THE ROLE OF MANAGERIAL OWNERSHIP, LEVERAGE, AND COMPANY SIZE IN EARNINGS MANAGEMENT PRACTICES

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Abstract. *Earnings management is a practice carried out by management to influence accounting information for specific purposes, which often affects the transparency and reliability of financial statements. Numerous studies have examined various factors that influence earnings management, including managerial ownership, leverage, and firm size. This article aims to review the literature that discusses how these three variables affect earnings management. The method used is a literature review based on relevant national and international journal articles published between 2020 and 2025. The findings show that the influence of managerial ownership, leverage, and firm size on earnings management remains inconsistent. Managerial ownership may suppress earnings management in certain contexts but appears insignificant in others. Leverage is often associated with debt pressure that encourages earnings management, while the impact of firm size varies across studies. This review provides a comprehensive understanding of the dynamics of earnings management and offers theoretical and practical implications for future research and decision-making.*

Keywords: *Earnings Management; Firm Size; Leverage; Managerial Ownership*

1. INTRODUCTION

Financial statements are crucial reports for both institutions and companies. These statements serve as the outcome of a series of processes involving the recording and summarizing of business transaction data (Setiawan, 2022). A professional accountant is expected to have comprehensive competence in managing various types of accounting data available within a company. This ability encompasses not only the preparation of accurate and standardized financial reports but also the skills to interpret each figure presented and analyze the information to produce a deep understanding of the company's financial condition. Financial statements play a vital and strategic role; they are used by internal management as a basis for evaluating performance and making operational decisions, while also serving as a key source of information for external parties such as investors, creditors, and financial analysts in assessing the company's prospects and financial health.

Therefore, accountability and transparency in the presentation of financial statements are critical, considering that investment and funding decisions made by stakeholders heavily depend on the validity and reliability of such information. Consequently, company management should not solely focus on short-term profit achievements. They must also consider long-term aspects such as business sustainability, consistent growth, and financial stability. Efficient and effective resource management is key to meeting the expectations of all stakeholders, both internal and external, while maintaining optimal profitability.

A company that consistently generates profit demonstrates its ability to operate effectively. This can also serve as an early indicator of its capacity to grow and survive amid increasing competition. However, in practice, not all companies are in ideal conditions. Some, especially those under economic pressure or facing challenging targets, may choose to engage in earnings management. This practice aims to create the perception that the company is performing well, even if it is not. Therefore, earnings management is often used as a strategy to maintain the company's image in the eyes of investors and the public, although such practices undoubtedly have consequences on the integrity of financial statements. Earnings management refers to management actions that manipulate financial statements for certain interests, including practices such as income smoothing, taking a bath, and income increasing (Nelyumna, et al., 2022).

Earnings management is not merely a theoretical concept discussed in academic settings; it has been widely observed in real-world business practices. One notable case occurred with PT Timah Tbk, a state-owned mining company that came under public scrutiny due to allegations of financial report manipulation. A study conducted by Saputri et al. (2024) stated that prior to the exposure of the corruption scandal at PT Timah Tbk in 2023, there were indications of irregularities in its financial statements. These included a reduction in reported losses from 2019 to 2020, followed by a significant increase in operating cash flow during the same period, which potentially influenced the Dividend Per Share (DPS) received by shareholders. The study explained that the notable decrease in losses from 2019 to 2020 lacked sufficient logical explanation and was accompanied by a rise in operating cash flow. This increase could give the impression that the company had strong operational performance, whereas the underlying reality might differ. Moreover, these changes likely influenced shareholder perceptions through the rise in DPS, ultimately benefiting management in the short term.

The mismatch between the income statement and operating cash flow, as well as significant fluctuations in key components of the financial statements, serve as early warning indicators of possible manipulation or earnings engineering. This suggests the presence of irregularities in reporting, which ideally should reflect the company's financial condition objectively and accurately. If not addressed, such practices can erode investor trust, distort markets, and hinder governmental efforts to foster a transparent and trustworthy investment climate.

Cases like this underscore that earnings management is a serious issue that cannot be ignored. It serves as a warning for regulators, auditors, and other stakeholders to strengthen oversight and tighten the implementation of good corporate governance principles. Furthermore, companies must cultivate a culture of accountability and transparency as part of their commitment to honest and responsible financial reporting. The PT Timah Tbk case exemplifies how financial statement manipulation can not only damage a company’s reputation but also have systemic impacts on public trust and national economic stability.

Several factors can drive a company to engage in earnings management practices. One of the main factors frequently discussed in accounting literature is managerial ownership. Managerial ownership refers to the proportion of company shares owned by management, such as directors, executive managers, and other high-level officials directly involved in strategic decision-making. When management owns shares in the company, they are expected to be more accountable and motivated to enhance overall company performance, rather than prioritizing personal gain. Managerial ownership is defined as the percentage of shares owned by the management of a company, where such ownership is expected to lead to better company performance, prioritization of collective interests, and increased shareholder wealth (Rahayu & Rusliati, 2020). In this context, managerial ownership can function as an internal control mechanism capable of reducing agency conflicts between management and company owners.

By owning shares, managers are indirectly "aligned" with company owners, thus expected to make decisions that align with shareholders' interests. This also encourages managers to maintain the integrity of financial reports, as these reports directly reflect their own performance, ultimately affecting the value of their shares. However, it is important to acknowledge that managerial ownership can also lead to adverse consequences. In some cases, share ownership by managers gives them greater control over information, including financial reporting. When internal controls and external oversight are weak, managers who own shares may engage in earnings management to create a falsely positive image of company performance. For example, they might manipulate earnings reports to appear as though targets are being met, thereby inflating share prices and securing personal financial benefits. This phenomenon illustrates that the effectiveness of managerial ownership in preventing earnings management highly depends on the company's governance structure, including the presence of an independent board of commissioners, the role of internal audit, and financial reporting accountability. Managerial ownership can be a double-edged sword; on one hand, it provides incentives to improve company performance, while on the other hand, it opens the door to the misuse of power in financial decision-making. Therefore, balanced supervision and transparency in managerial shareholding systems are essential. A deep understanding of the dynamics of managerial ownership is crucial in preventing earnings management practices that could harm stakeholders and undermine public trust in the integrity of corporate financial information.

Another factor influencing earnings management is leverage. Leverage is one of the financial ratios used to assess a company's ability to meet its debt obligations, both short-term and long-term (Arfandi, 2022). It refers to the use of borrowed funds by companies to finance assets or operations, where companies with high leverage levels often face pressure to report stable or increasing profits to meet creditor expectations and avoid default risk (Aulia & Hidayat, 2023). High-leverage firms often experience considerable pressure to meet financial obligations, particularly in interest payments. This pressure may push management to engage in earnings management to maintain stable financial ratios and remain attractive to investors and creditors.

Company size is another factor that can influence management's decision to engage in earnings management. Company size, which can be categorized based on total assets or revenue, also affects the company's capacity to manage earnings (Helmi et al., 2023). The larger the company, the higher the level of transparency and governance it must adhere to, making earnings management more controllable. The presence of stricter oversight can serve as a deterrent to manipulation, as the reputational and legal consequences are far greater. Additionally, large companies typically implement Good Corporate Governance (GCG) principles more consistently and possess more complex and structured internal control systems, which can more effectively detect and prevent irregularities. However, the impact of company size on earnings management is not always linear or uniform. In some instances, large firms have more resources and capacity to conceal earnings management through complex accounting strategies that are difficult to detect. They may also exploit loopholes in financial reporting standards to enhance their financial performance without explicitly violating regulations. Thus, despite tighter supervision, large firms still have the opportunity to engage in earnings management, albeit in more concealed and sophisticated ways.

Conversely, smaller firms may be more vulnerable to financial statement manipulation due to minimal oversight and weaker internal control structures. However, they also face limitations in terms of resources and technical capacity to systematically conduct earnings management. Therefore, in the context of accounting research and practice, company size should not only be seen as a direct determinant of earnings management tendencies but must also be understood in conjunction with other factors such as ownership structure, operational complexity, and the intensity of external monitoring. Understanding the influence of company size is not only theoretically relevant but also critical in audit practice and capital market supervision.

Numerous studies have been conducted on the factors influencing earnings management, yet the findings remain inconsistent and require further investigation. One frequently studied factor is managerial ownership. Research by Arfandi (2022) found that managerial ownership significantly affects earnings management, whereas studies by Christi et al. (2022) and Hakki et al. (2024) concluded that it has no significant effect. These inconsistencies suggest the need for further exploration through a literature synthesis approach to comprehensively understand the role of managerial ownership in earnings management practices. Additionally, leverage has been widely associated with earnings management. Several studies, including those by Arfandi (2022) and Susanti et al. (2022) found that highly leveraged firms tend to engage in earnings management to maintain financial credibility in the eyes of creditors and investors. However, there is still limited understanding of how financial pressure from debt obligations specifically drives managerial opportunism. On the other hand, firm size is also considered an influencing factor. Findings from Joe & Ginting (2022) show a significant relationship between firm size and earnings management, while studies by Adyastuti & Khafid (2022) and Effendi et al. (2021) found no such effect. These conflicting results highlight a gap in the literature, especially regarding research context, study period, and industry characteristics. Therefore, a systematic literature review is needed to summarize and analyze past findings, offering a more comprehensive understanding of the relationship between managerial ownership, leverage, and company size with earnings management practices. The purpose of this study is to conduct a literature review on the roles of managerial ownership, leverage, and firm size in earnings management practices.

2. LITERATURE REVIEW

This study is based on a grand theory, namely agency theory, which serves as the primary foundation in explaining the relationship between management and company owners, as well as the factors that influence earnings management practices. Agency theory was first introduced by Jensen & Meckling (1976), who stated that the relationship between the principal (owner) and the agent (manager) has the potential to create a conflict of interest, particularly when both parties have differing objectives. This conflict is exacerbated by the separation between ownership and control, where the owner delegates management authority to the manager but still expects the manager to act in alignment with the owner's interests. In practice, managers often have motivations to maximize personal gain or enhance the company's image in the eyes of the public, thus risking decisions that may not align with the primary objectives of the owners. One of the most relevant forms of conflict of interest in this context is information asymmetry, a condition where managers possess more and deeper information about the company's condition compared to owners or shareholders. This information gap provides opportunities for managers to engage in manipulative behavior in the preparation of financial statements. According to Felicya & Sutrisno (2020), under certain conditions, agents do not always act in the best interests of the principals. Greater access to information gives managers an advantage in selectively presenting financial data, one of which may be through earnings management. This practice includes various deliberate accounting actions intended to adjust reported earnings for specific objectives, such as meeting investor expectations, maintaining the company's reputation, or avoiding breaches of financial agreements with creditors. While this strategy may offer short-term benefits to management, in the long term it can result in harm by misleading external decision-makers and undermining the credibility of the company's financial statements.

To mitigate such conflicts of interest, managerial ownership is considered one of the effective internal mechanisms. Managerial ownership refers to the condition where managers hold shares in the company, thereby having a direct stake in the company's performance and success. Widodo et al. (2021) noted that managerial share ownership can align the objectives of managers and shareholders, since managers are not only responsible for operations but also benefit from the results of their decisions. In other words, the greater the proportion of shares owned by managers, the less likely they are to take actions that could harm other shareholders, including engaging in earnings management. Christi et al. (2022), suggest that such conditions can motivate managers to act more objectively and professionally, and reduce their tendency to manipulate financial statements. Similar support is provided by Mufidah (2020), who explains that managerial ownership is measured by comparing the number of shares owned by management with the total number of outstanding shares. The higher this ratio, the stronger the incentive for management to act in line with shareholder interests.

In addition to managerial ownership, leverage or the company's debt level also plays an important role in determining the extent of earnings management. Leverage reflects the degree to which a company utilizes borrowed funds in its capital structure. According to Arfandi (2022), leverage is an indicator of a company's ability to meet both short-term and long-term financial obligations. Companies with high levels of leverage face significant pressure to maintain financial performance that appears healthy and capable of meeting interest and principal payments. In such situations, management is often compelled to engage in earnings management in order to present financial reports that appear stable and do not raise concerns among investors or creditors. A study by Sonia & Khafid (2020) stated that companies with high debt burdens are at greater risk of violating debt covenants, which encourages managers to manage earnings in a way that remains within acceptable limits for lenders.

Another factor that also influences earnings management practices is company size. In this context, company size is one of the indicators that reflect the strength, capacity, and operational sustainability of a business entity. Riyanto (2020) explained that company size can be measured in various ways, such as total assets, sales volume, market capitalization, or the number of employees. Larger companies tend to attract greater attention and more intense scrutiny from various parties, including regulators, investors, the media, and the general public. As a result, large firms are more cautious in preparing their financial statements because their reputation and credibility are at greater risk. Conversely, smaller or medium-sized companies may not face the same level of scrutiny and thus have more flexibility to engage in earnings manipulation. Arfandi (2022), noted that while large-scale companies face higher pressure to show consistent performance, they also have stronger incentives to protect their reputation.

Earnings management is defined as actions taken by managers to influence or manipulate reported accounting earnings in financial statements. According to Ramadhan (2021), earnings management is an accounting policy applied by management to present financial statements that meet specific targets. This practice may involve utilizing the flexibility of accounting standards to manipulate the timing of revenue and expense recognition, accrual adjustments, or selecting certain accounting methods. Sadzili & Suhartini (2025) add that earnings management is often carried out to meet market expectations, maintain financial performance stability, or attract investor attention. However, this practice is often viewed negatively, as it can obscure the true financial condition of the company and harm stakeholders who rely on accurate financial information for decision-making. While earnings management may yield short-term benefits for managers, in the long run, it can damage the company's credibility, worsen relationships with investors and creditors, and increase legal and reputational risks (Arfandi, 2022).

3. RESEARCH METHODS

This study employs a qualitative approach using a literature review method to analyze various scholarly articles that examine the influence of managerial ownership, leverage, and firm size on earnings management practices. The data sources used are secondary data obtained through searches on the Google Scholar database, with a focus on articles from SINTA-accredited journals (levels 1 to 6), as well as conference proceedings and other national journals with registered ISSN numbers. The selected articles had to meet several criteria, including being published within the last five years (2020–2024), being relevant to the topic discussed, and having undergone a peer-review process. The articles included in this study are written in either Indonesian or English and explicitly address the relationship between the key variables of this research. The data analysis technique used is content analysis, which involves systematically reading and examining the contents of the articles and categorizing the findings based on the variables studied.

4. RESULTS AND DISCUSSION

Financial statements represent the final outcome of a series of processes involving the recording and summarizing of business transaction data. Strong performance in generating profits can reflect a company's operational capabilities and serve as a foundation for future growth and sustainability. Financial statements are closely related to earnings management practices, wherein management may manipulate financial reports to achieve specific objectives. Managerial ownership refers to the percentage of company shares held by members of management. When this ownership percentage is high, managers tend to be more cautious in making decisions, including those related to financing and operational strategy, as they have a direct interest in the company's performance. The greater the proportion of shares owned by management, the stronger the incentive for them to act transparently and accountably (Mufidah, 2020). A study conducted by Arfandi (2022) explains that managerial ownership plays a role in determining the extent to which management is involved in earnings management, while leverage may influence a company's financial flexibility in making decisions related to financial reporting. The presence of managerial shareholding can reduce agency conflicts, which arise from the divergence of interests between company owners and managers.

In line with this, a study by Rizki (2021) on the influence of leverage on earnings management shows that leverage can directly affect a company's capital structure or assets through policies such as debt-financed investment. Companies with high leverage ratios are more likely to engage in earnings management due to the increased risk of default.

Company size is also a critical factor for investors and creditors, as it is directly related to the level of investment risk. Larger companies typically have greater access to various sources of funding. Research conducted by Rizki (2021) Rizki (2021) on the effect of firm size on earnings management concluded that there is a positive relationship, where the larger the company, the higher the tendency to engage in earnings management. This is because larger firms often have more complex operational activities compared to smaller companies, thereby increasing the opportunity for earnings management. Additionally, a study by Umah & Sunarto (2022) also found that firm size has a positive effect on earnings management.

CONCLUSION

Earnings management practices represent a critical issue in the preparation of financial statements, as they can affect the quality of information presented to stakeholders. Managerial ownership plays a significant role in controlling earnings management, where a higher proportion of shares owned by management increases their incentive to act transparently and reduce agency conflicts. In addition, company size is also related to the level of oversight and transparency, which ultimately can suppress the tendency toward earnings management. Meanwhile, leverage or the level of corporate debt exhibits varying effects on earnings management and does not always have a direct relationship.

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