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The Impact of Financial Performance Analysis On Earnings Management In Manufacture Companies

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Abstract: This study aims to examine the effect of financial performance using : the ratio of leverage, the ratio of profitability, and the ratio of firm size on earnings management. Discretionary Accrual is used as the proxy of Earnings Management. The data used in this study are secondary data, which are manufacture companies are listed on the Indonesia Stock Exchange (IDX). The samples used in this study are 10 manufacture companies which are listed in Indonesia Stock Exchange in the years of 2016 until 2020 in which selected by using the purposive sampling technique. The measurement of Earnings Management in this research has been carried by using modified Jones Model Discretionary Accrual. The analytical method of this study uses multiple linear regression. The result of this research describes that the leverage variable have any significant influence to the earnings management, since the size of the debt affects earnings management actions. The amount of debt will increase the risk of failure for the company, so management uses earnings management to reduce company failure. The profitability variable does not have any influence to the earnings management. Therefore, when the profitability of the company decrease, the practice of earnings management is tend to occur. And, the firm size variable has not influence to the earnings management. This problem occurs because large companies tend to do less earnings management activity than small companies.

Keywords: Leverage, Profitability, Firm Size, And Earnings Management

INTRODUCTION

The Indonesian economy is influenced by the manufacturing industry, therefore manufacture companies must prioritize their financial performance in preparing financial statements to obtain maximum profit. The main objective of company is maximize profit. Operating earnings is a corporate finance and accounting term that isolates the profits realized from a business's core operations. Specifically, it refers to the amount of profit realized from revenues after you subtract those expenses that are directly associated with running the business, such as the cost of goods sold (COGS), general and administration (G&A) expenses, selling and marketing, research and development, depreciation, and other operating costs. Operating earnings are an important measure of corporate profitability. Because the metric excludes non-operating expenses, such as interest payments and taxes, it enables an assessment of how well the company's chief lines of business are doing.

This study focuses on reanalyzing whether financial performance has an effect on earnings management through financial statements, to avoid loss or decline in profits, also other factors that affected earnings management. The action of companies to assess or analyze earnings management is from the financial statements. Financial statements are used as the basis to assess the company's performance that used by management to demonstrate accountability for its performance to investors, creditors, suppliers, employees, customers, and government. The financial statements can reveal whether a company has a good performance or not so that it can help stakeholders to make decisions.

Financial statements must be prepared properly to avoid errors in decision making. The importance of financial statements for companies is often followed by issues of the efforts of company managers to carry out earnings management, this is not is a new problem in the field of management. The company was founded with the aim of increasing the value of the company through increase the wealth of the owners or shareholders. The manager have different goals, especially in terms of improving individual achievements and compensation to be received. Differences in interest will lead to deviant behavior from managers, one of which is earnings management.

Management is one of the factors that can provide policies in the preparation of the financial statements to achieve certain objectives. Therefore, management has a tendency to take actions that can make good financial reports, namely earnings management. Increased earnings management activities have increased public attention on the disclosure of accurate information.

One of the most important information in financial statements is profit. Earnings information is one part of financial information that is the center of attention and the basis for stakeholder’s decision making, for example used to assess the performance of the company or the performance of managers. Statement of Financial Accounting Concept (SFAC) No. 1 states that the earnings information in general is a major concern in assessing the performance or accountability of management, as well as helping the owners or other parties to do an assessment on earning power in the future.

Tendency to pay attention to profit is realized by management, especially managers whose performance is measured by information, thus encouraging the emergence of dysfunctional behavior, one of which is earnings management. The problem that arises is how to detect manipulation in earnings management, such behavior has been predicted in agency theory. Agency theory hypothesizes that management tries to maximize welfare with the aim of increasing performance through increased revenue, but not in a fair way, this is of course against the interests of shareholders.

According to Scott (2003), this behavior occurs because managers have more complete information about earnings compared to outsiders. Detection of the possibility is important, because it relates to the factors that drive managers to manage reported net income. Managers do earnings management when the company is predicted to experience a decline profit . So that financial performance company will look good for shareholders and the public, even the company will experience a decline in profits.

The formulation of problems are as follows : 1). Does leverage have an effect to earnings management?, 2). Does profitability affect earnings management?, 3) Does the size of the company affect earnings management?

The research objectives are as follows : 1). To test the effect of leverage on earnings management, 2). To examine the effect of profitability on earnings management, 3). To examine the effect of firm size on earnings management.

LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

Manufacture

A manufacturer is a person or company that produces finished goods from raw materials by using various tools, equipment, and processes, and then sells the goods to consumers, wholesalers, distributors, retailers, or to other manufacturers for the production of more complex goods. Nowadays, manufacturing is a quintessential component of a prosperous economy. Generally, modern manufacturers are associated with mass production. Technological advancements enable the mechanization of production processes, as well as improve overall efficiency and productivity.

Made to Stock (MTS)

Made to Stock manufacturers produce substantial quantities of goods and store the manufactured goods before their final sale. MTS businesses aim to forecast the demand for their products in the market and then produce the quantity of goods corresponding with the predicted demand. The success of made to stock manufacturers mostly depends on their ability to forecast the market demand correctly. If the forecast significantly deviates from the actual demand, they will face the under- or over-production.

Made to Order (MTO)

Unlike their MTS counterparts, made to order manufacturers produce goods only if they receive orders from customers. The nature of MTO production eliminates the necessity to forecast future demand for the products. Thus, MTO businesses will not face overproduction. However, MTO manufacturers generally face a higher lead time between the initiation and completion of an order. In addition, a sudden increase in the current demand for the products tends to put additional pressure on the operations, which, in turn, will lead to even higher lead times.

Made to Assemble (MTA)

Instead of immediately producing a final good, made to assemble manufacturers initially create the basic parts of a final good that can be quickly assembled together when an order from a customer is received. MTA production significantly reduces lead times for customer orders. Nevertheless, the business could face lower demand for certain types of basic parts.

Financial Performance

According to Harmono (2014: 23) in his book Financial Management. Performance of companies are generally measured on the basis of net income (profit) or as a basis for other measures such as return on investment or earnings per share. Elements directly related to the measurement of net income (profit) are income and expenses. Recognition and measurement of income and expenses and net income (profit), depends in part on the concept of capital and maintenance of capital used by the company in the preparation of financial statements.

According to Riyanto (2002:253) in his book Measuring The Performance of The Public Sector. Performance is a description of the level of achievement of the implementation of a activities/programs/policies in realizing the goals, objectives, mission and vision of the organization contained in the strategic planning of an organization. Financial performance is one of the achievements of the company, then profit is one of the tools used by managers. Financial performance will provide a description on the efficiency of the use of funds and the results of the profits can be seen after comparing net income after tax.

Laverage

Leverage defined as ratios are used in determining the amount of debt loan the business has taken on the assets or equity of the business, a high ratio indicates that the company has taken a large amount of debt than its capacity and that they will not be able to service the obligations with the on-going cash flows. It includes analysis of debt to equity, debt to capital, debt to assets and debt to EBITDA. Harahap (2004:306) states that the results of the calculation of the leverage ratio show how much the company is financed by debt with the ability of the company described by assets.

Agency problems can also occur between managers and creditors who provide loans to companies (Sulistyanto, 2008:93). Conceptually, manager will sign a debt contract (lending contract) at the time of agreeing on accounts payable between the company and creditors.

The debt contract is made to guarantee that the manager will repay the loan on time. thus encouraging creditors to periodically monitor all manager activities using the company's financial statements. so that the manager always obey the agreement then the agreement also regulates penalties if the manager does not obey it, such as additional debt restrictions. debt covenant violations prove the existence of earnings management by increase the profit in the annual financial statements of companies that violate the agreement (Sulistyanto, 2008:94).

Profitability

Profitability is the net value of policies and decisions from company. The profitability ratio measures how much the company's ability to generate profits through existing sources such as assets (Harahap, 2004:219). There are various ways to assess the profitability of a company and depend on profit and assets or capital which will be compared between one and the other. the comparison between profit from operations or business, profit net before tax with total assets, or the ratio between net profit before tax with capital.

Syamsuddin (2007: 53) states that the amount of profit earned on a regular basis and an increasing trend is a very important factor that need the attention of the manager because for the continuity of the company must be in a profit condition. Hadri (2006:10) states that profit is still a measuring tool for company performance. Companies that earn regular profits tend to increase get a better chance to retain and attract foreign capital. This will affect earnings management actions because logistically, profitability is an important instrument directly related to the object of earnings management. Companies with high profitability. tend to take earnings management actions by decreasing profits (income). so that if profit in the future period is predicted to decrease drastically, companies can use previous earnings, and vice versa.

Company Size

Brigham and Houston (2011: 117-119), suggest that company size is a scale in which the size of the company can be classified according to various ways, including: total assets, log size, stock market value, and others. The size of the company is only divided into 3 categories, namely: "large companies (large firms), medium companies (medium size) and small companies (small firms)." This variable is measured by the average total value of assets owned by a company (total assets The measurement scale used is the ratio scale. The size of the company can be measured by using the total assets, sales, or capital of the company. One measure that shows the size of the company is the size of the assets of the company.

Large assets show that the company has reached the maturity stage where in this stage the company's cash flow is positive and is considered to have good prospects in a relatively long period of time, besides it also reflects that the company is relatively more stable and more able to generate profits than the company with total small assets. The manager will tend to carry out earnings management by increasing profits so that the company seems to have large assets in order to earn profits source of funds from outside the company, with the aim of obtaining loans or attract new investors.

Earnings Management

According to R.A Supriyono (2018: 123) states that: “Earnings Management is an action used by managers to influence earnings according to their objectives.” “Earnings management is the choice by a manager of accounting policies, or actions affecting earnings, to achieve some specific reported earnings objective.” (Scott :2015). Agnes Utari Widyaningdyah (2008:92) divides the definition of earnings management into two :

1. Narrow definition. Earning management in this case is only related to the selection of accounting methods. Earning management in a narrow definition is the behavior of managers to "play" with the component of discretionary accruals (which is an accrual component that can be adjusted and engineered according to the company's manager's policy).

2. Broad definition. Earning management is a manager's action to increase or decrease the currently reported profit of the unit for which the manager is responsible, without increasing or decreasing the long-term economic profitability of the unit.

RESEARCH METHODS

The population in this study are 10 listed manufacturing companies on the Indonesia Stock Exchange for the period 2016-2020. The sampling technique that used is purposive sampling. Criteria used to select samples are as follows: (1) Data on the financial statements of manufacturing companies that have been audits for the 2016-2020 reporting year, (2) Company issue financial statements in rupiah currency, (3) Sample company the company publishes financial statements using the same financial year ends on December 31, (4) Have the necessary information data in research.

Table 1. List of Manufacturing Companies That Became the Research Sample

No	Code	Name of Company	Sector
1	DLTA	Delta Djakarta	Multi-industrial sector
2	GGRM	Gudang Garam	Consumer goods industry sector
3	HMSP	HM Sampoerna	Consumer goods industry sector
4	ICBP	Indofood CBP	Consumer goods industry sector
5	INTP	Indocement Tunggal Prakasa	Basic and chemical industry sector
6	KAEF	Kimia farma	Basic and chemical industry sector
7	KLBF	Kalbe Farma Tbk	Basic and chemical industry sector
8	ROTI	Nippon Indosari Corpindo	Consumer goods industry sector
9	ULTJ	Ultrajaya Milk Industry & Trading Company	Consumer goods industry sector
10	UNVR	Unilever Indonesia	Multi-industrial sector

RESEARCH RESULTS AND DISCUSSION

Descriptive statistics

Descriptive statistical test aims to provide an overview or description of a data seen from the number of samples, average value, and standard deviation of each variable. The following describes the statistics of the research data in table 1.

Table 2. Descriptive Statistics

	Mean	Std. Deviation	N
DA	0.001196	0.0026410	50
LEV	0.3362	0.18955	50
ROA	0.1514	0.10727	50
SIZE	23.4026	1.21448	50

Source : SPSS 26, 2021

The following are the details of descriptive data on research variables from manufacturing companies for the 2016-2020 period which have been processed and the results are presented in table 1:

1. Variable DA (earnings management) an average value of 0.001196 with the standard deviation is 0.0026410.
2. The LEV (leverage) variable has an average value of 0.3362 or 33.62% with the standard deviation is 0.18955 or 18.95 %.
3. The ROA (profitability) variable has an average value of 0.1514 or 15.14 % with standard deviation of 0.10727 or 10.73 %.
4. The SIZE variable (company size) has an average value of 23.4026 the standard deviation is 1.21448.

Partial Regression Coefficient Test (t-test)

This test aims to determine the significance relationship of independent variable to the dependent variable. The t-test was conducted to determine whether the three variables had a significant effect on earnings management. The results of the t-test in this study are shown in table below:

Table 3. Regression Coefficient

Model				Standardized Coefficients	t	Sig.
				Beta		
1	(Constant)	-0.003	0.007		-0.423	0.675
	LEV	0.005	0.002	0.333	2.332	0.02
	ROA	0.001	0.003	0.059	0.413	0.68
	SIZE	0.000	0.000	0.047	0.336	0.74

The formula is if the value of Sig of t test < 0.05, it means that the independent variable affects the dependent variable and if the value of Sig > 0.05, means that the independent variable has no effect on the dependent variable. Based on the results of the t statistical test in the table above, it shows that from 3 variables included in the regression model, only Leverage (LEV) which significantly affects earnings management (DA). This can be seen from the value of significance probability for LEV is 0.02 (Sig. < 0.05). As for the variable profitability (ROA) dan Company Size (SIZE) were found to be insignificant. This can be seen from the value of significance probability for ROA is 0.68 (Sig. > 0.05) and the value of significance probability for SIZE is 0.74 (Sig. > 0.05). So it can be concluded that the earnings management variable is only influenced by the variable of laverage.

Simultanious Regression Coefficient Test (f-test)

The formula is if the value of Sig Anova > 0.05, it means that simultaneously all independent variables have no significantly affects on dependent variable and if the value of Sig Anova < 0.05, means that simultaneously all independent variables have significantly affects on dependent variable.

Based on the results of the f statistical test in the table above, it shows that from 3 variables included in the regression model, nothing has significantly affects on earnings management (DA). This can be seen from the value of sig. Anova is 0.088 (Sig. > 0.05). So it can be concluded that Simultaneously, the earnings management is not influenced by the variables of Laverage, ROA and Size.

Coefficient Determination Test (R Square)

The coefficient of determination (R2) test was carried out to find out how much the overall independent variable had an effect on the dependent variable. The value of the coefficient of determination is between 0 and 1. If the value is close to 1, it means that the independent variable provides almost all the information needed to predict the dependent variable. However, if the value of R2 is getting smaller, it means that the ability of the independent variables in explaining the dependent variable is quite limited (Ghozali, 2016). Results of the coefficient of determination can be seen in the table.

Table 4. Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.362[a]	0.131	0.075	0.0025406	2.309

Source : SPSS 26, 2021

From table above, it can be seen that R Square (R2) is 0.131 or 13.1 % which shows that the independent variable has a contribution effect of 13.1 % to the dependent variable. While the remaining 86.9 % is explained by factors other than the independent variables analyzed. Contribution effect of R Square (R2) is very low only 13.1 % because only Leverage has an effect on earnings management, while ROA and firm size have no effect on earnings management and simultaneously all independent variables (Laverage, ROA, Size) have no significantly affects on dependent variable (earnings management).

Discussion

Effect of Leverage (LEV) on Earnings Management

In this study, leverage has an effect on earnings management. The size of the debt affects earnings management actions. The amount of debt will increase the risk of failure for the company, so management uses earnings management to reduce company failure. Managers will make financial statements that show high profits so that they seem able to pay off the company's debts. Long-term debt covenants, this motivation is in line with the debt covenant hypothesis in positive accounting theory, If the company is getting closer to violating debt covenants, then managers will tend to choose accounting methods that can reduce companies facing default on debt contracts.

Effect of Profitability (ROA) on Earnings Management

In this study, profitability has no effect on earnings management. The size of the company's profit level does not affect earnings management actions. Companies that earn regular profits tend to increase get a better chance to retain and attract foreign capital. However, in this study, it indicates that there is no relationship where if earnings management is considered to mislead the parties with an interest in the company, then good profit is the profit that is actually obtained by the company. So it can be concluded that the profitability of a company reflects the actual performance of the company, which can then reflect the company's image in the public.

The Effect of Company Size (SIZE) on Earnings Management

In this study, firm size has no effect on earnings management. The size of the company has no effect on the company's earnings management because the larger the size of the company, the less likely the company is to manage earnings (negatively related). Company size is a value that shows the size of the company. There are two views about the relationship between firm size and earnings management. The first view states that company size has a positive relationship with earnings management, because large companies have more complex operational activities than small companies, making it more likely to carry out earnings management.

The second view states that firm size has a no relationship with earnings management. Large companies have a tendency to take smaller earnings management actions than small companies, while small companies have a tendency to take larger earnings management actions. This is because large companies are seen as more critical by shareholders and outsiders so that large companies get stronger pressure to present accurate financial reporting. So, it can be concluded that firm size has a no effect on earnings management.

This means that companies that have a large scale, there is a small probability of earnings management compared to companies that have a small scale.

CONCLUSIONS

This study aims to examine the effect of financial performance (leverage, profitability, and company size) on earnings management. the results of multiple regression testing using SPSS 26, it can be concluded that: (1) Leverage has an influence on earnings management. because the amount of debt will increase the risk of failure for the company, so management uses earnings management to reduce company failure. Managers will make financial statements that show high profits so that they seem able to pay off the company's debts. (2) Profitability has no effect on earnings management. It indicates that there is no relationship where if earnings management is considered to mislead the parties with an interest in the company, then good profit is the profit that is actually obtained by the company. So it can be concluded that the profitability of a company reflects the actual performance of the company, which can then reflect the company's image in the public. (3) Based on the results of regression testing shows that the size of the company has a no effect on earnings management. This indicates that the size of the total sales owned by the company which shows the size of the company has an impact on the company's earnings management. This is because large companies tend to take fewer earnings management actions than small companies.

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