

## ***THE ROLE OF GOOD CORPORATE GOVERNANCE ON EARNINGS MANAGEMENT IN INDONESIA***

### **PERAN TATA KELOLA PERUSAHAAN TERHADAP MANAJEMEN LABA DI INDONESIA**

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#### ***Abstract***

*This study aims to analyze the effect of implementing good corporate governance in controlling corporate earnings management in companies listed on the Indonesia Stock Exchange (IDX). Earnings management is the dependent variable in this study and the independent variables used in this study are the board of commissioner's size, the independent board of commissioner's size, the board of commissioner's activity, of the audit committee size, the independent audit committee size, and the audit firm size. The control variables in this study are audit quality, company size, leverage, and return on assets. The research population is companies listed on the Indonesia Stock Exchange. The samples used in this study involved 127 manufacturing companies listed on the Indonesia Stock Exchange in the period 2013 to 2017. The sample selection was carried out using the purposive sampling method. The data used in this study is financial data in annual reports published on [www.idx.co.id](http://www.idx.co.id). The results of this study have proved that the board of commissioner size, independent board of commissioners, audit committee size, audit committee independence and return on asset have significant positive influence on earnings management. Board of commissioner activity, audit firm size, and leverage can significantly influence earnings management negatively. Audit quality and company size were not proven to significantly influence earnings management.*

***Keywords:*** Good Corporate Governance; Earnings Management; Indonesian Stock Exchange

#### ***Abstrak***

Penelitian ini bertujuan untuk menganalisis pengaruh good corporate governance dalam pengendalian manajemen laba perusahaan pada perusahaan yang terdaftar di Bursa Efek Indonesia (BEI). Manajemen laba merupakan variabel dependen dalam penelitian ini dan variabel independen yang digunakan dalam penelitian ini adalah ukuran dewan komisaris, ukuran dewan komisaris independen, aktivitas dewan komisaris, ukuran komite audit, ukuran komite audit independen, dan ukuran komite audit independen. ukuran perusahaan audit. Variabel kontrol dalam penelitian ini adalah kualitas audit, ukuran perusahaan, leverage, dan return on asset. Populasi yang digunakan dalam penelitian ini adalah perusahaan yang terdaftar di Bursa Efek Indonesia. Penelitian ini melibatkan 127 perusahaan manufaktur yang terdaftar di Bursa Efek Indonesia pada periode 2013-2017 sebagai sample penelitian. Pemilihan sampel dilakukan dengan menggunakan metode *purposive sampling*. Data yang digunakan dalam penelitian ini adalah data keuangan dalam laporan tahunan yang dipublikasikan di [www.idx.co.id](http://www.idx.co.id). Data yang diperlukan diambil dari laporan keuangan tahunan kemudian diuji dengan metode regresi linier berganda. Software statistik SPSS dipilih untuk menguji data dalam penelitian ini. Hasil penelitian ini membuktikan bahwa ukuran dewan komisaris, dewan komisaris independen, ukuran komite audit, independensi komite audit dan return on asset berpengaruh positif signifikan terhadap manajemen laba. Aktivitas dewan komisaris, ukuran perusahaan audit, dan leverage secara signifikan dapat mempengaruhi manajemen laba secara negatif. Kualitas audit dan ukuran perusahaan tidak terbukti berpengaruh signifikan terhadap manajemen laba.

**Kata Kunci:** Tata Kelola Perusahaan; Manajemen Laba; Bursa Efek Indonesia

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## **INTRODUCTION**

Financial reporting is one of the means to assess the performance of a company. Financial statements provide financial information including financial position, financial performance, changes in the financial position, cash flow of a company that is used for making decisions. The manager is a party who is very instrumental in evaluating the company's performance in decision making. Such a report is also employed as a tool to communicate the company's performance, including both financial and non-financial information, to external elements such as investors or shareholders, creditors, government, and other related stakeholders. However, financial reporting often becomes a questionable book for investors as it is a product yielded by the management implying that they can intervene in it.

Corporate Governance is a process and structure applied in company to manage shareholder value by regarding the interest of stakeholders. Various financial scandals involving many large cooperatives such as Enron, World Com, Parmalat, Xerox, and soon in the 2000s gave rise to public opinion that earnings management was imposed due to the opportunistic behavior of managers who wanted to gain personal profit (Suyono, 2017).

According to Al-Janadi, Rahman and Alazzani, (2016), one of earnings management goals is to minimize taxes. The company considers tax as an expense, so they will minimize their tax payments. Taxes can be minimized in the legal and illegal forms, according to the law, or referred to as tax avoidance and tax evasion. Companies will choose a safe way to avoid tax legally by doing tax avoidance. Earnings management and tax avoidance which are deviations and can be prevented by the existence of good corporate governance (GCG) (Abbadi, Hijazi, & Al-Rahahleh, 2016). Corporate governance role in earnings management is to take control on manager in the possibility of earnings management practice (Lolana & Dwimulyani, 2019; Tiurmaida, 2018).

Earnings management arises as an effect of agency problems, namely the inconsistency of interests between managers and company owners due to information asymmetry, a condition where there is an imbalance in information between management and shareholders (Abed, Al-Attar, & Suwaidan, 2011). Recent earning management practice case in Indonesia accured in PT. Garuda Indonesia, Tbk. The firm found to be reported earnings in 2018 higher than it should. The auditor found that they report revenue from transaction that should not be accounted as revenue yet, therefore they can earn income (CNN Indonesia, 2019).

Based on the discussion above, the data concluded that earnings management is one of the factors that influence the quality of financial statements so that it can influence the decisions of accounting information users. Therefore, this research focus on the effect of good corporate governance on earnings management.

## **LITERATURE REVIEW**

Earnings management is a practice to misrepresent a firm's performance according to management's benefit. Earnings management is a strategy used by management companies to intentionally manipulate such as raising and lowering company revenue so that the numbers are exactly what has been determined by the company's target (Iraya, Mwangi, & Muchoki, 2015).

According to Hernando (2011), earnings management will add bias in financial statements for stakeholders. This will affect the quality of financial information and give bias information regarding financial performance that may lead to the misleading decision making. Therefore, earnings management can reduce credibility of financial statements and disrupt financial statement users in the reliability of financial statements information.

### **Corporate Governance and Earnings Management**

Corporate governance can help to create the specific structure of the distribution of rights and responsibilities of each different person within an organization (internal and external parties) and adhere to rules and procedures in the decision-making process so that decisions are made the best decisions that each company has and of course different and separate ownership. The practice of corporate governance becomes very important to

do which certainly has a very effective effect on companies in the market in the industry. If this mechanism does not work well or even does not exist, outside investors will be reluctant not even want to spend their investment in the company, which will undermine the financial condition of the company itself (Xue & Hong, 2016; Abed, Al-Attar, & Suwaidan, 2011). Good corporate governance is a corporate governance system used to improve company's performance and binding all interested parties, including the company's management by using certain principles. Corporate governance is needed not only for internal company but also by external parties. This will relate to how the external party obtains the best information and guarantees for the company for the future.

Board characteristics might influence the possibility of firm managing earnings (Hanim et al., 2012; Aygun & Sayim, 2014). Then research conducted by Amin et al. (2017) states that the size of the board of commissioners negatively affects earnings management. The board of commissioners oversees supervising and providing input to the company's board of directors. The main function of board of commissioners is to supervise the quality of performance reporting.

Isnalita and Utama (2013) stated that independent commissioner is the member of commissioner board from outside organization and stand independent without any relation to the organization. Independent commissioner has functions as other board commissioner which provides advice, opinions, and input for the management to achieve company goals. Independent of board commissioner has significant negative effect on earning management.

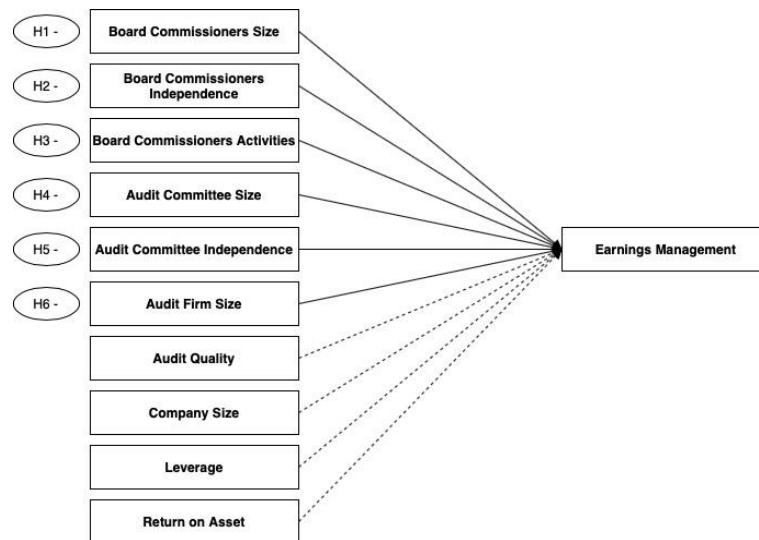
Salleh and Haat (2014) state that the activities of the board of commissioners have a negative relationship with earnings management. Board of Commissioners meetings are often held in one period, the opportunity for earnings management to be smaller. This is because companies with less frequent board meetings tend to produce poor quality financial reports. These results are consistent with Amin et al. (2017). While Iraya et al. (2015) stated that the activities of the board of commissioners had a significant positive effect on earnings management.

Audit committee also has influence on earnings management practice of firm (Susanto, 2016). Mardjono and Chen (2020) found that there was a negative relationship

in earnings management which showed that a larger audit committee could reduce earnings management activities in a company. Ayemere and Elijah (2015) stated that the independence of the audit committee had a negative influence on earnings management. The more independent the audit committee, the less the level of earnings management can be. The more independent members of the committee, the more reliable the quality of financial reporting by companies and can reduce the company in earnings management, and fraud in financial reporting.

Based on the results of studies conducted by Laily (2017), Vina and Zulaika (2014), showed that the larger audit firm that audits the company's financial statements, where there are auditors who have high experience and expertise, the earnings management practices in the company are small. Auditors in big audit firm are more able to find errors in the client's accounting system, besides that the auditor is likely to limit the client's earnings management practices (Yasser & Soliman, 2018; Tambun, Sitorus, Panjaitan & Hardiah, 2017). The audit firm with good audit quality can increase the control of firm's earning management practice (Ahmad, Suhara, & Ilyas, 2016).

Based on the description above, the hypothesis in this research are as follows:



**Figure 1. Research Model**

## METHODOLOGY

This research is a basic research and can be calculated by using statistics analysis method. The population used in this study to test the hypothesis is companies listed on Indonesia Stock Exchange (IDX). The data used are financial statement published in IDX website at [www.idx.co.id](http://www.idx.co.id). The companies that were chosen as the samples are 127 manufacture public companies listed on the Indonesia Stock Exchange from 2013-2017. We used purposive sampling method to choose samples that matches with research purposes. Sample criteria are as follows:

1. Whether the manufacture company is public and listed in the Indonesia Stock Exchange.
2. Companies that publish annual audited financial statements (audited annual report) from 2013 to 2017.
3. The company's financial statements have data relating to the research variable.

### Research Variables

The dependent variable is Earnings Management. Earnings management are measured using discretionary accruals. In this research, discretionary accruals used Jones Model. Board Commissioners size, Independent of Board Commissioners, Activity of Board Commissioners, Audit Committee size, Independent of Audit Committee, and audit firm size are the independent variables. While the Audit quality, Company Size, Leverage, and Return on Assets are control variables in this research. The research model is described in the form of a formula as follows:

$$EM_{it} = \beta_1 BC_{it} + \beta_2 BCI_{it} + \beta_3 BCA_{it} + \beta_4 AC_{it} + \beta_5 ACI_{it} + \beta_6 BIG4_{it} + \beta_7 AQ_{it} + \beta_8 SIZE_{it} + \beta_9 LEV_{it} + \beta_{10} ROA_{it} + \varepsilon_{it}$$

Where:

$EM_{it}$ , is Earning Management;

$\beta_1 BC_{it}$ , is total number of Board Commissioners members;

$\beta_2 BCI_{it}$ , is total number of Independent Board Commissioners members;

$\beta_3 BCA_{it}$ , is number of meetings of Board Commissioners;

$\beta_4 AC_{it}$ , is total number of Audit Committee members;

$\beta_5 ACI_{it}$ , is total number of Independent Audit Committee members;

$\beta_6$ BIG4<sub>it</sub>, is audit firm size;

$\beta_7$ AQ<sub>it</sub>, is audit committee members that skilled in accounting;

$\beta_8$ SIZE<sub>it</sub>, is the company size by total assets;

$\beta_9$ LEV<sub>it</sub>, is leverage ratio;

$\beta_{10}$ ROA<sub>it</sub>, is ROA ratio;

$\epsilon_{it}$ , is residual error;

## RESULT AND DISCUSSION

The number of companies registered at Indonesia Stock Exchange are 572 companies, of which there are 417 non-manufacturing companies and 155 manufacturing companies. Among the 155 manufacturing companies, 28 companies did not fulfill the criteria, and the samples used were 127 companies with 635 observational data and 30 outlier data.

**Table 1 Descriptive Statistics Results of Research Variables**

	N	Minimum	Maximum	Mean	Std. Deviation
Earning Management	605	-5,1400	1,0800	-0,8581	0,5366
Board of commissioner size	605	2,0000	11,0000	4,1700	1,6800
Board of commissioners Independence	605	0,0000	1,0000	0,3900	0,1410
Board of CommissionersActivity	605	1,0000	82,0000	13,7400	11,4410
Audit Committee Size	605	2,0000	5,0000	3,0100	0,4070
Audit Committee Independence	605	0,0000	1,0000	0,0483	0,19095
Audit Quality	605	0,0000	1,5000	0,7750	0,2602
Company Size	605	10,7500	17,3900	12,3554	0,7459
Leverage	605	0,0000	4,3000	0,5233	0,3481
Return on Asset	605	-0,6100	2,1200	0,0491	0,1490
Valid N (listwise)	605				

Base on the descriptive statistical test result above, it shows that EM has a minimum value of -5,14 and a maximum value of 1,08 with the average value is -0,8581. If the test results show a negative value, it means the company is doing earnings management by lowering their profits. To achieve a certain goal is also a reason for a company to decrease its profit. If the test results show a positive value, it means the company



increases their earnings. It can be concluded that most of the manufacturing companies in Indonesia did not increase their profits as evidenced by the test results showed a value of -0.88581.

Manufacturing companies in Indonesia have an average of 4.17 boards of commissioners. With details of the minimum number is 2 and the maximum boards of commissioners are 11. This has fulfilled the requirements issued by OJK No.33/POJK.04/2014 article 20 which required minimum 2 of boards of commissioners. In the regulation issued OJK No.33/POJK.04/2014 article 20 paragraph 3 required at least 30% boards commissioners are independent. According to the data that has been tested, we can see that the minimum amount is 0 and the maximum is 1 with an average of 0.39. This means that not all companies have implemented the regulation well yet. POJK Regulation number 30 of 2014 article 31 also has been explained that 'the Board of Commissioners must hold a meeting at least once in two months.' And can conclude that the minimum meeting is 6 times a year. From data that has been tested shows that the minimum number of meetings of the board of commissioners is 1 and a maximum of 82 meetings. The average board meeting is 13.78 times. This figure has met the standards set by POJK.

The results of the audit committee size indicate an average value of 3.01, a minimum value of 2 and a maximum of 5. This result reflects that the average company in Indonesia has complied with regulations issued by BAPEPAM by regulation number KEP-643/BL/2012, where the audit committee consists of at least three members.

The results of the independence of the audit committee showed an average value of 4.83%. This result reflects that companies in Indonesia have not complied with regulations issued by BAPEPAM, where at least 51% of the audit committee members are independent commissioners or independent parties. An external audit committee can protect the interests of shareholders from earnings management actions taken by management. The minimum number is zero, meaning that it does not have an independent audit committee in the company.



**Table 2 Descriptive Frequency Statistics Results of Research Variables**

		Frequency	%	Valid %	Cumulative %
Valid	Non Big 4	332	54,9	54,9	54,9
	Big 4	273	45,1	45,1	100,0
	Total	605	100,0	100,0	

From the total of 605 data that has been tested, we can see that 54.9% or 332 of the company's data were not audited by the big four auditors. In opposition, 273 company data or 45.1% of them have been audited by big four auditors.

**Table 3 t-Test Result**

Variable	t-Statistic	Prob.	Description	Expectation
C	-0.730499	0.4654		
Board of Commissioner size	1.131809	0.0282	Significant Positive	H1 Not Proven
Board of Commissioners Independence	0.0282	0.0404	Significant Positive	H2 Not Proven
Board of Commissioners Activity	-0.034021	0.0129	Significant Negative	H3 Proven
Audit Committee Size	0.268982	0.0480	Significant Positive	H4 Not Proven
Audit Committee Independence	1.097255	0.0330	Significant Positive	H5 Not Proven
Audit Firm Size	-3.328068	0.0009	Significant Negative	H6 Proven
Audit Quality	-0.328803	0.7424	Not Significant	-
Company Size	0.377832	0.7057	Not Significant	-
Leverage	-8.038176	0.0000	Significant Negative	-
Return on Asset	7.809811	0.0000	Significant Positive	-

Test results of t-test show a number less than 0.05 probability for BC, BCI, BCA, AC, ACI, BIG-4, LEV and ROA, which means that this variable has a significant effect

on EM. Conversely, if the test results show probability values above 0.05 such as AQ and SIZE, this indicates that these two variables do not have a significant effect on EM.

Based on the results of tests that have been carried out, BC and BCI show significant positive effect in EM. This means that the bigger BC and BCI will increase the possibility of EM. Therefore, the H1 and H2 is not supported. The results of this study also indicate that BCA significantly influence EM. Therefore, the H3 is proven. This result is in line with Salleh and Haat's (2014) hypothesis which states that the higher BCA in one period can reduce the opportunity for management to manage earnings.

The results of this study indicate that the AC and ACI has significant positive effect on EM. Increasing audit committee members can increase the possibility of EM showing the presence of members does not provide much incentive to retain EM. Therefore, H4 and H5 is not supported. This result is not consistent with the research hypothesis by Ayemere and Elijah (2015), Iraya et al. (2015), and Salleh and Haat (2014).

In the results of tests that have been carried out, we can see that the results of the research show BIG-4 has significant negative results. This result indicates that the bigger audit firm who audited company's financial statements with high experience and expertise, the EM practices in the company are smaller. Therefore, H6 is supported. It also consistent with the research of Kono (2013).

## **CONCLUSION**

Based on the research of manufacturing companies registered in the Indonesia Stock Exchange (2013-2017), it can be concluded that BC, BCI, AC, ACI, and ROA show significant positive result to EM. On the contrary, BCA, BIG-4, and LEV has a significant negative effect on EM. AQ and SIZE does not significantly influence EM. The result might suggest that corporate governance practice in Indonesia have not significantly reducing earnings management practice. It might be because the majority of listed companies are complying with the corporate governance regulation but ignoring the effectiveness of the good corporate governance practice in increasing earnings quality (Sari, 2017).

This research has some limitations because there are still many companies listed on the Indonesian Stock Exchange that do not publish annual report data or complete data

from 2013 to 2017, respectively. Recommendations that can be given from the author for future research are to expand the time horizon of the study for the best result and could show the right model with observational data. Then to add other corporate governance measures as independent variables which have a stronger influence to producing a better research model.

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