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THE INFLUENCE OF CORPORATE SOCİAL RESPONSİBİLİTY, FİRM CHARACTERİSTİCS, AND GOOD CORPORATE GOVERNANCE ON EARNİNGS MANAGEMENT

Mardianto, Selvina
Fakulty of Business and Management, Universitas Internasional Batam, Indonesia
{ mardianto.zhou@uib.ac.id , 1842002.selvina@uib.ac.id }

Abstract

This paper aims to examine the factors that have impact on earnings management of listed company in Indonesia. The independent variables considered in this study are corporate social responsibility, firm characteristics such as leverage, firm size, and financial performance. Good corporate governance mechanisms such as board of commissioners size, audit committee size, and managerial ownership are also part of this study. The finding of this study is financial performance has significant and positive impact on earnings management and board of committee size has a significant and negative impact on earnings management. The other independent variables is insignificantly affect earnings management. These results were achieved from the data of 44 companies for a period of five years from 2016 to 2020 using purposive sampling and were analyzed using panel regression techniques supported by SPSS and E-Views.

Keywords: *Earnings management, corporate social responsibilities, firm characteristics, good corporate governance*

Introduction

Every user of financial reports definitely needs information related to the actual condition of the company. The most crucial information in the financial reports is the profit or loss of the company as it is a reflection of the company's performance. However, companies frequently use the information contained in financial reports in order to show the best condition of the company which will meet the expectations of users of financial statements (Fauziah and Marissan, 2014). İt goes the same with statements by Ronen (2016), earnings management occurs when managers make changes to their financial statements as if the company's performance is in line with stakeholder's expectation. Too much earnings management can lessen the usefulness of financial statements (Scott, 2015).

Numerous developing countries encounter with any kind of financial issues, the public constantly requires companies to take responsibility for environmental preservation, local community, development and employment safety. With that in mind, most companies are encouraged to pay more attention and commitment in practicing corporate social responsibility (CSR) (Shafai et al., 2018). Some of the strong points a company could gain from implementing CSR are financial performance enhancement, image and reputation development, achieved competitive advantage, advancement of company's value, and enhanced transperancy of financial statements (Putriana et al., 2018).

Apart from CSR, firm characteristics and corporate governance have the possibility to influence earnings management. Research by Bouaziz et al (2020) states that the bigger a company is, the stronger the internal control system and the more capable internal auditors are. But whether it's a huge or small-scale company, there is still bankruptcy risk. Leverage controls the possibility of company's bankcruptcy. Leverage measured by debt to asset ratio. High ratio could indicates debt agreement violation which means revenue added through earnings management using accrual-based calculation (Manzano et al., 2019). The discussion on earnings management somehow associates with good corporate governance (GCG). Iqbal et al (2015) declares that corporate governance holds important role in controlling manager's opportunistic behavior as well as reducing earnings management (EM) and other look-alike scheme.

The CEO of Toshiba Corporation, Hirao Tanaka in 2015 is caught for doing earnings management in the amount of USD$1,2 billion. Moreover, the company executives put up a high profit target. To achieve the goal, head of division start to recod any transaction falsely include the accounting records. Due to this scandal, Hirao Tanaka and the executives resigned (Santi & Wardani, 2018). Similar case related is PT Tiga Pilar Sejahtera Food Tbk (AISA) which was proven guilty for managing earnings as the board of company's director asked before(Wareza, 2019).

Applying GCG is expected to diminish EM. Board of commissioners size as one of the GCG mechanism is expected to do so. According to UU RI No 7 Year 2007 about Limited Company explains board of commissioners is responsible for supervising the corporate's operations and providing opinions and interests of the corporate to corporate in accordance with the corporate's objectives. The quality of financial reports must be ensured in accordance with corporate's actual state. Later on, board of commissioners receive professional opinion from board of auditors about financial reports. This statement proves board of auditors existence which is expected to oversee every management's actions (Lidiawati & Asyik, 2016). Both managers and shareholders will have similar actions if managers have share ownership in the company. Low ownership drives managers to behave opportunistically then it will trigger them to do EM (Halim et al., 2020).

Literature Review

EM occurs when manager of the company use certain consideration in changing the financial reports. The purpose of changing the financial report is to measlead its user about firm performance and affect the outcome of contracts that depend on financial statements (Healy and Wahlen, 1999). EM as management effort to affect or manipulate reported earnings. These efforts can be execute with certain accounting methods, such as accelerating cost or income transactions. Other efforts can also be done with the intention of influencing short-term earnings (Omoye and Eriki, 2014).

Scott (2015) explained that EM can be seen from two perspectives. From financial reports point of view, manager able to apply EM to avoid loss reporting or to achieve earnings forecast. While from contractual view, EM able to protect company from unexpected event as the consequence of rigid and incomplete contracts. Motives for implementing EM are to allow communication of information related to company's future performance using discretionary accruals and to maximize personal gain (Cudia and Dela Cruz, 2018).

Profit-manipulating firms tend to increase their involvement in CSR (Habbash & Haddad, 2019; Setiawan et al., 2019). CSR is one of the firm's responsibilities towards stakeholders regarding the impact of the firm's operational activities. Pakawaru et al. (2021) and (Santi and Wardani (2018) stated that CSR positively affect EM as well.

H_1: There is significant positive relationship between CSR and EM.

Leverage has a positive impact on EM. Especially when the company wants to reduce debt covenant violations and negotiate debt(Chamberlain et al., 2014). High leverage means the possibility going bankrupt is also large. So, the solution about it is to do earning management in order to be able to pay debt (M. T. H. Khanh & Thu, 2019; Nalarreason et al., 2019).

H_2: There is significant positive relationship between leverage and EM.

A bigger company is likely to manage earnings by decreasing its revenue. Firm size motivates EM practices due to regulations such as tax regulations, sntitrust laws, banking regulations, etc (Ruwanti et al., 2019). According to research by Susanto (2016) and (Santi & Wardani (2018) negatively affect EM.

H_3: There is significant negative relationship between firm size and EM.

While financial performance significant and negatively affect EM. The higher the profit is will decrease company's desire to include EM practices because there is nothing to manipulate since the profit is slowly rising and will achieve stakeholders expectation (Buertey et al., 2020; Prieto et al., 2020; Wasiuzzaman, 2018).

H_4: There is significant negative relationship between financial performance and EM.

Supervision by the board of commissioner will motivates managers to behave according to good and correct accounting policies. With existence of board of commissioners, it can reduce EM and prohibit opportunistic behaviour (Mardjono et al., 2020). Board of commissioner size is able to reduce EM practices (Jatiningrum et al., 2016).

H_5: There is significant negative relationship between board of commissioner size and EM.

The audit committee as one of the corporate governance mechanisms has a significant negative relationship with EM. The smaller the audit committee size, the more likely it is that EM practices will occur (Juhmani, 2017; Ngo & Le, 2021; Zehri & Zgarni, 2020).

H_6: There is significant negative relationship between audit committee size and EM.

Apart from effect of audit committee towards EM, managerial ownership has significantly affect EM. The greater managerial ownership will increase earnings management activities in the company (Aygun et al., 2014; Luthan et al., 2016; Mahariana & Ramantha, 2014; Suartama & Sukartha, 2020).

H_7: There is significant positive relationship between managerial ownership and EM.

Research Methods

This study involves listed companies by seeing its published financial reports and annual reports. Sampling criteria include listed company in 2016-2020, published sustainability report in 2016-2020, published audited annual report in 2016-2020, the company disclosed data or information related to variables.

This is a panel study and the relationship between CSR, firm characteristics, good corporate governance and EM. These variables is analysed by using fixed effect regression model (FEM). There are plenty of methodology selections for this study, however, only the result of FEM will be presented in this paper. Model specification for this study is formulated below:

$$DA_{it}= \beta_0+\beta_1 CSR_{it}+\beta_2 SIZE_{it}+\beta_3 LEV_{it}+\beta_4 ROA_{it}+\beta_5 ACS_{it}+\beta_6 BCS_{it}+\beta_7 MO_{it}+\varepsilon_{it}$$

Where DA is measured in discretionary accruals, CSR is referring to corporate social responsibility which is measured using CSR index, SIZE refers to firm size which is measured using natural logarithm of total asset, LEV refers to leverage which is measured by the ratio of total debt and total assets, ROA refers to financial performance or profitability which can be measured by using Return on Asset (ROA), ACS refers to audit committee size which is measured by the number of its members, BCS refers to board of commissioners size which is measured by the number of board commissioners members, MO refers too managerial ownership which is measured using the ratio of numbers of shares owned by management and number of outstanding shares in the end of period. ε is the white noise error term. The data and information are all extracted from financial report, annual report, and sustainability report from 2016 to 2020 which collected from Indonesia Stock Exchange (IDX).

Results and Discussion

The result will first start by analyzing the descriptive statistics of all the variables. Descriptive statistic is the term given to the investigation of information that portrays, show or sum up information in an important manner with the end goal that summarize out of the information. Table 4.1 illustrates the descriptive statistic for all variables.

Table 4.1.

Descriptive Statistics					
	N	Minimum	Maximum	Mean	Std. Deviation
DACC	195	-.28782	.30023	-.00102	.089341
CSR	195	.00000	.68132	.25934	.14407
LEV	195	.12642	1.22865	.59244	.22963
SIZE	195	28.37627	34.79875	31.35851	1.51416
ROA	195	-.11431	.27151	.03465	.05053
MO	195	.00000	.09599	.00397	.01557
BCS	195	2.00000	11.00000	5.95897	1.78723
ACS	195	1.00000	6.00000	3.60513	.89268
Valid N (listwise)	195				

Based on table 4.2 Chow test shows probability value of EM is 0.0000, can be concluded that the best model to be used is fixed effect model.

Table 4.2.

Dependent Variable	Effect Test	Prob.	Conclusion
DACC	Cross-section Chi-square	0.0000	*Fixed Effect Model*

Table 4.3 shows Hausman test which is resulted in fixed effect model with probability value 0.0155.

Table 4.3.

Dependent Variable	Effect Test	Prob.	Conclusion
DACC	*Cross Section Random*	0.0155	*Fixed Effect Model*

Table 4.4 shows F test which is resulted with probability value 0.0000. the probability value is less than 0.05 which means the independent variables are significantly affect earnings management.

Table 4.4

Dependent Variable	Prob.	Conclusion
DACC	0.000000	Signifikan

Table 4.5 below shows that from all the independent variables, firm financial performance and audit committee size are the only variables that significantly affect EM while CSR, leverage, firrm size, managerial ownership and board of commissioners size don't have any relationship with EM. CSR is insignificantly affect EM didn't prove H_1.

Firm financial performance is significant and positively affect EM. When the amount of debt increases, company tend to carry out EM or earnings manipulation to make financial information more attractive. This statement is supported by the study of (Kapoor and Goel, 2017) and (Indracahya and Faisol, 2017). With the probability value 0.012, audit committee size is proven has a significant and positive effect towards EM. If the size of audit committee is too small then there will be not enough number of directors to serve the audit committee.

Table 4.5

Variable	*Coefficient*	Prob.	Conclusion	Hypothesis
Constant	-0,58862	0,5511		
CSR	-0,04494	0,4040	Insignificant	Rejected
LEV	-0,02798	0,7040	Insignificant	Rejected
SIZE	0,02157	0,4935	Insignificant	Rejected
ROA	1,02920	0,0000	Significant +	Rejected
MO	-4,56174	0,2353	Insignificant	Rejected
BCS	0,00375	0,6521	Insignificant	Rejected
ACS	-0,02786	0,0123	Significant -	Accepted

Conclusions

The purpose of this research is to obtain empiricial results of the effect of CSR, leverage, firm size, financial performance, managerial ownership, board of commissioner size, and audit committee size on earnings management. ROA is used to measure firm's capability to earn profit during certain period. According to Gunawan et al. (2015), the manager would take on earnings management to show the best performance in their company. Financial performance was found positively affect earnings management. This result is consistent with research conducted by Alexander & Hengky (2017); H. Khanh & Khuong (2018). Audit committee size has significant negative effect on earnings management. This result is consisten with study conducted by (Salihi & Jibril, 2019).

This study focuses on the effect of CSR, firm characteristics, and good corporate governance of 44 listed companies in Indonesia toward earnings management. This research will not cover other problem that are not consider as one of the variables. Future study is suggested to measure financial performance using Return on Equity (ROE), Tobin's Q, or total shareholder return. Other prime compnents of good corporate governance are also suggested to incorporate as variables such as audit committee meetings, board of comissioner meetings, gender of both board of commissioner and audit committee.

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