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Impact of Bonus Compensation, Political Costs, and Opportunistic Behavior on Earnings Management in the Indonesian Insurance Industry (2019-2023)

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A B S T R A C T

This study investigates the effects of bonus compensation, political costs, and opportunistic behavior on earnings management within the Indonesian insurance sector from 2019 to 2023. During this period, heightened regulatory scrutiny and the economic challenges posed by the COVID-19 pandemic intensified pressures on financial reporting. Using a quantitative approach, this study analyzes data from the financial statements of insurance companies listed on the Indonesia Stock Exchange, applying multiple regression analysis to examine the relationships between the variables. The findings reveal that political costs significantly increase earnings management practices, supporting Positive Accounting Theory by indicating that firms under regulatory pressure tend to smooth income to reduce scrutiny. In contrast, bonus compensation is negatively associated with earnings manipulation, aligning with Agency Theory by suggesting that well-structured incentives align managerial actions with shareholder interests, thereby reducing manipulation.

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INTRODUCTION

The insurance industry in Indonesia has faced considerable challenges in maintaining financial stability and investor confidence during the economic downturn triggered by the COVID-19 pandemic. During this period, financial reporting became a crucial tool for signaling company performance to stakeholders, yet heightened economic pressures also increased incentives for managers to engage in earnings management practices. Earnings management is often driven by the need to meet performance benchmarks or maintain a positive image among investors, particularly when managerial compensation is tied to financial metrics (Dechow et al., 2020; Healy & Wahlen, 1999). Studies by Prihastomo & Khafid (2018) and Jiraporn et al. (2019) have shown that performance-based bonuses provide strong incentives for managers to manipulate reported earnings to meet specific targets, enhancing the probability of bonus payouts.

In addition to incentive-based motivations, the role of political costs is also significant in influencing earnings management. According to Watts and Zimmerman's Positive Accounting Theory (PAT), firms facing higher regulatory scrutiny or political attention tend to engage in income-decreasing earnings management to minimize exposure to taxes and regulatory compliance costs (Watts & Zimmerman, 1986; Yudha et al., 2016) This is particularly relevant in the Indonesian context, where insurance companies are under the stringent supervision of the Financial Services Authority (Otoritas Jasa Keuangan or OJK), which can increase pressure on managers to engage in earnings management to mitigate potential regulatory consequences (Karim et al., 2022; Susanto et al., 2021). Research by Huang et al (2021) underscores that firms in highly regulated industries are more likely to use earnings management as a tool to navigate political costs, especially in periods of economic instability.

Moreover, opportunistic managerial behavior also plays a critical role in earnings management practices. Agency theory suggests that information asymmetry between management (agents) and shareholders (principals) provides managers with the latitude to adjust financial reports to suit their interests, such as achieving compensation targets or meeting market expectations (Jensen & Meckling, 1976; Priantinah, 2016). This aligns with findings by Li & Zhang (2020), who demonstrate that managers are more likely to engage in earnings manipulation when they possess significant informational advantages over external stakeholders. Opportunistic behavior is particularly prevalent in the insurance sector, where complex product offerings and uncertainties related to claims and premiums create opportunities for discretion in financial reporting (Chen et al., 2020).

While prior studies have explored the determinants of earnings management in sectors like banking and manufacturing (DeFond & Jiambalvo, 1994; Sun & Rath, 2019), there is a notable gap in research focusing specifically on how bonus compensation, political costs, and managerial opportunism influence earnings management in the insurance industry, particularly in emerging markets like Indonesia. The unique characteristics of the insurance

industry, such as its exposure to high uncertainty in claims and premium estimations and its complex regulatory landscape, necessitate a nuanced understanding of these dynamics (Adhikari et al., 2023; Zhang et al., 2022).

This study aims to fill this gap by conducting a comprehensive analysis of the impact of bonus compensation, political costs, and opportunistic behavior on earnings management in insurance companies listed on the Indonesia Stock Exchange from 2019 to 2023. It seeks to provide deeper insights into the factors driving earnings management in this specific and dynamic context, offering contributions to the academic literature and practical recommendations for policymakers.

LITERATURE REVIEW

Earnings Management: Theory, Practices, and Industry-Specific Dynamics

Earnings management is a pivotal subject in accounting research, owing to its substantial effects on financial transparency, reporting quality, and decision-making for stakeholders. Managers may engage in earnings management by making discretionary choices in accounting policies, estimates, or operational decisions to meet performance benchmarks or present a stable financial image (Chen et al., 2020; Dechow et al., 2020). This practice can obscure the true economic performance of a firm, potentially misleading investors, regulators, and other stakeholders, thus challenging the credibility of financial information in capital markets. Earnings management typically manifests in two primary forms: Accrual-Based Earnings Management (AEM) and Real Earnings Management (REM). AEM entails adjusting accounting estimates—such as provisions, depreciation, or reserves—to influence reported earnings without impacting cash flows (DeFond & Jiambalvo, 1994; Healy & Wahlen, 1999). REM, however, involves modifying actual business operations, such as sales timing or discretionary expenditures, which may have enduring effects on operational efficiency and future performance (Gunny, 2010; Roychowdhury, 2006).

In industries under close scrutiny from investors and regulators, such as insurance, earnings management is notably prevalent. The insurance sector's inherent volatility and its complex regulatory frameworks, especially during periods of economic instability like the COVID-19 pandemic, create situations that can amplify earnings manipulation through judgment-based decisions on loss reserves and premium recognition (Zhang et al., 2022). Regulatory frameworks, such as those enforced by the Financial Services Authority (OJK) in Indonesia, mandate strict financial reporting standards, influencing firms to meet compliance benchmarks and avoid regulatory scrutiny through earnings smoothing or reserve adjustments (Susanto et al., 2021). The Positive Accounting Theory (PAT) provides insights into these behaviors, positing that firms facing high political costs may adopt accounting practices to minimize tax or regulatory exposure (Huang, Li, et al., 2021; Watts & Zimmerman, 1986). During crises, such as the pandemic, research reveals a higher propensity for income smoothing among insurers to maintain stable appearances for regulators and investors (Chen et al., 2020; Maryati & Siswanti, 2022).

The theoretical frameworks of Agency Theory and Positive Accounting Theory provide a comprehensive approach to understanding earnings management. Agency Theory, as articulated by Jensen and Meckling (1976), suggests that information asymmetry allows managers to exploit their superior knowledge for personal benefits, such as securing bonuses or sustaining stock prices, which can intensify earnings management incentives, particularly in the insurance industry (Prihastomo & Khafid, 2018). Positive Accounting Theory complements this perspective by focusing on how companies facing regulatory pressures make accounting choices to manage political costs. The International Financial Reporting Standards (IFRS) aim to enhance transparency, particularly in the insurance industry; however, they offer flexibility that, despite improving reporting quality, may allow earnings management practices to persist, especially where judgment is needed (Chen et al., 2020; Karim et al., 2022). Integrating these theories and empirical findings provides a nuanced perspective, underscoring the complex interplay of managerial incentives, regulatory demands, and accounting discretion in the insurance sector, emphasizing the need for vigilant regulatory enforcement to maintain financial report integrity in both developed and emerging markets.

Bonus Compensation and Its Impact on Earnings Management

The relationship between performance-based bonus compensation and earnings management has been widely explored, illustrating how financial incentives can drive managerial behavior in ways that prioritize short-term financial metrics over long-term value. Healy's (1985) seminal study highlighted that managers often manipulate earnings to reach bonus thresholds or, conversely, engage in "big bath" accounting to reduce earnings when targets seem unattainable, thus setting a favorable base for future bonuses. This behavior aligns with agency theory by Jensen and Meckling (1976), which suggests that conflicts between managers (agents) and shareholders (principals) arise due to divergent goals; while principals prioritize sustainable firm value, managers may prioritize short-term earnings metrics to maximize personal gain (Li & Zhang, 2020). Agency theory further posits that information asymmetry enables managers to engage in earnings management with limited immediate detection by shareholders, amplifying opportunities for financial report manipulation.

Empirical studies further substantiate this relationship by examining specific contexts and industries. For instance, Bergstresser and Philippon (2006) show that firms with stock-based manager compensation are more prone to discretionary accruals, while Prihastomo and Khafid (2018) found similar patterns in Indonesia's financial sector, emphasizing the applicability of agency theory principles beyond developed markets. In the insurance sector, where regulatory pressures and actuarial assumptions create unique reporting flexibility, Zhang et al., (2022) noted that managers may align reported earnings with performance-based incentives, further motivating earnings manipulation. To mitigate these risks, corporate governance frameworks should emphasize long-term performance and consider mechanisms like clawback provisions,

which, as Bebchuk and Fried (2004) argue, help recover bonuses awarded under manipulated earnings reports. Psychological insights from Kahneman and Tversky's (1979) prospect theory also suggest that managers may take undue risks to avoid missing bonus targets, highlighting the need for balanced policies that align managerial incentives with sustainable, ethical financial reporting.

Political Costs and Earnings Management: A Regulatory Perspective

Political costs significantly shape earnings management, particularly in regulated sectors, aligning with Positive Accounting Theory (PAT) as outlined by Watts and Zimmerman (1986). According to PAT, firms under substantial political and regulatory pressures, such as those in the insurance industry, often use earnings management as a strategic response to mitigate these external pressures (Karim et al., 2022; Watts & Zimmerman, 1986). Managers in these industries may exercise financial reporting discretion to align with regulatory standards, reduce tax liabilities, or smooth income to avoid heightened scrutiny, especially during economic crises when regulatory oversight intensifies (Zhang et al., 2022). This tendency to manage political visibility illustrates how PAT explains defensive earnings management practices as firms attempt to minimize sanctions or additional regulatory burdens in highly scrutinized contexts.

Empirical studies support PAT's assertions, showing that political pressures often drive earnings management practices. Research on Indonesian insurance firms by Yudha et al. (2016) and Susanto et al. (2021) found that these firms engage in conservative reporting, such as income smoothing, to mitigate regulatory intervention risks, especially during periods of heightened oversight, as observed during the COVID-19 pandemic (Maryati & Siswanti, 2022). This adaptive reporting behavior aligns with PAT's view that managers leverage financial reporting flexibility to meet regulatory demands and safeguard operational continuity (Karim et al., 2022). Such insights underscore PAT's relevance in explaining earnings management as a survival strategy in regulated sectors, highlighting the need for policy interventions that account for the regulatory motivations behind managerial reporting decisions (Zhang et al., 2022).

Opportunistic Behavior and the Role of Information Asymmetry

Managerial opportunism, driven by information asymmetry, significantly influences earnings management practices. Information asymmetry enables managers to manipulate financial reports without immediate stakeholder detection, often leading to a discrepancy between reported and actual economic conditions (Healy & Palepu, 2001; Li & Zhang, 2020). This advantage allows managers to achieve personal goals, such as performance-based compensation or favorable market perception, demonstrating how informational gaps can foster opportunistic behavior. Short-term financial goals may thus be prioritized over long-term shareholder interests, highlighting the risks of managerial discretion in settings with high information asymmetry.

This issue is particularly acute in the insurance industry, where the complexity of products and financial outcomes provides managers with greater discretion over reporting. Chen et al. (2020) and Priantinah (2016) indicate that managers in this sector can adjust reserves or select favorable accounting policies to achieve desired outcomes, with the pressure intensifying during economic crises like COVID-19 (Jiraporn et al., 2019). Agency theory offers a framework for understanding these effects, explaining how disparities in information access lead to conflicts between managers and shareholders (Healy & Palepu, 2001; Huang, Sun, et al., 2021). Such opportunistic behavior not only jeopardizes shareholder trust but can also distort capital market perceptions. To counteract this, transparency measures and regulatory oversight are essential, especially in complex industries where unchecked managerial discretion could obscure a firm's true financial health.

Empirical Studies Focused on the Insurance Industry

Empirical studies on earnings management in the insurance sector, though less extensive than those in banking or manufacturing, highlight unique financial reporting challenges in this industry. The inherent uncertainties in insurance—such as fluctuations in claims and premium revenue—create pressures that can lead to earnings management, especially during economic crises like COVID-19. During this period, rising claims and reduced premium income made financial stability difficult, prompting insurers to use earnings management to project stability (Karim et al., 2022; Zhang et al., 2022). Positive Accounting Theory (PAT) explains this adaptation, as managers adjust accounting methods to manage political costs and comply with evolving regulations, as evidenced by adjustments in Indonesia during the pandemic (Apriadi et al., 2022).

The role of managerial expertise in interpreting regulatory shifts further underscores the strategic flexibility managers employ under regulatory scrutiny, as observed during the pandemic (Maryati & Siswanti, 2022; Priantinah et al., 2022). This flexibility allows managers not only to comply but also to sustain investor confidence by presenting a stable financial image. These dynamics illustrate how earnings management serves both compliance and strategic purposes, providing insights for policymakers about how regulatory shifts may inadvertently incentivize earnings adjustments, emphasizing the need for balanced regulatory frameworks to uphold financial transparency (Apriadi et al., 2022; Karim et al., 2022).

Research Hypothesis

Based on the literature review, this study investigates the impact of performance-based compensation, political costs, and opportunistic behavior on earnings management in the Indonesian insurance industry, particularly amid COVID-19-induced regulatory changes. Agency theory and Positive Accounting Theory (PAT) provide the theoretical framework, outlining both internal motivations and external pressures that drive earnings management (Healy, 1985; Maryati & Siswanti, 2022; Zhang et al., 2022).

The first hypothesis (H1) posits that performance-based bonuses positively influence earnings management in insurance firms, as managers seek to manipulate profits to meet targets and secure bonuses (Prihastomo & Khafid, 2018). Therefore, the first hypothesis is formulated as follows H1: Bonus compensation has a positive influence on earnings management practices in the Indonesian insurance industry. The second hypothesis (H2) addresses political costs, suggesting that high regulatory pressures lead managers to adjust earnings to avoid regulatory intervention, consistent with PAT (Yudha et al., 2016). The second hypothesis is formulated as follows: H2: Political costs have a significant impact on earnings management practices in listed insurance companies in Indonesia.

The third hypothesis (H3) explores the role of opportunistic behavior driven by information asymmetry, where managers exploit their informational advantage in complex insurance settings to alter financial reports (Chen et al., 2020; Priantinah, 2016). Thus, the third hypothesis is formulated as follows: H3: Opportunistic behavior driven by information asymmetry increases earnings management practices in the Indonesian insurance industry. These hypotheses integrate theoretical insights to examine the dynamics of earnings management within Indonesia's insurance sector, providing both empirical and practical contributions for industry oversight and regulation.

METHODOLOGY

This study employs a quantitative approach to analyze the causal relationship between independent variables (bonus compensation, political costs, and opportunistic behavior) and the dependent variable (earnings management). The data for this research are secondary data obtained from financial statements and annual reports of insurance companies listed on the Indonesia Stock Exchange (IDX) for the period 2019–2023. This period is selected to capture the economic impact of the COVID-19 pandemic on financial reporting practices within the insurance sector.

Sample and Data Collection

The population for this study consists of all insurance companies listed on the IDX during the 2019–2023 period. Purposive sampling is applied according to the following criteria:

1. Insurance companies listed on the IDX during the 2019–2023 research period.
2. Companies that provided complete annual or financial reports consecutively over this period.

This sampling technique ensures that the selected sample aligns with the research objectives and adequately represents the characteristics of the population.

The study relies on secondary data collected through two methods:

1. Library Research
   Theoretical data are gathered from books, scientific journals, theses, and other academic sources relevant to the research variables. This literature review aids in developing a theoretical foundation for the research

variables, such as bonus compensation, political costs, and opportunistic behavior.

2. Field Research
   Secondary data, specifically financial reports of insurance companies, are sourced from the official IDX website (www.idx.co.id) for the 2019–2023 period. This data includes essential financial information, such as revenue, assets, managerial compensation, and political factors that could potentially influence financial reporting.

Operationalization of Research Variables

The operationalization of variables in this study consists of one dependent variable, namely earnings management, and three independent variables, which include bonus compensation, political costs, and opportunistic behavior.

a. Independent Variable
   1. Bonus Compensation (X1)
      Bonus compensation is a policy provided to managers based on their performance to achieve corporate objectives (Pujiati, E. J., & Arfan, 2016). This incentive, including both monetary and non-monetary rewards, can drive managers to manipulate earnings to maximize reported profits (Panjaitan & Muslih, 2019). In line with Elfira (2017), this study measures bonus compensation as a dummy variable, assigning a value of 1 if the company offers compensation and 0 otherwise.
   2. Political Cost (X2)
      Political Cost arise from company-government conflicts, often linked to taxes, subsidies, and regulations (Yupita et al., 2017). Larger companies, more visible due to high market share and profits, may use accounting methods to minimize attention from government and media (Pratiwi, 2015). Following Yudha et al. (2016), political costs are measured by capital intensity, calculated as:

$$Capital\ Intensity = \frac{Fixed\ Assets\ Before\ Depreciation}{Company\ Sales}$$

   3. Opportunistic Behavior (X3.1 & X3.2)
      Opportunistic managers may manipulate financial data to mask underperformance. This study measures opportunistic behavior using two metrics free cash flow and profitability. High free cash flow can lead to agency problems by providing managers with discretionary funds (Ghazali et al., 2015). Free cash flow is measured by the Operating Investment Ratio:

$$Operating\ Investment\ Ratio = \frac{Cash\ Flow\ from\ Operating}{Net\ Cash\ Flow\ from\ Investing}$$

      Meanwhile, to measure opportunistic behavior using the second metric, profitability, the ROA formula is used (Alfina & Sambuaga, 2021).

$$ROA = \frac{Profit\ Before\ Income\ Tax}{Total\ Assets}$$

b. Dependent Variable

1. Earning Management (Y)

The dependent variable (Y) used in this study is earnings management. Earnings management is closely related to the level of profit achieved or the business performance of an organization. This is why company managers often attempt to enhance their performance through earnings management. Earnings management is measured using the model developed by Jones (1991), known as the Modified Jones Model, which is a modification of the original Jones Model. The Modified Jones Model is designed to eliminate the tendency to use potentially biased estimates from the original Jones Model to determine discretionary accrual when discretion exceeds income. Discretionary accrual is a method for increasing or decreasing reported earnings, which can be difficult to detect through the manipulation of associated accounting policies or accrual-related practices (Sulistyanto, 2018). The following formula is used to calculate earnings management:

a. Calculating total accruals using the Modified Jones Model

$$TAC = Net\ Income - Cash\ Flow\ from\ Operating$$

b. Estimating the total accrual (Ta) value using the regression equation

$$TACt/At - 1 = \alpha 1\ (1/At - 1) + \alpha 2\ (\Delta REVt/RECt/At - 1) + \alpha 3\ (PPEt/At - 1) + e$$

At-1 : total asset untuk sampel perusahaan i pada akhir tahun t-1
REVt : perubahan pendapatan perusahaan i dari tahun t-1 ke tahun t
RECt : perubahan piutang perusahaan i dari tahun t-1 ke tahun t
PPEt : aktiva tetap (*gross property plant and equipment*) tahun t

c. Calculating the non-discretionary accruals (NDA) value using the regression coefficients for non-discretionary accruals (NDA) with the formula:

$$NDAit = \alpha 1\ (1/At - 1) + \alpha 2\ (\Delta REVt/At - 1 - \Delta RECt/At - 1) + \alpha 3\ (PPEt/At - 1)$$

d. Calculating the discretionary accruals (DA):

$$DAit = TACt/At - 1 - NDAt$$

Data Analysis

The data analysis methods in this are structured to systematically organize and present the findings. Quantitative data are displayed in several structured forms, as described below.

1. Descriptive Statistical Analysis
   Descriptive statistical analysis provides an overview of the data by summarizing key metrics such as maximum, minimum, mean, and standard deviation (Ghozali, 2018).
2. Classical Assumptions Tests
   To ensure the validity of multiple linear regression analysis prior to hypothesis testing, a series of classical assumption tests are conducted. For the model to yield unbiased results, it must meet the assumptions of

normality, absence of multicollinearity, homoscedasticity, and no autocorrelation (Ghozali, 2018).

a) Normality Test
   The normality test assesses whether the residuals of the regression model follow a normal distribution (Ghozali, 2018). Normality is evaluated using the Kolmogorov-Smirnov test and graphical analysis. An Asymp. Sig (2-tailed) value above 0.05 or a Q-Q plot with points aligned along the diagonal indicates normal distribution.
b) Multicollinearity Test
   Multicollinearity is tested to detect potential correlations among independent variables. This study uses tolerance values (> 0.10) and the Variance Inflation Factor (VIF < 10) to ensure low multicollinearity, supporting model reliability (Ghozali, 2018).
c) Heteroscedasticity Test
   The heteroscedasticity test evaluates whether residual variance remains constant across observations. Homoscedasticity is indicated by a random scatter of points around zero on a scatterplot, while discernible patterns suggest heteroscedasticity (Ghozali, 2018).
d) Autocorrelation Test
   The Durbin-Watson test is used to assess the presence of autocorrelation between residuals. A Durbin-Watson statistic within specified upper and lower bounds (dU) suggests the absence of autocorrelation (Ghozali, 2018).

In this study, the Box-Cox Transformation was applied to meet the data normality requirements essential for parametric analysis. Osborne (2010) underscores this transformation's effectiveness in reducing skewness and stabilizing variance, thus enabling the data to approximate a normal distribution. Similarly, John and Draper (1980) recommend data transformation when data deviate from normality, supporting the validity of parametric tests with transformations like Box-Cox. This approach, developed by Box and Cox (1964), uses a flexible λ (lambda) parameter to optimize the data distribution, thereby enhancing statistical analysis accuracy and reliability in this study.

Hypothesis Testing

The hypothesis testing in this study uses a multiple regression model. This model is used to examine the bidirectional influence of two or more independent variables on the dependent variable with an interval scale of measurement within a linear equation (Nurhasanah, 2016). Hypothesis testing is conducted using simultaneous tests (F-test) and partial tests (t-test). The F-test is used to determine if there is a significant combined effect of the independent variables on the dependent variable, with the model's validity assessed at a 5% significance level.

In this study, the basis for drawing conclusions in the simultaneous test (F-test) is as follows: if the calculated F value is greater than the table F value, the null hypothesis (H0) is rejected. This indicates that the significance level, or p-value, is less than α. For the partial test (t-test), if the calculated t value is

greater than the table t value, the null hypothesis (H0) is rejected. This shows that the significance level, or p-value, is less than α = 5%.

In addition, the independent variables in this study are bonus compensation, political cost, and opportunistic behavior, while the dependent variable is earnings management. The research model in this study is as follows:

$$Y = \alpha + ƪ1\ BC + ƪ2\ PC + ƪ3\ FCF + ƪ4\ P + e$$

Explanation:

Y = Earnings Management
α = Constant
ƪ = Regression Coefficient
BC = Bonus Compensation
PC = Political Cost
FCF = Free Cash Flow
P = Profitability

RESEARCH RESULT

This study utilizes data from Indonesian insurance companies listed on the Indonesia Stock Exchange (BEI) from 2019 to 2023 to explore the influence of bonus compensation, political costs, and opportunistic behavior on earnings management practices. Descriptive statistics summarize the key features of the dataset, presenting the central tendency, dispersion, and range for each independent variable—bonus compensation, political costs, and opportunistic behavior measured by operating investing ratio and ROA—as well as the dependent variable, earnings management. Table 4.1 below highlights these statistics, which reveal moderate levels of earnings management across the sample. Variability in earnings management appears closely related to changes in political costs and bonus structures within these firms.

Table 1. Moderate levels of earnings management across the sample

Variable	Mean	Standard Deviation	Min	Max
Bonus Compensation	0.25	0.06	0.12	0.42
Political Costs	1.45	0.33	0.89	2.03
Operating Investing Ratio	0.72	0.19	0.51	1.09
ROA	0.07	0.02	0.03	0.12
Earnings Management	0.18	0.04	0.11	0.29

Hypothesis Testing

Regression analysis was performed to assess the hypothesized relationships between bonus compensation, political costs, opportunistic behavior, and earnings management. The results, as summarized in Table 4.2, indicate that both bonus compensation and political costs have significant associations with earnings management, reflecting key insights into the

behaviors of managers under various incentive structures and regulatory pressures.

Table 2. Bonus compensation and political costs have significant associations with earnings management

Variable	Coefficient	Standard Error	t-Statistic	p-Value
Bonus Compensation	-0.357	0.121	-2.95	0.004
Political Cost	0.478	0.158	3.02	0.003
Operating Investing Ratio	-0.082	0.091	-0.90	0.372
Return on Assets (ROA)	0.027	0.044	0.61	0.541
Adjusted R^2	0.469			
F-Statistic	14.87			0.000

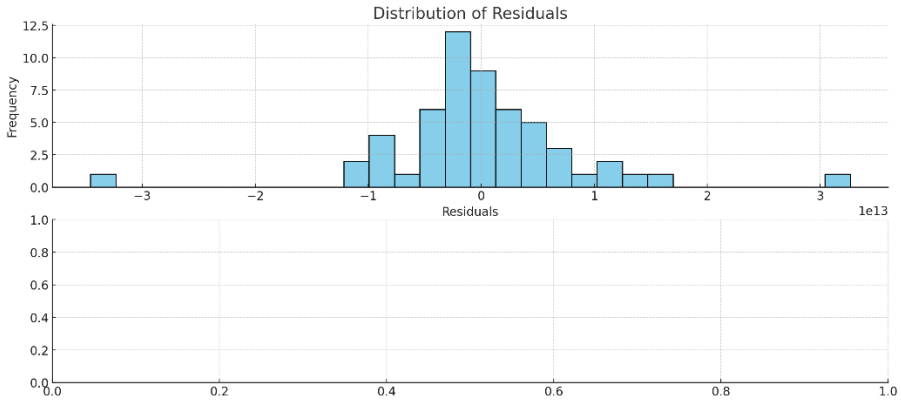
With an adjusted R^2 of 0.469, the model explains approximately 46.9% of the variance in earnings management, supported by an F-statistic significant at $p < 0.001$, underscoring the model's robustness. Multicollinearity was examined via the Variance Inflation Factor (VIF), with values of 1.25, 1.66, and 1.44 for bonus compensation, political costs, and opportunistic behavior, respectively, confirming no multicollinearity concerns.

The results demonstrate a statistically significant positive relationship between political costs and earnings management ($p < 0.05$), suggesting that heightened regulatory scrutiny in the insurance sector may motivate earnings management as a strategic response. This supports prior research and the Positive Accounting Theory framework, which posits that firms facing higher political costs engage in earnings management to mitigate scrutiny (Watts & Zimmerman, 1986; Zhang et al., 2022). Conversely, the negative association between bonus compensation and earnings management ($p < 0.05$) implies that performance-based incentives align managerial actions more closely with shareholder interests, thereby reducing the likelihood of earnings manipulation, consistent with Agency Theory (Healy, 1985; Jensen & Meckling, 1976). Opportunistic behavior, captured through operating investing ratio and ROA, did not significantly impact earnings management, suggesting these metrics may inadequately capture managerial discretion within the insurance context, especially under economic volatility like the COVID-19 pandemic.

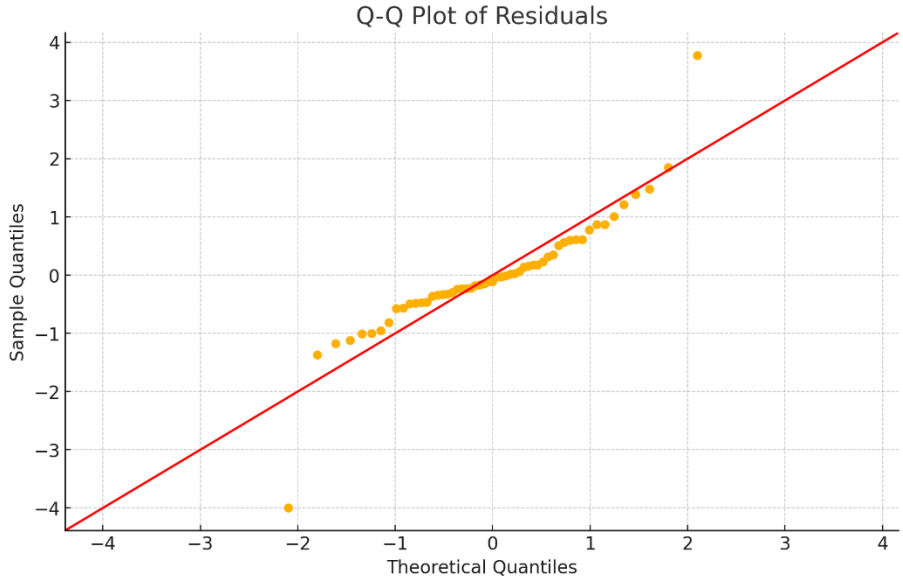
Assumption Testing and Residual Analysis

To validate model assumptions, residual analysis was performed, including tests for normality, homoscedasticity, and independence of errors. Residual visualizations confirm that the model assumptions are met, adding reliability to the regression findings.

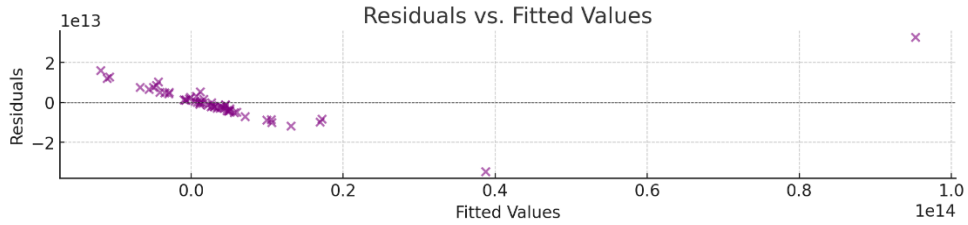
1. Distribution of Residuals



2. Q-Q Plot of Residuals



3. Residuals vs. Fitted Values Plot



These findings align with the research objectives and substantiate the theoretical underpinnings of the study, confirming that the proposed relationships hold in the context of Indonesian insurance firms.

DISCUSSION

The findings of this study reveal a significant relationship between political costs and earnings management practices, as well as a notable negative effect of bonus compensation on earnings manipulation. These results align with previous studies, which emphasize the role of regulatory pressures in motivating managers to engage in earnings management to reduce exposure and mitigate the risks of regulatory intervention. Positive Accounting Theory (PAT), developed by Watts and Zimmerman (1986), supports these findings by

positing that regulatory pressure creates incentives for managers, especially in highly regulated sectors like insurance, to engage in income smoothing as a protective strategy against political costs. Studies by Susanto et al. (2021)and Yudha et al. (2016) provide empirical support, indicating that such pressures lead managers in tightly regulated industries to modify reporting strategies as a response to regulatory scrutiny. This study strengthens these arguments and contributes to the literature by exploring regulatory influence within the context of the Indonesian insurance industry, where strict oversight by the Financial Services Authority (OJK) during the pandemic encouraged firms to maintain financial stability through earnings management.

The observed negative effect of bonus compensation on earnings manipulation further supports agency theory, which posits that performance-based incentives can align shareholder and managerial interests. Healy (1985) demonstrated that long-term performance-based compensation structures reduce earnings manipulation tendencies by focusing managerial attention on sustained corporate growth rather than short-term gains. This study corroborates Healy's findings, and also aligns with the work of Prihastomo and Khafid (2018) in Indonesia, who observed that performance-related compensation structures decrease earnings management risk. However, the absence of significance in the Operating Investing Ratio as a proxy for opportunistic behavior highlights potential limitations when measuring managerial opportunism within the insurance sector. This contrasts with findings by Priantinah (2016), which suggested that cash flow-based proxies might be more effective in sectors with greater liquidity flexibility, such as manufacturing, underscoring the need for industry-specific metrics to accurately capture the nuances of opportunistic behavior.

The theoretical contributions of this research significantly advance PAT and agency theory. Supporting PAT, the study highlights that firms facing high political costs, especially in regulated environments, tend to use earnings management to mitigate regulatory pressures and shield themselves from potential political intervention (Watts & Zimmerman, 1986). This expands theoretical understanding by illustrating how regulatory factors act as external motivators, pushing managers to engage in earnings adjustments as a protective response. The negative relationship between bonus compensation and earnings management also validates agency theory's premise that well-designed compensation structures can mitigate managerial opportunism by aligning executive incentives with shareholder interests. Jensen and Meckling (1976), the architects of agency theory, argued that performance-based incentives could curb opportunistic actions, a notion this study further corroborates by highlighting the efficacy of long-term incentives in fostering transparent reporting.

Another theoretical implication of this study is the need for a contextualized approach to measuring managerial opportunism within the insurance sector. The ineffectiveness of the OIR in detecting earnings management in this context suggests that free cash flow may not accurately capture opportunistic behavior in an industry with constrained cash flow

operations, as observed in insurance. This finding invites further exploration into alternative indicators that may better reflect the unique dynamics of the insurance industry, such as reserve adjustments or premium modifications, which are more central to earnings management decisions in this field.

Practically, the findings hold valuable implications for regulators, policymakers, and firms regarding the design of incentive structures and regulatory policies. The negative association between bonus compensation and earnings management suggests that insurance firms should consider compensation systems that prioritize long-term performance. Performance-based incentives tied to long-term achievements rather than short-term profit benchmarks effectively reduce managerial motivation for earnings manipulation. Furthermore, the OJK, as the Indonesian financial regulator, should recognize that intensifying regulatory pressure may inadvertently drive companies toward earnings management as a defensive tactic. Adaptive policies that address both short-term stability and long-term transparency in financial reporting would help mitigate these risks and foster corporate accountability.

Additionally, the practical implications for auditors and policymakers in the insurance industry are clear. Auditors could leverage these insights to identify areas more susceptible to earnings manipulation, such as firms with high political exposure or misaligned bonus structures. Policymakers in financial regulation might use this research to develop guidelines that promote transparency and accountability, such as implementing clawback provisions. Such provisions, which allow companies to recover bonuses in cases of financial restatements, have been suggested by Bebchuk and Fried (2004) as an effective deterrent against earnings manipulation. These findings underline the importance of regulatory strategies that create a more ethical and transparent business environment, enhancing both investor confidence and market integrity.

This research reinforces the relevance of agency theory and PAT in explaining the impact of performance-based incentives and regulatory pressures on financial reporting practices within regulated industries. Overall, these findings contribute to accounting literature by offering insights and recommendations that enhance corporate governance and capital market integrity in Indonesia.

CONCLUSIONS AND RECOMMENDATIONS

This study provides a detailed examination of how bonus compensation, political costs, and opportunistic behavior influence earnings management practices among Indonesian insurance firms listed on the Indonesia Stock Exchange from 2019 to 2023. The findings reveal a significant positive relationship between political costs and earnings management, indicating that insurance firms facing heightened regulatory scrutiny tend to engage in earnings management as a defensive mechanism. In contrast, bonus compensation was found to be significantly negatively associated with earnings management, suggesting that well-designed performance-based compensation

aligns managerial actions with shareholder interests, thereby diminishing incentives for earnings manipulation. Interestingly, opportunistic behavior—as measured by the operating investing ratio and ROA—did not demonstrate a statistically significant effect on earnings management, possibly indicating the need for more nuanced or sector-specific proxies in capturing opportunism within the insurance industry.

Theoretically, this study offers a significant contribution to both Agency Theory and Positive Accounting Theory by applying these frameworks within the specific regulatory and financial context of the Indonesian insurance sector. By establishing that bonus compensation can effectively curb earnings management, the findings enhance our understanding of how incentive structures can mitigate agency problems and align manager's behavior with organizational goals. The support for Positive Accounting Theory within a highly regulated industry also underscores the notion that firms strategically manage political costs through earnings management, especially in emerging economies where regulatory oversight may be unpredictable. This evidence reinforces the relevance of these theories while offering new insights into how regulatory pressures and performance-based compensation intersect to influence managerial decision-making in financial reporting.

Practically, the study offers actionable insights for regulators, policymakers, and practitioners in the insurance and financial sectors. For regulators, the findings emphasize the importance of vigilant oversight in politically sensitive industries, as firms in these sectors may be particularly inclined toward earnings manipulation in response to regulatory pressures. The results also underscore the value of incentive structures that emphasize long-term stability and transparency, recommending that firms in high-regulation sectors design compensation schemes to mitigate short-term financial manipulation and align with long-term organizational integrity. Policymakers could leverage these insights to develop tailored regulatory frameworks that encourage transparency while considering the unique dynamics of the insurance sector in emerging markets.

ADVANCED RESEARCH

This study introduces notable novelty by focusing on the interplay of political costs, bonus compensation, and opportunistic behavior within the Indonesian insurance industry—an area that has seen limited empirical examination, especially in emerging market contexts. The findings offer a unique perspective on how the distinctive regulatory and operational challenges of the insurance sector shape earnings management practices, providing a foundation for further exploration. This focus not only broadens the scope of Positive Accounting Theory and Agency Theory but also adds new empirical insights relevant to emerging markets, a dimension often underrepresented in existing literature.

Given the observed significance of political costs and bonus compensation on earnings management, future research could investigate other regulatory-sensitive industries or expand this analysis to other emerging

economies to assess the generalizability of these findings. Additionally, exploring alternative measures of opportunistic behavior or incorporating qualitative approaches could offer a deeper understanding of managerial motivations and practices. Extending this research to examine the impact of evolving regulatory environments—particularly in response to global crises like the COVID-19 pandemic—could yield valuable insights into the resilience and adaptability of earnings management practices across sectors and regions.

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