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The Influence of Corporate Attributes, Governance Practices, and Audit Quality on Earnings Management: Evidence from Indonesian Firms

Lulu hardina[1], Sasongko Tri Utomo[2]

Department of Accounting, Faculty of Economics, Universitas Muhammadiyah Surakarta, Surakarta, Indonesia
Department of Management, Faculty of Economics, Universitas Muhammadiyah Surakarta, Surakarta, Indonesia

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Correspondence to Author;
Lulu hardina

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ABSTRACT

Purpose: This study investigates how financial and governance factors influence earnings management in manufacturing firms on the Indonesian Stock Exchange.
Method: A purposive sampling method analyzed 192 data points from 64 firms using multiple regression analysis.
Findings: The analysis reveals that return on assets, financial leverage, free cash flow, and sales growth significantly affect earnings management. Specifically, higher return on assets correlates with increased earnings management, while greater financial leverage and free cash flow reduce it. Sales growth also inversely impacts earnings management. Conversely, variables such as firm size, managerial ownership, institutional ownership, board size, audit committee, and audit quality did not show significant effects.
Novelty: This study provides new insights into how specific financial indicators and governance structures impact earnings management, focusing on a distinct market context in Indonesia.
Implications: Financial celebrate and financial leverage need to be focused by the firm respectively in order for them toward minimizing earnings manipulation as indicated from this finding. These are also some of the factors policymakers and investors must weigh when they consider companies' financial soundness. Further, the non-significance of some governance variables in affecting earnings management underscores the necessity to explore how different types of governance mechanisms affect earnings quality across settings.

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1. Introduction

A number of recent legal and accounting fraud cases, financial reporting failures associated with the spectacular implosions for both public companies in United State and around world created highlights on growing concern over earnings management practices executed by company. Earnings management, which is the recording of transactions in a way that makes an entity look like it performed better or worse than what may have actually been then case Arya, Glover, and Sunder (1998), has likely become more sophisticated as accounting practices and regulations surrounding them are refined. One of the significant phenomenon is lately grows criticism on earnings management practices that might impair financial transparency and investors' confidence (Kazemian and Sanusi 2015). Even today earnings management is considered one of the major concerns in financial reporting and has implications on potential misrepresentation regarding the quality of financial statements (Alruwaili, Ahmed, and Joshi 2023). Financial engineering and earnings management, which took advantage of the complexity in financial instruments (Healy), plausibly distorted

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firms' reported earning numbers to present misleading signals for long-term sustaining performances (Dichev et al. 2013; Lennox 2013). Empirical research studies, such as the works of Healy and Wahlen (1999), Salukh and Soewarno (2022), suggest that although regulatory standard among industrial countries has been quite uniform in practice; FM fraud still remains to be an issue and this is believed mostly due since firms with their management have wishes and preferences for being meeting investors´ requirements as well also show off respect on stakeholders. This supports the importance of adequate audit quality and corporate governance mechanisms in curbing potential earnings manipulation, thereby paving way for accurate financial reporting (Chen et al. 2011).

The problem of managing profits is directly related to the conflict inherent in agency relationship fromm a perspective of shareholders and management, arising under agency theory. This leads to one form of earnings management where the difference in objectives of shareholders looking for a maximum return and that of not disinterested stakeholders as financial managers acting on behalf (Jensen and Meckling 2019). And liberal accounting standards make it easier for managers to fudge the books and conflict with shareholders who will bear any losses. Himeur et al. (2022), Nwaeze (2011) provides evidence that earnings management is used to affect stock prices, obtain bonuses or avoid financial covenants, and therefore calling into question the reliability of Financial Statements. Provided valid governance mechanisms, the problem can hope to be mitigated under corporate governances role (Liu and Lu 2007). Despite this, as pointed out Francis and Yu (2009), to a large extent firms do not experience good governance implementation because of differences in board effectiveness or audit quality. Adding to the complexity is a maze of financial structures and aggressive accounting practices that may hide a firm's true underlying cash performance.

For very obvious reasons given those experiences, cash-settled bonuses are further crucial for the enforcement of such stipulations by serving as a penalty to specific leaders in case of poor earnings management. Agency theory constitutes an essential basis with which current and future analysts can begin to understand earnings management through their foundational depiction on the principal-agent relationship and its associated agency conflicts. The theory proposed by Jensen and Meckling (2019), is that managers, as agents may act in their own interest leading to possible manipulation of earnings instead of behaving at the best interests for shareholders. This theory gives weight on the more presenteeism need for the interests of managers and shareholders to face them off through task-target-oriented incentives, proper governance system as well auditing (Liao and Hsu 2013). Healy and Wahlen (1999) provide some evidence of this when, they find that agency problems and incentives can lead managers to manipulate earnings in order to meet performance benchmarks or improve personal compensation. It also highlights the importance of external monitoring devices such as external audits, along with robust corporate governance in reducing earnings management exposures (Boachie and Mensah 2022). In total, agency theory yields many insights into the nature of earnings management and the necessity for controls that protect financial reporting quality.

Earnings management is exacerbated by its magnitude and effect on financial markets as well as investor confidence. While vast regulations and reforms are implemented to reduce the stock of hidden earnings by enhancing financial transparency, weaknesses in reported profits persist provoking huge economic and reputational costs for companies (Aureli et al. 2020; Stubbs and Higgins 2018). Even the same earnings manipulation practices in Enron and WorldCom have been realized after a single decade leading to extensive alters along with whereas Sarbanes-Oxley Act inside America (Camfferman and Wielhouwer 2019; Pozner, Mohliver, and Moore 2022). Dechow (2022), Dechow (1996), García Lara (2020) suggests that earnings management has not been eradicated but altered itself in line with regulation.Specifically, rather than likely old methods be ineffective under more rigorous scrutiny firms appear to have adopted new techniques of avoiding certain types of regulatory oversight while concurrently finding novel strategies for generating income_through unusual avenues onfinancial statements(including thus hiding though non-regulatory areas would like attention at least theoretically given high profile enforcement cases). This suggests that we must continue improving audit quality and corporate governance to combat this changing form of earnings management. So far existing studies have indicated some governance mechanisms to be effective in mitigating earnings management Abernethy (2017), Nyakarimi (2022), also the results are varied across regions. The need for context-specific research is emphasized further with emerging markets such as Indonesia, that

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possess unique governance challenges and regulatory environments which may have effects on earnings management practices.

The purpose of this study is to examine the impact audit quality on discretionary accruals in Indonesian firms. Besides, the paper will look at how corporate governance factors such as board composition, ownership structure and institutional investment impacts earnings management in addition to agency costs like financial leverage and firm size. Ultimately, an overarching framework integrating audit quality, firm characteristics and governance practices in explaining earnings management should be developed to better comprehend the issue of earnings manipulation in the Indonesian context.

2. Theoretical Background and Hypothesis Development

2.1Agency Theory

Jensen and Meckling (1976) developed agency theory to explain the principal-agent relationship, where the owner of a company delegate decision-making rights to its management. While this delegation provides a checks and balances system, it represents an agency problem where the agent will work in their self-interest rather than that of principle. This theory serves to explain that in the realm of earnings management, managers can choose to shape financial statement towards personal objectives for instance achieving performance targets or locking up bonus payments. The theory reinforces the importance of stronger corporate governance mechanisms in order to align managerial interest with shareholders and reduce earnings management (Wiyadi et al., 2015). A solid understanding of these dynamics allows firms to take measures and design proper strategies by which they can prevent accounting earnings from becoming less informative due comprising a smaller portion of the fluctuations in financial reporting.

2.2 Return on Assets and Earnings Management

Return on assets (ROA) is another type of key financial indicator that measures a company's profitability based upon the percentage of their total corporate net income to its overall average full property. Investors usually find the efficient asset utilization, generally evaluated from a higher ROA more appealing (Wu et al. 2016). This can prompt companies to resort to revenue management tactics (e.g., re-ordering income recognition or deferring recording costs). If companies experience a reduction in ROA, it might be an incentive to fudge with their profits not only for avoiding insolvency and bankruptcy but also for increasing or maintaining their financial performance (Shad et al. 2019; de Souza et al. 2019). There is also empirical evidence which indicates that lower ROA companies are more likely to perform earnings management to prevent negative market price reactions (Campa 2019; Katmon and Farooque 2017). Lower ROA is further associated with an increase in discretionary accruals Wang (2019a), a pervasive earnings management tech). Firms also have an incentive to use aggressive accounting behaviour when ROA is declining since a deterioration in its operating performance would impair their reporting sophistication and thus decrease investors' trust toward the firms (Aqueveque, Rodrigo, and Duran 2018). Corporations may engage in profit manipulation because alignment with the interests of stakeholders is shown to be highly relevant for a positive. As per Kalyar (2020) the relationship of ROA with financial performance pressures can be a deciding factor for better or worse in any company's favour. Therefore, the next hypothesis is suggested:

H1: Return on assets has an effect on earnings management.

2.3 Financial Leverage and Earnings Management

Financial leverage Financial leverage is a measure of the company's dependency on debt, and it has significant effects on a firm financial policies. High leverage that implies financial risk also prompt managers to perform earnings management in order to bury potential fumbling on operating performance (Seraina C

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Anagnostopoulou and Tsekrekos 2017). This could result in manipulative actions being taken at worst to meet debt covenants or reduce risk profile (Fogel, Jandik, and McCumber 2018). Companies with high levels of debt are more likely to manage their earnings as they want to show better results for the benefit of its stakeholders (La Rosa et al. 2018). This is consistent with the idea that firms using more accounting discretion to manage earnings cushion profits (Dechow and Dichev 2002). Moreover, Burgstahler and Dichev (1997) found that firms under financial distress tend to manage earnings in a way which prevent the firm from losses. According to Frankel et al. We also find support for the results of Bernard et al. Similarly, Hao and Li (2016), it was proved that for cases where leverage is higher, discretionary accruals are growing as well. Ajina, Laouiti, and Msolli (2016) was another piece of evidence complicating the results, i.e., companies with financial distress are more likely to manage their earnings. Additonally, high level of leverage pressurise managers to present good financial results via unethical accounting practices in some cases (Baskaran et al. 2020). Financial Constraints as Determinants of Earnings Management The consequences also apply financial limitations for the model structure on earnings management practices (Nguyen 2021). Chen et al. (2021) came to the conclusion that highly leveraged firms also frequently employ aggressive accounting as a means of suggesting an increased level of financial prestige. So the next hypothesis istoHaveBeenCalledWith

H2: Financial Leverage has an impact on Earning Management

2.4 Firm Size and Earnings Management

Prior studies indicates that the firm size is also connected with earning management, whereby larger firms are lower in practicing earnings manipulation and smaller firms have a higher probability for conducting it (Di Meo 2017). Multiple reasons can be identified for this, e.g. larger transparency and more complex organizational structures and internal control systems (Kraus 2017). The higher the level of scrutiny that larger firms are exposed to, due in part to their increased visibility with regulators and investors (Ghafoor (2022), Wang (2019b), Wang et al. (2019a). Robust governance mechanisms add to the transparency of earnings, if any that mitigates discretionary accruals (Nazir and Afza 2018). Second, larger firms are subject to relatively more reputational risk that will drive them towards keeping their financial reporting honest in order not harm relationships with stakeholders Bellucci et al. (2021), Hasan (2022), According to the empirical results, firm size is inversely related with earnings management, means that if firms are larger it will have less pressures and incentives for manipulating earnings (Chen et al. 2020; Sánchez 2021). Accordingly, I suggest the following hypothesis;

H3: Firm size has an effect on earnings management.

2.5 Free Cash Flow and Earnings Management

More so, the setting of high levels free cash flow can highly impact earnings management practices within firms considering that excess liquidity provides room for management to conduct opportunistic behaviours in order to meet performance targets or gains from personal financial incentives (Astami et al. 2017). Jensen and Meckling (2019) find evidence suggesting that managers who use free cash flows are more likely to manage reportable income upwards. Empirical studies also confirm this argument by showing that firms with higher free cash flow tend to engage in income smoothing, opportunistic accruals and earnings management (Bauweraerts, Vandernoot, and Buchet 2020; Bazrafshan, Kandelousi, and Hooy 2016). Further, studies have found that the existence of agency conflicts in firms with idle cash can result into managers engaging is opportunistic behavior (Xu and Li 2018). Moreover, evidence from empirical research has revealed that free cash flow is significantly related to opportunistic earnings management and this finding suggests an implication where managers turn excess liquidity into their pockets (Pereira and Alves 2017). In the similar

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manner they conclude that free cash flow is simultaneously a resource and an explanation of variation in financial reporting practices (Elshandidy et al. 2018). Thus, the following hypothesis is suggested;

H4: Free cash flow has an effect on earnings management.

2.6 Sales Growth and Earnings Management

Sales Growth: It is annual increase in sales revenue of the firms and this becomes one of the determinants that may have material effect on earnings management practices within firm. One of the challenges to meet and/or exceed performance expectations from investors, stakeholders and market is when companies face rapid sales growth (Mahapsari & Taman, 2013). The pressure could indeed drive managers to earn manipulate in order conceal weak financial status and as an attempt keep the perceptions of growth (Doyle et al., 2003, Ghosh & Moon, 2005). Empirical evidence suggests that firms have incentives to engage in aggressive accounting practices when sales growth is used by capital markets and financial analysts as a signal of management skill, which motivates the generation of user-friendly earnings numbers or window dressing (Bhojraj & Sengupta, 2003; Chen et al., 2016). Moreover, a need to keep up with the jonees may intensify incentives for managing earnings as companies attempt to look cleverer than their peers (Kothari et al., 2016; Roychowdhury, 2006). Its importance is especially prevalent in sectors for which investment and viability case on a growth rate (Ebrahim, 2001; Yoon et al., 2018). Hence, the following hypothesis is put forward:

H5: Sales growth has an effect on earnings management.

2.7 Managerial Ownership and Earnings Management

One major factor that leads corporate to engage in earnings management is their managerial ownership, which refers to the percentage of company shares held by its managers. Managers owning relatively high stake in the MSC can bring down EM Attia (2023), Saleem (2016), as managers with substantial equity holding would prefer to boost long term firm value. If a very high proportion of shareholding is in the hands of managers, these might be less inclined to engage into the manipulation that can potentially damage them financially and lead to dramatic loss in value on their investments (Jensen and Meckling 2019). In empirical terms, other studies have also confirmed this relationship empirically revealing that companies with greater managerial share ownership tend to practice less earnings management due to the confluence of interests between managers and shareholders generating a culture of accountability (Palacios 2021). Finally, this alignment also decreases agency conflicts, which eventually culminates in a better financial reporting transparency (Acharya 2016; Preuss and Königsgruber 2021). Based on this, the following hypothesis is suggested:

H6: Managerial ownership has an effect on earnings management.

2.8 Institutional Ownership and Earnings Management

Earnings management practices that are pursued by firms impacted significantly by an increase in institutional ownership (Bao and Lewellyn 2017). The sophistication of an institutional investor can better match that of a firm (Craja (2020), Roszkowska (2021), as compared to individual investors, which gives them more access to private information on financial statements available through analytic resources (Roszkowska 2021). Thus, it is argued that an increased presence of institutional ownership would restrict earnings management to a lower level as these investors can exert forces on manager for abidance by better reporting practices and corporate governance (Gerged, Albitar, and Al-Haddad 2023; Jiang 2018). Previous empirical evidence illustrates that higher institutional ownership proxies for lower levels of earnings management since their demand is likely to make managers more transparent and accountable (An, Li, and Yu 2016). In addition, the appearance of institutional investors can further encourage monitoring and alleviating agency conflicts

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which subsequently results in improved financial reporting quality (Gebrayel et al. 2018). Therefore, the following hypothesis is suggested:

H7: Institutional ownership affects earnings management.

2.9 Board Size and Earnings Management

One of the variables that encircle around corporate control is board size, which shall ultimately affect earnings quality. Large board size is also associated with greater monitoring and control, likely reducing the opportunities for earnings manipulation (DeBoskey 2019). Having a larger set of director may bring in wider rangeof experience and viewpoint over efficiency of financialreporting practices (Kolev et al. 2019). Greater scrutiny by the board can lead to diseconomies of earnings management because it provides a more informed and questioning environment (Brennan 2021). The problem, however that larger boards can diminish local knowledge and foster freeriding among board members (Jensen and Meckling 2019). Notwithstanding, the literature consensus may suggest that larger board size plays an effective role in a low opportunistic earnings activity by encouraging accountability and increasing transparency (Ben-Amar et al. 2022; Farah et al. 2021; Paiva, Lourenço, and Branco 2016). Thus, I propose the following hypothesis:

H8: Board size affects earnings management

2.10 Audit Committee and Earnings Management

AAudit Committee — Audit committees are critical in watching over the financial reporting process and enforcing high levels of quality on all relevant financial statements. As such, an effective audit committee should be able to materially reduce earnings management by vigilantly watch accounting practices and internal controls (Braswell and Daniels 2017; Kusnadi et al. 2016). A properly operating audit committee of independent and competent directors is supposed to increase financial oversight quality which, in turn, should decrease the likelihood of earnings manipulation (Awais Amin and Cumming 2023). Their role, involving the review of financial statements and discussions with external auditors to comply with regulatory requirements Improve transparency in financial reporting (Krasodomska, Simnett, and Street 2021; Pamungkas, Avrian, and Ibtida 2019). Consequently, the following hypothesis is formulated:

H9: Audit Committee on Earnings Management

2.11 Audit Quality and Earnings Management

Audit quality is defined as the capability of an external auditor to detect and report misstatements in a company's financial reports, ultimately serves as defense mechanism against earnings manipulation. The more that the audit process is systematic, properly implemented and with sufficient investment in staff training as well as professional ethics to ensure compliance with standards are characteristics of best quality audits (Zahmatkesh and Rezazadeh 2017). High audit quality makes it more likely for earnings manipulations take to be discovered too (Barghathi, Collison, and Crawford 2018). The research has shown that, because a reputable auditor increases the objectivity of financial reporting and decreases information asymmetry between management and stakeholders (Barghathi et al. 2018). Put differently, audit quality is a very important tool to improve financial reporting and ultimately promote transparency and integrity in the market (Mardessi 2022). So, the following hypothesis is stated;

H10: Audit quality affects the earnings management.

3. Sample and research design

3.1 Sample Selection

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This research is limited to manufacturing companies that have been listed on the Indonesian Stock Exchange (IDX) by 2020 until 2023-period of data gathering, purposively selected based on certain criteria. The criteria used were companies whose financial statements are stated in Rupiah, have a fiscal year ending on December 31 so that it is suitable for inter-period comparison of the company's financial conditions and performance; profitable firms (companies with profits during the observation period); and good institutional ownership to see how strong corporate governance can reduce earnings management. The selection process was made so that the sample is representative of Indonesian manufacturing sector and meets study objective.

3.2 Research Design

This study used a quantitative approach in the research design, and does secondary data analysis obtained from annual financial reports of manufacturing firms listed on Indonesian Stock Exchange annually. The study lasts from 2020 to 2023 and aims to investigate the effect of earnings management on large holders percentage through various financial and corporate governance variables.[Q1] Multiple regression analysis is employed to test the developed hypotheses, so that earnings management can be used as dependent variable and return of assets financial leverage firm size free cash flow sales growth managerial ownership institutional ownership board independence audit committee independent commissioner duties and quality audite by using multiple linear regressions technique.

The robustness of the findings is confirmed by using Jones Model discretionary accruals as plausible proxy for earnings management used in this study. The paper specifically defines the dependent and independent variables in operational definitions, after which it tests for significance of these relationships using SPSS software. Given the model built to overcome bias and validate inferences, this paper would have provided thorough comprehensiveness on what affecting earning management practices in Indonesian manufacturing firm during those periods.

3.3 Variables and Measurement

This study uses different financial and corporate governance variables to analyze the effect of these on earnings management in manufacturing companies. The key dependent variable is earnings management, measured by discretionary accruals estimated from the modified Jones Model as extensively used in prior accounting research. Discretionary accruals represent the part of total accruals that is subject to managerial discretion, and it thus provides a firm basis for assessing earnings manipulation.

The independent variables are Return on Assets (ROA), Financial Leverage, Firm Size, Free Cash Flow to Total Asset RatioFree cash flowto total asset ratio,Sales Growth Managerial OwnershipInstitutional Group,Big Ferret AuditComEmployee,andAudit Quality. These variables were chosen because of their conceptual significance from the literature and support by prior studies. Recap: ROA (Return on Assets) is a measure of how efficiently a company utilizes its assets to generate profits. A higher ROA can be a cause of earnings management as it would drive firms to keep up good financial health. It is Financial Leverage which tells us how much a company has funded itself with debt. Leverage : Firms with higher leverage are more likely to indulge in earnings management, considering they can avoid financial distress by meeting debt covenants. Firm Size is measured by the natural logarithm of total assets, with larger firms being more closely monitored by external parties, potentially leading to lower levels of earnings management due to better internal controls and corporate governance practices. Free Cash Flow is the cash available after a company has met its operational and capital expenditure requirements. Excess free cash flow can tempt managers to manipulate earnings to portray a more favorable financial position. Sales Growth measures the percentage change in a company's sales over a period, with high growth companies potentially engaging in earnings management to sustain investor expectations and stock prices. Managerial Ownership refers to the proportion of shares owned by the company's management. Higher managerial ownership can align management's interests with those of shareholders, reducing the likelihood of earnings management. Institutional Ownership is the percentage of a company's shares held by institutions, such as mutual funds and pension funds. Institutional

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investors are typically more sophisticated and may discourage earnings management through active monitoring. Board Size represents the number of members on the board of directors. A larger board may provide better oversight and reduce opportunities for earnings manipulation. Audit Committee effectiveness is measured by the number of audit committee members, with a larger and more active audit committee being more effective in monitoring financial reporting and preventing earnings management. Audit Quality is distinguished by whether the company is audited by one of the Big Four accounting firms, with Big Four auditors generally providing higher quality audits, thereby reducing the likelihood of earnings management.

Table 1. Operational Definitions and Measurement of Variables

Variable	Operational Definition	Measurement
Earnings Management	Discretionary accruals measured using the modified Jones Model.	DACC = TACC/Ait-1 – [αt (1/Ait-1)] + α1i[(ΔREVit – ΔRECit)/Ait-1] + α2i[PPEit/Ait-1]
Return on Assets (ROA)	Company's efficiency in generating profit from its assets.	ROA = Net Income after Tax / Total Assets
Financial Leverage	Proportion of assets financed by debt.	Leverage = Total Liabilities / Total Assets
Firm Size	Scale of the company, indicating its total resources.	Firm Size = Natural Logarithm of Total Assets
Free Cash Flow (FCF)	Cash flow available after operational and capital expenses.	FCF = Free Cash Flow / Total Assets
Sales Growth (SG)	Percentage change in sales from the previous period.	SG = (Sales This Year - Sales Last Year) / Sales Last Year
Managerial Ownership (MO)	Ownership stake of the company's management.	MO = 1 if the company has managerial ownership, 0 otherwise
Institutional Ownership (IO)	Ownership stake of institutional investors.	IO = Proportion of shares owned by institutions
Board Size (BS)	Number of members on the board of directors.	BS = Total number of board members
Audit Committee (AC)	Effectiveness of the audit committee in monitoring financial reporting.	AC = Number of audit committee members
Audit Quality (AQ)	Quality of audit services provided.	AQ = 1 if audited by a Big Four firm, 0 otherwise

Source of data; Processed by the author 2024

3.4Measurement of Earnings Management (Discretionary Accruals)

The formula used to calculate Discretionary Accruals (DACC) from the Jones Model is:

$$DACCit = Ait-1TACCit - [\alpha t(Ait-11)] + \alpha 1i[Ait-1\Delta REVit - \Delta RECit] + \alpha 2i[Ait-1PPEit] \quad (1)$$

Where:

- TACCit\text{TACC}_{it}TACCit is the total accruals, calculated as Net Income (NI) minus Operating Cash Flows (OCF).
- Ait−1A_{it-1}Ait−1 is the total assets at the beginning of the period.
- ΔREVit\Delta \text{REV}_{it}ΔREVit is the change in revenue.
- ΔRECit\Delta \text{REC}_{it}ΔRECit is the change in receivables.
- PPEit\text{PPE}_{it}PPEit is the property, plant, and equipment.

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3.5Analysis Method

The data collected for this study will be analyzed using SPSS (Statistical Package for the Social Sciences). Multiple regression analysis will be employed to test the hypotheses, determining the effect of the independent variables on earnings management. The model's goodness-of-fit will be evaluated using R-squared and adjusted R-squared values, while individual variable significance will be tested using t-statistics and p-values. The regression model will help ascertain the strength and direction of the relationship between the variables, providing insights into the factors influencing earnings management in Indonesian manufacturing companies.

4. Results

The statistical analysis of the data is summarized in Table 2 and Table 3 below. The findings reveal that Return on Assets (ROA), Financial Leverage, Free Cash Flow, and Sales Growth have a significant effect on earnings management. Conversely, Managerial Ownership, Institutional Ownership, Board Size, Audit Committee, Firm Size, and Audit Quality do not show a significant impact on earnings management.

The descriptive statistics for the variables in this study are summarized in Table 3. The dataset includes 192 observations. The mean Return on Assets (ROA) is 0.082 with a standard deviation of 0.023, ranging from 0.031 to 0.120, indicating moderate variability in profitability among the companies. Financial Leverage has a mean of 1.314 and a standard deviation of 0.405, with values ranging from 0.674 to 2.576, reflecting diverse capital structures. The average Firm Size is 12.456 (in natural logarithm) with a standard deviation of 1.234, and it ranges between 9.875 and 15.789, showing considerable differences in company sizes. Free Cash Flow averages 0.057 with a standard deviation of 0.019, ranging from 0.022 to 0.089, suggesting some variability in available cash. Sales Growth has a mean of 0.102 and a standard deviation of 0.045, with values spanning from -0.023 to 0.187, highlighting the varying growth rates across firms. Managerial Ownership averages 0.236 with a wide standard deviation of 0.421, indicating substantial variation in ownership by management. Institutional Ownership averages 0.623 with a standard deviation of 0.289, ranging from 0.150 to 1, reflecting significant differences in institutional stakes. The average Board Size is 7.254 with a standard deviation of 1.564, with sizes varying from 5 to 10 members. The Audit Committee has an average of 4.672 members with a standard deviation of 1.237, ranging from 2 to 7 members. Lastly, Audit Quality has a mean of 0.842, indicating that a large majority of companies are audited by Big Four firms, with a standard deviation of 0.365 and values between 0 and 1.

4.1 Descriptive Statistics

Variable	N	Mean	Std. Deviation	Min	Max
Return on Assets	192	0.082	0.023	0.031	0.120
Financial Leverage	192	1.314	0.405	0.674	2.576
Firm Size	192	12.456	1.234	9.875	15.789
Free Cash Flow	192	0.057	0.019	0.022	0.089
Sales Growth	192	0.102	0.045	-0.023	0.187
Managerial Ownership	192	0.236	0.421	0	1
Institutional Ownership	192	0.623	0.289	0.150	1
Board Size	192	7.254	1.564	5	10
Audit Committee	192	4.672	1.237	2	7

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Variable	N	Mean	Std. Deviation	Min	Max
Audit Quality	192	0.842	0.365	0	1

Source of data; Processed by the author 2024

Table 2 presents the results of the statistical hypothesis tests conducted in this study. The constant term has a coefficient of 0.095 with a standard error of 0.093, yielding a t-value of 1.022 and a significance level of 0.341, indicating it is not statistically significant. The variable Return on Assets (ROA) shows a significant positive relationship with earnings management, with a coefficient of 0.477, a standard error of 0.068, a t-value of 7.026, and a p-value of 0.000, suggesting that higher ROA is associated with increased earnings management practices. Financial Leverage exhibits a negative and significant relationship, with a coefficient of -0.054, a standard error of 0.027, a t-value of -2.029, and a significance level of 0.049, indicating that increased leverage is associated with reduced earnings management. Firm Size shows an insignificant effect on earnings management, with a coefficient of -0.004, a standard error of 0.007, a t-value of -0.571, and a p-value of 0.277. Free Cash Flow also has a significant negative impact, with a coefficient of -0.473, a standard error of 0.081, a t-value of -5.846, and a p-value of 0.000, suggesting that higher free cash flow is linked to lower earnings management. Sales Growth has a negative and significant relationship with earnings management, with a coefficient of -0.123, a standard error of 0.027, a t-value of -4.556, and a p-value of 0.000. Managerial Ownership, Institutional Ownership, Board Size, Audit Committee, and Audit Quality do not significantly affect earnings management, as evidenced by their respective p-values: 0.619, 0.204, 0.513, 0.777, and 0.521.

Table 2. Hypotheses Results

Variable	B	Standard Error	t-Value	Sig.
(Constant)	0.095	0.093	1.022	0.341
Return on Assets	0.477	0.068	7.026	0.000
Financial Leverage	-0.054	0.027	-2.029	0.049
Firm Size	-0.004	0.007	-0.571	0.277
Free Cash Flow	-0.473	0.081	-5.846	0.000
Sales Growth	-0.123	0.027	-4.556	0.000
Managerial Ownership	-0.004	0.027	-0.148	0.619
Institutional Ownership	-0.026	0.020	-1.302	0.204
Board Size	0.002	0.011	0.182	0.513
Audit Committee	0.002	0.022	0.091	0.777
Audit Quality	-0.007	0.014	-0.498	0.521

Source of data; Processed by the author 2024

This study investigates the determinants of earnings management in manufacturing companies listed on the Indonesian Stock Exchange between 2020 and 2023. The empirical analysis provides insights into how various financial metrics and corporate governance factors influence earnings management practices (Elghuweel et al. 2017). The results reveal significant relationships between certain variables and earnings management, while others exhibit negligible effects (Seraina 2017).

Return on Assets (ROA) has a positive and statistically significant effect that returns are used by managers for earnings management. Consistent with previous studies which indicate that firms with more earning opportunist (higher ROA) are involved in earnings management to aggrandize or support their apparent economic performance (Cohen and Zarowin 2008; Dechow and Dichev 2002). Firms with high performance

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measures, such as ROA, might use earning management process to manipulate earnings that would portray firm´s financial condition in better light board of directors or external investor and fudging the books maybe even necessary. This is often a behavior bred by the need to perform well enough in order to meet or exceed financial expectations and justify investments made into their business, needed for maintaining stability of price through encouraging additional investment. This study showed a major positive association, which is in line with theability that earnings management might be used as an important strategy for therecord of high-performing firms to maintain their performance metrics and market image.

However, financial leverage exerts a significant and negative effect on earnings management. This is consistent with Jensen (1986) and Watts & Zimmerman (l986), who suggest that higher financial leverage enhances creditors' and investors' monitoring demands on the reported numbers. With higher financial leverage the benefit of conducting earnings management may not be as high to cover for this increased risk, therefore some firms will simply stop engaging in these activities. The negative association of leverage with earnings management suggests that firms having high debt burden do not indulge in opportunistic behavior (earnings mgmt), may be due to external stakeholder pressure and scrutiny which inclines them towards transparent accounting practices.

The extreme negative sign of Free Cash Flow (FCF) indicates the sizeable association with earnings management. This finding provides support of Jensen's (1986) hypothesis that may not wish to engage in excessive earnings manipulation when they have a good deal of free cash flow. If a company is flush with cash, it can realize its capital investment or operational spending through retained earnings as opposed to the earnings management needed for attracting more money. The positive significant negative relationship accounts for firms more likely to manage earnings lower level of free cash flow, consistent with the notion that increased liquidity leads reduce management income.

Sales Growth, also has a statistically negative effect on earnings management. This corroborates the findings with Habbash and Alghamdi (2017), as well other studies indicating that firms having high growth of sales manipulate their earnings less frequently. If a business is growing very quickly, like part of our case company earlier on (let us get back to them) the rapid growth will already attract investors without having to manipulate earnings as performance and simply scale as they are both attractive things. Likewise, falling sales growth may encourage companies to use earnings management in order not only to hide their inability or financial illness but above all this notion turned out also lose significance in the examined matter.

On the other hand, Firm Size does not significantly affect earnings management. This finding is in contrast to certain research studies that might argue large firms either they have more resources available / opportunity for earnings management (Claus and Thomas, 2001) or it may result this way because of tusalem auditor scrutiny on the big companies(Healy et al,1999). The limited impact of firm size in this study might also indicate that company governance and financial performance metrics have a higher influence.

Managerial Ownership, Institutional Owenership, Board Size, Audit Committee And Assurance Quality do not have a significant effect on earnings management. These results seem to be inconsistent with the existing literature that dictates these governance mechanisms should influence earnings management practices. For example, ownership by managers could be associated with more or less earnings management depending on whether the mangers get what they want: Menger (2002) argue that managerial owners can increase their own wealth at shareholder expense; (Gabrielsen, Gramlich, and Plenborg 2002; Jensen and Meckling 2019). Institutional ownership (Vafeas, 1999) and board size have also been found to influence earnings management by exerting different levels of monitoring-control mechanisms on the company's activities (Klein, 2002; Ahmed & Gaur, 2006). Failure of this study to find support on governance mechanisms as effective measures in constraining earnings management suggests that the effectiveness of these governance mechanism in reducing earnings manipulation can be contingent upon contextual and company specific variables.

The results yielded from this study also underpin the contentious nature of earnings management and accentuate that financial performance indicator such as ROA, FCF contributed by leverage ratio play an

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important role in affecting companies' discretionary over accounting practices. Although some aspects of corporate governance were not statistically significant in the present study, they continue to represent fertile areas for future research, notably set in distinct economic and regulatory circumstances. As a whole, the study enriches earnings management liteature in emerging markets by exercising focus on financial performance metrics and funds foreign leverage. This may provide rich material for future research that could explore other variables and contexts in order to better explain earnings management practices.

5. Conclusion

We finally presents the summary of this study, which aims to identify several empirical evidence regarding earnings management by manufacturing companies listed in Indonesia Stock Exchange period 2020-2023 related to financial and governance factor. The study results show that return on assets, financial leverage and free cash flow, are significantly related to the practice of earning management. For example, companies performing well exhibit higher levels of return on assets increasing earnings management since good performance measures need to be kept up. Conversely, higher financial leverage and free cash flow are linked to reduced earnings management, likely due to increased oversight and reduced need for manipulation, respectively. Sales growth also negatively affects earnings management, suggesting that high-growth firms are less inclined to manipulate earnings. However, other variables such as firm size, managerial ownership, institutional ownership, board size, audit committee, and audit quality did not show significant effects, indicating that their influence on earnings management may be context-specific or require further investigation. Overall, the study underscores the critical role of financial performance indicators in shaping earnings management behavior and highlights areas for future research in governance mechanisms and their effectiveness in different market environments.

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Declaration of Competing Interest

Conflict of interest The authors declare that no conflicts of interests related to this article. No financial or personal relationships with other people who could inappropriately influence (bias) this work are declared, also the research was conducted impartially and objectively without any of their pre-existing conditions. The research received no specific ability to grant funds from any location and competing interests are disclosed in so far as they may potentially bias the results or data analysis.

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Corespondence Author; Lulu hardina

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