The table displays data attributes such as mean, standard deviation, maximum, and minimum values. The descriptive statistics are shown in Table 2.

Table 2. Descriptive Statistical Test Results

Variable	N	Minimum	Maximum	Mean	Std. Deviation
IC	278	0	4	1,62	0,774
AC	278	1	4	3,02	0,328
ACI	278	1	4	2,926	0,474
IO	278	0,093	0,997	0,641	0,194
CA	278	0,602	1,833	1,479	0,210
LEV	278	0,053	0,876	0,391	0,180
CS	278	25,687	32,454	28,695	1,431
AQ	278	0	1	0,270	0,445
DA	278	-0,217	0,214	-0,005	0,067

Source: Sample selection results

The data normality test in this study used 282 non-financial company data, which was not normally distributed. After carrying out the outlier test, there were 4 outlier data.

So, the data used is 278 data. The data was found to have a normal distribution following the repetition of the normality test. So, this research uses data from outlier testing, totaling 278 data.

Testing the classical assumptions in this research consists of the multicollinearity, heteroscedasticity, and autocorrelation tests. The findings from the test for multicollinearity indicate that there is no issue of multicollinearity among the independent variables, suggesting that the dataset is appropriate for regression analysis. The results of the heteroscedasticity test reveal that there is no heteroscedasticity present in any of the independent variables, signifying that the data is suitable for regression modeling. The outcomes of the autocorrelation test demonstrate the absence of autocorrelation, indicating that the data is well-suited for analysis.

When testing the hypothesis in this study, the correlation coefficient (R) analysis value is 0.293, indicating a weak but positive relationship between earnings management (DA) as the dependent variable and independent commissioner (IC), audit committee (KA), audit committee independence (ACI), institutional ownership (IO), company age (CA), leverage (LEV), company size (CS), and audit quality (AQ) as independent variables. The adjusted coefficient of determination (adjusted R2) is 0.059, suggesting that only 5.9% of the variability in earnings management (DA) can be explained by variations in the independent variables (IC), audit committee (AC), audit committee independence (ACI), institutional ownership (IO), company age (CA), leverage (LEV), company size (CS), and audit quality (AQ). The remaining 94.1% of the variability is attributable to other factors not considered in the analysis. The F-test results indicate a significance level of 0.002<0.05, indicating that the model used in this research fits the data well. The t-test results are shown in Table 3 and can be interpreted as follows:

Table 3. Results of the t-statistical test

Variable	B	Significance	Description
(Constant)	-0,080	0,416	-
IC	0,006	0,297	Uninfluential
AC	0,015	0,353	Uninfluential
ACI	-0,014	0,179	Uninfluential
IO	0,000	0,276	Uninfluential
CA	0,065	0,001	Influential
LEV	-0,033	0,170	Uninfluential
CS	0,000030	0,993	Uninfluential
AQ	-0,030	0,003	Influential

Source: Sample selection results

The variable representing the independent commissioner (IC) holds a significance level of 0.297, which is greater than 0.05, indicating that Ha1 is not supported. The constant value for this variable is 0.006, suggesting that the independent commissioner does not have an impact on the dependent variable, earnings management. The findings of this research are consistent with previous studies that have been conducted by Almalita

(2017). This result can occur because independent commissioners in the company fail to detect earnings management.

The audit committee (AC) variable is statistically insignificant with a significance level of 0.353>0.05, indicating that Ha2 is rejected. Furthermore, the constant value associated with this variable is 0.015, indicating that the presence of an independent audit committee does not impact earnings management. This research's results align with the results of previous research conducted by Khosheghbal et al. (2017). The findings suggest that while the audit committee serves as an effective tool for corporate governance, it is not capable of detecting instances of earnings manipulation in financial statements.

The ACI variable for audit committee independence shows a significance level of 0.179, which is greater than the threshold of 0.05, which means Ha3 is not accepted. The constant value in this variable is (-0.014), which explains that independent audit committee independence does not affect the independent variable's earnings management. This research's results align with the results of previous research conducted by Mardjono et al. (2020). The reason for this is that the lack of autonomy within the audit committee has failed to stop fraudulent activities committed by the executive team. It could be that its existence is limited to complying with applicable regulations, so it is not compelling enough to reveal profit-increasing activities (Handayani et al., 2020).

The institutional ownership (IO) variable has a significance value of 0.276>0.05, which means Ha4 is not accepted. The constant value for this variable is 0.000, suggesting that the amount of ownership by institutions does not impact the manipulation of earnings or earning management. This research results align with previous research conducted by Asitalia and Trisnawati (2017). Almalita (2017) believes temporary institutional ownership focuses more on current earnings.

The company age variable (CA) is 0.001<0.05, meaning Ha5 is accepted. The constant value for this variable is 0.065, which shows that the company age variable positively influences the dependent variable earnings management. The results of this research are from previous research conducted by Debnath (2017). Agustia & Elly (2018) claimed that companies with a long history benefit from seasoned management that can predict trends based on past experiences, allowing them to develop innovative designs that boost profits and competitiveness. This sets them apart from both newly established companies and other long-standing competitors.

The leverage variable (LEV) has a significance value of 0.170>0.05, which means Ha6 is not accepted. The constant value for this variable is 0.033, which indicates that the independent variable leverage does not influence the dependent variable earnings management. This research's results align with previous research by Chandra and Djashan (2018). The outcomes of this study show that companies with significant debts identified during audits are unable to engage in earnings manipulation. Additionally, businesses that rely on loan-based capital face increased scrutiny from creditors, leading to challenges in manipulating earnings (Yunietha & Palupi, 2017).

The significance value of the company size (CS) variable is 0.993, greater than 0.05, indicating that hypothesis Ha7 is not supported. The constant value associated with this variable is 0.000030, suggesting that changes in company size do not impact earnings management, the dependent variable. This research's results align with the results of previous research by Alexander and Hengky (2017). The results of this research indicate

that the size of a company is not an indicator for carrying out earnings management (Arifin & Destriana, 2016).

The variable representing the quality of audits (AQ) has a significance level of 0.003, indicating that it is statistically significant. Since this value is less than 0.05, it suggests that Ha8 is supported. The constant value associated with this variable is -0.030, suggesting that the quality of audits has a negative impact on earnings management. The findings of this study are consistent with those of prior research conducted by. Hadi and Tifani (2020). That could be because managers avoid earnings management if the Accounting Firms has good quality. The big four Accounting Firms are known for their quality, independence, ability, and experience. They are alert when conducting audits to maintain their reputation so that the quality of the audits remains good (Dewi & Ariyanyo, 2017).

5. CONCLUSION

In this research, the results obtained explained that the variables company age and audit quality influenced the earnings management variable. That is because companies that have been around longer have more experienced management and can create a trend based on trends from previous periods to create plans that can encourage the company by increasing profits and competitiveness against companies that have been established for a long time and new ones. Managers tend to avoid earnings management if the Accounting Firms has good quality. The big four Accounting Firms are known for their quality, independence, ability, and experience. They are alert when conducting audits to maintain their reputation so that the quality of the audits remains good. Organizations must also improve their internal capabilities to achieve organizational goals with the best operations (Siahaan et al., 2024).

The limitations that researchers experienced in this research include that this research only had a period of 3 (three) years. That means the research results cannot describe the situation that occurred explicitly and accurately; this research only researched 8 (eight) independent variables, and the adjusted R2 value in this regression model was 0.059 or 5.9%. So, the dependent variable can only be explained by variations in the independent variable of 5.9%.

Therefore, the author has suggestions and recommendations for future researchers to overcome these problems. Namely by conducting research over more than 3 (three) years in order to obtain a larger population of data, adding other independent variables to conduct research such as return on assets, operational cash flow, audit committee size, audit committee experience, board of directors, and managerial ownership as well as replacing or adding independent variables with other variables that may have a strong influence on the dependent variable, namely earnings management such as return on assets, operational cash flow, audit committee size, audit committee experience, board of directors, managerial ownership, etc.

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