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Earnings management, leverage and earnings quality of manufacturing companies in Indonesia

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Abstract

Problems with the reliability of earnings information often occur in Indonesia, thereby reducing investor confidence in earnings quality. This study aims to test and prove the effect of earnings management and leverage on earnings quality. This research is quantitative with secondary data. The sample used in this study consisted of 78 manufacturing companies listed on the Indonesian (2018-2021) Stock Exchange using a purposive sampling technique. The data analysis technique used is descriptive statistical test, classical assumption test and hypothesis testing which consists of t test, f test, multiple linear regression analysis test, and the coefficient of determination test the results of this study indicate that earnings management has a negative and significant effect on earnings quality, the higher the earnings management performed in a company, the lower the earnings quality. Leverage has a negative and significant effect on earnings quality. This shows that the higher the level of leverage, the lower the quality of the profits generated. Theoretical and practical findings in this study find theoretical implications that these findings expand theories about lava management and leverage in a company and the results of this study can strengthen in practice for manufacturing companies to be able to increase profits stably in each period, improve performance its finances, making strategies, and this research can also be used as material for consideration for entities and institutions to improve their organizational performance systems.

Keywords: Earnings Management, Leverage, Earnings Quality

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INTRODUCTION

One of the important information in the financial statements is profit information. Quality profits are profits that reflect the company's actual financial performance (Teguh and Dewi 2022). Earnings quality refers to the ability of earnings information to provide market reactions. higher earnings quality provides more information about the characteristics of a company's financial performance that is relevant to specific decisions made by certain decision makers (Elyzabet, 2019). In recent years, due to the conflict of interest of the board of directors and the board of directors, the annual financial reports are often not in accordance with the actual situation. The existence of management actions that increase or decrease the profits of directors through accounting policies applied in the financial statements can affect the profits reported in the financial statements, and profit problems can cause investors to make wrong investment decisions which can lead to a decrease in profits (Setiawan et al. 2017). A company must be able to maintain and improve its performance in order to survive.

Problems with the reliability of earnings information often occur in Indonesia, thereby reducing investor confidence in earnings quality. As happened to PT 3 Pilar Sejahtera Food Tbk (AISA) in 2018, it made an overstatement of funds (which was exaggerated) in accounts receivable, inventories and assets worth Rp. 4 trillion (Pande et al, 2017). In addition, a number of other affiliated transactions were also not reported. A number of other financial items also showed an increase. This condition indicates that the profit content in the financial statements is not in accordance with the conditions it should be, so the profit figure is considered to have low earnings quality (Kurniawati, 2017). One of the most prominent cases of profit information released by the company occurred in the case of the water company issuer PT Akasha Wira International Tbk (ADES) which recorded a net profit growth of 38.48% to Rp 52.96 billion from the previous year of Rp 38.24.

Table 1 Manufacturing Company Production Profit Growth Rate 2015-2019

Year	Previous year's profit growth	Enhancement
2015	20.000.000	56.949.098
2016	40.000.000	76.446.823
2017	60.000.000	81.522.550
2018	80.000.000	99.294.788
2019	100.000.000	101.302.310

The increase in net profit was achieved even though the company's sales were corrected by 1.25% to Rp 804.3 billion from the 2017 achievement of Rp 814.49 billion (Marpaung and Indrawati, 2019). However, businesses can generate significant additional income through interest on current and term deposits. Interest earned is recorded in the company's financial income account.

This phenomenon indicates that profit cannot explain the actual profit that is included in the financial statements when investors use it for decision making (Setiawan, 2017). Financial reports that are presented with low quality make it difficult for users of financial statements to assess whether the contents of the financial statements as a whole are appropriate or vice versa, including the profit elements in them. Return quality and deal quality are very important for deal users because they are used to inform investment decisions (Sartika, 2019)

There are several factors that affect earnings quality, including earnings management and leverage. The first factor affecting earnings quality is earnings management. Earnings management refers to management's ability to make certain decisions in financial reports and transactions to change financial statements as a basis for company performance aimed at hiding from owners or shareholders, and to reduce the reported accounting impact (Alvin, 2019). Earnings management will certainly affect earnings quality. The higher the level of corporate earnings management, the lower the earnings quality. In addition, the quality of the results of financial reports influences stakeholder decision making (Fifit, 2018). The second factor is leverage. Leverage is a measure of the amount of assets funded by liabilities. The debt used to finance assets comes from creditors, not shareholders or investors (Teguh, 2022). Companies with high leverage cause investors to lose confidence in the company's reported earnings. With high leverage, investors are hesitant to invest, so the market reaction is relatively small. That is, the higher the leverage, the lower the quality of a company's earnings (Pande and Putra 2017). This leverage has an influence on the quality of earnings, because when a company's assets generate more money than its obligations, the role of investors decreases (Marpaung and Indrawati 2019).

Based on the description above, there are still some debates from previous researchers, so that earnings quality is still an interesting topic to study in order to determine the predictive factors of earnings quality in manufacturing companies listed on the Indonesia Stock Exchange (IDX). The difference between this research and previous research lies in the variables and research objects. The first difference is that this study uses independent variables, namely earnings management and leverage. The researcher uses the earnings management variable because the researcher wants to know if the company has to increase or reduce company profits so that it can influence decision making for both external and internal users of financial reports. The choice of manufacturing companies as objects is due to the many cases that have occurred in manufacturing companies. Thus, based on the background described above, this study aims to determine the effect of earnings management and leverage on earnings quality.

This research is important because the results of this research can contribute to several parties. For companies, this research can be used as an additional reference in improving their financial performance, making strategies, and this research can also be used as material for consideration for entities and institutions to improve their organizational performance systems. For investors, this research can be used as a recommendation model in measuring earnings quality and assisting in making investment decisions. The last contribution is that for academics this research can be used as a reference for conducting further research. With this research, it is hoped that readers will be able to find out the relationship between earnings management and leverage on earnings quality, whether it has a positive or negative effect.

LITERATURE REVIEW

Agency Theory (Agency Theory)

Agency theory is the relationship between the principal and the agent, the principal is the party who gives the mandatory task and the agent is the party who receives the task or job to be completed within a certain time. Connection Proxy occurs when one or more people (principals) hire another person (agent) to perform their services and delegate decision-making authority to the agent (Scott and William R 2015).If both parties have the same goal of maximizing the value of the company, then agent is considered to act in the interest of the principal conversely, if each individual has their own motivation, this allows conflicts of interest to arise between agents and principals (Zulman and Abbas 2019).This conflict can arise because in the agency relationship there is a conflict between management and shareholders who each pursue different goals. A conflict of interest arises between the owner and the agent against the interests of the client, resulting in agency fees.

Signal Theory (Signalling Information)

Signal theory was later developed by Scott (2012) stating that executives have better information about their company then convey this information. This signal theory explains that all actions contain information, and this is due to information asymmetry. Good information can be in the form of a picture of the quality of earnings which has increased from year to year. Meanwhile, bad information can be in the form of a picture of the quality of earnings which has decreased from year to year. Signal theory is information that is published as an announcement that will be a signal for investors, creditors and business people (Rizkika Dea Safitri, 2020).

Signal theory states that company managers who have better information about their companies will be encouraged to convey this information to potential investors in order to increase the value of their companies through reporting by sending signals through their annual reports (Scott and wa 2012). *Signal theory* explains that quality earnings can provide a positive signal for company stakeholders. Positive quality profits can be positively responded by the market and external parties will believe in the performance of the company's management. This trust makes investors interested in investing in companies that can be used to develop businesses and increase profits (Scott and William R 2015).

Hypothesis

The Effect of Earnings Management on Earnings Quality

Hendang (2019) in his research stated that the practice of earnings management resulted in a decrease in the quality of earnings to be reported. Abdullah (2017) research said that earnings management affects earnings quality. Earnings quality can be a sign of quality financial information. Profit includes an important component in the financial statements, but often cannot be used to reflect the actual condition of the company because of earnings management practices. Therefore, a financial report must be able to provide actual information. The level of earnings management practices can provide an indication of low earnings quality. High earnings quality occurs when earnings management practices are not found in a company and the lowest earnings quality is found when a company performs earnings management. Therefore,

The existence of a conflict of interest causes shareholders to act not as far as the interests of the principal. The separation of ownership causes conflicts in the control and management of the company because managers can make decisions that are not in accordance with the wishes of the company owners (Fifit, 2018). This conflict arises because managers prefer to obtain personal benefits to the exclusion of the interests of the owners. This is in line with agency theory, which states that earnings management practices are influenced by conflicts of interest between (agent) and owners (principals) that arise when each party tries to achieve and maintain the level of prosperity it wants (Nanang and Tanusdjaja 2019).

On research Shahsavari (2016) earnings management has a negative effect on earnings quality. Study Farika (2017) earnings management has a negative effect on earnings quality. This research is also

supported by Suardi (2017) which states that earnings management has a negative effect on earnings quality. Based on the description above, the hypotheses developed are as follows:
H1: *Earnings Management Has a Negative Effect on Earnings Quality*

Effect of Leverage on Earnings Quality

According to Safitri (2020) Leverage is used to explain the company's ability to use company assets and sources of funds. If the company's level of leverage is low, then the company will indicate the use of assets financed internally. Conversely, if the level of leverage is high, it will show that the assets in the company are more than the forest from external parties (Setiawan, 2017). If the company's assets are mostly financed by debt, this will result in investors being afraid to invest, resulting in a relatively low market response. That is, the greater the level of leverage, the lower the quality of a company's earnings (Setiawan, 2017).

Based on signal theory, the debt ratio will provide a signal to investors regarding information on how much the company's assets are funded by debt. The use of debt in companies to measure the quality of earnings because the presence of information about the amount of high debt causes the quality of earnings to decrease (Sartika, 2019). Companies with a high level of leverage tend to practice earnings manipulation so that the profit information presented attracts investors to invest their funds. Companies with a high level of leverage cause investors to have less confidence in the earnings information published by the company (Marpaung, 2019)

The research results of Ramadiawati (2012) show that Leverage has a negative effect on earnings quality. Situmorang research (2017) is also in line with this study which states that leverage has an insignificant negative effect on earnings quality. In the third study conducted by Marpaung (2019) the variables leverage, liquidity and company size have a negative effect on earnings quality. This research is in line with Safitri (2020) research that leverage has a negative effect on earnings quality. Based on the description above, the hypothesis developed is as follows:
H2: *Leverage Has a Negative Effect on Earnings Quality*

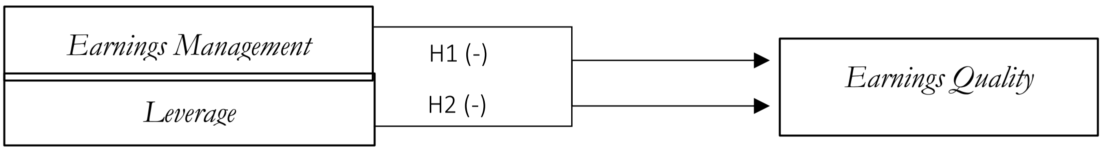

Figure 1. Research Framework

METHODS

Sample Selection

This research is quantitative in nature with the aim of testing the hypotheses that have been set. The type of data used is secondary data obtained through the IDX website (Indonesian Stock Exchange), namely www.idx.co.id. Using documentation techniques from data published by companies from the IDX official websitewww.idx.co.id. The population used in this study are all manufacturing sector companies listed on the Indonesia Stock Exchange (IDX) in 2018 – 2021. he sampling technique in this study uses the purposive sampling method, which is a random sampling method where the sample group has certain targets or criteria that has been adapted to the needs of researchers (Ramadiawati, 2012). The criteria for the sample in this study are. (1) Companies that are not listed on the IDX consecutively from 2018-2021. (2) Companies that do not report financial statements for the 2018-2021 period. (3) Companies that do not use rupiah currency. (4) Companies that experience losses.

Operational Definition and Research Variable Indicators

Earnings quality

Earnings quality is the earnings in the financial statements that reflect the company's actual financial performance. Quality earnings refer to profits that can reflect sustainable earnings in the future which are determined by the accrual items and their cash flows. Profit quality is calculated using accrual quality

(Teguh and Sintia, 2021). Earnings quality is calculated using the quality of income ratio. The calculation model is as follows:

$$\text{Quality of income} = \frac{\text{Arus kas operasi}}{\text{EBIT}}$$

Earnings management

Earnings management is a condition where management intervenes in the process of preparing financial statements for external parties so as to level, increase and decrease profits (Pinditya, 2019).

$$DAit = \frac{TACit}{Ait - 1} - NDAit$$

Leverage

*Leverage*is the company's ability to use assets and other sources of funds to increase returns to owners. One of the ratios that can be used to measure leverage is the debt ratio. The debt ratio measures the proportion of debt owned by the company to finance its assets. Companies with high leverage will make investors less confident in the profits reported by the company (Teguh and Dewi, 2022).

$$DTA = \frac{Total\ Utang}{Total\ aset}$$

Data analysis technique

This study using statistical calculations using SPSS software. Data analysis consisted of descriptive statistical methods, classical assumption test, and hypothesis testing. In testing the independent variables, the dependent variable was moderated using multiple regression analysis. Multiple linear regression analysis is the method used to describe the relationship between a dependent variable and two or more independent variables. with the following equation:

$$Y = a + b_1X_1 + b_2X_2$$

Information:
Y= Profit Quality
a= constant
b_1 =regression coefficient for X1
b_2 = regression coefficient for X2
X_1= Earnings management

RESULT AND DISCUSSION

Descriptive Statistics Test

Descriptive statistics are a description of a data seen from the average value, standard deviation, maximum, minimum, deviation, kurtosis, sum, skewness and range, calculated using SPSS V 21. Based on Table 2, the average earnings quality variable means that the average difference between accrual-based earnings and operating cash flow to profits in the sample companies is positive with a value of 0.91060. The standard deviation of earnings quality is 0.331572 indicating the variation in the value of earnings quality. The minimum and maximum values for the earnings quality variable have the lowest value of 0.099 and the highest of 2.099. The average value of the earnings management variable in the sample companies is 1.04802 and the standard deviation of the earnings management variable is 0.081023 indicating the variation in the earnings management value.

The minimum and maximum values for the earnings management variable have the lowest value of 0.736 and the highest of 1.372. The leverage variable in the sample companies is 0.60961 and the standard deviation of the leverage variable is 0.166488 indicating the variation in the leverage value. The minimum and maximum values for the leverage variable have the lowest value of 0.115 and the highest of 1.396. From the results of this analysis, it can be concluded that the earnings management and leverage variables have an average value (mean) greater than the standard deviation value, thus indicating good data quality and data distribution showing normal results.

Table 2. Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
KL	209	0,099	2,099	0,91060	0,331572
ML	209	0,736	1,372	1,04802	0,081023
LV	209	0,115	1,396	0,60961	0,166488
Valid N (listwise)	209				

Source: Secondary data processed, 2022

Classic assumption test

The model used in this study will produce the right estimating parameters if it fulfills the classical assumption test. The classical assumption tests carried out in this study consisted of a normality test, multicollinearity test, heteroscedasticity test, and autocorrelation test.

The data normality test in this study was the Kolmogrov Smirnov One-Sample non-parametric statistical test. The normal criterion in this test is that if the significance value is > 0.05, then the data is normally distributed. It can be seen that the unstandardized residual has an Asymp-sig value of 0.090 greater than a significant level of 0.05, so it can be stated that the regression model used in this study meets the normality requirements.

The multicollinearity test is a statistical test that aims to test whether the regression model has a correlation between the independent variables. One of the techniques used is the Variance Inflation Factor (VIF). If the tolerance value is ≥ 0.10, then multicollinearity does not occur in the data. In this study it can be seen that the regression equation model does not show multicollinearity symptoms. Evidenced by the tolerance value of the variable > 0.10 and VIF < 10. The tolerance value for the variable ML_X1 (0.998) and the VIF value is less than 10 (1.002). on the variable leverage_X2 (0.998) and the VIF value is less than 10 (1.002).

Heteroscedasticity test results use coefficients with a significance level of more than 0.05. The test results in this study can be seen that all independent variables have a significance value greater than 0.05 so that heteroscedasticity does not occur.

Autocorrelation test aims to determine whether in a linear regression model. To test the presence of autocorrelation, this study used the Durbin-Watson statistical test (DW test) with dU<DW<4-dU. The test results of this study showed that the DW value was 1.974, dU = 1.7887 and 4-dU = 2.026 which means dU (1.7887) < DW (1.974) < 4-Du (2.026). Therefore, it can be concluded that in this research model there are no autocorrelation symptoms.

Hypothesis Testing

In study testing all research hypotheses F test, T test and Determination coefficient test (R2) refers to the multiple linear regression coefficients found in the model below:

Table 3. Multiple Linear Regression

Model	B	T	Sig
(Constant)	2,519	6,368	,000
ML_X1	-1,270	-3,439	0.001
LV_X2	-0.395	-2.265	0.025
F Count			9,000
Adjusted R			,078
Sig			,000

Source: Secondary data processed, 2022

In Table 3 above, the following regression equation is generated:

$$Y = \alpha + b_1X_1 + b_2X_2 + \text{e}$$
$$Y = 2{,}519 - 1{,}270 - 0{,}395. + \text{e}$$

1. Constanta value2,519shows that if earnings management (X1) and leverage (X2) are equal to zero, then the quality value of lan (Y) tends to increase by2,960.
2. The value of the regression coefficient X1 means that if earnings management increases by 1%, the value of earnings quality increases by -1,270.
3. The value of the regression coefficient X2 means that if leverage increases by 1%, the value of earnings quality increases by -0.395.

F test

Regression period a significant value of 0.000 was obtained and the calculated F value was 9.000 and the F Table value was 3.04. So, the model is fit or appropriate to use because the significant value is 0.00 <0.05, and F count (9.000) > F Table (3.04) so that simultaneously the independent variables of earnings management and leverage affect the dependent variable of earnings quality. It can be concluded that the research model is appropriate.

Coefficient of Determination Test (R2)

The adjusted square value is 0.078. This means that 7.8% is the dependent variable, namely earnings quality can be explained by the independent variables, namely profit management and leverage. While the remaining 92.2% is explained by other factors not included in the analysis used in this study.

T test

The Effect of Earnings Management on Earnings Quality

Based on the research results, it can be seen that earnings management on earnings quality obtained a value of t_{hitung} -3.439 and a significance of 0,001. When compared t_{tabel} with -1.65251. then the value is t_{hitung} (-3.439) > t_{tabel} (-1.65251) and the significance is 0.001 <0.05. It can be concluded that partially the earnings management variable has a negative and significant effect. These results indicate that H1 which states that earnings management has a negative effect on the quality of the dukun's earnings.

This research is based on agency theory, which states that earnings management practices are influenced by conflicts of interest between (agrnt) and owners (principals) that arise when each party tries to achieve and maintain the level of prosperity it wants. The results of this study are in line with research by Shahsavari (2016), Farikah (2017) and Suardi (2017), proving that earnings management has a negative effect on earnings quality. Companies that tend to practice efficient earnings management to maintain low earnings volatility so that earnings quality is maintained. High earnings volatility occurs when earnings management practices are not found and the lowest volatility is found when there are earnings management practices. Therefore,the higher the practice of earnings management, the lower the quality of the company's earnings.

Effect of Leverage on Earnings Quality

Based on the results of the study, it can be seen that the leverage value on earnings quality is obtained by a value of t_{hitung}-2.265 and its significance is 0.025. When compared t_{tabel} to -1.65251, the value t_{hitung} (-2.256) > t_{tabel} (-1.65251) and the significance value is 0.025 < 0.05. It can be concluded that partially the leverage variable has a negative and significant effect. These results indicate that H2 which states leverage has a negative effect on the quality of backed earnings.

This research is based on signal theory, the use of debt in companies to measure earnings quality because with the information about the amount of high debt causes earnings quality to decline. Companies with a high level of leverage tend to practice earnings manipulation so that the profit information presented attracts investors to invest their funds.

The results of this study are in line with research by Marpaung, (2019) which state that leverage has a negative effect on earnings quality. This means that the higher the level of leverage, the lower the quality of earnings can be obtained. Leverage is used to describe the company's ability to leverage its assets and sources of funding to increase returns for its owners. Highly leveraged companies trick investors into prioritizing debt payments over dividends. This is evidenced by the fact that some of the manufacturing companies on the IDX studied have a high level of leverage (greater than 30%). In other words, the role of investors is reduced when the company's assets are funded by debt rather than equity. This is because investors are considered unable to achieve a financial balance between the amount of capital available and the capital needed to manage their funds. Companies with larger debt will try to show good performance in order to gain the trust of investors. This affects management's tendency to take earnings management actions by reporting high earnings so that earnings quality becomes low.

CONCLUSION

This study aims to examine and analyze the effect of earnings management and leverage on earnings quality. Based on the data analysis and discussion that has been done previously, several conclusions can be drawn including earnings management has a negative and significant effect on earnings quality. The higher the earnings management carried out in a company, the lower the quality of earnings, while companies that tend to practice efficient earnings management to maintain low earnings volatility so that earnings quality is maintained. Leverage variable has a negative and significant effect on earnings quality. This shows that the higher the level of leverage, the lower the quality of the profit generated.

The contribution made by the author is to provide knowledge about the results of the research that has been carried out to the reader as a reference for further research. In this research, it is hoped that the reader will be able to find out the relationship between earnings management and leverage on earnings quality whether it has a positive or negative effect. As well as research results can also be used as material for consideration for entities and institutions to improve their organizational performance systems.

This study has limitations including the period of this study only covers four years. The variables in this study can only explain 7.8% of the dependent variable, and only 92.2% of the independent variables, while 92.2% is explained by other factors that affect earnings quality that are not included in the analysis of this study. This research is limited to one type of company, namely a manufacturing company, so the results cannot be used as a reference to generalize to all types of companies.

Based on the conclusions, the suggestions that can be given to further researchers are: (1 Future research is expected to increase the research period so that the research can describe the long-term condition of the company. (2) Future research is expected to add or replace variables other than those used by previous researchers in order to see other factors that can affect earnings quality, such as auditor quality and earnings persistence. (3) Further research is suggested to be able to expand the scope of the research object not only to manufacturing companies, but also to other companies such as mining, transportation sector, real estate.

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