Factors affecting the implementation of earnings management practices - case study: companies indexed in the capital market (Indonesia Stock Exchange)

Fatores que afetam a implementação de práticas de gerenciamento de resultados - estudo de caso: empresas indexadas no mercado de capitais (Bolsa de Valores da Indonésia)

DOI:10.34117/bjdv9n12-086

Recebimento dos originais: 17/11/2023
Aceitação para publicação: 22/12/2023

Husein Pasaribu
Master in Accounting
Institution: Universitas Sumatera Utara
Address: Jl. Prof. TM Hanafiah 12, USU - campus Medan
E-mail: huseinpasaribu1945@gmail.com

Hasan Pasaribu
Master in Accounting
Institution: Universitas Sumatera Utara
Address: Jl. Prof. TM Hanafiah 12, USU - campus Medan
E-mail: mhdhasanpasaribu@gmail.com

Wahyul Huda Nanda
Master in Accounting
Institution: Universitas Sumatera Utara
Address: Jl. Prof. TM Hanafiah 12, USU - campus Medan
E-mail: wahyulhudananda16@gmail.com

Sabariah
Master in Accounting
Institution: Universitas Sumatera Utara
Address: Jl. Prof. TM Hanafiah 12, USU - campus Medan
E-mail: sabariahsabariahria@gmail.com

Iskandar Muda
Doctors in Accounting
Institution: Universitas Sumatera Utara
Address: Jl. Prof. TM Hanafiah 12, USU - campus Medan
E-mail: iskandarl@usu.ac.id

ABSTRACT
The purpose of this study is to further understand what factors can affect the implementation of a Profit Management action in a company entity, especially those listed in the Capital Market of the Indonesia Stock Exchange. This research will adopt a qualitative approach with a literature review method where researchers will review and observe what factors might affect the implementation of profit management practices in companies engaged in several different types of sectors. The results will be presented...
using the literature study data analysis method. The results obtained by the researchers after carrying out a series of related procedures include; For manufacturing companies, profit management is not affected by financial distress in the 2016-2019 period, but financial distress actually affects profit management when entering the Covid-19 pandemic period accompanied by the influence of the accompanying Good Corporate Governance variables. In companies engaged in the infrastructure, utilities, and transportation sectors show financial distress and free cash flow have a significant effect on profit management, then in mining sector companies financial distress affects profit management but not the audit committee on profit management. Finally, in pharmaceutical companies, financial distress does not affect profit management, but variable leverage affects the implementation of profit management, and if leverage is accompanied by financial distress, it can have a significant effect on profit management.

**Keywords:** earning management, capital market, IDX.

**RESUMO**
O objetivo deste estudo é entender melhor quais fatores podem afetar a implementação de uma ação de gerenciamento de lucros em uma empresa, especialmente aquelas listadas no mercado de capitais da Bolsa de Valores da Indonésia. Esta pesquisa adotará uma abordagem qualitativa com um método de revisão da literatura em que os pesquisadores analisarão e observarão quais fatores podem afetar a implementação de práticas de gerenciamento de lucros em empresas envolvidas em vários tipos diferentes de setores. Os resultados serão apresentados usando o método de análise de dados do estudo da literatura. Os resultados obtidos pelos pesquisadores após a execução de uma série de procedimentos relacionados incluem: Para empresas de manufatura, a gestão de lucros não é afetada por dificuldades financeiras no período de 2016-2019, mas as dificuldades financeiras realmente afetam a gestão de lucros ao entrar no período da pandemia de Covid-19, acompanhadas pela influência das variáveis de boa governança corporativa. Nas empresas envolvidas nos setores de infraestrutura, serviços públicos e transporte, a dificuldade financeira e o fluxo de caixa livre têm um efeito significativo sobre a gestão de lucros; em seguida, nas empresas do setor de mineração, a dificuldade financeira afeta a gestão de lucros, mas não o comitê de auditoria sobre a gestão de lucros. Por fim, nas empresas do setor farmacêutico, as dificuldades financeiras não afetam o gerenciamento de lucros, mas a alavancagem variável afeta a implementação do gerenciamento de lucros e, se a alavancagem for acompanhada de dificuldades financeiras, ela pode ter um efeito significativo sobre o gerenciamento de lucros.

**Palavras-chave:** gerenciamento de resultados, mercado de capitais, IDX.

**1 INTRODUCTION**

In carrying out an act of financial reporting in the capital market by a company body, not infrequently the company's management also accompanies the reporting published into the capital market with certain intentions. The existence of certain intentions implied by management certainly has the potential to trigger changes that are not in accordance with the reality that occurs in the field. These change intentions
generally have the aim that the company can still attract and retain investors by covering financial conflicts that occur within the company. One common effort in the field is profit management actions, where the company will try to make itself look stable in a financial context when in reality the fact is the opposite. As previously explained, this is so that the company can still retain existing investors and attract more investors so that the capital embedded in the company can be more.

This action is certainly not a good thing to do, especially if it is done in the long term, maybe if for a moment it can be used so that the company does not fail (just to maintain the company to survive at the last points) but if it is done in the long term (sustainable) and the company cannot revive the actual finances, So this company will actually become a trap hole for investors where in this case they will invest their funds in entities that are unable to return the funds they have invested. So that we can understand profit management as an action where profit management is carried out deliberately on the basis of personal interests by certain parties (Ridwan & Suryani, 2021).

2 LITERATURE REVIEW
2.1 PROFIT MANAGEMENT

Profit management is an action that should not be done by the company's management because this practice will actually provide an unrealistic picture based on the reality that occurs in the company, profit management actions are very likely to be used by the company in handling critical financial situations of the company, but this will provide errors in understanding the actual situation by the general public. The patterns commonly used in the actions of profit management practices according to (Noviardhi & Hadiprajitno, 2013) These are:

1. Taking a Bath, is a pattern in profit management where management will try to report profits earned in the current period in stark contrast to what was obtained in the previous period and after, the contrast can be made so that the profits obtained are very large or very small from what should happen,
2. Income Minimization, is a pattern in profit management where management seeks to report profits earned in the current period slightly lower than what was actually earned in the same period,
3. Income Maximization, is a pattern in profit management where management seeks to report profits earned in the current period slightly higher than what was actually earned in the same period, and
4. Income Smoothing, That is a profit management pattern that is carried out so that profits obtained from period to period, on average, look stable and consistent at the same level or not too contrasting between one period and another.

2.2 FINANCIAL DISTRESS

Financial Distress or usually called Economic Turmoil is a state in which a business encounters a downturn in its financial standing. This predicament can be categorized into two distinct forms: the first being moderate Economic Turmoil, marked by a reduction in funding that yields only minor repercussions, and the second being acute Economic Turmoil, characterized by an ongoing depletion of financial resources to the extent that the company is on the brink of substantial losses, inevitably leading to imminent bankruptcy. Financial Distress as known as Economic Turmoil is generally characterized by the company's failure to carry out its product marketing campaign which is then followed by a decrease in company profits due to not maximizing product sales while at the same time the operational costs incurred by the company are fixed (Assaji & Machmuddah, 2019).

If the company experiences severe Financial Distress, generally this will cause investors to withdraw from investing in the company concerned, because to deal with this it is very possible for company management to carry out profit management practices so that investors continue to invest in the company.

2.3 FREE CASH FLOW

Free Cash Flow is a form of excess and unused funds for a funding activity carried out by the company. Free Cash Flow can also be understood as the difference between the amount of funds provided and the amount of funds used in the funding activity. Generally, Free Cash Flow is something that is targeted by shareholders because in their opinion Free Cash Flow is something that should be used as dividends rather than later used by the company for other activities, even though the company is actually very likely to use this excess funds for project investment and other aspects that are expected to bring more profits (Augustpaosa Nariman, 2021).

If Free Cash Flow has occurred in the company, as explained earlier, the company has two options, namely distributing it in the form of dividends to shareholders or using it for project investment or other aspects, but keep in mind that project investment and other aspects can likely fail and actually cause minimal profits and losses. This creates
the impression that the company has failed to utilize the excess funds, and to cover up these failures, the company often makes profit management efforts so that the company's image is maintained.

2.4 GOOD CORPORATE GOVERNANCE

GCG stands for "Good Corporate Governance". GCG encompasses a set of principles, values, and practices that guide how a company or organization is run and supervised. The main objective of GCG is to create a transparent, accountable, fair, and ethical business environment, so as to increase the trust of shareholders, the community, and other stakeholders (Suprapti, Fajari, & Anwar, 2019).

If a company implements GCG well, profit management actions should decrease, this is because the company will be more transparent in presenting financial reporting that is in accordance with reality based on what is obtained and happens in the field, not fictitious and not manipulative just for the sake of achieving personal goals from management.

2.5 AUDIT COMMITTEE

The Audit Committee comprises seasoned professionals well-versed in the intricacies of financial auditing. Collaborating closely with company commissioners, this group ensures the meticulous observance and effective implementation of Good Corporate Governance principles within the company's financial reporting framework. (Cahyati, Hariyanto, Setyadi, & Inayati, 2021). A larger composition of individuals within the audit committee yields a heightened positive impact on the company. This expanded committee not only fosters transparency but also fortifies the assurance of Good Corporate Governance. With a multitude of professionals on the committee, the task of executing manipulative efforts, including profit management, becomes more challenging for the management, thereby enhancing overall governance integrity.

2.6 LEVERAGE

Leverage is a form of ratio that is commonly used to see a picture of how much funding comes from a company's external debt. This ratio is also often used to see how much the company's ability to cover or pay the debts they incur, both long-term and short-term debt (Hidayat, 2018). Logically, if the company has additional funds sourced from the company's external debt, then the company will gain control of an asset of greater
value and of course the company can use these assets to make a profit. But keep in mind, that the greater the leverage value owned by the company, the greater the risk borne.

As explained earlier, if a leverage value owned by the company is getting bigger, the risk obtained will be even greater, this is because if once the company fails, the level of losses incurred will also be greater so that in handling a leverage must be taken seriously, if the company is not able to handle the leverage burden that is too large it can cause the company to have an image impression which is not good in the eyes of investors and external parties, that's why companies tend to potentially take steps to carry out profit management so that the company's condition looks fine. In addition, even though it does not fail, companies that have a high leverage ratio generally do not look attractive to potential investors because as explained earlier, the risk obtained is quite large, therefore to convince potential investors not infrequently the company's management actually carries out profit management to make it appear that the company is confident that it can overcome the leverage borne even though in reality it is not the case.

3 METHODS

In this study, the researchers adhere to a descriptive qualitative approach where this study will use literature review as a method where this study aims to further review aspects that might affect profit management based on reviews of studies that are references in conducting literature reviews. More or less, at least research with the literature review method can contribute to comparing the findings that have existed so far and concluding conclusions on all phenomena that have occurred.

For the data collection technique, the researchers collected a number of research articles, especially articles in the form of journals that discuss aspects that affect profit management, all of which involve companies that report their financial reporting into the capital market, especially the Indonesia Stock Exchange (IDX).

4 RESULT AND DISCUSSION

4.1 RESULT

Previously, researchers have collected a number of studies that discuss what aspects might affect the practice of profit management in a company, as for the tabulation of the results of the extraction that researchers do based on the findings of phenomena contained in studies that discuss this matter among others as follows:
Table 1. Results of Article and Journal Extraction

<table>
<thead>
<tr>
<th>Author</th>
<th>Year</th>
<th>Number of Research Subjects</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Putri Kristyaningsih, Diyah Santi Hariyani,</td>
<td>2021</td>
<td>48 Companies Data</td>
<td>In the dataset spanning 2016-2019 for manufacturing firms listed on the Indonesia Stock Exchange (IDX) capital market, it becomes evident that the Financial Distress variable does not exert any influence on profit management. Researchers posit that this outcome is rooted in the perception of company management, whereby they deem profit management actions to be detrimental to the company's future, leading to a reluctance to engage in profit management, especially when Financial Distress is the contributing factor. (Kristyaningsih, Hariyani, &amp; Sudrajat, 2021)</td>
</tr>
<tr>
<td>Muhammad Agus Sudrajat</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yati Mulyati, Bayu Kurnia</td>
<td>2023</td>
<td>87 Companies Data</td>
<td>The findings derived from this investigation affirm a substantial body of evidence indicating that both the Free Cash Flow variable and the Financial Distress variable wield significant influence over profit management, whether examined individually or concurrently. The consequential impact arises from the potential ineffective use of funds within Free Cash Flow and the challenges posed by unresolved Financial Distress situations. These dual variables exert pressure on companies, particularly those operating in infrastructure, utilities, and transportation sectors, compelling them to adopt profit management strategies. (Mulyati &amp; Kurnia, 2023)</td>
</tr>
<tr>
<td>Widyan Tri Laksono, Liliek Nur Sulistiyowati,</td>
<td>2022</td>
<td>100 Companies Data</td>
<td>The results obtained from this study state that Good Corporate Governance in manufacturing companies listed on the capital market of the Indonesia Stock Exchange (IDX) has a significant influence on profit management (partially), as well as Financial Distress on profit management which has a significant influence (partially) Then together (simultaneously) these two variables are able to have a significant influence on management profit. (Laksono, Sulistiyowati, &amp; Setyahety, 2022)</td>
</tr>
<tr>
<td>Ririh Anggraini Setyahety</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maya Mustika, Preztkia Ayu Ardheta, Yudhstiria Rannu Paembonan</td>
<td>2020</td>
<td>36 Companies Data</td>
<td>The results obtained from testing data from companies engaged in mining, especially those listed on the capital market of the Indonesia Stock Exchange (IDX) per period 2016-2018 stated that the variable Financial Distress affects profit management actions, then for the Audit Committee variable it does not have any influence on profit management. (Mustika, Ardheta, &amp; Paembonan, 2020)</td>
</tr>
<tr>
<td>Tania Eka Putri, Syamsul Huda</td>
<td>2023</td>
<td>40 Companies Data</td>
<td>Based on research conducted on companies engaged in pharmaceuticals, it was found that the Financial Distress variable does not affect the application of profit management, but for the Leverage variable it can actually have a significant influence on profit management, then if tested simultaneously, both together can affect profit management in the company. (Tania &amp; Syamsul Huda, 2023)</td>
</tr>
</tbody>
</table>

Source: Authors

4.2 DISCUSSION

Profit management can be understood as an effort that can be done by the company to raise the image of the company's financial statements and health for certain purposes, this practice if carried out in the long term and is continuous will have a negative impact on the company because what is reported is not in accordance with the reality that actually happens in the company itself, and the company may not necessarily be able to realize what they include in the financial statements published.

There are several factors that can affect profit management, in companies engaged in manufacturing (especially those listed on the capital market Indonesia Stock Exchange) in the period 2016-2019 it is stated that Financial Distress is not proven to affect the
implementation of a manipulative action in the form of profit management. The researcher who conducted the research stated that it is likely that companies are reluctant to do profit management even though they have experienced Financial Distress because the company thinks that if profit management is carried out it will actually harm the company in the future.

In a recent investigation into corporations operating in the domains of infrastructure, utilities, and transportation particularly those publicly listed on the Indonesia Stock Exchange between 2019 and 2021 it was revealed that the Free Cash Flow parameter exerts a noteworthy impact on profit administration. Additionally, the study unveiled a significant correlation between the Financial Distress variable and profit management. Intriguingly, when these two variables were subjected to simultaneous testing, their combined influence on profit management emerged as markedly consequential. This outcome aligns with the findings of other researchers who assert a compelling body of evidence, suggesting that both Free Cash Flow and Financial Distress variables wield substantial influence over the execution of profit management strategies.

The next study conducted on companies engaged in manufacturing showed a change in findings when compared to the first study, where in this one study although it still involves manufacturing companies, but in fact after adding an observation period and other variables, namely Good Corporate Governance, it was stated that Financial Distress had a significant effect on Profit Management as well as Good Corporate Governance significant effect on Profit Management. Furthermore, if tested simultaneously, both also show a significant influence on profit management. The emergence of this difference in findings is thought to be due to the involvement of company data per 2020 which as we know in that year there has been a global pandemic which resulted in every level of society in general allocating their finances for the needs of health products such as medicines so that the manufacturing sector was affected and experienced a decrease in profits, this is what prompted manufacturing companies to carry out profit management in order to The company did not go bankrupt due to the impact of the pandemic.

In a subsequent exploration focused on mining companies, particularly those listed on the Indonesia Stock Exchange (IDX) capital market from 2016 to 2018, it was revealed that Financial Distress significantly influences profit management. This suggests that when a company encounters Financial Distress, it becomes more inclined to undertake profit management measures. However, the study found that the audit committee variable does not impact profit management. This is attributed to the belief
held by mining companies that, regardless of the committee's size, it does not play a substantial role in shaping decisions related to profit management.

Conversely, an investigation into pharmaceutical sector companies listed on the Indonesia Stock Exchange (IDX) capital market from 2017 to 2021 produced contrasting results. It indicated that Financial Distress is not the primary motivator for implementing profit management actions. Despite the challenges posed by the COVID-19 pandemic in the observation period (2020 to 2021), pharmaceutical companies, benefiting from the directed allocation of public funds towards the pharmaceutical and health sectors, did not experience significant market share loss. In this context, Financial Distress did not exert a substantial influence on the adoption of profit management practices. Notably, the leverage variable emerged as a significant factor affecting profit management. Simultaneous testing of Financial Distress and Leverage variables revealed a noteworthy impact on profit management, with Financial Distress contributing relatively minimally to the occurrence of profit management actions.

5 CONCLUSION

The conclusion that can be drawn based on observations of research journal literature in this paper is, the practice of Profit Management can be influenced by various factors, but the type of companies themselves can also affect the implementation of profit management. For example, companies engaged in manufacturing, before the pandemic occurred, Financial Distress was not the main reason for them to take profit management actions, but conditions changed when the pandemic hit at the end of 2019 which caused the Financial Distress variable to affect profit management followed by supporting contributions that accompanied the implementation of profit management such as Good Corporate Governance. The same thing also happened in companies engaged in Infrastructure, Utilities, and Transportation which showed Financial Distress had a significant effect on the implementation of Profit Management in the company, at the same time many investment projects were actually idle due to the influence of the pandemic, causing many funds that should have been used in projects to be unused which caused related companies to allocate idle funds to other investments in order to make a profit but it seems that the results obtained are not in accordance with expectations so that the management must participate in profit management. Then for the mining sector, Financial Distress seems to have a significant influence on profit management, but for variables the Audit Committee does not seem to contribute to profit management, this
is because the company does not care about the number of members of the audit committee, they will continue to do profit management if needed in the future in order to deal with Financial Distress. Finally, for companies engaged in pharmaceuticals, different from previous sectors, during the Covid-19 pandemic the Financial Distress variable did not affect the implementation of a profit management action, because in that period the pharmaceutical sector was the sector that was most in demand by the public so that profit management efforts were not influenced / based on the occurrence of Financial Distress, but it was the Leverage variable that caused this sector to actually carry out profit management. Even if we conduct simultaneous influence tests, Financial Distress only contributes a small amount to influencing the occurrence of profit management in the company.
REFERENCES


