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THE EFFECT OF GOOD CORPORATE GOVERNANCE ON EARNINGS MANAGEMENT OF MANUFACTURE COMPANIES LISTED IN INDONESIA STOCK EXCHANGE

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ABSTRACT

This study aims to analyze the effect of implementing good corporate governance in improving the corporate earnings management of manufacturing companies listed on the Indonesia Stock Exchange (IDX). Earnings management is the dependent variable in this study and the independent variables are the size of board commissioners, the independent board of commissioners size, the activities of board commissioners, committee of audit 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.

172 manufacturing companies listed on the Indonesia Stock Exchange are involved in this study, during the period from 2013 to 2017. The sample selection was carried out using the purposive sampling method. The data used in this study is in the form of an annual financial report published on the website of www.idx.co.id. The required data is taken from the annual financial statements and then tested by multiple linear regression methods. While statistical software was chosen to test the data in this study.

The results of this study have proved that the board of commissioner size, independent board of commissioners, audit committee size, and the control variable of return on the asset are able to significantly influence earnings management. A variable control, leverage, then board of commissioner activity, audit firm size, are has a negative significant effect on earnings management. While the audit quality and company size were not proven to significantly influence earnings management.

Keywords: *good corporate governance, earnings management, commissioner size*

INTRODUCTION

IICG (The Indonesian Institute for Corporate Governance) defined Corporate Governance as the process and structure that applied to manage a company to increase shareholder value over the long term by regarding the interest o f stakeholders based on existing laws and norms (Forum for Corporate Governance in Indonesia, 2001). 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 Rahman et al. (2013) 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).

In Indonesia, PT. Kimia Farma made a mark up of profits in the 2001 annual financial report of Rp. 32.6 billion. Based on the BAPEPAM (Indonesian Capital Market Supervisory Agency) investigation, it was stated that audit firm who audited the PT Kimia Farma's financial statements had followed the applicable audit standards, but failed to detect such fraud. Also, the audit firm was not proven to help management preventing fraud. This issue also suggest that the internal control of the firm and the roles of the corporate governance were questionable (Kompas, 2002).

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. Therfore this research focus on the effect of good corporate governance on earnings management.

LITERATURE REVIEW

Many definitions of earnings management but mostly they share a similar meaning of earnings management is to misrepresent company performance. 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).

Corporate Governance introduced by the Cadbury Committee with the following definition, "A set of rules that define the relationship between shareholders, managers, creditors, government, internal and external employee and other stakeholders concerning the right and responsibility". Also, corporate governance is simply seen as procedures and processes that are consistent with the direction and control of each company (OECD, 2004).

Corporate Governance and Earnings Management

In the manufacturing companies, there is no significant negative effect between the size of board commissioners and earnings management (Widiatmaja, 2010). Then research conducted by Rahnamay and Nabavi (2010) states that board commissioners size negatively affects earnings management. Research conducted by Madubuko (2019) shows significant negative results between the size of the board of commissioners on earnings management.

Warsono et al. (2010) stated that independent commissioner functions as an advisor who provides advice, opinions, and input in the context of achieving company goals. Main tasks of commissioners independent are to assessing and directing the strategy of companythe policy of risk control, budgets per annual, and business plans. Base on this research he states independent of board commissioner has a significant positive effect on earning management. However, Ruparatne & Meegaswatte (2019) in their study found significant negative results between the independent committee board and 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 Siam et al. (2014), Gonzalez and Meca (2013), Wang (2011), Ugbede et al. (2013), as well as Yang et al. (2009). Iraya et al. (2015) stated that the activities of the board of commissioners had a significant negative effect on earnings management. But Ruparatne & Meegaswatte (2019) stated that meetings conducted by members of the board of commissioners have positive results. Because the regular meetings at least once in 1 quarter will reduce fraud that might occur.

Yang and Krishnan (2005) found that there was a significant negative relationship in earnings management which showed that a larger audit committee could reduce earnings management activities in a company. The existence of the Audit Committee is essential to protect the interests of shareholders. If the Audit Committee performs its role well, which is monitoring management activities in preparing financial reporting, the quality of the financial reporting will significantly improve. Accordingly, the existence of this Audit Committee will harm earnings management. It means that such a committee can allay the manager's opportunistic attitude to commit earnings management.

Ayemere and Elijah (2015) stated that the audit committee independence 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 an analysis conducted by Vina & Zulaika (2014), it shows 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. Also, the factor of the economic dependence of auditors on clients is smaller on large auditors, meaning that auditor independence on large audit firms is greater awake.

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

H1: On earnings management, is the board commissioners size has a significant negative effect?

H2: On earnings management, is the board commissioner's independence has a significant positive effect?

H3: On earnings management, is the activities of board commissioners has a significant negative effect?

H4: On earnings management, is the committee of audit has a significant negative effect?

H5: On earnings management, is the independence of the audit committee has a significant negative effect?

H6: On earnings management, is the audit firm size has a negative significant effect?

METHODOLOGY

This research is a basic research and can be calculated by using statistics and method of data settlement is a non-participant observation with information at the Indonesia Stock Exchange website at www.idx.co.id. The companies that be researched are public manufacture companies listed on the Indonesia Stock

Exchange from 2013-2017. It used a sampling method that this research used the sample that matches with research purpose. Company sample criteria as follows:

1. Whether the manufacture company is public and 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.

Reaserch Variables

The dependent variable in this research is Earnings Management. 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:

Emit, is Earning Management;

β1**BC**it, is total number of Board Commissioners members;

β2**BCI**it, is the total of Board Commissioners Independence / Total of Board Commissioners;

β3**BCA**it, is number of meetings of Board Commissioners;

β4**AC**it, is total number of Audit Committee members;

β5**ACI**it, is total number of Audit Committee Independence/ Total of Audit Committee;

β6**BIG4**it, is audit firm size measured with dummy variabel, if the firm audited by Big 4 is 1, otherwise 0;

β7**AQ**it, is audit committee members that skilled in accounting;

β8**SIZE**it, is the company size by total assets;

β9**LEV**it, is leverage ratio;

β10**ROA**it, is ROA ratio;

εit, is residual error;

According to Salleh and Haat (2014), by discretionary accruals, we can measure the earnings management. Accruals that can be manipulated by managers are discretional components of accruals. In calculating discretional accruals used Jones Model.

$$TAC_{it}/A_{it-1} = \beta_1[1/A_{it-1}] + \beta_2[(\Delta REV_{it} - \Delta REC_{it})/A_{it-1}] + \beta_3[PPE_{it}/A_{it-1}] + \varepsilon_{it}$$

Where:

TAC_{it}, is a total accrual company i in year t;

A_{it-1}, is the total assets of company i in period t-1;

ΔREV_{it}, is the sales in year t are reduced by sales in year t-1;

ΔREC_{it}, is the receivables in year t are reduced by receivables in year t-1;

PPE_{it}, is the value of the company's fixed assets at the end of the year t;

ε_{it}, is residual error;

This study uses secondary data which is a source of data obtained indirectly by researchers but through intermediary media (Indriantoro & Supomo, 2009). Data examined in the form of financial statements of manufacture companies listed on the Indonesia Stock Exchange from 2013-2017. Secondary data can be obtained from the official website of the Indonesia Stock Exchange, www.idx.co.id.

RESEARCH FINDINGS

The data used in this study are secondary data from annual reports of manufacturing companies listed on the Indonesia Stock Exchange (IDX). The financial statements used must have data that will be used to calculate the Board Commissioners Independence, Board Commissioners Activity, Size of Audit Committee, Audit Committee Independence, Audit Committee Activity, audit firm size, Audit Quality, Company Size, Leverage, Return on Asset and Earnings Management. The selection procedure for selecting samples for study is as follows :

Descriptive Analysis

The number of companies registered at Brusa Efek Indonesia, there 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.

Below, the results of descriptive statistics by Statistical Package for Social Sciences (SPSS).

Table 1 Descriptive Statistics Results of Research Variables

	N	Minimum	Maximum	Mean	Std. Deviation
Eearning Management	605	-5,1400	1,0800	-0,8581	0,5366
Board of Commissioner size	605	2, 0000	11, 0000	4,1700	1,6800
Board Commissioners Independence	605	0, 0000	1, 0000	0,3900	0,1410
Board of Commissioners Activity	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	0,1909
Audit Quality	605	0,0000	1,5000	0,7750	0,2603
Company Size	605	10,7500	17,3900	12,3554	0,7459
Leverage	605	0,0000	4,3000	0,5233	0,3480
ROA	605	-0,6100	2,1200	0,0491	0,1490
Valid N (listwise)	605				

Source: Processed secondary data, 2020.

The results show the scores for the mean value, minimum value, maximum value, and standard deviation value for each variable for this study. The N column is the amount of data that observed in this study, with total data of 605 data. According to Table 1, the average of Earning Management shows negative amount. This result means that the evarage of firms are manage their earning downwards. Based on the data that has been tested, showed in Indonesia the manufacturing companies have an average of 4.17 boards of commissioners in each company. 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 stated that 2 persons are the minimum member of board commissioners.

In the regulation issued OJK No.33/POJK.04/2014article 20 paragraph 2 which states that 'In the case of the Board of Commissioners consisting of two members of the Board of Commissioners, 1 one of whom is an Independent Commissioner', and in paragraph 3 it is stated that ‘If the board of commissioners consists of more than 2 members, then the independent commissioners must have a minimum of 30% of the total’. It can be concluded that each company must have an Independent Board of Commissioners. But 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 13.74 times. This figure has met the standards set by POJK.

The results of the audit committee size variables indicate an average value of 3.01. Which has 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 from independent commissioners and parties from outside public companies.

Table 2 Descriptive Frequency Statistics Results of Research Variables

		Frequency	Percent	Valid Percent	Cumulative Percent
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	

Source: Processed secondary data, 2020.

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 F-Test Result

Dependen Variable	Sig.	Conclusion
Earning Management	0,000000	Significant

Source: Processed secondary data, 2020

The significant value for earnings management is 0.00000 and shows a smaller result of 0.05, indicating that the independent variables and control variables simultaneously have a significant effect on earnings management. The regression model in this study is used to predict earnings management variables.

T test results are used to determine the effect of each independent variable and the control variable on the dependent variable. T test results can be seen in table 4.

Table 4 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 Commissioners Independence	0.0282	0.0404	Significant Positive	H2 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	-

Source: Processed secondary data, 2020.

Test results that show a number less than 0.05, such as the value of the probability of the size of the board of commissioners, the independent board of commissioners, the activities of the board of commissioners, the size of the audit committee, independent audit committee, audit firm size, leverage and return on assets, which means that this variable has a significant effect on earnings management. Conversely, if the test results show probability values above 0.05 such as Audit Quality and Company Size, this indicates that these two variables do not have a significant effect on earnings management.

Based on the results of tests that have been carried out, the size of the board of commissioners shows a significant positive result in earning management. This means that the bigger the size of the board of commissioners has a high possibility of earnings management. This is not in line with Widiatmaja (2010) who has stated that the size of the board of commissioners has no significant negative effect on earnings management in manufacturing companies. And also research conducted by Rahnamay and Nabavi (2010) who has stated that the size of the board of commissioners negatively affects earnings management. Although the descriptive analysis results show that the average of Indoensia firms has fulfilled the requirements issued by OJK to have minimun requirement of board of commissioners, but the finding shows that the board of cimmissioners don’t have influence to reduce earnings management. This means the role of board of commissioners in improving reporting quality have not fullfiled yet. The same result also found In Board Commissioners Independence. This is also in line with research conducted by Warsonoet.al (2010) which states that the increase in independent board of commissioners will increase the probability of earnings management. Research conducted by Al Azeez, Sukoharsono, Roekhudin, & Andayani (2019) also showed positive significant results between the independent board of commissioners and earnings management.

The results of this study indicate that the variable activity of the board of commissioners negatively influence earnings management. This result is in line with Salleh and Haat's (2014) hypothesis which states that the high activity of the board of commissioners in one period can reduce the opportunity for management to manage earnings. These results are not consistent with the research hypothesis by Siam et al. (2014), Gonzalez and Meca (2013), Wang

(2011), Ugbede et al. (2013), as well as Yang et al. (2009).

The results of this study indicate that the audit committee size variable has a significant positive effect on earnings management. Increasing audit committee members can increase the possibility of earnings management, but the presence of members does not provide much incentive to retain earnings management (Chandrasegaram et al., 2005). These results are also in line with research from Kapoor & Goel (2019) which states a significant positive result between the size of the audit committee and earnings management. Although the results of descriptive analysis shows the average firms in Indonesia has complied with regulations issued by BAPEPAM to have minimum 3 members of audit committee, the findings show that audit committee can not reduce the possibility of earnings management. The increase in audit committee members will increase earnings management. This means audit committee roles in the average firms in Indonesia have not fulfilled their function to reduce earnings management. Kapoor & Goel (2019) also stated that an independent audit committee was very effective in carrying out its role as a good monitor.

In the results of tests that have been carried out, we can see that the results of the research show audit firm size has significant negative results, which means that the big audit firm who auditing the company's financial statements, where there are auditors who have high experience and expertise, the earnings management practices in the company are small (Vina & Zulaika, 2014). Ruparatne & Meegaswatte (2019) also stated that the financial statements audited by the Big 4 audit firms have significant negative results on earnings management.

Table 4.Test Result of Goodness of Fit Model

Variable Dependent	Adjusted R square
Earning Management	0,603284

Source: Processed secondary data, 2020.

Based on the test results, it was found that 60, 33% of variables had a significant effect on earnings management variables, but the remaining 39.67% might have other variables that had a significant effect but were not included in the research model. As the variables that have been widely studied in previous studies such as the activities of the audit committee, the size of the board of directors, the board of independent directors, the activities of the board of directors and so on.

CONCLUSION.

Based on the research of manufacturing companies registered in the Indonesia Stock Exchange (2013-2017), it can be concluded that Board Commissioners size, Board Commissioners Independent, Audit Committee size, Audit Committee Independent, and Return on Assets shows a significant positive result to Earning Management. On the contrary, Board Commissioners Activity, size of audit firm, and Leverage has a significant negative effect on earnings management. Audit Quality and Company Size does not significantly influence to earnings management.

This research has some limitations because there are still many companies listed on the IDX that do not present annual report data, both variable disclosure or annual report data are incomplete from 2013 to 2017, respectively. Recommendations that can be given from the author for future research are to expanding the time horizon of the study for the best result and could show the right model with observational data. Then to add other independent and dependent variables which have a stronger influence to producing a better research model. Such as adding the activities of the audit committee, the size of the board of directors, the board of independent directors, the activities of the board of directors and others.

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