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EARNING MANAGEMENT IN MANUFACTURING COMPANIES IS INFLUENCED BY COMPANY CHARACTERISTICS AND AUDIT ELEMENTS

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Abstract: This study seeks empirical evidence regarding the effect of growth opportunities, leverage, fixed asset turnover, profitability, company size, company age, audit quality, audit independence, and audit committee on earnings management. This study uses the reporting of manufacturing companies listed on the Indonesia Stock Exchange from 2016 to 2018. The research sample consisted of 309 data, which were selected as the final sample using purposive sampling. This study uses multiple regression analysis with the SPSS program to test the relationship between independent and dependent variables. The results of this study indicate that the variables of growth opportunity, profitability, and audit quality affect earnings management. While the variables of leverage, fixed asset turnover, company size, company age, audit independence, and audit committee do not affect earnings management.

Keywords: Audit Quality, Earnings Management, Growth Opportunities, Leverage, Profitability.

INTRODUCTION

Financial reports are used to provide information about the condition or state of a company, where investors can find out the company's financial situation and profits. Thus, investors can assess whether the company is feasible and safe for investors to invest in. That can trigger several parties to misuse financial reports according to the manager's wishes; the aim is to attract investors to invest in the company and give the impression to the owner that the company has been well managed, meaning that the profits are good. Sometimes, company efforts tend to lead to deviations or fraud (Siahaan et al., 2023b, 2024).

The problem in this study is whether there is an effect of growth opportunities, leverage, fixed asset turnover, profitability, company size, company age, audit quality, audit independence, and audit committee on earnings management. This study seeks empirical evidence regarding the effect of growth opportunities, leverage, fixed asset turnover, profitability, company size, company age, audit quality, audit independence, and audit committee on earnings management.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Agency Theory

Agency theory explains the relationship between shareholders and management. This relationship can lead to an imbalance in the acquisition of information, namely asymmetrical information, because managers, as company managers, are in a position to know more

information about the company than the owners or shareholders (Jensen & Meckling, 1976; Siahaan et al., 2023a).

Information asymmetry owned by managers (agents) can encourage them to hide information unknown to shareholders (principals). In these asymmetric conditions, managers can manage the earnings presented in the financial statements. These conditions can lead to conflicts of interest between principals and agents, where individuals act to maximize their welfare with the information they have (Zhou & Elder, 2004).

Earnings Management

Earnings management occurs when managers can change a financial statement, mislead some shareholders, or influence the outcome of contracts (agreements) that depend on accounting values presented or reported (Healy & Wahlen, 1999; Pradipta, 2011). Earnings management can reduce the integrity of financial statements, increase errors in assessing financial statements, and disturb users' trust in the numbers in the financial (Christiani & Nugrahanti, 2014; Setiawan & Na'im, 2000).

Growth Opportunities and Earnings Management

Growth opportunity shows how much a company has developed since its formation. When a company is not experiencing rapid growth, managers are more encouraged or motivated to carry out earnings management in the financial statements to maintain good company performance. When the company is not experiencing rapid growth, managers are more encouraged or motivated to carry out earnings management in the financial statements to maintain the appearance of good company performance in the eyes of the public (Zouari et al., 2015).

H_1: Growth opportunities Affect Earnings Management.

Leverage and Earnings Management

Leverage is the debt the company uses to pay for assets in its operational activities. The company will be liquidated if the owner faces a considerable risk, increasing company debt. The owner will manage earnings by asking for higher profits so the company will not be threatened with liquidation (I. K. Gunawan et al., 2015).

H_2: Leverage Affects Earnings Management.

Fixed Asset Turnover and Earnings Management

Fahmi (2017) and Vincent et al. (2018) state that the impact on a company's finances can be seen from how far the effectiveness of turnover on fixed assets owned by the company. The more ineffective it is in using its fixed assets, it indicates a slow turnover or produces a low ratio value, so company managers will tend to do window dressing so that managers appear to have good performance (Afriandi & Wahidahwati., 2013).

H_3: Fixed Asset Turnover Affects Earnings Management.

Profitability and Earnings Management

Profitability is a measure of a company's performance in obtaining profits by carrying out its operations (I. K. Gunawan et al., 2015); if the company has enormous profitability, the assets used are more efficient, and profits will also increase because managers perform earnings management actions, namely by increasing profits so that they can get higher bonuses as well (Yuliana, A., & Trisnawati, 2015).

H_4: Profitability Affects Earnings Management.

Company Size and Earnings Management

Company size can determine how much earnings management practice the manager will engage in. Large companies prefer not to engage in earnings management because they are more concerned by investors and financial analysts. They are also cautious in managing their companies and are more directed towards

implementing efficient earnings management (Zhou & Elder, 2004).

H_5: Company Size Asset Turnover Affects Earnings Management.

Company Age and Earnings Management

The company's age is how long it has been established; the longer it has been established, the more it desires to carry out earnings management by increasing its profits because, previously, the management had experience managing its business. The company will also reduce the risk of earnings fluctuations in companies whose rapid growth will use compensation contracts and debt. (Savitri, 2014).

H_6: Company Age Turnover Affects Earnings Management.

Audit Quality and Earnings Management

DeAngelo (1981) says that audit quality is an opportunity to find and report violations in the financial statements and is considered an ability to improve a company's financial reporting. The higher the audit quality, the more the company hopes to strengthen investor confidence.

H_7: Audit Quality Turnover Affects Earnings Management.

Audit Independence and Earnings Management

As an auditor carrying out his audit duties on the company's financial statements, it is imperative to be independent (Jesika et al., 2015), so earnings management can be avoided if the auditor is independent; otherwise, if the auditor is not independent, it can cause earnings management to occur (Amijaya & Prastiwi, 2013).

H_8: Audit Independence Affects Earnings Management.

Audit Committee and Earnings Management

The audit committee, which is composed of several board members, is responsible for ensuring that auditors can remain independent of management (Arens et al., 2017), so that discretionary accruals will be low, which indicates that the quality of earnings obtained is increasing (Asward & Lina., 2015).

H_9: Audit Committee Affects Earnings Management.

METHOD

The sample selection used in this study is a purposive sampling method, where the sample is selected based on specific requirements or considerations. The following are the results of the samples selected per the predetermined criteria:

Table 1. Sample Selection Results

No.	Description	Description Number of Companies	Total Data
1.	Manufacturing companies listed on the Indonesia Stock Exchange for the period 2015-2018	137	411
2.	Manufacturing companies that do not publish financial reports ending on December 31 from 2015-2018	-6	-18
3.	Manufacturing companies that do not use the Rupiah currency in the published financial statements from 2015-2018	-26	-78
4.	Companies that do not have complete data	-2	-6
	Total data used in the study	**103**	**309**

Source: Data Processing Results.

Sample Selection Results Earnings management is measured by discretionary accruals used by Alexander and Hengky (2017) and calculated using the Modified Jones Model. The following are the steps to calculate discretionary accruals taken from the research of Dechow et al. (1995):

CFO = NI - TA

Description:

CFO = Cash flow from operation

NI = Net income

TA = Total accruals

$$TA_t / A_{t-1} = \alpha_1 (1 / A_{t-1}) + \alpha_2 (\Delta REV_t / A_{t-1}) + \alpha_3 (PPE_t / A_{t-1}) + e$$

Description:

TA_t = Total accruals in year t

A_{t-1} = Total assets in year t-1

ΔREV_t = Revenue in year t minus revenue in year t-1

PPE_t = Gross properties, plants and equipment in year t

α_1, α_2, α_3 = Coefficient

e = Error

$$NDA_t = \alpha_1 (1 / A_{t-1}) + \alpha_2 ((\Delta REV_t - \Delta REC_t) / A_{t-1}) + \alpha_3 (PPE_t / A_{t-1})$$

Description:

NDA_t = Non-discretionary accruals in year t

A_{t-1} = Total assets in year t-1

ΔREV_t = Revenue in year t minus revenue in year t-1

ΔREC_t = Receivables in year t less receivables in year t-1

PPE_t = Gross properties, plants and equipment in year t

α_1, α_2, α_3 = Coefficient

$$DAP_{it} = TA_{it} / A_{it-1} - NDAP_{it}$$

Description:

DAP_{it} = Discretionary accruals of company in year t

TA_{it} = Total accruals of company i in year t

A_{it-1} = Total assets of the company i in year t-1

$NDAP_{it}$ = Non-discretionary accruals of the company i in year t

Growth opportunity is the probability that the company will grow during the achievement level or in the process of developing the company (Bintara, 2018). The proxy used to measure the growth opportunity variable is taken from Alexander and Hengky (2017).

$$Growth = \frac{Market\ Capitalization}{Total\ Equity}$$

Description:

Market capitalization is derived from the number of outstanding shares x market price.

Leverage compares the company's total debt to its total assets. When the ratio value is significant, it illustrates that the company's debt is also significant. Alexander and Hengky (2017) used the debt-to-total asset ratio as a proxy for the leverage variable.

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

Fixed Asset Turnover is used to measure how effectively fixed assets are managed by management (A. Gunawan & Wahyuni, 2013). Fixed Asset Turnover uses proxies from Alexander and Hengky (2017), which are formulated as follows:

$$FATO = \frac{Sales}{Net\ Fixed\ Assets}$$

Profitability is the company's performance when making a profit or profit by operating the assets the company has (Wiyadi, Trisnawati et al., 2016). Profitability is denoted by the symbol Return on Asset (ROA) following the research Alexander and Hengky (2017); the proxy used is taken from the research of Aygun et al. (2014).

$$ROA = \frac{Net\ Income}{Total\ Assets}$$

Company size is a scale that can be categorized from several points of view or methods, including total assets, total sales, stock market value, and others (Amertha et al., 2014).

Company size is measured by the natural logarithm of total assets, as taken from Alexander and Hengky (2017)'s research. The formula is:

Firm Size = Natural Log (Total Assets)

Company age is how long a company continues to exist, can compete healthily, maintain company continuity, and become documentation that shows the company's goals (Suryamis & Oetomo, 2014). Company age is measured using a proxy, as Alexander and Hengky (2017) have done. The formula is

AGE = Number of years since the company Established

Audit quality can trigger companies to increase disclosure in financial reports, inhibiting earnings management (Puspita & Kusumaningtyas, 2017). Alexander and Hengky (2017) research used a dummy variable proxy to measure audit quality, which can be formulated as follows:

0 = if the company's financial statements are audited by KAP non-Big Four;

1 = if KAP Big Four audit the company's financial statements.

Audit independence is not allowed for too long on related parties in the same company, so it is always considered independent (Guna & Herawaty, 2010). Audit independence is measured by the dummy variable proxy used by Alexander and Hengky (2017).

Where 0 = if the same auditor audits the company's financial statements within 3 years;

1 = if the same auditor does not audit the company's financial statements within 3 years.

The audit committee is a party responsible for supervising and controlling to create responsibility, accountability, transparency, and fairness. So that these four factors make the financial statements of higher quality. The audit committee will use the proxies in Affes and Smii (2016)'s research, which are as follows:

0 = if the audit committee members are less than 3.

1 = if the audit committee members are at least 3.

RESULTS

The results of the descriptive statistical tests are presented in Table 2:

Table 2. Descriptive Statistical Test Results

Variable	N	Minimum	Maximum	Mean	Std. Deviation
EM	309	-0,400552	1,188738	0	0,10814
GRWTH	309	-1,220413	69,355082	3,059833	7,533489
LEV	309	0,076893	3,593281	0,511625	0,396299
FATO	309	0,002807	177,60777	4,51195	11,689836
ROA	309	-0,548466	0,920997	0,046949	0,121927
SIZE	309	25,21557	33,473727	28,37329	1,558585
AGE	309	7	89	38,4	13,452
AQ	309	0	1	0,36	0,481
AudInd	309	0	1	0,83	0,378
COMM	309	0	1	0,91	0,283

Source: Data Processing Results.

Table 3. t-test Results

Model	B	t	Sig.	Description
(Constant)	0,038	0,346	0,73	
GRWTH	-0	4,435	0	Affected
LEV	0,01	0,784	0,43	Not Affected
FATO	0	1,153	0,25	Not Affected
ROA	0,639	12,85	0	Affected
SIZE	-0	0,462	0,64	Not Affected
AGE	0	-0,83	0,41	Not Affected
AQ	-0,04	-3,03	0	Affected
AudInd	0,008	0,597	0,55	Not Affected
COMM	0,012	0,652	0,52	Not Affected

Source: Data Processing Results.

The growth opportunity variable hurts earnings management. That can happen because low growth opportunities cause managers to manage earnings. After all, the company is in a bad investment situation, namely instability in revenue, so earnings management will be carried out to attract investors' attention (Nozarpour & Norouzi, 2015). The leverage variable does not affect earnings management. That can happen because, according to (Christiani & Nugrahanti, 2014), companies do not have to rely on earnings management practices. As Zhou & Elder (2004) stated, other factors affect the security of debt agreements, such as the company's credibility, the guarantees provided by the company and the timeliness of instalment payments.

The fixed asset turnover variable does not affect earnings management. That can happen because fixed asset turnover is not a determinant of the size or size of earnings management carried out by the company. Fixed asset turnover is a ratio that measures the effectiveness of the use of funds embedded in the company's fixed assets in order to generate sales, in other words, how effective the company is in using its fixed assets to increase revenue if the turnover is slow, it indicates that the company is unable to use its assets effectively and if this ratio is higher, the use of fixed assets is more effective (Afriandi & Wahidahwati., 2013). The profitability variable has a positive effect on earnings management. That can happen because the higher the profitability of the company, the higher the taxes that must be paid by the company, so the higher the management's desire to carry out earnings management to get a low tax burden by reducing the value of earnings (Yunietha, & Palupi, 2017).

The company size variable does not affect earnings management. That can happen because the size of a company cannot be used as an indicator of a company in carrying out earnings management, meaning that the possibility of earnings management practices still exists for small companies or large companies (Arifin & Destriana, 2016). The company age variable does not affect earnings management. That can happen because companies that have been operating for a long time or are newly established are not an influence on positive earnings reporting on company loss reporting, and there is also no evidence that newly operating companies will be more willing to carry out earnings management in order to avoid reporting losses (Savitri, 2014).

The audit quality variable hurts earnings management. That can happen because large companies are more ogled by the public, so companies will be cautious in reporting their financial statements. KAP Big-Four will maintain the company's good name by providing information on the presentation of financial

statements that are not misleading to its investors. Thus, fraudulent earnings management actions that have been carried out by management can be (Edi & Michell, 2018). The audit independence variable does not affect earnings management. That can occur because earnings management carried out by managers cannot be detected by auditors, so audit independence is not proven to inhibit fraudulent acts against corporate earnings reporting by management. Whether established for a long time or briefly, the relationship between the company and the auditor is irrelevant if used as a parameter for earnings management (Amijaya & Prastiwi, 2013). Likewise, the committee variable does not affect earnings management. That can occur because the board of commissioners forms an audit committee in a company that is not independent and has weaknesses in the supervision and control of the audit committee, which can trigger managers to manage earnings (Firnanti, 2017).

CONCLUSION

Based on data analysis and discussion on the research that has been conducted, it can be concluded that three variables partially influence earnings management, namely growth opportunities, profitability, and audit quality. Meanwhile, the other six variables, namely leverage, fixed asset turnover, company size, company age, audit independence, and audit committee, have no effect on earnings management. The limitations of this study are that this study only uses 3 (three) years, namely from 2016 to 2018, only uses 9 (nine) independent variables, and there is heteroscedasticity and autocorrelation. Based on the limitations, further research can use a longer research period (for example 6 years), replace independent variables that may affect earnings management such as independent commissioners, institutional ownership, and managerial ownership, and perform data transformation of the independent variables in the regression model.

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