

*Original Article*

# The Effect of Managerial Ownership in Moderating the Factors that Influence Earnings Management

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**Abstract:** *The purpose of this study was to obtain empirical evidence about the effect of Profitability, Leverage, Bonus Motivation, and Board Size as independent variables on earnings management moderated by managerial ownership in non-financial companies in Indonesia. The population taken in this study were all non-financial companies on the Indonesia Stock Exchange during 2018 to 2022. The sample that was successfully filtered through purposive sampling was 36 companies as a sample of non-financial companies, which later resulted in 180 data that could be used as samples. Multiple linear regression and hypothesis testing are used as data analysis methods in this research. The results obtained in this study indicate that Bonus Motivation influences earnings management statistically. Conversely, the variables of Profitability, Leverage, and board size do not influence the earnings management of non-financial companies listed on the Indonesia Stock Exchange in 2018-2022.*

**Keywords:** *Earnings Management, Profitability, Leverage, Bonus Motivation, Board Size, Managerial Ownership.*

## I. INTRODUCTION

The regulation is influenced by the prevalence of debt-taking in the financial sector, which involves the provision of financial reports, which promotes ethical transparency and accountability in financial reporting. Regulations aim to ensure transparency in financial reporting, reduce conflicts of interest, and maintain auditor independence to protect investor interests and enhance market performance.

Financial reporting is a crucial document that outlines the financial health of a company, with manipulation of financial information being a common issue. This can lead to increased risk for investors and negatively impact the company's financial performance.

Earnings Management, as defined by Schipper (1989), refers to the manipulation of financial reports to gain non-interested interest. This involves manipulating financial data to increase personal interest while manipulating financial statements to satisfy investors or creditors about the company's financial health.

The use of accounting principles in financial reporting can lead to misleading financial statements, as auditors may misinterpret the data and make assumptions about the company's financial health. This can lead to a lack of trust in the company and a potential for fraud. In conclusion, financial reporting is essential for maintaining investor confidence and ensuring the integrity of financial reporting.

## II. LITERATURE REVIEW

### A) Literature Review

Positive Accounting Theory (PAT) is a theory that can predict and influence business development. It focuses on predicting actions such as accounting policies and managers' responses to new accounting standards. PAT suggests that businesses can optimize their profits and meet the needs of their owners by using their resources efficiently and effectively. A company can act as a counter-balancer with financial fluctuations. PAT also suggests that when a company is successful, managers will possess accounting techniques that align with their own interests. PAT supports this by presenting three hypotheses: the bonus plan hypothesis, the debt covenant hypothesis, and the political cost hypothesis. The bonus plan hypothesis suggests that managerial activities influence accounting decisions, while the debt covenant hypothesis suggests that management can manipulate accounting information. A company's strategy to reduce the creditworthiness of financial reports can help reduce conflicts between investors and management. Agencies should focus on providing financial reports based on their principles, ensuring their performance aligns with their interests and, in turn, generating compensation (Watts and Zimmerman 1990).



Jensen & Meckling's (1976) theory of agency explains the difference between principles (Shareholder /Creditor) and agents (management). Motivasi between the two groups is unclear, and the relationship between them is complex. Agents can be influenced by the situation, as they have more information than principles. Managers use accounting techniques to manage financial data to their advantage. This is because public financial information provides investors with significant information about business activities. Conflict between managers and investors is possible, as they have more power to manipulate private wealth. The theory also suggests that managers should be aware of their influence on financial information.

Ross (1973) created the first signal theory that states that financial reports can indicate improved company performance. How the success or failure signal of the manager is delivered to the principal is explained by the theoretical signal. The use of the term corporate social responsibility (CSR) highly indicates that companies are committed to making an impact on employees, society, and the environment. (Hong & Andersen, 2011). Signal theory involves several parties, both inside and outside the company. Since management is the one sending the signal, investors are called insiders in this theory. (Spence, 1973).

**a. Profitability**

Profitability is the degree of performance of a company in generating profits on the company. Kashmir (2014:198) Knowing the level of profitability, the position of profit, the increase in profitability rate, the rate of net profit, and the productivity of the total expenditure spent is an advantage to profitability. A study by Brigham and Houston (2018) suggests that profitability ratio and cumulative margin are two names for profitability indicators.

According to Brigham, Gapenski, and Ehrhardt (2009), a company's profitability rate is the net operating outcome of the combined impact of liquidity, asset management, and debt management. Therefore, profitability can be regarded as a potential investment to generate income. However, if the profitability is too high, investors can misunderstand and assume the company is running well. As a result, investors are more likely to suspect companies of monopoly practices, which in turn raises their expectations and demand.

**b. Leverage**

The result of comparing the total liabilities to the total assets is called leverage. Therefore, the value of the company's debt increases as the leverage ratio increases. (Yuliana & Trisnawati, 2015). Leverage is a method of estimating the amount of capital needed to create a financial structure with the ultimate goal of maximizing profits. Operating leverage and financial leverage are the two main forms of leverage. Operation leverage states that a company uses a fixed operating cost in the company's investment activity. In contrast, financial leverage refers to the use of cash from debt or preferential stock issuance. Fixed charges, such as interest or dividends, arise when the funds are used.

**c. Bonus Motivation**

Priansa (2016) defines bonuses as monetary payments in return for services rendered or work done. The bonus is given periodically on the basis of the desired job and is given only to the employee who obtained it. A bonus is money given to an employee by a superior in recognition of the performance of such employee, as defined by Kashmir. (2016).

When managers meet set performance targets, business owners reward them with bonus motivation (Wimelda & Chandra, 2018). If a manager's bonus depends on achieving a certain profit target, then the manager will work harder to reach that target. That's what drives management to manipulate profitability for the promised bonus. Money or promotion are two examples of how these benefits are compensated.

**d. Board Size**

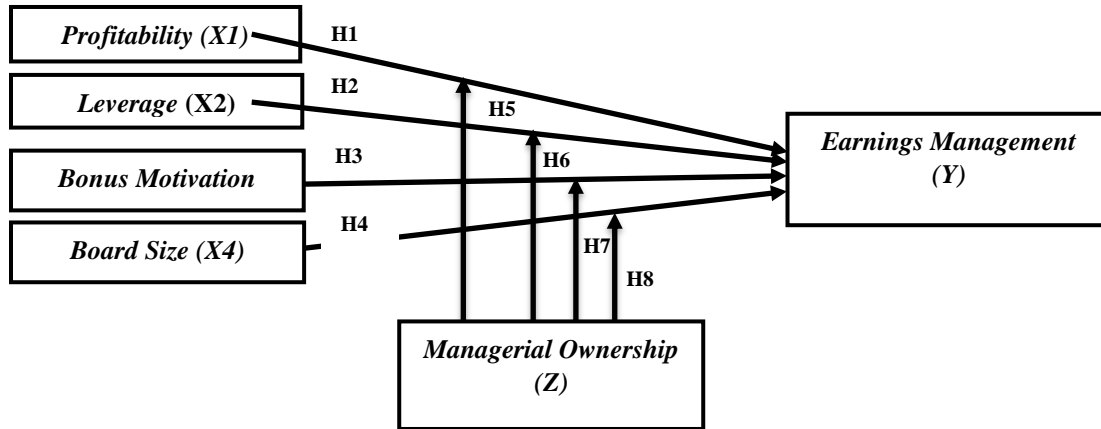
Board size can be seen as an internal control mechanism that affects the way profit management is demonstrated by discretionary accrual and internal corporate governance processes investigated by (Sáenz González & García-Meca 2014). Larger boards may have fewer committees due to increased council size (Monks and Minow, 1995). Dalton et al. (1999) argued that larger councils were more effective in protecting shareholders' interests because they were less susceptible to managerial domination and had more varied training and technical composition to fight management domination in companies.

**e. Managerial Ownership**

The amount of shares held by the management of the company as a whole is referred to as "manager ownership." Businesses that are high-risk and give high rewards drive their management to maximize revenue. Since management is confident in its ability to deliver reasonable and real profits, shareholders do not have to worry about earnings management. (Kalbuana et al., 2019).

## f. Earnings Management

Scott (2015) describes earnings management as the use of various accounting methods and creative strategies by managers to meet a set goal. One approach to earnings management (opportunistic earnings management) is based on the incentive of managers to maximize their own utility in return for lower wages, lower interest payments, and lower political costs, as described by (Zainuldin & Lui, 2020). When managers treat earnings management like efficient contracts, they can protect the interests of the company and their own interests by finding ways to deal with unexpected possibilities.



**Fig. 1: Conceptual Framework**

Based on the description above, hypotheses 1 until 8 were formulated in this study as follows :

The capacity to generate profit is one of the most important metrics for any business. The success of a company is often measured by its profits. When the company's profit is high, then the company's performance is said to be good. This means that the value of profitability correlates positively with the level of management experiencing a decline in profitability. This is because companies with high profits tend to be a government concern, which is known as political cost. Political cost is a cost or transfer of wealth that a company has to bear in connection with various regulations such as tax rates and labor claims, subsidies, antitrust actions by the government, and so on. This leads companies with high profits to do profit management by lowering their recognition based on fewer tax payments. On the contrary, if the company only produces little or no profit at all, then its performance is poor. Both Agusti Widyantoro et al. (2023) and Rahmadhani & Ardiansyah (2023) found a correlation of positive influence between profitability and profit management.

**H1: Profitability has a positive impact on Earnings management.**

The higher the leverage ratio, the larger the company's debt. The creditor will tighten up the company's oversight according to the amount of debt he has, in line with the theory of corporate finance, where this theory covers corporate financial decision-making, including the selection of funding sources. Companies with high debt risk may face challenges in managing interest burdens and debt payments, which can affect related accounting policies. This leads to less management flexibility in implementing earnings Management. In other words, the higher the leverage ratio, the less likely the management is to implement Benefit Management. Sari and Khafid (2020) and Devi and Wirawati (2019) found that financial leverage had a negative impact on profit management.

**H2: Leverage has a negative impact on Earnings management.**

According to Panjaitan and Muslih (2019), bonuses significantly improve earnings management. The company that gives the bonus does it to increase the profits of its employees. Profits are increased artificially by management to increase their bonus payouts. Cahyanto and Madelyn (2022) found that Bonus Motivation had a positive influence on earnings management.

**H3: Bonus motivation has a positive influence on Earnings management.**

The short- and long-term policies of the company are determined by the board of directors. (Taco, 2016). Companies with many boards of commissioners can't collaborate, communicate, and make decisions better than companies with smaller boards. A large number of commissioners can make the supervisory process effective, and earnings management practices can happen. (Scott, 2015). Tanujaya and Verent (2020) found that Board Size had a positive influence on earnings management.

**H4: Board Size Positive Impact on Earnings Management**

Management is a strategy used to address problems and focuses on the importance of management and leadership based on public perception. Management efficiency can be increased if management increases the amount of shareholding in the company. Management features have been studied to understand how they moderate the relationship between the variables of independence and leadership. Management characteristics also prevent conflict with leadership, according to a study by (Sari & Khafid, 2020). The lack of research on management characteristics as moderation variables in the context of leadership makes this factor a potential moderator.

**H5: Managerial ownership moderately influences profitability on Earnings management.**

**H6: Managerial ownership moderately influences leverage on Earnings management.**

**H7: Managerial ownership moderates the influence of Business Motivation on Earnings management.**

**H8: Managerial ownership moderately influences Board Size on Earnings management.**

**B) Variable and Measurement**

**a. Earnings management**

The dependent variable for earnings management is the DACC or discretionary actual variable. In their research, Dechow et al. (1995) assessed the performance of industrial models Healy, Deangelo, Jones, and Modified Jones for knowledge of earnings management. They found that Jones' modified model was more suitable for earnings management studies and, therefore, used to estimate discretionary accruals in research. (Bagheri et al., 2010).

$$TACCit = NIit - OCFit$$

**Information:**

- TACC = Total Accruals
- NI = Net Income
- OCF = Operating Cash Flows

$$TACCit/Ait-1 = \alpha1 (1/Ait-1) + \alpha2 (\Delta REVit - \Delta RECit)/Ait-1 + \alpha3 (PPEit /Ait-1) + eit$$

**Information:**

- TACCit = Total accruals of firm i in year t.
- Ait-1 = Total assets of firm i in year t-1.
- $\Delta REVit$  = Change in revenue of firm i in year t. (NET)
- $\Delta RECit$  = Change in accounts and notes receivable of firm i in year t. (NET)
- PPEit = gross value of property, machinery, and equipment of firm i in year t.
- eit = Error of model for firm i in year t.
- $\alpha1, \alpha2, \alpha3$  = estimated coefficients of modified Jones model.

$$NDACCit /Ait-1 = \alpha1 (1/Ait-1) + \alpha2 (\Delta REVit - \Delta RECit)/Ait-1 + \alpha3 (PPEit /Ait-1)$$

$$DACCit = TACCit - NDACCit$$

**b. Managerial Ownership**

In general, management ownership is the total amount of shares of a company owned by management, such as the board of directors and board of commissioners (Laurencia & Mulyana, 2022).

$$MOWN = \frac{\text{number of share is owned by dir and comm}}{\text{Outstanding Share}}$$

**c. Profitability**

Profitability is the rate of performance of the company in earning profit in the company. Profitability has the benefit of knowing the level of a profit, the position of the profit, the growth of the rates of profit, the rate of net profit, and the productivity of all the costs that the company issues (Arieska et al., 2023).

$$ROE = \frac{\text{Net Income}}{\text{Net Equity}} \times 100\%$$

**d. Leverage**

The leverage is the result of the comparison between the total liabilities and the total assets. This results in a greater leverage ratio. This means the higher the value of the company's debt. The leverage is intended to determine the amount of financial resources needed to consider the composition of the financial company aimed at increasing profits (Prajitno & Vionita, 2020).

$$LEV = \frac{\text{Nets Liability}}{\text{Net Asset}}$$

**e. Bonus Motivation**

Motivational bonuses are bonuses given by company owners to managers if they achieve company performance according to a specified target. This means that the greater the bonus that the manager will get, the greater the manager will try to manage profits to achieve the specified target (Kalbuana et al., 2019).

$$ROA = \frac{\text{Net Income}}{\text{Net Asset}} \times 100\%$$

**f. Board Size**

Board size can be viewed as an internal board control mechanism that affects a company's earnings management (Prajitno & Vionita, 2020).

*Number of the board of commissioners of a company*

**III. RESULTS AND DISCUSSION**

**A) Result and Discussion**

**a. Descriptive Statistics Analysis**

**Table 1: Table Descriptive Statistics Test Results**

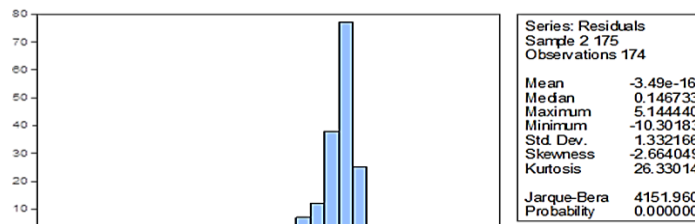
	N	Minimum	Maximum	Mean	Std. Deviation
ROE	175	-6,7928	4,9774	0,0156	0,7689
LEV	175	0,0224	1,8537	0,4344	0,2697
MB	175	-0,5757	0,3099	0,0173	0,1031
BZ	175	2,0000	8,0000	4,7600	1,7517
MO	175	0,0005	0,8742	0,2666	0,2697
EM	175	-0,1049	0,0791	-0,0006	0,0265
Valid N (listwise)	175				

The table above shows four research variables: Profitability, Leverage, Bonus Motivation, Board Size, Managerial Ownership, and Earnings Management; the findings of the descriptive statistical analysis of the dependent and independent variable data are shown in Table 1. The table displays the quantity of disclosures made by non-financial companies in 2018-2022 using 175 indicator items. Based on the data collected, the Profitability disclosure includes a minimum of -6.7 and a maximum of 4.6. Then, the mean column shows the average or majority value of Profitability disclosure in the observed companies, which is 0.015 or 1.5% with a standard deviation of 0.76 or 76%. Furthermore, leverage has a minimum value of 0.02, a maximum of 1.85, and an average value (mean) of 0.43 (or 43%), and the standard deviation shows 0.26 (or 26%). Furthermore, bonus motivation produces a minimum value of -0.57 and a maximum value of 0.30 with an average (mean) of 0.0173 (or 1.73%), while the standard deviation of the Bonus Motivation variable is 0.10 (or 10%). In addition, Board Size produces a minimum value of 2.00 and a maximum value of 8.00 with an average (mean) of 4.76 (or 476%), while the standard deviation of the Bonus Motivation variable is 1.75 (or 175%). Furthermore, earnings management as the dependent variable produces a minimum value of -0.10 and a maximum value of 0.079 with an average (mean) of -0.0006 (or 0.06%), while the standard deviation of the Bonus Motivation variable is 0.02 (or 20%). In addition, managerial ownership as a moderating variable produces a minimum value of 0.0005 and a maximum value of 0.8742 with an average (mean) of -0.26 (or 0.26%), while the standard deviation of the Bonus Motivation variable is 0.26 (or 26%).

**B) Classic Assumption Test**

**a. Normality test**

The results of normality testing using Jarque Bera are indicated by the p-value of Jarque Bera statistics of 0.000 < 0.05, which means Ho is rejected, so it can be concluded that the error distribution is not proven normal. Thus, it can be concluded that the hypothesis stating that the normality assumption must be met is not proven. Based on the data graph stretching to the left, it can be concluded that the data does not meet the assumption of normality. More details can be seen in Figure 2.



**Fig. 2: Normality Test**

**b. Multikolinearitas Test**

The processing results for multicollinearity testing can be seen in Table 2. Information from the table shows that of the 8 independent variables used, only the interaction variable between MB\_BO does not occur in multicollinearity.

**Table 2 : Multikolinearitas Test**

Variable	VIF	Simpulan
PR	53,0739	Ada multikolinearitas
LEV	111,3559	Ada multikolinearitas
MB	63,4423	Ada multikolinearitas
BZ	22,1561	Ada multikolinearitas
PR_MO	53,6824	Ada multikolinearitas
LEV_MO	60,0121	Ada multikolinearitas
MB_MO	1,5655	Tidak ada multikolinearitas
BZ_MO	29,8582	Ada multikolinearitas

**c. Autokorelasi Test**

The processing results for testing autocorrelation using the LM test are shown in Table 3 with a p-value of obs \* R square of 0.9866 > 0.05, meaning Ho is accepted, so it can be concluded that there is no autocorrelation. Thus, the assumption of no autocorrelation required in the model is fulfilled. More details can be seen in Table 3.

**Tabel 3: Autokorelasi Test**

Breusch-Godfrey Serial Correlation LM Test:			
F-statistic	0,000263	Prob. F(1,163)	0,9871
Obs*R-squared	0,000281	Prob. Chi-Square(1)	0,9866

**d. Heteroskedastisitas Test**

The result of the processing for heteroskedasticity testing using the ARCH test is shown in Table 4. The p-value value of the obs\*R square of 0.5995 > 0.05 means that Ho is accepted so that it can be concluded that no heteroskedasty is found. Thus, the assumption of the absence of the heterocadasthesis required in the model is fulfilled.

**Tabel 4 : Heteroskedastisitas Test**

Heteroskedasticity Test: ARCH			
F-statistic	0,2731	Prob. F(1,171)	0,6020
Obs*R-squared	0,2758	Prob. Chi-Square(1)	0,5995

**C) Multiple Linear Regression Test**

Using a Partial Testing (t-test), ascertain each independent variable's proportionate contribution to the explanation of the dependent variable. Regression testing was performed using the aforementioned equations, and Table 5 shows the results.

**Table 5: Partial Testing (t-test)**

Variable		Idiosyncratic Model		
		Coefficient	T <sub>statistik</sub>	P-value
PR	(+)	0,0922	1,0745	0,1421
LEV	(-)	-0,0096	-1,2727	0,1024
MB	(+)	0,0048	1,8612	0,0322
BZ	(+)	0,0002	0,7577	0,4497
PR_MO		-0,1491	-1,0218	0,3084
LEV_MO		-0,0332	-3,1683	0,0009
MB_MO		-0,4919	-1,0203	0,3091
BZ_MO		0,0037	3,1667	0,0009

H1 = positive impact of profitability on earnings management. Processing results obtained an estimated coefficient value of 0,082248, which means an increase in profitability of 1% will increase earnings management by 0,0922 points and vice versa. A statistical t value of 1,0745 yields a p-value value of 0.1421 > 0.05, which means Ho is accepted, so the hypothesis that profitability has a positive impact upon earnings management is not proven.

H2 = the negative impact of profitability on earnings management. The processing result obtained an estimated coefficient value of -0,0096, which means that a 1% increase in leverage would reduce earnings management by 0.0096 points and vice versa. A statistical t-value of -12727 yielded a p-value of 0.1024 > 0.05, which means Ho was accepted, so the hypothesis that leverage had a negative impact on earnings management was not proven.

H3 = positive influence of bonus motivation on earnings management. The processing result obtained an estimated coefficient value of 0.0048, which means that an increase in bonus motivation of 1% will increase earnings management by 0.0048 points and vice versa. A statistical t value of 1.8612 yielded a p-value of  $0.0322 < 0.05$ , which means  $H_0$  was rejected and  $H_a$  accepted so that the hypothesis that bonus motivations had a positive influence on earnings management was proven.

H4 = positive influence of board size on earnings management. Processing results obtained an estimated coefficient value of 0.0002, which means that an increase in board size by 1 person will improve earnings management by 0.0002 points and vice versa. A statistical t value of 0.7577 yields a p-value value of  $0.4497 > 0.05$ , which means  $H_0$  is accepted so that the hypothesis that board size has a positive impact upon earnings management is not proven.

H5 = test managerial ownership moderates the influence of profitability on earnings management. Processing results obtained an estimated coefficient value of -0.1491, which means that increased profitability will reduce earnings management by moderating managing ownership and vice versa. A statistical t value of -1.0218 produces a p-value value of  $0.3084 > 0.05$ , which means  $H_0$  accepted that no proven managerial ownership moderates profitability against profit administration.

H6 = test managerial ownership to moderate the influence of leverage on earnings management. Processing results obtained an estimated coefficient value of -0.0332, which means that increased leverage will reduce earnings management by moderating by managing ownership and vice versa. A statistical t value of -3.1683 results in a p-value value of  $0.0009 < 0.05$ , which means  $H_0$  was rejected, and  $H_a$  accepted so that managed ownership has been proven to strengthen the negative impact of the leverage influencing the management of profits.

H7 = test managerial ownership moderates the influence of the bonus motives on the management of profits. The processing results obtained an estimated coefficient value of -0.4919, which means that increased bonus motivation will reduce the earnings management moderated by the management ownership and vice versa. A statistical t value of -1.0203 results in a p-value value of  $0.3091 > 0.05$ , which means  $H_0$  accepted that no proven managing ownership will moderate the impact of bonus motivations on earnings management.

H8 = Testing managerial ownership moderates the influence of board size on earnings management. Processing results obtained an estimated coefficient value of 0.0037, which means that increasing board size will improve earnings management by moderating by management ownership and vice versa. A statistical t value of 3.1667 yields a p-value value of  $0.0009 < 0.05$ , which means  $H_0$  was rejected, and  $H_a$  accepted that proved managing ownership reinforces the positive impact of board size influencing the management of profits.

#### **IV. CONCLUSION**

Based on the results of the research, some conclusions can be drawn from this study, namely:

1. Profitability variables projected with Return On Equity (ROE) have no significant impact on earnings management. The results of this study are consistent with the results of previous research conducted by wowor et al. (2021), which stated that profitability had no significant influence on earnings management.
2. The leverage variable projected with the Debt to Asset Ratio (DAR) has no significant impact on earnings management. This study is consistent with previous research by Akbar & Yuniningsih (2022) Prajitno & Vionita (2020), which stated that leverage has no significant impact on earnings management.
3. The Bonus Motivation Variable projected with the Return On Asset (ROA) has a positive impact on earnings management. The results of this study are consistent with the results of previous research conducted by Anastasius et al. (2022), which stated that bonus motivation has a significant positive impact on earnings management.
4. The Board Size variable projected by the number of commissioners within the company has no significant influence on earnings management. This study is consistent with previous research by (Angelita Mungniyati, 2023), Fung Jin (2021), Mardianto & Chintia (2022), and Maryati et al. (2022), which stated that board size had no significant influence on earnings management.
5. Management ownership variables have proven to be influential as moderation variables towards earnings management.

#### **SUGGESTIONS**

1. Further research is expected to be able to use samples according to the company sectors, which do not use different sectors in one study. This is estimated to produce significant data results with the value of similar companies and does not have a distant value gap.
2. Further research develops research on the other sectors of companies in the EIB that have not been studied from the previous research, such as the health sector because this sector has no adverse impact on Covid-19.
3. In further research, it is recommended to add other independent variables, such as audit quality and Good Corporate Governance (GCG).
4. Further studies can use the variable of managerial ownership as a moderation variable because, in this study, the variables

have been shown to moderate earnings Management.

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