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Profitability, Leverage, and Tax Avoidance: Evidence from Earnings Management

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Abstract

Main Purpose - This study aims to examine the effects of profitability, leverage, and tax avoidance on earnings management in insurance subsector companies listed on the Indonesia Stock Exchange (IDX) during the 2019-2023 period.

Method - This study employs a quantitative approach using secondary data from annual financial statements. Purposive sampling yielded six companies with 30 observations. Earnings management is measured using discretionary accruals based on the Modified Jones Model, profitability using ROA, leverage using DAR, and tax avoidance using CETR. The data were analyzed using multiple linear regression with SPSS 27.

Main Findings - The results show that profitability has a positive effect on earnings management, as higher profits may encourage management to maintain performance. Meanwhile, leverage and tax avoidance have no significant effect, as they do not exert sufficient pressure on management to engage in earnings management.

Theory and Practical Implications - The findings indicate that agency theory can explain the relationship between profitability and earnings management but does not fully explain the effects of leverage and tax avoidance. Companies should strengthen earnings-reporting oversight, particularly when profitability increases, to ensure reliable financial information.

Novelty - This study examines profitability, leverage, and tax avoidance in insurance subsector companies characterized by reporting involving estimates, technical reserves, and claim liabilities, providing empirical evidence of their relationship with earnings management.

Keywords: Profitability, Leverage, Tax Avoidance, Earnings Management, Insurance Company

Abstrak

leverage, dan penghindaran pajak terhadap manajemen laba pada perusahaan subsektor asuransi yang terdaftar di Bursa Efek Indonesia periode 2019-2023.

Metode - Penelitian menggunakan pendekatan kuantitatif dengan data sekunder laporan keuangan tahunan. Sampel dipilih melalui purposive sampling dan menghasilkan 6 perusahaan dengan 30 observasi. Manajemen laba diukur dengan discretionary accrual melalui Modified Jones Model, profitabilitas dengan ROA, leverage dengan DAR, dan penghindaran pajak dengan CETR. Data dianalisis menggunakan regresi linier berganda melalui SPSS 27.

Temuan Utama - Hasil pengujian menunjukkan bahwa profitabilitas berpengaruh positif terhadap manajemen laba karena laba yang tinggi dapat mendorong manajemen mempertahankan kinerja. Sementara itu, leverage dan penghindaran pajak tidak berpengaruh signifikan karena belum memberikan tekanan yang cukup bagi manajemen untuk melakukan pengelolaan laba.

Implikasi Teori dan Kebijakan - Hasil penelitian menunjukkan teori keagenan dapat menjelaskan hubungan profitabilitas dengan manajemen laba, tetapi belum sepenuhnya menjelaskan leverage dan penghindaran pajak. Perusahaan perlu memperkuat pengawasan pelaporan laba, terutama saat profitabilitas meningkat, agar informasi keuangan tetap wajar.

Kebaruan Penelitian - Penelitian ini menguji profitabilitas, leverage, dan penghindaran pajak pada perusahaan subsektor asuransi yang memiliki karakteristik pelaporan berupa estimasi, cadangan teknis, dan kewajiban klaim, serta memberikan bukti empiris mengenai kaitannya dengan manajemen laba.

Kata Kunci: Profitabilitas, Leverage, Penghindaran Pajak, Manajemen Laba, Perusahaan Asuransi.

INTRODUCTION

Financial statements serve as an important source of information for investors, creditors, and other stakeholders in assessing a company's financial condition and performance. Among the various pieces of information presented, reported earnings are of particular importance because they are commonly used as a basis for economic decision-making. However, reported earnings do not necessarily provide a complete representation of a company's underlying economic condition (Ali, 2024; Pouryousof et al., 2025). The flexibility available to management in determining accounting policies and estimates may create opportunities for earnings management practices (Abubakar et al., 2021). Such practices are closely associated with conflicts of interest between owners and management, as explained by agency theory (Yustina, 2024). The case of PT Asuransi Jiwasraya illustrates how reported earnings that are not supported by the company's actual financial condition may mislead users of financial statements (Monok et al., 2018). The Audit Board of the Republic of Indonesia (BPK) identified an under-reserving issue amounting to IDR 7.7 trillion, despite the company having previously reported a profit of IDR 360.3 billion in 2017. Consequently, BPK issued an adverse opinion on the company's financial statements (Naura & Kawedar, 2024).

This phenomenon warrants particular attention in the insurance industry, as the sector manages substantial amounts of public funds and is characterized by financial reporting practices that rely heavily on estimates, provisions, and reserves. Data from the Financial Services Authority (OJK) indicate that insurance premium income in Indonesia reached IDR 320.88 trillion in 2023, representing a 3.02% increase from the previous year. Meanwhile, premiums in the general insurance and reinsurance sectors grew by 20.89% to IDR 143.47 trillion. The scale of activity within the industry is also reflected in the growth of its investment value, which increased from IDR 1,030.5 trillion in 2018 to IDR 1,437.3 trillion in 2022. This trend is consistent with previous findings indicating that premium income and investment funds within Indonesia's insurance industry have experienced significant growth in recent years (Ariani & Zulhawati, 2021; Wahyuddin & Mauliyana, 2021).

Earnings management may be influenced by various internal conditions within a company, one of which is profitability. Low profitability may place pressure on management to present a more favorable image of the company's performance to investors and shareholders (Gonçalves et al., 2021). Conversely, high profitability may also encourage management to sustain their earnings performance or meet certain targets (Christiningrum & Pinasti, 2025; Citradika & Iliana, 2025). Therefore, the relationship between profitability and earnings management has yet to demonstrate a consistent direction.

Leverage may also serve as a factor that influences earnings management. A high level of debt can increase pressure on a company to meet its obligations to creditors, thereby encouraging management to maintain favorable reported financial performance (Lou et al., 2026). However, high leverage may also strengthen creditor monitoring and constrain managerial opportunistic behavior. Previous studies have reported inconsistent findings, including a positive effect (Khanh & Phung, 2019), as well as negative and statistically insignificant effects (Naburgi et al., 2025).

In addition, tax avoidance is related to earnings management due to the differing objectives of financial reporting and taxation. Tax avoidance strategies may be employed to reduce tax burdens, but under certain circumstances, they may also provide management with greater discretion in determining reported earnings (Hlel, 2024). Several studies have found a positive relationship between tax avoidance and earnings management (Abubakar et al., 2021; Lou et al., 2026), whereas other studies suggest that the relationship remains inconclusive (Delgado et al., 2023).

These divergent findings indicate that the relationships between profitability, leverage, tax avoidance, and earnings management have yet to yield consistent conclusions. This issue is particularly relevant in the insurance industry, where financial reporting has distinctive

characteristics compared with many other sectors (Isayas, 2021). The determination of technical reserves, claim liabilities, and various actuarial estimates requires managerial judgment in determining the amounts presented in financial statements (Cazzari & Moreira, 2021). Such discretion may become increasingly important when companies face pressure to maintain profitability, meet debt obligations, or obtain tax-related benefits through tax strategies (Durana et al., 2021; Farida & Sugesti, 2023). Accordingly, a company's financial condition may not only influence management's incentives to engage in earnings management but may also be related to how such discretion is exercised in the financial reporting process (Aljughaiman et al., 2023; Pramono et al., 2022).

Given the divergent findings reported in previous studies and the relatively high degree of estimation and accounting judgment involved in the insurance industry, further examination of the factors associated with earnings management remains necessary. This study aims to provide a clearer understanding of the roles of profitability, leverage, and tax avoidance in influencing earnings management among insurance subsector companies listed on the Indonesia Stock Exchange during the 2019-2023 period. The novelty of this study lies in examining these three factors simultaneously within the context of Indonesian insurance companies, thereby contributing additional empirical evidence on earnings management in an industry characterized by financial reporting practices that differ from those of other sectors.

LITERATURE REVIEW

Agency Theory

Agency theory conceptualizes a firm as a nexus between the owners of the company (principals) and management (agents), whose relationship is governed by contractual arrangements that define the rights and obligations of each party (Ajaegbu & Mmayie, 2025; Wardoyo et al., 2021). This relationship arises when the principal delegates tasks and decision-making authority to the agent to act on the principal's behalf. Consequently, the respective authority and responsibilities of both parties are formally established through mutual contractual agreements (Özdemir & Kahraman, 2023; Papireddygaru & Waggoner, 2022).

In companies whose capital is primarily sourced from equity, shareholders act as principals who appoint the Chief Executive Officer (CEO) as an agent to manage the company's operations in accordance with their interests (Amis et al., 2020). This delegation includes authority over strategic decision-making, requiring the agent to act professionally and responsibly in pursuit of maximizing value for the principal (Alrashdan, 2024; Sakawa & Watanabel, 2020).

Earnings Management

Earnings management refers to actions undertaken by company management to influence reported earnings so that they appear to reflect an economic advantage that the company has not actually experienced, potentially causing adverse consequences for the company itself in the long term (Burlacu et al., 2024; Švábová et al., 2020). Such practices arise when managers exercise discretion in financial reporting or in structuring transactions to alter the presentation of financial statements, either to mislead stakeholders about the company's underlying economic performance or to influence the outcomes of contractual arrangements whose value depends on reported accounting figures (Saleem et al., 2023).

Profitabilitas

Profitability is one of the key measures commonly used by investors to evaluate a company's performance and support investment decision-making (Krstić et al., 2023; Tudose et al., 2022). This indicator reflects a company's ability to generate profits from the resources it controls; therefore, a higher level of profitability generally indicates better managerial performance in managing the company's assets and overall operations (Kayakuş et al., 2023; Türegün, 2022). Accordingly, profitability serves not only as an indicator of managerial effectiveness but also as an important signal for external stakeholders when assessing a company's prospects and competitiveness in the capital market (Aydoğmuş et al., 2022).

Leverage

Leverage refers to the use of assets or funds that requires a company to bear fixed costs as a consequence of the financing obtained (Botta & Colombo, 2022). Technically, leverage is measured by comparing total liabilities with total assets, allowing the ratio to indicate the proportion of a company's assets financed through debt relative to other sources of funding (Arhinful & Radmehr, 2023; Ullah et al., 2020). This has significant implications for investors, as a higher level of leverage generally corresponds to greater financial risk. Consequently, investors tend to require higher returns as compensation for the additional risk exposure associated with highly leveraged companies (Kling et al., 2021; Li et al., 2023).

Tax Avoidance

Tax can be defined as a compulsory levy imposed by the government in accordance with statutory provisions, with the revenue collected allocated to finance public expenditures and promote broader societal welfare (Simonidesová et al., 2021; Turcanu, 2022). As a mandatory obligation, taxation represents a contribution payable by individuals and business entities to the state without any direct benefit or immediate consideration that can be individually enjoyed by the taxpayer (Hassan et al., 2021; Rusdiyono, 2020). In other words, the benefits derived from tax payments are neither personal nor directly received by individual taxpayers; rather, they are returned to society collectively through the financing of various public expenditures and services provided by the state (Nikoloski, 2020).

HYPOTHESIS DEVELOPMENT

The Influence of Profitability on Earnings Management

From an agency theory perspective, differences in interests between management and owners may encourage managers to maintain the company's performance image through the information presented in financial statements (Ibrahimov et al., 2025; Tudose et al., 2022). Profitability is one of the measures that can reflect management's success in utilizing and managing the company's resources. When profitability is high, management may have an incentive to sustain such performance in order to maintain the confidence of owners and external stakeholders (Fatmawatie, 2022; Simonidesová et al., 2021). This situation may encourage management to exercise greater discretion in the reporting process to manage reported earnings. Accordingly, the higher the level of profitability, the greater the likelihood that management will engage in earnings management to preserve the performance that has been achieved (Oke & Ajeigbe, 2024).

The positive relationship between profitability and earnings management is supported by several previous studies. Christiningrum & Pinasti, (2025) and Citradika & Iliana, (2025) found that profitability has a positive effect on earnings management. Similarly, Damayanti et al., (2023); Hamdana & Samsudin, (2024); Hermanto & Berutu, (2022) reported a positive relationship between profitability, as measured by return on assets (ROA), and earnings management. These findings suggest that companies with higher profitability tend to have greater opportunities to manage their

reported earnings. Accordingly, high profitability may strengthen management's incentive to sustain earnings performance through the exercise of discretion in financial reporting. Based on this argument, the following hypothesis is proposed:

H1: Profitability has a positive effect on earnings management.

The Effect of Leverage on Earnings Management

From an agency theory perspective, leverage may intensify conflicts of interest between management, creditors, and company owners. The greater a company's reliance on debt, the greater the pressure on management to demonstrate its ability to meet its financial obligations. This situation may create an incentive for management to exercise accounting flexibility to maintain reported earnings, thereby presenting the company's financial condition favorably to creditors and investors (Aljughaiman et al., 2023; Ibrahimov et al., 2025). Accordingly, the pressure arising from high levels of debt may represent one of the conditions that encourage management to engage in earnings management.

That statement is supported by several previous studies. Ahmed & Sulong, (2023); Nopiana & Salvi, (2022); Priharta et al., (2022) found that leverage positively affects earnings management, indicating that higher debt may increase management's tendency to manage earnings. Similarly, Ahmed & Sulong, (2023) showed that pressure from debt-based financing can encourage managerial behavior aimed at managing reported earnings, while Choiriah, (2022) found that high leverage may strengthen management's incentive to maintain reported earnings performance. Collectively, these findings suggest that greater financial obligations may increase the tendency toward earnings management. However, high leverage can also strengthen creditor monitoring and constrain managerial opportunism, although substantial debt obligations may encourage management to maintain reported earning (Huang et al., 2024). Therefore, higher leverage may increase management's tendency to engage in earnings management.

H2: Leverage has a positive effect on earnings management

The Effect of Tax Avoidance on Earnings Management

From an agency theory perspective, tax avoidance may be associated with earnings management because differences in interests between management and owners can influence corporate decisions regarding tax expenses and reported earnings (Delgado et al., 2023). Tax avoidance provides management with an alternative means of reducing the company's tax burden without necessarily altering reported earnings through earnings management practices. By employing tax strategies that remain within the applicable regulatory framework, companies may achieve greater tax efficiency without manipulating reported earnings figures (Lou et al., 2026). This condition may reduce management's incentive to exercise accounting discretion in managing reported earnings.

Several studies provide support for this negative relationship, Nugrahani et al., (2025) found that tax avoidance has a negative effect on earnings management. Similar findings were reported by Kusuma & Lukman, (2023), who found that tax avoidance may reduce earnings management practices. These findings are further supported by Wardani et al., (2025), who demonstrated that tax avoidance has a negative effect on earnings management among companies listed on the Indonesia Stock Exchange. These findings suggest that tax avoidance may serve as a managerial strategy for achieving tax efficiency without relying on earnings management as a means of influencing reported earnings (Sánchez-Ballesta & Yagüe, 2021). Accordingly, the higher the level of tax avoidance, the lower the tendency of companies to engage in earnings management.

H3: Tax avoidance has a negative effect on earnings management

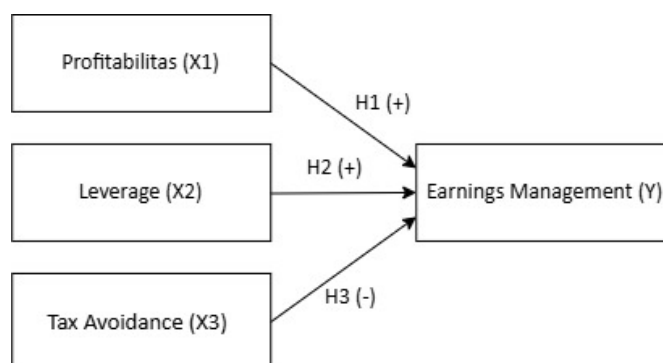


Figure 1. Conceptual Framework

RESEARCH METHOD

This study employs a quantitative method with a descriptive approach. The study population comprises all insurance subsector companies listed on the Indonesia Stock Exchange (IDX) during the 2019–2023 period. The study uses secondary data obtained through documentation of the companies' annual financial statements available on the official IDX website and the respective company websites. The sample was selected using purposive sampling based on the criteria that the companies had published complete financial statements and reported profits throughout the study period. The sample selection resulted in six companies, yielding 30 observations based on five years of observation. The data were analyzed using multiple linear regression. Data processing and statistical testing were conducted with the assistance of SPSS version 27.

The variables examined in this study comprise earnings management, profitability, leverage, and tax avoidance. Earnings management is measured using discretionary accruals estimated through the Modified Jones Model. This model is applied to identify the portion of accruals attributable to managerial discretion after accounting for changes in revenue, receivables, and property, plant, and equipment (Martinez & De Carvalho, 2021). Although insurance companies have distinctive characteristics involving estimates of technical reserves and claim liabilities, the model is employed as a general measure of accrual-based earnings management rather than as a specific measure of managerial discretion over claim reserves (Bisco et al., 2023).

Total accruals (TA) are calculated as net income less operating cash flows, whereas non-discretionary accruals (NDA) are derived from the estimated parameters of the Modified Jones Model. The parameters are estimated using a pooled approach based on all 30 observations, given that annual estimation would involve only six companies. Discretionary accruals (DA) are then calculated as the difference between TA and NDA and are used as the measure of earnings management. Accordingly, the measurement of earnings management in this study follows the formulation proposed by Zelicca et al., (2025), as follows:

$$TACit = Nlit - Cfit$$

$$DA = \frac{TA}{A < sub > t - 1 < \frac{1}{sub} >} - NDA$$

Profitability is measured using Return on Assets (ROA), calculated as the ratio of net income after tax to total assets. This ratio indicates the company's ability to generate profits from the resources under its management. The measurement of ROA is formulated based on Widyowati et al., 2024, as follow:

$$\text{Return On Asset} = \frac{\text{Net Income}}{\text{Total Aset}}$$

Leverage is measured using the Debt to Asset Ratio (DAR), which is calculated by comparing total liabilities with total assets. This ratio shows the proportion of company assets financed by liabilities. The measurements formulated by [Aristya & Oktris, \(2025\)](#) o measure Leverage are as follows:

$$\text{DAR} = \frac{\text{Total Liabilitas}}{\text{Total Aktiva}}$$

Meanwhile, tax avoidance is measured using the Cash Effective Tax Rate (CETR), defined as the ratio of cash taxes paid to pre-tax income. In this study, the CETR is understood as the rate of cash tax payments; thus, a lower CETR value indicates a relatively higher tax payment and a tendency toward a higher level of tax avoidance. Consequently, the relationship between CETR and earnings management is interpreted based on the direction of the tax payment rate, rather than by equating a higher CETR value with increased tax avoidance. In the study by [Grasia et al., \(2025\)](#) the CETR is formulated as follows:

$$\text{CETR} = \frac{\text{Cash Tax Paid}}{\text{Pretax Income}}$$

Hypothesis testing in this study was conducted using multiple linear regression analysis with the aid of SPSS software version 27. The regression equation used in this study is formulated as follows.

$$\text{EM} = a + \beta_1 \text{PROF}_{it} + \beta_2 \text{LEV}_{it} + \beta_3 \text{TA}_{it} + e$$

RESULTS

Stistik Deskriptive

Tabel 1. Statistik Deskriptive Result

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
Profitabilitas	30	0,0028	0,0767	0,0242	0,0175
Leverage	30	0,2029	0,7136	0,5005	0,1405
Penghindaran Pajak	30	0,0083	0,3373	0,1144	0,0897
Manajemen Laba	30	-0,0496	0,1044	0,0293	0,0359
Valid N (listwise)	30				

Source: Processed secondary data, (2024)

Based on the descriptive statistics for the 30 observations, the mean profitability was 0.0242, with a standard deviation of 0.0175, indicating a relatively low level of profitability with limited variation across the companies. Leverage had a mean of 0.5005 and a standard deviation of 0.1405, suggesting that the companies' capital structures relied on debt for approximately half of their total assets, with a moderate degree of dispersion. Tax avoidance recorded a mean of 0.1144 and a standard deviation of 0.0897, indicating considerable variation in tax avoidance practices across the companies. Meanwhile, earnings management had a mean of 0.0293 and a standard deviation of

0.0359, suggesting that, in general, earnings management practices were relatively limited, although noticeable variation existed among the companies examined.

Classical Assumption Tests

Normality Test

Tabel 2. Normality Test Result
One-Sample Kolmogorov-Smirnov Test

		Unstandardized Residual
N		30
Normal Parameters ^{a,b}	Mean	0,0000000
	Std. Deviation	0,03071299
Most Extreme Differences	Absolute	0,113
	Positive	0,071
	Negative	-0,113
Test Statistic		0,113
Asymp. Sig. (2-tailed) ^c		0.200 ^d
Monte Carlo Sig. (2tailed) ^e	Sig.	0,411
	99% Confidence	Lower Bound
	Interval	Upper Bound
		0,398
		0,423

Source: Processed secondary data, (2024)

The decision-making criterion for the Kolmogorov-Smirnov test is that if the Sig. (2-tailed) value is greater than 0.05, the residuals are normally distributed. Based on Table 2, the test results show a Sig. value of 0.411 which is greater than 0.05 indicating that the residuals in the regression model are normally distributed and the research model satisfies the normality assumption.

Multicollinearity Test

Tabel 3. Multicollinearity Test Result
Coefficients^a

Model	Collinearity Statistics	
	Tolerance	VIF
Profitabilitas	0,995	1,005
Leverage	0,682	1,467
Penghindaran Pajak	0,684	1,461

Source: Processed secondary data, (2024)

Table 3 shows that the Tolerance values for all variables are greater than 0.10, while the VIF values are below 10. These results indicate that there is no multicollinearity among the independent variables in the regression model. Therefore, the multicollinearity assumption is satisfied in this study.

Heterokedasticity Test

Tabel 4. Heterokedasticity Test Result

Model	Coefficients ^a		t	Sig.
	Unstandardized Coefficients	Standardized Coefficients		
	B	Std. Error	Beta	
1 (Constant)	0,004	0,014		0,297
Profitabilitas	0,013	0,205	0,012	0,065
Leverage	0,054	0,031	0,392	1,760
Penghindaran Pajak	-0,073	0,048	-0,337	-1,517

Source: Processed secondary data, (2024)

Table 4 shows that the significance value for profitability is 0.948, while the significance values for leverage and tax avoidance are 0.090 and 0.141, respectively. These results indicate that there is no evidence of heteroscedasticity in the regression model. Therefore, the heteroscedasticity assumption is satisfied in this study.

Autokorelasi Test

Tabel 5. Autokorelasi Test Result

Model	Model Summary ^b				
	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.517 ^a	0,267	0,187	0,0324365	1,813

Source: Processed secondary data, (2024)

Table 5 shows that the Durbin–Watson (DW) value is 1.813. The DW value is compared with the critical values in the Durbin–Watson table using a 5% significance level, a sample size of 30, and three independent variables ($k = 3$). Based on these criteria, the upper bound value (d_U) is 1.6498. Therefore, it can be concluded that there is no positive or negative autocorrelation in the regression model, as the DW value falls within the specified range: $d_U < DW < 4 - d_U$ ($1.6498 < 1.813 < 2.3502$).

Hypothesis Testing

Partial t-Test

Tabel 6. Partial t-Test Results

Model	Coefficients ^a		t	Sig.
	Unstandardized Coefficients	Standardize d Coefficients		
	B	Std. Error	Beta	
(Constant)	0,021	0,024		0,874
Profitabilitas	1,011	0,345	0,493	2,928
Leverage	-0,021	0,052	-0,084	-0,414
Penghindaran Pajak	-0,046	0,081	-0,116	-0,570

Source: Processed secondary data, (2024)

Based on the results of the partial t-test, profitability has a positive and statistically significant effect on the dependent variable, with a regression coefficient of 1.011 and a significance level of 0.007 ($p < 0.05$). Meanwhile, leverage and tax avoidance have significance values of 0.682 and 0.573, respectively, both of which are well above 0.05. Therefore, neither variable has a statistically significant partial effect on the dependent variable. Accordingly, among the three independent variables examined, only profitability is shown to have a statistically significant partial effect on the dependent variable in the research model.

Coefficient of Determination Test (R^2)

Tabel 7. Coefficient of Determination Test Results

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.517 ^a	0,267	0,183	0,0324365	1,813

Source: Processed secondary data, (2024)

Table 7 shows a coefficient of determination (R^2) of 0.267, indicating that profitability, leverage, and tax avoidance collectively explain 26.7% of the variation in earnings management. The remaining 73.3% is explained by other variables that are not included in this study.

DISCUSSION

The Effect of Profitability on Earnings Management

The research results indicate that profitability has a positive effect on earnings management. This finding implies that an increase in profitability is accompanied by a tendency for management to manage reported earnings. Such a situation suggests that high earnings do not necessarily reflect superior earnings quality, as achieving high performance can create an incentive for management to sustain those results in the eyes of shareholders and external parties. These results support agency theory, particularly where management's interest in maintaining a positive assessment of corporate performance drives the use of discretion in financial reporting. This finding aligns with [Nugrahani et al., \(2025\)](#) ; [Prasetyo & Suhendah, \(2023\)](#), who found that profitability positively influences earnings management.

On the other hand, the results of this study differ from those of [Hanum et al., \(2024\)](#) who found that ROA had no effect on earnings management. Meanwhile, [Naburgi et al., \(2025\)](#); [Zandrafitria & Tarmizi, \(2025\)](#) found a negative effect of profitability on earnings management, including within insurance companies. Findings in the manufacturing and banking sectors also showed insignificant results [Hidayah & Nurjanah, \(2023\)](#); [Winata & Simon, \(2024\)](#). These discrepancies indicate that the impact of profitability on earnings management can be influenced by firm characteristics, oversight mechanisms, profitability metrics, and the observation period. These results reinforce agency theory in specific contexts but also highlight factors that constrain this relationship. Therefore, oversight regarding accounting policies, estimates, and internal controls needs to be strengthened ([Avalone et al., 2026](#); [Boulhaga et al., 2022](#)). Particularly in insurance companies that rely on various estimates and reserves ([Balaban et al., 2026](#); [Hery et al., 2023](#)). Strong profitability must be accompanied by transparency and oversight to maintain earnings quality ([Alhawtmeh, 2023](#); [Allayla & Al-Ibrahimi, 2025](#)).

The Effect of Leverage on Earnings Management

The research results indicate that leverage does not have a significant effect on earnings management. These findings suggest that the company's debt level does not exert sufficient pressure on management to engage in earnings management (Andari et al., 2025). Thus, the research findings do not yet support agency theory, which posits that liability pressure and conflicts of interest with creditors drive opportunistic behavior (Muhtaseb et al., 2024). This situation may arise because the companies' leverage remains at a manageable level, meaning their debt obligations have not compelled management to exercise accounting discretion excessively (DeMarzo & He, 2021). These results align with the findings of Dianty, (2021); Kalbuana et al., (2022); Naburgi et al., (2025); Zandrafitria & Tarmizi, (2025), who also found no significant effect of leverage on earnings management.

These results differ from Laeli et al., (2025); Nopiana & Salvi, (2022); Rely, (2022), which who found that leverage positively affects earnings management because pressure to meet creditor obligations may encourage management to maintain the company's financial position through earnings management. In contrast, the insignificant effect of leverage in this study suggests that higher debt does not necessarily lead to opportunistic behavior, as the relationship may depend on industry characteristics, creditor oversight, and financing structure. Thus, these findings do not entirely refute agency theory but indicate that debt pressure may be insufficient to trigger earnings management among the sampled insurance companies. Therefore, companies should maintain controlled debt levels to minimize financial pressure that could affect reporting quality (Synn & Williams, 2023). Although leverage has no significant effect, monitoring liabilities and reporting policies remains important because increasing debt may, under certain conditions, heighten the risk of opportunistic behavior (Lumbantobing et al., 2025).

The Effect of Tax Avoidance on Earnings Management

The research results indicate that tax avoidance does not have a significant effect on earnings management. This implies that corporate efforts to minimize tax burdens do not directly drive management to alter reported earnings (Dinata & Asqolani, 2024). These findings do not support agency theory, as management's interest in reducing tax burdens is not strong enough to prompt opportunistic behavior through earnings management (Ardillah, 2023). This situation may arise because tax planning can be executed through tax policies without necessitating changes to accounting earnings (Komariah & Herliansyah, 2024). These findings align with those of Budiantoro et al., (2022); Firmansyah & Ardiansyah, (2021), which demonstrate that tax avoidance and earnings management are not necessarily undertaken concurrently.

The results of this study differ from those of Hlel, (2024); Lou et al., (2026) who found a positive effect of tax avoidance on earnings management. This suggests that tax savings pursued alongside earnings management can encourage management to exploit the divergence between accounting and tax reporting interests (Isthifaiyyah et al., 2024). Such discrepancies in findings may be attributed to firm characteristics and tax conditions (Thalita et al., 2022). Thus, this study does not entirely refute agency theory but indicates that tax-related conflicts of interest were not sufficiently strong to drive earnings management among the insurance companies in the sample (Alkausar et al., 2023). Consequently, tax strategies must be accompanied by oversight, transparency, regulatory compliance, and the strengthening of internal controls and accounting policies to prevent the excessive use of discretion (Elumilade et al., 2022; Muslim, 2024; Rahayu et al., 2025). In this way, tax efficiency can be achieved without compromising the reliability of earnings information for investors and stakeholders.

CONCLUSION

Research results indicate that profitability has a positive effect on earnings management, whereas leverage and tax avoidance do not have a significant impact on companies in the insurance sub-sector. These findings suggest that increased profitability can actually drive management to sustain performance through earnings management; consequently, high earnings do not necessarily reflect superior reporting quality. Conversely, leverage levels and tax avoidance have not proven to be sufficiently strong factors to drive earnings management in the companies studied. These results demonstrate that earnings management practices within insurance companies are closely linked to the company's profitability and management's drive to maintain achieved performance levels. Thus, monitoring earnings quality remains essential, particularly when companies exhibit high levels of profitability. This study is limited by its sample size and scope. The sample consists of only six companies with 30 observations over the 2019-2023 period, thereby limiting the observable variation in company conditions. Furthermore, the study is confined to insurance sub-sector companies listed on the Indonesia Stock Exchange (IDX). Consequently, the characteristics of companies outside this sub-sector are not reflected in the findings. Additionally, earnings management is measured solely using the Modified Jones Model, whereas insurance companies possess specific reporting characteristics that are not fully captured by general accrual measurements.

RECOMMENDATION

The recommendation are divided into two:

1. Practical advice: Increased profitability needs to be accompanied by stronger oversight of the financial reporting process, as research indicates that profitability has a positive effect on earnings management. Management must maintain transparency and strengthen internal controls to ensure that reported earnings accurately reflect the company's true condition. Investors should not immediately view high profitability as an indicator of earnings quality; instead, they should also consider the fairness of the information presented in the financial statements.
2. Theoretical Suggestions: The scope of the study could be expanded by increasing the number of companies, the observation period, or the subjects within other sub-sectors to yield more diverse results. Future research could also take into account the specific characteristics of insurance companies, thereby allowing earnings management measurements to provide a more accurate reflection of conditions within the insurance industry.

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