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# Firm Size, Leverage, And Political Connection On Earnings Management In Mining Company

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**Abstract:** The purpose of this study is to determine the effect of firm size, leverage, and political connection on earnings management of mining companies in indonesia stock exchange, the periode in which this study is 5 (five) years, namely 2017-2021. This study uses descriptive research with a quantitative approach. The population in this study is 47 mining companies listed on the Indonesian Stock Exchange. The sampling technique used was purposive sampling and obtained a sample of 12 mining companies. The analytical method used is panel data regression analysis using eviews version 12 software. In this study the dependent variable is earnings management (Y) and the independent variable is firm size (X1), leverage (X2), political connections (X3).The results of this study indicate that partially positive and significant firm size on earnings management, leverage and political connection have no effect and are not significant on earnings management

**Keywords:** Earnings Management, Firm Size, Leverage, Political Connection

## INTRODUCTION

Indonesia is a country rich in natural resources. The potential of this natural wealth seems to be inexhaustible by time and age. The diversity of natural resources includes biological and non-living natural resources. Having plenty of natural resources, particularly non-renewable ones, makes Indonesia one of the countries that has become one of the centers of world attention. Excavation material as a non-renewable natural resource is a very valuable raw material in all respects. Indonesia's position in terms of potential wealth of minerals always puts Indonesia in the world's top ten, regardless of the type of minerals. Indonesia comes with so much beauty and natural wealth in it and the mining sector is no exception.

In the growing economic activities, every company, especially in the mining sector, has a major influence on the condition of the Indonesian economy and also the regions where there are companies in the sector (Manggau, 2016). Companies in the mining sector in Indonesia have many natural resources that attract investors to invest because it is currently one of the potential natural resources that can be used as a source of currency for national development, and is the most potential industry to be developed because Indonesia has many natural resources that attract investors to invest capital. In making an investment, of course, potential investors will look for companies that have good financial statements from year to year, and a manager will practice earnings management so that the financial statements of the corporation are favorable.

Earnings management is an action taken by a manager to select accounting policies that are carried out to influence reports to achieve certain goals (Scott, 2015). Earnings management is a phenomenon where financial reports do not describe the company's true financial situation, so that it no longer has good quality. Earnings management can also be referred to as an error made intentionally when making reports on accounting data so that the information is used as a consideration to replace or change someone's decision according to the National Association of Certified Fraud Examiners (Lim & Siregar, 2021). In order to carry out this opportunistic move, he selects specific accounting standards that allow him to change, boost, or lower the company's profit as desired.

Because it may give an overview of manager behavior in financial reporting inside a firm(Santoso & Aprillianto, 2019), earnings management is an intriguing subject to research. Indonesia has a number of examples. That led to earnings management in mining sector companies, including the case that occurred at

PT Timah Tbk allegedly lying to the public by engineering financial statements. The alleged difference in irregularities in the 2019 financial statements of PT Timah Tbk and its subsidiaries is to cover up leaks so that the balance sheet of the examination results becomes a balance, so that there is corruption in the financial audit report of PT Timah Tbk and its subsidiaries in the 2019 fiscal year, which costs the state more than Rp. 300 billion. (www.pandawa98.com). Another case occurred at The FMPK (Justice Concern Community Forum) notified PT Ancora Mining Service (AMS) to the Ministry of Finance's Directorate General of Taxes (DGT) in 2011 for alleged financial statement manipulation. Mustopo, head of the FMPK Investigation Section, outlined how the revenue of Rp 34.9 billion, but no investment movement, provides evidence of this manipulation. In addition, despite AMS's claims that the company had no debt, proof of interest payments totaling Rp 18 billion was discovered. Fmpk also discovered evidence of receivables of Rp 5.3 billion, although the transactions were unclear. (www.republika.co.id). The phenomenon of financial scandal cases in financial reports that occurred in Indonesia proves that there is still a lack of honesty principles in producing financial reports and presenting information in financial reports with actual conditions. Firm size and leverage are two of the many variables that impact earnings management practice of a corporation.

According to research by Ketut Gunawan, et al (2015) Large companies have a significant incentive to control their earnings because, among other things, they must be able to fulfill the expectations of investors or shareholders. Firm size can have an impact on earnings management. Firm size describes the total assets, sales and market capitalization owned by the company (Dewi , et al, 2019). In Law No.20 of 2008, firm size can be classified into 4, namely micro businesses, small businesses, medium businesses, and large businesses.

Firm size is one of the triggers for earnings management practices, the larger the size of the company, the more the manipulation of financial statements by earnings management increases. Because large companies usually need more funds than small companies. Additional funds can be obtained from issuing new shares or additional debt, the motivation to obtain these funds will encourage management to practice earnings management, so that potential investors and creditors are interested in investing their funds by looking at high earnings reports. Large companies, however, also have a strong incentive to control earnings because they must be able to meet the expectations of shareholders or investors(Santoso & Aprillianto, 2019). Not only firm size affects earnings management, another factor that affects earnings management is leverage(Nursaid et al., 2021).

Leverage is a ratio to measure how far the company is financed by debt. The capital structure of a company can be determined by the leverage ratio. The company's capital structure consists of own capital and foreign capital where the company has short-term debt and long-term debt, one of which also affects earnings management is the amount of debt used to finance the company's needs. Investors will view the firm with the lowest leverage ratio because the leverage ratio impacts the effect of risk that happens. Leverage has a tie to earnings management methods(Qomariah et al., 2022). Therefore, the lower the leverage ratio the risk is lower (Nasution, et al, 2021). Creditor confidence will be affected by the leverage ratio as it increases the danger that the business will not be able to pay its debts (Rice, 2013). It is believed that a high value of the ratio indicates substantial external debt. High leverage encourages management to control earnings.  Apart from company size and leverage, political connection is also one of the factors that influence earnings management(Agustina et al., 2022).

A company can be politically connected if one of the largest shareholders (who has approximately 10% of voting rights) or has the top rank (CEO, director, deputy director) in the company as a member of parliament, a minister who has strong relations with the police, politicians, military, or political parties (Faccio,2006). Companies that have political connections will get legal protection which makes companies use earnings management to influence their company's performance. This certainly shows the non-transparency of companies that have political connections, especially in terms of financial reporting( sanosra et al., 2022).

Politics and business are interconnected, stable political conditions will have a positive impact on the business world, and political funding can be obtained from political activities. Companies that have business connections will gain a number of benefits(Agustin Hari et al., 2021) such as ease of obtaining bank loans and obtaining government-related contracts but political connection can be one of the potential for tax avoidance (Zhang 2016; Chen et al, 2015). Political connections also make it easier for companies to enter business industries that have high barriers and can help these companies. Having political connections gets wider opportunities than companies that do not have political connections. Companies can take steps to delay financial reports, deceive investors and embezzle a transaction, if the company wants to avoid corporate sanctions, the company can make low financial reports and political connections are able to protect the company (Chaney, et al 2009).

## LITERATURE REVIEW

### Agency Theory

Earnings management practices gave birth to agency theory. The agency relationship between principles and agents is covered in this theory. According to agency theory, it is very important to transfer control of the company's activities from its owners (principals) to parties that can run the company better (agents). (Sulistyanto, 2018: 29).

The idea of agency theory is based on the problem of agency that arises when a company's management is separated from its owner. To optimize long-term profitability, the company is a role that provides the possibility for different players to contribute in the form of capital, skills, and labor. Participants who contribute capital are referred to as owners (principals). People who participate labor experts are referred to as business managers (agents). The presence of these two people raises the issue of the responsibilities that should be assigned to balance their different interests. (Hendrawatu 2017: 27).

### Positive Accounting Theory

According to Watts and Zimmerman in Wati and Momon (2020: 37) Based on positive accounting theory, there are several motivations behind company managers in carrying out earnings management, namely:

1. To Maximize Bonuses

Managers will try to adjust the net profit so that they can maximize their bonuses based on the company's compensation plans.

2. To fulfill certain requirements in debt contracts

Bankers and creditors assess companies that deserve credit are companies that have the ability to return the debt plus a return in the form of interest. Companies that are able to repay debt are companies that are successful in generating profits. With a high level of profit, it is hoped that the company can be trusted by creditors, so that creditors can provide additional facilities in the form of low interest. If the company is declared in violation of the debt agreement, it will carry out earnings management with a pattern of increasing profits so as to increase the debt-to-equity ratio and interest converage at the specified level.

3. Political cost motive

Scott states that the greater the costs to the company in terms of politics, the probability of management will choose accounting procedures that postpone earnings reports in this period to a future period.

4. Moitif avoids decreasing profits and losses

Poor management performance is that which does not match the expectations of shareholders, which is often in the form of increased profits. If the company's operations result in a loss or decrease in profit, there is a strong possibility that management will carry out earnings management to avoid shareholders' bad judgment.

5. Initial public offering (IPO) motive

IPO is the initial gateway for companies to raise funds from the public. By increasing profits ahead of the IPO, signaling to potential investors that the company is performing well and is attractive for investment. In return for the high interest of potential investors is a high share price, which means that the funds that can be raised are getting bigger.

### Earnings Management

According to Sulistyanto (2018: 47) says that "Earnings management is an attempt by company managers to intervene or influence information in financial statements with the aim of misleading stakeholders who want to know the company's performance and condition".

According to the National Association of Certified Fraud Examiners in Sulistyanto (2018: 49) says that "Earnings management is the deliberate falsification of significant accounting facts or data in reports to mislead readers when all available information is used to create an equilibrium that will ultimately induce them to change their views or take different actions".

### Firm Size

According to Wati and Momon (2020: 65) say that " The variable "firm size" represents the size of the company. One of the factors taken into account by investors in making investments is company size".

According to Prasetyorini in Hery (2017: 11) says that " A scale known as "firm size" can be used to classify the size of a company in several ways, such as total assets, stock market value, and other elements.

The phrase "firm size" describes how big a company is, which can be measured in terms of total assets or total net sales. A company's assets and sales grow with its size.

**Leverage**

According to Hery (2017: 16) says that "Leverage is a financial strategy connected to a business's choice to use debt to incur loan principal commitments and interest costs. Due to the high risk of debt default associated with the use of debt (external financing), consideration should be given to the company's ability to repay the loan".

According to Kasmir in Hery (2017: 12) says that "Leverage is a statistic that assesses the proportion of a company's assets that are financed by debt". This means that the leverage ratio is used to assess the ability of the company to fulfill all of obligations current and future obligations.

**Political Connection**

According to Wati et al in Wati and Momon (2020: 3) say that "Political connections include members of the DPR RI, DPD RI, officials or former state officials, including in executive agencies (state ministries, departments, nondepartmental government agencies, and other central government organizations), legislative institutions, who are leaders of the company's board of directors or board of commissioners."

According to Leuz and Gee in Wati and Momon (2020: 2) "Political connection companies are companies that in some way seek to be close to the government or have political ties. Many businesses consider political ties to be a very significant source of political capital".

## METHOD

A quantitative method with a causal approach was applied in this study. Secondary data was used in this investigation. The financial statements for 2017-2021 were obtained from the official website of the Indonesia Stock Exchange, www.idx.co.id, which served as the secondary data source for this study. Using E-Views 12, panel data regression equation is the data analysis method used. 47 companies constitute the study population. Purposive sampling is the sampling method used The criteria for getting a test are as takes after: Mining companies listed on the Indonesia Stock Exchange consecutively during the 2017-2021 period, mining companies that publish complete annual reports during the 2017-2021 period, mining companies that experienced profits during the period 2017-2021, have all the data used to calculate the variables that are the focus of the research. Based on the data of 47 mining companies, 5 companies that are not listed on the Indonesia Stock Exchange, 7 companies do not report annual reports, 23 companies that suffered losses, 0 companies that do not have all the data used to calculate variables, implying that the sample of companies obtained is as many as 12 companies.

**Variable Operational Definitions**

Firm Size (X1) : Logaritma Natural (Total Assets)

Debt to Equity Ratio (X2) : $\frac{Total\ Utang}{Total\ Ekuitas}$

Political Connection (X3) : Dummy

Earnings Management (Y) : discretionary accruals method according to Sulistyanto (2018)

1. Determining the value of Total Accrual (TAC)

$$\boxed{TAC_{it} = NI_{it} - CFO_{it}}$$

2. Total Accrual estimated by OLS (ordinary l east Square).

$$TCAit/Ait{-}1 = \text{b1 } (1/Ait{-}1) + \text{b2}(REVit/Ait{-}1) + \text{b3}(PPEit/Ait{-}1) + eit$$

3. Calculating Non Discretionary Accruals (NDAC)

$$\text{(NDA)}NDACit = \text{b1}(1/Ait{-}1) + \text{b2}((REVit{-}RECit)/TAit{-}1) + \text{b3}(PPEit/Ait{-}1)$$

4. Discretionary Accrual (DAC)

$$DACit= [TAC/Ait{-}1]{-}NDACit$$

## RESULTS AND DISCUSSION

### Analysis of Descriptive

**Table. Analisysis of Descriptive**

Date: 06/03/23 Time: 03:59
Sample: 2017 2021

| | Y | X1 | X2 | X3 |
|---|---|---|---|---|
| Mean | -0.304750 | 26039.92 | 0.688067 | 0.716667 |
| Median | -0.286500 | 24251.50 | 0.636000 | 1.000000 |
| Maximum | 0.147000 | 30158.00 | 1.653000 | 1.000000 |
| Minimum | -1.339000 | 22303.00 | 0.097000 | 0.000000 |
| Std. Dev. | 0.234212 | 2944.556 | 0.360732 | 0.454420 |
| Skewness | -1.911130 | 0.256686 | 0.656420 | -0.961645 |
| Kurtosis | 9.263357 | 1.285406 | 2.779331 | 1.924761 |
| Jarque-Bera | 134.5983 | 8.008455 | 4.430609 | 12.13796 |
| Probability | 0.000000 | 0.018238 | 0.109120 | 0.002314 |
| Sum | -18.28500 | 1562395. | 41.28400 | 43.00000 |
| Sum Sq. Dev. | 3.236459 | 5.12E+08 | 7.677542 | 12.18333 |
| Observations | 60 | 60 | 60 | 60 |

Source: Eviews 12, Data processed 2023

Descriptive statistical analysis of the research variables will be discussed first before testing the overall relationship between the factors of firm size, leverage, and political connections to earnings management. The following is an explanation of the findings of descriptive statistical analysis of 60 data:

**Earnings Management (Y)**

The results of descriptive statistical analysis show that the minimum value of earnings management is -1.339 and the maximum value of earnings management is 0.147. The highest earnings management value in the company Toba Bara Sejahtera Tbk 2020 period, 147000 while the lowest value is in the company Adaro Energy Tbk. 2019 period.

**Firm Size (X1)**

The results of descriptive statistical analysis show that the minimum value of firm size is 22303 and the maximum value of firm size is 30158. The highest firm size value is in the company Harum Energy Tbk 2021 period, while the lowest value is in the company Elnusa Tbk. 2017 period.

**Leverage (X2)**

The results of descriptive statistical analysis show that the minimum leverage value is 0.097 and the maximum leverage value is 1.653. The highest leverage value in the company Toba Bara Sejahtera Tbk 2020 period, while the lowest value is in the company Harum Energy Tbk. 2020 period.

**Political Connection (X3)**

The results of descriptive statistical analysis show that the minimum value of political connection is 0.000000 and the maximum value is 1.000000. And from a sample of 12 companies, 8 companies are politically connected.

**Table 2. Hypotesis Test**

| Variable | Coefficient | Std. Error | t-Statistic | Prob |
|---|---|---|---|---|
| Costanta | -1.226735 | 0.373852 | -3.281339 | 0.0018 |
| Ukuran Perusahaan (X1) | 3.62E-05 | 1.37E-05 | 2.633338 | 0.0109 |
| Leverage (X2) | 0.078681 | 0.097496 | 0.807014 | 0.4231 |
| Political Connection (x3) | -0.095257 | 0.083736 | -1.137590 | 0.2601 |
| Adjusted R-squaerd | | 0.111583 | | |

Source: Eviews 12, Data processed 2023

**Firm Size (X1)**

The result of the t-statistic value of firm size is 2.633338 > T table of 2.00247 and probability 0.0109 <0.05. So it can be concluded that firm size proxied by the natural logarithm has an effect on earnings management proxied by discretionary accruals.

**Leverage (X2)**

The t-statistic result of leverage is 0.807014 < T table 2.00247 and probability 0.4231> 0.05. So it can be concluded that leverage as proxied by the debt to equity ratio (DER) has no effect on earnings management as proxied by discretionary accruals.

**Political Connecetion (X3)**

The t-statistic result of political connection is 1.137590 < T table 2.00247 and probability 0.2601 > 0.05. So it can be concluded that political connection as proxied by dummy variables has no effect on earnings management as proxied by discretionary accruals.

**Discussion**

**The Effect of Firm Size on Earnings Management**

The conclusion is that firm size has an effect on earnings management. This shows that one of the drivers of earnings management practices is firm size, the greater the firm size, the more the manipulation of financial statements by earnings management increases. Because large companies usually need more funds than small companies. Additional funds can be obtained from issuing new shares or additional debt, the motivation to obtain these funds encourage management to practice earnings management, so that potential investors and creditors are interested in investing their funds by looking at high earnings reports. And the larger the size of the company tends to make the company get pressures to fulfill market desires, so it is encouraged to practice earnings management.

**The Effect of Leverage on Earnings Management**

The conclusion is that leverage has no effect on earnings management. This shows that the high or low leverage of the company has no effect on earnings management. This is because the mining businesses tested in this study do not rely on debt to finance their business assets, so they cannot influence company management decisions regarding how much profit should be announced if the debt level changes. The findings also suggest that, Despite the fact that leverage has a corporate goal of obtaining cash from creditors and investors it can result in a favorable management technique, information about leverage in the company's annual report provides less attractive information for investors and creditors.

**The Effect of Political Connection on Earnings Management**

The conclusion is that political connection has no effect on earnings management. This shows that companies that have political connections have no effect on earnings management. This is due to the insignificant role of the politically connected board of directors and commissioners so that it cannot be a factor in the occurrence of lab management itself.

## CONCLUSION

Based on the test results that have been carried out, it can be concluded that firm size has an effect on earnings management. This shows that firm size is one of the triggers for earnings management practices, the greater the company's size, the more the manipulation of financial statements by earnings management increases. Because large companies usually need more funds than small companies. Leverage has no effect on earnings management. This is because the mining companies studied in this study do not rely on debt to finance their company assets, Therefore, if the amount of debt changes, they cannot influence the company management's decision on how much profit to record. This is due to the insignificant role of the politically connected board of directors and commissioners so that it cannot be a factor in the occurrence of earnings management itself.

## SUGGESTIONS

Based on the conclusions and limitations that have been described, researchers try to put forward suggestions that may be useful as follows: in investing in mining companies, investors or potential investors should properly assess the financial statements of the company whose shares will be purchased and be careful when making decisions when investing in mining companies so that later they get maximum profit.

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