EARNINGS MANAGEMENT:

Empirical Study of LQ45 Companies Listed

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Abstract

Purpose- This study aims to explore earnings management in LQ45 companies listed on the Indonesia Stock Exchange in 2011-2015. The factors tested in this study are profitability, financial leverage and company size as the independent variable, while earnings management as the dependent variable.

Design/Methodology/Approach- The population in this study consisted of 45 companies included in LQ45 on the Indonesia Stock Exchange in the 2011-2015 period. The research sample consisted of 22 companies using a sampling technique that is purposive judgment sampling. The data used is secondary data. The analytical method used in this research is multiple linear regression analysis. The conclusion of the hypothesis is done by observing the coefficient of determination by considering the results of the significant test that is the t-test and F-test significance level of 5%, which first have been tested classical assumptions such as normality test, multicollinearity test, heteroscedastity test, and autocorrelation test. All statistical calculations in this study were carried out using SPSS version 21.0.

Findings- Based on the results of the study showed that partially only financial leverage variables that significantly influence earnings management, while profitability and company size variables did not significantly influence earnings management. Simultaneously profitability, financial leverage and firm size significantly influence earnings management.

Research Limitations/Implications- This study has several limitations, including the following: 1) Research subjects are limited to companies included in LQ45 companies listed on the ID. 2) The research year is limited only during the 2011-2015 period. 3) The research variables only use three independent variables, namely profitability, financial leverage, and company size.

Practical Implications- The advice that researchers can convey based on the results of research that has been done is: 1) For the company, it is suggested that the company be more effective and efficient in carrying out company activities in order to reduce earnings management practices so that the company can demonstrate its performance appropriately. 2) For investors, the results of the study show that earnings management practices can be influenced by the amount of financial leverage. It is therefore recommended to consider ratios in investment decision making.

Originality / Value- The results of this study are not in accordance with the study which states that simultaneous company size, profitability, and financial leverage do not have a significant effect on the dependent variable, namely earnings management.

Keywords Company Size; Earnings Management; Profitability; Financial Leverage.

Paper Type Research Paper

Introduction

At present earnings management is a central issue and has become a common phenomenon that occurs in a number of companies (Hamdani & Maulani, 2018; Maulani & Hamdani, 2019; Setiawan, Alam, & Solihat, 2020). Several cases of accounting reporting scandals or illegal earnings management practices that are widely known, such as Enron Corporation (2001), Xerox Corporation (2002), WordCom (2002), Olympus (2011) and others. Some of the cases above show some earnings management practices are not new. The cruelty of the market and the high level of competition have in the end created an impetus or pressure on companies to compete in showing good quality and performance, regardless of whether the method used is permitted or not. This is a challenge for investors and other external parties in assessing whether the information content contained in the financial statements reflects the facts and actual values or is the result of management widowdressing (Solihat, 2019). The level of earnings management in Indonesia is relatively high (ranked 15th largest among 31 countries) using data between 1990 and 1999 (Leuz, Nanda, & Wysocki, 2003).

Income smoothing is likely to be done by companies that have the most liquid stocks (Wulandari & Arfan, 2013). In companies that are classified as liquid 45 (LQ45) income smoothing is a common phenomenon that is allegedly carried out by company management known as Blue Chips to maintain its position as the best company. Companies classified in the LQ45 index try to maintain their profits so that they can attract investors to invest their capital, because investors generally prefer companies with stable earnings compared to fluctuations. The study was conducted on LQ45 companies listed on the Indonesia Stock Exchange (IDX) in 2011 to 2015 which were published on the internet site, www.idx.co.id. The time of the study was conducted from September 2016 to December 2016 (Hamdani & Herlianti, 2019).

Literature Review

1. Profitability

In this research, profitability is proxied by return on assets (ROA). Companies that have high profitability will tend to manage their profits. Profitability is a performance indicator that is carried out by management in managing the company's wealth as indicated by the profits generated (Sudarmadji & Sularto, 2007). The ultimate goal to be achieved by an important company is to obtain maximum profit or profit, in addition to other things. By getting the maximum profit as targeted, the company can do a lot for the welfare of the owner, employees, and improve product quality and make new investments (Hamdani, Herlianti, & Maulani, 2019). Therefore the company's management in practice is demanded to be able to meet the targets set. This means that the amount of profit must be achieved in accordance with expectations and does not mean profit origin. To measure the profit level of a company, use the profit ratio or profitability ratio, also known as the profitability ratio (Kasmir, 2013). Profitability has a positive effect on earnings management significantly (Widyastuti, 2009).

H1 : Profitability has a positive effect on earnings management significantly

2. Financial Leverage

One alternative source of corporate funds besides selling shares in the capital market is through external sources of funds in the form of debt. The company will try to fulfill the debt agreement in order to get a good assessment from creditors. This can then motivate managers to manage earnings to avoid violating large debt agreements (Jao & Pagalung, 2011). The motivation of companies to conduct earnings management is to meet external funding needs and fulfill debt agreements (Dechow, Sloan, & Sweeney, 1996). In this study, financial leverage is proxied by a DAR (debt to asset ratio), this is because DAR explains the amount of wealth a company is financed by debt. Company assets that are too much from debt will create risk for the company because if the company uses more debt to finance its activities, it will affect the magnitude of the company's obligations in the form of fixed and interest obligations, on the other hand the debt is also able to build opportunities to improve company performance (Damayanti & Reva, 2016). Companies with high debt ratios tend to use accounting procedures that are income-increasing to secure the level of liquidity of the company in the eyes of creditors. Leverage has a positive and significant effect on earnings management (Widyastuti, 2009).

H2 : Financial leverage has a positive effect on earnings management significantly

3. *Company Size*

The size of the company is a value that indicates the size of the company. In this study, company size is proxied by Ln total assets. The size of the company is measured using a proxy for Ln total assets, this is intended to reduce the excess data fluctuations. If the total value of direct assets is used just like that then the value of the variable will be very large, billion and even trillion. By using natural log, the value of billions or even trillions is simplified (Sudirham, 2011). There are two views about the shape of the relationship of company size with earnings management. The first view states that company size has a positive relationship with earnings management. That is, the greater the size of the company will lead to greater earnings management. Large companies have high political costs are more likely to choose accounting methods to reduce reported profits than small companies (Januarti, 2004). The second view states that company size has a negative relationship with earnings management. The size of a small company is considered more practice earnings management than large companies (Hamdani, Nugraha, & Suparman, 2020; Hamdani, Susanto, & Abdul Fatah Maulani, 2018; Jao & Pagalung, 2011). Small companies tend to want to show the condition of companies that always perform well so that investors invest their capital in these companies. Company size significantly influences the company's earnings management (Butar & Sudiarsi, 2012).

H3 : Company size has a positive effect on earnings management significantly

4. *Earnings Management*

Earnings management is a manager's actions carried out through the choice of accounting policies to obtain certain objectives (William R Scott, 2009). Earnings management is a manager's actions carried out through the choice of accounting policies to obtain certain objectives. Earnings management is often defined as the time planning of revenues, expenses, profits and losses to flatten earnings fluctuations. Earnings management is an intervention with a specific intention to the process of deliberate external financial reporting to obtain some personal benefits (Harahap, 2004). Earnings management is the company's manager's efforts to intervene or influence the information in the financial statements with the aim of tricking stakeholders who want to know the performance and condition of the company (Sulistyanto, 2008). Earnings management is a management action in the form of interference in the process of making up the financial statements with a view to improving their welfare in person and to increasing the value of the company (Hamdani, Maulani, & Solihat, 2020; Hamdani, Solihat, & Maulani, 2019).

Methodology/Materials

Paragraph text/ Tables Figures etc.

1. *Hypothesis Development*

H1 : Profitability has a positive effect on earnings management significantly

H2 : Financial leverage has a positive effect on earnings management significantly

H3 : Company size has a positive effect on earnings management significantly

2. *Method*

2.1 *Sample and Data Collection*

The population in this study are companies that go public which are included in the LQ45 index which are listed on the Indonesia Stock Exchange (IDX) and have never been deleted from delisting during the period February 2011 to February 2015. 22 companies

2.2 *Measurements*

The analytical method used in this research is multiple linear regression analysis. The conclusion of the hypothesis is done by observing the coefficient of determination by considering the results of the significant test that is the t-test and F-test significance level of 5%, which first have been tested classical assumptions such as normality test, multicollinearity test, heteroscedastity test, and autocorrelation test. All statistical calculations in this study were carried out using SPSS version 21.0.

Result

1. Measurement

Coefficients^a

Model	Unstandardized Coefficients		Standardized Coefficients	T	Sig.	Collinearity Statistics	
	B	Std. Error	Beta			Tolerance	VIF
(Constant)	-,173	,196		-,882	,380		
1 Return On Asset	,020	,061	,040	,331	,742	,571	1,751
Debt to Asset Ratio	,063	,031	,275	2,011	,047	,438	2,285
Total Asset	,005	,006	,133	,801	,425	,298	3,352

a. Dependent Variable: Discretionary Accruals

Source : Output SPSS 21.0

2. Hypothesis testing

H1 : Profitability has a positive effect on earnings management significantly

Partial hypothesis testing results, researchers found the significance value of the indicator of return on assets of $0.742 > 0.05$. In addition, it can also be seen from the results of the calculation between t_{value} and t_{table} which shows t_{count} of 0.331 while t_{table} of 1.98260. From these results it can be seen that $t_{\text{value}} < t_{\text{table}}$ is $0.331 < 1.98260$, it can be concluded that H1 is accepted, which is partially profitability has no effect on earnings management.

H2 : Financial leverage has a positive effect on earnings management significantly

Partial hypothesis testing results, researchers found the significance value of the debt to asset ratio indicator of $0.047 < 0.05$. Besides that, it can also be seen from the calculation result between t_{value} and t_{table} which shows t_{value} is 2,011 while t_{table} is 1.98260. From these results it can be seen that $t_{\text{value}} > t_{\text{table}}$ is $2.011 > 1.98260$ it can be concluded that H2 is rejected, which is partially financial leverage affects earnings management.

H3 : Company size has a positive effect on earnings management significantly

Partial hypothesis testing results, researchers found the value of the total asset indicator significance of $0.425 > 0.05$. Besides that, it can also be seen from the calculation result between t_{value} and t_{table} which shows t_{value} of 0.801 while t_{table} of 1.98260. From these results it can be seen that $t_{\text{value}} < t_{\text{table}}$ is $0.801 < 1.98260$, it can be concluded that H3 is accepted, which is partially the size of the company has no effect on earnings management.

This F test is used to determine the effect of all the independent variables used in the regression model simultant on the dependent variable being tested.

ANOVA^a

Model	Sum of Squares	df	Mean Square	F	Sig.
1 Regression	,043	3	,014	5,514	,001 ^b
Residual	,276	106	,003		
Total	,319	109			

a. Dependent Variable: Discretionary Accruals

b. Predictors: (Constant), Total Asset, Return On Asset, Debt to Asset Ratio

Source: Output SPSS 21.0

The results of simultaneous hypothesis testing, researchers found a significance value of $0.001 < 0.05$. Besides that, it can also be seen from the calculation result between F_{value} and F_{table} that shows F_{value} of 5.514 while F_{table} is 2.69. From these results it can be seen that $F_{\text{value}} > F_{\text{table}}$ is $5.514 > 2.69$, it can be concluded that simultaneously profitability, financial leverage and company size affect earnings management.

Findings

Profitability has no effect on earnings management restrictions so that the increase or decrease in the value of ROA which is a proxy of profitability will not improve earnings management. On the other hand, leverage used in this research is debt to asset ratio (DAR). Debt to asset ratio (DAR) is the ratio between total debt and total assets. The greater the debt of a company compared to its assets, the greater the risk faced by the company to pay its obligations. The greater the leverage ratio shows the greater the level of company dependence on external parties (creditors) and the greater the burden of debt costs (interest costs) that must be paid by the company. The higher the level of corporate leverage, the earnings management will also increase. This is because management must pay its debt obligations and maximize the debt it gets to produce maximum returns to investors, for this reason the company has pressure to manage earnings. The manager will manage and manage the profits so that the debt obligations that should be settled in a certain year can be postponed for the following year. This is a manager's attempt to regulate the amount of his profit which is an indicator of the company's ability to settle its debt obligations. Furthermore, The size of the company that was originally thought to affect earnings management, it turns out in this study the results obtained that the size of the company does not affect earnings management. This is because, with such strict supervision, if the manager does the practice of income smoothing, it is likely to be known by the government, analysts and investors so that this can damage the image and credibility of the company's managers. The nature of Indonesian investors is speculative and tends to be capital gains. Moreover, the condition of companies in Indonesia, with the amount of assets owned does not guarantee a good company performance. In developed countries, the government imposes political costs on companies, so the larger the company, the greater the political costs it must bear. Whereas in developing countries like Indonesia, the government is actively promoting the country's economic growth, so the government will encourage the development of companies and tend not to impose political costs.

Conclusion

1. Profitability variables that are proxied by using ROA (Return On Assets) do not have a significant effect on earnings management at LQ45 listed on the Indonesia Stock Exchange (BEI) in 2015-2019.
2. Variable financial leverage proxied by DAR (Debt to Asset Ratio) has a significant effect on earnings management in LQ45 companies listed on the Indonesia Stock Exchange (IDX) in 2015-2019.
3. Company size variables that are proxied by Ln Total Assets have a significant effect on earnings management in LQ45 companies listed on the Indonesia Stock Exchange (BEI) in 2015-2019.
4. Variable profitability, financial leverage and company size have a significant influence on earnings management in LQ45 companies listed on the Indonesia Stock Exchange (BEI) in 2015-2019.

Implications

The author suggests to the researcher further to expand the scope of his research, namely:

1. Conduct research in different company sectors and add years of research to obtain conclusions that may be different in order to add insight into the researchers themselves and readers.
2. Conduct research using other indicators to obtain a picture of other variables that can affect earnings management.
3. Adding externally that is thought to influence earnings management practices, such as inflation and the adoption of new financial accounting standards. This is based on the 11.1% Adjusted R-Square level in this study. This means that there are 89.9% of other information variables that affect earnings management.

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