EARNING MANAGEMENT AND GOOD CORPORATE GOVERNANCE: A MODERATION OF SIZE AND AGE COMPANY

Aprelia Anggi Safitri;
Bambang Sugeng
Nurika Restuningdiah

ABSTRACT

This research aims to examine the effect of good corporate governance on earnings management and under what conditions this influence can be maximized. The test was carried out on 51 manufacturing companies listed on the Indonesia Stock Exchange in the period 2012-2018. The independent variables used are Managerial Ownership, Institutional Ownership, Size of the Board of Commissioners, Financial Leverage, with the moderation of company size and company age. Statistical test results show that the board of commissioners and financial leverage can suppress earnings management. Furthermore, in large company sizes, institutional ownership and the board of commissioners can further suppress the practice of earnings management. Finally, in the moderation of long company life, only managerial ownership and institutional ownership can suppress earnings management practices. The implication of this research is to provide empirical evidence of the consequences of agency relationships that can be beneficial or detrimental to the company.

Keywords: Earnings Management, Managerial Ownership, Institutional Ownership, Board of Commissioners Size, Financial Leverage, Company Size, Company Age

INTRODUCTION

Research related to earnings management is important even though it has been repeatedly tested by previous researchers because it is often found in developing markets such as Indonesia and this is allegedly having an impact on the quality of earnings presented in the financial statements of listed companies. The findings of the latest earnings management practice, namely PT Garuda Indonesia in 2018 which carried out earnings management in the form of income smoothing by recognizing receivables as profit PT Inovisi Infracom in 2014 made an error in the financial statements. PT Elnusa in 2011 used the company's reserves to polish its financial statements. In 2010 the Bakri Group, namely PT Kaltim Prima Coal, PT Arutmin Indonesia and PT Bumi Resources reported lower than expected sales during the 2003-2008 period. In the same year the Bakri Group PT Bakrie & Brothers (BNBR), PT Bakrie Sumatra Plantantions (UNSP), PT Energi Mega Persada (ENRG) manipulated investment funds at Bank Capital. PT Katarina Utama in 2009 manipulated receivables and inflated the company's assets. PT Agis in 2007 polished the subsidiary's financial statements without any evidence and errors in accounting principles. In 2003 PT Bank Negara Indonesia made a fictitious fund reserve of up to 1.7 trillion rupiahs. These various earnings management cases prove that the ultimate goal of earnings management looks good in the "glasses" of investors.

Earnings management is carried out by intervening in the process of preparing financial statements for external parties so that they can even out, increase, and decrease company profits using various accounting methods. The practice by management of choosing accounting methods in financial statements is, in fact, a reflection of positive accounting theory. Earnings management behaviour is connectivity between shareholders and managers, agency conflicts arise when managers are obliged to optimize shareholder profits but on the other hand, management also needs incentives/bonuses (Jansen and Mekling, 1986). The simple term is the existence of opportunistic behaviour caused by inappropriate incentives, which encourage managers to distort information in financial statements.

Earnings management in emerging markets has received great attention from researchers (Bao and Lewellyn, 2016). Emerging markets are characterized by unstable institutions, a weak rule of law, and a lack of information transparency and disclosure (Li et al., 2014). Bao and Lewellyn (2016) argue that the quality and accuracy of financial information reported by companies today continue to be questioned in practice and scientific research. This indicates that today's society is increasingly critical of responding to information published by the management. Regulatory bodies in emerging markets are also paying more attention to earnings management conditions, as it can threaten foreign investment and corporate partnerships in emerging markets.

Various previous repeated studies have shown that there are various conclusions with gaps related to findings related to earnings management that form three patterns, namely the presence of a significant positive effect, a significant negative effect and no influence at all on the variables of managerial ownership, institutional ownership, and the size of the board of commissioners. , financial leverage on earnings management. These results are related to the existence of agency theory predicting a low level of managerial ownership implying poor alignment of interests between management and shareholders (Jensen & Meckling, 1976) i.e. with little ownership may have incentives to manage accounting numbers to increase income-based compensation, reduce constraints. contracts, or avoiding debt covenants (Healy, 1985; Holthausen et al., 1995). Managerial ownership can be seen as a way to limit the opportunistic behaviour of managers who are considered capable of controlling earnings management (Warfield, Wild, & Wild, 1995; Fayoumi et al., 2010; Aygun et al. 2014; Yuniarti, 2013; Cahyawati and Setiana, 2018).

The existence of institutional investors is considered capable of being an effective monitoring mechanism in every decision made by managers, this condition will reduce agency conflicts which are increasingly difficult to do. Involvement in strategic decision making becomes the strength of institutional investors in exercising control. Furthermore, the board of commissioners is also considered an effective governance mechanism that reduces earnings management practices because the existence of a supervisory board will certainly cause management to reduce opportunistic behaviour in earnings management. Meanwhile, companies that have high financial leverage due to the amount of debt compared to assets owned by the company are suspected of carrying out earnings management because the company is threatened with bankruptcy, that is cannot fulfil its obligations to pay debts on time (Anagnostopoulou and Tsekrekos, 2016). This condition certainly does not provide benefits to management, it is not surprising that all resources will be used, including doing earnings management.

The majority of previous research was conducted on manufacturing companies listed on the Stock Exchange starting in the 2007 period until the last in 2017 period, research findings in this range, resulted in quite diverse conclusions, Pradana (2018) conducted in mining companies, Dul Muid (2009) companies banking sector, Andawiyah (2016) in automotive and component companies listed on the Indonesia Stock Exchange. The existence of the age range of the company and the size of the company is suspected to be one of the various conclusions (Alzaubi et al, 2012 and Huang et al., 2013). Large companies have complexity and complexity in monitoring and openness to access to information, considering that there are many parties involved in the mechanism compared to small companies. In addition, the company that has been established for a long time has various experiences in managing operations, the reputation that has been built will encourage institutional investors to become part of the company because they see the potential of the company. Therefore, companies with long life and large size are considered to be able to strengthen the role of GCG in earnings management.

The final objective of this research is to determine how the components of good corporate governance (GCG) can minimize earnings management. In addition, the size and age of the company are used as a moderator to prove whether variations in the length and size of the company can increase the influence of both. The results of this research can provide empirical evidence and support for the agency theory used, besides that it is also able to explain the importance of market credibility related to the preparation of regulations and corporate governance.

METHOD

This study uses a quantitative approach to examine the population and sample. Data were collected using instruments, then analyzed with statistics. In this study, researchers obtained data from financial reports where researchers collected data using documentation and literature review. Researchers will observe and test the data obtained to make conclusions.

RESULTS AND DISCUSSION

The results of testing managerial ownership on earnings management do not support agency theory which agrees that agency conflict is caused by differences in interests between agents and principals. The difference in the results of this study may be because manufacturing companies in Indonesia in 2012-2018 tend to improve the practice of Good Corporate Governance (GCG) to harmonize the existence of earnings management in the company. This means, the larger the shares owned by the manager, the higher the probability that the manager will carry out earnings management. The results of this study support the results of Pradana's research (2018) which reveals that high managerial ownership increases the opportunities for managers to carry out earnings management. The results of this study are consistent with the results of research by Al Fayoumi et al. (2010); Aygun et al. (2014); Yuniarti (2013); Cahyawati and Setiana (2018).

The test results show that the second hypothesis is rejected because institutional ownership has a positive effect on earnings management. This means that the larger the shares owned by the institution, the higher the probability that the institution will carry out earnings management. This is probably because institutional investors in manufacturing companies in Indonesia in 2012-2018 may be included in investors who monitor passively or are short-term oriented rather than actively participating in company operations. Elysiani and Jia (2010) reveal that the passive monitoring view is that institutional investors with short term traders are interested in getting short-term profits based on the superiority of their information to meet portfolio needs rather than overseeing corporate governance. These results support the research of Lin and Fu (2017).

The board of commissioners represents an effective governance mechanism that can harmonize earnings management practices. When the interests of the two parties are not in line, managers are assumed to try to maximize their interests, according to agency theory. The results of this study support the results of Chin et al. (2006), Davila and Watkins (2009) and Obigemi et al. (2016) which shows a negative relationship between the size of the board of commissioners and earnings management. The difference in roles that arise from the shareholder and manager as a manager raises a conflict of interest. So this is where the importance of the presence of the board of commissioners as the company's operational supervisor, to minimize management's opportunistic behaviour. The test results show that financial leverage harms earnings management. This means that the higher the financial leverage, the lower the level of earnings management that occurs in a company. The results of this study may be because manufacturing companies in Indonesia in 2012-2018 considered leverage as a mechanism to reduce company information asymmetry.

In the condition of large company size, the board of commissioners was proven to be effective in preventing old management practices. This is because opportunistic behaviour can be prevented by the presence of a controller that is the board of commissioners. This is evident in one case of an airline owned by a state-owned company that carried out earnings management, but two commissioners found irregularities in the report even though four commissioners signed the financial statements. In general, the larger the company, the more complex the field of work carried out, so it will require more commissioners (Salihi and Jibril, 2012).

Meanwhile, in conditions of long company age, managerial ownership and institutional ownership have conditions that are more able to suppress earnings management. This is because age and size are representations of the long journey and complexity of problems that result in the company's experience in running the company. Management processes in companies that have been operating for a long time and have a large size are considered to have complete information with a low error rate in presenting financial statements. Even though there are indications of opportunistic behaviour, it is possible, as explained by agency theory, considering that each party has an interest. Especially if the management has a share of shares in a company that has been well managed for a long time, it certainly has sufficient experience to manage the company (Mery, 2007). These results are consistent with research by Huang et al (2013) and Herdjiono and Sari (2017).

Finally, in the conditions of developing countries in Indonesia and during the observation period, various events occurred which made not all GCG components able to suppress earnings management. The board of commissioners and financial leverage are considered capable of suppressing and weakening earnings management practices that occur. And in the condition of large companies, institutional ownership and the board of commissioners have the biggest role in suppressing earnings management. Finally, in companies that have been around for a long time, institutional and managerial ownership are the ones that are most able to suppress earnings management practices.

CONCLUSION

This study produces several important findings and supports related to earnings management from the perspective of agency theory and positive accounting theory in manufacturing companies listed on the Indonesia Stock Exchange for the period 2012-2018. The test results find interesting results that not all GCG components can suppress earnings management under normal conditions. There are various conditions in which these components can suppress earnings management practices more strongly. Such as the findings which state that even though the Board of Commissioners and Financial leverage are considered capable of suppressing and weakening earnings management practices that occur. However, in the condition of large companies, institutional ownership and the board of commissioners have the greatest role in suppressing earnings management. And in companies that have been around for a long time, institutional and managerial ownership are the ones that are most able to suppress earnings management practices.

This study also adds to empirical evidence of positive accounting theory which shows that firm size reduces the ability of institutions and boards of commissioners to control earnings management, while firm age reduces the ability of institutions, management, boards of commissioners, and financial leverage to control earnings management. This proves that there are consequences for the agency relationship between parties in the company and is related to positive accounting theory. In addition, this study also supports the theory which states that the board of commissioners is an effective governance mechanism to reduce earnings management practices with the authority to supervise management in running the company.

However, this study looks at immediate managerial ownership, namely direct ownership of the company that is not explored more deeply and the amount of ownership of a shareholder is determined only based on the percentage of shares written in the name of a shareholder. On this basis, it is expected to use ultimate ownership, namely direct and indirect ownership of public companies. Based on the ownership concept, the series of ownership must be explored more deeply so that the ultimate owner can be identified more specifically.

REFERENCES

Ajay, Rajitha dan Madhumathi, R. (2015). Institusional Owbership and Earning Management in India. *Indian Journal of Corporate Governance*. Vol.8. no.2:119-136.

Al-Fayoumi,N., Abuzayed, B., & Alexander, D. (2010). Ownership Structure andEarnings Management in Emerging Markets: The Case of Jordan. *InternationalResearch Journal of Finance and Economics*, 38, 28–47.

Alves, Sandra. (2011). The Effect of Board Structure on Earnings management:Evidence From Portugal. *Journal of Financial Reporting & Accounting*, 9(2),141-160.

Alzoubi, E.S.S. (2017), Audit quality, debt financing, and earnings management: Evidence from Jordan. *Journal of International Accounting, Auditing and Taxation*, 11(1), 51-76.

Anagnostopoulou, S.C., Tsekrekos, A.E. (2016). The Effect of Financial Leverage onReal and Accrual-Based Earnings Management. *Accounting and BusinessResearch*, 47(2), 191-236.

Andawiyah, Syarifah rabi dan Furgani, Astri. (2016). Faktor-Faktor Yang Mempengaruhi Manajemen Laba pada Perusahaan sub Sektor Otomotif dan Komponen yang Terdaftar di Bursa Efek Indonesia (periode 2010-2015). Jurnal Performance Bisnis dan Akuntansi. Vol.6. No.2. pp:11-21.

Bao, S. R., & Lewellyn, K, B. (2016). Ownership Structure and EarningsManagement in Emerging Markets: An Institutionalized Agency Perspective. *International Business Review*, xxx, xxx-xxx

Cahyawati, Noor Endah dan Setiana, Nurtyas Mei. (2018). Manipulasi Aktivitas Riil pada Perusahaan Manufaktur: Studi Empiris di Bursa Efek Indonesia. *Jurnal Akuntansi dan Auditing Indonesia*. Vol.22 No.1. pp:61-69.

Cahyawati, Noor Endah dan Setiana, Nurtyas Mei. (2018). Manipulasi Aktivitas Riil pada Perusahaan Manufaktur: Studi Empiris di Bursa Efek Indonesia. *Jurnal Akuntansi dan Auditing Indonesia*. Vol.22 No.1. pp:61-69.

Chin, K., Firth, M., & Kim, J. (2006). Earnings Management Corporate GovernanceAnd The Market Performance of Seasoned Equity Offerings. *Journal ofContemporary Accounting and Economics*, 36, 73–98.

Davila, M., & Watkins, K. (2009). Corporate Governance and Turnovers in Me´xico.*Working Paper*(pp. 1–34). Universidad Popular Auto´noma de Puebla

Dul Muid. (2019). Faktor-Faktor Yang Mempengaruhi Manajemen Laba Pada Perusahaan Perbankan di Bursa Efek Indonesia. *Jurnal Dinamika Ekonomi dan Bisnis*. Vol. 6. No.2. pp:121-136.

Healy, P. M. & Wahlen, J. M. (1999). A Review of The Earnings Management Literature And Its Implications For Standard Setting. *Accounting Horizons*, 13 (4), 365-383.

Holthausen, R. W., Larcker, D. F., & Sloan, R. G. (1995). Annual Bonus Schemes and The Manipulation of Earnings. *Journal of accounting and economics*, 19 (1), 29-74

Jensen, M.C. and Meckling, W.H. (1976). Theory of the firm: managerial behavior, agency cost, and ownership structure. *Journal of Financial Economics*. Vol. 76, pp. 305-360.

Li, S., Park, S. H., & Bao, R. S. (2014). How Much Can We Trust The FinancialReport? Earnings Management In Emerging Economies. *International Journalof Emerging Markets*, 9(1).

Obigbemi, I.F., Omolehinwa, E. O., Mukoro, D. O., Caleb, E. B., & Olusanmi, O. A.(2016). Earnings Management and Board Structure: Evidence From Nigeria.*Sage Open*, 6(3).

Pradana, Alfino Bagus. (2018). Faktor-Faktor Yang Mempengaruhi Manajemen Laba Pada Perusahan Go Public Sektor Pertambangan Yang Terdaftar adi Bursa Efek Indonesia. Skripsi tidak diterbitkan. Yogyakarta: Universitas Islam Indonesia.

Shayan-Nia, M., Sinnadurai, P., Mohd-Sanusi, Z., & Hermawan, A. Ni. A. (2017). How efficient ownership structure monitors income manipulation? Evidence of real earnings management among Malaysian firms. *Research in International Business and Finance*, 41(April), 54–66.

Yuniarti, Penti. (2013). Faktor-Faktor Yang Mempengaruhi Manajemen Laba (Studi Perusahaan Manufaktur Terdaftar di Bursa Efek Indonesia). Skripsi tidak diterbitkan. Surakarta: Universitas Muhammadiyah Surakarta.

Aprelia Anggi Safitri;
Faculty of Economics and Business
Universitas Negeri Malang, 65145 Malang, Indonesia
Email: apreliaanggis@gmail.com

Bambang Sugeng
Faculty of Economics and Business
Universitas Negeri Malang, 65145 Malang, Indonesia
Email: bambang.sugeng.fe@um.ac.id

Nurika Restuningdiah
Faculty of Economics and Business
Universitas Negeri Malang, 65145 Malang, Indonesia