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ANALYSIS OF PROFITABILITY AND LEVERAGE FACTORS THAT AFFECT PROFIT MANAGEMENT IN COMPANIES

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ABSTRACT

This study aims to examine and understand the profitability factors and leverage factors that influence earnings management in companies. Financial reports are information that describes the financial condition of a company. One important element that is often highlighted in financial reports is profit. Profit is a measure of company performance that is often used as a basis for decision making. The number of articles used in this research was 50 articles, but only 10 articles were used in the research sample that met the criteria related to the research topic collected from various sources. The method used in this research is a literature study where the data collection technique is to carry out a review study of books, literature, notes and reports related to the problems faced. The results of this research show that Profitability Ratios and Leverage Ratios have a positive effect on earnings management in companies.

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INTRODUCTION

Every company that is established is expected to be able to survive and be able to operate continuously for a long period of time. Developments in today's business world have required every company to be able to create a competitive advantage in its business field. In order to maintain its efforts to achieve its goals in the development of the increasingly advanced business world, the efficient and effective use of company resources can help companies to compete in the market. The increasingly fierce competition between companies and supported by the country's economic conditions that tend to be uncertain, companies of course need funds to support all their operational activities.

Profit management is one of the important aspects in the business world, especially for companies listed on the capital market. This practice is related to management's efforts in managing financial statements to achieve specific goals, either to attract investors, meet market expectations, or for the internal interests of the company. While profit management can help create a better financial image, the practice is often controversial, as it can mislead stakeholders regarding the true financial condition.

Profit management is not necessarily associated with attempts to manipulate accounting data or information, but rather is skewed to be associated with the selection of accounting methods that management deliberately chooses for a specific purpose within GAAP constraints. Those who are against profit management consider that profit management is a reduction in the reliability of information that is accurate enough about profits to evaluate the returns and risks of their portfolios (Ashari et al., 1994 in Assih, 2004).

One phenomenon related to earnings management is the case of PT Indofarma Tbk (INAF), which indicated irregularities that caused state losses of IDR 371.8 billion. This case emerged after the Investigation Report (LHP) on the Financial Management of PT Indofarma Tbk. and the subsidiary was handed over by the Deputy Chairman of the BPK, Hendra Susanto, to the

Attorney General, ST Burhanuddin at the Indonesian Attorney General's Office, Monday (20/5/2024). This inspection is a BPK initiative that originates from the development of Compliance inspection results for the Management of Income, Expenses and Investment Activities from 2020 to Semester I 2023 at PT Indofarma Tbk, Subsidiaries and Related Agencies. (www.cnbcindonesia.com)

Profit management has several factors that affect it and is the motivation of managers to do profit management, ranging from profitability and leverage. Profitability describes a company's ability to generate profits over a certain period of time. The higher the profitability of a company, the company's ability to generate profits will increase. The relationship between profitability and profit management is When the profitability generated is small in a certain period of time, it will trigger the company to carry out profit management. Based on research by Syarif M Helmi et al. (2023) Profitability has a positive effect on profit management. The greater the profitability indicates the company's ability to generate profits.

Management has an interest in the size of the profitability figure to reflect the company's performance to reflect the company's performance to give confidence to new investors to invest in the company. Similar research related to profitability conducted by Selviani (2017), Purnama (2017) and Rahayu (2019), also shows that profitability has a positive effect on profit management In contrast to the results of research conducted by Rina Dwiarti and Anna (2019) which stated that profitability is proxied by ROA, the absence of ROA is suspected because investors tend to ignore the existing ROA to the maximum so that management is not motivated to do management profit through the profitability variable.

Leverage has a relationship with profit management practices, where investors will see the smallest leverage ratio of the company because the leverage ratio affects the impact of the risk that will occur. So, the smaller the leverage ratio of a company, the less risk it is, and vice versa. In this way, when the company has a high leverage ratio, the company tends to practice profit management, because the company is threatened with not being able to fulfill its obligations by paying its debts on time. Based on previous research conducted by Astari and Suryanawa (2017), it shows that leverage has a positive and significant effect on profit management. In addition, research by Pramesti and Budiasih (2017) and Rahdal (2017), also found that leverage has a positive effect on profit management. However, unlike the research conducted by Anindya et al. (2020) which shows that leverage has no influence on profit management because the company is in a default position, the realization of profit management cannot overcome this.

Various factors can affect profit management practices in a company. Internal factors such as company size, financial leverage, ownership structure, and management compensation are often associated with management's decisions in managing profits. On the other hand, external factors such as accounting regulations, market conditions, and supervision by third parties also play a role in influencing the extent to which a company is involved in profit management practices.

This study aims to examine and find out the profitability factors and leverage factors that affect profit management in companies. It is hoped that the results of this study will be able to provide information and benefits to the company so that the company can maximize its profitability and leverage to manage the company's profit.

Theoretical Review

Agency theory

Agency theory is a theory that explains the relationship between company management as an agent and capital owners as principals (Shoimah et al., 2021). This theory was introduced by Alchian and Demsetz (1972) and Jensen and Meckling (1976). This agency theory explains that agency relationships arise when one or more people (principal) hire another person (agent) to provide a service and then delegate decision-making authority to the agent. The management is a professional (agent) who understands more about running company management so that the company owner can get the maximum profit possible at the most efficient cost. Meanwhile, the principal is the owner of the company (shareholder) who wants to get the maximum profit possible with the costs it has incurred and will provide incentives to agents of various facilities, both financial and non-financial (Anggraeni, 2011)

In agency theory, all individuals act on their own interests. Shareholders as principals are usually only oriented towards increased financial results or their investments in the company. Meanwhile, agents are assumed to receive satisfaction in the form of financial compensation with the conditions that accompany the relationship. Because of these differences in interests, each party tries to increase profits for themselves. Principals want the largest and fastest return on their investments, one of which is reflected by an increase in the dividend portion of each share owned through reports presented by management. But there is often a tendency for management to polish the report to look good so that management performance can look good in the eyes of the company owner.

Profit management is a phenomenon that often occurs in the world of investment in the capital market. According to Sulistyanto (2008), in general, profit management is defined as an effort by a company manager to intervene or influence information in financial statements with the aim of deceiving stakeholders who want to know the company's performance. Whelan and McNamara (2004) stated that profit management can be used as an indicator of profit reliability. Therefore, if the company's financial information is indicated to contain profit management, then the information cannot be relied upon as a basis for making investment decisions.

The same thing was conveyed by Wijaya (2016) who stated in the study that there is a tendency for management to polish the reports presented to get a good assessment from the principal. But on the other hand, agents want their interests to be accommodated by providing "adequate" compensation/bonuses/incentives/remuneration as much as possible for their performance.

Profit management

Profit management is a practice carried out by the management of a company to deliberately influence the numbers in the financial statements. Goal? To make the report appear more attractive to stakeholders, such as investors, creditors, and market analysts. Profit management according to Fischer and Rozenzwig (1995) is the action of a manager who increases (decreases) the reported profit of the unit for which he is responsible which has no relationship with the increase or decrease in the company's profitability in the long term. Profit management is a choice of actions or accounting policies carried out by managers to influence profits in financial statements to achieve certain profit goals. (William, 2015) This means that the Management can choose accounting policies in compiling financial statements so that the Financial Statements presented provide value in accordance with the expectations of the Management.

Several cases about profit management practices for both companies in Indonesia and companies at the international level are actions of managers in the preparation of financial statements only to make a company that has been managed appear both from the perspective of creditors and investors. Profit management is carried out deliberately or consciously through discretionary policies that are still within the reasonable limits of accounting standards in order to achieve a level expected from financial reporting. Ideally, the financial information presented in the financial statements can be used by decision-making by users of financial statements (Firmansyah, Utami, et al., 2020b).

Leverage

Leverage is a level of the company's ability to use assets and/or funds that have fixed liabilities (debt and/or special shares) in order to realize the company's goal to maximize the wealth of the company's owners. According to Fakhrudin (2008:109), leverage is the amount of debt used to finance / buy the company's assets. A company that has debt greater than equity is said to be a company with a high level of leverage. *Leverage* is a ratio that measures the extent to which a company's assets are financed by debt. Leverage can be measured using *Debt to Assets Ratio* (DAR). DAR is a ratio that can be used to calculate the value of a company's assets financed by debt (Kasmir, 2015). *Leverage* has a relationship with profit management behavior because *Leverage* can show how much of the company's assets are financed by debt. Companies that have assets financed from debt will tend to carry out profit management because they need the trust of creditors will be willing to provide funding to the company (Sherly & Suriani, 2022).

Profitability

According to Kasmir (2019, p. 196), profitability is a ratio to assess a company's ability to seek profits or profits in a certain period. This ratio also provides a measure of the level of effectiveness of a company's management as shown by the profits generated from sales or from investment funding. Profitability (Jatmiko, 2017) is a measure of the ability to generate profits on the assets it owns so that the measure of profitability is return on assets (ROA). Although there are findings that profitability affects profit management (Damayanti, 2018), but in practice, companies that are able to generate profits are interested in using most of the profits for the company's internal activities so that they will be higher in making profit management efforts (Tala & Karamoy, 2017). Profitability is a ratio that measures a company's ability to generate profits. Profitability can be measured using *Return On Asset* (ROA). ROA is a ratio to show the company's ability to manage assets to generate profits. (Kasmir, 2015) ROA is a ratio that shows how much assets contribute to creating net profit. *Return on Asset* (ROA) can help management and investors to see how well a company is able to turn its investment in assets into profits or profits (*profit*).

Research Methods

The method used in this study is a literature study. According to M. Nazir (1998: 112) stated that Literature Study / Literature Study is a data collection technique by conducting a study of books, literature, notes, and reports related to the problems at hand.

The information used as a reference for this study was obtained from 50 articles obtained from various sources related to factors affecting profit management. However, after the observation of the selected journals as a research sample, namely as many as 10 journals with a publication time span between 2017 and 2024 which were then studied with the researcher's research topic, namely the liquidity ratio and profitability ratio to profit management actions in the company. This research consists of several stages. First, the research topic is determined and selected, then the articles are compiled to be a reference, then analyze and discuss to draw conclusions from the articles to be published.

Discussion

Agency theory which states that company managers are agents who carry out profit management actions on the basis of having a motive to get bonuses and the company obtains a positive image by external parties/*share holders* as principals to invest in the company. This action is selfish because it prioritizes personal interests where the company's management as an agent manipulates financial statements so that external parties/*share holders* as *principals* can suffer losses.

Based on research conducted by Rahmi, Armel and Rosalia (2023) Partial profitability has a positive and significant influence on profit management, the meaning of the positive sign is that the higher the profitability value of a company, the higher the profit management in a company and the lower the profit management occurs. The results of this study are in accordance with previous research conducted by Millana Tasya et al. (2022) which stated that profitability affects profit management. The higher the profitability, the higher the company will be in carrying out profit management. Companies with large profits will try to maintain these profits to be able to increase and maintain investor confidence.

Therefore, the management can do profit management by way of profit equipment. Previous research was also conducted by Wisnu Setya et al. (2021) and stated that profitability affects profit management. This is because there is motivation from the management in presenting performance reports well will get certain rewards, thus triggering the practice of profit management. The presentation of good profitability will attract investors to be able to invest in the company. Investors' interest in the value of profitability is what drives the practice of profit management.

Agency theory explains the relationship between the owner *(principal)* and the company manager *(agent)* that there is a conflict between the owner and the company manager that occurs because of the conflict of agency, which is a conflict that exists in the company that arises due to the intention or desire of the manager to optimize the welfare of the product but in a fraudulent way, namely deceiving *stakeholders* that do not have adequate access and resources regarding the source of such information. Companies that have a high *leverage* ratio due to the large amount of debt from the company's assets are suspected of practicing profit management because the company is threatened with *going concerns* and conditions where the company cannot fulfill its obligations in paying debts on time.

The results of this study are in accordance with previous research that has been conducted by Sri Suwanti (2017), namely *leverage* affects profit management. This means that the higher the leverage on a company, the greater the profit management. Similar results are also in accordance with the research of Rahma Suci et al. (2022) who stated that leverage has a positive and significant effect on profit management, a case study on manufacturing companies in the *food and baverage* sub-sector listed on the IDX in 2017-2021. Similar research was also conducted by Rahmi, Anisya and Rosalia (2023) where the result is that leverage partially has a positive and significant influence on profit management. Companies that have a high ratio due to the amount of debt compared to the assets owned by the company, are suspected of practicing profit management because the company is threatened with default, namely not being able to fulfill its obligations in paying debts on time.

Previous research has highlighted that both leverage and profitability positively contribute to profit management practices in companies. With a high level of leverage, the company wants to lower the apparent risk of debt obligations, while with a high level of profitability, the company wants to maintain the positive image it has built. Therefore, companies often conduct profit management to display stable and positive financial conditions according to the expectations of creditors and investors. This is in line with research conducted by Rahmi, et al. (2023) which stated that Profitability and Leverage partially affect Profit Management in the Company.

Conclusion

This study aims to examine and find out about profitability factors and leverage factors that affect profit management in companies. Based on the literature study conducted on the articles that have been collected, it can be known that the profitability ratio and leverage ratio have an influence on profit management in the company, so the company must conduct periodic evaluations to assess the effectiveness and strategies implemented as well as efficient debt management to avoid profit management in the company and can manage profits effectively. In this study, the researcher has limitations, including; The researcher did not conduct research directly, the number of references in the collection of this article was also limited and the variables that became the research factors also only used profitability and leverage.

Based on these limitations, the researcher suggested that the next study use more diverse variables and expand the results of the next study.

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