

## The Effect of Firm Characteristic on Earnings Management (Empirical Study of LQ45 Companies for the period of 2018-2022)

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### *ABSTRACT*

The purpose of this research is to determine the effect of firm characteristics consisting firm size, managerial ownership, leverage, audit committee expertise, and audit committee tenure on earnings management at companies that listed in index LQ45 during period of 2018 to 2022. This study used a sample of 21 companies that were selected using purposive sampling method with a total 64 observations data that are free from outlier data. This study used multiple linear regression analysis to test the effect of the independent variables on the dependent variable. The result of this study indicate that firm size has an effect on earnings management, while managerial ownership, leverage, audit committee expertise, and audit committee tenure have no effect on earnings management

**Keywords:** Earnings Management, Firm Size, Managerial Ownership, Leverage, Audit Committee

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## I. INTRODUCTION

The performance of a company can be seen based on the financial reports that have been published, because it includes all the company's financial activities in one year (Hasty & Herawaty, 2017). In the company's financial statements, the value that gives an overview of the company's performance is sustainable cash flow activity or can also be called profit (Hadi & Tifani, 2020).

The amount of profit also reflects how the management carrying out its duties in manage the company. Therefore, profit-related information is often be the target of fraudulent actions by management for their own benefit and interests. This action is called earnings management (Nasution & Nengzih, 2020). In theory, earnings management actions are related to agency theory. Agency theory is a theory that describes the working bond between the owner of the company who employs agents to manage the company and the agents who are employed (Jensen & Meckling, 1976). This working relationship is often the cause of agency problems and information asymmetry (Hadi & Tifani, 2020). Agency problem and information asymmetry is the reason why management doing earnings management (Chang et al., 2018).

The earnings management can be caused by several characteristics owned by the company that able to motivate the management doing earnings management, such as company size, managerial ownership, leverage,

expertise and tenure owned by the audit committee in a company (Tang & Fiorentina, 2021) . Based on research from (Fajriana, 2023), (Nasution & Nengzih, 2020), (Nalarreason et al., 2019), (Sihombing & Laksito, 2017), and (Cheung & Adelopo, 2022) show that company size, managerial ownership, leverage, expertise, and tenure of audit committee members have a positive influence on earnings management. However, based on research from (Panjaitan & Muslih, 2019), (Lestari & Murtanto, 2018), (Annisa & Hapsoro, 2017), (Widasari & Isgiyarta, 2017), (Ardyanti, 2023) suggests that company size, managerial ownership, leverage, expertise , and the tenure of the audit committee has a negative effect on earnings management.

According to the findings from these studies, can be seen that each study has different findings regarding the influence of company characteristics on earnings management. From this, the question arises whether each characteristic possessed by the company is able to have an impact on earnings management actions. In order to be able to answer these questions, this research was conducted.

Based on this background, the researcher intends to carry out research that related to the effect of company characteristics on earnings management by using companies listed on the LQ45 company list on the IDX from 2018 to 2022 as research population. The title

that taken for this research is **The Effects of Company Characteristics on Earnings Management (Study Empirical in LQ45 Companies for the 2018-2022 Period)**.

## II. RESEARCH METHOD

This study uses a quantitative method for testing the hypotheses. The quantitative method is a research method based on experiments and surveys that uses research data in the form of numbers and statistical analysis (Sugiyono, 2013). This study uses a population of the companies listed on the LQ45 index on the IDX. The sample in this study was obtained by utilizing the purposive sampling method, that is a method that using certain criteria or characteristics made by the researcher (Sugiyono, 2013). The criteria used for sampling in this study were:

| Criteria  | Amount     |
|---|------------|
| Companies listed on the IDX   | 825        |
| Companies included in the LQ45 list                                       | 45         |
| Companies included in the LQ45 list during 2018-2022 period consecutively | 23         |
| Successively published annual reports during 2018-2022 period             | 21         |
| <b>Observation data for the period 2018-2022 (5 years)</b>                | <b>105</b> |

Table 1  
Research Sampling Criteria

This study examines the effect of five independent variables, that is firm size, managerial ownership, leverage, audit committee expertise, and audit committee tenure on earnings management. The following is the method for calculating each variable tested in this study:

### a. Earnings Management

In calculating earnings management, this study uses measurements from Roychowdhury (2006) where there are 3 measurements in it, namely measurements of earnings management in sales activities, production costs, and discretionary costs. The following is the order of the calculation formula:

$$1. \quad \frac{CFOt}{At-1} = a_0 + a_1 \left( \frac{1}{At-1} \right) + a_2 \left( \frac{St}{At-1} \right) + a_3 \left( \frac{ASt}{At-1} \right) + \epsilon t$$

Keterangan:

- CFOt : Operating cash flow
- St : Total sales
- At-1 : Total asset 1 year before
- $\alpha_{0...3}$  : Constat
- $\epsilon t$  : Error term

$$2. \quad \frac{PRODt}{At-1} = a_0 + a_1 \left( \frac{1}{At-1} \right) + a_2 \left( \frac{St}{At-1} \right) + a_3 \left( \frac{ASt}{At-1} \right) + a_4 \left( \frac{ASt-1}{At-1} \right) i + \varepsilon t$$

Keterangan:

- PRODI<sub>t</sub> : Production Cost
- St : Total Sales
- At-1 : Total asset 1 year before
- A<sub>0...3</sub> : Constant
- ε<sub>t</sub> : Error term

$$3. \quad \frac{DISEXt}{At-1} = a_0 + a_1 \left( \frac{1}{At-1} \right) + a_2 \left( \frac{St}{At-1} \right) + \varepsilon t$$

Keterangan:

- DISEX<sub>t</sub> : Discretionary Cost
- St : Total Sales
- At-1 : Total asset 1 year before
- α<sub>0,1</sub> : constant
- ε<sub>t</sub> : Error term

b. Firm Size

$$UP = \ln(\text{Total Asset})$$

c. Managerial Ownership

$$KM = \frac{\text{Jumlah saham yang dipunyai manajemen}}{\text{Jumlah saham yang beredar}} \times 100\%$$

d. Leverage

$$DAR = \frac{\text{Total debt}}{\text{Total asset}}$$

e. Audit Committee Expertise

$$KK = \frac{\text{Jumlah anggota komite audit yang ahli}}{\text{Jumlah seluruh anggota komite audit}}$$

f. Audit Committee tenure

$$MJ = \frac{\text{Jumlah masa jabatan komite audit}}{\text{Jumlah anggota komite audit}}$$

### III. RESULT AND DISCUSSION

The following are the results of the t analysis test performed:

| Coefficients <sup>a</sup> |       |       |
|---------------------------|-------|-------|
| Model                     | t     | Sig.  |
| 1 (Constant)              | -     | 0,002 |
|                           | 0,557 |       |
| Firm Size                 | 0,210 | 0,008 |
| Managerial Ownership      | 1,519 | 0,134 |
| Leverage                  | 0,832 | 0,409 |
| Audit Committee Expertise | 0,089 | 0,929 |
| Audit Committee Tenure    | 0,173 | 0,863 |

Table 2  
Partial T Test

From these results it can be seen that:

1. The Effect of Company Size on Earnings Management

The result of the t test that has been carried out gives a significance value of 0.008 which is less than 0.05 which means that company size has a significant effect on earnings management, in other words the first hypothesis (H1) is accepted. Companies that have a large size will make these companies get great attention from the public so that every step taken by the company will not be separated from public attention (Ugo & Frank, 2022). Therefore, the company's management will always be careful in every action taken and always avoid fraudulent actions such as earnings management.

## 2. The Effect of Managerial Ownership on Earnings Management

Based on the results of the tests conducted, the results show that the significance value of the managerial ownership variable is 0.134 which is greater than 0.05. Based on these results it can be concluded that the second hypothesis (H2), namely managerial ownership has an effect on earnings management is rejected. This means that even if a company has managerial ownership, it cannot guarantee that the company is free from agency problems that lie behind earnings management actions. The results of this study indicate that even though management has a role as a shareholder, this cannot reduce the tendency of management to take actions that can benefit themselves by carrying out earnings management actions (Panjaitan & Muslih, 2019).

## 3. The Effect of Leverage on Earnings Management

From the results of the t test that has been done, it can be seen that the significance value of leverage is 0.409, greater than 0.05, which means that the leverage variable has no significant effect on earnings management variables. So it can be concluded that the third hypothesis (H3), namely leverage has an effect on earnings management is rejected. The test results can be caused because the average leverage value of the companies used as samples is 0.5%, which means that these companies have relatively low leverage values so

that management does not need to take earnings management actions. If the company's leverage value is low, then the company does not need to worry about defaulting on its debts because the number of assets owned by the company is able to pay the amount of existing debt (Panjaitan & Muslih, 2019).

## 4. The Effect of Audit Committee Expertise on Earnings Management

The t-test that has been carried out shows a significance value of 0.929, which means that the audit committee expertise variable does not have a significant effect on earnings management because its significance value is greater than 0.05. So the fourth hypothesis (H4), namely audit committee expertise has an effect on earnings management is rejected. POJK Number 55/POJK.04/2015 stipulates that an audit committee must have at least one member who is competent in accounting or finance. However, in practice, these competencies are not accompanied by an understanding of the company's operations and business activities so that the audit committee members are unable to exert a major influence on preventing earnings management actions (Sihombing & Laksito, 2017).

## 5. The Effect of Audit Committee Tenure on Earnings Management

Based on the results of the tests carried out, it was found that the results of the significance in the t test were 0.863 which was worth greater than 0.05, which means that the fifth

hypothesis (H5), namely the audit committee tenure has an effect on earnings management is rejected. Audit committee tenure does not have a significant effect on earnings management. On the other hand, audit committee members who have a long tenure will lose their independence and become one camp with management so that the audit committee is unable to identify earnings management actions properly (Cheung & Adelopo, 2022). So that both members of the audit committee have a short or long term of office, it has no effect on earnings management actions taken by management.

#### **IV. CONCLUSION**

The purpose of this research was to determine the effect of company characteristics on earnings management in LQ45 companies for the 2018-2022 period. The characteristics of the companies tested in this study are firm size, managerial ownership, leverage, audit committee expertise, and audit committee tenure. The results of this study indicate that firm size has a significant effect on earnings management. For the other four variables, namely managerial ownership, leverage, audit committee expertise, and audit committee tenure have no significant effect on earnings management.

This research still has some limitations, such as the research

sample used is companies that continue to be listed in LQ45 companies during the 2018-2022 period where the number of companies is limited so that the research results cannot be generalized to other objects. Besides that, all the independent variables studied were only able to describe the dependent variable by 29%, of which there were still 71% of other variables that were able to describe the dependent variable but were not tested in this study.

Based on the research results obtained, the following are suggestions that can be used for further research in order to obtain better research results :

1. Future researchers should consider using a study population other than LQ45 companies, such as manufacturing companies listed on the Indonesian Stock Exchange
2. Adding the independent variables tested with variables that are suspected of having an influence on earnings management, such as institutional ownership, and the quality of external auditors

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