THE EFFECT OF BONUS MOTIVATION, FREE CASH FLOW, AND OTHER FACTORS ON EARNINGS MANAGEMENT

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ABSTRACT

This research aims to obtain empirical evidence regarding bonus motivation, free cash flow, and other factors on earnings management. This research has eight independent variables, namely bonus motivation, free cash flow, leverage, company size, sales growth, audit committee, managerial ownership, and institutional ownership on earnings management. The sample used in this study amounted to 198 data from 66 cyclicals and non-cyclicals companies listed on the Indonesia Stock Exchange obtained from data collection techniques in the form of purposive sampling method. The hypothesis testing method used in this study is the multiple regression method. The results of this study found that bonus motivation and free cash flow affect earnings management. On the other hand, variables of leverage, company size, sales growth, audit committee, managerial ownership, and institutional ownership have no effect on earnings management.

Keywords: Earnings Management, Bonus Motivation, Free Cash Flow, Sales Growth, and Institutional Ownership

INTRODUCTION

Businesses compete intensely to survive in the current era of modern globalization and economic expansion, constantly trying to outperform competitors (Jane & Firnanti, 2018). In order to meet the needs of investors, management provides financial statements that show the performance of the business, act as benchmarks for financial activity over predetermined time periods and include essential information like profit and loss (Paramitha & Firnanti, 2018).

Profit becomes a benchmark for company performance where high profits reflect the company's ability to use financial resources appropriately and effectively to obtain optimal revenue. Businesses will keep working to increase profits, because doing so helps to preserve its reputation, which in turn helps to win over and keep current investors (Pradipta, 2019). Given the condition of how important profit is, management is encouraged to treat earnings, which are more commonly known as earnings management practices, by producing financial reports that appear stable and appealing to investors and potential investors (Maghfiroh & Trisnawati, 2021).

One of the earnings managements practic in Indonesia was committed by PT Tiga Pilar Sejahtera or TPS Food, a company engaged in the production of consumer goods. This case stems from the discovery that a subsidiary of PT TPS Food, namely PT Indo Beras Unggul (IBU), was collecting subsidized farmers' rice to be processed and repackaged into premium rice. Due to this incident, PT TPS' shares dropped significantly and made the company try to beautify its 2017 financial statements. At the 2018 Extraordinary General Meeting of Shareholders, shareholders filed an investigation into the 2017 financial statements and found several fraudulent statements, including an alleged overstatement of IDR 4 trillion. In the accounts receivable, inventories and fixed assets of the TPSF Group and Rp 662 billion in Sales and Rp 329 billion in Food Entity EBITDA. In addition, there are allegations of cash flow of Rp 1.78 trillion under various schemes from the TPSF Group to parties allegedly affiliated with the Old Management. Regarding relationships and transactions with Affiliated Parties, there is no adequate disclosure to relevant stakeholders.

This research is the development of the previous research that has been done by (Susanto & Pradipta, 2020) with the independent variables of bonus motivation, free cash flow, leverage, company size, sales growth, audit committee, managerial ownership, and institutional ownership. This research is expected to provide positive benefits and is expected to be useful in the future, for related parties, including management, investors, creditors, academicians, and future research.

Agency Theory

Agency theory is defined as a relationship between an agency which is known as managements of a company and a principal, which referred to the owners. An agency relationship is defined as a legal arrangement in which one or more parties (the principals) hire a third party (the agent) to carry out a task on their behalf and assign some service of decision-making authority to the agent (Jensen & Meckling, 1976).

This conflict of interest is known as agency conflict, and it will occurr as long as there is a relationship between the agency and the principal (Millenia & Tjhai, 2021). This problem resulted in an existence of agency costs. According to Jensen & Meckling (1976), there are three types of agency costs, such as monitoring expenditures by the principal, bonding expenditures by the agent, and residual loss.

In addition, agency problems are caused by asymmetric information. This condition occurs when between two parties there is one party that has more information than the other party, resulting in an information imbalance (Millenia & Tjhai, 2021). Information imbalance can cause 2 problems, namely adverse selection and moral hazard (Yogi & Damayanthi, 2016).

Earnings Management

Financial reports are prepared in accordance with accounting principles to give external parties accurate financial information. Earnings management involves management strategically choosing accounting methods to present a positive performance impression, especially when profit targets were not met, by modifying financial statements (Sebastian & Handojo, 2019).

Earnings management is the intentional involvement by management in the earnings determination process, typically to further personal interests. Financial statements, especially the bottom-line earnings figure, are frequently window-dressed. Earnings management can enhance the content in financial statement, in which case managers change accruals without affecting cash flow (Subramanyam & Wild, 2009).

There are several strategies in conducting earnings management, which are increasing income, big bath, and income smoothing. In increasing income strategy, reported income could be increased temporarily to boost profit. In big bath strategy, account write-offs are taken as frequently as possible, resulted in raising income in other accounting period (Subramanyam & Wild, 2009). Lastly, income smoothing is a method used by management to minimize the variability of reported revenue streams relative to management's perceived objectives through accounting methods or transaction manipulation (Maghfiroh & Trisnawati, 2021).

Bonus Motivation to Earnings Management

Profits show the effectiveness of management's performance. When a company meets its profit objectives, it usually awards its employees bonuses. The possibility of earnings management practices in a company will be high if its profitability, or also known as motivational bonus, is significant (Wimelda & Chandra, 2018).

increase the number of profits (Valensia & Trisnawati, 2022). In contrast, businesses which earn a substantial amount of revenue and achieve their objectives are less likely to manipulate their earnings (Djashan & Lawira, 2018). Other research also shows that investors make investments for reasons other than just seeing a profit for the business and are aware that the earnings shown on the income statement are accumulated values under the management of the business (Marchellina & Firnanti, 2021). Based on the research above, it can be concluded as a hypothesis below:

H_1: Bonus Motivation has effect on earnings management.

Free Cash Flow to Earnings Management

Free cash flow is the part of a company’s operating profit that can be distributed to shareholders but is not eligible for fixed asset purchases or working capital (Valensia & Trisnawati, 2022).

A company with high free cash flow tends to maximize shareholder value while neglecting of stakeholder welfare, engage in earnings management by funding non-profitable projects rather than sharing profits with investors or stakeholders, and maximize shareholder value (Hastuti et al., 2018). However, businesses with adequate free cash flow are more assured of their financial performance and consequently more unlikely to use earnings management (Susanto & Pradipta, 2020). Based on the research above, it can be concluded as a hypothesis below:

H_2: Free Cash Flow has effect on earnings management.

Leverage to Earnings Management

Leverage can be used to show how much the company’s operations are financed by debt. The greater the level of debt, the riskier the company will be unable to pay its debts, illustrated by high leverage (Primalestari & Tjhai, 2022).

Companies will utilize earnings management by increasing profits in order to be able to maintain the quality of their financial reports. This causes the company's ability to pay debts to remain trusted by creditors so that they are given the source of funds the company needs (Florensia & Susanty, 2019). Nevertheless, a high level of leverage in a company will reduce earnings management practices, where companies with high levels of debt will be closely monitored by creditors, so management will not have the opportunity to manipulate financial reports, so the possibility of management to manipulate profits can be reduced (Primalestari & Tjhai, 2022). Additionally, high financial leverage indicates that the company's debt is very high which creates a lot of risk and pressure from creditors, because the company still has capital as company assets which can be used to pay off the company's debts and obligations, so the company is said to be safe from financial leverage which will minimize the company's practice of profit management (Valensia & Trisnawati, 2022). Based on the research above, it can be concluded as a hypothesis below:

H_3: Leverage has effect on earnings management.

Company Size to Earnings Management

Company size reflects the smaller size of the company which appears in the company's total assets. Whether a company is large or small does not rule out the possibility of carrying out earnings management practices, there are still two views regarding the size of the company (Chandra & Djashan, 2018).

Companies that have large assets tend to carry out earnings management. This is because large companies have a good name, so they need to maintain that good name and reputation by carrying out earnings management (Yuliana & Trisnawati, 2015).

In the contrary, research by (Tonay & Sutrisno, 2020) shows that large corporations will prepare their financial reports with more caution because they will attract greater public attention. Reducing earnings management practices is a result of the company's desire to uphold its public image.

Another research also found that no matter how big or small the size of a company is, it will not affect its practice in earnings management (Djashan & Lawira, 2018; Valensia & Trisnawati, 2022). Based on the research above, it can be concluded as a hypothesis below:

H_4: Company Size has effect on earnings management.

Sales Growth to Earnings Management

Sales growth is an increase in sales from year to year. Companies that have high sales growth can attract investors quite easily. Thus, if sales growth is good, management will reduce earnings management. However, if on the contrary, when sales growth decreases, it is likely that earnings management will be carried out (Benedicta & Mulyana, 2022).

Companies with high sales growth rates have the motivation to carry out earnings management to gain profits or to maintain profit trends and sales trends (Benedicta & Mulyana, 2022).

On the other hand, research by (Firnanti et al., 2019) stated that businesses with rapid sales growth can easily draw in investors. As a result, there is a decreased chance of earnings management techniques. Likewise, the reverse will occur if a company's sales growth slows down.

Another research also shows that there is no effect between sales growth to earnings management, as it indicates no relationship between both (Valensia & Trisnawati, 2022). Based on the research above, it can be concluded as a hypothesis below:
H_5: Sales Growth has effect on earnings management.

Audit Committee to Earnings Management

A company's audit committee is made up of chosen external directors who actively supervise the company's accounting and financial reporting policies (Hayes et al., 2014).

A high supervision of audit committee reduces the chance for management to do earnings management practice. It also applies in reverse, if the supervision of audit committee is low, then there is a high chance that management can practice earnings management (Tonay & Sutrisno, 2020).

The number of audit committee in a company also does not define its relationship with earnings management practive due to the ineffectiveness of the audit committee in carrying out its duties means that earnings management practices within the company cannot be detected. This happens because the company only formed an audit committee as a formality in accordance with existing regulations (Pungesdika & Sanjaya, 2022). Based on the research above, it can be concluded as a hypothesis below:

H_6: Audit Committee has effect on earnings management.

Managerial Ownership to Earnings Management

Managerial ownership is defnied as shares owned by a company's management, either personally or shares owned by the subsidiaries of the company (Valensia & Trisnawati, 2022).

Managers who have share ownership in the company will most likely act in line with shareholders in general and ensure that the company's financial reports are presented fairly and reveal the real condition of the company, so as to minimize earnings management practices (Paramitha & Firnanti, 2018).

Otherwise, share ownership by management does not affect the occurrence of earnings management, because the profits from management are the same as the profits from other shareholders so that management cannot reduce the possibility of earnings management practices in the company (Gabrielle et al., 2022). Based on the research above, it can be concluded as a hypothesis below:

H_7: Managerial Ownership has effect on earnings management.

Institutional Ownership to Earnings Management

Institutional ownership is when businesses like banks, insurance companies, and investment firms purchase shares in a company (Millenia & Tjhai, 2021).

An institution that owns a sizable portion of a company's shares has the ability to directly or indirectly control the company's operations. It tends to enhance earnings management and has the authority or resources to guide management's actions (Jane & Firnanti, 2018).

On the contrary, Institutional investors possess a sizable number of shares, which allows them to monitor management and generally refrain from managing earnings (Susanto et al., 2021).

Other research also shows that the size of voting rights a company owns do not influence the level of earnings management carried out by a company's management (Primalestari & Tjhai, 2022).

Based on the research above, it can be concluded as a hypothesis below:

H_8: Institutional Ownership has effect on earnings management.

RESEARCH MODEL

Based on the theoretical framework above, the research model used in the research can be seen as follows:

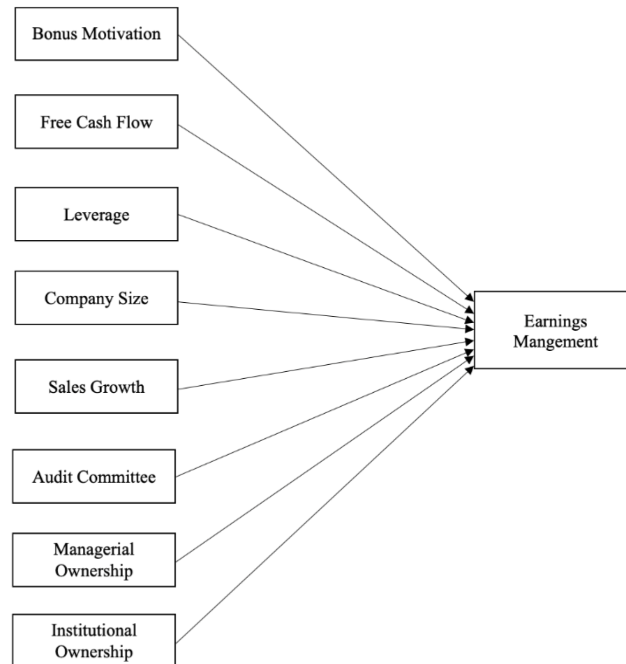

Figure 1 Research Model

RESEARCH METHODOLOGY

Sampling and Data Collection Mehods

The population used in this research are cyclicals and non-cyclicals companies listed in the Indonesian Stock Exchange (IDX) from the period of 2020-2022. Meanwhile, the sample used is listed cyclicals and non-cyclicals companies selected using purposive sampling method with criteria in the table shown below.

Table 1 Sample Selection Procedure

No	Criteria Description	Total Companies	Total Data
1	Cyclicals and Non-cyclicals companies that are consistently listed on the Indonesia Stock Exchange during the period 2019 to 2022	192	576
2	Cyclicals and Non-cyclicals companies that publish annual financial reports with a financial year ending December 31 for the period 2019 to 2022.	(14)	(42)
3	Cyclicals and Non-cyclicals companies that use the Rupiah currency in their financial statements for the period 2019 to 2022.	(13)	(39)
4	Cyclicals and Non-cyclicals companies that consistently earn net profit after tax during the period 2020 to 2022.	(97)	(291)
5	Cyclicals and Non-cyclicals companies that consistently have institutional ownership during the period from 2020 to 2022.	(2)	(6)
	Number of Samples Companies Used	66	198

Operational Definition and Variable Measurement

Earnings management is a management intervention used to calculate profit for personal benefit (Susanto et al., 2021).
Earnings management is measured using absolute discretionary accruals and applying the modified jones model (Susanto & Pradipta, 2020). The formula to measure absolute discretionary accruals is as follows:

$$TAC_{it}/A_{it-1} = \beta_0 (1/A_{it-1}) + \beta_1 ((\Delta REV_{it} - \Delta REC_{it})/A_{it-1}) + \beta_2 (PPE_{it}/A_{it-1}) + \epsilon_{it}$$

TAC_{it} is total accruals in year t, A_{it-1} is total asset in year t-1, ΔREV_{it} is changes in revenue in year t, ΔREC_{it} is changes in accounts receivable in year t, PPE_{it} is gross property, plant, and equipment in year t, and ϵ_{it} is discretionary accruals in year t.

Bonus motivation are ratios that determine a business' potential for long-term earnings, assessing management's ability to manage the company's wealth in order to generate profit for the company (Tonay & Sutrisno, 2020). According to (Susanto & Pradipta, 2020), bonus motivation can be measured as follows:

$$BM = \frac{\text{Net income before tax}}{\text{Total Assets}}$$

Free cash flow is the actual cash flow that will be distributed to investors after the company makes investments and working capital that is useful for the company's survival (Jastin et al., 2021). According to (Susanto & Pradipta, 2020), free cash flow can be measured as follows:

$$FCF = \frac{\text{Operating cash flow -}}{\text{Total Assets}}$$

Leverage is a ratio that measures the amount of assets that will be financed by the company's debt, applied by a company which finances its operational activities using loan capital, and also bears the interest expense that will be paid to creditors (Valensia & Trisnawati, 2022). Leverage is measured using the debt to assets ratio. According to (Susanto & Pradipta, 2020), leverage can be measured as follows:

$$LEV = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

Company size refers to how big or small a company is, which can be seen from total assets, market capitalization, number of sales, and number of employees (Millenia & Tjhai, 2021). According to (Susanto & Pradipta, 2020), company size can be measured as follows:

$$CS = \text{Ln (Total Assets)}$$

Sales growth is an increase in sales from year to year (Harahap, 2021). According to (Susanto & Pradipta, 2020), sales growth size can be measured as follows:

$$SG = \frac{\text{Current year sales - Prior year sales}}{\text{Prior year sales}}$$

The audit committee is a non-management, separate party with no ties to management and no financial stake in the operation of the company's internal control system (Susanto et al., 2021). According to the research by Firnanti, Pirzada, and Budiman (2019), the audit committee in a company is measured by:

AC = Number of audit committee members of a company

Managerial ownership is the number of company shares owned by management, both the board of directors and commissioners, excluding shares owned by principals, the community and institutional parties (Paramitha & Firnanti, 2018). The formula to measure managerial ownership by the research of (Firnanti et al., 2019) is as follows:

MO = 1 for companies with managerial ownership while 0 is for firms with no managerial ownership

Institutional ownership is company shares owned by institutions or institutions such as insurance companies, banks, investment companies and other institutional ownership (Pradipta, 2019). The formula to measure institutional ownership by the research of (Firnanti et al., 2019) is as follows: IO = the proportion of share ownership owned by non-management companies

RESULTS AND DISCUSSION

Table 2 Descriptive Statistics Results

Variable	N	Minimum	Maximum	Mean	Std. Deviation
EM	198	0.00011630	0.815451573	0.070254547	0.088163810
BM	198	-0.00387512	0.494307692	0.102517064	0.085900374
FCF	198	-0.21408969	0.536016870	0.139560727	0.139240176
LEV	198	0.000417432	0.888151877	0.400734705	0.196405758
CS	198	26.2827659	32.8263823	29.2390409	1.50151123
SG	198	-1.0000000	2.65522783	0.120466780	0.331112311
AC	198	2	4	3.03	0.212
MO	198	0	1	0.75	0.433
IO	198	0.000485	0.999758	0.795905367	0.250026752

Table 3 t Tests Results

Variable	B	Sig.	Decision	Conclusion
Constant	0,289	0,134		
BM	0,526	0,000	H_{A1} accepted	Has Influence
FCF	-0,174	0,000	H_{A2} accepted	Has Influence
LEV	0,013	0,685	H_{A3} rejected	No Influence
CS	-0,007	0,102	H_{A4} rejected	No Influence
SG	0,020	0,246	H_{A5} rejected	No Influence
AC	-0,031	0,242	H_{A6} rejected	No Influence
MO	0,016	0,221	H_{A7} rejected	No Influence
IO	0,024	0,319	H_{A8} accepted	No Influence

The results of the t statistical test show that bonus motivation (BM) has a coefficient value of 0,526 and sig. of 0,000. Sig. value of 0,000 is less than the alpha value of 0,05, so H_{A1} is acceptable. Hence, there is an individual influence of bonus motivation (BM) on earnings management (EM). The coefficient of bonus motivation (BM) has a positive sign, so it can be interpreted that bonus motivation (BM) has a positive effect on earnings management (EM). If a company's profitability (bonus motivation) is high, the likelihood of earnings management practices in that company is also high in order to maintain that company's level of profitability, so that the company can send a positive signal to investors while also allowing managers to benefit personally (Wimelda & Chandra, 2018).

The results of the t statistical test show that free cash flow (FCF) has a coefficient value of -0,174 and sig. of 0,000. Sig. value of 0,000 is less than the alpha value of 0,05, so H_{A2} is acceptable. Hence, there is an individual influence of free cash flow (FCF) on earnings management (EM). The coefficient of free cash flow (FCF) has a negative sign, so it can be interpreted that free cash flow (FCF) has a negative effect on earnings management (EM). The higher the free cash flow, it shows that a company has sufficient capital to meet its needs, both financial and operational, and in this high cash flow conditions, management will generally minimize its motivation to carry out earnings management practices, because it does not require further search for investors (Valensia & Trisnawati, 2022).

The results of the t statistical test show that leverage (LEV) has a coefficient value of 0,013 and sig. of 0,685. Sig. value of 0,013 is greater than the alpha value of 0.05, so H_{A3} is unacceptable, so there is no individual influence of leverage (LEV) on earnings management (EM). This shows that the presence or absence of leverage in a company will not have an effect on earnings management practices.

The results of the t statistical test show that company size (CS) has a coefficient value of -0,007 and sig. of 0,102. Sig. value of 0,102 is greater than the alpha value of 0.05, so H_{A4} is unacceptable, so there is no individual influence of company size (CS) on earnings management (EM). This shows that the presence or absence of company size in a company will not have an effect on earnings management practices.

The results of the t statistical test show that sales growth (SG) has a coefficient value of 0,020 and sig. of 0,246. Sig. value of 0,246 is greater than the alpha value of 0.05, so H_{A5} is unacceptable, so there is no individual influence of sales growth (SG) on earnings management (EM). This shows that the presence or absence of sales growth in a company will not have an effect on earnings management practices.

The results of the t statistical test show that audit committee (AC) has a coefficient value of -0,031 and sig. of 0,242. Sig. value of 0,242 is greater than the alpha value of 0.05, so H_{A6} is unacceptable, so there is no individual influence of audit committee (AC) on earnings management (EM). This shows that the presence or absence of audit committee in a company will not have an effect on earnings management practices.

The results of the t statistical test show that managerial ownership (MO) has a coefficient value of 0,016 and sig. of 0,221. Sig. value of 0,221 is greater than the alpha value of 0.05, so H_{A7} is unacceptable, so there is no individual influence of managerial ownership (MO) on earnings management (EM). This shows that the presence or absence of managerial ownership in a company will not have an effect on earnings management practices.

The results of the t statistical test show that institutional ownership (IO) has a coefficient value of 0,024 and sig. of 0,319. Sig. value of 0,319 is greater than the alpha value of 0.05, so H_{A8} is unacceptable, so there is no individual influence of institutional ownership (IO) on earnings management (EM). This shows that the presence or absence of institutional ownership in a company will not have an effect on earnings management practices.

CLOSING

Based on the research results, it can be concluded that bonus motivation and free cash flow have an influence on earnings management. On the other hand, leverage, company size, sales growth, audit committee, managerial ownership and institutional ownership have no influence on earnings management.

Limitations on this research are the study's research period is only three years, which are from 2020 to 2022, so it means that it is not describing the company's actual conditions over the long run. There is also a heteroscedasticity problem that occurs in the bonus motivation and managerial ownership variables, the research residual data used was not normally distributed even after the outlier test was carried out, and lastly the research object used in this research are limited to consumer non-cyclicals and consumer cyclical companies that cannot reflect company's actual conditions.

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