DETERMINANTS OF EARNING MANAGEMENT AND GOOD CORPORATE GOVERNANCE AS INTERVENING

by Shadrina Sari

DETERMINANTS OF EARNING MANAGEMENT AND GOOD CORPORATE GOVERNANCE AS INTERVENING

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ABSTRACT

The development of the chemical industry which is one of the manufacturing industry sectors is currently growing rapidly. The development of the chemical industry needs support through the supply of capital from investors that can be obtained on the stock market. Investor need financial information that's reported by the company through their financial statements, earnings are one measure used to measure company performance. Based on accounting theory, management uses their information to influence the profit, called earning management. This research wants to analyze the factors of earning management with good corporate governance (GCG) as intervening variable. Sample of this research are the basic industrial and chemical manufacturing companies listed on the Indonesia Stock Exchange for 2013 until 2017. The determinants of earning management that use in this research are auditor reputation, audit committee, the number of board directors, independent commissioners and percentage of shares. We also use good corporate governance as intervening variable because a good form of corporate governance is when a company is able to disclose the information needed by outsiders, when company apply GCG it will pressure management to do earning management. This study used path analysis and 21 companies as samples. The results found that (1) the number of board directors, independent commissioners and percentage of share has direct effect to GCG, (2) the number of board directors, independent commissioners, percentage of share and GCG has direct effect to earning management, and (3) GCG can mediate audit committee, the number of board directors, independent commissioners and percentage of share to earning management.

Keywords: *Earnings management, good corporate governance, chemical industry, board directors, auditor reputation.*

1. INTRODUCTION

Manufacturing companies consist of three sectors, namely the basic and chemical industries, various industrial sectors, and the goods and consumption sector. One sector that plays an active and prominent role is the basic and chemical industry sector because the basic industrial and chemical sectors are sectors that have basic elements that are often used in daily activities. The items used daily are products of basic and chemical industry companies [1].

Profit is one of the potential information contained in financial statements and is very important for internal and external parties. Earnings information is a component of the company's financial statements that aims to assess management performance, helping to estimate representative earnings capabilities in the long term, and assessing investment risk. Besides that profit information can also be used by other parties who have an interest in helping predict the company's earning power in the future [2].The factors affecting earning management in banking sector in Indonesia are managerial ownership, institutional ownership, size of bank and CAR[3].

Earnings management is the tendency of management to make income smoothing to increase company value. Therefore, before doing earnings management a manager must consider the costs and benefits he feels. Moreover, earnings management is actually an activity with a pattern of certain actions that should not be mistaken in applying it. Just as managers want the stocks they offer to be responded positively by the market, the pattern of earnings management that must be done is to increase profits. This is due to a positive relationship between earnings and stock prices [4].

The concept of Good Corporate Governance (GCG) is increasingly being expressed by business practitioners as a tool to prevent the occurrence of financial cases. One of the various components that play an important role in the process of implementing good corporate governance is the audit committee. The role of the audit committee in ensuring the quality of the company's financial reporting has been in the spotlight since the accounting scandal that became public attention. The audit committee is a GCG component that plays an important role in the financial reporting system by monitoring the participation of management and independent auditors in the financial reporting process. The audit committee is tasked with assisting the board of commissioners to ensure that: The financial statements are presented fairly in accordance with generally accepted accounting principles. The internal control structure of the company is carried out properly. Internal and external audits are carried out in accordance with applicable audit standards and follow-up to audit findings implemented by management [5].

Auditor reputation is a variable that influences management to report discretionary accruals [6]. A good auditor reputation can detect the possibility of early earnings management. The reputation of the auditor can reduce the possibility for managers to make earnings management (Widyaningdyah, 2001). Independent commissioneris a non-affiliated member of the board of commissioners, other commissioners and controlling shareholders, and is free from business relations and other relationships that may affect his ability to act independently or act solely for the benefit of the company. The existence of independent commissioners in the company serves as a counterweight in the decision making process to provide protection to minority shareholders and other parties related to the company [7].

According to [4]the percentage of shares offered to the public is the only source of information in this initial public offering process because in addition to the prospectus there are almost no other sources of information available to investors. Therefore, investors tend to rely on the prospectus to find out information and assess the company that made the stock offering. This is why managers do earnings management at the time of the initial public offering.

2. METHODOLOGY

2.1 The influence of auditor reputation to GCG

The auditor's reputation determines the credibility of the financial statements. Where financial statements become information for managers and shareholders with the principle of good corporate governance can convince shareholders that there is equal treatment for all shareholders (Riswandi, 2012).

2.2 The influence of audit committee to GCG

The Audit Committee has the responsibility to carry out independent oversight of the process of implementing corporate governance in a company, especially to ensure that the company has been carried out in accordance with the prevailing laws and regulations, conduct business ethically, and effectively implement conflicts of interest or fraud committed by employee or company manager [4].

2.3 The influence of the number of board directors to GCG

The size of the board of directors is the number of boards of directors in a company, the more councils in the company will provide a form of supervision on better company performance, with good and controlled company performance it will produce good profitability and will later increase the value company. The board of directors is the party responsible for the implementation of a company's good corporate governance[8].

2.4 The influence of independence commissioner to GCG

Independent commissioners are those who have the responsibility to encourage the implementation of the principles of good corporate governance within the company through empowering the board of commissioners to be able to carry out supervisory duties and provide advice to managers effectively and provide added value to the company [4].

2.5 The influence of the percentage of shares to GCG

The application of good corporate governance in each company is expected to be able to improve and improve supervision of the management performance of a company, thereby increasing the performance or value of the company and will have an impact on the percentage of the company's shares.

2.6 The influence of auditor reputation to earning management

Research by [7]found that there are allegations that reputable auditors can detect the possibility of earning management earlier, so that it can reduce the possibility for managers to make earnings management.

2.7 The influence of audit committee to earning management

The effectiveness of the audit committee in assessing the performance of managers as direct operators of earnings management actions, if the audit committee periodically and continuously checks when the process of making financial statements and making accounting method policies, therefore the management will not get the opportunity to practice earnings management [9].

2.8 The influence of the number of board directors to earning management

Research conducted by [10]states that the board of directors has a significant effect on earnings management, the study indicates that the more the number of directors, the more pressing earnings management will occur.

2.9 The influence of independence commissioner to earning management

The existence of independent commissioners in the company serves as a counterweight in the decision making process to provide protection to minority shareholders and other parties related to the company[11].

2.10 The influence of the percentage of shares to earning management

The public has an important role in creating a well-functioning governance system because they have financial interest and act independently in assessing management. The greater the percentage of shares offered to the public, the greater the internal information that should be disclosed to the public, so it is likely to reduce the intensity of earnings management [7].

2.11 The influence of GCG to earning management

The financial statements no longer objectively inform what the company has done and experienced, because managerial engineering activities are used by managers to hide the frauds that have been done, even earnings management is also used by managers to plan frauds that will be done in the future. Therefore, one effort to realize good corporate governance is an effort to eliminate earnings management in the management of the business world [4].

2.2 Platform Design Ideas

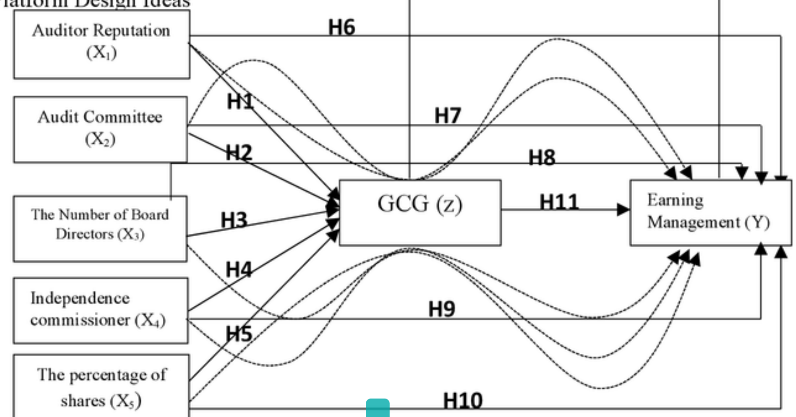

Fig 1. Platform design ideas

Fig. 1 displays this platform design ideas of this research, we want to know which one of auditor reputation, audit committee, the number of board directors, independent commissioners and percentage of shares arethe determinants of earning management and uses GCG as intervening variable between both of variable.

2.3 The Sample

The samples of this research are 21 companies of the basic and chemical industrial sector in manufacturing companies on Indonesia Stock Exchange for 2013 until 2017. We uses purposive sampling to choose the sample, the sample must publish their financial report during 2013 to 2017 completely.

2.4 Data Analysis Method

2.4.1 Path Analysis

Path analysis is a technique to analyze the causal relationships that occur in multiple regressions. The independent variable affects dependent variables not only directly but also indirectly. Path analysis alone cannot determine a causal relationship and also cannot be used as a substitution to see causality between variables.According to [1] structural equations can be seen as follows:

Y = PYX1 + PYX2 + PYX3 + PYX4 + PYX5 + e

Z = PZX1 + PZX2 + PZX3 + PZX4 + PZX5 + PZY + e

Explanation:

Y = earning management

Z = good corporate governance
X1 = auditor reputation
X2 = audit committee
X3 = the number of board directors
X4 = independent commissioners
X5 = percentage of shares

3. RESULTS

3.1 Construct Path Analysis Model

Tabel 1. Regression Model 1

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.821	3.112		1.228	0.223
	Auditor reputation	0.507	0.428	0.049	1.185	0.239
	Audit committee	-0.403	0.758	-0.020	-0.532	0.596
	The number of board directors	1.765	0.444	0.170	3.973	0.000
	independent commissioners	0.980	0.052	0.775	18.843	0.000
	percentage of shares	2.765	0.278	0.377	9.952	0.000

a. Dependent Variable: GCG

Table 2. Regression Model 2

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	1.189	0.826		1.439	-0.153
	Auditor reputation	0.093	0.114	0.085	0.820	0.414
	Audit committee	-0.078	0.200	-0.037	-0.389	0.698
	The number of board directors	-0.279	0.126	-0.256	-.2.216	0.029
	Independent commissioners	-0.076	0.029	-0.567	-2.568	0.012
	Percentage of shares	-0.376	0.104	-0.485	-3.626	0.000
	GCG	0.056	0.027	0.527	2.090	0.039

a. Dependent Variable: Earning Management

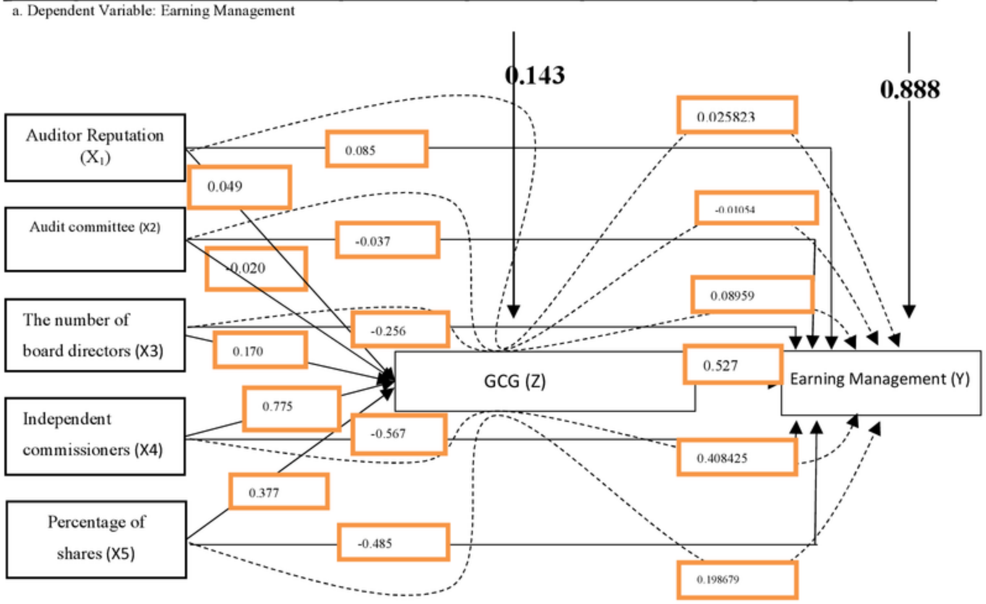

Fig 3. Result of Path Analysis

1. Effect of Auditor Reputation (X1) on GCG (Z) Test results prove that the Auditor's reputation has a positive but not significant effect on GCG. So the hypothesis which states that the Auditor's Reputation has an influence on GCG is not proven true.
2. The influence of the Audit Committee (X2) on GCG (Z) the result testing proved the Audit Committee on GCG has a positive but not significant effect on GCG. So the hypothesis which states that the Audit Committee is expected to influence GCG is not proven true
3. Effect of the Number of Board Directors (X3) on GCG (Z) Test results prove that the Board of Directors has a positive and significant effect on GCG. So the hypothesis which states that the number of Directors is expected to affect GCG is proven to be true.
4. Influence of Independent Commissioners (X4) on GCG (Z) Test results prove that Independent Commissioners have a positive and significant effect on GCG. Because the value ρ-value is smaller than α (0,000 <0,05) then H0 is rejected. So the hypothesis stating that it is suspected that the Independent Commissioner has an effect on GCG is proven to be true.
5. Effect of Percentage of Shares (X5) on GCG (Z) Test results prove that the Percentage of Shares has a positive and significant effect on GCG. So the hypothesis which states that the Percentage of Stocks has an effect on GCG is proven to be true.
6. Influence of Auditor Reputation (X1) on Earning Management (Y) the test results prove that the Auditor's Reputation has a positive but not significant effect on Profit Management. Thus there is no significant influence of Auditor Reputation on Profit Management.
7. Influence of the Audit Committee (X2) on Earning Management (Y) The results of the Audit Committee's testing have a negative but insignificant effect on Earning Management. Thus there is no significant influence of the Audit Committee on Earning Management. So the hypothesis which states that the alleged Audit Committee has an effect on Earning Management is not proven true.
8. The Influence of the Number of Board of Directors (X3) on Earnings Management (Y) The test results prove that the Board of Directors has a significant negative effect on Earning Management. Thus there is a significant influence on the Number of Directors on Profit Management. So the hypothesis which states that the number of Directors is expected to influence the Management of Profit is proven to be true.
9. Influence of Independent Commissioners (X4) on Earning Management (Y) the results of the tests show that the Independent Commissioners have a significant negative effect on Profit Management. So the hypothesis stating that it is suspected that the Independent Commissioner has an effect on Profit Management is proven to be true.
10. Effect of Percentage of Shares (X5) on Earnings Management (Y) test results proves that the Share Percentage has a negative and significant effect on Profit Management. So that the hypothesis stating that the Percentage of Shares Influence on Earnings Management is proven to be true.
11. The Influence of GCG (Z) on Earnings Management (Y) The test results prove that GCG has a positive and significant effect on Earning Management. So the hypothesis which states that GCG is allegedly influential on Earnings Management is proven to be true.

4.CONCLUSION

The results found that (1) the number of board directors, independent commissioners and percentage of share has direct effect to GCG, (2) the number of board directors, independent commissioners, percentage of share and GCG has direct effect to earning management, and (3) GCG can mediate audit committee, the number of board directors, independent commissioners and percentage of share to earning management.

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