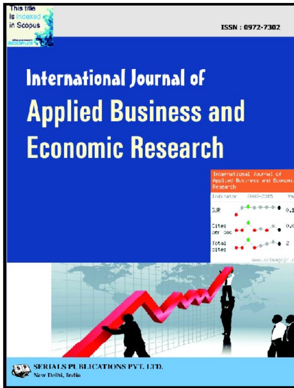

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Factors Affecting Earnings Management

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Abstract: This study Aimed to estimate and analyze the factors that influence earnings management, either partially and simultaneously.The method used is the panel regression analysis of data and the data collected by purposive sampling method, Consist of six companies consistently follow the corporate governance perception index (CGPI) in a row since 2010 to 2015 and listed on the Indonesia Stock Exchange. The results show that, the partial CGPI has significant negative effects, audit quality has significant negative effects, firm size has a significant negative effect, leverage has a significant positive effect, to earnings management. Simultaneously, CGPI, audit quality, company size, and has significant leverage effect to earnings management.

Keywords: Corporate governance, company size, leverage, earnings management.

1. INTRODUCTION

In recent time this business world many were surprised by the legal cases caused by manipulation or an accounting scandal. The events that has resulted in decreasing public confidence, including manipulation by Toshiba Corp. in 2015, Olympus Corp. in 2011, also in England in 2014 experienced by the largest supermarket called Tesco. While in Indonesia also occurred in 2015 and which the stock trading of PT Inovisi Infracom Tbk. (INVS) suspended (suspension) by the Indonesian Stock Exchange (BEI) which is one of the reasons is the number of errors in the financial statements.

In many practices of accounting manipulation, engineering generally do because of the accrual basis applied in the preparation of financial statements giving rise to the desire of the manager to show the financial statements that are considered good by the shareholders. The phenomenon can be seen as a conflict of agency that has been overshadowed by the conflict of interest as described in agency theory (Jensen and Meckling, 1976). Agency relationship arises when the principal as the owner of the company delegated authority to the agent to make the best decisions for the principal to conduct business. Agent is

responsible for optimizing the benefit of those owners by providing a large amount of profit so that they perform earnings management practices in order to meet these demands. Further motivation agent in earnings management practices as described by Stice *et al.*, (2004) was to (1) meet internal targets; (2) meet the external desire; (3) income smoothing (leveling profit); and (4) window dressing (dressed figure financial statements) in order to obtain a loan or in the framework of the IPO.

The occurrence of earnings management practices would be many questions related party management companies (corporate governance). Related to the implementation of corporate governance in Indonesia there is an agency called The Indonesian Institute of Corporate Governance (IICG) as an independent agency dissemination and development of corporate governance. Since 2001 the agency goes ranking programs known as Corporate Governance Perception Index (CGPI) is a program of research and ranking of good corporate governance to determine the extent to which companies in Indonesia to implement the principles of good governance which the participation of companies in the this program is voluntary.Other corporate governance proxy audit quality. Audit quality is seen as the ability to enhance the quality of financial reporting for high-quality audit is expected to effectively act as a deterrent earnings management. In addition to corporate governance other factors assessed affecting earnings management practices is the size of the company. The size of the company shows the magnitude of the information contained in it, making the public's attention. Generally, large companies get more attention than small firms, thus encouraging management to be more careful in the formulation of financial reports. Another factor is leverage. Companies that have leveraged generally will use these funds to be careful because there are restrictions that must be followed and these funds are in control of the lender. The greater the leverage, the greater the risk that companies face in fulfilling contractual obligations to the creditors related to debt ratio. Based on the above it is understood that the financial statements as a source of information in decision making external parties should be presented is in accordance with the accounting principles and to encourage the preparation of reliable financial statements that should not happen in the company's earnings management practices. Reasonably suspected, the implementation of corporate governance, company size, and leverage are the factors that influence earnings management practices.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1. CGPI and Profit Management

The Indonesian Institute for Corporate Government (IICG) explained that the CGPI in the assessment using the three spheres of application, namely the aspect of compliance (compliance) to ensure that all business operations of companies already do well and do not conflict with the applicable rules, the aspect of compliance (conformance), which is the alignment of policies and the company's operations with the norms, ethics, and values espoused, and aspects of performance (performance) is an achievement in fulfilling the operational demands ethical and dignified manner.

These three aspects are in the perspective of agency theory indicates that planning and control functions implemented so that no irregularities in the operations of the company, in accordance with the norms, ethics and values espoused, and to encourage the achievement of the performance targets of the company. With the good corporate governance, manipulation in its various forms can be avoided because there is adequate control. Several studies have linked corporate governance to the CGPI as a proxy to earnings

management practice has been done, including by Agustin (2012), which concluded that the quality of good corporate governance that is described by a score in the CGPI negatively affect earnings management, which means the greater the CGPI score the better the quality of corporate governance of a company so that action will be smaller profit management. Further research Wuryanti (2013) which concluded that the CGPI significant negative effect on earnings management, which means that the increasing adoption of good corporate governance in the company then demotivate management for earnings management measures so as to increase investor confidence. Next is research Vajriyanti *et al.*, (2015) which concluded that good corporate governance is able to moderate the effect of earnings management in enterprise value, which means that the lower the earnings management the higher the value of the company, this applies to companies that implement good corporate governance practices (value CGPI) tall one.

H1 : CGPI negatively affect earnings management.

2.2. Audit Quality and Earnings Management

Bodie *et al.,* (2008) defines quality as the audit firm's ability to understand the client's business. Understanding the client's business also means understanding the techniques of doing earnings management practices by management. Further Aljufri (2014) states that audit quality is any possibility of the auditor in carrying out his assignments were able to find a violation and to report on the audited financial statements. Therefore, a quality auditor will provide useful feedback to avoid the occurrence of earnings management practices.

Several studies to assess the effect of audit quality on earnings management of which is done by Triadhi and Goddess (2016), which concluded that the quality audit negatively affect earnings management, and these findings are also consistent with the results of previous studies conducted by Eny *et al.*, (2015), Jordan *et al.*, (2010), Guna and Herawaty (2010), Hwang and Lin (2008), Francis *et al.*, (1999) and Becker *et al.*, (1998).

Based on the description and explanation above, then the hypothesis is as follows:

H2 : Quality audits negatively affect earnings management.

2.3. Firm Size and Earnings Management

The size of the company to earnings management can be explained by the theory of signaling approach by Ross (1977). The amount the company will demonstrate the magnitude of the information contained in it, so that people look at a large company is more reliable in presenting financial reporting (Jama'an, 2008). In addition to the greater attention of the public is increasingly encouraging large companies to be more careful in presenting financial reporting, in contrast to small companies that tend to show that corporate performance is always good to investors to invest (Nasution and Setiawan, 2007).

Several studies have been done, including Juliana and Trisnawati (2015), Jao and Pagalung (2011), Cornett *et al.*, (2009), Liu and Lu (2007), Saleh *et al.*, (2005), Midiastuty and Machfoedz (2003), Lee and Choi (2002), and Chtourou *et al.*, (2001) which concluded that the size of the company has a significant negative effect on earnings management.

Based on the above, then the hypothesis is as follows:

H3 : The size of the company negatively affect earnings management.

2.4. Leverage and earnings management

Leverage influence on earnings management can be explained with the debt covenants in the positive accounting theory hypothesis by Watts and Zimmerman (1986). In many debt agreement, the debtor is required by the lender to maintain a debt to equity ratio over the life of the agreement, therefore the manager of the company that has the leverage ratio that is large tend to select the accounting procedures with the change in reported earnings from future periods to the current period, as it will give the company leverage ratio is small. Thus the leverage will drive the earnings management practices for their management needs of the debt to equity ratio.

Some research has been done related to the leverage effect on earnings management. Naftalia research and Marsono (2013), Lin *et al*., (2009), Tarjo (2008), Saleh *et al*., (2005), shows that the leverage has a significant positive effect on earnings management. Furthermore, Christie and Zimmerman (1994) and Easterwood (1997) found that the company that has leveraged earnings management action to avoid a debt agreement.

Based on the above, then the hypothesis is as follows:

H4 : *leverage* positive effect on earnings management.

2.5. Influence CGPI, audit quality, the size of the company, and jointly leverage to earnings management

Earnings management as a form of self-interested behavior of managers related bonus plan hypothesis in a positive accounting theory (Watts and Zimmerman, 1986) should be avoided by the application of corporate governance. The participation of companies in the ranking CGPI certainly increase the company's efforts to create a good corporate governance implementation. Similarly, public accountant with a quality audit is expected to understand the client's business and assess the fairness of the financial statements, all of which are expected to be able to avoid the occurrence of earnings management practices. Furthermore, associated with signaling theory (Ross, 1977) the size of a large company that gives a signal that there is a large information within the enterprise, consequently the company will receive greater attention from the public so as to avoid the practice of earnings management. Earnings management practices will likely happen for companies with high leverage. In many debt agreement, the debtor is required by the lender to maintain a debt to equity ratio for the duration of the agreement, so that the leverage will drive the earnings management practices for their management needs of the debt to equity ratio. For that reason, the proposed hypothesis is as follows: so the leverage will drive the earnings management practices for their management needs of the debt to equity ratio. For that reason, the proposed hypothesis is as follows: so the leverage will drive the earnings management practices for their management needs of the debt to equity ratio. For that reason, the proposed hypothesis is as follows:

H5 : CGPI, audit quality, the size of the company, and *leverage* jointly effect on earnings management.

3. METHODOLOGY

Financial statement data obtained through the website *www.idx.co.id* and the Indonesian Capital Market Directory (ICMD). The population in this study are companies that participated in the assessment of CGPI organized by IICG cooperate with SWA magazine, and samples selected using purposive sampling with the following criteria:

1. Companies consistently participated in the assessment of CGPI since 2010 to 2015;
2. The company has gone public in Indonesia Stock Exchange since 2010 and on listing until 2015;
3. The company has the financial reporting data that is complete and available to the public in accordance with the study variables.

Based on the criteria that have been diuraian above, the selected sample as shown in Table 1.

3.1. Variables Used

In the model the dependent variable is earnings management, the independent variables consist of CGPI, quality audit, company size, and leverage.

Corporate Governance Perception Index (CGPI)

CGPI is the end result in the form of a score or rating of a program of research and application of good corporate governance ratings on companies in Indonesia organized by IICG cooperate with SWA Magazine since 2001. The results of the rating CGPI program normed assessment based on the range of scores achieved by categorizing the participants by using the term “reliable”.

Quality Audit

Measuring the quality of audits using the scoring method that includes six measures of quality audit of some previous studies, namely competence (DeAngelo, 1981), independence (DeAngelo, 1981), specializes auditor (Elder *et al.*, 2015; Behn *et al.*, 2008), audit tenure (Deis and Giroux, 1992; Francis and Yu, 2009; Herusetya, 2012), peer (Deis and Giroux, 1992), and affiliated the big 4 (Jordan *et al.*, 2010; Damayanti and Rochmi, 2014). Furthermore, the criteria are met will be added together and then divided by six.

Company size

Company size is the size of a company in this study was measured by market capitalization (Riyanti, 2012; Utami, 2006). To calculate the size of the company is done by the natural logarithm of market capitalization.

Leverage

Leverage describe the amount of debt-funded assets. In this study, the leverage is calculated bycomparing the total debt to shareholders’ capital (Brealey *et al.*, 2001). Calculations using the leverage of debt to equity ratio.

Profit management

Earnings management in this study using a specific model of accrual, ie working capital accrual by the following equation:

$$\text{Management Profit} = \frac{\text{Working Capital Accrual}}{\text{sale}}$$

To obtain working capital accruals of data can be obtained directly from the statement of cash flows operating activities, so that investors can directly obtain such data without performing complex calculations (Utami, 2006).

4. RESEARCH RESULT

Panel data regression model used in this study consists of three models, the common effet, fixed effect and random effect. With the pair test the importance that the right model for estimating the factors that influence earnings management is the fixed effect model. The next problem is eliminated with mengkonstankan residual heteroskedasticity through White-heteroscedasticity. Based on table 2 that the results can be explained as follows:

Against CGPI influence Profit Management

Based on the results of the study proved that the variable CGPI significant negative effect on earnings management, which means the higher the score CGPI it will lower earnings management. The results are consistent with research Agustin (2012), Wuryanti (2013) and Vajriyanti *et al.*, (2015) which states that the CGPI negatively affect earnings management practices. Thus companies that follow the CGPI program turned out to have been able to push and prove thatthree scope of application of corporate governance in the CGPI is aspects of compliance (compliance), aspects of compliance (conformance), and aspects of performance (performance), has been able to reduce earnings management for companies that follow the CGPI program.

In theory, these results prove that the difference in interest between principal and agent that allow the earnings management practices as described in agency theory can be reduced with good corporate governance practices. This study therefore has managed to strengthen the evidence that good governance practices will be able to reduce the opportunistic behavior of managers in managing the company.

Effect of Audit Quality of Earnings Management

Based on the study proved that the quality of the audit significant negative effect on earnings management. These results indicate that audit quality would reduce the occurrence of earnings management and supports the findingsTriadhi and Goddess (2016), Eny *et al.*, (2015), Jordan *et al.*, (2010), Hwang and Lin (2008), Francis *et al.*, (1999) and Becker *et al.*, (1998).

These results strengthen the agency theory that explains that the agent has more information than the principal, so the need for good corporate governance, one of which is the auditor as an independent third party to ensure sound accounting practices within the company. Thus, these results prove that high quality audit was able to act as an effective deterrent earnings management and audit quality can be seen as the ability to enhance the quality of corporate financial reporting.

Against Company Size Effect of Earnings Management

Based on the study proved that the size of the company and significant negative effect on earnings management, which it indicates that the bigger the company the more it will minimize the possibility of earning management company. These results reinforce the findingsJao and Pagalung (2011), Cornett *et al.*,

(2009), Liu and Lu (2007), Saleh *et al.*, (2005), Midiastuty and Machfoedz (2003), Lee and Choi (2002), and Chtourou *et al.*, (2001).

Size the company shows the magnitude of the information contained in it, so that the size of the company becomes a part or public concern associated with its performance. Based on the signaling theory, because the higher the attention of the public towards large companies, it is increasingly encouraging large companies to be more careful in presenting financial reporting thus avoiding profit management. This study therefore strengthen the signaling theory that large companies is getting more attention than small companies so as to avoid the practice of earnings management.

Effect of Leverage to Profit Management

Based on the research results that leverage has a positive and significant impact on earnings management. This indicates that the higher the leverage, the more encouraged companies to manage earnings. These results confirm the conclusions of research Naftalia and Marsono (2013), Lin *et al.*, (2009), Tarjo (2008), Saleh *et al.*, (2005), which indicates that the leverage has a significant positive effect on earnings management.

Thus the results of this study are consistent with the debt covenants hypothesis in a positive accounting theory which states that in a lot of debt agreements, the debtor is required by the lender to maintain a debt to equity ratio over the life of the agreement, therefore the manager of the company that has the leverage ratio that is large tend to choose accounting procedures with changes in reported earnings from future periods to the current period, because it would give the company leverage ratio is small. Thus the leverage will drive the earnings management practices for their management needs to a certain debt to equity ratio.

Influence CGPI, Quality Audit, perusaahaan Size and Leverage In Together Against Profit Management

By using the F-test showed that the variables CGPI, quality audit, company size, and leverage jointly affect earnings management variables significantly with the coefficient of determination R2 = 0.688401, thus goodnes of fit testing showed that all independent variables which includes CGPI, quality audit, company size, and leverage can explain the rise and fall of earnings management variation of 68.84% while the remaining 31.16% is explained by other factors that are not included in the model. Next the coefficient of determination adjusted for R2 = 0.580540 shows that after considering the degrees of freedom (degree of freedom) all independent variables that is used to explain the variations that occur in the management of profit of 58.05%.

5. CONCLUSION

The study provides empirical evidence that significant in the development of theories related to the agency theory, signaling theory and positive accounting theory.

1. CGPI variables based on empirical evidence of a significant negative effect on earnings management, so that the results of this study prove that the CGPI variable as a proxy for corporate governance practices can reduce the occurrence of earnings management. Thus these empirical findings reinforce the agency theory that agency problems between the principal and the agent can be avoided by the practice of good corporate governance (GCG).

2. Variable quality of audits based on empirical evidence of significant negative effect on earnings management. These findings indicate that the quality of the audit as an external mechanism of corporate governance was able to reduce the occurrence of earnings management practices that strengthen the company's financial statements present reliably. This result is reinforced agency theory that the difference in interest between principal and agent resulting agency problems can be avoided by the presence of an independent third party, which acts as an external mechanism in corporate governance practices that either (GCG) with the implementation of the external audit quality.
3. Variable sized companies based on research results significant negative effect on earnings management. These empirical findings contribute as amplifiers signaling theory that explains that company size is a sign or a signal regarding the amount of information contained in it, so that large companies get more attention from the public that have an impact on management to avoid earnings management practices.
4. Variable leverage based on the findings empiricalsignificant positive effect on earnings management. Thus the level of debt owned would encourage management to improve equity in the form of accelerating revenue and delay the recognition of expenses, in order to obtain the ratio of debt to equity is lower. These results confirm d*EBT covenant hyphotesis* the positive accounting theory which explains that in a lot of debt agreements, the debtor is required by the lender to maintain a debt to equity ratio over the life of the agreement therefore corporate managers tend to perform earnings management practices.

6. LIMITATIONS AND SUGGESTIONS RESEARCH

6.1. Research limitations

This research is expected to make a significant contribution in the development of science, however, it is realized that there are several limitations to this study which can be explained as follows:

1. The independent variables that affect earnings management still covers a limited number, because there are many other factors that potentially affect. Similarly, the measurement of earnings management as the dependent variable, there are many proxies or models that can be used.
2. The object of this study consists of various industries that lacks comparability or power level that is equal appeal between one company with another company.
3. The sample used in this study is limited to only six (6) companies that consistently follows the CGPI assessment in the period 2010 to 2015, or only six (6) years.

6.2. Research suggestions

Based on the limitations of the study, the suggestions given for further research in order to provide a more varied findings so as to confirm or complement the results of this study are as follows:

1. This study can be expanded by adding other independent variables that influence earnings management, for example, the application of professional ethics, concentration of ownership,

cash flows of the company, company growth, the level of financial difficulties, taxes, and so forth. In addition to the dependent variable, a proxy for earnings management may use other measurements, for example with real earnings management.

2. The following research is recommended to focus on the industry so that it has comparability of financial statements that give a picture influence earnings management more precisely.
3. Related to the number of samples and the study period, in order to seek further more the number of samples with a longer study period so that the results are better.

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other

website: www.idx.co.id

Data - Indonesia Capital Market Directory (ICMD)

The Indonesian Institute for Corporate Governance, Research Reports and Ratings - Corporate Governance Perception Index, 2010-2015.

APPENDIX

Table 1
Sample Selection with purposive sampling

Keterangan	Jumlah Perusahaan
Jumlah Perusahaan Mengikuti CGPI Periode 2010-2015	80
Tidak konsisten setiap tahun mengikuti	(70)
Konsisten mengikuti sepanjang periode 2010-2015	10
Perusahaan belum go public	(4)
Jumlah Sampel Penelitian	**6**

Source: Data processed

Table 2
Estimation of Factors Affecting Earnings Management Fixed Effect Method White Cross-Sections (No-Heteroscedasticity)

Dependent Variable: MALA?
Method: Pooled EGLS (Cross-section weights)
Date: 03/10/17 Time: 01:38
Sample: 2010 2015
Included observations: 6
Cross-sections included: 6
Total pool (balanced) observations: 36
Linear estimation after one-step weighting matrix
White cross-section standard errors & covariance (d.f. corrected)

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	5.725414	1.068819	5.356764	0.0000
CGPI?	-3.018742	0.542800	-5.561423	0.0000
KUALAUD?	-0.253762	0.117253	-2.164220	0.0398
UKPER?	-0.211646	0.044783	-4.726072	0.0001
LEV?	0.235887	0.060397	3.905605	0.0006
Fixed Effects (Cross)				
_ANTM--C	0.520508			
_BMRI--C	0.351924			
_BBNI--C	0.174630			
_BBTN--C	-1.696404			
_JSMR--C	0.498792			
_TINS--C	0.150551			

Effects Specification

Cross-section fixed (dummy variables)

Weighted Statistics

R-squared	0.688401	Mean dependent var	0.380630
Adjusted R-squared	0.580540	S.D. dependent var	0.319580
S.E. of regression	0.229191	Sum squared resid	1.365742
F-statistic	6.382297	Durbin-Watson stat	1.036709
Prob(F-statistic)	0.000094		

Unweighted Statistics

R-squared	0.710422	Mean dependent var	0.367809
Sum squared resid	1.645919	Durbin-Watson stat	1.014646