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Influence of Financial Targets, Political Connections, Institutional Ownership, And Going Concern on Earnings Management

Mollika Mariana[1*], Wiwik Utami[2]

[1, 2] Faculty of Economics & Business, Mercu Buana University, Jakarta, Indonesia
[1*]Corresponding Author

Abstract
The purpose of this study was to determine and analyze the effect of the financial target, political connection, institutional ownership, and going concerned on the possibility of earnings management practices. The independent variables in this study are the financial target, political connection, institutional ownership, and going concern, while the dependent variable in this study is the possibility of earnings management practices. This study measures the possibility of earnings management practices using the MSCORE model. This study uses as many as 62 samples of manufacturing companies listed on the Indonesia Stock Exchange in the period 2019 to 2021, so the total sample is 186 samples. The data is collected from the annual reports This study aimed to determine and analyze the effect of the financial target, political connection, and institutional ownership, and are researched on the Indonesia Stock Exchange website. The sampling technique used is the purposive sampling technique and the analysis used is binary logistic regression using the Eviews 12. The results show that political connection, institutional ownership, and going concern will hurt the possibility of earnings management practices. Meanwhile, financial targets do not affect the possibility of earnings management practices.

Keywords: Earnings Management, Financial Target, Political Connections, Institutional Ownership, Going Concern

Introduction

In an era of *a* growing business, many business problems arise, especially financial problems, so financial reports are very important in the company's operational information. Often users of information are only focused on profit, so the quality of profit is needed. Management often takes steps, namely earnings management or earnings manipulation so that earnings quality looks good. These actions usually occur because of pressure, opportunity, and rationalization factors. Such as the existence of pressure regarding financial targets that must be achieved and the opportunity to carry out earnings management due to the lack of implementation of Good Corporate Governance.

This condition gave birth to an agency theory that illustrates the existence of a working relationship between the principal, namely shareholders, and the agent, namely management in the form of cooperation. When both parties have goals and expectations that are not in line, it will cause a conflict of interest between the principal and the agent. Financial targets, political connections, and institutional ownership arise from the existence of agency relationships between principals and agents to delegate decision-making to agents. Also in line with the signaling theory proposed by (Akerlof, 1970) discusses the problem of information asymmetry between parties involved in business transactions that lead to adverse things. When a company's condition is in a poor financial condition or financial targets are not achieved, then management may conduct earnings management to provide information that the financial statements look good and to minimize the occurrence of agency conflict, one of which is done by having

political connections or institutional ownership.

One of the factors that causes earnings management is the financial target that must be achieved. For research on financial targets, research conducted by (Leo Handoko, 2020), (Husmawati et al., 2017), shows that financial targets have no effect on fraudulent financial statements, while research conducted by (F. A. Fitri et al., 2019), (Rengganis et al., 2019), (Akbar, 2017), shows that financial targets have an influence on fraudulent financial statements. (Rahmatika, 2019) uses the dependent variable with the MSCORE model and suggests research using independent variables, one of which is the financial target (ROA).

For research on political connections, research conducted by (Liao et al., 2020) shows that political connections can weaken the level of accrual-based earnings management, which helps private companies obtain more preferential funding policies and assistance. And research conducted by (Fan, 2017) shows that politically connected CEOs perform less tangible earnings management, possibly because their political connections make capital raising easier and reduce incentives for earnings management.

Research on institutional ownership conducted by (Tifanny & Wijaya, 2020), (Kusumawardhani & Murdianingrum, 2022), (Ranjbar & Amanollahi, 2018), (A. Fitri & Muda, 2018) shows that institutional ownership has a negative and significant effect on management earnings, while research conducted by (Varia Juita, 2020), (Wahyudi, 2020) shows that institutional ownership does not affect earnings management.

From the studies described above, it can be seen that there are several differences in results, therefore the author wants to test some of these variables. In this study, there is also an independent variable, namely going concerned because we know that in 2020 there was a case of Covid 19, and in the research sample, the author chose a manufacturing company listed on the IDX, namely the annual financial reports for 2019 and 2021 because it can be seen that manufacturing companies are companies that produce and sell goods where in 2020 the Covid 19 case can cause company revenue to decrease due to people's weak purchasing power due to inflation, and many industries to close.

Therefore, the title taken in this study is: "The Influence of Financial Targets, Political Connections, Institutional Ownership, Going Concerned on Earnings Management".

Literature Review

Agency Theory

Agency theory problems in firms can be very complex. According to (Jensen & Meckling, 1976) a relationship (principal) involves other people (agents) to perform certain services in the interest of the principal, by delegating authority to him. The relationship between agency theory and financial targets is that when a company is in bad financial condition, management often practices earnings management so that financial reports look good that conflicts of interest arise because management may act contrary to the interests of the principal. To minimize this, good corporate governance is needed to run properly.

Signaling Theory

According to (Spence, 1973), signaling theory is that the sender (owner of the information) gives a signal or signal in the form of information that reflects the condition of a company that is beneficial to the recipient (investor). (Brigham & Houston, 2015) states that a signal is an action taken by company management that gives instructions to investors about how management views the company's prospects. *So* from this, if a company does not reach the target or the financial condition is bad to make the signal that appears good, management often practices earnings management, but so that it is not detrimental from

an investor's point of view to overcoming this, good corporate governance is needed which must be obeyed. well in a company.

Earnings Management

Earnings management according to (Diri, 2018: 8) is "earnings management as the within GAAP management discretion over external financial reporting by abusing some contracting deficiencies, stakeholders' bounded rationalities, and information asymmetry in the market, through some economic decisions, a change in the accounting treatment, or other sophisticated methods. The purpose of management is to present earnings in a way different (up or down) from what is known to them to achieve private benefits while misleading the stakeholders; although such discretion may not always be harmful to them.

Financial Targets

According to (Singleton & Singleton, 2010: 133) unrealistic financial targets are one of the elements that give rise to sizable fraud. In this case, the good or bad management of the company can be seen from the high or low percentage of results from the calculation of the ROA formula. In calculating the ROA ratio, it can also be used to compare different companies, that have a business in the same sub-sector. So in this study, to measure financial targets using the ROA ratio, namely the current year's ROA value is reduced by the previous year's ROA value.

Political Connections

Political connections within a company can anticipate a decline in earnings management so that the quality of the resulting earnings is better. In this study, the composition of the board of commissioners and directors consisting of commissioners and directors was measured by those with political relations rated at 1, and by those without political relations rated 0 (Hashmi et al., 2018), (Fan, 2017), and (Harymawan & Nowland, 2016).

Institutional Ownership

The existence of institutional ownership in a company will encourage increased monitoring of management performance. The greater the institutional ownership, the greater the power of voice and encouragement from these financial institutions to oversee management and consequently will provide greater impetus for management to optimize company performance and align management interests with shareholders or stakeholders (Arlita et al., 2019).

Going Concern

According to (Belkaoui, 2006) going concerned is a proposition that states that an entity will continue its operations for a long enough time to realize its projects, responsibilities, and activities - activities that are not stopping. Financial distress occurs before bankruptcy.

Conceptual Framework

Financial Target on Possible Earnings Management Practices

For research on financial targets, research conducted by (Leo Handoko, 2020), (Husmawati et al., 2017), shows that financial targets do not affect the proxy approach and have no effect on fraudulent financial statements, while research conducted by (A. Fitri & Muda, 2018), (Rengganis et al., 2019), (Akbar, 2017), with the ROA proxy approach influence al targets, influence fraudulent financial statements. In this study, the dependent variable used is earnings management, if earnings management is low then earnings quality is good.

H1: Financial targets have a negative effect on the possibility of earnings management practices.

Political Connections on Possible Earnings Management Practices

For research on political connections, research conducted by (Liao et al., 2020) shows that political connections can weaken the level of accrual-based earnings management, which helps private companies obtain more preferential funding policies and assistance. Research conducted by (Hpolitically connected politically connected companies have significantly lower earnings quality compared to companies that are not connected. And research conducted by (Fan, 2017) shows that politically connected CEOs perform less tangible earnings management, possibly because their political connections make capital raising easier and reduce incentives for earnings management.

H2: Political connection has a negative effect on the possibility of earnings management practices.

Institutional Ownership on Possible Earnings Management Practices

Research conducted by (Tifanny & Wijaya, 2020), (Kusumawardhani & Murdianingrum, 2022), (Ranjbar & Amanollahi, 2018), (F. A. Fitri et al., 2019) shows that institutional ownership has a negative and significant effect on earnings management, while research conducted by (Varia Juita, 2020), (Wahyudi, 2020) show does not affectional ownership does not affect earnings management. Measurement of institutional ownership where the role of management greatly influences company decisions so that earnings management practices are often carried out.

H3: Institutional ownership has a negative effect on the probability of earnings management practices.

Going Concern on Possible Earnings Management Practices

Research conducted by (Ranjbar & Amanollahi, 2018), (Rizka Riadiani et al., 2015), (Sari & Meiranto, 2017), (Ghazali et al., 2015) shows that financial distress affects earnings management with the ZSCORE proxy approach , while research conducted by (de Luca & Paolone, 2019) shows that the financial crisis has no effect on earnings management using the ZScore proxy approach. So in this study, the authors want to try to find out and analyze that the effect of going concerned on earnings management practices will be smaller. Because when the company has suffered a loss, the pressure to practice earnings management is diminishing, because management has run out of ways to manage earnings before financial distress occurs or before the company experiences successive losses.

H4: Going concern has a negative effect on the possibility of earnings management practices.

Research Method

The type of data used in this research is secondary data. Secondary data is data obtained through existing sources and does not need to be collected by the researcher himself. The data needed in this research is in the form of company financial reports obtained from the web www.idx.co.id and for capitalization market information obtained from the web www.sahamok.com. This study will analyze the effect of independent variables on earnings management. Tests *were* carried out using eviews 12 software.

Earnings management will be measured using the MSCORE method which consists of ratios in the financial statements. This study uses the MSCORE model because the proxies used in the MSCORE model can be used in manufacturing companies and also this model uses a cut-off of -1.78. These ratios are days sales in receivables index (DSRI), gross margin index (GMI), asset quality index (AQI), sales growth index (SGI), total accrual to total assets (TATA), depreciation index (DEPI), sales general and administrative expenses index (SGAI), and leverage index (LEVI). The following is the MSCORE model used by (Beneish et al., 2012):

MSCORE= -4.48 + .920*DSRI + .528*GMI + .404*AQI + .892*SGI + .115*DEPI - .172*SGAI - .327*LEVI + 4.679*TATA

Based on the definition and operationalization of the researcher presents a variable operational

measurement table as shown in table 1 below:

Table 1. Variables

Variable	Formula	Scala
Y	Model MSOCRE	Nominal
X1	ROA = Net Profit t / Total Assets t - Net Profit t-1 / Total Assets t-1	Ratio
X2	The composition of the board of commissioners and directors consisting of commissioners and directors is measured using a dummy variable with 0 for the composition of the board of commissioners and directors who have never held positions that have political connections (work experience in government), and 1 for one of the compositions of the board of commissioners and directors who have held or currently hold a position that has political connections (work experience in government)	Nominal
X3	INST = (Number of institutionally owned shares / Total outstanding shares) X 100%	Ratio
X4	going concern is measured using a dummy variable, 0 for companies that do not experience losses for 2 consecutive years and 1 for companies that experience losses for 2 consecutive years.	Nominal

Logistic Regression

Testing the hypothesis in this study is to use logistic regression where the independent variable is a combination of continuous variables (*M*etric data) and categorical (non-metric data). The equation formed using logistic regression is as follows:

Models : Ln P/(1-P) = β0 + β1 FT + β2 KP + β3 INST + β4 GC + €
Information:
Ln P/(1-P) : MSCORE models
FT : Financial Targets
KP : Political Connection
INST : Institutional Ownership
GC : Going Concern
€ : disturbance error

It can be done in several ways to assess the overall fit of the model. Among them:
i. Coefficient of Determination (*R*2 McFadden)
ii. 2x2 Classification Table
iii. Regress Coefficient Significance Test

Results

Descriptive Statistics

From the results of descriptive statistics using eviews, it will be seen the mean value, standard deviation, and maximum and minimum values of each variable used. In Table 2 are the results of descriptive statistics performed.

Table 2. Descriptive Statistics

	Y	X1	X2	X3	X4
Mean	0.591	0.001	0.225	0.072	0.096
Max	1.000	1.195	1.000	0.946	1.000
Min	0.000	-0.841	0.000	0.000	0.000
Std. Dev	0.492	0.151	0.419	0.189	0.296

(Source: Processed data, eviews 12)

In Table 2 it can be seen that the number of samples (N) used in this study, namely as many as 186. For variable (Y) is the dependent variable, the variable used in this study is the possibility of earnings management practices as measured by the MSCORE model. Possible earnings management practices are assessed based on the cut-off value of -1.78. The maximum value of the variable (Y) is 1 and the minimum value is 0 because the value is in the form of a dummy, and the average value is 0.591.

Variable (X1) is the independent variable, namely the financial target variable as measured by the ROA proxy, namely the current year's ROA value minus the previous year's ROA value. The maximum value of the variable (X2) is 1.195, the minimum value is -0.841, and the average value is 0.001. In this study, the median value is -0.002. From the average value, it can be concluded that more than half of the sampled sample companies have good company performance.

Variable (X2) is an independent variable, namely political connections as measured by the composition of the commissioners and directors measured using a dummy variable with 0 for the composition of the boards of commissioners and directors who have never held a position that has political connections (work experience in government), and 1 for one the composition of the board of commissioners and directors who have held or currently hold positions with political connections (work experience in government). The maximum value of the variable (X1) is 1 and the minimum value is 0 because the value is in the form of a dummy, and the average value is 0.225. In this study, the median value is 0.000. So that it can be said that political connections are based on the median, that fewer companies have one of the compositions of the board of commissioners and directors who have held or currently hold positions that have political connections (work experience in government).

Variable (X3) is the independent variable, namely the variable institutional ownership. The indicator used to measure institutional ownership is the percentage of shares owned by institutional parties from the entire company's outstanding share capital. The maximum value of the variable (X3) is 0.946, the minimum value is 0.000, and the average value is 0.072. In this study, the median value is 0.000. From the average value, it can be concluded that no more than half of the sample companies that are sampled are owned by institutional parties from all of the company's outstanding share capital.

Variable (X4) is going concerned which is proxied by if 0 for companies that do not experience losses for 2 consecutive years and 1 for companies that experience losses for 2 consecutive years. The maximum value of the variable (X4) is 1.000, the minimum value is 0.000, and the average value is 0.096. In this study, the median value is 0.000. So it can be said that companies that have experienced losses for 2 consecutive years are less than the total sample.

Coefficient of Determination ($R2$ McFadden)

It is known that in this study the value of $R2$ McFadden in the estimated output results of the model determination coefficient is 0.2374. It can be concluded that the independent variables shown by the indeclinable in the model can explain the dependent variable which is equal to 0.2374 or 23.74% and the remaining 76.26% is explained by other variables outside the research model.

Table 3. Determination Coefficient Test (R2)

Test Results	
McFadden	0.2374

(Source: Processed data, eviews 12)

Hosmer and Lemeshow's Goodness of fit Test

In table 4 below it can be seen that the model feasibility test shown by the results of the Hosmer and Lemeshow Test shows a Chi Square Probability of 0.1738. *The* test subcriteria are by the feasibility of the regression model, sure that H0 is accepted. The *Chi-Square* value is 0.1738 > 0.05, which means that there is no difference in the estimated data of the logistic regression model with the research observation data. This indicates that the regression model is said to be feasible and appropriate (appropriate) to be used in this study.

Table 4. Hosmer and Lemeshow's Goodness Test

Goodness-of-Fit Evaluation for Binary Specification
Andrews and Hosmer-Lemeshow Tests
Equation:
UNTITLED
Date: 04/09/22 Time: 00:40
Grouping based upon predicted risk (randomize ties)

Quantile of Risk Low	High	Dep=0 Actual	Expect	Dep=1 Actual	Expect	Total Obs	H-L Value
Total		76	76.0000	110	110.0000	186	11.5225

H-L Statistic	11.5225	Prob. Chi-Sq(8)	0.1738
Andrews Statistic	16.6532	Prob. Chi-Sq(10)	0.0824

(Source: Processed data, eviews 12)

Clarification Matrix

Table 5. Expectation-Prediction Test

Expectation-Prediction Evaluation for Binary Specification
Equation: UNTITLED
Date: 09/04/22 Time: 00:41
Success cutoff: C = 0.5

	Estimated Equation Dep=0	Dep=1	Total	Constant Probability Dep=0	Dep=1	Total
P(Dep=1)<=C	46	10	56	0	0	0
P(Dep=1)>C	30	100	130	76	110	186
Total	76	110	186	76	110	186
Correct	46	100	146	0	110	110
% Correct	60.53	90.91	78.49	0.00	100.00	59.14
% Incorrect	39.47	9.09	21.51	100.00	0.00	40.86
Total Gain*	60.53	-9.09	19.35			
Percent Gain**	60.53	NA	47.37			

(Source: Processed data, eviews 12)

In the results in Table 5 above, it can be seen that in the estimated equation column it is known that the total results from the percentage value of correct prediction accuracy are obtained at 59.14%, which means that the percentage of model accuracy in predicting the possibility of earnings management in manufacturing sector companies in this study.

Logistic Regression Analysis Results

The results of the regression analysis function to describe or explain the output related to the independent and dependent variables in the study so that in this case the linkage factors from the regression results can be linked and re-estimated according to one variable to another. *This* study *uses* a logistic regression model (logistic regression).

Table 6. Logistic Regression Results

Dependent Variable: Y
Method: ML - Binary Logit (Newton-Raphson / Marquardt steps)
Date: 09/04/22 Time: 00:39
Sample: 2019 2021
Included observations: 186
Convergence achieved after 4 iterations
Coefficient covariance computed using observed Hessian

Variable	Coefficient	Std. Error	z-Statistic	Prob.
C	1.272122	0.222857	5.708254	0.0000
X1	-2.215674	1.547388	-1.431880	0.1522
X2	-2.729276	0.496050	-5.502013	0.0000
X3	-3.086333	1.430146	-2.158055	0.0309
X4	-1.325186	0.563491	-2.351743	0.0187

McFadden R-squared	0.237417	Mean dependent var	0.591398
S.D. dependent var	0.492902	S.E. of regression	0.417075
Akaike info criterion	1.085303	Sum squared resid	31.48520
Schwarz criterion	1.172017	Log likelihood	-95.93317
Hannan-Quinn criter.	1.120443	Deviance	191.8663
Restr. deviance	251.6006	Restr. log likelihood	-125.8003
LR statistic	59.73427	Avg. log likelihood	-0.515770
Prob(LR statistic)	0.000000		

Obs with Dep=0	76	Total obs	186
Obs with Dep=1	110		

(Source: Processed data, eviews 12)

Discussion

The Effect of Financial Targets on the Likelihood of Earnings Management Practices

On the results of logistic regression testing, there is no significant effect of the financial target variable on the possibility of earnings management practices. This research contradicts the results obtained by (A. Fitri & Muda, 2018), (Rengganis et al., 2019), influence targets influence fraudulent financial statements and are consistent with *the* research (Leo Handoko, 2020), (Husmawati et al., 2017) do not affect coal targets do not affect fraudulent financial statements. This may be caused, if the company is still in a stable condition or profit, then it is likely that management's desire is still very little to carry out earnings management.

The Effect of Political Connections on the Likelihood of Earnings Management Practices

The results of the logistic regression test for the political connection variable have a coefficient of -2.72, which means the relationship is in the opposite direction between each increase in the political connection variable and the possibility of earnings management practices. This means that if there is a political connection, then the percentage value of the possibility of earnings management practices decreases, and has a significance of 0.00, which means that political connections have a negative effect on the possibility of earnings management practices. This research is consistent with (Liao et al., 2020), (Fan, 2017) that political connections have a negative effect on the possibility of earnings management practices and contradicts the results obtained by (Hashmi et al., 2018), (Harymawan & Nowland, 2016) which has a positive effect on earnings management, so it can be concluded that with the existence of effective corporate governance coupled with the influence of political connections from the board of commissioners/board of directors can make companies comply with regulations and avoid earnings management practices because the political connections that are owned make the company earn special treatment, such as ease in obtaining capital loans, low tax audit risk. This is in line with the agency theory and signaling theory where there is a conflict of interest whereby the agent may act contrary to the interests of the principal. To minimize the occurrence of fraud in a company, good corporate governance is needed so that it is run properly. Where from the results of the study it can be seen that political connections have a negative effect on earnings management practices, which means that if there are political connections in a company, the percentage value of possible earnings management practices decreases.

Effect of institutional ownership on Likelihood of Earnings Management Practices

The institutional ownership variable has a coefficient of -3.08, meaning that the relationship is in the

opposite direction between the ratio of institutional ownership and the possibility of earnings management practices. This means that the higher the ratio of institutional ownership, the lower the percentage value of possible earnings management practices, and has a significance of 0.03, which means that institutional ownership has a negative effect on the possibility of earnings management. This study is consistent with (Tifanny & Wijaya, 2020), (Kusumawardhani & Murdianingrum, 2022), (Ranjbar & Amanollahi, 2018), (F. A. Fitri et al., 2019) and contradicts the results (Varia Juita, 2020), so that it can be concluded that the existence of effective corporate governance coupled with the influence of institutional ownership can make companies comply with regulations avoiding earnings management practices due to institutional oversight and can limit managers' behavior in earning management practices. The results of this study indicate that the existence of effective corporate governance can make companies comply with regulations and avoid earnings management practices because with institutional ownership they can receive special treatment such as ease in terms of borrowing funds so that when companies need funds the company does not experience pressure to display financial reports to look good. This is in line with the agency theory and signaling theory where there is a conflict of interest whereby the agent may act contrary to the interests of the principal. To minimize this, good corporate governance is needed to run properly. Where from the results of the study it can be seen that institutional ownership has a negative effect on earnings management practices, which means that if there is institutional ownership in a company, the percentage value of possible earnings management practices decreases.

The Effect of Going Concerned on the Likelihood of Earnings Management Practices

The going concern variable has a coefficient value of -1.32, which means that if going concern increases, the percentage value of possible earnings management practices decreases, and has a significance of 0.01, which means that going concern has a negative effect on the possibility of earnings management practices. This research is consistent with those conducted by (Ghazali et al., 2015) which have a negative effect and are contrary to research conducted by (Ranjbar & Amanollahi, 2018), (Rizka Riadiani et al., 2015), (Sari & Meiranto, 2017) shows that financial distress has a positive effect on earnings management and is contrary to research conducted by (de Luca & Paolone, 2019) do not affect crises do not affect earnings management, so It can be concluded that when a company has suffered a loss, the pressure to practice earnings management is diminishing, because management has run out of ways to manage earnings before financial distress occurs or before the company experiences successive losses. This is in line with the agency theory and signaling theory where there is a conflict of interest whereby the agent may act contrary to the interests of the principal. Before bad financial conditions or experiencing losses, management may often practice earnings management so that financial reports look good. To minimize this, good corporate governance is needed to run properly.

CONCLUSION, IMPLICATION, SUGGESTION, AND LIMITATIONS

This study aims to determine the effect of financial targets, political connections, institutional ownership, and going concern on the possibility of earnings management practices and uses the MSCORE model for the dependent variable. Based on the results of the analysis and discussion, the following conclusions can be drawn:

Financial targets do not have a significant effect on the possibility of earnings management practices.

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