

The Effect Of Profitability, Company Value, And Financial Distress On Earnings Management

**Case Study on Property and Real Estate Sector Companies
Listed on the Indonesia Stock Exchange 2018-2022**

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159

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ABSTRACT

The aim of this study is to examine the effect of the independent variables that consist of profitability was proxied by Return on Asset Ratio, firm value was proxied by Price to Book Value, and Financial Distress was proxied by Altman Z"-Score toward dependent variable, Earning Managements, was proxied by Discretionary Accruals of Modified Jones Model. The sample from this research are real estate and property companies that listed in Bursa Efek Indonesia from 2018 – 2022. The companies chosen to be sampled in this research were chosen using purposive sampling method. The data and model testing include classic assumption (normality test, multicollinearity test, and heteroscedasticity test), statistic descriptive analysis, and hypothetical test (T-test and coefficient determination test). The classic assumption states the data are able to be used in the research. The T-test show partially profitability has negative effect and does not have significant effect on earning managements, firm value has significant and positive effect on earning managements, and financial distress show positive and does not have significant effect on earning managements. Meanwhile, the coefficient determination test shows that profitability, firm value, and financial distress have 52,7% effect in earning managements.

Keywords: Profitability, Firm Value, Financial Distress, Earning Managements

INTRODUCTION

Business development today is increasing rapidly. Companies compete to expand their business in order to meet market demand. One of the efforts to expand the business is through funding aimed at increasing the company's income (Dewi, 2017). Funding is carried out to finance all forms of company operational activities. to business expansion. Not only companies, other parties involved in funding activities are investors. Based on data in the press release published by KSEI on November 21, 2022, as many as 10,100,628 capital market investors were identified based on *Single Investor Identification (SID)* with a dominance of investors under the age of 30 at 59% . Meanwhile, in 2022, the number of stock investors continued to increase to 4,323,643 investors.

Interestingly, this increase in investors occurred during the pandemic in 2020-2021 and the recovery period in 2022. However, the increase in the number of investors is not directly proportional to the level of financial literacy and inclusion. Based on the results of a survey of the level of financial literacy in the capital market sector in 2022, there was a decrease of 0.8% compared to 2019 which was at 4.92%. Meanwhile, the level of financial inclusion in the capital market sector was only at 5.19% in 2022. The assessment of the financial literacy index is measured using the elements of *knowledge , skills , confidence , attitude, and behavior* (OJK, 2022). Meanwhile, the financial inclusion index measures the level of availability of accessibility for the community in utilizing financial services and/or formal products. The following is a picture of the condition of financial literacy and inclusion in Indonesia in the period 2019-2022:

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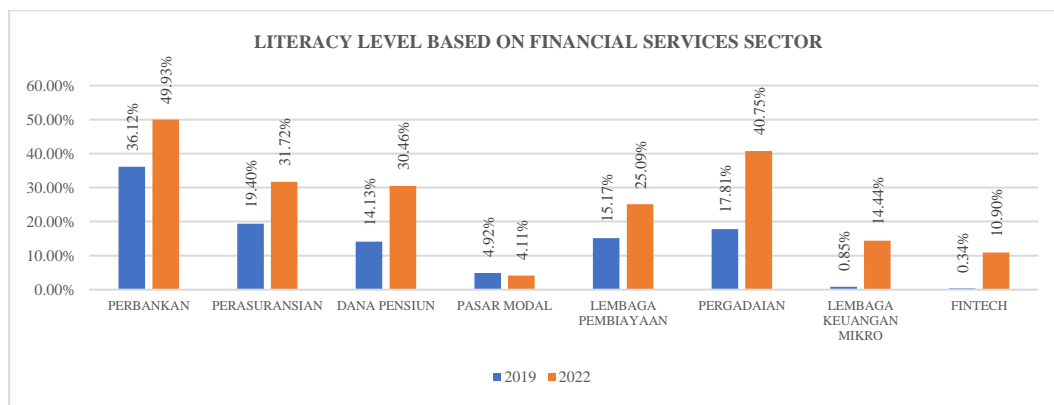


Figure 1 Literacy Level Based on Financial Services Sector
Source:(OJK, 2022)

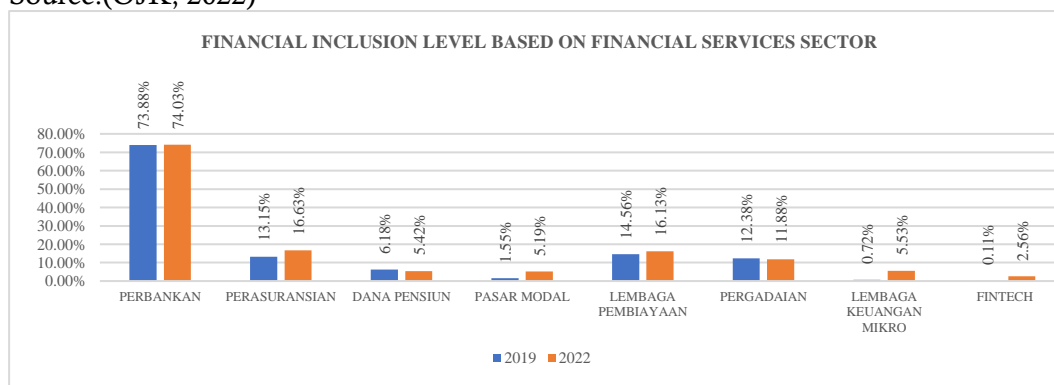


Figure 2 Level Based on Financial Services Sector
Source:OJK Tahun 2022

For companies that want to get funding, the company will carry out an IPO process on the stock exchange in accordance with the guidelines made by the regulator. Registered issuers must report real financial conditions in accordance with the conditions that occur without manipulating because financial reports are created with the intention of providing timely and reliable financial information (Damayanti & Kawedar, 2018). However, when preparing financial reports, there are management practices to change financial information known as earnings management. According to Healy and Wahlen (1999) in Chairunesia et al., (2018) Earnings management occurs when managers use *judgment* in financial reporting with the aim of misleading *stakeholders*. This is also closely related to the asymmetric information relationship that occurs between management and business owners due to limitations in disclosing information owned by agents alone.

Various earnings management actions occur in Indonesia. An example is the activity of PT Hanson International Tbk (MYRX) in 2016 which manipulated financial reports. In addition, there are other phenomena that occur in the property and *real estate sector*. One of them is the sluggish market conditions in this sector that have occurred in various parts of the world including Indonesia (Caesario, 2023). Recently, a Chinese property company, Evergrande, filed for bankruptcy in the United States on Thursday, August 17, 2023. (Nugroho, 2023) In Indonesia, the increasing increase in Bank Indonesia's benchmark interest rate has made property and *real estate sector* stocks increasingly lose their appeal.

This condition makes it increasingly difficult for companies to record profitability in their financial performance. Poor profitability conditions are one of the driving factors for deviations in financial reports and also the cause of earnings management practices (Farenska, 2022). On the other hand, investors will invest in business sectors with good investment prospects so that they can provide the highest *returns*. If a company has been *listed* on the stock exchange, the company's value will be seen in the company's stock price which is formed through *the supply and demand mechanism* that occurs in the capital market

(Suardana *et al.*, 2020). However, companies that have high company values tend to manage profits in order to attract many investors (Fitrianasari, 2019). In addition, the bad conditions experienced by a company can also threaten the sustainability of its business. One form of this bad condition is the condition of a company that is increasingly experiencing financial difficulties or has contract problems with creditors. This condition is known as *financial distress*. (Mithakhunnimah *et al.*, 2020) said that *financial distress* is one of the characteristics of a company carrying out earnings management.

There are several problems identified so that they can be concluded in the form of several questions that are asked as problem formulations in this study. Among others:

1. Does profitability have an effect on profit management in property and *real estate sector companies* ? listed on the Indonesia Stock Exchange in 2018-2022?
2. Does company value influence profit management in property and *real estate sector companies* ? listed on the Indonesia Stock Exchange in 2018-2022?
3. Does *financial distress* affect profit management in property and *real estate sector companies* ? listed on the Indonesia Stock Exchange in 2018-2022?

After explaining the problem formulation, the researcher also submitted a temporary answer in the form of a hypothesis to answer the problem formulation submitted, namely:
H1: Profitability Has a Positive Influence on Earnings Management in Property and *Real Estate Sector Companies* Listed on the Indonesia Stock Exchange in 2018-2022.

H2: Company Value Has a Positive Influence on Earnings Management in Property and *Real Estate Sector Companies* Listed on the Indonesia Stock Exchange in 2018-2022.

H3: *Financial Distress* Has a Positive Influence on Earnings Management in Property and *Real Estate Sector Companies* Listed on the Indonesia Stock Exchange in 2018-2022.

Through this research, the researcher hopes that the results of this research can answer the formulation of the problem and prove the hypothesis proposed and provide positive things to all elements involved in the business such as *stakeholders* and *shareholders* in managing the business so as to provide a sustainable good impact.

METHODS

This research is a quantitative research. This method is said to be quantitative because it uses data in numerical form and is analyzed using statistical analysis. Research This use profitability, mark company, *financial distress*, And management profit as object study. Then, The research subjects chosen were companies in the property and *real estate sector*. Which registered on the IDX. The implementation of this research was carried out in the period from August 2023 to August 2024.

In this study, the main theory used is agency theory. Scott, (2015) states that agency theory is a theory that studies the form of contract to motivate agents to act in accordance with the interests of the principal even though their interests will be contrary to the interests of the principal. The relevance of agency theory to this study is that the position of the agent who manages economic resources will have broader knowledge compared to the principal so that it will create asymmetric information. According to Fitrianasari, (2019) the knowledge in question is information about the work environment, self-capacity, and the state of the company in a complex manner. For that, agents who have more information than the principal will choose themselves into an agency relationship and will take the best action that benefits themselves.

Researchers selected samples using *purposive sampling* techniques . Sampling was obtained through population data of 31 companies. *The sampling* technique chosen is a non - probability type because not all companies can be samples in the study (Umar, 2022). The samples obtained amounted to 14 companies. Sample selection was based on the following criteria:

- A. Companies in the property and *real estate sector* registered in the period 2018-2022.
- B. Property and *real estate sector companies* that publish complete financial reports for the 2018-2022 period.

- C. Companies in the property and *real estate sector* that publish complete financial reports in Rupiah currency for the 2018-2022 period.
- D. Property and *real estate sector companies* included in the special monitoring board.

To facilitate understanding of the variables to be selected, an operationalization or description is needed. In this study, there are 2 main groups of variables, namely independent variables consisting of profitability variables proxied by the *Return on Asset ratio*, company value proxied by the *Price to Book Value ratio*, and *financial distress* proxied by the Altman Z"-Score model. Meanwhile, the dependent variable used in this study is earnings management proxied by discretionary accruals obtained using the 1 *Modified of Jones model*. The following is a table of operationalization of the variables used in this study:

Table 1 Operationalization of Variables

Variables	Variable Definition	Indicator
Earnings Management (Y1)	Scott (2015) argues that earnings management is a choice taken by management regarding accounting policies and real actions with the aim of influencing profits with the aim of achieving specific desired goals.	Determine total accruals (TAC) with the formula: $TAC = (Niit - CFOit)$, estimate with OLS: $\frac{TAit}{Ait-1} = (\beta1 \left(\frac{1}{Ait-1}\right) + \beta2 \left(\frac{\Delta REVit}{Ait-1}\right) + \beta3 \left(\frac{PPEit}{Ait-1}\right) + \epsilon)$ then determine <i>Nondiscretionary Accruals</i> with the formula: $NDAit = (\beta1 \left(\frac{1}{Ait-1}\right) + \beta2 \left(\frac{\Delta REVit}{Ait-1} - \frac{\Delta RECit}{Ait-1}\right) + \beta3 \left(\frac{PPEit}{Ait-1}\right))$ and calculate with the formula $DAit = \left(\frac{TAit}{Ait-1} - NDAit\right)$
Profitability (X1)	Profitability is the ability of a company to generate profits (Prihadi, 2019).	$ROA = \frac{\text{Laba Bersih}}{\text{Total Aset}}$
Company Value (X2)	Company value is an investor's perspective on a company which is linked to the share price (Saputri 2017 in Fitrianasari 2019).	$PBV = \frac{\text{Price per share}}{\text{Book value per share}}$
<i>Financial Distress</i> (X3)	Altman (1986) in Chairunesia et al., (2018) defines <i>financial distress</i> as a condition of declining company finances before bankruptcy occurs.	Z"-Score model with the equation: $Z''=6.56 (X1) + 3.26 (X2) + 6.72 (X3) + 1.05 (X4)$

Source: *Researcher's processed results*

In quantitative research, researchers will use classical assumption testing. The purpose of data testing with the classical assumption method is to assess the feasibility of using a regression model in a research. The classical assumption tests used include normality, multicollinearity, and heteroscedasticity tests. This is done with the aim of ensuring that a good equation must be in accordance with the *Best Linear Unbiased Estimator rule* (Yudiatmaja, 2013).

To analyze the data that has been obtained, the researcher chose two approaches. First, the researcher chose a descriptive statistical analysis method. Descriptive statistical analysis is a descriptive method used to display information in the form of analysis of the data obtained and is a description of the variables used in the study (Fitrianasari, 2019). Second, the researcher chose multiple linear regression analysis. According to Indriantoro (2014) in Cahya (2022), multiple linear regression analysis is known as an analysis tool that is carried out to test the influence of 2 (or more) independent variables (X) on the dependent variable (Y).

Meanwhile, for hypothesis testing, researchers use 2 testing models. First, researchers choose partial significance testing (T-Test) to determine the significance of the partial (individual) influence of independent variables on dependent variables. Second, researchers choose determination coefficient testing to estimate how much the regression model is able to explain the variation of independent variables.(Fitrianasari, 2019).

RESULTS AND DISCUSSION

Descriptive statistics are useful for viewing the description of the characteristics of the information being studied (Ghozali, 2018). The characteristics that can be seen from the data after data testing consist of maximum value, minimum value, average value, and standard deviation.

Table 2 Descriptive Statistical Analysis Results

Variable	Total Data	Minimum	Maximum	Mean	Standard Deviation
Profitability	70	.00	7402.00	6495.4429	922.32527
Company Value	70	.00	95910.00	90491.3000	16874.19589
<i>Financial Distress</i>	70	.00	44126.00	37936.5571	9527.68399
<i>Discretionary Accrual</i>	70	.00	25438.00	18344.5143	3747.39443

Source: *Results of data processing using SPSS 29.0*

Referring to the results of the tests that have been carried out, they can be summarized as follows:

1. The Earnings Management variable has a maximum value of 25438 with a minimum value of 0. While the average value is at 18344.5143 with a standard deviation value of 3747.39443.
2. The Profitability variable has a maximum value of 7402 with a minimum value of 0. While the average value is at 6459.4429 with a standard deviation value of 922.32527.
3. The Company Value variable has a maximum value of 95910 with a minimum value of 0. While the average value is at 90491.3000 with a standard deviation value of 16874.19589.
4. *Financial Distress* variable has a maximum value of 44126 with a minimum value of 0. Meanwhile, the average value is at 37936.5571 with a standard deviation value of 9527.68399.

Classical Assumption Test

The first classical assumption test conducted was the normality test. When conducting the normality test, the researcher obtained results that the data used were not normally distributed. The researcher then transformed the data into square root form (SQRT (KX)). After conducting the data transformation, the researcher conducted a *one-sample kolmogorov smirnov test* again with the results showing that the data was normally distributed. This statement is proven by the value of Asymp. Sig. (2-tailed) 0.200 which is greater than the value of 0.05.

Table 3 Normality Test Results

One Sample Kolmogorov Smirnov Normality Test	
Total Sample	70
<i>Test Statistics</i>	.091
<i>Asym. Sig. (2-Tailed)^c</i>	.200d

Source: *Results of data processing using SPSS 29.0*

The second test conducted is multicollinearity. The results of this test are obtained with the assumption of a *tolerance value* of less than 0.10 and a *VIF value* that does not exceed 10.0. Referring to the results below, none of the *tolerance values* of the three variables have a *tolerance value* of less than 0.10 and a *VIF value* that does not exceed 10.0 so that it can be concluded that there are no symptoms of multicollinearity in the three variables.

Table 4 Multicollinearity Test Results

Variables		Collinearity Statistics	
		Tolerance	VIF
Independent Variable	Profitability	.941	1,063
	Company Values	.994	1,006
	<i>Financial Distress</i>	.942	1,062

Source: *Results of data processing using SPSS 29.0*

The third test conducted is the heteroscedasticity test. A feasible regression model is a regression that is homoscedastic or the residual value from one observation to another is constant. The following is a table of heteroscedasticity test results:

Table 5 Heteroscedasticity Test Results

Variables	Significance
Profitability	.947
Company Values	.111
Financial Distress	.676

Source: Results of data processing using SPSS 29.0

Based on the results of the tests that have been carried out, it can be concluded that there are no symptoms of multicollinearity because the significance values of the three variables are above the significance value used as a reference in this study of 0.05.

Multiple linear regression analysis Result

Multiple linear regression analysis is conducted to determine the magnitude of the strength of the relationship between 2 or more variables and to show the direction of the relationship between the independent variable and the dependent variable. The following are the results of the multiple linear regression tests that have been conducted:

Table 6 Multiple Linear Regression Analysis Test Results

Variables	Unstandardized Coefficients (B)
Profitability	-0.427
Company Values	0.162
Financial Distress	0.033
Constants	5211.180

Source: Results of data processing using SPSS 29.0

Referring to the test results, the valid regression equation obtained is:

$$Y = 5211.180 - 0.427 (X1) + 0.162(X2) + 0.033(X3) + e$$

The interpretation contained in this equation is:

1. The constant value in this model is 5211.180. It can be interpreted that if all independent variables are considered constant (0), then earnings management will increase by 5211.180.
2. The regression coefficient value of Profitability (X1) is -0.427. It can be interpreted that if profitability increases by one unit, then profit management will also decrease by the coefficient assuming all other variables have a constant value (0).
3. The regression coefficient value of Company Value (X2) is 0.162. It can be interpreted that if the company value increases by one unit, then profit management will also increase by the coefficient assuming all other variables have a constant value (0).
4. The regression coefficient value of Financial Distress (X3) is 0.033. It can be interpreted that if financial distress increases by one unit, then earnings management will also increase by the coefficient assuming all other variables have a constant value (0).

Hypothesis Testing

The first hypothesis test conducted was a partial significance test (T-Test) with the aim of interpreting the independent variable coefficient (Ghozali, 2018). The following are the results of the partial tests that have been conducted:

Table 7 Partial Significance Test Results (T-Test)

Variables	Significance	t-count
Profitability	.223	-1.231
Company Values	<.000	8,769
Financial Distress	.323	.997

Source: Results of data processing using SPSS 29.0

The interpretation of this assumption is:

1. The significance value of X1 (Profitability) of 0.223 is greater than 0.05, so X1 does not have a significant effect on Y. Meanwhile, the assumption of t-count of 1.231 is smaller than t-table of 1.666914 with the regression coefficient showing a negative direction. These results determine the hypothesis obtained, namely:

- H1: Profitability Does Not Have a Positive Influence on Earnings Management in Property and *Real Estate Sector Companies* Listed on the Indonesia Stock Exchange in 2018-2022 is declared **accepted**.
2. The significance value of X2 (Company Value) of <0.000 is smaller than 0.05, so X2 has a significant effect on Y. Meanwhile, the assumption of t-count of 8.769 is greater than t-table of 1.666914 with the regression coefficient showing a positive direction. These results determine the hypothesis obtained, namely:
H2: Company Value Has a Positive Influence on Profit Management in Property and *Real Estate Sector Companies* Listed on the Indonesia Stock Exchange in 2018-2022 is declared **accepted**.
3. The significance value of X3 (*Financial Distress*) of 0.323 is greater than 0.05, so X3 does not have a significant effect on Y. Meanwhile, the assumption of t-count of 0.997 is smaller than t-table of 1.666914 with the regression coefficient showing a positive direction. These results determine the hypothesis obtained, namely:
Ha3: *Financial Distress* Does Not Have a Positive Influence on Earnings Management in Property and *Real Estate Sector Companies* Listed on the Indonesia Stock Exchange in 2018-2022 is declared **accepted**.

The second hypothesis test conducted is the coefficient of determination test. The following are the results of the coefficient of determination test that has been conducted:
Table Results of Determination Coefficient Test

Description	Determination Coefficient Value
<i>R Square</i>	.548
<i>Adjusted R Square</i>	.527

Source: Results of data processing using SPSS 29.0

Based on the results of the tests that have been carried out, the *Adjusted Square value* obtained is 0.527. It can be concluded that profitability, company value, and *Financial Distress* have an effect of 52.7% in describing profit management. While the remaining value of the determination coefficient of 47.3% is the amount of influence on the independent variables that are not selected as independent variables in the study.

The Influence of Profitability on Earnings Management

The results of the partial significance test of the company value variable are known to have a significant influence and have a positive direction (positive coefficient) on earnings management. This result is indicated by a significance value of <0.000 which is smaller when compared to a significance value of 0.05 and the t-count value of the profitability variable of 8.769 is greater when compared to the t-table value of 1.666914. In general, Earnings management can occur because there is motivation from the agent to gain profit (*bonus plan*). However, in sluggish economic conditions such as during the spread of Covid-19 have resulted in the majority of companies listed in the property and *real estate sector* experiencing losses. If an entity carries out earnings management with the intention of increasing profitability figures, it will look suspicious so it is better to show the actual financial condition. If, too often or too much earnings management is carried out, this can reduce the quality of information in the financial statements (Scott, 2015).

Besides that, in the condition of a company experiencing losses, it is better for the company to show its actual condition and not to carry out profit management so that profitability looks good because there is a correlation between profitability conditions and fiscal obligations. If in actual conditions the company experiences losses and tries to restore its financial condition to a positive position, then the company will still be burdened with tax costs. If management forces positive profit conditions too much, this can reflect actions that are too opportunistic (Scott, 2015). In addition, the Company also wants profitability conditions to grow rather than making profitability conditions high in one period and low in the next period. This result is also in accordance with the research conducted by Damayanti & Kawedar (2018) which states that earnings management is not influenced by the profitability of the entity. The company's profit conditions in positive or negative conditions do not affect agents to take opportunistic actions. This

condition occurs because the company's profitability has become the focus of attention of all *stakeholders* in the company's environment so that there is only a little gap available to take opportunistic actions like this. Another reason management does not carry out earnings management according to Jansen and Mackeling (1976) in Damayanti & Kawedar, (2018) is something that the principal does to the agent to minimize deviant actions by providing appropriate and sufficient incentives for the agent and also paying certain fees for monitoring activities on the operations carried out by the agent.

The Influence of Company Value on Earnings Management

The results of the partial significance test of the company value variable are known to have a significant influence and have a positive direction (positive coefficient) on earnings management. This result is indicated by a significance value of <0.000 which is smaller when compared to a significance value of 0.05 and the t-count value of the profitability variable of 8.769 is greater when compared to the t-table value of 1.666914. Company value is an external perspective on the company that is reflected through stock prices. Through the information stored in the financial statements, external parties, especially investors, the information in the financial statements has been trusted as a useful element for conducting fundamental analysis in investment activities so that all forms of information contained in the financial statements determine investors' decisions to invest or not. However, the problem is that the company does not stand as a single company, there are many companies in similar industries that are trying to achieve their best performance so that profit management becomes an option to make the company able to compete in a competitive environment (Pasaribu et al., 2016).

According to Scott (2015), there are reasons why management performs earnings management actions. First, this action needs to be done to meet investor expectations. Companies that perform opportunistic actions (earnings management) will have an increase in stock prices so that they will be in accordance with investor expectations, namely that the company can provide good signals regarding performance in the current period and future periods. Second, agents carry out earnings management activities to obtain maximum funding from issuing shares in the market (Scott, 2015). In addition, according to Saputri et al., (2017), management chooses an income smoothing management pattern with the intention of showing internal information to investors that the company has stable profits and continues to grow over time.

The Influence of Financial Distress on Earnings Management

When a company is under financial pressure, the company will not directly carry out earnings management. The earnings management chosen by the agent has a high risk if it is known by the market, especially in companies that trade their shares on the stock market (Scott, 2015). Agents also need to look at global economic conditions and similar industry conditions when reporting modified financial information. This is closely related to the pressure of the business environment in which the company is located.

According to Kamau (2023), the reason companies do not need to take earnings management actions is because there is no pressure from other parties that require them to report positive finances during a declining economy. Companies also feel more comfortable being transparent and making disclosures according to actual conditions. The results of this study are also consistent with research conducted by Fauziah et al., (2021) which states that earnings management is not the right action chosen by companies. The actions that should be taken by management are to focus on formulating policies and taking actions that have a real impact on changes in financial conditions. In research conducted by Musta'ana dan Siti Noor Khikmah (2021) also concluded similar results, opportunistic actions such as earnings management are not affected by the small and large *financial distress conditions*. If a company experiences *financial distress*, then the company is wiser to use the investment funds it still has to pay off its obligations. In this study, 48 research samples were in the *gray area category*. This means that the company is not fully declared to be experiencing financial difficulties. This condition can occur because the amount of equity is greater than the amount of liabilities borne.

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