



The Effect of Debt on Earnings Management with Managerial Ownership as a Moderating Variable

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ABSTRACT

Earnings management practices can occur in various sectors, including the healthcare sector. In 2021, Healthcare Services Group, Inc. and its former CFO were sued for management practices. This study aims to examine the effect of debt on earnings management, with managerial ownership as a moderating variable. The population was 34, and the sample was 30 companies listed on the Indonesia Stock Exchange (IDX) for the 2021-2023 period. Ninety observations were obtained using nonprobability sampling and purposive sampling methods. Agency theory and positive accounting theory were used to support and explain this research. Data analysis in this study was conducted using STATA using moderated regression analysis. The results of this analysis indicate that debt has no positive effect on earnings management, and managerial ownership does not significantly strengthen the influence of debt on earnings management.

INTRODUCTION

According to Scott (1997), earnings management is an accounting policy choice designed to influence earnings in order to achieve specific objectives. The issue of earnings management is important to highlight because it influences the misuse of information-based decisions and can have legal implications.

One company experiencing the phenomenon of earnings management practices is a company in the healthcare sector. On August 24, 2021, the Securities and Exchange Commission (SEC), an independent United States agency tasked with regulating stock exchanges and preventing corporate abuse in connection with stock offerings and securities sales, as well as corporate financial reporting, announced enforcement action against Healthcare Services Group, Inc. (HCSG) and its former CFO, John C. Shea, for earnings management practices involving accounting violations and disclosing earnings per share that failed to meet consensus estimates for several quarters. The phenomenon began with a collective lawsuit that resulted in financial impacts in the form of increased debt for HCSG. HCSG failed to accrue loss contingencies, resulting in \$8 million in debt. HCSG also under-accrued legal and accounting fees, accrued liabilities not yet approved by the court, recorded other expenses without documentation, and failed to record salary expenses and incentive compensation for certain managers (Securities, 2021). All of these accounting practices resulted in misstatements of HCSG's net income and earnings per share, as follows:

Table 1. Misstatement of HCSG Earnings Per Share

Period	Earnings Per Share reported	Earnings Per Share should be
Q1 2014	\$0.21	\$0.20
Q2 2014	\$0.20	\$0.19
Q3 2014	-\$0.31	(not stated in the decision)
Q2 2015	\$0.23	\$0.17
Q3 2015	\$0.24	\$0.18
Q4 2015	\$0.13	(missed the consensus estimate of \$0.26)

The practice of earnings management based on this phenomenon is explained using agency theory as the primary theory and positive accounting theory as a supporting theory. According to Chairunnisa (2022), managers are motivated to engage in earnings management to avoid potential technical defaults on debt agreements. A debt contract is declared breached if the principal (creditor)'s requirements are not met by the agent (company), including financial ratios (Capital, 2025), such as the debt-to-equity ratio. If debt increases and profits are low, the debt-to-equity ratio has the potential to fail to meet the terms of the debt agreement.

LITERATURE REVIEW

Agency Theory

Agency theory was first introduced by Alchian and Demsetz in 1972 and later expanded by Jensen and Meckling in 1976. Agency theory is a theory that explains the contractual relationship between the principal and the agent regarding the delegation of decision-making authority to the agent from the principal (Jensen & Meckling, 1976). This theory is widely used to explain various issues in the field of accounting (Sutisna et al., 2024), including issues of good corporate governance and earnings management (Arwani, 2024).

Agency theory underlies earnings management due to increased debt ratios resulting from conflicts of interest between principals and agents. Agency theory, which divides the roles of agents and principals, means that agents have prior knowledge of company information and process it to achieve specific goals before presenting it to the principal.

In terms of moderating ability, agency theory is used because the development of good corporate governance is based on agency theory which is based on a contractual relationship between the principal as the trustee to the agent as the party receiving the mandate to run the company. This theory is relevant to use in this study because the earnings management phenomenon used as a reference, namely at Healthcare Services Group, Inc., was carried out based on financial information processing decisions made by its former CFO, John C. Shea, as part of the executive management team.

Positive Accounting Theory

Positive accounting theory emerged from dissatisfaction with normative theory. In 1978, Watts and Zimmerman provided an alternative to accounting research, namely positive accounting theory, through the publication of their article "Toward a Positive Accounting Theory of Accounting Standards" in *The Accounting Review* (Magdalena, 2018). Friedman was the first to popularize the term "positive theory" in 1953, and it was later adopted by Watts and Zimmerman due to its widespread use in economics. According to Watts & Zimmerman (1990), there are three hypotheses that can be used as a reference in explaining and predicting the symptoms or events of earnings management in accounting, namely: (1) the bonus plan hypothesis, (2) the debt agreement hypothesis, and (3) the political cost hypothesis.

This positive accounting theory is relevant to the research conducted because one of its three hypotheses, namely the debt covenant hypothesis, underlies the research problem that occurred in the phenomenon of earnings management of Healthcare Services Group, Inc. due to a significant increase in debt.

Earnings Management

Earnings management is a condition where management intervenes in the process of preparing financial reports for external parties so that it can level, increase, and decrease profits (Farhadvand, 2017).

Debt

Debt is an obligation that must be paid by a company to creditors in the future (Jusup, 2017).

Managerial Ownership

Share ownership by company management (Hatane, 2019). The effect of debt on earnings management has been previously studied and has yielded varying results. Research by Brilian & Wulandari (2022), Dharma & Wirama (2020), and Sari & Khafid (2020) found that debt has a negative relationship with earnings management, while Maharani & Prastiwi (2023), Bailaen & Nugroho (2023), Dewi & Nurhayati (2022), Lim & Hendriyeni (2021), and Widayanti (2019) found that debt has a positive relationship with earnings management. Other research by Wijayanti (2024), Wardana et al. (2024), Atmamiki & Priantinah (2023), Kristi & Sofia (2023), Aulia et al. (2022), Puspaningrum & Indriyani (2022), and Chairunnisa (2022) found that debt has no effect on earnings management.

However, due to inconsistencies in previous research, this study uses managerial ownership as a moderating variable. Companies with managerial ownership can alter the effect of debt on earnings management. This is because management has two roles: management and shareholder. Gerged et al. (2023) state that managerial ownership can lead to increased earnings manipulation. These managerial actions are explained by agency theory. Based on agency theory, managers, as agents, possess more information than principals. High managerial ownership will weaken the principal's oversight of management.

The ability of managerial ownership to moderate the effect of debt on earnings management has been previously studied with mixed results. Studies conducted by Rely (2022) and Sari & Khafid (2020) found that managerial ownership moderated the effect of debt on earnings management in a positive direction, while research by Rahmah & Soekotjo (2017) found that managerial ownership had a negative effect in moderating the effect of debt on earnings management. On the other hand, most other studies, such as those by Wijayanti (2024), Wardana et al. (2024), Atmamiki & Priantinah (2023), Kristi & Sofia (2023), Aulia et al. (2022), Puspaningrum & Indriyani (2022), and Dewi & Nurhayati (2022), failed to moderate the effect of debt on earnings management.

Based on agency theory and positive accounting theory, phenomena, and previous research, the researcher wants to prove that debt has a positive effect on earnings management and managerial ownership strengthens the effect of debt on earnings management with the following hypothesis:

H1: Debt has a positive effect on earnings management.

H2: Managerial ownership strengthens the influence of debt on earnings management.

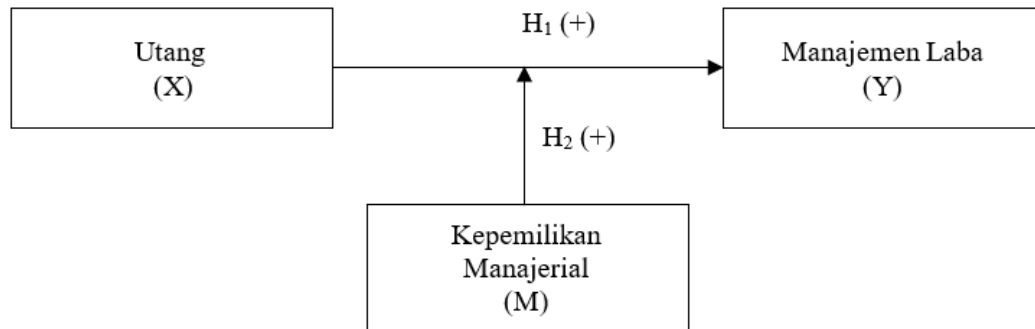


Figure 1. Conceptual Framework

METHODOLOGY

The Secondary data used in this study came from each company’s official website and the financial reports of healthcare companies posted on the Indonesia stock exchange website. The three-year trial period ran from from 2021 to 2023. There were 34 firms in the research population. Purposive sampling, on the other hand, was the method employed. Sampling that is not probability based thirty businesses were sampled using purposive sampling. Ninety observations were obtained by multiplying this figure by three-year observation period (2021-2023)

Earnings management is the study’s dependent variable. Accrual earnings management is used as a stand in for earnings management. Optional accruals. The calculation model starts by computing the total accrual in the manner shown below:

$$TAC_{it} = NI_{it} - CFO_{it} \dots\dots\dots(1)$$

Proceed by estimating the total accrual value using the regression equation in the manner described below :

$$\frac{TAC_{it}}{TA_{it-1}} = \alpha_1 \left(\frac{1}{TA_{it-1}} \right) + \alpha_2 \left(\frac{\Delta Rev_{it}}{TA_{it-1}} \right) + \alpha_3 \left(\frac{PPE_{it}}{TA_{it-1}} \right) + \varepsilon_{it} \dots\dots\dots(2)$$

The coefficient values obtained after conducting the regression are entered into the equation below to calculate the value. *non-discretionary accruals*.

$$NDA_{it} = \alpha_1 \left(\frac{1}{TA_{it-1}} \right) + \alpha_2 \left(\frac{\Delta Rev_{it} - \Delta Rec_{it}}{TA_{it-1}} \right) + \alpha_3 \left(\frac{PPE_{it}}{TA_{it-1}} \right) + \varepsilon_{it} \dots\dots(3)$$

The following formula is used to determine the value of discretionary accruals (DAC) once trhe values of non-discretionary accruals has been determined :

$$DAC_{it} = \frac{TAC_{it}}{TA_{it-1}} - NDA_{it} \dots\dots\dots(4)$$

Information:

- TAC_{it} = Total accruals company i in period t
- NDA_{it} = Non-discretionary accruals company i period t
- DAC_{it} = Discretionary accruals company i in period t
- NI_{it} = Net income company i in period t
- CFO_{it} = Cash flow operations company i in period t

- TA_{it-1} = Total assets company i in period t
- ΔRev_{it} = Change in sales of company i in period t
- ΔRec_{it} = Change in receivables of company i in period t
- PPE_{it} = Fixed assets of company i in period t
- $\alpha_1, \alpha_2, \alpha_3$ = Parameter values of the regression equation
- ε_{it} = Error term company i in period t

The independent variable in this study is debt. Debt is measured using the debt-to-equity ratio (DER) proxy, using the following formula:

$$DER = \frac{\text{Total Debt}}{\text{Total Equity}} \dots\dots\dots(5)$$

Information:

- DER= Debt to equity ratio
- Total Debt = Total debt
- Total Equity = Total equity

In this study, management ownership serves as the moderating variable. The following formula is used to determine the value of management ownership:

$$KM = \frac{\text{jumlah saham yang dimiliki pihak manajemen}}{\text{seluruh modal saham perusahaan yang beredar}} \dots\dots\dots(6)$$

Information:

- KM= Managerial ownership

Descriptive statistical test were the first step in this study's data analysis methodology. In order to choose amongst the Common Effect Model (CEM). Fixed Effect Model (FEM). And Random Effect Model (REM), the next step was to estimate a panel data regression model. The Lagrange Multiplier Test, the Hausman Test, and the Chow Test are example of model selection tests. The most effective model turned out to be the CEM model. The traditional assumption tests that are employed are impacted by this model selection. Based on the chosen model, the multicollinearity and heteroscedasticity test are the traditional assumption tests chosen for this investigation

The heteroscedasticity test was the only traditional assumption test required because the regression analysis in this work used moderated regression analysis. Which adds multicollinearity. Moderated regression analysis was the next step in the data analysis process after the traditional assumption test. The following is the regression equation:

$$Y = \alpha + \beta_1 X + \beta_2 M + \beta_3 XM + \varepsilon \dots\dots\dots(7)$$

Information:

- α = Constant
- $\beta_1, \beta_2, \beta_3$ = Regression coefficient
- Y = Earnings management
- X = Debt to equity ratio
- M = Managerial ownership
- XM = Interaction between debt-to-equity ratio with ownership managerial
- ε = Error term

RESEARCH RESULT

To describe the research data as seen from the minimum, maximum, standard deviation, and average values of the variables chosen for this study, descriptive statistical tests were performed.

Table 2. Descriptive Statistics

Variables	Number of Observations	Mark Average	Standard Deviation Value	Minimum Value	Maximum Value
Earnings Management	90	0.878	7,469	-0.248	70,657
Debt to Equity Ratio	90	0.537	1,959	-5,351	16,765
Managerial Ownership	90	0.330	1,118	0,000	5,466

The average value of earnings management is 0,878, with a minimum value of -0,247 and maximum values of 70.656. with an earnings management standard deviation of 7.469, the data distribution is heterogeneous since the standard deviation is higher than the average value.

The debt-to-equity ratio averages 0,537 and ranges from a minimum of -5.361 to a maximum of 16.765. with an earnings management standard deviation of 1.958, the data distribution is heterogeneous since the standard deviation is higher than the average value.

The average value of managerial ownership is 0,330, with a minimum value of 0 and a high value of 5.465. with an earnings management standard deviation of 1.117, the data distribution is heterogeneous since the standard deviation is higher than the average value.

The purpose of the heteroscedasticity test is to ascertain whether the variance of residuals varies unequally between observations. The picture below displays the the results of heterocedasticity test, demonstrating that this regression model is devoid of heterocedasticity symptoms because the computed C2 value is less than the table C2 value.:

Source	SS	df	MS	Number of obs	=	90
Model	1220.43175	3	406.810584	F(3, 86)	=	9.34
Residual	3744.6507	86	43.5424501	Prob > F	=	0.0000
				R-squared	=	0.2458
				Adj R-squared	=	0.2195
Total	4965.08246	89	55.7874433	Root MSE	=	6.5987

Figure 2. Heteroscedasticity Test Results

The effect of debt on earnings management was then examined using moderated regression analysis (MRA). with managerial ownership serving as a moderating variable. The following are the MRA result.:

Source	SS	df	MS	Number of obs	=	90
Model	1220.43175	3	406.810584	F(3, 86)	=	9.34
Residual	3744.6507	86	43.5424501	Prob > F	=	0.0000
				R-squared	=	0.2458
				Adj R-squared	=	0.2195
Total	4965.08246	89	55.7874433	Root MSE	=	6.5987

Y	Coefficient	Std. err.	t	P> t	[95% conf. interval]
LN_X	-.0711573	.3507318	-0.20	0.840	-.768389 .6260744
LN_M	10.19614	1.965853	5.19	0.000	6.288155 14.10413
XM	1.847901	.8816818	2.10	0.039	.0951756 3.600627
_cons	-.4018448	1.031004	-0.39	0.698	-2.451412 1.647722

Figure 3. Moderated Regression Analysis

The following regression equation model was created using the moderated regression analysis findings:

$$Y = -0,401 - 0,0711X + 10,196M + 1,847XM$$

It is well known that the constant value of -0,401 means that earnings management will drop by 0,401 units if the debt variable (x). managerial ownership (M), and the interaction variable between the debt-to-equity ratio and managerial ownership (XM) are all constant.

The debt-to-equity ratio (X) regression coefficient value is -0,0711, and its probability value is higher than 0,05. This suggest that, if all other factors stay the same, earnings management will not change significantly if debt rises by one unit.

Managerial ownership (M) has a regression coefficient value of 10.196 and a probability value of less than 0,05. This means that, assuming all other factors remain same, earnings management will rise by 10.196 units for every unit increase in the managerial ownership ratio.

With a probability value of less than 0,05, the moderation regression coefficient between managerial ownership (XM) and the debt-to-equity ratio is 1.847. This means that, assuming all other factors stay the same, earnings management will rise by 1.847 units if the debt-to-equity ratio rises by one unit with managerial ownership.

The findings of the MRA test can also be used to determine the result of the hypothesis test, model feasibility test, and coefficient of determination test.

With an adjusted R² of 21.95%.the degree to which managerial ownership (M), the debt-to-equity ratio (X), and the combination of the two factors affect earnings management is 21.95%, with 78.25% being influenced by factors not included in the study.

Because the significance value is less than 0,05 and the prob > f value is 0,0000, this regrsion model is also appropriate for use.

The effect of debt on earnings management was tested,and the results showed that managerial ownership mitigates this effect.

- 1) The effect of debt on earnings management

H0: Debt has no effect on earnings management

H1: Debt has an effect on earnings management

The MRA test results show that the coefficient value for the analysis of the effect of debt on earnings management is -0.07, with a negative t-value of -0.20

and a significance value greater than 0.05, namely 0.84. Therefore, it is concluded that debt has no effect on earnings management.

2) Managerial ownership moderates the effect of debt on earnings management

H0: Managerial ownership is unable to moderate the effect of debt on earnings management.

H2: Managerial ownership is able to moderate the effect of debt on earnings management.

The MRA test results show a coefficient value of 1.87 for the analysis of the influence of debt on earnings management, with a positive t-value of 2.10 and a significance level of 0.03, less than 0.05. Therefore, it is concluded that managerial ownership moderates the influence of debt on earnings management.

DISCUSSION

The first hypothesis test's findings indicated that debt had little bearing on earnings management. This result is consistent with research by Fadhillah & Kartika (2022). Which discovered that debt had a negligible but detrimental impact on earnings management

The study's findings, as interpreted by agency theory, show how stringent oversight by the principal (creditor) over the agent (business) leads in wise management that serves the lender's interest (Asyati & Farida, 2020). Therefore, debt does not necessarily result in earnings management, even though it does increase. This violates the debt covenant theory in positive accounting theory.

The second hypothesis test result shows that the detrimental impact of debt on earnings management is mitigated by managerial ownership. This result is consistent with study by the managerial ownership. This result is consistent with study by Sari & Khafid (2020), who discovered that managerial ownership can mitigate the adverse correlation between earnings management and debt.

Agency theory explains the study's findings, which show a conflict of interest between the principal (creditor), who wants financial reports that reflect the company's actual state, and the agent (company), which wants to avoid breaking the debt ratio requirements when debt rises because it may result in a negative assessment of creditors. Which will affect the company's stock price, management positions, and future financing opportunities. In keeping with the debt agreement concept. Positive accounting theory also supports these findings

CONCLUSION AND RECOMMENDATIONS

The study's conclusion is that debt has no beneficial effect on earnings management, as measured by the debt-to-equity ratio. The impact of debt on earnings management is not amplified by managerial ownership. It is possible that stringent creditor oversight keeps management from using earnings management techniques, which is why debt has little bearing on earnings management. Because managerial ownership implies that managers also have a role as shareholders, they will implement management practices to prevent stock prices from being impacted by negative creditor assessment if the company does not meet the financial ratios specified in the debt agreement. This is why managerial ownership does not

strengthen the positive influence of debt on earnings management and can actually weaken the negative influence of debt on earnings management.

ADVANCED RESEARCH

There is only one independent variable and one moderating variable in the study. According to the adjusted R² test. These two factors can account for 21.95% of the dependent variable, with 78,25% being impacted by variables not included in this study. Additionally, the scope of this study is restricted to the 2021-2023 observation period and the observed industry, which is healthcare industry listed on the Indonesia Stock Exchange. As a result. The findings cannot be applied to every industry. It is therefore hoped that additional research will be able to look at other industries.

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