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Corporate Risks and The Impact on Earnings Management

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Abstract

This study aims to determine the effect of corporate risk factors including debt contract motivation, employee diff, and litigation risk on earnings management in manufacturing companies in Indonesia. Data were collected from 100 manufacturing companies in Indonesia with purposive sampling so that 300 samples were obtained from 2017-2019. Multiple linear regression analysis is used to test earnings management in manufacturing companies in Indonesia by analyzing the debt contracts motivation, employee diff, and litigation risk. The results show that three variables in this study, namely debt contract motivation, employee diff, and litigation risk have a significant effect on earnings management. This study uses the litigation risk variable as a corporate risk factor that can encourage managers to report company finances more conservatively manner. Litigation risk has the potential to incur significant costs for dealing with legal issues. Rationally, managers will avoid losses due to litigation by conservatively presenting financial statements, because the profits are too high.
Keywords: ***Corporate; Earnings; Management; Motivation; Risk***

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INTRODUCTION

A business entity requires financial reports as a source of information for decision making and a means of communicating with stakeholders. Financial statements can provide a signal for decisions to make investments (Nazalia & Triyanto, 2018). Financial reports as a form of accountability for management performance during a certain period or fiscal year. Earnings opacity describes the existence of reporting on economic and accounting earnings by companies that are not clear, due to the relationship between several factors. These factors include managerial motivation, accounting standards, and implementation. Profit is a measure of the achievement of business performance. Problems can arise when reporting high profits and hiding losses. Such information will be bad for decision making by interested parties in making investments. Especially in assessing the earning power in the future.

The phenomenon of problems regarding earnings management is as described in PT Tiga Pilar Sejahtera Food Tbk. The company produces consumer goods and conducts business activities through several branches that focus on selling rice. Based on the search and existing facts from PT Ernst & Young Indonesia (EY). The traceability of AISA's management activities on March 12, 2019, indicated that there was inflation in receivables, fixed assets, and inventories. Allegations lead to an inflated fund of Rp 4 trillion, inflation that occurred in income of Rp. 662 billion and Rp. 329 billion in earnings before interest, tax, depreciation and amortization items from businesses engaged in food by issuers. Not only that, other findings stemmed from a number of fund flows of Rp 1.78 trillion through various AISA Group schemes aimed at parties affiliated with the old management, including in the form of bank loan disbursement, time deposit disbursement, transfer of funds through bank accounts, and the cost of financing.

Allegations of earnings management practices carried out by AISA Group officials have become a serious problem experienced by the company. This action motivates management to manipulate the presented earnings. This is then termed as earnings management. Management performance appraisal is based on earnings information, so that motivation ultimately encourages earnings management. The earnings management action is through strong efforts in manipulating the earnings presented in the financial statements. This condition then leads to fraud against financial statement readers who do not know the true conditions in the company. Managers modify a company's financial statements with the aim of misleading stakeholders about evaluating economic performance or influencing contractual outcomes based on reporting accounting numbers (Widarti & Pramajaya, 2018). Leuz et al (2003) disclose the causes of earnings management practices that are closely related to the size of the capital market owned, the distribution of share ownership, the strengths or weaknesses of investor rights, and law enforcement in a country. Earnings management practices can ultimately reduce public confidence and become an obstacle that hinders the flow of funds in the capital market. Interested parties argue that managers deviate from flexibility in Generally Accepted Accounting Principles (GAAP) and consciously alter substantial information in financial statements to mislead interested parties.

Debt contract motivation is an effort that is able to make managers to practice earnings management. This motivation is the basis for managers' actions in managing their profits which lead to a deliberate delay in the settlement of the company's debt obligations (Kalbuana et al., 2019). The proportion of debt risk that is greater than the company's capital will have a significant influence on the assessment by external parties or creditors. The high risk of debt to equity will encourage earnings management efforts by the company's management. The debt risk becomes a problem for the company in getting funds and eventually the company will be threatened with violating the debt agreement or contract.

Other dimensions is thought to influence earnings management is employee differences. Employee diff describes the condition of the gap that occurs in the growth of employment to income. This is explained in research by Bukit & Nasution (2015), The findings lead to inconsistent motives for non-financial measures such as employee growth and financial measures—that is, in the form of greater revenue growth. In the end, managers take advantage of these conditions to take manipulative actions on the information presented in the financial statements by practicing earnings management.

Losses that then arise from earnings management practices by company managers have an impact on investors and creditors, even leading to the risk of litigation (lawsuits).

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Investors only pay attention to the profit information provided without tracing the actual profits obtained by the company. The motive behind it is the authority mandated to managers in choosing accounting recording methods that have an impact on information asymmetry (information inequality). Various pressures in a very competitive business world cause companies to finally manage earnings. Companies that experience an increase in profits consistently and periodically will result in a risk of loss that is greater than the percentage increase in profit. The average company is motivated to manage earnings with the aim of avoiding debt covenant violations (Britskiy, 2018). Litigation risk is a factor outside the company that is another motivation for managers to present company financial information in a more conservative form. The risk of litigation has the potential to trigger high costs for dealing with legal issues that arise. If understood through the aspect of rationality, managers will try to avoid losses caused by litigation. The solution is to present the financial statements conservatively, because the profits are too high. Regulation and law enforcement that apply in the accounting environment is one of the mandatory requirements for managers to focus their attention on the accounting practices used. The demands for stricter compliance with law enforcement lead to litigation if the company is proven to have committed an attempted violation. In the end everything will increasingly encourage managers to be careful in applying accounting methods.

Managers will increase their income by trying to maximize the value of the company. Agency theory is the basis for explaining the efforts made by managers to obtain incentives through managerial ownership. When managers acquire shares of a company, their interests align with those of the shareholders. Alves (2010) states that high managerial ownership is able to reduce managers' motivation in carrying out earnings management actions. The increase in shares owned by a manager makes him not choose actions that lead to profit manipulation. Even though in actual conditions, the agent and the principal have interests that cannot be said to be aligned. Agency problems arise because of the asymmetry of information between agents and principals, which of course can trigger managers to perform dysfunctional behavior. Managers will do things that are opportunistic from the agent, namely management behavior to maximize their welfare which is against the interests of the principal.

Earnings management which has the objective of fulfilling debt contract agreements arises as a result of the company's long-term debt contracts. This debt agreement aims to protect the borrower against the manager's actions. According to Kalbuana et al (2019), debt contract motivation is the basis for managers' actions in managing their profits. As a result, all of the company's debt obligations that should be due will be delayed in the following year. The motivation for debt contracts is measured using the leverage ratio (Kalbuana et al., 2019). Research by (Adrianto & Anis, 2014) states that debt contract motivation does not have an effect on EM practices. According to research conducted by (Tarjo, 2010), the hypothesis regarding the debt covenant hypothesis states that if all other things remain the same and the company is getting closer to the debt covenant violation, it will allow managers to carry out activities that move reported earnings from future periods. to the current period. Then the company will carry out earnings management practices. Based on the arguments, the hypothesis is:

H_1: Debt contract motivation has a positive effect on earnings management

Employee diff is a condition where there is a gap between income growth (financial data) and employee growth (non-financial data) (Saputri & Achmad, 2017). Managers make profit changes for several reasons, including large-scale losses, business failures experienced by the company, competitiveness, and high growth. Management's desire is of course to provide maximum benefits for shareholders in the capital market and fulfill debt covenants. A manager can modify sales, revenue, or profit data, as well as adjust non-financial data so that the actions taken are trustworthy. However, some non-financial data cannot be adjusted easily in a short time. This concerns the level of customer satisfaction, the number of employees, and the number of facilities. Discrepancies between financial and non-financial data, known as employee discrepancies, can raise suspicions that the company is not providing correct financial information (Ames et al., 2012). Research conducted (Bukit & Nasution, 2015) states that there is a positive relationship between employee diff and EM. Based on these arguments, the hypothesis is:

H_2: Employee diff has a positive effect on earnings management

Litigation risk is a risk inherent in the company and allows for threats by parties who have an interest in the company and feel disadvantaged. These stakeholders include creditors, investors, and regulators. Measurement of this risk through various financial indicators that can indicate the occurrence of litigation. Lately, the risk of litigation against companies due to financial reporting errors often occurs in companies going public. The intensity of litigation risk is higher when law enforcement in a capital market environment is carried out properly (Utami, 2011). Research by Mustikasari et al (2020), indicate that litigation risk significantly affect on accrual discretionary, which is the inverse quality of the financial statements. Likewise, Huang et al (2020) and Aimin & Zhi (2017), litigation risk effects on earnings management, meanwhile Trisnawati et al (2015) and Dou et al (2016) stated that litigation risk does not affect on EM. Based on the above arguments:

H_3: Litigation risk has a positive effect on earnings management

This research is a development of previous research. The importance is due to the frequent occurrence of earnings management cases in large companies in Indonesia. Where this case occurs in large companies such as PT Lippo Karawaci in addition to the State-Owned Enterprises (SOEs), namely PT Garuda Indonesia (Persero) Tbk. Where this research is related to the development of the era, this research is still relevant to be researched at this time. This study also adds two new independent variables, namely employee diff and litigation risk. The reason the researcher added this variable is because employee diff is a variable used to measure the difference between the percentage change in income and number of employees. So that an understanding of the employee diff variable can warn various parties within the ranks of a company (such as directors, creditors, investors and auditors) about the probability of fraudulent financial statements. So it can be said that the difference between financial and non-financial measures can effectively detect and assess the risk of fraud in a company.

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RESEARCH METHOD

The subjects consist of manufacturing companies in Indonesia and listed on the Indonesia Stock Exchange (IDX). Secondary data collection through reports related to the problems studied, namely debt contract motivation, employee diff, litigation risk, and earnings management. Data on the financial statements of manufacturing companies were obtained through the website www.idx.co.id including balance sheets and profit/loss reports for 2017-2019. The population of this study consisted of 150 manufacturing companies. The sampling method used purposive with certain criteria, so that then 100 companies were obtained. The period is used for 3 years because it is considered sufficient as a proxy for the condition of manufacturing companies before the covid 19 pandemic. In addition, many cases occurred in Indonesia related to manufacturing companies during that period, this is supported by the statement of Subiantoro Chairman & Executive Director of LAPSPI quoted from bisnis.com on April 30 2018, stated that the total cases during January 2016–April 18 2018 amounted to 99 cases or an average of four cases per month. As much as 90 percent of the mediation carried out can result in a peace agreement, the remaining 10 percent consists of partial agreement and disagreement

Debt contract motivation (X_1) is defined as the manager's motivation in managing and managing company profits, which aims to ensure that the company's debt obligations that should be settled in a certain year can be postponed for the following year. Employee diff (X_2) is defined as a condition where there is a gap between income growth (financial data) and employee growth (non-financial data). Litigation risk (X_3) is inherent in the company which allows the threat of litigation to arise due to parties who feel aggrieved by the company. Earnings management (Y) as an act of manipulation by managers or financial statement makers in the financial reporting process of an entity because of the expected profit motive for their actions.

$Y = \alpha + \beta_1 DCM + \beta_2 ED + \beta_3 LR + \varepsilon$

Information:
Y = Earnings Management
X_1 = Debt Contract Motivation
X_2 = Employee Diff
X_3 = Litigation Risk
α = constant / intercept
β_1, β_2, β_3 = Regression coefficient
ε = Error disturbance (confounding variable)

RESULTS AND DISCUSSION

The independent variables consisted of Debt Contract Motivation, Employee Differences, and Litigation Risk, while the dependent variable was earnings management. The choice of manufacturing company as the subject of this research is because it has different characteristics from other sectors and the number dominates. The research period was 3 years with the aim of knowing the company's growth through the company's life cycle, so that 300 company data were obtained as samples. Manufacturing companies have various production areas and attract investors to invest in these sectors.

The descriptive statistical test used in the early stages of the study aims to determine the description or distribution of data from the dependent variable, namely earnings management and several independent variables, namely debt contract motivation, employee differences, and litigation risk.

Table 1. Descriptive Statistics

	N	Min	Max	Mean	Std. Deviation
Debt Contract Motivation	300	1.31	5.10	2.4346	0.53094
Employee Diff	300	1.16	3.51	2.0600	0.52833
Litigation Risk	300	1.21	3.30	1.7264	0.45086
Earnings Management	300	1.02	2.45	1.4353	0.31004

Source: Output SPSS IBM, Version 20.0

Table 1 shows that the variables of debt contracts motivation, employee diff, litigation risk, and earnings management have an average value (mean) that is close to their maximum value, which means that all variables have almost the same or varying values.

Classical assumption testing is carried out as an initial stage before moving on to the next test using a multiple linear regression model. Kolmogorov Smirnov's normality test uses a significance level greater than 0.05 which indicates that the data distribution is normal. After the data is declared normally distributed, then the test can be continued to the next stage. The results of this test are as described:

Table 2. Normality Test

		Unstandardized Residual
N		297
Normal Parameters[a,b]	Mean	0E-7
	Std. Deviation	0.15875758
Most Extreme Differences	Absolute	0.072
	Positive	0.072
	Negative	-0.053
Kolmogorov-Smirnov Z		1.233
Asymp. Sig. (2-tailed)		0.099

Source: Output SPSS IBM, Version 20.0

The result of the Kolmogorov-Smirnov Z test is 1.233 with a significance value is 0.099 which indicates a significance value of more than the minimum required limit of 0.05. The distribution of data can be expressed as normally distributed and pass the test. Multicollinearity test results are contained in output statistics.

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Table 3. Multicollinearity Test

Variable	*Collinearity Statistics*		Information
	Tolerance	VIF	
Debt Contract Motivation (X_1)	0.352	2.722	Multicollinearity does not occur
Employee Diff (X_2)	0.369	2.833	Multicollinearity does not occur
Litigation Risk (X_3)	0.690	1.528	Multicollinearity does not occur

Source: Output SPSS IBM, 2021

Table 3 illustrates the tolerance value limit for the analysis of all variables used in this study with a value exceeding the minimum limit of 0.1 and VIF required below a value of 10. The indication is that there are no symptoms of multicollinearity in the research data, so the next step is to detect the possibility of autocorrelation using the test Durbin Watson. Assessment on autocorrelation is able to determine the relationship in the linear regression model regarding the confounding error in a time period denoted by the t-symbol and its value in the t-1 period (previous). To explain the regional provisions of whether positive or negative autocorrelation occurs, or whether autocorrelation does not occur, it can be seen in Figure 1.

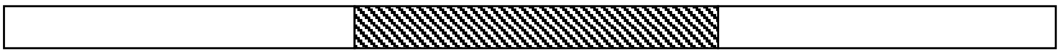

Figure 1. Autocorrelation Interval Curve Source: Output SPSS IBM, 2021

The Durbin Watson test shows that there is a DW value according to the specified conditions, namely 0.161 and the veranda is between -2 and +2 ($-2 < 0.161 < +2$). Through data analysis, it can be interpreted that there is no autocorrelation symptom in the model built on the research. The next symptom that must be detected is heteroscedasticity through the Glejzer test. The significance value for the independent variable showing a value less than 0.05 is said to be unable to escape from heteroscedasticity, but on the contrary if it is greater than 0.05 then it is free from heteroscedasticity. The description of the results of the nominal analysis of the heteroscedasticity test data which is a requirement in following the next test.

Table 4. Heteroscedasticity Test

Variable	Sig
(Constant)	0.060
Debt Contract Motivation (X_1)	0.092
Employee Diff (X_2)	0.570
Litigation Risk (X_3)	0.457

Source: Output SPSS

Related to the results of the analysis of research data on the output of the regression model in this study, it shows that there is no heteroscedasticity. Through the output of the classical assumption test that has been interpreted previously, it shows the results as required to carry out further tests in answering the regression model. Then the results are able to answer the hypothesis that has been formulated and its development through the built literature. Testing of the hypothesis has been carried out, then leads to the coefficient of determination test as a measuring tool for the ability of the independent variables to influence the dependent variable. The basis for the assessment required is the R^2 value between 0 (zero) and 1 (one). The results indicate that the value of R^2 which is getting closer to 1 indicates a better value in the regression model and is considered capable of explaining the dependent variable by the variation of the dependent variable.

Table 5. Determination Test

Model	R	R^2	Adjusted R Square	Std. Error of the Estimate
1	0.849	0.720	0.727	0.15957

Source: Output SPSS

The adjusted R square value shows a large value, namely 0.727, which means that 72.7 percent of earnings management in manufacturing companies can be explained by variations in the independent variables, namely debt contract motivation, employee differences, and litigation risk. Apart from the model used, there are other variables that can influence 27.3 percent. The use of multiple linear regression model is able to analyze the effect of the independent variable-motivation of debt contracts, employee differences, and litigation risk and earnings management-bound with the strong influence of independent and dependent variables. Tests show results as required.

Table 6. Multiple Linear Regression Analysis

Model		Unstandardized Coefficients		Standardized Coefficients
		B	*Std. Error*	*Beta*
1	(Constant)	0.125	0.049	
	Debt Contract Motivation	0.083	0.035	0.143
	Employee Diff	0.254	0.033	0.457
	Litigation Risk	0.268	0.027	0.396

Source: Output SPSS

Multiple linear regression tests describe the result of hypotheses, it was obtained a constant value (α) of 0.125; regression coefficient value of Debt Contract Motivation (β_1) of 0.083; the value of the Employee Diff Coefficient (β_2) is 0.254; and Litigation Risk (β_3) of 0.268. To test this relationship, one can compare the significant value with the probability value (0.05). The following is the output of SPSS:

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Table 7. Results of Partial Test Analysis

Model		T	Sig.
1	(Constant)	2.552	0.012
	Debt Contract Motivation	2.639	0.007
	Employee Diff	8.923	0.000
	Litigation Risk	10.583	0.000

a. dependent variable: Earnings management

Source: Output SPSS

Y = 0,125 + 0,083DCM + 0,254ED + 0,268LR + ε

The interpretation of multiple linear regression analysis results: at a constant level of 0.125 it can be interpreted that the debt contract motivation (X_1), employee differences (X_2) and litigation risk are equal to zero, so it can also be stated that the earnings management value (Y) is 0.125. Another interpretation of the coefficient of debt contract motivation (β_1) is at a value of 0.083 which indicates a positive effect on earnings management (Y). Statistically reveals that there is an increase for each variable of debt contract motivation (X_1), it can also be interpreted that the value of earnings management (Y) will increase. Likewise, the value of the employee diff coefficient (β_2) which shows the magnitude of the coefficient value of 0.254 and states its positive influence on earnings management (Y). This can also be interpreted that for every increase in employee difference (X_2) by one unit, it will also have an impact on increasing the value of earnings management (Y) by one unit. Likewise, the litigation risk coefficient (β_3) of 0.268 states that it has a positive effect on earnings management (Y). This implies an increase in litigation risk (X_3), capable of influencing an increase in the value of earnings management (Y).

If interpreted the results of the analysis of the significance test in table 7 can be stated regarding the value of each variable in detail as explained in a structured manner. Debt Contract Motivation (X_1) affects Earnings Management. The first hypothesis (H_1) reveals the test results of the influence of debt contract motivation variables on earnings management by referring to the results of SPSS output with a significance level of 0.007. This value is smaller than the required value of 0.05, so the first hypothesis can be accepted. On the other hand, the t-value shows a positive result of 2,639. It can be concluded that H_1 is accepted with the statement that the debt contract motivation states a positive and significant influence on earnings management. Employee Diff (X_2) also affects Earnings Management. The statement in the second hypothesis (H_2) regarding the effect of the employee diff variable on earnings management. Based on the results of SPSS output with a significance value of 0.000 which is certainly smaller than the value of 0.05, so the second hypothesis can be accepted. Even if viewed at the t-value shows a positive result of 8.923. The conclusion from this statement is that H_2 is acceptable, in the sense that employee diff has a positive and significant effect on earnings management. Litigation Risk (X_3) also affects Earnings Management. The third hypothesis (H_3) shows the effect of litigation risk variables on earnings management. SPSS output results show the value obtained is a significance of 0.000 and below the minimum value of 0.05, so the hypothesis is declared accepted. The t-value shows a positive result of 10,583. This shows the acceptance of the third hypothesis, namely litigation risk is able to have a positive and significant influence on earnings management.

Research results are able to reveal that earnings management can occur when managers apply an assessment of transactions in financial reporting and prepare transactions in such a way with the aim of modifying the financial statements. This in turn can provide stakeholders with misleading information about the company's actual economic performance or to influence the contract-related outcomes and this is dependent on accounting numbers as well (Ghazali et al., 2015). There is also a statement that earnings management is a behavior to influence financial statements. Influencing financial reports can be done in various ways according to the manager's interests. In addition to decisions to choose certain accounting methods or procedures, managers are also given the freedom to change the accounting methods and procedures they use. However, the manager's freedom to choose and use accounting standards, as well as stakeholder ignorance of the information disclosed in footnotes will encourage a manager's opportunistic behavior. There have been incidents of earnings management that have shocked the business world, such as the Enron and Worldcom cases that have caused huge losses to the business world. Not only abroad, but cases of earnings management also occur in Indonesia (Sulistiawan & Alvia, 2011). EM practices often cause agency problems, information asymmetry, losses, and a crisis of investor confidence. In the current situation of the Covid-19 pandemic, the government advises companies not to carry out earnings management activities and to make an inaccurate representation of the economic phenomena of companies affected by this pandemic. For example, if the company experienced a significant decline in sales in the first quarter of 2020, this fact must be reflected in the first 2020 interim financial statements.

In this study, found that there is a positive and significant influence of debt contract motivation on earnings management. The effect shows a significance value of 0.000. It is statistically stated that the first hypothesis is accepted. This study shows results that are consistent with the research of (Adrianto & Anis, 2014); Kalbuana et al (2019) states that debt contract motivation positively affect on earnings management. Every company in carrying out its company operations certainly requires capital. This capital can come from personal capital and capital that comes from company loans. The company makes these loans to meet the source of company funds to finance the company's operations, both in the short and long term. Loans are capital obtained from external parties from creditors. Managers must show good performance from their company in the context of managers' efforts to attract creditors so that creditors are willing to invest their funds in the company (Sulistiawan & Alvia, 2011; Sutrisno, 2017). The results of the manager's efforts in

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attracting creditors to get loans and loans made by the company certainly demands the company's responsibility. Creditors will always supervise the company condition.

A positive and significant effect is also shown from the employee diff variable on earnings management, namely the significance value of 0.000. In addition, hypothesis two can be accepted. Empirical evidence that can be explained on this relationship is the relationship between non-financial data and earnings management. The meaning of this interpretation is that data that does not match between income growth and employees is declared as employee diff. This raises the suspicion that the company did not provide financial information according to the actual situation. This opportunity can be a space for managers to practice earnings manipulation. It can be stated that, the higher the gap between revenue growth and employees will motivate managers' actions to carry out earnings management. In line with research by Saputri (2017), Ames et al (2012), Kong et al (2020) which states that employee diff affects earnings management.

The third variable research, litigation risk shows a positive direction and a strong/significant effect on earnings management with a significance value of 0.000. The value can be stated as less than 0.05, which means that the hypothesis is accepted. According to Utami (2011), litigation risk is defined as the risk inherent in the company that allows the threat of litigation by interested parties in the company such as creditors, investors, and regulators. Research conducted by Suryati (2019), Mustikasari et al (2020), Cao & Narayanamoorthy (2011), Huang et al (2020), Jackson et al (2015), and Liao & Ouyang (2019) stated that litigation risk has positively affect on earnings management. Litigation risk as a risk from a legal perspective. Furthermore, this risk will be borne by the company arising from lawsuits by various parties who suffer losses. This risk allows the company to experience litigation by investors and creditors. Litigation risk originating from creditors is expressed through the risk indicator of the company's inability to pay short-term and long-term debt. From the investor's point of view, litigation can occur because the company carries out activities that will result in losses. This is reflected in the movement of stock prices and volumes by hiding some negative information as a signal for investors (Mustikasari et al., 2020).

The risk of litigation can of course burden the company because it requires a large amount of money to deal with legal issues. The higher the risk of litigation/lawsuits, the management will try to cover it up by manipulating the financial statements. it will be appear to contain good information for those who have an interest in the information. This manipulation finally makes the information users trust and intend to invest.

CONCLUSION

Data analysis that has been done previously on the subject of this study reported a significant influence and a positive direction for the entire variables. The regression equation model provides answers to the proposed hypotheses and examines them from the theoretical aspect and also based on existing empirical data. The independent variables, namely debt contract motivation, employee differences, and litigation risk affect earnings management as the dependent variable. If it is understood in terms of the theoretical basis used, namely agency theory, then companies that seek to separate their governance and ownership functions will more easily experience agency conflicts. Agency conflict arises as a result of asymmetry of information provided by managers or indicates manipulation. One of the common practices carried out by managers is earnings management. Earnings management is a choice of accounting policies made by managers to achieve certain goals that are profitable for them. The opinion expressed by Jensen and Meckling, where the agency relationship arises when an individual or more as the principal authorizes another individual as an agent to provide services and then make decisions that can benefit the principal. The existence of a gap in this theory shows the differences in interests that occur between agent and principal. The agent has a moral responsibility to optimize the profits of the principal. In return, managers will be compensated according to the contract they have agreed to. It can be said that there are four patterns of earnings management, namely bathing which makes the company's profits look very extreme from the previous period. Minimization of income which makes the profit in the current period's financial statements lower than the actual profit earned by the company. Maximization action that makes profit in the current period. The current period's financial statements are higher than actual profits, and income smoothing is the method used to make accounting profit relatively consistent from one period to the next.

Further research can expand the reach not only to manufacturing companies but also to other business fields listed on the Indonesia Stock Exchange. Earnings management practices can affect the quality of financial reporting, precautionary monitoring measures need to be taken to protect the shareholders interests and to improve reporting quality. This research is limited contain to manufacturing companies so that it is still less representative of companies in Indonesia with a wider scope of fields. Also, the variables accounting conservatism can be used in this research. The researcher also suggests for further researchers to use different measurement scales, with different company sectors, further researchers can also do this. Through this research, investors are expected to be more careful in investing in a company. By looking at the motivation of debt contracts, employee diff and the risk of litigation owned by a company can avoid the occurrence of earnings management carried out in the company.

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